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Y. Lissovolik:

Colleagues, I suggest we start our panel discussion. Good morning, everybody. My name is Yaroslav Lissovolik and it is my pleasure to welcome all of you to the economists' roundtable here at the St. Petersburg International Economic Forum. Today's topic of discussion is global growth, or rather lack thereof. During this discussion, we will discuss the reasons for the economic slowdown and what can be done in order to deal with this situation. I think if there is one issue that all economists today can agree upon, it is precisely that global growth is not faring too well, and essentially in every major region that you look at today, there are notable headwinds to growth. Virtually all of the major international organizations are sounding alarm bells regarding the tremendous challenges that global growth is experiencing today. Probably we could call them unprecedented challenges. The Global Trade Alert is sounding alarm bells about record-high levels of protectionism, the IMF and the OECD are writing about record-high levels of income inequality. The OECD is also writing about record-low levels of growth in productivity, so clearly, when you look at all of these factors taken together, it is probably a small wonder that global growth is not doing too well. But are these the only factors out there that are accounting for slow growth rates, or is there something else? Today, we have a great panel to discuss these issues. We have a great mix of decision makers, representatives of the financial markets, and probably some of the foremost economists from academia who will shed some light on a lot of these issues, but we would also like to ask the audience, to hear your views on what the outlook for the global economy is in the next five years. So in the beginning of this panel discussion, we ask you three questions that we would like you to answer in the next minute or so. The first question is what is your expectation for global growth in the next five years? Is it lower growth rates than in the past five years, more or less the same, or actually an acceleration in global growth rates? Then the second question that we would like you to answer

is on the growth outlook for Russia, essentially along the same lines, and this is basically about whether Russia's growth is going to be less than 2%, between 2% and 4% or more than 4%. Another question is about the next driver of global growth. What is going to be the main region that is going to be the best-performing region or the region accounting for the main growth impulse in the global economy in the next five years? So these are the three questions that we would like you to answer. While you are voting, I would also mention that we directed several questions to our panel participants, and we will reveal the answers to these questions a bit later on during our discussion, but in terms of the questions, the way we would like to approach this issue is in a thoroughly Russian spirit and Russian way: Basically, through the prism of two key themes, two issues. First, what is to blame? Who is to blame for the global economic slowdown? And then, obviously, in terms of how Russian literature poses these questions: What is to be done to deal with the global economic slowdown? Now we will start with the first question, who is to blame or what is to blame for the global economic slowdown? In terms of the responses from our panel, what I can say is that there were the usual suspects like infrastructure underdevelopment, lack of productivity growth, and demographics was mentioned by our respondents as a problem; but interestingly, there was one response, so-called 'residual other factors' referred to by our panel speakers, that accounted for the bulk of the response. So without keeping you in suspense for too long in terms of what this mysterious residual factor is, I will tell you that the residual is debt. According to our respondents, one of the very important factors accounting for the global economic slowdown is the debt problem. To discuss this culprit behind the global economic slowdown, I would like to first turn to Kenneth Rogoff, Professor of Public Policy at Harvard University. Dr. Rogoff, in the beginning of this year you published a paper where you explored all of the factors accounting for the global economic slowdown, and one of the factors that you singled out was private-sector deleveraging as one of the things that could facilitate the

attainment of higher growth rates. My question is, what role do you see for this factor, not just in advanced economies, but also in emerging markets, including in countries such as Russia where we have seen significant deleveraging in the course of the last year?

K. Rogoff:

Thank you very much, and thanks for the opportunity to speak on this panel. I have to say, Yaroslav, when you said that you were going to have questions in the spirit of the Russian tradition, I thought you were going to talk about the saying that goes something like, "I don't mind being miserable if my neighbour is more miserable." I think in the United States our growth is slow, but in Europe it is slower, and in Russia you are in recession, but at least you are not Greece. Certainly, I want to first say that in terms of measuring productivity, in terms of talking about the global slowdown, we need to have some humility about the numbers. Gross national product is an artificial construct that was created in the 1930s to try to measure output, and there are a lot of assumptions. We do not measure what we call "real growth", in other words price-adjusted growth, without figuring out what prices are. And as this is a period of great innovation, it is very difficult to tell. My guess is that true growth is somewhat faster than measured growth, because of things like social networking, the value of the cell phone. My daughter can speak to her grandmother face-to-face on Skype or another program for nothing. How would you have valued that 25 years ago? And medical care. Yes, the price has gone up, but the quality has gone up enormously with new drugs and new medicines. I think a lot of economists who work on this think this. This has always been a problem, but I think during what I perceive as a period of very fast innovation, it is a greater problem. And finally, as I work a lot on historical statistics, you would be surprised at how often economic historians completely re-evaluate a period, asking, you know, was the United Kingdom in recession? Was it actually growing? And they will actually go

