



Rethinking Growth: Learning From Experience and Adapting to New Challenges

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What is our focus?

- **Sustained high inclusive growth and the policies, investments and political underpinnings that support it.**
 - Sustained means over several decades
 - High means high single digits or above (ideally 7%)
 - Inclusive is meant to capture more than income: opportunity, productive employment, access to services, protection for people and families in economic transitions
- **Primary target audience: political and policy leaders in developing countries with responsibility for strategies and policies for growth**

Ends and Means

- **We understand (and are explicit) that growth is not the end goal**
- **It is a means to several ends: poverty reduction, human development, health, the opportunity to work and to be creative, achievement of the MDGs (probably not on schedule)**
- **Most of the MDGs will be hard to achieve and even harder to sustain without growth**

How did we go about it?

- The strategy has been to put the following pieces together:
 - An assessment of the state of the art in areas of policy related to growth (with the involvement of the leading academics in these fields)
 - Combined with experience of leaders and practitioners
 - And with country case studies
- To produce a short commission report, highlighting the essential growth dynamics, key policy underpinnings for growth, and significant global trends that will influence and alter growth strategies in the coming decades
- A collection of published working papers and volumes by distinguished experts, country case studies and workshop reports to provide for more in depth treatment of specific challenges
- A web site to make the work available
- A blog to stimulate a dialogue and facilitate continuous learning from research and experience

Sustained High Growth is Very Difficult to Achieve and Our Knowledge is Incomplete

“Some of the literature gives the impression that it is after all pretty easy to increase the long-run growth rate. Just reduce a tax on capital here or eliminate an inefficient regulation there, and the reward is fabulous, a higher growth rate forever, which is surely more valuable than any lingering bleeding-heart reservations about the policy itself.

But in real life it is very hard to move the permanent growth rate; and when it happens, as perhaps in the USA in the later 1990s, the source can be a bit mysterious even after the fact.”

(Bob Solow, 2007, OREP)

“When you get right down to business, there aren’t too many policies that we can say with certainty deeply and positively affect growth.”

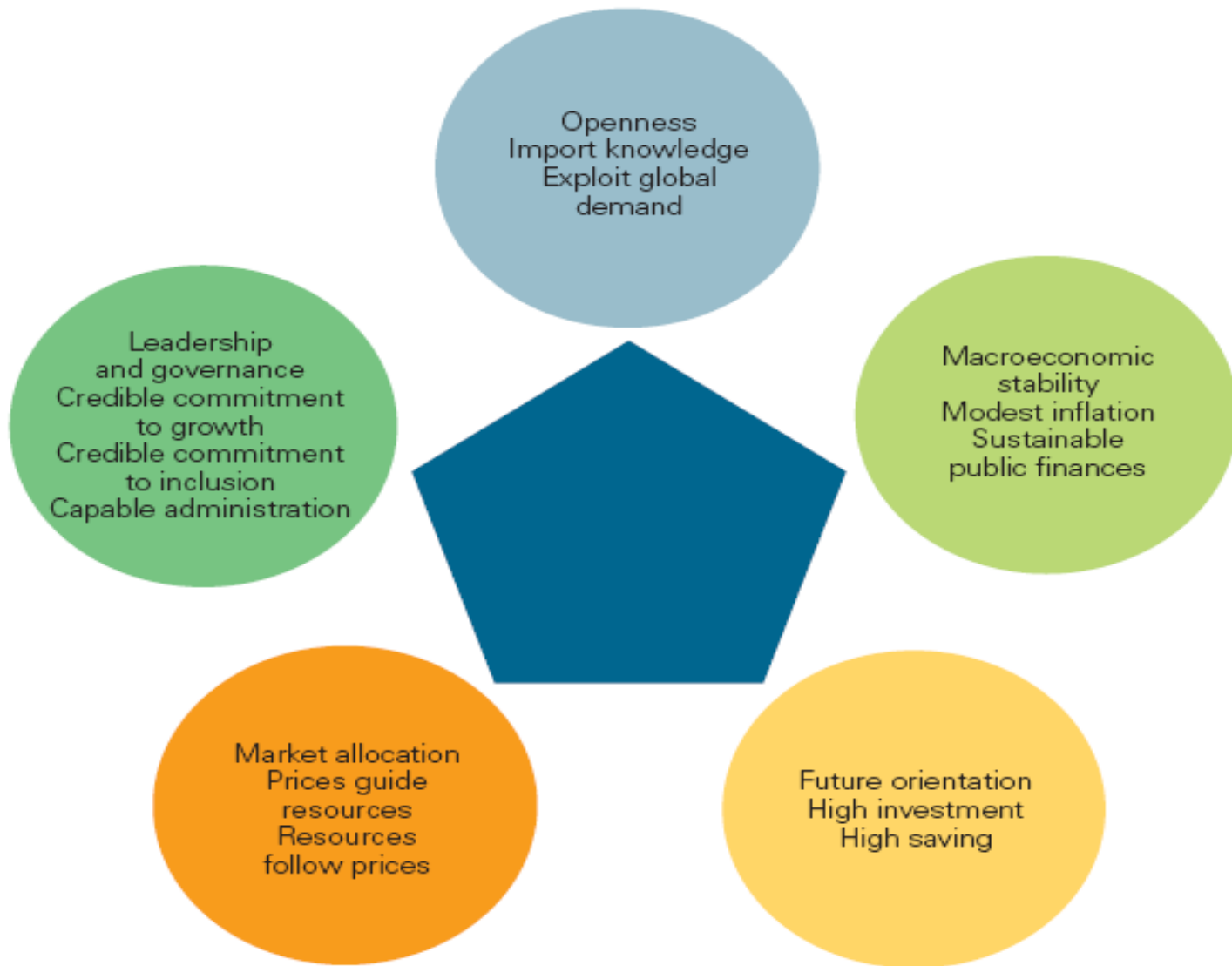
(Arnold Harberger, July 2003. IMF Survey)

