Growth in the Post-Crisis World

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Macroeconomic Stability

- Was before the crisis and still is a necessary but not sufficient condition for sustained high growth
- In domestic and global economy
- The challenge presented by the crisis is how to achieve it
- While most of the discussion is about policy
- I think it is a mistake to focus only on policy – the conceptual frameworks used by the private sector participants affect behavior via the accuracy or inaccuracy of the assessment of the dynamics of risk, and hence the self-regulatory properties of the system – which evidently failed in the crisis

Growth Dynamics

- In advanced countries – long run growth driven by innovation
- In EM’s the main ingredients are
  - Engagement with the global economy
  - Inbound knowledge transfer
  - Export diversification and continuous structural change
  - Capital deepening: High investment rates (above 25-35% of GDP) financed mainly by domestic savings
    - With capital/output ratios of 2.5 to 3.0, this will support growth at 7-10%
  - High rates of public sector investment (5-7% of GDP)
  - Policy setting is decision-making under uncertainty and has a pragmatic, experimental character to it in successful cases

However There are Longer Term Issues

- Can be thought of as a series of adding up problems
- Environment, climate, water, energy, global governance and coordination
- These will force shifts in the growth models in all countries

- For example, almost all of the incremental energy consumption and carbon emissions will come from EM growth
  - Even with a highly effective coordinated energy efficiency and mitigation strategy, carbon emissions, by my estimates will at best be flat for two decades
  - In the race between growth and energy efficiency, growth will win in the short to medium run

- It is not a sustainable path

Impact of the Crisis

- There was some concern that the crisis would be misinterpreted as a broad-based failure of the market driven capitalist approach
- And that the growth model would be rejected in favor of a more inward looking, state driven and interventionist approach
- Put another way, the global economy is too dangerous
- That has not happened in part I think because of the speed and completeness of the recovery in the developing countries

- There is heightened attention to initial positioning and to pre-built rapidly deployable mechanisms for handling the distributional effects of shocks

Diversity of Views and Practice

- Policies and investments under the heading of economic and export diversification, SEZ's , supporting urbanization, demonstration effects, and accelerating knowledge transfer have been used routinely
  - But there are benefits and risks (incompetence, waste and capture)
  - Varying degrees of success across cases
  - No real way of knowing the counterfactual
  - The limited duration principle
- The pace and sequencing of opening up on the current account side is important and is more art than science at this point
  - probably the key metric or guideline is keeping the rate of job creation out ahead of job loss via foreign competition and productivity growth
- The capital account pace and sequencing similarly

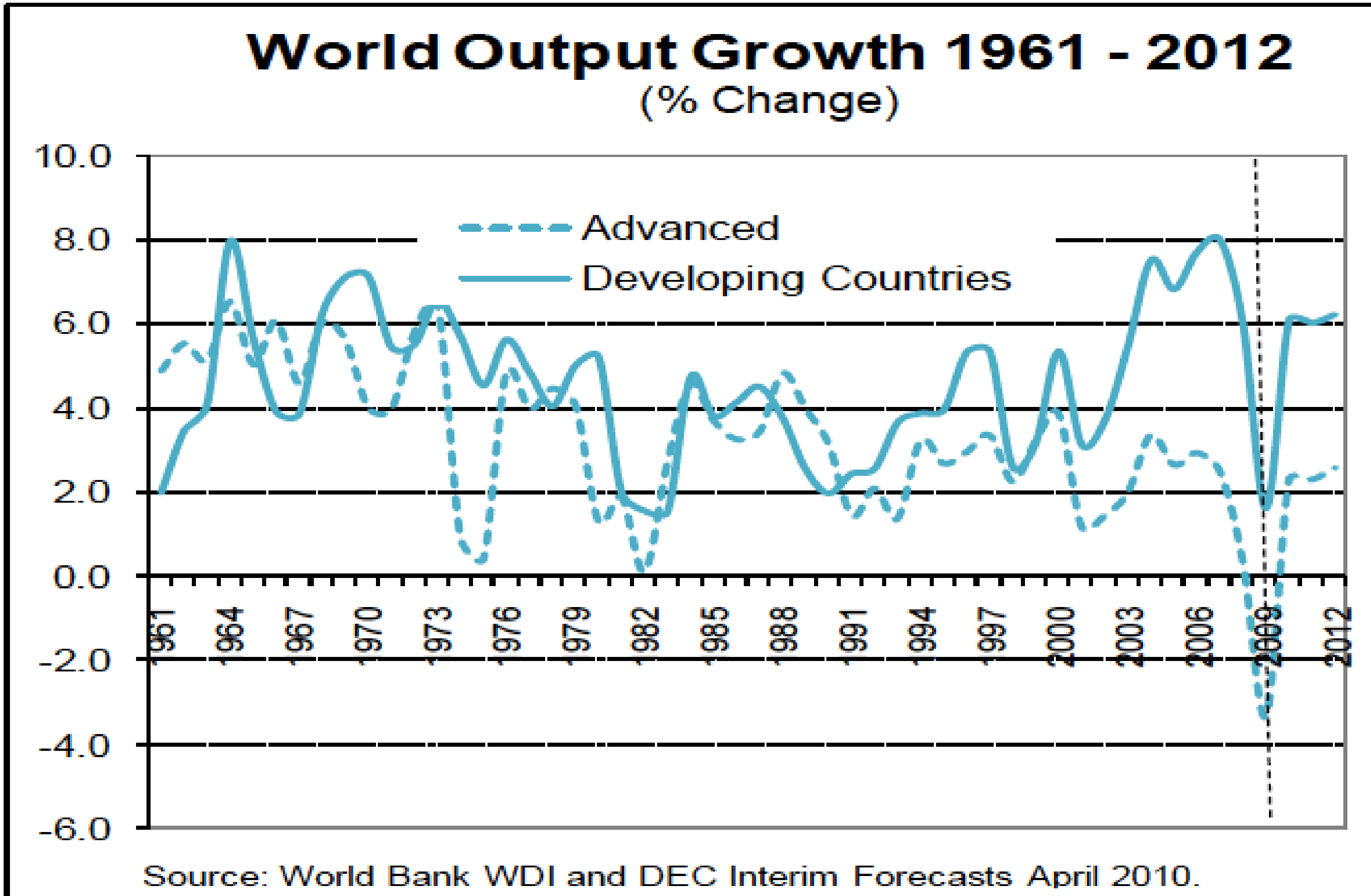
- Generally, the crisis reinforced prior beliefs and lessons from experience and past crises:

The Crisis and Developing Countries

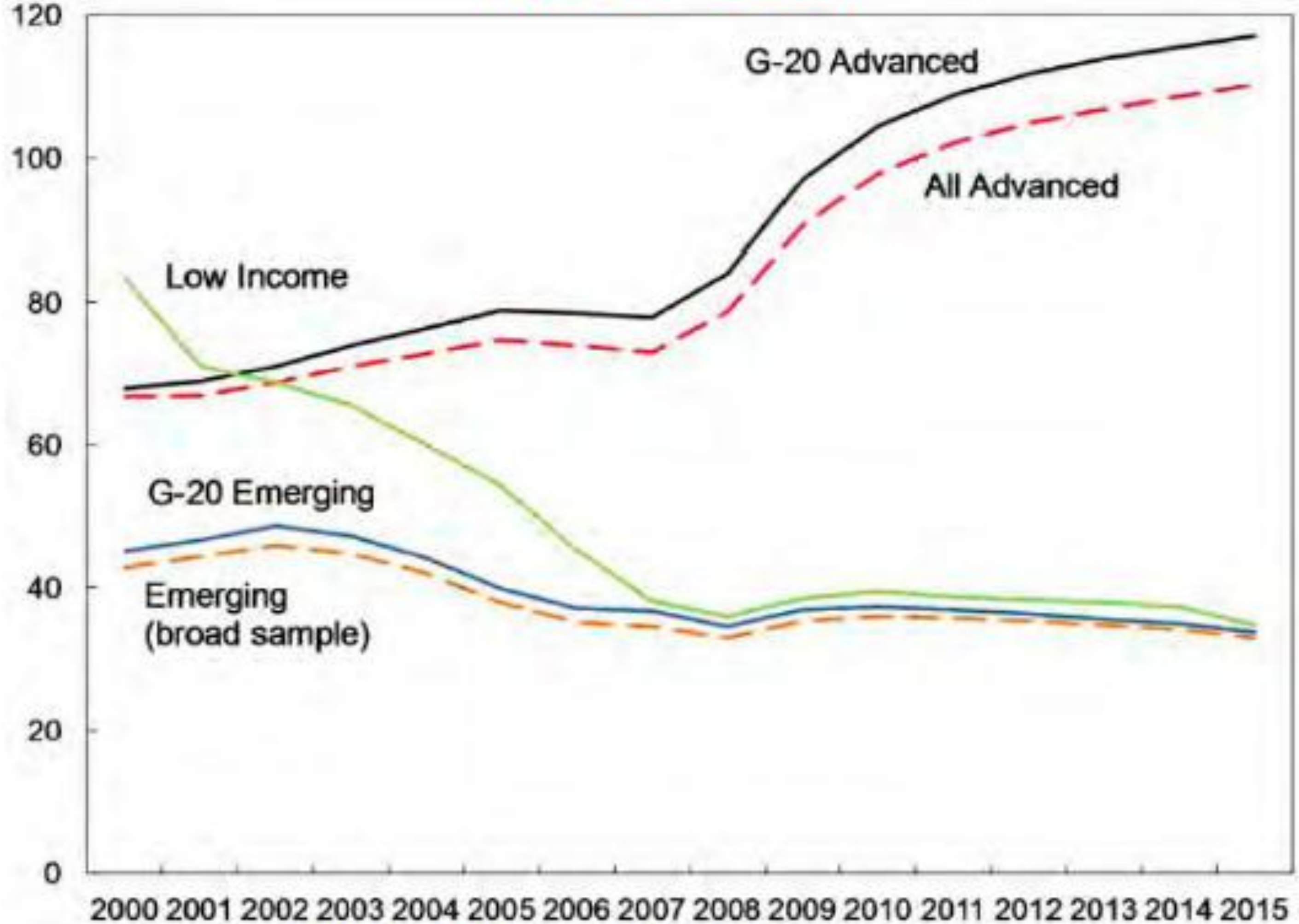
- Two main channels of Impact
  - 1. Exodus of capital and credit tightening
  - 2. Huge fall off in trade – followed by a sharp recovery
- An impressively fast recovery
- China, India and Brazil bounced back in that order
  - Substantial domestic ownership in financial sector
  - Rapid response by central banks
  - Trade bounced back
  - Reserves
  - No toxic assets
  - Absence of excessive leverage and ,oimited balance sheet damage in the household
- EM's had v-shaped recovery that policy makers and markets in advanced countries mistakenly expected with a cyclical mindset

Partial Decoupling

Figure 1



G20 Countries: General Government Debt to GDP Ratios (2000 – 2015)



Source: IMF, *Fiscal Monitor*, May 2010

Sustainability of Growth in EM's

- In the context of a difficult, extended slow growth in advanced economies
- It looks like the growth is sustainable
  - EM growth dynamics still in place
    - structural change and supporting policies deeply embedded
  - Economic size of EM group
  - Trade within EM group
  - Higher incomes and closer match between demand and supply sides of the economy
  - China's growth has become an important engine
    - Main export partner for Korea, India, Brazil and lots of others
  - The network structure of global has shifted