back and forth, saying it was -2%, no, +2%, and then they come up with a new revision and say no, it is -3%. You can see these examples. So when you are talking about relatively small changes, particularly when you are talking about productivity numbers, I think it is hard to say. I would lastly say that we are in a period of economic restructuring, and it is again hard to tell in a period of restructuring what is going on. I have had a long-running debate with my colleague and my friend, Lawrence Summers, who says that we are in a period of secular stagnation. I guess the terminology will be familiar here. It is just that we are going to grow very slowly for a long time. And I think this is a fundamental misreading of what is going on in the global economy. Yes, people are aging. Yes, we have problems with the environment. Yes, there are problems with inequality, but I think that much of what we are seeing, the acute problems we are feeling, is debt. We have gone through what I would call a debt supercycle that started in the United States. Things were better than they seemed, because there was a lot of credit. The credit collapsed and then they seemed worse than they are. Europe came later, and is still in the middle of it. The emerging markets are starting to experience it now. There was a rush of money into the emerging markets and there is the risk that it might rush out. We could go into detail, but I do not claim that that is everything. I do not claim that demographics and other things are not important, but I think we are in this cloud that makes it very hard to tell. There definitely is a debt problem. Everything, looking at other debt supercycles, looks very familiar, quantitatively and qualitatively, so I tend to think that we may grow much faster in the future, we may grow much slower in the future, I do not know. But what we are feeling at the moment is this debt overhang problem.

Y. Lissovolik:

If debt is indeed such a significant problem for global growth, do you see that being a resultant part of rules being undermined and policy getting more

discretionary globally? Debt is clearly a growing problem in a lot of regions. Take, for example, Europe, the eurozone, and some of the departure from the Maastricht criteria or some of the benchmarks that were set there. Do you sense that this could be one of the factors accounting for the severity of the debt problem today?

K. Rogoff:

I think it is normal human nature, and you see it in many societies and in many periods when things are going well, that you start to relax your regulations, you start to relax your concerns as an investor. Then there is a collapse and then you get too scared. I think people right now are actually too scared of risk. Regulation, perhaps, is overshot. It is actually very hard for small and medium-sized businesses to borrow money in Europe and the United States. Some of this is necessary regulation, but I think also some of it is misplaced. So, yes, there are many problems with policy. The title of my book with Carmen Reinhart is *This Time Is Different*. It is supposed to be ironic, because every time in the middle of the boom people think it is going to be fine, and every time afterwards they think it is going to get better than they think it should, but human nature does not change.

Y. Lissovolik:

Thank you very much, Dr. Rogoff. Now I would like to turn to a policymaker working on the monetary front, to Ms. Yudaeva, and ask your opinion about this debt issue. How do you perceive the impact of debt on growth, and is it related to global imbalances, which is also widely seen as a very significant problem for global growth? How do you see this interaction and the impact of global imbalances today on growth?

Y. Yudaeva:

Well, thank you very much for this question. Actually, answering it is a problem, and I am thinking that Ken will say the same thing about global growth. There are actually many definitions of global imbalances. There are trade imbalances, but actually trade imbalances globally are going down. I recently looked at this America–China deficit–surplus problem, they are down quite significantly. Actually, it is interesting, because the exchange rate between these two countries was roughly fixed, but otherwise the dollar was not that cheap over the time the deficit has gone down. It raises a significant problem which is partially probably the other side of the trade problem as well. I would like to mention the third definition of global imbalances, some kind of structural definition, rather than our original, statistical definition, which is the theory of Ricardo Caballero that we have a deficit of riskless assets in the global economy, which has been growing in the last 20 years. We have lots of savers from our emerging markets entering the global markets. All of them are looking for some kind of riskless asset, and we do not have that many on the market. It used to be treasury bills, then financial engineers constructed mortgage-based securities, which in the end turned out to be not that safe. Now there is a surge for something else. Speaking of monetary policy, actually, recently I heard that Ricardo came up with a new theory that this deficit has significant consequences for monetary policy. For instance, you have better QE or not so good QE. QE which increases this deficit is not necessarily that good for growth, QE which decreases it is better for growth. This has implications for Russia as well, because Russia has a very small government deficit and this is definitely the most riskless asset for Russia, as actually Russia has that overhang in some other sectors. When we speak about monetary policy, we have this big debate in the Bank of Russia about how we should defend our risks. On the other hand, in our monetary policy, like the fact that we accept a wide range of collateral, not only government debt and some bond markets, means that we actually release some of the better quality

collateral for the market and allow the market to work for that. I think this theory has significant implications for that, and it definitely has some implications for fiscal policy I think, but that is different. It is a completely different question. You actually asked me originally to speak about whether there is some kind of global solution in terms of policy coordination, more than inter-policy coordination. Everybody speaks about monetary policy coordination. I think that the real monetary policy coordination we had in 1985, the Plaza Accord, worked, but I guess not everybody was satisfied. So right now, I think that we have much more talk about monetary policy coordination than real coordination. On the other hand, in terms of pure monetary policy, monetary policy as a policy which has price stability as a goal, at the end of the day we have some coordination, very basic, because now more and more countries are following an inflation targeting framework with very similar inflation targets. So at the end of the day, this is the coordination in monetary policy in terms of having the same nominal benchmarks. To some extent, it may prevent things like competitive depreciations and so on. You may say that it is not fully prevented, but it definitely is a similar structure. There is a need for policy coordination or for some policy action, I would say, in the area of financial stability, because partially due to this global imbalances problem, we have a very volatile world, an imbalanced world. We have bold businesses and consumers in a country like Russia going for global safe assets every time they felt risks were growing. Countries are working on two markets, basically: the national currency market and some global reserve currency markets. We need, at some point in time, a lender of last resort in foreign currencies on domestic markets and, well, the national central banks increasingly have to take this role and, if you like, this obsession about reserves is coming out from that. You may try to solve this problem a little bit through a global safety net. This global safety net is not fully there. The IMF is a provider of resources, which works well in a crisis, but it has a stigma historically attached to it for other reasons, so countries are reluctant to go to the IMF for these

purposes. The United States has this swap programme which is very, well, unstructured. It is unclear who can get this swap, and who cannot, it is a decision of the Fed. There are no rules to how it can be granted, so it is not really a safety net either. I think that in terms of coordination, when we talk about financial stability, maybe we do not need so much to coordinate policy per se. Maybe what we have right now is openness and communication, and similar goals are the right solution. But we definitely need the safety net for financial stability purposes and it is not yet there. Thank you.

