

# A New Economy: Growth, Social Development, and Equity

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# I. Major changes in the global economy—with large effects on all countries

- **Global warming** and the response to it: moving to a carbon-free economy
- The **demographic transition**: moving toward a stable population
  - With some large imbalances—Africa major source of global population growth
  - Giving rise to **migration pressures**
- The move from a **manufacturing economy to a service- and knowledge-based economy**
  - With some economies having to do a “double” transition—from agriculture
  - Associated shift from rural to urban

# I. Major changes in the global economy—with large effects on all countries

- The challenge of **robotization and AI**
  - Will there be enough **jobs**?
- Rethinking **globalization**
  - Reconstructing a world where borders matter?
- The challenge of **inequality**
  - Can there be political and social stability with ever increasing levels of inequality?

# Markets on their own won't manage these transitions well

- There will be a need for collective (public) action
  - To make necessary investments in the “new” economy
- But political processes often get captured by special interests
  - Those who are well-off because of their success in rent-seeking wish to maintain rents and existing inequalities
  - Those who see themselves as losing will use political processes to fight change
    - Helping coal miners rather than renewable energy
    - Focusing on old industries rather than new

# Markets on their own won't manage these transitions well

- Those countries that manage to find a way of adapting to and promoting change with benefits of growth widely shared are likely to be most successful
  - Scandinavian model vs. US
    - Where large fractions of population are worse off than they were a third of a century ago
  - China over the past third of a century

# New economy will present some big challenges

- New technology industries dominated by five American firms
  - Both natural and man-made **barriers to entry**
  - Giving rise to **large rents**—contributing to **inequality**
  - Huge fraction of **increase in stock market value**
  - In spite of large capitalizations, **limited employment**
  - Europe raising important **competition issues**

# New economy will present some big challenges

- **New technologies** transforming economic structure
  - Online marketing destroying traditional retail sector
- Raising important issues of **transparency and privacy**
  - With discussion being dominated by tech firms themselves
- But much of “business model” based on **advertising—limited long-run growth potential**
- **Distorting innovation process**—pace of increases in real standards of living lower than a century ago (even though we think of the economy as an innovation economy, doesn’t show up in statistics)

# Anti-globalization movement

- Used to be developing countries who thought that the rules of the game were rigged against them
- Now workers in US supported by Trump claim similarly
- US largely wrote rules of globalization: how could they have written it against the interests of the US?
  - The US got most of what it wanted. The problem was with what it wanted.
  - Advanced certain corporate interests
  - Weakened bargaining power of workers
  - Workers are correct: globalization has made them worse off
  - Didn't have to be that way: there were gains to trade. If gains were shared, all could have been made better off.
- Globalization is being blamed for broader societal problems—failure to help ordinary individuals adapt and adjust to changes in technology

# Broken promises

- Most of Trump's promises will be broken
  - High tariffs against Mexico, China
- Repeal of NAFTA, WTO would require acts of Congress
- Would entail unprecedented absence of principles on part of Republican Party
  - NAFTA negotiated by President George W. Bush
  - Open markets central part of traditional Republican platform

# Broken promises

- America has always pursued its self-interest, but it has always pursued an *enlightened self interest*, realizing that economic and political stability of others is in America's interests
  - Trump views the world in zero-sum terms
  - Pursuing his strategies in ways that are negative-sum
  - But globalization, if correctly managed, is positive-sum

# There are consequences

- Even if Trump totally fails in his trade agenda
- The damage is long-term
  - We had been moving towards a world without borders—now we realize that borders do matter
  - Strong implications for structure of global supply chains
  - Countries need to be more careful in relying on others for energy and food

# There are consequences

- American politics may also be “broken”
  - Hard to achieve cooperation, even trust
  - Different groups see the world through totally different lens
  - Even when it is apparent that Trump has lied and won't achieve what he has promised, his supporters—though still a minority—remain committed
  - Cause and consequence: a divided society, marked by a high level of inequality
  - Lessons need to be taken on board by all countries

# Short-run global economic prospects

- The global macro-economy is likely to remain weak—the new mediocre
  - Underlying problem: weaknesses of global aggregate demand
    - Underlying that: austerity in many countries (even in US); growing inequality; persistent eurocrisis; structural reforms throughout the world; and the slowdown in China
    - Repeated signs of a mild strengthening in one country or another—followed by disappointment: pattern is likely to continue

# Short-run global economic prospects

- Consequence is weak global commodity prices—which will affect Colombia
  - But perhaps encouraging it to think about the longer run, when consequences of global warming are more fully taken on board
    - Imperative to devise a green, diversified economy, looking towards the 21<sup>st</sup> century challenges and transformations—strengthening domestic economy, including the construction sector, and ensuring success of the peace process

