Michael Spence

in conversation with
Ann Bernstein

Democracy | Markets | Development
A South African resource influencing policy for over 25 years

To mark 25 years since its establishment, in November 2020 CDE initiated a series of discussions with global experts and prominent individuals in South Africa on important questions on democracy, business, markets, and development. The series was relaunched in 2022 as CDE Conversations. This was the 24th event in the series.

Ann Bernstein: It's my great privilege to welcome Michael Spence, Nobel Prize winner, and former head of the Stanford Business School. He also chaired the Global Commission on Growth and Development, which was sponsored by several national governments and the World Bank. Michael, thank you very much for joining us today.

What was the Global Commission on Growth and Development, why was it important, and perhaps a bit unusual?

Michael Spence: The so-called Growth Commission started work in 2006, roughly 15 years after the much-maligned Washington Consensus was published. One goal of the Commission was to take the debate beyond the Washington Consensus, which had its limits, but definitely did not deserve the beating it has taken.

The Commission was led by two economists – Robert Solow and me – supported by a team of economists and advisors. The commissioners who worked with us were mainly prominent people from the developing world – like Trevor Manuel – who held important policy making positions in their governments, as well as business leaders and policymakers from developed countries.

The hands-on experience of most commissioners was the definitive part of the Growth Commission. Our assignment was to collect the lessons from the experience of the 13 economies that since 1950 had grown at an average rate of 7 percent per year or more, for 25 years or longer. At the rate that they grew, those economies were able to nearly double in size every decade.

We wanted to use those lessons to inform the thinking and actions of the next generation of leaders, policymakers and businesspeople in the developing world.

Some of the thinking in our report is now dated. We knew global warming was coming, but we did not give it the prominence it deserves. We also did not fully grasp the full impact the digital transformation would have. And we definitely did not predict the fragmentation and partial falling apart of the global order that happened after we disbanded the commission.

Ann Bernstein: What were the key insights and recommendations, in your view, that are worth preserving? Where did you end up?

Michael Spence: All high growth countries leverage the global economy and global technologies. If you take those away, you take away any prospect of growing at high speed. If a country relies on domestic demand and fails to adapt technologies from elsewhere it may generate some growth, but it will never emulate the success of the post-war high growth countries.

The growth commissioners

Montek Singh Ahluwalia (India), Minister of Planning

Edmar Bacha (Brazil), board member of Banco Itau, former President of the National Bank for Economic and Social Development

Dr. Boediono (Indonesia), Coordinating Minister for Economic Affairs

Kemal Dervis (Turkey), Administrator of the United Nations Development Programme, former Minister of Finance of Turkey

Alejandro Foxley, (Chile), Minister of Foreign Affairs

Han Duck-Soo (Korea), Chairman of the Presidential Committee on Facilitating KORUS FTA Finalization

Goh Chok Tong (Singapore), Senior Minister and Chairman of the Monetary Authority of Singapore

Pablo Kuczynski (Peru), Former Prime Minister

Trevor Manuel (South Africa), Minister of Finance

Mahmoud Mohieldin (Egypt), Minister of Investment

Ngozi N. Okonjo-Iweala (Nigeria), Managing Director, World Bank

Sir K. Dwight Venner (Saint Kitts and Nevis, West Indies), Governor of the Eastern Caribbean Bank

Ernesto Zedillo (Mexico), Director of the Yale Center Study of Globalization, former President of Mexico

Zhou Xiaochuan (China), Governor of the People's Bank of China

Lord John Browne (Great Britain), former CEO of British Petroleum

Danuta Huebner (Poland), Member of the European Commission

Carin Jaemtin (Sweden), Former Minister for International Development Cooperation

Danny Leipziger (USA), Vice President of the Poverty Reduction and Economic Management Network at the World Bank PREM

Robert Rubin (USA), Director, Citigroup, former Secretary of the US Treasury

Hiroshi Watanabe (Japan), President and CEO of the Japan Bank for International Cooperation (JBIC)

Another fairly obvious universal insight is that without the required investment rates high growth cannot happen. We found that you need to invest about 25 percent or more of GDP to get the kind of high, sustained growth that most of our 13 countries achieved. Without those kinds of rates, you may get growth spurts, but growth will not be sustained. Further, while it is possible to have various kinds of mixes between private and public investment, at least 20 percent of investment has to be public sector investment into public goods the private returns of which are not even close to the social returns that they can generate.