Y. Lissovlik:

Thank you very much, Ms. Yudaeva. Now I would like to turn to a representative from the financial market trenches, Mr. Neil MacKinnon, Global Macro Strategist for VTB Capital, to ask about your view on this whole debate about secular stagnation, that supercycle, and what role for monetary policy do you see in terms of improving the growth process for the global economy?

N. MacKinnon:

Thanks, Yaroslav. I think that the shadow of the global financial crisis still overhangs the global economy, certainly the advanced economies, and we know that seven or eight years on from that crisis, economic growth in the advanced economies has been subpar, unemployment in most cases, especially in the eurozone, has been high and until very, very recently, there was lots of concern of deflationary risks, which seem to have dissipated only just a little bit. Over that period, we have also seen the introduction of quite remarkable, unconventional monetary policies, whether it is zero-rate policies, or in Europe, negative-rate policies showing that we are not constrained by the zero-nominal bound on interest rates. We have also seen quantitative easing, QE, programmes in which the major central banks have expanded their balance sheets quite considerably, to about 30% of GDP on average, although in Japan that is nearer 80% as it is in

Switzerland. I think that the point that Ken made about the quality of GDP statistics is an interesting one, because of the accommodative monetary policies that we have had now for some time. It is interesting that so far this year, 52 central banks have cut interest rates, Russia earlier this week, Norway just yesterday, and the Federal Reserve has kept US interest rates flat or cut interest rates for 80% of the time since 1987. Those of us in the financial markets have been used to the Fed and other major central banks effectively backstopping financial markets, which has created this imbalance between asset valuations, equity market valuations, and what is going on in the real economy. There has been a disconnect. I think that as of now, this GDP issue is interesting, because ultra-easy monetary policies may start to become the problem themselves. I think we all acknowledge that in the first instance in the crisis, the Fed and the US Treasury were right to implement the policies that were required to stabilize the system. But it is hard to agree now that an emergency monetary policy for an emergency situation still applies. The US economy is not in a depression, the UK economy is not in a depression. Bits of the eurozone may be in a depression, as we are seeing in the current debt discussions in Greece, and of course debt is just not confined to the advanced economies. China has an incredible debt problem and an explosion in credit that has created a bubble in the property market and in their equity market. However, I think the issue of financial stability is important, and it may well be that monetary policy should start to take this into consideration, because certainly in the US, equity market valuations are very stretched. The Fed acknowledge this. But there is a real danger that we just perpetuate the financial cycle, that the financial cycle actually becomes an albatross around our necks and that we are actually creating the seeds of the next recession, the next financial crisis, and yet the major central banks do not have the monetary ammunition to deal with that unless you are a believer in helicopter money and very, very unusual monetary policies that really take us into uncharted territory. So we need to be careful that we are not creating undue

volatility, something that Mario Draghi, the ECB President, warned us about earlier this year. There are a number of paradoxes with quantitative easing for it to work. We are told that bond yields should go down, but really the ultimate success of quantitative easing is that economies recover, that we have a little bit of nice inflation and bond yields go up. We also have a liquidity paradox that despite ample central bank liquidity, within the markets we have compressed liquidity that can create flash crashes. Ksenia mentioned the availability of safe assets. That is important, and that can create problems in relation to the availability of collateral in the repro markets, for example, which was the real problem at the time of the crisis. So there are a number of issues that I think are weighing on the global economy, and it may be that a continuation of ultra-easy policies might actually be creating future problems that might be more difficult for us to deal with.

Y. Lissovolik:

Thank you very much, Mr. MacKinnon, and now I would like to turn to another policy maker, this time from the Ministry of Finance. My question is the following: when we asked our panel participants several questions and one of them was on the reasons for the global economic slowdown, your response was the unsustainable structure or unstable structure of economic growth in the long term. Perhaps you could expand on that a bit.

M. Oreshkin:

Thank you, Yaroslav. You know my view that we should always go into details and look at what the growth is based on, because if you are not going into details and looking from the macro level, we will always be using past growth rates for future forecasts. We always need to look at two important things. The first one is of course basic level trends. For example, the key one in my opinion is in demography, which alone will shave roughly two decimal points from the growth

