The Quality of Growth and the Role of the State in Sub-Saharan Africa

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- IPD and JICA have been collaborating closely and fruitfully in work on African development
- When we started our work together about a decade or so ago Africa was just emerging from its lost quarter century
- The revival of growth since has led to some talk of “Africa Rising”
- But the growth has been based mostly on booming commodity prices and hydro-carbon discoveries with a few exceptions, notably Ethiopia and Rwanda

- Concerns about limited structural transformation and learning with e.g. share of manufacturing still roughly at same level as 4 decades ago
- New or enhanced concerns about quality of growth: rapidly rising inequality, employment, climate change, and non-GDP metrics of welfare/quality of life. Many reflected in SDGs
- Will place the TF's concerns in broader context of recent developments in economic theory and trends in Africa and the global economy

Rethinking the Role of the State

- Influenced by major successes and failures of the last 30 years
  - Which have also led to reshaping our understanding of development
- And by major changes in economic theory

Major insights:

- Government policies need to pursue even wider range of objectives, using a wider range of instruments than envisioned then
- We now know more about how government can successfully pursue these objectives, incl. to reduce the risk of "government failure"
- We need to broaden our analysis to go beyond thinking about the role of the state vs. the role of the market
  - More complex interactions
  - More actors, more institutional arrangements

I. Some of the Major "Events" and the Lessons They Taught

- The success of East Asia, including China
- Development/growth beyond anything that had been thought possible
  - And contrary to what others (Myrdal) had thought would occur
- Based on government assuming a major role in the economy
  - But using markets
- Major debate about what it was that the government did that led to success
  - Different countries did different things, policies changed over time but a common strand: ***appropriate industrial policies and learning economies***

WC/Neo-liberalism Failures

- In Africa, structural adjustment led to a lost quarter century and deindustrialization
  - Growth recovered, partly as a result of China's involvement in this century and partly industrial policies in a few countries along the lines advocated by our TF
    - Will it be sustained as China slows and Great Recession's impact lingers? Seems unlikely with commodity prices and growth falling
- Policies focused on limiting the role of the state, limiting the ability of the state to increase its capacities
  - The countries that achieved macro stability and "good governance" didn't see a flow of foreign investment except in natural resources

Other Events

- WC policies also failed in Latin America
- Except in China and Vietnam and the countries joining the EU, the transition from central planning to a market has been a real disappointment
  - Shock therapy didn't work
  - Reliance on WC policies arguably contributed to failures
- The 2008 crisis showed that markets on their own were neither efficient nor stable
  - Economy only saved through massive government intervention
    - Irony: attempt to reduce role of gov't led to increased role of gov't
- The Euro Crisis: another example of economic globalization outpacing political globalization
  - With important lessons for developing countries – Monetary policies, industrial policies, austerity policies

Growing Inequality

- In most countries around the world
  - But some countries managed to reduce inequality
- Showed that trickle-down economics didn’t work
  - And implied that GDP was not a good measure of economic performance
- Differences among countries showed that it was not just a matter of economics, but of policies
- If inequality matters for growth, then markets on their own *can’t* get efficient solution (even apart from other market failures)

II. Advances in Economics

Behavioral economics

- Standard model based on "wrong" view of individuals
- Psychological literature: lack of rationality, systematic biases (confirmatory bias) equilibrium "fictions"
- Sociological literature: beliefs largely determined by those around us
  - At the center of development is a societal transformation
  - Including changes in mindsets about change
- New instruments
- New questions about how to assess societal improvements
- Standard welfare analysis does not apply
  - Raising questions about prescriptions based on models assuming fixed preferences
- New interpretations of successes and failures, e.g. of micro-credit schemes

Endogenous Technology and Learning

- Most of advances in standards of living associated with learning and improvements in technology
- What separates developing from developed countries is more a gap in knowledge than a gap in resource
- But markets are not efficient in promoting learning, innovation
- And policies based on standard model (e.g. WC) may actually retard learning, counterproductive to learning and increases in standard of living
- A new and different role of the state
  - Argument for industrial policies, exchange rate management, and carefully designed trade policies
  - Argument against excessive financial sector liberalization (excessive opening to foreign banks)
  - Argument for well-designed intellectual property regimes (*not* TRIPS)

Institutions and Markets

- Markets are institutions
- Markets do not exist in a vacuum
  - They are structured by norms, laws, and regulations
- The way they are structured makes a big difference for how the economy behaves
  - Can lead to stronger or weaker economic performance
  - Can lead to more or less inequality
- The Reagan/Thatcher era and WC entailed “rewriting the rules” in ways that led to slower growth and more inequality
  - There are alternatives which can promote development and equality

Equality and Economic Performance

- Older theories paid little attention to inequality
- Second welfare theorem said that efficiency and distribution could be separated
  - Led to view that economists should focus on efficiency, leaving issues of distribution to "politics"
  - But modern economics explained why, in general, the Second Welfare Theorem did not hold
- Now, wealth of theory and evidence that the distribution of income affects economic performance
- But *no one* ever claimed that markets generated a socially desirable distribution, let alone one that maximized, in some sense, economic performance
  - Further reinforcing the importance of the role of the state in promoting equality and equality of opportunity

- Aside from implications of a learning economy, and of equity and economic performance, additional arguments for state interventions stem from managing macroeconomic and financial sector risks, public goods and institutions
- Government has a regulatory role, a catalytic role, and a coordinating role
- In the most successful developing countries in both East Asia and Africa, the government has assumed the role of a *development state*
  - Even in most successful advanced countries, government has played an important role in promoting technology—the *entrepreneurial state*

Concluding Thoughts

- The “quantity” and “quality” of growth are inextricable for Africa to generate economically and environmentally sustainable, widely-shared development
- That also implies decent jobs and cities
- And all that means governments acquire and utilize capabilities for interventions, especially of industrial policy variety
- We have learned a lot about how to manage and minimize risks of government failure

- The work of this TF should aim at helping to identify in some detail the right policies and with how to go about implementing them
  - Within the framework of “broader objectives, more instruments, more actors”
  - Identifying particular sectors, technologies, instruments
  - Assessing spill-overs, externalities—especially in *broad* learning context
  - Recognizing political economy concerns

More Concluding Thoughts: On Assessing Success

- Metrics have become increasingly important, but wrong too focus narrowly on GDP
- The International Commission on The Measurement of Economic Performance and Social Progress emphasized deficiencies in measure

(a) what we measure affects what we do and the design of policy: metrics are important;

(b) no single number can capture something as complex as our society;

(c) accordingly, there will have to be a “dashboard of indicators”;

(d) the dashboard which is appropriate for one country may be different from that of another;

(e) but among the metrics that should be included are those that reflect distribution and environmental sustainability;

(f) there need to be improvements in the way we measure the value of government and other services;

(g) median income adjusted for inflation almost certainly reflects a better measure of what is happening to the typical individual, and therefore it should be among the numbers