- Downside Risks to Baseline Case
  - Another major downturn downturn in advanced countries
  - Failure to deal with rebalancing of demand
  - Serious outbreak of protectionism
  - Mishandling the current distortions caused by advanced country recovery policies – low interest rates and QE2
  - Growth falters in China

Evolving Structure of Global Economy

- G20 85% of GDP and 66% of population
- EM’s will soon pass 50% of global GDP within a decade
- Asymmetries declining
- Systemic impacts are rising
- Old Hybrid’s
  - Assumed correctly that the systemic impacts of EM’s were limited
  - Enabled focus largely on domestic growth and development
  - Won’t work now
  - Systemic impact coming at much lower income levels – China and India
    - Creates tensions and challenges for global coordination of policies

- EM’s are a double edged sword for advanced economies
  - Big market opportunity
  - Challenge to employment in tradable sector of advanced economies as they move steadily up the value added chain

China and the Middle Income Transition

- Parallel Shifts in Structure in 12th Five Year Plan

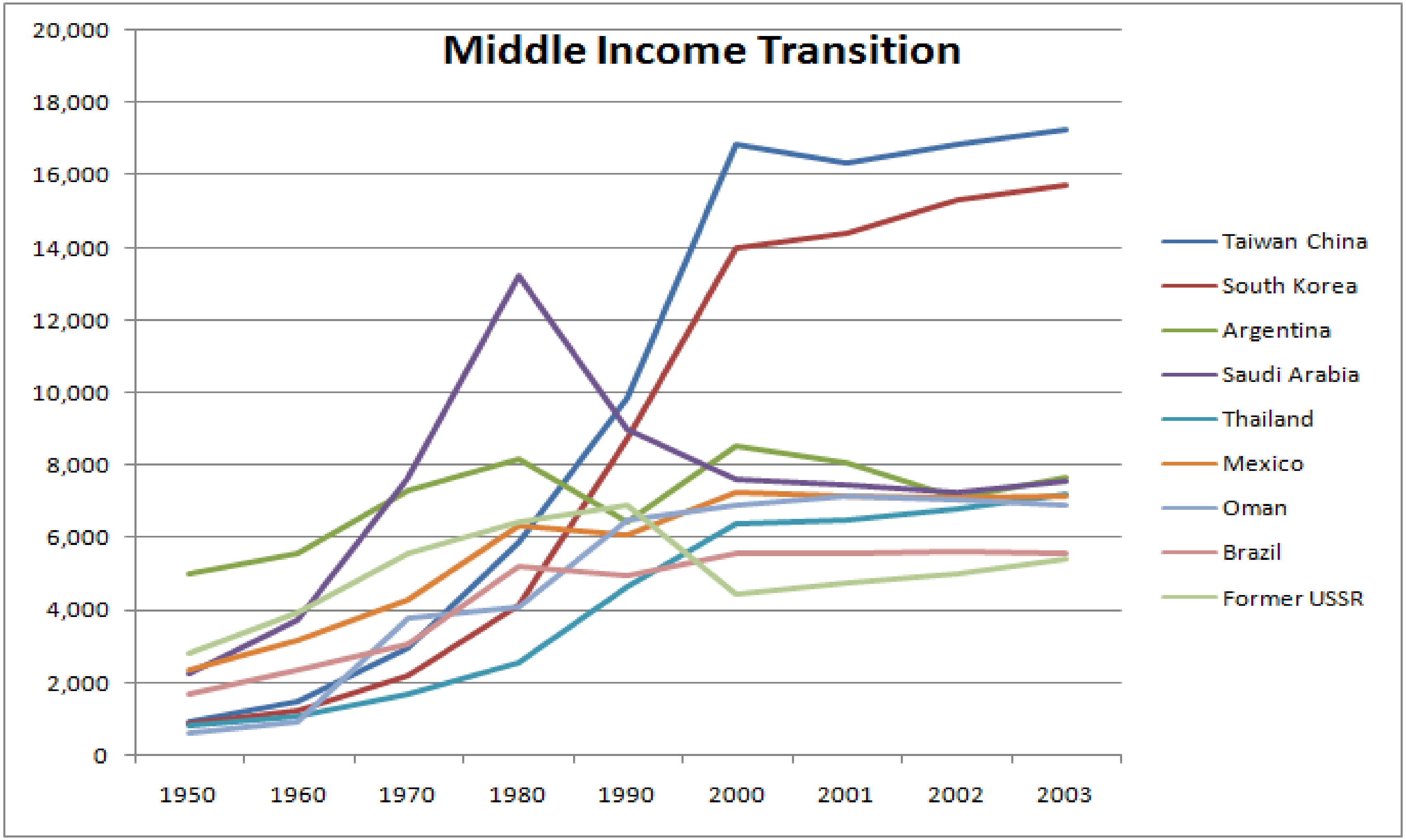
- Middle income transition in China
  - Major internal structural change on supply side
  - Wages in Pearl River Delta post-Foxcomm

- Parallel shift in demand side structure involving national income and saving
  - Required to have domestic demand drive growth and the structural evolution of the economy

- Global rebalancing of aggregate demand and elimination of current account surplus and excess savings – but without loss of growth momentum

- The crisis and China's growing size has made all of the above more immediate and urgent
  - Domestically and in the Global Economy

