

# Global Trends and Challenges

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International Forum on City Planning

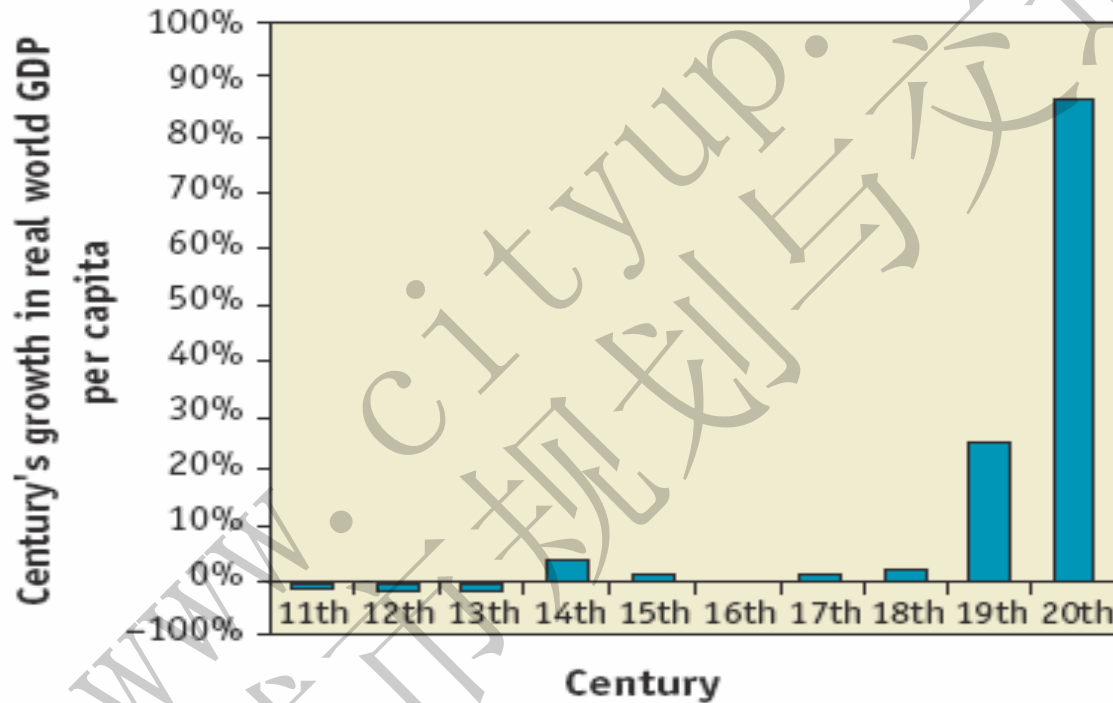
Beijing

June 2007

# Very Long Term Economic Growth

FIGURE 11

## Worldwide Growth in Real GDP per Capita, 1000–Present



Source: DeLong 2000.

# Globalization - Driving Forces

## Globalization

is the unification of many of world's markets (goods, services and capital) combined with very high growth leading to growing integration and interdependence

## The Driving Forces

The GATT and WTO processes of opening up

The end of the divisions of the cold war

Reduction of transaction costs

Information and communications technology -that reduces transaction costs and partially removes geography as a factor in market definition and segmentation

Unification of some global labor markets

Widening and deepening of global capital markets

Growing awareness of REAL economic interdependence

# Global Technological Trends

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# Network Based Information Technology

Its impacts are evolving very rapidly

Important part structure of middle and advanced income countries

Impacts are in three classes (more or less in historical order) and all in relatively early stages of a lengthy evolution (decades)

All fit the general description of lowering transactions costs, but in different areas

The headings are

1. Automation of information processing functions
2. Lowering the cost of finding things and of transactions
3. Making remote HR resources much more accessible and therefore valuable in supply chains

# 1. Automation of Information processing, monitoring, accounting, control and reporting

Labor saving technical change - dramatically

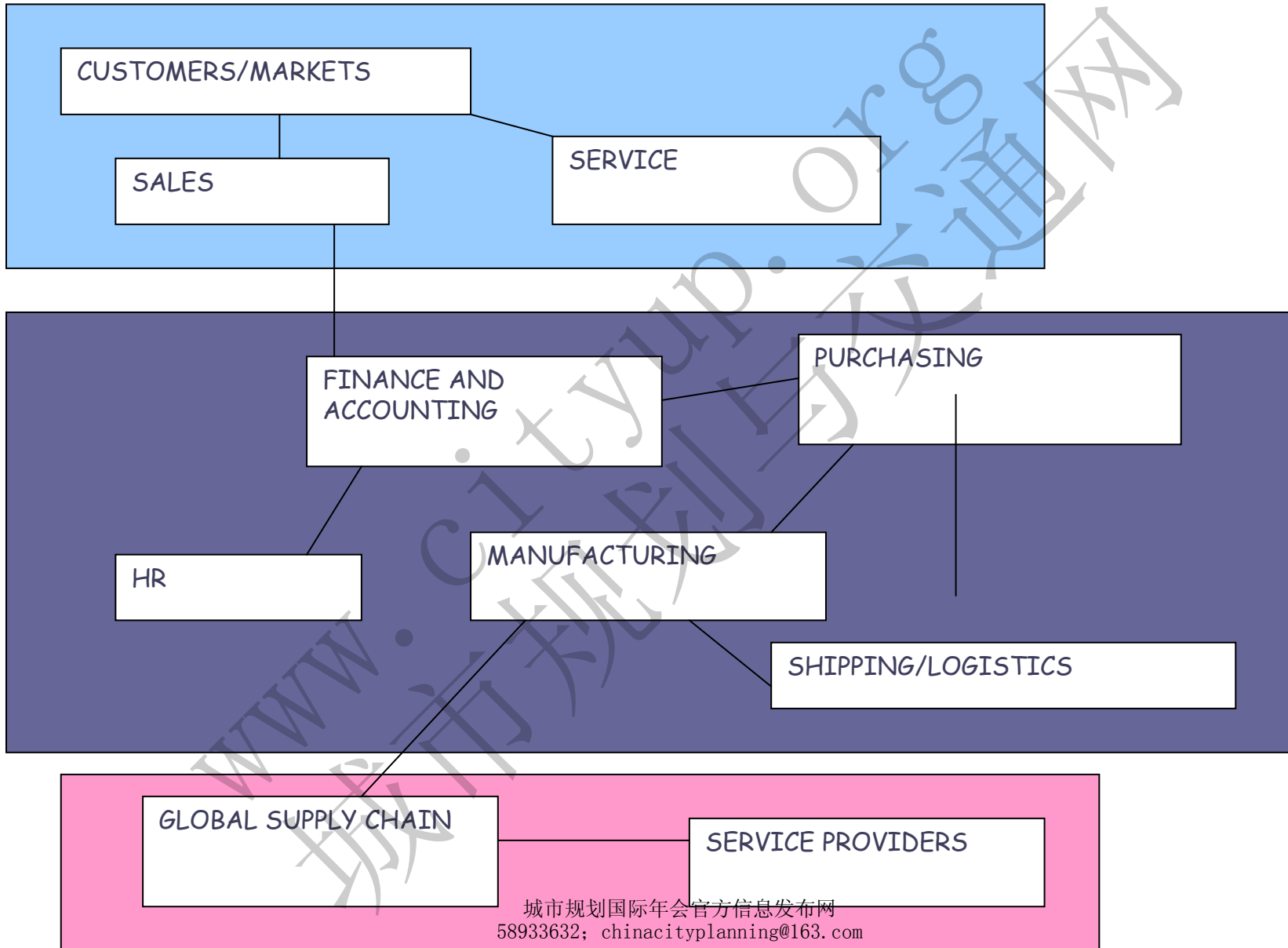
Source of much of the US productivity growth spurt and it is in process in other advanced countries with a lag.

