DID DEREGULATED GLOBAL FINANCE
INCREASE WORLD GROWTH?

(What do IMF data tell us?)

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Economists are deeply divided among those who want to preserve as much as possible of the lightly-regulated global financial system that has sprung up in the past years, and those who want to change it in a very comprehensive way because of the catastrophe they believe it created.

Those of the first group (who seem to be winning) admit that the system contains many imperfections (pro-cyclical regulations, too narrow a perimeter of surveillance, perverse compensation practices, etc.) but they believe that the main body is nevertheless worth saving because of the positive effect it had on world growth. If the flaws are corrected, it should be possible to keep, and harness, this highly performing system that so impressively *accelerated world growth*.

The idea is widely held by some of the most well-known European (French) economists. On the 7th of July, for example, Alain Minc declared that "during 10 years we had 5% a year world growth … the world grew at a speed unprecedented in human history"[2]. The idea seems implicit, also, in the *de Larosière Report* on financial supervision in the European Union[3], and is strongly suggested in Pascal Lamy's *2008 World Trade Report*[4]. These specialists are afraid that overregulation could stifle this admirable growth. Don't throw the baby out with the bath-water, is the message. But, is it really true that our new globalised financial system accelerated world growth?

What do the data tell us?

If one consults the latest statistics published by the International Monetary Fund (the *World Economic Outlook* database of April 2009), performances seem rather good. World GDP growth (the ten year moving average) started accelerating after the year 2000. It had been growing at a rate of 3.1% per year, and then started regularly increasing until it reached

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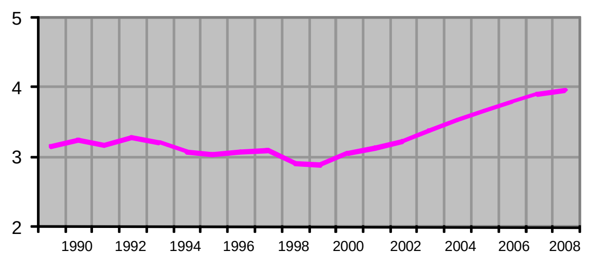
[2] Alain Minc, BFM radio, Tuesday 7th of July13h-13h30 www.franciscovergara.com/Minc.mp3.

[3] The de Larosière Group, *The High Level Group on Financial Supervision in the EU, Report*, Bruxelles, 25 février 2009.

almost 4% a year around 2008 (Figure 1). This is less than "5% per cent à year during ten years" and far from being "unprecedented in human history" (it is one percentage point lower than the growth rate of the sixties and early seventies). Nevertheless, at first sight at least, it does seem to vindicate our global, and lightly-regulated, financial system. But, if one looks more closely at the data, it appears that this acceleration is not due to better performance by the regions and groups of countries that make up the World (Figures 2, and 3), but to a change in their relative weights, what French statisticians call an "*effet de structure*".

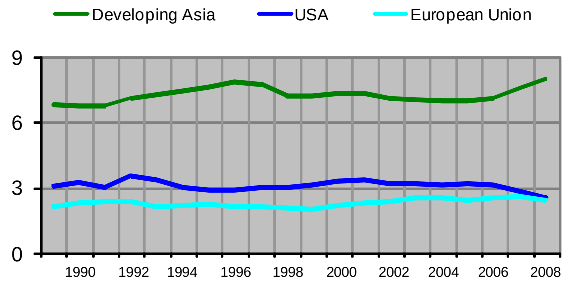
The explanation is quite simple. For the past twenty years – between 1988 and 2008 – the growth rate of Developing Asia (the 10 year moving average) remained very steady, at a rate of about 7.5% a year. Since the growth rate of the European Union, the United States, and the rest of the World was much lower, Developing Asia's part in World GDP increased, passing from 9.5% to 21% of the total (see Table 1). The World growth-rate (the weighted average) was thus *mechanically* increasing, without the growth of any of these regions accelerating, simply because the weight of the faster growing region (Asia) was increasing. As the International Monetary Fund (IMF) explains in a small foot note "aggregates shift over time in favor of faster-growing economies, giving the line an upward trend"[5].

