Growth in the Post-Crisis World

Michael Spence
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 limited 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**

*World Output Growth 1961 - 2012 (% Change)*

- Advanced
- Developing Countries

*Source: World Bank WDI and DEC Interim Forecasts April 2010.*

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

### Total Change in Jobs, 1990-2008

<table>
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### Legend
- Net Difference
- Tradable
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The Impact of EM Growth on US Structure

Value Added in the US Economy
Value Added Does not Show the Same Pattern

Total Change in Value Added, 1990-2008

Billions of Chained 2005 Dollars

- Total: 4,504
- Tradable: 1,520
- Non-Tradable: 3,084
Value Added Growth

Log Tradable/Nontradable Value Added, 1990-2008

Log (Billions of Chained 2005 Dollars)

Tradable
Nontradable
Valued Added per Person Employed – US Economy
Big Employment Sectors – Non Tradable
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