

Ashok Desai

## Episodes of Growth and Decline



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I had expected to work in the Kolleg on ultra-long-term forces shaping economic growth. But my perspective changed between the time when I formulated the proposal in 1990 and when I arrived in Berlin in 1993. In the interval, I worked in the government and was engaged exclusively with extremely short-term problems: the government which came to power in 1991 inherited an economic emergency; every day began with a crisis and one had to think on one's feet. I realized that economic policy is always made in the short term and became interested in the short-term steering of economies — which is the core of policy-making today in many developing countries and East European economies.

What one is trying to do in these countries is to initiate a process of growth in production and employment which can be accelerated and sustained as long as possible. Spectacular bursts of growth have occurred in a number of economies in recent decades — in western Europe in the 1950s and 1960s, in Japan from the 1950s into the 1980s, in Brazil in the 1960s and 1970s, in Korea and Taiwan in the 1970s and 1980s, and the boom which began in China in the 1980s and which still continues. Conversely, there are long periods of stagnation or decline in some countries. Argentina and Philippines are the prime examples, but episodes of poor growth are also marked in the USA, UK, and India.

In studying these processes, one inherits from conventional economics a bias towards efficiency which is useful but insufficient. Economic policy is not written on a clean slate: one starts with an economy that is already there, and its characteristics have to be taken into account. There is considerable empirical literature that is supposed to guide one in the circumstances, based on the successes and failures of various countries. While working in the government I had developed a distrust of this approach. All too often, a bureaucrat who wanted to advocate a particularly stupid policy would argue that it was the policy in some heroic country such as Japan or Korea or Germany. Such arguments were so wrong so often that I formulated a law: every folly has a precedent in a model country.

On arrival in Berlin, I began by reading the literature on comparative economic policy in various countries, and finally decided that lessons of policy were not transferable across economies: a more analytical approach was needed. So I turned to the question: what causes economies to grow faster or more slowly? This is a very old question in economic literature: it goes back a hundred and fifty years at least. In the first half of this century, this line of research crystallized into trade cycle literature. After World War II, it died out as trade cycles in the traditional sense ceased. But more recently, the lasting slow-down in the growth especially of the European economies has led to a revival of interest in one form of trade cycle, namely long waves or Kondratieffs. I went through this literature and decided to work out postwar cycles for various countries.

I spent considerable time trying to derive cycles for a sample of countries. But after much experimentation I was forced to the conclusion that cycles are an artifice of economists, and that no objective method gives cycles of even remotely comparable length for different countries. Very simply, a cycle can be defined as a pair of turning points in an economic series, for instance a series of total output or of prices. I worked out many frequency distributions of the interval between two turning points. They showed that the longer the period between a pair of turning points, the lower the frequency of occurrence of the period. In other words, variations in growth processes can be legitimately viewed as purely random: I could find no robust support for the notion, well established in economics for the last 75 years, that there are Kitchins lasting 3-4 years, Juglars lasting 8 — 9 years, and Kondratieffs lasting about half a century.

Here there is a problem of deriving comparable figures of growth; what is regarded as growth in one period or country may not be so regarded in another period or country. For output is aggregated at a certain set of prices. The prices change so radically over time that countries rebase their output series roughly once every ten years. Relative prices vary even more across countries. At current prices and exchange rates, the output per head

of two countries may differ by 40 to 1; when valued by the same set of prices — prices of either country — the difference often shrinks to 10 to 1 or less. Besides, it is not 10 to 1 in respect to all the goods produced and consumed. The pattern of consumption changes as countries grow richer. So people in a poor country may have only a hundredth as many cars as those in a rich country, but may actually eat more bread or rice per head. These facts are well known thanks to the inter-country comparisons of gross domestic product pioneered by Gilbert and Kravis in the 1950s, and expanded to cover the majority of non-communist countries by Summers and Heston, who carried on their work. I obtained their time series, stretching from 1950 till 1992, for about 56 countries, and carried out a number of experiments on them.

These experiments established that there is a positive association between the long-term growth rates of output in different countries and the stability of growth, as measured by the reciprocal of the coefficient of variation of growth. The result is quite robust for 15 countries that were my primary sample (USA, Brazil, Argentina, Mexico, UK, France, Germany, Spain, Italy, Japan, Korea, Thailand, Philippines, India and Pakistan), less so for the larger sample of 56 countries which included a number whose statistics were suspect or whose openness made them highly susceptible to outside disturbances. I further found that the serial correlation of growth rates was generally positive in fast-growing countries and negative in slowly growing countries: in other words, that a year of high growth was more likely to be followed by another year of high growth in fast-growing countries, and the reverse in slowly growing countries. This result explained the failure to find standard cycles across countries: the cycles were likely to be shorter, and growth was likely to be interrupted sooner in more slowly growing countries. The highest growth rates recorded were often higher in slowly growing countries, but growth episodes collapsed faster in them.

From this point one could proceed in two directions: either one could look for inherent features in the growth processes of slowly growing countries that would lead to their quicker reversal and did not do so in fast-growing countries, or one could look at the operation of constraints in both types of economies. The second approach is easier to follow, since the constraints are well known and have been intensively studied. In particular, the concepts of the internal savings constraint and the external balance-of-payments constraint are standard. So I started in this direction, and established that the interruptions of growth processes were not caused by variations in investment and savings; savings and investment ratios were in general much more stable than output. Some other intriguing results emerged at this stage. For instance, investment-output ratios

over standard periods of 10 or 20 years were distinctly lower in the fast-growing Asian economies — Japan, Korea and Thailand — and higher in the European economies. The latter were so high in periods of low growth that the investment could not have been driven by the rate of return.

Putting these results together, it seemed to me that the variations in growth were caused by variations in demand rather than in supply, and yet, that they were not classically Keynesian in the sense of being driven by instability of investment. After this, the next step would have been to investigate the behaviour of the external constraint in different economies, and also the role of macroeconomic policy. But at this rivetting juncture in the investigation, my work was interrupted by a medical emergency, and self-repair had to take precedence over the repair of economies.