By Johan Fourie

ECONOMY

Economic growth: what we know and don't know

It's unclear exactly what causes economies to take off, which makes it difficult to implement policies that create more prosperous societies.

The idea of economic growth is under attack. As the planet heats up, Australia burns and drought in many parts of South Africa continues, many are wondering whether the economic model of the twentieth century is the right one for the twenty-first.

Some suggest we pivot our expectations to a zero-growth scenario: Stop producing more and more goods and instead focus on living sustainably. Others are even more extreme: They want de-growth, a world where we all become progressively poorer.

Apart from its paternalistic attitude – you should stay poor because the world cannot afford that everyone be as rich as us – the view that economic growth is the scapegoat rather than the solution is just, well, wrong.

Economic growth, measured by growth in the gross domestic product (GDP), calculates the value of all goods and services produced within the borders of a country within a year. If we produce more than last year, there is economic growth. SA, on a per capita basis, has basically produced the same amount of goods and services for the last decade. That cannot be good, right? If we want people to move out of poverty, we must produce more so that incomes can increase and South Africans, especially the poorest, can purchase the things they now lack.

While we do not yet have all the answers, we keep learning by testing new theories against historical and experimental evidence.

That doesn't mean economic growth should be our only priority. In rich countries, the economic growth of the last four decades has largely benefitted those at the extreme ends of the income distribution, meaning a hollowing-out of the middle-income group. This has raised income inequality, which has had political ramifications, as Thomas Piketty explains in his new book, *Capitalism and Ideology*. (Currently only available in French, the English-language translation appears in March.)

A far more nuanced debate about economic growth is found in the challenging but excellent new book, *Good Economics for Hard Times*, written by the 2019 Nobel prize winners Abhijit Banerjee and Esther Duflo. Instead of economists' unrelenting focus on growth, they propose a focus on wellbeing – measuring whether kids go to school, or how frequently they are hungry, or whether they live fulfilling lives.

Apart from the usual concerns with GDP – that it doesn't include leisure, measures quality improvements poorly, says nothing about the distribution of income or the environmental impact – Banerjee and Duflo make an additional (and important) point: We actually don't know what causes economic growth. Why should we target something without a recipe for success, they ask, when we can instead focus on various aspects of wellbeing that development economists have been able to target pretty accurately?

This is true. Economists have not identified the elixir of growth – that one policy, if implemented, that causes economic growth to skyrocket. Instead, theory and evidence point to many things that we like to call 'necessary but not sufficient': an openness to trade, protection of property rights, an educated workforce, and so forth.

But that doesn't mean growth theory is meaningless. No, economists have learned a great deal from real-world examples about what we should not do. This is what Banerjee and Duflo fail to mention, probably because they assume most readers know this already.

We've learned, for example, that when a country closes its borders to international trade, it stops growing. When a government decides to set prices of goods and wages for labour, the market system collapses, and poverty escalates. We've learned that competition among firms leads to less rent seeking; oligopolies and monopolies are more likely to lobby government to protect their privileges. And that independent central banks are more likely to stabilise prices and fight inflation. Any time a government has tried to go against these lessons, they've destroyed wealth and exacerbated poverty.

The reasons we don't know what exactly causes economies to take off is because human societies are incredibly complex things. As behavioural economists show us, humans constantly make rational and irrational decisions, and often don't make any – even if it would be in their interest to do so.

Politicians, torn between their own goals of re-election and the public interest, must make sense of this complex web of behaviours and social interactions to design policies that improve wellbeing. Viewed from this perspective, the fact that there is any progress at all is a miracle.

Yet that doesn't suggest economists have learned nothing about how to design policies that work within this complexity. While we do not yet have all the answers, we keep learning by testing new theories against historical and experimental evidence.

As Banerjee and Duflo summarise: "The only recourse we have against bad ideas is to be vigilant, resist the seduction of the 'obvious', be sceptical of promised miracles, question the evidence, be patient with complexity and honest about what we know and what we can know. Without that vigilance, conversations about multifaceted problems turn into slogans and caricatures and policy analysis gets replaced by quack remedies."

What economists have learned is that there are things we unequivocally should not do. It's a bad idea to close our borders to international trade, or remove property rights, or give too much power to monopolists and oligopolists. What we should do instead, both to raise growth and improve wellbeing, is less clear. This is where we should follow the advice of Banerjee and Duflo, and through context-specific, evidence-based analysis implement policies that build a more prosperous society. ■

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