

Striving for Growth in a Perilous Environment: An Economic outlook

Joseph E. Stiglitz

Hong Kong

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Where we are: a brief overview

- Slow growth—Great Malaise, New Mediocre
 - Not a crisis *yet*
 - But persistent moderately high unemployment in many countries (in some cases disguised), higher unemployment among youth and marginalized groups
 - Disproportionate share of slow growth going to a few at the top—growing inequality, wage stagnation
 - Even in countries with low “official” unemployment, raising questions of quality of job growth and disguised unemployment

Immediate prospects

- 2015 worst global growth since Global Financial Crisis
- And apart from GFC, one of weakest years in a long time
- Hope is that 2016 will be better
 - But little reason to expect significant improvement
 - IMF has been downgrading its forecasts—as it does almost every year

Weaknesses everywhere

- Slowdown in China
 - With knock-on effects especially in those countries dependent on exporting natural resources
 - Most of which failed to take advantage of commodity price boom to adequately diversify their economies
 - On going debate in China about how to respond—mix of supply side and demand side measures
 - Reflecting debate about source of growth slowdown
 - Difficulties making the structural transformation to next stage
 - Cause and consequence of global slowdown
 - Political dimensions

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Weaknesses everywhere

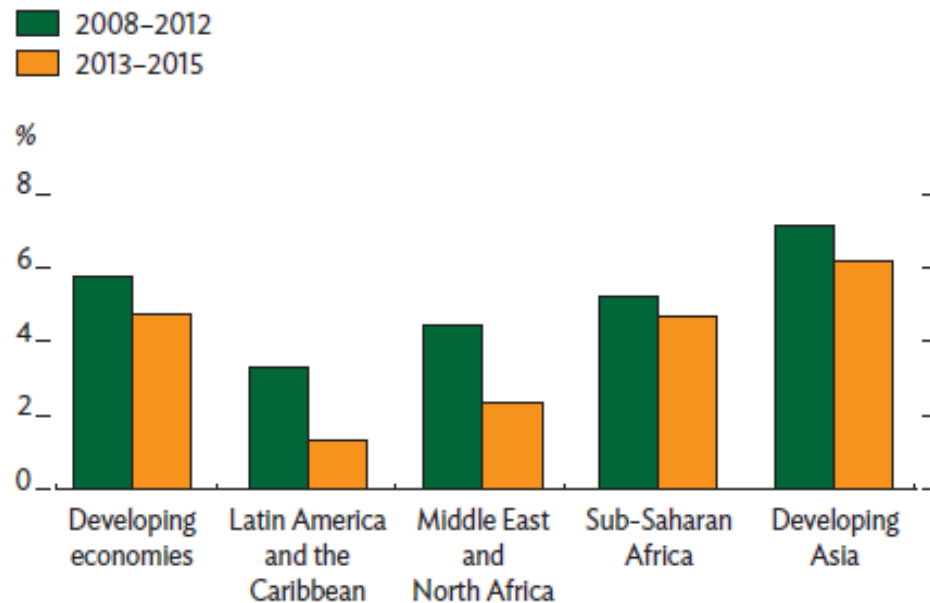
- Continuing weakness in Europe
 - The Eurozone crisis is not over
 - Fundamental structural flaws in the design of the euro
 - Economic integration outpaced political integration
 - Reforms too little, too slow
 - And disagreements about what reforms are needed
 - Reform in the structure of the Eurozone itself—more than the structure of the individual countries
 - Continuing austerity is having its toll
 - Ideology has overcome economic analysis

