

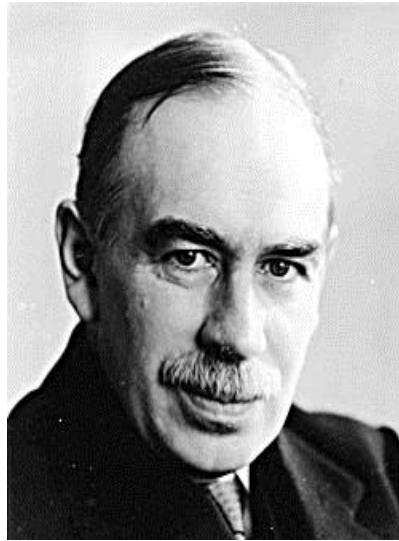


# 2010-2020: a lost decade for the world economy?

Michael Kitson



UNIVERSITY OF  
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“The day is not far off when the economic problem will take the back seat where it belongs, and the arena of the heart and the head will be occupied or reoccupied, by our real problems — the problems of life and of human relations, of creation and behaviour and religion.” Keynes (1946)

# Map

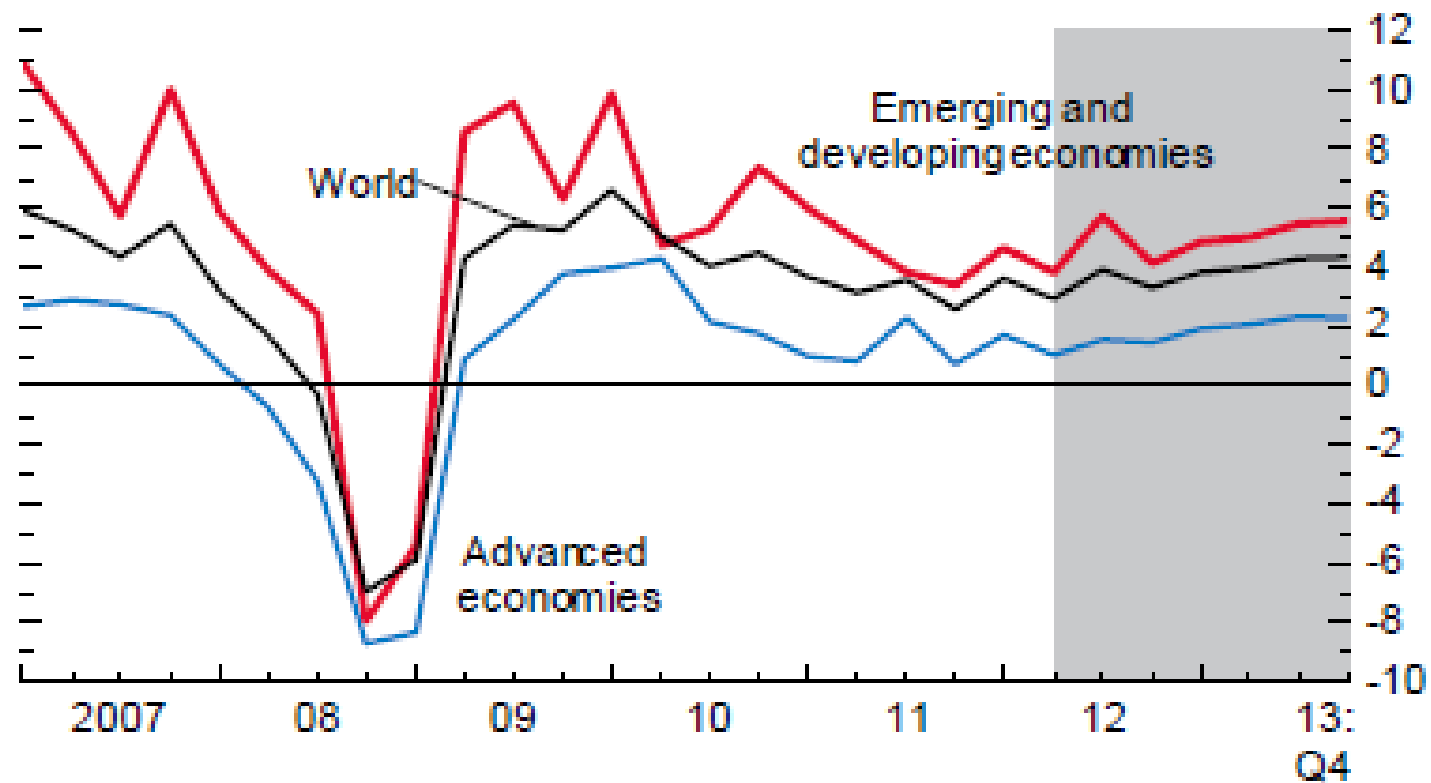
1. The evidence
2. Dismal prospects
3. Reasons to be cheerful
4. Can economics help?
5. Some ways forward

