A SLOW TR

**ECONOMIST BART VAN ARK SEES GLOBA
JUST NOT AS FAST AS ANYONE WANTS.**

"THE GROWTH PERFORMANCE IN MATURE ECONOMIES WILL IMPROVE IN 2014, BUT THAT DOESN'T MEAN WE'RE OUT OF THE WOODS YET." AFTER A DISAPPOINTING 2013, HAMPERED BY CORPORATE HESITANCY AND POLITICAL PARALYSIS, THE GLOBAL ECONOMY COULD USE CLEAR DIRECTION AND STABILITY, BUT THAT'S NOT HAPPENING. YET THINGS WILL LOOK SOMEWHAT BRIGHTER IN THE MATURE ECONOMIES, ESPECIALLY IN THE UNITED STATES, PROJECTS BART VAN ARK, CHIEF ECONOMIST OF THE CONFERENCE BOARD. IT'S THE REST OF THE WORLD—THOSE COUNTRIES WHOSE RAPID GROWTH HAS DRIVEN THE GLOBAL ECONOMY—THAT ARE LOOKING A LITTLE SHAKY GOING FORWARD. "IN THE EMERGING MARKETS, PARTICULARLY IN CHINA, WE'LL SEE A LOT MORE VOLATILITY," VAN ARK SAYS. "AND YOU NEED TO PREPARE FOR THAT VOLATILITY."

For 2014, The Conference Board projects global growth improving to 3.5 percent, with the Euro area moving into positive territory and the U.S. economy picking up from 1.9 percent to nearly 3 percent. As China's transition continues, its growth will likely slow, to a still-hot 7 percent; India is seen as staying stable, growing slightly faster at 4.4 percent; Latin American countries will pick up a little, from 2.4 to 2.7 percent.

With economies facing a wide range of obstacles, and plenty of political and social turmoil, the key to long-term recovery is strengthening growth drivers; this demands that business and government join forces to better direct public and R&D investment and goose productivity. Granted, after witnessing the last year's self-inflicted wounds in Europe (austerity) and the United States (government shutdown), skepticism is practically mandatory. But van Ark is confident about long-run prospects: "Ultimately, the economy will

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ANSITION

L GROWTH PICKING UP SPEED—

BY MATTHEW BUDMAN

pick up, but the question is when, how, and where."

In the couple of months since van Ark's original 2014 forecast, The Conference Board has pulled back a little on expectations for the U.S. economy, seeing some weakness based on unfavorable weather—both the record heat in the West and the record cold in the East. In addition, we're seeing more volatility than anticipated in several emerging markets, particularly in Latin and South America, mainly due to the effects of monetary tightening.

FOR FIVE YEARS, PEOPLE HAVE BEEN ASKING, "WHEN WILL THINGS GET BACK TO NORMAL AND RESUME HIGH GROWTH?" IS IT TIME TO TELL THEM TO STOP ASKING?

I've always argued that "the new normal," which people started talking about after the recession hit in 2008, is not a good way to think about adjustments after a crisis. There is no new normal: Economies undergo continuous adjustments, partly cyclical and partly structural. Every time is *different*. When you start thinking that you have arrived at normality, things start changing again. When businesses sit still, they fall behind. We need an environment that allows for making those adjustments in a world of continuous uncertainties.

History tells us that it takes about ten years to leave the impact of an economic or financial crisis as we experienced in 2008 behind us. But growth will surely pick up—the question is when, where, and how.

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CONSIDERING YOUR LONG-TERM PROJECTIONS OF SLOW GROWTH, THAT SOUNDS AWFULLY OPTIMISTIC.

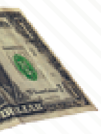
Well, you are correct that the model we use for our projections tells us that the long-term trend suggests a slowdown for the world economy. Slowing population growth in most economies plays a big role, and the trends in investment and productivity are not moving in the right direction. But that can all change to the positive, if the right actions are taken: If we can take advantage of ongoing demands from rising middle classes in emerging economies, if we make the investments to deliver on those demands, and if reforms are made so that investments don't get locked up where they don't generate much return, then there is a good chance that we can bend the slowing curve.