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Weaknesses everywhere

- Continuing slow growth in US
 - Mild austerity
 - Political gridlock

GDP Growth of Developing Economies

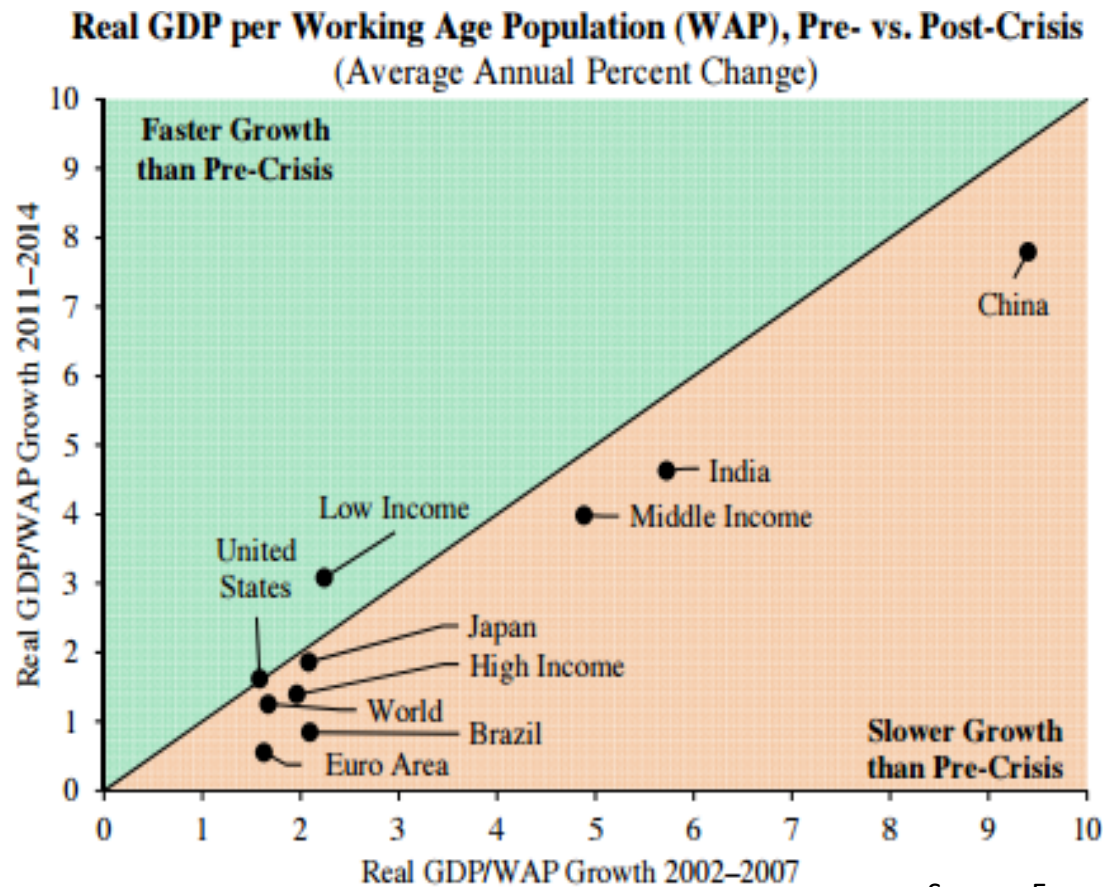


Note: Latin America and the Caribbean, Middle East and North Africa, and Sub-Saharan Africa are classifications in the International Monetary Fund's *World Economic Outlook* database. "Developing economies" combine these regions with developing Asia.

Sources: International Monetary Fund, *World Economic Outlook* database, October 2015; Asian Development Outlook database; ADB estimates.

Source: Asian Development Bank, *Asian Development Outlook 2016*

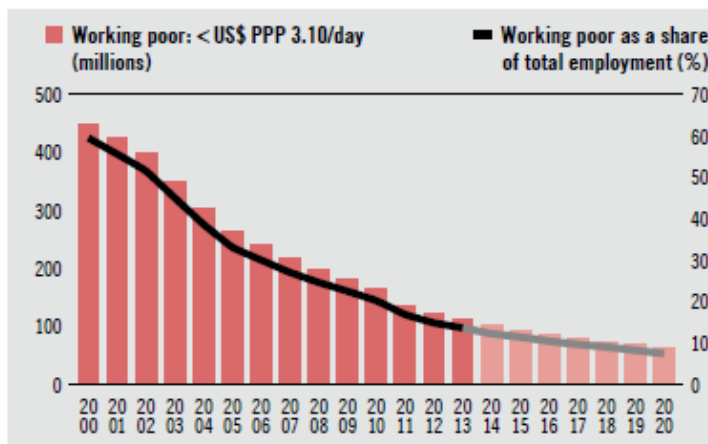
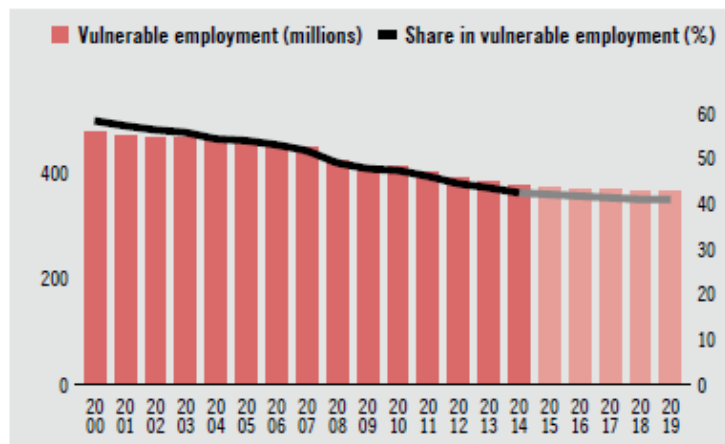
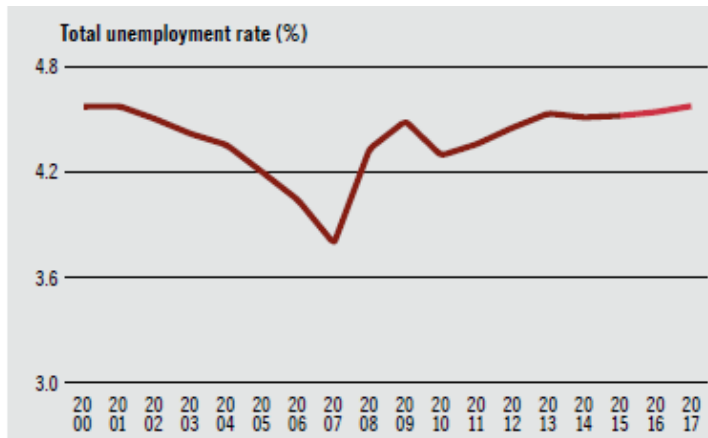
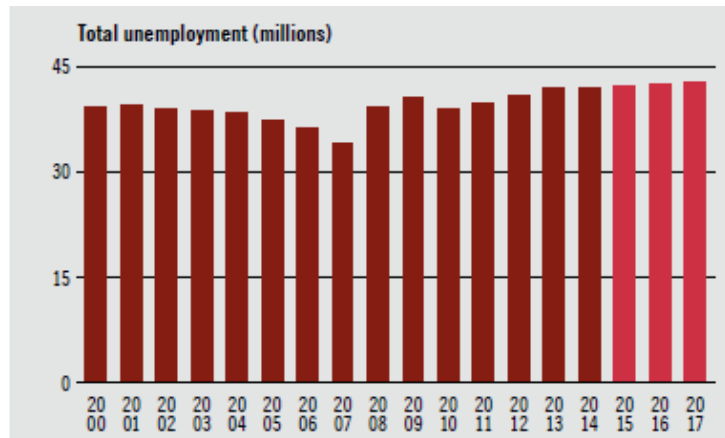
Output per member of working-age population is lower than before the crisis for most countries



Note: Working age population is aged 15-64.
Source: World Bank; CEA calculations.

