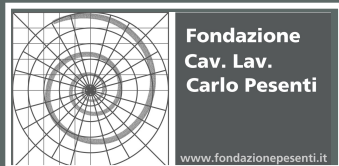


# Michael Spence

*Chair of the Commission of Growth and Development, winner of 2001  
Nobel Prize in Economic Sciences*

## Growth and development perspectives



**Obama's America: back to the future**  
Bergamo, 13 dicembre 2008

# Prospects for Developing Countries

- **Long term, the sustained high growth model will continue to work**
  - **Assumes a return to a stable global economic environment**
- **In the short run there are major headwinds**
- **The financial crisis (as of the last two months) has the potential through multiple channels to slow growth quite dramatically**
- **In some countries this may derail it for a longer period (for political as well as economic reasons)**
- **Confidence in the stability of global economy is shaken and will not return right away**
- **Balance of benefits and risks in the global economy may be shifting at least for awhile**
- **Risk mitigation will be a higher priority in growth strategies**

# Topics

- **Very brief account of the longer term sustained growth model in developing countries**
- **The impact of the financial and economic crises**
- **Some longer term challenges to developing country and global growth**



# Commission on Growth and Development

- **Montek Ahluwalia (India), Deputy Chairman, Planning Commission**
- **Edmar Bacha (Brazil), former President of the National Bank for Economic and Social Development, now in Banco Itau.**
- **Dr. Boediono (Indonesia), Minister for coordinating Economic Affairs**
- **Lord John Browne (Great Britain), former CEO, British Petroleum**
- **Kemal Dervis (Turkey), former Minister of Finance; Head of the UNDP program.**
- **Alejandro Foxley, (Chile), Minister of Foreign Affairs in Chile, former Finance Minister.**
- **Duck Soo Han (Korea), Prime Minister, Former Minister of Finance and Deputy Prime Minister**
- **Goh Chok Tong (Singapore), Senior Minister and Chairman of the Monetary Authority of Singapore.**
- **Danuta Hübner (Poland), Member of the European Commission**
- **Carin Jämtin (Sweden), Parliamentarian, former Minister for International Development Cooperation**
- **Pedro Pablo Kuczynski (Peru), former Prime Minister and former Minister of Finance**
- **Danny Leipziger (USA), Vice president, World Bank, PREM Network (Vice Chair).**
- **Trevor Manuel (South Africa), Minister of Finance**
- **Mahmoud Mohieldin (Egypt), Minister of Investment**
- **Ngozi N. Okonjo-Iweala (Nigeria), former Minister of Finance Nigeria, Managing Director, World Bank**
- **Robert Rubin (USA), Chairman Citigroup, former Secretary of the US Treasury**
- **Robert Solow (USA), Professor Emeritus, MIT.**
- **Mike Spence (USA), Stanford University, CA (Chair)**
- **Sir K. Dwight Venner (Saint Kitts and Nevis), Governor of the Eastern Caribbean Bank (West Indies)**
- **Ernesto Zedillo (Mexico), former President of Mexico, Director of the Yale Center Study of Globalization**
- **Zhou Xiaochuan (China), Governor of the People's Bank of China (Central Bank of China).**

# High Growth Cases

- **There are 13 economies that experienced sustained high growth--defined as 7% per year or more for 25 years or longer, post WW II**
- **Botswana, Brazil, China, Hong Kong (China), Indonesia, Japan, Korea, Malaysia, Malta, Oman, Singapore, Taiwan (China), and Thailand**
- **India and Vietnam are close because of growth accelerations in the past 10-15 years**
- **There may be others because of recent growth accelerations (in part due to demand induced upward shift in the relative price of energy, commodities and food.**
  - **These initial growth accelerations can be transformed into sustainable growth dynamics: rapid employment creation and structural diversification – But it is not easy**



# Common Characteristics of the Sustained High Growth Cases (1)

- **Engagement with the global economy**
  - Demand \*
  - Knowledge (catch up growth)
- **High levels (and effectiveness) of savings and public and private investment**
  - Total 25% of GDP or above\*
  - Public sector 5-7% of GDP\*
- **Market incentives and decentralization**
  - Rapid diversification and incremental productive employment
  - Continuing structural transformation
  - Resource mobility – especially labor – across sectors
  - Rapid urbanization
- **Macroeconomic and Financial Stability and Predictability\***
  - Domestically and in global environment\*

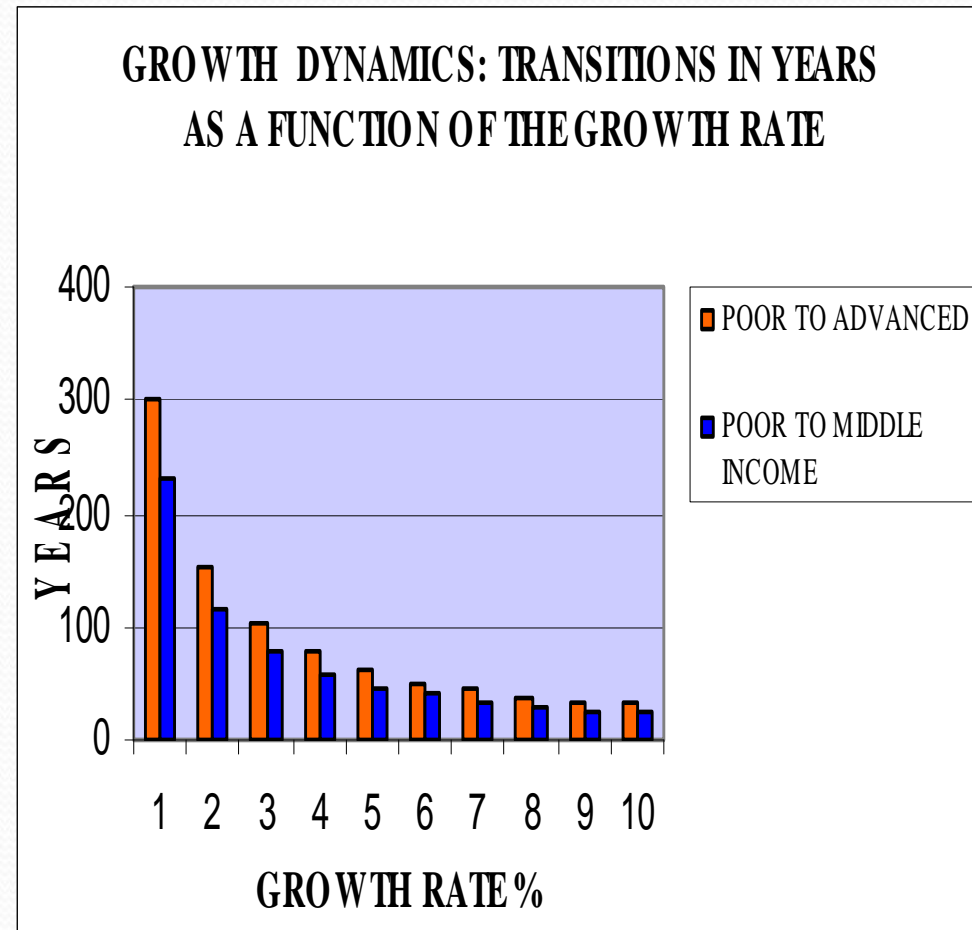
# Common Characteristics Politics and Leadership

- **Leadership, Governance, and Effective Government**
  - **Political leadership and effective, pragmatic and when needed activist government**
  - **A focus on inclusive growth: combined with persistence and determination**
  - **Long Time Horizons**
  - **Willingness to experiment, in face of uncertainty about policy impacts, and avoidance of paralysis**
  - **Government that acts in the interests of all the citizens of the country – as opposed to itself or subgroups**



# Long Time Horizons

- It takes a minimum of 50 years to make the transition from low to advanced income levels
- Persistence and a determined focus on the objective is critical
- Major crises will halve the growth rate or worse
- Bottlenecks (unanticipated blockages) are the norm in high growth environments – rapid responses are an important dimension of policy and effective government





# Key Ingredients

- **Inclusiveness and equity**
- **Structural Transformation and Competition**
- **Labor Markets, Mobility and Flexibility**
- **Urbanization is a Key Ingredient of Sustained Growth Dynamics**
  
- **Additional Issues**
  - **Environment**
  - **Energy Subsidies**

# Complex and Controversial Areas: Benefits, Risks and the Need to Make Choices

- **Industrial policies – export promotion**
- **Exchange rate management**
- **Pace and sequencing of opening**
  - **Capital account (financial sector)**
  - **Current account (trade in goods and services)**
  - **WTO constraints**
- **Capital controls:**
  - **independent ability to influence inflation and the exchange rate**
- **Reserve accumulation and insurance**
- **Central bank autonomy and coherence of growth strategy**
- **Fiscal stability and sustainability – rules or discretion**





# **The Financial Crisis and Global Growth**

# Where Are We Now?

- **Considerable damage has already been done**
- **Major financial institutions will be**
  - **Gone**
  - **Transformed,**
  - **Substantially owned by governments for a period of time**
- **Equities globally have declined in value by about 30 trillion dollars**
  - **Starting point \$65 trillion**
  - **Global GDP is about \$55 trillion**
- **Emerging market stock markets down more than 50% on average**
- **Deleveraging dynamics and asset deflation still in process and accelerating**
  - **Estimated costs of recapitalizing the financial sector are in the 1 to 2 trillion dollar range and rising rapidly**



