

# **Slower growth and greater inequality - which policies will work?**

## **A bird's eye view on the world economy**

*- based on recent reports from IMF, OECD and UNCTAD*

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*The views expressed are those of the author and do not necessarily represent the position of Norges Bank or Levy Economics Institute*

IMF's Christine Lagarde (september, 2016):

**GROWTH HAS BEEN TOO SLOW,  
FOR TOO LONG AND FOR TOO FEW**

## Selected real GDP growth forecasts (sept. 2016)

	World	USA	Euro	UK	Japan	China	India	Brazil
2015	3,2	2,6	2,0	2,2	0,5	6,9	7,6	-3,8
2016	3,1	1,6	1,7	1,8	0,5	6,6	7,6	-3,3
<i>Ch. from April 2016</i>	<i>-0,1</i>	<i>-0,8</i>	<i>0,2</i>	<i>-0,1</i>	<i>0,0</i>	<i>0,1</i>	<i>0,1</i>	<i>0,5</i>
2017	3,4	2,2	1,5	1,1	0,6	6,2	7,6	0,5
<i>Ch. From April 2016</i>	<i>-0,1</i>	<i>-0,2</i>	<i>-0,1</i>	<i>-1,1</i>	<i>0,7</i>	<i>0,0</i>	<i>0,1</i>	<i>0,5</i>

Source: IMF WEO

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## World economy moving sideways

- *“Perhaps the most striking macroeconomic fact about advanced economies today is how anemic demand remains in the face of zero interest rates”*

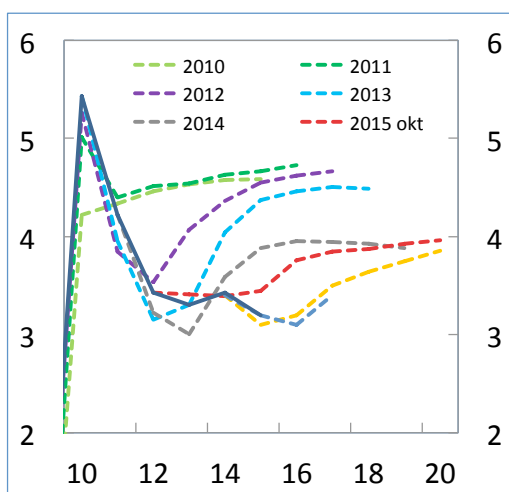
Former IMF chief economist Olivier Blanchard, now at the Peterson Institute

## IMF's Lagarde in 2014: *Global Economy Facing 'New Mediocre' Risk*



- Christine Lagarde says the global economy is facing "the risk of a new mediocre, where growth is low and uneven"

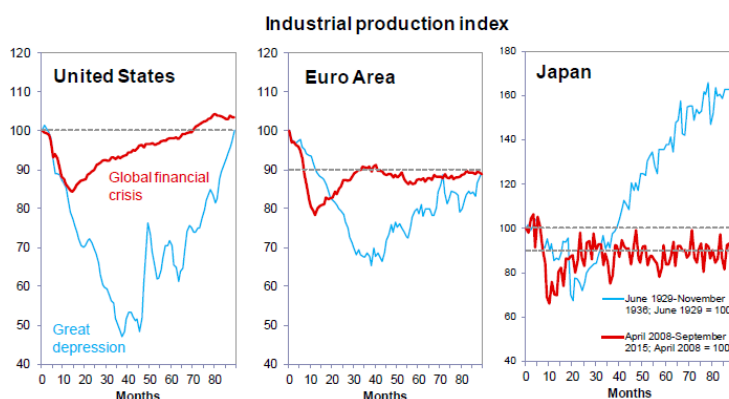
## A history of (over-) optimistic growth projections



- ✓ The world economy has moved sideways
- ✓ Global growth sub-par at 3.1 percent
- ✓ Persistent stagnation in advanced economies
  - ... could fuel anti-trade sentiment
- ✓ Countries need to rely on all policy levers – monetary, fiscal and structural – to lift growth prospects

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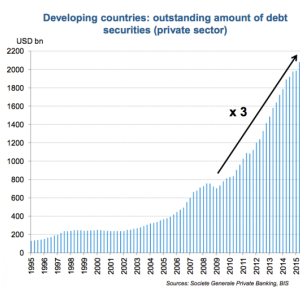
# Weak recovery