Source: Economic Report of the President 2016

Eastern Asia: Employment Outlook

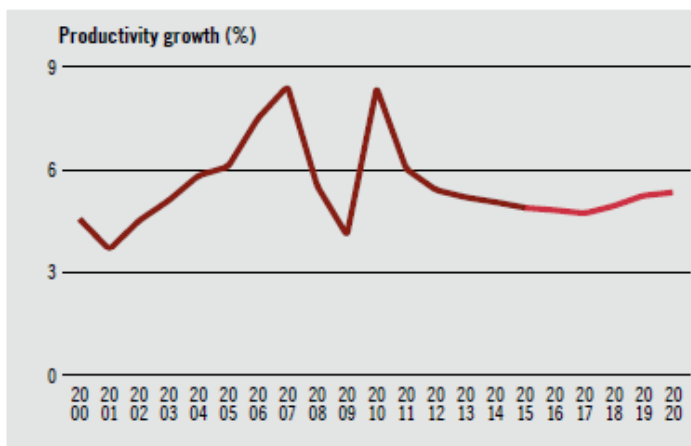
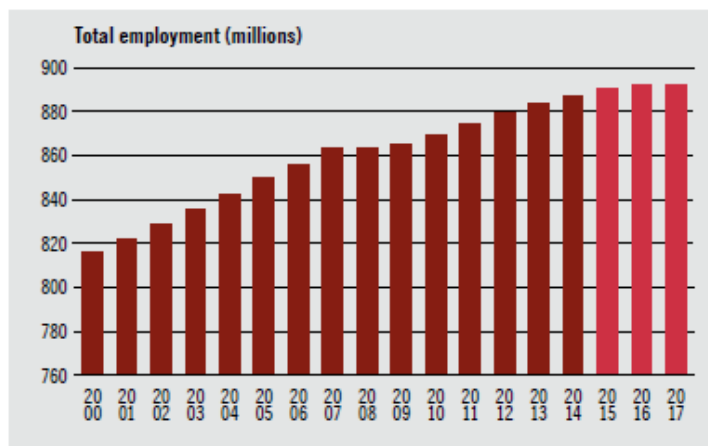
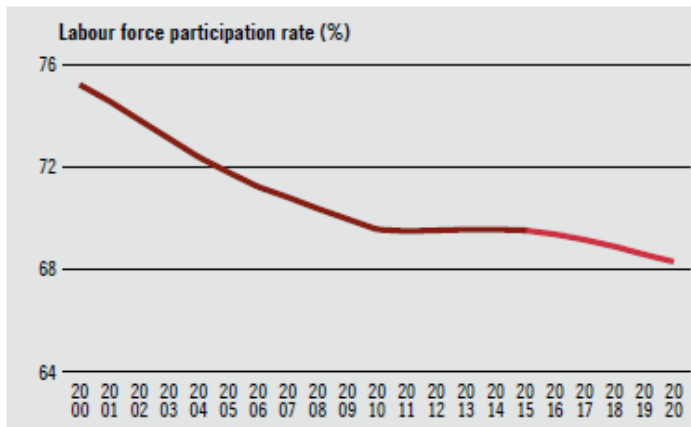
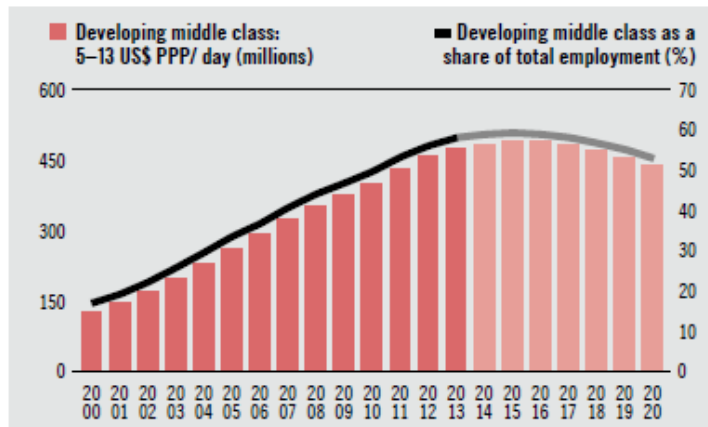


Note: Eastern Asia includes China, Hong Kong, Japan, Republic of Korea, Macau, Mongolia, and Taiwan.

Source: ILO, *World Employment and Social Outlook: Trends 2016*.