## II. US experience has important lessons for the rest of the world—including Colombia

- A country ignores the well-being of large fractions of citizens at its own peril
  - Trickle-down economics doesn't work
    - While US GDP grew, large fractions of Americans' incomes declined and job opportunities shrank
    - To the point where even health and life expectancy of the average American began to decline
- **There cannot be sustained economic prosperity unless there is shared prosperity**
- **Excessive inequalities often give rise to political and social divides, that manifest themselves in ways that are deleterious to the functioning of the economy and society**
  - More than a moral issue
  - Equality and economic performance go hand in hand

# *Inequality: one of Colombia's greatest challenges*

- Colombia has long been one of the countries with the highest level of inequality
  - But there is now heightened sensitivity to inequality
  - And to the full economic and social consequences of the lack of equality of income, wealth, and opportunity
  - Highlighted by the fact that the IMF has now put inequality at the center of its attention

# The ever present dangers of the “*resource curse*”

Colombia is lucky to have an abundance of resources.

But in most countries, an abundance of resources has turned into a curse

- Lower economic growth
- More economic instability and frequently political strife
- High level of inequality
  - Latter is especially surprising and disturbing, since resource wealth should be viewed as belonging to the country as a whole, and benefits should be directed at helping those most in need and in promoting overall development
- But these adverse effects are not inevitable: a few countries have managed to ensure that resources are the blessing they should be
  - Problems are largely the result of poor macroeconomic management, a failure to share equitably the benefits of the resources, and a “laziness” in making critical investments
    - A destructive fight to get resource rents
    - Switzerland had no choice but to invest in its people and in technology

# The *peace* settlement presents unprecedented challenges and opportunities

- A long-standing conflict has finally begun to be resolved
  - Peace agreement with FARC has been signed and is being implemented
  - But just starting with ELN
- Such conflicts have enormous political and social consequences
  - Undermining economic growth both in the short run and the long, as well as economic stability
  - With adverse spillover effects on others
  - Colombia's economic strength despite the long period of conflict is truly impressive
- The conflict imposed large adverse economic costs throughout society, and one hopes that ensuring sustained peace will bring an overall peace bonus
  - If matters are managed well, there could be a significant peace dividend
- However, ensuring peace will also impose fiscal costs, which the government must be ready to shoulder and which will present both economic and institutional challenges

# Post-conflict societies

Face not only an economic challenge; also:

- Reintegration of the economy
- Finding employment for those previously engaged in conflict
- Rectifying distortions created by the conflict
- Addressing grievances that contributed to conflict

But also a broader societal challenge

- Restoring trust and a sense of national cohesion

These challenges come on top of some pressing current economic challenges

- But ensuring the investments necessary for the peace process should be given high priority
  - High social, political, and economic returns
  - Could even strengthen macroeconomy
  - Colombia can afford and finance those expenditures

# Multiple other challenges facing Colombia today

- Managing its economy through a changing global economy that is simultaneously going through the *weak phase of a commodity cycle*—a phase that may be prolonged
  - Leading to concerns about current account deficits
  - Highlighting standard problems facing natural resource economies—the resource curse
- Exacerbated by other problems in some of its major trading partners
- Compounded by the threat of a *new era of protectionism*
  - A new level of uncertainty about globalization
- Structural changes in the global economy suggest that the model for development that worked so well for so many countries—export-led growth—may no longer work in the future

# Short-run responses of government

- Colombia had been running **procyclical monetary and fiscal policies**—
  - End of commodity cycle weakening exchange rate,
  - Leading to increased fears of inflation,
  - Leading in turn to higher interest rates;
  - And striving to maintain fiscal balance, government cutbacks have augmented downturn
  - Resource curse economies typically have exchange rate that impedes manufacturing exports
    - Important to keep a stable, real competitive exchange rate
- **Monetary policy now seems to be turning around**
  - But inflation target still seems excessively tight
  - Rethinking about appropriate targets since the global financial crisis

# Fiscal policy: scope for more expansion within constraints

- Fiscal policy has been contractionary
  - Including increase in basic VAT rate
  - Announcement of budget cuts for next year
  - Worry about policy space—given debt levels
- But there is scope for a balanced budget multiplier—an increase in taxes matched by an increase in spending is expansionary
  - Especially if the taxes and expenditures are chosen appropriately
    - Expenditures to implement peace agreement would yield multiple dividends
  - Well-designed tax system could help address problems of inequality
- Contractionary fiscal policy has played a role in Colombia's slow growth

# Colombia's *long-run* economic strategy needs multiple elements

- Old “recipe” for successful development—manufacturing export-led growth—less likely to work in the future
  - Globally, limited growth in manufacturing jobs
  - Countries like Colombia will get a declining share of those jobs

# Colombia's long-run economic strategy needs multiple elements

- May need to combine multiple strategies
  - **Manufacturing**—more directed, more limited, where possible, taking advantage of natural advantage (mineral resources), aimed at *learning*, increasing country's dynamic comparative advantage in high value added activities
  - **Agriculture**—basis of employment, but can be restructured in ways that are more dynamic, with more learning, learning to learn, a kind of transformation *in situ*
  - **Mining and oil**—important for foreign exchange (maximize revenues, taking advantage as much as possible of spillovers)
  - **Services**—will be the growth sector of the future
    - Understand implications
    - Understand how to maximize growth potential
- Government may need to take a more active role if there is to be successful structural transformation

