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Good times, bad times

Prospects for the global economy are currently shrouded in a fog of international trade tensions and geopolitical disputes. But, the bigger story a decade after the G20 stepped in to contain panic in markets and salvage a battered financial system, is that growth has failed to find a firm footing.

The United States is in its longest recovery on record but it is also one of the weakest, and the impact on incomes has been subdued. The pick-up since the 2017 tax cut is fading, with little sign of the promised investment boom. Elsewhere in the developed world, the pick-up has been even more short-lived. The eurozone is slipping back towards stagnation, with the German economy showing clear signs of fatigue; and while Brexit is an unwanted distraction for the entire European economy, the United Kingdom looks set for a particularly traumatizing 2019.

There is a good deal of speculation that recessionary winds will blow the advanced economies, and with them the global economy, off course in 2020. Monetary normalization has already been put on hold by leading central banks but there are growing concerns that even another round of quantitative easing will fail to provide the needed boost to overall demand.

Whether or not pushing down on the monetary accelerator would again help emerging economies is also an open question. The slowdown this year, 2019, is apparent across all developing regions, with Latin America particularly hard hit. Talk of “decoupling” and “convergence” which briefly captured the popular imagination after the global financial crisis (GFC), as developing and emerging economies bounced back quickly, has gone quiet. The BRICS economies, which as a group saw average annual growth over 10 per cent immediately after the GFC, grew at 6.3 per cent last year.

With debt levels higher than ever across the developing world, totalling around $67 trillion, keeping interest rates on hold would ease servicing pressures. But against a backdrop of rising uncertainty and investor anxiety, a flight from emerging markets to the relative safety of the United States could still trigger a self-reinforcing deflationary spiral.

Not surprisingly, policymakers everywhere are scanning the horizon for possible shocks. Heightened trade tensions are one likely source of increased friction. Trade has stalled with the weakening of global demand; growth in the first quarter of 2019 relative to the corresponding quarter of 2018 is estimated at just 0.4 per cent. Unilateral tariff increases by the United States, which began in early 2018 on specific products and have subsequently been extended on a broader range of imports from China, have not helped. Retaliation has followed in a number of countries. While the impact to date has been contained, a resumption of tit-for-tat tariff increases could prove costly if combined with a further slowdown in investment.

There are other dangerous currents beneath these already troubled economic waters. There is a growing awareness that the dispute between the United States and China is less about tariffs and more about technological ambitions. Accessing foreign technology helped today's advanced economies climb the development ladder and efforts to kick that ladder away by further reducing their policy space will face resistance from developing countries. This could add to the already diminished levels of trust in the multilateral system, with further damage to global economic prospects.

Currency movements are adding to the sense of economic anxiety. These have become much more volatile in the era of hyperglobalization with the financialization of currency markets. The Morgan Stanley Emerging Market Currency Index rose significantly at the beginning of 2019 but fell sharply between mid-April and late May, only to climb again thereafter. Three factors are behind this volatility: sharp fluctuations in crisis-hit countries such as Argentina and Turkey; the volatility of capital flows to emerging markets resulting from policy uncertainty in the developed countries and weaker growth prospects in emerging markets; and more generalized pressure in the United States to keep the dollar "competitive". In an international financial system still heavily dependent on a predictable role for the dollar, turning that role – long recognized as an "exorbitant privilege" – into a source of economic ordnance could bring more destabilizing consequences. An immediate worry for many developing countries is that any sharp loss of confidence in their own currency coming after a rapid increase in external debt could expose them to much deeper deflationary pressures, as has already occurred in Argentina and Turkey.

Commodity markets have been on a rollercoaster ride since the financial crisis; these are now in a softer phase, with prices well below post-crisis highs. While depressed demand underlies the absence of price buoyancy in many commodity markets in recent months, medium-term volatility has been influenced by the wide fluctuations in oil prices and by the financialization of commodity markets and the concentration of market power in a small number of international trading companies. The UNCTAD commodity price index fell from 134 in October 2018 to 112 in December that year, and since then has risen to reach a level in the neighbourhood of 120. Fuel prices drove the fall in the index in the last quarter of 2018, with the index of fuel prices falling from 149 in October to 115 in December. The subsequent recovery has been partially on account of higher oil prices affected by sanctions on Iran and partially because of mild buoyancy in the prices of minerals, ores and metals. But the general trend is that of a decline in commodity prices that matter most for many developing economies.

