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Stability and growth in a global economy

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Abstract:

The hopes that dawned with the end of the Cold War of improving everyone's well-being through globalisation and technological progress have been partly disappointed. They have been replaced by uncertainty about the effects of these profound changes on the distribution of wealth, the availability of work, the possibility of growth continuing at the same pace as in the last few decades, the impact on the environment, the consequences of demographic trends, and the balance of power between countries, between companies, and between companies and consumers. The need to govern these changes is now clear and greater attention must be paid to those who have difficulty adapting, not only in advanced countries, where automation and global competition are displacing many workers employed in routine jobs, but also in emerging and developing countries, where the prospects of further poverty reduction are diminishing. These are crucial challenges for the world economy.

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The end of the Cold War ushered in a phase of increasing openness and international economic integration, as well as one of rapid technical progress of unparalleled depth and breadth. The most prominent characteristic of this period has been the astonishing decrease in the cost not only of cross-border movements of people, goods, services and capital, but also and above all in that of communication, facilitating the transmission of technology, information and ideas. It has even been said, somewhat exaggeratedly, that now 'the world is flat' and that 'distances really [do] not matter'.[1]

Hopes flourished that against this background a solution might more easily be found to such global problems as hunger, poverty and the exploitation of labour and that it would be

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[1] See, for example, Friedman (2005).

possible to improve the well-being of everyone. Many expected that, under pressure from financial markets and international competition, national governments would reduce macroeconomic imbalances and introduce reforms to raise productivity. Although the global economy has indeed achieved significant progress on many fronts in recent years, those hopes have to some extent been dashed.

1. What has changed: some figures

A few figures can help us to understand the extent of the changes that have taken place. The global economy has grown sixfold in the last 50 years. Between 1990 and 2017, in particular, world GDP increased two and one-half times, while the volume of world trade quadrupled, growing from 17 percent of GDP to almost 30. Some areas of the world have seen significant economic growth, as well as a substantial improvement in living conditions.

The world population has increased by 2.2 billion since 1990, more than 90 percent of which in emerging and developing countries. Notwithstanding this boom, extraordinary progress has been made in combating poverty, and the number of people living in extreme poverty (i.e., whose daily income or consumption is less than $1.9 at 2011 prices) has fallen by 1.1 billion. The target of reducing the extreme poverty rate at a global level by half by 2015, which was one of the United Nations Millennium Development Goals agreed in 2000, was achieved five years in advance. Some macroregions, such as East Asia and the Pacific, as well as Europe and Central Asia, have already met the 2030 target of reducing extreme poverty rates to less than 3 percent of the population.

In 2017, the global under-five child mortality rate was reduced to below 40 per 1,000, less than half the figure for 1990. Thanks to this result, to medical progress and to better economic conditions, life expectancy (average expected life at birth) has risen from 65 to 72 years, with peaks of over 82 years in several countries, including Italy.

The pace of economic development has been considerably faster in emerging and developing countries than in advanced nations. In the first group, it almost quadrupled between 1990 and 2017 and increased more than sevenfold in Asia, while in the second group it nearly doubled. As a result of these dynamics, the emerging and developing countries' share of world GDP (calculated at purchasing power parity based on IMF data) has risen from less than 40 percent in 1990 to around 60 percent in 2017 and that of the Asian economies has risen from 12 to 32 percent. China alone, whose share in 1980 was just half that of Italy, overtook Japan in 1999, the euro area in 2010, and the United States in 2014; it now accounts for the largest share globally.

The notably faster pace of growth in emerging and developing economies has narrowed the income gap between countries and reduced inequality worldwide. At the same time, though, income distribution within the single countries has changed, for the most part in the direction of greater inequality (Lakner and Milanović, 2015). As François Bourguignon succinctly phrased it, world inequality has become 'internalised': a smaller income gap between Americans and Chinese has partly given way to a wider gap between rich and poor within both the United States and China (Bourguignon, 2015).

These trends have led to a change in global income distribution, well summarised in Branko Milanović's famous 'elephant graph,' which charts real income growth at different percentiles of distribution from 1988 (Milanović, 2013; 2016). The growth rate is particularly low for the poorest people, living mainly in Sub-Saharan Africa, and for the middle classes in advanced countries. On the other hand, it is very high for people in emerging countries, as well as for the wealthiest people, who are concentrated in advanced economies.[2]

Globally, inequality did not diminish after the financial crisis of 2007-08, and indeed it continued to increase even during the recovery, especially in some advanced countries. In the United States, for example, the share of total income in the hands of the wealthiest 1 percent rose by 5 percentage points between 1988 and 2014, to 20 percent, with about 1 percentage point recorded since 2008.