Reference Points: Our View of the State of Knowledge

- **Countries and institutions are learning from experience and adapting**
- **We do not know the necessary and sufficient conditions for sustained growth at this stage**
- **The report presents a framework**
 - **The nature of the growth dynamics (a model of sorts)**
 - **Leadership, policies and politics that support them**
- **Strategies and policies priorities are set at the country level**
 - **And vary across countries and time**
 - **They are context specific**
 - **The art of focusing on a cross between what is important and what is feasible**
- **It could be characterized as sequential, group decision making under uncertainty with learning**
- **The parallel process of development**

Growth Dynamics

- There are 13 economies that have experienced sustained high growth--defined as 7% per year or more for 25 years or longer, post WW II
- Botswana, Brazil, China, Hong Kong (China), Indonesia, Japan, Korea, Malaysia, Malta, Oman, Singapore, Taiwan (China), and Thailand
- India and Vietnam are close because of growth accelerations in the past 10-15 years
- There may be others because of recent growth accelerations (in part due to upward shift in the relative price of energy, commodities and food. Demand induced).
 - These initial growth accelerations can be transformed into sustainable growth dynamics: rapid employment creation and structural diversification



Common Characteristics of the Sustained High Growth Cases

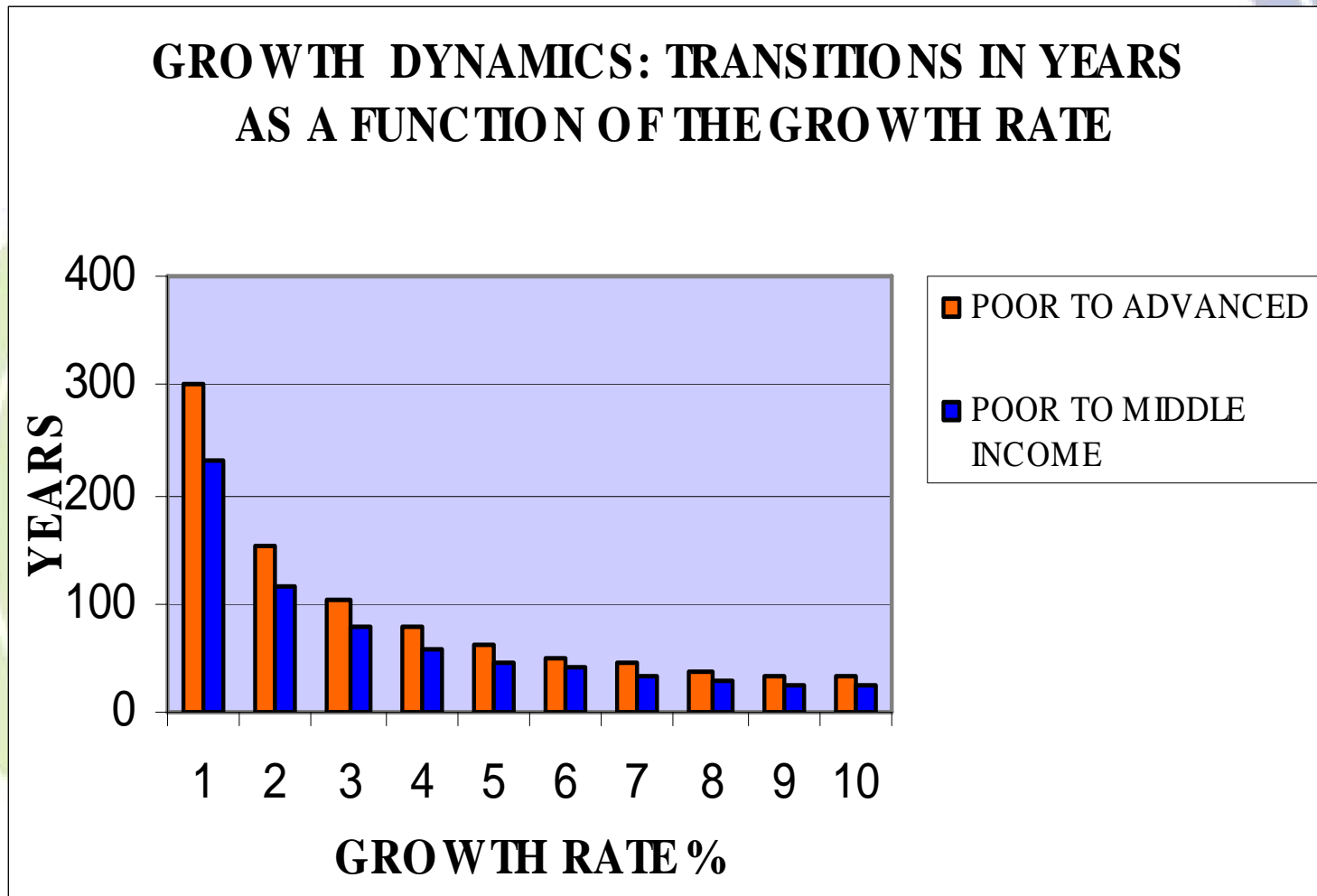
