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IT'S OFFICIAL: THE RECESSION IS OVER. Technically, anyway. It's all too easy to look past the economic indicators—mostly up for each of the last six months—and question whether sustainable growth will arrive anytime soon. In the United States, fourth-quarter growth—an encouraging 3.4 percent—was largely driven by inventory depletion, and consumer spending will no doubt drop off after the holidays. CEOs around the world are still unwilling to leap in and begin hiring and expanding until they're assured of future growth . . . but, of course, there won't be much future growth until they do.

All that said, Bart van Ark, chief economist of The Conference Board, sees higher economic output globally in 2010, along with global shifts in economic power. Five or so years from now, the landscape may look substantially altered. Here, van Ark looks beyond the figures to offer a glimpse of what's ahead for the economy in the United States, Europe, and the developing world.

>>>A Slow Recovery

Bart van Ark sees the economy getting back on track in 2010, but rebuilding will be neither easy nor pretty.

By Matthew Budman

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IN NOVEMBER 2009, YOU PUBLISHED YOUR ECONOMIC OUTLOOK FOR THE WORLD ECONOMY FOR THE NEXT YEAR AND BEYOND. THE GOOD NEWS IS THAT YOU SEE THE WORLD ECONOMY GROWING IN 2010. SHOULD WE BE FEELING UPBEAT?

Well, I expect world output to grow at about 3 to 3.5 percent, and that's definitely a lot better than what we had in 2009, when the global economy came to a standstill, at zero percent growth. We have started to recover remarkably well in the past few months. But we are not yet in a place where we can comfortably speak of a sustainable new growth phase. If you look at the underlying dynamics of the recovery—whether it's in advanced economies or in emerging economies—a lot of it is still related to the long climb out of a deep hole: the rapid growth of global exports, the depletion of inventories, even the return of positive investment rates. After one of the deepest recessions we've had since World War II, it will take a long time for everything to fall back into place.

So no, I'm not upbeat about 2010. I don't sense a lot of comfort with the near future among businesses, investors, or consumers, and I think that discomfort is justified.

FOR THE ADVANCED ECONOMIES, OVER THE NEXT SIX YEARS, YOU'RE FORECASTING ONLY 1.5 PERCENT ANNUAL GROWTH. WHY SO LOW?

Because we have so much ground to make up. The deep hole in the economy is what economists call an output gap, and the total pie we currently produce has fallen as much as 7 or 8 percent below what we can produce if we use our labor and our capital and our technology at full speed, and without creating inflation. This means producers are sitting on a lot of unused capacity, and they underutilize their people by reducing working hours.

If the recovery takes a long time, the maximum output level that we can produce when utilizing all our resources may shrink. As a result, what we call potential output growth is going to slow, and that means we may be cutting into our sources of growth. For example, U.S. companies have become very productive, so they may not take back all the people they laid off; many of them will need more people only if markets expand beyond the current recovery. Some of them don't want to leave their machines idle until business gets better, so they just scrap them. They don't invest as much in research and development, and as a result, our pace of technological change is falling behind.

WILL CLOSING THE OUTPUT GAP REQUIRE US TO ALL START SHOPPING AGAIN?

If we all start shopping again in the same way as we did before the crisis, we'll soon be in the same trouble as we were before. Much of the consumption was credit-financed. U.S. household debt, including mortgages, as a percentage of disposable income had gone up to 130 percent of disposable income, and the deleveraging has only just started. Savings rates are likely to stabilize at higher levels, leaving even less room for consuming ourselves out of this recession. Where we may be seeing changes is in spending *patterns*. There may be a shift toward even more consumption of services. If energy and commodity prices change significantly, we might see changes in consumer patterns toward more durable consumption habits. It's hard to predict, but the composition of consumption may create more opportunities for new business than the actual growth of consumer expenditure.

ARE OTHER ECONOMIES AS RELIANT ON CONSUMER PERFORMANCE AS THE UNITED STATES'?

On average in advanced economies, consumer expenditure is between 60 and 70 percent of the economy, versus 71.5 percent in the United States. Naturally, the adjustment to lower and more sustainable levels of consumer expenditures will be smaller in the rest of the developed world. But in Europe, economic recoveries tend to be driven by the external sector much more than by the domestic sector, so most of the consumer growth we'll see globally is in emerging economies—that's where middle classes get created.