of developed countries and five decimal points from the growth of developing countries in the next five years. But it is also important to look into different cases to see what the structure of growth is, whether it will be sustainable or not looking into the future. For example, in the United States. For the past three years, we have an average growth here of 2.3%, but at the same time unemployment was declining rather fast, from 9% to 6%, so roughly 1% per year. We know full well that the US economy is gradually reaching a point at which a further decline in unemployment will be impossible, but at the same time forecasters continue to expect the acceleration of yearly growth. You know that the IMF sees growth as above 3%, and it is really strange to see that type of forecast. We have 2.3% growth for three years, each year, and at the same time, we are hearing about a decline in unemployment, and going forward we have a forecast in which unemployment is stable, but growth accelerates. For example, this year, the IMF initially had 3.6% for the US in terms of growth expectations. In two steps they are already at 2.5%. I believe that going forward, we will see more and more revisions. You mentioned the problem of income inequality, which is really a structural problem for growth in developed countries going forward, because you know in order to have sustainable growth, you need to have sustainable growth in the final demand and economy. But with wages for most of the groups of households not growing, it really is not sustainable. One would say that if unemployment eventually goes lower, we will see wage growth, but then the question arises of what will happen with the equity market in that case? Because as wages grow faster, with the same pace of GDP growth, growth in corporate profits will not be that strong, and thus the evaluations in the equity market should change. Of course, we always see what happens to the economy if we see high volatility on the financial markets. And of course there is China. In the aftermath of the crisis of 2008–2009, they chose the path of stimulating investment activity, which jumped from 40% to 50% of GDP. You know it is really hard to find enough projects with proper profitability when you have such a high

level of investment of GDP. Of course, gradually problems arise, because you invest more and more in those projects with really low or negative profitability. The big question that was already mentioned by Neil is about the chain of finances – this investment activity. The GDP for the Chinese economy has jumped 280% according to the latest estimates, which is above the US level. The total debt jumped in seven years from USD 7 trillion to USD 30 trillion, and we are already starting to see some problems here. We see the first bankruptcies in the real-estate market, we see the government trying to improve the situation with regional debt, we see growing NPOs in the traditional banking system. It is really unclear what is happening in the shadow banking system there. One would say that it is okay, investment growth will slow down, the situation will normalize and consumer demand will replace it, but to have strong and sustainable consumer growth, you need a base for it. Can there be a continuation of double-digit wage growth in China? It is really questionable, you know, because the level of wages there is already quite high, well above their peers, especially taking into account that the renminbi was behaving the same way as the US dollar and depreciated a lot in the past several years. Commodity countries: we have a new, much lower level of commodity prices. There are two ways to react to this situation. One can react like Russia did, fully adjust to the new external environment and start growing in the beginning with new equilibrium, or continue to spend reserves to finance the balance of payments and fiscal deficits. Some of the commodity countries continue to do so, and if the oil prices and other commodity prices remain where they are currently, what will happen with growth in those countries? It is a big question. The only country that has a positive view from this structural point is actually Russia. If you look at the years 2012–2013 and 2013–2014, growth in the nominal demand, in domestic demand, was already below potential because we have gradual improvement in the current account. Of course, last year there was significant external shock, but Russia adjusted, and now we are in a position with, for example, a really effective

exchange rate that is in line with the fundamentals, and we are in a position where there is a transfer of wealth from households to the corporate sector which will be stimulating investment activity going forward. So here, in my opinion, growth will be faster than in the previous five years.

Y. Lissovlik:

Thank you very much, Mr. Oreshkin. I think it is great to have at least some optimism regarding Russia's economic growth prospects. Later on in our discussion, we will review the responses from the audience and from the speakers that will shed some more light on what the outlook is. But now I would like to turn again to a representative from the financial markets, Mr. Jacob Frenkel, Chairman of JP Morgan Chase International, and my question to you is, which regions do you see as the main drivers of the global economy in the next five years? And are there models to be emulated out there that are successful, that could be used by Russia or by other emerging markets?

J. Frenkel:

Thank you. You mentioned the word global economy. The title of this session is about the global economy, and yet you are asking about regions, which suggests that the global economy is not monolithic. There are different regions, there are different circumstances, and yet each region impacts the rest of the world. One of the dangers is that countries which are in difficulty will try to separate themselves from the so-called global economy, and then we will really need to ask, what is the cost of protectionism and the like? So I take it as a premise that this hurdle is being crossed and that we do have a global economy, and that we have learned the lessons about the extraordinary damage that protectionism and illusory separation from the rest of the world can yield. The next question is, starting where Ken started, is it the end of growth? The answer is no. He already spoke about his opinion about secular stagnation, and I agree with Ken 100%. It is

enough to look at history. At each point in time, someone said that all the innovations were behind them, and before you turn around, a new innovation has come in, and in fact at an accelerated pace. So I am basically optimistic about the world, and what it means is that missing this boat is very, very costly, much more costly than what meets the eye. Where are we now? The IMF came out with their forecasts that the world economy is growing, at more than 3% per annum. In fact, there are different regions in the world, but still, there is a fundamental change in the centre of gravity of the world. In 1990, if you wanted to ask what is the world, or where is the world going, it was enough to look at three countries. The US, Japan and Europe gave you 60% of world output and this is all that you needed. Today, the very same three groups give you 37% of world output. Where did it all go? The centre of gravity moved to emerging markets, and within emerging markets, primarily to Asia. We have a representative from China, our good friend David Li. China and India together, in the year 1990, produced less than 7% of world output. Today, that is close to a quarter of world output. So in other words, the world economy has changed. Number two, as we look at the world economy, 2016, according to most forecasts, is going to be a world that is very different from 2009. The year 2009 was the depths of the crisis and our mindset was very influenced by it, and we started to think about the end of growth. The fact is that come 2016, the US will grow at 2% plus, Europe will grow at about 2% or 2.5%, even Japan will grow at 1.2%, China and India 7% and maybe more. So this is a moving world and there is no room for pessimism. The second question is, how do we benefit from all of this? The fact of the matter is that trade in the year 2009, the depth of the crisis, collapsed by 10%. Never in recorded history has trade collapsed so much. Since then, trade has recovered, and trade is growing, and that is the mechanism by which countries can benefit from each other if they allow this benefit to materialize. In the year 2000, only 5% of all European exports went to China. Today it is a quarter of European exports. In the year 2000, less than 5% of US

