

**ECONOMICS OF GROWTH
AND DISTRIBUTION**

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Erinç Yeldan
Professor of Economics
Bilkent University, Ankara
yeldane@bilkent.edu.tr

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Gazi Mustafa Kemal Bulvarı

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Tel: +90 312 232 0036 / 232 0086

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PRAISE FOR THE ECONOMICS OF GROWTH AND DISTRIBUTION

“**T**his is the book on economic growth and distribution that I have been waiting for: an insightful, readable and teachable account of classical and modern growth theory that is not afraid of history, is not afraid of institutions, and does not try to sweep under the carpet the messy problems of the actual world we live in. A. Erinc Yeldan's "Growth and Distribution" is coming out just in time: as the world confronts the worst economic crisis since the Great Depression of the 1930's, we can no longer afford to teach the standard economics as if it were the only real truth. We owe it to the students -and to the world- to teach growth economics from a broader perspective as Erinc Yeldan's book does so well. I wish I had had this book when I was a student!”

*Gerald Epstein Professor of Economics and Co-Director,
Political Economy Research Institute (PERI), University of
Massachusetts, Amherst*

“Western macroeconomic theory and pedagogy have been in serious trouble for some time, especially in the developing world. This has been underscored by the current crisis, which mainstream macroeconomics failed to prepare the world for. Arguably, much of so-called open economy macroeconomics actually made things worse by presuming globalization to be fundamentally benign. Yeldan’s new alternative

growth textbook draws from heterodox thinking to better prepare new generations of students to be more realistic, more critical and thus more useful.”

*Jomo K. S., United Nations, Assistant Secretary-General for
Economic Development*

“Erinc Yeldan’s book fills a yawning gap in the economics literature, taking on the central questions of economics with a broad historical sweep as well as logical consistency and analytical insight. Yeldan brings together questions of growth and distribution in order to understand the process of economic development. His approachable style provides an exposition of the main approaches to growth and their applicability that will be extremely useful for students. But the questions that he raises and addresses are broader, and cover issues that are of direct contemporary and policy relevance, so this book deserves a much larger readership. Now that several myths of economic orthodoxy are being demolished by material realities, Yeldan’s critique of mainstream theories and his effective presentation of different heterodox analyses are especially valuable. This book is likely to become essential reading for anyone interested not only in the past and present, but also the future of economies. “

*Jayati Ghosh, Jawaharlal Nehru University and International
Development Economics Associates, New Delhi*

“Virtually all textbooks on growth and distribution construct and manipulate models whose assumptions are chosen to generate perfect market conclusions and support free-market government policy perspectives. However, the free market policies of neoliberalism led to the recent global economic and financial collapse; only unprecedented government financial market bailouts and a dramatic shift to expansionary macro policy prevented a global depression. It is more thus important than ever that growth and distribution theory be based on institutionally and empirically realistic assumptions that can help inform effective policy. Erinc Yeldan’s new book does a masterful job of giving students access to realistic models that can help them understand the economic world in which they live and intelligently assess different policy perspectives. I highly recommend it.”

*James Crotty, Sheridan Barber Professor of Economics, University
of Massachusetts, Amherst*

“In this book the author ventures into an old territory with a historical and social perspective. Unlike most treatises in this field he starts with history rather than theory of economic growth, and uses the former as a benchmark for the latter. This naturally leads him to treat global interactions explicitly, notably between lesser and more advanced economies, rather than introducing international trade and cross-border financial and technology flows as an afterthought. Clearly, like most of us, he has his own convictions, but this does not deter him from giving a lucid account of competing theories of economic growth. He also makes an effort to draw socially relevant policy conclusions from them. With all these features this book is a must for anybody who wishes to make sense of the current debate on globalization and the factors that account for income gaps between and within nations.”

Yılmaz Akyüz, Special Economic Advisor South Centre. Former Director and Chief Economist, UNCTAD, Geneva.

“Professor Yeldan, the foremost critique of mainstream economics in present day Turkey, has performed an invaluable task by providing the advanced undergraduate and graduate students with a technical yet comprehensible textbook on growth and distribution theory. It is rich in detail in a non-esoteric way, supplementing theory with real world data, and offering the reader an insight into competing explanations of economic phenomena.”

Dr. Orhan Kurmuş,

“With this valuable manuscript Erinc Yeldan has contributed immensely on the economic issues of current interest. I am confident that this book will help enrich both the undergraduate and graduate economics programs tremendously.”

Fikret Şenses, Middle East Technical University

“For analytical tractability, contributions to the theory of economic growth are based upon maintained hypotheses which tend to focus on a narrow set of causal factors, and other simplifications that make their policy relevance narrow and a challenge to formulate. The “Theories of Growth and Distribution” breaks out of this mode. It provides an excellent and extremely policy relevant presentation of the causes and effects of economic growth without sacrificing the use of quantitative modeling techniques. In doing so, the book takes account of socially relevant

policy questions, and frequently delves into alternative hypotheses to avoid narrow policy prescriptions, thus providing students and others insights into alternative and likely more socially responsible policy options. This very noteworthy contribution will be of endearing value for the way it integrates theory, policy and social relevance.”

Terry L. Roe, Professor of Economics, University of Minnesota

“Growth and development economics has become captive of the game of orthodox theorizing and self-affirming econometrics. Axioms, existence theorems and statistical significance camouflage faith, dogma and ideology while insights based on intuition, evidence and experience are sacrificed at the Procrustean bed of methodological rectitude. Now more than ever before, the field sorely needs a catholicity of methods to harness new ideas, and liberation from orthodoxy to advance real knowledge. Yeldan’s book is a thoughtful and timely contribution eminently suited to fill these needs. Drawing on multiple paradigms to chart a world of development challenges and possibilities, it is designed to serve as an apparatus of the mind which good economics should be.

It will prove valuable to students, researchers and policy analysts who seek to escape old habits of thought and cultivate new frontiers.”

