The Stockholm Statement: New Strategies for Inclusive Development

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Nairobi

May 9, 2018

I. Stockholm Statement representing a rethinking of development strategies

1. GDP growth is not an end in itself
2. Development has to be inclusive
3. Environmental sustainability is a requirement, not an option
4. The need to balance market, state, and community
5. Providing macroeconomic stability

But this does not just mean balancing budgets or focusing exclusively on inflation

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6. Attending to the impact of global technology and inequality
    - Key issue is not developed vs. less developed countries, but appropriate treatment of labor, in both developed and developing countries
    - Requires investment in human capital
    - Creating new instruments of redistributions within and between countries

7. Social norms and mindsets matter
    - Bringing the insights of modern behavioral economics to bear in development economics
    - Effective ways of altering behavior (savings, fertility, etc.)

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8. Global policies and the responsibility of the international community

- Recognizing the interdependence of countries
  - That the policies of the large rich countries have large externalities on the rest of the world, which they often don't take into account (including their monetary, regulatory, trade, and migration policies)
  - But tax havens affect all countries
- International agreements cover only part of these arenas
  - Climate change agreements do not go far enough
  - Do not cover cost of adaptation by poor countries
- Developed countries have not lived up to their commitments of .7% of GDP in aid

Marked change from the Washington Consensus

- With its primary emphasis on markets
- With its inadequate treatment of market failures
- With its narrow view of macro stability
- With its narrow conception of the goals of development
  - More instruments
    - More instruments for monetary policy (now embraced even by advanced countries, e.g. in QE and macro-prudential regulation)
    - More instruments for macro-stability (now embraced in new Institutional View of IMF, on capital controls)
    - More instruments for developmental transformation—including industrial policies
  - Broader goals

Broader goals to reflect challenges of the 21st century

- Climate change
- Inclusive growth
  - Trickle down economics doesn’t work
  - Greater inclusivity can lead to more robust growth
  - There are policies that can simultaneously increase equality and growth
  - Seeing equality and growth as complements rather than substitutes is major change in development thinking
- There may be further challenges: Is Trump ushering in a new era of global protectionism?
  - Underlying social and political forces go beyond Trump

Clearer distinctions between means and goals

- Privatization, markets are not ends in themselves—they are only (possibly) *means* to the broader goals described earlier
- Other variables too need to be looked at through this lens
  - Inflation, budget deficits, current account deficits
- But not attending to some of these variables in a timely way may make it difficult to achieve our goals

II. The special challenges posed by natural resources: the resource curse

- Countries seemingly blessed with natural resources have grown more slowly and more unequally
  - With benefits of growth often accruing to only a few
- Not inevitable: a few countries have managed resources well
  - Norway, Chile, Botswana
- Both political and economic problem
  - Natural resource economies give rise to rent seeking
    - Rather than wealth creation
    - And too often, too much of the rent goes to foreigners
  - Often leading to corruption
  - And undermining democracy

Economic problems

- Export of natural resources leads to high exchange rate, making other sectors uncompetitive
- Volatility of natural prices subjects country to high and costly macroeconomic volatility
- Exacerbated by global financial system, which lends in good times and demands repayment in bad
- Natural resources do not create many jobs
  - forcing most of the rapidly expanding labor force into very low productivity agriculture and the informal sector – often a form of disguised unemployment
- Natural resources do not promote transformation of the economy
  - Weak productive linkages with rest of the economy
  - Source of revenue, but not of development

None of this inevitable: there are policies that can counteract all of these problems, promoting inclusive growth

Rent seeking from foreigners

- Need to maximize revenues from natural resources from well designed auctions and contracts
  - It may be necessary to auction off different parts of the production process, rather than to have a bid for a "manager"
- Contracts need to be complemented by excess profit taxes
  - Countries need to be careful not to sign investment agreements that circumscribe ability to change taxes and regulations
  - Those that have signed such agreements should exit or renegotiate (e.g. South Africa)
  - Even with these agreements, it may be preferable to change contracts (e.g. Israel)
  - Those countries demanding conditions that circumscribe renegotiation should refrain from doing so, preferably under a multilateral framework (especially for correcting "odious" contracts)

