Returning to high growth

Do markets know best?

The high economic growth rates experienced by most countries following the Second World War have not only slowed down in the last couple of decades, but the world has been undergoing serious crises recurring every ten years on average, the most serious of which has been the great recession starting in 2008 and from which the world has scarcely recovered. NDU economics professor Dr. Louis Hobeika argues that, in returning to high growth rates, we should invest in thinking big about new roles for everybody, including the state. We are living in an important and precious period that we should not waste.

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The numbers don't lie

GDP growth rates between 1961 and 2017 have been declining in most regions and countries worldwide, from 4.3 percent in 1961 to 3.2 percent in 2017. Rates dropped even more dramatically in the European Union, from 5.6 to 2.4 percent for the same period and in Latin America from 6.5 percent to 1.7 percent. More recently, between 2010 and 2016, annual rates of growth declined in Asia, from 10.3 percent to 7.1 percent in India and from 10.6 percent to 6.7 percent in China.

GDP growth rates are important for development and in fighting unemployment and poverty. But in formulating new policies, are the theories implemented from 1945 to 2000 still valid, or should we look for alternatives? Are we giving a very strong–and unrealistic–role to the private sector and minimizing the role of the public sector? Do markets know best?

Most recent theories for stimulating economic growth supported by international organizations gave the state a minimal role. Many economists accused the state of being responsible for the 2008 Great Recession, even though it was provoked mainly by debts and errors in the private sector and not by public debts or wrong actions by public officials. In doing so, they had turned economics away from its logical concern with production to focus instead on the optimality of resource allocation and macro-economic stabilization. The idea dominating economic thought in the past few decades has been that the state should limit itself to setting the parameters in which the private sector can work, innovate and grow.

The idea behind these theories is that the crowding out effect has been very harmful to growth and prosperity. Therefore the state should lower its deficit to the minimum possible, and leave the private sector to do business and research and development (R&D) alone. But with less than optimal growth rates in the past few decades, this view ought to be reconsidered.

The United States, for example, has for decades directed large public investment programs in technology and innovation that explain its overall economic successes. The U.S. government funded many of the innovations behind the Silicon Valley revolution. To this day, the U.S. government finances many programs in health, space and information technology (IT) that benefit the private sector directly.

Before discussing the foundations, or parameters, that will help us define a new role for the state, it is important to note the following:

1) The private sector was never able to flourish alone. The most sophisticated private sector inventions would not have taken place without state subsidies or without benefitting from public R&D used for free by companies. The public sector, in a way, shared the costs of innovation but did not share any of the credit.

2) Globalization had many benefits and positive impacts on the world economy. However, it led to outsourcing the production of goods and services in order to achieve lower costs. Consequently, it weakened many national productive bases and helped external markets. The solution today does not lie in implementing high tariffs

and harming international trade but in going back to the original role of the state in supporting production over consumption.

3) Austerity policies have failed, as data from Greece, Italy, Portugal and most European economies show. They created poverty, left the private sector alone in R&D investment and failed to create the healthy macro-economic environment for growth–although the role of corruption and the lack of ethics cannot be discounted.

4) A new role for the state should be defined that not only requires governments to ensure stability, but that would allow it to use its budget generously to support R&D that in turn can help businesses innovate and grow. We need to return to an economic framework that focuses on production, entrepreneurship and governance, with stabilization playing a supporting role, not a dominant one.

5) Standard models assumed decreasing returns to scale and relied therefore on the theory of comparative advantage for growth choices. The production approach relies on the increasing returns to scale and technological change based on innovation. We should replace the Ricardian theory of decreasing returns to scale with Charles Babbage's theory of increasing returns to scale by investing in R&D and innovation. The importance of human capital to achieve this significant revolution cannot be ignored.

New parameters

Michael Best,[1] in his book *How Growth Really Happens*, posits that societies should focus on the production system, business organization and skill formation

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to impact economic performance. This is how many East Asian and Latin American countries succeeded during many previous decades. According to Mariana Mazzucato[2] in her book *The Entrepreneurial State*, what stimulates innovation is the entity that takes the boldest risk, that is the state. A new role for the state is required for solid economic growth.

In the Middle East North Africa (MENA) region, the role of the state has varied substantially between the two groups of oil exporters and oil importers. Exporters used much bigger budgets to subsidize the consumption of food, fuel and utilities than to finance local R&D. Now with revenues decreasing because of lower oil prices, budgets have been financing less of both. In the oil importers' group, budgets have been insufficient to play any significant role in growth. We cannot ignore the impact of corruption and mismanagement in all private and public sectors across the region. The role of the state should be redefined with significant attention to production systems, business organizations and skill formation.

Strong growth cannot happen again without public investment in education, research and technological change. Businesses should also think outside the box. We should remind ourselves of what Keynes said: that public officials should think big. Karl Polanyi wrote that free markets are themselves products of state intervention. We need a mission-driven public sector not a recorder of accounts. As Joseph Schumpeter said: "the capitalist economy is not, and cannot be, stationary."

Finally, the idea is that we should make governments more competent, smarter and not necessarily smaller. We should promote innovation-led growth. It is well believed that the "Secular Stagnation" or zero growth rates are related to what the State is not doing. We need, as Mazzucato argued, an entrepreneurial role for the public sector.

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Endnotes

1. Best Michael H., *How Growth Really Happens*, Princeton, 2018.
2. Mazzucato Mariana, *The Entrepreneurial State*, Penguin, 2018.