Economic recovery: A long road with new horizons

The signs of economic change are all around us, but are they harbingers of something better? INSEAD economics professor Antonio Fatas looks at a world in flux.

After decades of spending exceeding earnings, developed economies are fast running out of steam. Europe, faced with an ageing population and dwindling resources, is struggling to contain an unprecedented debt-crisis; the great "American Dream" is crumbling; and the widening gap between rich and poor is creating social and political tensions. Industries are desperately looking for new consumer markets to pull them out of recession at a time when common sense tells us all to cut back on spending.

This puts the focus on emerging markets, many of which have experienced a decade of unprecedented economic development and are fast catching up with advanced markets in terms of productivity and income growth, as potential stabilisers of the financial crisis. Are the emerging markets growing fast enough to resuscitate and sustain the global economy? And do we have the political and business leaders brave enough to make the tough decisions?

Tough politics

Fatas says change will come out of necessity but it won't be fast or easy. "As an economist, it's very easy to find a solution (to the crisis), but when you advise governments it's much harder to think about solutions that are politically feasible," Fatas noted at the recent INSEAD Leadership Summit Middle East in Abu Dhabi.

In advanced economies, people have become used to a certain standard of living. The ageing population has retirement plans which demand a strong income while the educated, younger generation has grown up with the expectation of steady, meaningful employment and a lifestyle better than that of their parents. Instead, they're faced with frozen pensions, shrinking job opportunities and governments burdened with unsustainable levels of growing debt which will take generations to pay off.

"This is not an economic problem, this is a political problem," Fatas insists. "What we have to decide as a society, along with the political process, is who pays for the debt."

Who pays?

In countries like Japan where the Japanese citizens or institutions hold the government debt there is no choice. If a government defaults, it's a "tax" its citizens must pay. But in the case of countries such as Greece where some debt is held outside the country, there is an option. "They can refuse to pay debts to other countries or they can tax the people in Greece. Politically that is a choice," Fatas says.

Right now the world needs strong political leaders with the ability to address these long-term economic challenges and make the tough decisions. But this alone is not enough to revive the world's economy, says Fatas. The world also needs confident business leaders and entrepreneurs prepared to make risk-taking investments to kick-start spending. And it needs people and countries who are willing to buy the products the debt-strapped economies want to produce.

"The world is short of spending over the next 10 years … and it cannot come from those countries that have accumulated debt over the last decade," he says. Germany and Japan have had a history of high household savings compared to the U.S. and some southern European countries, but Japan's nuclear crisis has put pressure on the country's already fragile economy and Germany has seemed immune to pleas by the EU to spend more.

The oil-rich Gulf region, which escaped relatively unscathed from the 2008-2009 recession, prefers to place much of its surplus in wealth funds to invest more actively and generate profit for future generations. Meanwhile Norway's US$561 billion wealth fund, where the bulk of the country's oil riches are stowed, has indicated plans to reduce exposure to European assets in favour of emerging markets.

All eyes on emerging markets

It is to these developing economies, with their massive population growth and burgeoning middle class which the world needs to look if it hopes to avoid recession, Fatas states. "Solid growth in emerging markets is going to be the key for the world of advanced economies in the 10 years ahead." But this growth must be sustained and it must translate into spending in a way that it hasn't done in the past.

For the last decade, many developing countries have experienced massive advancement in terms of population and GDP assisted by economic reforms. But this cannot be relied on.

"A lot of what we've seen in the last 10 years is not the norm," Fatas warns. "There are still many countries that don't grow fast enough. If you go back in time there are many decades that don't look like the last decade. The last few years have been very good for emerging markets, certainly better than for advanced economies, but emerging markets go through crisis." And economic reforms alone are not enough to bring the countries up to advanced status, he adds.

Institutional reforms

For convergence to continue, deep institutional reforms are needed, aimed at curtailing corruption and promoting transparency in transactions while fostering entrepreneurs, private enterprise and international investment.

"Governments can't change a country without businesses. In all the countries we know around the world, business and the private sector are the most important component of the economy." Many countries, like China and Brazil, might fall into crisis. Others, such as those in the politically-fragile Middle East and northern Africa, have found authoritarian regimes and a growing, educated middle-class brings its own social turmoil hampering economic progress. For emerging economies to make a difference, these markets need to move ahead.

From necessity comes change

"There's certainly still growth in emerging markets (and) we're seeing some of the spending shifting but not fast enough," Fatas says. "But the area we're all more concerned about is change in political leadership and mental change in advanced economies to address some of the long-run disequilibrium and long-run challenges they face. I see less progress than I like but I remain optimistic because I see that out of necessity countries change."

*Antonio Fatas and fellow INSEAD economics professor Ilian Mihov collaborate on a blog on global economy. Click **here** to view.*

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