

CSR, Sustained High Growth, and the Global Economy

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Overview

- **Sustained high growth dynamics and policies**
- **Use that Framework to discuss aspects of CSR that pertain to growth and development**
- **Identify some areas where CSR is critical**
- **Define GSR (Government Social Responsibility) and use it to think about CSR**
- **Some global challenges that have important CSR components**

CSR's Effectiveness is Highest When

- **Government understands CSR, that is the private sector's crucial role and acts on it.**
- **The dividing line between public and private sector is clear – but pragmatic and evolving**
- **Corporations (domestic and global) understand the economic and social objectives**
- **And align their interests with them**
- **There is a shared understanding of goals and priorities and a pattern of communication that renews this continuously**
 - **Political and policy leadership, business, CSO's and citizens**
- **This alignment comes about in part from important interactions with employees, customers, suppliers, regulators, gov't and social goals and citizens**
 - **As part of performing the primary functions of business**

Background

- **30 years ago, there were 1 billion people living in advanced or rapidly growing economies out of a world population of 5.5 B**
- **Say 18%**
- **Now that number is 4 billion or more out of 6.5 B**
- **Say 62%**
- **Because of sustained growth, the size and impact is large**
- **This presents new challenges**
- **Many institutions of governance, domestic and international are imperfectly adapted to this in the global landscape**
- **Corporations are the best adapted, and in a quasi governance vacuum, are going to have a central role in maintaining stability and support for the global economy**
- **That support is waning (Pew Survey etc) and the financial crisis will not help**

Commission on Growth and Development Members

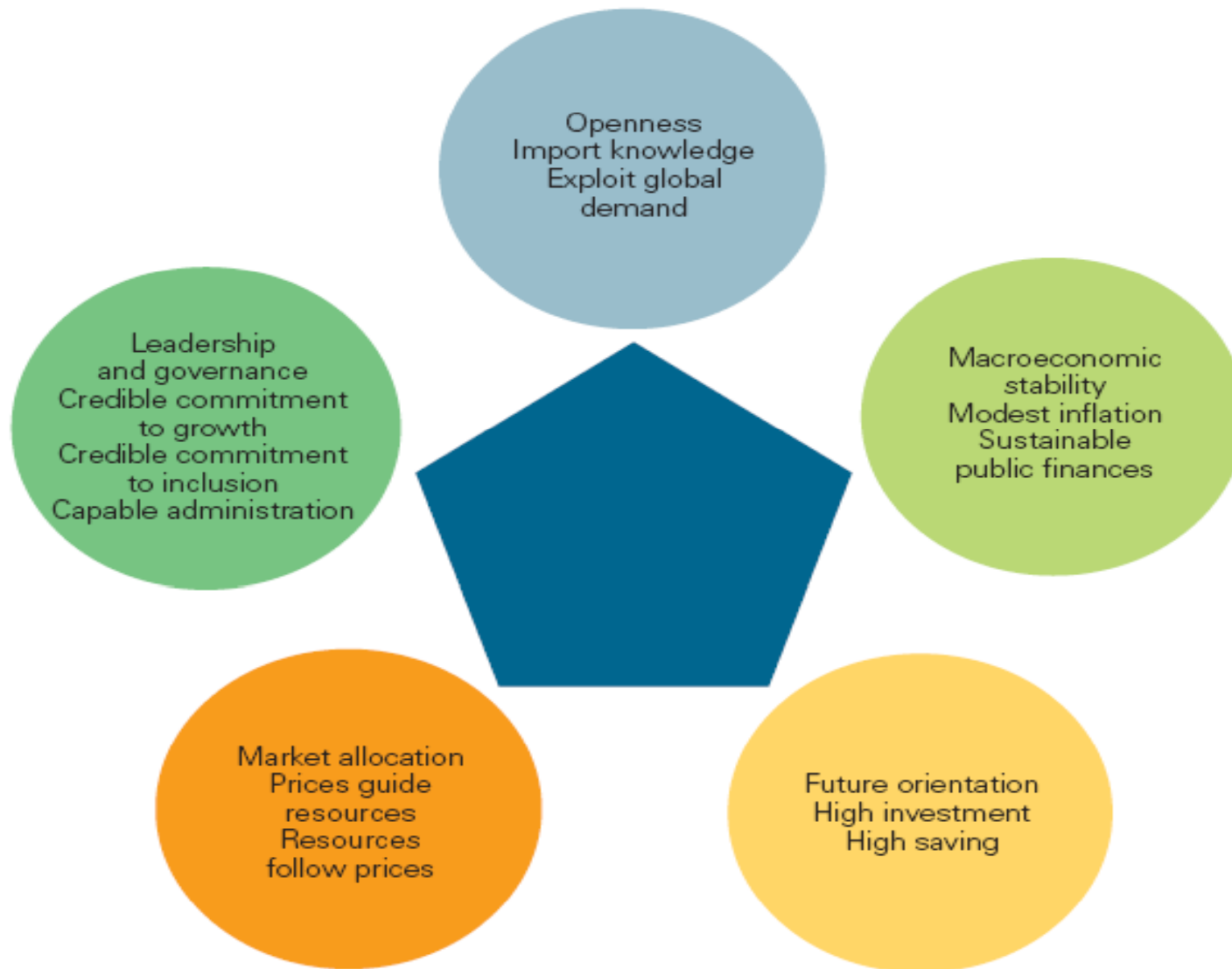
- **Montek Ahluwalia (India), Deputy Chairman, Planning Commission**
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- **Dr. Boediono (Indonesia), Minister for coordinating Economic Affairs**
- **Lord John Browne (Great Britain), former CEO, British Petroleum**
- **Kemal Dervis (Turkey), former Minister of Finance; Head of the UNDP program.**
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- **Mike Spence (USA), Stanford University, CA (Chair)**
- **Sir K. Dwight Venner (Saint Kitts and Nevis), Governor of the Eastern Caribbean Bank (West Indies)**
- **Ernesto Zedillo (Mexico), former President of Mexico, Director of the Yale Center Study of Globalization**
- **Zhou Xiaochuan (China), Governor of the People's Bank of China (Central Bank of China).**

