

Comments at the Conference on “Macro and Growth Policies in the Wake of the Crisis”

Dani Rodrik

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What's new in the post-crisis environment

- Advanced countries hobbled by high public debt
- Possibly lower growth in the North
- Doubts about cross-border financial flows
- From a multilateral regime to a G-0?

Growth theory in one slide

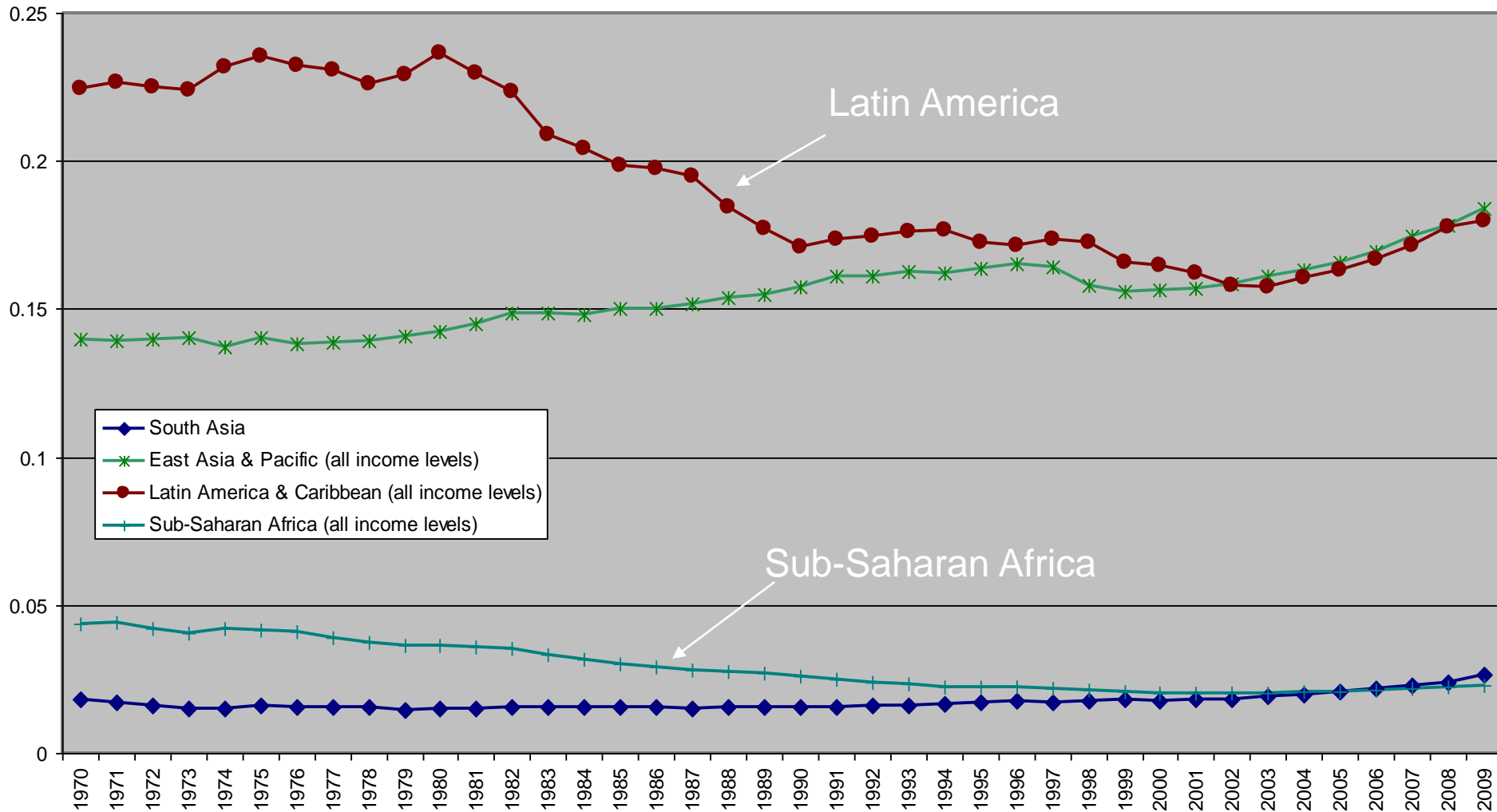
- Rate of economic growth is a function of convergence
 - closing existing gaps in knowledge and capital-labor ratios
- But convergence is conditional
 - depends on doing the “right things”
- So growth rate of rich countries largely irrelevant
 - unless it affects possibilities of catch-up
- But not clear we have a good handle on what the “right things” are
 - the new consensus is about search and pragmatism rather than ready-made of list of to-do’s

