

# **Recent transformations in the Global Economy and its consequences for economic and social development**

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December 2016

# Outline

- The recent evolution of beliefs system about what makes for a good economy in the US and elsewhere
- The recent technological transformations
- Recent international political changes
- Impact of these processes for development strategies in Latin America and the Caribbean

# A brief history of the recent evolution of beliefs systems

- 1989-2008: “Golden Age” of American Style Capitalism
  - Washington Consensus neoliberal policies led to massive failures in the developing world
  - Led to more social exclusion, poverty, inequality, and did not increase growth
- 2008-2016: Increasing recognition that unfettered financial markets are dysfunctional, neoliberal agenda failed
  - Example: The IMF recognizes the desirability of capital controls; importance of equality for economic performance
  - Still deep problems of global governance that threaten the functioning of globalization
- 2016: Trump, Brexit
  - Political consequences of neoliberalism’s failure become evident

# Recent technological transformations

- Large changes in modes of production as consequence of “digital revolution” —including lower communication costs
- Increases in productive fragmentation
  - Production chains are more dependent on a larger variety of intermediate inputs
  - Supply chains structured so profits accrue in advanced countries

# Recent advances

- Manufacturing technologies
  - Robotics, automation, 3D printing
- Energy technologies
  - New forms of fossil fuels, alternative energy sources
- Biotechnologies
  - Genetics applications, use of big data
- Information technologies
  - Hard to measure value of some of them as for instance social media
- Finance technologies
  - Reduce transaction costs, although much of this savings has not been passed on to consumers
- Transportation technologies
  - Drones, intelligent cars

# Technological progress and the challenges for development

- In the new context, it is more difficult to promote technological progress with job creation
  - Declining global employment in manufacturing
  - East Asia export led growth model may no longer work as well

# Conditions for “healthy” social and economic development

Three conditions for a development strategy:

1) Macroeconomic consistency

2) Full employment

- Development strategies entail an interdependence between demographic-educational structure and the structure of production

3) Technological progress

# Development strategies in the current era

- There are trade-offs among those 3 conditions
- Some sectors create jobs for the less educated population but do not foster technological progress
- Some sectors are competitive but do not create many jobs or technological progress, or have limited spillovers (as for instance the extraction of natural resources)
- Some sectors create technological progress but “learning” takes time
  - May not be able to compete internationally until they learn enough
  - Production may require imports, which threatens macro consistency until learning makes the sector competitive
  - May create jobs but likely intensive in more educated workers, not resolving the problem of market inclusion for less educated workers

# Development strategies in the current era

- Recent technological transformations exacerbate trade-offs
- Development strategies of the past cannot be replicated today
- Labor costs are becoming less important
- Example: Adidas announced it will move first factory from China to Baviera in 2017
  - Can produce shoes with no people (just a few to supervise the robots), not even for sewing or painting them (robotization + 3D printing replace humans)

# Development strategies in the current era

- These changes do not mean that developing countries can afford not having industrial sectors
  - Especially necessary for job creation in countries with large endowments of “less-skilled” labor
  - Not only direct creation of jobs, but also indirect creation through multipliers that increase demand for services intensive in less-skilled labor
- Trade-off between social and economic returns: one dollar invested in sectors with dynamic comparative advantage may bring larger “efficiency” gains than one dollar invested in other sectors
  - Of course, inclusion also has large dynamic gains

# Recent development performance in Latin America

- In the 1990s, we could identify a few key policy mistakes
  - Development strategy based on Chicago school insights was a total failure
- Is there a corresponding set of mistakes in the last decade?
- The record of the last decade is mixed:
  - More social inclusion
  - Not good record in terms of diversification of economic structure
    - Most Latin American economies are still highly reliant on exports of commodities
    - Countries did not use the commodity boom (mostly from Chinese demand) as an opportunity to make necessary reforms

# Latin American performance over the previous decade

- Sharp reduction in indebtedness
- Accumulation of foreign exchange reserves
- Improvements in human development due to increases in Social Spending/GDP
- Improvements in labor markets
  - Regional unemployment fell from 11.3 percent in 2003 to 6.2 percent in 2013 (ECLAC)
  - Employment in the informal sector went from 48.3 percent of total employment in 2002 to 44 percent in 2014
  - The portion of the population aged 15 to 64 with jobs increased by 4.6 percentage points
- Improvements in income distribution in most countries
- Increase in the size of the middle class from 2002 to 2014
  - Proportion of people living on incomes between \$10 and \$50 a day grew from 23 percent to 34 percent of the population
- Strengthening of democracies

# The current scenario in Latin America

- But those signs of progress are now being reversed
- We are observing a growth slowdown
- Decreases in investment, increases in public debt, and slow reversion in poverty and inequality trends
- In Brazil, a weakening of democracy
- Explanatory factors:
  - Insufficient reforms during the boom
  - In some cases, macroeconomic mismanagement (Venezuela, and to a lesser extent Argentina)
  - Reaction to disappointment in economic expectations, political “failure” (corruption, attempts at aggrandizement of power)