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Eastern Asia: Employment Outlook

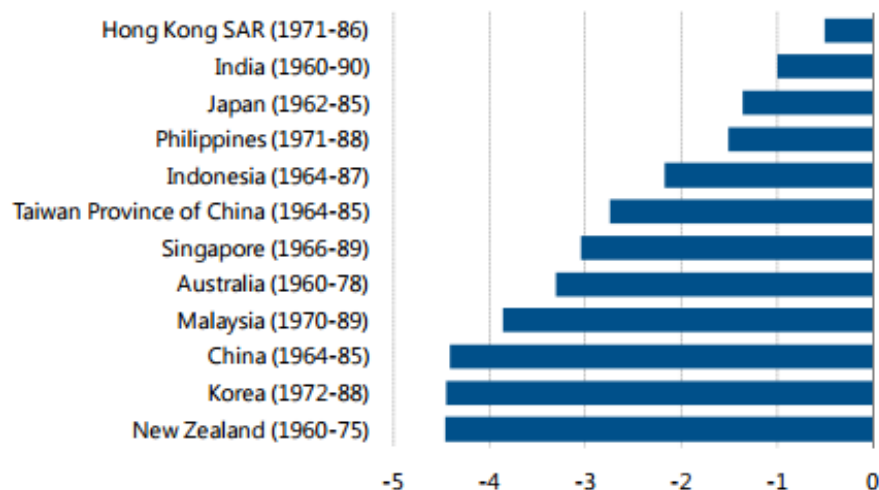


Source: ILO, *World Employment and Social Outlook: Trends 2016*.

Inequality in Asia: on the rise since early 1990s

Figure 1: Selected Asia: Income Inequality, Pre-1990

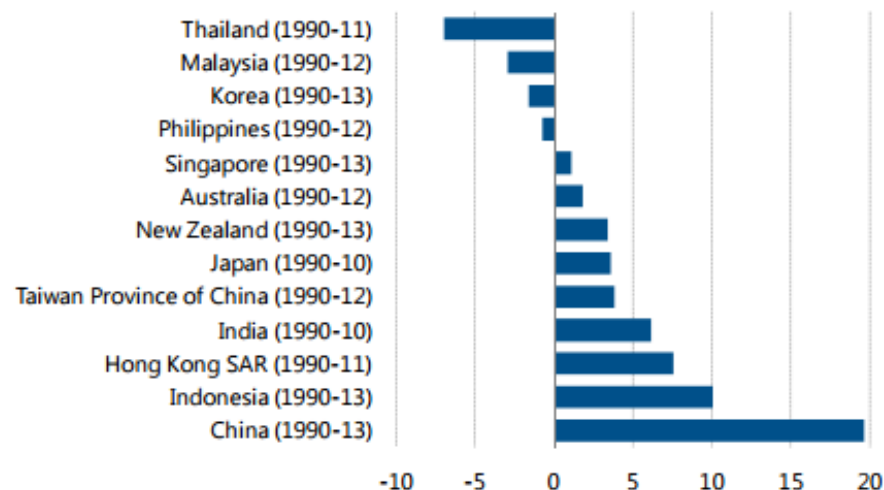
(Net Gini Index; in Gini points; change during the period indicated in parenthese)



Sources: SWIID Version 5.0; and IMF staff calculations.