Likely cause of part of the "middle income" problem in US

The network is critical because it connects disparate databases and users - hence the starting point is the mid 1990's

Evident in macro data and at the micro level of the firm

# Classic Supply Chain



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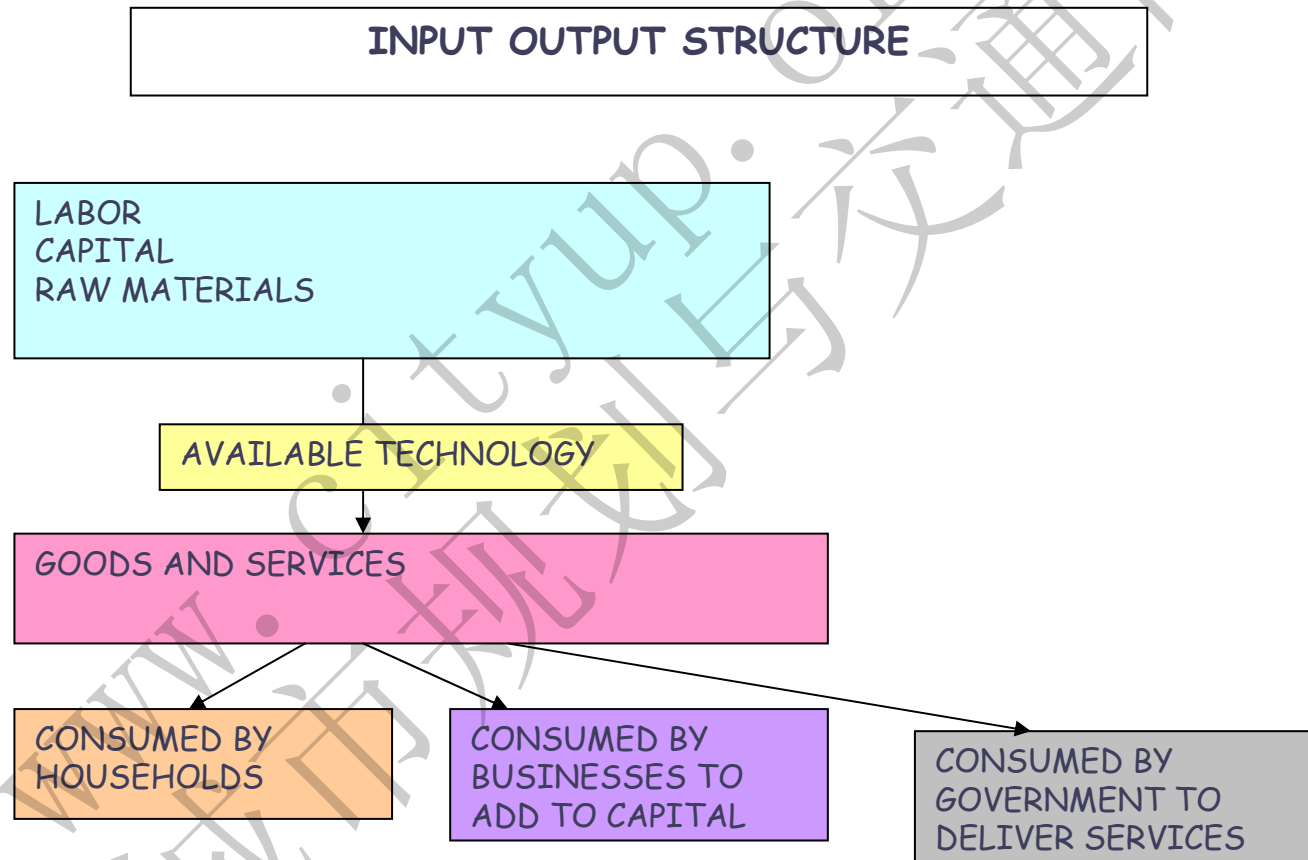
# Technological Change in the Information Service Sector and Productivity Increases

Why are the effects of technological change in the information processing and information services sector large

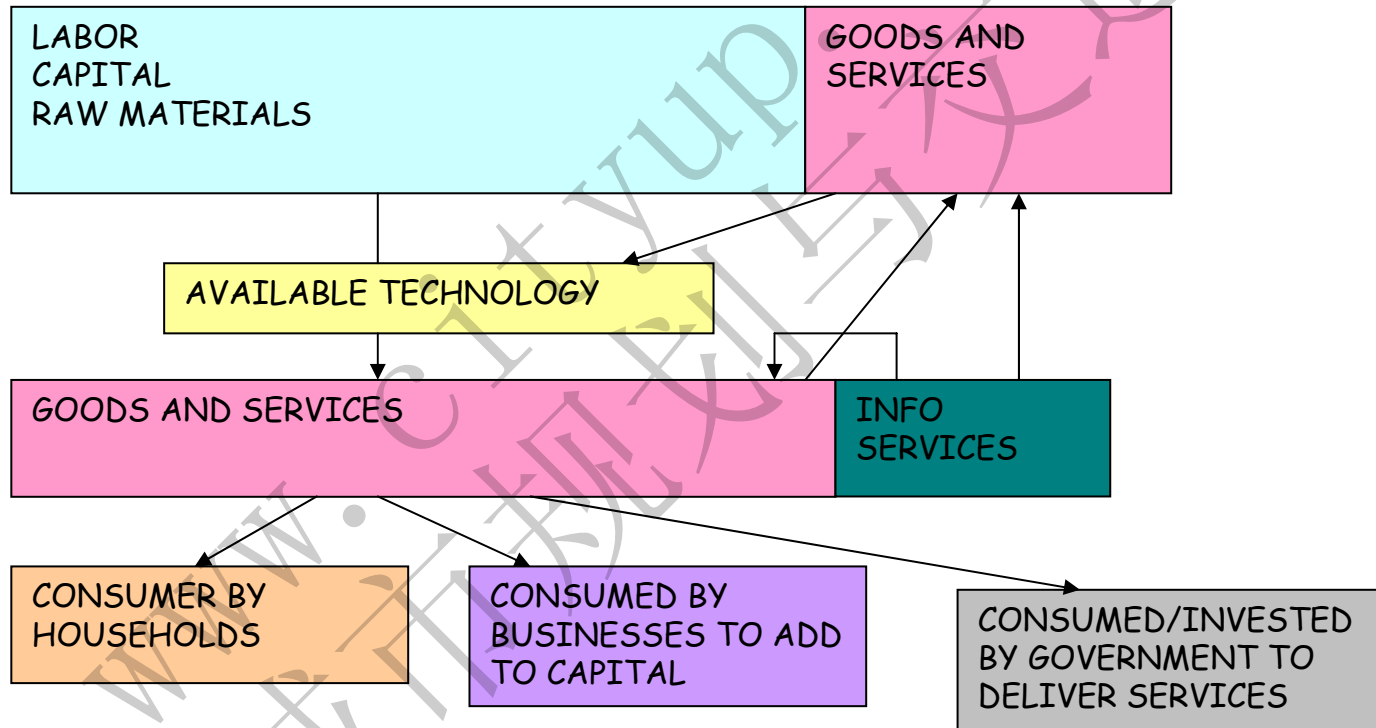
It has to do with the input-output structure of advanced economies

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# Simple Input Output Structure



# Input-Output Structure with Feedback Loops



## 2. Search and Transacting Costs

Making markets - buyers and sellers finding each other - eBay

Quasi natural monopoly

Better informed buyers

Transacting services - banking and financial services

Market liquidity and the geographic boundaries of markets - more buyers

Government Services - the DMV example from California

Finding specific valuable human resources

Education

Measurement of economic benefits is harder than in the automation case

### 3. Accessing Geographically Disparate Human Resources Efficiently

IT services

Business Process Outsourcing

Much of the opportunity here is DOMESTIC (NOT JUST INTERNATIONAL)

R&D

Other human capital and skill intensive functions (see India below)

In certain kinds of functions, the geographic boundaries of labor markets are breaking down

The nature of this kind of technological progress

Production functions

Transactions costs

Comparative Advantage of the Advanced Countries?