Mohan Rao, University of Massachusetts, Amherst

“Finally, a modern reexamination of the inquiry set out by Adam Smith over 200 years ago to explain both growth and its unequal distribution: the cornerstone of understanding global economic development. This extraordinary text masterfully and uniquely combines theory, policy and history, weaving a narrative that is both instructive and powerful. An essential read for students of economics, development and public policy.”

Daniel Barbezat, Amherst College

“This book offers an important aid to students of mainstream growth theory both by virtue of exposition of its leading content and, even more important and rarely, situating the orthodoxy within a critical account of its origins, omissions and deficiencies.”

Ben Fine, SOAS, UK.

“In the beginning economics was growth theory. Today growth theory is largely a mathematical exercise in moving a state of full employment

equilibrium through time, especially at the undergraduate level. It crouches over in one corner of macroeconomics and fights to preserve its shadow in development economics. Students continually ask for more realism and especially policy relevance. Professor Yeldan navigates Scylla and Charybdis. The book exposes students to alternative growth theories, while analyzing and not simply ignoring the neoclassical approaches. It eschews math-for-math's-sake, while embracing appropriate modeling. The Economics of Growth and Distribution offers students once again a vision of growth theory as it should be - a socially relevant social science.”

Al Campbell, University of Utah

“The best way to learn economics is to have a textbook that develops a theoretical framework, along with, generating practical questions. Growth economics has no exception from this rule. Growth economics needs to be exciting and contemporary. Frequently, however, it easily becomes an area of difficulty, and sometimes nightmare for students. Professor Yeldan’s book “Economics of Growth and Distribution” has a sound insight, The subjects from neoclassical growth theory to alternative theories, from Solow to Marx and from distribution problems to development are impressive and are helping to upper undergraduates to understand the insight behind the growth theories.

It is also a timely book, channelling and motivating students and other audience thinking over the alternative growth models on the crisis we are already experiencing. Indeed, we need to develop such alternative growth models for post-crisis period. He has really produced an invaluable book which is clearly understandable and which is committed to helping students and audience to understand the intuition behind the models.”

Mahir Fisunoğlu, Çukurova University

“Excellentlly organized, well written, with an extensive coverage of the most important contemporary theories of economic growth as well as distributional issues on a comprehensive and understandable manner. I deeply believe that this book will be a treasure for a wide range of economists, policy makers and researchers who are interested in this subject. It is definitely a must reading for advanced undergraduate and graduate students who would like to do research in the fields of economic growth and development.”

Mustafa Özer, Anadolu University, Eskişehir.

“This book provides a balanced, rigorous and empirically grounded introduction to economic growth. In times of crisis, in both the economy and economics, the readers will appreciate being exposed to alternative theoretical approaches and challenged beyond mathematical problem sets.”

Roberto Frenkel, CEDES and University of Buenos Aires

“This book is a very welcome addition to the existing library of books on the economics of growth and distribution. As a teacher of growth economics, I was yearning for the arrival of a new textbook with a non-doctrinaire approach to the subject matter.

Upon reading this book, one can see that a great effort was put into giving space to alternative conceptual frameworks and alternative visions of the world around us.

Of note, this book is true to its name by having a more pronounced focus on issues of distribution than had been the case in other books on economic growth.

Instructors, students and anyone with an interest in this subject will certainly enjoy the many-sided approach embraced by this book.”

Antonio Marasco, Assistant Professor of Economics, Lahore University of Management Sciences (LUMS)

“Throughout the book, Professor Yeldan focuses on a set of issues which are the matters of vital importance for the developing economies. He presents lucid and well written explanations for the richness of the new contributions to the growth theory behind the technically sophisticated models.”

A. Suut DOĞRUEL, Marmara University, Istanbul

“Professor Yeldan adopts a distinctive approach to the theory of economics growth, which cautiously blends the abstraction of the models with the examples from the real world. The book presents comprehensive coverage of the topics in growth theory including neoclassical growth theory, alternative debates on growth, and endogenous growth. The author also draws attention to the distribution problems and the development issues. I would like to congratulate the author for this excellent book.”

Fatma DOĞRUEL, Marmara University, Istanbul



PRELUDE: WHY THIS BOOK WAS WRITTEN

This book was written in an attempt to respond to my students' increased feelings of frustration with the current state of growth economics. I have been teaching courses on '*Growth Economics*', '*The Economics of Globalization*', and '*Development Economics*' at various levels and various institutions for over twenty years by now. And over these years, students' appeals for more realism, policy relevance, and for the quest of alternative approaches of analysis had all but intensified. In every Fall, over and over again, I had to respond to their complaints that the main apparatus with which they were being confronted was too mechanistic; *a*-social; did not fit much of the historical facts and the relevant contextual institutional development they were spelled in; and perhaps more importantly, was not grounded on policy relevance.

In retrospect, I now find it an exasperating experience indeed to witness how, over the course of these twenty-some years, the subject matter has increasingly become an alienating exercise in technical detail with a set of brain-teasing exercises. It is true that at higher level graduate courses a more realistic and richer set of models were being pursued, and most of the hypotheses of the *mainstream* were being '*relaxed*'. It had been my experience from my students in undergraduate classes, however, that our '*intermediate*' level material has increasingly become restricted to the same apparatus -the idea of optimization at the margin in

an environment characterized by the full employment of resources, full and freely available information, smoothly functioning and competitive markets, and diminishing returns. This construct was being utilized verbatim once again, with no respect to the indigenous structural conditions and the historical realities of the subject matter at hand. What was expected from the students, in turn, was a devoted demonstration of their abilities to use this *a*-historical and *a*-social construct at the most complicated and abstract level possible, with a keen emphasis on developing an ever higher level of innovation in mathematical technicalities.

