The World in 2017

EDITED BY ANDREA E. GOLDSTEIN

Nomisma

We know that they are changing fast, but we have little idea of where the winds are blowing and how the times will be. So Nomisma has asked prominent experts from around the world to identify major trends that will shape the global agenda in 2017. Will debt dynamics prove unsustainable and precipitate a new crisis? What can be done to reignite growth in productivity and living standards? What about the future of jobs and the jobs of the future? Which topics will dominate the political agenda in key geographies in the industrial world and emerging economies?

Andrea E. Goldstein

Andrea E. Goldstein is Managing Director for policy research and outreach at Nomisma. He joined in October 2015, after a 23-year career in global governance, at the OECD, the UNESCAP Subregional Office for East and North-East Asia, and the World Bank Group. Andrea has published widely on emerging economies, is a regular La Stampa columnist, and an Adjunct Professor at the Catholic University of Milan. He is also Past President of the Bocconi Alumni Association, Paris and participates in the activities of Aspen Italia.

Contributors

In ancient Greek, “nomisma” means the real value of things. It is in this spirit that Nomisma has monitored and analyzed local, national and global economic trends for more than 35 years, gaining strong recognition as one of Italy’s leading economic think tanks and consultancies. Nomisma’s development has reflected its interdisciplinary vision of the economy, paying particular attention to agribusiness, industry, real estate, territorial development, international cooperation, public services, energy and sports.

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PRODUCTIVITY IN 2017

As Paul Krugman once noted, productivity isn’t everything, but in the long-run it is the only thing we have got to sustain growth, which is the economist’s version of the popular saying that money can’t buy happiness but it helps to achieve it. The problem is that productivity growth has been declining in almost every country of the world since before the great crisis, and so far has not been giving signs of recovery to the high rates that were prevailing at the turn of the century. Thus, productivity is likely to remain a major source of concern for governments for years to come, and certainly in 2017.

Indeed, declining productivity growth rates underpin slowing growth in potential output, and potential output measures the ability of world economies to keep increasing living standards, fulfill commitments to future generations and reassure domestic and foreign creditors that debts will be serviced and eventually repaid. In most countries, productivity growth has been declining due to both weak investment and slower average increases in so-called multifactor productivity, which in economists’ jargon means increases in the efficiency with which goods and services are produced from given quantities of labor and capital. Weak investment is largely a legacy of the crisis, which increased risk, depressed confidence and left aggregate demand wavering. One can only hope that decisive public intervention, for instance by boosting public investment and
by building confidence, might strengthen it, as suggested by many, including the OECD and other international and supranational institutions. But declining multifactor productivity growth is rooted in negative structural trends that preceded the crisis and therefore may be more difficult to address.

An economy’s multifactor productivity growth can be thought of as a combination of the innovation by firms that are at the frontier of technology and the speed at which these innovations spread to other “laggard” firms in the economy via either innovation spillovers or adoption of frontier technologies: in short it is largely a reflection of business dynamism and knowledge diffusion. Worryingly, recent research by the OECD and others has uncovered that business dynamism, as measured for instance by the rate of start-ups or investment in intangibles (such as R&D, patents and managerial and organizational skills) has been falling since the turn of the century. This has been accompanied by two other troublesome phenomena. The gap between the productivity gains achieved by the best, most innovative firms and the rest has risen – in other words, an apparent breakdown in the engine of innovation diffusion that has sustained global growth for much of the past century; and the ability to reallocate workers and funds to where they can be used most efficiently, that is towards the most innovative and productive firms, has declined. Failure to diffuse best practices throughout the economy and to let the best firms attract the resources they need to grow appears therefore to be the main structural reason for the generalized productivity slowdown beyond the (hopefully shorter-term) faltering investment rates.

A by-product of these structural phenomena, as well as an additional drag on aggregate productivity, is the rising number of low-productivity firms that survive market selection. A number of country-specific and cross-country studies suggest that not only the rate of entry of new firms has declined since the early 2000s, but exit mechanisms that should help dispose of low-productivity firms are failing to work properly, leading for instance to a relatively large and rising share of “zombies” in the economy (i.e. firms that survive for extended periods even though they are unable to generate
operating income to cover interest expenses on their debt). Such zombies not only drag down aggregate productivity directly, but also trap resources that could be used by more viable and productive firms, thereby putting a brake on aggregate productivity growth.

The breakdown of the technology diffusion machine, the declining efficiency of resource reallocation mechanisms, and the fattening tails of relatively unproductive firms have placed the inversion of the productivity slowdown at the center of policy agendas. But to what extent are public policies responsible for the slowdown and what can policies do to boost productivity? Ongoing research is investigating the forces acting on productivity and the role of policies. It would be pretentious at this stage to claim that economists have found the perfect alchemy that could reverse the productivity slowdown, but a number of insights are emerging.

For example, accelerating reforms that remove obstacles to competition in the services sectors can help: countries that have done so have been able to reap larger productivity benefits from growth at the global frontier and have experienced a lesser slowdown in the economy-wide diffusion of such productivity gains than other countries. Also, reforms that maintain and upgrade workers’ skills and facilitate their mobility across firms can sustain efficient reallocation and the growth of high-productivity firms: such measures include strengthening active labor market policies, supporting lifelong training and removing obstacles to residential mobility (e.g. lowering transaction costs in housing markets). Finally, reforms in financial markets and exit policies – such as removing banking sector distortions induced by non-performing loans and reviewing inadequate insolvency regimes – can contribute to restoring well-functioning credit markets and reduce the burden of low-productivity firms on the economy.

Giuseppe Nicoletti is head of the Structural Policy Analysis Division of the OECD Economics Department.
The October 2016 issue of the IMF Fiscal Monitor (FM) informed us that “global gross debt of the nonfinancial sector has more than doubled in nominal terms since the turn of the century, reaching $152 trillion in 2015”. This news made headlines, and for good reasons. “The negative implications of excessive private debt ... for growth and financial stability are well documented” continued the FM. Too much private debt is dangerous.

So is too much public debt. It is odd for a publication that was launched to monitor fiscal risks, that the FM did not say much about the risks arising from excessive public debt. Rather, it discussed how public spending could be used to promote the restructuring of private debt. And yet, the focus in 2017 and subsequent years will be on high public debt and its effects. Gross public debt in advanced economies rose from 77% of GDP in 2007 to 116% in 2016. According to the FM, it is not expected to decline much during the next five years. High public debt causes at least two problems. First, it leaves countries exposed to rollover risks. Granted, high debt is not a sufficient condition for a rollover crisis, but most economists would agree that it is at least a necessary condition. Second, high public debt can lower potential growth through the distortionary taxes needed to service it and through crowding out. This is more controversial, but I believe the empirical evidence points mainly in that direction.

And yet... If high public debt is so bad, why do we not see its draw-
backs? Interest rates on public debt are much lower than they were in 2007 in both nominal and real terms. Should higher interest rates not be the first signal of increased rollover risks and crowding out? Have we perhaps underestimated the amount of public debt that advanced economies can sustain without major problems? Is 120 the new 60?

Not so fast. A large share of the increase in public debt since 2007 has been purchased by central banks (through QEs) and has, therefore, remained in public hands. Japan’s fiscal deficit, averaging 8.5% of GDP since 2008, has been entirely financed by the Bank of Japan. In the same period, the Bank of England purchased more than half of the increase in UK public debt. In the US the share was about one third. In the euro area, purchases were lower until 2014 but surged thereafter.

The counterpart to these public debt purchases has been an unprecedented rise in base money. Base money has quadrupled in Japan since 2007, while it has more than quintupled in the UK. In the US and Europe the increases have not been as large, but still substantial by historical standards. So, if anything, the mystery is not why interest rates on public debt have not increased, but why inflation has remained so low in spite of the liquidity flood. Liquidity has lingered in the banking system, though, not did not lead to an increase in bank loans. The reasons why this happened are unclear. Lack of demand for bank loans – caused by the existing private debt overhang – may be a reason. On the supply side, banks could be particularly prudent in extending loans because they are constrained by lack of own capital following the increase in capital requirements in the post-crisis world. They may also be afraid of possible further increases in capital requirements.

But what is clear is that this situation is unlikely to last forever. The liquidity created over the last eight years will have to be mopped up at some point, requiring central banks to sell government paper. Interest rates will then rise and, indeed, have already started rising in the US. In Europe, once the purchases of government paper by the ECB come to an end, the spreads could widen as well. And in three years, the presidency of the ECB will change,
perhaps leading to changes in – let’s say – the way the ECB mandate is implemented. Under orderly conditions, an increase in interest rates will occur during a period of faster nominal GDP growth. But, with monetary contraction, the differential between interest rates and GDP growth will likely increase, putting pressure on the public debt ratio. Moreover, the increase in interest rates may not occur smoothly and could lead to larger-than-usual increases in the interest rate-growth differential for some countries. At that point, the implications of high public debt will become apparent.

Thus, we should not take comfort from the effects of current low interest rates on public debt. Rather, we should use this time to strengthen the fiscal accounts, so as to be ready to withstand the interest rate shock when it materializes, not to mention the demographic shock which can weaken the underlying fiscal position. Time is of the essence, and it is not in infinite supply.

Carlo Cottarelli is the IMF Executive Director for Albania, Greece, Italy, Malta, Portugal and San Marino.
The financial crisis of 2008 has clearly shown that the real estate market plays a key role in economic trends, both in terms of social implications and its close relationship with credit. Never before had it been so evident that the sector is capable of triggering financial instability and economic recession on a global scale.

Restoring normal macroeconomic conditions has turned out to be a long and difficult process, but it allowed the price of real estate in most advanced economies to reach levels that are now only slightly below those observed prior to 2008 (around 5 percentage points), as compared to the significant gap recorded during the post-crisis period of 2011-12 (more than 15 percentage points).

Taking a closer look, the Eurozone is essentially still catching up in the recovery process, with an average price level that is 11% lower than the one recorded before the crisis. On the one hand the Global House Price Index of the IMF has essentially returned to pre-crisis levels; on the other hand there remain significant differences between individual Continental markets. In the gloom countries, including Italy, housing prices are still lower than at the beginning of the Great Recession; in the bust and boom countries, prices began rebounding in 2013, after the sharp 2007-12 drop; in the boom countries, the decline of 2007-12 was slight and followed by a quick rebound.

While credit expansion was much more pronounced in the boom
economies than in the other two clusters, thus favoring the recovery, in the gloom economies the GDP contribution of the construction sector and building permits fell steadily when compared to the other two groups of markets. The paucity of new buildings, which is usually a driving force for housing prices, did not generate any rebound.

In the second quarter of 2016, residential real estate prices increased significantly in almost all advanced economies (+4% annually in real terms), with notable peaks in New Zealand (+13%), Canada (+10%), United Kingdom (+8%) and Germany (+6%). Within the EU, Italy is one of only two markets (the other is Cyprus) where a negative change was recorded, both on a trend (-1.4%) and on a cyclical basis (-0.4%).

During the post-crisis period and until now, the increase in housing prices was not accompanied by a notable increase in household debt, thus reflecting a significantly more cautious attitude. Only in a few countries, including Australia, Canada, Sweden and the United Kingdom, did levels of debt in relation to household income remain at high levels.

By the beginning of 2014, emerging economies had reached a level that was 10% higher than in 2008 before they stabilized. Prices rose significantly, particularly in Asia and Latin America, where they increased by 22% and 34%, respectively. The second quarter of 2016, prices remained basically flat, with increases in Mexico and Turkey, for example, offset by sharp decreases in Brazil and Russia.

Are we witnessing the inflation of yet another bubble? Overall, there do not seem to be any price divergences as far as the fundamentals are concerned, and the annual growth rates are consistent with the long-term average. In a context of growing disparities at the territorial level, it is not surprising that there are markets in which demand pressure makes the prices of residential properties almost inaccessible. Amsterdam, Berlin, London, Paris, Stockholm and Zurich in Europe, San Francisco, Vancouver, Sydney and Shanghai in the Pacific Area, are all examples of contexts in which, in the last three years, prices almost doubled in relation to the national average.

Unlike in the past, this phenomenon is not based on excessive
financialization, but on the centripetal force exercised by the most dynamic and evolved urban areas, which progressively attract increasing numbers of people and capital in a manner which is not always consistent with respective national economic performances. In the next few decades, the dichotomy between the real estate markets in the centers and in the peripheries of the global economy will be ever more accentuated in all regions. Contributing to the migratory phenomenon and the consequent growing urbanization are mainly the younger generations, seeking better job opportunities and income growth. The very same generations which the rising cost of real estate is now running the risk of excluding from home ownership.

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Across the OECD area, labor markets continue to recover, but there is still a substantial way to go to close the jobs gap caused by the 2008-09 Great Recession. Unemployment will continue to fall in most countries, but by the end of 2017, it will still be well above pre-crisis levels in a number of them. This decade-long job crisis signals the social and economic costs many workers and their families had to endure and the main challenges policymakers have to face to help them.