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DO YOU BELIEVE THAT WE'LL SEE, AS YOU PUT IT, "A FUNDAMENTAL TRANSFORMATION IN DEMAND"?

There's a significant probability that that will happen, especially if some of these massive changes in the economy—such as policy action on health care—go forward. If climate change stays on the agenda, either government intervention or changing consumer preferences will change behavior, though it won't happen quickly. Business will need to anticipate these changes to be ahead of the competition in terms of picking up some of the resulting growth.

AND YOU SEE MUCH OF THE COMING GROWTH GOING ELSEWHERE: YOU PROJECT THAT EMERGING AND DEVELOPING ECONOMIES WILL DRAMATICALLY INCREASE THEIR GLOBAL SHARE OF GDP BY 2016, FROM 50 PERCENT NOW ALL THE WAY TO TWO-THIRDS.

Yes, that's true, but don't forget that even those countries will slow—just not by as much. The more important question is: What is the nature of that growth? Many emerging economies do not have the kind of market mechanisms that we have built over decades, and a lot of growth is driven by large state interventions. It is hard to see how that can be sustained. China is one of the best examples of this, where the state has intervened by ramping up bank loans in the past year. But there are other countries with economic models very different than what we have here, and we have to see how that's going to play out in terms of sustainability of growth.

I'M CURIOUS: WITH TWO-THIRDS OF GLOBAL GDP, AT WHAT POINT WILL THERE STILL BE A DISTINCTION BETWEEN DEVELOPING ECONOMIES AND ADVANCED ECONOMIES? WHEN WILL THEY HAVE *EMERGED*?

Well, it's a very diverse group of countries when you lump them together. Some countries are quickly approaching our living standards and business-sector sophistication. For example, it is customary these days to include South Korea and Taiwan with the advanced economies. But other countries—notably in South America and sub-Saharan Africa but also in parts of Asia—still have large pockets of very poor citizens and haven't really jumped onto the bandwagon of integration into the global economy. It's unclear whether such large pockets will ever become part of an integrated economic and business system. Those parts that do grow rapidly may take a larger part of the growth pie, making it even harder for less-developed economies to pick up their share.

HOW SHOULD THOSE LIVING AND WORKING IN THE ADVANCED ECONOMIES FEEL ABOUT THE SHIFT OF ECONOMIC POWER TO EMERGING ECONOMIES?

One can be depressed about it, but I would rather stress the blessings of a global economy to benefit all of us, provided we are willing to face the structural changes it involves. Advanced economies enjoy very high living standards that give us huge advantages in terms of education levels and our capacity to create innovations. That serves us in developing local economic and business activities, for example in services. Most service industries are local and have much room for growth and innovation. Health care is not going to go away to emerging economies, and we have to think hard about making that a more productive, more efficient industry that contributes to people's quality of life, in particular now that our society is aging.

CAN THE SERVICE SECTOR BE A SOURCE OF GROWTH AND PRODUCTIVITY?

We're seeing a lot of technological change and innovation in the service part of the economy, and there's definitely more coming down the road. We're entering a whole new phase of information technology in which connections are made between different applications of IT, with enormous benefits for productivity growth in services. Our research shows that intangible innovations in services are a larger and larger part of the growth story. That's where more jobs are being created.

WHAT ABOUT MANUFACTURING?

Many manufacturing firms in advanced economies are still very competitive on a global scale. They succeed in capturing market share at the higher end of the value chain.

ARE CEOS MAKING INNOVATION ENOUGH OF A PRIORITY?

It has definitely become more of a priority than it was. Even into the IT age, most company boards saw innovation as a resource they would gladly leave to their R&D and IT managers to operate. I think that has changed as innovation has become key to most companies' existence; it should be a boardroom issue.

The key challenge here is to scale up the quality of our labor force and be able to employ them. It causes a lot of structural change, creates many winners and losers, and it requires hard work by businesses, government, and workers to make the transition work. That's also what The Conference Board's Human Capital program is all about: to help companies manage their workforce through this transition and make workers ready for the changes ahead of us. While we have seen many young people going back to school, the concern is whether this investment will pay off when they are looking for higher-quality jobs. For that, businesses are challenged to look for new growth opportunities at home and overseas.

SPEAKING OF OVERSEAS: IT SEEMS AS THOUGH AMERICAN EXECUTIVES ARE EVER MORE TERRIFIED OF CHINA AND WHAT IT REPRESENTS. DO YOU SEE THAT COUNTRY'S ECONOMIC POWER CONTINUING TO RISE?