Is pre-crisis growth sustainable?

- Bad news: for LAC and SSA, it was mostly making up for lost ground
- Good news: “convergence gap” remains wider, for those countries, than at anytime since the 1970s

A wider convergence gap (for most)

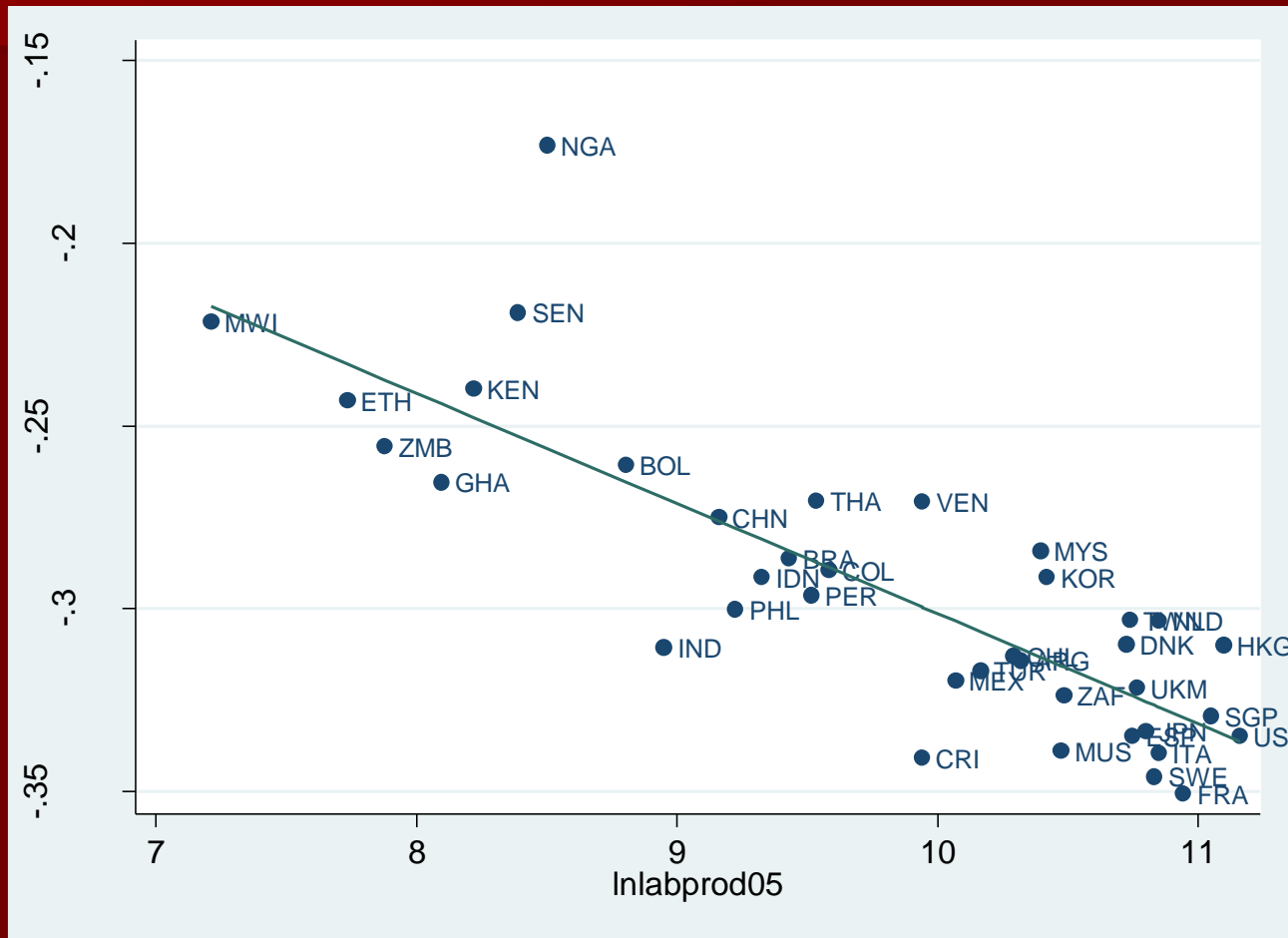
Incomes as a ratio of high-income countries