Thus, one confronts a widening gap between standardized technicalities -delivered to our young colleagues at the very early stages of their careers as undergraduate majors- and the richness of the real world out there. As the demand for higher and higher levels of such analytical abstraction and technical expertise is intensified, the literature on growth has increasingly lost touch with real world phenomena, and has become flooded with standardized models of hypothetical economies. A new jargon was invented and the whole realm of economics has been turned into a language incomprehensible for the non-professionals, as the so-called 'professionals' became alienated from the real economic phenomena. *'In the medieval ages, the clergy used to speak in Latin to gain prestige among the common folk who could not follow the divine words of authority; now economists likewise use the high jargon of mathematics for the same reason'* has become a widely circulated self-critical joke within our discipline.

Hence, over the years of my teaching experiences, I found myself constantly stockpiling an extra set of 'outside' readings to whatever text I was using. The standard 'mainstream' had to be complemented with 'alternative' approaches, from both the right and the left, and with real world data and real world discussions. As years passed, this list of outside readings piled into an excess baggage larger than the elephant itself. But what was even more frustrating (and alarming) was my observation that each new generation of students came to the classroom with a sense of ever-increasing self-consciousness that 'they already know all the answers', and they revealed less and less of an interest in 'what the alternative ways of thinking about the subject might be'. It was precisely the methodological self-assurance of the mainstream approach with a divine faith in markets and the one-sided technocratic look that was increasingly luring the students to think and act as a 'technical team of experts' armed with a set of sophisticated tools to simply apply and

solve all the utopian, heaven-sent problems of a make-believe world. There was no need to consider the possibility of alternative explanations of a given subject matter, and frankly, neither was there time for *doubt*. Not only the ‘solutions’ but even the ‘problems’ were all given; issues were well-stated all in advance; the subject matter was standardized; tools were all derived and developed; and all you had to do was to get trained and then demonstrate your ability with a new round of increased technicality and abstraction.

Yet this need not have been so. ‘*Growth Economics*’ was actually the centerpiece of our profession dating back to the days before Adam Smith. Recall that his seminal work was titled: *An Inquiry into the Nature and Causes of the Wealth of Nations!* Thus an inquiry, not only of ‘*growth*’ but also of ‘*distribution*’, was an integral part of the research paradigm upon which ‘modern’ economics was erected. “*The discovery of the laws which regulate distributive shares*”, thus claimed *David Ricardo* in the Preface to his *Principles of Political Economy*, “...is the principal problem in political economy”.

Hence, this book attempts to bring issues of distribution and growth together within a context which has become customary now to be referred as ‘*the grand theories of development*’. Our main purpose will be to shift from the domain of demonstrations of technical expertise for the sake of elitist jargon-making, to the domain of using that expertise to understand the real world economic phenomena: *how the economic machine moves over time and space*.

The issue, to be sure, is not whether to use mathematical modeling or abstractions in economic policy analysis. All classical economists, including Karl Marx and David Ricardo, were the leading mathematical economists of their age. The issue, however, is to use abstract mathematical modeling techniques with a sound grasp of the underlying hypotheses and their implications, and to answer *socially relevant* policy questions in a *socially responsible* manner (to coin a phrase from Lance Taylor’s 1991 text). Alternative hypotheses derived from contesting perspectives change the results, and it is not correct to flood students’ minds with only a single set of possible approaches, claiming that the others are ‘not within the acceptable realm of the widely-accepted paradigm’.

This book attempts to do this. It attempts to arm the students with an analytical tool box of alternative modes of thinking, to enable them to become aware of the contesting perspectives, and of different ways of

approaching to a given set of problems. It has to be noted at the outset that the primary objective of this book is *not* to *teach* theories of growth and distribution, nor provide answers to all relevant questions on the subject. Rather, the objective here is to increase awareness among the students that there exist various alternatives and contesting ideologies over these subjects, and that they are ultimately interlinked. The literature is abundant with manuscripts with the former (the *teaching* aspect), but it is hard to claim the same for the latter objective (the recognition of alternative ways of thinking within contesting paradigms) in the current age of mainstream orthodoxy.

I also would like to stress that the book uses mathematical modeling no more and no less than that of the ‘standard’ texts out in the profession. Yet, it does so with explicit cautions on whether the hypotheses were really necessary or were they of *simplifying* nature; whether they were introduced for convenience and (probably) did not have much of an effect on the results; and goes into pains in highlighting those that were indispensable for a given paradigm and yet were hidden behind innocent and ‘objective-looking’ algebraic forms. The book is written with the upper level undergraduates of economics majors and first year graduate students in mind. Yet, it should be of practical value to whomever is interested in the vast area of growth, development, and globalization—our colleagues from the sister fields of social sciences, researchers and professionals at various institutes, and intellectuals at large who had developed a general interest on *an inquiry into the origins and causes of the wealth of nations*.

The book can be cast in three broad divisions in implicit form. The first two chapters narrate rather the philosophy of the concept of economic growth and trace the history of economics as an emerging science since the early dawn of humanity. It starts with an extended discussion on the origins of growth; and tries to provide answers to questions such as: “why did the Industrial Revolution take place in England?; and why then?”. It discusses contrasting theories and evidence on the nature and causes of growth; the role of private property rights, technology and governments in growth accelerations. Chapter II continues with a discussion of the major players of the 21st century capitalism; the new international division of labor and the distinguishing characteristics of the core states versus the peripheral economies; the altering hegemonic powers of the world economy throughout history; the emergence of the *third world-led capitalism*; patterns of production and flows of trade

across the world economy. Then in sections III through, I focus on, what can be termed as the *grandé theories* of growth and development. We start with a simple ‘toy’ model to specify the routes of departure among the main divisions of economic thought. We discuss the traits of what makes a model *neoclassical*, *Marxian*, or *Ricardian/Keynesian*. Based on this departure the alternative visions of thought are introduced analytically in chapters IV and V. From chapter VI-onwards we approach to *modern* varieties of growth, with emphasis on endogenous motion of the economic machine, the role of the public sector, of technology, the nature of markets—whether competitive or oligopolistic, and so on. Finally in chapter VIII we wrap up taking a stock of what we have learned over about 250 years of research on the “nature and causes of per capita income differences across nations”; report on the reform experiences of the 1980s and the 1990s; trace “life after” the Washington Consensus; study expectations of reform and provide discussions of the end results. Thus, the book tries to strike a balance between the abstractions of the ‘theory’ and the living ‘reality’, often an uneasy one. Hopefully, the reader will accept my apologies in trying to bring so much diversity in an undergraduate textbook.