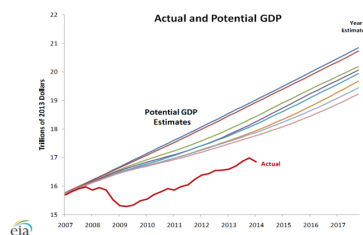
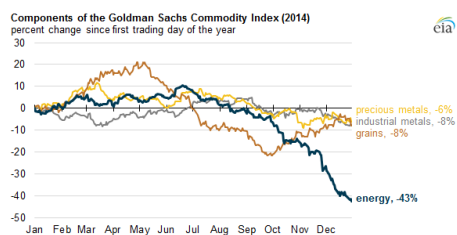
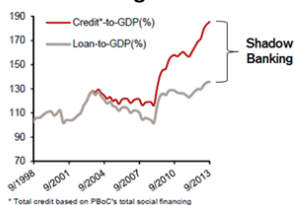
Note: For the Euro Area, the 1929 to 1936 series corresponds to the average across France, Germany, and Italy.  
 Source: Echeingreen, B. and K.H. O'Rourke. (2010) "What do the new data tell us?" VoxEU.org - 06 March; League of Nations. Statistical Yearbooks 1934-38 made digitally available by North-eastern University Library at <http://digital.library.northwestern.edu/leaguestat.html> ; Federal Reserve Bank of St. Louis; Haver Analytics and IMF staff estimates. Latest observation September 2015.

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# Risks on the downside



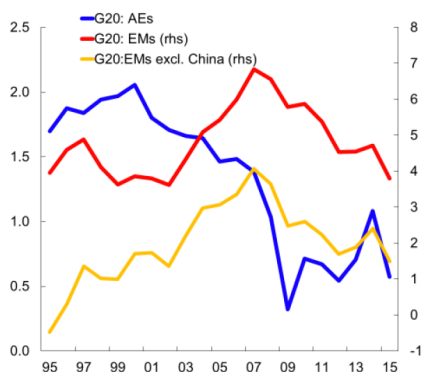
## China credit growth



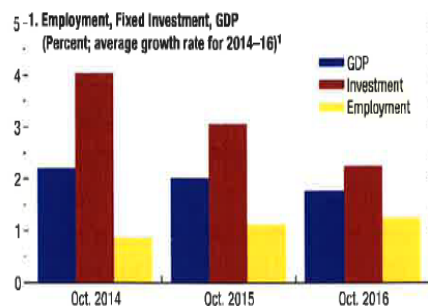
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## Falling productivity and investment

**G20 labor productivity 1/**  
(index 1995=100; GDP-weighted;  
5-year moving average)



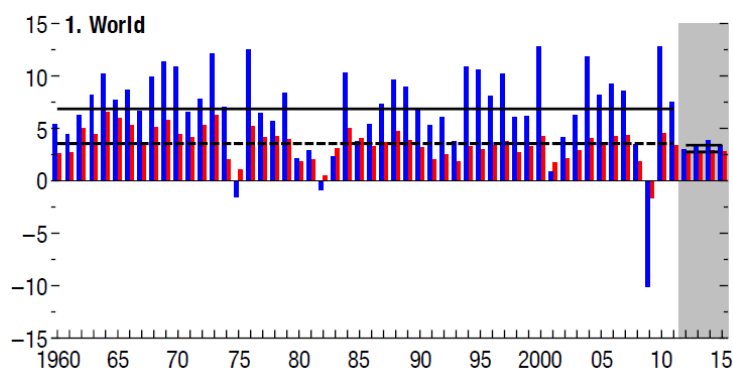
**Figure 1.12. Advanced Economies: Growth, Investment, and Employment in Recent WEO Vintages**



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## Downward shift in global trade