# Developing Countries

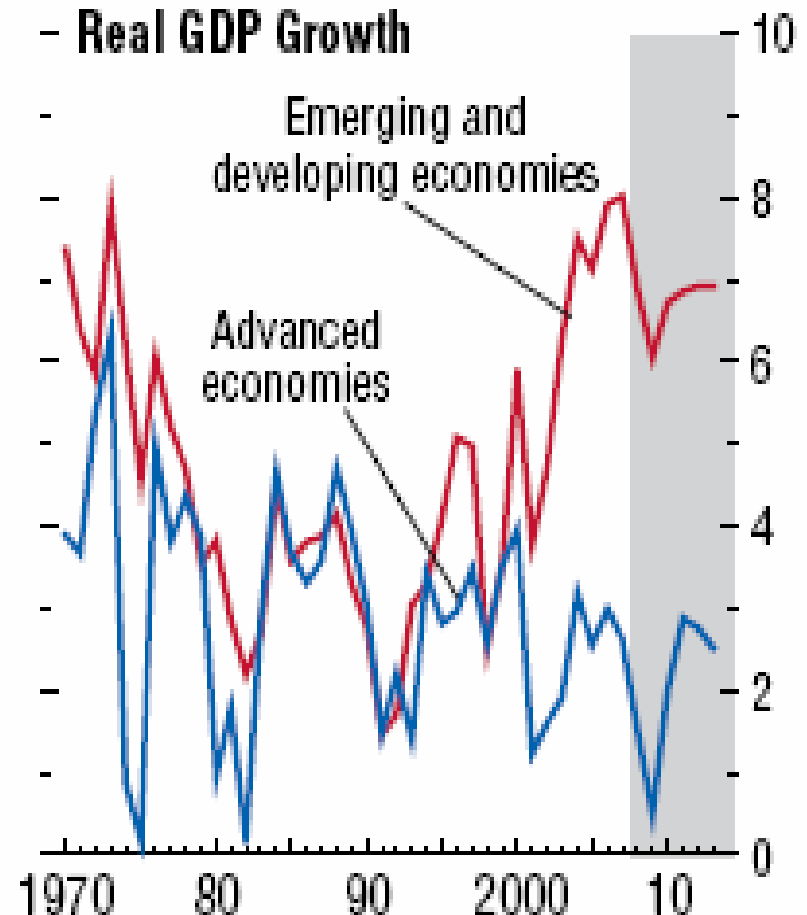
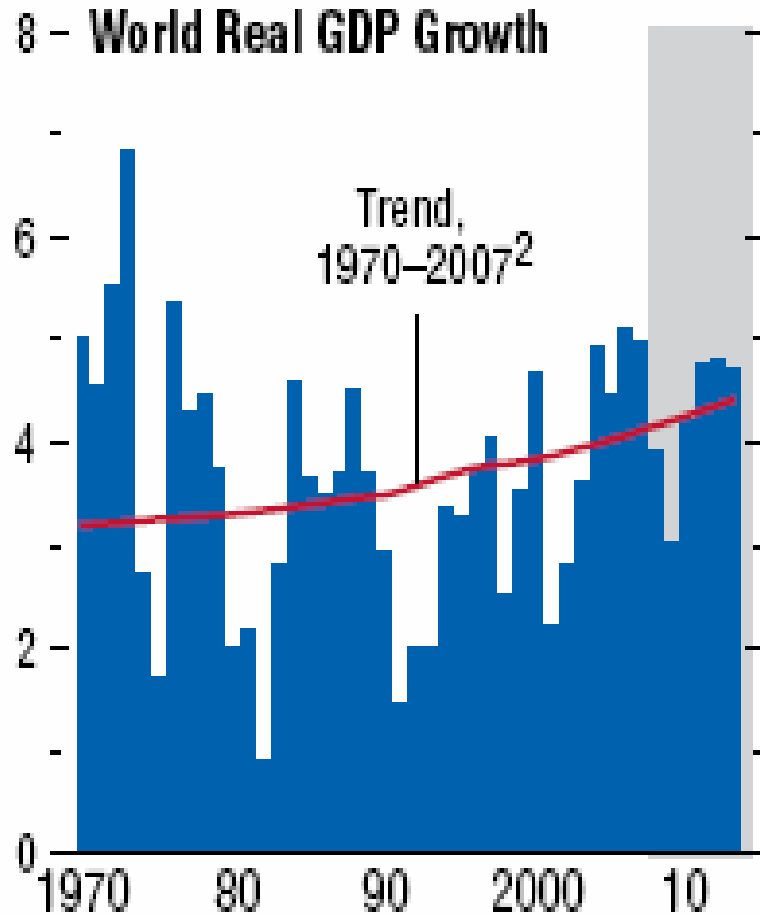
- **Up Until September Tough But Manageable Headwinds**
  - Food and energy price shock
  - Food emergency for poor
  - Major inflation issue – now abating
  - Temporary balkanization of agriculture markets
  - Global demand slowing
- **But**
  - Negligible holdings of toxic assets
  - Post 97-98 much stronger macroeconomic fundamentals
  - Some asset bubbles
  - Variable positioning on fiscal deficits, savings versus investment, trade deficits, reserves

# September 2008 Inflexion Point

- **Capital is exiting and exchange rates volatile and falling**
  - **Not a flight to safety**
  - **It is a capital vacuum – flight to emergency liquidity and capital adequacy problems in developed economies**
- **Credit tightening is nearly universal**
  - **IMF, Reserves, Dollar Swap Facilities**
- **Global slowdown likely to be much more severe**
- **Commodity prices abating - helpful**
- **Growth will depend entirely on the ability and willingness to use domestic demand to fill in for falling foreign demand**
  - **Varies considerably across countries**

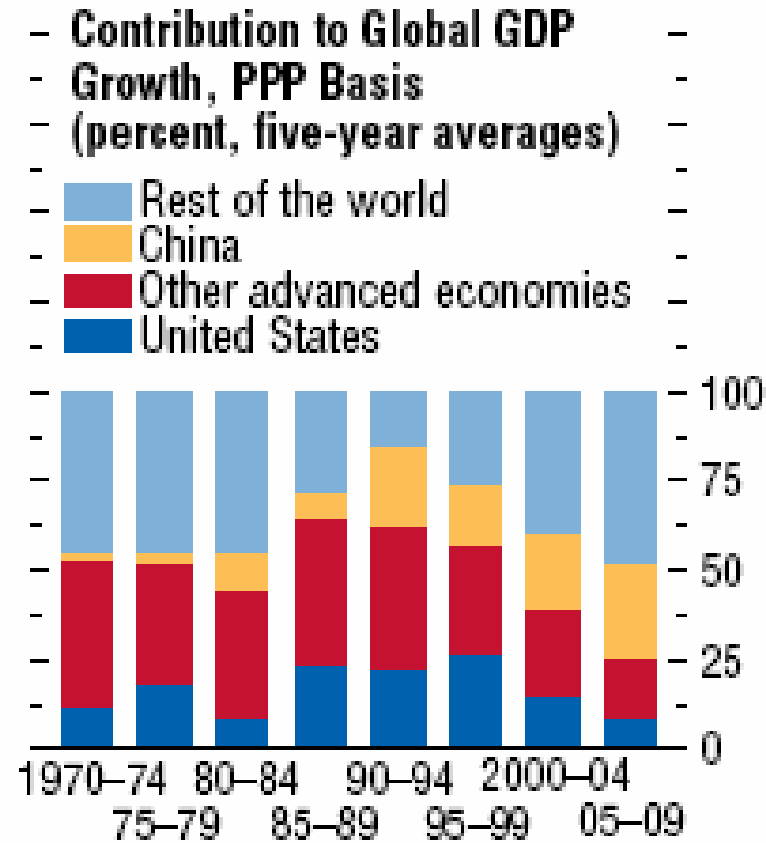
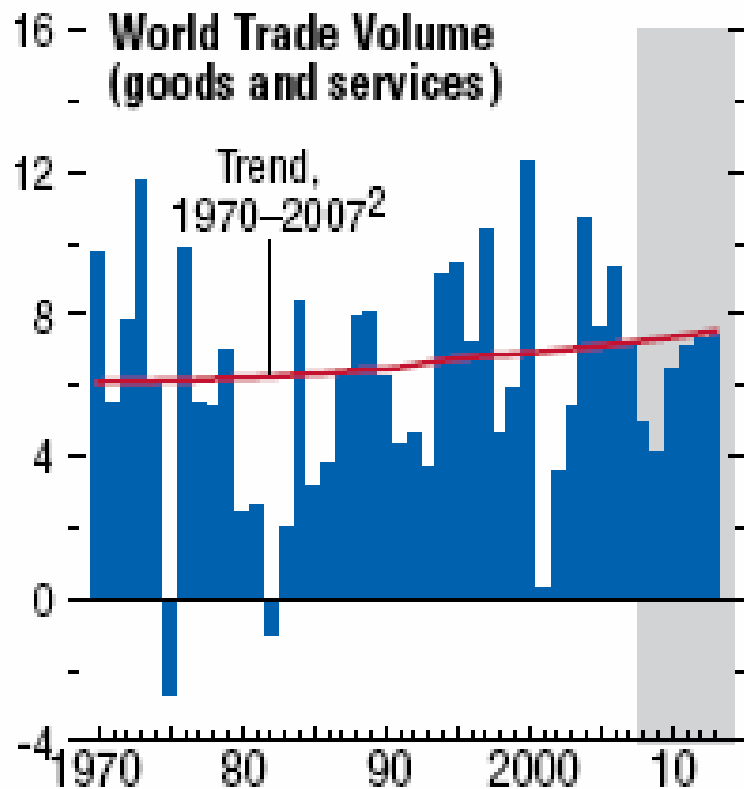


# IMF Forecasts Oct 2008



# IMF Forecasts Oct 2008

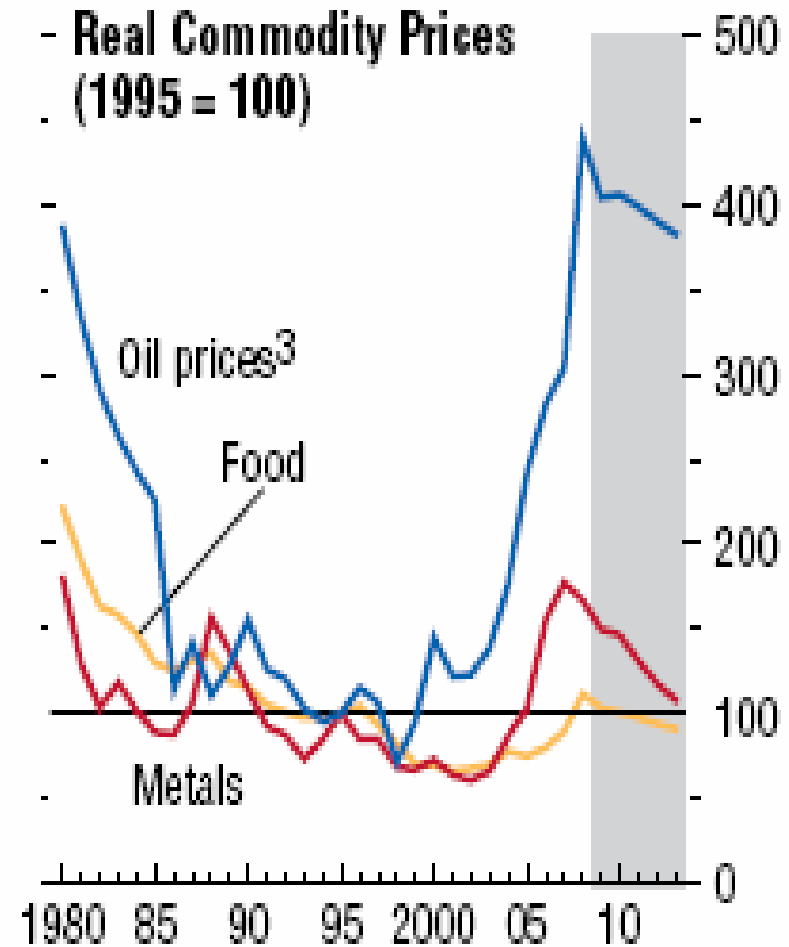
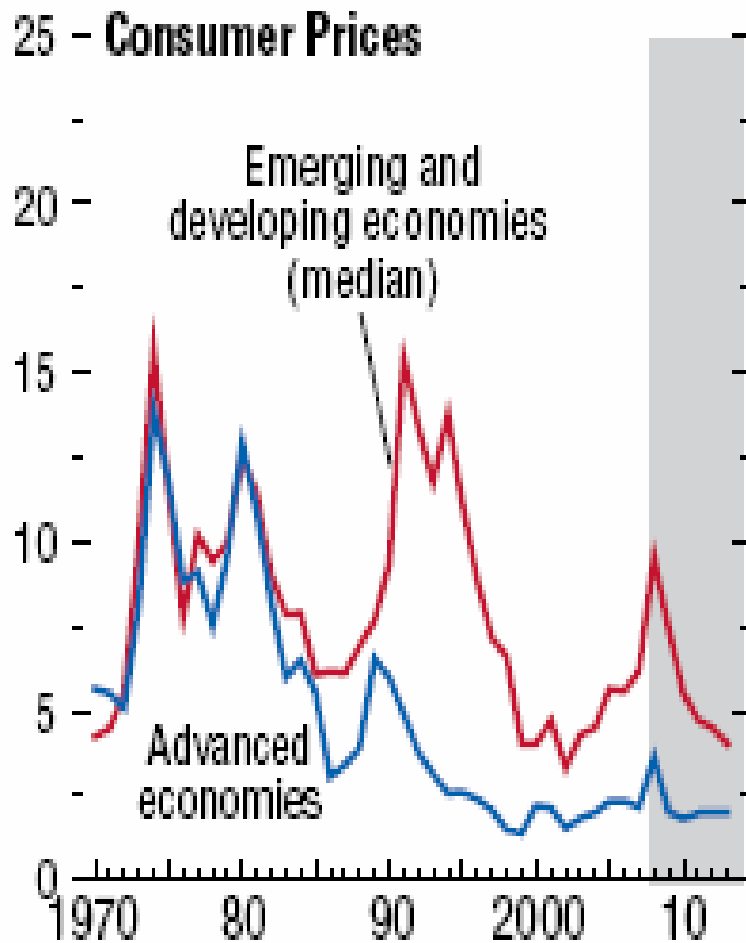
These are now too optimistic especially for developing countries