Common Characteristics of the Sustained High Growth Cases (1)

- **Engagement with the global economy**
 - Demand
 - Knowledge (Catch up growth)
- **Macroeconomic Stability**
- **Future Orientation**
 - High levels (and effectiveness) of savings and public and private investment
- **Market incentives and decentralization**
 - Rapid diversification and incremental productive employment
 - Continuing structural transformation
 - Competition, entry and exit
 - Resource mobility – especially labor – across sectors and
 - Rapid urbanization

Common Characteristics (2)

- **Leadership, Governance, and Effective Government**
 - **Stable and functional investment environment**
 - **Political leadership and effective, pragmatic and when needed activist government**
 - **Multi decade process: strategies, priorities and role of government evolves**
 - **Willingness to experiment, act in face of uncertainty about policy impacts, and avoid paralysis**
 - **A focus on inclusive growth: combined with persistence and determination**
 - **Government that acts in the interests of all the citizens of the country – as opposed to itself or subgroups**

Sustained Growth Time Horizons



Long Time Horizons

- **It takes a minimum of 50 years to make the transition from low to advanced income levels**
- **Persistence and a determined focus on the objective is critical**
- **Major crises will halve the growth rate or worse**
- **Bottlenecks (unanticipated blockages) are the norm in high growth environments – rapid responses are an important dimension of policy and effective government**