# Economic Growth

- Where does growth come from:
  - Using more inputs
  - Developing new ideas

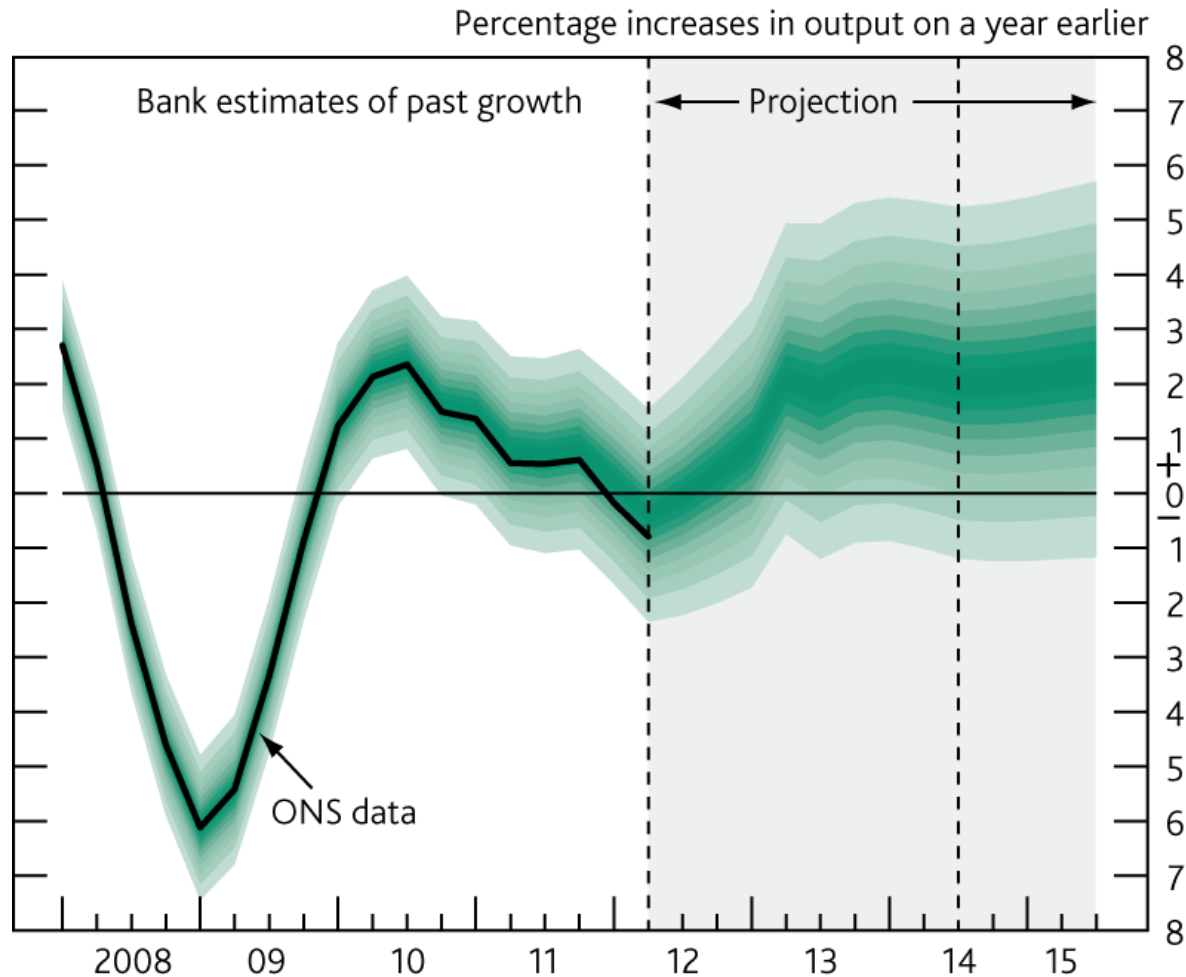
# **1 Growth: The Evidence**

**Figure 1. Global GDP Growth**  
(Percent; quarter over quarter, annualized)

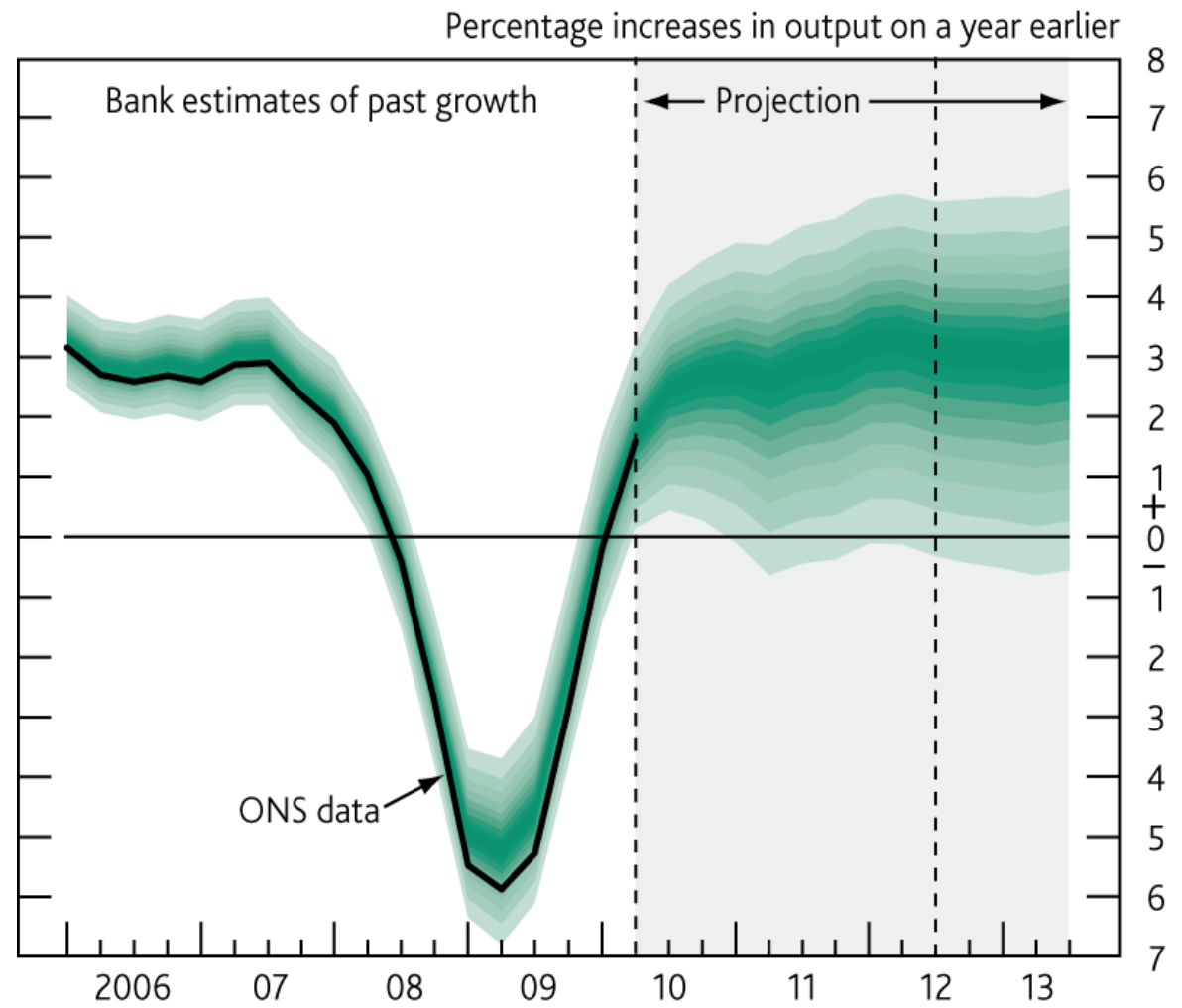


Source: IMF staff estimates.

# GDP projections (source: Bank of England, August 2012)

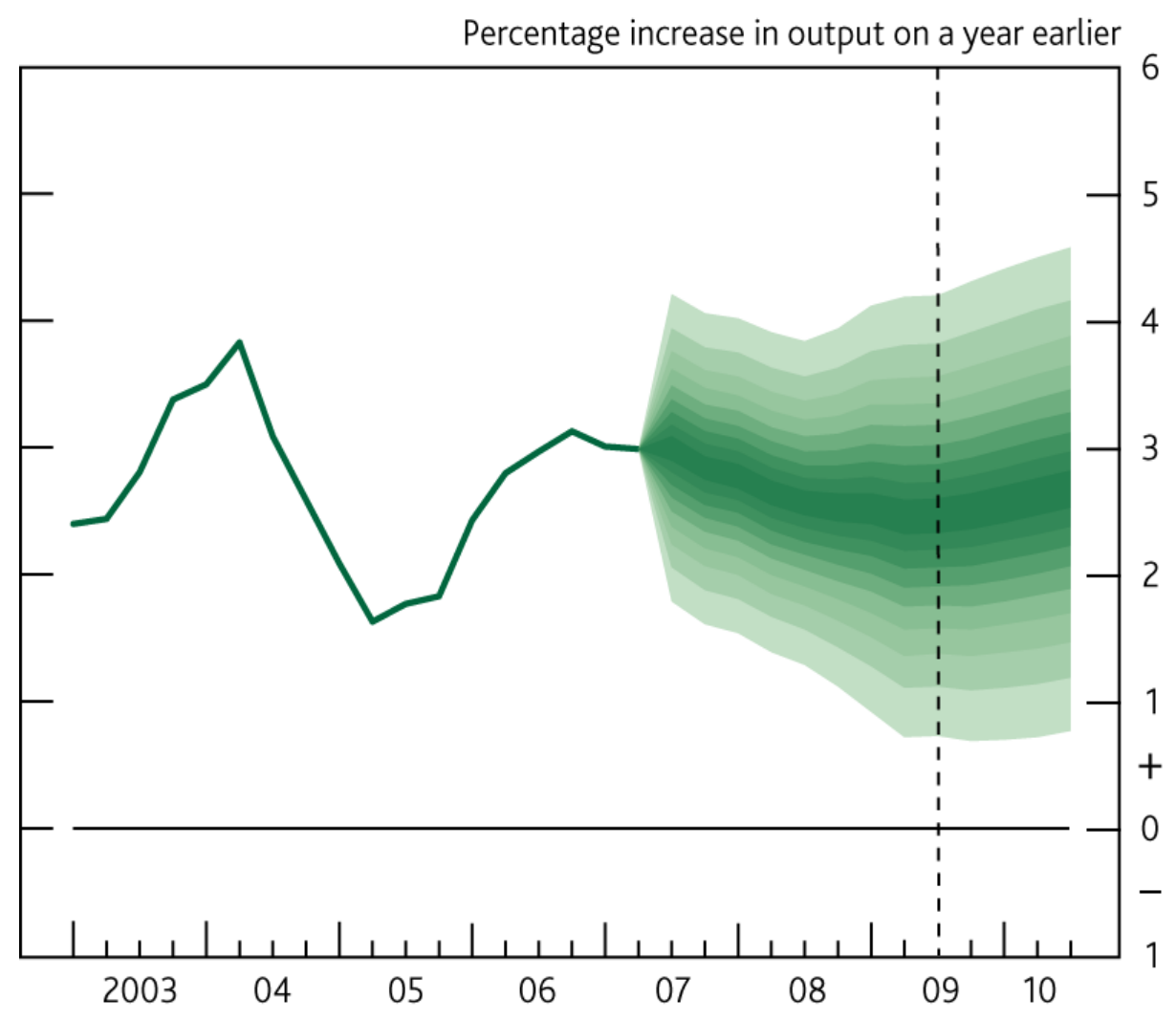


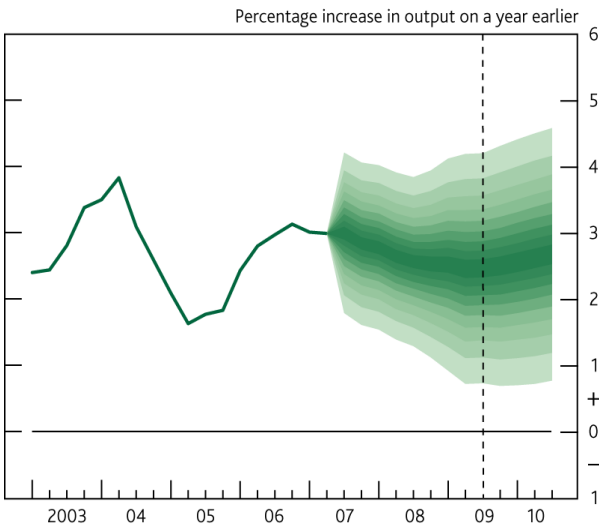
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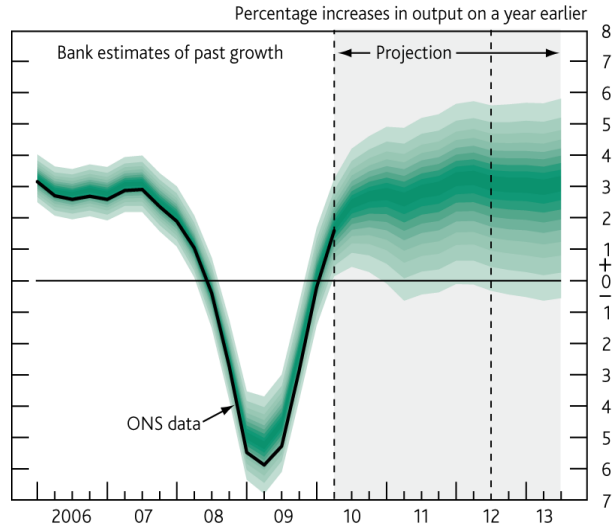


