The Global Economy in 2004

Interview with Augusto Lopez-Claros, Chief Economist, World Economic Forum,
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Stefan von Bergen of *Berner Zeitung* (Switzerland), interviewer

***Stefan von Bergen*: Everybody talks about the recovery and a new boom of the world economy. Will it come in 2004?**

ALC: Certainly the conditions appear to be in place for some recovery in 2004, if not quite a "boom". A prolonged period of fiscal loosening and historically low interest rates in the United States seem finally to be having an impact on aggregate demand. Also, there has been some clearing up of some uncertainties on the international political front. The war in Iraq did not have the dire consequences that were initially anticipated, oil prices did not shoot up to $80 a barrel, the network of collaborative arrangements between the major powers which have underpinned several decades of prosperity in the post war period did not collapse. And all of this has been good for consumer and investor confidence. But the recovery, in the US and elsewhere, could be fragile and I am not sure we are in completely safe territory just yet.

Will the divide between the rich and poor increase?

ALC: This is a serious problem and, regrettably, the statistics are horrible. Whereas in 1960 the income of the top 20% of the world's population was about 30 times higher than that of the bottom 20%, by 1995 this ratio had risen to 82 before scaling new heights early in the new century. These trends will not be reversed simply if we wait for the "invisible hand" of the market to impose its self-correcting mechanisms. Income distribution has worsened sharply even in countries like the United States, the acknowledged centre of free enterprise and the market. They will be reversed only as a result of active public policy that redirects budgetary resources, particularly in the developing countries, to boost investment in education, public health, and infrastructure. I think it remains a great tragedy that the developing world continues to spend more on the maintenance of military establishments than in education and public health combined. This is a perversion of the development process and one of the main reasons why there is so little to show in the way of success for more than half a century of development aid.

Will Asia and especially China be the main site of a boom?

ALC: I have already mentioned China and India as likely "boom" places. Japan is also showing signs of a fledging recovery, after a decade of stagnation. So, yes, Asia seems like a good candidate for high growth in the near to medium-term. In China, however, there are two other factors at work. First, there is a major process of migration by peasants from the countryside to the cities, where labor productivity is higher. This probably boosts GDP growth by at least 2-3 percent per year and, although it could go on for several more years, at some point it is going to run out of steam and China's growth could come down to more sustainable rates, lower than the 8%+ that we have seen in recent years. Second, China has ahead of itself a political transition to democracy and representative government that, we all hope, will be peaceful and stabilizing. One worrying sign about rapid economic growth in Asia is the impact it is having on the environment. The continent is becoming rapidly polluted and previously pristine places like Bangkok are facing serious problems of water contamination, traffic jams of unheard of proportions and smog as we have not experienced it in the West after more than 200 years of industrialization. Not many policymakers in the region are giving this much attention.

Will the wealthy western nations come under pressure from China, from its low salaries and its job market?

ALC: Yes, there will be pressure. But we must be careful not to exaggerate these concerns. The global economy is constantly under this sort of pressure. Technological innovation has led to major changes in the structure of production in the economy during the last two centuries and this process is likely to accelerate in coming decades. Entire industries have disappeared and others have emerged in their place, not always in the same locations, of course. Countries have to be adaptable to a global environment in which barriers are quickly coming down, whether governments like it or not, under the pressures of globalization—which really means the spread of knowledge and information, which in this age no longer recognizes national boundaries. Rather than worry about low salaries in China and India, policy makers in the West, particularly in Europe, should worry about how to make their economies more nimble and flexible. How to eradicate inefficiencies (from wasteful subsidization to over-regulation) that will boost their competitiveness and create environments conducive to technological innovation and the production of goods and services with high value added. This is not a zero sum gain. It is possible to have gains in prosperity everywhere and a country's gain need not be seen as somebody else's loss.

How about the future economic evolution in Africa? Will its position even get worse?

ALC: There is a risk that it will get worse, in relative terms, before it gets better. We need a combination of better policies, improved governance (that is, leaders in the region need to better understand the difference between private gain and public benefit which, ultimately, is what good governance is all about) and enlightened foreign aid. Not the politically motivated, "strategically" inspired aid programs of the Cold War era which were largely a waste of resources, but rather programs that overwhelmingly emphasize education (particularly of girls) and improvements in public health. Africa would also benefit from the introduction of some collective security arrangement for the region which would ease security concerns of political leaders and allow them to redirect their resources—including foreign aid—to more profitable ventures, with higher rates of social return, instead of building up the army.