# Multiple responses to new protectionism

- Strengthening current alliances
  - Pacific Alliance
- Creating new trade agreements—South/South
  - Free Trade Area of the Americas
  - Opportunities for comparative advantage and returns to scale
- Strengthening domestic economy
  - Colombia is a large economy and has ample room for growth
- Construction industry is a central part of all of these strategies
  - Infrastructure
  - Housing

# III. Globally, the construction sector has faced many challenges

- Low productivity growth
  - Averaging 1% globally over the past two decades
  - Compared to 2.8% for the global economy
  - And 3.6% for manufacturing
- Numbers partly deceptive
  - Construction an important employer of non-college graduates
  - Marked increase in monopoly rents in many other sectors

# Still, in most countries, there is scope for large increases in productivity

- Large gaps between best and average practices
  - Taking advantage of new technologies, new materials, etc.
- More extensive use of “manufacturing style” construction
  - Especially for low and medium income housing

# Multiple roles of government

- In facilitating **advances in knowledge and sharing of knowledge**
  - Particularly important in industries with a large number of firms
  - Social benefits of research exceed private benefits
- In encouraging **green construction**
  - **Carbon tax** can be an important source of revenue and improve efficiency of the economy
    - And can even provide macro-stimulation, as firms and households retrofit themselves for the green economy
  - Rethinking construction to make it “green” can itself lead to productivity improvements
- In **improving education/skills**
  - Not just inadequate provision of education
  - But education system does not always provide skills needed by today’s market

# Shortages of adequate housing

- Especially important in countries going through process of urbanization
- Addressing housing is particularly important to avoid high inequality
  - Having adequate housing important aspect of well-being
- Housing has to be linked with jobs
  - Public transportation systems/infrastructure crucial
- In many countries, better land management is necessary
  - Zoning
  - Taxes on underutilized land (discouraging speculation)

# 21<sup>st</sup>-century cities

- **Modern city based on a service sector economy** different from 19<sup>th</sup>- and 20<sup>th</sup>-century cities
- Can and should **integrate work and living**
  - Important for limiting carbon emissions
- Can **integrate across income levels**
  - Many societies are increasingly economically segregated
  - Undermines social solidarity, contributes to a divided society, with deep social and economic consequences

# Housing finance

- Lack of finance important impediment in access to housing
- Many countries have failed to create a good system of housing finance
  - Flawed US system led to financial crisis
  - US has still not been able to create a viable housing financial system, more than a decade after the breaking of the bubble
- Needs to be supported by a good public system of recording ownership
  - Absence leads to high costs and unnecessary uncertainty
- Systems for rental ownership can be important where large fractions of population have inadequate wealth for home ownership
  - Can facilitate labor mobility
  - But there are strong arguments in favor of homeownership—helping individuals create the wealth that enables them to be homeowners

# Housing finance

- Growing support for a “public option”
  - Government would provide (at least to all taxpayers) a mortgage at an interest rate slightly higher than the rate at which it can borrow
  - Payment would be income-contingent
  - Collection would be integrated with tax system
  - Interest rate could be variable, but with payment fixed, maturity of loan variable
- Lower transactions cost, better risk management
  - At the heart of mortgage markets are two pieces of information—value of properties and individual’s income
  - At least in many countries, this information is part of government data base
  - Reducing scope for exploitation so evident in run-up to the 2008 crisis

# Construction and the peace process

- Rural housing
- Tertiary roads—important for development of these regions
  - Complementary to other economic activities
- Active construction programs could be an important source of jobs
- Successful rural development program is estimated to need 1.2% of GDP
- Time is important

# Concluding Remarks

- This is a time of true opportunity for Colombia
- But it is also a time of daunting economic challenges
  - Including a “mediocre” global economy
- Addressing the challenges posed by the settlement of the conflict can actually help Colombia weather its way through these challenges
  - If matters are managed well, there could be a significant peace dividend
- The world as a whole is going through a series of crucial transformations
  - As Colombia responds to the short run challenges, it should bear in mind these long-run forces
    - Including moving to a low-carbon economy in response to climate change
    - And the increased awareness of the adverse consequences of inequality

# Concluding Remarks

- Responding to the multiplicity of challenges will require a *different* set of economic and social policies than have often been employed in the past
- It will require a strengthening of public institutions and active government interventions in certain areas
- The construction industry will have to play an important role in the response both to the challenges in the short run and the long run
  - Success will require greater efforts at increasing productivity
  - And improvements in institutions—including those providing finance for housing
- I hope this lecture has provided some insights into what those policies might look like, and the role that the construction sector can play in the future of Colombia