

An Agenda for Sustainable and Inclusive Growth for Emerging Markets

Joseph E. Stiglitz
ASSA Meetings
San Francisco
January 2016

Outline

1. Brief description of the current global economy
2. Explanation: lack of global aggregate demand
3. Agenda for restoring growth
4. Global Reforms
5. China
6. Concluding Remarks

I. Weak global economy

- 2015 slated to be worse year since Global Financial Crisis
- And apart from GFC, one of weakest years in recent decades
- Hope is that 2016 will be better
 - But little reason to expect significant improvement

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**
- Continuing weakness in Europe
 - The Eurozone crisis is not over
 - Continuing austerity is having its toll
- Continuing slow growth in US
 - Mild austerity
 - Political gridlock

II. Central problem in global economy: lack of global aggregate demand

- **Growing inequality in most countries**
 - 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
- In China, from export led growth to domestic demand driven growth
 - From quantity to quality
- Markets on their own don't manage these transformations well

Lack of aggregate demand (cont'd)

- **Global imbalances**
 - Eurozone has exacerbated problem
- 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**

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
 - 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

III. Agenda for achieving sustainable and shared growth

1. Carbon price would lead to high investment to retrofit economies for global warming
2. “Fixing” financial market would provide finance
 - Not just preventing harm
 - But inducing financial markets to perform societal role that they are supposed to perform
3. 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.

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

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

Industrial Policies

- Focus on knowledge spillovers/learning-by-doing effects
- Many instruments
 - Trade agreements impose some restrictions
 - Competitive and Stable Real Exchange Rates
 - In many countries, development banks have played an important role
- Need a development oriented intellectual property regime
- 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).

More than just creating enabling conditions for private sector

- Active agenda is more than just creating the enabling conditions for the private sector
- Agenda is more than the standard “good governance agenda”
 - Which too often focuses on constraining the public sector
- Agenda entails strengthening the public sector and enhancing its capabilities

IV. Global reforms

- Need new global reserve system
 - Current system leads to biases towards surpluses
 - Weaknesses in reserve currency countries
 - China should not want to be a reserve currency
- Need global coordination to reduce global imbalances
 - China's surpluses are in process of being reduced
 - But those in the Eurozone are increasing
 - Will need deep reforms in eurozone
- Need better ways of recycling surpluses
 - New development banks move in the right direction
 - But reforms, expansion of World Bank stymied by US

Finance for development

Could simultaneously recycle surpluses, adding to global demand, and promote development, but there are three impediments

- Debt markets: no international framework for debt restructuring
 - Important initiative at the UN, supported by vast majority of countries
 - But US and some European countries arguing against a “rule of law”
- FDI: investment agreements undermine the ability of countries to regulate
- Taxation of multinationals: international tax regime makes raising revenues difficult
 - Race to the bottom
 - BEPS agreement at G-20 left key issues unaddressed

Action on climate change

Attention on short run problems has resulted in long run problems festering—most importantly climate change

- Investments to retrofit the economy for climate change would provide needed stimulus to global economy
- Environment and economic growth are *complementary*
 - Especially if we measure growth correctly
- Providing a price on carbon would provide incentives for investment
- Paris meeting was important in creating momentum, so business community realizes that in one form or another there will eventually be a price for carbon
 - Key investments (infrastructure, housing, buildings, power plants) are long term

V. China: at the center of the slowdown in emerging markets

- Had to move from “quantity” to quality of growth
 - From export led growth to domestically driven growth
 - From manufacturing to a service sector
 - From agrarian to urban
 - From an economy with increasing inequality to one with more shared prosperity
 - Towards more environmental sustainability

Many of key problems require *more government*

- Move to market created problems of instability, environmental degradation, inequality, dysfunctional cities
- Market, on its own, won't correct them
- Market can be an instrument used by government
- But government will have to have regulations for health, safety, the environment, competition; urban planning; write (and re-write) rules of economy to ensure more equality, less opportunity for exploitation
- Creating an innovation economy will require more than IPR
 - Inappropriately design IPR regime could inhibit innovation
 - Functioning financial system not focused on speculation
 - Government support of basic research and education
 - Broad agenda of *creating a learning society*

Demand and supply problems intertwined

- Key problem now is lack of aggregate demand
 - With global slowdown
 - Share of GDP going to household sector *very* low
 - So even if savings rate not very abnormal (by Asian standards), with high corporate savings, national savings rate high
 - Already excess supply in many industries, undermining investment
 - Weak economy hard time to engage in structural reforms
 - Leads to unemployment

Government policies to strengthen demand

- Increase share of household income
 - Wage increases
 - Greater distribution of corporate profits
- Increase consumption rate
 - Stronger systems of social protection/better public education and health
- Government investments in cities, environment, technology
 - Not financed by new debt
 - But by increased taxes, dividend distribution from government owned firms
- Taxes can improve economic efficiency and equality
 - Environmental taxes, financial transactions taxes, capital gains taxes
 - Land and natural resource taxes non-distortionary

Key structural reforms

- Need new system for financing localities
 - To avoid excessive reliance on real estate
- Restructuring inefficient sectors
 - But unless accompanied by demand policies will move resources from low productivity uses to zero productivity unemployment
- Creating a *good, efficient* financial sector
 - Not imitating US model
- Key deficiencies—inadequate regulatory scheme
 - Shortage of good milk is because consumers cannot be sure of milk quality

VI. 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
 - In US, large decreases in life expectancy and health
 - Likely to be associated with decreases in productivity
- 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