A spluttering North, a general slowdown in the South and rising levels of debt everywhere are hanging ominously over the global economy; these, combined with increased market volatility, a fractured multilateral system and mounting uncertainty, are framing the immediate policy challenge. The macroeconomic policy stance adopted to date has been lopsided and insufficiently coordinated to give a sustained boost to aggregate demand, with adjustments left to the market through a mixture of cost-cutting and liberalization measures. Short-lived growth spurts and financial volatility have been the predictable results. But there are deeper challenges ahead that are truly daunting for people and the planet.

A climate for change: The case for a global green expansion

Beyond the immediate risks that could stall the global economy are a series of macrostructural challenges that predate the GFC and have gone largely unattended since then. Four stand out because of their high degree of interdependence: the falling income share of labour; the erosion of public spending; the weakening of productive investment; and the unsustainable increases in carbon dioxide in the atmosphere.

International economic-policy gatherings, where fidelity to the virtues of open borders, capital mobility and market competition are often extolled, have largely neglected these challenges. But if trends continue along current lines, the global economy in 2030 will have gone through another decade of substandard and unstable growth, income gaps within and across countries will have widened further and the natural environment will be stretched to breaking point.

As labour shares across the world continue to fall, household spending will weaken, further reducing the incentive to invest in productive activities. At a minimum, this will mean lacklustre job creation and stagnant wages in developed countries as well as slow expansion (or outright contraction) of domestic markets in developing countries. Both outcomes will worsen if governments keep promoting cuts to labour costs as their adjustment strategy of choice. Aggregate demand will be weakened further, as governments continue to reduce social protection and abstain from infrastructure investment, which will also make supply constraints tighter. Unchecked private credit creation and predatory financial practices will continue to fuel destabilizing financial transactions, while failing to stimulate private productive investment. In the meantime, absent sufficient investment and international agreement on technology transfer, carbon emissions will push the climate closer to, or over, a point of no return.

Against these trends, it is critical for governments across the world to reclaim policy space and act to boost aggregate demand. To do so, they must tackle high levels of income inequality head on, adopting more progressive fiscal arrangements, and directly targeting social outcomes through employment creation, decent work programmes and expanded social insurance. But they must also spearhead a coordinated investment push, especially towards decarbonization of the economy, both by investing directly (through public sector entities) and by boosting private investment in more productive and sustainable economic activities.

The threat of global warming requires immediate action to reduce greenhouse gas emissions and stabilize the Earth's climate. Recent studies by the Intergovernmental Panel on Climate Change (IPCC) and the United States Global Change Research Program, among others, have made it clear that if we fail to change course, we are only a few decades away from disastrous climate-driven losses.

A successful response to the climate crisis will have multiple benefits, including environmental "co-benefits" such as cleaner air and oceans and forest reclamation. Less obvious, but also important, is the economic impact of climate policy. Climate protection requires a massive new wave of investment, reinventing energy and other carbon-emitting sectors. New low-carbon technologies must be created, installed and maintained on a global scale.

That wave of green investment would be a major source of income and employment growth, contributing to global macroeconomic recovery. Many, though not all, of the jobs created by green investment are inherently local to the area where investment occurs and involve training in new skills. Recent discussions call this strategy (in combination with high wages and standards, social services, and employment opportunities for all) the "Green New Deal" recalling the 1930s New Deal, which tackled unemployment and low wages, the predatory nature of finance, infrastructure gaps and regional inequalities, in the context of recovering from the Great Depression.

