

How should the crisis affect our views of growth and growth policies?

Background Note for Session V – Monetary Policy
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I. Income distribution and growth.

The crisis was preceded by a long period of high growth, and higher income inequality. This was true both within advanced countries, and within emerging market countries. The share of profits increased. The distribution of wages widened. The share of income going to the top 1% increased even more.

This raises issues of equity. These are important and well understood. It also potentially raises issues of efficiency. Some argue that this increase in income inequality was at the source of the large decrease in household saving in the US, as people tried to maintain consumption growth by borrowing (Rajan). Some argue that the emergence of a middle class in China is essential to the development of more advanced products, in which technological progress is higher.

If the diagnosis is correct, can the problem be handled through conventional policies, or does it require a more dramatic reassessment of the growth model and of institutions?

II. Catch up, export-led growth, industrial policy.

Pre crisis, countries far from the technology frontier were catching up with those at the technology frontier. Growth rates were much higher in emerging market countries than in advanced countries. This is clearly a desirable development, but one that raises a number of issues.

Many emerging market countries followed an export led growth strategy: A low exchange rate, associated with low domestic demand; a large manufacturing sector, associated with technology transfer, and high productivity growth. The strategy has clearly worked very well in many countries. Should they continue, or shift to domestic demand? Should they be allowed to continue? Or should it be seen as a form of unfair competition, and treated as such? Are there ways of following a similar strategy without running large current accounts (along the lines of Dani Rodrik’s work)?

Some advanced economies, in particular in Europe, are having very low growth. Most of them are close or at the technology frontier? Can their growth rates be substantially increased?

A while back, Samuelson argued that technology transfer could make advanced countries strictly poorer. The argument was largely dismissed by trade economists, on the grounds that it implied a decrease in trade, which we have not observed. Could it be that, while not dominating now, the effect is present, perhaps even increasing in strength, with important implications for growth in advanced countries?

III. Industrial policy and growth

One of the lessons of the crisis is that unfettered markets do not always work best. In many countries, there is increasing talk of industrial policy. Should we revise our views about the pros and cons of industrial policy (for example along the lines advocated by Philippe Aghion) . How does the case for industrial policy depend on how far you are from the technology frontier?

IV. Institutions and growth.

Emerging countries have for the most part done much better than advanced countries in the crisis. After suffering a sharp decline in trade, and, in many cases, sharp outflows, they have returned to growth, and, in some cases, to the pre-crisis output path. Conventional wisdom is that they had better institutions (in part due to the lessons from past crises), better fiscal policy (better than in the past, but better than advanced countries?). Is it the reason? Was the extent of financial integration relevant to the outcome?

V. Financial liberalization and growth

The crisis has shown very clearly the tradeoff from financial liberalization: More efficient intermediation, but higher risk (Rajan). If we take it as given that regulation will always remain one step behind financial innovation, should we revisit the benefits and costs of financial liberalization, and of financial openness, for growth?