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ECONOMIC VIEWPOINT

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The Global Growth Outlook: Does Pessimism Dominate?

The Seoul Summit has highlighted a few unpleasant truths about the global economy and its custodians. First, the expansion from the G7 to the G20, while salutary in terms of including new global players, has not fundamentally changed the way in which summits endorse the expected and avoid the unpleasant. Post-Seoul, we are still facing an uphill battle to get global growth back on track. Why is this proving to be so difficult?

The first reason is that we are faced with some difficult tradeoffs that pit economic reality against political necessity. In the case of Europe, the need to maintain the fixed exchange inside the expanded Euro-zone has meant that five highly indebted countries—Spain, Portugal, Ireland, Greece, and Italy—will continue to suffer high unemployment and fiscal consolidations that can only be accommodated with the European Central Bank expending resources to buy highly priced debt and the EU continuing to transfer large sums to the south. This will continue as long as Germany and other surplus members continue to over-save and under-spend.

The second reason is that the US motor has stalled. Despite quantitative easing, which substantially increases the money supply, and despite record low interest rates, the recovery is tepid. And fiscal policy is stuck in a dilemma of large deficits and accelerating debt, yet low confidence and low spending. A drift towards Japanese decline is not out of the question. And at the same time, the inequality in the US distribution of income has reached alarming levels with the top one percent of the population controlling a quarter of the nation's income.

And the final reason for concern is that the Chinese supercharged export engine continues to gobble up markets due to a highly competitive exchange rate, a government policy that is both supportive and smart, and a repressed level of domestic consumption accompanied by capital controls. The imbalances issue was not addressed in Seoul, and the IMF is not sufficiently empowered to deal with it, much as it was powerless during the decade preceding the great recession. Yet China depends on the economic health of the West to sell its products, so that global underperformance is not really in its own economic interest.

All this pessimism articulated, what's to be done? First, the US needs to restore domestic confidence, which requires some political understanding between warring parties. Second, it needs to distinguish among debt profiles. In the short term, we need stimulus that works and that helps create jobs. In the medium-term, we need a National Infrastructure Bank to underpin future growth by rebuilding the US, so that long-run debt can be afforded; moreover, the US needs an assertive industrial policy to effectively compete.

Europe needs to change its priorities to encourage internal migration; it needs to admit Turkey into the EU; and it needs to let a few Euro members default on their debts. Only with a haircut, can growth be resumed and incomes restored. And the fiction that all Euro debt is similar in quality has to be discarded if the Euro is to be maintained.

Finally China needs to start spending at home and on imports beyond raw materials. The average Chinese citizen gains very little from the almost $3,000 in international reserves per person resting in the central bank. The Chinese economy needs rebalancing. That said, much can learned from the Chinese model, similar to the Korean model, in which government and business work together to spur productivity and capture economies of scope and externalities of planning. Low growth is not written in stone; however, past policies will not get us out of the low growth trap. New ideas and bold actions are needed. ■

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