

The Holy Trinity of Growth*

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Michael Best:

How Growth Really Happens: The Making of Economic Miracles through Production, Governance and Skills

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Hogyan történik valójában a növekedés? Gazdasági csodák teremtése termelés, irányítás és készségek által

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The birth of macroeconomics is mainly related to the study of cyclical movements in the economy. Keynes was inspired by the societal cost of the recurrently appearing, rather persistent unemployment to develop his general theory that diverged from the Neoclassicals. At that time, theory and economic policy (Roosevelt's New Deal) were evolving in parallel, but a sophisticated measurement of real economic performance, i.e. the establishment and general spread of national accounts, was at least a decade away.

After a few years of data collection, statisticians and economists also began to analyse the emerging trends. This was the period when the long-term, so-called *stylised facts* of economic growth were first documented (*Kaldor 1957*). One of the most important phenomena awaiting explanation was that GDP per capita was steadily increasing in the USA and in some developed industrialised countries. Overall, economists struggled to map this phenomenon for quite some time, with rather limited success. In fact, empirical studies showed that the bulk of the growth was due to the residual principle, which was not addressed in the models. This is what the entire literature on growth accounting was all about. For good reason, *Moses Abramovitz (1956)* called the "Solow residual" a "measure of our ignorance", pointing out that there are indeed more unanswered questions about economic growth than there are satisfying answers. The situation is just made

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more complicated by the experience of middle income economies over the past half century. In most countries, the catch-up process gets stuck after a while. This is called the Middle Income Trap (MNB 2018). However, there are countries that have broken out of this trap as a growth “miracle” and have joined the elite club of developed economies.

Miracles and ignorance. That does not sound very scientific! Why is it so hard to capture the phenomenon of growth? What is so special about the process? What are the key factors that will make a country and economy successful or moderately developed? Some researchers consider the human capital (Lucas 1988), some the increasing return observed in the R&D sector (Romer 1990), others the institutional conditions (Acemoglu and Robinson 2012) and still others the spatial structure (Varga 2009) to be a critical factor. Who is right? Probably everyone is partly right. At the same time, economics has still not been able to ensure that after much hard work, a standard,¹ comprehensive theory and model is elaborated which, by including the important factors, could explain *how growth really happens*.

Michael Best takes on this task in his book. Best, by the way, can be considered a black-belt veteran on the subject of industrial growth: he is a Professor Emeritus at the University of Massachusetts Lowell and Co-Director of the Center for Industrial Competitiveness. He has examined businesses in more than 20 countries and personally gotten to know hundreds of companies thoroughly over the past nearly 20 years. He is the author of a number of books and scientific articles, a real hotshot on the subject.

But let’s get back to the book. The methodology of research is based primarily on case studies. Unfortunately, in standard macroeconomic growth theory methodology, we do not often encounter the methodology of case studies, even though it is a complex system incorporating the functioning of the economy, which can be well demonstrated through historic examples. The reader gains a very interesting insight into the American wartime economy and the industrial ecosystem around Boston. But the book goes beyond an analysis of the narrowly understood industrial economy of the USA. It also presents the secret of Germany’s successes, the background to the Japanese production miracle and the rise of China. At the same time, it cites bad examples: it reveals the decline in industrial production in the United Kingdom, the dual economy of Ireland and the growth slowdown in the USA in recent years. All this is made even more exciting by instructive sectoral stories.

The book’s main conclusion is that the key to success lies in the so-called Capability Triad. This Capability Triad consists of business model, production system and skill

¹ Like the standard theory emerging in physics.

formation. Accordingly, there is no point in us having a great business model if we do not have the production technology to produce the given product in the right volume and quality. Continuous development of the skills of business professionals, managers and employees is at least as important. Best found that successful development policies are the ones that are aware of the interrelated, mutual impacts of this Capability Triad and that build the strategy on their development.

Best's book focuses on the supply side of the economy. On the one hand, this supply side is often painfully simplistic in the standard macroeconomic models and, on the other hand, it is a critical factor in terms of whether macroeconomic demand can support growth or increases inflation or possibly impairs the external balance.

In the fourth chapter of the book, the author deals with the theoretical historic sprouts of the Capability Triad. This can be considered the theoretical basis of the Capability Triad derived from the case studies. Although the list of quoted classical economists is impressive and multifaceted, the theoretical conclusions are not very convincing. The key, according to the author, is the increasing return, the existence of which is so easy to disprove (*Jones 1995*), even in activities such as research development. The so-called Moore's law is an excellent example of disproving the increasing return (*Bloom et al. 2017*). The law states that the complexity of computing processors doubles roughly every two years. In order to sustain this growth, however, today 18 times as many researchers have to work on the task as did in the 1970s. Therefore, we need to invest more and more resources to uphold Moore's law. What is this if not a diminishing return?

Another thought on my mind while reading the book was that the demand side was completely omitted. In recent years, researches on hysteresis have definitely shown that negative demand effects (crises) cause permanent damages, on the supply side of the economy as well (*MNB 2016*). By contrast, a managed, high-pressure economy can permanently increase its performance. Long-term, sustainable economic growth requires demand, adequate fiscal, monetary policy, deepening credit markets as well as expanding productive capacities.

My third critical observation concerns the strict industrial focus that permeates the entire book. In modern economies, the weight of the service sector is dominant today and this large-scale sectoral rearrangement is expected to continue in its favour in the future (*MNB 2017*). Does the Capability Triad also play a key role in the growth of this sector? Maybe so, but certainly not in the same way as it occurred in the case of the 20th century industrial success stories cited as examples.

Socially, ecologically and financially sustainable economic growth is in the common interest of all of us. So no one can be indifferent to the subject. I particularly recommend the book to those students familiarising themselves with growth

theories, who – in addition to dry equation systems – want to understand the success stories of economic growth in their own complexity. The devil is indeed in the details, and fortunately the reader gets to know a great many details when reading the book. At the same time, industry and development policy professionals and business leaders alike will find a useful framework for thinking.

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