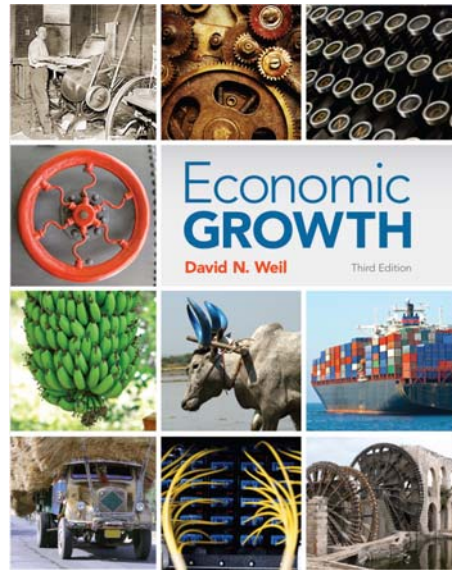


FUNDAMENTALS



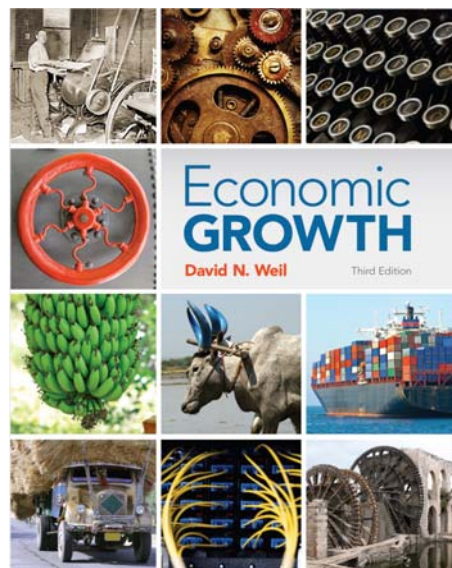
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Chapter 12

GOVERNMENT



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Asia at night



The case for government intervention in the economy

Public goods

Externalities

Monopolies and other imperfect markets

Coordination failures

Infant industry (bad and good examples)
alternative: "picking the winner"

Equity-efficiency trade off

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The case against government intervention in the economy

Government failures (worse than market failures)

Privatisation and deregulation

Rent seeking phenomenon and biased incentives

Things change along time: swings of the pendulum

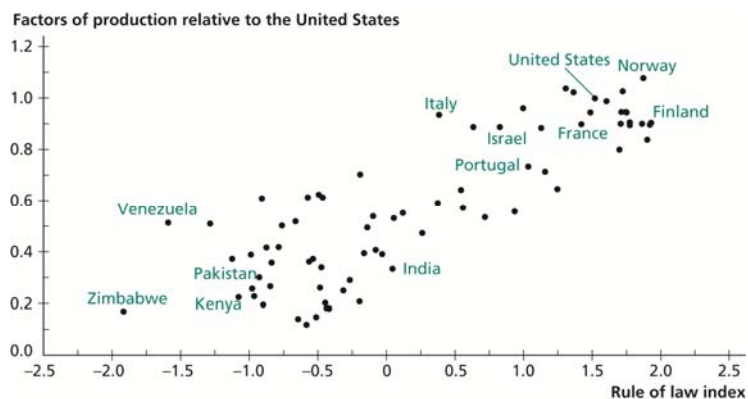
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Figure 12.1 Rule of Law and Factor Accumulation, 2009

RULE OF LAW
the principle that all people and institutions are subject to and accountable to law that is fairly applied and enforced; the principle of government by law.