While dealing with persistent joblessness, policymakers must also confront at least three structural forces that are shaping the world of work: demographic changes, globalization and especially the digital revolution. Let’s focus on the latter. Unprecedented and continuously-growing computer power, Big Data, Internet penetration, artificial intelligence, the Internet of things, and collaborative platforms are radically changing the prospects of what work is needed and by whom, and where and how it will be carried out. This is not new. Since the first industrial revolution, major innovations have led to the decline of some sectors, with large job losses, but to more productive and (often) rewarding jobs in expanding sectors. But some argue that this time is different. Andrew McAfee and Erik Brynjolfsson point to the fact that technological progress in the digital era evolves along a gradual but exponential trajectory, whereby human capital is replaced even in skilled tasks once con-
sidered to be beyond automation. The specter of technological unemployment first highlighted by John Maynard Keynes in 1931 has re-emerged with force.

The evidence on the jobs at risk of automation is mixed. Carl Benedikt Frey and Michael Osborne have recently argued that almost half of the jobs in the US are at risk of being substituted by computers and machines. A recent study commissioned by the OECD concludes that less than 10% of jobs may directly disappear because of automation, but for another 25% on average 50-70% of the current tasks could be performed by machines. These jobs will survive, but workers would have to acquire new skills and competences to perform the new tasks. But Enrico Moretti also suggests that for each job created by the high-tech industry, around five additional, complementary jobs could be created.

One thing is more certain: significant changes in occupational structure. Digitization will continue to change how existing jobs are carried out. Information technology tools are already required in all but two occupations in the United States: catering dishwashers and food-cooking machine operators and tenders (though robot chefs might soon be in a kitchen near you).

The digital revolution will also continue to alter how work is performed. The Internet has enabled more businesses to hire competitive suppliers around the global supply chain, and workers to enjoy the flexibility and benefits of teleworking and freelancing, not least to top up their incomes. This has led to the flourishing of the “gig”, “on-demand”, “sharing”, “peer-to-peer” or “platform” economy. Though still small in scale, the platform economy raises probing questions about wages, labor rights and access to social protection for workers, as well as employers and consumers. It is early to say, but non-standard jobs appear to have risen during the recent recovery, often substituting for more traditional jobs in declining sectors. Some of these jobs may allow for greater flexibility for the workers, but they often lack full social protection coverage, have lower access to training opportunities, and provide weaker career progression than those in more traditional jobs. Moreover, the fact that under the platform economy workers are more likely to hold
jobs and multiple income sources challenges the role of statutory working hours, minimum wages, unemployment insurance and other pillars of traditional labor market institutions and policies.

Against this backdrop there are also pressures to facilitate greater labor mobility and promote incentives for workers and employers to take advantage of the new job opportunities that open up, wherever they may be. With today’s fiscal constraints, effective and well-targeted labor market programs are needed more than ever. Comprehensive strategies are required, focusing not only on building adequate skills, but promoting skills adaptation to allow workers to evolve with new requirements. Tax and benefits schemes must also evolve to protect those who lose out from change, while social protection schemes need to reflect new work arrangements, such as consulting, freelance and other contracts that no longer fit into traditional employee-firm relationships. Addressing these challenges is key to responding to the growing sense of insecurity among not just low-skilled, but also many middle-skilled workers. They represent a large part of the middle class, but many of them no longer feel part of it because of this uncertainty. Addressing their concerns is crucial to counteract the populist movements that offer them easy, albeit ill-suited, solutions.

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Since recovering from a steep decline in 2009 as a result of the financial crisis and resulting shock to global demand, world trade growth has been negligible. Trade has not been a driver of urgently-needed economic expansion; indeed, anemic rates of economic growth in part reflect the absence of trade dynamism. Reasons for slow trade growth include both cyclical factors associated with the state of the macro-economy and financial stress, as well as structural factors. In particular, there appear to be diminishing incentives to engage in the supply chain-based fragmentation of international production and associated offshoring and outward investment that was a major force driving very rapid increases in gross trade values.

The ongoing shift in China towards greater reliance on domestic, as opposed to external, demand is similarly weighing on trade dynamism. Policy factors have also played a role. The failure to conclude the WTO Doha round of trade talks, the resistance by voters to support new trade agreements (TTIP, rejection of the EU-Ukraine agreement by Dutch voters, concerns about the Canada-EU Trade Agreement, the refusal by both US Presidential contenders to support the Trans-Pacific Partnership agreement) and, most notably, the Brexit vote in the UK are all reflections of declining public support for international economic integration.

Developments in 2016 reveal the need for much more effort in
2017 by leaders in major trading nations to safeguard the open, rules-based international trade regime that supported economic growth and rising incomes in a large number of countries. Managing the distributional consequences of the “rise of the rest”, including China, is not a new challenge, but will be even more urgent in 2017. The big risk for trade is that the path of protectionism and trade conflict is chosen over concerted action to leverage economic opportunities and bolster the ability of workers to participate in increasingly services-dominated economies where well-paying assembly jobs in manufacturing industries are in short supply as a result of technical change.

Trade protection will not re-create those jobs. However, as documented by the Global Trade Alert, governments have implemented a variety of measures that discriminate against foreign products and foreign producers, including both traditional instruments that are permitted by the WTO, such as antidumping (often used intensively against China), and less transparent measures to encourage domestic economic activity. There is debate about the extent to which such measures have suppressed trade growth, but clearly they impact negatively on demand, distort investment incentives, and work against the restructuring required to reduce global excess capacity in industries such as steel.

A key question for the EU and the world economy more generally is whether the post-2010 pattern of slow trade will be reversed in 2017. Unfortunately there are downside risks that may impede a recovery in trade. There is substantial uncertainty about trade and corporate tax policy which can only have concomitant negative effects on investment. Recent and prospective decisions by the EU and by the United States in these policy areas may well impact detrimentally on global trade and investment flows. Rising protectionist pressures are reflected not just in the steady use of trade policy instruments to shelter specific industries, but also in the successful lobbying effort in the EU and the US against according China market economy status at the end of 2016, reneging on promises made as part of the deal that was negotiated when China acceded to the WTO in 2001. This led China to invoke dispute-settlement
proceedings in December 2016, and may ultimately give rise to retaliatory measures that impede trade further.

Trade relations between the United States and the rest of the world, most immediately countries such as Mexico and China, are likely to deteriorate. President-elect Trump has made clear his dissatisfaction with the status quo. Although it is not yet clear what the next US administration will do, policy reforms are likely to seek to make offshoring and global sourcing less attractive to US companies. Even if outright protectionist measures are avoided, changes to US corporate taxation to favor domestic production and repatriation of offshore funds by US multinationals will have trade implications. If reforms explicitly discriminate against foreign products they may generate major trade conflicts.

Thus, 2017 is likely to be characterized by more rather than less uncertainty for trade policy. There are strong interests opposing a major shift towards protectionism, and ultimately policy will depend on how effective pro-trade businesses and their constituencies are in the political process. Whatever 2017 may bring for global trade, it is a safe prediction that the multilateral institutions put in place after the Second World War to avoid recourse to beggar-thy-neighbor policies, including the European Union and the WTO, are likely to be tested further in 2017.

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INTERNATIONAL INVESTMENTS IN 2017

According to the UNCTAD World Investment Report 2016, global flows of foreign direct investment (FDI) rose in 2015 by about 40% to $1.8 trillion, the highest level since the global economic and financial crisis began in 2008. A surge in the value of cross-border mergers and acquisitions (M&As) to $721 billion in 2015, up from $432 billion in 2014, was the principal factor behind the global rebound. This momentum was lost in the first half of 2016, as cross-border M&A went down 33% compared to the same period of 2015, according to the Baker & McKenzie Cross-Border M&A Index, reaching a three-year low. The value of announced greenfield investment remained at the high level of $766 billion in 2015.

Discounting some large-scale corporate reconfigurations, there was a more moderate increase of around 15% in global FDI flows. Inward FDI flows to developed economies almost doubled to $962 billion. As a result, developed economies tipped the balance back in their favor with 55% of global FDI, up from 41% in 2014. Strong growth in inflows was reported in Europe. In the United States FDI almost quadrupled, albeit from a historically low level in 2014. In the first half of 2016, however, the largest reductions in deal values were experienced in the EU and North America.

Developing economies saw their FDI inflows reach a new high of $765 billion, 9% higher than in 2014. Developing countries in Asia
as a group, with FDI inflows surpassing a half a trillion dollars, remained the largest FDI recipient region in the world, while flows to Africa and Latin America and the Caribbean faltered. Developing economies continue to comprise half of the top 10 host economies for FDI flows.

Outward FDI flows from developed economies jumped by 33% to $1.1 trillion. Despite the increase, outward FDI flows remained 40% below their 2007 peak. With flows of $576 billion, Europe became the world’s largest investing region. FDI by multinational enterprises (MNEs) from North America stayed close to its 2014 level. Primary sector FDI activity decreased, while FDI in manufacturing increased. A flurry of deals raised the share of manufacturing in cross-border M&As to above 50% in 2015. FDI in the primary sector declined because of reductions in planned capital expenditures in response to declining commodity prices, as well as a sharp fall in reinvested earnings as profit margins shrunk. Services continue to account for over 60% of global FDI stock.

FDI flows were expected to decline by 10-15% in 2016, reflecting the fragility of the global economy, persistent weakness in aggregate demand, sluggish growth in some commodity exporting countries, effective policy measures to curb tax inversion deals and a slump in MNE profits. According to the UNCTAD medium-term forecast, published in the first quarter of 2016, global FDI flows should resume growth in 2017 and surpass $1.8 trillion in 2018, reflecting an expected pick-up in global growth.

This forecast does not appear to be supported by more recent data on the development of the world economy. In September 2016 the WTO announced that world trade would grow more slowly than expected in 2016, expanding by just 1.7%, well below the April forecast of 2.8%, leading to a downward revision for 2017 from 3.6% to a growth range between 1.8% and 3.1%. In view of the increasing interrelation between trade and FDI and the importance of global value chains in the strategies of multinational enterprises, the impact on investment will be substantial.

Looking at policy trends, foreign investment decisions and flows are first of all influenced by global economic trends affecting major
areas and the international policy choices made by the most important economies. The recent upsurge in the dollar following Donald Trump's presidential victory in the US and the coincident fall of the yuan led China to announce restrictions on overseas takeovers by domestic firms. On the other hand, if the restrictions announced by Mr. Trump against delocalization by US firms materialize, cross-border transactions by US firms will also decline.

Furthermore if TTP is abandoned and the TTIP negotiations are put on hold, expected FDI, especially in the Pacific area, may well not materialize. The rival economic alliance sponsored by China, the Regional Comprehensive Economic Partnership (RCEP) between China and the ASEAN countries, might receive a boost, increasing the mega-regionalization of trade and investment trends, especially in the Asia-Pacific region.

Two more specific considerations may affect FDI policy measures in 2017. The first one is the policy debate concerning investment agreements, both Bilateral Investment Treaties (BITs) and Investment Chapters in regional agreements. As seen in the case of the Canadian-European Trade Agreement (CETA), signed in November, non-business sectors are concerned with the arbitral investor-state dispute settlement (ISDS) mechanism. So-called civil society influences the legislators who must approve these deals – both the EU Parliament and national and even sub-national legislatures. The ISDS system, which is customary in BITs between developed and developing economies as a means to protect investors against government abuses and hence encourage investments, has been criticized as unnecessary in democratic developed countries and leading to unfair advantages for multinationals and foreign investors vis-à-vis local enterprises. The EU Commission’s proposal, which has been inserted in the final text of CETA, is to replace this arbitration mechanism with an International Investment Court (IIC). This has also been suggested for the TTIP, but criticism has not been placated. The Commission further proposes that the IIC be multilateralized in due time.

In a parallel development, major emerging economies such as India, Indonesia and South Africa also announced that they would
unilaterally terminate their BITs when they expire. They seek to let them lapse and to cajole Western governments to come and negotiate future BITs on more favorable terms, including tightened rules governing when foreign investors could request international arbitration. New Delhi, in particular, took a hardline stance over renewing an investment treaty with the Netherlands just days before it expired.

The second relevant set of policies and measures concerns the control and screening for security and political reasons of the acquisition of strategic assets by certain foreign investors, such as State-Owned Enterprises and Sovereign Wealth Funds. The recent blocking by the US of a Chinese fund’s acquisition of chip manufacturer Aixtron, only a few days after Germany’s first veto of a Chinese acquisition, hints at increased political concerns for such operations. This reflects the less benign view of globalization that is starting to prevail in public opinion and in the electorate. The important strides made by nationalistic concerns in the most advanced nations on both sides of the Atlantic do not bode well for further liberalization of FDI regimes and the opening up of economies.

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Reconciling climate and trade policies will be a priority next year. The Paris Climate Agreement reached in December 2015 is widely viewed as representing a fresh start for the mitigation of climate change through taking global measures. While falling short of setting a global price on carbon, nevertheless the Paris Agreement registers the world’s first global commitment to collectively reduce carbon emissions. As such, it opens the way to more detailed discussions as to how countries might implement their Intended Nationally Determined Commitments (INDCs). Central to this process will be the role played by promotion of clean-tech industries, particularly renewable energy industries, and the way that national promotion measures such as imposition of local content requirements (LCRs) will interact with the global trade regime.

