Global Development in the Twenty-first Century: the maturation of global development – responses to three critiques

Modern economic development does not travel for long in a straight line. Making sense of the periodic changes in direction is the never-ending challenge of economic analysis.

My 2015 Holmes Lecture (Garnaut, 2015b) took up the challenge of explaining new twists and turns in the 21st century. Productivity and output growth are markedly lower in the developed countries, especially but not only since the great crash of 2008. The populations of the developed countries are ageing rapidly and the labour forces declining or growing slowly. Global savings are high and investment low, giving rise to historically low real interest rates. Low business investment, despite the low interest rates, makes it harder for the developed countries to maintain high levels of employment. Inequality in the distribution of income in the developed countries compounds the effects of low output growth on the standards of living of ordinary people. Increased influence by corporate money in the political process makes it difficult to correct adverse tendencies in economic development.

While these developments have generated hard times in the rich countries over the past decade, growth rates have remained reasonably strong in the developing countries – those low-income countries that have their feet on the escalator of modern economic growth. Or at least remained reasonably strong until 2014 or 2015, when most large developing countries, but not India, experienced bumps in the development road. People in other low-income countries – the bottom billion in what I call the underdeveloped countries – face less encouraging prospects, although some are doing better in the 21st than in the last quarter of the 20th century. For as long as a large part of the bottom billion remain left behind by modern economic development, there is a risk that humanity as a whole will remain tangled in a new version of the Malthusian trap.

In the Holmes Lecture, I thought it possible that the combination of contemporary tendencies in economic development may make the maturation of economic growth – the achievement of developed-country living standards for most of the world’s people – possible in the current century. While the contemporary challenges to the living standards of ordinary people in developed countries were real and large, this may be simply a small part of a general experience of transition to a world of abundance for the necessities of life and of reduced inequality.

In three thoughtful responses in Policy Quarterly, Gary Hawke, Grant Scobie and Geoff Bertram have added insights and raised important questions.

Gary Hawke (Hawke, 2015) adds value to my own analysis in several ways. The contrast of my own conclusions about the association of low population growth with changes in income levels with those of Kuznets is worth noting. Hawke is right to point out that we have been surprised in the past by sharp changes in fertility and may be surprised again. The powerful association over the past half century between income levels and fertility nevertheless provides the base case from which change would have to occur. Hawke brings a wider literature into support for my generally positive view of humanity’s prospects of breaking the old nexus between economic growth and greenhouse gas emissions.

Hawke queries my emphasis on the challenge from the influence of corporate money to good governance in the public interest in the developed country democracies. He thinks that pressure from other special interests is similarly important. While not wishing to downgrade the importance of distortions from other interests, and while acknowledging that New Zealand may be different, it seems to me that the recent experience of the larger English-speaking countries is clearly that corporate investment in the democratic

Ross Garnaut is Professorial Research Fellow in Economics at the University of Melbourne. He was the 2015 Sir Frank Holmes Visiting Fellow in Policy Studies at Victoria University of Wellington. He has published widely on a diverse range of economic issues, including development economics, macroeconomics, trade policy, climate change policy, the Australian economy and China’s economic development.
process represents a fundamental barrier to dealing effectively with major public policy challenges.

Gary Hawke and Grant Scobie (Scobie, 2015) both draw attention to the risks to maturation of global economic development from weakness in economic growth in China. Hawke is right to point out that China is so important to the global savings story that changes in China could alter prospects for the world.

It is not possible to bring everything one has written on a subject into every new paper, so I am glad that Hawke has drawn attention to my discussion of the risks to Chinese growth in other published work, including *Dog Days: Australia after the boom* (Garnaut, 2013). (For a more recent treatment, see Garnaut 2015a.) Scobie cites Pritchett and Summers (2014) as authority that the high rates of growth in China over the past three and a half decades are likely if not certain to give way to decisively lower growth. Pritchett and Summers point to a step down by more than half in rates of growth in many countries. They think that China’s political system makes it especially vulnerable. Yes, there is uncertainty, and other countries should make sure that policy settings are robust against the possibility of China making heavy weather of the transition to a new model of economic growth (Garnaut, Cai and Song, 2013; Garnaut, 2015a). But there are also powerful forces pushing to sustain Chinese growth at rates significantly above the global average until it has entered the income range of the developed countries in the 2020s.

Scobie says that the Holmes Lecture fails to acknowledge another serious challenge to the maturation of global development: the feeding of the world’s growing (for the time being) population. How do we provide food for all people at the standards of consumption of the advanced countries? I didn’t neglect the point altogether: the food challenge is one reason to be concerned about the effects on global fertility rates of any failure of development amongst the bottom billion. My own deep involvement in international agricultural research as chair of the boards of the Australian Centre for International Agricultural Research and then the International Food Policy Research Institute makes me aware of both the history of achievement in raising productivity in agriculture since the 1960s, and the inadequacy of current public investment in international agricultural research. But I doubt that food supply will be a binding constraint on the maturation of global development unless a failure of development in a substantial part of humanity prolongs high global population growth.