What is the focus of the Growth Report?

- **Sustained high inclusive growth and the policies, investments and political underpinnings that support it.**
 - **Sustained means over several decades**
 - **High means 7% or above**
 - **Inclusive is meant to capture more than income: opportunity, productive employment, access to services**
- **Primary target audience: political and policy leaders in developing countries with responsibility for strategies and policies for growth**
- **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 sustain without growth**

Growth Dynamics

- **There are 13 economies that 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
 - The openness of the global economy has been the key enabler
- **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
 - Resource mobility – especially labor – across sectors and
 - Rapid urbanization

Common Characteristics GSR and Government's Role

- **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**
 - **Sequential decision-making under uncertainty with learning**
 - **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 – I will use this as a working definition of GSR in relation to growth and development**

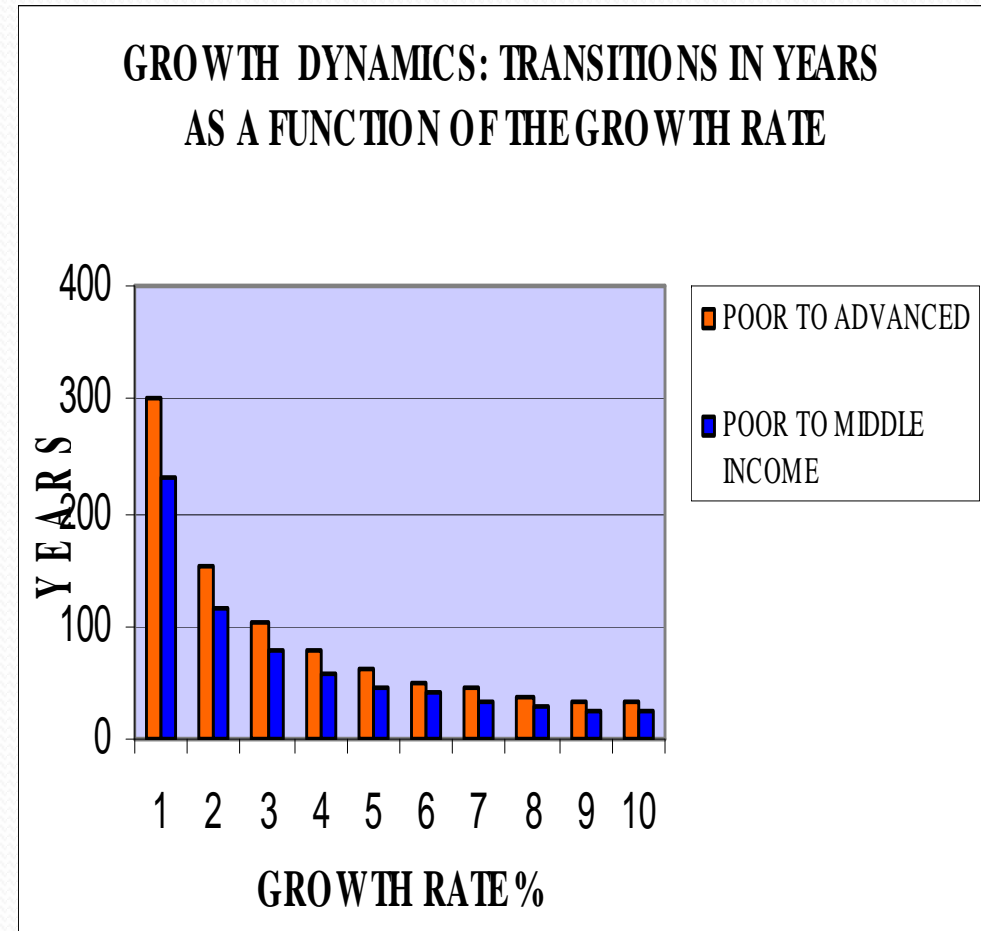
Growth Failures

Two major categories

- **Underinvestment**
 - **Time horizons**
- **Leadership, Government, Policy Setting and Implementation**
 - **A failure of GSR – acting in own interest or that of a subgroup**
 - **Wrong growth strategy**
 - **Inability to bring electorate along**
 - **Failures of implementation**
- **Successes and these failures occur in a variety of forms of government**
 - **Autocratic, dominant single party, full multi-party democracy etc**
 - **Political economy research in these dynamics**

