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Barriers to growth threaten the post-Covid recovery

Ballooning government debt is the principal factor that could cause prolonged downturn across the world

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Angela Merkel, pictured this week in Berlin, warned eight years ago of the risks of welfare spending Credit: Getty

While the world remains mired in the Covid-19 crisis and its economic fallout, economists' thoughts are nonetheless turning to the post-pandemic landscape. With this in mind, there are five major barriers to growth in the years ahead.

First, government balance sheets will get even bigger than they already are, with both fiscal deficits and public debt continuing to expand in monetary terms.

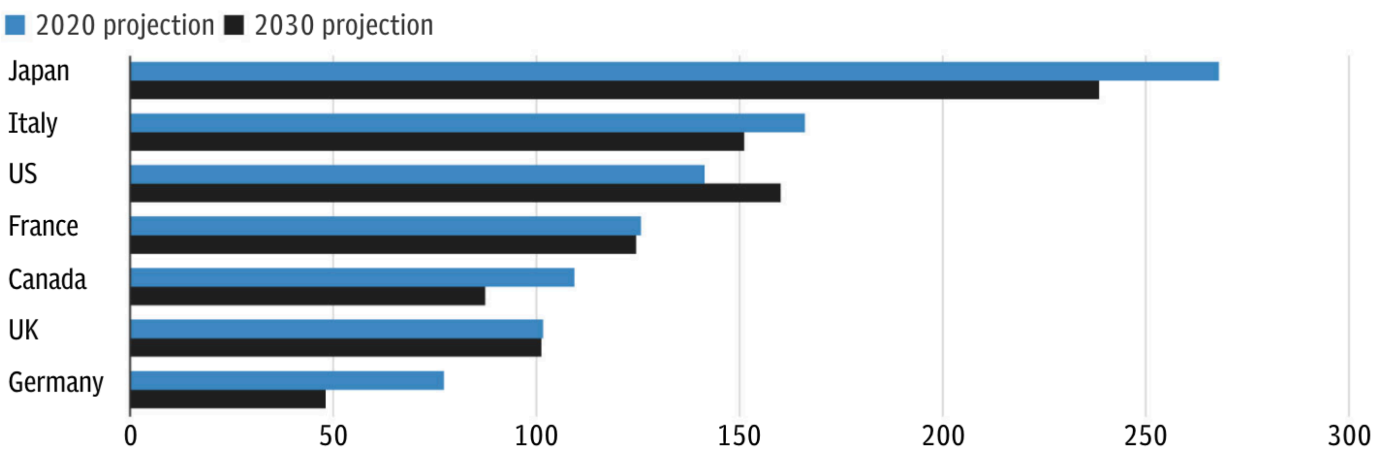
At the start of this year, total global debt as a share of GDP had already passed 300pc, with the IMF warning that global government debt will surpass, and remain above, 100pc for at least the next two years.

Major economies such as the UK and US have already breached this ratio in responding to Covid-19.

Back in 2012, Angela Merkel warned about the scale of Europe's welfare system, pointing out that a region representing roughly 7pc of the world's population and 25pc of global GDP accounted for 50pc of global welfare payments.

European government spending has only grown since then. In 2018, the US and the EU together represented 12pc of the world's population, and half of global GDP, but 90pc of global welfare payments.

Debt-to-GDP



SOURCE: INTERNATIONAL MONETARY FUND (2020), OXFORD ECONOMICS (2030)

A second barrier to growth is the state's expanding role in the economy. Since the 2008 crisis, governments' policies have gone far beyond traditional fiscal stimulus, while central banks pursue loose monetary policies, reducing benchmark rates to near, or below, zero.

