

## **THE WORLD ECONOMY: GROWTH AND CRISIS**

### **Course Description**

**Introduction.** The world economy is gradually recovering from the financial and economic crisis that originated in the United States in 2007-2009. Despite the slow recovery of Europe and the U.S., world economic growth has continued at an accelerated pace since the mid-1990s. This is due to very rapid growth of Asian economies, especially China and India. China overtook the U.S. as the world's largest economy in 2014, while India surpassed Japan in 2012, becoming the world's third largest economy. The objective of Economics 1490 is to assess the prospects for sustainable growth of the world economy. Will slower growth of the U.S., Japan, and the leading economies of Europe lead to worldwide stagnation or will the accelerated growth of the world economy continue?

**Comparing Economies across the World and over Time.** Our first challenge is to measure the growth of the world economy. For this purpose we utilize the world's largest and most elaborate project in economic statistics, the World Bank's International Comparison Project. This project compares levels of the GDP for the benchmark year 2011 for 199 countries. We also consider comparisons based on standards of living or economic welfare, as suggested by Chad Jones, Pete Klenow, and other leading economists. Although output and welfare are highly correlated, the results of international comparisons can differ substantially. As a basis for analyzing rates of economic growth, we incorporate the sources of economic growth – labor, capital, and productivity. The sources of growth provide links to demography, finance, and technology, the forces that drive world economic growth. Finally, we analyze the integration of economies through international trade and investment. The elaboration of global value chains for production has led to intense international competition and dramatic increases in the globalization of economic activity.

**The Great Debate over the Financial and Economic Crisis.** Despite the impressive growth of the world economy over the past two decades, the economic and financial crisis that began in 2007 continues to affect the growth of economies in North America, Europe, and Asia. The great debate over the crisis in the United States has engaged leading policy-makers such as Ben Bernanke and Janet Yellen, chairs of the Federal Reserve Board, as well as academic critics of monetary policy like John Taylor. The analysis of the impact of President Barack Obama's fiscal stimulus program, the American Recovery and Reinvestment Act of 2009, has generated a heated controversy over the effectiveness of fiscal policy. Important contributions to the debate have been made by key fiscal policy makers, notably, Treasury Secretaries Hank Paulson and Tim Geithner. Financial regulation includes micro-prudential regulation of banks and other

financial institutions and macro-prudential regulation of the financial system as a whole. The U.S. debate has emphasized the regulatory failures that preceded the Lehman Brothers bankruptcy in 2008 and the resulting financial collapse. A new regulatory framework, intended to avoid a recurrence of the crisis, has been put in place. Finally, the slow pace of the economic recovery has revealed strong differences of opinion among leading economists such as Ken Rogoff and Larry Summers about “secular stagnation” and the prospects for future U.S. economic growth.

**The European Slowdown and Crisis in Europe.** The economic and financial crisis spread to Europe in 2008. The crisis was preceded by a marked slowdown in European growth, ending the economic convergence of Europe and the U.S. over the postwar period. The European slowdown provoked a debate over causes of the slowdown and possible remedies, leading to the Lisbon Agenda of 2000 and the more recent document, *Europe 2020*, published by the European Commission in 2010. These initiatives have been largely overtaken by the European policy response to the economic and financial crisis. For the 19 countries that belong to the Euro System, this has involved the monetary policy of the European Central Bank. The central banks of countries not included in the Euro, most prominently the Bank of England, have also responded to the crisis. The most surprising development is Brexit, the decision by the British electorate last June to exit the European Union. We will consider the possible consequences of Brexit for Great Britain and the European Union, drawing on the work of John Van Reenan and his colleagues of the Centre for Economic Performance at the London School of Economics.

**Will Asian Economic Miracles Continue?** We conclude our discussion of growth and crisis for major countries by turning our attention to the spectacular growth of Asian economies, especially China and India. We also consider economic developments in Japan and Southeast Asia. We review the debate initiated by Paul Krugman, the Nobel Prize-winning economist and leading columnist of the *New York Times*. Krugman’s view in 1994, widely shared at the time, was that the Asian “economic miracle” was a myth and would shortly come to an abrupt end. Alwyn Young, a leading development economist, presented evidence that Asian growth rates could be sustained for some time. In 1990 Indian output per capita slightly exceeded that of China, but China grew more than twice as fast as India over the following three decades. Asian economies and economies around the world were confronted by a collapse of trade in 2008-2009, but this was quickly reversed by unleashing an unprecedented economic stimulus. While the growth rates of many Asian economies have slowed, Asia has continued to grow more rapidly than the world economy. Surprisingly, India has recently emerged as the world’s most rapidly growing major economy.

