Institute of Policy Studies

IPS Corporate Associates Breakfast, 1 March 2011
"The Global Economy in 2011: An Impending Perfect Storm?"
Speaker: Dr Dan Steinbock

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At an IPS Corporate Associates Breakfast on 1 March 2011, Dr Dan Steinbock, Research Director of International Business at the India China and America Institute (USA), and Fellow at Shanghai Institutes for International Studies (China), spoke on the "impending perfect storm" facing the global economy in 2011. Based on his analysis of global economic trends in the recent to long term, Dr Steinbock believed that the world was heading towards turbulent times ahead due to the global converging of regional risks and challenges.

Dr Steinbock noted that the subprime crisis in the United States (US), which had precipitated the global economic crisis, had converged with cyclical economic transitions faced by many regions. He predicted that the effects of the synchronised global recession would last until 2016, even as the G3 economies of the US, Europe and Japan struggled to address weak fundamentals. Meanwhile, the BRIC countries (Brazil, Russia, India and China) were also experiencing globalisation at a very rapid pace, as changes that had been expected to take 30 or 40 years were now taking place within 10 to 15 years. As a result, inflation risks, as evident in rising prices of food and commodities, were very high and this is a significant symptom of turbulent times ahead.

Looking towards the US, Dr Steinbock was impressed by the economy's effort to restimulate exports and was optimistic about its resurgence in manufacturing. However, the output gap and high levels of unemployment faced in the US would take a long time to correct. Economically vibrant cities in the past such as Detroit now faced 20 percent unemployment as companies permanently relocated their production. Dr Steinbock estimated that the US would have to create approximately 11 million new jobs to regain its pre-crisis position – a task that would take years. Reforms in the financial sector also remained incomplete, while the housing market was still plagued with home foreclosures and low new home sales. Unfortunately, even as the Federal

Reserve in the US embarked on a second round of quantitative easing (QE2) in the hope of stimulating job growth, Dr Steinbock believed that US policy makers' focus on improving employment in the domestic economy had obscured larger global implications affecting the rest of the world, such as rising inflation.

Examining the growth of China, Dr Steinbock noted that massive broad based monetary stimulus had helped create conditions conducive for foreign direct investment and robust GDP growth. This had also driven millions of Chinese from rural areas to coastal cities to seek employment. The next stage of China's growth would prove challenging as it had to contain the potential for property bubbles in the residential markets of many cities. As cities continued to grow, they would require significant investment in affordable housing to meet the demand of up to 400 million more people over the next few years. Investments in affordable housing would also help the government address the very wide disparities in income levels.

In Europe, several countries were close to bankruptcy and Dr Steinbock considered bailout measures including a debt financing facility inadequate and ineffective in improving liquidity and solvency in the region. Ironically, he observed, many European countries today would not be eligible to join the European Union, as they would not be able to fulfil its criteria for debt and deficit levels. To help reinvigorate the competitiveness of Europe's economies, Dr Steinbock emphasised the importance of harmonising policies across the region, restructuring unsecure debt, and recapturing European zombie banks, which would all prove challenging. So far, German and French leaders had indicated their plans to harmonise tax rates and adjust retirement ages while curtailing debt, but were likely to face heavy political opposition.

On competitiveness rankings like the *Lisbon Review*, Dr Steinbock noted that East Asian scores had far outstripped those of the US and Europe. This debunked common perceptions that Europe was still the centre of innovation competitiveness while growth in emerging Asia was driven primarily by cost competitiveness. In fact, Asia was increasing its innovative potential very quickly, as the emphasis on competitiveness had become very important in twin giants China and India. The world had already seen the rise of Chinese players in the area of clean energy and green technology in the short span of a few years.

Dr Steinbock observed that the structural problems and challenges faced by the US, China and Europe were now coinciding with other issues, like uncertainty over price hikes in oil, due to the tide of political turmoil sweeping over North Africa and the Middle East. The media often characterised these uprisings as "out of the blue", but Dr Steinbock considered them to be predictable outcomes of long-standing political discontent and the failure of governments to provide people with jobs. Future governance in these countries now experiencing change would have critical implications on the industrial and infrastructural development of economies around the world, particularly in China, India and emerging Asia. They now faced the prospect of much higher energy costs as they entered new stages of industrialisation. The rapid industrialisation of emerging Asia also meant that food and commodity prices would keep rising, even for basic items like sugar. This was because unlike the price of oil, which was driven by supply, global growth was now driven by demand. Dr Steinbock observed that inflation was accelerating in China, where the national average was about 5 percent, but food prices in stores were rising by much more.

Looking ahead, Dr Steinbock noted that the advanced economies were likely to experience muted growth of one to three percent, assuming that they contained present problems and the threat of social turmoil, and that the US would develop credible fiscal adjustment. Asia meanwhile, had to be careful of the capital inflows flooding the region. From West to East the global economy would soon experience massive changes in economic and therefore political power.

During the discussion session that followed, participants asked about the prospects for India. Dr Steinbock's view was that perceptions of India's potential to replace China as the global engine for growth by 2050 were often argued on the basis of population growth. However, comparing relative literacy, he noted that an estimated 50 percent of women in India were illiterate, while in China literacy levels among women were higher. Certain cultural obstacles and political ones such as the recent government corruption scandal, were ultimately more challenging to address than infrastructural development.

Concerns also arose as to the role of the environment in the development of emerging Asia. Dr Steinbock noted that the full implications of industrialisation in terms of pollution, and environmentally hazardous effects would become more apparent in about fifteen years, with future generations facing widespread health problems like asthma. Many of these effects were unfortunately underestimated and would prove costly in the long run. The issue of coordinated water management was brought up, as many upstream activities in China for instance, were causing the downstream Mekong region to dry up. Bangladesh and India would also be affected as the source of the Ganges River is derived from China. Countries in Southeast Asia had therefore tried to engage countries affected to talk about the coordinated harvesting of water resources. Going forward, and as with many other sectors of development, long-term and systematic cooperation with China would be necessary.

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