# Global Economic Trends: Sustained High Growth

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Sustained High Growth

China and India especially because of the size and impact

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# Sustained High Growth - Unique in History

Somewhat arbitrarily I define it as 7% per year or more for twenty plus years

There are only 11 cases

8 in Asia

They are (Botswana, China, Hong Kong, Indonesia, Korea, Malaysia, Malta, Oman, Singapore, Taiwan and Thailand)

Japan was close in its post war recovery

India is about to join in

All after WW II

All leverage the global economy to generate large increases in productive employment

- Huge elastic demand

- Transfer of knowledge (technology and know-how)

- Comparative advantage

- Surplus labor in traditional sectors initially

Over time the domestic economy becomes bigger and more important in producing growth

In all cases **URBANIZATION IS A KEY DRIVER OF GROWTH**

# China and India

China has been in this high growth mode since 1978

Major challenges in the past have been dealt with effectively - now there are new ones to sustain high growth

Many are familiar

Service industry development, Deepening of capital markets and gradual opening of the capital account, Environment damage, Income inequality, Rural Services and Insurance Systems

The harder ones have to do with the evolution of the economy through middle income to advanced status

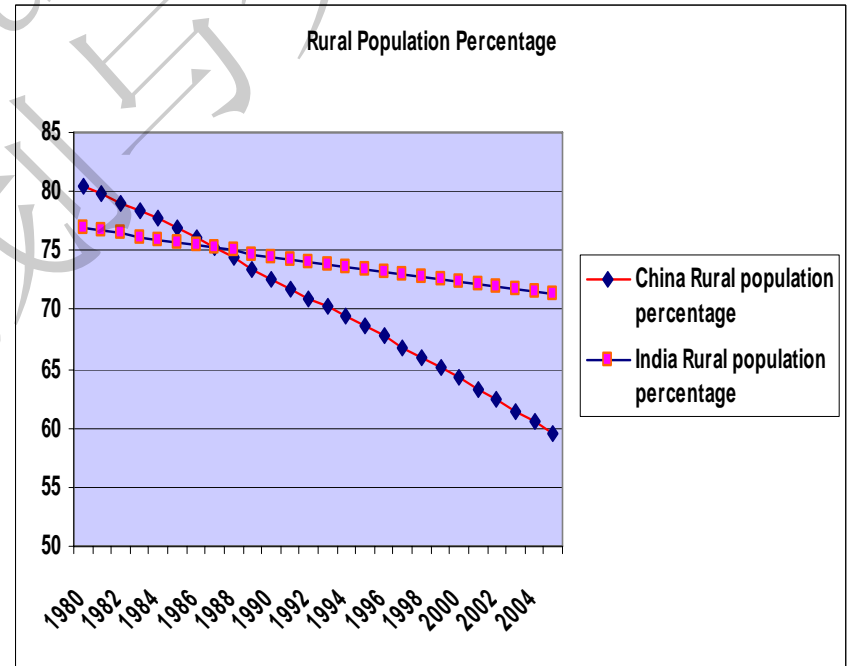
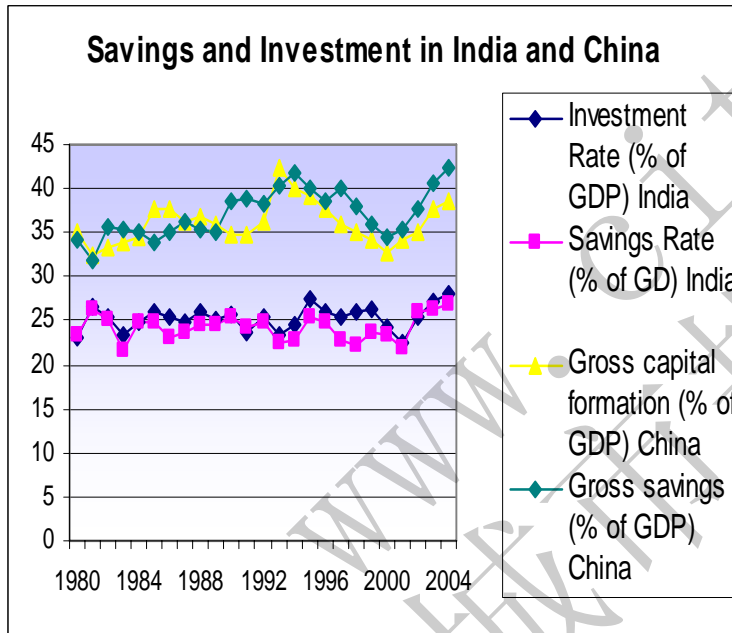
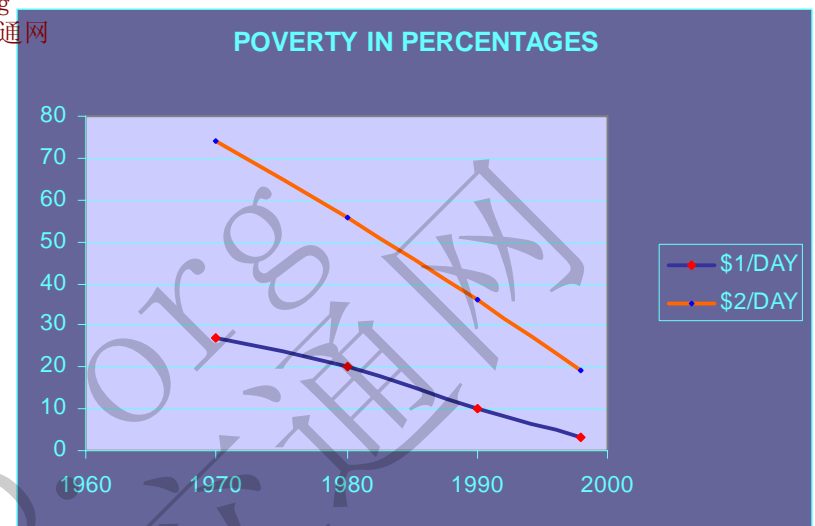
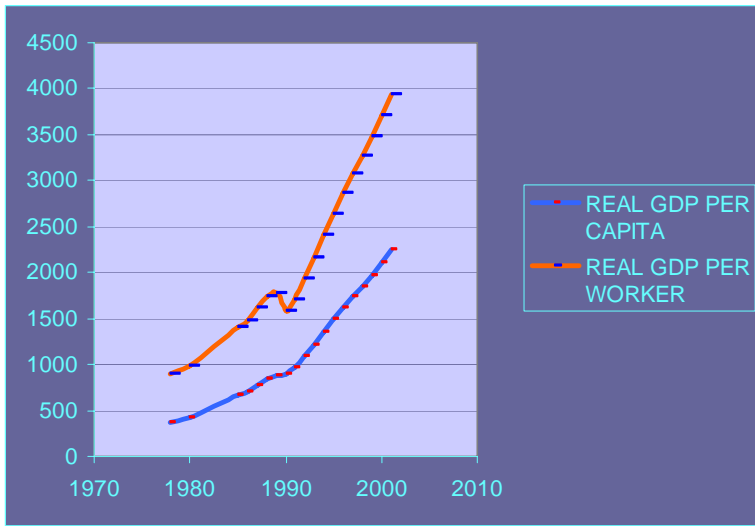
Rapid change in the economic portfolio in the next stages of growth

The process of creation and destruction or churn

The shift away from labor intensive sectors as incomes rise and make them uneconomical

Urbanization as an integral part of that process





# India

India, having lagged behind, is about to jump into the high growth category

India's current five year plan which just began, has average growth over 9% accelerating to over 10%

