The Commission on Growth and Development and its implications for development in the Pacific

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Earlier this year the final report of the Commission on Growth and Development was released. Following their analysis of 13 high-growth economies, the Commission confirmed the centrality of economic growth as the means to achieve poverty reduction.

There was no 'magic bullet' to achieving high growth, but high growth economies were connected by a strong commitment to economic openness and policy flexibility. They had active governments with strong leadership committed to growth, and invested heavily in infrastructure, education and health. Many also had interventionist industrial policies, but were careful for these to correspond with their comparative advantage. This article highlights how the Commission's work is useful for policy makers in the Pacific, with relevant recommendations on the importance of government institutions, public and private investment, and global and regional integration.

The Commission's finding that growth paths were country-specific is an important one for policy-makers. As such, the report moves the development debate away from one which prescribes a generic path to growth to one which requires a better understanding of individual developing economies.

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Introduction

Sustained growth is the most effective means of reducing poverty. In the last 30 years, absolute poverty — the number of people on less than US$1.25 a day at 2005 prices — has fallen substantially. This is almost entirely due to sustained growth. Economies that grow around 3 per cent take a very long time to catch up with developed economies. However, economies that grow around 7 per cent move up in one or two generations.

Finding the 'recipe' for strong economic growth and raising living standards is controversial enough in developed economies. It is even more problematic in developing economies where formal legal, financial, and government institutions are weak; education and health services are low, at best; infrastructure is often non-existent; and, resources are misallocated. History and culture are also important influences.

After the 1990s, policy-makers, the World Bank, and donors began to appreciate the scale of the growth challenge. Technical solutions, such as the so-called 'Washington Consensus' was seen to take too narrow a view of development. In 2005, the World Bank found that some countries that followed the Consensus' prescriptions exceeded forecasts, while others fell well short (World Bank 2005). On the other hand, while the Consensus called for a scaling back of the role for government, many high-growth economies had quite interventionist governments.

The Commission on Growth and Development or the 'Growth Commission' was established to examine those economies that did achieve high growth, in an attempt to draw out lessons for lower growth economies.[2] It closely examined 13 cases of sustained high growth — those economies that had achieved seven per cent or more for 25 years or more. As can be seen from the list of the 'Growth 13' countries in Table 1, while the familiar Asian economies dominate the list, every other region of the developing world is represented, with economies from a spectrum of natural resource endowments and population size.

2 Established in April 2006, the Commission released its final report on 21 May 2008. Chaired by Nobel Laureate Michael Spence, it included fellow Nobel Laureate and growth expert Robert Solow, as well as 19 political and business leaders from developing and developed countries. There were five meetings of the full Commission, 11 workshops, 50 thematic papers and 25 country case studies. Led by the World Bank, it was funded by several donors, including Australia.

Table 1: 13 Success stories of sustained high growth

Country	High growth period	Per capita income at: the beginning of the high growth period	2005
Botswana	1960–2005	210	3,800
Brazil	1950–1980	960	4,000
China	1961–2005	105	1,400
Hong Kong, China	1960–1997	3,100	29,900
Indonesia	1966–1997	200	900
Japan	1950–1983	3,500	39,600
Korea, Republic of	1960–2001	1,100	13,200
Malaysia	1967–1997	790	4,400
Malta	1963–1994	1,100	9,600
Oman	1960–1999	950	9,000
Singapore	1967–2002	2,200	25,400
Taiwan (China)	1965–2002	1,500	16,400
Thailand	1960–1997	330	2,400

From its study of the high growth economies, the Commission observed common factors, and from that sought to draw out some policy conclusions. While it identified what it saw as key ingredients, the Commission characterised these as contributing to country-specific recipes, rather than a one size fits all approach.

Box 1: Growth and poverty reduction

The focus of the Commission's report is on the factors that contributed to high growth. While the Commission provides evidence of the well-recognised link of growth to poverty alleviation, the connection between growth and poverty alleviation does not feature prominently in the report. The report does, however, recognise an important role for government in an economy's growth path. The Commission highlights the centrality of education and health for high growth, as well as inclusive social safety nets to maintain support for high growth. Therefore, in a high growth economy, not only does growth reduce poverty, but a government focused on high growth will provide services that, at the same time, also improve the lives of the poor.

The following sections summarise the findings of the Commission and distil some of the more relevant parts of the report for development in our region. We then consider the broader implications of the Commission's work as part of a new, more diagnostic approach to national development strategies.