Principal Messages, Ideas, Areas of Analysis

Engagement with the Global Economy

- **Knowledge and the catch-up effect**
- **Rapid increase in magnitude and scope of potential output**
- **Channels**
 - FDI
 - Just exposure and experience
 - Foreign education, training and experience, networks
- **Demand**
 - Surplus labor
 - Highly elastic and very large global demand
 - Permits high rates of investment in areas of comparative advantage
 - Terms of trade
 - Growth proportional to investment rates

Leadership is Crucial

- **Choice of strategic approach**
 - **A coherent growth strategy**
- **Communicating vision**
 - **Credible given the short term sacrifices involved in high investment rates**
- **Persistent determined focus on the goal**
 - **Inclusive long term growth**
- **Building consensus among stakeholders – bargains or promises**
- **Creating pragmatic, effective and when needed, activist government over time**
- **Understanding and respect for markets, price signals, decentralization, and private sector investment as key ingredients in growth.**
- **Institutional development and maturity**

Structural Transformation and Competition

- **The world looks very different in the macroeconomic treetops and in the microeconomic shrubbery**
- **Export diversification**
- **Creation and destruction**
- **Matching job creation with job destruction**
 - **Pace and sequencing on current account**
 - **Need for policy space: flexibility in global trading system**
- **Protecting people in transitions**
 - **Income, retraining, access to basic services (education health and housing)**
 - **Protecting jobs, firms and sectors will put brakes on competition, entry and exit, productivity and growth**
 - **Static versus dynamic efficiency**

Inclusiveness is Essential

- **Inclusiveness means equity, equality of opportunity, and protection in market and employment transitions**
- **The commission believes in the strongest possible terms that inclusiveness is an essential ingredient of any successful growth strategy**
- **Both are necessary conditions for growth**
- **Failures on either dimension will cause the growth process to derail through lack of support for the policies that sustain it**
- **Equity (refers to market outcomes)**
 - **Natural tendency of income inequality to rise – people understand this and will accept it up to a point**
 - **Needs to be constrained by policy**
- **Equality of opportunity (refers to access)**
 - **Systematic inequality of opportunity is toxic – and will derail the growth process through political channels or conflict**

