



A Global Forum

Paul Romer

in conversation with Ann Bernstein



CDE@25 | Democracy | Markets | Development

A South African resource influencing policy for 25 years

In November 2020, CDE initiated a series of events to celebrate 25 years since its launch in August 1995. The series focuses on global conversations on democracy, business, markets and development.

As **Laurie Dippenaar**, CDE chairman said at the opening event, "CDE is almost as old as South Africa's democracy and we are very proud of both. From the start, we have looked at how this country can consolidate its democracy and achieve the growth, jobs, and prosperity we desperately need. One of CDE's exceptional contributions has been its ability to tap global expertise for the benefit of the country."

Our first conversation is with Paul Romer, professor of economics and the law at New York University. Romer is the winner of the 2018 Nobel Memorial Prize in Economic Sciences, former chief economist of the World Bank, founder of the Marron Institute at NYU, and a great friend of CDE.

Ann Bernstein: In my many interactions with you, I have always encountered an economist who asks difficult and important questions about many of the things we all take for granted, and someone who is deeply committed to democracy and seriously concerned with how to expand opportunities and the quality of life in developing countries. I remember the first time we invited you to South Africa in 2008, another year filled with crisis and momentous changes.

Paul Romer: That's right. I remember it well. During that trip I visited Windhoek, and I vividly remember waking up to learn that Barack Obama had won the US elections. I was moved by the fact that in a country with a deep legacy of racism and slavery, we had elected a black man as President. But what really impressed the government officials I spoke to in Windhoek was the honourable concession speech given by John McCain, a speech that traditionally served to end the disputation of the election and to signal the willingness to work together as citizens. I never felt more proud to be an American than I did on that day. It fills me with shame that the country I live in now has departed so far from those norms of civility and citizenship. If I look back to 2008, I didn't have any idea that just over 10 years later we would be in a life and death struggle to keep alive the legacy of the Enlightenment, and to protect it from a decline back into a world of tribalism, where emotions rather than reasoned disagreement completely dominate.

At the same time, I did start to consider issues relating to how one argues a point and presents the facts while I was in South Africa. Before I came to South Africa, I don't think I paid much attention to the moralistic versus the factual side of the discussions about the labour market. But it certainly became a front and centre issue for me and it has showed up in my work ever since. My experience in South Africa taught me that part of persuading people of the facts and the logic of your case requires paying attention to assertions of right and wrong, as well as a degree of empathy with people who might share beliefs that are slightly different from my own.

Having said that, facts are our friends. That is the lesson of the Enlightenment. If we know the facts, we will make better decisions and achieve better outcomes for everyone. And we can establish the facts if we engage with each other in a particular way. That way is the social process we refer to as science – where people are transparent and exchange messages about what is true and what is logical. People may disagree, but they do so with respect, and eventually, out of those conversations, some kind of consensus will emerge, which is the closest we humans will ever get to the truth.

The facts about South Africa that were so gripping and compelling to me, and about which Ann and I have stayed in touch ever since, concern the unintended, unfortunate side effects of policies that are designed to raise wages and improve the quality of work for people who have jobs, but which unfortunately reduce the likelihood of other people getting jobs. This is what economists refer to as the downward sloping demand curve for labour. If the price employers have to pay for workers is too high, the economy will hire fewer people, and there will be many who would like to work but do not get the chance.

Ann Bernstein: Why is that so concerning? Tell us more about this concept of 'work as school' that you have developed, which points to the real costs of denying people a chance to work and to move up the jobs ladder.

Paul Romer: When someone works in a job, they learn things. The benefits they get are both a combination of the wages that they get to take home and the additional skills that will make them a more productive worker throughout their career, which will earn them higher wages in other jobs that they take. If we use this idea of 'work as school', we can approach the question of what is right and what is wrong about payment in a work relationship with fresh eyes and come up with a different perspective on what is the best moral action to take. After all, we share an ultimate goal of wanting to give people a sense of dignity, an opportunity, and the possibility of making improvements throughout their lifetime.