A rash of disputes over green energy promotion, both those brought before the World Trade Organization (WTO) and pursued by countries imposing unilateral “trade remedies” on each other, threaten to subdue countries’ enthusiasm for building green industries and undermine all the efforts to be taken within the framework of the UNFCCC agreed in Paris. These disputes have come to a head in the past few years, leading scholars and diplomats to label them as the “next generation” of trade and environment conflicts and viewing them as imposing a serious risk of reversing whatever
gains might be made in the forums established within the terms of the UNFCCC.

The imposition of LCRs as a means of promoting indigenous green industries by emerging economies dates back to China’s active development of its wind power industry in the late 1990s and early 2000s. There is widespread agreement that this was a highly successful program and one that is largely responsible for China’s wind power generation and wind turbine manufacturing sector becoming #1 in the world in the 2000s. It did not result in a formal WTO dispute because China discontinued the program after judging it to be a success.

The case of India tells a different story. The LCR provisions of the National Solar Mission are quite explicit – and have provided a template also for the National Wind Program. At the instigation of the US, a Panel of the WTO was convened to consider India’s promotion of green industries, and reported in early 2016, finding against India. The country is clearly serious about building its renewable energy industry and creating manufacturing industries to support both solar and wind power development on a large scale – and it is not about to let a dispute in Geneva block its ambitions.

So this case of India vs the US at the WTO indicates that there is a very real danger that actions brought against countries in the name of upholding the principles of free trade might jeopardize the gains won in Paris. What is won within the arena of the UNFCCC might be lost again within the arena of the WTO. How is this highly undesirable outcome to be avoided?

What has been missing in the various proposals advanced so far for greening of the WTO is an element of supranational endorsement of any particular country’s imposition of promotional measures such as local content requirements. Such a goal might be pursued in the name of a global public good in the form of mitigation of climate change through promotion of green energy and clean-tech industries, with full industrial policy support. The goal would be given added credibility if it could appeal to the Paris Agreement as a collective aspiration of humanity.

One way forward would be for the 2017 Conference of the Parties
(COP) under UNFCCC (organized by Fiji and hosted by Germany) to adopt a resolution recognizing a group of green products and processes as being eligible for exemption from trade law for a set period (say five years), a period which would enable countries that wish to do so to take advantage of a broad but limited exemption from trade rules in order to build their green industries.

Rather than leave individual countries on their own to argue their case before the WTO, such a resolution would lend the authority of the UNFCCC to such matters, cutting through the complications raised by WTO procedures and establishing once and for all that climate change mitigation is the ultimate “public interest” that needs to balance stringent application of trade provisions with exemption for certain designated products and periods from the rules of full competition.

The power of this proposal lies in the point that it promotes diffusion of green industries through allowed imposition of green industrial policy; it does not undermine WTO principles of free and fair trade, but simply allows the WTO to (implicitly) recognize the UNFCCC as providing the authority needed to specify products or processes as being green, and give countries that wish to do so a window of protection to allow them to build the needed green industries.

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Fundamental issues of development policy will be in play in early 2017 as the orientations and decisions of the new US Administration take effect, at the level both of global economic dynamics and international development cooperation (notably the World Bank’s IDA 18 approval process).

Until the election of Donald Trump, the outlook for developing countries in 2017, in the aftermath of the end of the commodities super-cycle, mirrored the assessment of secular stagnation in advanced countries. Later in 2016, various international institutions have argued that Keynesian fiscal expansion in the world’s largest economy, including the inauguration of an infrastructure renewal and expansion program that could stretch over a decade or more, heralds a radical escape from the liquidity trap.

What then, might be the new narratives for development prospects and issues in 2017, taking into account the Trump policy package as a whole, which includes vigorous trade policy actions tied to a competition-for-jobs view of trade and development dynamics? For a complete picture here, we need also to bring China into the picture – not just as a potential target of such trade policy action, but as the originator of the most significant global infrastructure program yet conceived, with large economic and geopolitical impacts, namely the One Belt One Road (OBOR) Initiative.

The immediate impacts of the Great Trump Reflation are not all
positive for developing countries. Rising interest rates and a rising dollar pose capital account and debt burden threats to a range of emerging markets and some low-income countries that have ventured into the cheap international bond markets of the post-financial crisis years. African countries such as Ghana and Zambia, which benefitted enormously from international debt reduction initiatives, are now entering into IMF programs to avert risks of debt distress. But offsetting these dangers is the Trump impact on global growth, not least via commodity prices, supercharged by the US infrastructure expansion plans and China’s OBOR, with associated expectations already showing up in the market valuations of mining companies and their suppliers and the uptick in metal prices.

Nevertheless, at some early point a glaring incoherence in the Trump economic program will enter into play. A US fiscal expansion will, by definition, raise the US balance of payments deficit as a macroeconomic phenomenon, not as a trade phenomenon. Yet this is likely to add fuel to the protectionist agenda set out in the campaign. A prime target is likely to be China. At the same time, the new Administration will find that measures against China will encounter significant opposition inside the US. The cost of a shopping cart of clothing, footwear and electronic goods would rise significantly. Complex supply chains would be disrupted. And key US companies are big contractors to the Chinese projects in the OBOR program, with significant numbers of US jobs involved.

Furthermore, a uniform hike in tariffs against Chinese imports would only hasten the relocation of Chinese labor-intensive industries to low-income developing countries. China has an explicit policy of helping the industrialization process in Africa, which it managed to make into a G20 strategy as an outcome of the Hangzhou G20 Summit. In a bipartisan move, the US Congress last year extended until 2025 the African Growth and Opportunity Act (AGOA) that provides zero tariff entry to a wide range of African-sourced goods, allowing China to shift its production platforms there.

On another level, there is the question of the US position on development finance. China has emerged as a major force in development financing via the China Development Bank and the ExIm
Bank with state-guaranteed funding power. The two policy banks finance not only development projects, but also exports and outward investment by Chinese companies, including in renewable energy and ICT infrastructure.

With little success, the Obama Administration challenged China in the field of export credits, and with counterproductive results, opposed the creation of the Chinese-based Asian Infrastructure Investment Bank (AIIB) and the BRICS New Development Bank (NDB).

Will the Trump Administration launch a full-scale attack on the exercise of financial power by Chinese policy banks and companies? Or will it seek to assist US companies as they leverage the OBOR for contracts and jobs? Or, as has been suggested, will it establish its own US Development Bank to leverage US entrepreneurship in developing countries?

On the multilateral front, the IDA18 replenishment agreement will be the subject of decision by the new Administration, with the approval process expected to culminate at the IMF/WB meetings in April 2017. With its comprehensive programming content across frontier issues of jobs and economic transformation, infrastructure, climate change and conflict and migration, and with important links to the 2015 UN agreements on Sustainable Development Goals and climate change, IDA18 will provide a key indication of the development philosophy of the Trump Administration.

Of particular importance will be the US position on burden-sharing in an international development system with new players and institutions and a coalescing of development and national security issues. US contributions to IDA require Congressional assent. The US still retains the casting vote in the World Bank, with some memorable episodes of contestation and delay, and could again oppose IDA expansion and policies, but only if the new Administration were unconcerned about the geopolitical costs of losing leadership of the World Bank.

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On 1 January 2017, the OPEC (Organization of Petroleum Exporting Countries) production-limiting agreement, signed on 30 November 2016, came into effect, thus marking the first time that such an agreement receives external support from a large group of non-OPEC producers, led by Russia. The cartel has promised to cut its production by 1.2 MMBD (million barrels per day) from the October 2016 record of 33.7 MMBD to the new cap of 32.5 MMBD. The non-OPEC producers, 11 countries in all, have pledged to reduce output by another 0.55 MMBD, with a total reduction of 1.7 MMBD, a shift that can guarantee more stability in a market that in the last two years has been marked by oversupply and weak prices. If all producers truly respect their commitments, then prices will quickly return to over $70/barrel, a jump from the 2016 average of $44, but still well below the $110/barrel level at which prices had stabilized before 2014. As learned from the experience of the last 30 years, such agreements are rarely respected in full. Nevertheless, the late 2016 developments represent a turning point for oil policy.

The OPEC agreement by itself is historic, insofar as such cooperation has not yet been seen in the twenty-first century. The last commitment to reduce production with quotas allocated to all players, including Iraq, dates back to 1998, when the cap was set at 27.5 million barrels a day, 6 million less than today, and with prices that
ranged around $10 per barrel. Since then, agreements have always aimed at increasing production, in order to satisfy a demand that rose much faster than production, within a spiral that pushed prices to a record $140/barrel in 2008. Subsequently prices stabilized at around $110/barrel until mid-2014, when Saudi Arabia decided to flood the market in reaction to Obama’s decision to remove the sanctions on Iran, its historic enemy. The election of Trump on 8 November 2016 has reassured Riyadh, and, paradoxically, has facilitated a rapprochement with Iran within the cartel.

Against the backdrop of the great uncertainty that has dominated the oil market for the past 50 years, a basic rule that affects prices has prevailed: if Iran and Saudi Arabia get closer, then prices will go up, but if they are at odds with each other, then prices will go down. Since 29 September 2016, when an informal meeting was held in Algiers, relations have improved and Saudi Arabia has accepted Iran’s return to producing 4 MMBD, the pre-sanctions level, up from 3.7 MMBD in October 2016. Before the 1979 revolution, Iran produced 6 MMBD and it was the Shah’s goal to exceed the 10 MMBD level of Saudi Arabia. One of the many paradoxes of oil is the fact that Iran now has to fight hard in order to return to 4 MMBD.

This is a historic moment, particularly in terms of the support provided by the group of non-OPEC countries following their 10 December 2016 summit. Previous attempts had always failed, because from the beginning the non-OPEC countries were weak, not very representative, and lacked a leader. Today, however, Russia, which has agreed to accept more than half of the cut (0.3 MMBD), is playing that role and all the large non-Western producers are involved. Since the spring of 2016, Moscow has been making diplomatic efforts to bring Iran and Saudi Arabia together. At the end of 2016 it succeeded, but not before committing itself, for the first time, to a sharp cut in production, which is also at record levels above 11 MMBD. Compared to the attempts made in the past with other non-OPEC members, this time the commitment seems to be much stronger, precisely because of Moscow’s role.

Major support to producers will come from the increase in de-
mand. The rule, which has been in effect for 40 years now, is that every year consumption rises between 1 and 1.5 MMBD and that supply will adapt to it, more or less quickly. In the past two years, the increase in global consumption has slowed, but the underlying trend remains solid and could become more robust in case of strong global economic recovery.

A cap on price recovery comes from the United States, where oil from hydraulic fracking is ready to start flowing again if prices restabilize above $60. Drilling has started to increase again, as the cost-cutting process that began with the low prices of 2014 has continued in 2016 as well. In 2012, production costs per barrel in Texas were between $70 and $90, while at the end of 2016 in the best areas these are between $40 and $60.

Following tradition with Republican Presidents, Donald Trump will do everything to help the oil industry and this will result in greater supply, which will act as a curb on the ambitions of OPEC and its new allies. On the other hand, the intense competition between producers that has brought down prices has ended, and as early as 2017 a new cycle of rapidly-rising oil prices is ready to start.

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Notwithstanding the gloom and doom within the progressive community regarding recent global political and economic developments, the field of Responsible Business Conduct (RBC) or Corporate Sustainability should pick up momentum in 2017 due to a number of new initiatives being launched and the consolidation of a few others from 2016.

We can expect three main trends in 2017: a shift towards binding measures regulating RBC, the increasing use of corporate rankings as a way to influence corporate behavior, and a spreading acceptance of human rights as a risk factor in more branches of business.

First, there is an international shift toward binding measures stemming from recognition by nation states that corporate accountability can be improved by requiring greater disclosure and due diligence of environmental and human rights metrics.

The key regulation of note is the 2014 EU Directive on Non-Financial Information Disclosure, which requires companies with over 500 employees to report annually on their policies, main risks and outcomes relating to environmental matters, treatment of employees, respect for human rights, anti-corruption/bribery issues and board diversity. Several countries have by now transposed this directive or have legislation in place to meets its requirements.
The year 2017 will also herald a more comprehensive set of company reports on human trafficking and slavery under the UK Modern Slavery Act of 2015. This act requires top company representatives to report annually on the due diligence undertaken on its supply chain with regard to human trafficking. This covers companies headquartered or doing business in the UK. The EU itself may use the Act as the basis its own legislation.

Furthermore, there is an interesting referendum movement afoot in Switzerland which would compel Swiss-based multinationals to undertake human rights and environmental due diligence on all of their business activities abroad. Companies could be held accountable for abuses committed by entities under their control. This referendum, expected in late 2017/early 2018, would affect most major global companies, banks and insurance companies.

A second trend is the catalytic impact of benchmarking/ranking initiatives. There is nothing like a public ranking to focus the minds of company executives – especially if their company is ranked behind a main competitor(s). Building on already successful rankings – such as Oxfam’s Behind the Brands (food and beverage sector), Access to Medicine (pharma), Ranking Digital Rights (ICT) and Know the Chain (forced labor), and the Dow Jones Sustainability rankings – the new entrant for 2017 will be the Corporate Human Rights Benchmark Initiative. This index (promoted by a number of investors, like Aviva, and several think tanks) plans to rank the world’s top 500 companies by turnover on their labor, environmental and human rights performance, and will publish rankings on the first 100 in March 2017. The expectation is that this ranking system will drive a race to the top – always a good thing.