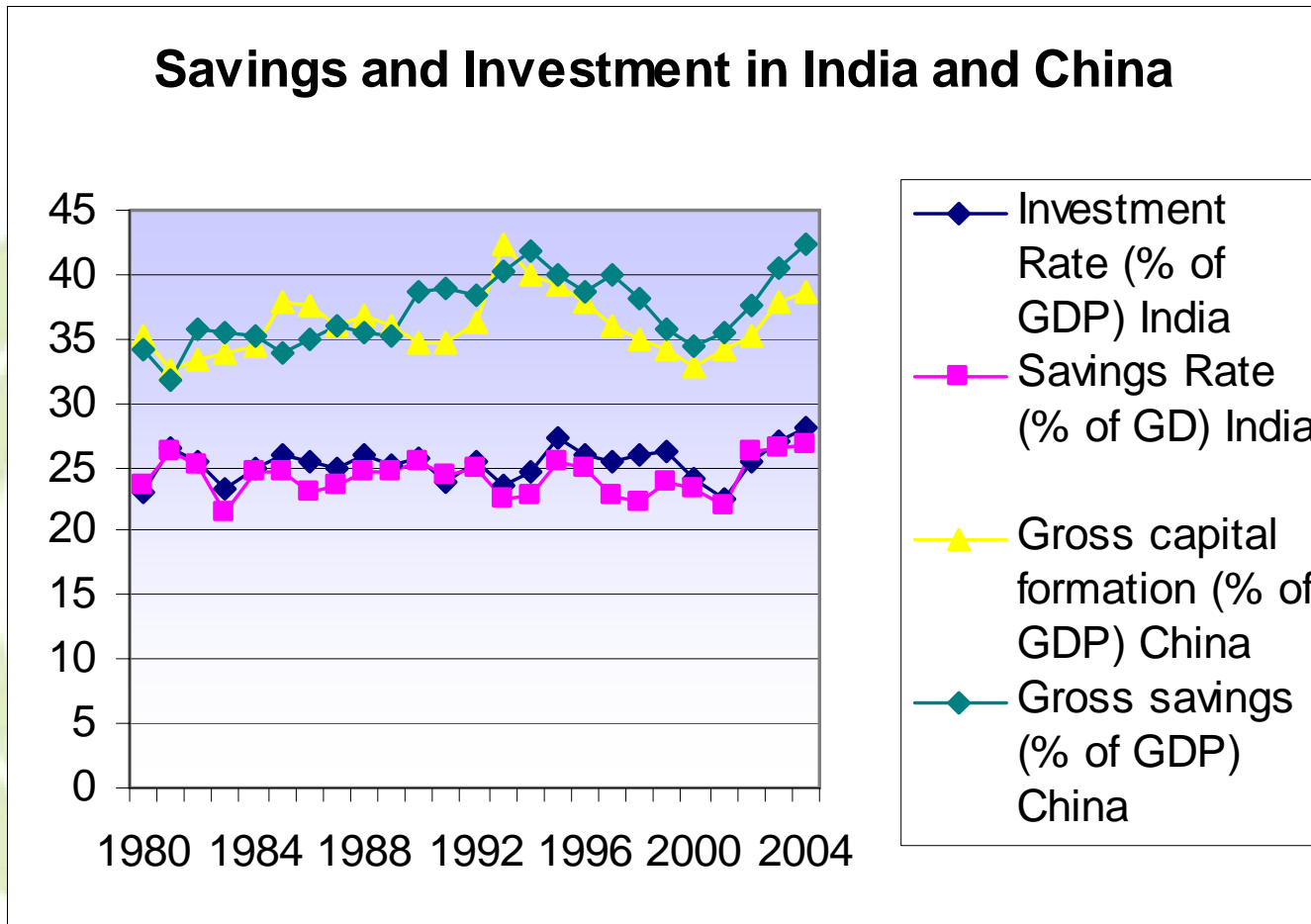
Growth and Poverty Reduction

- **Growth is a necessary condition for poverty reduction in poor countries**
- **It is arithmetically impossible to reduce poverty through redistribution in countries where the average income is below 700 dollars a day**
- **The high growth cases all exhibit rapid poverty reduction**
- **Sustained high growth requires rapid incremental productive employment**
 - **Tends to be inclusive and contributes to poverty reduction**
- **“Shocks” for most people are emergencies for the poor**
 - **Current food emergency**
 - **Policy focus has to be dealing with the emergency rather than adapting to the cause of the shock**
 - **Similar problem for the poor in adaptation to climate change**
 - **Poverty reduction increases adaptability to shocks**

Saving and Investment

- **High rates of saving and investment appear to be necessary to sustaining high growth**
- **There are no counterexamples that we can find**
- **25 % of GDP or above**
- **Public sector component**
 - **5-7% of GDP**
 - **Infrastructure and education**
 - **Crowding out and systematic pattern of underinvestment**
 - **Increased focus of external development agencies**
- **Public sector saving and investment is well below the optimum in much of the developing world**
- **Stable investment environment**

Saving and Investment: India and China



Health and Early Childhood Nutrition

- Health is clearly mainly a valued objective for people and societies and not primarily a means to an end
- Affects growth through multiple channels
 - Productivity
 - Investment in human capital
- But one channel seems to have overwhelming importance
- Early childhood malnutrition produces a near permanent reduction in children's subsequent ability to acquire cognitive and non-cognitive skills
 - Affects impact of education
 - Very long term effects
 - Deeply unfair
 - If widespread, puts limits on growth

Education

- **Rapid progress in enrollments**
- **Nevertheless, illiteracy is high in many countries**
- **There is a widespread quality problem that needs to be addressed**
 - **Years of schooling is an input**
 - **Cognitive and non-cognitive skills is an output**
 - **Testing**
 - **Private education growth**
- **The portfolio: primary, secondary and tertiary**

