Introduction

Arrigo Opocher and Neri Salvadori

A common feature of the recent theories of economic growth is that they tend to be increasingly inclusive. Many factors which were previously considered as fixed in the background are now recognized as changing and varying across countries, requiring an explanation within the theory. Institutions, in particular, are widely studied in relation to potential growth. The quality of formal, legal institutions which, in a broad sense, define the rules of the game and the structure of economic incentives, is placed quite naturally among the fundamental factors affecting potential growth and, most importantly, among the effects of it. The many informal institutions embedded in habits and social norms, such as fertility choices, attitudes towards education and health care, and the use of leisure, are clearly recognized to interact with economic growth. Institutions and social norms are explained by means of economic categories and related mutually to growth, giving rise to a variety of self-reinforcing mechanisms. Poverty traps, increasing returns and the accumulation of human capital are among the paramount features of the modern theories of long-run growth. At the same time, and partially resulting from this growing awareness of the role of institutions, increasing stress is laid on economic growth in relation to living standards. The rate of potential growth and per capita real income are, in fact, poor indicators of the overall performance of the economic system. Broader indicators of progress in well-being, such as the quality of social relations, safety, environmental protection, life expectancy and literacy rates, are increasingly being used to characterize growth. Such indicators also interact with the strictly economic and quantitative profiles of growth and give rise to self-reinforcing mechanisms.

The fundamental breakthrough in this direction was provided in the 1980s by the theories of endogenous growth of Romer (1986) and Lucas (1988). Accumulation of physical and human capital is at the same time the proximate effect of growth, and the requisite for the continuation of growth through time. There is no natural, inevitable tendency of long-run growth rates to slow down as the economy gets bigger and bigger. This is so since all factors are accumulable and technology may exhibit increasing returns.
All this is generally considered a big leap forward starting from the traditional Solow model. Thereafter, inclusiveness in the explanation of the causes of potential growth has proceeded at an increasing pace. Technological conditions have been included in the explanandum list by the theories of endogenous progress of Romer (1990), Grossman and Helpman (1991) and Aghion and Howitt (1992). The process of creation of new technology, in turn, was swiftly recognized as depending on the organization of society: property regimes, product regulation, financial and labour markets, patent protection, and fiscal and education policies directly affect the creation and diffusion of new technology. But also the level of ‘democracy’, transparency and accountability in public governance is equally if not more important. Having recognized this, a host of other, more spontaneous, factors lent themselves as explanations of technical progress and economic growth: the degree of confidence in the stability and enforceability of the fundamental rules of society, fairness in industrial and trading relations, religion, culture, and so forth. Hence there is a variety of contributions seeking a precise, stringent relationship between some broad historical facts and economic growth. Long or very long periods have been analysed, secular time series have been reconstructed and institutional differences among countries have been analysed on a systematic and scientific basis. A valuable survey, with extensive references, of this modern institutional view of long-run growth can be found in Acemoglu, Johnson and Robinson (2005). This attempt is certainly very ambitious, because an explanation of the reasons why institutions differ across countries and evolve through time involves no less than an endogenous theory of institutions, in which the latter are determined as an equilibrium of a variety of economic, social, political and cultural factors. Moreover, so long as these theories are based on some typical economic categories, such as preferences, endowments, allocative efficiency and equilibrium, they may convey to scholars of other related fields – such as law, history, sociology, anthropology, and so on – a certain sense of economic imperialism.

The most accomplished attempt at making the many historical facts of long-run growth endogenous in a coherent model on the basis of a very few, permanent, behavioural assumptions, is the so-called Unified Growth Theory by Oded Galor. Such a theory ‘is designed to capture the complexity of the process of growth and development over the entire course of human history’ (Galor, 2005, p. 174). The different phases of growth and the international differences are considered as evidence of a hidden fundamental process of creation of habits, institutions, social and individual choices. Everything tends to become endogenous until a permanent structure of human rationality and choice under constraint emerges. To unveil this hidden process by means of a detailed analysis of all possible historical evidence and by means of a
coherent statement of a lasting micro-foundation, is the main purpose of the Unified Growth Theory. In spite of its breathtaking ambitiousness and its profession of economic imperialism, Galor’s theory had enormous success. Time was ripe, in fact, for integration between growth and development studies. The traditional distinction between a theory of economic growth in industrial societies characterized by refined market mechanisms on the one hand, and a qualitative study of the problems of institutional transition in less developed countries on the other, is increasingly found inadequate. Likewise, the related distinction between the theories of homogeneous quantitative growth and the theories of structural change can hardly any more be considered as relating to different objects of analysis. The institutional frameworks in ‘advanced’ countries are far from perfect: they differ from one another, which matters quite a lot in relative economic performance; moreover, they evolve and can do so in ways which may encourage or impede economic growth. In other words, growth theory needs to be connected to institutional change, and development studies need some firmer theoretical and mathematical foundations. This integration also has high potential for the many practical policy issues concerning long-run growth. Although it may be questioned whether a magnificent painting on a very big canvas such as the Unified Growth Theory is really needed, the latter is now the main point of reference for a great variety of specific studies in the fields of human capital, social capital, health, education and fertility – all in relation to growth.