Third, 2017 will see greater engagement and buy in on the UN Guiding Principles (UNGPs) for Business and Human Rights from different actors: institutional investors, insurers and reinsurers, lawyers, and accountants. Similarly, major corporations are beginning to align with a number of Sustainable Development Goals. So, 2017 will usher in a shift from a “name and shame” environment for corporate conduct to a “report or explain” one.
Institutional investors – key laggards until recently – are finally understanding that they must take into account all factors that may be material to the performance of specific assets under their control – including Environmental, Social and Governance (ESG) factors. This is a seismic shift that will doubtless see further consolidation in 2017, thanks to work undertaken by the UN Principles for Responsible Investment Group, the International Corporate Governance Network, and many others. Ditto with the emergence of insurers (and re-insurers) in this movement. Those that embed sustainability into their business operations will be able to catalyze the kinds of financial and investment flows and long-term perspectives that have been lacking.

Lawyers too are starting to engage. The International Bar Association’s May 2016 published guidance on the UNGPs for general counsel and external lawyers will help increase engagement from the legal profession, as its role is expanded to trusted counselor and risk avoider in all areas from M&A to corporate procurement practices.

All of these trends in RBC are important and are here to stay. Notwithstanding this progress, it would be remiss not to close with a reflection on the possible effects of a Trump Presidency on efforts for increased transparency and sustainability regarding the business sector.

The RBC community should be concerned about a possible US withdrawal from the recent Paris Climate accords, evisceration of the US Foreign Corrupt Practices Act and the repeal of the Dodd Frank Act – including provisions 1502 (regarding the traceability of conflict minerals from the DRC in the supply chain) and 1504 (regarding reporting of payments to foreign governments for companies in the extractive industries).

These two provisions were due to be harmonized with European regulations in 2017, so this effort may be compromised. However, even US companies have long time horizons and may not deem it expedient to roll back their commitments to environment and human rights if they are working with international institutional investors and savvy consumers. Companies will continue to feel the
pressure from public rankings/indexes and from their financers, insurers and legal advisors – and all of this is a good thing.

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The roadmap for improving European migration policy is very clear and has gained general support among experts. Nonetheless, what Europe actually will be able to achieve on such a sensitive issue remains in the hands of the Member States – i.e. of Council – which react to short-term domestic priorities, especially during electoral periods. As 2017 is an election year in many EU countries, it is unrealistic to expect substantive progress in making rapid decisions and finding efficient solutions.

The roadmap is clear, the most urgent problem is to make policies more effective, pro-active and fair, not only for asylum seekers and refugees, but also for the countries of first arrival, first asylum, and final destination.

Thus policy should first of all make “resettlement” procedures, namely the legal channel for asylum-seekers looking for protection, more viable. Under the resettlement scheme, 22,000 refugees were to be resettled between July 2015 and mid-2016: in practice, the process was concluded for only 8,000 individuals and at any rate both figures are quite low compared to the numbers of those crossing the Mediterranean (around one million according to the UNHCR). Similarly, six months after the March agreement with Turkey that aimed to dissuade illegal entrance to Greece by offering programmed resettlement in Europe, only 1,600 Syrian refugees have been resettled. The resettlement policy has clear benefits –
fewer deaths at sea, lower costs for unforecasted arrivals by sea or land – but unless there is common sea patrolling and border controls, it will be impossible to move forward with the intra-EU “relocation” or “redistribution” of asylum-seekers.

The more EU Member States cooperate in the control of borders and the faster refugees can be identified, the easier it will be to redistribute asylum-seekers to final destination countries. Yet this is a very divisive policy based on “intra-EU solidarity”, a value that no top-down approach – from the Council to Member States – can instill, but which must be accepted by citizens as well. This necessitates both economic and political incentives, taking different historical circumstances into consideration and gaining the support of local communities. The revision of the EU asylum policy must pay adequate attention to understanding the roots of discontent in public opinion and invest in appropriate communication.

In this respect, the implementation of efficient policies at the local level is crucial. All too often, public opinion has reacted negatively and even aggressively to what has been seen as the mismanagement of assistance, justified by humanitarian motives with insufficient attention to the integration of asylum-seekers. Assisting refugees is a highly complex task, and non-governmental organizations are often given responsibilities that far exceed their human and organizational capabilities.

The integration policies implemented while the requests are processed, and after the recognition of the right to international protection, are crucial in determining the success of the entire migration policy. On the one hand, the likelihood of the asylum seekers’ returning home after the end of a conflict reduces the incentive to invest in their human capital; on the other hand, the uncertainty surrounding prospects in conflict areas obliges to invest in their future in the destination countries. The usual integration instruments (language courses, education, training and cultural values) should be adopted with particular attention to the modality that best facilitates the acceptance of foreigners by the local community. The Commission should play an active role in coordinating national policies in order to avoid disparities, while
at the same time leaving national governments the leeway to deal with local cultures.

Among European priorities is also supporting first-asylum countries in providing food, education and healthcare to the refugees with the objective of alleviating the burden of providing such assistance. The principle of “international solidarity” implies that Europe should intervene with financial support as well as provide food, water, education and health care in order to alleviate the situation of the refugees and the burden to European citizens.

Which legal instruments need to be revised? The Common European Asylum System is comprised of various legal elements and structures. The revision of the Dublin System to more effectively address the needs of refugees and EU countries alike is a fundamental, but complex, task as it needs to incorporate a mechanism for redistribution which has to be negotiated at the Council level. The mandate of the European Asylum Support Office should also be revised in order to reduce the divergence of implementation among Member States and support countries in need during periods of extraordinary migrant pressure.

Lastly, the EU should impress on other more distant G20 partners that coping with refugee crises, in Syria in particular, cannot only be a European responsibility. It is natural for countries of first asylum to be more involved in providing assistance to asylum-seekers, but other big global players such as Russia and China should also be concerned and assist the migrants, both with targeted resettlement programs (as a final destination) and with dedicated resources to support first-asylum countries.

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Almost ten years after the Global Financial Crisis and the start of the Great Recession, the Eurozone is still struggling to recover, investments are still low and unemployment remains at high levels. In this context, the European Central Bank (ECB) has announced that it will continue an expansionary policy, with quantitative easing extended throughout 2017, though with smaller amounts. This decision probably anticipates that little stimulus will come from fiscal policy. Though necessary, the fact that the ECB continues to carry the entire burden of expansionary policy may allow governments in the Eurozone to avoid assuming their responsibilities in a common fiscal stimulus and in strengthening policy coordination. In the face of mounting euro skepticism and the risk of disintegration of the Eurozone and even of the European Union, are we going to observe significant changes in the framework for fiscal policy in 2017? What about the tensions between “positive” national fiscal policies and “negative” policies, based only on rules defining limits?

In response to the threat to stability brought on by the post-crisis debt explosion, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which comprises the Fiscal Compact, was signed by the European Council in March 2012 and ratified by 12 Eurozone members in January 2013. The Compact made fiscal rules more automatic and stricter: at its core
there is the balanced budget rule, with an automatic correction mechanism and the debt reduction for public debt above 60% of GDP. Rather than strengthening the sustainability of the common currency, the Fiscal Compact has been increasingly perceived as an obstacle to European integration. With the benefits of hindsight, what was needed in 2012 was a common expansionary fiscal policy to help Euro economies get out of the double-dip recession, which eventually contributed to the sovereign debt crisis in several Southern European countries. Furthermore, rather than contributing to fiscal discipline, the Fiscal Compact led to a chaotic situation in which many Member States did not comply with the rules. Continuing in the tradition of the Stability and Growth Pact, the new fiscal rules are complex and subject to arbitrary measurement. Indeed, the assessment of the balanced budget position is made with reference to the structural balance, which is the government budget balance corrected for the cyclical position of the economy. This requires measuring the potential output of the economies, a practically impossible task in the context of a major structural break like the Great Recession.

One important aspect of the Fiscal Compact is that non-complying countries cannot access funds of the European Stability Mechanism (ESM). This issue is particularly relevant for countries, such as Italy, that are still struggling to find a solution for their troubled banking sector and may need help from the ESM. However, the contradictions of the Fiscal Compact are more general, as it undoubtedly acts as a major obstacle to recovery. It is difficult to find an economic rationale for the reluctance to increase government expenditure, especially investments, in countries running a surplus in the current account of the balance of payments (which also equals the difference between savings and investments) of more than 8% of GDP (Germany). Moreover, even countries in dire straits run sizable current account surpluses, and thus fiscal austerity has little meaning even for them. What is even more worrying is that the continuing period of low growth is contributing to the collapse of support for both the EU and the euro. Facing the deepest recession since the 1920s, the rapid impoverishment of the
middle class in many European countries, the exploding youth unemployment rate, and the deterioration of infrastructure in most European countries, the only solution that the EU could come up with was creating a scheme for automatic fiscal austerity.

A wish for 2017 is that the Fiscal Compact will be overhauled or temporarily frozen. The sustainability of the European Union itself depends on a common effort to implement “positive” European policies, built around three main pillars: (1) a common unemployment insurance, linked to a European fund; (2) a large European investment program for investments in infrastructure (much larger than envisioned in the Junker plan); (3) expenditure for education and research and development based on EU-wide and EU-sponsored programs. Europe needs to show its citizens that common policies are implemented to achieve common goals and that European policies are not synonymous of “negative” rules. This approach to exiting from the dangerous spiral that the Eurozone is experiencing would also help in differentiating popular policies from populist policies. Proposals for sizable increases in public expenditure in the context of historically low interest rates on government debt are not populist, as they are based on rational economic thinking. It is time to exploit this unique opportunity, increase public expenditure, and/or reduce distortionary taxes, and finance spending with Euro-bonds guaranteed at the Eurozone level. Today, such Euro-bonds would carry a close-to-zero interest rate and thus the true question is not whether these proposals are populist, but why they are not implemented?

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Banks in 2017

Banks will be facing various challenges in 2017, partially a legacy of the financial crises of the last decade.

The first challenge will come from regulatory changes. The ECB, the national supervisors and the Financial Stability Board (the latter for the banks that are relevant at the global level) tend to make the financial system more stable and able to deal with any new crises with specially designed instruments. In Europe, they include the Single Resolution Mechanism (SRM) and the Single Supervisory Mechanism (SSM), the Supervisory Review and Evaluation Process, the stress tests, and the evaluations of business models and of the appetite for risk, that have led to additional capital requirements. At the global level, the Basel Committee proposes putting limits on client risk assessments (based on the modeled track record of each bank), giving more weight to a standardized and therefore more cautious evaluation. This would require European banks to put aside more capital in order to finance businesses, but not American banks: these mainly invest in financial instruments, which are riskier than corporate loans, but whose risk cannot be estimated by the models.

The remedy proposed by the Basel Committee is, from 2018 onward, to add a new parameter that does not require risk assessment of individual applications, using the financial leverage coefficient (ratio of net capital to total assets) as a new indicator for supervi-
sion, with a threshold of 3%, and 4% for the larger banks. This threshold is insufficient to ensure that a bank will be able to survive substantial write-downs of its portfolio – European banks generally operate at much higher levels – but it is more easily accessible to American banks. Providing credit to the real economy would thus become more difficult, weakening European companies – given that American firms are financed from sources other than banks – and this would be a problem especially for countries where SMEs account for a large share of businesses. Therefore 2017 could be a year of extensive mediations.

The second challenge is related to the complexity of risk management, which requires costly technological and human resources, a very heavy burden for small and medium-sized European banks. Of which there are still too many in Europe (according to the ECB, as of March 2016 there were 3231 banks, though only 35 large ones), with an average (weighted) cost-income ratio of 0.63. As noted by Victor Costâncio, since there is an inverse relationship between concentration and the cost-income ratio, it is possible to gain efficiency through aggregation. In 2017, in all likelihood, we will see the formation of new banking groups.

The third challenge relates to the recovery of profitability after years in which shrinking interest margins – caused by the easing of monetary policy following the crisis – have weighed heavily on the balance sheets of retail banks. In Europe their average profitability declined by 62% (Bloomberg estimates that ROE has decreased from 16.8% in 2007 to 6.5% in 2015), while investment banks overseas have returned to generating earnings well above pre-crisis levels. Given the capital requirements associated with exposure to business loans, European banks probably will also reduce this type of exposure in favor of fee-generating business and asset management, rather than interest margins (lending). Banks will be asked to provide new specialized advisory services – also linked to the development of new technologies – and transactional activities will play a smaller role, challenged by competing services also provided by non-bank intermediaries.

The fourth challenge concerns the management of non-perform-
ing loans, a systemic problem in Europe: in mid-2016 these totaled over €1 trillion. In 2017, a solution must be found, particularly for the countries (10) that have NPL ratios higher than 10% of total gross loans. These are the outcome not only of the long crisis, but also of the slowness of judicial procedures, which vary by country and lead to incentives/disincentives and possible competitive advantages/disadvantages. It is necessary to strengthen and increase the efficiency of the judicial systems, to facilitate the use of extra-judicial resolutions, to assess real estate collateral in a more transparent way, and to set up companies that are specialized in the management of impaired assets.