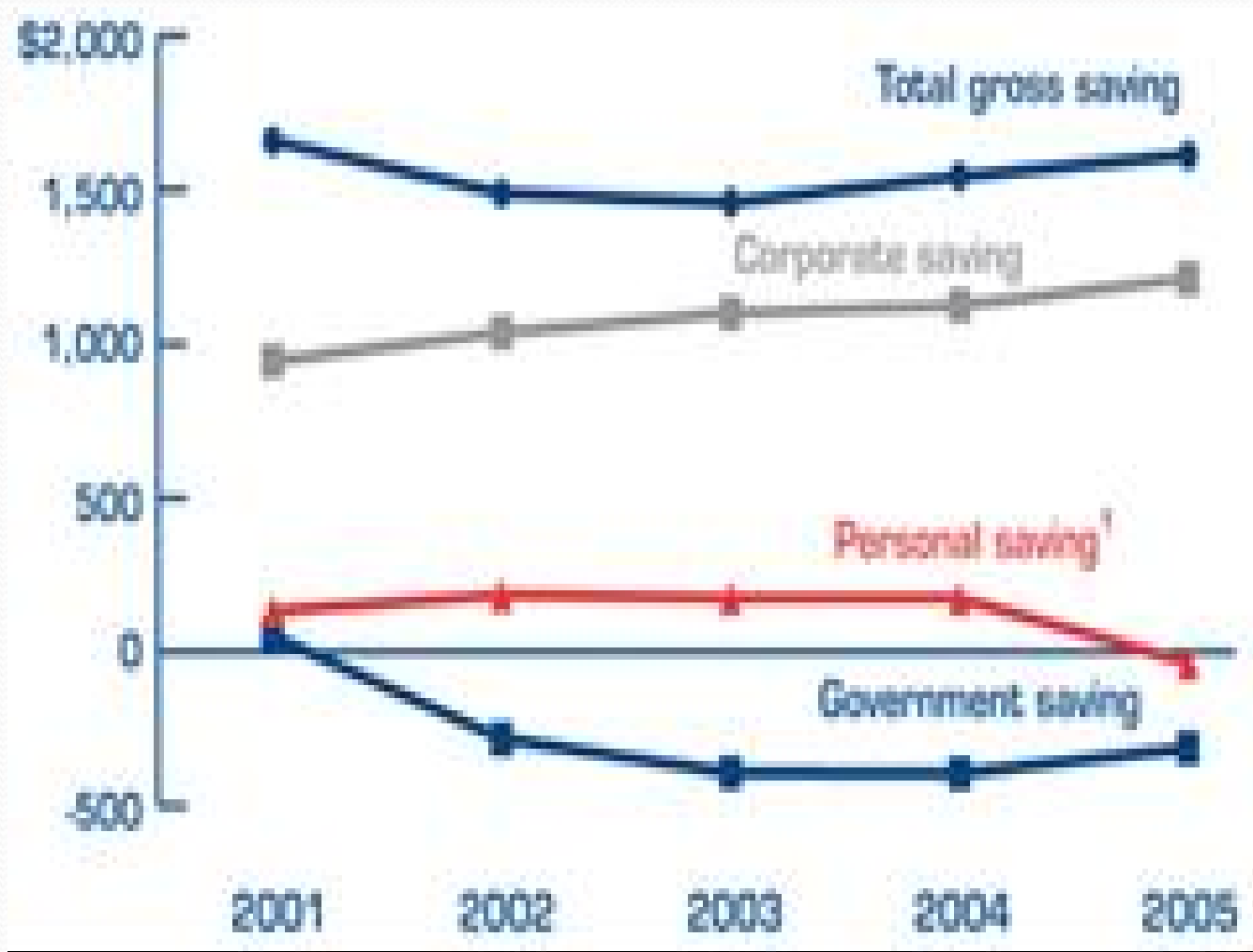


# IMF Forecasts Oct 2008

## Developing Countries have an Inflation Challenge



# USA: Expenditure Exceeds Output

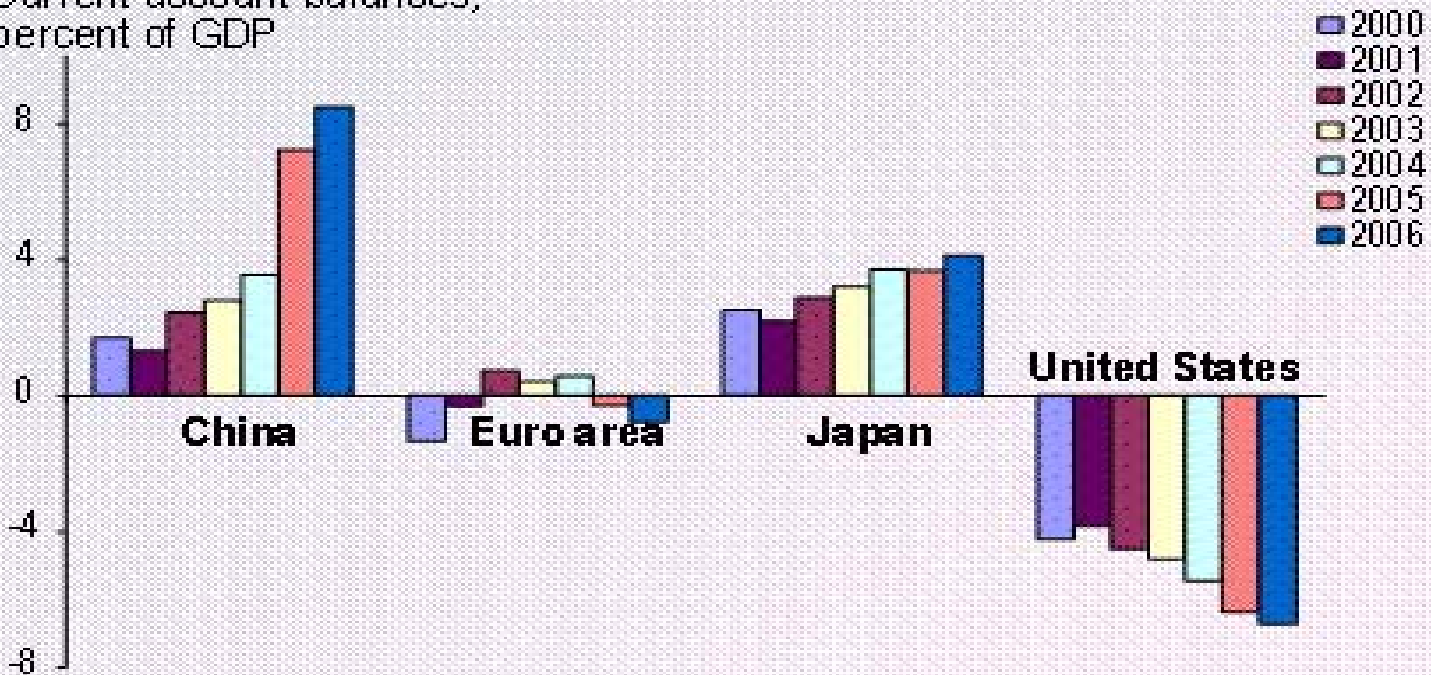




# Global Imbalances

## Global imbalances

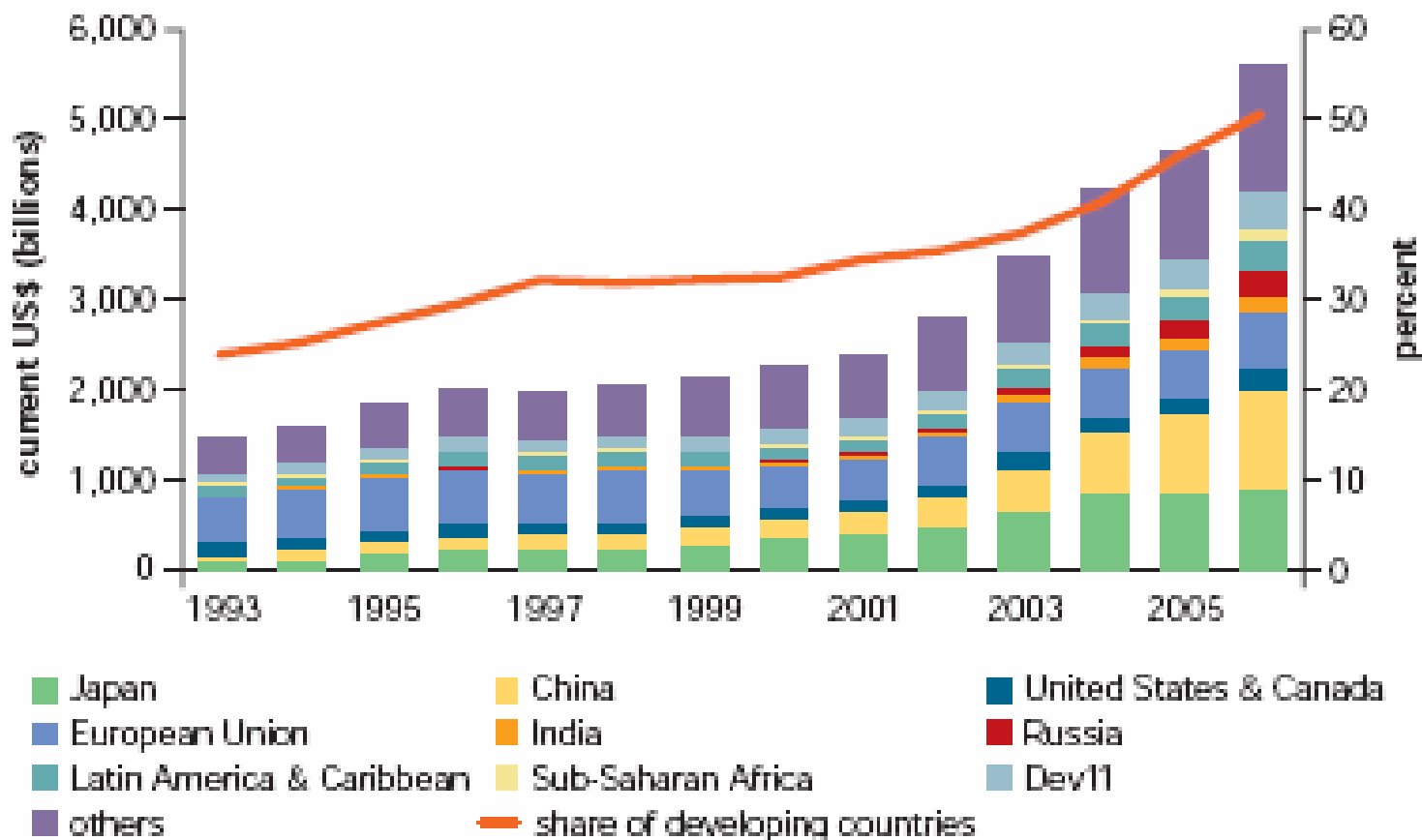
Current account balances,  
percent of GDP



Source: IMF and World Bank staff estimates.

### 6.11.3 Buildup of Reserves in Developing Countries, 1993–2006

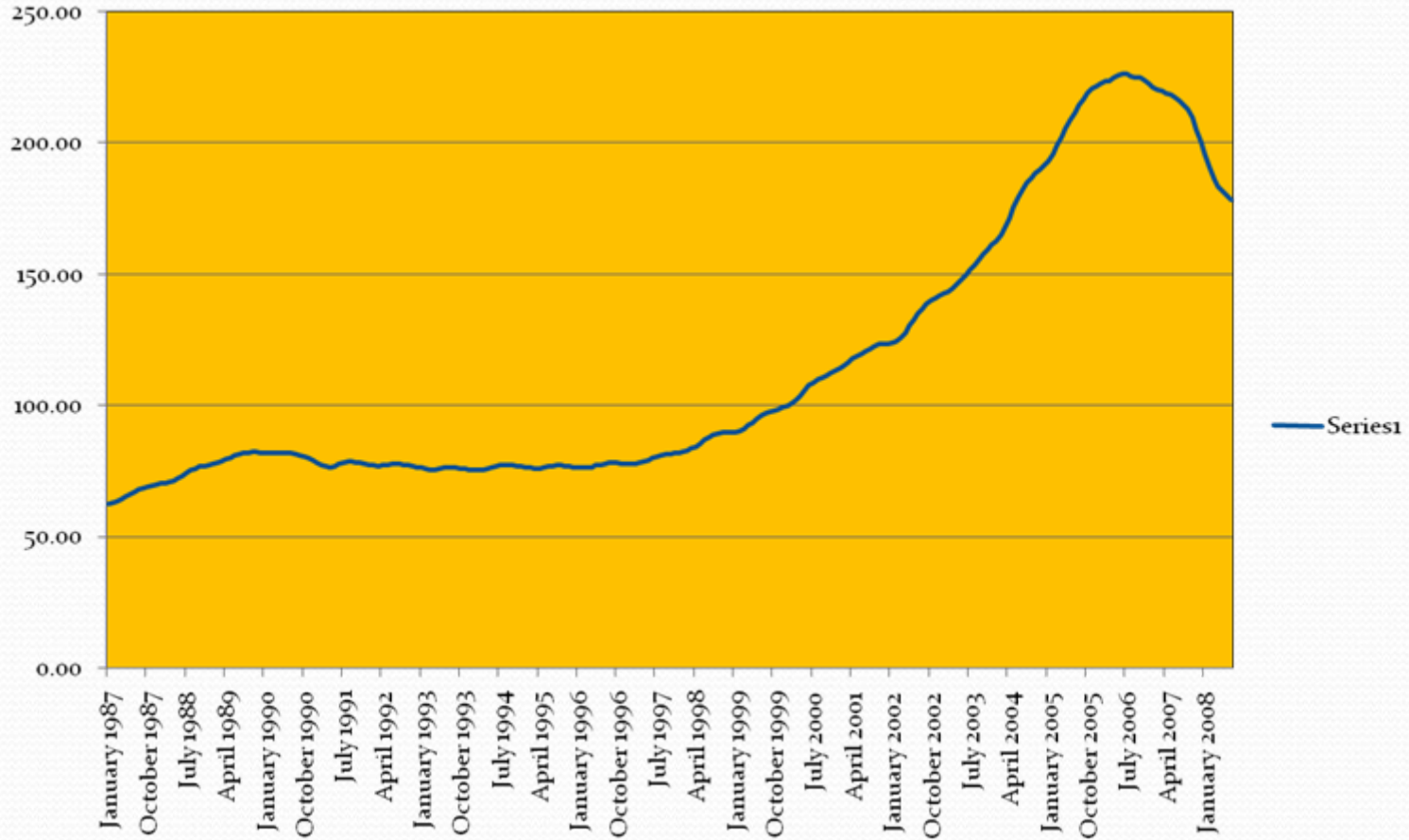
Over the last decade, developing countries have started accumulating substantial reserves.



Source: World Bank, World Development Indicators 2007.