Technological change may ease what would otherwise be a binding constraint on the maturation of global development in new and different ways. Necessity is the mother of invention. Rising food prices from large increases in demand in rapidly growing developing countries in the absence of accelerated productivity growth in agriculture may ease the path to expansion of non-agricultural food supply. Unpalatable as it may be for generations of *homo sapiens* accustomed to food from agriculture, and challenging though it is for food-exporting countries like New Zealand and Australia, the biological sciences are taking us towards synthetic substitutes for traditional food that at least meet nutritional requirements. My own personal preference for lamb and milk from the farm, and the preferences of others of my generation, whatever the taste of alternatives, are unlikely to be a decisive barrier to global development.

Geoff Bertram (Bertram, 2015) challenges my preference for Keynes over Picketty in assessment of likely trends in the relationship between savings, investment and the distribution of income and wealth. Here I focus on three points in Bertram’s critique: the distinction between inequality in the world as a whole and among the seventh of humanity living in the developed countries; the prospects for the rate of return on capital returning to the high historical levels presumed by Picketty; and the importance of positional goods in assessment of economic welfare.

The Holmes Lecture is about global inequality and not the distribution of incomes in the developed countries alone. While inequality has expanded markedly in the developed countries over recent years, it has not increased in the world as a whole. Figure 7 and the associated reference to changes in the global Gini coefficient make the point that Bertram overlooks. I do not say in the Holmes Lecture or elsewhere that inequality in developed countries is inconsequential. It is important to many people and it may determine the fate of government by, as well as for, the people – the democratic political systems that have made their homes in the developed countries. That matters a great deal to the future of humanity. It may or may not matter to the prospect for the maturation of global development.

On the second point, Bertram sees future savings and investment adjusting until a balance is found which leaves rates of return on investment at high levels. He gives us no better reason to expect such an outcome than that this has been the case in much earlier economic history; one could say most except for the globally golden and silver years since the Second World War.

Bertram recognises that abundant capital kills returns. Like the neo-classical growth theorists, he expects the rate of accumulation of savings to fall in response to low returns on investment, to bring savings in line with falling investment, and sees natural floors to investment rates.

Like Keynes, I see no reason for, and no sign of, low returns causing a diminution of the rate of savings. I see no reason to expect the combination of opportunities for investment at low interest rates, and depreciation, to grow more rapidly than savings from now on, and so raise the returns on low-risk investment above their currently negligible levels.

It is worth noting in response to Bertram’s view that not only does the price of bonds rise with falls in the interest rate: the prices of other assets, including equities and real estate, also rise. As a result, falling interest rates have led to increases in most asset values in the 21st century so far, contributing a large part of the increases in inequality in the developed countries measured by Picketty over this period.

Bertram notes that rents for land and assets in fixed supply will rise with growth in population, and may do so
with growth in incomes. This is separate from the increases in capital incomes associated with reductions in interest rates. It is not obvious that this source of increase in asset values will remain important with the maturation of global development and stable or falling global population.

We should make sure that we include in the assets in fixed supply not only land, but all assets that are subject to such restriction in supply that they generate increasing amounts of economic rent. Monopolistic and regulatory rents and the value of the assets which generate them seem to be increasingly important in developed countries today. The cause may be the increased influence of corporate interests over the policy-making process.

Bertram is right to pull me up for dismissing too quickly inequality in the distribution of positional goods. Knowledge, literature, music, theatre and sport are fairly freely available for most people through electronic mechanisms, and standard social security arrangements make a reasonable minimum of most essential goods and services available to most people in the developed countries. The increased abundance of material comforts with the maturation of economic development would extend these advantages to most of humanity. But there is a danger that increasing corporate influence over the policy process will lead to access to more and more services being restricted behind private paywalls of various kinds. To combat such tendencies, we have to rely on the integrity of established democratic processes in the developed countries, and on the extension of government for the people to parts of the world from which it is currently excluded.

I am happy to agree with Hawke, Scobie and Bertram that there is uncertainty about many of the variables that affect the future trajectory of global inequality. The Holmes Lecture asks the reader to consider an alternative outcome to that proposed by Picketty and thought likely by Bertram: that the maturation of global development will diminish rather than expand inequality. While I think the basic tendencies may turn out to resemble Keynes’ more closely than Picketty’s vision of the future, I am concerned enough about the remaining inequality to concur with Picketty’s support for international taxes on capital, and with his assertion of the crucial role of democratic systems in effecting the policy change that is necessary to maintain equity in distribution in individual countries and in the world as a whole.

Finally, I take the opportunity to correct two errors in presentation in the original Policy Quarterly article which may have discouraged some readers. On page 10, the original text said that high natal masculinity was the source of a decline in the zero population growth fertility rate. It was meant to say that high natal masculinity was increasing the fertility rate that was consistent in the long term with zero population growth. And the heading of Figure 6 should read ‘Secular trend in relative price of capital goods’.

References

Can we Nudge Citizens Towards Better Civic Behaviour?

Speakers: Liz Richardson, Director Undergraduate Studies, University of Manchester and Scott Miller, Chief Executive Volunteering NZ

Friday 4th December - 12:30 – 1:45pm
Intercontinental Hotel, Wellington
RSVPs required. See more at http://igps.victoria.ac.nz/events