# GDP projections (source: Bank of England, August 2007)

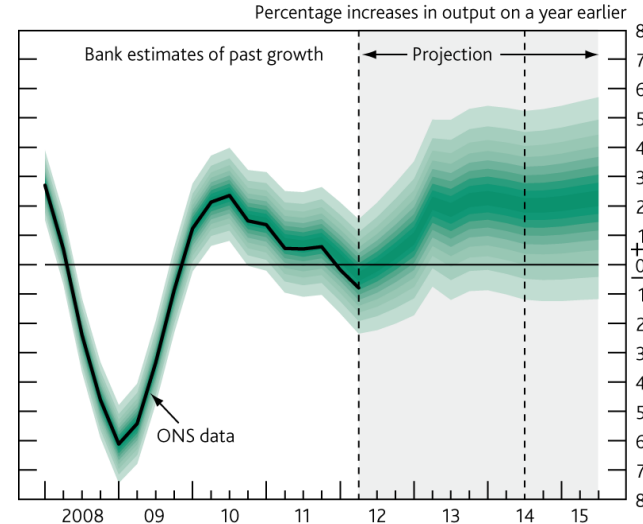




2007



2010



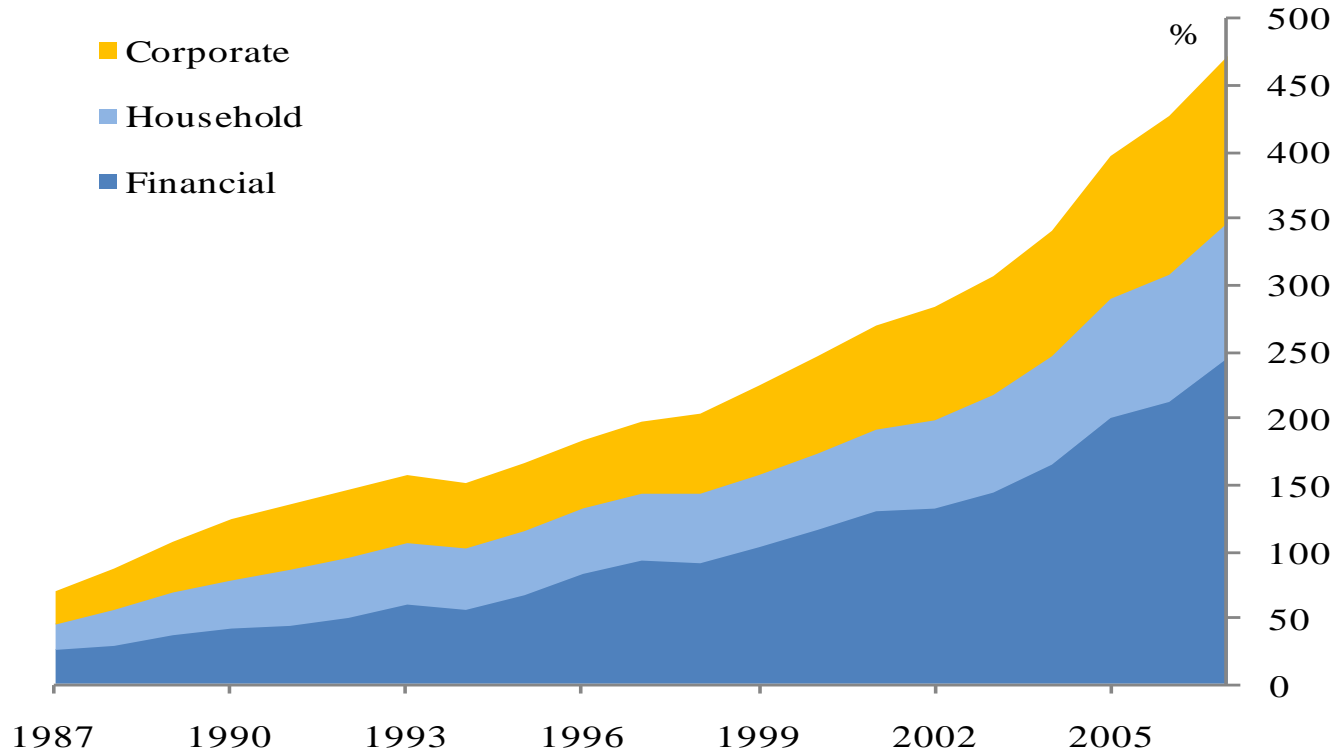
2012

# **2 Growth: Dismal Prospects**

# Growth: Dismal Prospects

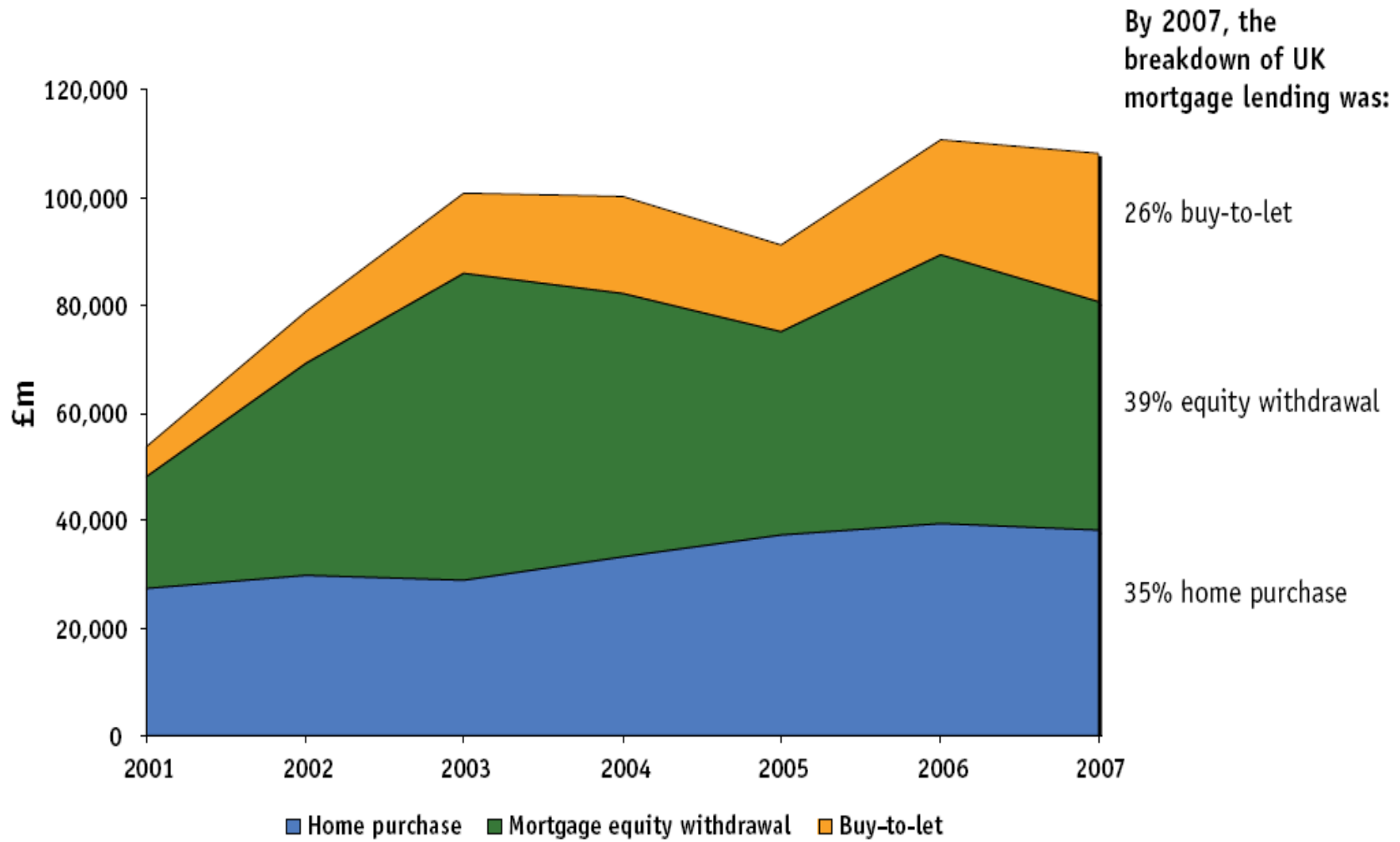
- The problems of debt and structural imbalances
- The policy vacuum

# UK Debt by Sector as % of GDP



Source: FSA (2009)

