

Objectives of economic growth and development

[Economics](#)



Economic growth is defined by, among other things, material capital formation, human capital formation and the creation of innovation. Put another way, economic growth is determined by the amounts and types of capital and labor that are invested, and how they are utilized for production. The objective of economic growth through economic policy is not necessarily GDP or GNP maximization but maybe enhancing and improving quality of life or other values that cannot be measured by GDP.

If we limit our outlook to economic growth itself, the questions of what to assume as the objective of economic growth and how to measure it is decided by people. It is possible and desirable, to have a scheme wherein issues that are not easy to quantify, such as quality of life, are taken into account when policy choices are prepared and decisions carried out. The idea here is only that no matter what kind of economic society one visualizes, the issues of investment of capital and available resources are of extreme importance.

This is to say while the objective of economic policy is improving the welfare of citizens, it will primarily be dependent on resource investment and productivity, no matter how that improvement may be defined. Whether looking at GDP or quality of life, different levels of attainment have been achieved from nation to nation. The enormous cross-country differences in economic development and growth have led to research interest in the determinants of economic growth. Three main competing explanations exist with regards to stunted economic development and growth.

The first explanation centers on the role of increased international trade. The basic idea here is that an economy struggling to increase development and

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growth should become more actively involved in the larger global economy. By integrating with the larger global economy, a nation hopes to increase trade that drives productivity change and income growth. Unfortunately, this explanation relies on a dependency of a particular economy to be logistically connected to the global economy.

In other words, trade must have some way of getting to and from the developing economy. The second view emphasizes the role of quality institutions, or rather the lack thereof, as the reason for low economic growth and development. According to Daron Acemoglu, a proponent of this view, some societies have good institutions that encourage investment in machinery, human capital, and better technologies, and, consequently, these countries achieve economic prosperity. In other words, economic development and growth are products of good institutions.

Concentrate on establishing good institutions and economic growth and development will follow. The final view revolves around the geography of a nation and economy, specifically its resource constraints and physical location, which can impact transportation costs, technological productivity and disease, all that directly influence its ability to integrate with the larger global economy. Economists such as Jeffrey Sachs argue that the role of geography in the growth and development of an economy is often underestimated as an explanation for poverty-stricken nations.

The geography view emphasizes the need for struggling economies to receive direct interventions, backed by donor assistance, to address disease, geographic isolation, low technological productivity, and resource limitations that trap them in poverty. The first of the views to stimulate stagnant

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economic development and growth by way of increased trade derives its main ideas from David Ricardo. Ricardo was a nineteenth century economist who developed the idea of comparative advantage (Ricardean Theory). In short, the theory sets out that all nations can increase their standard of living through specialization and trade.

Further, the theory concedes that raising a nation's standard of living can be accomplished though it does not produce anything the cheapest and another country produces everything the cheapest (absolute advantage). By each nation concentrating on what it produces cheapest (relative advantage) and importing the rest, the result will be greater gains than losses and increased standard of living. Following David Ricardo and his theory was John Stuart Mill who pointed out three principal gains from trade in his Principles of Political Economy.

The three principal gains from trade were: 1) direct economical advantages of foreign trade, 2) indirect effects of trade which must be counted as benefits of a higher order, 3) the economical benefits of commerce are surpassed in importance by those of its effects which are intellectual and moral. Although these theories and gains develop a nice foundation for a struggling nation to turn to increasing trade to resolve its stunted economic growth and development, they also pre-suppose some fundamental factors, mainly geographic location.

Looking deeper, one can see that if a nation were to increase its trade, it must first have the capacity to do so and the ability to get the goods to and from markets. Many economists who support this view of trade integration argue that a nation's ability to possess the above criteria is easier now than <https://assignbuster.com/objectives-of-economic-growth-and-development/>

before because of the technological advancements of the internet and communication methods. However, we must keep in mind that capital is needed for such technological advancements and the institutions to maintain them.

Thus we can see that a nation can increase its income by trade but also that income is needed to increase trade. This circular thought discourages the idea of increased integration leading to higher economic growth. Daron Acemoglu sees the need for this capital but does not direct a country to expand trade but rather evaluate their institutions as it is countries with good institutions that achieve economic prosperity. What are good institutions? Acemoglu defines good institutions as the following:

Good institutions have three key characteristics: enforcement of property rights for a broad cross section of society, so that a variety of individuals have incentives to invest and take part in economic life; constraints on the actions of elites, politicians, and other powerful groups, so that these people cannot expropriate the incomes and investments of others or create a highly uneven playing field; and some degree of equal opportunity for broad segments of society, so that individuals can make investments, especially in human capital, and participate in productive economic activities.