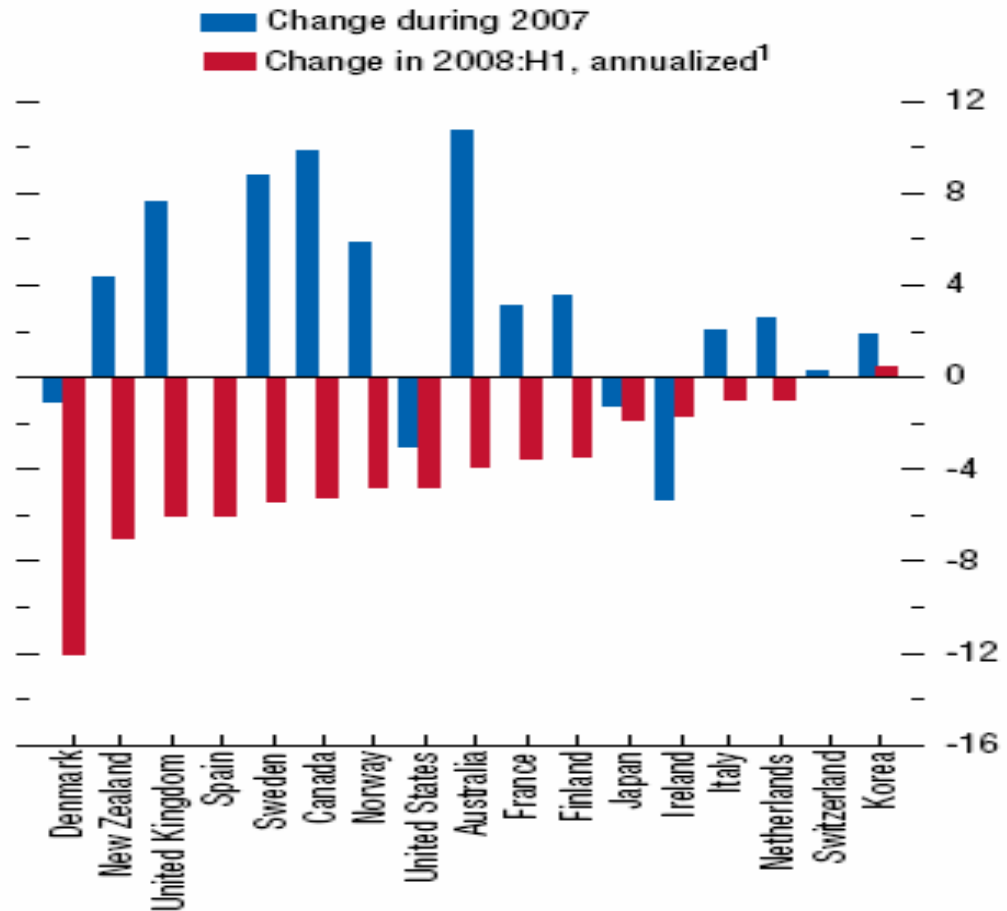


# Case-Shiller House Price Index Composite USA



# Housing Prices Globally

**Changes in Real House Prices**  
(Percent)

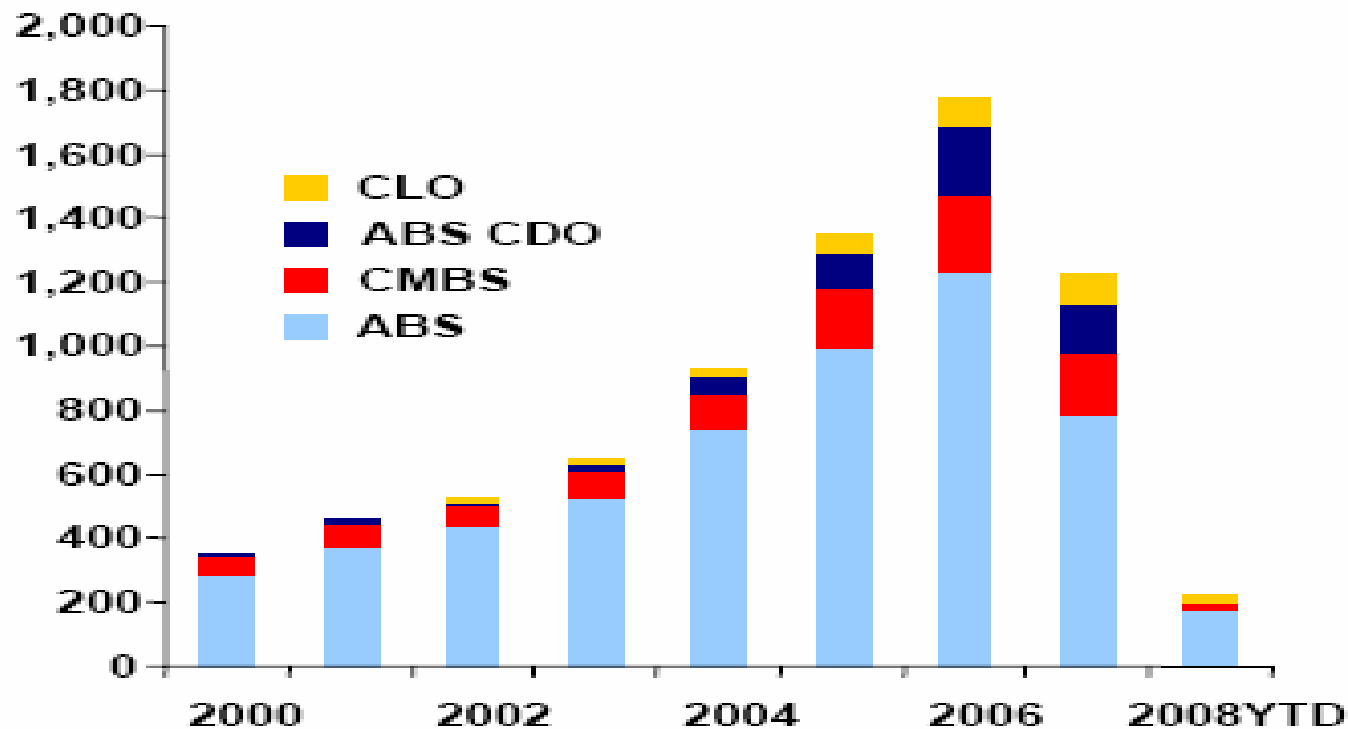


Sources: Organization for Economic Cooperation and Development; and IMF staff calculations.

<sup>1</sup>Change in 2008:H1, annualized, for Canada, Denmark, France, Ireland, Italy, Japan, New Zealand, and United States.

# Securitization

## Securitisation Issuance *US, \$ bn*

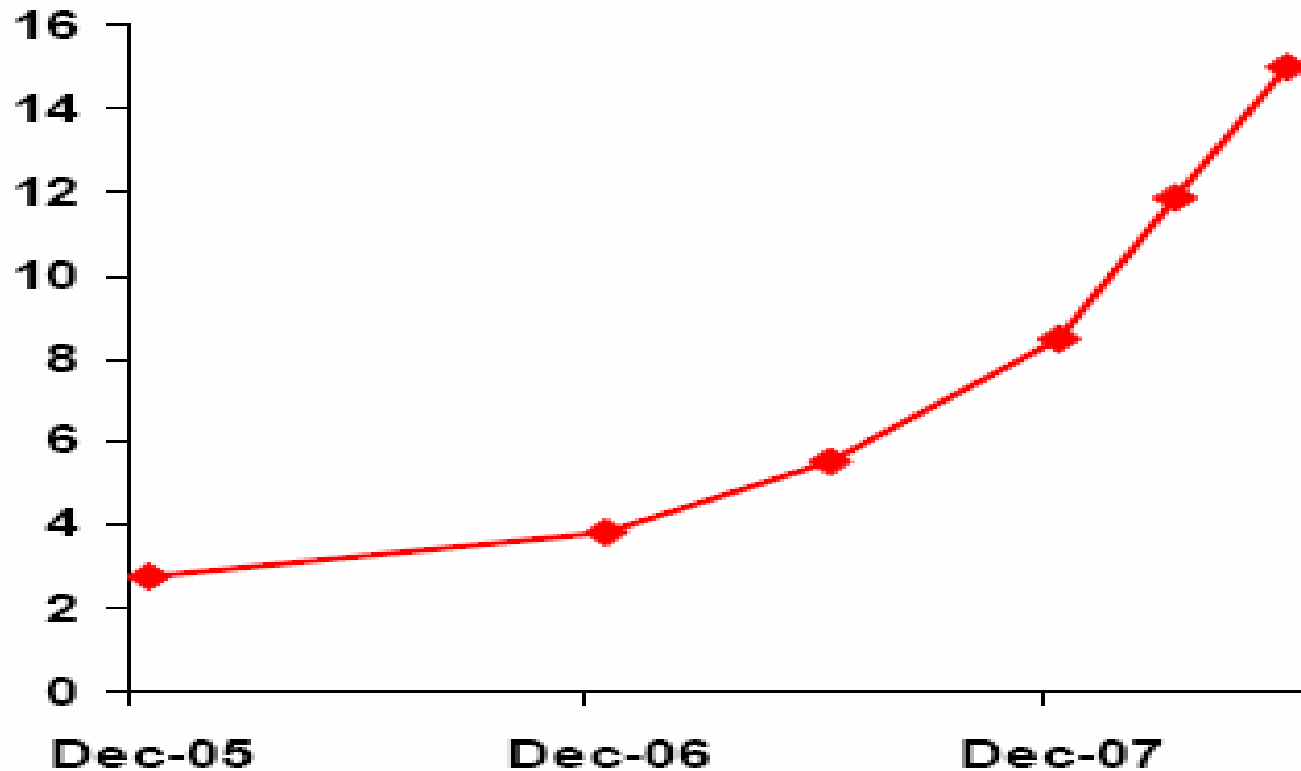


Source: Inside MBS and ABS, Securities Data Corp., Commercial Mortgage Alert, Moody's, IFR Markets, Citi.