The fifth challenge regards the governance of banks. The financial crisis has brought to light weaknesses in both the functioning of governing bodies and management teams, as well as in internal controls that are at times unable to prevent excessive risk-taking by some operators. In the meantime, the ownership structure of banks, especially the largest ones, has changed, becoming increasingly international, composite and better able to react proactively to external changes. Among the main objectives of a Board is contributing to the efficiency, soundness and profitability of the bank by building on the diversity of backgrounds and interests within a modern governance structure.

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ECOMpetition policy in 2017 will undoubtedly be dominated by the relationship between anti-trust regulations and the collection and use of large quantities of personal data. The now widely diffused ‘buzzword’ used to identify this phenomenon is ‘Big Data’, and it refers more specifically to the use of a large volume of data, derived from various sources, which can be processed quickly, and from which it is possible to extract great value (thus the four Vs: Volume, Variety, Velocity and Value). The phenomenon is pervasive in many markets. We should not think only in terms of the most obvious examples of Google and Facebook, but also of the data collected in the fields of telecommunications, energy, insurance, banking, medicine and transport.

Big Data are relevant to competition in at least two aspects. First, the collection and exploitation of data by a company can create barriers to market entry of new competitors and thereby give rise to a dominant position or strengthen it. Second, they can improve transparency in the market and allow companies to engage in some dangerous anti-competitive business practices.

With regard to the first aspect, the size of the incumbent company in the areas where the data have a high value takes on a significance which goes beyond the already very important role it has in traditional markets. A company that is already operating in the market benefits from the ‘snowball’ effect, in which the larger quantity of
data that it has at its disposal compared to new entrants is in itself a reason for acquiring an ever greater amount, from its customers as well as from consumers. Other companies are not able to enter the market or are forced to leave it, not because they are less efficient, but simply because they are smaller. In contrast, however, it should be noted that when data become available, they can reduce barriers to entry in a market, for example in those cases where they may be used to identify and address the needs of consumers in another market.

Increased market transparency can also generate negative effects from the perspective of competition. While in principle this benefits consumers, who can compare prices and quality of the goods or services offered, transparency can also increase the stability of a collusive cartel, since it allows for easier identification of companies that have strayed from the agreed conditions. In addition, the real-time availability of market prices and the use of sophisticated algorithms could allow companies to collectively anticipate the behavior of competitors and therefore make it easier to arrive at oligopolistic equilibria. In this context, some practices may have particularly adverse effects. For example, mergers in sectors where data have a high relevance could allow the new company to combine various databases that allow it to gain a competitive advantage not surmountable by competitors.

From the regulatory point of view, the biggest challenge in the near future will be the integration of competition law in this business with the law on the protection of privacy. In this regard, it can be noted that, even when the law that protects the right to confidentiality is of a unitary nature, the methods for collecting data and the characteristics of the latter are quite varied. For example, the personal data available on social media are conferred in an entirely free manner and outside of commercial relations, even though one cannot exclude that the transfer of such information may create quantifiable benefits. In contrast, with regard to e-commerce sites, the data that are provided voluntarily (typically address, e-mail address, telephone and credit card numbers, etc.) are normally associated with the operation of the requested service. However, based
on user search behavior, businesses can extrapolate other information that is not always consciously provided, such as age, spending power, level of education and cultural background. Furthermore, in relation to certain sites, on the one hand users provide extremely sensitive data, and on the other hand offer themselves as targets for unsolicited commercial information. Think for instance of the consultation of news websites which make it possible to identify the political and cultural orientations of the user and, at the same time, make the user a commercial target for companies that adopt the site as an advertising platform for their products.

But of course the most sensitive issues associated with the relationship between competition and privacy arise in relation to the ‘platform of the platforms’, i.e. to companies such as Google and Facebook, without which the other sites would find it almost impossible to operate. It is with regard to these modern ‘railways’ or ‘energy networks’ that competition law often has imposed obligations of opening up and neutrality. Nor is it a coincidence that with regard to Google, in 2016 the European Commission has launched an investigation into the breach of competition regulations whose outcome promises to heavily influence the commercial policy of the US giant for years to come.

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The British voters’ decision that the UK should leave the EU is an earthquake in slow motion. Nothing has yet changed but the tectonic plates are shifting and, like animals in the wild, we are alert and uneasy. As Auden wrote, “The sky is darkening like a stain / Something is going to fall like rain / And it won’t be flowers.” (The Witnesses)

As 2016 closes, some speculate that Brexit may yet not happen. But, despite a cross-party “Remain” majority in the UK Parliament, there is no political appetite now not to follow through on the result of the referendum. So sometime after Easter next year, whether after a Parliamentary vote or not, the UK will invoke Article 50.

Might we nevertheless in 2017 somehow find the collective will to turn away from the door marked Brexit? A meta-argument is raging over which, if any, Brexit destination was the ‘people’s choice’ on 23 June. Behind this, for many, is the hope that, either through a second referendum or through a general election, the country can reverse course. But, with the Conservative Party closing ranks, there is no majority in the House of Commons to legislate for a second referendum; and the scheduled 2020 General Election will come too late.

How might this political calculus change and could it do so in time? The short answer is that we will all need to start feeling the pain before we might recover our senses. Once the negotiations
begin, the ambiguities that were carefully preserved by the Brexit camp will begin to be stripped bare. The slow-burn economic effects of the uncertainty created by the June vote will begin to be felt. When growth slows, when the pound weakens further, when inflation kicks in and real wages fall, when interest rates rise, when foreign and domestic investment stalls, might the public and hence the parliamentary mood change?

Pro-EU Conservative MPs will hold the keys to this. With the new Parliament Act, it is hard but not impossible to force early elections. Rebel Tory MPs facing de-selection in their constituencies would need to be prepared to split the party. So far the attraction of Conservative party dominance of English politics for a generation seems to outweigh their concern for the integrity of the UK and the nation’s strategic interests. But will that continue through 2017-18, when the public begin to feel the consequences of what they have done?

How might our rejected EU partners affect this? The main reactions among the EU-27 to the June vote were shock and some sadness, turning to anxiety and anger. The British question had distorted the EU agenda already for three years and now threatens even greater dangers to EU cohesion and Eurozone stability. The May government’s prevarication is keeping the EU in the doldrums. The US election campaign and its astounding outcome have obscured the EU’s internal travails for months but they will re-emerge all too clearly in 2017. The Italian referendum on 4 December provided a foretaste of tensions to come with the Dutch, French and German elections.

As has been widely noted, the UK former partners’ minimum aim is to prevent contagion. The rabid British disease must be kept out of the continent. The European project needs breathing space to recover its mojo. So in the negotiations a predominant motive of the Commission and our former partners will be to demonstrate conclusively that leavers suffer and suffer badly. They will be as rigorous as they can be in defending the “Four Freedoms” from dilution. Sustaining the impression that the terms of our exit will be as painful and threatening as possible will also be the best spur our partners could give us to undertake a re-think.
Paradoxically, the EU-27 have a selfish interest in nurturing long-term UK engagement with Europe, and so in protecting whatever slim chance remains that the UK might return to full EU membership. Despite the frustrations of dealing with us, the EU-27 still have much to gain from London’s role in the global financial market place. Our business supply chains are intricately linked. Britain is indispensable to broader European defense and security credibility.

A similar contradiction will emerge next year between the UK’s short and longer-term perspectives. The UK public are largely unaware of the turbulence they have caused in the EU by the vote to leave. Many Brexit voters would, if truth be told and sad to say, rejoice at it. The more reflective, however, know that the UK still has a strong strategic interest in the long-term success and stability of the EU. Yet the obvious tactic to maximize our leverage in the Article 50 negotiations will be to seek, as discreetly as we can, to divide the EU-27 and exploit the economic malaise and popular disaffection with ‘Brussels’ which the example of Brexit has already encouraged.

Thus 2017 will not see resolution of these tensions, only the firing up of the negotiating process. Both sides are divided. All are hurting. We will pass the year scanning the darkening skies. More of us may begin to understand that what is about to fall “won’t be flowers”.

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If the saying “It’s the economy, stupid” applied to Germany, then the result of the autumn 2017 elections could be taken for granted. The German economy grew by 1.8% in 2016 and, according to Bundesbank forecasts, it will grow at the same pace this year. Unemployment is at record lows since German reunification in 1991 and has been halved over the past five years, with employment at a record level of 43 million units. Germany is no longer “the sick man of Europe”.

Even so, when announcing her candidacy to seek a fourth term in office, Chancellor Angela Merkel has declared that the 2017 elections will be “the most difficult” of her political career. Her controversial policy of opening the doors to war refugees from the Middle East, leading to the arrival of nearly one million people in Germany in 2015, has eroded the popularity of the Chancellor, created a rift within her party, the CDU, and with their Bavarian allies, the Christian Social Union, and swelled the ranks of the anti-immigrant party, the Alternative for Germany (AfD). For the first time in the post-war period, the Christian Democrats of Angela Merkel will have a challenger from the far right. The AfD has achieved resounding success in regional elections, beating the CDU in the very electoral basin of the Chancellor, Mecklenburg-Western Pomerania, and reaching 15% in nationwide opinion polls.

Something has been broken in the unconditional trust between
“Mutti” – Mom, as the Germans call Angela Merkel – and her constituents due to fears of a Muslim “invasion” and the unpreparedness shown by the reception apparatus. Yet, with successes in the economic field and with her deliberate pace, the chancellor has slowly regained ground, also in part due to a crackdown on immigration announced at the last party congress. It is difficult to think that the next legislature will not feature a government headed by Mrs. Merkel. The CDU/CSU bloc has risen back to 35% in the polls, and her greatest concern, besides keeping the AfD at bay, is to prevent the emergence of a red-red-green coalition (comprising the Social Democrats of the SPD, the left-wing Linke and the Greens), like the one that rules at the local level in Berlin. Playing the game of alliances will not be easy in a Parliament which could see, for the first time, representatives of six parties.

Yet, if 2017 in Germany will be the year of politics, according to economists at Commerzbank, it is not only because of the elections. The crisis in the Eurozone will further put to test the reluctant German leadership, while elections are held in France, the Netherlands and probably Italy. But, following the election of Donald Trump in the United States, Mrs. Merkel is also seen as the defender of the liberal values of the West and a bulwark against populism. She was the only one to respond with a message to the President-elect offering cooperation, but conditional on the respect “of democracy, freedom, the rule of law and the dignity of humanity, regardless of origin, skin color, religion, sexual orientation or political opinions”. Values that Trump has not always shown signs of wanting to honor during the electoral campaign.

This is a difficult balancing act with regard to a partner to which Germany still owes the foundations of its security and defense and is its most important trading partner. Trade with the United States is at record highs (173.9 billion euro in 2015, having overtaken trade with France for the first time), as is the German trade surplus. Around 1.5 million German jobs depend on trade with the US, according to Clemens Fuest, president of the IFO research center of Munich, and one of the five “wise persons” who advise the Berlin government on the economy. And Germany, as the world’s leading
exporter, cannot afford the luxury of the trade wars that could be triggered by the new Trump Administration, if election promises are kept.

Brexit represents another risky political front: Germany has already made it clear that it does not want to make concessions to London, fearing a domino effect, but is also conscious of the importance of the British economy to its interests. The British market, for example, is the most important destination for the automotive industry, the backbone of German manufacturing.

2017 will also be a decisive test for the two most emblematic names in the German economic-financial establishment. Volkswagen and Deutsche Bank are suffering from deep self-inflicted wounds, due to mistakes and fraudulent conducts that went on for years. The champion of the German car industry will have to extricate itself from the rigged-emissions affair, the so-called Dieselgate, which has undermined sales outside of Germany. The country’s largest bank is struggling with a radical restructuring after an embarrassingly long series of financial scandals and mismanagement episodes. At one point, even the survival of both players seemed in doubt. In 2017 we should know if this extreme eventuality has been totally averted.

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French public life in 2017 will be dominated by politics and the two elections that will be held in the spring – first to elect a new President in April-May, then the National Assembly a few weeks later. The French are increasingly critical of their politicians and of politics in general. Nonetheless, and possibly different from the case in most other European countries, many remain interested in ‘life in the Cité’ and are easily mobilized by the presidential campaign.

The spring polls are likely to bring to light a watershed in French political life – the emergence of a tri-polar system.

First, the Front National (FN), represented by its candidate Marine Le Pen, is the most homogeneous of the major parties, despite the existence of different factions, each more or less attuned to her strategy of turning the FN into a ‘normal’ party.

Second, the right and the center which support François Fillon, the somewhat surprising winner of the November 2016 primaries, who will have to deal with the different sensitivities in his camp.

Third, the left – or rather its many and often irreconcilable expressions, which are going to present multiple candidates, including former Prime Minister Manuel Valls and Jean-Luc Mélenchon for the left of the left. A big unknown is whether Emmanuel Macron, former Minister of Economy under François Hollande, will be...
able to validate his image as a young reformer and create sufficient momentum to shake up this tripartite disequilibrium.

It would be reasonable to predict that François Fillon and Marine Le Pen will face each other in the 7 May second round. However, these days, making political forecasts has become all too risky. It is better to point out the major challenges that the new President will face, whoever s/he will be.

