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Economic policy and growth – an introduction

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Economic growth has always been at the centre of the policy debate. This is quite natural since the long-run consequences for welfare of even a small change in the growth rate is considerable. Recently, much of the popular growth debate has dealt with the so-called ”new economy”. This is not a well-defined concept, but it usually refers to the expectation of a long period of high growth induced by the IT revolution. This expectation has been fuelled by the long upswing of the US economy in the 1990s with what appears to be unusually large productivity gains.

While the ”new economy” has not yet been the subject of much careful research, the last decade has nevertheless witnessed a substantial research output dealing with growth issues. Behind this development is the new theory of *endogenous growth*, spurred by the works of Paul Romer and Robert Lucas in the late 1980s (Romer, 1986; Lucas, 1988). According to this theory, the rate of growth is endogenous and can thus be affected by economic policy. In contrast, the old, *neoclassical* theory maintained that economic policy could only cause a once-and-for-all shift in the growth path of GDP per capita, while the long-term growth rate was determined by the exogenously given rate of technological progress.

The new growth theory has inspired both theoretical and empirical research—not only among the economists who belong to the “endogenous growth school”, but also among economists who adhere to the traditional, neoclassical view. This has invigorated the entire research field. In 1999, the Economic Council published an anthology (in Swedish) on growth on behalf of the Swedish Ministry of Finance

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(Calmfors and Persson, 1999). This issue of the *Swedish Economic Policy Review* contains six essays based on papers in that volume.

In the first essay, *Assar Lindbeck* discusses Swedish economic growth against an international background. He shows that Sweden has experienced slower growth than comparable countries during the last three decades. The reasons for this are not very clear, but the process has been associated with a continuous deterioration of Sweden's terms of trade. For one reason or another, it seems that Sweden has tended to concentrate its productive resources on goods that have had an unfavourable price development in the world markets. Lindbeck is, however, fairly optimistic about the future growth prospects for the Swedish economy because of recent product-market deregulations and reforms in the tax and welfare-state systems.

The following two papers deal with issues of central importance to endogenous growth theory, namely education and the accumulation of human capital. One of these papers, by *Kjetil Storesletten* and *Fabrizio Zilibotti*, provides a survey from a macroeconomic perspective of how various forms of human capital accumulation, such as basic schooling, innovation and research, and learning by doing in firms, affect growth. The authors emphasise strongly the need for economic incentives in order to promote human capital accumulation. Such incentives include high relative pay in the education sector in order to attract qualified teachers, pay differentiation in favour of successful teachers within the education sector in order to promote efficiency there, and high relative pay for educated people in general in order to make higher education more attractive. Storesletten and Zilibotti also explore the extent to which (lack of) human capital accumulation has accounted for the slow-down of Swedish growth relative to other OECD countries. Their conclusion is that this factor has had little to do with the difference in growth performance.

In the other paper on education and human capital accumulation, *Anders Björklund* takes a more detailed look at the productivity of various forms of education. He surveys various microeconometric studies of the private return to education, and also discusses empirical studies of the productivity of investments in education. Björklund reports strong empirical evidence suggesting that an additional year of schooling in Sweden raises earnings by around four per cent. At the same time, he argues that the benefits of adult education may have been overstated in the recent Swedish policy debate.

The final papers in the volume address three specific issues that have been connected to growth in the policy debate. *Lars Calmfors* and *Bertil Holmlund*, in their paper on the relationship between unemployment and growth, emphasise the distinction between, on the one hand, policy measures that cause a reduction in unemployment and thus a once-and-for-all shift in the GDP growth path, and on the other hand, measures that affect the long-run rate of growth. Calmfors and Holmlund survey theoretical and empirical research on how various labour-market institutions affect unemployment and also discuss the political economy of labour-market reform. While there is strong reason to believe that labour-market reforms may reduce equilibrium unemployment, the relationship between unemployment and long-term growth is less clear. It is not evident that policies leading to lower unemployment will necessarily increase growth or that higher long-term growth will reduce unemployment

In his paper, *Bengt Kriström* challenges the common view that growth is harmful to the environment. At earlier stages of development, there might well be a positive correlation between GDP and pollution. As real incomes grow, however, the demand for a clean environment may well turn out to have a high positive income elasticity; as people become richer, they may demand a cleaner environment, and thus the correlation between GDP and pollution may become negative. Kriström also discusses the possibility of a "double dividend", i.e. that a shift from labour taxes to environmental taxes can both improve the functioning of the labour market and raise environmental quality. He is sceptical to this possibility.

The final paper, by *Magnus Blomström*, addresses the issue of internationalisation. For Sweden, this phenomenon may be related to the country's relatively poor growth performance; while empirical data show that Swedish *companies* seem to be competitive and successful, Sweden as a country has been lagging behind other countries in terms of growth, as discussed by Lindbeck in his essay. The reason may be that Swedish companies have chosen to expand abroad, rather than to develop their operations in Sweden. Blomström shows that this seems to be particularly true for those fields that are conducive to growth, i.e. high-tech areas, which are human-capital intensive.

The policy conclusions to be drawn from these papers appear very simple. Education and research are important, and the government should create incentives for broad, high-quality education as well as for advanced research. At the same time, the government should keep an eye on the possibility that capital (human and physical) flows out of the country. This implies low taxes on human capital, i.e. less progressive taxes on labour income, and low taxes on physical and financial capital. While these policy recommendations are simple from an efficiency point of view, they imply well-known distributional conflicts and are thus politically difficult.

At the same time, international tax competition is increasingly constraining individual governments. In fact, according to the new growth theory, the tax bases that are the most internationally mobile are also those that are most conducive to growth. If so, it may be the case that it is tax competition—rather than technological development and the IT revolution—that will produce a "new economy" with higher long-term growth than earlier, but probably also with a more uneven income distribution.

References

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