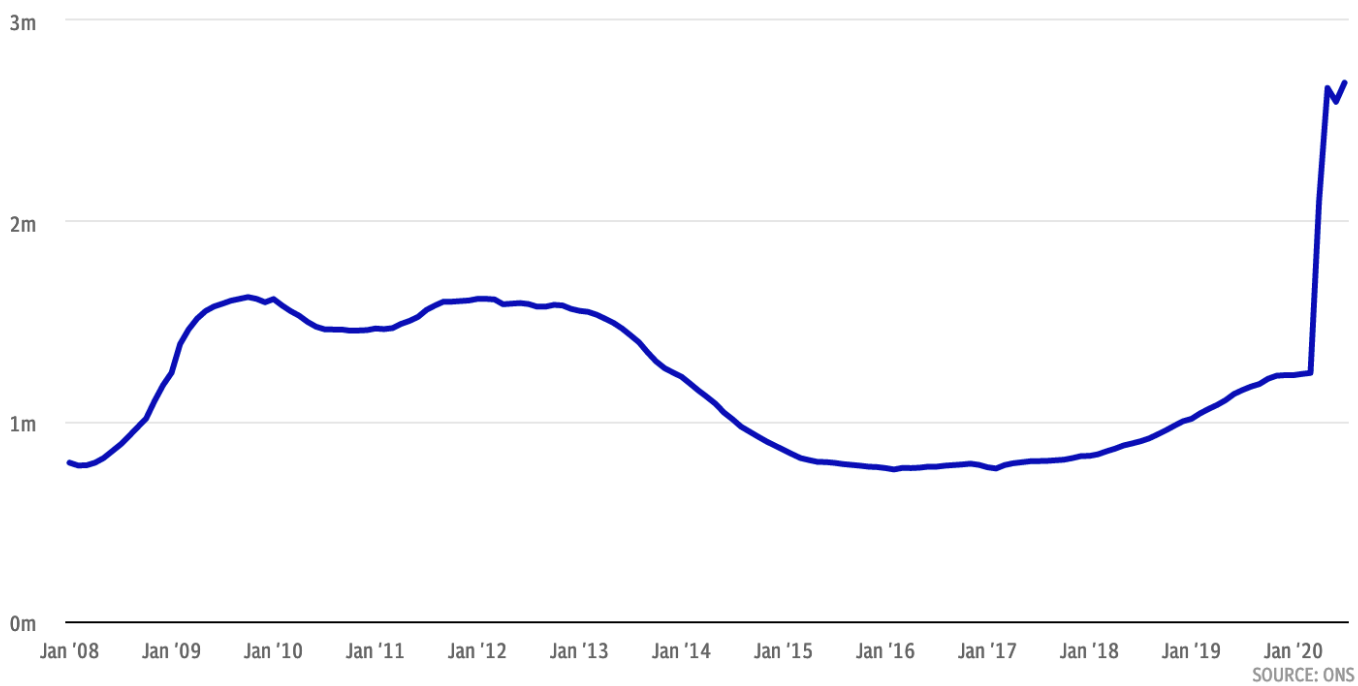
Additional structural factors suggest the state's economic footprint will continue to expand, with economies around the world confronting massive unemployment as a result of the crisis.

Any recovery will likely be driven heavily by technology, raising the prospect of labour-replacing automation and the creation of a jobless underclass. In short – a more automated, digitised workforce with more long-term unemployment.

So, high unemployment and low growth will make it even more likely that the state's enormous expansion will become permanent.

Rising again

The total Universal Credit and Jobseeker's Allowance claimant count rose during July



Third, as government rapidly expands, the private sector shrinks. The private sector's contribution to GDP around the world was already in decline.

In the UK, its output shrank for four consecutive quarters up to September 2019, representing British enterprise's poorest run in more than 25 years. In fact, even as headline UK GDP increased by 1.8pc in September 2019, private sector output actually fell by 0.8pc. A number of factors explain this trend. There are fewer publicly traded companies today than there were twenty years ago.

Many firms are looking to avoid the added transparency and scrutiny that regulators and markets demand while, at the same time, many industries are consolidating, with acquisitions no longer listed on stock markets.

A fourth major barrier to growth will come from tax and regulatory policy, where there is growing pressure to address market concentration.