exports went to China. Today, it is the same story – about a quarter. The centre of gravity and the patterns of trade have changed. The business sector recognized the opportunity. While politicians are negotiating and thinking about China maybe as a threat, business sees China as an opportunity, and this is a very important mindset that we should have as we look down the road. Then the question is, if it is so good, why are we so worried? We are worried because of the fact that policies that were introduced as appropriate policy responses to a crisis are still in the system even though the crisis is behind us. Do you remember unconventional monetary policies? They were introduced as an emergency measure, as a detour, not as a new paradigm, but this was seven years ago. People said it reminds them of their mother-in-law who said she is coming for a visit for one week, but she stays for many years. The fact is, we are talking about how to normalize, but people say we are afraid to normalize. Why? Normalization is the norm, and we should really recognize that if the US is talking about removing the acceleration and the exaggerated monetary expansion, we should not worry about it. We should see this as an opportunity. Because this means that the Federal Reserve assesses that the system is sufficiently robust and that the boat is sufficiently steady. So my position is that I am much more optimistic about it, and it reminds me of Mark Twain's description of Mahler's music. It is much better than it sounds.

Y. Lissovolik:

Thank you very much, Mr. Frenkel. I think it is only natural that we now turn to China and to a discussion of the growth prospects in that very important region for the global economy. I will now give the floor to David Daokui Li, Director of the Center for China in the World Economy.

D. Li:

Thank you very much for including me in this very, very important and insightful session. Let me first make a quick point about why the global economy is slowing down in comparison with the situation before the global financial crisis. Let us not make it complicated: I think the simple reason is that the US and the UK, even though they may not be the leaders of economic growth, are the financial leaders of the world, let us make no mistake. The US dollar is still the leading international currency. The implication is very simple. So when the US and the UK were doing their QEs, they were very, very intelligent. I really give full credit to the US monetary policymakers and the UK monetary policymakers because while doing QEs, they were repairing their financial system. They were doing deleveraging as Ken described, or implied, so now they are okay. Now the US and the UK economies are going back to normal. I think 2.5% GDP growth is close to the US natural rate of growth. We can debate about details, one or two percentage points, but roughly speaking it is in the territory of their normal growth. So now the UK and the US are going back to their normal monetary policy. And here is the problem. When the US and UK were doing QE, we were having a party, at least in China, right? We were also expanding. We had wild and rapid GDP growth in 2009 and 2010. We forgot about doing our reforms, which China had been doing very effectively. And the rest of the world, frankly speaking, in the emerging markets, was also having a party. We were not doing enough, like the UK or the US, in restructuring, in deleveraging. So now they are going back to normal, now the monetary policy in the US is beginning to stabilize. We will feel the impact. That is the fundamental reason we are slowing down. Everybody is beginning to feel the pinch of the upcoming US monetary policy change, even in China. Now, back to China. What is going on in China? Well indeed, I fully agree, in China there is a tremendous expansion of credit after the financial crisis. That is the case, right, partly because of the US monetary policy expanding and China's monetary policy doing the same in order to match, because the US is the leader. Now China benefitted from this in the short run.

The current problem is leveraging, deleveraging, and the Chinese situation is quite different from many other countries. In China the national savings rate is very, very high, still close to 50%. It is amazingly high. In other words one half of every year's GDP is put aside as savings, both corporate and household. So given the high savings rate, which has inertia, which does not come down easily, I would argue that the leverage ratio of the Chinese economy should be much higher than other economies if we compare China with the US or with Japan. Even Japan should be higher. The current problem is the structure of the leverage is bad, with too much corporate debt, and not enough government debt. The central government debt is no more than 15% of GDP. So the issue is reform. The reform has to transform part of the corporate debt into government debt and then enlarge the maturity period of the debt. Currently much of the debt is meant to be invested in infrastructure, with two or three years of maturity. That is crazy. At 7% interest rates, with inflation being only 2%, this is a 5% real interest rate financing infrastructure investment by banks. That is crazy. So what China is doing now is to expand sovereign debt – Ministry of Finance debt. You start to swap out local government investment debt, which is also borrowed from commercial banks, and that is going up. So if this process can be done in the coming one or two years, then there is hope for China to go back to its proper higher pace of growth, in my mind 7.5%, in the next five years. The next decade. Because China is only 20% in terms of per capita income of the US. Russia is about 40%.

Y. Lissovlik:

It is still a significant deceleration from the past five to ten years.

