Chapter 4
A Survey of Economic Growth

ABSTRACT

This chapter is a survey of the two prominent theories of economic growth (the neo-classical theory as proposed by Solow [1956] and the endogenous growth theory that originated from the seminal works of Romer [1986]). To date, works following these have essentially been their extensions/refinements and some of the important extensions have also been summarised in this chapter. The current chapter discusses their major findings and implications for policy. It is also shown that the Solow model can be extended and used for policy. The endogenous growth theory, although stated to have some drawback, is useful for policy, as it has added new thoughts on how productivity may be generated. The chapter remains highly theoretical and derivations are suppressed, unless they become necessary. This survey finds that while the driving force of growth has been known since Solow’s proposition, the endogenous models have provided some discussions on how economies may achieve productivity growth. Some important sources of productivity advancements that have been suggested are through human capital, research and development, innovations, knowledge creation, and supportive institutions and social infrastructure.

INTRODUCTION

Regardless how systematic the study of economic growth may seem to be, the varied growth experiences recorded overtime and across countries have made growth policy ineptly confusing. Pritchett (2006) argues that although there is a noted progress in the economic growth literature, there still remains a sizeable gap between academic research and the needs of policy makers. He thinks that the

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theoretical growth models are not useful for restoring short-to medium-term growth rates and accelerating technological catch-up for developing countries. According to Pritchett, theorizing about economic growth must relate policies to tackle four important questions. Briefly, these are (i) which factors account for continued per capita growth in incomes and technological progress of the leading countries (ii) how some countries are able to sustain rapid rates of growth (iii) why some go into phases of slow growth; and (iv) why others remain in this mode for a very long periods of time. While it is conceivable that there are no universal theory and set of policies that could promote sustainable growth, Pritchett believes that appropriate growth policy will differ in different economic situations. Therefore, studies exploring why some countries are rich while others are poor and how the latter could possibly catch-up with the former are of immense interest because satisfactory explanations to the context-specific sources of growth are not forthcoming. Numerous explanations have surfaced to explain the cross-country development patterns. However, there still persists an enormous gap between the rich and poor, which in fact has diverged – the patterns of world income distribution have already been examined in Chapter 1. Berg (2001) argues that economic growth rates per se should not be blamed for such gaps in incomes, but it is the pace of progress that matters. Thus it is important to understand how to increase and sustain high rates of growth.

This chapter is structured as follows: After a brief background, it discusses the two prominent growth theories. The aim here is to discuss the mechanics and processes leading to growth rather than providing the analytical derivations. Some important issues pertaining to endogenous models are discussed and finally the chapter concludes with plausible direction for growth theory in the future. The final section also summarises the findings on endogenous models on important forces of growth.

BACKGROUND

It is acceptable to say that the growth literature provides some understanding on accelerating and managing economic growth. For example, it is agreed that opening-up for trade and financial flows have strong positive associations with high rates of growth. Similar case can be made for education and learning-by-doing. Further, innovation and R&D activities are also useful growth factors. We know that economies require practical policies to escalate growth rates including those for removing structural inefficiencies resulting from internal and external shocks. However, it is also true that some of the major drivers of growth are invariant to policy. Sala-i-Martin’s (1997) experiments (details later) show that religious, social and cultural factors rank on the list of top-10 determinants of growth. Conversely, Levine and Renelt (1992) argue that only (equipment) investment is important. Practical expe-
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