Inequality between people is multidimensional: it does not concern just income, but also wealth, education, quality of work, and even health. On average across OECD countries, for instance, a 25-year-old graduate can expect to live at least eight years longer than a non-graduate of the same age; moreover, inequality goes hand in hand with an extremely low degree of intergenerational social mobility, which has even been declining in recent years.[3] There is now widespread fear that the future generations will have a lower standard of living than their parents.[4]

Progress in information and communication technology has also fostered the development of international finance; both its role and its penetration in the economy have increased significantly. While this has allowed greater risk diversification and made financial services accessible to a greater number of countries and businesses, it has also facilitated the transmission of financial shocks among countries. Several instances of contagion were recorded as early as the 1990s, notably during the Asian crisis of 1997-98. Later, clear cases occurred during the global financial crisis, spreading from the United States to Europe and to the rest of the world, and during the sovereign debt crisis of 2010-11, which engulfed first Greece and then other euro-area countries, including Italy.

In the ten years leading up to the global financial crisis, the United States, and other countries too, moved away from the traditional commercial banking model to a system in which loans granted are rapidly transformed into other financial products guaranteed by those same loans and then sold on the market. The difficulty of assessing the quality of the loans was thus compounded by the problem of fully understanding the true role of structured products. This complexity was cited as an argument in favour of a sort of 'benevolent detachment' on the part of regulators (Visco, 2015b).

Following this idea proved to be a fatal error. Financial stability became once again the cornerstone of economic policy. Entities were set up to facilitate cooperation, such as the Financial Stability Board (FSB). Under political pressure from the G20, the FSB introduced some major regulatory changes, drafted within the Basel Committee on Banking Supervision, with the intention of making financial crises less frequent and economic systems more resistant. As regards financial institutions of systemic importance, the regulation of banks that are 'too big to fail' continues to be a focus of attention.

Credit and banking markets are opening up to competition from new operators, in both advanced economies and emerging countries. Many FinTech companies already offer

[2] The figures are taken from sample surveys of households, in which it is known that respondents tend to underestimate their income more, the higher that income is. Moreover, since the wealthiest people are more likely not to answer surveys, these might well underestimate both the actual growth in income and the real extent of the increase in inequality (Lakner and Milanović, 2015).
[3] See OECD (2018); for Italy, see Cannari and D'Alessio (2018).
[4] See, for example, Dobbs et al. (2016).

innovative services at low prices in the field of electronic payments, asset management and securities trading. The leading international tech companies are also beginning to enter the sector of credit and financial services.

Shadow banking is rapidly expanding and, unless it is properly controlled, it could become a source of risk. The strategies adopted by managers of large investment funds can have a significant impact on the prices and liquidity of the products they invest in. The spread of automatic high frequency trading may lead to sudden increases in stock price volatility, especially if different traders react in similar ways to market movements. Even the indirect links between banks and other financial intermediaries are potential risk factors.

These concerns are aggravated by the increase in public and private debt in advanced and emerging countries in relation to world GDP, as this makes all economies more vulnerable to financial shocks. According to the Bank for International Settlements, between 2001 and 2017 the global debt-to-GDP ratio rose from 191 to 245 percent; in advanced economies it increased from 210 to 276 percent and in emerging countries from 111 to 194 percent. Among the latter, the increase has been most worrying in China, where the ratio jumped from 128 to 256 percent, mainly with regard to private debt, which rose from 104 to 209 percent of GDP.

2. The difficulty of adapting

When managing the consequences of technological progress and economic integration, it is important to bear in mind those who find it hardest to adapt to the changes, not only in advanced countries, where many workers are in danger of being cast aside, but also in emerging and developing countries, where the prospects of further poverty reduction are diminishing. The task of tackling these problems, including any linked to increased financial instability in the world economy, and the build-up of global imbalances is made more complicated by the crisis in international relations, which has deepened in the last two years with the US administration's new stance regarding the multilateral approach in effect since the end of World War II. Tensions have increased in Europe too; economic difficulties, demographic pressure (both internal and external) and the new rise of nationalistic fervour have stalled the process of integration under way for the past 70 years (Balassone and Visco, 2019).

The growth of income inequality in many advanced countries is reflected in three major, and closely connected, phenomena: a drop in the labour share of income in many countries (although not in Italy); a widening of the wage gap between high-skilled and low-skilled jobs; and an increase in the share of jobs at opposite ends of the wage distribution, usually described as job 'polarisation.'

