The Commission on Growth and Development was established in April 2006 as a response to two observations. While we felt that the benefits of growth were not fully appreciated, we recognized that the causes of growth were not fully understood. Growth is often overlooked and underrated as an instrument for tackling the world’s most pressing problems, such as poverty, illiteracy, income inequality, unemployment, and pollution. At the same time, our understanding of economic growth is less definitive than commonly thought—even though advice sometimes has been given to developing countries with greater confidence than perhaps the state of our knowledge would justify. Consequently, the Commission’s mandate was to “take stock of the state of theoretical and empirical knowledge on economic growth with a view to drawing implications for policy for the current and next generation of policy makers.” This mandate has even more significance in the aftermath of the financial and economic crisis of 2008. As developing countries seek to repair the damage to their economies and to relaunch themselves on a sustained high-growth path, there has never been a greater need for fresh new ideas and approaches to achieving sustained high growth.

To help gauge the state of knowledge, the Commission invited leading academics and policy makers from around the world to a series of 13 workshops, held from 2007 to 2009 in Washington, DC; New York; New Haven, CT; and Cambridge, MA and commissioned a series of thematic papers. These papers reviewed subjects such as the causes and consequences of the financial crisis, monetary and fiscal policy, climate change, inequality, growth, and urbanization. In addition, 25 case studies
were commissioned to explore the dynamics of growth in specific countries. Each presentation benefited from comments by members of the Commission and other workshop participants from the worlds of policy, theory, and practice.

The workshops were intense and lively affairs. It became clear that experts do not always agree, even on issues that are central to growth. The Commission had no wish to disguise or gloss over these uncertainties and differences; it did not want to present a false confidence in its conclusions beyond that justified by the evidence and accumulated experience. Researchers do not always know the correct "model" that would explain the world they observe, and even if they know the factors that matter, they cannot always measure them convincingly.

While researchers will continue to improve our understanding of the world, policy makers cannot wait for scholars to satisfy all of their doubts or resolve their differences. Decisions must be made with only partial knowledge. One consequence is that most policy decisions, however well informed, take on the character of experiments, which yield useful information about the way the world works, even if they do not always turn out the way policy makers hoped. It is best to recognize this fact, if only so that policy makers can be quick to spot failures and learn from mistakes.

The workshops from which we drew much of the inspiration for this volume, “Global Trends and Challenges” and “The Financial Crisis and Its Impact on Developing Countries’ Growth Strategies and Prospects,” were held in September 2007 and April 2009 in New Haven, CT, and Cambridge, MA, respectively. We were immensely fortunate to benefit from the wisdom and insights of outstanding researchers and experienced practitioners, and we are grateful to all of the participants, who are listed further in the volume. Globalization is an overarching theme that is relevant to the way we think of growth in open economies, and a volume on globalization and growth is particularly relevant given the current environment. The remainder of this preface is not an exhaustive summary of the workshops or the chapters; rather, it outlines the main goals and themes of this volume as well as the position and recommendations of the Commission with regard to the crisis.

Faced with increasing skepticism about the fate of globalization and the prospects for developing-country growth in the wake of the crisis, the Commission outlined its views in Post-Crisis Growth in Developing Countries: A Special Report of the Commission on Growth and Development on the Implications of the 2008 Financial Crisis (December 2009). The current crisis has raised numerous questions about the best strategies for achieving sustained growth and poverty reduction in developing countries, foremost among them whether the failure of the financial system also signifies a broader failure of market-oriented capitalist systems. Practically speaking, this raises questions as to whether the growth strategies that are understood to have worked in the past are still valid in the post-crisis world.

The Commission believes that the crisis was a failure of the financial system. The lightly and incompletely regulated model that characterized
the advanced-country systems, especially in the United States and United Kingdom, is fundamentally flawed and in need of change. Regulators, central banks, market participants, and researchers (with a few notable exceptions) failed to appreciate the full dangers of this financial fragility. Going forward, they cannot afford to maintain their narrow focus on consumer prices and employment, leaving asset prices and balance sheets to their own devices. Certain entities in the regulatory system will have to take responsibility for the stability and sustainability of asset prices, leverage, and balance sheets. The alternative, which is to go back to the pre-crisis status quo, is neither economically nor politically acceptable.

That said, we have not found any evidence of a more broad-based failure of the market and capitalist economies. While the real economy has been damaged globally, private sector responses have generally been appropriate to the diminished circumstances. In the Commission’s view, an outward-looking, market-driven strategy, as suggested in the original Growth Report, remains broadly valid. However, while this strategy remains the best alternative, it may not be as rewarding as it was in the years before the crisis, as the world economy that emerges from the recent upheaval is likely to be marked by slower growth in trade, costlier capital, and a more inhibited American consumer.

In the view of the Commission, the policy debate should be focused on the financial sectors’ stability and performance. The nature of this crisis has inevitably strengthened the hands of those who prefer a more expansive role for the state. Properly channeled, this is not necessarily a bad outcome, but there are ample opportunities to make mistakes or to go too far. A substantial expansion of the government into the broader economy might disrupt the private dynamism that has contributed to all the successful high-growth cases of which we are aware. In our view, the state’s expansion needs to be reversed as the crisis subsides. Central banks need to withdraw their support as private credit channels return, while in the meantime retaining the independence to do this when the time is right. The government should, however, be more involved in protecting people in the face of extreme economic turbulence, which would complement efforts to achieve greater economic and financial stability.