Figure 1 : **World GDP yearly growth rate** %
(10 year moving average)



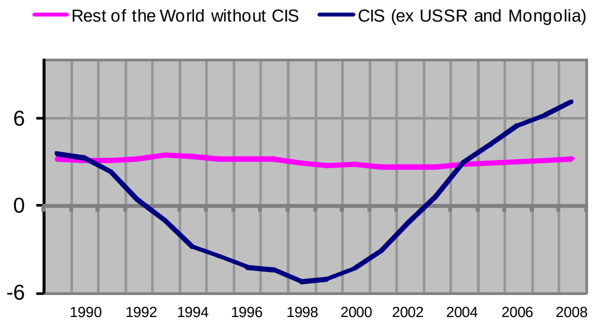
Source : IMF, WEO database, avril 2009, http://www.imf.org

Figure 2 : **GDP growth rate %** (10 year moving average)



Source : IMF, WEO database, avril 2009, http://www.imf.org

Figure 3 : **GDP growth rate %** (10 year moving average)



Source : IMF, WEO database, avril 2009, http://www.imf.org

Table 1 : **Share of World GDP**

	1988	**2000**	**2008**
Developing Asia	9,5	15,1	21,0
United States	22,9	23,5	20,7
European Union (27)	27,4	25,2	22,1
CIS	7,8	3,6	4,6
Rest of the World	32,4	32,5	31,6

Source : IMF, WEO database, avril 2009, http://www.imf.org

[4] OMC, *Trade in a Globalizing World, World Trade Report 2008*.
[5] FMI, *World Economic Outlook*, avril 2009, p. 1, note 2.
http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf

Graphics in Excell format : http://fvergara.com/GraphsforFT.xls

The upward slope of the World GDP curve after 2000 is also partly explained by the moderation of the contraction, and then the return to positive growth, in Russia, Ukraine, Belarus, Kazakhstan and the other smaller CIS countries (Figure 3). But this group of countries represents a very small part of the world economy (3.6% in 2000) and their return to growth has many causes other than deregulated global finance.

Deregulation and growth have not always coincided

The impact of deregulated finance on the growth rate of different countries and regions is neither evident nor simple. The excellent performance of Developing Asia, for example, has been very steady during the last 25 years, around 7.5% per year both before and after the recent world financial revolution. The performance is mainly due to China, India, and a few other countries where the financial system has remained quite traditional. As Kishore Mahbubani (Dean of the Singapore Lee Kuan Yeu School of Public Policy) put it in March, at the release of the latest United Nations Economic Commission for Asia *Economic Survey* "virtually all Asian states hesitated to copy America in deregulating their financial markets"[6].

As for the United States (the country that developed the most sophisticated new financial system), its' economic performance did not really accelerate during the years of the financial revolution. Its' GDP growth rate (ten year moving average) which had held steady at around 3.1% per year, has shown no tendency whatever to increase. It has even been falling, to 2.8% in 2007 and then 2.5% in 2008 (figure 2). And – as the NBER (National Bureau of Economic Research) has recorded – the expansion phase of the business cycle, which seemed to be getting longer and longer (92 months of expansion under Ronald Reagan, and then120 months under Bill Clinton), suddenly aborted at the end of 2007, after only 73 months of growth[7]. All this has raised legitimate doubts about the general usefulness of this complex, mysterious, and possibly dangerous financial system.

We are not proposing, of course, outlawing innovations. Nor are we arguing for financial autarky or anything of the sort. We are simply drawing attention to a widespread error that could obscure current discussion on the kind of financial system that is best suited for our modern world. For the clearness of this discussion, there is no need to exaggerate the virtues of the deregulated global financial system of the past few years, just as there is no need to

[6] United Nations Economic Commission for Asia and the Pacific (UNESCAP), New York, mars 2009, http://unescap.org/pdd/publications/survey2009/download/index.asp

[7] NBER, "US Business Cycle Expansions and Contractions", www.nber.org/cycles.

smear the different financial systems that so successfully accompanied European and Japanese growth after the second world war, or Korean and Taiwanese growth, or the excellent growth records of some less developed stats like Virginia or Georgia in the 1960s and 1970s.