Rent seeking

- Important to maintain transparency in auction and bidding process
  - Full disclosure of bidding procedures and process, contracts
  - Full disclosure of amounts paid and resources extracted
- Internal oversight procedures
- Strong media and NGO’s
  - To provide external oversight, system of checks and balances

Managing volatility and preventing exchange rate appreciation

- Sovereign wealth fund or stabilization fund
  - Need to be willing to spend out of fund when prices are low
  - And to put into fund money when prices are high—even though there are large needs for funds within the country
- Exchange rate appreciation will slow down growth
- To avoid appreciation, government could intervene directly in foreign exchange market
  - But that would be costly
- Particularly dangerous: pro-cyclical capital flows
  - Private markets exacerbate cyclical fluctuations
  - Markets are short sighted
  - Public lending particularly problematic: agency issues in both the public and private sector

Managing volatility and preventing exchange rate appreciation

- Governments need to use the full panoply of instruments to simultaneously manage exchange rate stability and macroeconomic stability
  - With a sensitivity to development consequences of different instruments
  - Changed views in the use of different instruments: new IMF "institutional view" on capital controls (capital account management techniques)
- Macro-stability is important as a goal in itself (especially in developing countries where there are few mechanisms for coping with instability) and as part of a development strategy
  - Providing stable macroeconomic environment is part of the "enabling environment" for the private sector

Natural resources and development

- A competitive and stable foreign exchange rate is an important instrument of industrial policy
  - If countries have a high exchange rate, will be hard to export and domestic firms will be hurt by imports
- There are multiple (and often complementary) tools for managing the exchange rate
  - Direct intervention, capital account requirements, monetary policy
- The effectiveness of the foreign exchange rate as a tool for development can be enhanced with complementary industrial policy tools
  - Provision of credit, infrastructure, technology, ensuring adequately educated labor force

Enhancing value added activities

- Natural resource is important source of comparative advantage, though this is of less relevance for Kenya than many countries in Africa
- Needs to be leveraged to be a more important source of dynamic comparative advantage
- Industrial policies can be used to develop and exploit potential horizontal, forward, and backward linkages
  - Balancing static costs with dynamic gains
- Distortions in the global trade regime—designed by advanced countries—are designed to discourage these value added job increasing activities
  - Escalating tariffs
  - US and EU refused in Development Round to eliminate these distortions
  - Seemingly protected in current WTO framework
- Countries with abundant natural resources can use industrial policies to undo these distortions, and then push growth enhancing linkages (positive spillovers)

III. Natural Resources, Structural Transformation, and the Stockholm Statement

- Central to successful development as a structural transformation
- New understandings have led to movement from a focus on projects to policies and then to institutions
- Corresponding to the realization of the importance of not just physical capital, but human capital, social capital, and knowledge capital
    - And a change in norms and mindsets
        - Including the mindsets about change is possible—a movement away from traditional society towards modernization
    - In the West, associated with the Enlightenment
        - Even in the West, these ideas are contested—Trump and his associates have a pre-enlightenment mindset

Structural transformation

- What separates developing countries from developed is not just a disparity in resources, but a disparity in knowledge and institutions
  - Development entails a structural transformation
  - There can be growth without structural transformation—especially common in resource dependent countries
- **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
  - In Africa both between and within sectors: from traditional to modern agriculture, from low to higher productivity services

Markets and structural transformations

- **Markets on their own don't manage these transformations well**
  - Impediments imposed by capital market imperfections
  - Important externalities and coordination failures
- Government needs to assume an important role
  - How best to do this central theme of talk
  - Multiple objectives

Among key structural transformation challenges facing Africa

- Diversifying economy
- Achieving inclusion
- Addressing Climate change
- Increasing Employment
- Promoting growth
- Regional integration
- Broader modernization agenda, including changing mindsets and expectations