Middle Income Transition is Difficult



Five High Speed Transitions

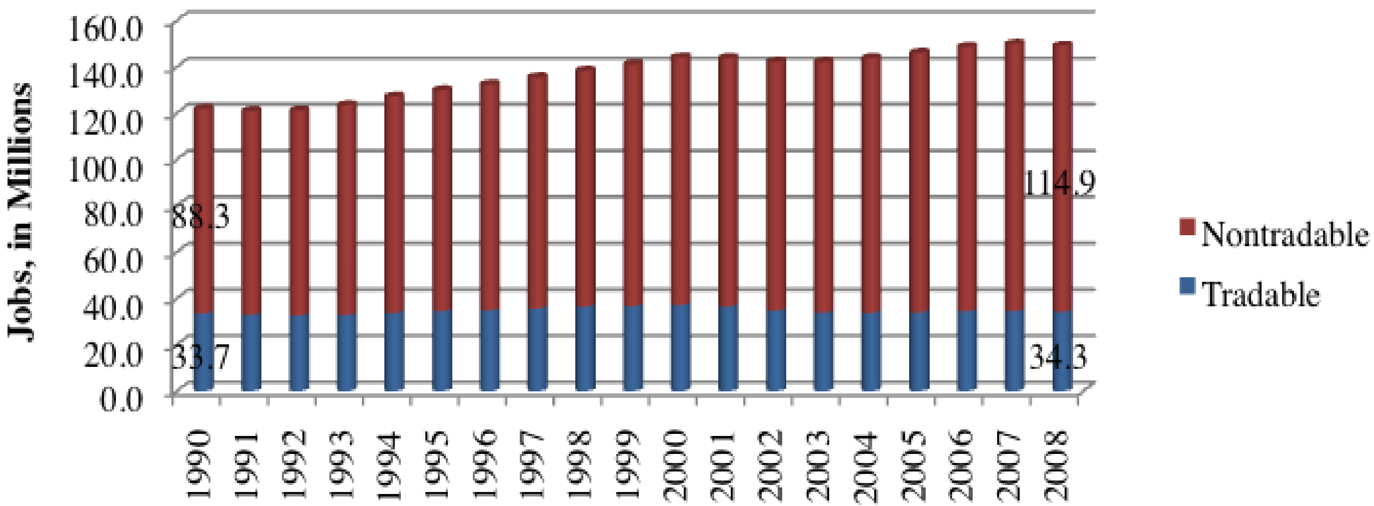
- Japan
- Korea
- Taiwan
- Hong Kong
- Singapore

Advanced Country Growth

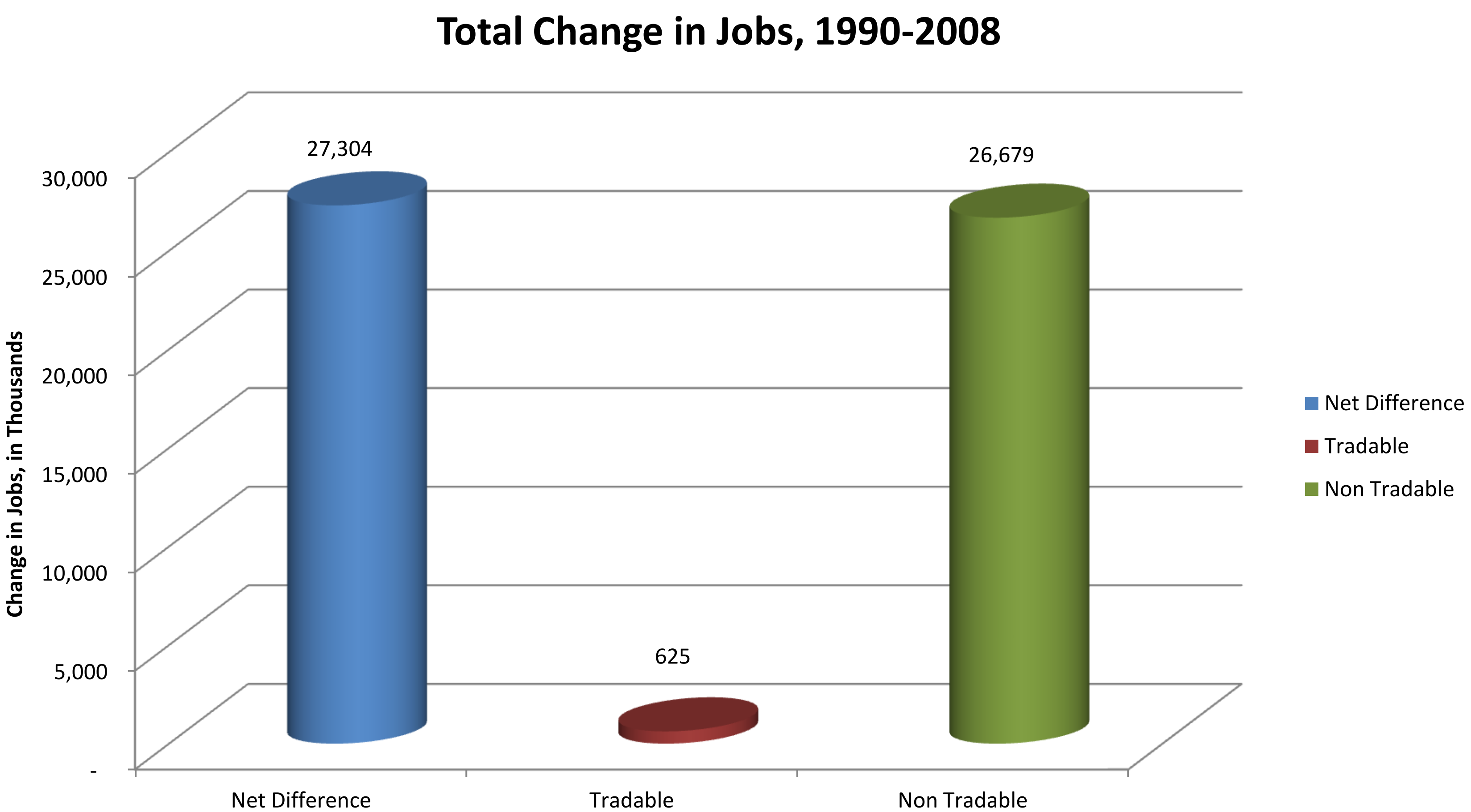
- Is more uncertain for a number of reasons
  - Fragility of the recovery on the balance sheet side
  - Restoring fiscal balance and attendant risks
  - Effectiveness of re-regulation
  - Domestic demand shortfall and insufficient ability to access global demand
  - Longer term structural shifts affecting growth and employment

