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Issues in the Design of Growth Exercises *

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Abstract

This paper deals with the design of quantitative exercises relating objectives for the growth of national income over the medium term to key macroeconomic policy variables. It focuses on the roles of capital formation, saving, and total factor productivity in the process of economic growth and examines the main conceptual and empirical problems involved in accounting for the growth of national income, dealing explicitly with the cost of borrowing from abroad. The paper examines the link between fiscal and structural policies and the growth of productive capacity through the effect of those policies on productivity, saving and the cost of capital.

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Summary

This paper deals with analytical and empirical issues in the design of growth exercises. These exercises are viewed as attempts to relate, within a quantifiable framework, medium-term objectives for the growth of national income to key macroeconomic variables, particularly policy variables. The paper focuses on the influence of capital formation, saving, and total factor productivity in the process of economic growth. It also examines conceptual and empirical problems involved in accounting for growth.

The paper extends the framework for growth exercises outlined in the recent Group of Twenty-Four Report to deal explicitly with the cost of borrowing from abroad and the servicing of external debt. Considerable importance is placed on the distinction between domestic output and national income. The paper suggests that the objectives of macroeconomic policy should be defined in terms of national income, because this concept excludes that portion of domestic output devoted to external-debt service. An important conclusion is that the extent to which inflows of foreign saving can be relied upon to finance higher domestic investment and growth is likely to be limited, particularly in the present environment in which the external debt of many developing countries is seen to be excessive. In those circumstances, more vigorous growth of national income will be achieved primarily by raising national savings and improving the performance of productivity.

The paper adopts a supply-side perspective: It does not deal with cyclical fluctuations in output, but instead concentrates on the behavior of potential GNP. It examines the links between fiscal and structural policies and the growth of productive capacity through the effect of these policies on productivity, domestic saving (both public and private), and the cost of capital. The paper also analyzes the implications of lags and uncertainty about the effects of policies and examines the differences and interactions between structural and fiscal policies. It concludes that fiscal and structural policies generally should be viewed as complementary rather than substitutable.