D. Li:

Correct. The figure of 7.5% is not bad. People are much more pessimistic oftentimes arguing that 6% is the future rate of growth. There are three areas of

new engines of growth in China if the adjustments, if the reforms, are properly done. The first area is steel infrastructure investment, because the country is still very much experiencing a shortage of infrastructure, so there financing is key. The second area of growth is what I call reindustrialization, because much of Chinese industrial output or capacity is polluting, or is very bad in terms of energy efficiency, and if there is a new round of replacing the production capacity, that will be a huge push for GDP growth. The third area is consumption, because wage rates are increasing, disposable income of households is increasing as a share of GDP, finally, after 20 years, so consumption as a share of GDP is going up. Right now it is 45%, and in three or four years it should be at around 50%. That is my analysis.

Y. Lissovlik:

Thank you very much, Mr. Li. Just as China is important for the global growth outlook, the banking sector is very important from a cross-sectoral point of view. So now I would like to turn to Ms. Ekaterina Trofimova, First Vice President and Member of the Management Board of Gazprombank, to ask her about the regulation of the financial sector, of the banking sector, and the degree to which this may be affecting the performance of global growth today.

E. Trofimova:

Thank you very much, and just to start with, to continue spreading a positive attitude, I think the banking system globally is warming up, which is a good sign. You are so correct to talk and to ask about banking regulation, especially in the context of the global original growth, because the banking system, the banking sector, is an important transmission mechanism for any process which is going on. This is the blood system. If it does not function, everything stops. Especially if you put it in the context of Russia, the big difference about the sensitivity of the banking industry this time around, compared to even the previous shock of

2008–2009, is that the banking system is bigger, and I would really appreciate the recognition which is given to this factor by the government. In the past few years, it has been very much always from the government agenda. Interestingly, the banking regulation fashion – and I would really stress this word ‘fashion’, because there are fashions for regulation as well – has been changing. If you all remember, it was once fashionable to talk about deregulation. I used to work in a ratings agency and we always praised the banking systems and the countries which developed deregulation. It was considered to be a good sign. Now this is different. At the beginning of this global crisis, it was fashionable to talk about contracyclical regulation, which has never been implemented; it is procyclical. And I think we are in a very contradictory situation right now, with quantitative easing on the one hand and with toughening regulation of the banking industry on the other. This obviously reduces the effectiveness of this quantitative easing and very much contributes to this defragmentation or fragmentation of the liquidity available and very much contributes to this boom and ballooning of the stock markets and to this squeezing out of operations and businesses into unregulated areas, which everybody has recognized to be one of the growing risks globally, not only in developed but also in emerging markets. That is why this area is extremely sensitive, and I think there is not so much recognition of how much impact it has on both sides of the equation. It is always that we need more efficient dialogue between the banking community – this unregulated community – the customers, and the government. Obviously in these very unstable years of the ongoing crisis, there is public demand for regulating banks more, but I think the balance is not there, because the extent of regulation is obviously excessive. I think, again contributing to this fragmentation and regionalization, the response is very different country by country. In Russia I think the contact and dialogue we have with the regulators, if I have the right to speak from the banking community’s side, is quite efficient, and we would like to see more visibility of whether we are going to find this fashion to be more stable.

Y. Lissovolik:

Thank you very much, Ms. Trofimova. Now I would like to explore another dimension in our debate on global growth, which is human capital. In their latest reports, the IMF alluded to lack of growth in human capital as one of the important sources of deceleration, overall and in terms of productivity as well. So I would like to turn to a representative of a major educational institution in Russia, to Mr. Vladimir Mau, Rector of the Russian Presidential Academy of National Economy and Public Administration, and ask his view on the role of human capital in global economic performance. Could it be the case that there was significant underinvestment into human capital that resulted in the slowdown?

V. Mau:

Thank you very much. The simplest answer and the shortest answer is that the role of human capital is extremely important. As the director of the university I have to say that we are underfinanced. We need more money. So I could put a full stop here, but let me not as a director, but as an economist, deliberate a bit on this issue. First of all, economic growth is definitely a conundrum. The origins of modern economic growth are a conundrum. We do not know why it started 300 years ago, and the next question is, we do not know if it is forever or not, because for the longest part of human history, modern economic growth did not exist, and it is quite a unique phenomenon. From the point that it started somewhere in England or Scotland 300 years ago, we do not know if it will last forever or for the time being. This may be one of the most interesting questions in our discussion and that is why the very phrase 'secular stagnation' sounds ominous, because if secular is for the next few years, it is fine, but if it is forever, it is an important question. Hopefully it is not forever, at least during our lifetime. Definitely it is an intellectual problem. But for Russia, the situation in some cases may be more difficult, but in some cases more simple, because for Russia it is not an intellectual problem. For Russia, the challenge of economic growth is

partly psychological and mostly structural. Why psychological? Do you remember that two years ago there was a debate in the Russian government when economic forecasts held that there would be 2% growth in the foreseeable future? The reaction was, why 2%? We need 5%, and only 5% would do. Now we are so happy that the forecast was -5% and now it is -2%. We listen and see all these events here and we see that we do not have a crisis: it is only -2%, it is not -5%, and that is great. So the first problem to be overcome is definitely psychological. The second problem is structural, and it is of course more difficult, and it is of course not secular stagnation, but it is demographic. Russia has a negative demographic trend whatever happens. Of course, we have had some positive signs in the last couple of years, but again we do understand that it is not forever. And another conundrum related to economic growth is whether modern economic growth could exist with a diminishing population. It is quite strange. It has never happened. We do not know how it works, and one of the challenges we have to respond to is what are the demographic sources of economic growth, how to compensate for a diminishing population, which is a phenomenon of many developed countries. One of the problems of Russian development is that in some dimensions, say in the demographic dimension, it is a developed country, while in terms of productivity, it is a developing country. This is one of the internal contradictions of this performance. The second part of this question is the diminishing quality of human capital. When this demographic crisis started about 20 or 25 years ago, the main response was that we would be the Canada of the 21st century. We would compensate for the diminishing of the population with migration. But we see now, and this is the result of our last 20 years of development, that this is the negative quality of migration. Russia is in a very strange situation in which those who live in countries that are poorer and less developed than Russia want to come to Russia, and those who are rich and smart are going to leave the country. When I say leave the country, I mean not only physical immigration. If people go to get medical treatment abroad and to