  - The direct impact of the evolving structure of the global economy and the EM's comes on the tradable side of any economy
  - Then there are indirect effects in the nontradable on employment wages and incomes
  -

Employment in the US Economy

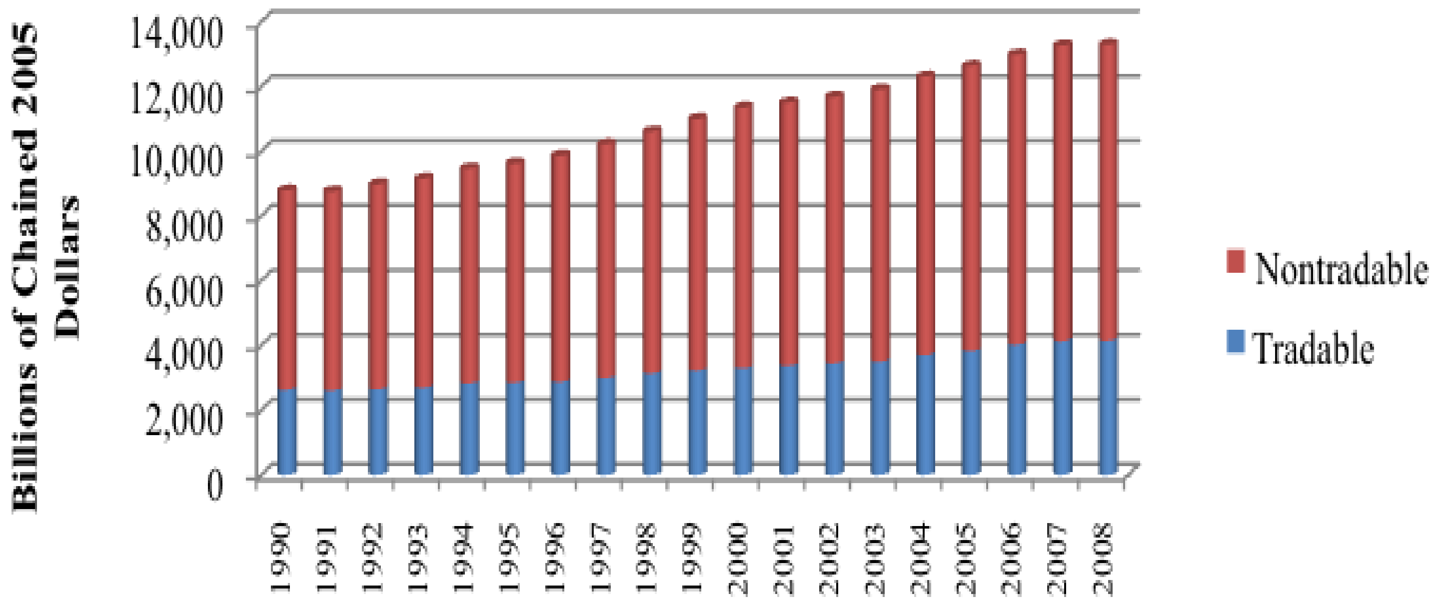