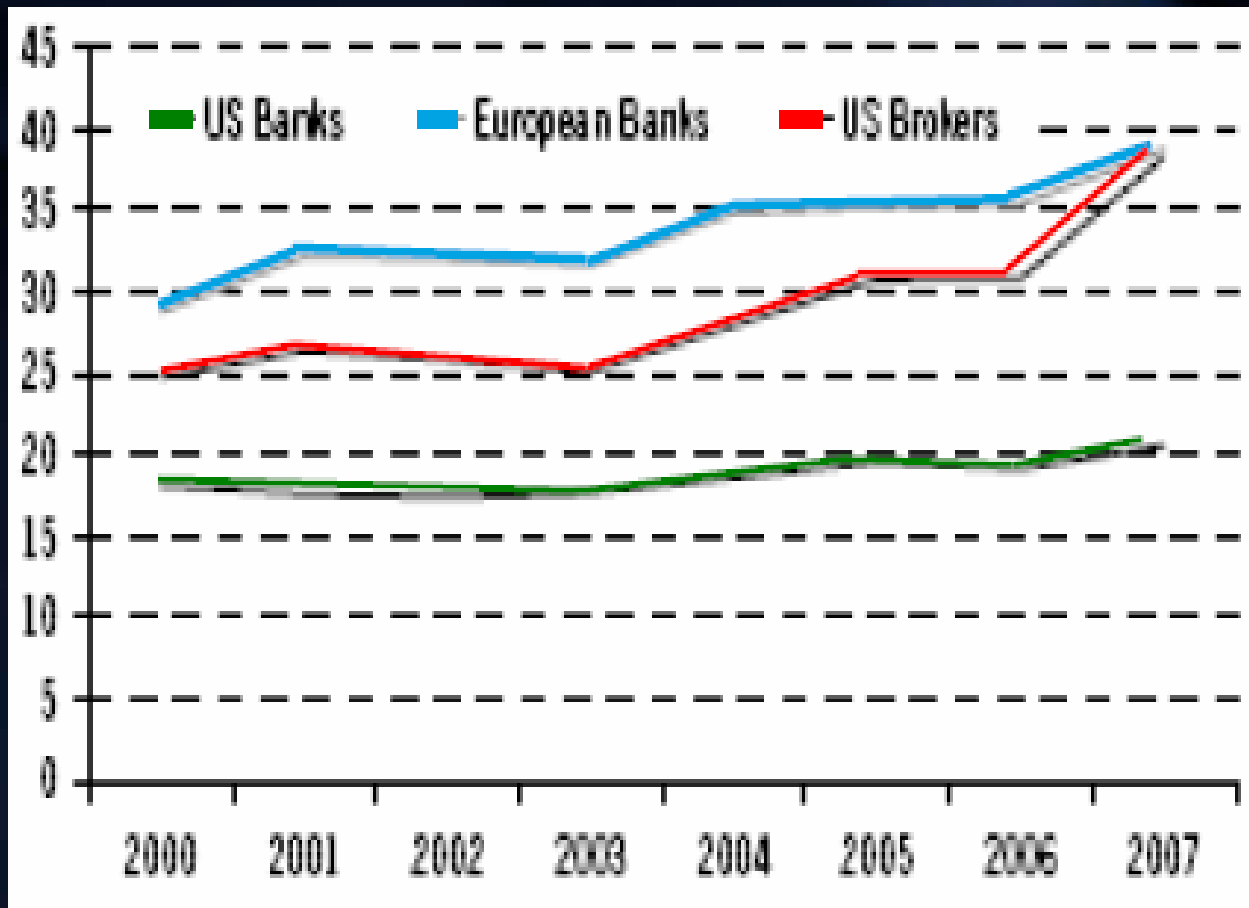
# Evidence of Low Credit Quality

**Non-Performing Assets**  
*Worst 200 US Banks, %*



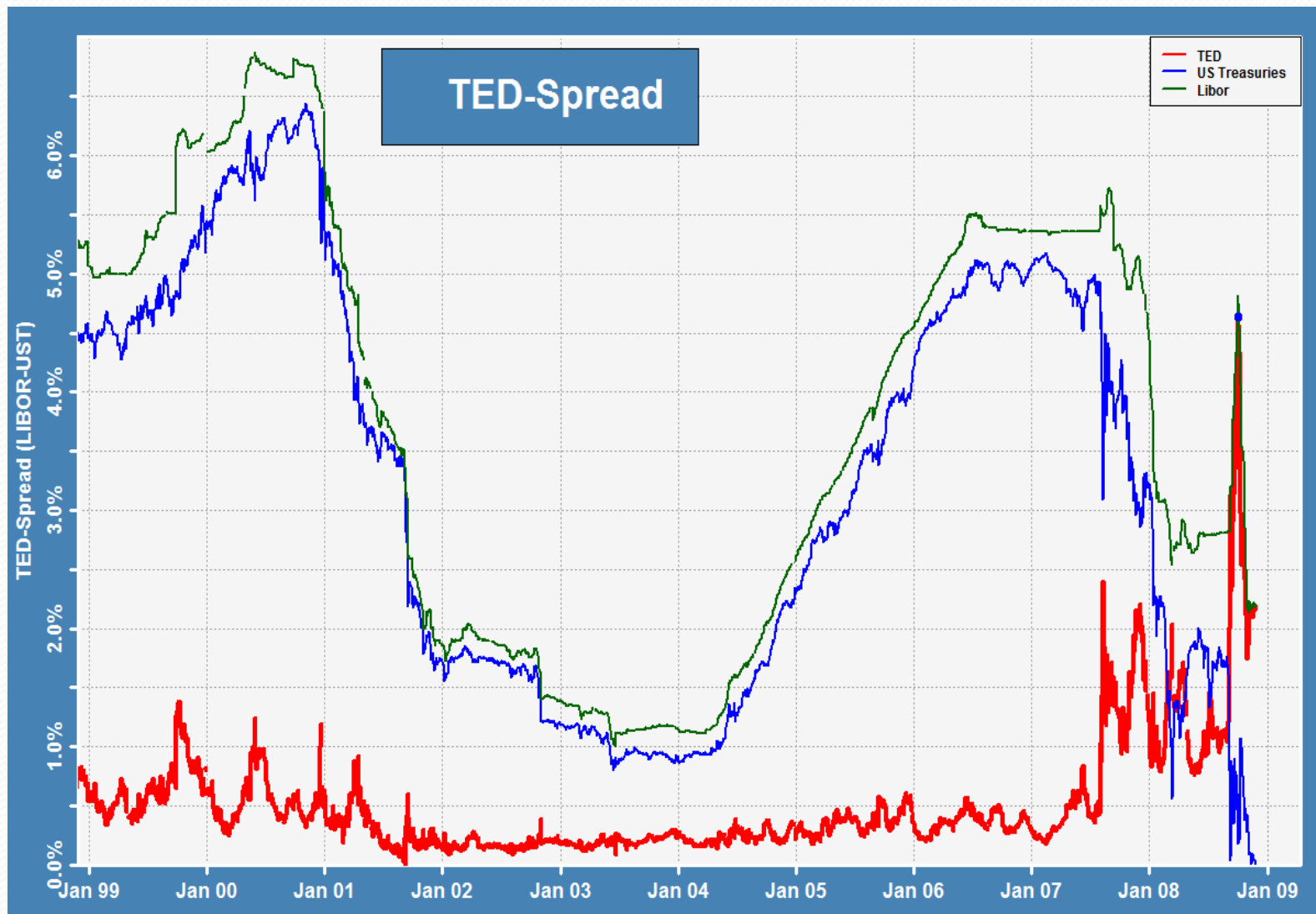
Source: Highline, Citi.

## Bank & Broker Leverage Levels (Assets/Equity)



(1) Source: Citigroup. September, 17 2008.

# Low Interest Rates Followed by Rapid Increase





# Upward Dynamics

- **Center of story is risk, perceptions and risk models**
- **Risk**
  - **1. Exogenous, stationary, uncorrelated**
  - **2. Endogenous, non-stationary (rising), correlated (systemic)**
- **Relevant data depends on the model underlying the beliefs**
- **If beliefs are closer to 1., then system does not produce disconfirming data until it breaks and the dynamics shift**

# September Inflexion Point

- **In Sept of 2008, the beliefs, expectations and dynamics changed sharply**
  - **as a result of a sequence of failures, emergency merger and seizures.**
  - **Lehman failure as tipping point**
- **Private capital ceased to enter the financial system**
- **Governments were left as the only source of capital to restore balance sheets.**
- **Viability/solvency issues for all major financial institutions caused inter-bank lending to dry up, and the payments system started to malfunction**
- **THE CHANNELS by which short term credit is delivered to businesses and municipalities locked up**
- **Triggered a variety of emergency responses that limited immediate large scale damage to the rest of the economy**

# TED Spread



- Source: Bloomberg



CHART 12

Sovereign Wealth Fund Investment in Wall Street

Country	Date of Deal	Amount	Company	Price of Stock on Deal Date	Price on 8/28/08	% Change
Kuwait	1/25/08	\$3 billion	Citigroup	\$26.00	\$19.08	-26.6%
Kuwait	1/25/08	\$2 billion	Merrill Lynch	\$54.22	\$27.52	-49.2%
Singapore	1/16/08	\$6.88 billion	Citigroup	\$29.52	\$19.08	-35.4%
Singapore	12/24/07	\$4.4 billion	Merrill Lynch	\$53.90	\$27.52	-48.9%
China	12/20/07	\$5 billion	Morgan Stanley	\$51.37	\$40.60	-21.0%