The first two phenomena stem largely from the very nature of technical progress, which has been more intensive in the production of capital goods, causing their prices to fall compared with wages and finished goods prices. When capital and low-skilled labour are replaced, the share of income going to labour diminishes.[5] This is amplified by the offshoring of the most labour-intensive jobs from advanced to emerging and developing countries–an 'unbundling' of production that ICT has made possible (Baldwin, 2016). The lower relative

[5] See Karabarbounis and Neiman (2014); on the trend in the share of labour in Italy and its determinants, see Torrini (2015).

price of capital and capital-skill complementarity have also helped to widen the wage gap between high-skilled and low-skilled workers (Krusell et al., 2000).

In recent years, moreover, machines have become able to replace medium-skilled workers who perform repetitive and routine tasks; by contrast, they complement managerial, creative and intellectual tasks. This has led to a gradual decline in the demand for workers performing basic tasks and earning close-to-average wages. At the same time, the rise in the disposable income of high-skilled workers has increased demand for certain services, such as personal services, which machines cannot easily replace. The main result of these dynamics has been job polarisation; moreover, wage growth has benefited mainly high-skilled workers.[6] The tendency towards job polarisation has been evident in Italy too since the 2008-13 recession, although to a lesser extent than in other advanced economies.[7]

These long-term structural phenomena have been compounded by the consequences of the recession that came in the wake of the global financial crisis. In many advanced countries, the share of households living in poverty has increased, aggravating social disadvantage and heightening the need for redistributive measures.[8] In Italy, the share has almost doubled in the last ten years, according to Istat's index of absolute poverty, and is now close to 7 percent.

Pressure in favour of a more equitable distribution of income and wealth is surfacing in less developed countries too, as the decline in extreme poverty rates slows and, in particular, as the number of poor people in Sub-Saharan Africa increases. While the percentage of the world population living in extreme poverty fell by more than 1 point a year between 1990 and 2013, from 2013 to 2015 it decreased by barely 1 point, to 10 percent (736 million people). Moreover, there has been a profound shift in the geography of poverty. At the end of the 1980s, two-thirds of the world's poor lived in just three countries: China, India and Indonesia. Today, more than half are in the low-income countries of Sub-Saharan Africa; they are mostly children living in rural areas, working in agriculture and with very low levels of education. This is worrying, not least because demographic projections indicate that by the end of this century Africa will have overtaken Asia as the most populated continent.

Yet many millions of people also live in poverty in middle-income countries, where inequality has increased enormously and government spending far exceeds the aid received from the international community. It is widely believed that the poverty reduction strategy adopted to date, based mainly on growth and international aid to local governments, is unlikely to prove as effective in the future.[9]

The eradication of extreme poverty depends on two increasingly crucial measures. One is to adopt appropriate redistributive policies in the emerging economies most in need of them. The other is for the international community to work to ensure that financial aid sent to the poorest countries is invested in services such as health and education, where it is best able to combat marginalisation, at the same time helping to set up institutions to end the labour exploitation that still plagues such countries and supporting more intensive and inclusive economic growth.

Measures to combat poverty and to limit the real and financial contagion stemming from increasingly interdependent economies can only be effective if the international community gives proof of greater capacity and willingness to coordinate efforts, an objective that seems

[6] See, for example, Autor and Dorn (2013) and Visco (2015a).
[7] See Basso (2018); for a comparative analysis of several countries, see OECD (2017).
[8] See the analysis and proposals in Piketty (2013) and in Atkinson (2015).
[9] See Page and Pande (2018), and World Bank (2018).

far beyond our reach given the recent changes in the political context. Even in the past, concerted action by governments was never more than sporadic; it happened only when all faced the same grave geopolitical and financial difficulties. Policy coordination among the G20 members, for example, gained high visibility briefly in April 2009, at the height of the global financial crisis, but since then it has not produced any important results. In the past few years, moreover, even some major international institutions committed to reconciling the interests of different countries, like the World Trade Organization, have faced a profound crisis, most recently with the imposition of unilateral tariffs by the United States.

At present, international cooperation takes two main forms. On the one side, there are regular meetings of permanent groups of countries, such as the G7 and the G20, whose decisions and joint statements tend to have a powerful impact on the media and on financial markets. On the other side, there are occasions when cooperation takes place in a less formal situation and is of a more technical nature. The regular meetings of central bank governors in Basel are an example; on these occasions a frank and full exchange of opinions on matters of monetary policy and financial stability takes place. Sharing national experiences helps to identify the best practices for tackling global challenges.

