STRUCTURAL SHIFTS AND CHALLENGES IN THE GLOBAL ECONOMY

MICHAEL SPENCE
NEW DELHI
JANUARY 2012
THE NEXT CONVERGENCE
THE FUTURE OF ECONOMIC GROWTH IN A MULTISPEED WORLD
MICHAEL SPENCE
WINNER OF THE NOBEL PRIZE IN ECONOMICS
下一个发展

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王青 刘其岩 译

THE NEXT CONVERGENCE
The Future of Economic Growth in a Multispeed World
What is the Next Convergence?

- Before the Industrial Revolution
- 200 years of divergence
- Post World War II: Reversal of the Divergence Pattern

- Now mid way through a century of convergence of developing and advanced economies
FOREIGN AFFAIRS

How America Can Compete

Globalization and Unemployment

Michael Spence

The Risks and Rewards of Health-Care Reform

Peter Orszag

Learning From the Germans

Steven Rattner

Does Obama Have a Grand Strategy?

Daniel Drezner
WORKING PAPER

The Evolving Structure of the American Economy and the Employment Challenge

Michael Spence and Sandile Hlatshwayo
March 2011
Key Elements in Sustained High Growth

- The global economy
  - Knowledge transfer and catch up growth
  - Market Size and specialization
- Very high rates of overall saving and investment
- An effective government that supports and complements the private sector dynamics
- Structural change and economic diversification
- Inclusiveness and a reasonable degree of equity
- Powerful employment engines in the modernizing part of the economy in both the tradable and non-tradable parts of the economy
- Leadership
When Does It Fail?

- Leadership
- Failures of governance
  - But the form of governance is not highly correlated with economic performance
- Pursuit of other objectives than growth
- Natural resource distortions of political
- National identity not formed
- Low rates of public sector investment
- “Bad,” meaning misguided strategy
- Inclusiveness failure
Partial Decoupling

Figure 1

World Output Growth 1961 - 2012
(% Change)

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 Japan, Korea, India, Brazil, Australia, ....
  - The network structure of global has shifted

- Downside Risks to Baseline Case
  - Another major downturn downturn in advanced countries – probably coming from Europe
    - NOW TURNING INTO A REALITY
  - Inability of advanced countries to deal effectively with structural growth challenges
  - Serious outbreak of protectionism
  - Growth slows down in China

Source: IMF, Fiscal Monitor, May 2010
Eurozone as Epicenter of Global Macro Risk

- **Mostly likely scenario**
  - Eurozone core holds together
  - Periphery (Greece and Portugal) exits
    - No growth model without a reset
- **Less likely but possible**
  - The eurozone core comes apart
  - Key is Italy
- **Reasons**
  - The eurozone core has the resources and the competence
  - The big question mark is the political will – at both national and EU levels. And they are linked.
Euro-dollar Exchange Rate

EUR/USD

Dec 13, 2011

© Yahoo!

Jan 07  Jan 08  Jan 09  Jan 10  Jan 11
Italy and Eurozone Stability

- Third largest sovereign debt market in the world
- Debt to GDP 120% (second to Japan)
- Highly vulnerable to escalating yields
- But (see graph) overall debt OK
- Household debt low
- Household net worth high
- Dynamic northern economy
- New government is highly competent
- The issues are political will and support from the ECB as implement reforms
  - Market sentiment and the equilibrium shifted dramatically in the summer of 2011
  - Even if reforms are likely to succeed, the rising yields could kill the benefits, and defeat the effort
  - Tension between political moral hazard and avoiding a very bad equilibrium outcome
- I will say more about this last part at the end
Total Debt in Selected Countries around the World, latest data available, as percent of GDP, by sector

- Black – government
- Red – non-financial corporate
- Grey – household
- Green – financial institutions
EXHIBIT 1 | Net Expected Tax Revenues Are Not Adequate to Continue Funding Current Social Policies

Unfunded liabilities and official government debt

% of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Official government debt</th>
<th>Unfunded liabilities</th>
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</thead>
<tbody>
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<td>U.S.</td>
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<td>522</td>
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<tr>
<td>Germany</td>
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<td>Greece</td>
<td>166</td>
<td>875</td>
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<tr>
<td>Spain</td>
<td>74</td>
<td>244</td>
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Sources: Jagadeesh Gokhal, “Measuring the Unfunded Obligations of European Countries,” 2009; OECD.

Note: Unfunded liabilities are the difference between the projected cost of continuing current government programs and net expected tax revenues. Government debt based on 2011 forecasts from the OECD.
Employment in the US 1990-2008

Change in Jobs, in Millions

- Total: 27.30
- Tradable: 0.62
- Non-Tradable: 26.68
Figure 15. Value Added per Job, 1990–2008

[Graph showing value added per job from 1989 to 2009 for tradable, nontradable, and total sectors.]