India has real assets with which to fuel growth

There are also formidable challenges

Infrastructure

Literacy

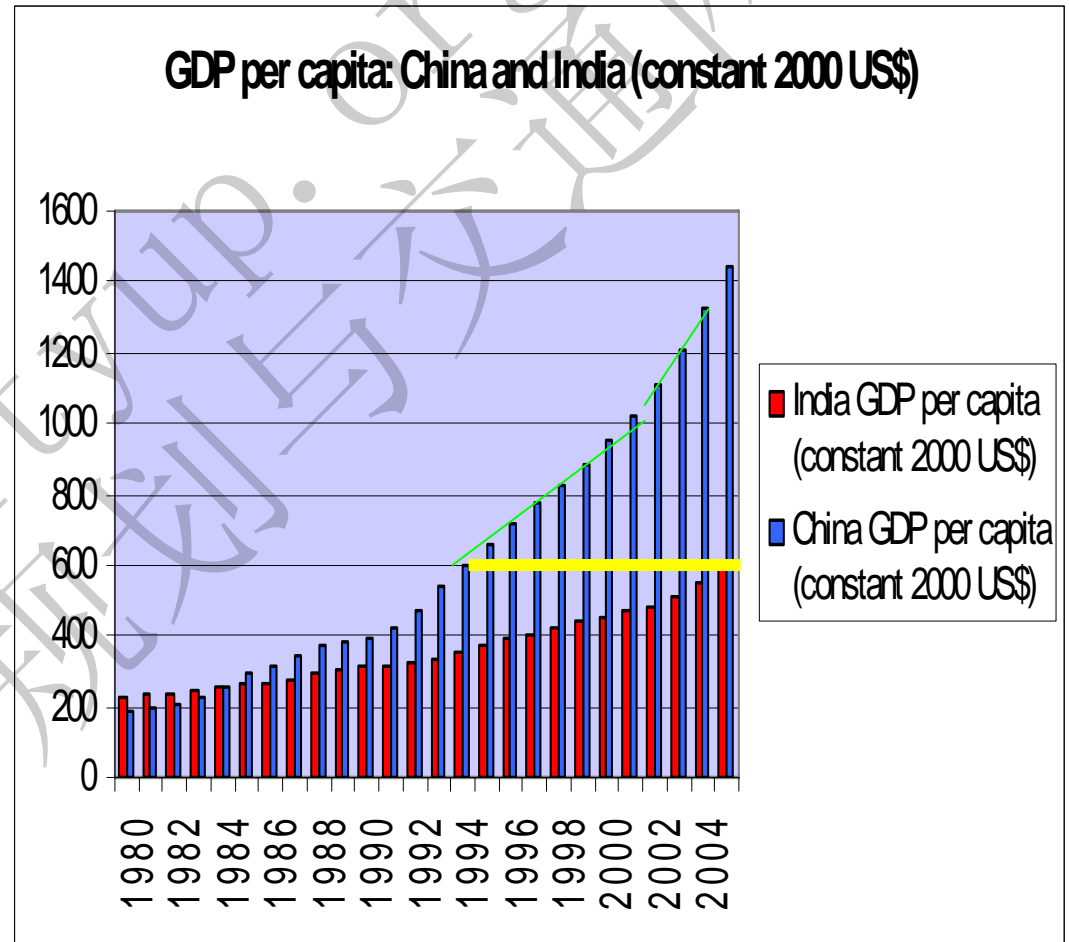
Education and quality

Political consensus

## India's Growth will Follow China With a lag of about 12 years

While the macroeconomics will look similar the industrial mix will be very different

India has had earlier development of service industries and supporting institutions (including the export ones)  
- and later development of labor intensive manufacturing



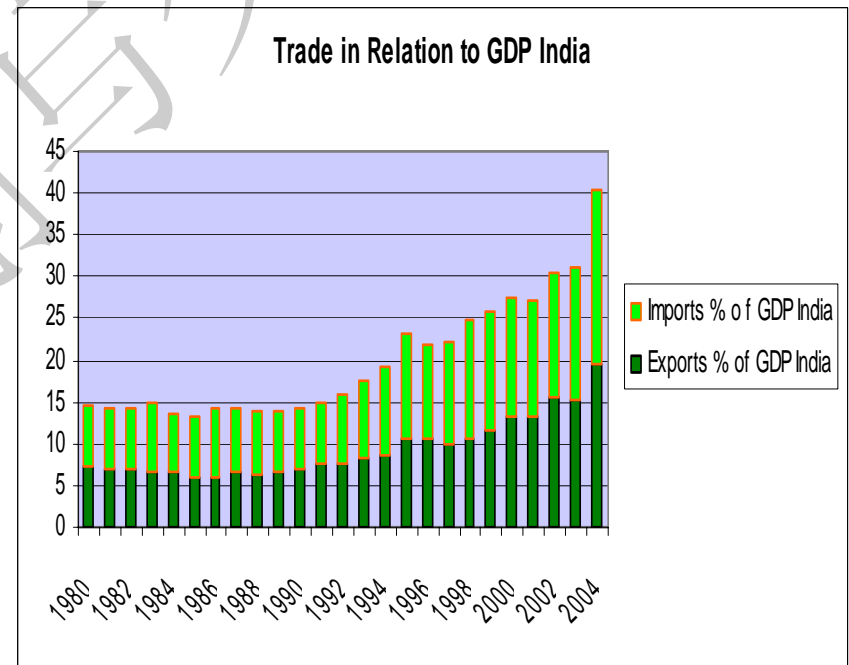
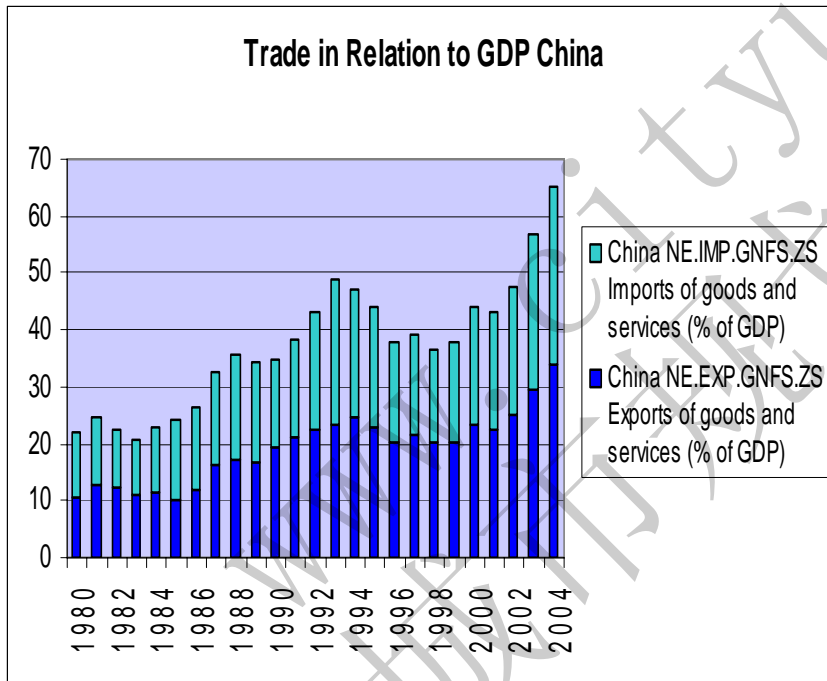
## Leveraging the Global Economy

### India's Engagement will Rise Rapidly and Look More Like China

Openness and Leveraging the Global Economy is essential for sustained high growth

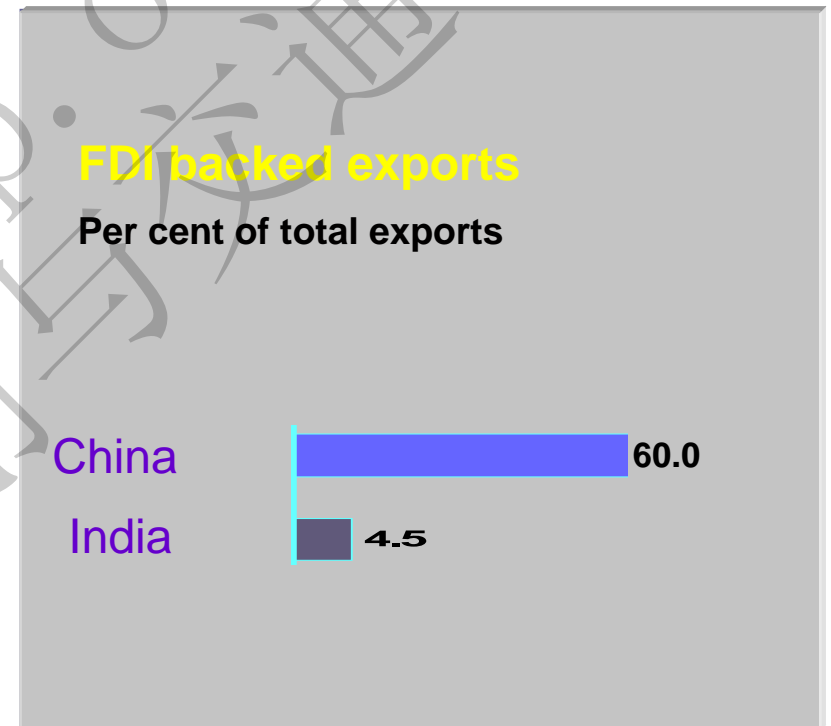
There are no counter-examples

This **DOES NOT** mean opening everything up suddenly on the current or capital account



