Comments by José Manuel Salazar-Xirinachs
Executive Director, Employment Sector, ILO, on

The Report of the Commission on Growth and Development
ILO, Geneva 4 September, 2008

Thank you Richard (Newfarmer), and thank you Roberto (Zagha) for your excellent presentation and your leadership and hard work as Secretary of the Commission on Growth and Development, and for agreeing to make your presentation of the report in Geneva here at the International Labour Organization. We are delighted to host this event.

This report deals with some of the most important issues for the prosperity and well being of people in the world today: how to achieve high, sustained and inclusive growth. And this and the nature of the commission itself probably explains why we have such a full room today. I would like to recognize in particular the presence of two Deputy Directors of the WTO, my good friends Alejandro Jara and Harsha Singh.

Many think that this conversation among economists, this search for growth and the sources of growth, is similar to the search for the Holy Grail. As an expression of hope and commitment to an end this is not such an inappropriate metaphor. So it is not surprising that the report has triggered numerous comments, some with appreciation, others with criticism:

- William Easterly, for instance, criticised it strongly, and in my view quite wrongly and cynically, as a statement of self-confessed ignorance from a distinguished group of high priests of development. For him the report represents the final collapse of the development expert paradigm.

- Martin Wolf called it a "pragmatic guide" to policies for accelerating growth in developing countries.

- And Dani Rodrik, also highly appreciative of the Report, argues that it reflects a broader intellectual shift within the development profession, from a traditional policy framework which is *presumptive*, that is, based on strong preconceptions about the nature of the problem and on drafting laundry lists and recipes for reforms, to a new thinking which is more *diagnostic*, and that focuses on trying to identify and remove the most significant economic bottlenecks and constraints rather than on pushing comprehensive one-size-fits all reforms.

My own view of the report is closer to the one by Wolf and Rodrik. I think the report makes a very important contribution, provides a pragmatic blueprint for policies, and does reflect an important intellectual shift away from the old fashioned Washington Consensus.

But of course, as all reports made by a Commission, it is a consensus report, and as such it tries hard to please everyone and include different perspectives simultaneously. There are clearly some subjects on which the Commissioners themselves disagreed. Still, the report is remarkable in drawing useful lessons and in having achieved consensus around ideas that in some places depart significantly from the traditional approach.

At the ILO, this should remind us of the criticism levelled at the report of our own World Commission on "The Social Dimension of Globalization". In that report, as in this one, its authority lies precisely in the fact that it is a consensus forged among prestigious but not necessarily like-minded people.

A strength of the Growth Commission Report is also the fact that it draws lessons not just from theory but from the experience of 13 specific countries that achieved sustained high growth, defined as 7% per year or more for 25 years or longer, or that had growth accelerations in the last 10 to 15 years.

It is very difficult to comment on a compact report that covers so much ground. I would like to begin by being more precise about where I see the main areas of contribution of the report, pointing out the many strengths but also a few weaknesses. Second, I will select a few subjects for more specific comments.

I. Main contribution and value added

As for the main contributions and valued added of the report, they can be summarized in seven major points.

1. The emphasis on growth itself.

The first, is the emphasis on the importance of growth itself for development and poverty reduction. Given the scepticism on the importance of growth in some quarters this is in itself an important message. But the Report also recognizes that growth is not an end goal, but a means to reduce poverty, promote human development, and create employment.

In some respects, the message on growth is quite close to one that the ILO has been putting forward and is quite central to our own approaches on promoting productive employment and decent work. Specifically, the report says that some kinds of growth reduce poverty more effectively than others: the expansion of smallholder farming, for example, cuts poverty quickly. Growth in labour-intensive manufacturing also raises the incomes of the poor. It points out that the expansion of capital-intensive mining can result in jobless growth and no poverty reduction. These comments are contained in Box 1 in page 14, so there is some sensitivity in the report to the need to ensure that growth is rich in jobs.

However, it is unfortunate that this topic is not developed further elsewhere in any detail. How can the employment content of growth be increased? How to give operational content to the idea that the sectoral pattern of growth matters? How to identify factors that constrain the growth of employment even when output is growing

at high rates? What factors influence the pattern of investment that in turn influence the employment content of growth?

In my view, and in the view of the ILO, the employment content of growth is a central issue of the inclusion agenda (that you described Roberto). And I think it is a missed opportunity that the report did not develop these questions further. I wonder, and perhaps Roberto you can tell us, how much the Commissioners and the workshops during the project, discussed the issue of the employment content of growth and how to promote it.