Common elements to high growth economies

Achieving sustained high economic growth is possible, but it is not easy. Only 13 economies have achieved it. The Commission found that there is no 'magic bullet' to achieving growth: 'orthodoxies only apply so far'. In fact, the Commission found that the necessary and sufficient conditions for growth are simply not known with a significant degree of conviction.

There were, however, five common elements to those economies that did achieve sustained high growth: 1) they fully exploited the world economy; 2) they maintained macroeconomic stability; 3) they mustered high rates of saving and investment; 4) they let markets allocate resources; and 5) they had committed, credible, and capable governments.

Outward-focus

All of the 13 economies made the most of the global economy. They used foreign direct investment and foreign education to achieve 'catch-up growth' by importing ideas, technologies and know-how: it is easier to learn something than invent it. These economies also specialised in products and exported them to the deep, elastic world markets. In short, the economies imported what the rest of the world knew and exported what it wanted.

Macroeconomic stability

While many of the 13 economies did experience macroeconomic volatility and even moderately high inflation, they avoided the worst of this turbulence. Many of the countries studied also ran budget deficits for extended periods and even high ratios of debt to GDP. But public debt did not get out of hand, primarily due to the economy growing faster than the increase in liabilities. Bouts of inflation, sometimes persistent and relatively high at around 15-30 per cent, were stable enough not to scramble market signals or deter savers. The benefits of bringing inflation to very low levels in a fast growing developing economy were 'unclear' to the Commission.

High savings and investment rates

A national savings rate of 20-25 per cent or higher was not unusual in the successful economies. The Commission found that while countries could rely more on foreign capital to finance their investment needs in principle, in reality capital inflows had a mixed record. They believed that foreign savings were an imperfect substitute for domestic saving, including public saving, to finance the investment that a booming economy requires.

Role of markets

The high growth economies all relied on a functioning market system. The economies studied had governments committed to growth and liberalised product markets, including the labour market. But they were not free-market purists. Many economies had quite interventionist governments, which provided tax incentives and subsidised credit. The Commission observed that their significance was hard to prove, but the interventions probably helped them to discover their comparative advantages. Importantly the policies did not defy comparative advantage, something that the many failed industrial policy interventions elsewhere generally attempted.

Committed, credible, and capable governments

The Commission found strong, capable leadership of effective governments to be vital. As the economy grows and develops, active, pragmatic governments have crucial roles to play. In the high-growth Asian economies, it was accepted that governments played a more complex role, despite inevitably making some mistakes along the way. But what size the state should be remains unanswered. The Commission preferred to leave it to Sir Arthur Lewis who noted that ‘Governments may fail either because they do too little, or because they do too much’ (Growth Commission 2008a, p 30).

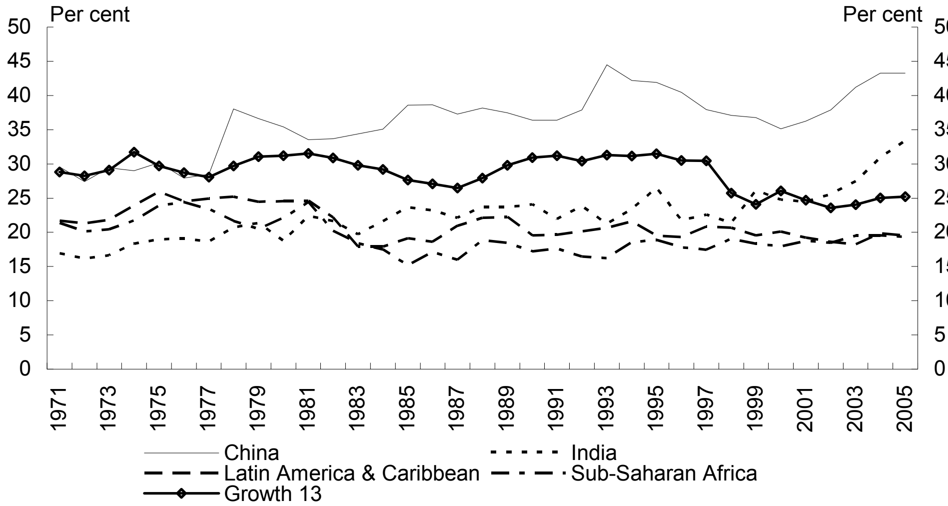
Policy ingredients of growth strategies

To sustain growth over time, a set of conditions and policies need to come together. The Commission had a keen sense of the policies that ‘probably matter.’ But they avoided prescribing a list of sufficient conditions for growth. The Commission was nonetheless confident that the policies discussed below will make a difference to a countries chance of sustaining high growth. They can be grouped together into five broad areas: accumulation; innovation; allocation; stabilisation; and inclusion.