You investigate competitiveness. Will it generally increase? Or will globalization and global competition remain in crisis since the WTO-summit in Cancun?

ALC: Competitiveness is a dynamic concept. As we define it, it is a function of many factors, from the macroeconomic climate to the quality of the country's public institutions to the development of its technological potential as a result of education and human capital investment. We have seen it improve in some countries in recent years and suffer in others. The important thing we have observed is that although, in a globalized world, policymakers' degrees of freedom are gradually being reduced (nobody controls capital movements, the dissemination of knowledge and information, the spread of terrorism and drug trafficking, to name a few of the forces largely outside the control of nation states), good policies and building up a country's institutions still can have dramatic implications for per capita income and economic stability. Witness the condition in Chile and Argentina. Two countries facing the same external environment for the last several hundred years, but two widely divergent paths in recent years. Argentina, gradually emerging out of financial collapse. Chile, an island of stability and prosperity.

Do you expect a new WTO-initiative? In which direction? Will the western nations make concessions? Will the balance of the big players in world economy change?

ALC: Yes, I think that in the end multilateralism will prevail because, at least during the postwar period, it always has, often after setbacks and crises. There is no other way but the recognition of common interests and working within a framework of agreed rules. The alternative is chaos. But, it is obvious, as Joseph Stiglitz has pointed out, that the developed nations need to take some of the same medicine that they have been urging the developing nations to swallow. Things such as the virtues of competition, the need to eliminate distortions in resource allocation, not to stand in the way of the inevitable restructuring and retrenchment that sometimes accompanies the process of globalization. So, this may mean curtailing production subsidies to farmers in the US, Europe and Japan.

In the WEF Competitiveness Report the Scandinavian countries are the leaders. What do they do better than others?

ALC: They have cautious macroeconomic management, including good fiscal policies. They have created conditions in which firms operate in an environment characterized by a scrupulous respect for the rule of law and in which the public sector, through its own example, sets a very high standard. They have invested heavily in education and have, as a result, among the most sophisticated labor forces in the world. In other words, they have not neglected any important areas.

A welfare state and a high rate of federal expenses don't seem to lead automatically to a weak economy. Is that true? And why?

ALC: What matters is not the level of expenditures per se but how efficiently resources are spent. Russia in the mid-1990s did not spend a great deal in terms of GDP because it did not pay wages and pensions on time and gave away billions of dollars of revenue in corrupt privatization schemes. Denmark spent twice as much in GDP terms, but the bulk of these expenditures were well directed and delivered some tangible good to the economy.

The economic growth of Switzerland is one of the lowest in the OECD. What is your comment about this fact?

ALC: I think there are various factors at work. First, exports have been hurt by the general weakness in the global economy. The financial sector has been hit especially hard by the sharp drop in equity prices in Switzerland and elsewhere. The IMF, correctly in my view, refers to "insufficient competition in domestic sectors" which raise questions about the vitality of Switzerland's growth. They add that: "barriers to the internal market, cartels, and sheltered sectors reflect a sluggish pace of product market liberalization." So, Switzerland needs to enter a phase of significant liberalization of its domestic markets if it wants to boost its growth prospects, including, as the IMF also notes, "dismantling of the high level of trade protection and subsidization of agriculture."

Is the economic level of Switzerland already that high that it can't grow like China?

ALC: Yes, for the reasons outlined above, unless Switzerland's scientists and entrepreneurs come up with some brilliant ideas that would, for instance, introduce some brand new technology with global reach—the Swiss equivalent of the discovery of electricity, which could boost investment and exports to record high levels. It could happen, but I think following the advice of the IMF is a more promising approach.

What would you recommend the new Swiss government to do? To reduce taxes? To reduce the welfare state?

ALC: Neither is a priority. Instead, as noted above, they should liberalize domestic markets. They are geographically surrounded by a set of economies that have been among the most liberalizing in the last 40 years. Switzerland simply cannot afford to fall back.

Augusto Lopez-Claros is the World Economic Forum's Chief Economist. He is also the Director of the Forum's Global Competitiveness Program.
