Development From the Viewpoint of Nonconvergence: Introduction

1. Introduction

- Recall our criticism of the conditional convergence hypothesis referring to the endogeneity problem.
  - Consider a regression that relates growth to the ratio of investment to GDP.
    - This may tell us that the investment share and growth are associated, but stops short of identifying a causal effect.
    - Even if we are confident that a change in investment would affect growth, this just pushes the relevant question further back: what determines investment?
    - Approaching growth and development from the viewpoint of convergence truncates our willingness to go further.
- Statements on conditional convergence are predicated on the similarity of "parameters" that are treated as exogenous – somehow structurally rooted in a society.
  - Not on some deeper underlying characteristics (such as social attitudes or the expression of individual preferences) which would presumably *determine* these "parameters" in a wider framework.

- ○ Such characteristics in turn may depend on
  - · the *history* of a country's development,
  - · what its citizens *expect* of or *aspire* for their own future.

- A very different way of asking the "big questions"
  - – Not grounded in any presumption of convergence.
- There are no fundamental differences across people of different societies.
- **Historically conditioned divergence:**

  Two societies with the same fundamentals can evolve along very different paths depending on
  - – past expectations
  - – aspirations
  - – actual history.

- Draw a line arbitrarily down through the middle of some country and endow the two parts with different initial conditions, captured by the initial state of their economic systems.
  - Convergence hypothesis would predict:
    - Disparities in living standards in the two parts would shrink over time and eventually disappear.
  - Historically conditioned divergence hypothesis, in contrast, predicts:
    - Disparities would persist, absent suitable shocks or policy interventions.
      - The very same fundamental society can be subsequently locked into very different, *self-reinforcing* modes of behaviour.
    - *Initial historical legacies* can precipitate one or more of these self-reinforcing outcomes by pinning down
      - expectations,
      - aspirations, or
      - some more concrete variable such as distribution of assets.

- ○ The bifurcation process can be reversed:

  The gaps in the standard of living between the two parts of the formerly same country might eventually vanish

  - · if the disparities in the economic systems are removed, perhaps by means of a one-time policy.

- ● Some of the best-known economists drawn to this view:
  - – Young (1928)
  - – Nurkse (1953)
  - – Leibenstein (1957)
  - – Myrdal (1957)

- Historical legacies need not be limited to a nation's inheritance of capital stock or GDP from its ancestors.
  - Various diverse factors may serve as initial conditions with a long reach:
    - the distribution of economic or political power,
    - legal structure,
    - traditions,
    - group reputations,
    - colonial heritage,
    - specific institutional settings.
  - Factors that have received special attention in the literature include
    - historical inequalities,
    - nature of colonial settlement,
    - character of early industry and agriculture,
    - early political institutions.

- It will be useful to distinguish between two forms of *self-reinforcing equilibria*:

1. **Inertial self-reinforcement:**

   Multiple equilibria (associated with differing levels of development) that are driven by alternative degrees of optimism or pessimism, with the equilibria in turn 'justifying' these beliefs – expectations or aspirations.

   - Beliefs that a "bad" outcome will occur do come true, in the sense that such beliefs precipitate the bad outcome.
   - Such beliefs may exhibit enormous inertia; hence the term inertial self-reinforcement.

2. **Historical self-reinforcement:**

   Historically given initial conditions can persistently influence current outcomes, thereby reinforcing historical legacies.

2. References

- This note is based on

1. Ray, Debraj (2008), "Development Economics", in *The New Palgrave Dictionary of Economics*, edited by L. Blume and S. Durlauf, and
2. Mookherjee, Dilip and Debraj Ray (2000), Introduction to *Readings in the Theory of Economic Development*, London: Blackwell.

– The references mentioned in this note can be traced in these two articles.