Accumulation and innovation

Economies need to accumulate the infrastructure and skills required for high growth. The Commission noted a big role for infrastructure in high growth economies. These economies had investment rates of at least 25 percent of GDP, with fast-growing Asia investing 5-7 per cent of GDP into public projects (Chart 1). The Commission found infrastructure spending in low-growth countries, on the other hand, to be badly neglected. Many developing countries invest only around two percent of GDP on public infrastructure, often less. The Commission was concerned that infrastructure spending was often crowded out by short-term, political priorities over longer-term needs. They appealed to governments not to divert the revenue of infrastructure-related state-owned enterprises away from investment.

Chart 1: Investment rates as a proportion of GDP for 'Growth 13' countries 1971-2005



Source: Growth Commission (2008a).

Investments in people were also important. Healthy, well-educated workforces allow economies to import knowledge, use and adapt it. The Commission observed that high growth economies put substantial public investment — at least 7-8 per cent of GDP — into their people. Foreign direct investment also played an important part in economies absorbing knowledge, technology and innovative approaches from the rest of the world.

Allocation and stabilisation

The Commission highlighted the importance of regulatory renewal in a fast growing economy: 'one of the most common mistakes … is to find a successful constellation of policies and industries, then stay with them … [W]hen it comes to growth very little is permanent' (Growth Commission 2008a, p 44). To promote growth, governments should facilitate the entry and exit of firms and labour mobility albeit not at the expense of safeguards for unsafe working conditions. Governments should protect people, not job positions through social safety nets to cushion the 'blows of the market' (ibid, p 44).

The Commission found that none of the high-growth economies were particularly quick to open their capital accounts, with policies that discouraged speculative capital flows proving useful in turbulent times. While the views on the value of manipulated exchange rates varied within the Commission, it was agreed that they could outlive their usefulness, particularly if pursued to extremes.

Inclusion

The Commission pointed out that the virtue of sustained growth is sometimes missed because people confuse rising inequality with a failure to make progress against poverty. In the early stages of growth, incomes of the rich increase faster than the poor, and income gaps therefore tend to widen. But at the same time, it is possible — and quite normal — for poverty to fall even as inequality rises. Serendipitously, in growing economies income can be redistributed without anyone's living standard falling, making the politics of redistribution that much easier. Redistributing some of the benefits of growth also maintains the consensus about the importance of growth. Governments should therefore seek to contain inequality — at both ends of the income spectrum — through social safety nets and access to basic services.

Growth and development in the Pacific region

The broad suite of key messages in the report represents more of a set of guiding principles than a strict handbook. The report stresses that a coherent and successful growth strategy should be 'country- and context-specific'. But if growth is to be sustained in our region, policy makers also need to learn from others who have achieved high growth.

While the Pacific economies cannot be characterised as a homogenous group (see Table 2, below), with significant differences in population and income, over the last two decades no country has come close to achieving consistent growth rates of over 7 per cent.

The recent Pacific 2020 regional initiative examined the challenges of growth in the Pacific. The Commission's report had significant parallels with the work of the Pacific 2020 report. These can be summarised into three key areas: institutions, investment, and integration. As in Pacific 2020, the Commission highlighted an important role for effective government institutions and implementation, and strong leadership in achieving high growth. Commission Chair Michael Spence noted that one of the biggest surprises was how important political leadership was to growth (Foreign Policy 2008). The Commission also echoed Pacific 2020's call for a focus on public and private investment, although the Commission also called for the careful consideration of a more interventionist industrial policy. Just whether interventionist policies suit the Pacific with its various constraints requires further, careful examination. Lastly, the Commission highlighted some of the benefits of regional and global integration. Below we examine these three areas in more detail.

Table 2: Key statistics for the Pacific

Country	Population ('000)	Income ($USm)	Real GDP growth (1990-2004)	Government Effectiveness
Melanesia				
Fiji	840	3,098	2.6	35.5
Papua New Guinea	5,800	695	3.6	25.1
Solomon Islands	521	513	0.8	20.4
Vanuatu	213	1,472	2.7	45.5
Polynesia				
Cook Islands	20	7,549(b)	2.5(d)	44.1
Niue	1.8(a)	4,364(c)		50.7
Samoa	181	2 030	2.4	49.3
Tonga	102	2 087	2.6	32.2
Tuvalu	11	1,346(c)	4.3(e)	40.8
Micronesia				
Kiribati	90	633	4.2	34.1
Marshall Islands, Rep.	61	1,803	-0.5	18.5
Micronesia, Fed. States	108	1,786	1.3	38.4
Nauru	10(a)	3,500(c)	-4.4	35.1
Palau	21	6,350	-0.8	36.5

'Government Effectiveness' is a World Bank measure which considers the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. The number represents the countries percentile rank, where 100 is the highest and 0 is the lowest. The measures are drawn from a diverse variety of survey institutes, think tanks, non-governmental organizations, and international organizations over the period 1996-2007.
(a) In 2001.
(b) In 2003.
(c) In 2002.
(d) In 1990-2003.
(e) In 1990-2002.
(f) Not available, N/A – not applicable.
Source: Columns 1-4: Commonwealth of Australia (2006), Column 5: World Bank (2008).