# India Fell Behind in Manufacturing, Exports and FDI

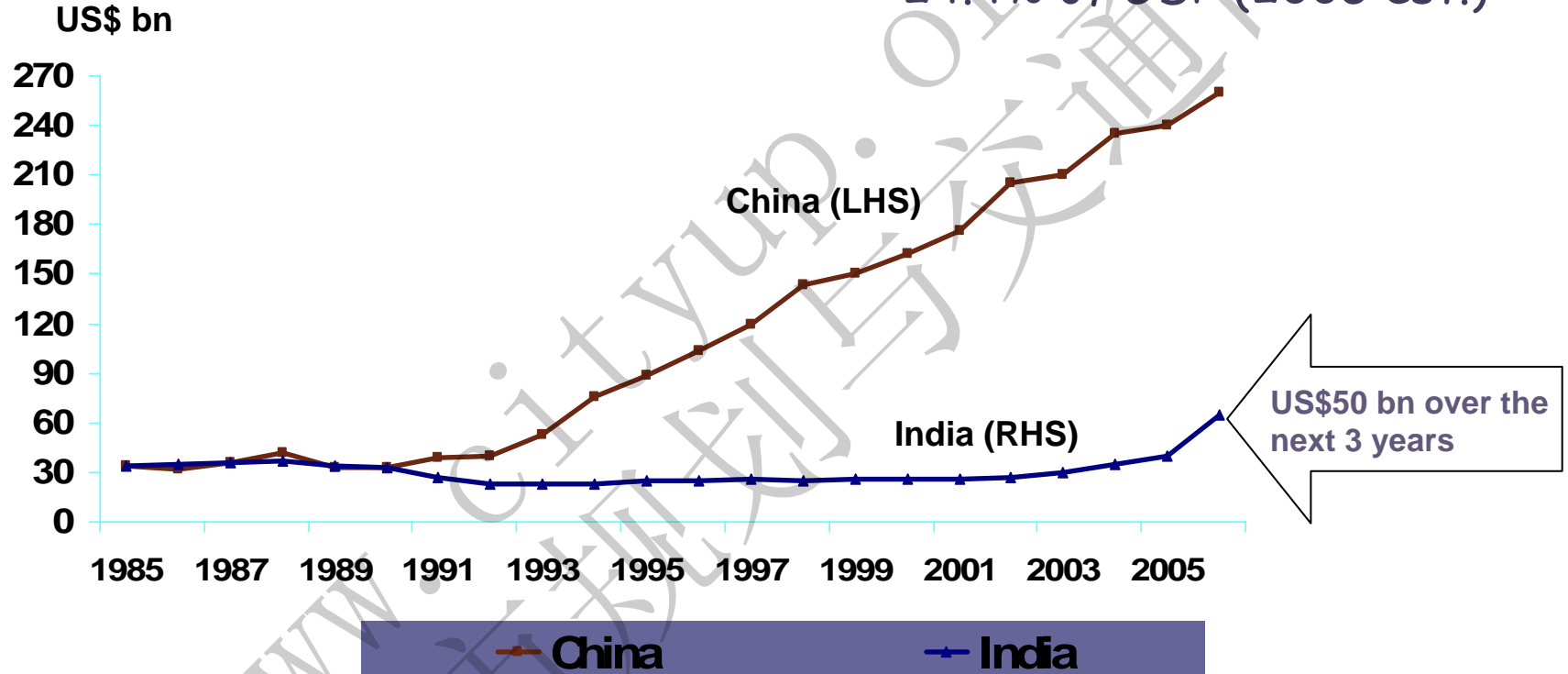
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# Also in Infrastructure

## China vs India - Infrastructure Formation

Public debt: China  
24.4% of GDP (2005 est.)



# India's Assets are Significant They include

Higher Education

New Optimism and Sense of Momentum

IT/BPO Outsourcing

Projected growth is 30% per year and India is the dominant player

Financial Sector and Reserve Bank of India

Growth in Trade in Services  
A Lot of Room to Grow

R&D

Medical Services

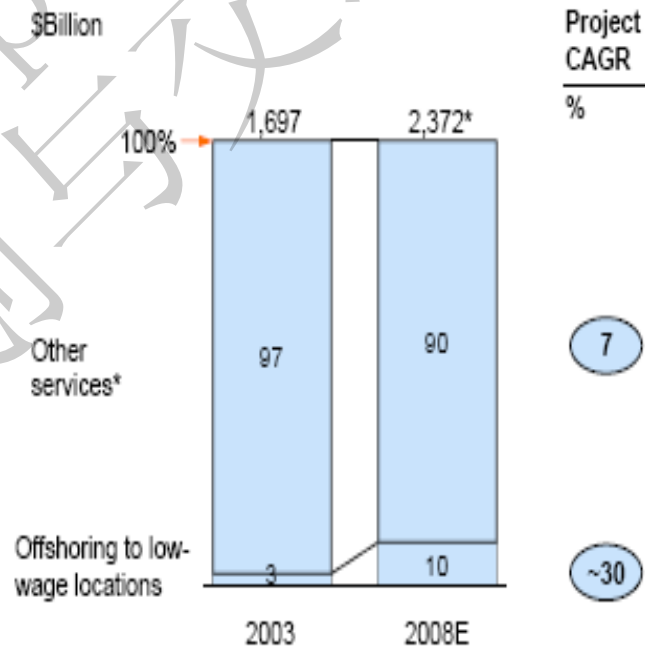
Political Speeches

Editing of newspapers and TV

Grading exams

OFFSHORING REPRESENTS AN EVEN FASTER GROWTH SEGMENT OF TRADE

BPO/IT offshoring to low-wage locations as a percent of total global service exports



\* Estimated at 6% annual growth from 2002 figure.

Source: WTO; McKinsey Global Institute analysis

# But

This is not enough to produce and sustain high and *inclusive* growth

It does not employ enough people.

India is adding additional powerful productive employment-generating engines

The need is very well understood by India's leaders

Labor intensive manufacturing and exports

Adding the China strategy to the portfolio

Open up to FDI

Special Export Zones (400+)



# Global Trends and Challenges

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# Global Economic Challenges

**Global Imbalances**

**Inequality and resistance to globalization**

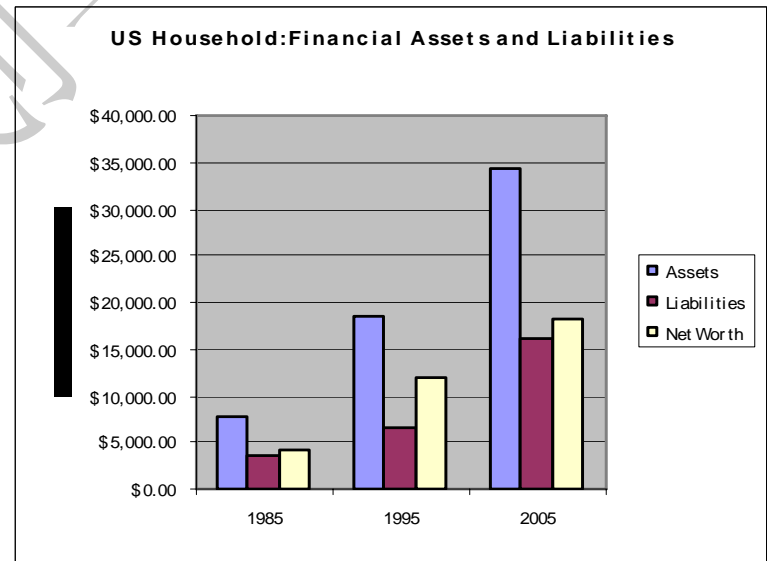
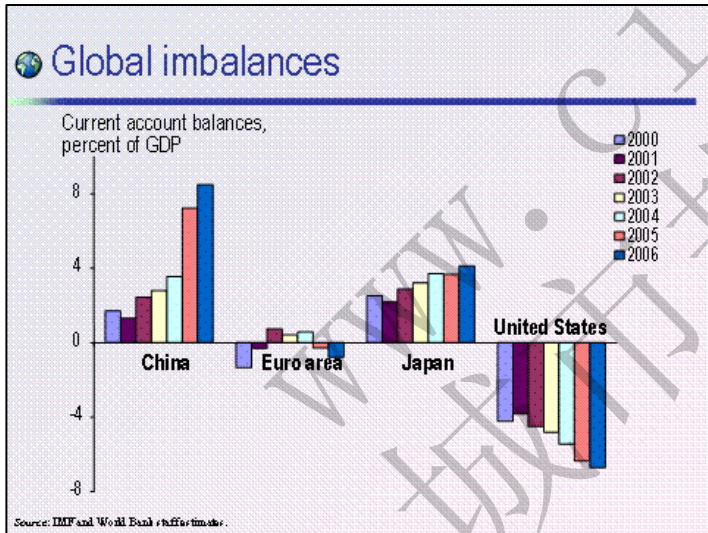
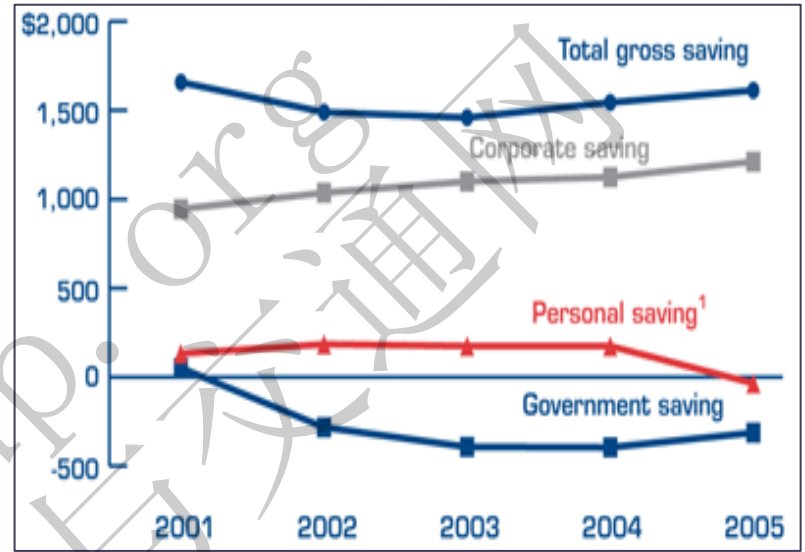
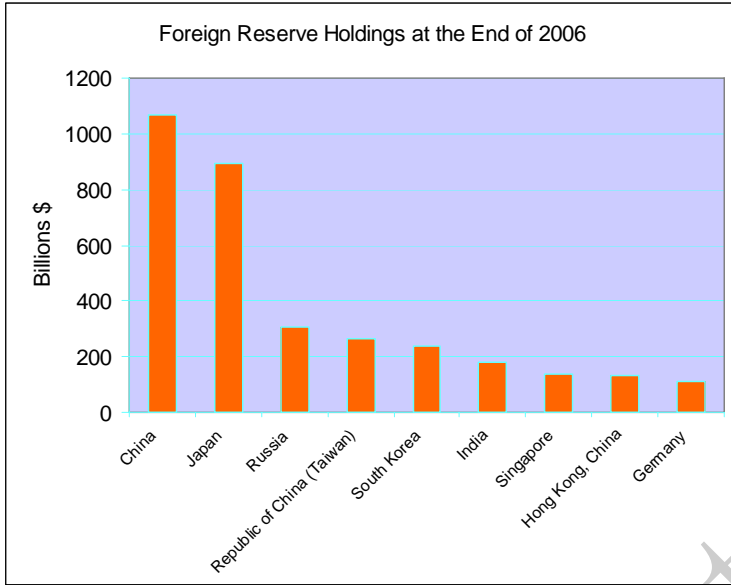
**Capital Market Integration and Deepening**