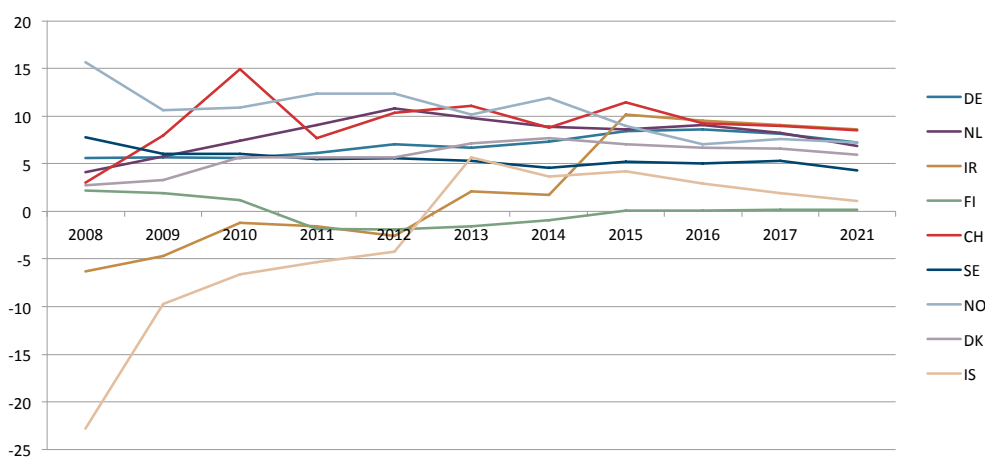
■ Import growth      ■ GDP growth  
— Average import growth      - - - Average GDP growth



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## Global imbalances (selected European countries)

Balance on Current Account (% of GDP)



Source: WEO Table A11

## “IMF fears slower growth as Lagarde pleads for an end to protectionism”

- An increase in trade barriers and other protectionist measures have contributed to trade’s recent slowdown



# “Backlash to World Economic Order Clouds Outlook at IMF Talks”

## Weak World Economy

Global growth slows to a six-year low

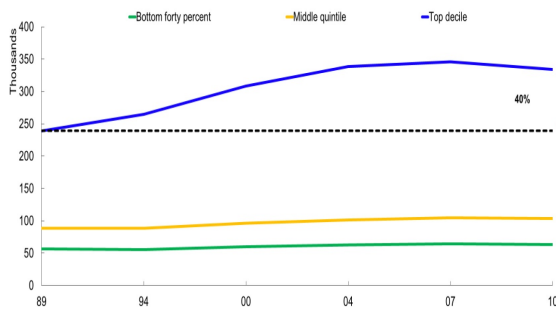


- “We’d like to see an end to the creeping protectionism in the world and more progress on moving ahead with free-trade agreements and other trade-creating measures”
- **Maurice Obstfeld**, director of the IMF’s research department

# Widening income gap => political reaction

## Income growth<sup>1</sup>: Mostly at the top

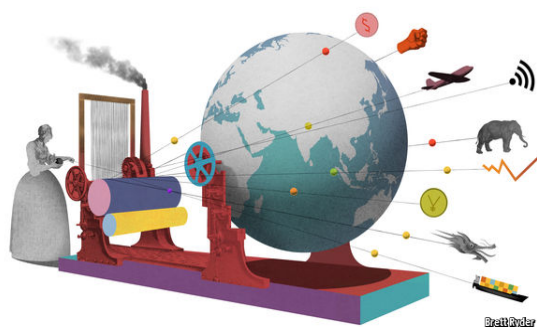
(2005 PPP dollars; thousands)



Sources: Luxembourg Income Survey; New York Times Income Distribution Database (2014); and IMF staff calculations.  
1: Evolution of mean equalized income of Canada, Germany, Italy, United Kingdom, and United States.

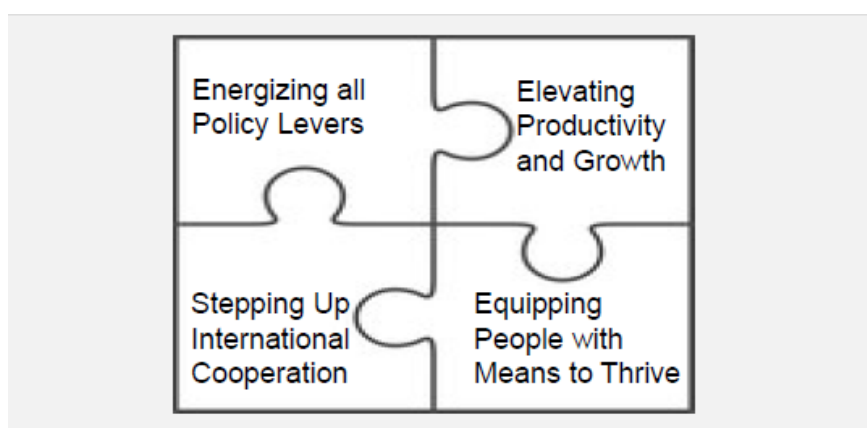


The  
Economist



- *The consensus in favour of open economies is cracking*
- *Is globalisation no longer a good thing?*