Two prerequisites for convergence

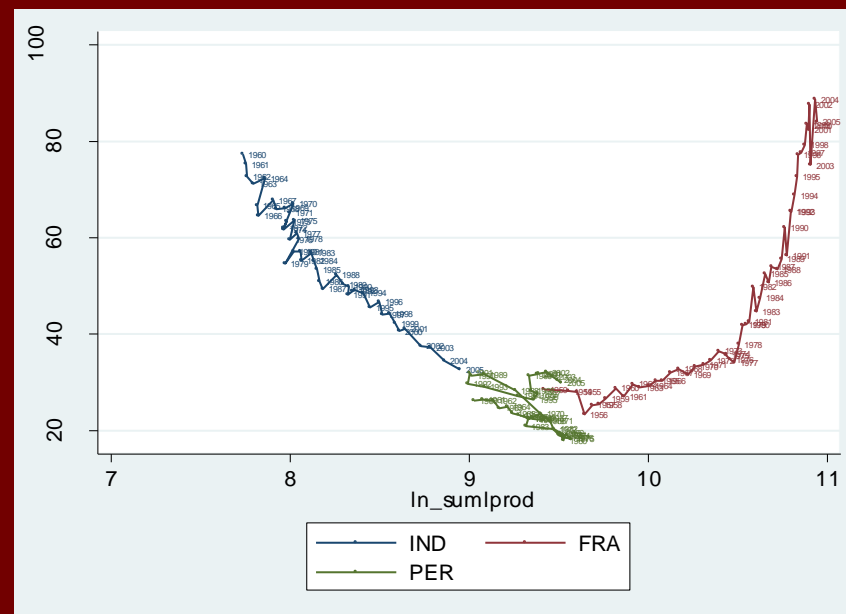
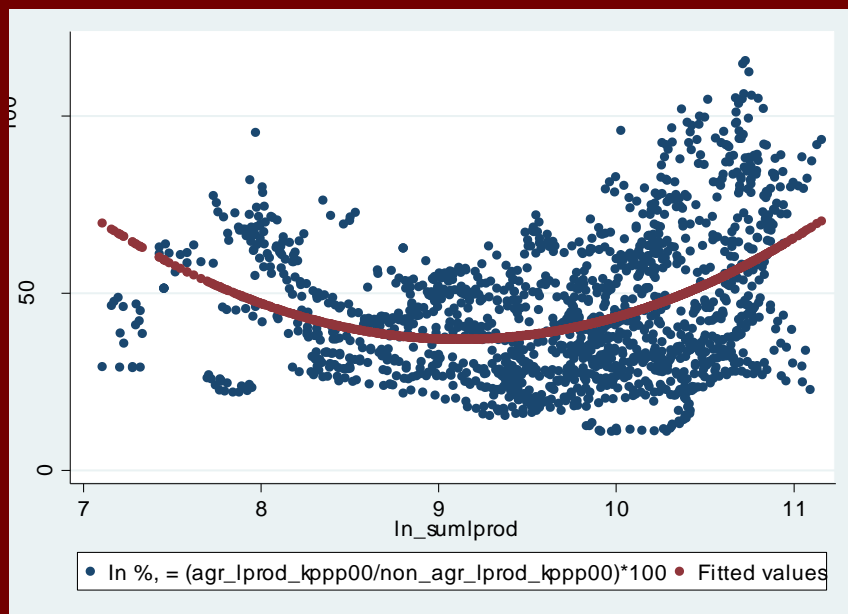
- Economic: ongoing structural transformation from low- to high-productivity activities
 - key role of modern tradables
 - need to focus on entire economy, not just misallocation within modern industries
 - “excessive” capital inflows and high commodity prices may be good in the short-term, but not in the medium- to longer-term
 - due to Dutch disease and governance problems
 - some financial de-globalization might be good news
- Political: building resilience to shocks through institutions of conflict management
 - key role of democratic governance