**Global Warming**

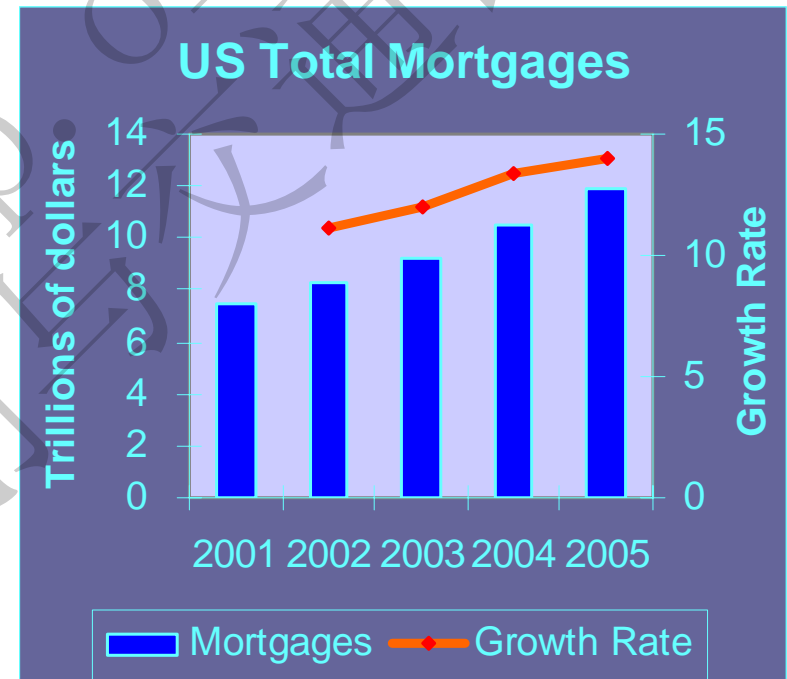
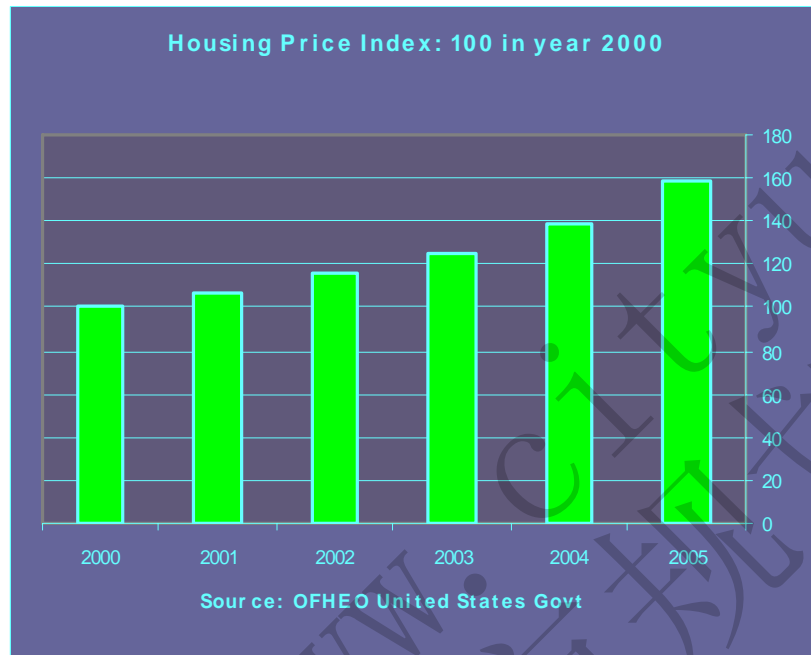
**Energy and Commodity Demand and Prices**

**Urbanization and Sustained High Growth**

# Global Imbalances: Reserves and USA Savings



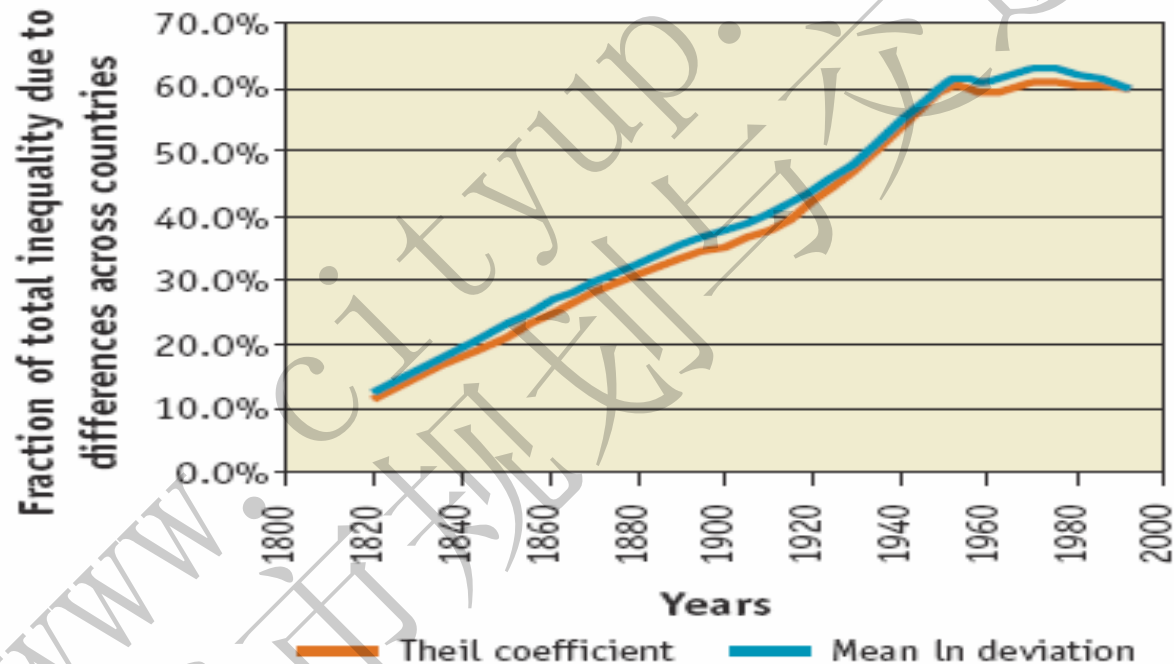
# Global Imbalances: USA Housing Prices and Mortgages