A very important insight that economists tend to ignore is that countries stuck in a low growth equilibrium require strong and visionary leadership to push through the reforms required to initiate a dynamic growth process.

To get out of the kinds of situations in which countries like Singapore, South Korea, China and others found themselves before they became high growth countries requires fairly dramatic shifts driven by determined leaders who have a vision and are able to articulate that vision and change expectations about what is possible. If those expectations do not change, then investment behaviour will not change, and growth cannot take off. The

commissioner from Singapore pushed that issue to the forefront, and it was a real eye opener for me. We ended up producing a collection of essays on that topic.

Ann Bernstein: That is very interesting, because a lot of people come up with advice on what to do. But they minimize the political changes required to get growth going. Growth experts very seldom talk about leadership in the way that you have.

Michael Spence: One reason for that is because it is hard to measure the contribution of leadership, and this generation of economists places a lot of weight on measurement. Nevertheless, following especially the work of Daron Acemoglu and James Robinson, economists are more than ever straying into the political economy side of things, and that is a good thing.

Ann Bernstein: Do you think the Commission had a lot of impact? What is your impression of this?

Michael Spence: When we, in a classic example of bad timing, published our main report *The Growth Report: Strategies for Sustained Growth and Inclusive Development* in the spring of 2008, it was promptly followed by the worst financial crisis since the 1930s. That was not helpful for drawing attention to our report. The focus shifted from global growth to dealing with a global recession. What is encouraging, though, is that our report is showing signs of having a reasonably long shelf life. There are people who have engaged seriously with the report over the years, and, judging from feedback I have received, are continuing to find insights from the report that remain relevant in today's context. I feel the growth report has left a legacy, but it needs updating for sure.

Ann Bernstein: Is there anything else that you want to highlight from your engagement with the 13 countries that achieved 7 percent growth over a sustained period?

Michael Spence: One interesting story, which highlights the challenges of measuring growth consistently across the globe, is how we came to 13 countries. We initially started with 12, but then our Brazilian colleagues convinced us that Brazil qualified, which led us to 13 countries. However, years later, it emerged that the calculations for Brazil were inaccurate, and it should really have been only 12 countries that grew at 7 percent over 25 years since 1950.

Another controversy is the charge that we based our study on a 'biased sample'. Of course, the sample was biased, by design. We could have spent a lot of time documenting disasters at the country level, but we did not think that would be particularly helpful. What we were curious about was whether there were common features to be found in the successful countries, and we pursued that question empirically. We were not trying to make statistical findings about our 13 countries in relation to a broader sample.

Ann Bernstein: One of the things that was unusual about your report was the section where you detailed what countries should avoid doing if they wanted growth. Can you tell us where that came from?

Michael Spence: The section was Montek Singh Ahluwalia's idea, one of your previous guests, a good friend of both yours and mine. Montek put it this way: "Policymaking in a developing country context happens amidst high levels of uncertainty." He pointed out that that means that policymakers really have two jobs. The one is to find and try to implement good policies for growth, and that is the job growth experts talk about all the time. But the second one is that you have to confront a lot of bad ideas that are proposed by various people and groups, and you have to be able to identify them, and stop them before they can be implemented.

To tackle that section of our report, we asked the commissioners and others to think about the two or three worst ideas they had seen. The worst idea was probably subsidising energy fossil fuels. It is very tempting because it does not involve any actual government expenditure. Instead, governments just tell oil companies to sell their product at below market prices. That subsidy benefits the middle classes, who use much more fuel than the poor. What governments should be doing instead is either allowing oil/gasoline to be sold at market prices, or they should be taxing it. Then they could collect the revenue and invest it in stuff that is actually important, like education and infrastructure. Even worse, in the longer term, a fossil fuel subsidy leads to the emergence of infrastructure that is mismatched for a world facing climate change, which means that the subsidy has put countries on an unsustainable path. This bad policy, therefore, has much deeper impacts than just screwing up current resource allocations. It really sets countries off on the wrong path and will create big challenges for years to come.

Ann Bernstein: Give us a flavour of some of what you would look at today that you didn't look at then; what's changed since the Growth Commission ended?

Michael Spence: A lot of things have changed. When we started work, the high growth countries looked like exceptions rather than the rule. But now, as a result of quite a few successful growth episodes, many more people are living in middle-income countries. That means the big challenge now is how to avoid the 'middle-income trap'. To get out of that, countries have to change their investment patterns, they have to face complex challenges like upgrading their science and technology and human capital levels. In many ways dealing with those is just as difficult, and sometimes harder, than getting a country out of poverty. We definitely should not forget about low-income countries that have not started the growth process, but the development challenge of moving through the middle-income phase is now much more prominent than it was when we published our report.