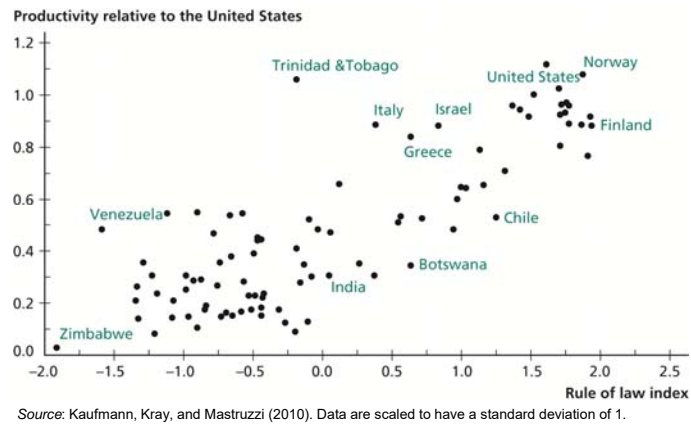


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Figure 12.2 Rule of Law and Productivity

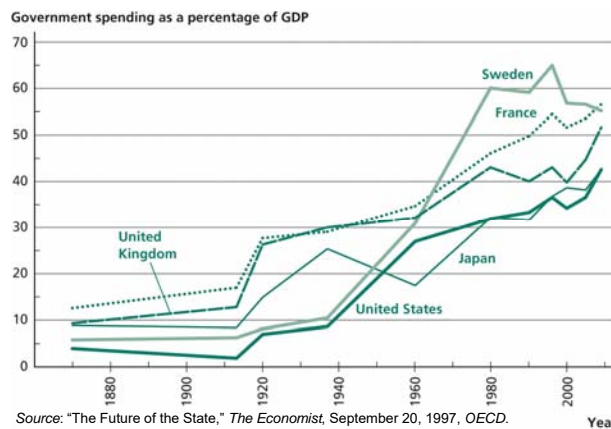


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Taxation, efficiency and the size of the Government

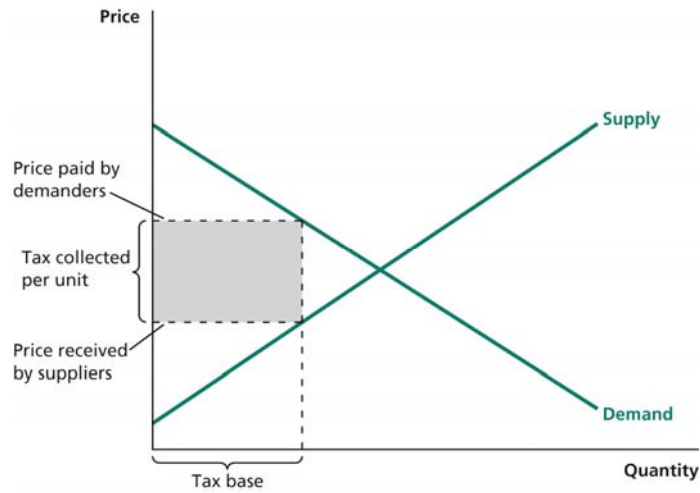


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Figure 12.4 Effect of a Tax

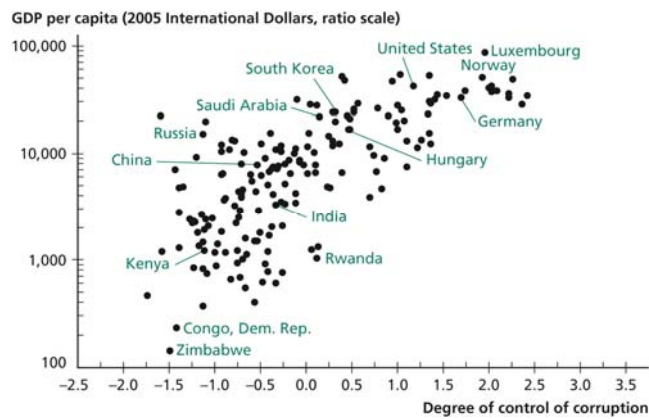


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Figure 12.5 Government Corruption versus GDP per Capita, 2009



Source: Kaufmann, Kray, and Mastruzzi (2010).