I had benefited from the indispensable support of many friends, colleagues, and students without which these pages could not have reached to you. I should particularly mention Bahar Araz, Cansu Cantaş, and Marjan Hajibandeh for their diligent research assistance and technical expertise. It is due to their help and painstaking revisions of the graphs, figures, and the data tables that the skeleton of this book got life and spirit. I also owe my debts of gratitude to my young colleagues and students at Bilkent, University of Massachusetts, Amherst, and at Amherst College for their attention, feedback and patience over many years of course work. I am further indebted to Gerald Epstein, Ebru Voyvoda, Ben Fine, Oya Köymen, Orhan Kurmuş, Yılmaz Akyüz, Oktar Türel, Korkut Boratav, Hasan Ersel, Tarık Kara, Fatma Doğruel, Suut Doğruel, Mustafa Özer, Terry Roe, Antonio Marasco, Mohan Rao, Daniel Barbezat, Geoffrey Woglom and James Crotty for their help, support, critical remarks, and suggestions at various levels of this undertaking. I am also grateful to Ms Fethiye Çolak and Türkan Sarı and all personnel of the *Ef-latun Publications* for their editorial expertise and management. Finally, I also would like to convey my gratitude to my wife and friend Lale Yeldan, and my daughters Selen and Ece for their support, understanding, and, above all, patience. *Hey girls, daddy’s homework is done...*



FOREWORDS

Korkut Boratav

Erinç Yeldan has written an important and timely book on the *Economics of Growth and Distribution*.

I was impressed with the ambitious analytical and empirical scope of the book. This was no surprise for me. Erinç has been a colleague with whom I have had the pleasure of interacting and collaborating for many years. We shared the same platform in numerous meetings discussing economic policy issues where I was able to observe his sharp analytical mind and grasp of current issues. We have at least three papers jointly signed. Those were the outcomes of research projects in which a number of economists both from the South and the North, but sharing a progressive world view, participated and discussed the issues of “growth and distribution” (the central theme of this book) in the periphery of the capitalist world system.

This is not all. Towards the end of 2000, it was clear to every economist who was not blinded by his / her neoclassical and neoliberal prejudices that Turkey, under the disastrous leadership of IMF, was drifting into a financial crisis. A number of economists, mostly from Ankara, came together to rally to the defensive cause of labor and against the destructive consequences of a potential crisis. That was how *Bağımsız Sosyal Bilimciler Grubu* (The Group of Independent Social Scientists) was formed. I take great pride to be among the founding members of this

Group together with Erinç. At its initial stage our joint and anonymous output aimed to caution the public opinion that the neoliberal policies imposed on the livelihood of working masses was not a historical and economic necessity; it was part of a comprehensive assault by international and domestic capital on the past acquisitions of labor and of the elements of economic independence realized by the Turkish economy throughout a long historical process. Our Group's predictions were validated by the 2001 crisis.

Bağımsız Sosyal Bilimciler Grubu not only survived that crisis, but continued and developed thereafter mainly because of the persistence of the ruling classes and governments with neoliberal policies despite their clear-cut bankruptcy. Erinç was, always, a main contributor to our periodical reports and at the debates, discussions leading to them. There once again, I observed, his energy, productivity and originality and benefited from them jointly with other colleagues of the Group.

Economics of Growth and Distribution is, I believe, not only based on the cumulative wisdom derived from the afore-mentioned and numerous other research activities of Erinç Yeldan, but, also, incorporates his experiences as a teacher of economics in Turkish and American universities. In the “prelude” to the book, he points out a number of reactions expressed by his students to the teaching of economics: *Increased feelings of frustration with the current state of economics... Appeals for more realism, policy relevance, and for the quest of alternative approaches... Complaints that the main apparatus with which they were being confronted was too mechanistic; a-social; did not fit much of the historical facts and the relevant contextual institutional development they were spelled in...* These reactions lead Erinç to challenge the “widening gap between standardized technicalities and the richness of the real world out there”. And the end result is the present book where Yeldan confronts his research experience on the “real world out there” with the mainstream-neoclassical economic analysis and, additionally, emphasizes the presence and essential contours of other schools of thought.

I am sure that *Economics of Growth and Distribution* will be a valuable and indispensable book to all students and teachers of economics who are not happy with the current state of the mainstream “dismal science” in terms of its inability to grasp and enlighten the boom/bust cycles, growth/crisis dualities, distributional conflicts of the world economy during the current moment and in the distant and near past.

Oktar Türel

Almost 40 years ago, Sen (1970:9) noted that “...(*The revival of interest in growth...was to a considerable extent the result of an immense practical concern with growth after the Second World War. (...) With this motivation, it would have been natural for growth theory to take a fairly practice-oriented shape. (...) This, however, has not happened and much of modern growth theory is concerned with rather esoteric issues. Its link with public policy is often very remote. It is as if a poor man collected money for his food and blew it all on alcohol.*)”

With few exceptions, the so-called “neo-classical synthesis” in post-war mainstream economics treated growth theory (in particular, its steady-state variant) as the counterpart of the long-run equilibrium in comparative static analysis (Hahn and Matthews, 1964:781). The preoccupation with steady-state growth (virtually, a mythical state of affairs in any actual economy) led the academic interest to the three related issues: (i) Is a steady-state solution possible? (ii) Provided that a steady-state solution exists, what are its properties? (iii) Does the economy move towards the steady-state path, if it is initially off it? This esoteric flavour of the post-war mainstream growth theory (persisting up to the present time), and its remoteness from realism and policy relevance cannot entirely be attributed to abstraction, which is indispensable to any kind of theory-building endeavour.