In this view, human influences matter most. How humans adapt human behavior to create a desirable economic behavior is the strong thread supporting this view and associated with Nobel Prize winner Douglas North. Its not that geography or expansion of trade have nothing to do with development and growth, it's more the notion that good institutions can overcome many handicaps associated with a nation. Dani Rodrik and Arvind
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Subramanian, two other notable economist of this view, narrow the important institutions down to property rights and rule of law.

Property rights and rule of law are institutions that attract and support security for investment into a particular economy. The idea is, if property rights and rule of law exist to uphold those rights, investors will be more likely to invest, in-turn supporting long-run economic growth and development. Dani Rodrik furthers this by attributing an investor's feeling of security, or rather the security of the investment itself to be the determination of investment in an economy. To exemplify this he compares Russia and China.

In Russia, property rights and an independent judicial system exist to protect those rights whereas in China, property rights are a new concept and the judicial system is bias. Given this, during the 1990's investors gave rule of law higher marks in China than Russia. So one can see that it is the security of the investment that attracts and perpetuates investment into an economy. Often, the quality of property rights and rule of law to uphold those rights produces an environment conducive for investment and an economy to develop and grow.

It is also their contention that the quality of institutions overrides geography and integration as shown by the following chart. Also of mention are ideas and data results from Barro " Economic Growth in a cross section of countries" published May 1991 in the Quarterly Journal of Economics. Barro's data produces results that indicate education as a key promoter of growth and closed markets, exchange controls and large governments all reduce growth. Barro's contention for a stunted economy is to open their markets and <https://assignbuster.com/objectives-of-economic-growth-and-development/>

establish a solid education system and economic growth will be soon to follow.

Though this prescription sounds nice, it appears to be a “ cookie cutter” approach to an issue deserving of more attention. Dani Rodrik addresses the issue of a “ rule of thumb” approach to economic growth in one of his more recent papers, published in October of 2004. He suggests that economists “ should get away from the rule of thumb economic when practicing policy advice” and offers instead a diagnostic approach that advocates “ taking economics more seriously, not less seriously”.

While Barro might not have the right prescription for all struggling economies, the strong correlation of education and growth in the data should be noted and added to Rodriks and Subramian’s list of important institutions. The prescription from this view is not always the same nor easy to assess but, always involves significant time. Concentrating on the development of good institutions centers on the heart of them, human behavior. Many contend the institution approach to economic development and growth does not give appropriate attention to the role of geography.

The geography explanation focuses on the climate and resource holds naturally existing in a nation that determine disease, transportation costs, and technology. Combined, these factors have a sizable influence on agriculture and human capital. Moreover, a nation struggling from a poor geographic location is often isolated from the international markets, either because of physical barriers, disease, or lack of capital, thereby making trade expansion a near impossibility. However, as seen in the above chart, geography by itself does not directly affect income.

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Instead, geography can influence just how good institutions are in a country. Jeffrey Sachs defends the geography view by using Sub-Saharan Africa and Central Asia to exemplify the type of “trap” poor geographic economies can be limited by. The prescription for these countries is direct interventions, backed by donor assistance, to address disease, geographic isolation, low technological productivity, and resource limitations. While it makes sense to address the above factors, the method of “direct intervention, backed by donor assistance” is questionable.

It seems as though resistance to direct intervention would be quite an obstacle to overcome, especially in countries with existing bad institutions. It's easy to prescribe an intervention to increase quality of life or GDP but suppose those are not the objectives of a particular society? The execution of the intervention would be harder to carry out if citizens don't want it. Another obstacle might be moral hazard. Corrupt governments leading poor institutions might just oppress its economy for donor assisted intervention just to use it for their personal desires and not the greater good of the people.

In other words, countries with bad institutions might possibly be wasting the assistance funds or resources to strengthen bad institutions. Or, there just might not be incentive enough for a struggling economy to use the assistance effectively. Though donor assisted intervention might well appear to be useful in some situations, it is a solution that should be used with caution to aid geographic “trapped” economies. After scratching the surface of this ongoing debate revolving around economic growth and development, one can see the many issues and opinions all of which have validity.

As this debate continues, policy makers must keep in mind that humans are at the core of the answer. Whether the objective is trying to attract investment, increase trade or productivity, establish quality institutions, or intervening to help a struggling nation, one must keep in mind that these objective are for humans by humans. This is to say that each nation and economy is unique, from the objectives of the people that live within, to its geographic location and resource holds, to the level of economic prosperity and involvement it attains, and must be treated as such.