universities abroad, it means they are abroad. They provide effective demand for education and medicine in other countries and this is more important than their physical presence and even whether they pay taxes, whatever Maksim Oreshkin would say from the Ministry of Finance perspective. And this is one of the key problems, one of the key structural impediments on economic growth in this country. Quality is not finance. I do like when government pays more for education and health, but again, quality does not just mean give us or them more money. It is something more important related to general patterns of policy, of law enforcement, of safety regulations in the country. Another problem is the structure of budgetary spending. For the last 25 years, we have discussed it a lot. You know, in an American book I read, there was a character who was an economic adviser for many American presidents. He was asked whether it was difficult to be an adviser to an American president, and he said it was very simple. You have to repeat one mantra. "Keep budget balanced", and that is enough. This is what we were doing for the last 25 years, but now we have to say that the structure of budgetary spending is not less important than a balanced budget, because when you have a balanced budget with a deterioration of structure, with a diminishing rate or share of human capital and infrastructure, it will destroy your system. Even if your budget is balanced. This is not a requirement to increase the budget deficit or borrowing, but this is a real problem, a real and serious problem, and that is why the structure of the budget manoeuvre is very, very important. Of course the last point that I want to stress is the necessity to stimulate domestic migration. Russia is territorially a big country and one of its sources to overcome stagnation, also related to human capital, is not only the development of human capital industries, which is very important, but also the concentration of a diminishing labour force and the points and the territories of economic growth. Stimulation of domestic migration is another important source for overcoming the current stagnant situation in our economy. Thank you.

Y. Lissovolik:

Thank you very much, Mr. Mau. I think this point on the quality of economic policy we can certainly discuss further. I will invite Mr. Nekipelov, the Director of the Moscow School of Economics of the Lomonosov Moscow State University, to expound a bit further on this issue, in particular from the angle of what I see as a bit of a trend, a bit of an infatuation, especially in the emerging markets, with industrial policy, with policies that at times favour the weaker currency to prop up competitiveness. What is your view on industrial policy, and where should it be headed in your view?

A. Nekipelov:

Thank you very much, Yaroslav. You know that for a long time I have been a proponent of an active industrial policy in Russia. This is not because I do not like the market, but because I believed that after the structural shock we suffered during the transition, this was the only way to keep Russia, or to try to keep it, among the developed countries. You know, we began by saying that the best industrial policy is no industrial policy. Now a lot of things are being done in this area. I am not going to discuss it, because it is a huge area. Of course, we can criticize what is being done, we can say that it is not complex enough, we can criticize it from another angle that it is excessive, but practically everybody understands now that it is needed to this or that extent. Then as far as the impulsive situation is concerned, of course to my understanding at least, it cannot just be a target of a policy for normal times, because we are not living in normal times, at least in Russia, and this is the reaction. Nobody put forward this target before. Even when we were discussing how industrial policies should be implemented, we never had it in mind to separate ourselves from the world market, from globalization processes and so on. We were speaking about the necessity to modernize the economy. Well, actually, we have not been very successful in this respect, but at least this was the idea. But this is what I would

like to say in broader terms. There are excellent, brilliant analyses of what is going on in the global economy and we have heard a lot today at this roundtable discussion as well, but what seems very important to me, and probably I will say something very primitive and abstract, but I think it is essential: We sometimes discuss things as though we are living in a perfect world, a perfect market world, and there are some strange people who do not understand this and they try to somehow worsen the themes. They introduce unnecessary regulation, they impose barriers for business and so on and so forth. But should we not think about why it is happening? Why is it happening? Well, my answer, very abstract and primitive, is that we are not living in a world of economic people as in Adam Smith. All of us have much broader feelings, much broader needs. Therefore governments are not something foreign to the economy. They are very important actors in economic processes, and not only in Russia, but everywhere. The sanctions are a good example. So I think the situation is that of course we can go on talking about how the market is good and what is to be done according to mainstream understanding, but this comes into conflict with what is going on in practice.

Y. Lissovolik:

Absolutely. Okay. Thank you very much indeed. The last speaker today is Mr. Anatole Kaletsky who is Chairman of the Institute for New Economic Thinking. My question to him is about his book that he wrote on the capitalist system, called *Capitalism 4.0: The Birth of a New Economy in the Aftermath of Crisis*. You suggest there, and I quote, that "Capitalism is not a set of static institutions, but an evolutionary system that reinvents and reinvigorates itself through crisis.. So my simple question is, after that crisis that we had in 2008, has capitalism reinvigorated itself?