2. Five principles shared by high and sustained growth economies.

The second contribution is the identification of the five common characteristics shared by the high and sustained growth cases:

The first is the fact that they fully engaged with the world economy. In the traditional Washington Consensus, this message was always equated with trade and capital market liberalization. This report is much more sophisticated than that. It talks about knowledge, learning, the role of FDI and the dynamism of world demand for goods and services. While it argues the benefits of openness, it recognizes the importance of strategic integration into the world economy, and does not argue for uncritical trade liberalization as the means for this integration.

The other commonalities, all useful to frame policy, include: macroeconomic stability, sustained high rates of saving and investment, reliance on markets to allocate resources, and having capable, committed and credible governments.

On the "reliance on markets" point the report is highly pragmatic. Gone is the old credo of privatization and deregulation and other tenets of market fundamentalism. Instead the report presents the view that the proximate cause for growth is the private sector and entrepreneurship responding to price signals and market forces. But this is not the same as letting markets and a laundry list of reforms determine outcomes.

The Report says that Governments should be pragmatic. Developing countries often lack the institutions necessary to underpin markets, such as property rights, contract enforcement, conveying of prices, etc. An important part of development policy is precisely the creation of these institutionalized capabilities. It adds that given that we don't know in detail how to engineer these institutions, it is prudent to pursue an experimental approach to the implementation of economic policy. The specific answers have to be discovered by trial and error. But it adopts the view that the private sector's process of "self-discovery" may be usefully helped along by the government's hand.

On the lessons about "creative destruction" the report is also quite sophisticated. It argues that the lesson from the high and sustained growth cases is that *they did not only not resist creative destruction, they actually promoted it, but at the same time protected people who are adversely affected by the growth dynamics and associated structural change*.

3. Role of government

The third positive contribution of the report is a belief on the role of government and on the need for a developmental state. However, in this area of lessons I see both strengths and weaknesses. On the side of strengths, the report puts to sleep the orthodox Washington Consensus notion that the state should just get out of the way. It makes clear that the advise "stabilize, privatize, liberalize" defines the role of government too narrowly or even wrongly. And that a preoccupation with the size of the state is misleading and can distract attention from the agenda about its effectiveness. The report argues that as the economy grows and develops, active, pragmatic governments have a role to play. It observes that the high growth economies typically built their prosperity on strong political foundations. Their policy-makers understood that growth does not just happen. Experience suggests that strong, technocratic teams, focused on long term growth, can also provide institutional memory and continuity of policy. A culture of honest public service must be fostered and maintained. The administration must also attract and retain talented people.

The report also emphasizes the need for strong leadership, with patience, long planning horizons and therefore decades-long commitment. It argues that policy-makers must "communicate a credible vision of the future and a strategy for getting there." It observes that some governments forged inclusive social contracts in support of growth, offering health, education and sometimes redistribution.

All of these are important, pragmatic messages that go beyond the traditional Washington Consensus.

However, on the role of government and the art of policy-making I think the report can be said to have two main weaknesses:

a) First, it does not analyse how a country can have a decades-long commitment and planning horizon when governments change every four or six years. The interaction of growth policies, their continuity and sustainability, with democratic institutions and changing governments is not analysed.

b) Second, I think Bill Easterly has a point when he argues that the Report, and perhaps also the World Bank in general, although this is raising the stakes here, seems to be wedded to a "leaders and experts" vision of economic reforms and of how growth should be promoted. In reading carefully the sections on the role of government and on the art of policy making one does not get enough about processes of participation or representation, about social dialogue, and about the real world of the politics of economic reform. It leaves a taste of development experts talking to technocratic leaders and policy makers. I would appreciate if Roberto tells us what he thinks about this, and if you can tell us more about how the Commissioners discussed the politics of reform and the necessary processes of social dialogue for economic growth.

4. Policy ingredients for rapid growth

The fourth positive contribution is the list of policy ingredients for rapid growth. These ingredients are meant to provide a framework for setting the policy priorities by those who will use them to cook a growth recipe locally. I counted some 13 possible ingredients: around 8 of them there seems to be a high degree of consensus nowadays in the development community. But over the other five, there is a lot of controversy. The report is conscious of this and in fact provides a pragmatic guide to these debates.

I would like to clarify that I made this distinction between the 8 and the 5 ingredients, this is not a distinction made by the report itself.

The ingredients around which I think there is more consensus are the following:

1) The need for high levels of investment and savings. The guideline provided is investment of at least 25% of GDP predominantly financed by domestic savings. Investment in infrastructure of at least 5-7% of GDP. And spending by private and public sectors on education, training and health of another 7-8% of GDP.

2) The need to promote inward technology transfer, facilitated by trade, FDI and sending students to study abroad.

3) The need for macroeconomic stability, although economists and policy makers disagree about the precise definition of stability and the best way to preserve it.

4) The need to accept competition, structural change and urbanisation, but managing well the process of creative destruction ensuring that job creation matches job destruction and protecting people in transitions.