Singapore	12/7/07	\$9.75 billion	UBS	\$50.48	\$22.16	-56.1%
United Arab Emirates	11/26/07	\$7.5 billion	Citigroup	\$30.70	\$19.08	-37.9%
Singapore	7/23/07	\$2 billion	Barclays	\$735.00	\$326.75	-55.5%
China	7/23/07	\$3 billion	Barclays	\$735.00	\$326.75	-55.5%

Source: A. Gary Shilling & Co. and Yahoo Finance

# Global Asset Deflation

- **Global asset deflation with near certainty of overshoot**
  - **Asset prices are increasingly disconnected from intrinsic or longer term values**
  - **Intrinsic values (PV of free cash flows) are endogenous**
  - **Balance sheet / income statement interaction**
- **Interacting with and accelerating global economic slowdown**
- **Driven by deleveraging process and technical factors associated with the unwinding**
- **Threatens a very deep recession globally and much longer term loss of trust in global economy and financial system**
- **What is required is a coordinated and simultaneous asset buying process combined with fiscal stimulus that arrests the overshoot.**

# The Housing Markets and Mortgages

- **The bottom has not been found**
  - **And won't be until the toxic assets are cleaned out**
  - **Huge transparency problem**
- **TARP (the bill Congress passed is still important economically and politically) has been set aside for now**
  - **Remove damaged assets, inject capital, reset mortgages, prevent excessive foreclosures into a falling housing market**
- **Did not act fast enough – Gordon Brown**

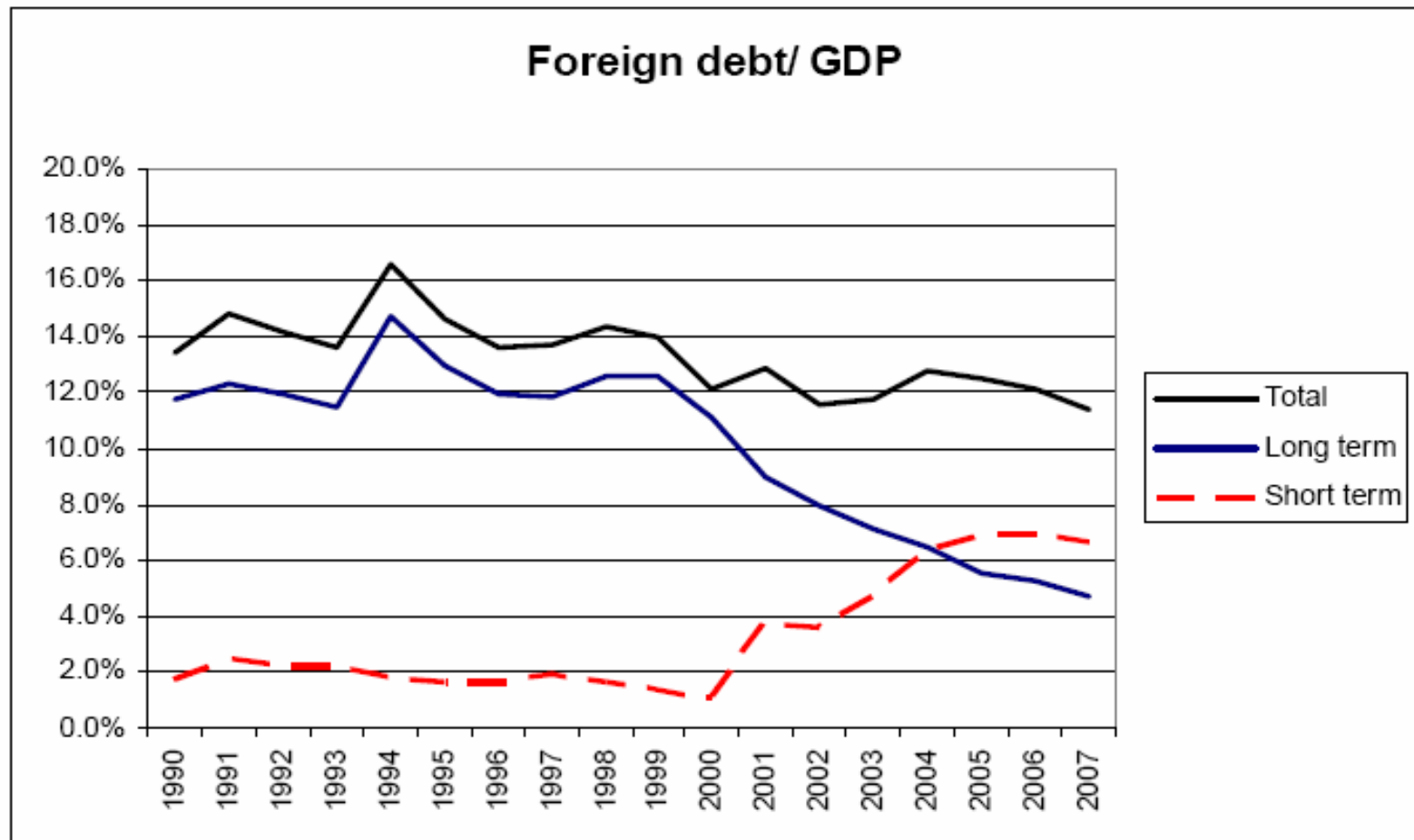


# China Likely to Weather the Storm

- **GDP \$3.5 trillion – a big domestic market**
- **Growth going forward 8% to 8.5% in 2009 down from 11% plus in 2007**
- **Huge reserves: 1.9 trillion dollars**
- **Another 500 billion in SWF and Banks**
- **Fiscal capacity (see graphs)**
- **Very high savings and investment rates**
  - **I = 45% of GDP S=55% of GDP**
- **Less export dependent than most think**
- **Structural Transition versus Global Slowdown**