YOU WRITE THAT BOTH MATURE AND EMERGING ECONOMIES "ARE DRAMATICALLY RESTRUCTURING TO ADJUST TO A SLOWER GROWTH ENVIRONMENT" OVER THE NEXT FIVE YEARS. BUT ARE THEY REALLY RESTRUCTURING? IT SEEMS MORE LIKE EVERY COUNTRY IS STUMBLING ALONG WITHOUT MUCH PLANNING AT ALL.

Yes, there is a lot of adjustment ongoing, much of it under the radar. It feels chaotic and uncoordinated. But if you allow experimentation, let newcomers in, and accept failures of incumbents, it surely creates upside opportunities for growth. Restructuring can be very messy. And in the middle of this, companies need to set themselves up to capture the resulting phase of growth, when it comes.

I think healthcare reform in the United States is a good example. There are few who wouldn't argue that we need some real, disruptive changes. Reform obviously isn't going smoothly, and we'll need to find out whether the current policy change is the plan that will ultimately work or whether it will need to be overhauled by *another* plan. But we'll end up in a better place than where we were.

The same is true in the banking sector—there's a massive restructuring going on there as well. The Dodd-Frank Act is being executed; the Volcker Rule is now accepted. Globally, Basel III is happening. Many of these changes have negative side effects because banks have to increase their capital requirements to the point where lending is discouraged. But is there anyone who thinks that things were sustainable in the run-up to the crisis? The same can be said of the muddling through in creating a banking union for the Euro Area. Is anyone arguing that we don't need it? Yes, we are in uncharted territory, but muddling through is not a bad outcome for Europe's future.



Now, of course, countries aren't doing enough to coordinate their restructuring efforts. The recent deal at the WTO to cut red tape at the borders is a baby step toward a new multilateral trade agreement but potentially a major impetus to new deals such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership. In particular, if China would join the TPP in a serious way, that could be a game-changer.

BUT ALL OF THIS IS LONG-TERM, AND AS KEYNES SAID, "IN THE LONG RUN, WE ARE ALL DEAD." READING ABOUT JAPAN AND EUROPE AND INDIA AND EVEN THE UNITED STATES, ONE GETS THE SENSE THAT POLITICAL AND STRUCTURAL ISSUES ARE SO DIFFICULT THAT THINGS WON'T BE RUNNING SMOOTHLY FOR YEARS TO COME. OR IS THAT TOO DOWNBEAT?

I never said it will be easy in the short term. The obstacles are very real. Take Japan, which has three arrows to stimulate faster growth: fiscal, monetary, and structural reforms. They've shot the first two, which has given the economy a bit of a boost, but they've been struggling with the third—the big one—for a long time. The reason it's so difficult is that those reforms tend to redistribute wealth from elderly people to younger people. That is necessary in order to incentivize the young to take up jobs, be productive, and contribute to the overall economy. But as elderly people are becoming the majority, they are pushing back on this, which is purely rational. So Japan needs charismatic leadership to convince people that the endgame is worth the pain in between.

Europe is struggling with structural reforms because many reforms need to happen at a European level rather than at the level of individual countries. Europe needs to scale up its internal markets to play a larger role in the global economy and to sustain growth and living standards in the longer term. However, as the electorate is very frustrated with Europe and the monetary union, it's hard for policymakers to tell people, "We need more *Europe*." It's a tough sell politically, and the European parliamentary elections are likely to bring out much more controversy about where to go with Europe. But everybody knows that for Europe to grow again we *do* need more Europe.

POLICYMAKERS ARE IN A DIFFICULT POSITION.

We can continue to beat up politicians and policymakers for not doing their job, but really what we need to do is convince electorates that ultimately society will be better off if those reforms are made, that an intergenerational transfer of wealth is in everyone's best interest, that people who are benefiting now may have to give up a little bit more to keep things going. Business should be part of that debate, I believe, and show what it is they can do to create jobs and provide people with a living.

WE HAD YEARS OF THE EMERGING MARKETS DRIVING GLOBAL GROWTH, FAR OUTPACING THE DEVELOPED ECONOMIES. WHAT DOES IT MEAN THAT WE'RE SEEING A CONVERGENCE BETWEEN EMERGING AND DEVELOPED COUNTRIES?