The most evident concerns are the economy and unemployment. French economic growth has been disappointingly low in recent years, unemployment remains persistently high, and social, gender, education, health, and regional inequalities have increased. It is this toxic combination that is fueling the deepening gap between growing segments of the population and the elites, who find themselves rejected if not hated. Hence the second challenge, the imperative to reestablish political legitimacy and restore trust in the democratic process, counteracting the decline in electoral participation and the success of ‘anti-establishment’ parties and groups that pretend that there are easy solutions to complex problems. This is easier said than done, necessitating honesty, fairness, transparency and “good governance” in order to reinvigorate the ethics of the République. This is further complicated by the other major current priority: responding to the demand for authority and references that the French are making in these troubled times, while at the same time navigating between the verticality of the presidential system and the horizontality of the popular desire for consultation, participation and accountability.

Going down this path will also play an important role in the efforts to recompose French society, which is increasingly divided along political lines, which is normal, but also by various contradictory tendencies. On the one hand, there are the many fears of the underclass (by birth, education, income) of losing their jobs and social welfare, of their children not having opportunities, of immigrants and refugees (often associated with the terrorists who have traumatized France since January 2015), of globalization and its consequences. On the other hand, stand those who benefit from open markets and technological change, take risks and establish
new firms, see opportunities where the former see risks, and call for human solidarity. Two interpretations of the same reality that translate into two diverging attitudes: populists from the right and the left alike are nostalgic for a glorious past and wish that France could close its borders and focus on herself, while a seemingly rootless urban upper-middle class argues that the country should get rid of outdated institutions and policies and embrace the future. Once more in the nation’s history, reconciling these two versions of France will be a priority for the next tenant of the Elysée Palace.

And what about Europe? Euroscepticism remains very high, making it necessary for the EU to regain its legitimacy and bring its institutions closer to voters. The right and the left express different views on this subject and the debate on the future of Europe may give rise to new transversal alliances, standing outside traditional divisions and creating bipartisan pro- and anti-Europe groups. Yet above all, France needs to reassert her role as a major actor in Continental politics, and, in order to do this, must completely rethink the traditional conception of European integration, abandoning outdated certainties and myths.

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Public debt is Italy’s main problem, and it will continue to loom on the horizon even in 2017, after we have had the privilege to forget for some years that we are one of the countries with the highest public debt in the world. The fourth, to be precise, after Zimbabwe, Greece and Japan. We were able to forget about it because the European Central Bank has kept interest rates near zero. In three years the cost of our debt (i.e. how much tax we have to pay in order to allow the State to pay the interest on the securities that were issued) fell by half a point of GDP (about 8 billion euros). Due to the average maturity of government bonds (around seven years), this decrease in the cost of debt will continue until it reaches an annual savings equivalent to one point of GDP in 2019. The “anesthesia” of the debt will end soon. The economic data of the Eurozone are rapidly improving. The (albeit slow) recovery is starting to affect wages and prices. Inflationary pressures will also be sustained by the recent agreement between some oil-producing countries that have decided to limit production. And even more so if the euro were to weaken further against the dollar – it has depreciated by 8% during the first month after the day of Donald Trump’s victory. The ECB has recently published its most recent inflation forecasts. For 2018 (the relevant horizon, given that the effects of monetary policy on inflation are not seen before a couple of years) the median estimated rate is between 1.5%
and 1.9%. If we then look at the distribution of these estimates, we note that it has become symmetrical: the probability that in 2018 inflation will be between 0.5% and 0.9% is similar to the probability that it will be between 2% and 2.5%. In short: the ECB finally seems to be approaching its statutory objective of inflation “close to, but below 2%”. Markets know this and indeed the rates on German 10-year bonds rose from a negative return (-0.2%) in July to 0.4% today.

Moreover, the yields on US 10-year bonds also rose from negative values during the summer to 2.4% after the announcement of Trump’s economic program. As historical experience shows, the correlation between ten-year yields in US and German bonds is very high. Thus the German rates can only move in one direction: upward.

The privilege of being able to forget about the debt has unfortunately already ended. Once again we have not been capable of taking advantage of the period of exceptionally low interest rates in order to cut our spending at least a bit, which is the only way to permanently reduce the debt-GDP ratio. We did not do it during the Letta and Renzi governments, and during the Monti government, rather than reducing spending, over two years we approved tax increases equivalent to over 5 percentage points of GDP. For each additional point increase in interest rates, the (primary) budget surplus that is needed in order to maintain our debt to GDP ratio stable rises (over a few years) by 1.3 points, or around 20 billion euros.

Unfortunately, the “anesthesia” of the debt will continue during the first half of 2017. Unfortunately: because also the illusion will continue. This is also reinforced by the fact that it is doubtful that the temporary government will have the political legitimacy needed to implement spending cuts. The reawakening will take place during the summer, when it is clear that the quantitative easing is going to end. It could be a rude awakening, at which – as always – we will arrive unprepared, perhaps after elections and an electoral campaign that will once more divide the country. And so, we will respond to market turmoil in the only way possible when one is
taken by surprise: raising taxes, as we did in 2011. To see what this will produce it is enough to look at what happened after the 2011 tax hike: a growth rate of -2% per year for two years.

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POLAND IN 2017

Poland’s fortunes will continue to be shaped by the ruling Law and Justice party (PiS in Polish), which has embarked upon a series of controversial and dangerous reforms over the past year. The moves by the PiS have been focused on three specific areas: the pension system, fiscal policy, and overall institutional reforms. Political dynamics in each of them will determine the path of Poland’s economic development in coming years and beyond.

Two bills passed by the Sejm in 2016 are set to change Poland’s current pension system, and not for the better. One sets a minimum monthly pension pay-out of zloty 1,000 (roughly €225), effective from March 2017, turning Poland’s pension program into a quasi-defined benefit system. The second, and potentially much more negative, bill lowers the retirement age to 60 and 65 years for women and men, respectively (down from 67 for both sexes, a measure approved only in 2012), effective as of October 2017. Given that Poland already faces unfavorable demographics (high age dependency ratio), the new bills are bound to have serious implications, both for the labor market (reducing the labor supply) and especially for the budget (adding to outlays and making it difficult to respect the target deficit of 3% of GDP).

While the new laws will only enter into force later in the year, some adjustments may occur in anticipation and may already impact the nation’s workforce. And while it may take some time for the full fis-
cal effects of the reform to become apparent, the government has already started to backpedal somewhat from full implementation, perhaps understanding the potential fiscal costs that will accrue. Indeed, the government has gone on record publicly in underlining that the new laws allow citizens to retire earlier, but do not compel them to do so. In tandem, there has been discussion on implementing a set of countervailing policies, discouraging potential pensioners from taking advantage of the early retirement option, such as a revocation or limitation of the right to undertake paid work while retired, or a prohibition on recalculating pensions based on contributions transferred from salary earned after retirement.

This limitation to the “right to retire” has translated into decreased public support, with between 60% to 84% of respondents supporting a lowered retirement age, but dropping to only 20% if the reforms include limitations or stipulations (such as prohibition of post-retirement work). Regardless, given the seriousness of the change, further discussions on the final shape of the pension system can be expected to be an important part of the public debate throughout 2017.

Pensions are not the only way in which the current government is stretching Poland’s finances to the limit. Another campaign promise has been fulfilled with the 500+ program, which offers monthly cash grants of zloty 500, or €112, for every child beginning with the second, regardless of the parents’ income. Coupled with full subsidization of medicines for citizens over 75 years old and increases in other social expenditures (including the aforementioned pension reform), this fiscal stance has translated into a massive increase in public spending since fall 2015.

Unfortunately, there are few concrete indications of how such inflated expenditure can be sustained, with current proposals focusing on decreasing the tax gap (i.e. increasing revenue collection). However, simply relying on the revenue side is unrealistic, as the government has been loath to introduce measures to tighten up tax administration, apart from imposing stricter VAT rules for fuel trading within the EU Single Market. While tax compliance appears to have improved somewhat, other measures have been less
successful. The so-called bank tax, a 0.44% fee charged on the assets of banks and insurance companies, was implemented in 2016 and the government has also tried to introduce a tax on large supermarkets (most of them foreign-owned), but has thus far been unsuccessful. Neither of these measures has the potential to actually close the fiscal gap, and may in fact widen it by depressing economic activity. Tax receipts in 2017 will also depend on the state of the economy: economic growth, which last year proved to be robust thanks to sound macroeconomic conditions and internal stability, is expected to slow down.

Finally, the PiS government has been very vocal about the need to overhaul many of Poland’s post-communist institutional structures, another set of reforms that have engendered a great deal of policy uncertainty, especially with regards to the true independence of the judiciary. The most controversial policy has concerned the Constitutional Tribunal, whose voting rules were changed in December 2015, sparking a crisis around the appointment of its members. Although the PiS appears to have prevailed on this issue and others (including making the state-owned media much more subservient to the official government line), further institutional volatility seems sure to follow. And with foreign investment already showing a decline, the last thing the economy needs is a prolonged bout of economic policy uncertainty, especially if it strikes at the key institutions which enabled Poland’s economic miracle.

In sum, Poland faces several fundamental economic challenges that will dominate the landscape in 2017 and beyond. As is the case in much of Europe, policies have shifted towards populism, with a dangerous cocktail of social conservatism and fiscal adventurism. Both approaches have the potential to severely harm Poland’s economic and social prospects for the future.

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Greece in 2017

Groundhog Day. In this – by now classic – 1993 American comedy, a reluctant weatherman, played by Bill Murray, is sent to a small town in order to cover a story about a weather-forecasting groundhog, only to find himself inexplicably living the same day over and over again, hoping that it will turn out differently every time. Three international bailouts and one mega debt haircut later, and still stuck in a crisis that has reduced GDP by a quarter while in the process consuming four prime ministers and nine finance ministers, it is tempting to think that Greece is living its own Groundhog Day.

All the signs are there: the periodic bailout review that was supposed to have been concluded months ago, thereby releasing much-needed funds for Greece, is still incomplete; a government behind in the polls is desperately trying to sell a “success story” of recovery being around the corner to a weary and exhausted population and to deeply skeptical investors; and the creditors seem to be disagreeing with each other on how to move forward or on whether indeed the country is a lost case, “unreformable”.

We have seen it all before. At the end of 2014, the EU and the IMF decided to pursue a hard line with the government of Antonis Samaras, convinced that given his populist turn it was best to deal directly with a Syriza government under Alexis Tsipras. What fol-
owed after the elections were six months of a negotiation that went to the brink, a deeply divisive referendum that almost cost Greece its place in the Eurozone, and a third bailout, just when Greece was turning the corner. To many, we are heading for a repeat. And yet... while in many ways, we are in a situation reminiscent of what happened two years ago, it is also vastly different. And the main difference is politics. In 2014, Syriza was ante portas, riding a wave of populism born out of anger, bearing hope and the promise of a future without austerity measures. But the illusions which carried it to victory have crashed, as it became apparent that in a game of chicken between a rickety moped and a big German truck, the truck always wins. Syriza signed on to its own bailout, and is now implementing the kind of austerity it was denouncing not long ago.

In many ways, Greece has been a trail-blazer. In 2009, its triple deficit (fiscal, competitiveness and credibility) made it the first Eurozone country to expose the flawed construction of the common currency and prompted a response from the EU and the IMF which broke all the rules and then wrote some new ones. In 2012 it was the first Eurozone country to see its debt restructured (by a massive €100 billion). In 2015 it was in Greece that the first populist party in Europe came to power. And it looks like it soon will be the first country to demonstrate the limits of the populist experiment and return to mainstream politics.

The good news, as we leave behind us a troubling 2016, is that as far as Greece is concerned, the tail risk seems to be no longer there. Perhaps the current government of Alexis Tsipras, with its disturbing right-wing nationalist coalition partner and its authoritarian tendencies, will manage to soldier on some more. Or Greece is heading toward elections in the coming year and a victory by the (semi-reformed) center-right New Democracy party under Kyriakos Mitsotakis. In either case, we are not likely to see a repeat of the kind of brinkmanship and instability we saw two years ago. With different degrees of success, reforms will go on.

More than that, and even if official 2017 growth projections are overly optimistic, the wide-ranging structural reforms of the last seven years (in budget and tax systems, in pensions, in product,
labor and financial markets) will finally start showing results. As the economy starts picking up, these by now built-in changes will be reflected in more efficient spending patterns, higher tax revenues and more importantly, in significant productivity gains for the economy.

So is all well? Not quite. The insistence by Greece’s European creditors to keep the medium-term primary surplus target at 3.5% of GDP means that the country’s growth potential will be stunted. The continuing disagreement between the IMF and the Europeans (read: Germany) on the necessity for further debt relief means that the debt overhang will continue to be an issue for markets and investors. This means that when the current program comes to an end in 2018, market financing will not resume in full and some follow-up funding arrangement will be necessary.

Even more importantly, the structural reforms are far from complete. And the political appetite for the kind of deeper institutional reforms – in everything from the political system to the judiciary and the public administration – that will finally transform Greece into a well-governed modern European country still seems to be lacking.

In the movie, Bill Murray finally breaks the spell of Groundhog Day when he realizes that real change must happen first within himself. Now, that will indeed be the way for Greece to break the cycle and awake to a new day.