As Professor Yeldan correctly points out in his Prelude to “Economics of Growth and Distribution”, the framework for analysis in growth theory has increasingly been circumscribed by “*the idea of optimisation at the margin in an environment characterised by the full employment of resources, full and freely available information, smoothly functioning and competitive markets, and diminishing returns*”. Many awkward questions raised by “non-orthodox” schools of thought were skillfully “domesticated” and placed as digressions into this highly stylised framework. Distributional issues which have been an integral part of the growth theory right from the start were given a very formal treatment. Clearly, this narrowing-down of the research agenda has ideological connotations as well. So any writer preparing a contemporary text on economics of growth and distribution faces a dilemma: If (s)he puts the emphasis excessively on (now, fairly standardised) technicalities, most of the real world phenomena is likely to be thrown off the kilter. On the other hand, if these technicalities were omitted, a common language for the exchange of views among professionals can hardly be found. Professor Yeldan strikes a very good balance in that respect: See Chapters III, IV and V plus the Mathematical Appendix in his book, which include the essentials of modelling growth and exclude unnecessary details and/or irrelevance.

To infuse realism and policy relevance to the mainstream growth theory is another (and very important) matter. Broadly speaking, two possibilities exist for that purpose: (1) Referring to (and trying to explain) the variety of historical growth experience, including structural change and international trade linkages. Professor Yeldan explores this avenue in Chapters I and II in his book. To his credit, the inquiry in these chapters goes far beyond the presentation of “stylised facts” of the late 20th century growth and the formal debate on convergence / non-convergence. (2) Endogenising the (neoclassical) growth model. As Professor Yeldan points out, this can be accomplished via three modeling strategies: (i) specifying production function so as to combine constant returns to capital and constant returns to scale; (ii) introducing externalities in form of positive spillovers to physical capital, while maintaining constant returns to scale and competitive markets; and (iii) as an extension to (ii), introducing externalities from knowledge (i.e. technological innovations). Chapters VI and VII in Professor Yeldan’s book are devoted to these tasks. In his concluding Chapter VIII, Professor Yeldan first takes stock: What are the lessons drawn from the growth experience of about 250 years since the Industrial Revolution? What do we know about the causes of and the constraints on economic growth? He then proceeds into two important issues of the world economy: (i) Did the “reforms” of the 1970s and the 1980s in the developing nations affect economic performance? If so, how and why? (ii) What are the clues obtainable from the findings of the growth theory for the design and implementation of development policies? His presentation and discussion of these issues are informative and stimulating. In sum, Professor Yeldan produced a very good text, concise and comprehensive at the same time. It will be of great help not only to postgraduate students and undergraduate majors trying to grasp the essentials of growth and distribution, but also to academics and professionals, who would like to update and refresh their stock of knowledge on these matters. Following the reprint of Professor Yılmaz Akyüz’s remarkable study, “Capital, Distribution and Growth” (by Eflatun Yayinevi, 2009, in Turkish), this new work by Professor Yeldan will be welcome indeed for Turkish as well as foreign readers, who would like to extend their vistas over and above short-term considerations dominating the current economic debates.

References

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Hasan Ersel

“Growth” and “distribution” are the two hardest and most contested areas of economics. Hard, because it entails two complex processes such as growth and distribution that display a simultaneous effect and counter effect relationships in a dynamic context. What I mean by its being a “contested” area is not due solely to the presence of various alternative theoretical formulations on the subject. The fact that this had been so should be regarded natural; the opposite would have been bizarre. Yet there exists a further difficulty on this fact; and this is due to the issue of methodology. Some economists prefer to handle this question on the basis of abstract theoretical models. Yet, some others share the view that the richness of the real world phenomena cannot be captured by such theoretical approaches. Their approaches are rather based on providing a historical analysis of the indigenous country episodes and to possibly deduce generalizations relevant for many.

Erinç Yeldan looks at these issues from the eyes of those who want to study them. For this reason, he chooses the hard way of confronting the two tasks of growth and distribution together. On the one hand, he investigates the issues of growth and distribution from the angles of available theoretical paradigms, their questions sought, their methodologies, and their end results. He tries to provide the reader the opportunity of viewing alternative approaches to the subject. Yet he does not leave a second dimension un-attended. He also evaluates real world observations in contrast with the theoretical debates. This is no easy task. Furthermore, it is probably the only approach to meet together those who do not wish to give any concession from the “purity” of their theoretical endeavour and those who regard the historical evidence as the “only” reliable source –at least in the arena of contestability.

A further important contribution of the book is its purpose to open up a debate regarding economic policies that would promote advances on the areas of growth and distribution. This is certainly another point of importance. This is because in Turkey (and to some extent in the world at large) issues of growth and distribution had been rather taken away from the main focus of economists. It is not easy to understand why this had been so. Because, at least in Turkey, these two issues are far from being resolved, and an expanding, sustained economy without serious distributional problems could not have been yet achieved. It is, as if, assumed that if other problems (such as stability) could have been

resolved, these problems would by themselves be dissipated on their own. Yet, what had been observed thus far is full of signs that this is not necessarily so.

This book achieves in showing us that the problems experienced in the areas of growth and distribution should not be regarded as our fate, but that they are mere phenomena that can be changed at our deliberate, conscious efforts. I applaud Erinç for undertaking this hard journey and for contributing this book to us, and thank him as a reader.