Multi-pronged strategy

- Some of these are complementary, in other cases there may be trade-offs; some are key means to broader ends—achieving increases in standards of living
- Will require *multiple* strategies
    - Some focusing on employment creation, some on inclusion, some on achieving a modern, diversified economy
    - Industrialization by itself unlikely to create enough jobs (especially given the demographics in Kenya, which in turn calls for policies to accelerate the demographic transition, even if Kenya is further along the transition than most countries in Africa)
    - Large fraction of population likely to continue working in agriculture—need to increase productivity by modernizing/industrializing agriculture
    - Service sector dominant in almost all advanced countries

Learning and dynamic comparative advantage

- Developing entrepreneurship and learning
  - Some sectors are better at doing this
  - Focusing on dynamic comparative advantage
    - Which may be based on a country's natural advantages (natural resources, agriculture, climate, etc.)
- Recognizing the importance of **dynamic comparative advantage**
  - Based on learning and dynamic efficiency, not just static comparative advantage
  - Enhancing a broad range of capabilities

Learning and government

- There is not only individual learning, firm learning, but also institutional learning
  - Capabilities of government can also be enhanced through “learning by doing”
  - Strengthening capacity to design and implement policies for dynamic transformation
- Because there are important spill-overs in learning, one can’t rely on just markets
  - The production of knowledge and learning is different from the production of goods
  - Central message of Stiglitz and Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social* Progress

And a new understanding of the role of government in development

- Key role of government: **the development state**
- While the role of government in setting and enforcing the rules, preventing exploitation, preventing negative externalities, encouraging activities with positive externalities, providing public goods and social protection, and formulating the overall direction of development is essential, it has to be balanced by other actors—the private sector and the community
  - More than just markets and government
  - Successful development is more than just projects and policies
- There has to be social cohesion
  - Social cohesion requires and facilitates inclusive growth
    - Inclusive in outcomes
    - Inclusive in process, participation
- Most likely path to ensure success of people-centered developmental strategies

Engagement with the private sector

- With complex technologies, the private sector often has a large advantage in the development of natural resources
- There is a natural conflict of interest—private firms wish to extract as much as they can, paying as little for workers as possible, doing as little as they can get away with to protect the environment and paying as little for resources
- Conducting auctions in the best, most transparent way possible combined with transparent, well designed contracts, with good oversight, may be the best way to ensure the best "deal" for the country

Engagement with the private sector

- Focus should be on overall development impact and overall well-being of the country
- Focus should be on the long run, even though there are incentives on both sides to focus on the short run
- There are some “good” companies, with high levels of corporate responsibility, whose management and employees are committed to contributing to country’s inclusive development
  - Sometimes supported by their government’s AID agencies
  - Assessing this is difficult, but important

Concluding remarks

Careful attention to metrics

- In expanding resource development and DFI in manufacturing or tourism, impact on GDP may be misleading
- What matters is *income* of Kenyans
  - GDP could go up, but all of increase could go to foreign owners/managers
- GDP does not include value of resource depletion and environmental degradation
  - In many areas adverse effects on environment and health can be very significant
- GDP says nothing about sustainability or inclusiveness of growth
- Important to bear in mind: what we measure affects what we do; if we measure the wrong thing, we may be led to do the wrong thing

Major message of Report of International Commission on the Measurement of Economic Performance and Social Progress, *Mismeasuring Our Lives: Why GDP Doesn't Add Up*

The Stockholm Statement provides guidance in how to ensure strong and inclusive growth

- Recognizing the limitations and the failures of the Washington Consensus
- A broader range of objectives and instruments
- And a more balanced view on the participation of different participants in the development process

Importance of a strategy for sustainable, inclusive growth

With the appropriate development strategy

- Avoiding the natural resource curse and environmental degradation
- Consistent with the Stockholm States
- It requires a comprehensive development strategy, a portfolio of instruments
  - Weighing carefully the interactions among the instruments
  - And assessing the costs and effectiveness of each
- With a balance between market, the state, and the community
  - And with participation of each in the formulation and implementation of the development strategy