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



Engagement with the Global Economy

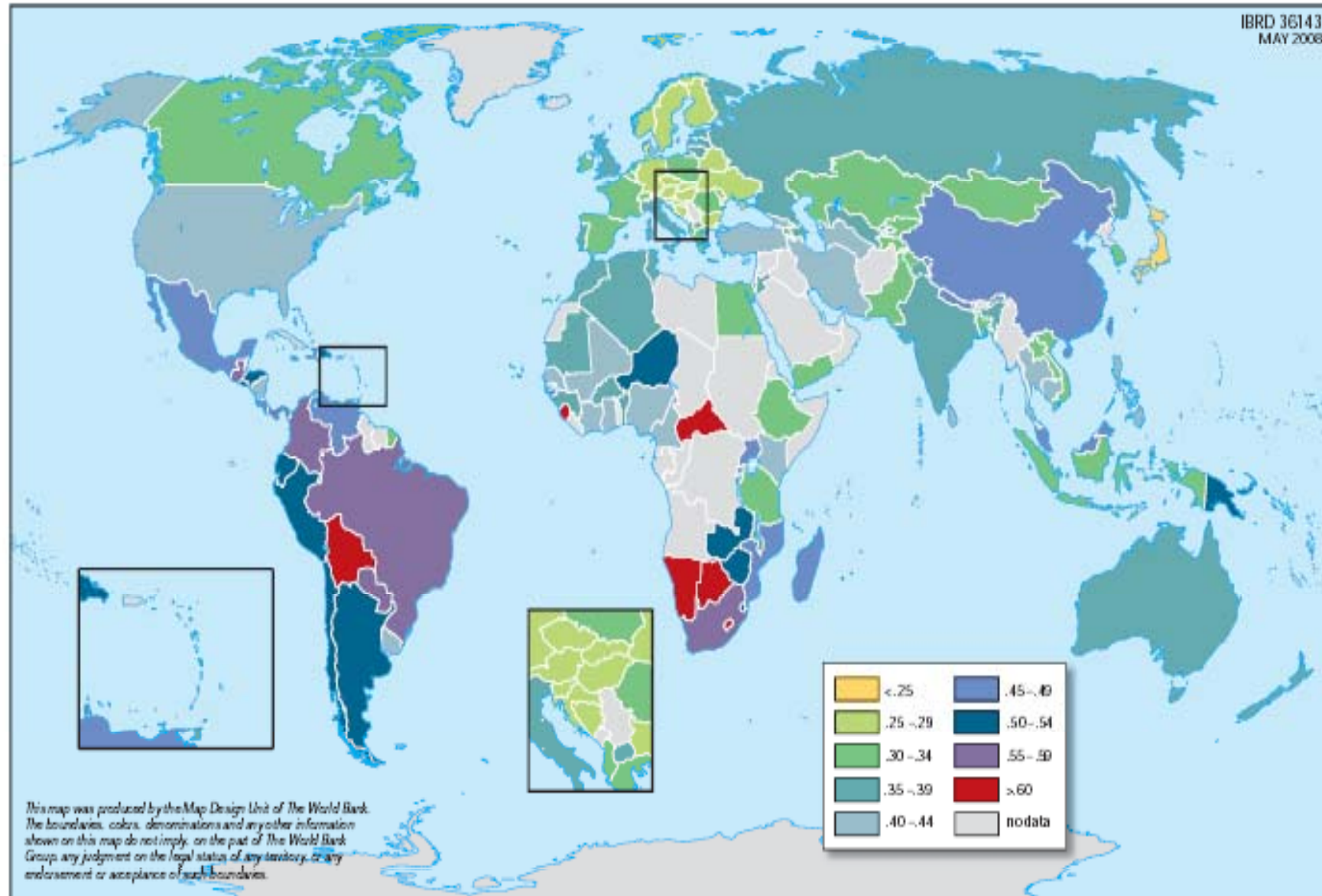
- **Knowledge and the catch-up effect**
 - This is the area in which the global private sector makes its largest contribution to growth and development
 - Growing rapidly implies and requires learning rapidly
- **Rapid increase in magnitude and scope of potential output**
 - **Channels**
 - FDI
 - Just exposure and experience – the learning curve
 - Foreign education, training and experience
- **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

Key Ingredients

- **Structural Transformation and Competition**
 - **The microeconomic engine**
 - **Policies that support or do not interfere with this**
- **Inclusiveness**
 - **Equity in outcomes managing income inequality**
 - **Equality of opportunity**
 - **Protection of people in transitions**

Gini Coefficients from the UN Human Development Report, 2007–2008

IBRD 36143
MAY 2008



Investment

- **Saving and Investment**
 - 25 % of GDP or above
 - Public sector component (Infrastructure and education)
 - 5-7% of GDP
- **Health and Early Childhood Nutrition**
 - Early childhood malnutrition produces a near permanent reduction in children's subsequent ability to acquire cognitive and non-cognitive skills
 - Very long term effects, deeply unfair, if widespread, puts limits on growth



Education and Quality

- **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**
- **I would characterize this as an opportunity for CSR – very context specific**