# The current scenario in Latin America

- The benefits of the positive terms of trade were particularly strong for energy and mineral-exporting economies (Venezuela, Chile, Bolivia, Peru, Colombia, and Ecuador), followed by the major agricultural exporters (Argentina and Brazil)
- In contrast, oil-importing countries were hurt, notably those in Central America and the Caribbean
- Fall in non-oil commodity prices since 2012 and in oil prices since second half of 2014 reversed the situation
  - The new losers are the energy and mineral-exporting economies, while Central American countries are the new winners
- The economic slowdown in China explains the end of the commodity boom

# Capacity for macro policies in Latin America

- The region is less able than it was in 2008 and 2009 to manage adverse external shocks
  - Because of rising external imbalances (which in some cases led to falling foreign reserves) and in some cases rising inflation; in some countries the capacity for monetary policy is more limited today than in 2008, when the global financial crisis started
- Most of the countries of the region have switched from running primary fiscal surpluses to deficits, which may limit capacity for expansionary fiscal policies

# Lessons for Development

- The long-term strategy must place technological change, learning, and inclusion through job creation *for every group* at the center
  - It also needs to ensure macro consistency, which requires a balanced strategy that includes traditional activities that generate revenues in foreign currency
    - Approaches that relied on the market, that were the rule in the 1980s and 1990s, did not work
    - We now have a better theoretical and empirical understandings of these failures

# Instruments for an inclusive development strategy

- Macro instrument: Competitive and Stable Real Exchange Rate Policies
- Must be accompanied by **Learning and Industrial Policies** and **public investments**
  - And monetary policies that don't stifle the real sector
  - Development Banks to support public and private investment
- Need for better education as part of the strategy
  - The strategy needs to ensure there are no bottlenecks in the supply of well-trained workers
    - Requires active state interventions: markets do not resolve these problems properly
- Need for update of infrastructure: investment in electricity, highways, ports, and airports
- Balanced sectoral policies
  - Service sector as well as manufacturing
  - In some countries, support for agriculture

# Structural Transformation

- **All countries are in need of Structural transformation**
  - In advanced countries, in response to technology and globalization
    - From manufacturing to service sector
  - In China, from export led growth to domestic demand driven growth
    - From quantity to quality
  - In all countries—in response to need to address problems of climate change (both mitigation and adaptation)
  - In natural resource economies—to diversify away from dependence on natural resources

# The timing of structural transformation

- But demographic-educational structures change slowly
  - A development strategy must provide the conditions for human development for the population the society has *today*
  - Therefore, inclusive strategies for structural transformation may need to be accompanied by protected low productivity jobs, at least until the labor force is re-trained
  - More generally, objectives must be broad: not just GDP, but also environment, equality, employment, economic diversification

# Learning and Industrial Policies

- Industrial policy: actions that aim to alter the allocation of resources (or the choice of technology) from what the market would bring about
  - Not confined to industry but also to policies aimed at other sectors e.g. finance or IT and agriculture
  - Could more generally be called “Productive Policies”
- Industrial policies were central to almost all countries that “caught-up” with the technological frontier and became developed
  - The most famous examples are East Asian “**developmental states**”
- Play an important role even in advanced countries
  - *Entrepreneurial State*
  - SME lending

# Learning and Industrial Policies

- Learning and industrial policies target the dynamic capacities of the economy
  - Allocating a given amount of resources in a way that is consistent with *static* efficiency, as desirable as it may seem, may actually impede development and growth
  - These and associated societal transformation depend on **learning**, in all its forms—including *closing the knowledge gap that separates developing and developed countries and learning to learn*
- Possible conflict between policies that enhance static efficiency and those that contribute to learning
  - Striking the right balance is at the core of success
  - Neoliberal Washington Consensus policies paid no attention to learning, seemingly unaware of the potential conflict, and thus failed to strike the right balance