Figure 2: Selected Asia: Income Inequality, 1990-Latest

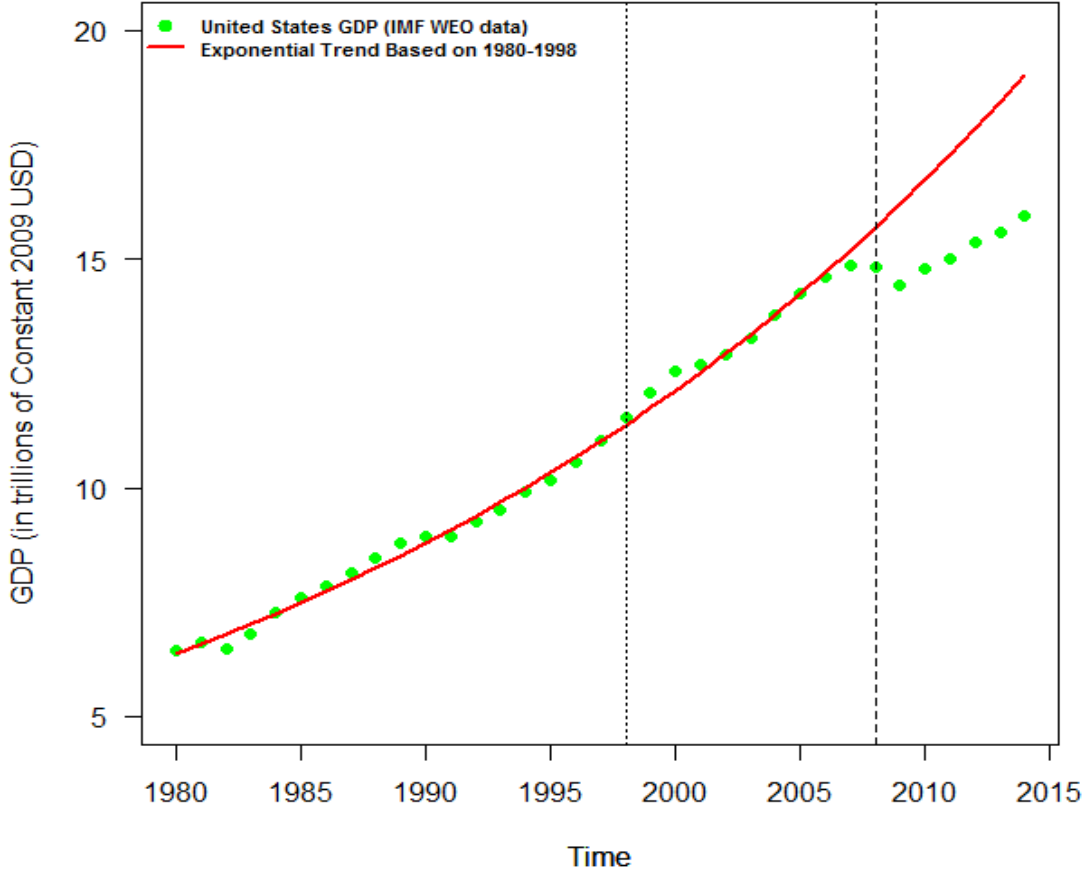
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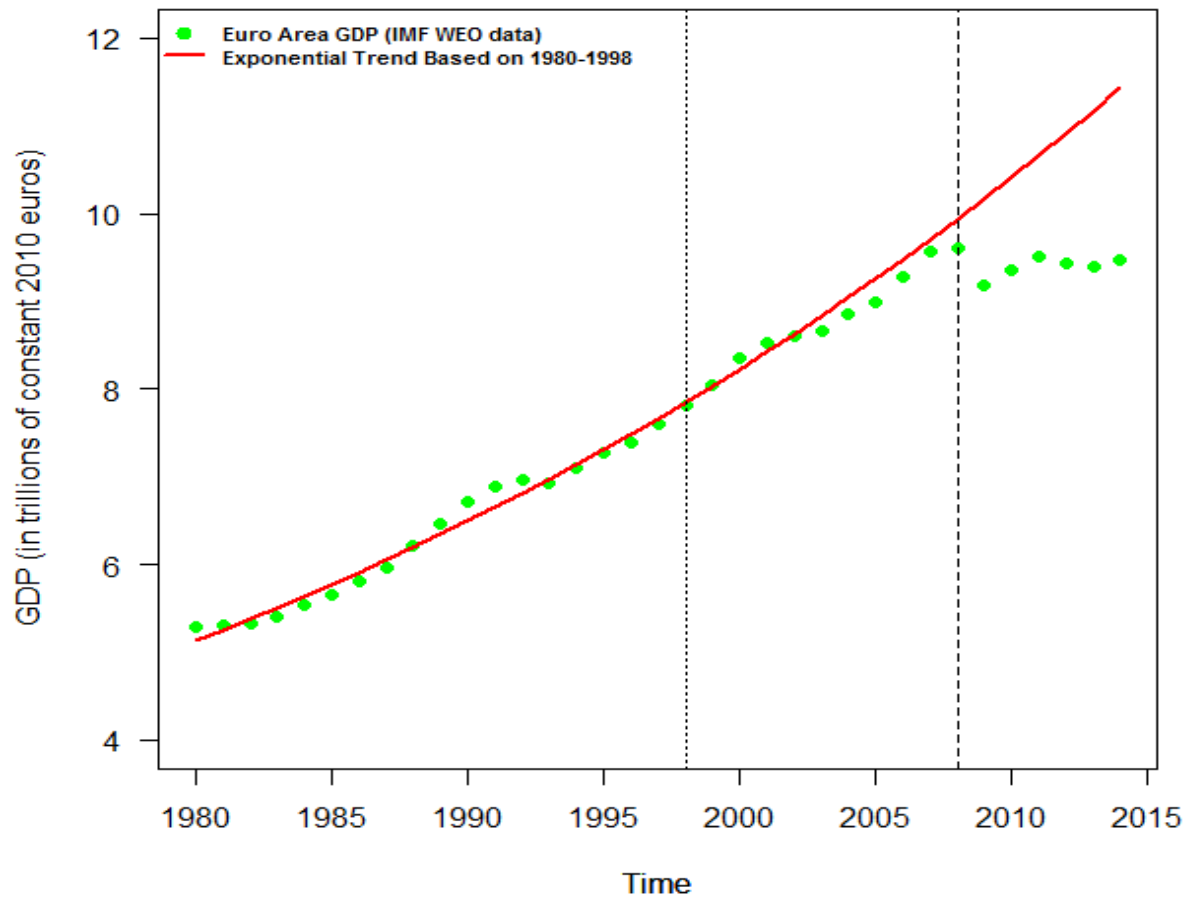
Growth continues to be far below the trend before the crisis: U.S.

