



Highlights of the Growth Report

Overview

The Growth Report was written over two years during which the 21 Commissioners interacted and consulted with, and learned from leading academics, business leaders, policy makers, and NGOs. The report reflects the learning over this period, and is informed by the Commission members' own experiences.

Engagement with the Global Economy

The Growth Report sees engagement with the global economy as crucial to future growth with strategies that rely exclusively on domestic demand having limited time spans.

The world economy offers developing countries a deep, elastic market for their exports, with a strong export sector a critical ingredient of high growth, especially in the early stages

Interaction with the global economy also allows fast-growing economies to import ideas, technologies and know-how from the rest of the world. Foreign direct investment and foreign education, which often creates lasting international networks, are viewed as particularly important in the Report.

Leadership & Governance

The Growth Report finds that successful, high-growth economies share the characteristics of credible, inclusive and pragmatic governments. While governments should not try to do too much, to try to replace markets or to close the economy off from the rest of the world, they still play an important role. It falls to the government, for example, to maintain price stability and fiscal responsibility, both of which influence the risks and returns faced by private investors.

Policymakers have to choose a growth strategy, communicate their goals to the public, and ensure that they have the populace's tacit support through a convincing that the future rewards are worth the effort, thrift and economic upheaval.

A long planning horizon and pragmatic approach to government is also crucial as is a culture of honest public service. Administration must attract and retain talented people, by offering better pay, promotions and recognition to officials who can measurably improve the public sector's performance. The Report also recommends an increase in the number of international exchanges for civil servants.

Economic Security

Because a rapidly growing economy is in constant transition, attention to individuals, families and their economic security is very important to growth, the Report finds. Policies that provide for income support in job transitions, as well as those that focus on retraining, mobility and access to basic services, are ethically necessary and critical to maintaining the support for growth oriented policies, the Report says.

Fiscal & Monetary Policy

While an important means of export promotion, *the Growth Report* warns that if exchange rate policies suppress a currency by too much or for too long, it will distort the evolution of the economy by removing the natural market pressure for change.

The Report also says that there is widespread agreement that central banks operate best in fulfilling their central mandate (to control inflation and via the interest rate to maintain a balance between actual and potential output) with a degree of independence.

Public Investment, Health & Education

Based on the experience of the sustained, high-growth cases, the Report suggests that overall (private and public sector) investment rates of 25 percent of GDP or above is needed. The Report urges that about a third of that figure should be public investment in physical infrastructure and "human capital" (education and training).

Investment in education and health and a focus on educational outputs, such as literacy and numeracy, are all viewed by the Commission as essential inputs to growth, concluding that currently educational spending in many countries is marred by waste and inefficiency.

The education of girls provides one strong test of a government's commitment to equality of opportunity. Educated women have fewer, healthier children.....Their children are then more successful in school. Educating girls is thus one way to break an intergenerational cycle of poverty.

Infrastructure investment is also viewed as particularly important to growth by the Report. The Report argues the need for clearly written and monitored private/public sector partnerships with commercial risks born by the private party. Governments must also resist the temptation to see infrastructure as a source of revenue through increased taxation, leading to overpriced services, out of reach to large parts of the population.

The Environment and Energy Use

The Report stresses that growth strategies should take account of the cost of pollution from the outset, even if they do not immediately adopt the toughest environmental standards upheld in rich countries.

The Report argues against the growing pattern of subsidizing energy consumption, which bias the capital investment away from energy efficiency and may negatively bias the structural evolution of the economy. These subsidies also impose a mounting fiscal burden as energy prices rise, diverting money that would be better spent on neglected public infrastructure. Finally, these energy subsidies will inhibit the participation of developing countries in global efforts to cut greenhouse gases.

Global Warming

The Report says that advanced economies need to take the lead in medium term mitigation targets, and in increasing the incentives and support for energy saving and other mitigation technology development. International negotiations should concentrate on agreeing to carbon cuts for more advanced economies, to be achieved ten or 15 years hence.

Other specific recommendations include more generous subsidies for the development of energy-efficient technologies, the setting up of an international institution to monitor emissions cuts and other mitigation measures, greater collaboration through cross border mitigation activity in a successor to the Clean Development Mechanism provisions in the Kyoto protocol with rich countries paying for carbon cuts in poorer countries, and an acceptance of the dual criteria of efficiency and fairness in carbon mitigation.

Labor Markets

Getting the labor market right is vital to both the economics and politics of growth. The Report examines the relationship between the formal and informal labor sectors where the formal sector typically offers better wages and terms than informal jobs. In most cases, the high cost of labor in the formal sector will deter investment, especially in export industries that must

compete in the global marketplace. The Report recommends a pragmatic compromise to breach the divide between the two sectors, where governments allow export-oriented industries to recruit workers on easier terms than prevail in the formal sector, creating room for employment to grow without threatening participants in the formal sector.

The Urban Rural Nexus

With half of the world's population now living in cities, the Report reminds us that no country has ever industrialized without also urbanizing. Rather than considering urbanization an unpleasant side-effect of growth, the Report calls for the better management of urbanization and its benefits. The Report calls for greater financing of urban infrastructure with clear guidelines and appropriate incentives, well regulated housing finance, sound planning principles, and a robust systems of property rights.

The Report also looks at the role of agriculture and the importance of rural public services, so that it is productivity that motivates migration to cities, rather than access to better services.

Recommendations for Countries Facing Specific Challenges

Specific recommendations for four sets of countries (African countries, small states, resource-rich countries, and middle income countries) include:

- In the case of *Sub Saharan Africa*, the Report calls for an increasing of the productivity and output of agriculture with the help of external resources, technology, and infrastructure investment. Export diversification and a larger, more connected continental market are also encouraged.