When we started work it was impossible to predict the magnitude and the many dimensions of the digital revolution. At that time, the iPhone had just come out. The notion of building economies on digital foundations did not yet exist. Many non-resource rich countries have grown by connecting to the global economy through comparative advantage in labour-intensive manufacturing. Sometime in the future digital technology will displace that option and robotics will take over. That is not yet the case, and the challenges of expanding robotics to all sorts of manufacturing processes are bigger than many of us thought. Nevertheless, there is a question about whether the kind of power that labour-intensive export production has had will continue in the future. The possibilities for adopting and benefiting from the so-called Asian growth model could be receding.

Ann Bernstein: My big question, then, is whether inclusive growth is still possible in the 21st century? You said that the manufacturing for export option, the so-called East Asian model, is still available and we shouldn't give up on it yet. Can you talk a bit about that?

Michael Spence: The first part of the inclusive growth process is for poor countries to get to the $10,000 per capita income mark, and the common starting point has been the adoption of labour-intensive manufacturing and assembly for export, and then, when you get there, you move into other, more productive activities, and other countries take over the low-skilled activities. In Asia this baton passing has been going on since World War II – from Japan to South Korea and Taiwan to Indonesia, and then to China, and more recently Bangladesh and Vietnam. That process is, in principle, still possible.

At the same time, there are new dimensions linked to the expansion of the digital economy with positive implications for growth and inclusion. There has been a global explosion of entrepreneurial activity in the digital space. On every continent new entrepreneurs are solving local problems with different kinds of digital

applications. For example, Amazon's online shopping model does not work well in India because the retail sector there is really fragmented. Local entrepreneurs have generated solutions that are much more appropriate for the Indian economy. Similarly, in Africa e-commerce, fintech and money transfer applications have reached people who have been underserved by traditional delivery modes. Across the world digital entrepreneurs are bringing previously excluded people into the economy at a faster rate than ever before.

Back in India, these technologies have produced a biometric identification system and a universal payments interface that benefits the mostly rural people who had neither identification documents nor an effective way to receive transfers and other payments. They now have access to mobile banking and, thanks to an explosion of mobile internet users, they can now participate in the economy in ways that were unimaginable before the digital revolution.

Finally, on the academic side, there is now a massive amount of really good research from Thomas Piketty, Emmanuel Saez, Raj Chetty, Gabriel Zucman and others on distributional issues, which allows us to think more clearly about how to spread the benefits of growth and include as many people as possible in developed and developing countries.

Ann Bernstein: Let me turn to a different question. You have said that there is no chance of inclusive growth if many non-tradable sectors remain productivity backwaters. What do you mean, and what can be done about this?

Michael Spence: Ten years ago, South African researcher Sandile Hlatshwayo and I wrote a paper that tracked the structure of the American economy from 1990 to 2010. It examined where we generate employment and which sectors generate increased productivity/value-add. We divided the economy into the tradable sector (goods and services that *can* be traded internationally) and the sector where goods and services cannot be traded. We found that productivity in the tradable sector is almost three times higher than in the non-tradable sector.

This is important because almost 80 percent of employment in the US economy is in non-tradable sectors. Government, health care, hospitality, traditional retail and construction alone generate 45 percent of employment. These are all sectors marked by, on average, low productivity, low income and low growth. Currently many of these sectors are experiencing labour shortages in the wake of Covid-19 because people do not want to work in those types of jobs. So, if the US economy is to become less unequal and more inclusive we have to find ways to raise the productivity and income levels in non-tradable sectors. Productivity increases that only impact tradeable sectors cannot compensate for the low incomes and lack of dynamism in non-tradeable sectors.

Ann Bernstein: Let's talk about the digital revolution and how that could contribute to raising productivity across the economy.

Michael Spence: Until now technology and globalisation have had the effect of shifting manufacturing jobs to developing countries and increasing income inequality in developed countries like the US. The consensus is that more than 10 million middle to high income manufacturing jobs were destroyed in the US as a consequence of the rise of China and other manufacturing centres. Those developments contributed to rising inequality in the US because they took out a big chunk out of the middle of the income distribution.