Labor Markets, Mobility and Flexibility

- Labor market mobility is an important enabler
- It is complex and varies from country to country
- Formal and informal sectors
- Incentive structure in a surplus labor environment
- Occupational health and safety
- Labor market reform
 - Often important
 - May not solve the access problem for the surplus labor
- A second track approach as a transitory strategy

Urbanization is a Key Ingredient of Sustained Growth Dynamics

- Rapid declines in rural population accompany all high growth and industrialization processes
- Labor and capital move across sectors and geographically
- Agglomeration effects cause this to happen
- It is always a somewhat chaotic process
- Challenge is to improve it, rather than resist it
- Specific challenges
 - Financing urban infrastructure (bond markets, land sales, public private partnerships)
 - Imperfectly defined property rights (price signals and land use)
 - Housing the incoming labor
- Agriculture
 - Urbanization is not an argument for ignoring agricultural technology, infrastructure, and productivity
 - Especially now when a large supply response is needed to rising agricultural prices
 - Exit of surplus labor increases productivity

Growth and the Environment

- **Grow first and deal with the environment later is a bad strategy**
- **It is very expensive**
 - **Long-lived assets are created that need to be replaced**
 - **Housing and other construction**
 - **Industrial assets**
 - **Biases structural evolution of the economy**
 - **Location decisions are inappropriate**
- **Adverse effects are greatest in lower income groups – so it is adverse with respect to equity and inclusiveness**
- **Energy subsidies are large and very widespread – cost in terms of foregone public investment high and rising with energy prices**
 - **Adverse positioning with respect to global warming**
- **While politically difficult, the energy subsidies should be eliminated as rapidly as possible.**

Natural resource wealth is not by itself a basis for sustained growth

- But with rising commodity prices it is a huge opportunity
- Resource curse is common
- Steps required to get it right
 - Auctioning of rights
 - Taxation
 - Funding public sector investment (magnitude and efficiency)
 - Creation and management of a fund
 - Investment decisions of the fund (domestic/foreign)
 - Payout from the fund for current consumption or tax relief – the intergenerational choice
- Transparency
 - EITI and EITI+

Controversial and Complex Areas

- **Industrial policies – export promotion**
 - **Competence and capture**
 - **Versus incomplete information and demonstration effects**
- **Exchange rate management**
- **Pace and sequencing of opening**
 - **Capital account**
 - **Current account**
- **Capital controls: independent ability to influence inflation and the exchange rate**
- **Reserve accumulation and insurance**
- **Central bank autonomy and coherence of growth strategy**
- **Fiscal stability and sustainability - rules**

Cases with Important Specific Challenges

- **African countries in various categories and the continent**
 - For historical reasons – the continent has a peculiar configuration
 - Landlocked percentage high– vulnerability to weakness of neighbors
 - Resource wealth percentage high
 - Tribal and ethnic diversity – incompletely mediated by the governance systems
 - Recent growth high
 - Effective leadership
 - Rising resource wealth creates a huge opportunity
- **Small States**
 - Lack of diversification and heightened exposure to economic and natural risks and shocks
 - Governance overhead costs

Specific Challenges

- **Resource Rich (or fairly rich) Countries**
 - Prone to conflict and governance problems
 - Distortion of the political economy towards rents
 - Challenge of economic diversification and expanding employment opportunity
- **Middle income to high income transitions**
 - Perceived threat of loss of basis of competitiveness
 - Shift policies and investment to facilitate the transition to human capital intensive basis for structural change and dynamic comparative advantage
 - Modify or abandon interventions (industrial policy, exchange rate) used to jump start export diversification and growth, before they become distortionary and dysfunctional
 - Bad policies are often good policies pursued for too long



Global Trends and New Challenges

Rising income inequality and resistance to globalization

- **Resistance to globalization is rising**
 - Pew Survey of attitudes
 - US elections
- **But it is what enables rapid growth and poverty reduction**
- **Insufficient attention and response to distributional issues**
 - In advanced and developing countries
- **Domestic policies need to adapt to the effects of globalization**
 - Rapid movement of economic activity, industries and jobs
 - Partial integration of labor markets (in traded services)
 - Rapid shifts in relative prices
- **The aggregate benefits are large, but it is hard work to make the distributional side come out fairly**