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Why poor countries have bad governments

- **Causation going from income to government quality**
 - Investment in human capital in institutions
 - Larger pie less incentives for destructive competition
- **Causation going from government quality to income**
 - Legacy of colonialism

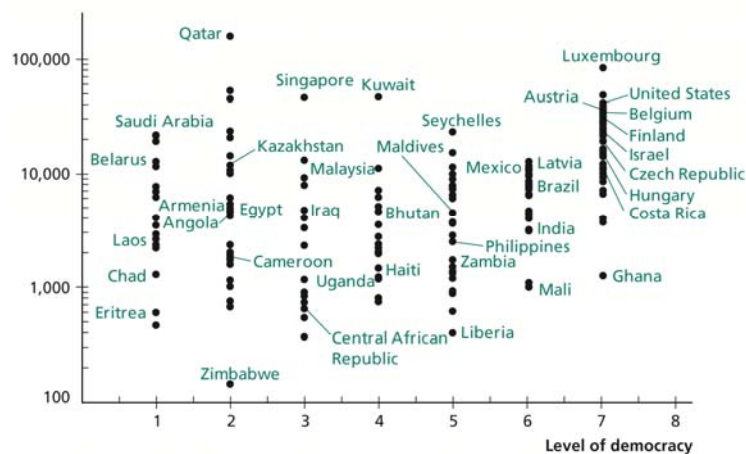
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Figure 12.6 Democracy and GDP per Capita

GDP per capita, 2009 (2005 International Dollars, ratio scale)



Source: Freedom House (2011).

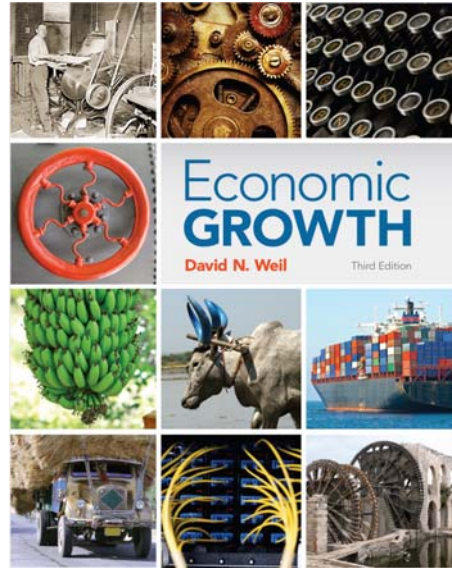
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Chapter 14

CULTURE



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Culture on economic growth

- Openness to new ideas
- Hard work
- Savings
- Trust (and optimism)
- Social capital
 - the value of social networks that people have and their inclination within these networks to do things for each other
- Social capabilities
 - Social and cultural qualities which allow a country to take advantage of economic opportunities

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World Values Survey

The World Values Survey (www.worldvaluessurvey.org) is a global network of social scientists studying changing values and their impact on social and political life, led by an international team of scholars, with the WVS association and secretariat headquartered in Stockholm, Sweden.

The survey, which started in 1981, seeks to use the most rigorous, high-quality research designs in each country. The WVS consists of nationally representative surveys conducted in almost 100 countries which contain almost 90 percent of the world's population, using a common questionnaire. The WVS is the largest non-commercial, cross-national, time series investigation of human beliefs and values ever executed, currently including interviews with almost 400,000 respondents. Moreover the WVS is the only academic study covering the full range of global variations, from very poor to very rich countries, in all of the world's major cultural zones.