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Donald Trump’s campaign promises give us some idea of what to expect from his economic policies. The domestic measures he has focused on during the campaign, and which he has emphasized since winning the election, include:

1. Substantial cuts to personal and corporate taxes;
2. A freeze or cuts to Federal spending, except on the military and the elderly (Social Security and Medicare);
3. A substantial program of infrastructure development, totaling between half a trillion and one trillion dollars.

These policies will dramatically increase the Federal budget deficit, and provide a potentially substantial fiscal stimulus. Both the deficit increase and the stimulus are paradoxical. Republicans in Congress roundly criticized the Obama Administration for budget deficits that they regarded as excessive, and vigorously opposed attempts at a fiscal stimulus. However, Republicans in the legislature are likely to be more favorable to Republican deficits and a Republican stimulus. In addition, the electoral success of President-elect Trump seems to have convinced other Republican policymakers to fall into line behind his proposals.

Candidate Trump was also highly critical of Federal Reserve policy he regarded as too expansionary, railing against low interest rates that harmed savers. This, along with the fiscal expansion and the generally positive state of the economy, will undoubtedly lead
the Fed to move in a more contractionary direction. The domestic economic-policy prospect, then, is for an expansionary fiscal policy and a more contractionary monetary policy. This is reminiscent of the first Reagan Administration.

With respect to international economic policy, candidate Trump was open about his disdain for globalization, which he said “has made the financial elite who donate to politicians very, very wealthy...but it has left millions of our workers with nothing but poverty and heartache.” He has threatened to impose an across-the-board 20% tariff on imports and a 15% tax on overseas investment by American corporations. To be sure, these are only threats at this point. Nonetheless, the threats alone may be enough to accomplish at least some of President-elect Trump’s goals. Trading partners could be induced to exercise “voluntary” restraints on their exports; American CEOs may be much more reluctant to relocate production abroad.

There is a contradiction between the domestic and international components of President-elect Trump’s economic policies. The fiscal stimulus and increased budget deficit – especially if combined with tighter monetary policy – will lead to a substantial strengthening of the US dollar. A stronger dollar will put serious pressure on American firms competing with foreign companies at home and abroad. This may heighten existing protectionist pressures. The contradictory effects of the Trump Administration’s proposed economic policies are likely to present the administration with substantial challenges – challenges that will also affect the rest of the world.

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Canada, often ignored as a small neighbor to the US, is now being touted as one of the last beacons and defenders of liberal democracy in the free world. No less than The Economist put Canada on its cover recently with the caption “Liberty moves north: Canada’s example to the world”. Which raises the question: is there a Canadian “exceptionalism”, and will it be manifested in 2017? The answer (in true Canadian fashion) is: well, yes and no, it depends.

The Canadian government led by Justin Trudeau has taken strong stands on a number of issues that do indeed set it apart, and the question for 2017 is whether or how they can deliver.

Let’s start with free trade and globalization. In the midst of Brexit, and the US election campaign in which the TPP and NAFTA were both questioned, Trudeau campaigned in 2015 on a free trade platform that included support for the TPP and other trade agreements. Within a year of his election, his government signed the Canada-Europe Trade Agreement (CETA). The question for 2017 is how the Trudeau government will respond to the possibility that NAFTA will be renegotiated and the TPP’s almost certain death in its current manifestation. Canada has expressed a willingness to renegotiate NAFTA. This is facilitated by the fact that underlying the NAFTA agreement is a pre-existing bilateral Canada-US trade agreement (CUFTA), which may serve as the basis for a subse-
quent agreement. While too early to tell, a China-led initiative to replace TPP would almost certainly be considered by the Trudeau government. It is important to note here that there is a broad political consensus in Canada on free trade. More importantly, public opinion has so far been behind the idea that, as a small country of 36 million people blessed with an abundance of natural resources, Canada’s high standard of living depends on access to international markets. We therefore expect that Canada will continue to push towards freer trade in a world where emerging protectionist sentiments abound.

From the mid-1990s until now, Canada has stood tall among G-20 countries with a record of sound fiscal management that reflected the economic orthodoxy of the time. Over that period, deficits were eliminated and Canada brought the debt-to-GDP ratio down from a peak of 70% to a low of almost 30% prior to the 2008 crisis. However, to the surprise of many, Trudeau campaigned on a promise to stimulate the economy by spending lavishly on infrastructure, by cutting taxes on the ‘middle class’, and by ramping up spending on social programs, notably on child care. Canada was therefore in the forefront of the questioning of austerity. These promises were embedded in the first budget brought down by the government, and it remains to be seen whether they will have an impact in 2017.

Any judgement of the impact of the budget on the performance of the Canadian economy must also account for various confounding factors, most notably the relative decline of the oil and gas sectors on which Canada remains dependent and the consequent weakening of the Canadian dollar, at least relative to the US dollar (beginning in 2013). Falling energy prices had a significantly negative effect on the performance of what had been Canada’s best-performing province, Alberta. To date, the depreciation of the dollar has not brought any compensating export expansion and Canada still runs a current account deficit.

The sluggish recovery and the decline of the energy sector complicate Trudeau’s strong environmental platform, including carbon taxation, an end to coal-fired electricity generation, subsidies for
green technologies, and support of the Paris Accords. His government has indeed moved to impose a national price on carbon and recently announced intention to phase out coal-powered electricity by 2030. As these actions are being taken at the precise moment that Trump promises to take the US in the other direction, they might well pose a competitiveness problem for Canada. In particular, there are concerns that phasing out coal will result in significantly higher hydropower prices, putting Canadian manufacturing at a competitive disadvantage at a time when outward FDI flows already exceed inward flows. Meanwhile, the possible approval of pipelines to carry Canada’s oil across the country to export terminals has raised the ire of environmental and First Nations groups across the country.

For 2017, the question is how the government will manage the tricky balance between moving ahead on the environment, on the one hand, while on the other hand encouraging growth in resource-rich provinces. One of the first things to watch for is whether the government approves the proposed Kinder Morgan pipeline expansion that would bring more oil to Vancouver to be shipped abroad by tankers. If approved, expect a huge backlash and strong protests.

Finally, perhaps the most important component of any Canadian exceptionalism is Canada’s consistent stand on human rights and its attitudes toward cultural diversity. Canada has maintained policies supporting multiculturalism, diversity, and openness to immigration. In particular, Trudeau campaigned on a promise to accept Syrian refugees and has announced that Canada would welcome some 50,000 of them. So popular is this policy that private demand to adopt Syrian refugees is also very high. At the same Canada will also accept close to 300,000 immigrants per year, a little less than 1% of the population. Canada is perhaps unique in the world in having a Ministry of Multiculturalism whose role it is to encourage Canadians to embrace and assimilate Canada’s culture while retaining aspects of their cultural origins. Furthermore, Canada has taken a leading role in legalizing same sex marriage and in protecting LGBTQ rights. The prime minister calls himself a ‘feminist’ on every occasion and women make up 50% of his cabinet. There are
four ministers of Sikh heritage in the cabinet (including the minister of defence), two more than in India. More than 50% of citizens in Canada’s largest city, Toronto, were born outside of Canada. And the list goes on.

What to watch for in 2017 is whether Canada can continue to maintain and improve on its embrace of broad cultural diversity and tolerance, at the very moment when much of the rest of the world is retreating from these values. While there is certainly more work to be done, notably in the area of First Nations rights, these policies alone may make the case for Canada as an example to the world.

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The Chinese economy is now recovering from the particularly sharp recession that occurred during 2015 and continued through the beginning of 2016. This downturn came in addition to the medium-term slowdown in economic growth as the economy moved into its so-called called “new normal”. As it enters 2017, the economy is quite buoyant. Apart from restrictions on housing demand in the major cities, there appear to be few contractionary pressures on the economy. Indeed, monetary conditions are still stimulatory. This suggests that economic growth in 2017 may be faster than in 2016 – a marked contrast to the consensus view which foresees a further slowdown in growth in 2017.

The primary factor driving the slowdown of the economy was the poor performance of exports. Export volumes fell significantly – only the second such episode in two decades. The fall was largely due to a fixed exchange rate against the dollar, allowing a significant rise in the effective exchange rate. As exports are primarily produced in the private sector, the growth of investment in that sector has slackened markedly.

During the course of 2015, as the scale of the downturn became evident, the direction of policy changed. Government outlays rose, increasing the deficit by nearly three percentage points of GDP. In addition, the policy of holding the exchange rate constant against the US dollar was abandoned in August 2015 and capital outflows
were encouraged. These latter two changes gave a strong boost to the economy, which generated a recovery in 2016. With state-owned firms investing abroad on a massive scale, the government had to intervene in order to slow the fall in the exchange rate, and finally in November 2016, it tightened capital controls to stem the drop in reserves. By December 2016, the exchange rate had decreased by over 10% and exports had started to grow again.

While it was clear that the economy was worsening in 2015, official GDP statistics barely registered any slowdown. During 2016, official data showed the same growth rate for three successive quarters – a very unusual development even in major OECD countries. The official GDP data appear to be calculated incorrectly rather than manipulated. In order to transform nominal to real growth, the Chinese authorities assume that the increase in the price index for value-added is the same as that for gross production, which is rarely the case. This shortfall can be corrected by using official data, and then GDP can be shown to have grown very slowly in 2015 and then to have experienced a sharp recovery during 2016.

Looking to 2017, macroeconomic policy will still be imparting a positive thrust to the economy. The government has planned for a further increase in the fiscal deficit in 2016, as the impact of earlier stimuli wears off. In addition, previous declines in the exchange rate will continue to boost export performance and generate a recovery in private sector investment. So, on balance, macroeconomic policy should still be providing some boost to demand in 2017.

On the other hand, microeconomic policies aimed at the housing sector may hold back construction activity. In order to limit the increase in housing prices in the major cities, government policy has aimed to reduce demand in these areas, so checking investment. However, major cities account for only one-quarter of total demand. In smaller cities, price rises have been more modest and are indicative of excess inventories being reduced, so production may rise further in these areas.

One area where there is more uncertainty is the development of consumption, which has been particularly buoyant in 2016. Banks have been re-orienting their portfolios towards household lending
and this seems likely to continue in 2017, thus allowing consumption to continue growing faster than income.

Avoiding a further slowdown in the new normal rate of growth will require further structural reforms. The Chinese Communist Party (CCP) has put into place a new set of local structures charged with implementing such policies and reporting to a central reform committee chaired by the CCP General Secretary, Xi Jinping. In addition, the five yearly reshuffle of CCP leaders will take place in the autumn of 2017, giving local leaders an incentive to comply with the center in order to advance their careers.

In 2016, the emphasis of the structural reform policy has focused on traditional industries, such as steel and coal, aiming to limit excess capacity and reduce employment. The policies have met with some success. In the steel industry, the fall in prices, which created a world-wide profitability crisis during 2015 and early 2016, has been eliminated. In contrast, it is generally acknowledged that the wider State-owned enterprise (SOE) restructuring policies adopted in 2013 have failed.

In such an environment, faster growth will require a boost to the performance of the private sector. In November 2016, confidence-boosting measures were introduced to limit the arbitrary confiscation of private sector assets and to restrict the period in which the origin of assets can be questioned.

In sum, then, after a start to the year when financial policies appeared to be in confusion, a clearer orientation has been given to policy with a set of structural policies complementing expansionary macro-economic policies. The current economic recovery appears likely to continue into 2017 and the growth of the economy may exceed the government’s target for growth between 6.5% and 7%. The momentum of SOE reform needs to spread beyond the steel and coal industries and needs to be the key policy for the second term of General Secretary Xi that starts in 2017.

Richard Herd was head economist for China at the OECD until 2015.
Brazil’s political and economic agenda will be dominated by at least four issues. The first one is associated with the continuation of the corruption scandal triggered by the Operação Lava Jato (Car Wash Operation), which still looks far from coming to an end. The second is the ambitious package of economic reforms proposed by the government. The third is the rapid increase in unemployment. The last one is the deterioration of the international economic and political environments.

As for the first issue, the country is likely to remain immersed in the largest corruption crisis in its history. Politicians of the highest ranks and from the major parties as well as top executives of many of the largest economic groups are being prosecuted on charges of corruption in the public sector. Many of them have been sentenced to prison, and the companies involved have experienced substantial economic difficulties. The political crisis has reached such a wide and deep magnitude that it has become one of the main causes of the country’s economic crisis. The plea bargaining currently underway by executives of large civil construction companies involved in the scandal will probably spill even more fuel on this controversy in the coming months.

Regarding the second issue, the government is proposing two reforms of great scope regarding the fiscal and pension systems. Due to huge fiscal deficits, federal and state public debts have
been growing rapidly, public finances of important states such as Rio de Janeiro have collapsed and others will likely follow suit in 2017. Pensions spending already accounts for more than half of the government budget and should continue to expand its participation due to the rapid demographic transformation and the very generous pension rules – today, the average retirement age is only 53. With a tax burden of 36% of GDP and a nominal deficit above 8% of GDP, Brazil seems to be nearing the limit in terms of taxation burden and will therefore have to seek other means to adjust public accounts. The government is proposing legislation intended to restrain public spending growth, to review the retirement age and the minimum period of contribution, and to end the privileges enjoyed by influential groups that account for a significant part of the pension problem. The reforms seek to adapt the country to its financial, economic and demographic realities. Discontented and influential interest groups that are most affected by the bills are already moving to block the reforms. This agenda will likely attract a lot more attention in 2017.

