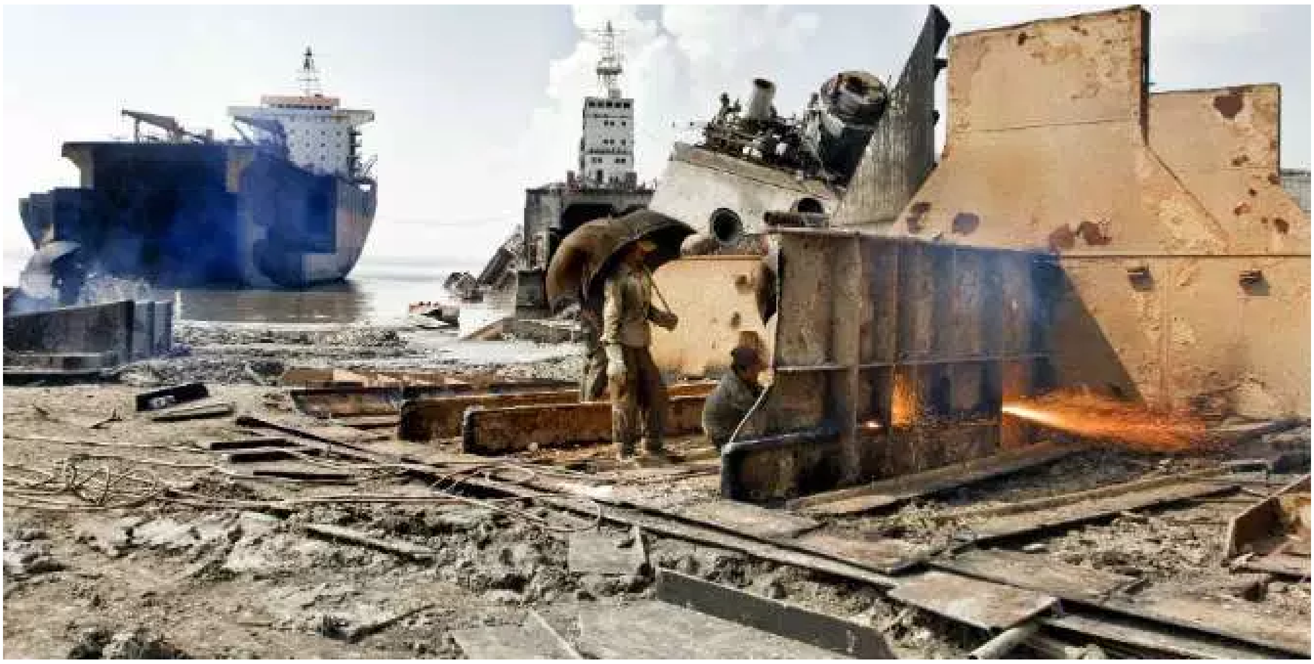
Post 2015: Growth and the new sustainable development agenda

*In the first of the **Africa at LSE**, **IGC** and **South Asia at LSE** cross-blog series on the Sustainable Development Goals, Paul Collier and Upaasna Kaul argue that achieving the new UN Global Goals will require governments to refocus policy agendas on growth. Substantial poverty reduction will only be achieved through inclusive and sustainable growth. The challenge is not simply to create more jobs, but to also develop market structures, public institutions, and urban infrastructures to support the creation of higher value, more productive jobs.*

In some countries the *average* person still lives in absolute poverty. These countries – the poorest on Earth – are where the challenge of addressing poverty is fundamentally about growth. In middle-income countries growth still matters, but those in absolute poverty can potentially be helped more quickly by redistribution. In contrast, in the poorest countries the average is too low for redistribution alone to work. Understanding why these countries are still so poor when many others have accelerated and sustained growth is the central question that now haunts international development.



Creating higher-value jobs requires investments in productivity Photo credit: Naquid Hossain via Flickr (https://www.flickr.com/photos/30088500@N00/4114723979)

Achieving the new Sustainable Development Goals (SDGs) will be no different. Ensuring that the poor have the opportunity to earn their way out of poverty is the foundation upon which sustainable pro-poor growth is created in developing countries. Economic growth therefore comes from policies that increase the overall productivity of ordinary working people.

Economic empowerment is about wage empowerment

Enabling ordinary people to earn a living wage helps them to participate in the social fabric and economic networks of their communities. Such growth cannot occur without concerted policies that foster organisations which are capable of generating productive job opportunities. Some of these organisations are in the private sector – modern firms such as factories and supermarkets – and some are in the public sector – modern agencies such as schools and tax offices.

People's ability to earn depends primarily on how productively they work. In low-income countries, ordinary people are often much less productive than their counterparts in high-income countries, and so their income is equivalently much lower. As a result, their lifestyles remain far below that of the majority of developed nations in the 21st Century.

Historically, the most common way for ordinary people to become more productive and receive higher incomes has been through access to wage employment within productive firms –firms that are large and organised along modern lines. However such large, productive firms are much less prevalent in low-income countries. This is why, in low-income countries, workers employed in modern sectors, whether private or public, are an income-elite. The challenge is therefore to expand the number of large, productive firms offering wage employment. The following section explores what productive firms look like and what government can do to support the entry and growth of these firms within their respective markets.