The Growth of China and India

- **Large long-term shifts in relative prices: labor intensive manufactured goods**
- **Can late arrivals compete, and will the growth strategies work**
- **The adding-up problem or the fallacy of composition**
 - **Decline in relative price – absorptive capacity of global demand**
 - **Protectionist response**
 - **First raised with Asian Tigers**
- **Global imbalances is the new version of the adding up problem**

Commodity Prices and Growth

- Energy, food and minerals
- Rapidly rising global demand
 - 30 years ago there were 1 billion people (<20% of world's population) in advanced or rapidly growing countries
 - Today that number is close to 4 billion and rising (approaching two thirds of the world's population)
- Food prices
 - Emergency response
 - Balkanization – needs to be removed to restore incentives for supply response
 - Opportunity for many countries
 - Supply response likely to be large (demand elasticity is low)
 - Review and if necessary remove bio fuels subsidies

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- **Energy prices**
 - Have the capacity to slow global growth
 - Supply elasticity depends on whether one includes alternatives
 - Demand elasticity likely to be very high
 - Longer term dependent on technology
 - **Relative price volatility likely to be a recurring feature of the global economy**
 - From the point of risk mitigation, it would be very unwise to assume that this is an unusual one-time event looking forward

Demographics, Aging and Migration

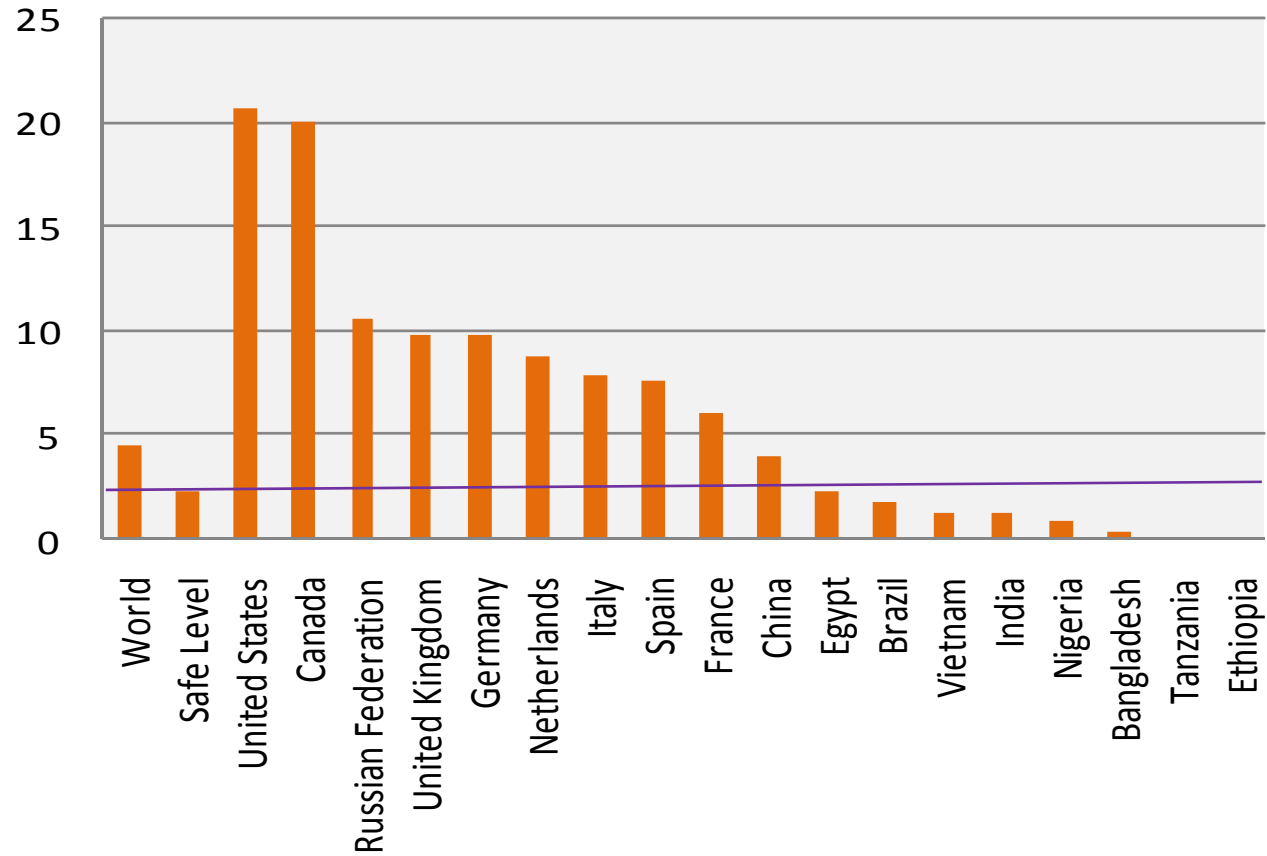
- **Aging in most of the advanced countries and a number of developing ones including China**
 - That is where most of the purchasing power resides now
- **Will this cause a slowing of potential global growth and opportunities for developing countries?**
 - Probably not – depends on adaptation of pension systems, employment options and incentive structures in a wide range of countries
- **Anti-aging in many of the poorer developing countries**
 - High fertility
 - Reduced longevity due to HIV/AIDS
- **Youth unemployment Challenge**
- **Migration, migration for work, and labor mobility**