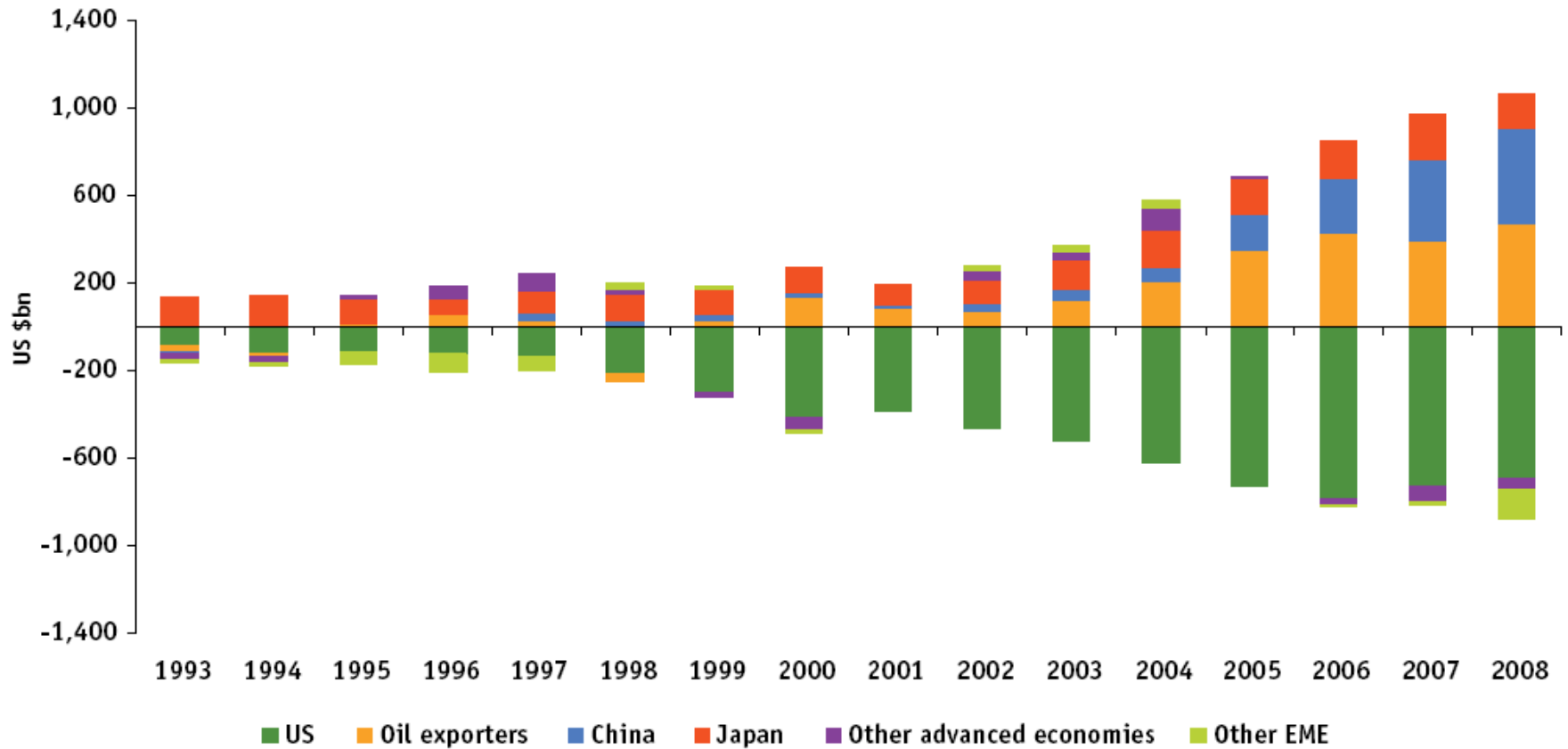
# Mortgage Lending by Purpose 2001-2007



Source: Bank of England, CML, FSA calculations

Published in FSA (2009)

# Global Trade Imbalances

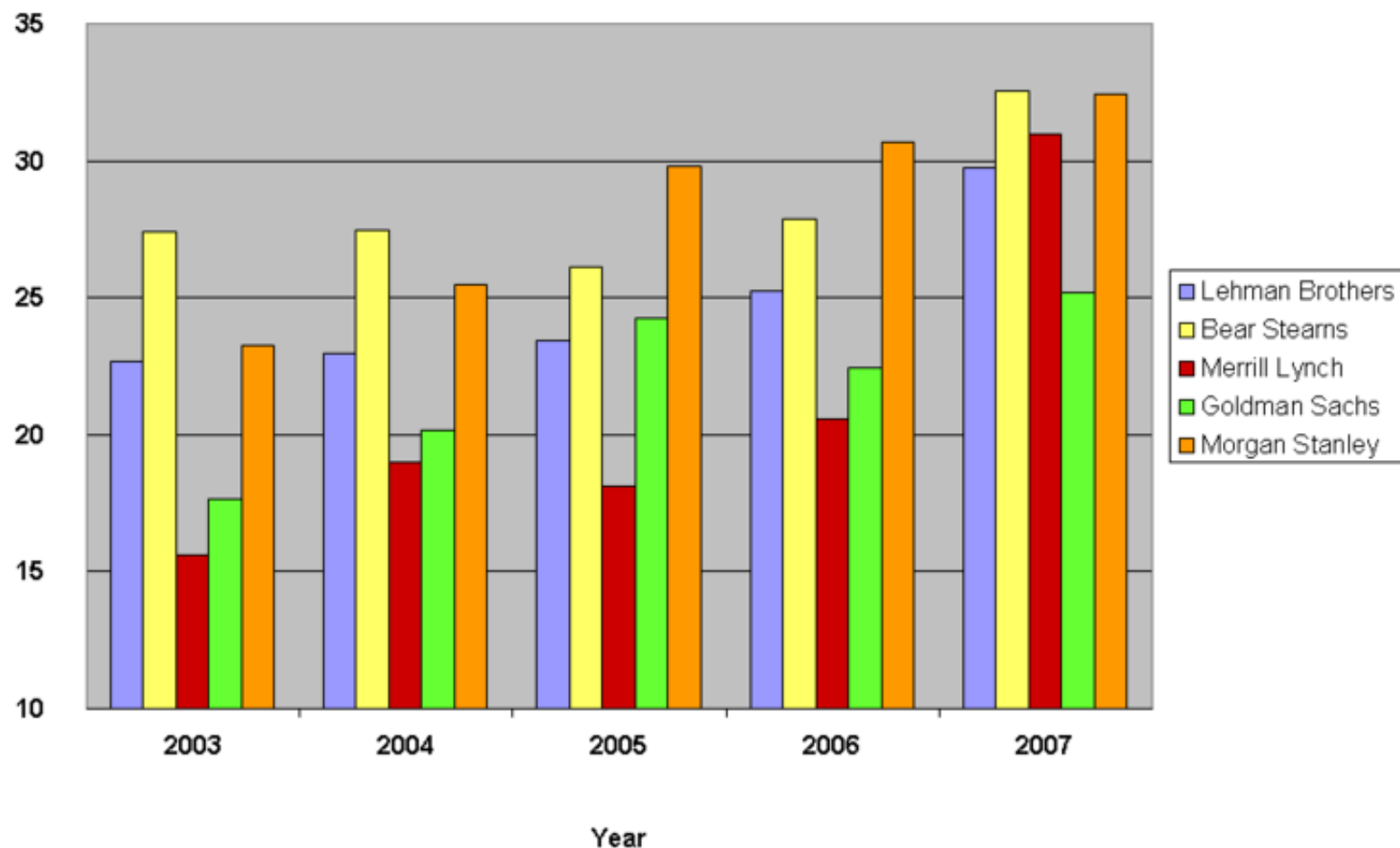


Source: IMF, FSA calculations

Published in FSA (2009)

# Leverage Ratios For Major Investment Banks

The leverage ratio is a measure of the risk taken by a firm; a higher ratio indicates more risk. It is calculated as total debt divided by stockholders equity. Each firm's ratio increased between 2003-2007.



Source Data: Company Annual Reports (SEC Form 10K)

Published in FSA (2009)



# The policy vacuum

- The new Treasury view:
  - The commitment to balanced budgets
  - No coherent growth strategy
- The EURO: half baked and unsustainable

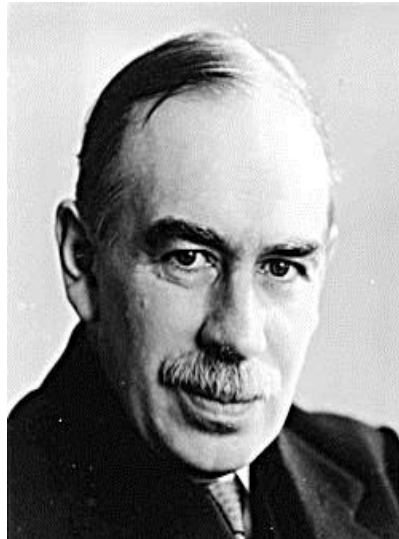
# The New Treasury View

"You will hear those arguing that we should abandon our plan and spend and borrow our way out of debt...You hear that argument again today. ...A credible plan to deal with our debts is an anchor of stability and a prerequisite of recovery."

George Osborne



"The Treasury view ... is that when the Government borrow[s] in the money market it becomes a new competitor with industry and engrosses to itself resources which would otherwise have been employed by private enterprise, and in the process raises the rent of money to all who have need of it"  
(Churchill 1929, cc.53).



Keynes was scathing about Churchill:

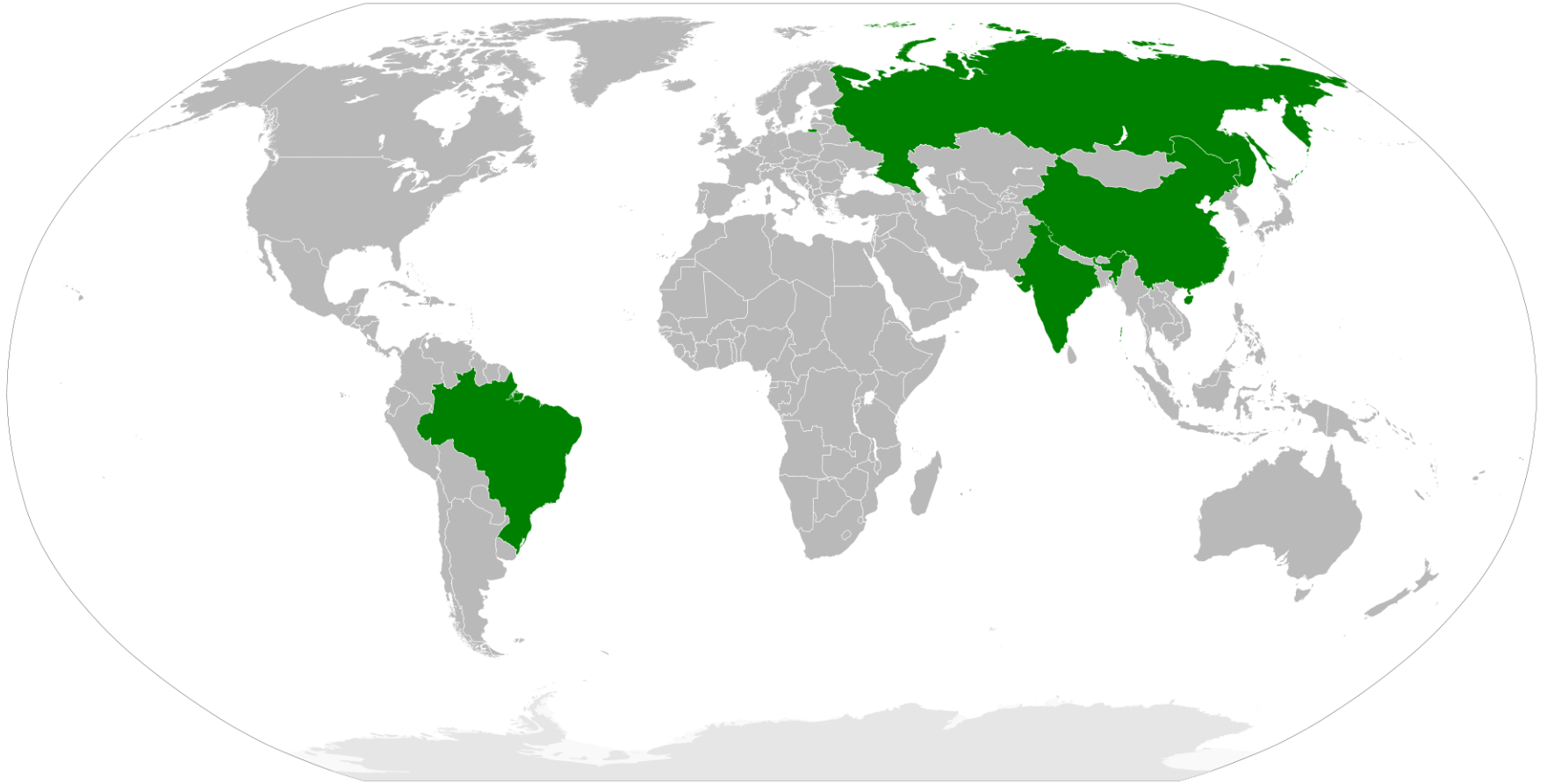
‘Why did he do such a silly thing? Partly, perhaps, because he has no instinctive judgment to prevent him from making mistakes; partly because, lacking this instinctive judgment, he was deafened by the clamorous voices of conventional finance; and, most of all, because he was gravely misled by his experts.’  
(Keynes 1925: 10)

# The Euroshambles

- A fixed exchange rate
- Common monetary policy
- But different economies
- With no fiscal integration to absorb shocks
- The future of europe
  - Further integration or disintegration?

# **3: Growth – Reasons to be Cheerful**

# The rise of the BRICs



# GDP – 2009 and 2050 (PPP measures)

PPP 2009 Rank	Country	GDP at PPP (constant 2009 US\$bn)	PPP 2050 Rank	Country	Projected GDP at PPP (constant 2009 US\$bn)
1	US	14256	1	China	59475
2	China	8888	2	India	43180
3	Japan	4138	3	US	37876
4	India	3752	4	Brazil	9762
5	Germany	2984	5	Japan	7664
6	Russia	2687	6	Russia	7559
7	UK	2257	7	Mexico	6682
8	France	2172	8	Indonesia	6205
9	Brazil	2020	9	Germany	5707
10	Italy	1922	10	UK	5628
11	Mexico	1540	11	France	5344
12	Spain	1496	12	Turkey	5298
13	South Korea	1324	13	Nigeria	4530
14	Canada	1280	14	Vietnam	3939
15	Turkey	1040	15	Italy	3798
16	Indonesia	967	16	Canada	3322
17	Australia	858	17	South Korea	3258
18	Saudi Arabia	595	18	Spain	3195
19	Argentina	586	19	Saudi Arabia	3039
20	South Africa	508	20	Argentina	2549

Source: World Bank estimates for 2009, PwC model estimates for 2050

Source: PWC  
(2011)



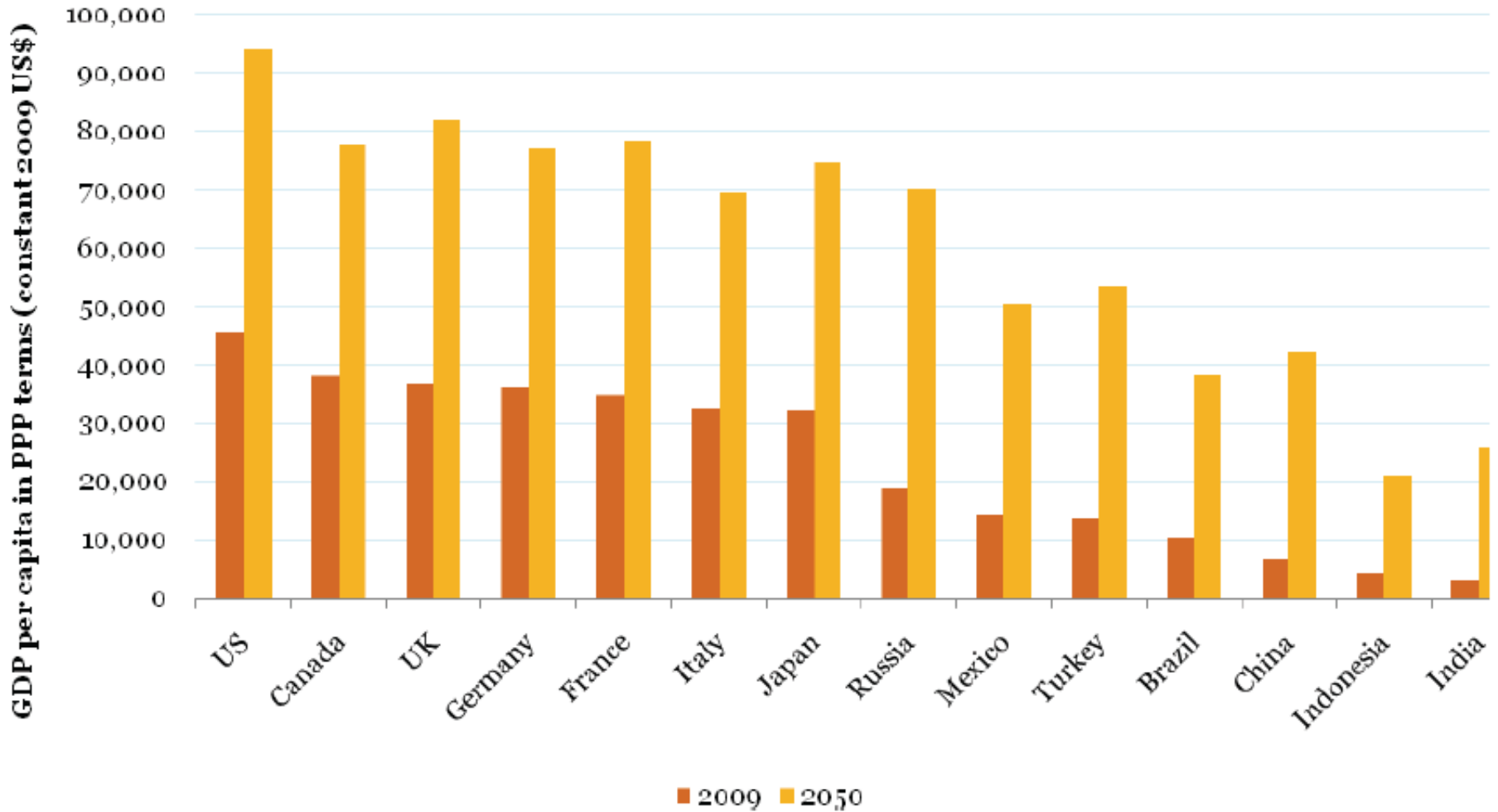
# Projected real growth in GDP (2009-50)

Country	Average annual real growth in GDP	Average annual population growth	Average annual GDP per capita growth
Vietnam	8.8%	0.7%	6.1%
India	8.1%	0.8%	5.3%
Nigeria	7.9%	1.5%	5.0%
China	5.9%	0.1%	4.6%
Indonesia	5.8%	0.6%	4.1%
Turkey	5.1%	0.6%	3.4%
South Africa	5.0%	0.3%	3.6%
Saudi Arabia	5.0%	1.4%	2.7%
Argentina	4.9%	0.6%	3.0%
Mexico	4.7%	0.5%	3.2%
Brazil	4.4%	0.6%	3.3%
Russia	4.0%	-0.7%	3.2%
Korea	3.1%	-0.3%	2.6%
Australia	2.4%	0.7%	1.9%
US	2.4%	0.6%	1.8%
UK	2.3%	0.3%	2.0%
Canada	2.2%	0.6%	1.7%
Spain	1.9%	0.1%	1.8%
France	1.7%	0.2%	2.0%
Italy	1.4%	-0.2%	1.9%
Germany	1.3%	-0.3%	1.9%
Japan	1.0%	-0.5%	2.1%

