In times of uncertainty, where can governments find opportunity?

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EY Global GPS Macroeconomic and Policy Outlook 2018

At EY Global Government and Public Sector, we take pause each New Year to consider the macroeconomic trends that will shape the policy agenda for leaders in the coming quarters and further into the future. We have a debate on major policy priorities, strategies and challenges in areas such as infrastructure, public finance management, service delivery and workforce. This debate refines our understanding of the key trends that we believe will shape the macroeconomic and policy landscape for 2018.

George Atalla
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The global economy is set for an inconsistent economic upswing in 2018

There is evidence that economic growth will be strong at the start of 2018. Global GDP growth is forecasted at 3.7% in 2018, up from 3.6% in 2017 and an average rate of 3.4% in 2012-2016. Asset prices and business sentiment have also been trending higher in recent quarters. However, this doesn't mean an economy in rude health, as other key indicators paint an inconsistent picture. Inflation is below target in most developed countries, growth remains subpar in many commodity-dependent economies and global interest rates remain very low. Poor productivity, sluggish income growth, rising inequality and rising debt in some major economies are persistent risks. Furthermore, yet unresolved geopolitical risks may have political ramifications that will further dampen the economic results of 2018.

... Suggesting smart fiscal consolidation is critical

The expected positive economic performance for the global economy in the near-term, coupled with several major underlying risks, highlight that there is unique opportunity to refocus on fiscal policy. High levels of borrowing and record levels of public debt mean limited financial resources for some governments to respond to future shocks. Accordingly, for countries close to full employment, now is the time to gradually reduce debt levels through measured fiscal consolidation. These economies can also afford to ramp up smart investment, including in education and technology. For other countries, including commodity exporters, where spending outstrips hard-hit revenues, difficult decisions will be necessary. These governments should rethink their taxation and spending policies, to reduce public deficits, encourage economic diversification and innovation, and widen their fiscal space.

For governments, this environment drives some clear focal points for policy in 2018-19, and beyond. We see four key themes that will shape policy opportunities for the year ahead:

a) Infrastructure builds growth

The need for infrastructure investment growth has been one of our long-standing macroeconomic themes, and remains a high priority in 2018. Many countries need to create or renew infrastructure to improve societies and enable economic growth. In fact, with risks to demand still persisting, and productivity a challenge in many major economies, increasing investment in infrastructure promises significant economic payoff, even in a constrained fiscal environment. For those countries with more budget wiggle room, public investment in infrastructure now can be an important safeguard against long-term strains on growth. Indeed, IMF estimates suggest that investing in bridges, roads, telecoms, schools, public housing and other infrastructure can virtually pay for itself, even if financed through debt, through boosts to jobs and demand in the short-run, and productivity gains in the long-run.[1] As a result, we continue to see infrastructure investment as a means to boost connectivity, supply chains and trade, mobility of labor and regional growth opportunities.

b) Education for the new "future workforce"

Human capital is another critical piece of the productivity puzzle. In 2018, the impetus for greater public investment and reform will be the rapid transformation in digital technologies and their integration into business models and the workforce. Artificial intelligence (AI) poses some new and quickly-evolving labor market challenges, indicating that reskilling, upskilling and K-12 education need to quickly adapt. This is particularly important because skills and productivity are together the major sources of sustainable and inclusive growth.[2] In emerging countries, there is an opportunity for government to work with private providers to create new educational institutions or delivery methods that leverage technology. In mature markets, education systems need to change to provide the right skills to compete and remain relevant in an increasingly AI-focused workplace.

1 blogs.imf.org/2016/12/13/infrastructure-done-right/
2 OECD, "The Future of Productivity", 2015

c) Testing the mettle on data as the new "asset"

There are major transformations happening to the global economy, including rapid technological change and a persistent slowdown in productivity. To turn the trajectory up for economic activity, there is hunger from business and governments for a new "fuel" for growth. In this time of digital tools and falling technology costs, data is increasingly seen as the new driver for the global economy, which will fuel the engine of AI and robotics systems.

Using data to drive growth is a case of doing "more with more." With smartphone penetration and internet connectivity so strong, and the use of digital tools high and rising, there is an abundance of data. Citizens have a detailed digital footprint and identity and contribute in real time to an ever-expanding data resource. For policymakers, how then can this resource be used to fuel economic growth?