***

One may reasonably wonder to what extent all this is really new. In an imaginary diagram with time on the horizontal axis and ‘inclusiveness’ in the explanations of growth on the vertical, are we not on the rising branch of a U-shaped curve? Are we not reverting to conceptions of growth which were common before a certain process of specialization had taken place? Adam Smith, J.S. Mill, A. Marshall and some representative development theorists (such as Myrdal, Rostow, Nurkse and Rosenstein-Rodan) are sometimes mentioned as precursors of this new approach to growth. There is more than that, however. At the end of the 18th century and first half of the 19th, it was apparent to all social philosophers and economists that economic growth, institutional and social change and living standard improvements belonged to one and the same process which required a single, coherent explanation. It is well known that Malthus’s Essay on Population was originally meant to rebut a widespread view of an indefinite improvability in human condition in the new economic regime. Such a view was typical of French Enlightenment authors such as Condorcet and his English followers such as Godwin. Malthus himself in subsequent editions reverted to less pessimistic views,
Long-run growth, social institutions and living standards

and the possibility that economic growth could foster virtuous changes in social habits, and above all fertility rates, and in legal and administrative institutions, featured prominently in his change in judgement. The Neo-Malthusian theories around the middle of the 19th century went straight along these lines. Nor was institutional change less important. The reformation of the Poor Laws and the Corn Laws, the establishment of new factory laws, the definition of new property regimes and institution of a new educational system lay at the heart of the conceptualization of economic growth by English authors during the 19th century. Mill’s *The Claims of Labour* (1845) and the famous chapter of his *Principles* on ‘The probable futurity of the labouring classes’ are notable examples. After J.S. Mill, Arnold Toynbee’s *Lectures on the Industrial Revolution of the 18th Century in England* were representative of a certain optimistic view of a positive mutual relationship between economic growth and socio-institutional change. The main idea was that ‘better lives’ of the population at large were at the same time a potential effect of growth and the main cause of it. Better lives, in turn, required appropriate institutions, like sound factory legislation or an efficient system of education, and the establishment of virtuous social habits.

A detailed account of the progress made in this direction in England in the period 1832–1867 can be found in a very interesting 1867 book by J.M. Ludlow and L. Jones (a lawyer and a former worker, respectively), which escaped oblivion thanks to Marshall. Marshall’s economic theory, in turn, is full of self-reinforcing mechanisms involving what we now call human capital: basically, industrial growth called for (and made possible) a higher fraction of skilled labour, which raised overall productivity; since competition forced employers to pay the full ‘net product’ of labour, wages and leisure would increase thus determining – via a better intellectual and moral cultivation – a further rise in skills and productivity.

Needless to say, the 19th century analyses of the economic progress lacked the statistical power and the mathematical refinement of the modern theories. Even though from the 1830s, in England, detailed statistical evidence of the various aspects of economic and social progress was available on a systematic basis, as shown by Porter’s famous book (Porter, 1836) and the *Journal of the Royal Statistical Society*, the economic analyses typically involved a few broad statistical data and a great many qualitative, illustrative facts. Moreover, even though the crucial role of the economic inducements was fully recognized (for example in the debate on the Poor Laws), the strictly economic argument was, so to speak, on the same foot as other social, ethical, legal and broad historical arguments. Yet it can hardly be denied that they are still very helpful for a clear understanding of what the two 19th century industrial revolutions meant for the history of civilization.
The modern theories adopt the same ‘secular’ perspective and pay special attention to the transition from what Galor calls the Post-Malthusian Regime to the Sustained Growth Regime. It is doubtful, however, to say the least, whether that age is better analyzed by modern theories than it was by its contemporaries; and the fact that the former have been presented as a radical re-think, does not help to that effect.

***

The chapters presented in this book, which is an outcome of a wider research group on the institutional and social dynamics of economic growth, are all based on the premise that any explanation of the differences in long-run growth rates (across countries, and in the course of time) requires detailed analysis of the many mutual relationships between growth, social institutions and living standards. In a sense, this premise captures what is common to the 19th century concerns about long-run growth and the modern theories of endogenous growth. They are, however, uncommitted to a specific overall economic theory. Rather, they contribute rather freely to the understanding of specific aspects concerning labour market and participatory institutions, health, education, learning in consumption and environmental policies.