# Inequality: Globally Since Industrialization Began

FIGURE 1.4

## Fraction of World Inequality Accounted for by Differences across Countries

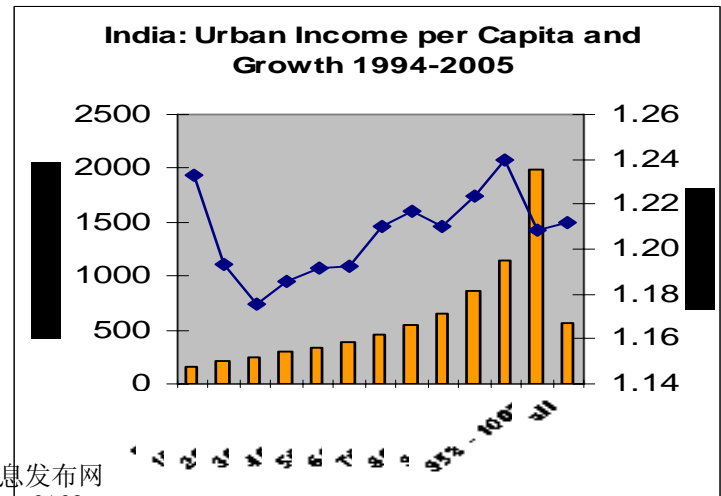
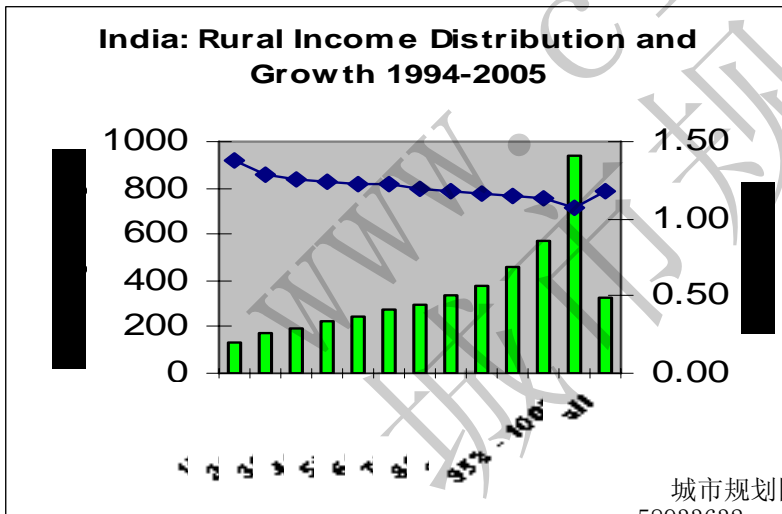
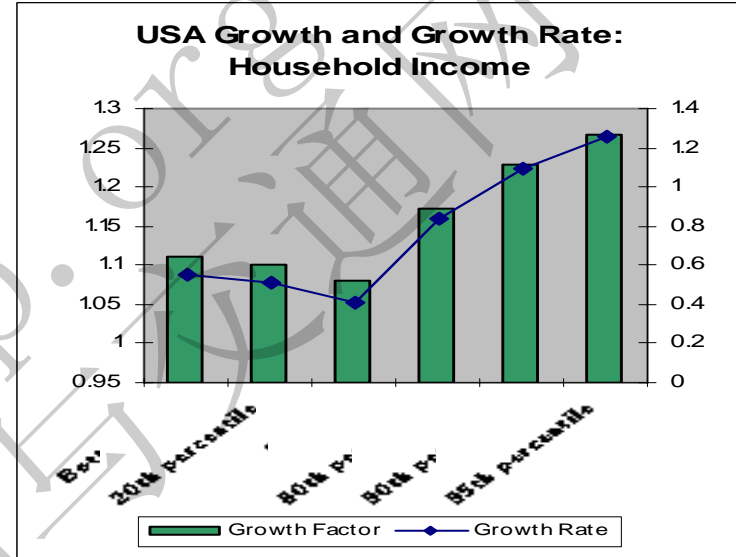
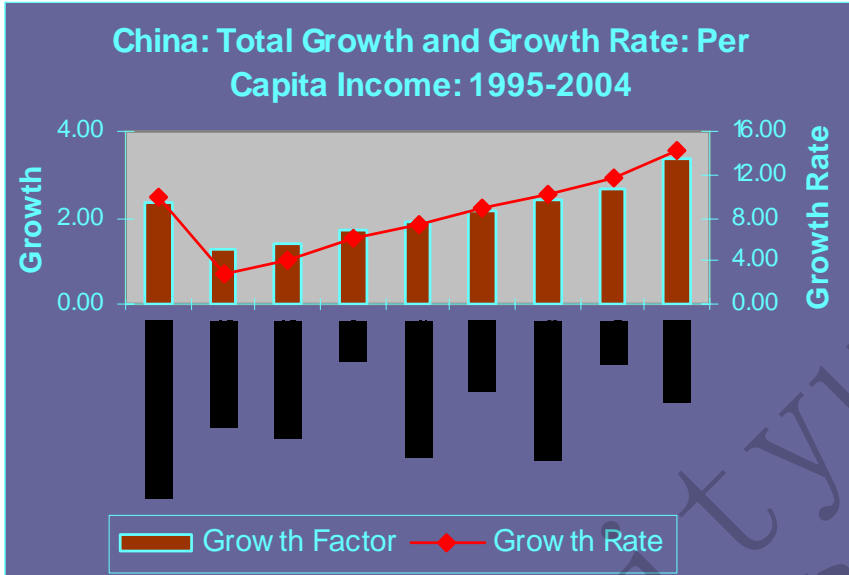


Source: Source: Bourguignon and Morrison 2002.



