PROJECT SYNDICATE
AN ASSOCIATION OF NEWSPAPERS AROUND THE WORLD

The "New Normal" for Growth

by Kenneth Rogoff

Cambridge – Markets are bubbling over signs of "green shoots" in the global economy. An increasing number of investors see a strong rebound coming, first in China, then in the United States, and then in Europe and the rest of the world. Even the horrible growth numbers of the last couple quarters don't seem to discourage this optimistic thinking. The deeper the plunge, the stronger the rebound, some analysts say.

Perhaps these optimists are right. But how strong an expansion can one reasonably expect when the worst is finally over? Is the "new normal" going to be the same as the "old normal" of the boom years from 2002 to 2007?

I have trouble seeing how the US and China, the main engines of global growth for two decades, can avoid settling on a notably lower average growth rate than they enjoyed before the crisis.

Let's start with the US, the epicenter of the financial crisis, and still the most important economy in the world. In the best of worlds, the US financial sector will emerge from the crisis smaller and more heavily regulated. Not to worry, some economists, say. The US grew rapidly in the 1950's and 1960's with a relatively heavily regulated banking system. Why not again?

Sure, but the early post-war financial sector wasn't called upon in those days to support nearly as diverse and sophisticated an economy as it is today. If authorities set the clock back several decades on banking regulation, can we be so sure they will not also set the clock back on income?

US consumption, the single biggest driver of global growth, is surely headed to a lower level, on the back of weak housing prices, rising unemployment, and falling pension wealth. During the boom, US consumption rose to more than 70% of GDP. In the wake of the crisis, it could fall down towards 60%.

And what about the major political shift the US has experienced? Tired of go-go growth, voters now look for more attention to addressing environmental concerns, health-care issues, and income inequality. But achieving these laudable goals will be expensive, coming on top of the giant budget deficits the US is running to counter the financial crisis. Higher taxes and greater regulation cannot be good for growth.

True, there is room to run the government more efficiently, especially in the areas of education and health care. But will these savings be enough to offset the burden of a significantly larger overall government? I hope so, and certainly the Obama administration is a breath of fresh air after the stunning ineptness of the Bush-Cheney years. But governments all over the world are always convinced that their expansions can be substantially financed by efficiency gains, and that dream usually proves chimerical.

Chinese growth is set to slow over the longer run, as well. Even before the financial crisis, it was clear that China could not continue indefinitely on its growth trajectory of 10% or more. Environmental and water problems were mounting. It was becoming increasingly clear that as China continued to grow faster than almost anyone else, the rest of the world's import capacity (and tolerance) could not keep up with China's export machine. China was becoming too big.

With the financial crisis, the Chinese economy's necessary adjustment towards more domestic consumption has become far more urgent. True, even as exports have collapsed, the government has managed to prop up growth with a huge spending and credit expansion. But, while necessary, this strategy threatens to upset the

delicate balance between private- and public-sector expansion that has underpinned China's expansion so far. The growing role of the government, and the shrinking role of the private sector, almost surely portends slower growth later this decade.

Europe, too, faces challenges, and not just from the fact that it now has the worst downturn of the world's major economic regions, with Germany's government warning of a surreal 6% decline in GDP for 2009. The ongoing financial crisis will almost surely slow the integration of the accession countries in Central and Eastern Europe, whose young populations are the single most dynamic source of growth in Europe today.

Not all regions will necessarily have slower economic expansion in the decade ahead. Assuming continuing reforms in countries such as Brazil, India, South Africa, and Russia, emerging markets could well fill some of the growth gap left by the largest economies. But, in all likelihood, after years of steadily revising up its estimates of trend global growth, the International Monetary Fund will start revising them down.

Even after the crisis, global growth is almost certain to remain lower than the pre-crisis boom years for some time to come. This change may be good for the environment, for income equality, and for stability. Governments are right to worry about the quality of growth, not just its speed. But when it comes to tax and profit estimates, investors and politicians need to reorient themselves to the "new normal" – lower average growth.

Kenneth Rogoff is Professor of Economics and Public Policy at Harvard University, and was formerly chief economist at the IMF.

Copyright: Project Syndicate, 2009.
www.project-syndicate.org