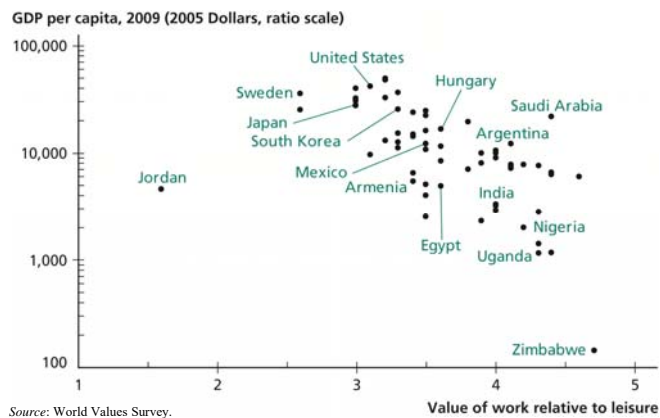
The WVS seeks to help scientists and policy makers understand changes in the beliefs, values and motivations of people throughout the world. Thousands of political scientists, sociologists, social psychologists, anthropologists and economists have used these data to analyze such topics as economic development, democratization, religion, gender equality, social capital, and subjective well-being. These data have also been widely used by government officials, journalists and students, and groups at the World Bank have analyzed the linkages between cultural factors and economic development.

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Figure 14.1 Value of Work versus GDP per Capita

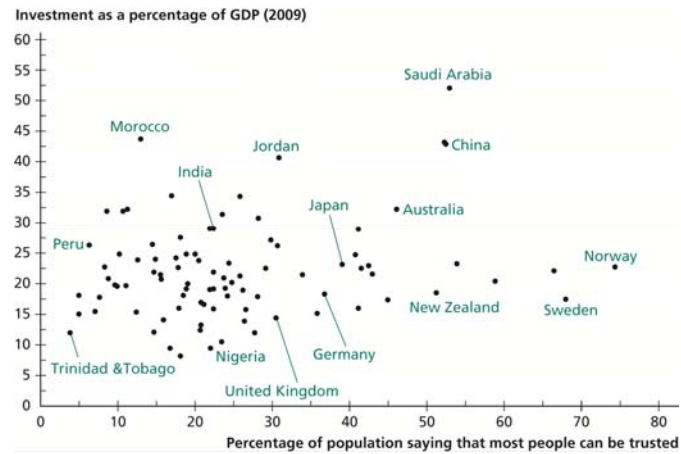


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Figure 14.2 Relationship between Trust and Investment



Sources: World Values Survey, Waves III, IV, and V; Heston et al. (2011).

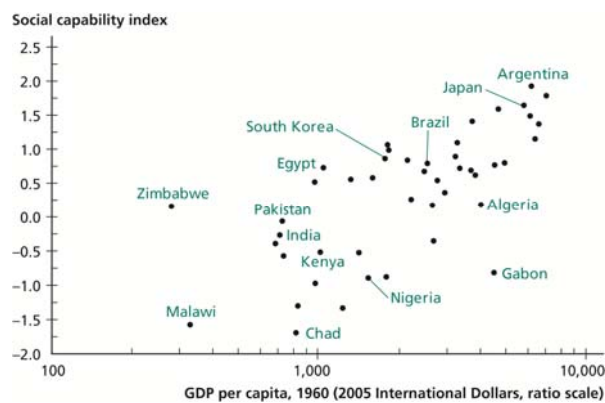
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Figure 14.3 Social Capability versus GDP per Capita in 1960

Social capabilities denote a person's opportunity and ability to generate valuable outcomes, taking into account relevant personal characteristics and external factors



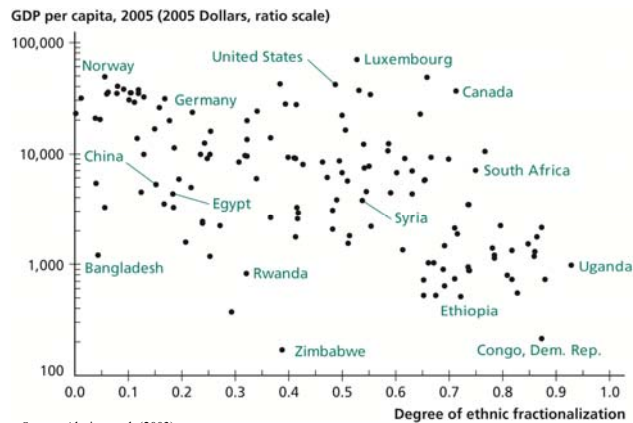
Sources: Temple and Johnson (1998); Heston, Summers, and Aten (2011).