USA Structure

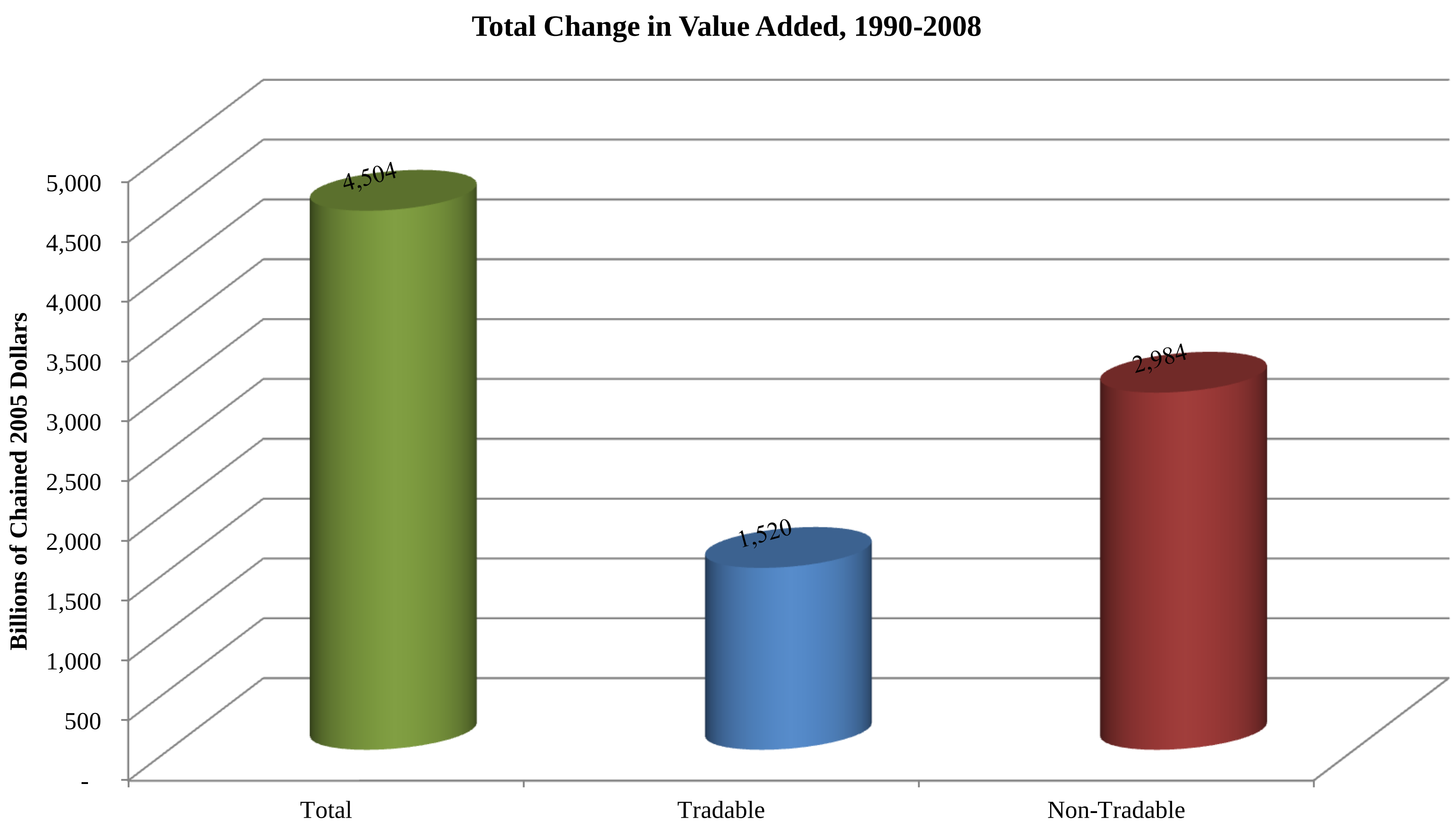


The Impact of EM Growth on US Structure

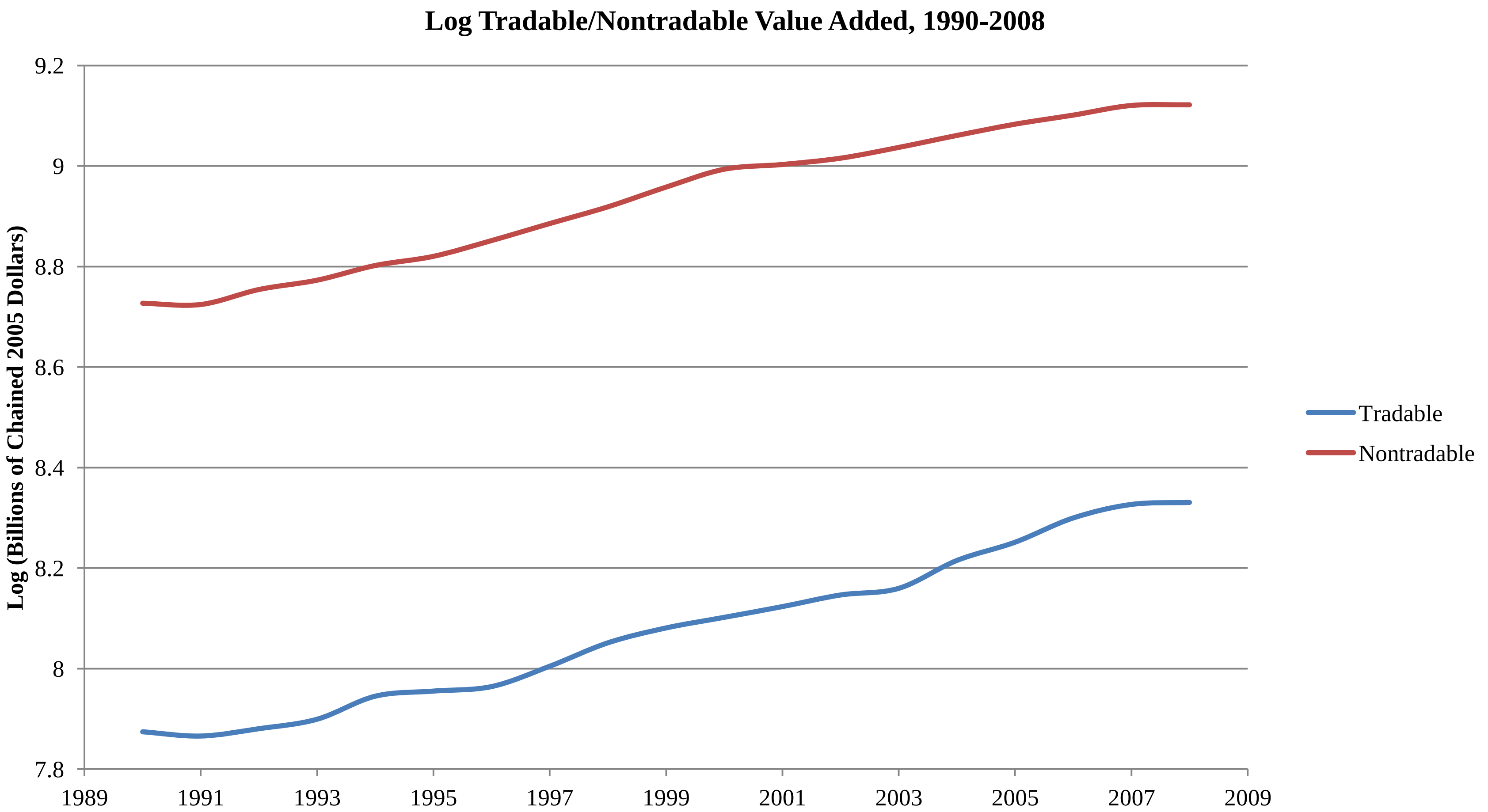
Value Added in the US Economy



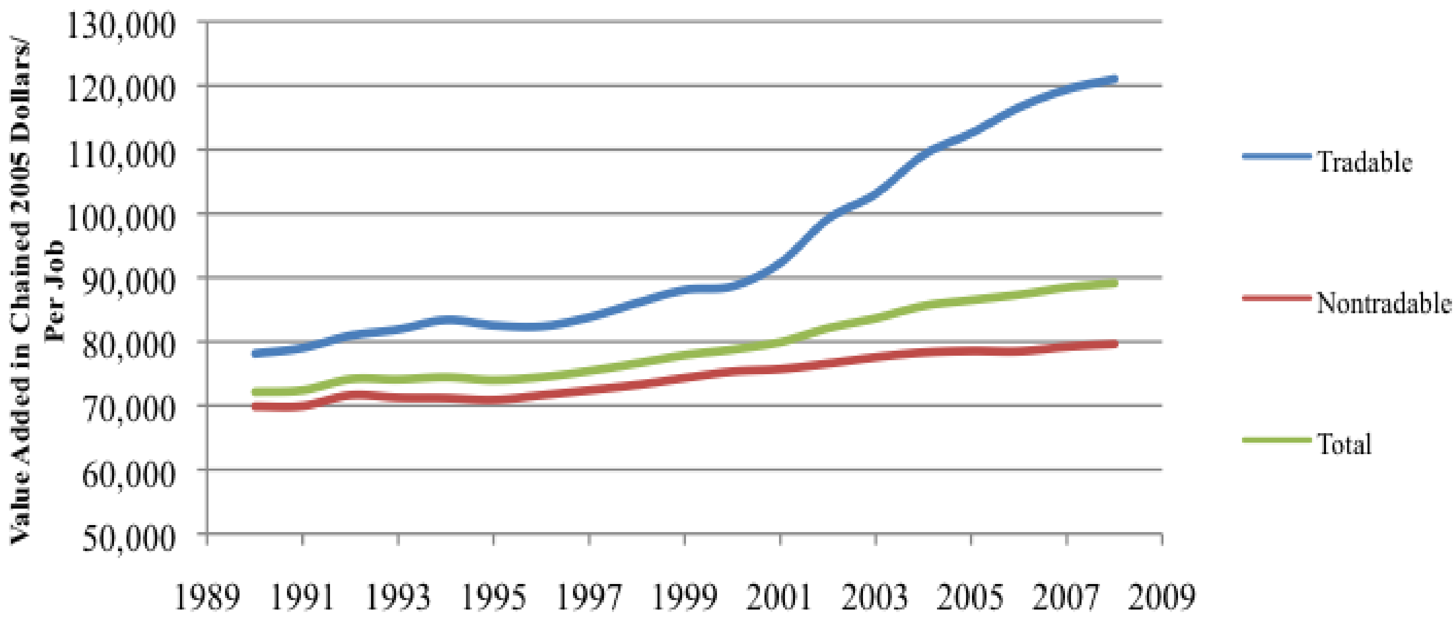
Value Added Does not Show the Same Pattern