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There are two aspects to that convergence. The first is that we expect the mature markets to begin growing a little faster than in the past five years. Many mature markets still have too high unemployment, underutilization of capacity, and a lot of technology that is not being used. I think we are beginning to make up for at least some of that. That's why our outlook for the United States over the next few years is a bit more optimistic. It's not because the long-term trend is improving—it's because we will ultimately make up for what we lost. It's the same in Europe, which is coming out of a two-year recession, its second recession in five years. It *has* to grow in the next few years.

The bigger issue is the slowdown in emerging markets. There are two things here as well. Since the 2009 recession, emerging economies have grown faster than their long-term trend, given their employment and capacity and technology. They've benefited from the massive global liquidity and their own rapidly emerging middle class. But this changed in 2013. Now that the United States is tapering quantitative easing, monetary liquidity will become a little more tight in the global economy, and emerging markets with current-account deficits, like India and Brazil, will need to adjust internally.

The longer-term shift is that many of the larger emerging markets are showing signs of maturing; they are becoming richer. That's a great thing, but when you become richer, you develop needs and demands that lead to the rise of industries that grow more slowly than manufacturing: more services to satisfy people's demands, including better health care, education, and so on. With manufacturing, you add machinery, and you have a lot of innovation and technology. Services sectors just don't grow productivity as fast.

This is a natural process, and ultimately, millions of people will begin asking for products and services of higher value and will ultimately create higher living standards and a better world. So the process of maturing and slowing is good for the global economy. Also, seeing these countries converging means that capital flows will become less volatile and more manageable compared to the rapid flows of hot money in recent years that aimed to maximize interest or capital gains. So the slowing trend is a blessing in disguise: The convergence in the global economy makes the transition process a little easier.

ARE YOU SEEING EMERGING ECONOMIES MAKING THE NECESSARY INVESTMENTS TO EVENTUALLY ESCAPE THE RACE TO THE BOTTOM?

Many governments, notably China's administration, realize that they need to make the transition. But these things don't happen smoothly, and they don't happen overnight. China is struggling to balance the economic and political transition. Our China Center colleagues notice a lot of tension in the policy environment with mixed results for business, but there are silver linings, too. China is investing heavily in the intangibles, spending massively on, for instance, software and design—things that matter

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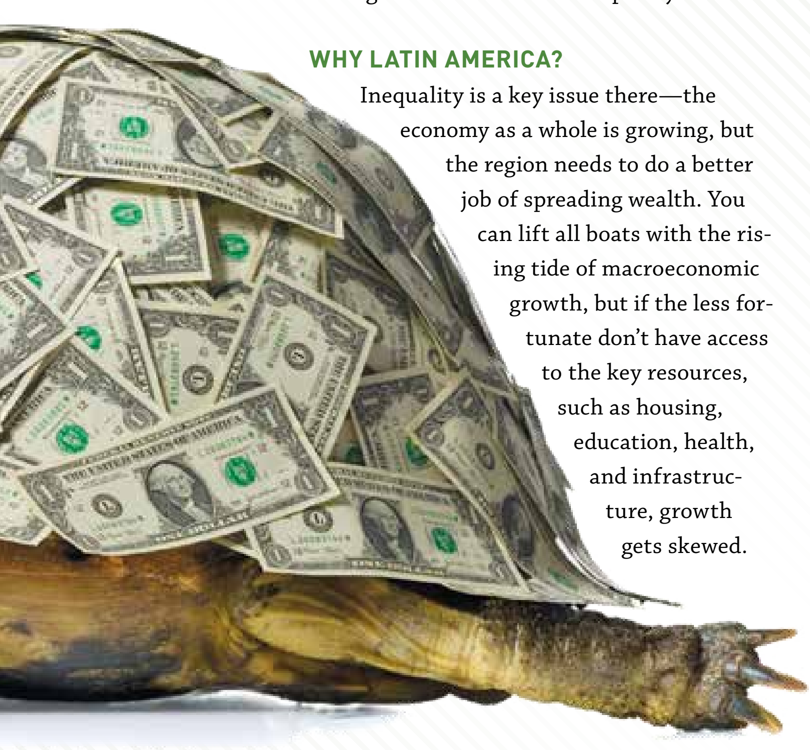
for a knowledge economy. Much of that investment will turn out to be wasted if the reforms don't happen. Mature economies took decades to turn themselves into knowledge economies, and even today they are struggling.