In Chapter 1, Opocher considers in a historical perspective the major question of the goals towards which society tends with its industrial and institutional progress and discusses some elements of continuity and of originality in the works of J.S. Mill, Marshall and J.M. Keynes. These authors belonged to three successive English generations whose lifetimes spanned over a century or so which was crucial for economic, social and institutional evolution. They shared the fundamental idea that a ‘good life’ for people at large was at the same time the possible outcome of progress and its main lasting source. They differed, however, on the relative emphasis laid on the various practical aspects of goodness in their times: broadly speaking, Mill emphasized fertility, Marshall emphasized skills, and Keynes emphasized wisdom in leisure and economic abundance.

School, factory and informal education featured prominently in Mill’s and Marshall’s arguments and was the subject of lively debates in England. These debates and the specific economic arguments used in them, are critically presented in Chapter 2 by Pomini. This chapter particularly deals with the establishment of a system of compulsory education and its financing. The chapter first outlines the evolution of schooling in England during the first half of the 1800s, up to the Education Act of 1870 and then considers the theories of Smith, McCulloch, J.S. Mill, Nassau Senior and Marshall. State intervention was increasingly felt as necessary in order to correct the limits of market mechanisms due to what we now call positive externalities and short-sightedness of economic agents.
Mastromatteo, in Chapter 3, offers an interpretation of the role of public institutions in Minsky’s works. Starting from an attempt to identify a unifying analytical element in his treatment, attention is drawn to the originality of his thought on this subject, which distinguishes him both from the recent literature of neo-liberal orientation, and also from the tradition of post-Keynesian thought that shows the greatest affinity with his approach. Minsky’s favourable assessment of policies beneficial to the lower income bands and to social consumption is linked not only to the enhanced possibility of economic growth and stabilization associated with such policies, but also to the need to achieve fairer and more satisfactory social living conditions.

In Chapter 4, Gualerzi presents a survey of the theories of consumption in which growth and development processes are the key explanatory element. The analyses of consumption which can be found in some works of Lancaster, Steedman, Pasinetti, Sen and Levine share an interest in the question ‘what shall I do’ rather than the question ‘what shall I buy’ and naturally offer the basis for a theory of consumption based on growth trajectories and evolving living standards. In the approach taken, consumption evolution is systematically linked to the growth process and rests on the existence of a positive feedback between growth and consumption, which might lead to a shift in the consumption–growth frontier.

After these four chapters, which deal with some relevant historical issues, six chapters concern education and health in relation to long-run growth. In Chapter 5, Dardanoni and Modica present an analysis of the informative value of school grades as signals of cognitive competence, and as a message for potential employers and universities. Based on evidence from Italy and international comparisons, they report some aspects of grading practices in schools and universities, and note that there are distortions which reduce the informative value of grades as market signals. Hence, it is arguable that it would be appropriate to search for some common standards to which the separate decision centres may adhere.

In Chapter 6, Pomini considers the evolution of the connection between education spending and economic growth in the passage from the exogenous growth models of the 1960s to the current endogenous growth models based on the accumulation of human capital. It is argued that increasing emphasis has been placed on the incompleteness and imperfection of markets and on the income-inequality in access to education as factors which affect the overall accumulation of human capital and the growth rate. Such emphasis has produced theories which offer an analytical justification for entrusting education to the state and not to the market.
In Chapter 7, Bassetti studies the effect of education on economic growth from other points of view. He considers the way in which education may generate the observed non-linearities in the process of economic growth and presents a model in which the assumption of a non-constant human capital obsolescence rate causes non-constant returns to education in the production of human capital. This allows us to identify the conditions under which a poverty trap may arise in a Solow growth model. Sufficient investment in education may help poor countries to escape from this trap. Some econometric analyses prove that, at the aggregate level, such theoretical conclusions are confirmed by evidence.

Chapter 8, by Fioroni, considers the effect of child mortality and fertility reduction on economic growth. It develops a two-period overlapping generations model where altruistic agents differ in their human capital endowment. Parents care about the number of their surviving children and the future level of human capital of each of them. Children’s probability of surviving to adult age is an increasing concave function of parents’ human capital. This framework generates Galor’s ‘demographic transition’ and has the effect of creating multiple development regimes (such as ‘Malthusian stagnation’ or ‘sustained growth’) in which the growth rate of the economy depends on initial human capital endowments.

