

## Forward thinking

*Forty years of economic achievement can be undone if the right institutions and policies are not in place, argues Mr Visco. Some of the challenges ahead leave no room for complacency, like pressures from migration and ageing. One ingredient that is vital to help sustain progress is knowledge.*

Ignazio Visco, OECD Chief Economist, 1997-2002

What have been the most important transformations of the last 40 years? An obvious answer, one might say, is the new wave of globalisation, accompanied by major demographic changes and the overwhelming success of the market economy. This answer should, however, be qualified, as it is rather the nature of the process towards closer integration of markets that has really changed.

To be sure, world trade has grown more than twice as fast as world GDP. And capital has certainly become much more mobile, with sharp increases in fixed direct investment outflows, especially in the past two decades.

But from an historical perspective, these are not really new achievements. Between 1870 and 1915, in fact, another major globalisation wave had seen substantial integration of the world's economies, whose effects have been visible not only in trade and capital movements, but also in the exceptional freedom people had to move across regions. International migration is now very much restricted, and contrary to popular perceptions in OECD countries, rather low compared with a century ago.

One could also point out that, while more integrated than in the 1950s, the world economy still shows a relatively low degree of openness on several levels. Tariff rates have been substantially cut in the OECD economies, but major barriers remain for a number of products, particularly in agriculture and textiles. And after their dramatic plunge in the 19th century, shipment costs continued to fall sharply during the first half of the last century, but in the past 40 years technological progress has not led to further significant cuts, with the exception of airfreight, and even this was only until 1980. While the EU, with its single market, and other less sophisticated regional trade arrangements, are important steps in the direction of higher economic openness, protectionist pressures are still far from vanquished.

The truly new achievement of recent decades has been the dramatic fall in communication costs. This, and the technological breakthroughs behind it, has led to a diffusion of ideas, technological know-how and general spread of information at a pace that is quite unprecedented in the history of humankind.

Even if cause and effect are difficult to disentangle, this new wave has at the very least underpinned economic progress. Its effects have not been limited to the OECD economies, though the catching-up of the rest of the world has been far from uniform, at least in terms of per capita income. Worse, some of the poorest countries have been unable to make any progress at all.

Economic growth is neither a mechanical nor a smooth process. We have learned in the post-war period that peace and democracy, as well as macroeconomic stability, are fundamental conditions for a sustained rise in economic performance. Furthermore, without good institutional settings and effective rules of the game, these conditions might not last. As we have been recently reminded, nothing should be taken for granted, not even in the OECD; institutions must be maintained, looked after and skillfully adapted to changing times.

Being adaptable is clearly one of the major challenges ahead, as the current difficulties in the New Economy and the attendant corporate fallout show. These, as well as the stock market reversal of the past couple of years, should not alter the principle that, with the right policies and institutions, the higher productivity growth we have observed in several countries in the past decade can be maintained and extended to other economies around the world. These productivity gains are clearly linked to continued investment in physical capital, education and research. But, if the rules of the game start to become blurred or non-transparent, sustained economic progress may be deeply affected.

This is equally important for the second challenge before us: that of making the best use of the opportunity that comes from the diffusion of knowledge to close the gap in well-being between the developed and developing world. Remember, the catch-up process cannot be taken for granted; protectionist attitudes remain a great obstacle, and markets that lack confidence and support risk being too weak a tool to overcome this.

Obviously, political and diplomatic relations cannot be limited to the economic sphere. Nor can peace and democracy be considered as inevitable steps in the development of nations. They are intertwined with the fundamental challenges that a large part of the world still faces with respect to poverty, health and education. Which brings me to one of the most difficult challenges ahead: population.

Even if decelerating since 1970, world population growth is still above 2% in the less developed countries, compared with less than 0.5% in the more developed ones. Developing countries now account for over 80% of the world's population and this share is set to rise. Nevertheless, much progress must still be made to reduce infant mortality, which is still above 60 per 1000 births in the developing countries and 100 per 1000 births in the least developed countries, compared to just 6 in the industrialised countries. Substantial population movements seem inevitable, unless economic growth and living standards rise sharply in the developing world.

In OECD countries demography poses a different challenge. The drop in fertility rates and the spectacular rise in life expectancy of recent decades have led to a much older society. This phenomenon can also be found in some major developing economies such as China. Ageing will have important consequences for public finances and the working of labour markets worldwide and will affect many other fronts, from immigration flows to changes in preferences and consumption patterns, even corporate strategies. It clearly calls for the introduction of major reforms. The challenge to economic policy and politics *tout court* cannot be underestimated.

To quote the 19th century Danish philosopher Søren Kirkegaard, "Life can only be understood backwards, but must be lived forwards". So, to end on an optimistic note, let's remember that GDP per capita in developing Asia (excluding Japan) is now close to five times that of 1950, despite population having more than doubled. While such great progress has not been smooth across all Asian countries, it shows that even major development challenges can be met. But to do so, we must make sure we have good institutions and good policies. This also demands sharing knowledge as much and as widely as possible.