

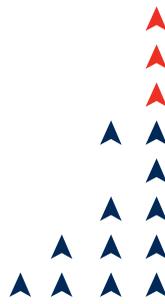


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**Economic**

**GROWTH**

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## ECONOMIC GROWTH

### Book Summary

#### ► *"Why states have different levels of income?"*

There is no single answer to this question from Adam Smith to the present day. Maybe the reason is, in Adam Smith's time, the per capita income of the richest and the poorest countries differed only four times, but now the GDP per capita of the richest Monaco and the poorest Burundi differs 711 times! In other words, Madagascar's GDP per capita is twice more than Burundi's, Nepal's than Madagascar, Ghana's than Nepal, Jordan's than Ghana, Cuba's than Jordan, Latvia's than Cuba, Japan's than Latvia, Switzerland's than Japan, Monaco's than Switzerland.

In 2019, per capita GDP in high-income countries was \$ 44,613, upper middle-income countries \$ 9,014, middle-income countries \$ 5,562, lower middle-income countries \$ 5,071 and low-income countries \$810. Income gaps are growing not only among states, but also among people, companies and genders. According to OXFAM, the wealth of the richest 1 percent of the world's population is twice the wealth of 6.9 billion people.

Introducing the classical approach to economic growth, A. Smith and D. Ricardo identified three main factors of production: labor, capital and land. Later, Romer and others added technology to this line, and a number of scientists, including Rodrick, Robinson and others added institutions, and finally Hofstede, Huntington, and Inglehart, added culture as well. A long time ago, Ibn Khaldun accepted moral values in society as the basis of development.

This book explains the essence of economic growth using various model approaches, including the Solow growth model, the neoclassical model, endogenous technological change, stochastic growth. In addition to traditional factors affecting economic growth, the role of the factors was also touched upon, such as cultural diversity, narrative and social capital in economic development.

Jared Diamond considers geographical determinism as the basis of economic development, and therefore points out that the first agricultural farming in the history of the world was located in the "Fertile Crescent" in the Middle East, which has favorable natural conditions. Haussmann, Ricardo, and Velasco, in their "Growth Diagnostics" article,

developed an analytical framework that formed a tool to identify binding constraints to growth in each country, and concluded that reforms might be successful if targeting binding constraints. The Russian writer Leo Tolstoy wrote in *Anna Karenina* that "all happy families are alike, and each unhappy family is uniquely unhappy." The same is true for economies: each country must have its own approach to economic growth. The methodology developed at Harvard University is called the Problem Driven Iterative Adaptation (PDIA) approach. In our opinion, growth diagnostics and PDIA complement each other. If growth diagnostics help to get to the heart of the problem and find critical barriers to growth, the PDIA identifies a way out of the problem.

Nobel laureate Esther Duflo wrote in his "The Economist as Plumber" article that, since economists support governments develop more and more new policies and regulations, they go into the details of public policy and thus provide a plumbing approach. When theoretical approaches are not enough, the plumber knows what can work in the real world.

An economist must have both theoretical training and practical skills to make the right policy decisions. In the 1960s, it was thought that Standard Oil, the Communist Party, and the Catholic Church were the best-planned and managed organizations: the future was as planned. Later, strategic management came to the fore. The modern world requires not only to plan at the macro level, but also to be flexible and agile in accordance with the requirements of the day and the challenges of the future. On the business level, McKinsey recommends even combining a flexible approach with lean management.

For the past 40 years, prominent figures in the behavioral economy, such as Daniel Kahneman, Robert Shiller, Richard Thaler, Angus Deaton, George Loewenstein, and others, challenged the principle of rationality of individuals, which underlies classical theory. Behavioral economics emphasizes the role of psychology in people's decision-making and economic behavior, as well as the relationship between rational, perceptual, and emotional processes. Some even believe that, 70 percent of human decisions are emotional and 30 percent are rational. Gallup's research added a new color to economic growth: behavioral economics play an important role in ensuring high growth and profitability. Thus, companies applying the principles of behavioral economics show 85% more sales growth and 25% more profit growth than their competitors.

Gallup's research shows that behavioral economics has the potential to collect a "low-hanging fruit" rather than "six-sigma" or "lean management." Gallup teaches business leaders how to achieve real growth by understanding human nature.

The Law on Artificial Intelligence proposed by the European Commission will set the new requirements for the applied artificial intelligence. Artificial intelligence will give a new tone to economic relations by applying it on a new stage and scale, taking into account not only the human mind, but also emotions. Meanwhile, it is impossible to agree with the statements about the negative impact of the Fourth Industrial Revolution on employment. Because during the previous three industrial revolutions, such concerns did not justify themselves.

Even 90 years ago, John Maynard Keynes wrote, "Our speed of discovering possible ways to save on labor exceeds our speed of finding new ways of using it." But even this great economist's assumption did not come true. Of course, during the Fourth Industrial Revolution, the need for a number of specialties will be eliminated, but nevertheless, there will be a demand for emerging of new ones. Only the countries with a new skilled labor force will be able to ensure economic growth on a higher trajectory.

There is a fifth generation of geo-technological competition in the digital age in the world. In order to compete, each country i) strengthens the tools of government using 5G technologies; ii) stimulates the use of 5G technology by government, business and consumers; iii) develops 5G technologies at the national level in hardware, software and digital services. Estonia is already implementing the economic strategy working in real-time regime.