Resource Mobility

- **Labor Markets, Mobility and Flexibility**
 - Labor market mobility is an important enabler
 - Formal and informal sectors
 - Incentive structure in a surplus labor environment
 - Occupational health and safety
 - 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
 - Agglomeration effects cause this to happen
 - It is always a somewhat chaotic process

Growth and the Environment

- **Grow first and deal with the environment later (the normal pattern) is a bad strategy**
 - **Actually, it is worse than that**
- **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

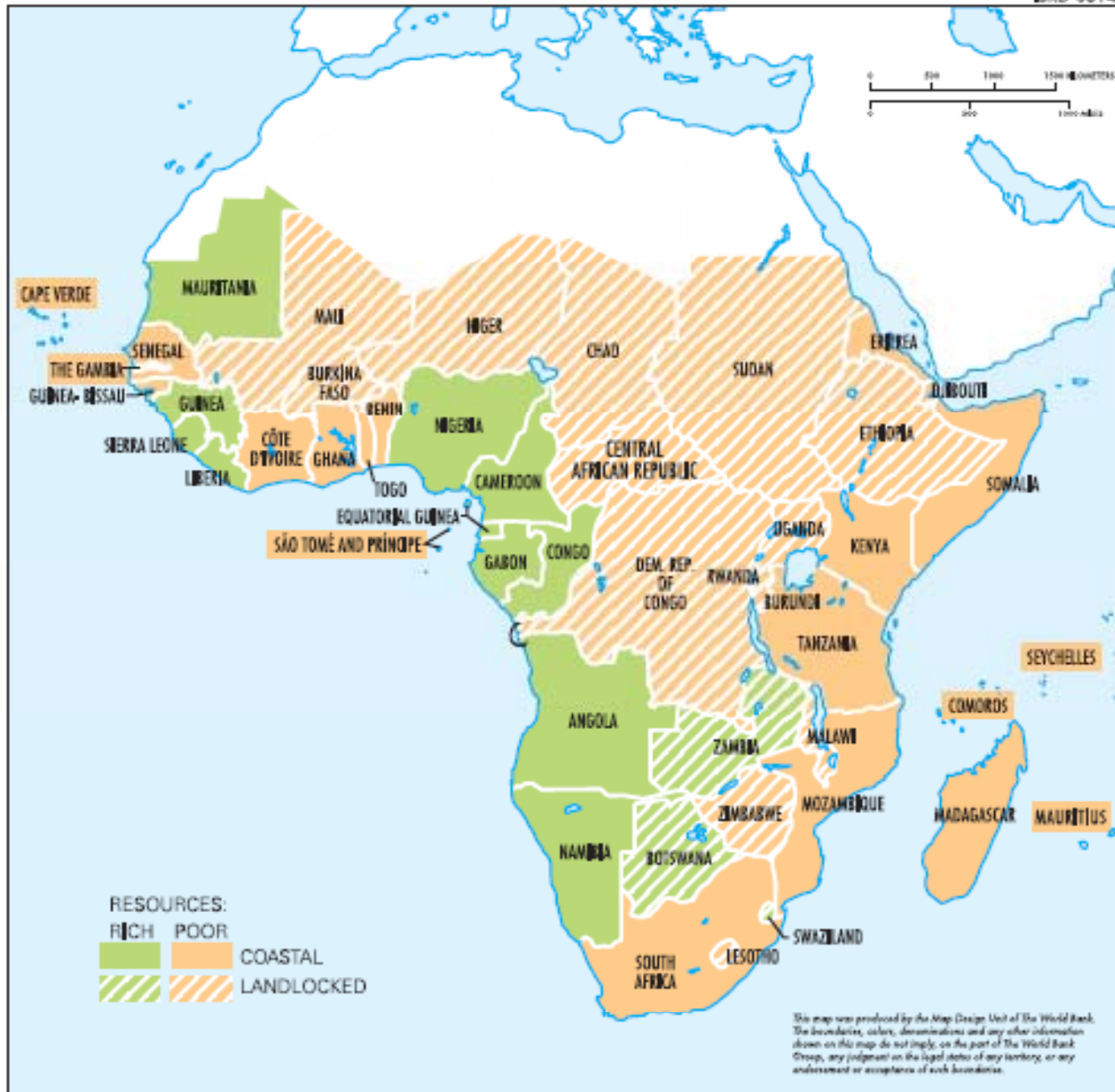
- **Energy subsidies are large and very widespread – cost in terms of foregone public investment high and rising with energy prices**
 - **Adverse positioning with respect to global warming**
- **These policies are a mistake and a bad idea**
 - **Bias investment and the structural evolution of the economy**
 - **Not sustainable**
 - **If it were a tax it would be regressive**
- **While politically difficult, the energy subsidies should be eliminated as rapidly as possible.**