While, for the time being, the last form of cooperation appears to be the only one capable of producing tangible results in the new international political framework, it is nevertheless important to correct a long-standing fallacy that now threatens to become newly rooted in international politics: that economic relations between countries and free trade are a 'zero-sum game,' in which one side can win only at the expense of the others. The opposite theory, notably that free trade is mutually advantageous, is not an act of blind faith on the part of economists, but a fact based on solid evidence that has withstood centuries of rigorous testing.

If we are effectively to reap these advantages, then we must acknowledge that many people have been left behind by the liberalisation of trade, and above all by the accompanying technical progress. We need to offset the cost paid by the weakest segments of the population by making the rules of international trade compatible with the pursuit of broader social objectives, ensuring that the activity of banks and financial intermediaries is properly regulated and supervised and taking steps to limit all forms of labour exploitation.[10] Without such measures, a legitimate demand for safeguards could lead to the re-introduction of barriers to economic integration. This would be an error as grave as that of 'withdrawing' from the frontier of technology on the grounds that not everyone enjoys the same benefits: we should not forget that protectionism and over-regulation benefit only a few interest groups at the expense of everyone else.

3. An uncertain future

Technological progress and globalisation offer huge opportunities for growth, although they also present, mainly in the short-to-medium term, risks for labour availability, for a balanced distribution of income and wealth, and even for social cohesion. These risks are sufficiently pressing to call into question the sustainability of the growth rates of recent decades. In addition, there are other risks associated with the environmental impact of

[10] See Rodrik (2011) and International Monetary Fund (2018).

economic activity and with the challenges posed by demographic trends: population ageing in advanced economies and rapid population growth in poor countries.

The fundamental question concerns our ability to build and successfully manage the institutions needed to govern such risks, and to take advantage of the vast opportunities offered by technological innovation without creating a dystopian future of profound inequality, weak nations and powerful multinationals, dramatic climate change, and potentially destructive international tensions.

Massive capital-labour substitution can have serious repercussions on employment. This fear was also voiced in the past–for example, by David Ricardo in the 19th century–and it has resurfaced in recent years, particularly given the level of development achieved with the increased automation and digitalisation of goods production and widespread use of machine learning and artificial intelligence that make it possible to automate even tasks involving data and information processing where human input was believed to be essential.

The question that often arises in this regard is whether, and to what extent, robots will eliminate the opportunities and jobs available today. Some studies have gone so far as to state that more than half of the existing jobs could be automated within the space of 10 or 20 years.[11] More recent calculations downgrade these estimates, shifting the emphasis from the risk of an entire job being automated to the risk of automation of the single tasks that make up every job.[12] On this basis, the percentage of jobs at high risk of complete automation falls to less than 10 percent on average, although almost all jobs contain a percentage of automatable tasks (up to 50 percent). One problem that all these studies share is their focus on what man-machine substitutions are technically possible; however, they cannot say which substitutions might actually be worth making from an economic point of view.

In any case, the risk to replaceable workers should not be underestimated. The problem is potentially twofold, involving both aggregate demand and equity. If the technology revolution leads to a large decrease in labour income, even temporarily, who will buy the goods and services produced with increasingly automated techniques? Paradoxically, these questions indicate that the rapid progress of recent decades might be followed by a lengthy period of stagnation, with consequences not unlike those of the secular stagnation hypothesis that resurfaced a few years ago.[13]

At the same time, will it be socially sustainable for the fruits of progress to benefit only the few? The global companies at the forefront of technological innovation–including Big Tech, i.e., Amazon, Apple, Facebook and Google–are in the best position to benefit from the integration of economies by gaining early access to very broad markets. They can bring down prices by investing in technology, exploiting economies of scale and cross-border differences in the cost of equally skilled workers. The possibility of producing with lower input costs may benefit consumers, but the creation of dominant positions could prevent the reduction in costs being passed on to prices.

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[11] See Frey and Osborne (2017). Equally worrying conclusions are drawn by other studies; for example, the percentage of jobs at risk is thought to be over 50 in the leading European countries, including Italy, according to the Bruegel think tank (Bowles, 2014).

[12] See Arntz et al. (2016) and Manyika et al. (2017).

[13] The debate on secular stagnation was begun by Larry Summers (2013), who revived a theory put forward 75 years earlier by Alvin Hansen (1938). For a summary of the debate, see Pagano and Sbracia (2014).

These changes also affect the financial sector. Lower costs of data transmission, processing and storing are an incentive for the disintermediation of financial transactions and give a competitive advantage to those in the best position to manage such processes. Entire sectors within the financial industry, from payment services to securities trading, have already been digitalised. In many countries, the FinTech companies mentioned earlier, non-bank financial intermediaries operating on digital platforms, are expanding their market shares. Banks can meet the challenge posed by these developments if they learn to maximise their advantages–their direct customer information and the trust that stems from being subject to regulation and supervision–and to invest appropriately.