In Chapter 9, by means of an overlapping generations model, Dottori compares in terms of economic growth rates and income distribution two health funding regimes: private and public. Health is not only a component of human capital but it also yields direct utility and – by extending lifespans – it reduces future discounting thus affecting the propensity to invest in human capital accumulation. In the private system, health expenditure is chosen in a decentralized way, whereas in the public regime it is provided by government and funded through an income tax, with agents voting over the tax rate. Endogenous poverty and low development traps may arise. Inequality turns out to decline faster under a public regime, whereas in a private one it may be non-decreasing. A private system generally brings about higher growth rates, but when income distribution is sufficiently uneven, a public system may feature higher growth rates.

In Chapter 10, Balducci examines the effects on growth of both private and public investment in health, schooling and culture: in short, education. It is argued that the investment in education increases labour and capital stock productivity through a positive externality, and modifies saving and investment decisions through the substitutability between education and private consumption. The different effects on economic growth of publicly financed education and private investment in education are also investigated. The optimal growth rate depends on households’ preferences for education, and there will be an optimal tax rate that produces the same rate of growth in
Long-run growth, social institutions and living standards

alternative regimes of education financing. Universal public education exerts a strong positive externality on economic efficiency and growth, but – unlike private investments – it does not create sufficient incentives through income differentials to change consumer preferences for education.

The next pair of chapters concern labour market institutions. Chapter 11, by Jossa, considers labour-managed firms. This particular institution, together with profit sharing, was strongly supported by J.S. Mill and (albeit more mildly) by Marshall, as argued in Chapter 1, on the grounds that it would encourage efforts, skills and consciousness of workers and thereby would foster the better sides of long-run growth. Jossa argues that a necessary premise of such an argument is to show that a system of labour-managed firms is actually in a position to provide jobs to all those seeking employment more effectively than a capitalistic-firm system can do. The chapter argues that in effect labour-managed firms have many potential advantages in respect to the different kinds of unemployment.

In Chapter 12, Fanti and Gori show – contrary to prevailing common wisdom in the literature – that the introduction of minimum wages may generate production as well as welfare gains in the long run. From a policy point of view, motivated by a recent debate, the aim of this chapter is to investigate, for the Italian economy, whether the introduction of both minimum wages and unemployment benefits may eventually enhance long-run lifetime welfare if the increase in the tax burden on capital income is used for preserving the balanced budget instead of financing other public expenditures.

Environmental sustainability of long-run growth and the need for public policies is the subject of next two chapters. In Chapter 13 Borghesi and Vercelli discuss the recent trends in energy consumption and their compatibility with the requirements of sustainable long-run growth. To this purpose, they first critically discuss the conventional position on the market’s capacity to resolve spontaneously the problems of energy scarcity and pollution, pointing out some important shortcomings that cast doubts on this optimistic approach. Then, starting from a simple identity applied to the energy sector, they derive a few analytic requirements for the long-term sustainability of energy trends and examine whether they are satisfied on the basis of the currently available data.

Luzzati, in Chapter 14, illustrates Karl William Kapp’s major contributions concerning public policy for environment protection and more generally the satisfaction of human needs. It is argued that Kapp combined the notion of cumulative causation processes à la Myrdal with the view of the economy as an open system, a system embedded not only within society but also within nature. This framework implies, as a logical consequence, that ungoverned economic processes may not be able to deliver economic,
social and environmental sustainability. Kapp goes beyond this and shows that governance is indeed a must due to the very nature of the economic competitive process and the high social costs it generates.

The last two chapters are devoted to public or spontaneous participatory rules in the shaping of public policies in support to economic growth. Pignatti Morano, in Chapter 15, attempts an evaluation of the trajectories followed during the 20th century by economic policy and economic thought regarding participatory approaches to economic allocation of resources, with specific focus on economic planning in developing countries. Despite the generally negative evaluation given by conventional economic theory on the pursuit of public participation in development processes, recent economic analysis of social capital and social preferences highlights the feasibility and desirability of participatory mechanisms of economic governance in a wide variety of situations. It is argued, in particular, that groups of people tend to switch from individual to collective rationality if institutions and incentives are properly set.

Purificato, in Chapter 16, provides a model to capture how economic interests linked to the distribution between profits and wages can influence political decisions and how in turn such decisions can influence the economy. The model seeks to mix ingredients from different perspectives: the influence function approach (Becker), which concerns behaviour of interest groups, and the interest function approach (van Winden), which concerns political decisions, describe capitalists’ and workers’ interest in the policymakers’ decisional process whereas a neo-Kaleckian approach describes the operation of the economy. The analysis shows that fiscal policy has to take proper account of both the capitalists’ interest and the workers’ interest if it aims to favour a balanced change over time of the demand level and of productive capacity. Thus, policymakers have to solve the conflict between the capitalists’ interests and workers’ interests by avoiding polarization of fiscal policy.

REFERENCES