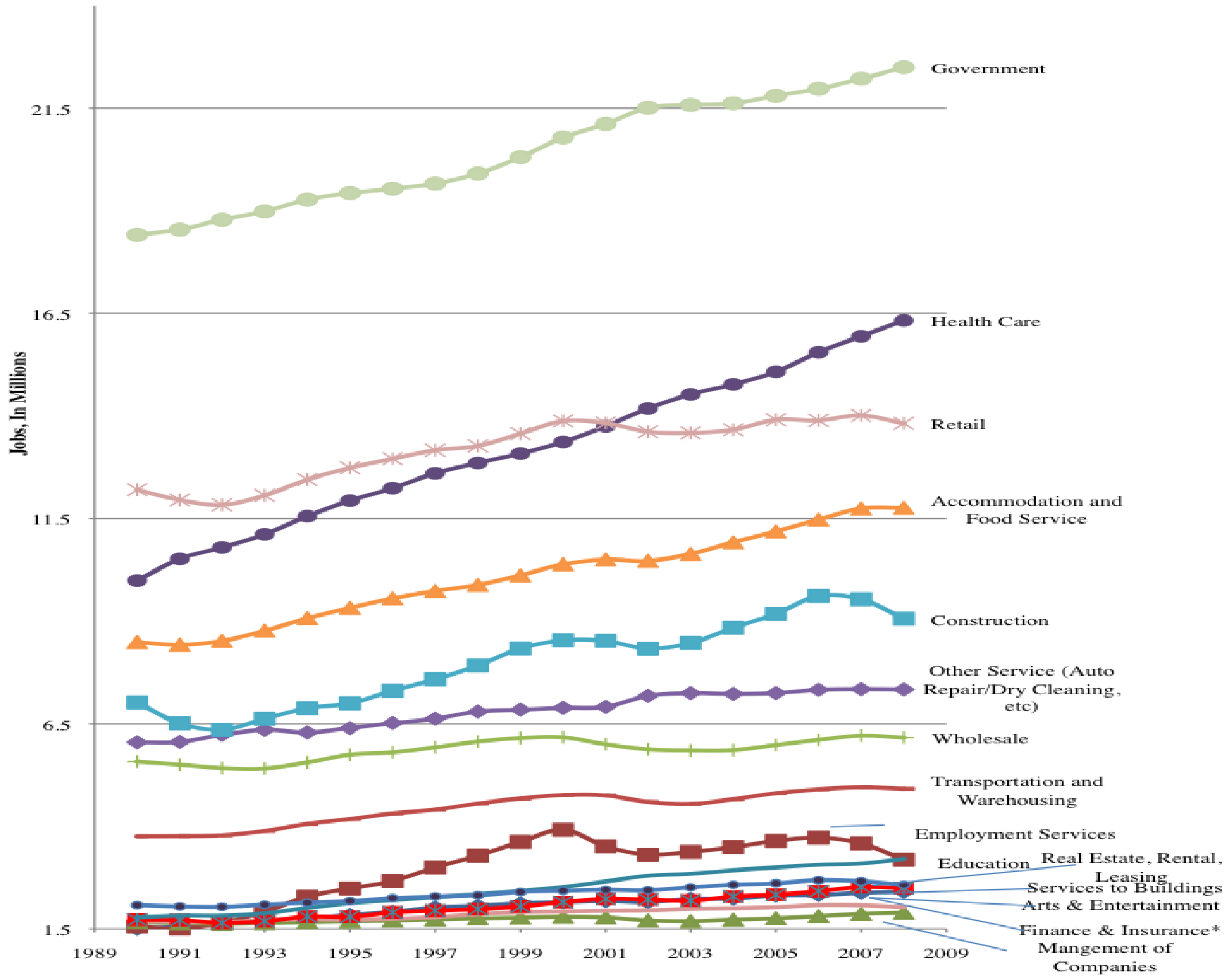
Value Added Growth



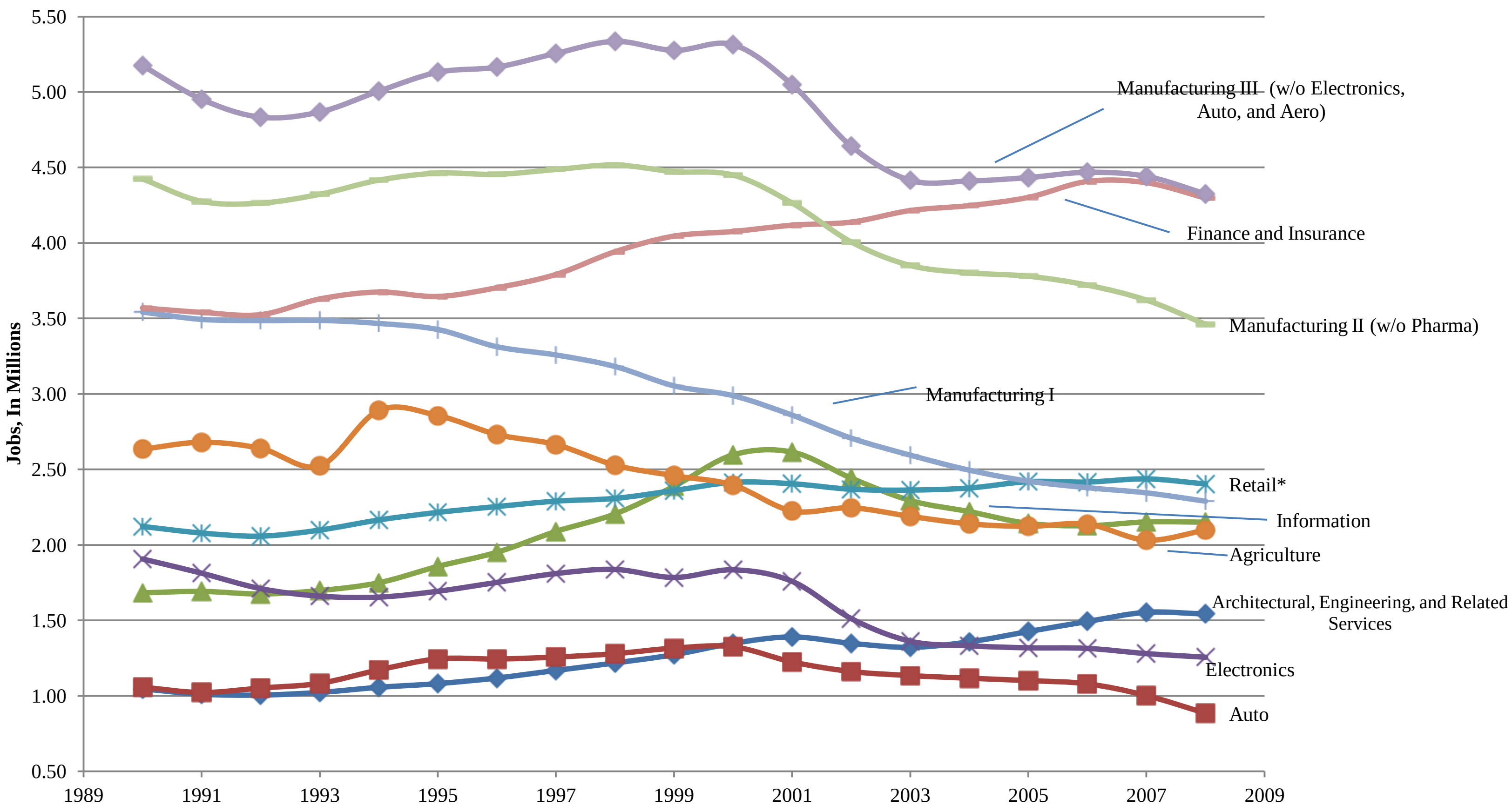
Valued Added per Person Employed – US Economy



Big Employment Sectors – Non Tradable



Tradable Sector Employment



Tradable Sector Value Added

- Value added is rising pretty much across the board in the tradable sector
- Including in the declining employment sectors (manufacturing) with complex value added chains that are partly migrating to other parts of the global economy
- Then there are sectors (finance, management of multinational enterprises, computer design, consulting etc) where employment and value added are rising, often quite rapidly

Summary

- Value added per person is rising in the tradable sector
- The lower value added jobs are moving off-shore
- The tradable sector is not an employment engine
- The non-tradable sector has been absorbing the work force
- If its absorptive capacity diminishes as seems likely, then unemployment will remain stubbornly high
- What has shown up largely as adverse shifts in the income distribution may become an employment challenge.

- The evolution of the US income distribution is reflective of these trends.

- This is not a market failure in the global economy
- It is a distributional issue

Outcomes

- Hard to know
  - This is not a cyclical phenomenon – a journey we only take once
- There are policies that would partial counter these trends (education, infrastructure, technology incentives and investments)
- But not completely
- My best guess is the growth will return to something like normal
- But employment won’t
- Growth and employment (quantity, scope and incomes) are set diverge - and that is new
- And the income distribution, absence intervention, and perhaps a shift in values, will continue to move adversely