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Figure 14.5 Ethnic Fractionalization versus GDP per Capita

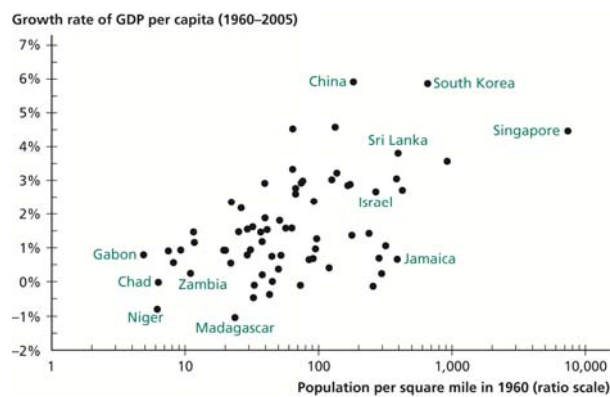


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Figure 14.6 Population Density versus Economic Growth



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History matters

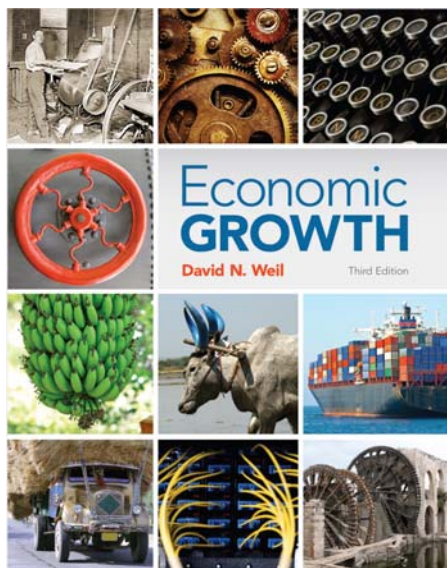


- Qwerty case
- Accidents or other random events may put the economy in an unefficient path (lock-in)
- Think about apple vs ms-dos

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Chapter 15

GEOGRAPHY, CLIMATE, AND NATURAL RESOURCES

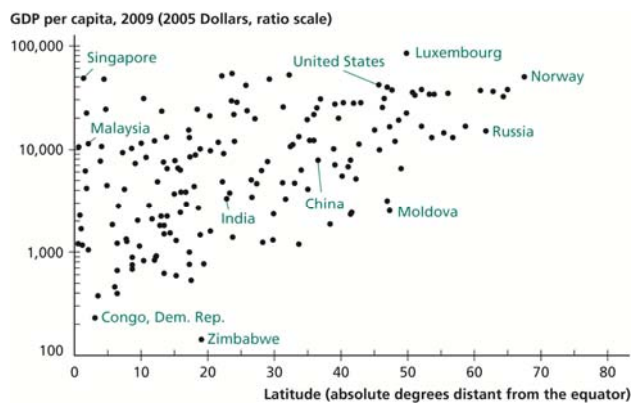


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Figure 15.1 Relationship between Latitude and Income per Capita



Sources: Heston, Summers, and Aten (2011), Gallup, Mellinger, and Sachs (2001).

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Location, trade and growth

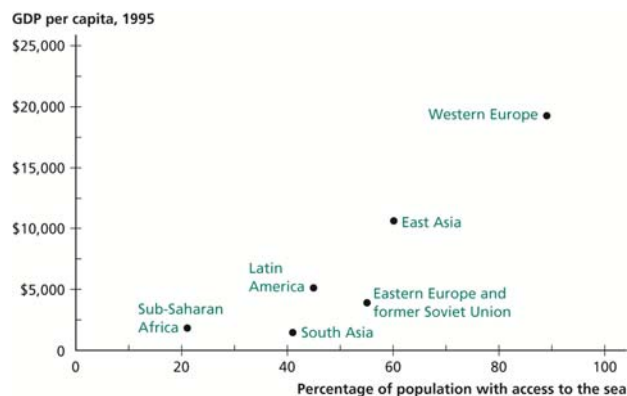
- Openness to trade depends on geography: think about landlocked countries
- Proximity to the sea or to a river may be a crucial factor in explaining income differences
- Proximity to major centers of economic activities can also be crucially important

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Figure 15.2 Regional Variation in Income and Access to the Sea



Source: Gallup, Sachs, and Mellinger (1999).