Internationally, some of the poorer countries only recently adopted fledgling growth-oriented policies, and the consensus in their favor, which was somewhat fragile going into the crisis, may break down as a result of it. If so, it may be the poorer, small countries that suffer the most lasting consequences. Meanwhile, their future depends greatly on developments beyond their borders: on how quickly foreign financing returns and on how soon their export markets revive. It would be morally unacceptable to leave these countries stranded by a crisis that was caused elsewhere. That is why the resources of the International Monetary Fund (IMF) must be equal to the crises that it and the global economy face. Lingering doubts about its governance need to be resolved so that the institution can act authoritatively and speedily. Resources and reform go hand in hand. Developing
countries should be given a greater say in the institution, commensurate with their new prominence in the world economy.

On the positive side, there are countervailing forces. Some of the fundamental determinants of growth are relatively crisis proof: demography, for example, or human ingenuity. Wealth has been destroyed, but the stock of know-how from which developing countries can learn is undiminished. In principle, the potential for “catch-up” growth depends only on the gap between the developing country and the technological frontier. Thus developing countries still have the opportunity to set and modify policies and resume progress toward sustained high levels of growth, despite the multitude of pitfalls that remain as a result of the crisis.

It is clear that there will be a wide variety of policy implications to be drawn from the crisis, unique to each country’s stage of development. With regard to two of the most important policy issues—the structure of financial sectors in developing countries and the macroeconomic policy framework—the Commission strongly recommends that developing countries adopt a more conservative, if more costly, financial model and position themselves favorably to withstand external shocks by maintaining low levels of public debt, ample foreign exchange reserves, and high domestic savings. In times of stability and relatively high growth, policy should lean in the countercyclical direction. The individual chapters in this volume provide more in-depth analysis of specific policy issues germane to developing-country growth in the post-crisis world, touching on aspects of fiscal policy, employment, inequality, demographics, and climate change, to name a few.

As an introduction, Danny Leipziger provides in chapter 1 a timely and comprehensive overview of the state of the world economy and the debates surrounding the future of globalization and economic growth once the crisis has passed. He concludes that, while multiple outcomes to the current crisis are possible, the post-crisis environment will hinge largely on the leadership displayed by governments in the present, most notably the United States, the European Union, and large emerging markets. This leadership will be shaped and influenced in no small part by the domestic political debates surrounding the benefits of globalization as well as the very real long-term fiscal and monetary consequences of present action. The remainder of the volume provides an in-depth analysis of the specific causes and effects of the crisis and their consequences for short-term, medium-term, and long-term growth in the developing world.

Contributions to part 1—The Global Financial Crisis: Causes, Mitigation, and Reform—meticulously detail the events and actions that contributed to and flowed from the current crisis. Part 1 takes us from the onset of the subprime crisis, highlighting the shortcomings of financial supervision, to the implosion of large financial institutions resulting in the near-collapse of credit markets and the entire financial system. Authors Daron Acemoglu, Charles Calomiris, Andrew Sheng, Richard Cooper, and Ravi Kanbur provide their insights into the intellectual and policy mistakes that contributed to the crisis as well as the enabling environment of broader macroeconomic
and financial trends. Part 1 concludes by highlighting areas of potential reform, with a focus on mitigating the effects of the crisis on the poor.

Following the description of the anatomy of the financial crisis and its far-reaching effects in part 1, part 2—How to Foster Real Growth—provides specific insight into the way forward for emerging and developing-market economies (EDMEs), highlighting specific issues and policy options to promote real growth in their economies. Authors Dani Rodrik; Antonio Estache and Marianne Fay; William Cline; and Philippe Aghion, David Hemous, and Enisse Kharroubi provide valuable insight into new ideas that have come to the surface in light of the crisis that have important implications for medium- and long-term growth. These topics touch on issues related to the government’s role in promoting sustainable economic growth, new ideas on the viability of the export-led growth model, the importance of infrastructure for long-term growth, and the appropriate role of countercyclical fiscal policy.

Finally, no volume on growth would be complete without taking account of the long-term challenges. Part 4 of The Growth Report: Strategies for Sustained Growth and Development (May 2008) provides a comprehensive overview of these challenges; however, the crisis has imbued them with a greater sense of urgency. While all countries face long-term challenges to their growth, developing countries face a unique set of obstacles due to their geographic and demographic circumstances. In part 3—Long-Term Challenges to Growth—authors David Wheeler; Robert Mendelsohn; and David Bloom, David Canning, and Günther Fink explore the issues of climate change and demographics and their implications for the growth of EDMEs. While these topics may seem a measure removed from the current crisis and long-term economic growth, they are, in fact, profoundly connected. Demographic trends will have an enormous impact on fiscal policy and economic geography in the years to come. Likewise, climate change will be one of the most significant challenges facing EDMEs, which, according to some estimates, will incur 80 percent of the associated damages. In prompting a rethinking of fiscal priorities in many countries, the crisis has forced EDMEs to confront climate change and demographic issues earlier than they might otherwise have.

To conclude, this volume endeavors to provide an overview of the current debates surrounding the impact of the financial crisis on the growth trajectory of EDMEs as well as new ideas and fresh approaches for dealing with future growth challenges. The scale and scope of the downturn leave no doubt that the economic environment post-crisis will differ markedly from that preceding it. While the Commission on Growth and Development does not seek to make specific predictions as to the future of the economic landscape, our goal is to present ideas at the forefront of the debate on what that landscape may resemble and how developing countries can best adapt. On behalf of the Commission Secretariat, commissioners, and participants, we hope that you enjoy this volume.