A New Economy: Growth, Social Development, and Equity

Joseph E. Stiglitz
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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 21st 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)
21st-century cities

• Modern city based on a service sector economy different from 19th- and 20th-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