United States GDP Trend Analysis

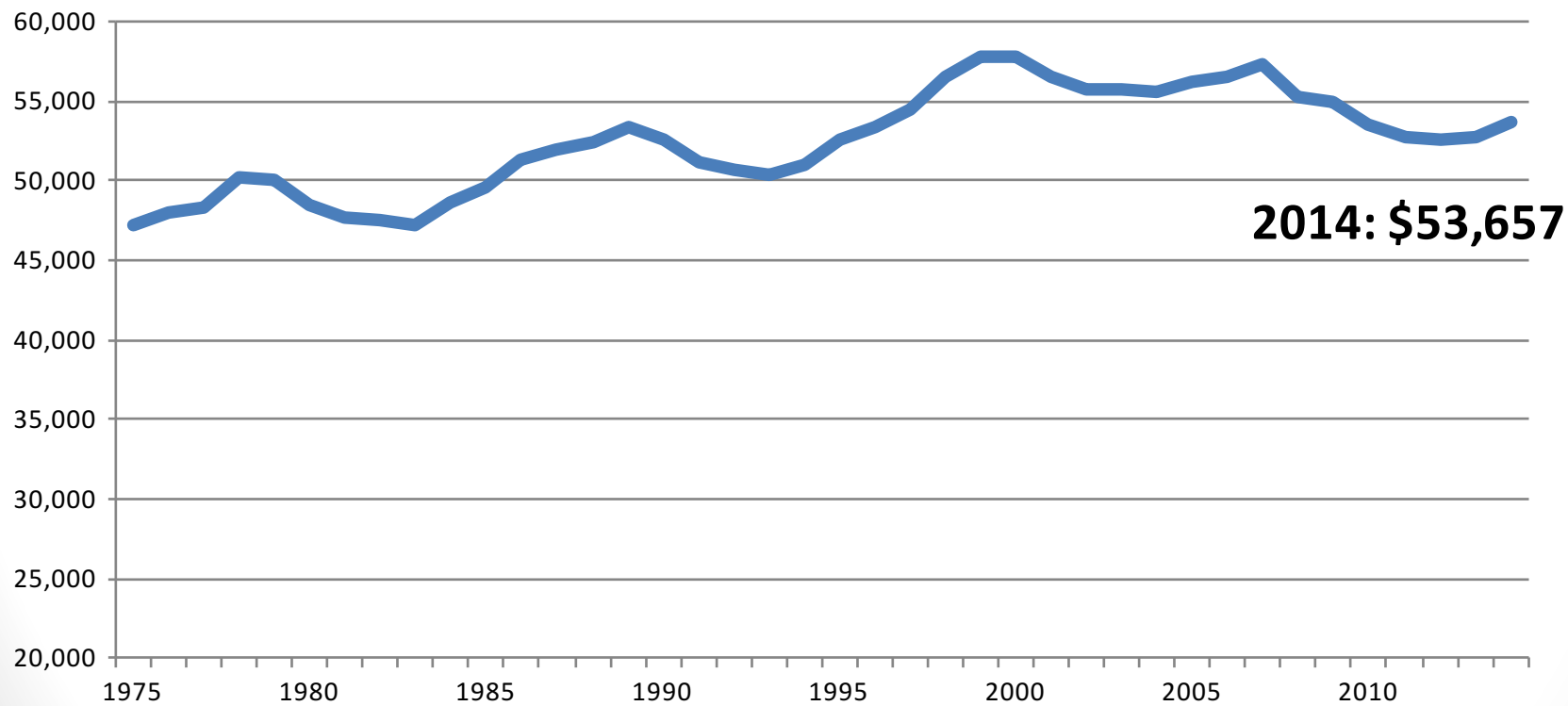


Europe is even worse

Euro Area GDP Trend Analysis



Stagnation: U.S. median household income (constant 2014 US\$)