Source: PwC model estimates

Source:  
PWC  
(20110

# GDP per capita 2009 and 2050 forecasts

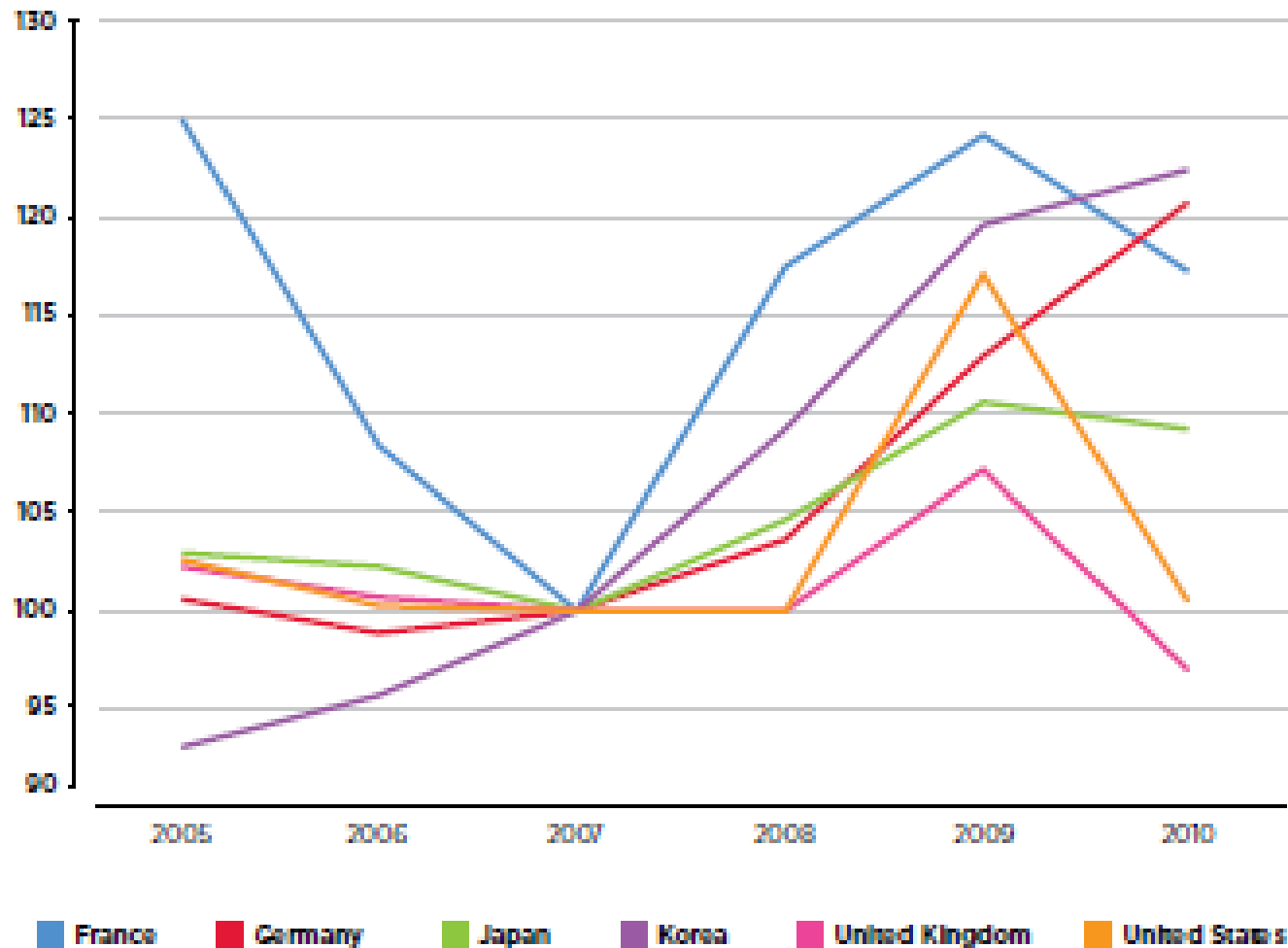


Source: PWC (2011)

# New Ideas

- The importance of new ideas
- But the development of new ideas requires finance and stable growing markets
- Both are in short supply during this period of austerity
- Governments must continue to invest in technology and new ideas to ensure future growth

# Government Budget Outlays on Research and Development (weighted by size of country), 2007=100



Source: OECD and NESTA

# **4: Growth – Can Economics Help?**

# The State of Economics

- How we do it
- Implications for policy

# The State of Modern Economics

On my first day as a graduate student at the Massachusetts Institute of Technology, the professor introduced the discipline by intoning, 'All of economics is a subset of the theory of separating hyperplanes.' (You don't want to know what that mathematical term means). I started to giggle. But then I looked around. Everyone else was scribbling notes. So I wiped the smirk off my face and muttered, only to myself, that I thought that economics was about the plight of people living in sub-Saharan Africa, of the impacts of technological change on living standards. Apparently I thought wrong – and wondered whether I had made a terrible career choice.

Michael Weinstein, New York Times economics columnist, 2000

# The State of Modern Economics

- Economics is a science ('physics envy')
- We can use maths to explain why people do what they do
- People are rational and respond to incentives – individuals maximise their welfare, firms maximise their profits



# Methodology: Marshall's Approach

1. Use mathematics as shorthand language, rather than as an engine of inquiry.
2. Keep to them till you have done.
3. Translate into English.
4. Then illustrate by examples that are important in real life.
5. Burn the mathematics.
6. If you can't succeed in 4, burn 3. This I do often.

Guillebaud, Marshall's Principles of Economics, Vol.2, p.775

# **Economics and Policy: The Role of the State**

# The Evolution of Macroeconomics

- The Interwar period – dominated by free market economists
- Keynes in the 1930s – argued that that the free market economists were wrong and that government intervention was needed to stimulate demand

# The Keynesian Golden Age, 1950-73

- Government management of demand
- Regulation of markets – especially financial markets
- Bretton Woods system of global financial architecture
- Rapid growth of the world economy

# Economic Policy: the impact of the economic crisis

- Impact of austerity may lead to a reassessment of economic policy
- The danger of unfettered markets?
- The need for more effective regulation
- A return to an active role for the state to promote economic growth?

# **5: Some ways Forward**

**The role of the state**

# **A Return to Demand Management**

# The deficit debate

- The economic crisis ushered in a (temporary) return to Keynesianism across the globe
- This led to an increase in Government budget deficits
- The debate about cutting the deficits now can be broadly divided between:

Deficit cutters – who believe that the private sector will respond positively

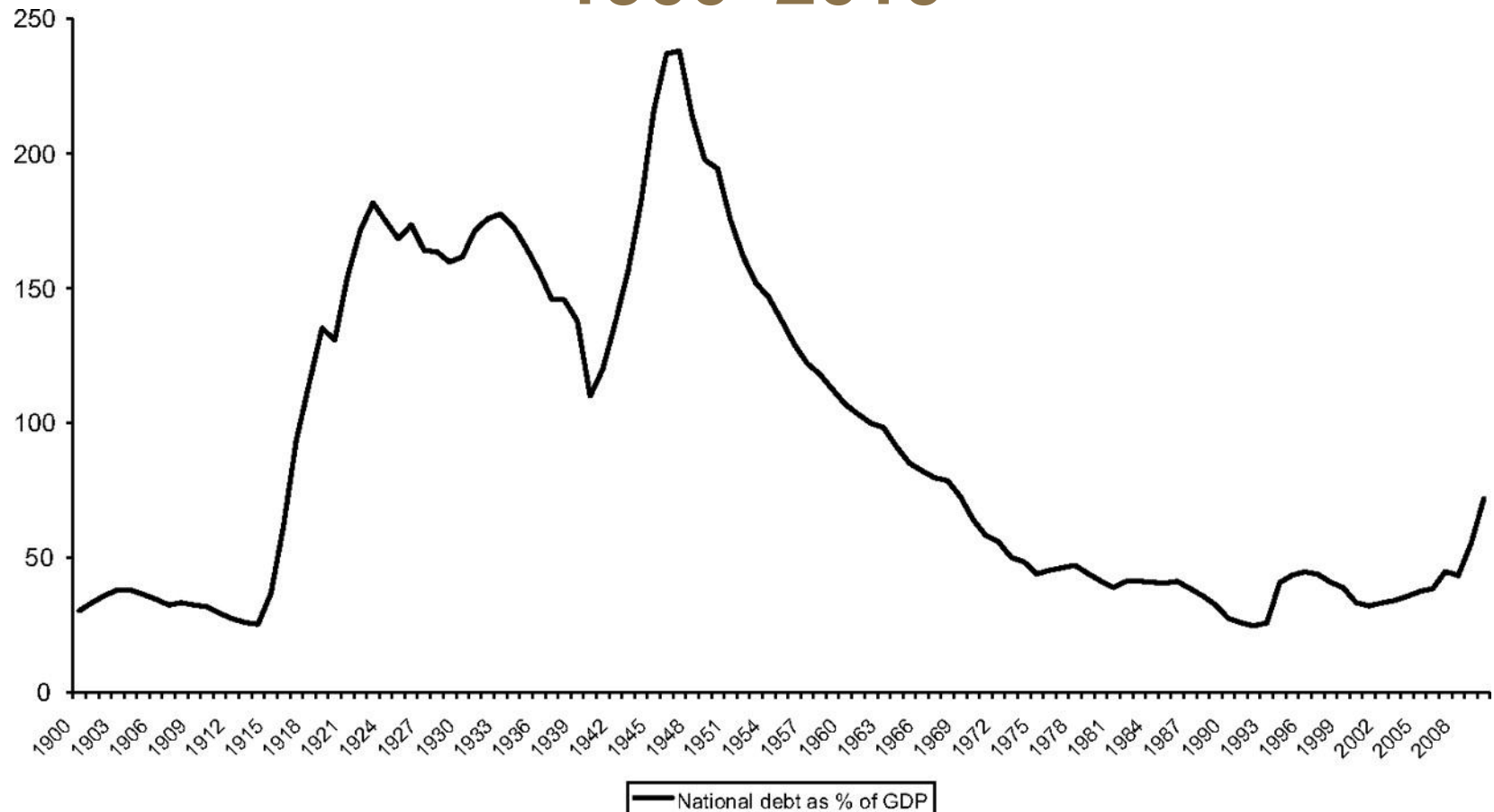
Deficit maintainers – who believe that in the short-run the economy requires stimulus from the public sector