## IMF: Policy priorities and challenges





## **More inclusive growth**

- Governments must work harder to make growth inclusive
- ... to make sure that gains from trade are widely shared, and
- ... that those at risk of loosing out are being supported

C. Lagarde (28.9.16)

## **“The whole can be greater than the sum of its parts” (Lagarde)**

- Pessimists believe that our traditional tools of monetary and fiscal policy are exhausted, but I beg to differ
- In my view, there is more policy space – more room to act – than is commonly believed
- It requires pushing harder on all policy levers and taking more advantage of the synergies between them

## Coherent, Comprehensive and Coordinated approach to economic policy

- **Comprehensive** policy actions exploit synergies by combining structural reforms with a demand management framework
- **Consistent** policy actions guided by firm long-term expectations
- **Coordinated** policy actions across countries amplify individual policy actions



## Global growth warning!

- Global GDP growth flat at 3% in 2016; only modest improvement projected for 2017
- Monetary policy has become overburdened and creates risks
- **A stronger collective fiscal and structural policy response is needed**
- **Fiscal space** has increased in many advanced economies, as interest rates have declined by more than GDP growth
- Specifically, EU should allow for a more supportive fiscal stance, for example
  - by excluding net investment spending from fiscal rules and using more discretion in applying the SGP fiscal rules

## OECD – changing views

- 2012: Further easing of monetary policy + structural policies; independent fiscal councils and credible fiscal rules
- 2013: Strong commitment to structural reforms in advanced and emerging market; gains from structural reforms will accumulate over the longer term
- 2014: Structural reforms are a key part of a comprehensive policy package
- 2015: Importance of productivity-raising structural policies
- 2016: Fiscal policy should take advantage of greater fiscal space by increasing high quality infrastructure investment

## Why is world trade so weak?

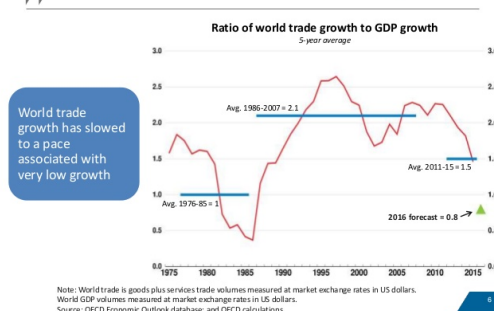
**Cardiac Arrest or Dizzy Spell:  
Why is World Trade So Weak,  
What Can Policy Do About It?**

PARIS, 21 September 2016

[www.oecd.org/economy/economicoutlook.htm](http://www.oecd.org/economy/economicoutlook.htm)  
EcoSCOPE blog: [oecdecoscope.wordpress.com](http://oecdecoscope.wordpress.com)

**OECD**  
BETTER POLICIES FOR BETTER LIVES

### World trade growth is exceptionally weak





### Structural reform priorities to boost trade and deepen global value chains

Stop new protectionist measures and rollback existing ones

Implement agreements already reached (Trade Facilitation and Trans-Pacific Partnership)

Conclude on-going sectorial negotiations in services

Revive multilateral negotiations on new issues such as digital trade

Liberalise further FDIs

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## IMF supports OECD's view

- “We must reverse the trend toward protectionism and restore a climate that supports a rebound in trade—by completing multilateral trade agreements and pushing forward reforms in services and other areas of the "new economy" such as regulatory cooperation and intellectual property rights”

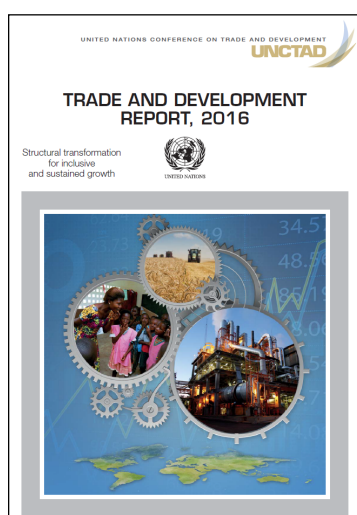
Lagarde: Boosting Growth and Adjusting to Change, 28.9.16

## But who is to blame for the trade slowdown?

- Weighing each country's import slowdown by its share of global trade (a "shift-share" framework), we find that Europe accounts for roughly half of the global trade slowdown.
- By contrast, China—which imports a far smaller fraction of global trade, but slowed its rate of import growth at a comparable pace—contributed only 10%.