The Report also calls for a continuing of the progress in elementary school enrollments, and the committing of more resources to secondary and tertiary education, as well as an undertaking that girls complete the journey from school entry to productive employment.

The Report also calls for an increase in the productivity of private sector firms with a reduction in the cost of doing business. Giving all citizens and sectors access to secure channels for saving and credit is also crucial. Particularly important for a resource-scarce, landlocked African country is regional cooperation and regional integration, the Report finds.

The Report also calls for industrialized economies to grant African countries' time-bound trade preferences to manufactured exports to help them overcome the disadvantages of being late starters, and a financing of

the expansion of Africa's tertiary education to make up for Africa's brain drain.

- In addition to ensuring that commodity rents are used to greatest effect, the Commission commends the work of the Extractive Industries Transparency Initiative (EITI) and EITI++ in promoting good governance and transparency in resource-rich countries. The Commission also argues that in resource rich countries, there needs to be a renegotiation process to restore the balance between the returns to the entities exploiting the resources and the government.

The Report also recommends that the first claim on resource rents be adequately funding public sector investments. The Commission recommends that the remaining rents should flow into a fund, managed by experienced investment professionals operating with a well defined set of parameters with respect return, risk and diversification. The fund should pay out (much as endowment funds in non-profit entities do) a percentage of the total each year for the benefit of the citizens either directly in the form of income or indirectly in the form of reduced tax burdens.

- The special challenges of the 50 small states in the world with individual populations of less than 2 million people were also examined by the Commission - in particular the absence of scale economies, higher costs of governance institutions per capita, and higher production costs for non-traded goods.

The Report argues that economic regional integration, a focus on trade, and partial political union with shared service providers as a focus needs to be an important part of any small state strategy.

- *The Growth Report* also says that the global financial industry and the international financial institutions should be able to create financial instruments of interest to small states. For example, Caribbean states, with the help of donors, have created an insurance fund for members struck by hurricanes or earthquakes. Their reserve pool is reinsured in the international financial markets.
- *The Growth Report* also examined countries that have reached middle income status and the policy shifts required to transition from middle income to high income levels and from labor intensive to human capital intensive industries. The Report warns of the dangers of intervening in the process of decline and job loss in the labor intensive industries.

Industrial policies, including export promotion via management of the exchange rate, special export zones, and tax incentives, can also be pursued for too long, the Report cautions. Investment in higher education and human capital is also a critical input to the diversification of economies at this stage of growth.

Global Trends – Protectionist Sentiment, India & China’s Rise, Commodity Prices, Changing Demographics, Global Imbalances and Global Governance

The Report also examines global trends that are beyond the control of any single developing-country policymaker.

In addition to global warming, the Report looks at protectionist sentiment, the rise of India and China, rising commodity prices, the world’s changing demographics, and global imbalances and global governance in the world economy.

Protectionist Sentiment

The Report stresses that structural change under competitive pressure is what propels productivity growth. It is counter-productive to cling to stagnating industries, even industries that were once responsible for the country’s growth. Governments, however, should try as far as possible to protect people from such fall-outs, through unemployment insurance, retraining and uninterrupted access to healthcare to name but a few.

The Rise of India & China

The Report also agrees that China and India’s abundance of labor has led to a decline in manufacturing prices, making it more difficult for countries to embark on labor-intensive growth strategies. The Report points out, however, that where labor is cheap, the returns from manufactured goods still exceed the cost of capital.

The Report notes that China and India represent a significant opportunity. Both countries import growing volumes of goods from elsewhere in Asia, which either serve domestic markets or feed the supply chains.

The Rises in Commodity Prices

The Report believes that higher prices for food, minerals, oil and gas are probably here to stay, even if they do not maintain their current levels.

Such higher prices provide strong incentives to economize on demand and expand supply. They should also spur technological improvements, such as raising agricultural productivity in Africa or improving energy efficiency in advanced economies. Based on this, the Report recommends that subsidies and price controls be avoided, if possible. The Report, however, stresses the need to develop more effective safety nets and redistribution mechanisms to protect people who are vulnerable to sudden shifts in prices.

Actions recommended by the Report to combat food price rises include an end to food exporters restricting exports; more effective safety nets; and a restoration of international trade in food with a removing of restrictions on exports. The Report also urges that policies that favor bio fuels over food be reviewed and if necessary reversed and that reserves and inventories be accumulated to relieve temporary shortages.

Changing Demographics

The world's ageing population and increased global migration are also addressed, with the question being asked whether this will have a negative effect on growth.

The Commission believes that reforms are needed to restore the fiscal viability of many national pension systems, which will help change the length and pattern of working lives. If these reforms are undertaken gradually, then the research suggests there is no compelling reason to expect a major slowdown in global growth.

The Report also believes that fast-growing economies, where opportunities abound, can attract substantial return migration. One means of keeping one's best talent is to offer students loans for people's education, then cut the repayment amount for every year they work in their home country.

Global Imbalances and Global Governance

Finally, the global imbalances in the world's economy and challenges of global governance are examined.

US savings rates are still low, China's reserve accumulation has not slowed, and its trade surplus, once modest, is now rising rapidly. Currencies that track the dollar (or the yuan) have largely accompanied the American currency on its descent, in defiance of their underlying fundamentals.

According to the Report, the challenge is to match the decline in the US's trade deficit with a reduction in excess saving in developing countries.

The Report calls for establishing a mechanism to coordinate policies of the growing number of influential countries and safeguard the stability of the global financial system.

The Report acknowledges that new global governance architectures will take time to develop. In the meantime there will remain a mismatch between the dimensions and magnitudes of interdependence and our collective capacity to regulate and respond in a coordinated way. This creates incremental risk that needs to be addressed in domestic policy postures in all countries.