OUTLINE AND BRIEF SYNOPSIS

I. History of Economic Growth and Economic Growth throughout History

I-1. The Most Well-kept Secret of Economists

the emergence of the idea of “growth economics”; thinking and formulating on economic growth; “secrets” of growth economists

I-2. Case in Point: Lessons from the Aftermath of the ‘End of History’

the almost uniform synthesis of macroeconomic policy advice known as “the *Washington Consensus*”; expectations and realized outcomes of the implemented reforms in the 1990s with the collapse of the soviet system and the rise of the so-called “*emerging markets*”; economic growth as inherently a complex matter, not amenable to simple formulas or recipes; policy reform and institutions do not travel well across boundaries

I-3. Further Difficulties in Theorizing Growth

difficulties in making comparisons across nations; the idea of the *purchasing power parity exchange rate*; difficulties in theorizing for growth

I-4. Growth Is a Fairly Recent Phenomenon

brief overview of the growth process; growth is only a recent phenomenon; empirical evidence on different rates of growth and the nature of growth accelerations since the 1820s

I-5. Why in Europe? Why in the Late 18th Century?

discussion on the origins of growth; why did the Industrial Revolution take place in England?; and why then?; contrasting theories and evidence on the nature and causes of growth; the role of private property rights, technology and governments in growth accelerations

APPENDIX: Suggested Readings

a brief summary of important texts and interesting material on growth and its ideology

II. Stylized facts and Empirical Regularities of Growth

II-1. Global Contours of the World Economy: Its Core and the Periphery

Discussion of the major players of the 21st century capitalism; the new international division of labor and the distinguishing characteristics of the core states versus the peripheral economies; the altering hegemonic powers of the world economy throughout history; the emergence of the *third world-led capitalism*; patterns of production and flows of trade across the world economy.

II-2. Cycles of Globalization and Growth

Identification of long cycles of growth-recession-crisis in the world economy; the notion of *Kondratieff cycles*; patterns of long run growth

II-2-1. The Two Recent Waves of Globalization

investigation of the two most recent cycles of globalization, 1840-1913 and 1970s-current; identification of the distinguishing characteristics of the 19th century *versus* the 20th century globalization.

II-2-2. The Rise of Finance Capital

ascendancy of finance over industry in the 20th century globalization wave under a regime of fiat currencies; the demise of the *Bretton-Woods system*; financialization as a symptom of deflation of industrial expansion and diminishing returns

II-3. Stylized Facts of Late 20th Century Growth Episodes

characteristics of the 20th century global capitalism; *Kaldorian stylized facts* on the “*Golden Age*”; development of the neoclassical (Solow) model; development facts on growth and “openness”, and

“size of government”; the rise of income inequality and patterns of uneven growth

II-3-1. The Role of Governments in Growth Episodes Proper

Government matters in promoting growth; the historical role of governments in successful growth episodes; what are the boundaries of governments in growth?

II-4. Lessons Learned? With More Questions Remaining...

Suggested Exercises

III. Modeling Growth

III-1. Common Elements, Different Paradigms

a bird-eye’s-view of the state of the modeling framework in growth economics; critical questions and challenges faced by growth economics; analytics of a simple general equilibrium growth model

III-2. Main Spirit of the Standard (Neoclassical) Growth Model

what makes a growth model “*neoclassical*”?; critical assumptions and key properties of the neoclassical approach to growth

III-2-1. Building Blocks of the Standard Neoclassical Growth Model

analytical equations identifying neoclassical growth; the idea of balanced growth and the *steady state*

III-2-2. Digression on Investment and Saving Equivalence

the so-called neoclassical closure in setting the saving-investment relationship; determination of the rate of interest under alternative theoretical approaches and the interest rate’s role in growth economics

III-2-3. The Notion of Steady State and Balanced Growth

the key to balanced growth; Harrod-Domar’s ‘*knife edge*’ phenomenon; the Harrod-Domar relationship as the key starting point of contesting paradigms of growth

III-2-4. Accounting for Disparities in the Wealth of Nations Using the Neoclassical Model

how does the standard neoclassical model fare in providing explanation to the observed disparities in the wealth of nations?; possible solutions to the observed deficiencies of the standard model

IV. Neoclassical Growth

IV-1. The Solow Model of Growth

the basic Solow model; characterization of the steady state; steady state versus transitional dynamics; distribution within the neoclassical paradigm; an early discussion on the ‘endogenous’ sources of growth; exercises

IV-1-1. Role of Distribution in the Solow Model

the neoclassical theory of income distribution; technology driven distribution distributional adjustments at work towards the neoclassical steady state; optimal saving rate; the golden rule

IV-2. Policy Implications of the Standard Neoclassical Model

empirics of neoclassical growth; convergence across nations; how successful is the neoclassical model in predicting realistic paths for growth?

IV-2-1. Typology of Growth under the Neoclassical System

transitional growth towards long run equilibrium; properties of steady state; the role of the aggregate production function; rate of growth *under* the steady state; rate of growth *towards* the steady state

IV-2-2. Technology and Solowian Growth

decomposition and empirics of growth; determinants of total factor productivity growth; distance to the steady state

IV-2-3. Economics of Catching Up and Convergence

convergence across nations; the idea of *conditional* convergence versus *absolute* convergence

IV-3. Endogenous Savings and Consumption Smoothing in the Neoclassical Model

extensions of the standard neoclassical model with fixed saving rates; the Ramsey-Cass-Koopmans model; economics of consumption smoothing and its implications;

Exercises and Food For Thought

V. Alternative Treatises on Growth

V-1. Neo-Ricardian Growth

Neo-Ricardian growth and distribution theory; the role of the “*independent*” investment function; neo-Ricardian general equilibrium

V-2. Marxian Growth

elements of Marxian growth and distribution theory; surplus value and the Marxian idea of exploitation; Marxian general equilibrium; exercises

V-3. Which Way to Go: *Classical* or *Neoclassical*?