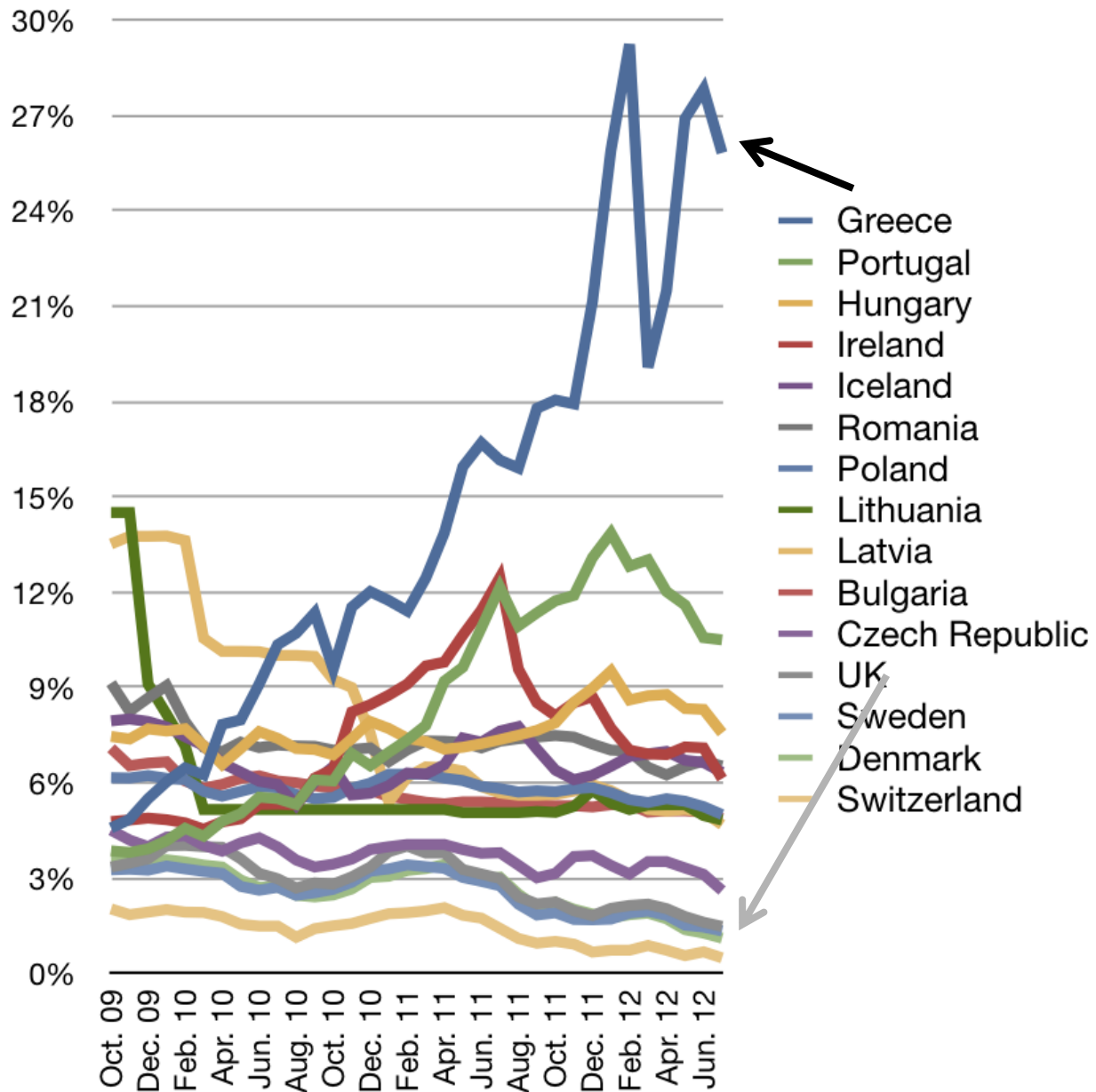
# A Return to Demand Management

- According to 'The New Treasury' view, Budget deficits lead:
  - 'Crowding' out of productive private economic activity
  - Unacceptable levels of debt
  - Rising rates of interest

