

The Global Benefits and Losses from The U.S. Recession and Recovery Package

by Francis Cripps, Director of Alphametrics Ltd., and Terry McKinley, Director of the Centre for Development Policy and Research, SOAS

Until 2007, many people had believed that global economic growth, led by the U.S., could continue unabated for the foreseeable future. Mainstream commentators based their optimism on greater global economic integration and the adoption of market-driven patterns of development. They seemed little concerned that global current-account imbalances, especially the U.S. deficit, would remain huge.

Using such rosy assumptions, our macroeconomic model, *State of the World Economy*, made a baseline projection that by 2015 income per capita would increase by 15 per cent in the U.S. and by significantly more in other developed countries. Income in many middle-income countries, such as those in the CIS, the Middle East and Latin America, would grow more rapidly.

China and many other countries in Asia would do moderately well, achieving growth rates of 6-7 per cent. South Africa would grow by almost five per cent but the rest of sub-Saharan Africa would gain only negligibly. In fact, energy importers in the region would have zero growth from 2008 to 2015.

During the last year and a half, this optimistic scenario has looked increasingly irrelevant. Several factors have been important: big increases in the prices of oil and food, the end of the U.S. housing boom, increased fragility of the U.S.-led banking system, sharp depreciation of the dollar, ongoing conflict in the Middle East and increasing evidence of global warming.

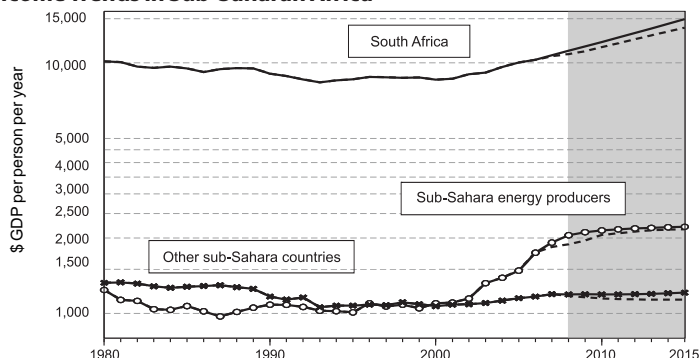
Assuming the combination of higher oil prices, U.S. recession and a falling dollar and no U.S. policy response, our macroeconomic model projected that the yearly growth of income per capita in the U.S. would have been -0.2 per cent between 2008 and 2015 and its level in 2015 would have been 15 per cent below the baseline projection.

But the Federal Reserve has moved swiftly to lower interest rates and inject credit into the financial system. And the Federal government has significantly increased spending and reduced taxes. While such measures are likely to improve spending in the U.S. and elsewhere, the disadvantage is that they are also likely to maintain high energy prices.

Under such conditions, our model projects that U.S. income per capita would improve slightly by 2015, ending up with a yearly growth rate of 0.5 per cent. But its level would still be 11 per cent below the baseline projection. Its long-term prospects would also be much bleaker. Income in Japan and Western Europe would be 8 and 12 per cent below the baseline, respectively. The U.S.'s mammoth current account deficit would worsen, in fact, from about 5.5 per cent of GDP to 5.9 per cent. Japan's surplus would continue at a little over four per cent of GDP.

The shortfalls in income (compared with the baseline) would be deepest in the middle-income countries in the CIS, the Middle East and Latin America (30, 22 and 17 per cent, respectively). While the current account surplus of the Middle East would drop markedly, that of the CIS (e.g., Russia) would increase.

Income Trends in Sub-Saharan Africa



The upper line for 2008-15 shows outcomes projected under the baseline scenario. The lower line (dotted) shows outcomes with a US recession and recovery package.

Growth in China would continue at only five per cent per year, in India at over three per cent and in the rest of developing Asia at less than three per cent. And the drops in their incomes, relative to the baseline, would be 8-11 per cent. China's current account surplus would drop substantially but India's deficit would be almost eliminated.

Our projection produces a more complex story in sub-Saharan Africa (see Figure). South Africa would do moderately well: it would grow at 3.7 per cent, lose only modestly relative to the baseline projection and gain a measurable decline in its huge current account deficit. Energy exporters in sub-Saharan Africa (such as Angola, Nigeria and Sudan) would grow at the same rate, 2.9 per cent, as under the baseline but their current account surpluses would decline below one per cent of GDP.

Energy importers in sub-Saharan Africa would fare the worst. Home to about 520 million people, i.e., almost two-thirds of the sub-Saharan total, these countries are overwhelmingly low-income. Though badly in need of rising incomes, they would experience a decline in income of 1.2 per cent per year. This compares with zero growth even under the optimistic baseline projection.

As a result of their domestic stagnation, their current account deficit, currently 7.4 per cent of GDP, would decline to five per cent in 2015. Heavily dependent on a few primary commodities for export revenue, they would still be subject to expensive oil imports since real oil prices would rise markedly.

Whether growth in the global economy increases or declines, it appears that these countries would still be stuck at the bottom of the ladder, in a 'poverty trap'. Their integration with the global economy is narrowly based and vulnerable. The results are asymmetric: they cannot gain from global upturns while they cannot escape the worst of global downturns. In future work with the model, we will analyze their condition more deeply and propose policy options.