The idea of the Higgs field, which won the Nobel Prize in 2013, justifies the policy of green economic growth. Presumably, the Higgs field gives mass to the particles passing through this field, and thus the energy is converted into mass. In this case, the natural harmony is preserved. Green economic development must also ensure such a harmony that natural harmony is not disturbed when producing goods and services from the resources.

The research conducted by the United Nations Development Program shows that, while economic growth is related to quantitative changes in the factors of production, the concept of economic development as a

broader concept refers to progressive qualitative changes of it. Qualitative changes in the factors of production, in turn, are associated with technological progress, human capital development and productivity growth. In fact, economic growth is not the goal in itself, the ultimate goal is the well-being and decent life of the people.

It is important to deconstruct the problem that hinders economic growth, that is, to break it down into details. It is possible to penetrate into the problem with the Japanese "five why questions" or "fish skeleton" methods. In this way, Toyota was able to bring its production to an almost perfect level by finding and treating the root causes of the problems. "Deliberation councils" with the participation of government, business, and civil society representatives can shed light on problems in the value chain. The experience of countries that have shown "economic miracles" in Asia proved the effectiveness of "deliberation councils".

In Japan, which has about 200 "deliberation councils", there is even a council that solves the problems of sumo wrestling. In keeping with the spirit of stakeholder capitalism, discussions involving all stakeholders have the potential to accurately diagnose economic problems. After identifying the problems of economic growth, the "3 A" (Authority, Acceptance, Ability) approach can be applied to answer the question of where to start. First, it is important to have the authority to ensure economic growth, then all stakeholders must understand and accept the problem, form a sense of ownership, and third, have the ability.

Azerbaijan is the "Glory Star" of this "Economic Growth" book. No matter to what extent the book analyzes general theoretical and practical issues, as well as global trends, it still does not leave the orbit of Azerbaijan. In fact, the problem of economic growth is unique in each country, and the "recipe" for economic growth is therefore different.

Former US President Ronald Reagan stated that "there is no limit to growth, because there is no limit to human intelligence, imagination and wonder." If this were not the case, then the economic growth would not still be the main topic of discussion, even though the world economy, which was only \$ 183 billion at the beginning of our era, is now over \$ 100 trillion. Imagine that in 1820, the world's GDP per capita was 1102 US dollars, in 2018 this figure was 15 times higher - 15212 US dollars. Economic growth were particularly rapid over the past 50 years. The pace of economic growth began to vary sharply across regions and countries. This book analyzes the nature of economic growth and the

resulting inequality, as well as provides policy proposals.

In 1990, per capita GDP in Latin America was more than a quarter of the US income level, while per capita GDP in developing Asian countries was only 5 percent of the corresponding US figure. From 1990 to 2019, Asian countries' economy quadrupled, but Latin America still remained at the same level. The reason for this was that Asia had twice as much investment as Latin America. However, the countries of Central, Eastern and Southeast Europe, which at that time attracted less investment than Asia, also developed faster than Latin America. The explanation for this fact was related to the quality of institutions and human capital.

In general, the level of productivity of the economy is more important for economic growth. Otherwise, Mexico would not have a lower rate of economic growth in the last 25 years if it had attracted more investment (relative to GDP) than Poland. The same amount of investment provides different levels of economic growth in different countries. Yes, investment boosts the economy, but to a certain extent. In the long run, the driver of economic growth is not investment, labor and natural resources, but productivity. Only then more economic growth might be achieved with the same amount of production. If the economy operates efficiently, it will attract both investment and skilled labor. Our conclusion is that the economy must be efficient.

For this, factors such as stability, quality of institutions, human capital, technology, infrastructure, favorable business climate, access to markets, participation in global value chains, cultural codes that trigger development, cultural and ethnic diversity, identity, narratives, behavioral economics and social capital must be taken into account. Each country can ensure economic growth only by creating its own "bouquet"(bunch) of these factors.

Along with global challenges such as the technological revolution and the shift of the center of capital from West to East, as well as global climate change, the new conditions created by the COVID-19 pandemic affect the trajectory of economic growth. The "fiscal space" and quality of the institutions, as well as digital solutions and green growth paradigms, are essential for the continuation of public policies supporting economic growth.

Business culture and business model also play a role in economic growth by being reformed in accordance with the requirements of the new era.

Along with the post-pandemic era, the post-conflict period also created new conditions for economic growth in Azerbaijan. The goal of Azerbaijan's economy, which more than tripled in the last 17 years, to double in the next 10 years, is the basis for further improving the state's objectives, including social welfare.

The final conclusion of this book is, the economic growth is not the end goal, but a tool for sustainable development and prosperity. We hope that, "Economic Growth" will be useful!

During the 30 years of independence, Azerbaijan's economy has more than tripled, providing the material basis for our economic and political superiority in the region, rising to the status of the most reformist country, improving prosperity, and providing Azerbaijan with an important hub at the crossroads of East-West and North-South. The next goal is to double the size of the Azerbaijani economy in the next 10 years and to achieve new successes by further strengthening our achievements as a state and society. For this reason, the transition to a high trajectory of economic growth is, as former Israeli Prime Minister Golda Meyer said, "our choice without alternatives."

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