Institutions and leadership matters

The Commission's insight that 'markets and institutions co-evolve' is a simple but important one. Institutions in developing countries often started life well ahead of markets during the early independence years. After this, their level of service delivery has tended to fall back in line with the undeveloped level of the markets in these economies. Even if we knew how to engineer institutions, moving them back to their original state will not lead to automatic prosperity.

Rather, these institutions need to evolve as the economy expands. The Commission saw benefits in incremental rather than rapid policy reform. Policy shifts and reforms are hard to predict accurately in a developing economy, especially when the resilience of economic institutions and the capacity of government is problematic. The Commission therefore endorsed Deng Xiaoping's maxim of the need to 'cross the river by feeling for the stones'.

The Commission's report repeatedly highlighted the importance of strong leadership. In successful high-growth economies, policy makers understood that growth did not just happen, but rather it was consciously chosen as an overarching goal. Such leadership requires patience, a vision with a long planning horizon, and a relentless focus on the goal of inclusive growth. One of the messages for the Pacific is that a broad consensus about the need to achieve high, sustainable growth is essential, with a consistent focus on it even as governments change.

Leadership is also required within the bureaucracy. Many high-growth economies had governments with increasingly capable technocratic teams, several having dedicated and influential reform teams. In order to build this capacity, the Commission endorsed the concept of international exchanges for civil servants. The Regional Assistance Mission to the Solomon Islands (RAMSI), amongst others, involves government personnel from Australia visiting the Solomon Islands and to a lesser extent, vice versa. The Commission considered that there is merit in extending such programs to exchanges between developing country bureaucracies.

Investment

The Commission emphasised the importance of both public and private investment. As noted, the Commission stressed the need for much greater levels of investment in infrastructure, education and health services than is currently found in low-growth economies such as those in the Pacific. Investment in these areas was seen as an essential building block of growth.

The Commission had recommendations on both regulations that might impede investment, and also more pro-active policies that might spur investment. Sensible regulations covering private sector investment and labour had a direct impact on private sector investment. Labour markets in many developing countries are plagued by regulations that essentially create rents for insiders and exclude outsiders. But removing these regulations is politically difficult — these laws are often cloaked in nationalistic rhetoric. So a more feasible strategy is to create an alternative employment track which allows lower wages for a certain period in the rapidly growing sections of the economy until productivity catches up.

The Commission's report also had some more controversial recommendations for encouraging investment, based on the more interventionist policies found in many high-growth countries. The Commission found that well-managed interventionist industrial policies such as time-limited taxation breaks and directed credit can be effective. The list of risks and caveats about such policies however is long, derived from the failure of industrial policies in many developing countries. The report highlighted the need to align them with an economy's comparative advantage, use them temporarily, critically evaluate them, and avoid the (often strong) temptation to pick winners. The report's warning about the often dominant influence of a single foreign investor in small states is pertinent here. Given this list of caveats, we make no recommendations about the benefits of these policies to the Pacific here, but rather suggest they require further, careful consideration.

Integration

The importance of economic integration, both within the global economy but also within the region, is the third area in the Commission's final report that has important relevance for the Pacific.

The Commission included a section on the particular challenges facing small states. They noted the importance of small states embracing the global economy, with a strong openness policy. However, as the report pointed out, to pursue growth, small states have little choice but to turn outwards. This is why they tend to already have a higher trade to GDP ratio than for other country groups.

On the idea of greater regional integration, the Commission discussed both regional pooling of services, and greater links with developed countries. In other regions the pooling of regional services goes beyond what is currently found in the Pacific. For example, the Central and West African region relies on multi-country central banking. The Eastern Caribbean has a single Supreme Court, a superior court of record with nine members. As well as pooling its services, the Eastern Carribean outsource the role of the final appellate court to the Privy Council in London. Here, states sacrifice some political sovereignty for better quality of service. While the rules governing these services are often difficult to agree and require continued commitment by all states, the consensus for many regional experiments is on balance a positive one.