# Income Inequality: China, India and the USA

## Potential Resistance to Globalization

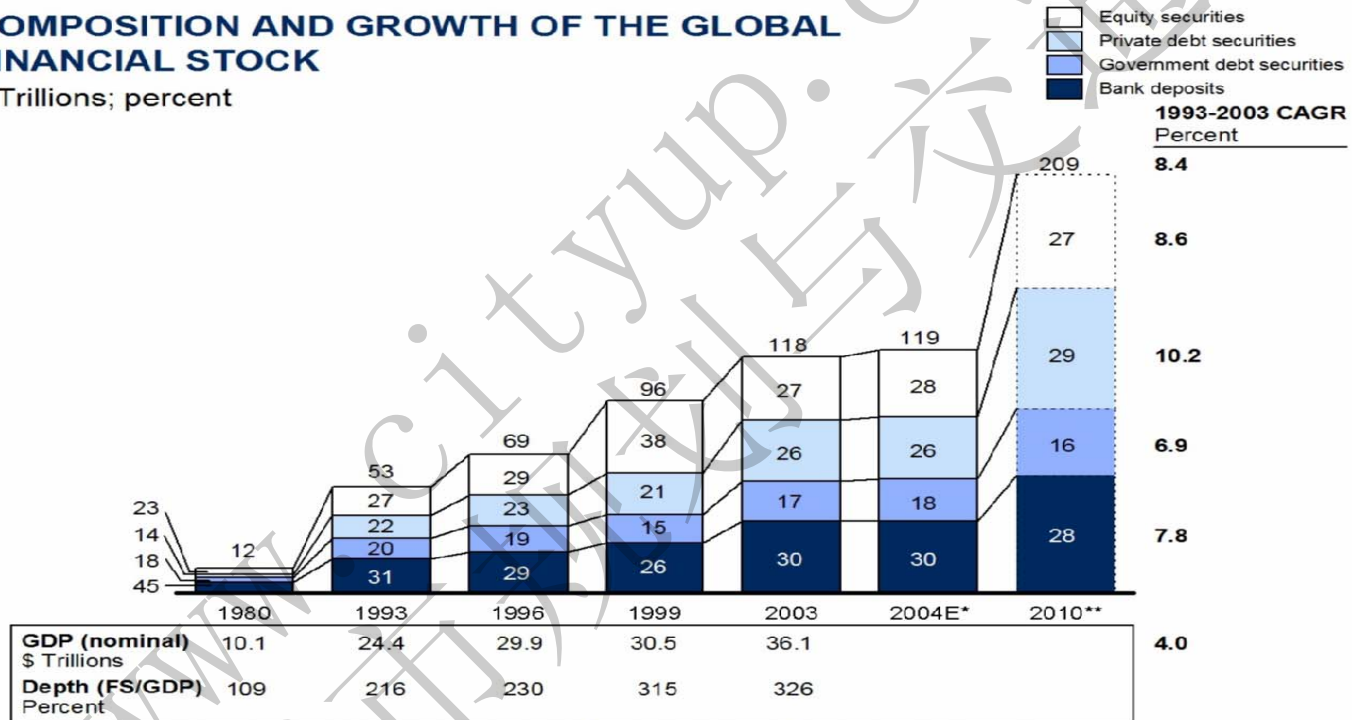


# Global Capital Markets: Capital Stock Growing 3 times Faster Than Global GDP

## Exhibit 1

### COMPOSITION AND GROWTH OF THE GLOBAL FINANCIAL STOCK

\$ Trillions; percent



\* Based on latest available data: September 2004 for equities, March/June 2004 for debt, June 2004 for bank deposits  
 \*\* Extrapolation off of 2003 base, with components grown at 1993-2003 CAGRs  
 Note: 2004E shares do not add to 100% due to rounding error  
 Source: McKinsey Global Institute Global Financial Stock Database; World Federation of Stock Exchanges; Merrill Lynch; Global Insight

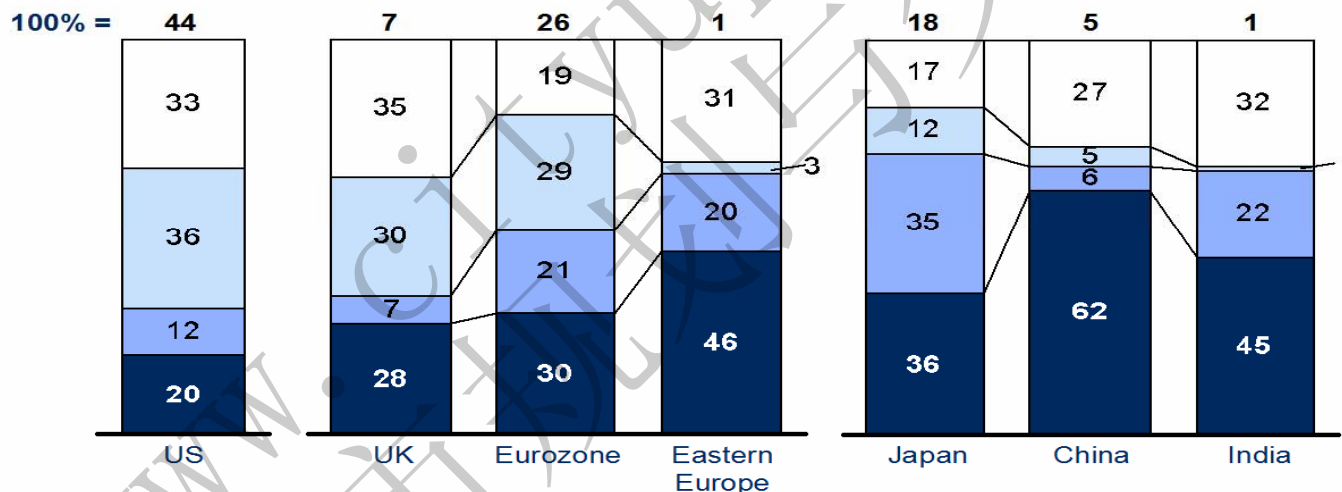


# Global Capital Markets: Capital Composition

## COMPOSITION OF FINANCIAL STOCK, 2003— THREE REGIONAL STORIES

\$ Trillions; percent

- Equity securities
- Private debt securities
- Government debt securities
- Bank deposits



<b>Depth (FS/GDP)</b>	397	385	314	99	411	323	137
Percent							
<b>CAGR</b>	8.6	11.3	9.8	19.3	4.0	14.5	11.9
Percent							

Note: Some numbers do not add to 100% due to rounding error  
Source: McKinsey Global Institute Global Financial Stock Database; Global Insight

# Global Warming

Decision making under extreme uncertainty

Very long time horizons

Large ranges in the estimates of climate impacts

These will decline over time as the science becomes more precise

The stocks and the flows of green house gases

The Kyoto impasse

How to allocate the emissions rights equitably

# Three Major Sets of Issues

## 1. Mitigation

Allocation of emissions rights across countries  
Efficiency - carbon trading market mechanisms

## 2. Technology

Reduction of the costs of mitigation  
Subsidies and rapid transfer globally

## 3. Adaptation

Capacity to adapt to climate change that does occur  
Poorer country problem

**RESPONDING TO CLIMATE CHANGE IS A MAJOR TEST OF  
OUR COLLECTIVE CAPACITY FOR GLOBAL GOVERNANCE**

# Demand for Energy and Commodities

- Large incremental demand for raw materials, commodities, and energy with effects on prices (China's construction of the equivalent of the US interstate highway system is an example)
- For developing countries with commodity exports, the effect can be beneficial in the short run - but rising commodity prices is not a basis for sustained growth
- Generally rising energy costs hurt poor countries more than richer ones
- Potentially damaging scramble for energy security - because of the size of the demand shock - and the potential for supply problems in unstable regions



# Urbanization and Sustained Growth

In the early stages of rapid growth, the agricultural sector is usually the location of a vast majority of the people. Typically, labor is underemployed in these traditional sectors. People move to cities and new industrial sectors where investment is taking place and productivity is higher. The loss in output in the traditional sector is minimal or zero because of the surplus labor condition, and hence the overall productivity gain is substantial.

**This movement of people geographically and across sectors is not an ancillary side effect of the growth process, but rather the essence of it."**

**Or to put it another way, it is the real micro-economics of high growth**

Source: Two articles on sustained high growth by the author in the  
WSJ, January 2007

# Why is orderly urbanization crucial

Advanced economies are urban economies (with no exceptions)

For reasons having to do with the way information flows in an economy

The economic activity that sustains growth in middle and upper income countries is essentially urban activity - it requires proximity

Urban-rural productivity differentials are large in China

As they are in India and other countries - this is normal

They will be eliminated by the movement of people to new sectors and to urban environments

Productivity growth in the rural sector results from the exit of people to new productive employment opportunities followed by consolidation and increased capital intensity in agriculture

The agricultural sector, though depopulated, becomes highly productive and enables many economies to be self-sufficient in food



**In two decades, China will likely have about 75% of its population in cities, possibly more.**

# Diversifying The Sources of Growth Requires Urban Development

Capital Markets, financial markets and investment efficiency

Diversifying sources of growth

Manufacturing sectors up the valued added chain

The Service sector

Domestic Market as engine of growth

"China is several different economies at different stages of development"

The most common mistake in growth policy for successful developing economies

Find what the economy is good at good at and keep doing it too long

Nothing in high speed sustained growth is permanent



# Key features of Orderly Urbanization and Growth

Labor mobility

Movement in response to economic and employment opportunity

Push versus pull

The Latin American problem

Factors that can retard urbanization

Imperfect markets in property leading to inefficient land use decisions - within the urban area and at the urban-rural boundary

Unsustainable public finance at the city level

Absence of organized and enforced zoning

Absence of affordable housing options

Lack of affordable transportation and mobility

Absence of basic service availability

Environmental quality, congestion and negative externalities

# Facilitating Policies and Reforms

To be discussed in great detail in the sessions this afternoon with experts

1. Clear property ownership so that land prices give accurate signals about land use (within urban and rural areas and at the boundaries)
2. A sharp distinction between the municipal balance sheets and income statements (with transparent reporting systems)  
Avoidance of funding expenses through asset sales for sustainability reasons
3. Creation over time of municipal financial markets and instruments
4. Shifting municipal incentive structures to orient them to attracting economic activity and delivering services to residents
5. Educational preparation of rural residents for employment in emerging urban sectors.
6. Enhancement of the aesthetic and cultural life of cities