A. Kaletsky:

Yes, and my simple answer is not yet, but it is in that process. Like Ken Rogoff, I think that history has a lot to teach us, not that it repeats itself, but that we can observe certain patterns which tell us something about the present. Ken's book was called *This Time Is Different*. What struck me in 2008–2009 as I was preparing to write that book is that, “this time is different”, is a phrase you hear not only at the top of booms, which is what he describes, but it is also what you hear at the bottom of a slump. At the bottom of every severe slump, I think as Jacob Frenkel was saying, people think this is never going to end, but actually it always does end. So what we can observe is that capitalism is very prone to crises, but there are two types of crises. One is a normal cyclical fluctuation, if you like – a crisis in capitalism. The other is a crisis of the system – a crisis of capitalism. We are sitting here, after all, in Russia, and many of you learnt all about crises of capitalism when you were young. It struck me that looking back over the history as Professor Mau said of 200 or 300 years of capitalism, I think there have been four systemic crises of which this is the fourth, which is why I called the book *Capitalism 4.0*. The first one was 1848–1862 when Marx wrote the Communist Manifesto. The second was 1914 or 1917 to 1932, ultimately the great depression in America. The third one was the great inflation of 1969–1980, and I think over the past ten years, we have observed the fourth great crisis of capitalism. Each of these have punctuated a transformation of the global capitalist system whereby it still remained the capitalist system, it was still based on private property, on contractual relations and so on, but the way it operated was fundamentally different. I think in each of these four phases the key difference was actually, and here I agree with Mr. Nekipelov, the relationship between the market and the government, between economic forces and political forces. Now in the first phase, classical capitalism if you like, the market and the government were completely separate. That was basically what Adam Smith and Ricardo were talking about. What happened from 1914 to 1932 is that that

system broke down, and you had a second phase where actually the government became dominant. People no longer trusted markets and they thought that governments were always right. Then what happened from 1969 to 1982 is we discovered that governments were often wrong, and we learnt a faith in markets, and that was the third phase, if you like, market fundamentalism, when people believed that the government was always the problem and the market was the solution. So what is this fourth phase? I think the fourth phase, and this may sound rather pessimistic but it is not. You know, in the 1950s and 1960s we thought that the government was always right and the market was wrong, then in the 1980s and 1990s, we thought the market was always right and the government was always wrong. What we discovered in the last crisis is that the government and the market can both be catastrophically wrong. Now that sounds very depressing, but actually it is quite empowering, because what it suggests is that you need a new system of checks and balances between government and market forces which is capable both of improving the functioning of the private sector and of disciplining the functions of government. I think the consequences of this are beginning to emerge. I will just list them very briefly. In macroeconomic policy, we are seeing a convergence of monetary and fiscal policy and a shift from pure, if you like, market fundamentalist inflation targeting to unemployment or GDP targeting, a little bit back to the Keynesian policies of the past. In microeconomic policy, we are seeing a recognition that financial regulation is necessary, but also has to be limited, that industrial policy has a role in infrastructure, in energy development, in healthcare. The pure theory of free trade: in a country like Russia, what does Ricardian comparative advantage mean? It means the resource curse, because the comparative advantage of Russia is natural resources, so we have that. And in politics, we have a recognition that Western-style democracy is not the only route to economic development.

Y. Lissovolik:

Thank you, thank you very much, Mr. Kaletsky. Unfortunately, we only have time to review the answers from the public in terms of what the views are, and it seems like on global growth, the majority believe that we are going to see similar rates of growth compared to what we have seen before. In terms of Russia, again, the view is that we are going to be pretty much along the lines of what we have seen as the average growth rate of the past five to ten years. More than half believe that Russia's growth is going to be 2–4%. For the third question, BRICS seems to be the most dynamic region according to the audience in the next five years, which is a bit of difference compared to the responses from the panel participants. So if I may ask to show the relevant answers from our participants here, you can see something that is very similar to what we have seen in the responses from the audience. Then in terms of the growth in China, our panel believes we are in for a slowdown, so we are not talking about double-digit growth rates in the next five years. In terms of Russia over the next five years we have something very similar to the responses from the audience: 2–4% is most likely. And as for the reasons for the slowdown, you can see this residual factor that we talked about, debt, which seems to be one of the more popular responses accounting for the global slowdown. What is the most problematic region for global economic growth in the next five years? The eurozone, say more than 50%, not surprising; but very interestingly, more than 40% say Asia. And then the next one, what should be done to deal with the economic growth slowdown? Structural policy, structural reforms related to the labour market, and trade liberalization are singled out as very important. And then the final question: which region will be the main driver? And very interestingly, according to the panel, rather than the BRICS, it is the US, while the BRICS and APEC have also garnered quite a lot of votes, but generally the picture seems to be that in terms of risk vis-à-vis the US, there is not a lot that is seen by our panel, but in terms of the growth possibilities, APEC, BRICS and the US seem to be the main driving

forces out there. In terms of a conclusion, I think the one very important point of the discussion is quantity versus quality. It matters not just how high growth is, but also the quality of this growth, as was mentioned by Mr. Shuvalov yesterday by the way, and productivity. Productivity is the key factor that needs to be addressed to boost growth rates and the global economy in the coming years. That follows from the responses of the panel. I think this was a very productive panel. In a little over one hour, we solved the world's growth problems, so thank you very much to our panel participants, to all of our audience for your participation, and I wish you all a very productive remainder of this Forum. Thank you very much.