National Transformation Plans: Challenges and Opportunities

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Managing the transformation out of an oil dependent country into a diversified, knowledge based economy

- Transformation is imperative
- But transformation will not be easy
- Weak global economy makes the task particularly difficult
- But there are lessons to be learned from successes and failures elsewhere
  - Failures abound: natural resource curse
  - Successes (in varying degrees): Chile, Norway, Australia, Botswana, Namibia
    - Includes both developing and developed countries
The imperative for transformation

- The price of oil is very volatile
  - But is unlikely to return to anything like the levels of the recent past
- And there is some risk that it could fall significantly
  - Significant increases in energy efficiency
  - With more on the way through improved technology
- Significant reductions in the cost of renewables
  - With more on the way through improved technology
- Likely to be significant “carbon prices” discouraging use of fossil fuels
  - Even with temporary strength of “climate deniers” in US
    - Much of US moving ahead in any case
    - Cross border taxes on high carbon production, a real possibility, would provide further motivation
- Significant increases in potential supply of oil and gas through fracking
Natural Resource economies have not done well

- “Paradox of plenty” “Natural Resource Curse”
- Lower economic growth
  - Partly exchange rate effect
  - Partly consequence of volatility
  - Partly because lower incentives for creating basis of long term success—knowledge and human capital
    - Switzerland and Japan have low resources
- More inequality
- Two linked
Managing volatility

• Sovereign wealth fund
  • Recognizing that unless wealth below the ground is invested above the ground, the country is poorer
  • Should think of resources as an “endowment”—create a permanent fund to sustain prosperity for future generations
  • Question then is what is best way to “invest”
    • In infrastructure, human capital, technology within the country
    • In assets (financial and otherwise) abroad
  • Answer:
    • Diversified strategy, based on “absorption” capacity, risk analysis
    • Investments that promote Learning: central theme of *Creating a Learning Society*
      • At the core of many success cases
    • Attention to macro-economic constraints (fx) and need for employment
Several successful examples

- Norway, Chile, Botswana—now joined by others
  - Including some countries without natural resources (Singapore, in a different form, focusing on retirement, Canada)

- Key elements in success
  - Long term—avoid being driven by short term focus of most financial markets
    - The long term horizon is potential strength of national SWFunds, should drive higher long term returns

- Risk management
  - Counter-cyclical
  - Offsetting natural resource price volatility and long term price risks
  - Diversification

- Professionalism
Investments within country

• Most important: knowledge and human capital
• Norway—even as it created huge sovereign wealth fund, invested heavily in knowledge (Innovation Norway) and in people
  • According to some, investments in women alone yield more revenue today than the return from oil
  • Was able to extend knowledge gathered from oil and gas production to generate returns in other areas
  • Exploiting complex knowledge linkages
  • Recognized limited value of investing more directly in many industries using gas and oil
    • Unless one successfully uses this as a platform for garnering knowledge and skills
    • Much of return accrues to those who control technology
    • Important exception: taking advantage of low gas prices
Societal transformation

- Key is promoting societal transformation
  - Dynamic comparative advantage
  - Taking advantage of other natural advantages (e.g. location, solar energy)
  - In principle, may be easier with a younger population
  - Human capital is the basis of long term wealth of nations
    - Using all of a country’s resources fully
    - Quality as well as “quantity” of education
  - Pace of technological change makes “catching up” increasingly difficult
    - And global transformation make traditional catch up models, e.g. manufacturing export led growth, increasingly questionable
  - The nature of work is changing—and this will necessitate changing societal attitudes (and systems of compensation)
A hard time for global economy

• Global economy’s recovery from 2008 crisis has been very slow
• Persistent problems in deficiency in demand
• Multiple causes
  • Austerity
  • Inequality
  • Pace and nature of technology—job destruction (and fear of job destruction) outpacing job creation
    • Decline in global manufacturing employment
    • End of export led growth model of development
  • Structural transformation—to a service sector economy
    • Both in developed and developing country
    • Markets on their own do not manage such transformation well
    • And austerity has impeded government’s ability
Particular problems in key countries

Europe—euro crisis

- Euro has not worked well—hard to make a single currency work for a diverse set of countries
- Europe did not create institutions that would enable it to work
- Result has been increased divergence, slow growth
- Resulting in turn in undermining the European project, solidarity
- Europe goes from one crisis to next
- Prospects not good
European crisis

• Economic policies have brought on recessions and depressions, and increased inequality
  • But hard to change: dominant powers who have imposed policies do not accept responsibility for what has happened

• What is needed is structural reform in the design of the euro
  • Not so much structural reform in the individual countries
    • Though in all countries there is room for improvement

• Question is: what are the desirable structural reforms?
  • Many of those that were pushed in the name of the Washington Consensus were counterproductive
  • Many of those imposed on euro-crisis countries by Troika have been counterproductive
China

• Has been engine of global growth in years after 2008 crisis

• But growth has slowed down markedly
  • Partly a result of weak global aggregate demand
  • Partly a result of difficulty in moving from export led growth to domestically demand driven economy
  • Partly a result of difficulties China faces as it moves into the next stage of its transition to a market economy—including macro-management
    • Away from export led growth towards a domestically driven demand
    • Away from manufacturing towards a service sector economy
    • Surplus labor being eliminated
    • Environmental constraints becoming binding
    • Less opportunities for catch up vs. increased abilities to catch up
  • Partly a result of political challenges

• Difficulties evidenced in a series of bubbles, controversies over supply side vs. demand side “reforms”

• China’s slowdown is having global repercussions
United States

- While performance has been better than that of Europe, still much weaker than before the crisis
  - Hidden unemployment
  - Low employment rate
  - Contributed to growing inequality
  - Some of this attributable to changing demographics
  - But much of it is attributable to weak aggregate demand
Europe has performed much more poorly than the US—even though the crisis originated in US
Trump presidency

• The only thing that is certain is that there will be a high level of uncertainty and volatility—both economically and politically

• Tax cuts for the top and infrastructure programs will provide some stimulus

• But bang for buck will be low
  • Too focused on very top
  • Infrastructure likely to entail privatization of existing assets
  • And financed through tax credit
  • Costly, given that government can borrow at close to zero real interest rate

• Likely resulting deficit may eventually generate anxieties
Offsetting effects

• Increases in interest rates
  • With consequent effect on exchange rate
  • Appreciation of the dollar will have unsettling effects for banks with large fx exposure
  • Some evidence of negative correlation between value of US dollar and commodities prices

• Trade tensions—or even a trade war

• Possible geo-political tensions

• Political uncertainty

• Potential increases in inequality—worsening one of country’s most serious problems
  • Likelihood is that “rustbelt” unemployment will increase

• Hostility with academics, Silicon valley
  • Technology source of US growth—Trump brings mindset of a real estate developer doing “deals” cheating suppliers, deceiving customers, constant renegotiation, repeatedly going bankrupt
    • Hostility towards science
  • Not the mindset required for running a successful knowledge based economy
On balance?

• Most likely growth continuing at tepid pace—or even slowing
  • Balance on Fed shifting towards significant rate increases

• US growth too tepid to offset weaknesses in China, Europe and elsewhere
Not the easiest time to set forth on a dramatic economic transformation

- But these global problems make such a transformation all the more imperative
- Delay has already proven very costly
- Successful transformation will require deep transformation not just of economy but of society
- Most successful economies entail high degree of decentralization
- With markets, civil society, and government all playing key roles
- Complementary roles
- Especially important in innovative/knowledge economies
- Saudi Arabia has been blessed with an abundance of natural resources
- The challenge is to ensure that these resources become the basis of sustainable growth for this and all future generations