China has established itself as a major economic power that needs to be reckoned with in global economic policymaking, but I don't think there's reason to see it as a big monster. Some of that feeling comes from the fact that we don't quite know and understand the way China organizes its economic model. There's a huge amount of state intervention—almost beyond imagination—which is one reason why the Chinese seem to have avoided a full-blown recession, although the economy virtually stopped growing for one quarter at the end of 2008. In China's policy framework, it made sense to massively invest itself out of that situation. The question is whether the government has the ability to manage an exit strategy from these high investments; frankly, they are likely to be good at that too.

The main issue that needs to be dealt with in China is the macroeconomic and domestic imbalances. U.S. deficits in trade, savings, and the public budget are translated into surpluses elsewhere, notably in China. The transition from an export-oriented economy to a consumer society is not an easy task. It takes a long time to materialize, as Chinese consumers are rapidly emancipating, and spending patterns are more unpredictable than are production plans of state-owned enterprises, which have picked up much of the slack recently.

ARE CHINESE CONSUMERS NOT BUYING ENOUGH?

They're actually very rapidly turning themselves into big consumers: Consumption in China has been growing by 15 to 18 percent a year. Consumers do save, but China's extraordinary high savings rate—between 30 and 40 percent—primarily consists of corporate savings. China doesn't have a shareholder society, so companies don't pay out much in the way of dividends and profits.

If a gradual transition to a consumer society can be realized, and China pulls back a little from its dominating export mode to become a bigger importer of some of these goods and services, it opens up possibilities for other countries in the emerging world. China is building strong economic relationships with some of these countries, partly fed by its hunger for natural resources but also by realizing other complementarities.

I expect China to somewhat slow in growth after 2010, to below 8 percent. The big surprises in growth may come from countries in the Asian region, such as Indonesia, which has sailed fairly well through this crisis, and India.

YOU NOTE THAT INDIA MAY OVERTAKE CHINA IN TERMS OF RATE OF GROWTH. DO YOU SEE SIMILAR TRANSITIONS AHEAD FOR THAT COUNTRY, OR IS IT ON A MORE SUSTAINABLE PATH?

Yes, India may actually begin growing faster than 8 percent a year. But the aggregate numbers hide a lot of the differences between the two countries. The Indian growth model is much more diverse, with more growth from services and a lot of still-unrealized potential in the manufacturing sector. Still, maybe only a quarter of the Indian economy is integrated into the world economy. Much of its economy is very locally organized; several hundred million Indian citizens are poor and basically unconnected even to a national economy. The labor markets are very rigid, and infrastructure and education are huge problems. So there's enormous potential, but it needs to be realized by ongoing structural changes. The economy is not a state-interventionist model in the same way as China's—it's a much slower process, requiring consensus-building. Still, it has been impressive how the governments in India—with huge political changes over the past two decades—have kept focus on the reform agenda and the growth agenda.

SOME HAVE POINTED TO EUROPEAN ECONOMIES AS RIDING OUT THE GLOBAL RECESSION WITH MUCH LESS DISRUPTION THAN IN THE UNITED STATES. BUT YOU FORESEE SLOWER GROWTH FOR EUROPE. WHY?

It's true that Europe has successfully managed to deal with the first phase of the crisis. The European policy environment is better equipped than the one in the United States to quickly implement interventions without too much political upheaval. They have social safety nets, which are so-called automatic stabilizers, and they worked when needed. Several European economies added significant stimulus, particularly Germany, which normally is one of the more fiscally conservative countries. I have been most amazed by the huge rescue operations in the European banking system. Some countries nationalized large parts of the banking sector.

The result of all these actions is that things don't look too bad at this moment. Unemployment has gone up but not as much as in the United States. The U.S. unemployment rate, currently 10 percent, is now somewhat higher than in Europe, whereas traditionally it's several percentage points lower.

But the question is how it's all going to unwind. The third-quarter growth rate for the euro area was disappointing, and we cannot be very confident about 2010. European countries are strongly dependent on exports of manufacturing goods and services and, therefore, depend on the dynamics of the world economy that could help to reduce the new debt and deficits. But exports don't look like much of an engine for growth right now. The other reason to remain cautious is that the structural reform agenda in Europe still needs completion. There's a lot of work to be done, and the agenda is unlikely to be speeded up in a weak economic environment, because the pain is higher now relative to the benefits. This will make Europe less competitive. Moreover, the implementation of a single internal market for services within the European Union is not on track, so prices for services remain too high, reducing consumer growth.