Productivity gaps are large in developing countries



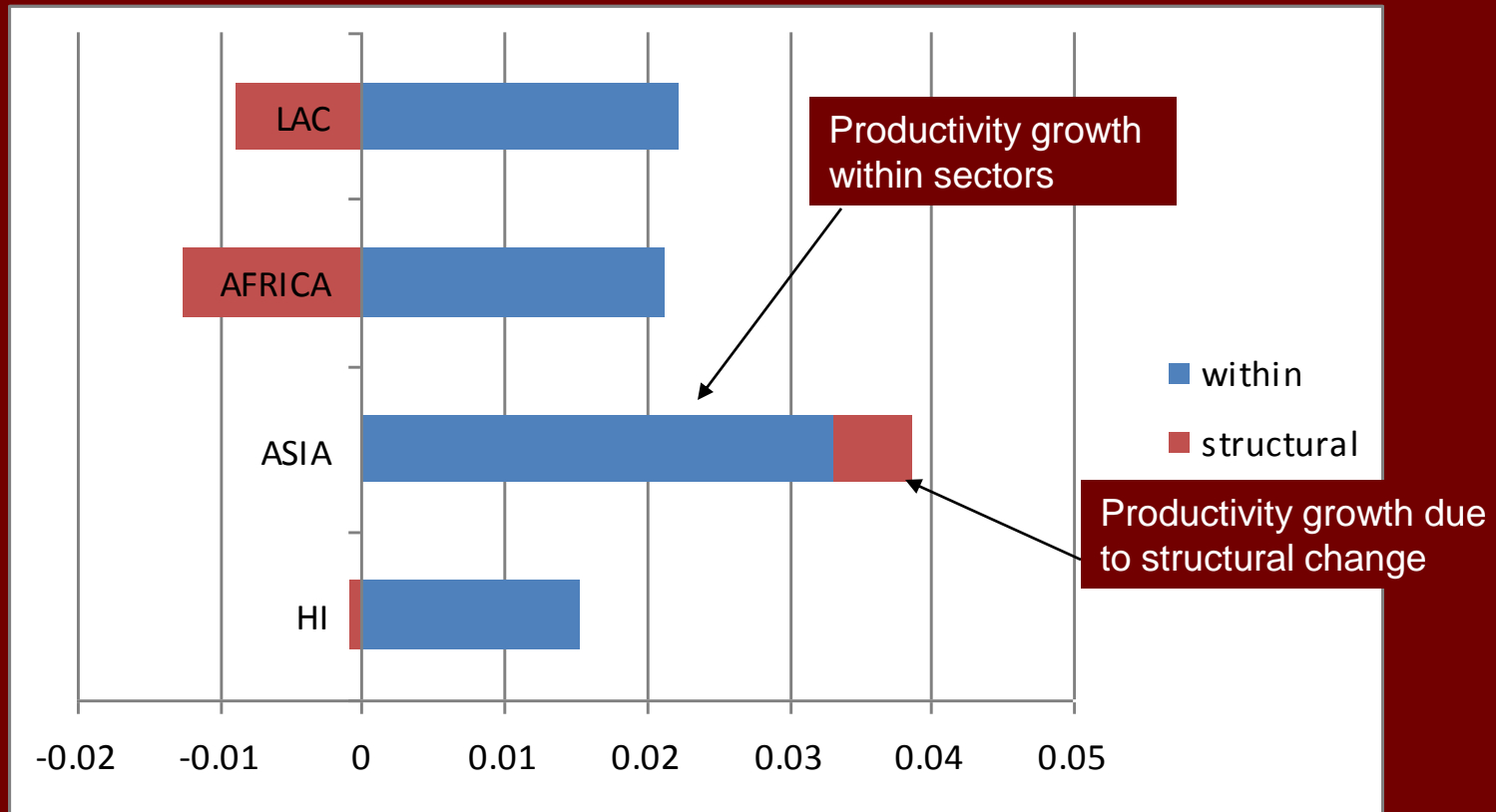
Relationship between inter-sectoral productivity gaps and income levels