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Geographic concentration and spillovers

- Role of spatial spillovers... and local increasing returns
- “Nature shows a tendency to decreasing returns, but the part of man shows a tendency to increasing returns....knowledge is our most powerful engine of production and it enables us to subdue nature and satisfy our wants”

–*Alfred Marshall*

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Guns, germs and geography (Jared Diamond, 1997)

- Europe and Asia had several key advantages over the world that allowed it eventually to dominate
 - Numerous species of plants (39 out of 56, only 4 in subsahara) and animals (cows, horses, pigs, sheep...rather than llamas and alpacas) to be domesticated
 - Orientation east-west for the development of common agricultural techniques
 - Endemic diseases in large dense population
- Production of surplus to devote to other actions other than getting food and survive...

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Geography's effect on government

- Size of the country depends on geography
- Centralisation of powers can affect growth but with ambiguous effects

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Clusters at night in Europe



To cluster or not to cluster?

a.k.a: external economies; cluster economies

**Agglomeration Economies: lower production costs
attract clusters**

**Agglomeration Diseconomies: very large clusters
repel economic activity**

Types of Agglomeration Economies

Localization Economies decrease the cost of production for every firm *in a specific industry*.

Urbanization Economies decrease the cost of production for every firm that locates in a particular city *regardless of industry*.

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Benefits of clusters

Clusters may increase product demand, allowing firms to benefit from internal economies of scale.

Marshallian externalities from clusters:

- Pools of specialized labor
- Specialized firms
- Technological spillovers

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Localization Economies

Pools of specialized labor

- Easy to recruit skilled labor
- Specialized training exists
- Formal/informal communication

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Localization Economies

Specialized resources

- Backward linkages (upstream products) (supplier of inputs)
- Forward linkages (downstream products) (buyer of output)
- Face to face communication
- Producer services (outsourcing)
- Capital markets/bankers understand that industry

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Localization Economies

Technological spillovers (technological externalities)

Stimulate innovation

Often created from poached labor from local competitors

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Urbanization Economies

Advantages connected with the size of an urban area regardless of industry.

Specialized labor:

Law of large numbers: lower unemployment rate if workers are willing and able to change industries.

More special services than in rural areas.

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Urbanization Economies

Specialized resources

Urban vs Rural Infrastructure

Large city projects less risky to finance

Technological spillovers

Novelty by combination from great variety of goods in a city.

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Other local externalities

- **Social capital**
- **Public capital**
 - basic infrastructure
 - low bureaucracy
- **Amenities**
- **Public 'social' capital**
- **Florida three T's: talent, tolerance and technology**

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Tiscali as a case study

Why in Cagliari?

Why in Sardinia?

Why in Italy?

Was it an accident? or is it the result of a specific strategy?

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Climate and agricultural productivity

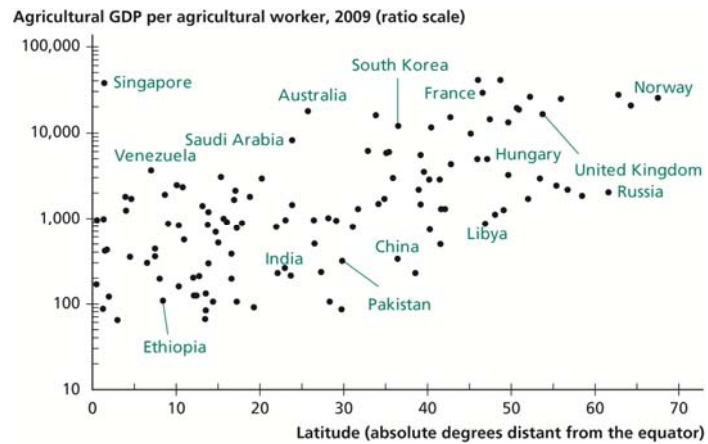
- Measures of agricultural output per worker differ greatly between tropical and temperate regions
- This does not imply that tropics are bad for agriculture
- Importance of ceteris paribus scenarios

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Figure 15.5 Latitude versus Agricultural GDP per Agricultural Worker



Source: United Nations Food and Agriculture Organization (2010).