Big data and open data are the version 1.0 of this asset. Significantly, we are now moving to much more valuable, 2.0 iteration. In this new model, data is not only being collected in huge volumes and access is open to public sources, but it is being aggregated, from many sources; triangulated across public and private; accessible through common data standards and enabled through IoT-backed data collection and widespread digital platforms. This transformation marks the arrival of powerful, new data assets. In particular, version 2.0 has very high potential economic value because it offers insight. Unused data by itself has no economic value. Rather, to have an impact, it needs to be combined with land, labor and capital in a material way. Data-driven insight on how services can be delivered more effectively, where budgets can be spent more efficiently can have a significant direct impact on governments. Furthermore, this insight also promotes innovation- including supporting new approaches to existing problems, such as through public-private collaboration (for example, in mobility, in education, in multiple other of citizens' lives); driving new opportunities for monetization and investment.

These approaches are only made possible by abundant, shared data and make data 2.0 a high-potential, unique asset.

For policymakers, testing the mettle on data as the new "fuel" for growth, through increasing practical applications and focusing on measurement and return on investment, seems critical in 2018. This also means intensifying the focus on security, including how to regulate storage, protection and analysis of data. In fact, current estimates point to the high annual costs of global cybercrime; by 2021, the global cost of cybersecurity breaches will reach US$6 trillion by some estimates, double the total for 2015.[3] This demonstrates that if this is not managed apace with growing data collection and applications, the new "data asset" comes with potentially significant costs.

3 Cybercrime Report 2017 Edition, Cybersecurity Ventures, October 2017

d) Maintaining an open world through geopolitical uncertainty

Our multi-polar and increasingly digitally interconnected world brings a broad and evolving range of risks that need to be addressed in cost-effective ways. In 2017, globalization seemed to be in retreat. With citizens facing unemployment, socioeconomic immobility and declining quality of life, there is a socioeconomic push for a new set of norms for global trade. These promise to be more restrictive, if left to run through. Globally, restrictive trade measures are increasing.[4] At the same time, the ability of multilateral institutions to establish and enforce shared rules seems to be weakening[5] and the role of the multilateral financial institutions that have been providing long-term capital flows to developing countries appears to be receding.[6] Beyond the economic story, grave social and humanitarian issues also highlight the importance of international community and cross-border frameworks and resources. Regional conflicts are also a serious concern, and a global issue.

For policymakers, continuing to spread the benefits of international connectivity — including through access to markets, knowledge, international norms, and social and humanitarian support — is, in our view, a critical objective. This includes through working to keep markets open as new or amended trade agreements are pursued; supporting open and integrated capital markets; and convening with global counterparts on the humanitarian agenda. At the same time, the recent groundswell in sentiment does make some new realities clear for policymakers. In particular, it pushes the issues of competitiveness and socioeconomic sustainability to the forefront. Governments will need to refocus on investment to upskill their own talent, and to create a tax environment that supports growth but also builds sufficient reserve to weather economic cycles.

4 "WTO records moderate rise in G20 trade restrictions," WTO website, www.wto.org/english/news_e/news17_e/trdev_29jun17_e.htm, accessed on 7 November 2017

5 "Why the U.S. needs the World Trade Organization," The Washington Post website, www.washingtonpost.com/news/monkey-cage/wp/2016/09/20/would-the-u-s-be-better-off-without-the-wto-not-when-the-wto-guides-98-percent-of-global-trade/?utm_term=.d4ad8c54a3ff, accessed on 7 November 2017

6 "Multilateral Development Banking for this Century's Development Challenges: Five Recommendations to Shareholders of the Old and New Multilateral Development Banks," Center for Global Development website, www.cgdev.org/publication/multilateral-development-banking-for-this-centurys-development-challenges, accessed on 3 November 2017

Invest in the fundamentals to keep growth in a good place

From the solid performance of 2017, the New Year 2018 promises to test the underlying strength of the global economy. To maintain solid economic activity not just in the next few quarters but beyond, focusing on the fundamentals seems critical for policymakers. This means investing in infrastructure; in education to stimulate productivity, and bolster activity. It also suggests investing in new assets for growth, including inclusive, smart data platforms, as well as maintaining the global connectivity and economic competitiveness, that will enable new innovation to thrive. The potential is enormous, and we are optimistic that policy can successfully guide economic activity, while governments too adapt their own culture and operations, to realize steady growth in the quarters to come.

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