Now the development of artificial intelligence (AI) may be having different effects. The recent advances in AI have in fact been in creative and knowledge economy sectors. There are still many challenges with respect to this kind of AI, one of which is that it can become too creative and generate much more fake news and fantasies as fact than humans can.

A recent *New York Times* article described a lawyer who used ChatGPT to file a suit on behalf of a client against an airline. The AI app produced a report that cited about 10 relevant legal cases, none of which was real, and the lawyer is now in serious trouble. Bard, a conversational AI chatbot developed by Google, was given the task of explain inflation, and it did a pretty good job. Unfortunately, at the end of the talk, it offered five books and articles for further reading with very plausible sounding titles. Those did not exist either. The chatbot just made them up.

Nevertheless, in spite of these challenges, AI developments will have a broad impact across the knowledge economy and will likely raise productivity levels in unexpected ways while also causing quite a lot of turbulence. Nurses, for example, have to interpret a lot of information and one can imagine developing digital assistance applications for them that will make them more productive.

The existence of some knowledge economy professions is probably under threat. Copy editing for advertising, for example, may no longer be available as a career for the next generation. At the same time, as long as we manage the development of the technologies and regulate the downsides as much as possible, the revolution in digital technologies and biomedical science should have the effect of broadly raising productivity, while also improving people's health and well-being. There is a reasonable chance that we will get a productivity surge in many lagging sectors.

A good way to illustrate the point is to think about a London taxi driver before and after Google Maps. Before the technology, specialised cabbies spent five years learning all the streets of London, but now everyone has Google Maps, which makes all the street names available to everyone with a phone and has the ability to plot the quickest route from point A to B. That does not mean that everyone is now at the same level as a highly experienced, knowledgeable taxi driver, but the difference between drivers is hugely reduced, which adds up to a highly inclusive productivity surge benefitting a broad swathe of people.

Ann Bernstein: I want to take you back to what emerged as a side project of the Growth Commission, which is the role that leadership can play in steering a developing country through a complex world with a lot of unknowns. You mentioned that it is important for leaders to build consensus in favour of a viable growth strategy, and any strategy needs sufficient time to develop, because you have to amend it as you go along, and you have to take people with you on the journey. Tell us more about leadership and growth.

Michael Spence: Firstly, it is usually not enough to have a strong individual leader. To be successful you need a team working with and in support of the leader's vision. And then, in a context where a large group of powerful people are pursuing goals that contradict the long run, best interests of the public, i.e., their primarily loyalty is to a smaller group or region and/or they are focussed on stealing resources rather than developing the country, leadership may not be enough.

In any event, leadership is very demanding. Political leaders have to operate in a world where it is difficult to know how things are actually going and what causes what. In such uncertain contexts leaders need to be ready to experiment, to communicate the goals of these experiments, to explain failures and to build on the unexpected successes. The private sector finds it much easier to pursue such experimental approaches, and to deal with failure. In the public sector it is, by contrast, often the case that politicians will get penalised badly if they fail.

Leaders have to say to the people who are developing and trying out policies and those who are affected by them that, "We don't expect all these things to work, what we're doing is trying to find out what does work." And that narrative has to be couched in a context of: "This is the vision we have, we think it's feasible. We are not taking our cues from a detailed 200-page strategy document where everything is worked out, but we have a strategy and

it is plausible." And while you are doing all that you have to overcome lots of internal bickering, which is always challenging.

The situation that leaders often find themselves in is that the mostly likely next outcome is worse and more unstable than the current low-growth equilibrium. The task is to somehow to hop over the unstable scenario and get onto a path where very different expectations and investment behaviours are possible. Unless you can convince people that that is possible and is starting to happen, then you will end up stuck in the more unstable and difficult equilibrium. The toughest challenges for leaders are therefore to be found at the start of the journey.

Once you start to succeed it is easier to convince people that this strategy is going to work, but at the start you do not have a track record to lean on and you have to rely entirely on your persuasive powers. That type of persuasion is vitally important, but we must not make the mistake to think that a growth strategy that is fundamentally flawed is ever going to work. No amount of persuasive powers will ever overcome following a strategy that does not work. You need to start with a strategy based on core principles that give it a chance of succeeding. Then you need some good luck, and then leadership can be the determining factor that decides whether a country ultimately succeeds or fails.

Ann Bernstein: You made this comment that I think follows from this – which will be familiar to South Africans – that if you want growth, you can't just have a list of reforms; you need a strategy and an agenda. In my view, South Africa's President has a list that he is trying to implement, but we are going backwards rather than forwards in most respects, and that is partly because we do not have a clear, workable strategy.

