GROWTH PATTERNS AND CENTRIFUGAL FORCES: Saving The Parts of Globalization that We Need

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NCPERS
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Who Is He?

• I am an economist
• Live in Milan (northern Italy – not Illinois)
• My wife is an Italian journalist
• Have a condo in Ft Lauderdale (and a boat)
• Spend time with PIMCO and a number of private equity funds
• Most of them operate around the world
• Keeps me grounded
• I think about growth patterns in developing and advanced economies
• And try to be helpful when I can (in China, India, Brazil)
• Grew up in Canada
What is he going to talk about?

• It has been a very tough investment environment
• Cyclical Outlook – getting better
• Synchronized global recovery for first time

• Assess the growth trends, patterns and challenges
• Describe some underlying structural and secular trends across the global economy
• Hoping you have some fun – stand back from the day to day
Short run Outlook

- US OK – stuck at about 2%
- At or near NAIRU – but inflation is weak
- Fed about to begin running off the balance sheet
- Europe: better, growth returning, still high variability across EU
- China 6-6.5% (relatively solid) India 7-8% recovery in Lactam not complete but better
- EM a major opportunity now
  - Need managers with local knowledge
- Volatility is low – suppressed deliberately and directly in China
WEAK RECOVERIES IN DEVELOPED COUNTRIES
Advanced Economies Output Gap

Output Gap, Percent of Potential GDP


Percent of potential GDP

-6 -4 -2 0 2
China Grew with Little Growth in Major External Markets

That is about a 63% increase
BUT

- China accumulated a pile of debt
- Some of that debt was used to finance assets whose value is less than the cost of creating them – hence excess capacity in heavy industries
- Growth holding at 6-6.5% because
  - Rising incomes and middle class demand
  - Growth of service sector businesses
  - Innovation across a wide range of private sectors
Exhibit 33

China’s debt reached 282 percent of GDP in 2014, higher than debt levels in some advanced economies.

Debt-to-GDP ratio
%

China

By country, 2Q14

<table>
<thead>
<tr>
<th>Country</th>
<th>Government</th>
<th>Non-financial corporate</th>
<th>Financial institutions</th>
<th>Households</th>
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<tr>
<td>Canada</td>
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</tr>
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Total debt $ trillion

2000: 2.1
2007: 7.4
2Q14: 28.2

NOTE: Numbers may not sum due to rounding.

SOURCE: MGI Country Debt database; McKinsey Global Institute analysis
Domestic Consumption and Innovation is Driving Growth in China

The “i-can” cohort represents more than 400 million people, or almost a third of China’s population and more than the working populations of the US and Western Europe combined. This new generation is expected to drive 65 per cent of consumption growth in China until 2020, when they will make up around 53 per cent of total consumption spending, up from 45 per cent in 2016.

Essentially, China’s “i-cans” leapt from the pre-web era straight to the mobile internet, skipping the personal computer altogether. On the way, their e-commerce activity has created one of the world’s largest digital economies and is spawning a new generation of Chinese IT companies that are making their presence felt on the global stage.

Helen Wong: CEO of HSBC Greater China
USA: Investment Lagging Badly in This Cycle
Figure 1. Cross-Country Average Labor’s Share in National Income
(Ratio of labor income to national income)

Source: OECD, Structural Analysis Database.
3D Printing
Figure 2
Change in Employment by Major Occupational Category, 1979–2012
(the y-axis plots 100 times log changes in employment, which is nearly equivalent to percentage points for small changes)
Figure 3
Change in Occupational Employment Shares in Low, Middle, and High-Wage Occupations in 16 EU Countries, 1993–2010
USA Income Distribution Trends

Income Inequality and Political Polarization
1947 - 2009

r = 0.93

Polarization Index

Gini Index

House Polarization
MEAN AND MEDIAN HOUSEHOLD INCOME  USA
USA: Employment Creation

U.S. Total Change in Jobs, 1992 to 2010

- Nontradable: 21.0
- Tradable: -1.7
- Total: 19.3

Change in Jobs, Millions
USA: Value Added and Growth

Total Change in Value Added, 1992-2010

- Nontradable: 2,575
- Tradable: 1,665
- Total: 4,240

Change in Value, in Billions
USA Value Added per Worker

US Weighted Value Added per Job, 1990-2010

Real 2005 USD


Nontradable
Tradable

142,534.70
82,259.36
Figure 3: Percent Change in Employment Shares by Occupation Group
Figure 1

Source: Based on Katz and Margo (2014), table 1.6, panel A, which is based upon the 1920 through 2000 Census of population IPUMS and 2010 American Community Survey.