# UK National debt as a percentage of GDP, 1900–2010



## Long-term interest rates

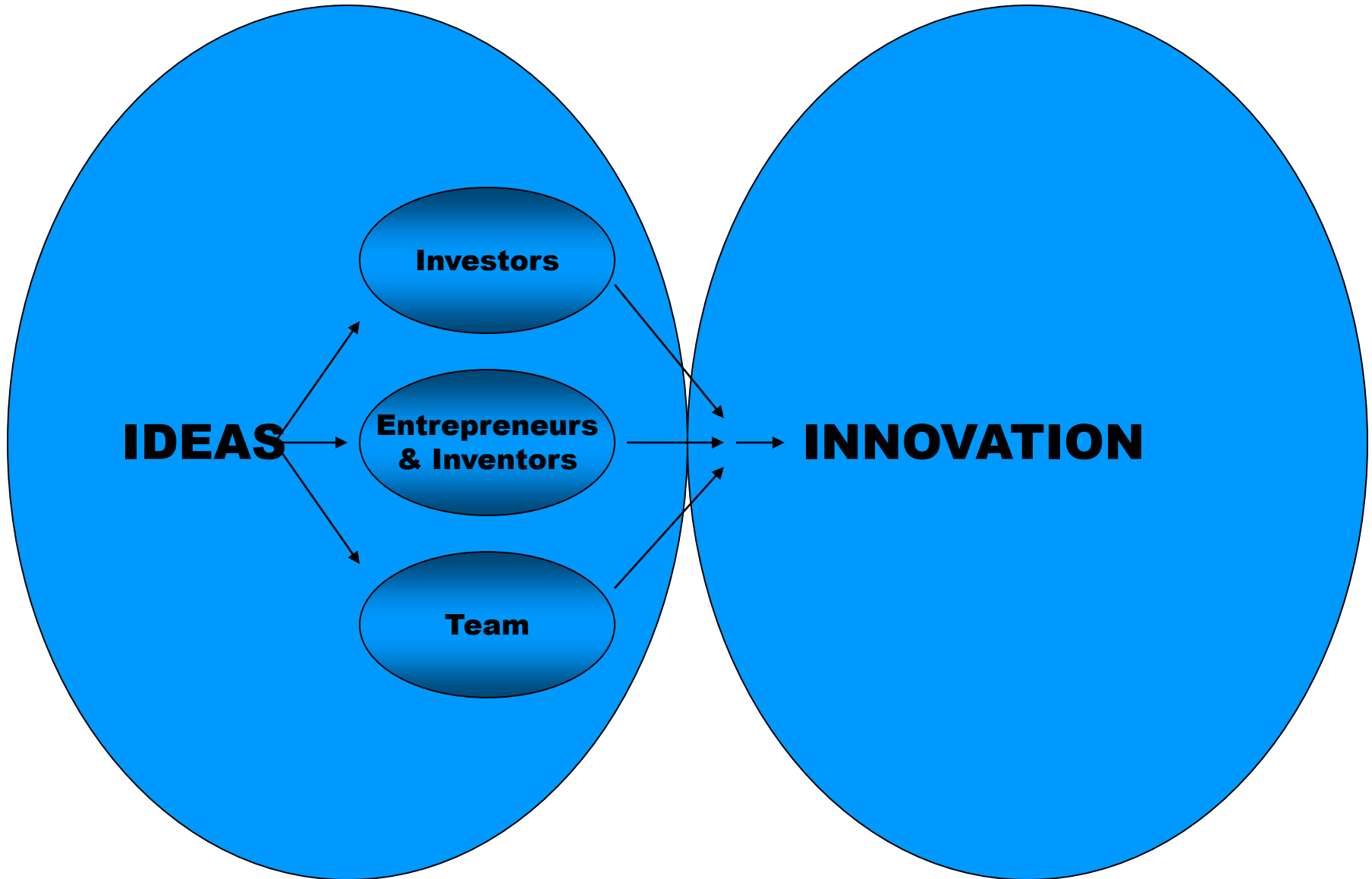


Source: ECB, Central Bank of Iceland, Bloomberg

## The role of the state

**Promote the  
Development and  
Diffusion of New Ideas**

# Growth: the Role of Innovation



# Promote the Development of New Ideas

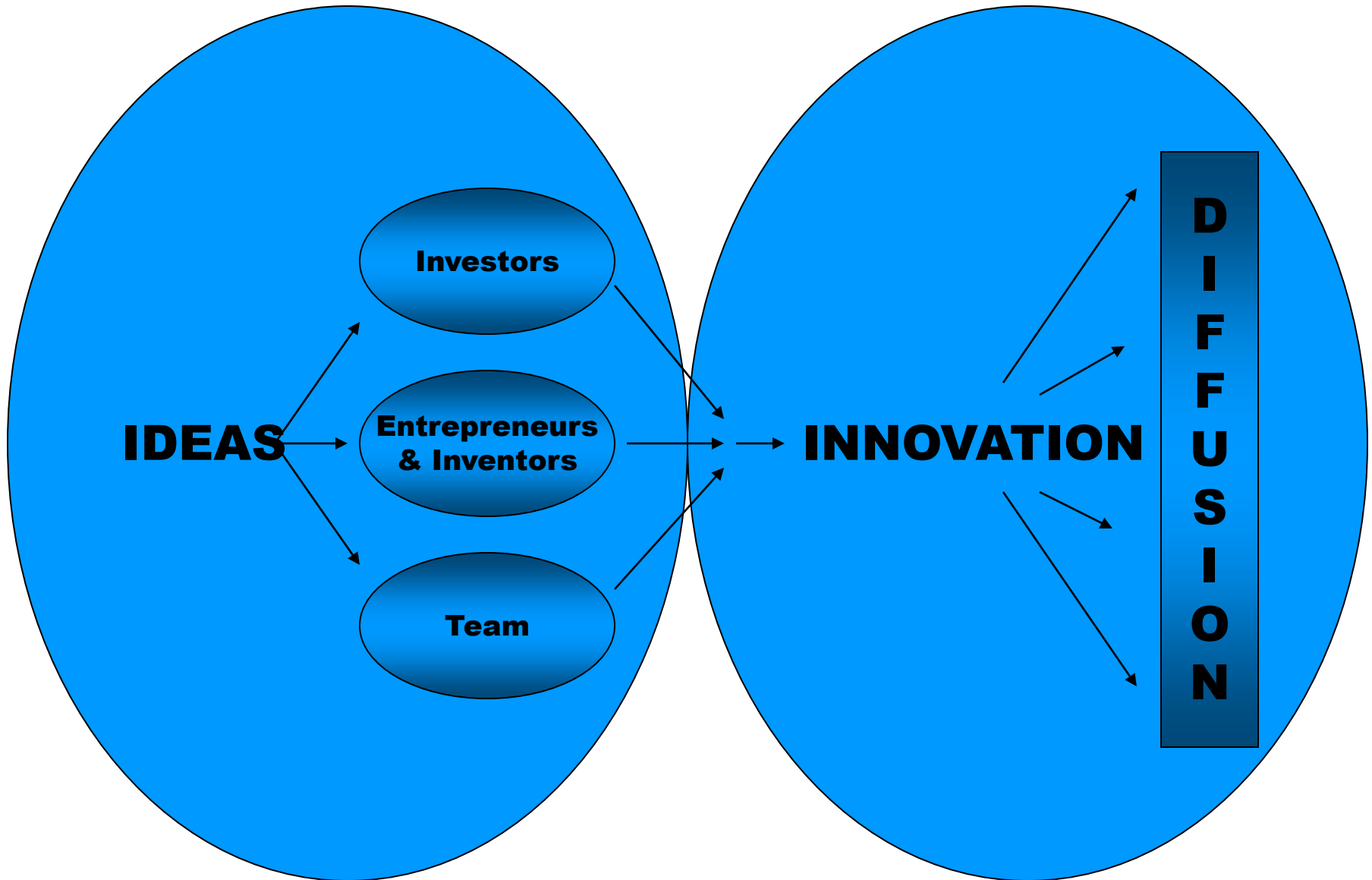
- It does not make sense for the private sector to invest in many new technologies
  - Most new ideas take a long time to develop, are expensive and fail
- Important role for the state because technologies produce positive social returns far greater than private returns

# Developing New Ideas

‘How many people know that the algorithm that led to Google’s success was funded by a public sector National Science Foundation grant? Or that molecular antibodies, which provided the foundation for biotechnology before venture capital moved into the sector, were discovered in public Medical Research Council (MRC) labs in the UK? Or that many of the most innovative young companies in the USA were funded not by private venture capital but by public venture capital such as through the Small Business Innovation Research (SBIR) programme?’

Mariana Mazzucato, *The Entrepreneurial State*, p.19

# Growth: the Role of Innovation





# The Diffusion of New ideas

- The most powerful economic impact of innovation comes from the diffusion of ideas
- Often into conventional sectors
- The same with all general Purpose Technologies
- But the diffusion, acquisition and absorption of new ideas is costly, difficult and time consuming

# Innovation and growth: the (Solow) paradox

“You can see the computer age everywhere these days, except in the productivity statistics”.

Robert Solow, 1987, (MIT, Nobel Laureate)

# The Innovation (Solow) Paradox

US Productivity growth 1995-2000: the three largest contributors to the productivity surge were, in order:

- wholesale trade
- retail trade
- security and commodity brokers

(Solow, CMI Summit 2001)

**The role of the state**

# **Invest in Education and Health**

## The Size of Government in OECD Countries 1960 - 2007

Total Government Outlays as a Percentage of GDP

	1960	1970	1980	1990	2000	2007	Increase 1960-2007
Australia	21.2	25.5	34.0	35.7	35.2	34.0	12.8
Austria	35.7	39.2	48.9	51.5	51.5	48.2	12.5
Belgium	34.5	36.5	50.7	52.2	49.0	48.3	13.8
Canada	28.6	35.7	40.5	48.8	41.1	38.6	10.0
Denmark	24.8	40.2	56.2	55.9	53.9	50.7	25.9
Finland	26.6	31.3	36.6	48.0	48.3	48.1	21.5
France	34.6	38.9	46.1	49.4	51.6	53.0	18.4
Germany	32.4	38.6	48.3	43.6	45.1	44.3	11.9
Greece	17.4	22.4	30.5	44.9	46.7	43.2	25.8
Iceland	28.2	29.6	32.2	41.5	41.9	43.1	14.9
Ireland	28.0	39.6	50.8	42.9	31.5	34.7	6.7
Italy	30.1	34.2	41.9	52.9	46.1	48.4	18.3
Japan	17.5	19.3	32.6	31.8	39.1	36.5	19.0
Luxembourg	30.5	33.1	54.8	37.7	37.6	37.8	7.3
Netherlands	33.7	46.0	57.5	54.9	44.2	45.7	12.0
New Zealand	27.7	34.4	47.0	53.2	39.6	42.3	14.6
Norway	29.9	41.0	48.3	53.3	42.3	41.0	11.0
Portugal	17.0	21.6	25.9	40.3	43.1	45.9	28.9
Spain	13.7	22.2	32.9	42.8	39.1	38.8	25.1
Sweden	31.0	43.7	61.6	61.3	57.1	53.8	22.8
Switzerland	17.2	21.3	29.3	29.7	33.4	34.0	16.8
United Kingdom	32.2	39.2	44.9	41.9	37.1	44.6	12.4
United States	28.4	32.5	33.7	37.1	34.2	37.4	9.0
Average OECD	27.0	33.3	42.8	45.7	43.0	43.1	16.1

## The Size of Government in OECD Countries 1960 - 2007

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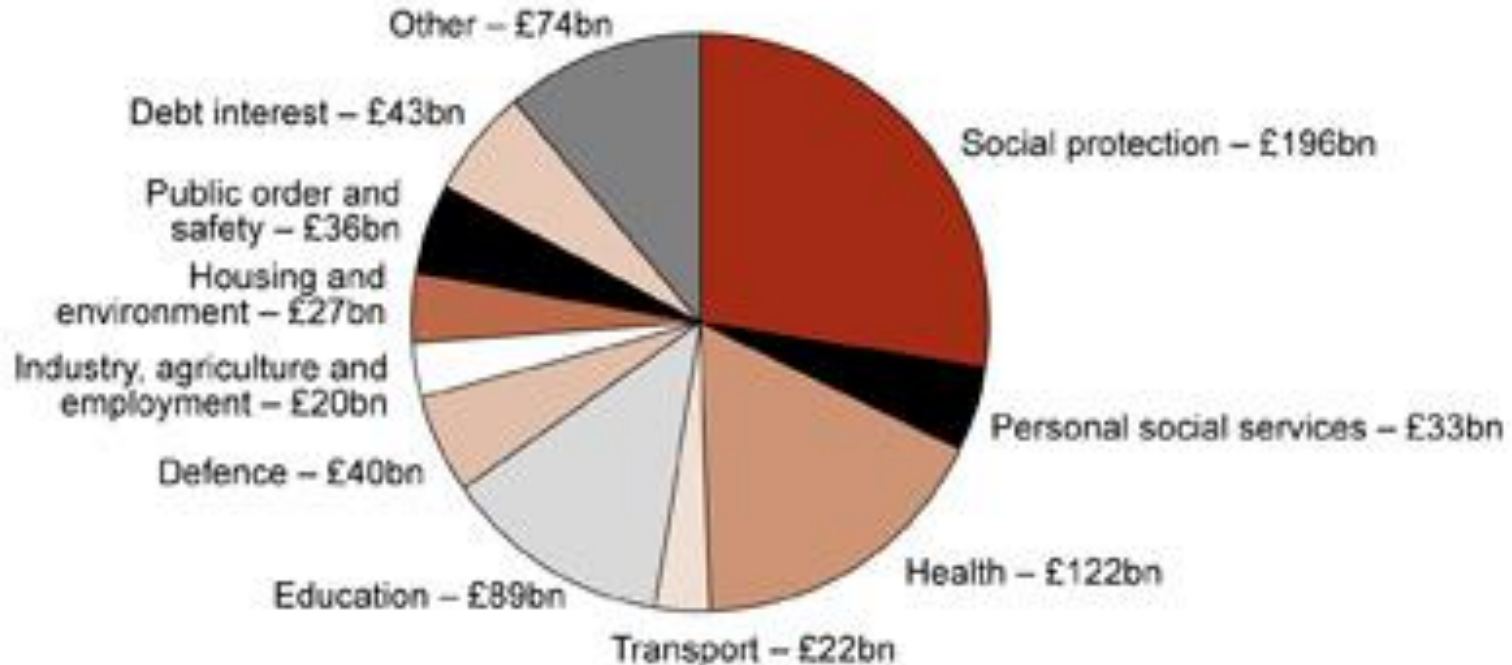
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Average OECD	27.0	33.3	42.8	45.7	43.0	43.1	16.1

# The Role of State

- Public expenditure in advanced countries has been rising due to:
  - Education
  - Health
  - Social protection

# UK Central Government Expenditure, 2010-11

**Total managed expenditure: £704 billion**



Source: HM Treasury 2010-11 near-cash projections. The allocation of spending to functions is largely based on the United Nations' Classifications of the Functions of Government (COFOG). Other expenditure includes general public services (including international services); recreation, culture, and religion; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted in AME, in line with OECD guidelines. Figures may not sum due to rounding.



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