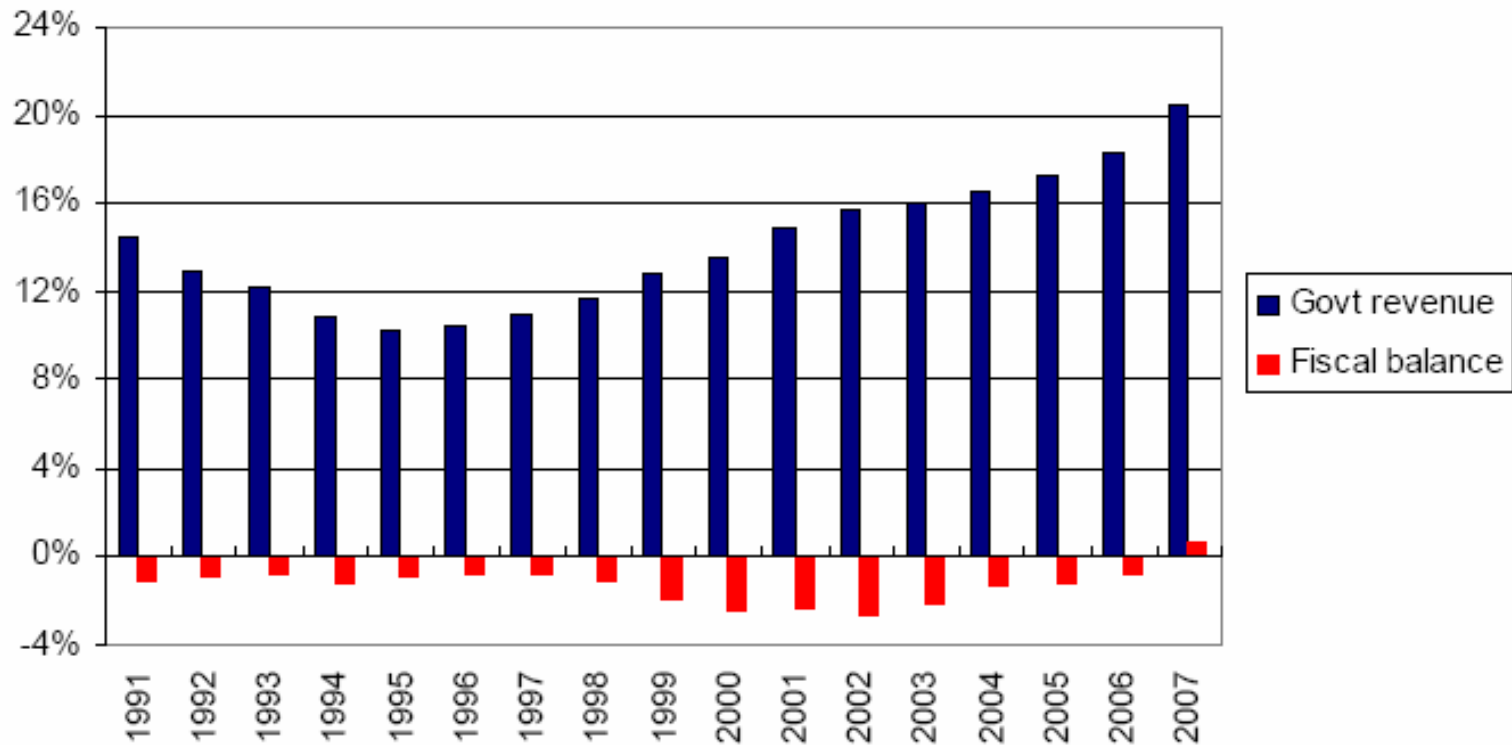
# China

Figure 4.



# China

**Government revenue and budget balance**  
% of GDP





# India

- **Challenge to hold 7% growth – was 9% in 2007**
- **First priority: stabilize financial system and restore credit**
- **Reserves used to partially reverse capital outflows rupee leveled off at 50 to the dollar**
- **Lowered interest rates**
- **Fiscal stimulus**
- **But large fiscal deficit**
- **Reliance on private and external capital for infrastructure**

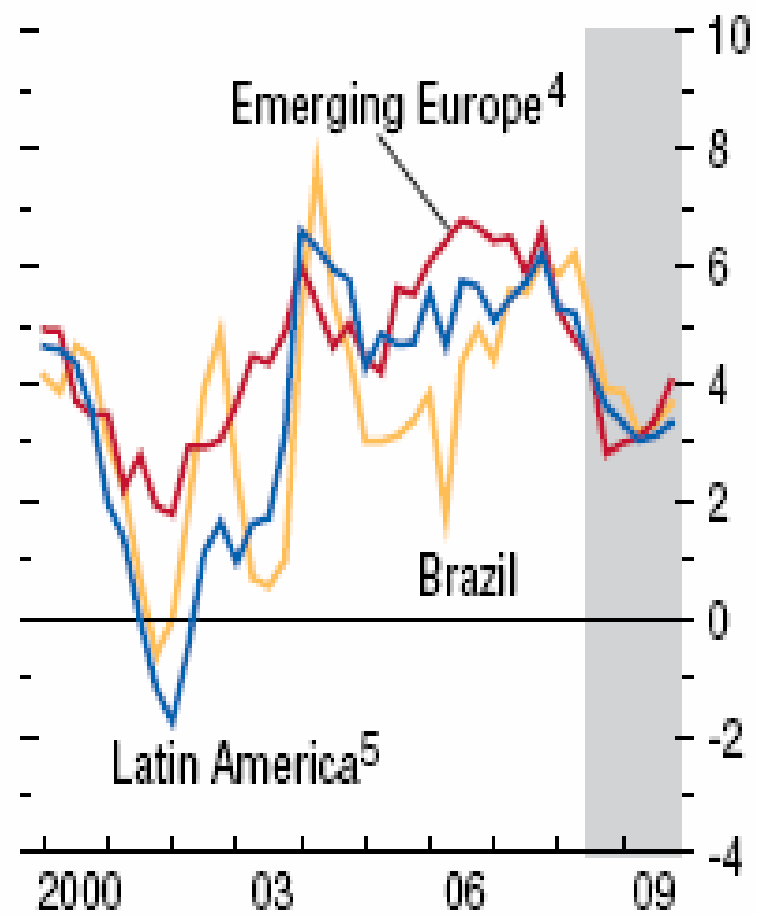
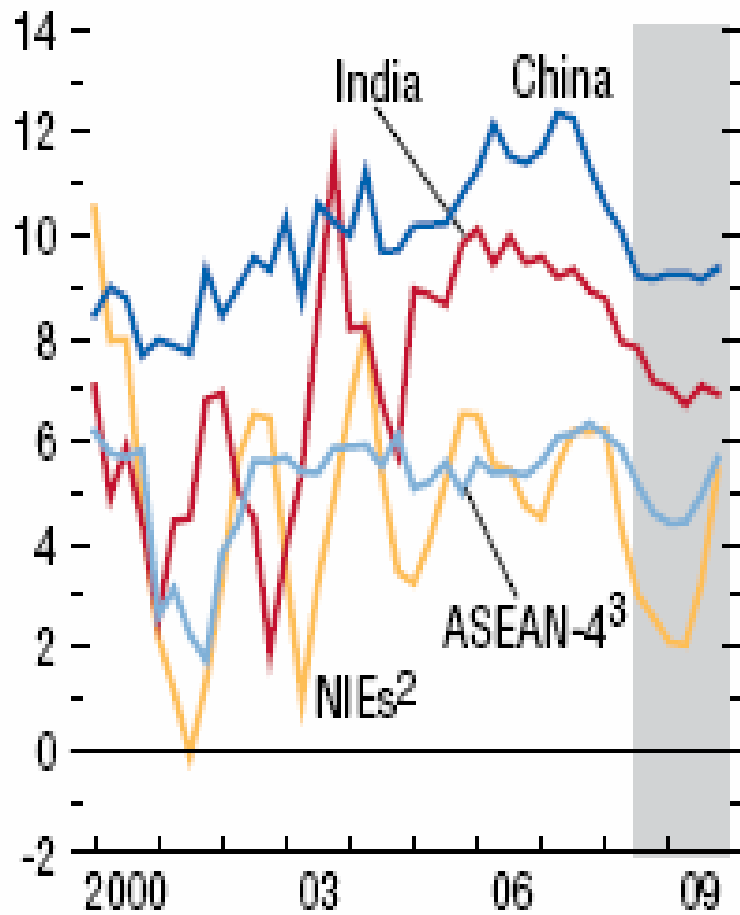
# Capital Outflows and Rapid Depreciation of the Rupee



Copyright 2008 Yahoo! Inc.

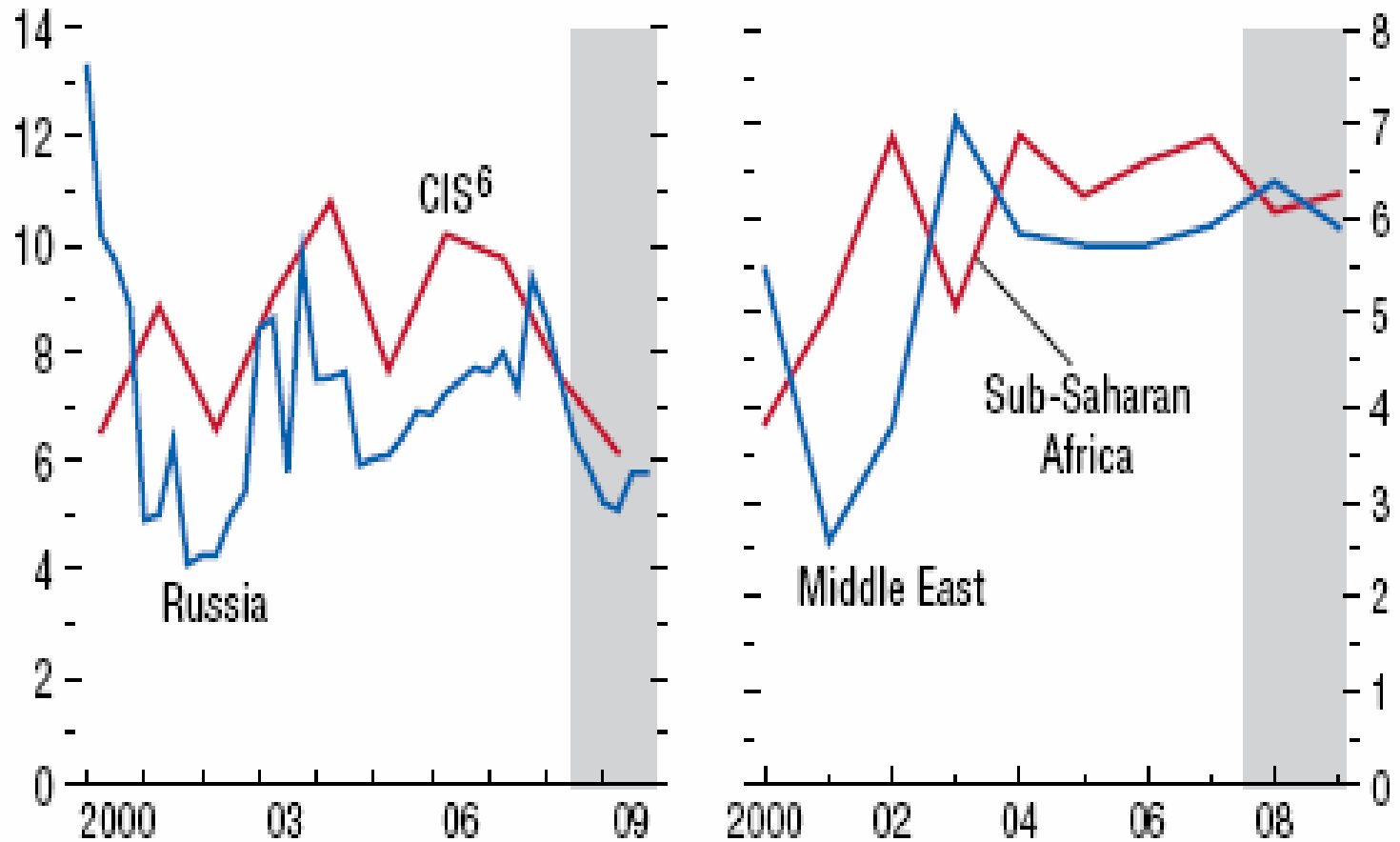
<http://finance.yahoo.com/>

# Growth Around the World





# Growth Around the World



# Longer Term Challenges

- **Rising income inequality, rising risk and resistance to globalization**
- **Impact of China and India – relative prices of manufacturing and labor intensive services**
- **Commodity price levels and volatility**
- **Energy efficiency, sufficiency and sustaining global growth**
- **Demographics – aging, anti-aging and labor demand/supply**
- **Climate Change**
- **Interdependence, risk and the management of the global economy**