Growth requires both new activities and ongoing structural change



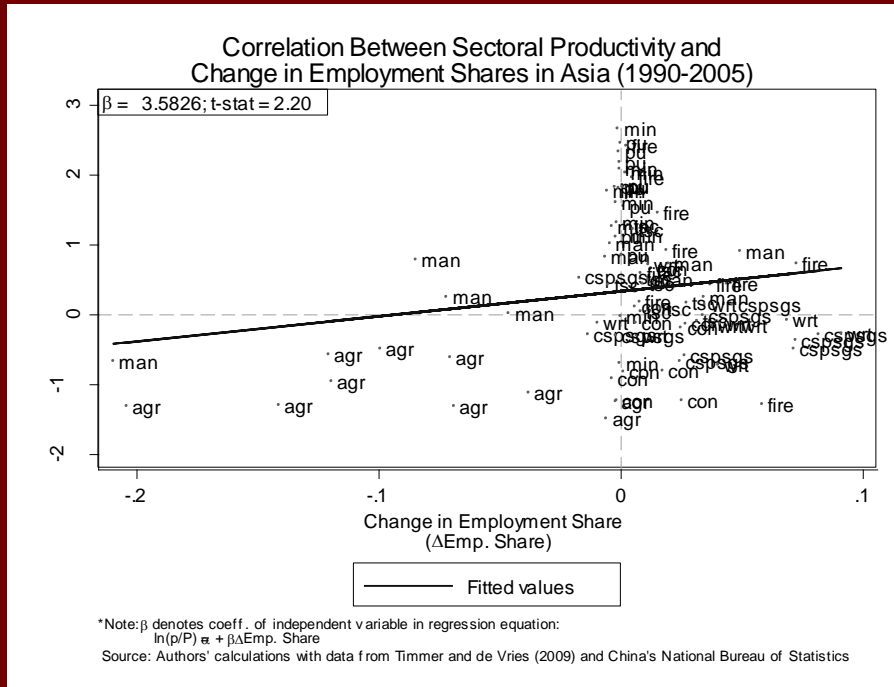
Relationship between economy-wide labor productivity (horizontal axis) and the ratio of agricultural productivity to non-agricultural productivity (percent, vertical axis)

