Kiel Institute for the World Economy

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Formulating a Sustainable Growth Strategy

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100 YEARS
UNDERSTANDING
AND SHAPING
THE WORLD ECONOMY

The Kiel Institute for the World Economy

General principles

- Sustainability
  - » Long-run perspective
  - » Long-run = sequence of short-runs
  - » Short-run steps in line with long-run direction
- Per-capita growth factors
  - » Division of labor (integration in the world economy)
  - » Capital stock (channeling savings into productive investment)
  - » Education and technology (human capital, innovations)
  - » Inclusive institutions (incentives, profit-liability-nexus)
  - » Entrepreneurship (human action)

⇨ **Do not expect quick-wins**

⇨ **Play with the market forces, not against them**

Autopsy and consequences of financial/debt crisis

- Financial/debt crisis: Symptom, not root of the problem
  - Reflecting distortions in the physical capital stock
  - Real sector unable to earn promised yields
- What caused these distortions in the first place?
  - Expansionary monetary policy stance outside the region (unsustainable demand vector)
  - Misperception of risk, tax-payers as risk buffer (illusion of risk-free financial assets, debt instead of equity)

⇨ **Restructure mechanisms before you restructure debt**

⇨ **“Buying time” is costly (zombie structures)**

⇨ **Do not touch the currency**

Stimulating growth by deficit spending?

- Bottom-line of Keynesianism
  - New debt is good (stimulates demand)
  - Old debt is bad (limits fiscal space)
- Defects
  - Obviously, today‘s new debt becomes tomorrow‘s old debt
  - Fighting over-indebtedness with new debt doesn‘t work
  - Multiplier-analysis assumes problems in the production structure away (low „growth“ as problem of capacity utilization)
  - Potential output paradigm extremely prone to misperceptions

⇨ **No trade-off between short-run and long-run (capital accumulation via domestic saving)**

⇨ **Debt legacy problem must be addressed (enabling workable allocation of savings into viable investments)**

Macroeconomic stabilization

- Financial/debt crisis
  - » Not a shock at all (does not come out of the blue)
  - » Market response of unveiling unsustainable claims
- Natural disasters
  - » Clearly exogenous
  - » Smoothening possible, but permanent income losses remain
    - higher cost of capital burden in the region
    - downward level shift of potential output
- Diversification as a stabilization device?
  - » Small countries gain most from globalization (if they specialize)
  - » Capital markets to replace internal public insurance systems

⇨ **"Shocks" are no excuse for running deficits**

⇨ **Do not stabilize growth away, specialization is key**

Shaping the production structure

- Search for comparative advantages
  - » Let the price system work
  - » Remove distortions

- Opportunities
  - » Reaching for comparative advantages
  - » Not copying the rest of the world

⇨ **Entrepreneurship is key**

⇨ **Focus on comparative advantages rather than compensate disadvantages**

Infrastructure and the government

- Most infrastructure systems
  - » Natural monopoly
  - » Not a public good
- Vast room for private sector involvement
  - » Financing on pay-as-you-use basis
  - » Government as a rule setter, not as a producer/investor
- Role of private investment
  - » Funding and expertise
  - » Risk taking (full liability, no hidden government guarantees)

⇨ **Private sector as beneficial enabler and beneficial disabler of infrastructure projects (priority setter)**

⇨ **True capitalism, no risk-exempt or captive investments (more equity, less debt)**

Regional cooperation for creating inclusive institutions

- Not Caribbean states compete, but firms do

- Anti-dumping agreements, not regional cartelization
  - » Preventing beggar-thy-neighbor policies
  - » Room for individual cost-benefit-packages

- Exploring regional synergies
  - » Economies of scale of regulation („know one, know all“)
  - » Harmonization where the “how” is less crucial

⇨ **Cooperate for competition**


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