Pro-active trade policies to help developing countries might also be part of greater regional integration. The report suggested that developed countries grant time-bound trade preferences to manufactured exports. Somewhat surprisingly, the Commission concluded that the costs would be minimal, even if they were not successful. The need to ensure that such policies align with developing countries' comparative advantages applies here.

The Commission noted that the per capita cost of government is much higher in micro states than was the case under their former colonial powers. An example was banking supervision, which costs a similar amount for a country of 400,000 as 4 million. The Commission suggested a self-governing structure for Pacific microstates in association with Australia or New Zealand. This was one of the few direct recommendations made in the report.

The report had surprisingly little to say on labour mobility or the importance of remittances to Pacific countries, an important part of regional integration around the world.

A new approach to growth and development strategies?

According to Harvard's Dani Rodrik, the Commission marked an important shift in growth strategies, from a presumptive approach to a more diagnostic one (Rodrik 2008). The traditional policy framework has been presumptive, starting with strong preconceptions about the nature of the problem, providing a 'laundry list' of reforms, and emphasising the need to undertake them all immediately, rather than in a sequenced and prioritised manner. The Washington Consensus which so dominated the development paradigm in the 1990s followed this approach through their prescription that governments (essentially) 'stabilise, privatise, liberalise' (Williamson 1990).

By contrast, the policy mindset reflected in the Commission is relatively agnostic about what works, recognising the limits of what we know about the development process. Political considerations, underdeveloped institutions, and unpredictable impacts of policy changes mean the path to high growth is not a linear one. Rather, a growing economy is a moving target. As Chairman Michael Spence said, 'no one set of policies will work in all circumstances. An effective strategy ... is context specific, country specific, time specific' (Financial Times).

Thus, the Commission represents a more diagnostic approach to growth and development. While they identify the key insights and policy levers that help countries raise and sustain the pace of growth and poverty reduction, countries themselves need to find local solutions to the most significant economic bottlenecks or 'binding constraints', and identify a relatively manageable number of reforms that give the highest payoff. This will often be a messy process, requiring much 'second-best reasoning', experimentation, and learning (Rodrik 2008).

Conclusion

Following the release of the Commission's final report, Commission Chair Michael Spence said that the real secret of economic development is that there are no secrets. The Commission's Vice-Chair Danny Leipziger agreed, noting that the World Bank is 'acutely aware that there are no silver-bullets to create long running, inclusive growth, and that no single paradigm exists' (Growth Commission 2008b).

For donors, this means they need to be less certain of advice given and more aware of controversy even when it seems that the solutions are obvious. Some, such as well-known aid critic Bill Easterly have criticised these conclusions, generalising the Commission's work as 'we do not know, but trust experts to figure it out' (Easterly 2008). To others, the Commission's report was all things to all people, and really just provided a list of policy areas that donors have been working on for some time.

But the diagnostic approach of the Commission's final report led prominent development thinker Dani Rodrik to believe it can be considered a 'watershed for development policy' (Rodrik 2008). Whether the approach will be extended the status of being considered a new paradigm remains to be seen. True, the Commission has gone over some traditional ground such as the importance of macroeconomic stability and the provision of public goods. But rather than Easterly's assertion that the Commission leaves us with nothing, it actually centres on some very important and broad development challenges for policy makers and donors that need answering.

The Commission's view on the importance of strong leadership in high-growth economies opens up important questions about what creates and sustains good leadership. It raises issues about leadership styles and the role of culture in leadership. The need to better understand how institutions evolve rather than trying to restore them to previous levels raises the question of just how institutions evolve.

The issues raised by the Commission also make us question whether the importance of the role of growth in development has not been underplayed. The fact that the Commission was created in 2006 could be thought of as a surprisingly late edition to the development discussion. The UK's 37 million pound 'International Growth Centre' was announced only this year (DFID 2008).

We can also look in our own region and ask just how deeply the growth challenge in developing economies in the Pacific is understood. This process was given a significant boost by the regional Pacific 2020 study. But the Commission tells us that more probing questions need to be asked at the country-level. What are the binding constraints of economies? How do economies find their comparative advantages and then exploit them once they do? Should some governments focus more on education to export labour or greater infrastructure to encourage tourists? As a first step, a greater, more consistent focus on improving data collection is required.

There may not have been many startling insights in the Growth Commission Report. But being more confident that there is no definitive answer to the development question is more likely to open a true dialogue between developing country policy makers, their citizens, and donors on how growth should be achieved that will ultimately benefit all, especially in our region.

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