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Economic Viewpoint

Notes by Danny Leipziger*

Six Points of Inflection

The global economic crisis has led to a fundamental reassessment of many aspects of public policy. Governments are struggling to regulate financial markets, to deal with record-high joblessness, and to restore confidence in a system badly shaken. Economists are being pushed to the wall to defend theories that made sense in normal times, and many foresee a major economic regime change coming. In the face of rising debt, fewer jobs, and slower growth, the costs of maintaining an open trading system seem high and economic nationalism is showing itself once more. How countries manage the difficult tradeoffs between national economic welfare and the global good is key in defining the "new-normal" and how this unfolds depends largely on how fundamental imbalances are tackled.

The first task is to rebalance global demand so that a substitute is found for the American consumer. This is no small task as it entails a search for one trillion dollars in effective demand. Excess saving countries like China and Germany are obvious candidates but excessive savings behavior is as hard to shift as profligate consumption. Increasing demand in surplus countries would also benefit the imbalances in exchange rates that have diverged from purchasing power parities by a wide margin. So excess savers must be encouraged to spend.

The second task is to reshape the drivers of productivity and provide a new motor to global growth. While the internet was able to substitute for other forms of capital and has been a potent force for globalization and growth, we can expect the increased cost of capital accompanying de-leveraging and more prudent risk management to limit capital additions and labor productivity gains. A major investment in education could help turn this around, and countries as diverse as the US, India and Brazil can all benefit from such investments in human capital. So we must retrain and educate.

In many parts of the world, with the major exception of China and some parts of the EU, infrastructure investment has lagged for decades and this has limited growth in Africa, Latin America, India and the United States. A major focus on roads and trains, alternative energy, and water is needed to reposition world growth. Given the disturbances in capital markets, this third challenge will require a greater role for government. Governments, long maligned for their size and inefficiency, must follow the role model of Singapore and do their jobs better. So the public sector has to deliver.

The fourth challenge is the needed realignment of skewed income disparities in key countries, most clearly the US. It is unrealistic to imagine sustained recovery in the US when one out of six Americans is unemployed, where ninety percent of American wage earners lost ground in real income even before the crisis, and where the net wealth of so many has taken such a massive hit in housing markets. With a quarter of the world's GNP, a struggling US economy will inhibit sustained recovery. Fixing the US economy cannot be accomplished without redressing the skewed distribution of income that separates the US from other major economies. Put simply, the middle class needs to be restored.

Fifth, a path towards more sustainable debt management is needed. Massive public monies have been spent to stave off an even larger economic collapse, but at the expense of public coffers. The outrage over Wall Street bonuses highlights the imbalance between the terms of bailouts and the payback to taxpayers. To avoid a world of tight money and constrained fiscal accounts, governments have to participate in a bigger way on the upside of recovery. Putting shares of bailed out companies and banks in trust for the public might help lower the debt facing the next generation. The public sector needs to be handsomely repaid for the provision of distress finance and gain a larger share of future income.

Sixth, the global system needs rebalancing. This is about more than votes at the IMF or World Bank, and the shift of focus from the G7 to the G20 does not fully accomplish this. Unfortunately, the new emerging economic powers have not seen it necessary to commit to the open world trading system and are therefore reaping more than they sow. On this path, as their importance grows, this will damage global growth prospects and encourage further economic nationalism. What is needed is a serious recommitment by the EU, US, Brazil, China and India to global economic rules. One might call this a call to arms for the new G5 who will shape the global future.

How these six points of inflection--global demand, labor skills, infrastructure, equity, debt, and global stewardship--are managed will in large measure shape our future growth.

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