Growth-enhancing structural transformation is not automatic

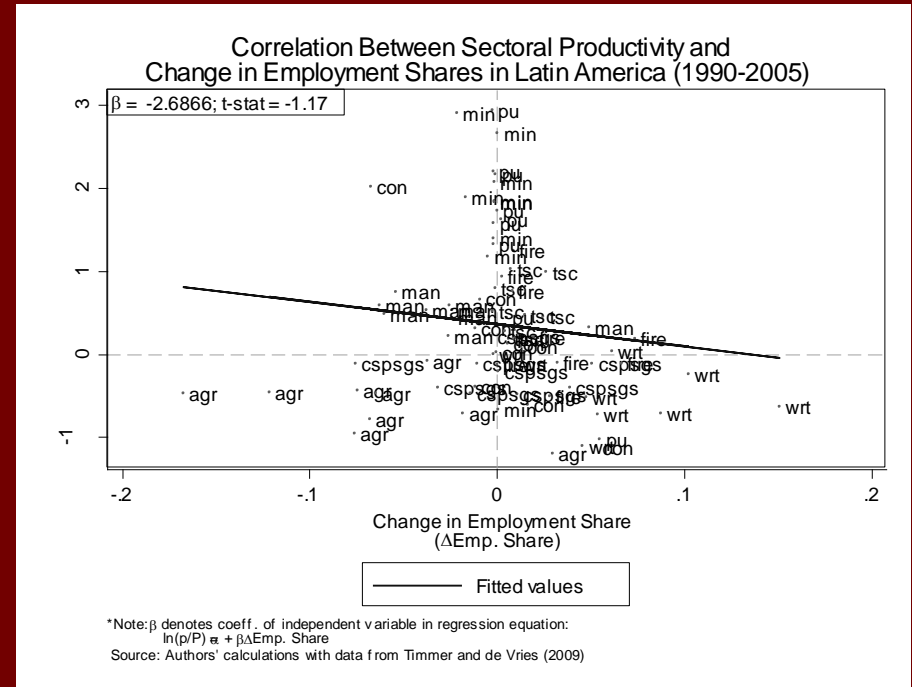


Decomposition of productivity growth by country group, 1990-2005

Patterns of structural change: Asia versus Latin America

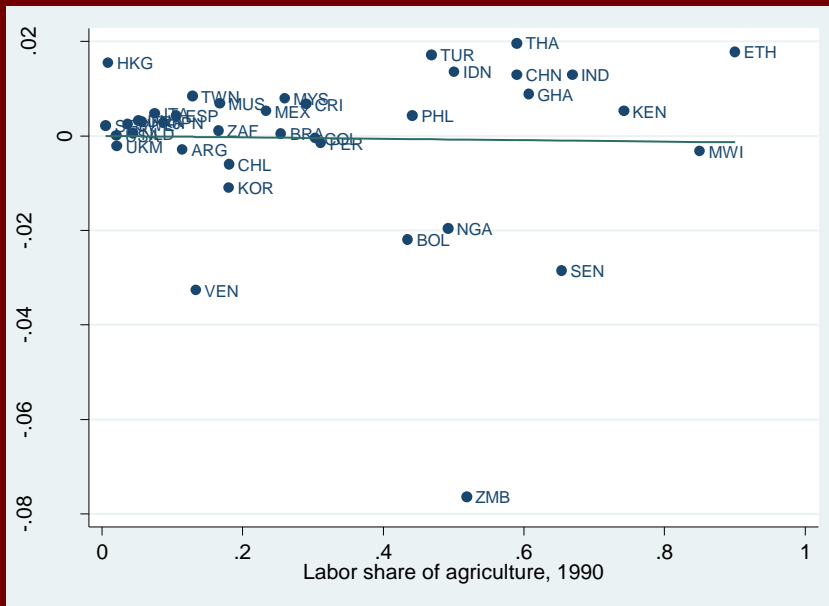


Asia

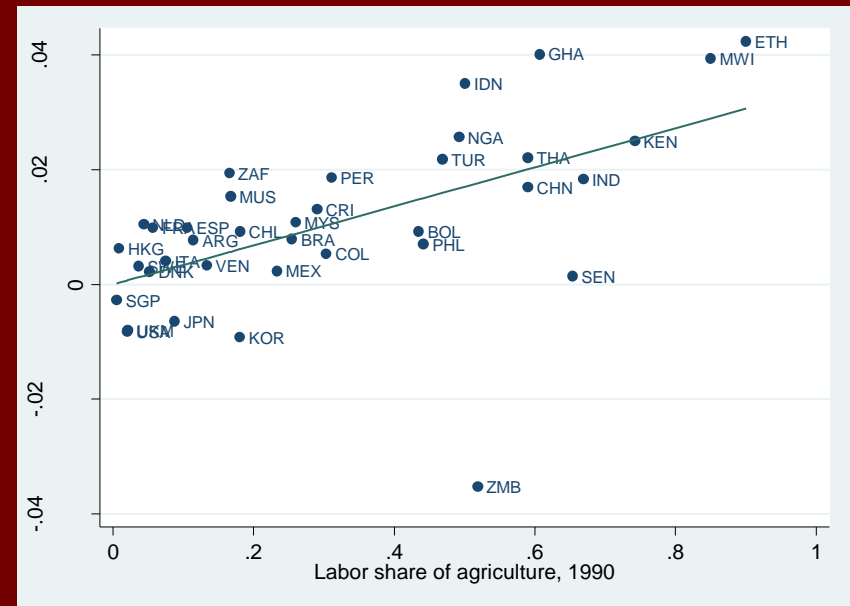


Latin America

Large reservoir of "excess labor" helps, conditionally



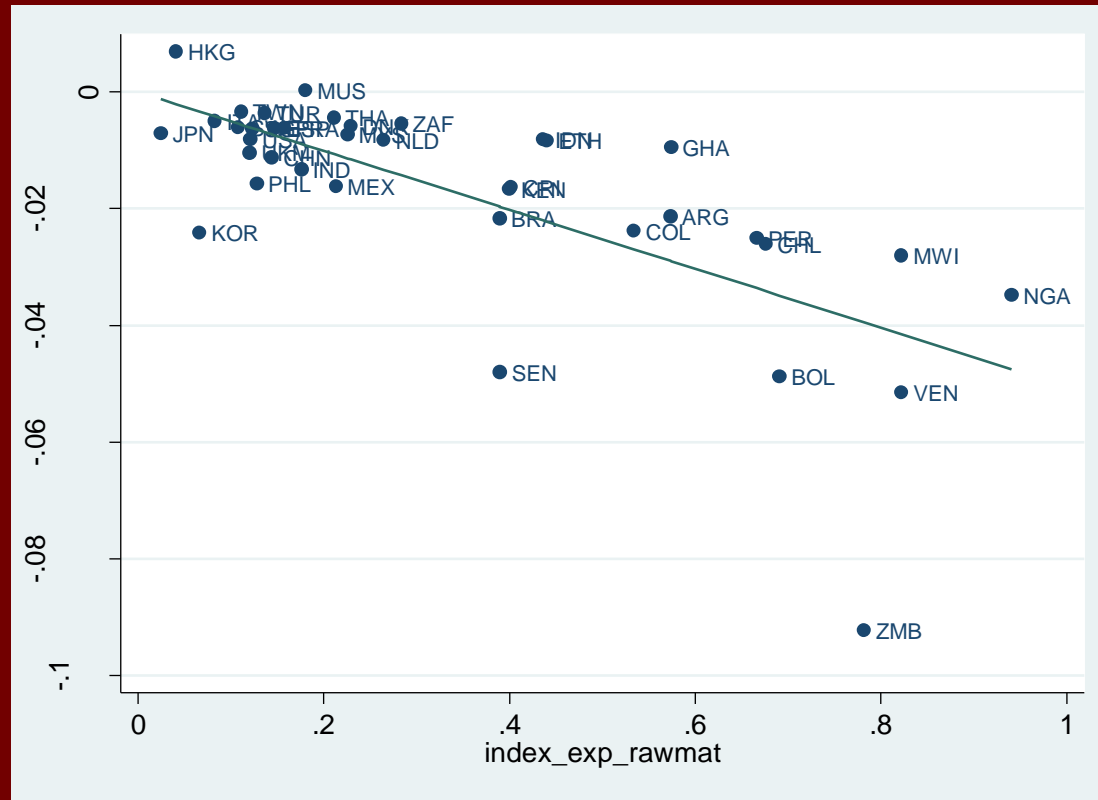
unconditional



conditional

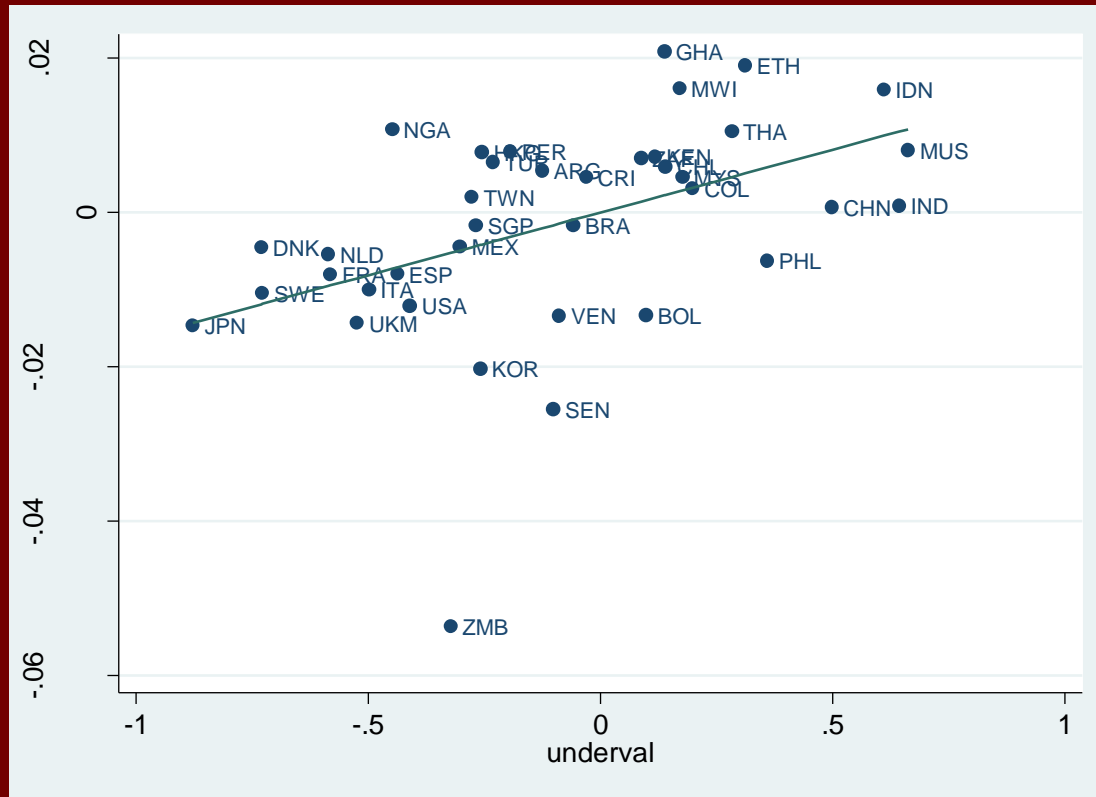
Association between the initial labor share in agriculture and the contribution of structural change to growth

Comparative advantage in primary products is bad news



Partial association between the share of primary products in exports and the contribution of structural change to growth

But policy can clearly help



Partial association between an index of currency "undervaluation" and the contribution of structural change to growth

Conclusions

- The presence of a large convergence gap ensures significant potential for rapid economic growth in developing world, regardless of what happens in the rich countries
- Fulfilling this potential requires ongoing process of diversification and structural change
- This process is not automatic, especially in countries with an initial comparative advantage in primary products
- It necessitates pragmatic, experimental policies that support new industries
 - along with an external environment that supports, rather than misdirects, such efforts
 - implications for WTO rules, and for WB/IMF policy advice