ARE DEFICITS A PARTICULAR CONCERN IN EUROPE?

With the formation of the euro area, European government agreed to keep national debt and budget deficits in check, as these were traditional sources of macroeconomic instability in Europe. During the recession, budget deficits have rapidly gone up, so eurozone governments will need to put on the brakes to get back to the agreed principle of keeping deficits below 3 percent of GDP, which almost all countries currently exceed by several percentage points. Subsidies of businesses and consumers are beginning to run out, and since these economies have large public sectors, it's going to impact growth and unemployment. It is understandable why European central bankers are a little more hawkish than their American

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colleagues, given the complexities and risks in the European monetary system.

DO YOU FEEL CONFIDENT THAT, IN GENERAL, GOVERNMENTS AND REGULATORS WORLDWIDE HAVE RESPONDED APPROPRIATELY TO THE CRISIS AND LAID THE GROUNDWORK FOR A RECOVERY?

On the whole, monetary authorities did what they needed to do: quickly and massively intervene. If they hadn't, we would have been in much deeper trouble. You can argue about whether some of the bailing out of financial institutions was a good idea or not, and how far we should have gone with this. But to the credit of policymakers, we were in pretty uncharted territory, and something needed to be done quickly to avoid a total collapse in confidence. Governments are now discussing exit strategies.

On the fiscal side, the exit strategies are much more complex. The first phase of the fiscal-stimulus packages has been primarily focused on consumer subsidies and tax breaks to help keep people's and businesses' heads above water, to avoid a downward spiral. The more tricky parts of the packages are the investment programs. We need to discuss the role of government and the role of business, and how we can form successful public-private partnerships. There is no single recipe: The relationship between public and private in China or Japan or Europe is very different from how it works in the United States. But in general, given the complexity of our economies, we have to give a role to the market mechanism that helps to match demand and supply. A certain amount of government intervention is needed, but to find that balance is a very, very difficult thing to do.

WILL WE BE SEEING GLOBAL SHIFTS IN THE LABOR FORCE? WILL WORKERS BE MOVING TO AREAS WITH MORE OPPORTUNITY, OR ARE PEOPLE MORE STATIONARY IN A RECESSION?

Even though migration has increased a lot, it is still small in percentage terms, and the recession won't change that long-term trend much. In some high-skilled occupational areas, notably engineering, migration volumes are increasing more rapidly, and more shortages for specific skills may arise once structural changes accelerate.

But while people may be relatively stationary, business cannot afford to be. Some types of jobs, notably the medium-skilled, are shifting toward the emerging economies. At the same time, there will always be new jobs created in service sectors and high-added-value manufacturing. Micro-firm-level studies do show that the churning of jobs rises when economic dynamics rise. It would be another sign of sustainable recovery.

DO YOU SEE CORPORATE LEADERS MAKING THE RIGHT MOVES FOR THE FUTURE?

Most global corporations know what major shifts are taking place in their markets—that the emerging economies are where the growth is and that the advanced economies are maturing markets. But like governments, they're big organisms that can't change direction immediately. Anticipating the changes is easier said than done. They're also facing tough questions about public-private partnerships, and about what they should leave to the markets. This has huge implications for outsourcing and executive compensation.

LAST: HOW WOULD YOU LIKE TO SEE EXECUTIVES CHANGE THE WAY THEY'RE THINKING ABOUT THE FUTURE?

During peaks and troughs in the business cycle, managers tend to think operationally and focus on the short term, as the imminent turning point can turn your business opportunities into bad management decisions anytime. But with such a long transition period ahead, a medium- and long-term orientation is needed. For example, some companies have decided to spare R&D from their cost savings. They basically said to their R&D people, "We can't use you for our day-to-day business, as there is none, but you just go and work together and think of where we want to be in ten years' time, and we're keeping you on the payroll." That's a courageous decision, and it can be expensive, but that's the only way to be ahead of the pack when things get better. CEOs may also need to think much more in terms of scenarios, building in strategic flexibility to deal with uncertainty and in case the organization needs to shift course. I think that's the kind of leadership that will be the most successful in these very uncertain years ahead of us. ■