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No return to 9% growth

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Given the economy's impressive performance in weathering the Great Recession and then accelerating this year, optimists feel that the good-old days of 9% growth are about to return. They think it is only a matter of time before we hit 10%.

I am less optimistic, and suspect that in the next few years, we will average 7.5-8 % growth. That can still be called a miracle rate of growth, but will be well short of the boom of 2004-08 .

That 9% growth stemmed from an unsustainable global boom. After the Great Recession, the world economy is headed for years of much slower growth. This will impact India too. May be the world economy will boom again later in the coming decade, and may be in that boom, India will finally touch 10% growth. But that's some way off.

Nobody anticipated the 9% growth boom of 2004-08 . But once it started, people began taking it for granted, as a reward for our own virtues. That was true only to a limited extent. The full story was that the global boom of 2004-08 lifted all boats, and India's too.

Developing countries as a whole grew by more than 7% annually. Even sub-Saharan Africa, which had grown at a dismal 2.4% per year in the previous two decades, more than doubled its growth rate to 6% in this period. India's growth rate did not double in this period, and in this limited respect, India actually underperformed Africa.

The global boom of 2004-08 was created by the emergence of Chimerica, the entwining of the boom economies of China and the US. The US contribution was innovation and rapidly-growing productivity. To this was added a borrowing-to-spend spree that accelerated consumption, taking advantage of very low interest rates.

China's contribution was to become the manufacturing heart of the world, churning out consumer goods at very low prices and taming inflation. To this, it added a huge savings rate that generated massive balance of payments surpluses that, in turn, were invested in western securities like US gilts.

This flood of money kept US interest rates very low, encouraging US corporations and households to keep borrowing to finance their consumption spree.

The Chimerica-led boom boosted the whole world economy. Everybody gained from the combination of high productivity, buoyant demand, low inflation and low interest rates. Europe and Japan, ageing regions with limited growth potential, also enjoyed some economic acceleration.

China's boom — and to a lesser extent India's — required relatively large amounts of raw materials. This raised commodity prices, greatly benefiting commodity exporters in Africa and Latin America. Even the chronically sick economies of these regions (like Argentina) began booming.

Alas, the boom was unsustainable. It was built on two great imbalances. One was the record trade deficit in the US matched by huge surpluses in China and Opec. The second was the falling of the household savings rate in the US to zero, even while savings boomed to record heights in China and other Asian countries . The unsustainablity of those imbalances led to the Great Recession.

What next ? The outlook is not unpromising . China and India have shown that their domestic demand can sustain respectable growth even in a deep recession. Meanwhile, the US economy is recovering fairly strongly, and its productivity is rising impressively . Japan's exports and GDP are picking up from a low base.

The dark corner is, of course, Europe. The Greek crisis has spread and become an eurozone crisis. Countries that were swearing by Keynesian stimuli six months ago have reversed direction sharply, and are now going for austerity programmes that will slash not only fiscal deficits but also jobs and incomes. The German economy still looks strong, but cannot hold up Europe alone.

More worrying, Greece's problems are more widespread than commonly believed. Historian Niall Ferguson has drawn on models from impeccable sources to look at two ratios, debt-to-GDP and debt service-to-tax receipts. He concludes that without major spending changes, virtually all western countries — including the US and UK —

will move in the next few decades towards a Greek-like fiscal implosion.

This is the consequence of a wilting welfare state that can no longer deliver all the entitlements that politicians keep legislating. Greece is an extreme example , but others are not far behind. In the US, just three entitlement programmes — social security (for retirees), Medicare (for the aged) and Medicaid (for the poor) — may by 2020 swallow up 20% of GDP against 7% today.

Unfunded liabilities like guaranteed pensions are growing everywhere. These are promises to spend that are financed by debt, which will have to be repaid by a future generation. This strategy was sustainable when the ratio of beneficiaries to workers was low.

But western and Japanese societies are now ageing, and the proportion of retirees to workers is rising much too fast to sustain entitlements. Jagadeesh Gokhale of the Cato Institute estimates that (including unfunded liabilities) the US is heading for a debt-GDP ratio of 500%, and Europe of 434%. This is too disastrous to contemplate, yet politicians are afraid to tell voters the harsh truth.

In coming years, western politicians will have to come to grips with this problem , just as Greece is doing today. The struggle will be bitter: existing beneficiaries will take to the streets to protect their entitlements, as in Greece. But, ultimately , change will come.

The next five years will witness the start of this struggle. That will make it difficult for the global economy to return to the boom conditions of 2004-08. The world will slow down compared with 2004-08 , and China and India will slow down along with it.

India's savings rate may be high, but the share of exports and foreign investment in GDP has more than doubled compared with the 1990s, so India is more sensitive than ever — though less so than China — to the global economy. That is why India is unlikely to average more than 7.5-8 % growth in the next five years.