Michael Spence: Any strategy will be made up of various components, and you can list them. But the key to an effective strategy is that it is coherent. A workable list will be more than the sum of its parts because of the way the separate components interact with each other. As economists put it, if one component is a complement to another, then if you do that one you get more of the other. For example, public sector investments should not be conceived as ends in themselves but should mostly be seen as important complements to private sector investment. If they are done right, they will raise the return to private investment, and that will then unleash much more growth, opportunities and benefits.

Think of the Washington Consensus. That was actually a very good list and John Williamson has been subjected to a lot of unfair criticism for coming up with it. The problem was firstly that it was oversold as a universal development strategy, which is encapsulated in the term "Washington Consensus". Williamson has often said he regrets that this term came to be associated with the remedies he compiled. At the same time, the problems that emerged were also attributable to governments treating the "Washington Consensus" like an à la carte menu. They cherrypicked the bits of the list they liked and ignored the ones they didn't like. These choices were often made on ideological grounds, and they ensured that countries would not get the benefits from complementarities built into the list, or would keep practices in place that completely contradicted the parts of the list that they did implement.

That was one of the criticisms we confronted after we published the Growth Report. Critics said, "All the strategies you highlighted are context-specific and you did not deal with that. You just produced a list of things for countries to consider." I agree that all strategies need to be context-specific to be effective, but that does not mean that all we did was produce a menu of things to consider. That ignores the ways in which the elements of the Growth Commission's list complement one another. That has to be taken into account when putting together a workable growth strategy, in my opinion.

Ann Bernstein: I'm afraid we've come to the end of what has been a fascinating conversation. We've ranged far and wide and I've certainly learned a great deal more about your thinking, the Growth Commission and about the digital world that we are moving towards. Thank you very much. Michael. We really appreciate your spending time with us. Hopefully you will get to spend more time on engaging with South Africa's challenges.

Michael Spence: I hope so, too. Thank you, Ann; it was a pleasure being with you again.

CDE Conversations

For recordings and publications of previous conversations

Paul Romer on "Work as school": Jobs in developing countries, watch here or read here
Montek Singh Ahluwalia on Reform and India's high growth years, watch here or read here
Francis Fukuyama on Populism after Trump, watch here or read here
Martin Wolf on The crisis of democratic capitalism, watch here or read here
Sir Paul Collier on Capitalism and the poor: Why Africa needs more firms, watch here or read here
Lant Pritchett on Schooling ain't learning, watch here or read here
Trevor Manuel on South Africa and the next five years, watch here or read here
Sir Jeffrey Jowell on Can countries succeed without the rule of law, watch here or read here
Mavuso Msimang on Corruption and cadre deployment, watch here or read here
Ed Glaeser on Capitalism, Covid and the future of cities, watch here or read here
Nancy Birdsall on Does the middle class matter in a developing country, watch here or read here
Lesetja Kganyago on The economy, jobs and growth, watch here or read here
Sir Mick Davis on Business, politics, and society, watch here or read here
Sir Michael Barber on Delivery: From talk to action, watch here or read here
Kgalema Motlanthe on South Africa in the next five years, watch here or read here
Francis Fukuyama on War in Europe and its Implications, watch here or read here
Andres Velasco on Growth, democracy and the fight against poverty, watch here or read here
Dr Ngozi Okonjo-Iweala | A global reformer: fighting corruption, promoting world trade, watch here or read here
Arvind Panagariya on Growth and inclusion in India, watch here or read here
Reuel Khoza on Leadership in South Africa, watch here or read here
Edward Luce on Can things get any worse in America? watch here or read here
Lawrence H. Summers on Are we heading for a global economic slowdown? watch here or read here
Moisés Naím on The 21st Century: Renaissance of autocracy, watch here or read here.
Michael Spence on Is inclusive growth still possible, watch here.

For information about forthcoming events see here
See www.cde.org.za for more information about the CDE Conversations series.

CDE Board: R Jardine (chairman), A Bernstein (executive director), A Ball, C Coovadia, B Figaji, S Maseko, M Morobe, I Mkhabela, M Nkosi, S Nkosi, S Ridley
CDE Patron: L Dippenaar

Published in July 2023 by The Centre for Development and Enterprise
5 Eton Road, Parktown, Johannesburg 2193, South Africa | PO Box 72445, Parkview, 2122
Tel +27 11 482 5140 | info@cde.org.za | www.cde.org.za