

## Five Threats and Five Transformational Responses for Defining a New Path for World Development

Colin Bradford

The current economic model generates imbalances, vulnerabilities, inequities, exclusion and polarization for current and future generations. What is required is, as many of you have said, is not recovery to the same state of affairs that existed prior to the financial crisis but *transformational change* to create a new set of global conditions that restores balance to the global economy, makes the poor more secure, creates greater equality, more inclusion, and holds the world community together rather than letting nationalism, protectionism, and regional blocs and predatory unilateralism take over.

To begin, we should be clear that global imbalances are not purely or even primarily external imbalances but are rather always and everywhere driven by internal imbalances, by the arithmetic of national income accounting, not by some fancy economic model or behavioral complexity. The chronic US trade deficit is in fact the external manifestation of the internal imbalance between government spending and tax revenue. The fiscal deficit essentially drives and determines the US current account imbalance with China. Similarly, the Chinese capital account surplus which finances the US current account deficit is generated by the internal surplus of savings over investment. So, the pathway out of the current set of global imbalances is through *internal macroeconomic adjustment*, not through explicit measures focused on the external imbalances per se, as if they did not have internal determinants. In this sense, the US persistent pressure on the Chinese government to cease undervaluing their exchange rate is focusing on the wrong variable.

To chart a new path for world development, five transformational changes are required in strategy, macropolicy, and in the roles of capital, the financial system and the market.

The transformation in strategy entails reversing the dominant model of trade-driven growth inherited from the 1980s into a new strategy of growth-driven trade. Indeed, the original formulation of export-led growth strategies was a mythical approach in which market liberalization, deregulation and privatization was meant to create an internal market economy which would “get prices right” and create optimal resource allocation and competitiveness which

would enable the economy to respond to external demand for exports with greater efficiency and dynamism. Export-led was an outside-in formulation.

Anyone who has studied the East Asian miracle economies from the 1980s or the Chinese economy more recently knows that these are cases of exceptional internal dynamism which generate a surplus of goods which spillover into exports to the world markets at growth rates far greater than the average growth of world export demand. In effect, these are cases of dynamic development from inside-outward based on export push rather than being cases of export-led growth. The world needs to abandon the ideology of export-led growth and replace it with a strategy of growth-led exports.

Secondly, once the global economy begins to come out of the current crisis, the world needs to reverse the current patterns of internal macroeconomic policy as a means of correcting external imbalances and regenerating global balance. For the United States, this means abandoning over time the recent pattern of consumption-led growth and fiscal deficits for a new pattern of investment-led growth, fiscal balance and greater private savings, which are currently near zero. For China, macropolicy adjustment means abandoning over time the recent pattern of savings-led growth, with savings somewhere between 35-40 percent of GDP for a new pattern of consumption-led growth based on poverty reduction strategies generating demand for labor-intensive wage goods. For the developing world, a more balanced development pattern of investment and consumption led growth based on internal dynamism rather than prioritizing export competitiveness and export-led growth would be called for in order to create more jobs and income growth based on low income growth for wage goods rather than relying so heavily on niche marketing of specialized goods for external consumption. These patterns of macropolicy adjustment and development reverse current patterns, practices and dogmas.

Thirdly, capital needs to be redefined to move away from an exclusive focus on financial capital for investment in capital goods to include a priority on human capital (education), social capital (social networks and institutions), and natural capital (natural resources and environmental capital). Prioritizing these softer types of capital, especially in the developing world would constitute significant contributions to greater income equality and would generate forces for a more rapid demographic transition whereby population growth rates would fall as human and social capital accumulation accelerates, as Ashok Khosla has argued so persuasively. This emphasis in development strategies in poor countries would be consistent with achieving the Millennium Development Goals which emphasize gender equality, education, health, and environmental balance all of which contribute to poverty reduction but also, importantly but often neglected, to lower population growth. Per capita incomes rise more rapidly with this

human development strategy for the simple reason that the denominator falls while the numerator is rising, indeed because of it, in the Khosla formulation!

Fourth, the financial system needs to be up-ended to serve the real economy rather than the other way around, as the historic patterns reveal. Since the end of the Bretton Woods era of fixed exchange rates, the world economy has followed a sequential pattern of chronic financial instability. Instead of the financial system serving the real economy, generating jobs and incomes, the global financial system has generated shocks to the real economy creating uncertainty and volatility which are destabilizing. The sequence of the oil shocks in the 1970s, the interest rate shock in the Reagan years in the 1980s, the capital flows shock in the late 1990s during the Asian crisis, and the banking shock to the global financial system and real economy in the 2000s reveal a chronic pattern of financial instability. As UK prime minister Gordon Brown said at the conclusion of the G20 London Summit on April 2<sup>nd</sup>, “the financial system should serve the people rather than itself.” This view reverses the current pattern and poses the promise that the current global effort coming out of the G20 Summit to strengthen financial oversight, supervision and regulation will enable the harnessing of the financial system to serve the real economy and end the pattern whereby the financial system has administered shocks to the real economy.

Finally, clearly the global economic crisis has laid bare for all to see the weaknesses and failures of an extreme version of the market economy which imposes huge costs on the global public. As a result we are in a new era in which a rebalancing of the government and market is occurring in which it will be more legitimate for the human mind to correct the market through government policy intervention. The global public is beginning to grasp the fact that in fact the market does not always “get prices right”, and that indeed that carbon is underpriced and that money is also underpriced in today’s economy. This opens the possibility that as we look ahead parliaments and publics may be more willing than previously to embrace government policy interventions to correct market prices to include future social and environmental costs to respond to the challenges of climate change, poverty reduction and environmental balance. The old mantra of free markets, free trade and free enterprise based on a hands-off, laissez faire market economy ideology may be giving way to a new era of pragmatism and balance in which inter-temporal discontinuities can be addressed as never before.

These five transformations in economic policy responses to the current challenges probably lead to an outlook for slower, more internally generated economic growth based on new fundamentals but it does not portend a new era of inward-looking growth and protectionism but rather a more stable, predictable, steadier and more equitable pattern of global growth in which the public will feel its interests are better served as we look ahead.