Goldman Sachs Global Macro Research: Top of Mind, September 29, 2016

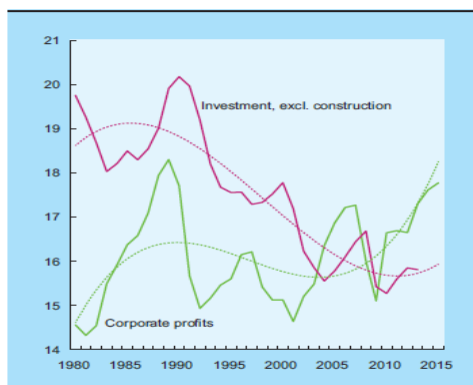
## UNCTAD Trade and Development Report



- Main problem is weak global demand due largely to **stagnant real wages**
- Profit shares have been rising, but not real investment

## Corporate financialization

CORPORATE PROFITS AND INVESTMENT  
(EXCL. CONSTRUCTION), 1980–2015  
(Per cent of GDP)

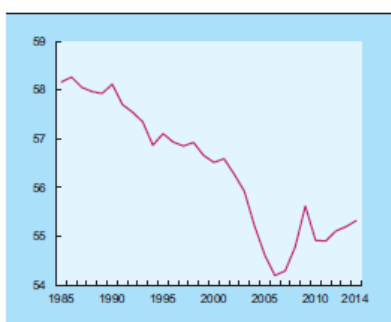


Source: UNCTAD secretariat calculations, based on data from Oxford Economics; and OECD, *National Accounts*.  
Note: Chart shows average values for France, Germany, Japan, the United Kingdom and the United States.

- Short-term position taking and financial trading have taken priority over real investment and production with long-term potential

## Deficient global demand

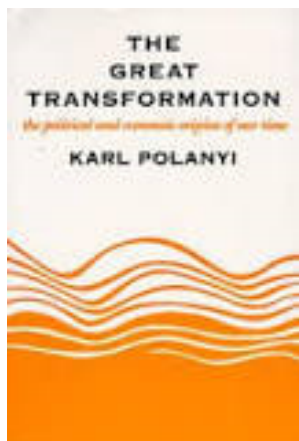
GLOBAL WAGE SHARE, 1985–2014  
(Per cent of global income)



Source: UN Global Policy Model using historical data compiled from UNSD and national sources.

- Blaming protectionism for current trends runs the danger of distracting policymakers from making inclusive growth the axis of a globally coordinated policy program

## A Great Transformation is needed



- Karl Polanyi (1944) insisted that a “great transformation” was needed if markets were to work for a stable and prosperous future for all
- Trust would have to be rebuilt, regulations strengthened, and rights and representation expanded.

## Industrial policy

- Manufacturing are a key for catch-up development by creating forward and backward linkages
- Wage compression and fiscal austerity weaken domestic demand for countries pursuing export-led industrialization

## Restoring the profit-investment nexus

- Establishing a strong profit-investment nexus requires substantial institutional and policy initiatives and change, including the creation or deepening of the banking system, ensuring it has appropriate capacities for long-term credit provision, along with proactive industrial policies

## Government should support long-term investment

- **Capital market regulations** should change the incentive structure for institutional investors and asset managers
- **Prudential regulations** and credit policies should promote long-term financing of targeted productive activities



## **Restructuring of the financial system**

- A restructuring of the financial system – particularly the banking system – is required to ensure that it serves the real economy better than in the past
- Central banks should also – through their financial policies - influence the direction of credit to firms undertaking productive investments for activities that are considered strategically important or to firms and sectors facing specific financing constraints, such as small and medium-sized enterprises and startups