The relocation of goods and services production from one country to another can cause considerable social disadvantage in the countries that lose large shares of production and jobs. It is not clear whether, in a global economy, national states can reduce these disadvantages through the traditional policies of taxation and redistribution, or whether the use of such policies might instead aggravate the situation by prompting more businesses to flee the countries that adopt them.

Another competitive advantage of Big Tech (and of FinTech companies too, though less so for the time being) is the huge capital of personal information that they have accumulated. This raises sensitive problems of IT security as well as of data management and processing. Such issues go well beyond the simple matter of safeguarding privacy, as we have seen in recent years when some of these companies have become involved in 'attacks on democracy,' spreading fake news or manipulated information. In the future, other attacks could give rise to 'IT crises'–with a breakdown of payment services, large-scale financial fraud or electricity blackouts–the consequences of which would be worse than those of 'traditional' crises spawned by the economic system. The complexity of these issues and their global nature mean that any attempt at unilateral regulation is bound to fail.

Another source of concern, in the face of which individual national states are impotent, is the environmental sustainability of economic development: the ability to grow without compromising the future of our planet. According to the latest report by the UN Intergovernmental Panel on Climate Change, we are already experiencing the consequences of global warming, with a rise in sea levels, melting of the Arctic Ocean, loss of biodiversity, and more severe and frequent extreme weather events; given current climate trends, global temperatures are expected to exceed pre-industrial levels by more than 1.5°C by 2040, with catastrophic consequences (Intergovernmental Panel on Climate Change, 2018). To prevent this happening, greenhouse gas emissions need to be halved by 2030 and eliminated by 2050. There are no real technological limits to such objectives; what is lacking, at the moment, is a strong political will to draw up and implement strategies that will help to reconcile economic growth and environmental protection.[14]

Although there is evident need for greater international coordination, global demographic trends are bound to aggravate the problems, as well as the tensions between countries. For the first time in history, the world population is not only increasing–it is expected to reach 10 billion in 2050, a third higher than at present–it is also ageing: today almost a billion people are aged over 60 (13 percent of the population) and this group is growing faster than the youth population. While most of the elderly live in advanced economies, the youngest people live mainly in emerging and developing countries (9 out of 10 of the 2.2 billion people born since

[14] For Italy, see ASviS (2018).

1990). Africa, which is the continent with the poorest countries in the world, has the fastest growing population. Without change, the migratory pressures will become enormous.

It would be unthinkable to tackle these challenges by surrendering to Luddite temptations or even by just slowing the rate of technological progress and restoring barriers to economic integration–although the latter tendency appears to be gaining considerable ground in recent years. We would be wasting enormous opportunities: the goods and services that can improve our living conditions would only reach us with enormous delay and at much higher cost.

4. Conclusions

In Italy, as in other advanced countries, action is needed to stop the loss of jobs and the growth of inequality. Traditional redistributive measures cannot replace the structural reforms that have been at the centre of economic and political debate for many years, but they can accompany them and help to limit the costs of transition. Job opportunities are created by guaranteeing sustained and lasting growth; it is not enough simply to provide short-term economic relief. This is why it is also important to guarantee financial stability, first and foremost by reducing the burden of the public debt on our economy.

No country alone can expect to govern technological innovation, economic integration, climate change and demographic trends. The only way to tackle these challenges and reap benefits for all involved is through international cooperation. This is the path we must take, never forgetting that discussion and compromise are tools that can bring clear and substantial gains at the cost of small and temporary losses.

We Europeans should be well aware of this. The integration of our economies has brought 70 years of peace to a continent ravaged by two wars at enormous cost in terms of human life. It has also accompanied economic growth, opening up a wider market to firms, making more funds available to support disadvantaged areas, facilitating cooperation in strategic fields such as basic research, and guaranteeing monetary stability. Continuing to draw benefit from the ‘economies of scale’ of membership in the European Union is the key to remaining on a stable path of growth now and in the future.

The European construction will only be truly complete with the advent of democratically designated institutions tasked with exercising common sovereignty. In a situation of global market integration and geopolitical change, pooling a part of one’s sovereignty–setting aside distrust and the relentless quest for mutual reassurance–is the only way to preserve it. Europe must continue to be an anchor of stability in a world that appears increasingly unstable and politically unpredictable. Our destiny is that of Europe, its development both shapes ours and depends on it.

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