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Climate and disease

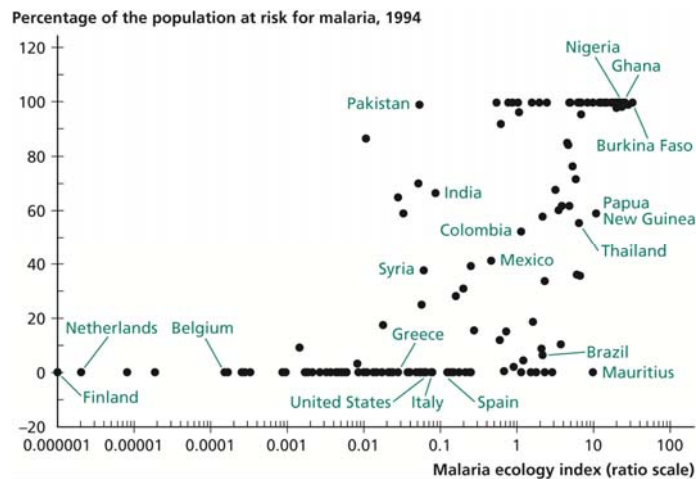
- There is good evidence that the tropics may constitute a bad health environment
- Malaria, among several diseases, has the largest effect on economic growth

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Figure 15.6 Malaria Ecology versus Incidence of Malaria



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Natural resources

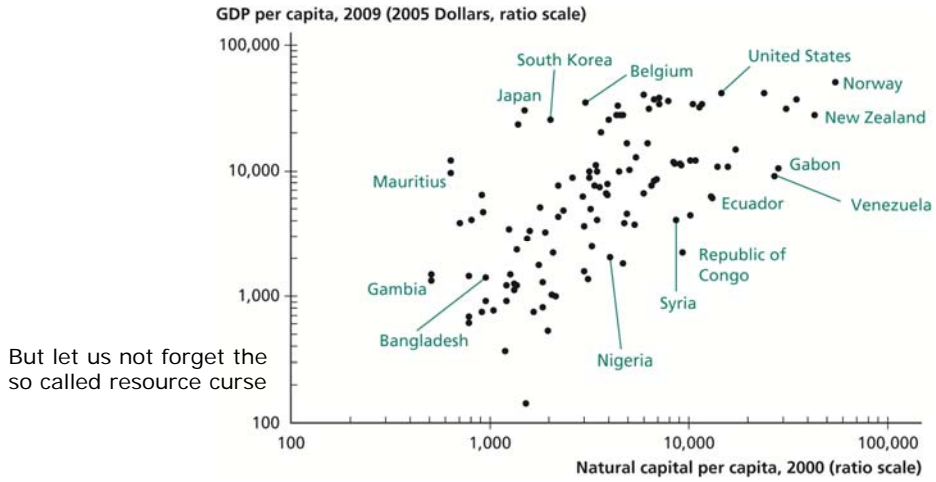
- Natural resources and growth
- Resource curse
 - Overconsumption
 - Dynamics of industrialisation: dutch disease
 - Politics: nigeria vs arabic gulf countries
- The case of coal in early industrial development
 - Western Europe: iron and steam engines
 - China: bad location of mines and no need for mechanised energy (no tech-push)

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Figure 15.7 Natural Capital versus GDP per Capita



But let us not forget the so called resource curse

Sources: World Bank (2006), Heston, Summers, and Aten (2011).

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