What Do We Know About Growth?

Simon Johnson
MIT Sloan
Where Did We Start?

• In Western Europe, 1800
  – Incomes roughly same low level as Africa today
  – Life expectancy: 36 years

• Private sector enterprise
  – Created the industrial revolution, 1820-
    • Lifting societies substantially out of poverty
  – Led the way for new drugs, chemicals, vaccines, particularly from 1880 and again after 1940
    • Public health also important, but private business (even individual inventors) essential
Why Argue With Success?

• Prosperity
  – Incomes per capita in “developed” world at unforeseen levels & continue to innovate, grow
  – Over the past 40 years, some countries have achieved unprecedented growth, “catching up” or becoming rich seems plausible

• Longevity
  – Life expectancies are higher than ever expected (or budgeted for…)
  – Shared across almost all countries
    • African average: 52 years (lower where major impact from HIV/AIDS)
Here’s the Problem

• Massive divergence of incomes during the nineteenth century
  – Some industrialized early, spontaneous entrepreneurship plus sensible state policies
  – Others postponed, because were oppressed colonies or had other rulers who felt threatened by new people, new opportunities

• Gap in incomes that opened 1800-1900 hardly closed 1900-2006
  – Modest trend increase in global income level
  – Very few countries changed their relative income per capita during the 20th century, so many stayed poor
  – Prominent exceptions, but only a handful
When the Divergence Took Place

Urbanization in Mexico, India and USA, 800-1930
(from Chandler, Mitchell and the UN)

Source: Acemoglu, Johnson, and Robinson, 2002
Important: this does not mean that poor countries never grow

- Most countries experience episodes of growth
  - Even badly run societies can grow fast for 10-20 years
- But there is no general tendency to convergence or catching up of incomes
  - For most countries, the most likely distribution of relative per capita income for the world in 2050 is what we have today
  - Whether this is also true at the individual level depends on what happens in India and China
    - For India and China, there are grounds for optimism
  - For much of the world, repeated rounds of economic/financial crises are likely (although form changes)
Figure 4. Latin American Countries: Log Income Per Capita and Structural Breaks
(breaks at p=0.10 in black, p=0.25 in red, p=0.33 in blue, and p=0.5 in green; dashes denote upbreaks)

Source: Berg, Ostry and Zettelmeyer (2006) IMF
What Explains this Pattern in the Data?

• Weak Institutions Lead to Severe Crises, Repeatedly

• Main issue: Property Rights (& underlying political institutions)
  – Protection against expropriation by government & powerful elites (e.g., constraint on executive power)
  – Country-level, for entrepreneurs & investors

• Also important for middle income countries open to capital flows (‘‘bumps in the road’’ or worse?)
  – Investor Protection
    • Protection against expropriation by entrepreneurs
    • Country level for outside investors
  – Corporate Governance
    • Protection against expropriation by entrepreneurs
    • Firm level for outside investors
What is Going On?
(The Short Version)

- Countries with weak property rights
  - Grow less over long periods of time (20-50 years)
  - Have more severe output collapses, banking failures etc
  - Can’t sustain productive private sector entrepreneurs

- Weak property rights are not generally due to mistakes or accidents
  - Historical origins (e.g., nature of colonialism): conscious creation and persistence
  - Favor powerful interests today (e.g., Russia)
Can We Fix Institutions?

• The optimists: yes, with Keynesian-type mechanisms and fine tuning
  – e.g., the World Bank’s Doing Business indicators

• The pessimists: no, the vested interests are too strong and sophisticated
  – e.g., Adaptation of elites to transparency initiatives in Africa

• The realists: perhaps, at the same time as we get scaled-up solar power (Dan Nocera: 50 years…)
  – Impossible task? Depends on the resources and focus
  – e.g., Macroeconomic management is now much more effective than in 1970
Still, Why Worry?
Private Sector Led Recent “Great Escapes” from Weak Institutions

…Through Manufacturing Exports

The (Preliminary) Political Economy of Escapes

- Manufactured exports: relatively low margins
  - Need to innovate, be close to customer, fast to market
    - Not much value if expropriated (unlike natural resources or manufactures for protected market)
    - Corruption/heavy taxes will destroy the sector

- Creating a broader middle class that wants a more even playing field (to some extent)
  - Perhaps not create a small elite that wants political monopoly and to restrain entry/new people (these are their suppliers)
So the Private Sector Can Save the World?

• It’s a bit more complicated; few escapes because
  – Standard policy prescriptions are probably necessary but not sufficient (IMF)
  – “Just export” doesn’t work
    • Africa: rising price of commodities, hurts manufactures (NBER Project)
  – Growth can worsen some inequalities, feeding resentment and political backlash
    • E.g., Latin America (CGD taskforce)

• And where exactly are the poor people located today and in the near future?
Just the (Demographic) Facts Please

• World Population
  – Today: ~6.5bn
  – 2050: ~9.1bn

• Largest countries, with population, 2050 (UN)
  – India, 1.6bn + China, 1.4bn
  – USA: 400m (NB: population falls in most rich places)
  – Pakistan: 305m
  – Indonesia: 285m
  – Nigeria: 258m
  – D.R.Congo, Ethiopia, Mexico, Philippines, Uganda,
    Egypt: 100-200m each
  – Iran, Turkey, Kenya, Tanzania, Sudan, Colombia, Iraq
    50-100m each
Significant Aside: A Sad and Difficult Irony

- International epidemiological transition, after 1940 (innovation from the private sector!!)
  - Saved millions of lives
  - More people survived to have children

- Instrument for life expectancy; panel regressions or long differences 1940-80, etc (Acemoglu & Johnson)
  - Big increase in population
  - Little or no increase in GDP from better health
    - Caution: many micro effects do not make a big macro effect
  - GDP per capita (& per worker) actually fell in many poorer countries
  - Lasting demographic consequences, even through 2050
    (also, varied impact of birth control)
Who is in and who is out of the Long Great Boom? (2000-2050)

- In: 5bn-; global modern production chains
  - Europe, including most of Eastern Europe
  - Former European settler colonies
  - Energy producers (with high fossil fuel reserves/pop.)
  - Asia with manufacturing exports + India
  - A few others

- Possibly Out: 4bn+, including much of
  - Latin America?
  - Africa?
  - Important parts of Asia? (Including some of Former Soviet Union, but not demographic expansion there)
Or is there another private sector, coming through?

• Innovation no longer so much driven by needs in rich countries
  – Not many fortunes at the bottom of the pyramid
  – But people who want to change the world, through technology & new business models
    • Microfinance as a forerunner, not a panacea
  – Leadership from private individuals in rich countries really can make a difference
    • But the key entrepreneurs must come from within the poor world
    • How much can they invest, how fast?
What’s Missing?

• We see, even in the poorest countries
  – Entrepreneurs
  – Early stage funding (angels, competitions [DM], etc)
  – Helping organizations (Endeavor, IFC’s GBI)
  – Social support, adoption new products/services

• We are not seeing
  – Anything that plays the role of venture capital
    • i.e., scaling up, fast, in ways that put alternative business models into head-to-head competition
It’s Later Than You Think

• Based on what we see now, private sector led economic development will lift incomes substantially by 2050
  – for 2-3bn people (yes, worry about the CO₂)
• But at least half the world’s population will likely not participate fully
  – Unless the model of private innovation, entrepreneurship and scaling-up changes (again)
  – Beware of unintended demographic consequences
    • Gates/Buffett, Clinton, Bono, etc, will have major impact in terms of saving lives in the poorest societies (public health)
    • Will these additional people stay poor? (economics & entrepreneurship; politics; still pre-“germ theory of disease”)
