New Growth Strategies
A Policymaker’s Practical Guide for 2015

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The Policymaker’s Milieu 2015

- IMF paints the “new mediocre” scenario
- The limits of monetary expansion are reached
- A stash of liquidity in search of safe returns
- Infrastructure the new focus at the IMF and in global pundit discussions, but less on the ground despite huge gaps and deficits
- The G-20 seemingly powerless to do much
- Uncertainties loom large
Reactions of Decision-makers

- Good time not to be in government!
- But if you are, you are in a search for growth and more than ever you worry about its distribution
- Looking at broad definition of MICs, there are also enormous middle-class aspirations that are increasingly at odds with trends in labor’s share and trends in TFP
- This leads to the search for easy solutions for hard to solve problems
The Search for Easy Solutions: The Initial List

• INNOVATION POLICIES to become more competitive--sounds good and forceful

• INDUSTRIAL POLICY to promote new industries--sounds forward-looking

• SUPPORT FOR DOMESTIC INDUSTRIES facing unfair global competition--sounds nationalistic and fair, and faces no political opposition

• But each of these “easy policies” is fraught with complications
Innovation Policies: Cautions

- The indispensability of complementary policies that are neither easy nor quick to put in place

- Consider policies in Israel or Korea in S&T, access to capital, universities, global firms, policy coordination and fiscal strengths

- Innovation policies are building future capacity, not solving short or medium term lack of demand; they require vigorous levels of domestic competition that favors new entrants; they require public monies and private sector by-in

- Gardening analogy: prep the ground via education, water with perf. based incentives, fertilize with R&D, and remove the weeds with institutional reforms—Innovation Policies, WB 2010
Industrial Policies: Plus Ca Change

• Although the stigma is off IPs, their direction, design, implementation and efficacy are in doubt.

• Of course there are no countries without implicit IPs, but most favor incumbent industries, are sub-rosa, and are at odds with innovative, new industries and activities!

• They often lead to domestic protection unless accompanied by either stronger export incentives or vigorous domestic competition and preferably both.

• To be effective, they require strong institutions, clear goals, coordination between government and business; good examples are Singapore, Korea.

• They can be icing on the cake if the dessert is baked!
Let’s Compare Brazil and South Korea

- In 1980, Brazil’s PCI was 34% of US PCI and Korea’s was 21% of US PCI—Brazil 50% ahead of Korea in the race.

- In 2010, Brazil’s relative PCI had fallen to 20% of US, while Korea’s had risen to 64%—Korea way ahead.

- During 1980-2000, both countries suffered oil price shocks, engaged in IP and selective trade restrictions although Korea liberalized earlier and had more concerted innovation policies.

- Korea adapted its policies and was export-driven, using global yardsticks to promote Samsung, Hyundai, LG and other conglomerates.
Brazil Today

- The process of de-industrialization has left manufactures at 15% of GDP compared to 30% in 1980.
- TFP has been flat for two decades.
- Aggregate demand has been primed by consumption, while infrastructure has been ignored. Logistics costs limit competitiveness and energy costs among the highest in the world.
- Borrowing costs high, venture capital limited, and lending of BNDES is questionable at best.
- Domestic protection makes innovation policies ineffective. Lack of competition at home leads to competitiveness problems.
- The price of seemingly easy solutions can be high and ignoring the basics can be very costly to growth strategies.
More Traditional (Hard) Solutions

- Traditional policies to create new, competitiveness industries and spur growth are harder to implement, but their efficacy is easier to predict.

- Increasing competitiveness via infrastructure—look at Logistics Perception Index where Korea is #21 and Brazil is #65.

- Growth Commission lessons still obtain.

- Pro-competition policies with pro-export policies are a viable political package.
Where Are The Effective Policies?

- Facing low growth traps, slowing world trade, more joblessness, and high aspirations, what should a policymaker be thinking?

- First, INFRASTRUCTURE = EFFICIENT INVESTMENTS. Low interest rates, need for domestic sources of growth, gives both ST and LT boost and can improve productivity.

- To incentivize PPPs, need both regulatory clarity and public expenditure to crowd-in. THAT’S THE COMPLEMENTARY AND NECESSARY POLICY.
How To Be Pro-Growth and Pro-Poor?

• HOUSING for the low and lower middle income can be subsidized, targeted and it produces jobs, domestic stimulus and gives assets to the non-rich

• What’s the COMPLEMENTARY AND NECESSARY POLICY? DEVELOPMENT OF MORTGAGE MARKETS

• Do you know that the average mortgage maturity in Korea is 5-7 years? Household debt is sky-high. Drag on consumption. Household savings are at an all-time low.

• New thinking on the link between poor distribution of income and lower consumption demand and weaker growth prospects.
Where Are the Plus Solutions?

- Stiglitz (NBER, 2014) argues for industrial policies to boost productivity and spur convergence.

- Rodrik (GD, 2014) argues for escalator activities, whether manufacturing or services, that can bring about unconditional convergence.

- Aghion has argued for a strong role of the state in producing better universities and more spillovers to newer, more creative industries.

- But no one advocates these instead of traditional policies to spur investment and improve institutions; no one argues for the easy solutions.
What Can Be Done Differently? A Renewed Focus on Competition

- Aghion argues that only intense competition forces reallocation of resources to efficient firms and those closer to the frontier.

- If innovation policies are to favor new industries, they must be accompanied by policies to weed out the inefficient.

- Innovation policies take hold where new firms can enter markets and where higher education is best—how to foster internal races via efficient markets.

- The political problem of challenging incumbents—Uber in Germany, state firms, few dominant firms.

- A World Bank Competition Index is needed to complement its other ranking exercises—what ever happened to Herfindahl?
A Message to Policymakers

Dear Policymaker,

I know that you are stressed and that growth has become harder to achieve and that for many convergence is not so obvious. We know that innovation and competition go hand-in-hand, so don’t ignore the latter. We also know that there are no neutral industrial policies, only captured ones or dynamic ones, so don’t support rent capturing IP and use efficiency yardsticks. Use your fiscal space wisely, namely, look for high returns in infra and skills before you are tempted to promote a new industry. Everybody now has a Ministry for Creative Industries but filmmaking is very competitive. Do the traditional first and the plus policies second. Yours faithfully.