Week 1 reading notes

Finance, Investment

Week 1 Reading Notes 1. Solow's surprise: investment is not the key to growth (by Easterly) * Investment cannot be the source of growth in the long run * The belief of increasing buildings and machinery is the fundamental determinant of growth = capital fundamentalism * Investment increases machine per worker would lead to diminish return in long run * Technological progress is the key to growth in long run because it increases the productivity of the machine itself rather than machine per worker * Labor-saving technology may cause unemployment but worker as a whole is better off with more productive technology * Increase machine per worker could not be a source of growth in the long run but it could be a source of growth in the transition to long run * Return to the machinery (investment) must be very high (very few) due to scarceness initially * Evidence against Solow vision applied across countries was the failure of growth in many poor countries * Very poor countries and very rich countries have about the same income as one or two centuries ago * Alwyn Young of Chicago Business School found out that the gang of four (Korea, Singapore, Taiwan and Hong Kong)'s fast growing are mostly due to capital accumulation and only a small part was due to technological progress * Critics about Young's approach: a) Doesn't take account for people respond to incentives b) Even if it's true, doesn't mean that it can be replicated elsewhere c) Rate of return didn't behave the way where it was supposed to if capital accumulation is the main source of growth 2. Educated for What? (by Easterly) * Lack of association between growth in schooling and growth in GDP * Some people found that the level of initial schooling is positively correlated with subsequent productivity growth but the relationship has to be temporary because it wouldn’t make much sense in the long run * Some economist found that the variations in growth of human capital across nations has very little to do with the variation of productivity growth * Other economist pointed out that if human capital is a major force behind growth, then more rapidly growing countries would have a higher growth in human capital * Enrollment in formal school maybe a poor measure of creation of skills * Lack of incentives for growth may be responsible for disappointing response to accumulation of machinery and schooling 3. Tales of increasing returns: leaks, matches and traps (by Easterly) * Knowledge grows through conscious investment in knowledge * New knowledge is complementary to existing knowledge * Knowledge leaks to increase other people’s return. When investors see increasing return, they invest more and more knowledge is developed (circle) * A good match of skilled workers can maximized their productivity * Unskilled workers lower each other’s productivity and put poor countries in to traps * Riches are “ trapped" too 4. Creative destruction: power of technology (by Easterly) * Old technology could limit the benefits of new technology * Exhaustion of existing technology without moving to the new technology fast enough * The group with old technology has incentives to oppose creatively destructive growth * Poor countries are less likely to be inventors of new technologies, instead they imitate 5. An introduction to institution and institution change (by North) * Institution are the rules of game * Institution reduces uncertainty by providing stable structures to human interactions * Institution determines opportunities in societies, organizations are formed to take advantage of these opportunities 6. Institutions, economic theory, and economic performance (by North) * The information and institution conditions required to realize efficient economic exchange: a) The affected parties must have the information and correct model to know that the bill affects them and to know the amount of gains or losses they would incur b) The result will communicated to their agent (the legislator) who will faithfully vote accordingly c) Votes will be weighted by the aggregate net gains and losses so that the net result can be ascertained and the losers appropriately compensated d) This exchange can be accomplished at a low enough transacting to make it worthwhile * The consequences of institutions for contemporary economic analysis a) Economic and political models are specific to particular constellation of institutional constraints that vary radically both through time and cross sections in different economies b) A self-conscious incorporation of institutions will force social scientist in general, and economist in particular, to question the behavioral models that underlie their discipline, and in consequence, to explore much more systematically than we have done so far the implications of the costly and imperfect of processing information for the consequent behavior of the actors c) Ideas and ideologies matter, and institutions play a major role in determining just how much they matter d) The polity and economy are inextricably interlinked in any understanding of the performance of economy and therefore we must develop a true political economy discipline 7. Institution as a fundamental cause of long run growth (by Acemoglu) * Changes in the structure of society and economy in the early 19th century altered the balance of political power, in particular making the exercise of de facto power by the politically disenfranchised much easier * Whether or not the increase in de facto power translated into democracy depended on a number of factors: a) How difficult and costly for elites to use repression to counter the increase in power of the masses b) How costly was the prospect of democracy * The emergency of democracy in the 19th century Europe illustrates how political institutions determine economic institutions and policies * Distribution of resources shows how political institutions change, especially in response to an imbalance of de facto power, as a credible way of influencing the future allocation of de jure political power