# Policies in a new global environment

- Current economic and political conditions foster global instability

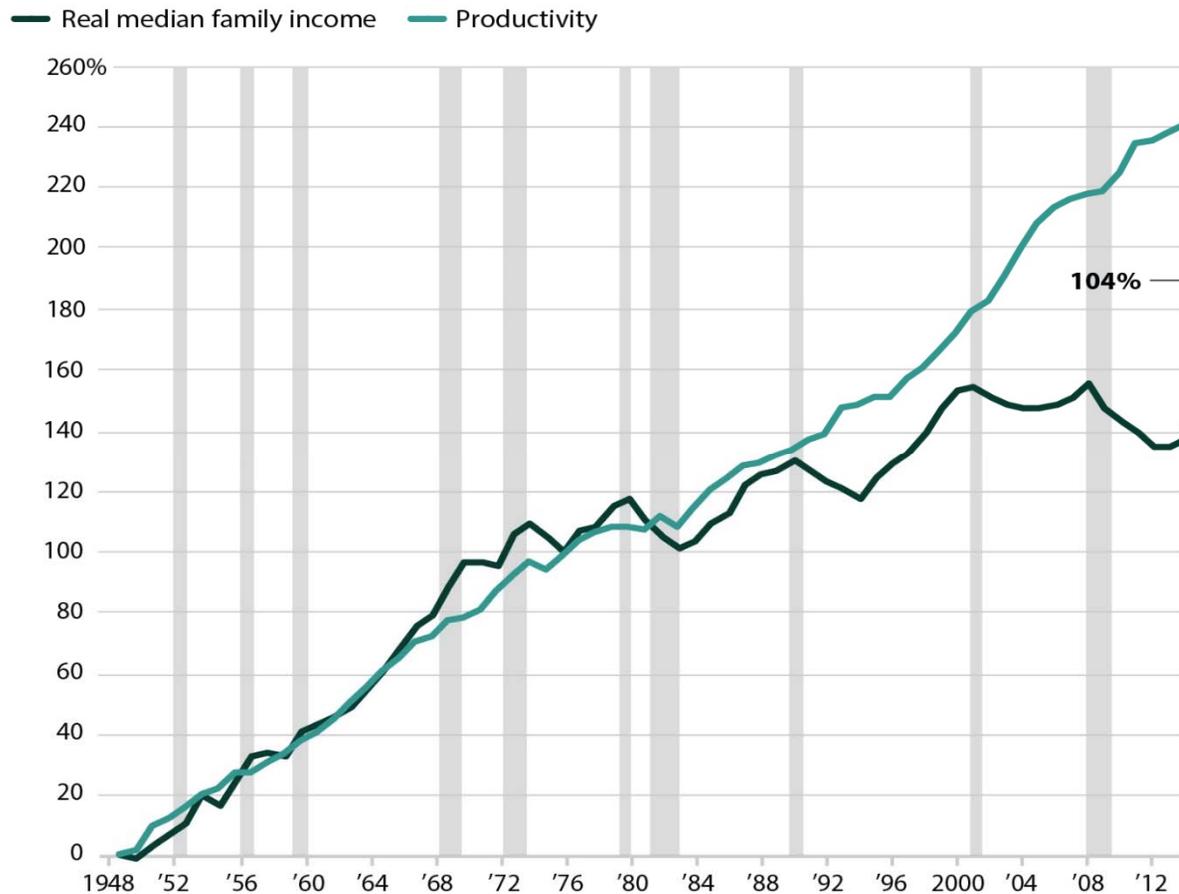
# Recent international political changes

- Trump in the US, Brexit
- The discontents with globalization: a system that worked very well for just a few and badly for many
- Next figure shows the myth of the “American dream”: divorce between labor productivity and income of the middle class

FIGURE 3.4

### Tectonic Shift in 1980 Reveals Growing Gap Between Productivity and Income

Percent change in U.S. median family income and productivity, 1948 to 2013



Note: This figure shows median income across all U.S. families, measured in 2013 dollars and indexed to 1948. Shaded areas indicate recessions as defined by the National Bureau of Economic Research.

Source: US Census Bureau, "Table F-7. Type of Family, All Races by Median and Mean Income: 1947 to 2013" (Current Population Survey, Annual Social and Economic Supplements), <https://www.census.gov/hhes/www/income/data/historical/families/> and Bureau of Labor Statistics, Productivity - Major Sector Productivity and Costs Database.

# Recent political changes

- Those changes will not help those who have been suffering
  - But will most likely hurt them and the world
- A system that works for the majority requires rewriting the rules that govern the market economy

# Insights for Cuba

- Opportunities for learning and productive policies
- Policies must ensure a balance among macro consistency, job creation, and technological progress
- Advantage: high educational levels
- Can foster activities that are intensive in skilled labor and still compete internationally
- There are large potential gains from trade, but opening policies must be carefully managed in order to ensure inclusion and growth rather than exclusion and instability
- Caution in opening up short-term capital markets

# Conclusions

- Increasing worldwide recognition that markets do not work in a vacuum
  - They are structured by norms, laws, and regulations
- Markets on their own are neither efficient nor stable
- Unfettered markets do not lead to shared prosperity
  - Markets do not generate either a socially desirable distribution or one that maximizes economic performance

# Conclusions

- But properly regulated markets can bring large societal gains
- Government is an essential actor of the development process
  - And a central part of development policy is improving the performance of the public sector
  - But so are markets
- The most successful countries had a developmental state. The strategies of the past will likely be unsuccessful
  - The developing countries with better prospects are those that invested more in education, that have more adaptable labor forces

# Conclusions

- Everywhere in the world there is need for better state policies
  - Involving more actors and better institutional arrangements
- There is some urgency to rethinking development strategies
  - In a world that is going through major technological changes, there are a multiplicity of challenges