Global Warming

- **Adaptation**
 - Major potential problem for poorer countries
 - Impact and Resources to Respond
- **Mitigation**
 - Tail insurance
 - Efficiency and fairness
 - Cost uncertainty and sequential decision making under uncertainty with learning
 - Costs for various sources
 - Efficient distribution of mitigation across countries
 - Inter-temporal cost reduction and technology development
 - Location of mitigation versus cost absorption for poorer countries
 - Long run targets too risky for developing countries – especially with unspecified cost sharing arrangements
 - Not right response to structure of the problem

CO2 EMISSIONS PER CAPITA

Tons per year



Dimensioning the Problem

- **If growth stopped, the global problem is a reduction in emissions by a factor of two**
- **If the developing countries (China and India) grow and hit EU-type per capita levels of emissions and advanced country incomes in 50 years, the challenge is a reduction in per capita emissions by a factor of at least 3.5**
- **Or more, depending on growth in income and energy consumption in the poorer but high population growth countries**
- **This requires major new technology**
 - **Without it we will run the risk or experience climate change or avoid it but at the cost of much slower global growth**
 - **The same is true of energy efficiency – a key component of mitigation**

Carbon Intensity Will Decline

(Gigatons of CO2 emissions per trillion dollars of GDP)

USA	0.46
EU	0.29
Japan	0.19
China	1.67
India	1.30

Framework for Developing Country Participation

- Agree that the challenge is a global one
- Reject the argument: “It is not our problem because we didn’t cause it,”
- Eliminate energy subsidies over time – it is not good growth strategy
- Full participation in building global monitoring system
- Cooperative participation in cross border mitigation (e.g. successor to CDM in the Kyoto Protocol)
- Long term targets (set now) for emission reduction are not appropriate for developing countries
- Costs of mitigation in poor countries shared by advanced countries
- Cost absorption rises with per capita income
- Advanced country incentives for technology development and rapid transfer to developing countries
- Educate the public as their behavior is part of the “solution”
- Re-forestation

Global Governance: Magnitude and Scope of Interdependence Versus Our Collective Capacity to Coordinate Regulatory and Policy Responses

- **The challenge of policy coordination with new important players**
- **Global imbalances**
- **Rising scope and magnitude of interdependence**
- **Not matched by capacity to regulate and coordinate policy responses**
 - **Financial markets and regulatory interdependence**
 - **Trade and shifting relative prices**
 - **Product safety and rules governing logistics**
 - **Infectious diseases**
 - **Energy demand, pricing and growth**
 - **Global warming**
- **Restoration of balance will take time, lots of thinking, experienced and talented people, and a measure of good will**
- **In the meantime the risks are rising in the global economy and will be there for some time.**