Applied modeling techniques; your ideology is important in choosing the “right” model

Exercises**VI. Endogenizing Neoclassical Growth****VI-1. Source of the Problem**

what is “*endogenous*” growth?; three ways to achieve endogenous sustained growth within the neoclassical system

VI-2. Early Progress in Endogenizing Growth: The AK Model

Rebelo’s AK model as a simple example of endogenous growth

VI-3. Endogenous Growth Models Based on Externalities

seminal examples of endogenous growth based on externalities; Lucas’ “human capital” driven growth model; economics of “*social capital*”; Barro’s strategic public good; geographical conglomerations

VI-4. Bringing Consumers into the Picture

Behavior of consumption smoothing consumers; putting all together

Exercises**VII. Economics of Knowledge and Innovation: R&D-Driven Growth****VII-1. Economics of Knowledge and Technical Change**

technology as special economic good; economics of technology production; the ideas of public good, rivalness and excludability;

VII-1-1. Evidence on R&D Expenditures and Growth

international evidence on R&D expenditures and growth across nations; US R&D expenditures

VII-2. Main Structure of R&D-Driven Growth

basics of Romerian growth; general equilibrium of the R&D-driven model;

VII-2-1. Nature of the Final Goods Production Technology

VII-2-2. Patterns of Income Distribution in the R&D-Driven Economy

VII-2-3. Accounting for foreign trade externalities with the aid of an R&D Driven Growth Model

VII-3. The Shape of the R&D Function

Jones' critique of the classical Romerian growth; alternative specifications of the R&D function and their implications; the role of public policy in affecting growth

VII-4. Schumpeterian Growth

The Schumpeterian R&D model based on technological progress as 'creative destruction'; extensions of the Schumpeterian model to issues of international trade; the role of trade in promoting technology flows

VII-4-1. Principles of Schumpeterian Creative Destruction for Sustained Growth

VII-4-2. Dynamics of Adjustment in the Schumpeterian Economy

Exercises

VIII. Overall Assessment: What Have We Learned?

taking a stock of what we have learned over about 250 years of research on the "nature and causes of per capita income differences across nations";

VIII-1. Economics of Policy Reform and Policy Space

the reform experiences of the 1980s and the 1990s; after the Washington Consensus; expectations of reform and discussions of the end results; given endowments leading to comparative advantage and specialization versus creating comparative advantage and diversification

VIII-2. Development Policy Implications of the New Theories of Growth

distribution and political economy of growth; role of institutions on growth; "*institutions do not travel well across nations*"; applications of the R/D-driven growth for designing appropriate industrialization policy for the developing economies; the role of the manufacturing sector and market stimulating industrialization and structural change

Appendix: Mathematical Tool Box

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HISTORY OF ECONOMIC GROWTH
AND ECONOMIC GROWTH
THROUGHOUT HISTORY

CHAPTER

1

CHAPTER ONE

History of Economic Growth and Economic Growth throughout History

I-1. The Most Well-kept Secret of Economists

“*Economic growth*”, according to the *Millennium Issue of the Economist* (31 December 1999), “*is the most well-kept secret of economists*”. The claim, which at first sight, could be regarded as too blunt and over-stated, has nevertheless a strong dose of truth in it. Our profession indeed does not have a satisfactory explanation of *how* and *why* nations grow at the so diverse rates observed across history.

More often than not, economists have devised sophisticated models which ascribe to alternative paradigms trying to explain the laws of motion governing economic growth. Yet, in each case the richness and the variety of historical experiences proved such attempts futile and short-circuited. At best, economists have devised models that could explain, in retrospect, the nature and causes of growth as a *historical reality* that had been observed and documented. But still, the profession had not been able to score an agreement on even laying out the main propelling factors that move the economic machine over time and space. What’s more, in many analytical modeling attempts, the *sources* of economic growth (such as productivity gains or technology acquisition) had been taken as an ‘*exogenous*’ factor, left virtually unexplained. ‘*A measure of our ignorance*’ was the conventional expression to convey the attitudes of the early neoclassical modelers towards technical change. Such models of the mainstream neoclassical approach felt content with simply narrating an episode where the economic structure simply *adapts* to the forces of an economy already in motion, leaving the question “*why growth*” out of economic analysis.

This, of course, is an uneasy anomaly especially because economics as a professional subject had been initiated to answer, “*An Inquiry into the Nature and Causes of the Wealth of Nations*” in the hands of **Adam Smith** as early as 1776 (see Smith, 1981).

This inquiry has, in the course of some 250 years, been relegated to a set of unexplained (exogenous) factors with limited success in explaining the causes of growth. Disheartening and cruel as it is, the verdict has well-grounded reasons. One is the ultimate diversity of growth experiences since the onset of the so-called industrial revolution in the mid-18th century. We often loosely partition the world as ‘rich’ – ‘middle income’ – ‘poor’ (sometimes with the addition of ‘very poor’), and often advance broad geographical divisions of our planet as the rich ‘North’, and the poor ‘South’. Even though such verbalizations may help generate interest and awareness in such broad questions as ‘*why are we so rich; and they so poor?*’ the approach is still too caricaturistic and blurry to convey meaningful/testable hypotheses of why and how we acquire economic growth. Let’s dwell on this shortly.

I-2. Case in Point: Lessons from the Aftermath of the ‘End of History’

Consider, for instance, the very recent episode when history itself was claimed to have reached its end. Following the collapse of the Soviet system and the demise of real-socialism in 1989, the decade of the 1990s had been an era of self-confident propagations of orthodox economics arguing that growth was simply a matter of ‘*getting the prices and national policies (and later in its most general form, the institutions) right*’. Dubbed under the term *Washington Consensus*, development policy was relegated to a set of standard practices: open trade; eliminate fiscal deficits and reduce the size of government expenditures; deregulate financial markets; and enhance the role of private entrepreneurship and markets in allocating resources. Much of this literature had been the subject matter of the Trade and Development Report, 2003 published by UNCTAD.