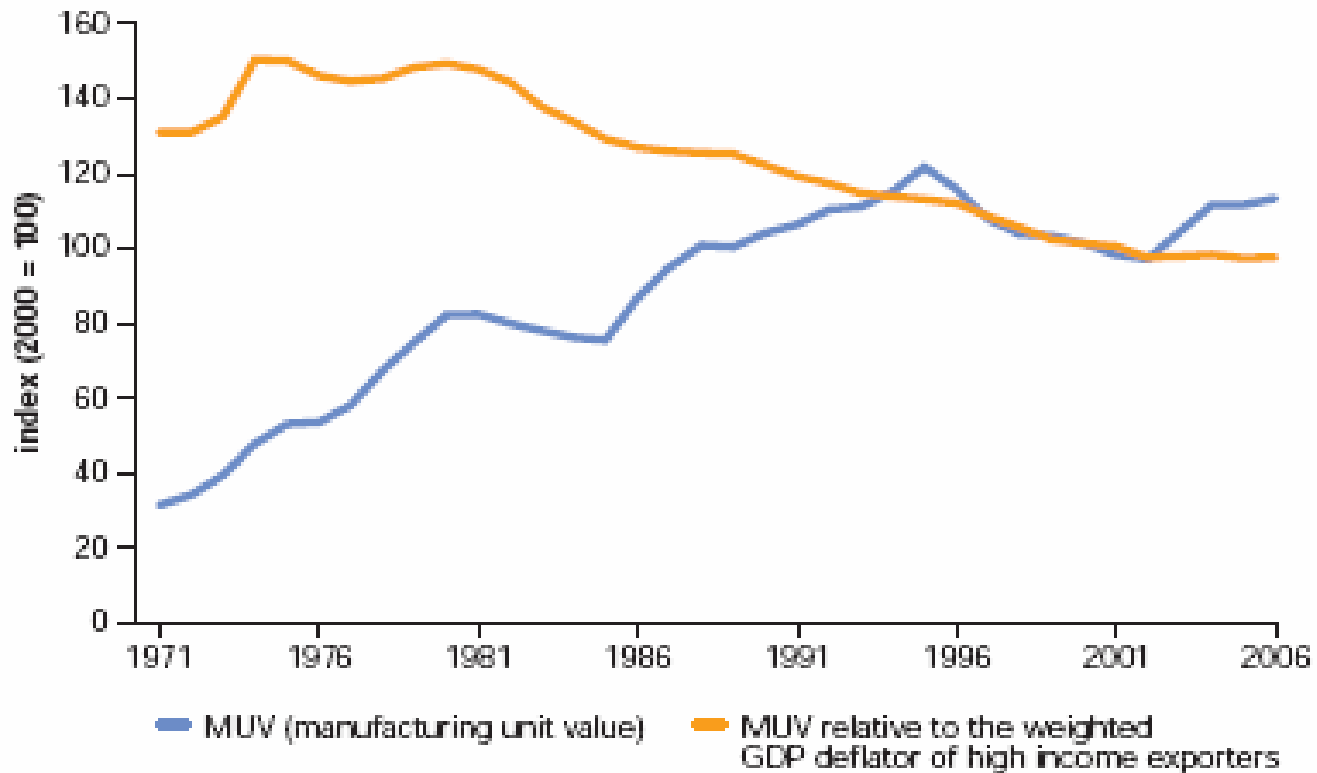
# Longer Term Challenges Detail

- **Rising income inequality and perceived risk and resistance to globalization**
  - Resistance to globalization is rising
    - Pew Survey of attitudes
    - Rising food and energy prices driven by rising demand
  - But it is what enables rapid growth and poverty reduction
  - Insufficient attention and response to distributional consequences (in advanced and developing countries)
  - The aggregate benefits are large, but it is hard work to make the distributional side come out fairly
- **The Impact of the Growth of China and India**
  - Large long-term shifts in relative prices: labor intensive manufactured goods
  - Can late arrivals compete, and will the growth strategies work
  - The adding-up problem or the fallacy of composition
  - Decline in relative price – absorptive capacity of global demand or protectionist response
  - Global imbalances one new version of the adding up problem



# Relative Price of Manufacturing Declined The China Effect

Figure 11 Chinese-Led Decline in Manufacturing Prices



Source: Development Economics Prospects Group, World Bank.

# Commodity Prices, Relative Price Volatility and Growth

- **Food prices**
  - **Emergency response**
  - **Balkanization**
  - **Opportunity for many countries**
  - **Supply response likely to be large (demand elasticity is low)**
- **Energy prices**
  - **Have the capacity to slow global growth**
  - **Demand response likely to be very high**
  - **Need for unified global market**
- **Relative price volatility likely to be a recurring feature of the global economy – it means additional risk**
- **Inflation**

# Demographics, Aging and Migration

- **Aging**
  - In most of the advanced countries and a number of developing ones including China
  - That is where most of the purchasing power resides now
- **Anti-aging**
  - in many of the poorer developing countries
  - High fertility
  - Reduced longevity due to HIV/AIDS
  - Youth unemployment Challenge
  - Migration, migration for work, and labor mobility

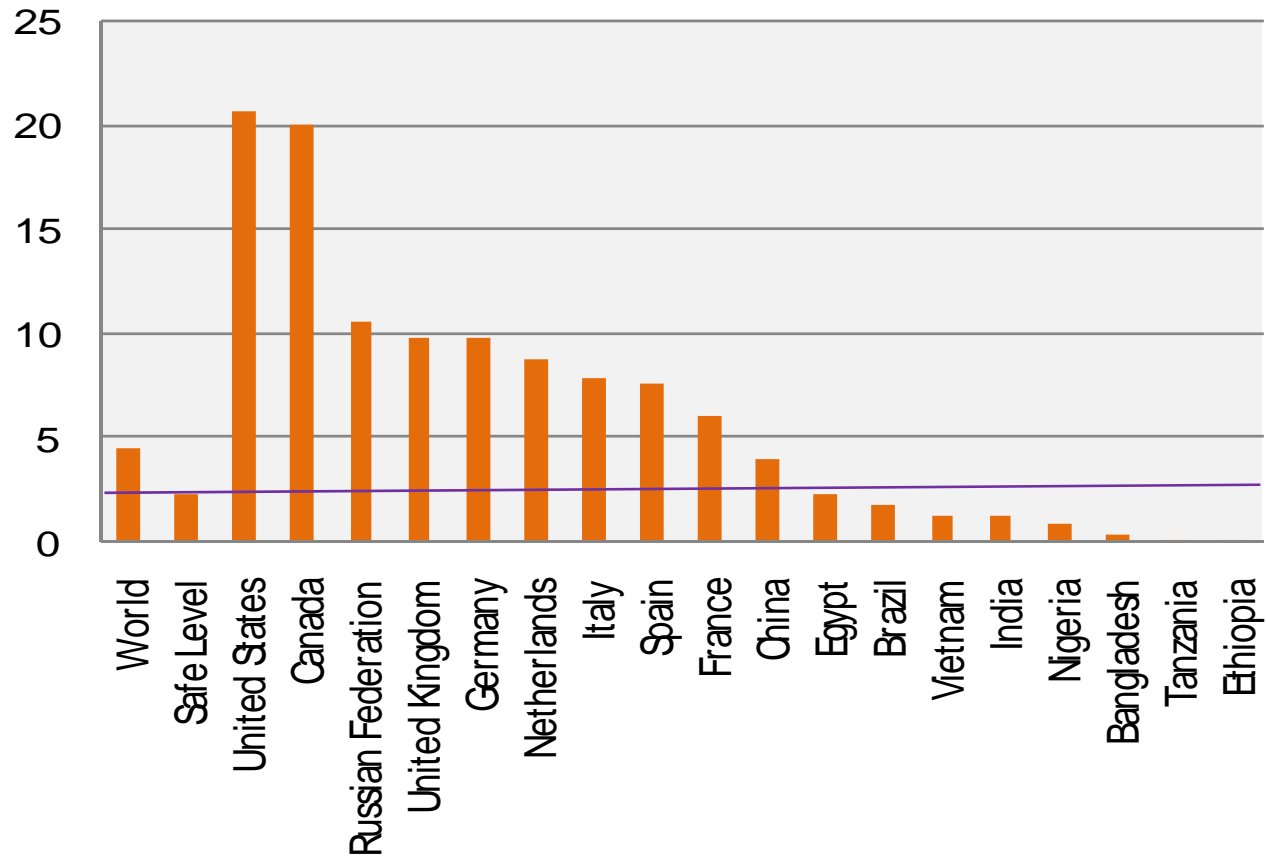


# Climate Change

- **Adaptation (Responding to Climate Change)**
  - Major potential problem for poorer countries
  - Impact and Resources to Respond
- **Mitigation (Reducing the Risk of Climate Change)**
  - Tail insurance
  - Efficiency and fairness
  - The Challenge:
    - accommodating developing country growth
    - Achieving “safe “levels of CO2 emissions by mid century
    - Complex mechanism design challenge

# CO2 EMISSIONS PER CAPITA

Tons per year



# Energy and Natural Resource Base

- 30 years ago, 1 billion people lived in advanced or rapidly growing economies
- Today the number is roughly 4 billion and rising
- Can global growth be sustained on the natural resource base that we have?
  - It is not clear
  - Not infinitely expandable
  - It will depend on
    - technology,
    - incentives (including shifting relative prices) being allowed to work,
    - human ingenuity



# Risk, Interdependence and the Management of the Global Economy

- **Rising scope and magnitude of interdependence**
  - Financial markets and regulatory interdependence
  - Trade shifting relative prices, movement of jobs
  - Product safety and rules governing logistics
  - Infectious diseases
  - Energy demand, pricing and growth
  - Climate Change
- **Not matched by capacity to regulate and coordinate policy responses**
  - Restoration of balance will take time, lots of thinking, experienced and talent people, and a measure of good will
  - The challenge of policy coordination with new important players
- **In the meantime the risks are rising in the global economy and will be there for some time.**