**Sustainability of Economic Growth.** Can accelerated growth of the world economy continue or will the slow recovery become a “new normal” of prolonged stagnation? To address this question, we consider the leading drivers of economic growth, beginning with economic demography. Demographers like Ronald Lee have been surprisingly successful in anticipating future population trends for individual countries and the world as a whole. However, population projections must be augmented by the accumulation of human capital in order to make growth projections for the world economy. The second issue is the sustainability of fiscal policy. Both advanced and emerging economies have accumulated massive government debt and many countries,

including the United States, are pursuing unsustainable fiscal policies. A leading illustration is the long-term budget outlook for the U.S. federal government, prepared by the Congressional Budget Office. We continue with a discussion of environmental sustainability for individual economies like China and India, as well as the world economy as a whole. We conclude with projections of extreme poverty, per capita consumption less than \$1.25 per day. Poverty has declined dramatically and will end by 2030 under the Sustainable Development Goals adopted by the United Nations, the World Bank, and other international organizations in 2015.

**World Economic Outlook.** Economics 1490 concludes with the outlook for the growth of the world economy. The International Monetary Fund publishes *The World Economic Outlook* in April of each year and updates its projections frequently. The economic outlook for emerging economies is presented by the World Bank in its annual *Global Monitoring Report*. We assess the sustainability of world economic growth by comparing the projections of the IMF and the World Bank with future trends in demography, finance, and technology, drawing on information presented throughout the course.

**Reading List.** The required readings for the course correspond to twenty-six lectures that cover the six topics we have summarized in this Course Description. The Reading List includes journal articles and book chapters by academic economists. We also include reports by international organizations like the IMF, the World Bank, the World Trade Organization, as well as government agencies such as the Congressional Budget Office, the Development Research Center of China, the European Commission, the Ministry of Finance of India, and the Cabinet Office of the Government of Japan. The required readings can be downloaded from the course website.

**Writing Requirement.** Short writing assignments (~ five pages) will be given at the end of each of the five main sections of the course. The writing assignments satisfy the Department of Economics writing requirement for economic concentrators. Students should prepare for these assignments by completing the required readings, participating in class discussions, and attending the review sessions held by Elaine Chung, the Teaching Fellow in Economics 1490. We will also organize students into study groups, each consisting of about five students. Based on past experience, we strongly urge students to attend a study group. You will meet some of the most interesting people in the world this way. The writing assignments will be posted on the course website after class on a Tuesday and will be due before class on the following Thursday. The answers will be submitted electronically and can be completed anywhere in the world. **The writing assignments cannot be re-scheduled.**

**Office hours.** The instructor's regular office hours are 2:00-4:00 p.m. on Mondays at 122 Littauer. Office hours by Elaine Chung, Teaching Fellow in Economics 1490, will be posted on the course website.

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**Enrollment Application**

Enrollment of Economics 1490 is limited to thirty students and preference is given to senior economics concentrators. The pre-requisites are Economics 1010A-B or 1011A-B. To enroll in Economics 1490, fill in this form and submit the application to Trina Ott ([ott@fas.harvard.edu](mailto:ott@fas.harvard.edu)) with your latest resume and transcript (student record) by **5 p.m. on Thursday, September 1**. Students admitted to the course will be notified by e-mail on **Friday, September 2**.

**NAME** \_\_\_\_\_

**YEAR** \_\_\_\_\_

**CONCENTRATION** \_\_\_\_\_

**HOUSE** \_\_\_\_\_

**TELEPHONE** \_\_\_\_\_

**E-MAIL** \_\_\_\_\_

Semester in which you took Economics 1010A/1011A \_\_\_\_\_

Semester in which you took Economics 1010B/1011B \_\_\_\_\_

If you are a senior, are you writing a thesis? \_\_\_\_\_

Students who are not economics concentrators should also apply and submit their latest resume and transcript. Visitors should submit a resume and a transcript from their home institution.