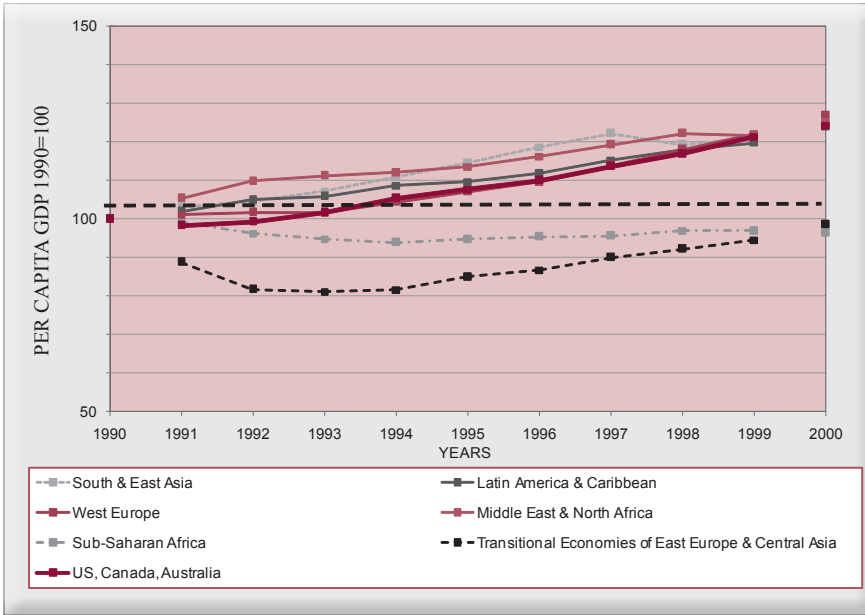
The term was initially coined by **John Williamson** (1991) to characterize the almost uniform synthesis of macroeconomic policy advice coming from the economists at the World Bank, the International Monetary Fund (IMF), and the US Treasury Department —all Washington DC institutions. As Zaghera *et.al* (2006) attest, the scope, breadth and depth of the reforms and the ongoing transformations were unprecedented in the course of economic history.

Thus, as the 1980s were referred to as the ‘lost’ decade, the 1990s had been an era of true *big bang* in terms of the adjustments involving transition to more open market economies with reduced government expenditures, elimination of tariffs on trade and of regulations on flows of capital, and the heightened role of small, efficient bureaucracies staffed with well-trained technocrats. The structural transformation embedded in this global experiment was so vast that by the end of the decade those countries which were referred to as ‘*developing economies*’ were graduated to a new phrase: ‘*emerging markets*’. The concept of developmental policy was replaced with the concept of structural reform and embracing the ‘*right*’ policies, as those national economies were converted into the realm of the ‘*emerging*’ markets.

These ‘reforming’ emerging markets, as the arguments ran, would enable their citizens to escape the trap of low growth – high inflation that had hindered them over all their post-War history, and would place them on the road to self-sustained growth. The results, as we know however, were quite unexpected. There had been successful growth episodes in countries such as China and India where the standard recipe was not followed in verbatim; and there had been cases of costly adjustments as well as financial crises such as Mexico 1994; East Asia, 1997; Brazil, 1999; Turkey, 2001; and Argentina, 2001. Overall, the picture had been that some countries managed to achieve rapid, sustainable growth with only a ‘modest’ set of reforms; while some others had been led into deeper chaos and stagnation after implementing an ambitious array of reforms.

The fact that similar sets of economic reforms yielded vastly different outcomes is depicted in Figure (I-1) quite clearly. If at all, the experience of the 1990s as the ‘decade of reform’ reveals only one thing: that the real world economies have disclosed a diverse structure and revealed responses in quite unexpected fashions, widely different than the simplistic text book models of growth and development. As observed even from this brief episode of recent economic history, economic growth is inherently a complex matter, not amenable to simple formulas or recipes, and that, policy reform and institutions do not travel well across boundaries.

Figure I-1. Wide Diversity in Response to Reforms in the 1990s



I-3. Further Difficulties in Theorizing Growth

A further major difficulty in putting our analytical tools together often regards problems of measurement. In almost all works in growth economics, and will also be the case in this book, the unit of analysis is the gross domestic product (GDP)—the market value of goods and services produced in one year in a given economy. Even though the practice of national income accounting is now fairly standard across many countries, crucial difficulties remain in making comparisons internationally. For one thing, comparisons of GDP across nations are prone to misleading calculations due to systemic deviations in the market values of the exchange rates in translating domestic currency units into international prices. A major part of the problem lies with the fact that not all domestically produced goods are traded internationally. Thus, subjecting the so-called home goods (and services) to international price ratios under a given market exchange rate may lead to swings in relative valuation. Generally speaking, it is often the case that comparisons of GDP at international market rates of exchange lead to systematic under-valuations of the relative GDPs of developing countries where differences in the relative price ratios of traded and non-traded goods and services are more pronounced.

To remedy this problem, economists have constructed a set of analytical exchange rates to reflect the relative price index of a standard basket of goods and services and called it the *purchasing power parity* (PPP) index. The PPP index takes into account both the traded and non-traded commodities in a standardized fashion across countries and allow for more reliable measures of the *wealth of nations* at any point in time. Yet, as can be noted easily, the procedure of setting up a standard basket of goods and services to reveal a given ‘*purchasing parity*’ is itself a cumbersome task, amenable to errors in design and measurement. Considering that such comparisons are due across countries of widely diverse historical structures and social norms, the use of PPP-exchange rates is, at best, a minor step in the right direction; and that’s how we shall interpret its usage along the remaining pages of this book.

An equally important facet of our difficulties in conceptualizing the growth process is based on the nature of our methods of scientific inquiry itself. As the rates of expansion and the levels of the *wealth of nations* shifted almost cyclically over the course of the last 250 years, the basic tenets of economics as a profession had been subject to wide swings. ‘Growth economics’ have become a rising, and then again a standardized, subject as the overall economic activity heightened and receded over time (a process for which Marxist economists have phrased as *Kondratieff cycles* — long term cycles of expansion, maturity, and recession over the course of 50-60 years in duration. (See further documentation in Section II-2 below). It is no coincidence that the early growth theories have erupted with the advent of the so-called *golden age*, depicting the unprecedented growth in human history roughly from 1950 to 1973. This episode of rapid growth was complemented with the surge of various competing theories of growth, each finding its analytical bases in alternative paradigms (which, in retrospect, now became part of our standardized tools of modeling research). The onset of stagnation and the overall deflationary environment following the two oil shocks and the onset of the debt crises during the 1980s had led to increased attention on the economics of ‘short run stabilization and adjustment’ pushing growth economics as more of an “older” subject matter to be consigned to pages of the history of economic thought. Yet, with the onset