School is a kind of work, one that we require by law, but we do not pay children anything for doing that work. We require it because we know that the skills they learn will improve their lives and will make the society better off because everyone will have higher levels of skills, and so higher wages, and they can be better citizens. If it is morally acceptable to do a rather unpleasant job like going to school for no compensation – I have often said that I would rather work in a sweat shop than have to go back to be a student in an American high school – then we can start to see that there may be other ways to solve our problems in the labour market.

Ann Bernstein: You came back to South Africa again in 2010, when we had a memorable set of engagements. You met with then Minister of Finance (Pravin Gordhan) to discuss jobs, providing an informal seminar for him and a growing number of senior staff in the National Treasury. The Minister subsequently started talking a lot more about youth unemployment and jobs. You also spoke to the Minister about wage subsidies. What are your ideas on that?

Paul Romer: I talked with the Finance Minister about using wage subsidies, maybe temporarily, to make up the difference between what the employer is willing to pay to hire an additional worker and what society believes they should get. But here we run into the problem that governments all over the world are very constrained for resources – they don't have enough revenue to provide big enough subsidies to make sure that everybody gets employed at the high wages that we would like to set for everyone. The temptation in the wake of the current economic crisis will be to push minimum wages higher rather than to do what we should do, namely, force ourselves to pay more taxes to collect enough revenue to pay wage subsidies to make sure that everybody gets a job.

A different option would be for government to become an employer of last resort in a public works programme like the American Civilian Conservation Corps from the 1930s. This perhaps might be the way forward. We have to be aware of the stark reality that the measures we have been trying for decades now have left so many people completely disenfranchised, completely excluded, and completely cut-off from a path towards opportunity and progress.

Ann Bernstein: South Africa is really in a weak position in terms of state capacity, which has been significantly diminished by what we called state capture during the past 10 years. So, I am worried about the challenges of implementing a Civilian Conservation Corps initiative or something like that here, and at the requisite scale.

Paul Romer: You could have some kind of external organisation that could offer to set up and run versions of the Civilian Conservation Corps camps. It can't be a commercial, for-profit entity, but I thought, for example, if you take some of the labour unions perhaps from the US or Europe, they might establish an organisation like that as an outsourced provider of the camp administration function for a country like South Africa, I realise that this might run into some scepticism and concern.

I don't diminish the many other dimensions of opportunity for improvement through economic reforms, or the room for improvement in government administration, and I do not diminish the harm that is being done to the economy in South Africa because the government can't provide the level of service that every modern economy needs. But I always come back to the issue that if we can't get the majority of young people into work – if we can't solve that problem – it may not matter what other problems you solve.

Ann Bernstein: I saw you and another good friend of CDE's, Harvard Professor Ed Glaeser, have a conversation about how to manage cities, the notion that there are no libertarians when it comes to urban services like the fire department or urban sewerage, and the possibilities for enhancing state capacity through outsourcing. I

understood you as saying that one way around capacity issues in cities might be to look at contracting services from other countries. Can you talk about that?

Paul Romer: You understood correctly. If capacity is the fundamental constraint, what kinds of things could we do to increase the capacity of governance, especially in cities? One solution may be to increase exports of government services from places that are good at some of these activities to other places. It raises complicated questions of accountability, but we could think of it as sub-contracting. It could be that a country that wants to introduce privatised water management but doesn't have the capability to regulate utilities could contract with someone like a specific British group and introduce their ability to manage utilities on site, and then let the private sector operate. So this is a possibility, but it has to be negotiated in conditions where the existing authorities are comfortable with some kind of outsourcing of a responsibility for specific decisions. Countries have outsourced management of customs. You could imagine other forms of outsourcing as a way to bring in capacity, but it is not typically a good way to build consensus in a country for the purpose of bringing about fundamental change.

I actually came to South Africa because I was hopeful that it might be the place where one could try this idea of creating an entirely new jurisdiction, perhaps a whole city, which could operate under different rules and which might therefore show people in the existing systems that a different way was possible. If one could see how such a regime operated, then it might be possible to get the benefits of creating employment opportunities without threatening existing arrangements.