Creating growth and the ingredients of productivity: Scale, specialisation, motivation and energy

As noted, the challenge is not simply creating *more* firms that hire and pay workers, but creating *productive* firms. In this section, we explore the three ingredients of productivity: scale, specialisation, and motivation.

Since Adam Smith, economists have understood that the fundamental ingredients of productivity are *scale* and *specialisation*. Large modern organisations, whether in the private sector, such as a manufacturing firm, or in the public sector, such as a tax office, enable work streams to be arranged in ways to harness economies of scale. Similarly, modern organisations arrange workers into distinct differentiated activities, enabling the matching of workers' abilities to the needs of differentiated tasks. Furthermore, by specialising in a single activity, workers develop specialised skills for those activities. This opportunity to learn by doing – accumulating specialist human capital instead of being a jack-of-all-trades – is perhaps the single most important mechanism by which scale and specialization raise productivity.

Harnessing productivity gains from scale and specialisation has an obvious spatial dimension – workers have to congregate together in cities. We speak idly of a country developing, but scale and specialisation are overwhelmingly urban phenomena: national development is fundamentally urban development. A manifestation of this is agglomeration effects, with similar firms clustering together, whether factories in a zone, or jewellers along a street. Clustering and supply-chain integration, in turn, promotes competition, fosters productivity, and induces knowledge sharing of processes and innovations. Firm clusters are now an integral part of the new economic geography, but the challenge remains finding ways to help firms in low-income countries shift into higher productivity industries. This can be achieved by widening a country's industrial base and supporting firms to enter higher-value global supply chains. Doing this requires both significant investments in improving product quality and an environment that attracts foreign investors and multinationals.

Even modest steps from small-scale informality to modern enterprises can yield dramatic gains in productivity and hence in incomes. For example, survey evidence of Ethiopian manufacturing firms shows that in firms with fifty employees the productivity of the average worker is *ten times* higher than in firms with only four employees.

In addition to requirements of scale and specialisation, effective organisations are those that can motivate their workers. Self-employed workers face much fewer incentive problems, as their incomes are manifestly related to effort. But large organisations face greater threats from free-riding: people would often rather shirk than expend effort. An *effective organisation* overcomes these motivational challenges through a varied set of approaches. Most obviously, a well-run organisation provides material incentives that motivate its workforce into effort. But more subtly, almost all successful organisations help their workers to internalise its objectives. People work not just for money, but from pride in their job, loyalty to their team, and a competitive desire to beat other organisations.

Finally, it is no accident that at times the language of economics overlaps with that of physics. Both disciplines use the term ‘effort’ but whereas economists relate effort to motivation, physicists relate it to energy. Both insights matter: to be productive, people need to be motivated, but they also need a supply of cheap and sustainable energy. A disastrous characteristic of most poor countries is that energy supplies are unreliable and massively more expensive than in more productive economies.

Economic policies must create more and higher-quality jobs

Low-income countries face acute shortages of effective organisations. The private sector is dominated by tiny informal enterprises lacking scale and specialisation. Such organisations are desperate responses to poverty and cannot provide their workers with an opportunity to be productive however hard they work. On the other hand, the public sector is dominated by large organisations that have sufficiency of scale and specialisation, but have failed to overcome the challenges that all large organisations face in motivating their workers. Tax collectors pocket bribes in return for overlooking tax evasion; teachers fail to show up for classes; resources or job-materials with higher market values are often at risk of theft from employees seeking to supplement low public-sector salaries. The electricity grid functions for only a few hours a day, so that firms either go without energy or have to get generators which are wildly expensive both to buy and to run. The combination of an unproductive private sector and an unproductive public sector traps ordinary workers in poor countries into poverty. Thus the main thrust of cultivating pro-growth policies is encouraging the emergence of effective organisations with adequate energy supplies.

Eradicating extreme poverty requires policies that encourage active, self-determined growth

Current development discussions focus heavily on improving service provision and traditional transfer programmes targeted at the poor. The rhetoric around such programmes inadvertently casts ordinary people into more passive roles where they are seen as recipients of aid and government spending programmes, rather than self-determined actors driving their own transitions out of poverty. Fundamentally whether people are poor or not depends much more upon their earning capacity than what they receive from the government.

Hence, for poverty in low-income countries to be sharply reduced, different policies are needed – policies must empower people to earn more, not simply focus on government transfers. Obviously, there is no ‘one-size fits all’ approach that can be applied as a panacea for growth in developing countries. Instead, successful policies depend upon identifying the right set of opportunities available to a country at a particular time. Whatever the circumstances, national governments and the international community should emphasise efforts to support productivity and growth with a view to creating better jobs that allow people to lift themselves out of poverty.

Only growth can enable the poorest societies to achieve their own aspirations, such as the broad list of global goals that will be finalised during the UN Summit this week. At the IGC we think of the growth process as depending upon on four pillars. States need to build its own effective organisations, such as schools and tax offices: we term these *effective states*. Government needs policies that foster effective business organizations: that is, *productive firms*. The spatial dimension of scale and specialization implies that governments need to foster *functioning cities*. Finally, and perhaps most obviously, the brute physics of effort implies that for ordinary people to be productive, the society needs a supply of affordable and *sustainable energy*.

This post forms part of a cross-blog series run by the **IGC**, **South Asia @ LSE** and **Africa @ LSE** blogs**.** Stay tuned for more posts.

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September 21st, 2015 | Development, Featured | 0 Comments