5) The need to bring environmental protection into development.

6) The imperative to promote inclusion which comprises equity in market outcomes to put limits on income inequality; equality of opportunity which refers to access, particularly for women; and protection in market and employment transitions.

7) The need to promote regional and local development, and

8) The need to promote effective government

While there is broad consensus around these, the following five ingredients are surrounded by a great deal of debate, which the report discusses to some extent:

9) The role of industrial policy and export promotion
10) The pros and cons of deliberate undervaluation of the exchange rate
11) The meaning of the ingredient that recommends “Getting the labour market right”
12) How far and how soon the economy should be open to capital flows

13) The difficulties inherent in developing the financial sector

I will come back to some of these in a moment.

The Report is quite careful in saying that this list of ingredients is not a recipe because the Commission does not believe in recipes. It stresses that economists don't really know the sufficient conditions for growth, nor do they know for sure which ingredients are necessary in specific contexts. Some countries have grown on the back of a much shorter list. But the point is that over 10 to 20 years all these ingredients will matter.

Timing and circumstance will determine how the ingredients should be combined, in what quantities, and in what sequence. Policy-makers need to determine in specific circumstances what are the binding constraints and distinguish them from the many constraints. Governments should focus their efforts in those areas with the highest incremental payoff to growth.

All of these shows the shift Dani Rodrik points out from the *presumptive* approach to a more *diagnostic* approach to growth. Here we see how far from the Washington consensus the approach to policy-making has evolved. However, we come back to the question about the belief in the power of experts and technocracy to make the right diagnostic. Or, reversing the question, which is the way to get the diagnostic right? Is there a methodology that can tell us where are the areas with the highest incremental payoffs to growth, or to inclusive growth?

In this respect the report argues that "This is why formulating a growth strategy is a job for a dedicated "reform team" of policy-makers and economists, working on a single economy over time." I have no doubt that much good can come from such a dedicated reform team that can really understand an economy, and the society and politics in which it is embedded. But again, the politics of the process and the nature of social dialogue seem to be missing in this picture. And I would say this is a shortcoming of the report.

5. A short list of bad ideas, or policies to be avoided.

The fifth important contribution of the report that makes it quite pragmatic, even close to a manual of do's and don't, is the short list of bad ideas or policies to be avoided that it contains in page 68.

The report is careful in saying that just as the recommendations for good policies is qualified by the need to avoid one-size-fits-all approaches, the list of bad policies should also be qualified, in the sense that there are situations and circumstances which may justify limited or temporary resort to some of these policies. But the overwhelming body of evidence suggests that they have large costs and their objectives are usually better served by other means.

These bad policies include:

1) Subsidizing energy (particularly relevant today)

2) Using the civil service as employer of last resort. This is different from public-works programmes.

3) Reducing fiscal deficits by cutting spending on infrastructure

4) Providing open-ended protection to specific sectors, industries, firms and jobs.

5) Using price controls as a way to curb inflation

6) Banning exports, to keep domestic prices low

7) Resisting urbanization and as a consequence under-investing in urban infrastructure.

8) Ignoring environmental issues in the early stages of growth on the grounds that they are an "unaffordable luxury".

9) Measuring educational progress solely by the construction of school infrastructure or even by higher enrolments, instead of focusing on the extent of learning and quality of education.

10) Underpaying public servants, such as teachers, and combining this with promotion by seniority instead of credible methods to measure performance and rewarding it.

11) Poor regulation of the banking system

12) Allowing the exchange rate to appreciate excessively, too quickly

A very good point made is that relentless scrutiny of policies should be an essential element in rational policy-making.

6. Challenges of today for specific groups of countries

Another important contribution is the discussion of today's challenges for some specific groups of countries, mainly Africa, small states and resource rich countries.

7. New global trends

Finally, the report contains a very useful identification and examination of new global trends, which are relatively new developments and new realities with which developing countries have to deal with and have to take into account in their growth strategies. These include:

1) Global warming and climate change
2) The rising income inequality and the surge in protectionist and anti-globalisation sentiment
3) The rise of China and India and change in relative prices of food and natural resources versus manufactures
4) Demographics, ageing and migration, and
5) Global imbalances and governance challenges

There is a lot of analysis and useful points on these global trends and perhaps we can visit these issues in the discussion.

II. Selected topics

I would like to finish with a brief comment on three of the ingredients for fast growth identified, where there is controversy.

First, the report takes a stand openly against some of what have been articles of faith of the Washington Consensus. Two examples are Export promotion and industrial policy and opening of the capital account.