I have also become sceptical about the prospects for cities to become centres of inclusion in South Africa. If a new or reformed city is going to operate in an environment where labour market restrictions exclude so many from the possibility of work, then a city cannot succeed. South Africa needs to find another way to get people free of the restrictions that keep them from working. Someday there may be places that someone who is disenfranchised in South Africa could move to where it is legal for them to work.

Ann Bernstein: Something like a special economic zone, maybe? Is that a more modest version of what you are talking about? Is that a way of experimenting with new rules and new ways of doing things?

Paul Romer: Yes, that is what I mean. I came to my ideas on SEZs partly because of my familiarity with the Mauritian experience, where a Free Trade Zone turned out to be an effective way to reform the economy. By creating a Free Trade Zone, they could bring in firms that were willing to hire local workers to work in garment assembly, which is one of the most mobile and flexible sources of employment around the world. One sign that this experiment worked was that the zone became the norm in the country as a result of its enormous success. You should think of these zones as a transitional measure in a broader movement for change in society.

The problem we see with most zones is that they don't have the effect of creating systemic change, but become protected enclaves. In fact, they can create an entrenched elite by virtue of the special treatment the firms get in the zone. The value of their assets, their land, and their investments in the zone will go down if the rest of the country begins to look like the zone, and so the zone can create a powerful elite that works to resist reform in the rest of the country. This typically happens when special concessions are given to a few. We shouldn't do concession zones; we should do reform zones. If there is genuine opportunity to create a reform zone, then it is worth pursuing. It would be well worth trying some more experiments.

Ann Bernstein: The idea of reform zones certainly aligns with CDE's thinking. If you were in charge of South Africa, which reforms would you prioritise, bearing in mind our fiscal constraints?

Paul Romer: Addressing the issue of the disenfranchised youth should be the highest priority for South Africa. Getting to an economy where every person has a chance to work is a very important part of where this process should end up. The steps to take right now can only be judged by people who live in South Africa, but it may well be that just restoring GDP growth is the first priority and that this will help build a stronger public sector, create more momentum for reform, and you can then start to create jobs for the excluded. I don't know what sequencing South Africa should follow, but as long as we can agree that success is when everyone, especially a young person, has a chance to make the transition from school to productive employment, then I am quite willing to recognise that the reform path that gets us to that goal might have to start with addressing other problems first.

Ann Bernstein: You have done a lot of work on the pandemic. You are the person who coined the phrase "a crisis

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is a terrible thing to waste" – although it was then appropriated. My final question to you is what you think we should be doing about Covid-19. Are there any opportunities here?

Paul Romer: Sometimes, as with the pandemic, a crisis is best thought of as a tragedy, I don't see much upside that we can take out of this experience. Sometimes a crisis is just a crisis; it is not an opportunity.

We have been stuck with a trade-off in this pandemic between either sacrificing lives or sacrificing livelihoods. In the US, the states controlled by Republicans, who tried to restore livelihoods more quickly, were able to have a faster recovery in terms of employment, but it came at the expense of more deaths and rapid spread of the virus. The way to escape from this terrible situation is to make the fiscal resources available for massive testing. If we did so, we could find a way forward where we could get people who have tested negative back to work and protect them from the spread of the virus. It is an investment where we can calculate the return – one dollar spent on testing will lead to 10 dollars return on economic activity – and so we surely want to spend that dollar to get the 10-dollar payoff.

Ann Bernstein: Thanks for talking to me and for sharing your wisdom with us, Paul. You have opened up a whole lot of issues for us to discuss and debate.

Paul Romer: Ann, thank you for engaging with me so effectively. I don't know if there is anybody from whom I've learnt as much and who has been as provocative for me in thinking about issues as you have been, so I owe you a huge debt of gratitude. Despite the setbacks the world has faced on support for truth and science, and despite the slow progress that we make in public policy, I think of you and I feel that I've never done enough to keep pushing forward in good cheer to make this a better world.

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