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Where is the world economy headed?: An overview☆

Dominick Salvatore *

Department of Economics, Fordham University, NY 10458, United States

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1. Introduction

After the slow recovery from the recent global financial crisis and “great recession”, future world economic growth is now forecasted to be much slower than its past trend. Other serious problems facing the world economy today are the high and increasing income inequalities, the serious slowdown in the growth of world trade and in the reduction of extreme poverty, and the risk of new global financial crises. These are the topics examined in this paper.

2. Slow world growth forecasted from growth accounting

Although economic growth seems to have picked up somewhat in advanced and emerging market economies since the beginning of this year, most international organizations (see, for example, OECD, 2014), research institutes (McKinsey Global Institute, 2015), and economists (Summers, 2015; Salvatore, 2016) generally forecast slower growth for the rest of this decade and the next in relation to the growth trend prior to the recent global financial crisis.

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* Fax: +1 914 337 3355.
E-mail address: salvatore@fordham.edu

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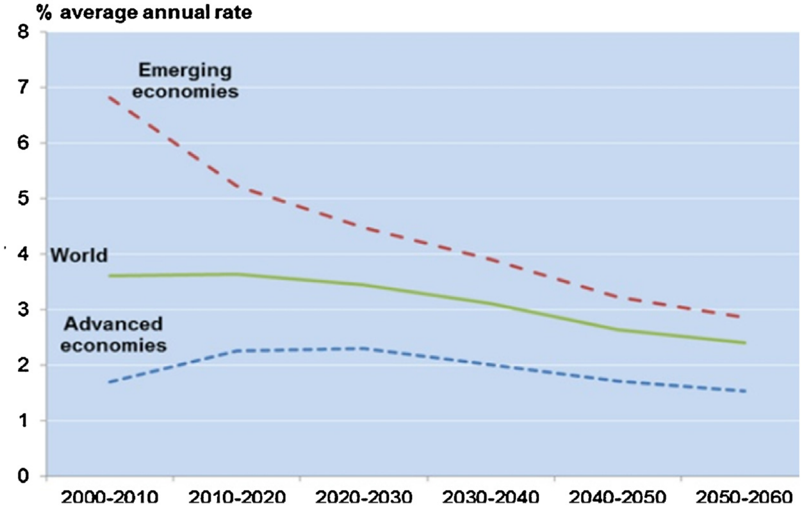

Fig. 1. Declining long-term growth forecast.

Source: OECD (2014).

From growth accounting, we know that the growth of the economy depends on the growth of hours worked and labor productivity (output/hour). Labor productivity, in turn, depends on the quality of labor, capital intensity, and Total Factor Productivity (the increase in the output/inputs ratio—which is mostly due to innovations and improvements in the organization of production). The fear of a new normal of slow growth (or even secular stagnation) for the world economy is based on the forecasted decline in the growth of the labor force and labor productivity.

Fig. 1 shows the declining trend in the average growth rate of advanced nations, the even faster decline in the growth rate of emerging market economies, and the decline in the average growth of the world as whole in the next 40–50 years forecasted by OECD (2014).

After their spectacular growth during the past decade (see Klein and Salvatore, 2013), the forecasted slower growth in emerging market economies is based on: the rapid slowdown in the growth of population, labor force and labor productivity; the convergence hypothesis (it easier to grow if starting from a low base when there are many technologies still available to be copied or adapted than later on); the related "middle-income trap" (the difficulty of emerging market economies taking off to reach advanced-economy status), and in today's highly interdependent world, the expected slowdown in the growth of advanced countries.

Fig. 2 shows the dramatic decline in the average growth rate of world GDP from 3.8% in the 1950–2014 period to 2.1% in the 2014–2064 period forecasted by the McKinsey Global Institute (2015). This is based on the expectation of a continued sharp decline in employment and on the assumption that labor productivity will continue to grow at the same average annual rate of 1.8% as in the 1964–2014 period (see Fig. 3). But labor productivity has fluctuated very widely over time (see Fig. 4) and has been notoriously difficult to accurately forecast. Should average labor productivity fail to grow as rapidly as in the past four decades, world growth would be even slower than the 2.1% forecasted by McKinsey. Of course, these long-term growth forecasts could be very much off the mark, but this is what they generally indicate now.

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