YOU SAY THAT SOME EMERGING ECONOMIES ARE IN DANGER OF ENTERING A MIDDLE-INCOME TRAP—WHAT IS THAT?

A middle-income trap is when you can't continue to get richer based on low-cost competition but you're not yet rich enough to grow on the innovation and climbing up in the global value chain. Every country's growth model makes the transition from low-cost exports to high-cost exports, from investment and exports to consumers and services. But some countries get stuck—in Latin America, for example, a number of economies have been sitting in a middle-income trap for years.

WHY LATIN AMERICA?

Inequality is a key issue there—the economy as a whole is growing, but the region needs to do a better job of spreading wealth. You can lift all boats with the rising tide of macroeconomic growth, but if the less fortunate don't have access to the key resources, such as housing, education, health, and infrastructure, growth gets skewed.



Redistribution policies help a little, but access to the sources of growth is much more important. Brazil made good progress on that during the 2000s, but its investment agenda is now stalling and reforms are slowing. That's an issue that many Latin American countries have trouble with, even though some, like Mexico, work hard to escape a trap.

We've also seen middle-income traps in countries like Thailand and Malaysia, where political constraints often make it hard to free up the economy for foreign investment. And some scholars have targeted China as a potential middle-income trap. But the average per-capita income in China is still low; it's not yet a middle-income country. China's average per-capita income, adjusted for purchasing power, is less than 25 percent of U.S. GDP, even though some East Coast provinces already approach 50 percent and are at risk of a middle-income trap.

BACK IN THE UNITED STATES, LARGE COMPANIES HAVE BEEN WAITING FOR THE ECONOMY TO PICK UP SO THEY COULD RESUME INVESTING AND SPENDING SOME OF THEIR BILLIONS IN CASH—DO YOU GET THE SENSE THAT CEOs HAVE THE RIGHT MINDSET TO MOVE FORWARD IN PRODUCTIVE WAYS?

I have noticed a lot of pessimism among CEOs. In the past few months, when I've done economic-forecast presentations, I often take a poll about my outlook, which is pretty cautious: *Do you think it's too pessimistic, right on target, or too optimistic?* The majority thought that I was either right on target or still a bit too optimistic. Yet, as we have been receiving somewhat better growth numbers in recent weeks, it seems the mood has been changing to a more positive outlook.

Still, there's a lot of uncertainty right now—issues around the implementation of health care and financial reform, for instance—which makes business leaders more concerned about short-term prospects. Things are not moving as fast as they would like them to. Demand growth has slowed around the world, and governments are not making investments to facilitate private investment. There's a global savings glut: People are not spending because of uncertainty. So then economies slow and governments get cautious with spending or even launch austerity programs, and as a result private companies hold off on making investments.

It's a vicious circle that can be broken in two ways. One is to have governments make more public investment, but many are constrained by the need to manage their debt; the other is to see private companies invest, but they will do so only if they see market opportunities. That is why companies need to prepare for the next growth phase. They need some confidence that it is worth taking some risk and be ready to make investments.

Everything now is about public-private partnerships and collaboration, trying to break out of that vicious circle and find a productive way forward. I don't blame CEOs for being skeptical about everything coming together. Incidentally, I think that the tapering of quantitative easing and the rise in long-term interest rates will get companies to rethink how to activate all that liquidity and seek better returns through investment.

SPEAKING OF CORPORATE INVESTMENT: YOU NOTE THAT WE'VE BEEN HEARING FOR SOME TIME ABOUT CLOUD COMPUTING AND BIG DATA ANALYTICS AND HOW THEY'RE ON THE VERGE OF REVOLUTIONIZING INDUSTRIES AND INCREASING PRODUCTIVITY. WHY HASN'T THAT HAPPENED?