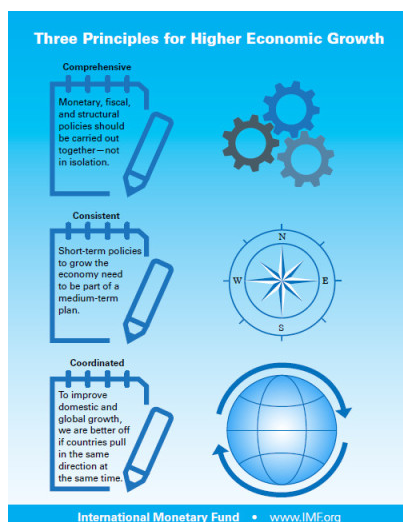
**CONVERGENCE OF VIEWS?**



## G20 Leaders' Communique Hangzhou Summit

- We are determined to foster an innovative, invigorated, interconnected and inclusive world economy to usher in a new era of global growth and sustainable development
- We will pursue innovative growth concepts and policies by forging synergy among fiscal, monetary and structural policies, ...as well as combining demand management with supply side reforms

## Will the IMF's 3-Cs catch on?



- It would be in each country's interest to coordinate their policies with other countries. By pulling in the same direction at the same time, they can amplify their domestic efforts to lift growth at home and, by implication, around the world.



## The Return of Fiscal Policy (26.9.16)

- We should begin activating fiscal policy now, for several reasons:
  - Most advanced economies have some fiscal space
  - Long-term government bond yields at all-time low
  - Public infrastructure investment with high returns
- Current uncoordinated fiscal stimulus: + 0,5 %
  - More is needed, particularly on infrastructure

<https://www.project-syndicate.org/commentary/shift-from-monetary-to-fiscal-policy-by-nouriel-roubini-2016-09>

## IMF: Fiscal policy can support monetary and structural policies

- Fiscal policy can be especially effective at ZLB
- Fiscal policy as backup for monetary policy
- Structural fiscal reforms can enhance growth
- Fiscal policy can also encourage structural reform

V. Gaspar (IMF): Fiscal Policy and Structural Reforms, <http://bruegel.org/wp-content/uploads/2015/11/Vitor-Gaspar-Structural-Reforms-Bruegel-Presentation.pdf>

## But, the IMF continues to push for fiscal consolidation in the Eurozone in 2017

- IMF needs to be as aggressive in recommending fiscal expansion in surplus countries as it is in recommending fiscal consolidation in deficit countries
- Judging by its recommendations in Europe, it still has a way to go

Brad Setser, Council on Foreign Relations

<http://blogs.cfr.org/setser/2016/09/15/do-not-count-european-fiscal-chickens-before-they-hatch/#more-7153>

## ... and many are cautious

- We continue to believe that the use of fiscal space depends on cyclical conditions and country-specific circumstances
- That said, we agree that responsible stimulus, including **infrastructure investments**, to lift growth in the short term can be warranted where conditions allow and within frameworks of sound and sustainable public finances
- This needs to be coupled with **structural reforms** to strengthen confidence and improve economic prospects in the medium and long term

**IMFC Statement** by Claus Hjort Frederiksen, Minister of Finance, Denmark  
On behalf of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, Sweden

## **UNCTAD calls for a global “new deal”**

- Proactive fiscal policy, incl. large public infrastructure spending
- Supportive monetary and credit policies
- Stronger financial regulations
- Redistributive policies
  - Incl. income policy, progressive taxes, minimum wage legislation, and welfare-enhancing social programs

## **IMF calls for more redistributive policies**

- Our efforts to lift growth must be accompanied by policies that support the poor and those displaced or negatively affected by change. Our countries must be more open to redistributive policies

– David Lipton, IMF, 29. September 2016

## **... and infrastructure investment**

- increasing productive capacity through infrastructure investment where there are clear shortfalls,
- introducing well-targeted tax incentives to boost research and development investment, and
- facilitating improvements in human capital by investing in education and health care

## **A “new” IMF?**

### **JAPAN – Article IV**

- Income policies and labor market reforms should move to the forefront
  - Ensure that profitable companies raise base wages by at least three percent
  - Raise availability of child-care facilities through deregulation

### **USA – Article IV**

- Policy actions are warranted to address falling labor force participation, an increasingly polarized income distribution, high levels of poverty, and weak productivity