There are certainly numerous opportunities for investment in energy efficiency and renewable energy supply, many of them already cost-effective at today's prices and in new patterns of high-density, transit-centred urbanism. This implies new configurations of housing, work and public services, connected by more extensive mass transit. A full-scale transition to electric vehicles will also require a more extensive infrastructure of charging stations, and continued progress in reducing vehicle costs. New technologies, not yet commercialized, will be needed to complete the decarbonization of the global economy, along with new agricultural practices, tailored to minimize emissions. A just transition will also require big investments in communities that have become dependent on resource-intensive livelihoods.

Developing countries may face lower conversion costs as they are still building their energy systems. As a result, the available resource savings from clean energy may be greater in developing countries. Clean energy is of great potential value to developing countries for another reason. Delivering energy to remote communities via an urban-centred national grid, as is usually done in developed countries, entails the substantial expense of long-distance transmission lines. Developing countries may be able to move directly to more efficient microgrid systems without the sunk cost of running wires far into remote areas. Still, they will need technology transfers and financial support from the international community to make the transition.

Such an investment push requires governments to use all policy instruments at their disposal, including fiscal policies, industrial policies, credit provision, financial regulation and welfare policies, as well as international trade and investment policies. International coordination is critical to counteract the disruptive influence of capital mobility, contain current-account imbalances and support the transition to a low-carbon economy, especially in developing countries.

Strategies for sustainable development and economic growth can take a variety of paths but they must all correct current patterns of aggregate demand. Leveraging the multiplicative effects of government spending and higher labour incomes is a straightforward approach.

First, raising the shares of labour income towards the levels of a not-so-distant past can by itself lead to significantly faster growth (0.5 per cent annually on average) thereby also increasing capital incomes. This effect will be strongest if all or most countries act in a coordinated manner.

Second, a fiscal reflation financed by progressive tax increases and credit creation would boost growth even more, owing to fiscal multipliers in the range of 1.3 to 1.8 (or even higher if fiscal expansion takes place in many countries in a coordinated way). In particular, with many economies currently experiencing weak or insufficient demand, fiscal stimulus is likely to elicit a strong response of private investment.

Third, public investment in clean transport and energy systems is necessary to establish low-carbon growth paths and transform food production for the growing global population, as well as to address problems of pollution and environmental degradation more generally. This requires the design of appropriate industrial policies, using subsidies, tax incentives, loans and guarantees, as well as investments in R&D and a new generation of intellectual property and licensing laws.

Based on the existing estimates, an internationally coordinated policy package of redistribution, fiscal expansion and state-led investment can realistically yield growth rates of GDP in developed economies of at least 1 per cent above what could be expected without it. In developing economies other than China, growth rates will increase by about 1.5–2 per cent annually. China will have a more moderate acceleration as its growth axis bends towards the household, with lower growth rates than the earlier East Asian tiger economies experienced when they had the current per capita income of China.

By 2030, employment would increase above projections from current trends by approximately 26 million in developed countries and by about 146 million jobs in developing countries (40 million of which would be in China). These are conservative estimates that probably underestimate the employment gains, because existing econometric estimates based on decades of job-shedding strategies cannot incorporate the potential of a globally coordinated strategy centred on state-led investment and social spending, the expansion of service employment and a new energy matrix.

Data on growth and employment as well as on environmental factors, suggest that bold efforts are necessary to achieve global growth and development that are sustainable economically, socially and environmentally. Estimates of multipliers for the world's 20 largest economies and the remaining regional blocs indicate that this is a matter of pragmatic policy choice, not of immutable financial constraints. A Global Green New Deal would require additional financial resources for less than a decade generated through a mixture of domestic resource mobilization and international cooperation agreements. Estimates also indicate that the growth impact of social spending is high in all countries, while progressive taxation has little or no cost in terms of growth, pointing to a future of higher labour incomes, lower inequality, stronger growth and a healthier environment that is available for policymakers to choose.

International coordination is key both to mobilizing the required resources and to expanding policy space to manage the changes involved. Today's economic and geopolitical tensions do not bode well in this respect. But it bears remembering that Franklin Delano Roosevelt called the founding of the International Labour Organization at the end of the First World War "a wild dream"; and wild dreamers are exactly what may be needed to deliver on the bold promises of the 2030 Agenda.