Notes: Observed long changes in US occupational employment shares over 1940–1980 and 1980–2010 are scaled by the number of intervening decades to yield average change per decade. Occupations are classified into occupational groups based on 1950 occupation codes using the consistent coding of occupations in all years into 1950 codes (the OCC1950 variable) in the IPUMS. Additional details are found in Katz and Margo (2014, p. 46).
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 traits have first and foremost benefited capital—ending labour shares in industrialised countries.

Source: Gascina (2006), based on OECDSTAN database.
<table>
<thead>
<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>
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Europe

Nominal Unit Labor Costs, Whole Economy

Source: Eurostat. Figures are normalized to 100 in 2000.
Europe: Labor Cost Divergence

Nominal unit labour costs, whole economy
(2000=100)
Why Globalization Stalled

And How to Restart It

By Fred Hu and Michael Spence

FRED HU is Founder and Chair of Primavera Capital Group.
MICHAEL SPENCE is William R. Berkley Professor in Economics and Business at New York University’s Leonard N. Stern School of Business. He received the Nobel Prize in Economics in 2001.
Global Growth Patterns

- Occurred under the post war architecture
- Produced war recovery, high growth
- Distributional aspects of growth patterns were largely benign
- That changed in the late 1970’s

- Since then, growth held up until 2008 crisis.
- But Distributional aspects of growth patterns deteriorated
- That trend accelerated post 2000
The Year 2000 Was a Turning Point

- Survived Y2K scare for computers/dates
- China entered WTO
- Eurozone came into existence and expanded
- Digital technology impact on jobs, economic structure, the complexity of global supply chains accelerated dramatically
- Multifiber agreement expired – end of 2004
- Internet Bubble
- 911 – followed by war in middle east
Globalization and Growth Patterns

• Global economy is characterized by flows of
  – Goods and services
  – Capital
  – Information/data/ knowledge and technology
  – People

• Today virtually every aspect of this framework is under assault or in question now, creating tremendous uncertainty about what the future holds in terms of opportunities and risks.
Goods and Services

• President Trump – some form of rejection of multilateralism
• Brexit
• Anti-Europe and anti-Euro parties in Europe
• NAFTA, TPP, TTIP, WTO, PARIS CLIMATE – renegotiated or scrapped
• “Renegotiate” the terms of engagement

• China and Europe remain committed to some form of multilateral structure – also most of developing world
• China has become a principal sponsor
• AIIB, OBOR, Development banks, swap agreements
Capital

• It has become clear (at least to me) that unrestricted international capital flows are at best a double-edged sword.
• Especially in a world of highly unusual and potentially distortive monetary policies
• Developing countries have had to try to protect themselves from volatile “tourist” capital flows
• China has had to partially shut off outbound capital flows to maintain stability (in the short to medium term)
People

• Immigration is a major challenge
• In Europe, the absorptive capacity with respect to Africa and middle east refugees is not large enough to absorb the flow
• More generally, immigration has become a symbol of lost of sovereignty and cultural identity
Data Information and Technology

• Cyber security threats in multiple dimensions have simply blown away the earlier naïve notion that a globally open internet based system was the new normal
  – Privacy
  – Cyber warfare
  – Industrial espionage
  – Terrorism
  – Fake news and related manipulation
The Bottom Line

• Powerful forces causing fragmentation and polarization within societies and across countries
• This polarization is caused in part by a failure by elites and governing bodies to address the problematic aspects of growth patterns as outlined above
• Yet global cooperation is crucial
  – For sustainability
  – For specifically climate change
  – For early stage developing countries
Key Elements in Sustain Global Cooperation

• Restore inclusiveness to growth patterns
  – Investment in human capital
  – Enhanced social security systems
  – Income redistribution
  – Where needed, removal of obstacles to growth
• Accept that international structures can get outdated and need cooperative revision to reflect an evolving reality
• The major players are now a mix of countries at various stages of development. They will have to work together.
SAVING GLOBALIZATION

Predictions that the era of globalization will soon end are too pessimistic. To be sure, the rapid expansion of trade, rising cross-border capital flows, and, above all, the spread of new technologies have transformed the global economy. They have created difficult challenges, and countries will continue to struggle to increase growth and productivity, while reducing inequality and creating good jobs. But there are also enormous opportunities. Turning back the clock to restore the old frameworks is impossible. The challenge is to build new ones that work.

Waving the banner of protectionism and nationalism may attract popular support, at least temporarily. But history has shown that, ultimately, it may well threaten global peace and prosperity. The United States, China, and the world at large would be far better off if they could find a path to a more sustainable globalization, reforming the existing global order rather than tearing it down completely.