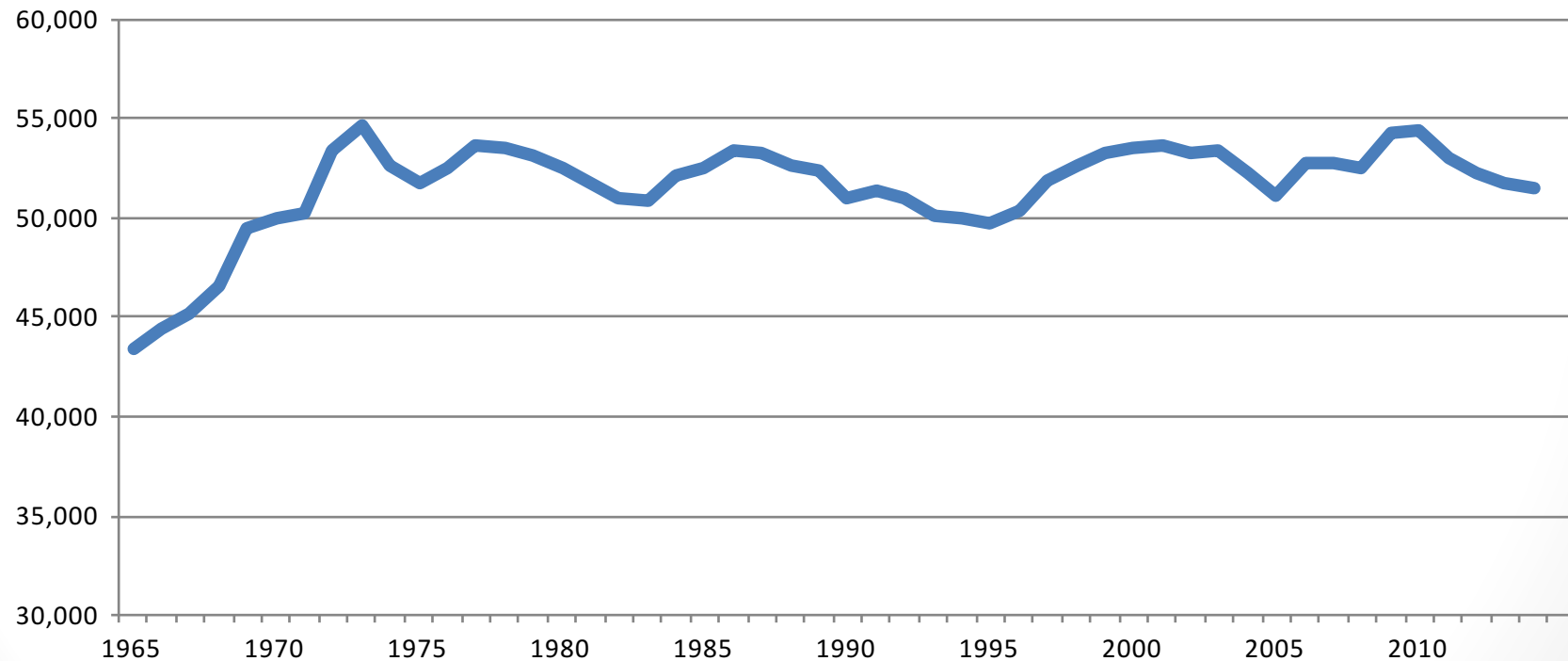


2014: \$53,657

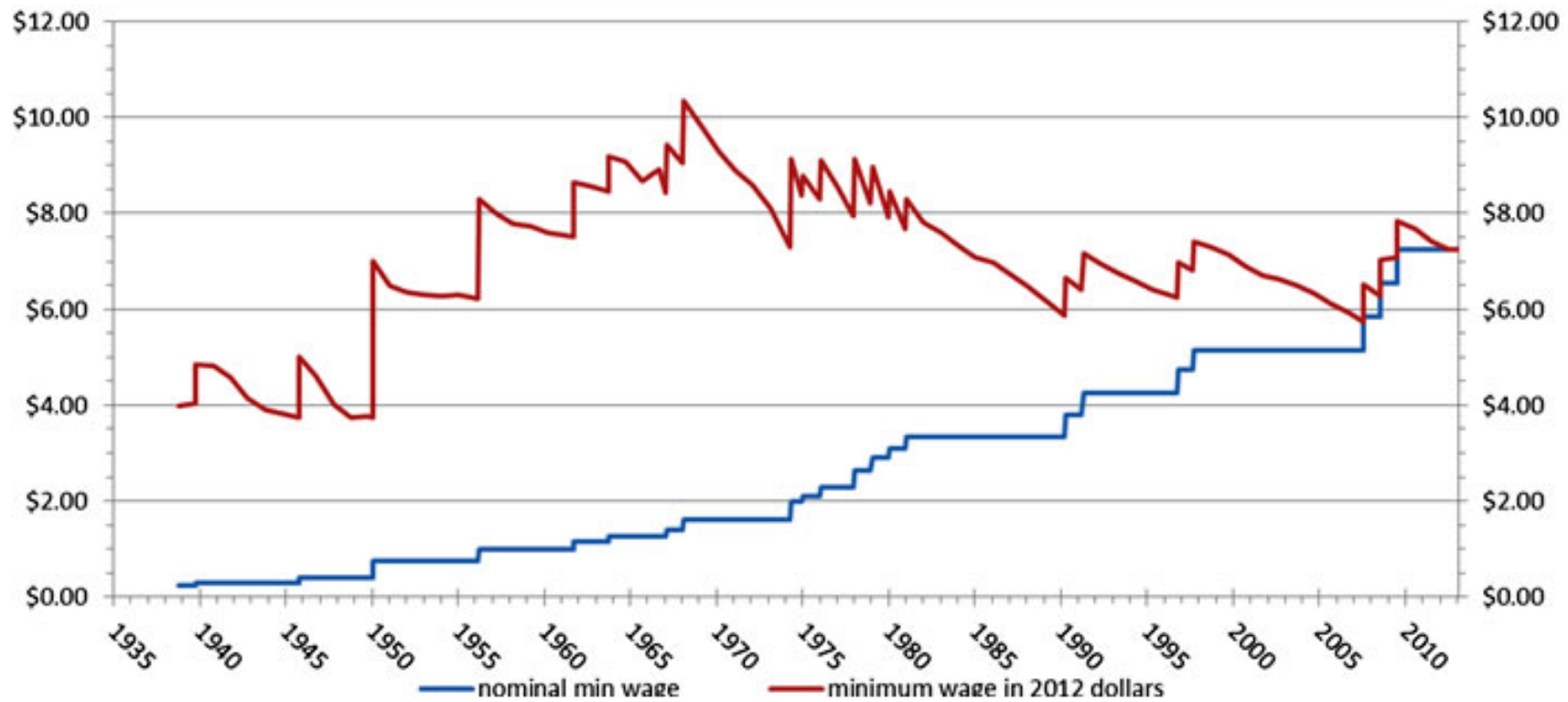
Source: U.S. Census Bureau

Decline in median income of full-time male worker in the U.S.