How far and how soon the economy should be open to capital flows

On the opening of the capital account the report observes that none of the sustained, high-growth cases were particularly quick to open their capital accounts and points out that despite this, developing countries have come under pressure from IFIs to do it. (Its judgement is that whether this is good advise seems to depend heavily on whether the economy is diversified, its capital markets mature, and its financial institutions strong.)

It also courageously takes the position that policies, such as certain types of capital controls, that actively discourage speculative, short-term capital inflows have proven useful in turbulent times.

Export promotion and industrial policy

On export promotion and industrial policy the report also takes a stand. To the sceptics who worry about government incompetence or capture by interest groups and prefer to do nothing, the report replies that there are also risks of doing nothing. And argues that if an economy is failing to diversify its exports or generate productive jobs in new industries, governments should look for ways to jump-start the process. This is a **courageous position** for the Commission to take and should be celebrated.

The Commissioners do stress that industrial policy and export promotion policy efforts should be subject to certain disciplines:

i. They should be temporary
ii. They should be evaluated critically and abandoned quickly if they are not producing the desired results

iii. They should remain as neutral as possible about which exports to promote
iv. And they remind us that export promotion is not a good substitute for other key supportive ingredients such as education, infrastructure, and appropriate regulation.

Getting labour markets right

Finally, a comment on the labour market. The report concludes that "getting the labour market right" is a key ingredient for growth. But what does this mean? It is interesting that you said Roberto, that on this point the discussion by the Commissioners was very intense and not always very clear.

In the view of the report it means promoting labour mobility, particularly in a labour surplus economy. To this end, the report discusses a number of broad measures: improve education and skills that would allow workers to enter new trades; facilitate urbanization; create gainful employment in export industries (the report even suggests that by using exchange rate and industrial policies proactively, if necessary), and overhaul labour market institutions and regulations.

On the overhaul of labour market regulations, the Report makes a statement of principle: "the Commission feels strongly that labour rights should not be sacrificed to achieve other economic objectives, including growth." (p 45) This is of course fully consistent with ILO thinking.

More analytically, however, the report refers to the outsider-insider model, and makes a number of very important points and a controversial proposal that nonetheless requires attention and discussion.

(a) First, it argues that if the demand for labour in a country is strong enough, high costs and heavy regulations in the formal sector pose few problems. In other words, in the face of excess demand for labour, many supposed regulatory impediments to growth decline in significance of vanish altogether. This is an extremely interesting point for us at the ILO and for countries around the world to think about and further test. If correct, it suggests that high growth itself can dissipate the weight of labour market regulations as a binding constraint.

(b) Secondly, it argues that a supply-side approach to employability that emphasizes the need for education and human capital investment, while not incorrect is insufficient. This is so because it is extremely expensive to upgrade skills of workers before finding employment for them, and because a lot of the skills learning takes place on the job. I would say this important policy message is also one the ILO has been advising.

(c) Third, and more controversially, the report is right is saying that a key question is: which policies will simultaneously create jobs, allow a viable return to industry and persuade the insiders in the formal sector not to be too defensive about excessive regulations? However, the report suggests a rather controversial pragmatic compromise based on a two track approach to the labour market. This would consist of allowing export oriented industries to

> recruit workers on easier terms than those prevailing in the formal sector, by creating special economic zones. The Report clarifies that this alternative employment track would not be free of regulation, and that core labour rights are not negotiable. But it would have cheaper rules on hiring and firing. The Report recognizes that this approach to the labour market is controversial, but it argues that the alternative is worse. It is to leave large segments of the population blocked from higher productivity employment. It also argues that the compromise suggested should be a temporary one. If successful, wages and benefits in the new industries will catch up with those in the formal sector.

I think this two track approach to the labour market is one that should be further discussed, and I invite colleagues from the ILO and constituents to address it further.

Given the importance of the labour market ingredient for growth, and the way the World Bank is pushing the labour market flexibility agenda, it would have been good to have a more extensive treatment of it in the Report. Some of the key issues are not discussed, such as the position of the Commissioners on labour market flexibility.

Furthermore, one does not get a picture about how the labour market and employment variables fit into the 13 country growth story. Some work done by my colleague Duncan Campbell shows that the labour market outcomes of many of these 13 star performers leave a lot to be desired. No doubt this is an area where much more research is needed.

In conclusion, much more could be said about and around this report. Overall I think it is a new landmark in development thinking and an excellent stocktaking of where we are and what has been learned. It is not the final collapse of the development expert, but it is indeed the final collapse of at least the simplified one-size-fits all version of the Washington Consensus. However, there is no room for complacency. The debate is far from settled in many areas, including in particular on labour market policies, industrial policy, export promotion, trade policy and others. Policy makers, business and trade union leaders, and everyone interested in development issues will benefit from the wisdom, clarity and honesty with which this report treats many relevant issues for growth and development.