Well, the weak confidence hasn't helped. These new IT technologies create huge disruptive opportunities for businesses, and many are trying to figure out what it means for them. These are not the kinds of technological changes that stay in the R&D department—they'll affect the entire business and challenge the business model. Big data and cloud computing are things that the CEO and the C-suite need to think about. So it's taking everyone a lot of time to experiment and figure out how to apply them in different industries. Some companies will get it; some won't. You need to have a long-term view and be sufficiently confident that it will pay off once the economy gets to a happier place. Not everyone, in particular not small- and medium-size enterprises, has the resources to take such large risks.

IS THAT HESITANCY AFFECTING PRODUCTIVITY OVERALL?

In the United States, productivity is not growing fast enough, and has been holding back the recovery. Some of it is because productivity was ramped up during the recession, and you cannot squeeze more out of the labor force. But somehow technology and innovation has not translated into productivity growth. That may have to do with all the reforms and restructuring, which take time to play out, or it may be that the current wave of technology and innovation just is not very productivity-enhancing. However, we are pretty sure that productivity will pick up again in 2014.

YOU IDENTIFY THE BIG CHOICES FOR COMPANIES AS: CHOOSING THE MARKETS FOR GROWTH, MAKING KEY INVESTMENTS, AND RAISING PRODUCTIVITY. AREN'T THOSE CHOICES THE SAME REGARDLESS OF WHETHER GROWTH IS FAST OR SLOW?

Yes, but the dynamics are different. When growth is fast, economies get in a hypercompetition mode. The sky is the limit, but you are forced to move fast, and productivity gains are relatively easy. Companies choose markets based on where you can get double-digit growth. You get very short-term-focused, and the pressure for long-term reforms is limited.

In a slow-growth environment, the focus moves to the long term. It's not a coincidence that we hear more leaders argue in favor of the need for long-term thinking. You look for markets to help sustain your business model; you make key investments for long-term returns. You don't, for instance, immediately relocate production to low-wage countries to try to get a small advantage, because that move would involve long-term costs and risks. But it also makes the way for businesses to think about investments a bit more cautious and perhaps more sustainable.

SPEAKING OF SLOW GROWTH: HOW MUCH DID THE U.S. GOVERNMENT SHUTDOWN AND DEBT-CEILING THREAT HURT GROWTH IN 2013?

It's bigger than I had expected. Kathy Bostjancic, our departing director of macroeconomic analysis, has convinced me that the U.S. economy might have grown 2.5 to 3 percent instead of, at best, 2 percent. We had the expiration of the payroll tax cut at the beginning of the year; that was a big hit, bigger than the sequester. We're still not sure about the impact of the government shutdown on the fourth-quarter results. Consumer confidence took a big hit but rebounded quickly. If the headwinds from policymaking weaken, growth should be somewhat faster next year.

THAT'S A BIG *IF.*

Well, Republicans have seen that a government shutdown doesn't help, and the Democrats have seen that they don't have that much clout. The recent deals suggest they'll muddle through and find some middle ground. But you're right that a grand bargain on a sustainable long-term fiscal plan seems far off.

DID THE SHUTDOWN HAVE A MEASURABLE IMPACT ON THE GLOBAL ECONOMY?

Slow U.S. growth always has a global effect, because it's one of the biggest markets for the rest of the world and can move global interest rates. But I think the United States has lost some of its global influence, simply because it's becoming a somewhat smaller part of the global economy, so the long-term effects may not be as bad as people fear. Having said that, the U.S. dollar will remain a safe haven for much longer than the size of the economy would suggest.

SOME CEOs MAY SEE YOUR FORECAST AS OVERLY UPBEAT, BUT WE'RE ALL *HOPING* THAT YOU'RE TOO PESSIMISTIC.

So do I. In presentations, I often say, "I'm not going to bake into the forecast an optimistic view that all necessary things will get done." So this year we produced a series of growth scenarios for seven major regions or countries in the world; this way we can get a better idea of assessing the upsides and downsides to the outlook.

Some things will get done, and I think there are more upsides now than, say, a year or two ago. If I see our member companies again next year, I wouldn't mind being told, "Things turned out better than you said." But I hate for companies to come back and say, "You gave a rosy outlook, and you got it wrong." So I also hope I am not too optimistic! Don't we all just want to be right? ■

IN A SLOW-GROWTH ENVIRONMENT, THE FOCUS MOVES TO THE LONG TERM.