Source: Authors’ calculations using Bureau of Economic Analysis and Bureau of Labor Statistics historical data series
The Effects of Structural Reform in Germany

Net Change in Employment, 1995-2008

- Nontradable: 2.0
- Tradable: 1.1
- Total: 3.1

Jobs, In Millions
US Bilateral Trade Deficits
China Trade Deficits with Selected Countries
China is Entering the Middle Income Transition

- In a very fragile global economy with significant downside risks
- It is a complex set of structural changes on the demand and supply sides of the economy
- Driven by market forces
- And by government that changes its role to creating the hard and soft infrastructure that supports the market driven economic diversification and productivity growth
- Low value added labor intensive economic components of global supply chains will necessarily migrate to lower income countries
- It has been done before in other countries and it is not easy to sustain the growth
Middle Income Slowdowns are Common
Five High Speed Transitions

- Japan
- Korea
- Taiwan/China
- Hong Kong/China
- Singapore

- None at China’s scale
Major Structural Changes

- Movement up value added chain to match income growth
  - The Smile
- Movement of labor intensive process manufacturing and assembly inland and eventually offshore
  - 85 million jobs
- Increases reliance on domestic demand (consumption and high return investment)
- Expanded role for markets and private sector
- Policy shift toward system reform and deepening the human capital and technology base of economy
Requirements are Understood and Embedded in the 12th Five Year Plan

- Significant change in the investment system
  - Shift from investment led to rate of return led growth
- Shift in structure of income side of the economy – shift toward the household sector
  - The Lewis turning point
- Elimination of low return investment
- Market takes larger role in driving structural change
- Government role shifts to innovation and human capital investment and the knowledge and technological underpinnings
- Financial sector development to expand savings options and recycle savings to productive (high return) investment
- Corporate governance
- Expansion of social insurance and services – with a focus on inclusion
- Urban service sector needs to take over from labor intensive process manufacturing as main entry level employment engine
Disposable Income Declining as Percentage of GDP

Household Disposable Income and Components (in percent of GNP)

- Investment income
- Net Current Transfers
- Disposable Income
- Wage Income

Graph 1: Labour Share in OECD Countries, 1960–2000

Labour participated fully in rising productivity in the pre-globalization era, but under globalization productivity gains and losses have first and foremost benefited capital—resulting labour shares in industrialized countries.

Source: Gascia (2006), based on OECD.STAN database.
<table>
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<tr>
<th>COUNTRY</th>
<th>INCOME OF THE RICHEST 10% OVER THE POOREST 10%</th>
<th>INCOME OF THE RICHEST 20% OVER THE POOREST 20%</th>
<th>GINI COEFFICIENT</th>
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Source: R&D magazine, December 2010.
### Figure I.

**COMPARING COUNTRIES’ AND ECONOMIES’ PERFORMANCE**

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<td>Latvia</td>
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The Long Term Sustainability Challenge

- Global economy will triple in next 25 years
- Most of the growth in absolute terms will be in Asia
- Asia contains the two future economic giants, China and India
- The natural resource base of the planet will not support this
- The old growth model will not scale
- Lifestyles and new growth patterns
“Sorry, Harold, but I'm reducing our carbon footprint.”
Figure 1. CO₂ Emissions per Capita
Markets and the Evolving Role of the State

- **Market strengths**
  - Efficiency, innovation, growth
    - With qualifications for externalities, informational asymmetries and coordination/multiple equilibrium issues

- **Vulnerabilities**
  - Stability, equity, sustainability and structural adaptation
    - Networks and local optimization
    - Global labor supply and rising return to capital, including human capital

- **Substantial and Healthy State Balance Sheet**
  - Capacity to respond to shocks
  - Recycle income when distributional trends are adverse
  - Capacity to invest in structural change
  - Capturing some of the return on public investment in knowledge and technology base of the economy
Two Scenario World

- **Signaling theory**
- **Endogenous expectations and multiple equilibria**
  - Beliefs/expectations determine equilibrium outcomes
  - Not so much accurate as self-confirming in the context of the structure
- **Example**
  - If something triggers a shift in beliefs, the equilibrium can shift suddenly
  - Sudden shift in expectation around Italy and Spain
  - Migration of instability to eurozone core
  - Right now, institutional investors are placing increasingly restrictive guidelines on eurozone sovereign debt holdings, for asset managers, except for Germany
- **Which equilibrium?**
  - Linked to policy response or its absence
  - Hence to political functionality or distraction
- **Uncertainty about that creates the two scenario case and bimodal distributions**
  - Very difficult to handle from an investment point of view
Policy Frameworks

- Too narrow for the present stage of evolution of the global economy
- There are new structural issues domestically and internationally
- Frameworks need to be lengthened
  - Beyond the cyclical view
- And expanded to modify market outcomes and vulnerabilities
  - In the areas of stability, distribution, and identifying unsustainable patterns
  - Irony is that US needs to shift the balance away from consumption lead growth with underinvestment and China needs to do the reverse and avoid the low return investment trap