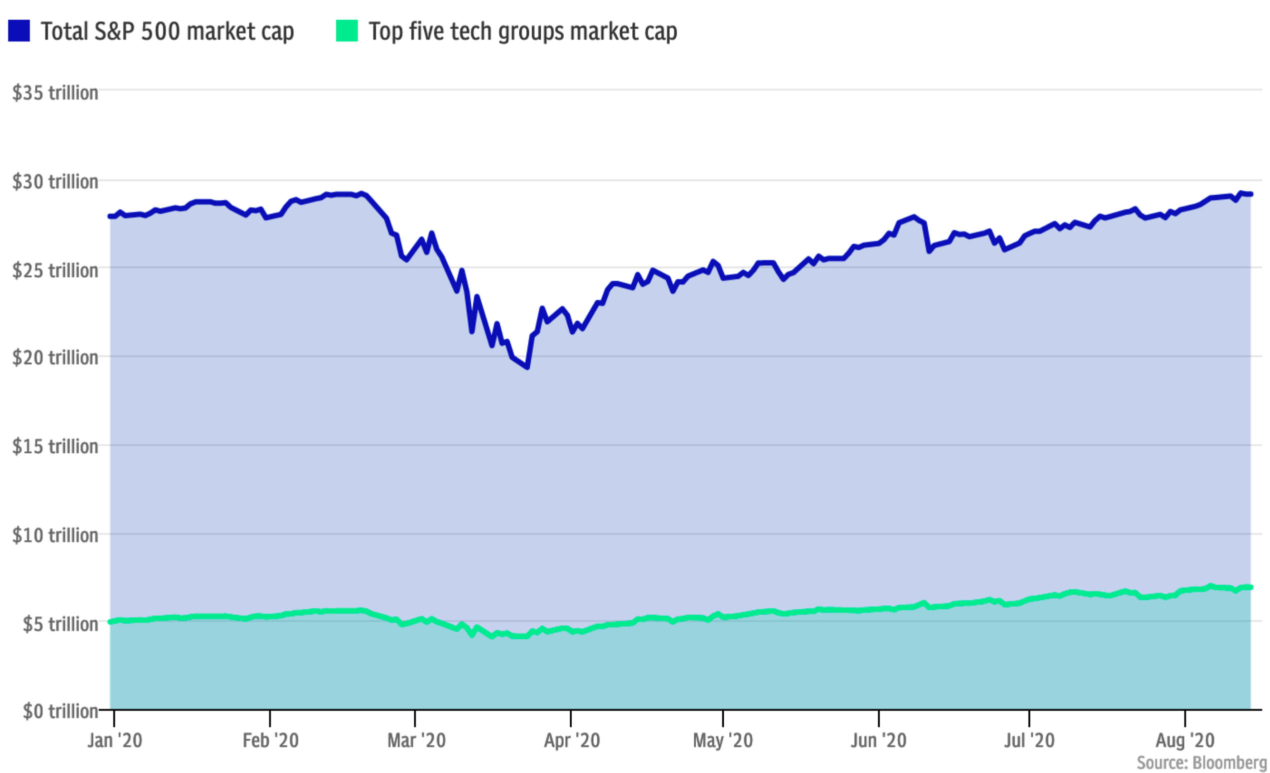
Fewer companies – some the product of mergers, others natural monopolies through growth – have come to dominate sectors such as banking, energy, pharmaceuticals, airlines, and technology.

The five largest US technology companies are not only dominant in their own sector, they also represent 20pc of the entire US stock market.

This concentration of market power in a few firms' hands risks leading to increased taxation and regulatory scrutiny, potentially harming the economy's leading growth engines.

Top five tech firms make up nearly a quarter of S&P 500's value

Total market cap



Finally, the post-pandemic era will likely be a period of accelerated deglobalisation, as pre-crisis trends toward protectionism become further entrenched.

These protectionist policies reflect broader challenges to the liberal international order as governments seek to defend domestic industries, as a response to populist pressure at home workers and other constituencies.

At this point, all five pillars of globalisation – trade, capital flows, immigration, the spread of ideas, and multilateral institutions – are increasingly under threat.

Aside from the escalating trade and technology conflicts between the West and China, as well as ongoing Brexit negotiations, global capital flows are declining, and populist political movements have brought more pressure to bear on migration.

Furthermore, the spread of ideas is now also at risk, not least due to the rise of the "splinternet".

Within the next decade, the global internet could be divided between competing China and US-led technological spheres.

Such fragmentation – of data, platforms, and protocols – would further disrupt global supply chains, adding to the pandemic-related economic damage.

Together, these trends further threaten to disrupt the global economy and add to the pandemic-related economic damage.

Covid-19 has magnified large risks that were already there, and revealed the extent of barriers to growth in the coming decade.

Unless these barriers are recognised and addressed, the global economy faces a prolonged economic downturn, regardless of how quickly the pandemic is brought under control.

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