3.2. Beyond the Neoclassical Growth Model: Other Factors Behind Economic Growth

The new growth theory is especially relevant when studying developing economies, since it provides a firm foundation on which to answer the question of why growth rates have differed across countries contrary to the traditional growth theory approach which says that income convergence between countries will occur. However, Harris notes that, while these models are interesting, they remain largely theoretical and untestable, owing to the absence of firm empirical data.[12] Nonetheless, they do present a number of ideas that are important for our understanding of the growth processes in developing countries. The development of the new growth theory has prompted economists to begin thinking again about the factors responsible for growth. Some of these variables are discussed below.

- **Investment in Human Capital**

As we have already seen, early development economists tended to focus only on physical capital in designing growth models. In the 1960s, the definition of capital began to expand to include human capital. In most models, labour was thought to be homogeneous in that one unit of labour was qualitatively equivalent to any other unit of labour. Human capital theory teaches that labour is not, in fact, homogeneous, but that qualitative differences do exist. The better the quality of labour, the more productive it will be when combined in the proper proportions with capital. Human capital is a complement to physical capital in the production process and, if not available, physical capital may not be attracted to capital-poor regions as predicted by the neoclassical model. This shortage of complementary human capital could be what is preventing some countries from achieving higher growth rates.[13] Appropriately targeted education is the key to improving the

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[12]Richard G. Harris, "Globalization, Trade, and Income," *Canadian Journal of Economics*, Vol. 26, No. 4 (November 1993), 555-76. In the case of the NICs in Asia, some empirical evidence does exist to support the new growth theory. Jati K. Sengupta, "Growth in NICs in Asia: Some Tests of New Growth Theory," *Journal of Development Studies*, Vol. 29, No. 2 (January 1993), 342-57, finds that investment in human capital, increasing returns to scale, and the impact of openness in international trade are all important in explaining the high rates of growth in Korea, Japan and Taiwan.

[13]Robert E. Lucas, Jr. "Why Doesn't Capital Flow from Rich to Poor Countries?" *American Economic Review*, Vol. 80, No. 2 (May 1990), 92-6. Also see James A. Schmitz, Jr. "Early Progress on the 'Problem of Economic Development,'" *Federal Reserve Bank of Minneapolis*