Real Median Income of Full-Time Male Worker, 1965-2014



U.S. minimum wage, 1938-2012



Source: U.S. Department of Labor. <http://www.dol.gov/minwage/minwage-gdp-history.htm>

Central problem in global economy: lack of global aggregate demand

- **Growing inequality in most countries**
 - Enormous increase especially in US
 - With bottom 90% having close to stagnant incomes for a third of a century
 - Decreases in life expectancy among important segments of population
 - Important issues of intergenerational justice
 - With deep political implications
 - Perception economic system unfair and political leaders cannot be trusted
 - Strong anti-globalization and anti-finance sentiments

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Lack of aggregate demand

- **Growing inequality in most countries (*cont'd*)**
 - Macro-economic consequences: Those at the top consume a smaller fraction of their income than those at the bottom
 - Some Latin American countries represent important exception
 - Part of new view: lower inequality is associated with better economic performance
- **Widespread austerity—government cutbacks or limited growth**
 - Importance of fiscal discipline now well accepted
 - But some countries have gone too far: failure to undertake high return investments when there are unemployed resources and access to low cost funds

Lack of aggregate demand

- **Structural transformation**
 - In advanced countries, in response to technology and globalization
 - From manufacturing to service sector
 - Decrease in global employment in manufacturing
 - And because of shifting comparative advantage, they will have a smaller share of this shrinking number
 - In China, from export led growth to domestic demand driven growth
 - From quantity to quality
 - From rural to urban
 - From manufacturing to service
 - Demographic transition
 - Markets on their own don't manage these transformations well

- **Global imbalances**

- Eurozone has exacerbated problem
- Now more important as source of imbalances than China

- **Asymmetrical adjustment**

- Countries (firms, households) facing a decline in income have to reduce consumption
- Those with increased income do not expand spending symmetrically
- Response to changes in oil price illustrates
 - Many had expected decrease in oil prices to stimulate global economy
 - But cutbacks in investment, spending in oil producers more than offsetting consumer benefits

Asynchronous monetary policies introducing new element of uncertainty

US talking about raising interest rates, Europe and Japan moving into negative interest rates

- Large implications for exchange rates
- New global uncertainties
 - Reversal of capital flows
 - Pace of outflows from China shows that even large reserves may not provide adequate protection
 - Putting stress on countries and companies in emerging markets that are over indebted

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Asynchronous monetary policies introducing new element of uncertainty

- Period of ultra-low interest rates has not had desired benefit in terms of increased investment
 - Has led to asset price bubbles, mispricing of risk, increased wealth inequality
 - Lower interest rates may even lower aggregate demand

Dysfunctional global financial market

- Standing between long term investment projects (infrastructure) and long term investors (pension funds, sovereign wealth funds) are short sighted financial markets
 - Haven't been able to recycle surpluses
- Most of attention in financial sector reform has been centered on preventing financial markets from imposing harm
 - Real need to make sure that financial sector performs its critical societal roles allocating capital, managing risk, and running payments system
 - All of this should be done at low cost

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Dysfunctional global financial market

- Traditional role focused on intermediation and lending to businesses
- Today, in US, financial sector engaged in disintermediation
 - Leading to lower levels of investment (lower levels of aggregate demand)
 - Level of lending to SMEs very constrained

Agenda for achieving sustainable and shared growth

Focuses on addressing underlying sources of weakness

1. Beyond austerity

Rethinking budgetary rules and frameworks

- Capital Budgeting
 - Balance sheet perspective especially important when cost of funds is low and returns to investments are high
- Stabilization Funds, especially for natural resource economies
 - To manage real exchange rate, smooth consumption and investment
- Using development banks to promote investment
 - If fiscal constraints still binding, use principle of balanced budget multiplier
 - If expenditures and taxes well chosen, can be high

2. Industrial Policies

- Central to economic/structural transformation
- Justified in terms of standard theories of market failures
 - Affecting the structure of production and the choice of technology
- Broad of objectives (not just GDP: environment, equality, employment, economic diversification)
- Especially important in creating a learning society/knowledge economy—
 - Real source of wealth of economy
 - Especially important in 21st century

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Industrial Policies

- Focus on knowledge spillovers/learning-by-doing effects
- Many instruments
 - Competitive and Stable Real Exchange Rates
 - In many countries, development banks have played an important role
- Need a development oriented intellectual property regime
- Agenda entails strengthening the public sector and enhancing its capabilities

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Industrial Policies

- Every country has an industrial policy
 - Embedded in expenditure and tax policies, and basic legal framework
 - Some countries do not realize that they have an industrial policy
 - US policy: promote dysfunctional financial sector
 - Worked: sector grew enormously

Basic ideas: J. E. Stiglitz and Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, New York: Columbia University Press, 2014 (abridged version, 2015).

3. Inequality

Increasing equality would increase consumption demand

- More progressive tax and expenditure policies
- *Rewriting the rules of the market economy* to make the economy more balanced, fairer would result in better distribution of market income, and faster growth

Stiglitz, J. E., N. Abernathy, A. Hersh, S. Holmberg, and M. Konczal (2015). *Rewriting the Rules of the American Economy*, New York: W.W. Norton, 2015.

4. “Fixing” financial market would provide finance

- Not just preventing harm
- But inducing financial markets to perform societal role that they are supposed to perform

Global coordination needed

- To respond to deficiency in global aggregate demand—large spillovers
- To prevent asynchronous monetary policies
- Hope was that G-20 would provide that
 - Hasn't happened

Concluding Remarks: There will be political and social consequences of Weak Global Economy

- High youth unemployment is especially troublesome—hysteresis effect
- In Europe, growth in extremist parties and separatist movements
- In US, anger evident in support of anti-establishment candidates
- Everywhere, underinvestment in people, infrastructure, and technology will lower growth
- In emerging markets, the way the less benign conditions are managed will determine distributional effects
 - Which in turn will affect growth and development prospects going forward

The World Economy: The Way Forward

- The New Mediocre, the Great Malaise, Secular Stagnation are not inevitable
 - They are the result of failed policies
- Reversing those policies could help restore economic growth