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 or discretion**

Cases with Important Special 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
- **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



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Dysfunctional States

- **Business does and should operate in environments in which to varying degrees there are shortfalls in GSR**
- **There may be cases in which not possible to operate for legal and ethical reasons**
- **An important set of issues: what is the nature of CSR in these environments**
- **It is a complex and ongoing subject – I am sure we will hear something about it in the next two days**
- **Rather than tackle it generally, I would like to focus on the management of natural resource wealth in Africa**



Natural Resource Wealth in Africa

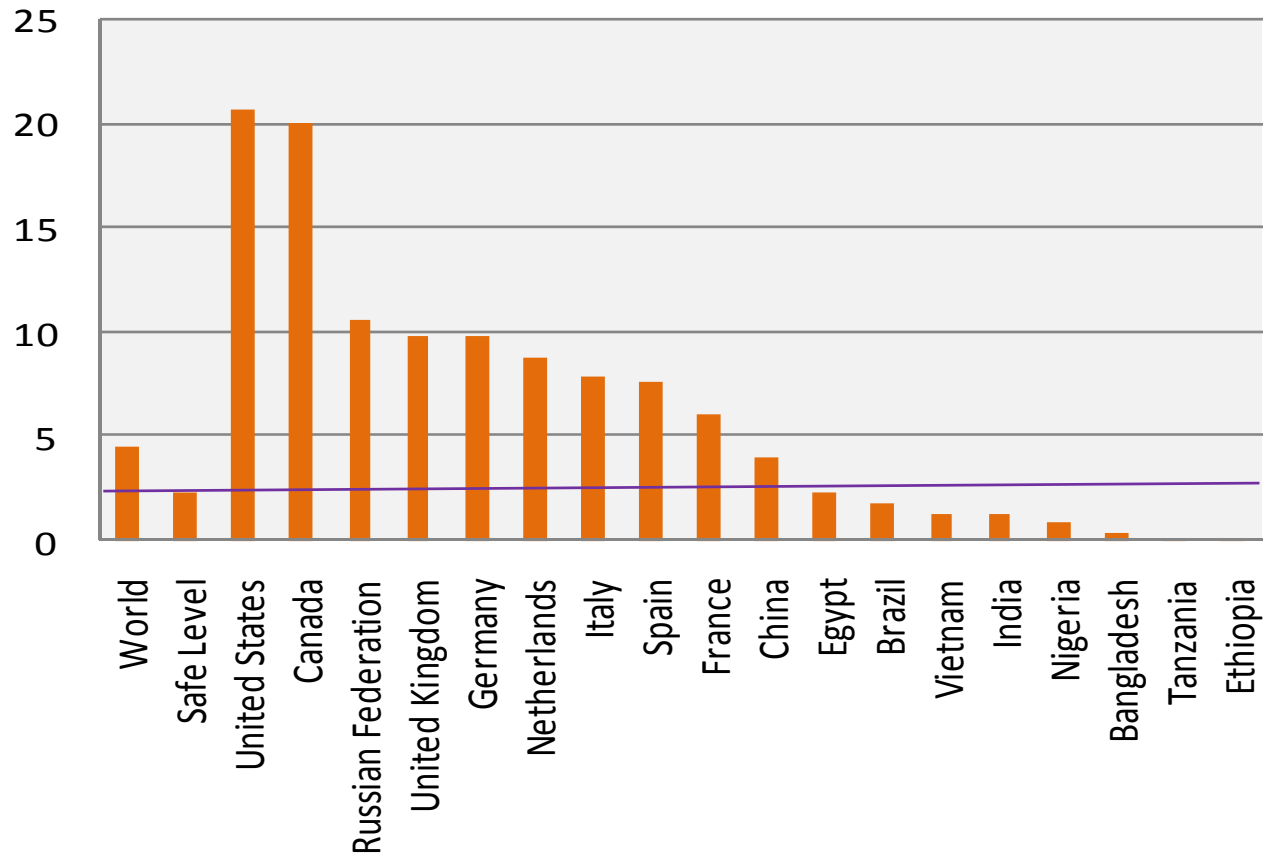
- **Has not produced much growth**
- **In large part because of mismanagement of natural resource wealth**
- **With the rapid rise in commodity prices, there is a huge opportunity**
- **The need is to capture, manage and invest an appropriate fraction of the increased wealth so as to jump start the dynamics described earlier**
- **Transparency (EITI is very important)**
- **CSR requires collective action - to prevent responsible behavior from turning into a competitive disadvantage**

Climate Change

- **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 now, 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 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 Financial Crisis

- **If we make it through this WITHOUT a credit lockup that lasts and the resultant deep and global damage it would cause**
- **Then we will**
 - **Deal with a dramatically altered industry structure and with changing the regulatory regime**
 - **It will have to be global because the spillover effects are too large**
 - **The alternative is firewalls that insulate economies and regions from turbulence outside them and damage the flow of capital in the global economy**



Ingredients of the Run-up to the Crisis

- **Global Imbalances and semi automatic stabilizers**
- **Unregulated mortgage lending – absence of consumer protection**
- **Low interest rates**
- **Housing (and other asset) bubble**
- **Growing leverage – creating more and more systemic risk**
- **Miss rating of derivatives – based on faulty risk model**
 - **Dramatic increase under estimation of systemic risk**
- **Flawed insurance model – CDS's**
 - **Creating the illusion or cover for apparently risky leverage**
 - **Absence of regulation or capital requirements**

Continued

- **Incentives**
 - **You can be a contrarian for two quarters**
 - **Enormously profitable**
 - **Even if traders understood the problem, it didn't matter**
 - **Boards and senior management did care about risk (and the institution) but did not understand it**
 - **The end of the chain holders of toxic waste were not just naïve investors**
- **Fragmented, incomplete and lax regulatory oversight**

Thoughts

- **The financial sector underpins the entire economy**
- **Carries a special set of responsibilities**
 - **Domestic and Global**
- **It is crucial that management and boards have a deep understanding of the risks**
- **If there is a regulatory problem (a dangerous unregulated sector), it needs to be addressed by the industry**
- **Regulatory arbitrage (even if the industry is not primarily responsible for it) is not acceptable**
 - **The potential economic and social costs are too high and too broad**
- **There is or will be a challenge of rebuilding credibility**
- **There may very well be excessively heavy-handed regulation as a response**

CSR in The Global Environment

- **Rising scope and magnitude of interdependence**
 - Financial markets and regulatory interdependence
 - Movement of jobs
 - Product safety and rules governing logistics
 - Infectious diseases
 - Energy demand, pricing and growth
 - Global warming
- **Not matched by capacity to regulate and coordinate policy responses**
 - Over time the balance can be restored
 - In the meantime the risks are rising in the global economy
 - And there is growing skepticism and resistance to openness
- **Global corporations are the main global players**
 - Individually and collectively they will need to be part of the governance of the system as well as participants and competitors within it