After years of rapid jobs creation based on the expansion of the services sector, easy credit, indebtedness, public spending, and rising commodity prices, unemployment rose from about 5% at the end of 2014 to more than 12% at the end of 2016. Tens of millions who benefited from that booming, non-sustainable period are now highly vulnerable to deteriorating economic conditions, which have created ample and rising frustration. The bad shape of the labor market is leading to disturbing social, economic and political consequences all over the country (including a rise in crime) and is also likely to receive a lot more attention.

Brexit, the election of Trump, the rise in extreme right-wing populism, commodity prices volatility, explosion of protectionism, increased financial sector fragility, continued stagnation in Japan and the Eurozone, economic slowdown in China, political stalemate in Venezuela, to name but a few, are growing risks that make it increasingly difficult to predict the future, especially in emerging economies that are more exposed to global financial developments. That, in turn, is fomenting a generalized sense of insecurity and
risk aversion. This environment will be damaging to Brazil because international investment and exports remain key drivers for the resumption of growth.

The outlook for 2017 is therefore worrisome. But there are at least two reasons for optimism. The first is associated with the independence of the Brazilian judiciary and media, as demonstrated throughout the political crisis, which has shown the impressive strength of the institutional framework of the country. The second is associated with the government’s adoption of tough, but realistic and necessary economic reforms, which will likely pay important dividends for sustained growth in the medium term.

“Sunlight is the best disinfectant,” Associate Justice of the United States Supreme Court Louis Brandeis said in 1914, referring to the benefits of openness and transparency in tackling corruption in the public sector. The same can also be said for poor fiscal and pension policies.

In facing up to its truths, it is likely that the Brazil that will emerge from the political and economic crises will be stronger, fairer and more resilient.

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In 2017, Russia will celebrate the 100 year anniversary of the Bolshevik Revolution which condemned the country to decades of planned economy and isolation from the Western world. Since the 1990s Russia has struggled to redeem herself, undertaking a long and difficult transformation to a market economy with mixed results to date.

After several years of robust growth in the early 2000s, the financial-economic crisis beginning in 2008 and the sharp drop in oil and commodities prices, coupled with Western economic sanctions against Russia for her role in the Ukrainian upheavals, dashed early hopes that GDP could double in ten years. The Russian economy to date is undermined by a number of unresolved institutional and policy problems inherited from the past and by tremendous external challenges, which the authorities cannot control.

After negative growth in 2015-2016, even steering the economy toward a path of modest sustainable growth will be challenging: in 2017 GDP growth is expected to return positive (at around 1%) and is expected to stabilize further on in the next decade at around 2%. The Russian economy faces serious threats in an international context that bears similarities to the post-WWII Cold War, and, more broadly, risks falling irredeemably behind her main competitors, in primis China, in terms of economic achievements and technological advances.
Economic sanctions from the West prevent Russian companies from accessing international funding. Foreign investors who eventually do exploit financial loopholes are also subject to the Damocles’ sword of Western retaliatory measures. A major problem will be to restore confidence in the country by improving the business environment and facilitating alternative foreign investment – from the BRICS and/or other emerging economies. From this perspective, the detentions and convictions of high-level political figures charged with bribery, whilst intended to fight widespread corruption, may actually turn into an economic curse by fueling uncertainty in the business climate.

While sanctions from the West and counter-sanctions from Russia have stimulated import-substitution in areas of concern to national security, including foodstuffs, this process has been costly. Defense manufacturing has been a major success and progress is noticeable in agriculture and segments of machinery manufacturing. State subsidies have been crucial in jump-starting import substitution, but cannot be sustained over time.

After incurring high federal deficits and vulnerability to foreign financial institutions in the late 1990s, Russia has put public debt under strict control with public external debt at around 13% of GDP in 2016. But the federal deficit is increasing and projected to reach circa 4% in 2017. The reserve fund for stabilization that helped to contain the federal deficit in the past will be nearly depleted in 2017, making it necessary to sell treasury bills to domestic institutions – assuming that sanctions are ongoing. Under these circumstances there is a real risk of crowding out private investment.

By the end of 2017, inflation is projected to reach the 4% target, down from the current 6.5%. Whether monetary policy should be loosened has become a matter of lively discussion, with the Ministry of Finance (MOF) pressing for a competitive exchange rate in support of exports and import substitution. Given high dependence on oil and gas revenues, fiscal revenues also suffer from ruble appreciation. If economic recovery in 2017 falters, there is little doubt that the Central Bank will have to adjust to the MOF’s desiderata. At any rate, neither fiscal nor monetary stimuli are panaceas.
Against the backdrop of international constraints that are unlikely to subside soon, the authorities seek new and/or closer partnerships with countries outside the Western sphere of influence. The Eurasian Economic Union (EAEU) came into force on 1 January 2015. It is comprised of five countries, Russia, Kazakhstan, Belarus, Kyrgyzstan and Armenia, that share a vision of economic integration inspired by the European Union. In light of the expansionary policy undertaken by China in order to reach the European market via land, the EAEU is becoming a major locus of negotiations for Russia. Regarding the Chinese “One Belt-One Road” project for Central Asia, Russia will not hesitate to exert geopolitical pressures to convince China to share transport routes across Russian territory. A number of economic and trade incentives are also being used to attract Chinese investors to the Russian Far East, although the “new normal” of slower GDP growth in China is cooling enthusiasm. Russia hopes that economic recovery worldwide will help dispel nationalist claims that her eastward strategies have been ill conceived. In the meantime, the authorities are trying to mend ties with Japan, reinforce links with South Korea and revive military cooperation with India (and promote exports of Russian armaments).

Rapid progress in repairing the ties with Turkey, seriously damaged in 2015 after the shooting down by Turkish anti-aircraft of a Russian fighter deployed in Syria, shows that Russia is determined to retain her areas of influence. On her Western front, Ukraine will remain a factor of instability, although Russia will increasingly resort to diplomacy rather than weaponry to help restore viable, if far from satisfactory, relations with the European Union and the Trump Administration in the US.

Silvana Malle, Professor of Economics (Emeritus), Verona University and Senior Honorary Research Fellow, University of Birmingham.
In his two years in power, Narendra Modi has managed to push into the background the concerns related to his links with the Hindu extremist factions where his political origins can be found. He has maintained a balanced approach, even though he has refrained from explicitly condemning the excesses that are often instigated by members of the BJP, his party. It would be excessive to speak of openly anti-Muslim attitudes, but the space given to “Hindutva” (or “Hinduness”), has become increasingly clear (also to some extent to the detriment of Christian minorities); it is important to understand if he has the ability – or the will – to keep it within limits and avoid further lacerations in a multi-ethnic and multi-religious society, tempted by the demon of intolerance.

Modi has focused on modernization as a means of establishing a national identity that at the same time pays heed to tradition and is coherent with the challenges of modernity. He has staged a relentless campaign against the impenetrable Byzantism of the bureaucracy. With the “Make in India” campaign, he has emphasized that, to be a great power, India needs to nurture a competitive manufacturing sector. Modi has also relaunched the process of economic reforms – first launched in 1991, resumed under Sonia Gandhi after 2004, and subsequently stalled – as the cornerstone for opening up the country to the world.

Shaking up the Indian productive and bureaucratic behemoth is
an undertaking that needs more than declarations of intent, and excessive reliance on the announcement effect has not always generated the expected results. That said, after decades of failures and delays, the introduction of single value-added tax has abolished the web of state duties and regulations that hampered the creation of a true internal market.

Opening the door to foreign investment still faces bureaucratic snares, but steps forward have been made. There remain the excesses of a culture of decisiveness that sometimes, for the sake of reaching easy consensus and economic ignorance, leads to dangerous mistakes. The latest clamorous event was the cancellation of the legal value of all large banknotes. By believing that the benefits of fighting against corruption would offset the hardships created by a decision that can cripple what is essentially a “cash” economy, Modi has raised doubts about his ability to manage complex issues and has alienated the support of the productive middle classes. But probably not of the majority of the population, which continues to see in him a symbol of redemption, no matter what.

Modi has been careful in grasping the implications of a rapidly evolving geopolitical environment and pursuing an unprecedentedly active foreign policy. Trump is an unknown entity, but revisiting Obama’s pivoting to Asia might allow India to achieve a long-sought equal footing with Washington – as a partner, never as an ally. The competition/confrontation with China continues along the fragile equilibrium of an economic relationship that is growing and a political stalemate that still awaits the signing of a peace treaty. India is trying to protect itself against the dreaded Chinese encirclement through the new “Silk Road”, extending its strategic projection into the Indian Ocean and strengthening relations with the countries of South East Asia.

India looks at the new regional equilibrium that is being sketched out with Japan and Australia in anticipation of the downsizing of the American presence. Tangential to this scenario, but strongly interconnected, is the relationship with Pakistan, where the unresolved and always festering problems of reciprocal identity complicate strategic choices. The overtures that were attempted by Modi
and his counterpart Nawaz Sharif came under fire from the hawks on both sides, and once again the rumblings of war can be heard, with the Kashmir crisis acting as both a detonator and a reflection. Although rationality is not the dominant feature of the bilateral relationship and tensions will remain high, an open war probably will not happen. This will impact negatively on India’s ambition to be recognized as a world superpower, and will maintain a high level of instability in the surrounding region, with Afghanistan looming menacingly in the background.

What about the relationship with Italy? It will still take a couple of years for the arbitration court in the Hague to reach a decision on the two Italian marines (accused of killing an Indian fisherman in 2011). The outcome should be favorable to Italy, but it is wise to remain prudent: if the outcome is negative, the dispute will heat up, making the relationship difficult. All the more reason to use the time paid to misunderstandings behind us and make use of opportunities and synergies. The Indians think in terms of balance of power; the stronger will be Indo-Italian economic relations and the perception of mutual interdependence, the easier will become managing political issues that could otherwise become very thorny.

Italy has a long tradition of relations with independent India. Few remember that Fiat, Vespa and Lambretta let Indians discover mobility. Or that Giuseppe Mazzini is known – and read – perhaps more than in Italy. Italy is nowadays seen as a country that has given up the role warranted by its history and might and which adapts itself to a perception of growing irrelevance. An image that the Enrica Lexie affair has reinforced and that is high time to correct. Politically, through “soft policy” initiatives aimed at overcoming stereotypes and wrong pretenses. Economically, by making full use of a highly visible “brand Italy”: mechanical engineering, agro-industry, chemicals, infrastructure, tourism are just some of the opportunities that are available. Not to mention luxury, even today the highest aspiration of the Indian emerging middle class. It is a complicated but inevitable course, if we want to avoid the risk of ending up isolated on the margins of one of the world’s fastest growing markets, and project a political role more akin to our
capabilities and mutual interests. A course which would positively impact also on the situation of our two marines.

*Antonio Armellini was Ambassador of Italy to India in 2004-2008.*
South Africa is at a critical juncture as the post-apartheid compromise unravels. Democracy in 1994 came as part of an agreement which largely entrenched the economic status quo and prevented any substantial redistribution of wealth. This was coupled with a market-friendly set of economic policies adopted by the first ANC government.

The narrative was that apartheid’s far-reaching interventions in markets had undermined the country’s productive potential. The government’s wholesale liberalization program swept aside intervention in agricultural markets and cut tariffs and non-tariff barriers. This was coupled with prudent fiscal policy, inflation targeting and lower corporate tax rates.

Economic growth has, however, not been strong. In particular, the mooted move to labor-intensive industries has not happened. Instead the economy remains concentrated on resource-based heavy industries, mineral exports and a rapidly growing services sector. Unemployment levels have remained stubbornly high, at 27% at end-2016 measured in narrow terms and at 36% on the broader definition which includes discouraged job-seekers.

The past 22 years have seen levels of inequality remain at global highs. The black economic empowerment policies, inducing the incumbent large firms to sell substantial minority stakes to black investors, has not resulted in a broad-based change in wealth own-
ership. Progress of land reform based on market-related prices has been incredibly slow. A growing black middle class including professionals and public servants is, in reality, very small. And, as the middle class opt out of public education and health, these services have deteriorated. The ‘fees must fall’ movement saw campuses being brought to a halt by demands for free education, even while it is evident that most university students are from the better-off ranks, given the poor state of public schools.

With the ‘rules of the game’ not working for the majority, there has been a rise in rent-seeking and corruption, from low-level practices such as traffic officers soliciting bribes to major scandals in state-owned enterprises. This has become exposed in 2016; however, it is not clear how effectively it is going to be addressed nor what alternatives are proposed.

The year 2017 therefore sees the country at a critical juncture. The governing ANC is split. The issues in the media have largely been about whether Jacob Zuma will be forced to step down and who will replace him. This ignores the question about what alternative paths will be chosen after the ANC choose a new leader and the de facto presidential candidate in December 2017. After losing control of important cities in local elections in 2016, the new leader will need to set out a vision for change.

One position within the ANC is to return to the principles of good governance and faith in markets. But, the economic model was not delivering for the majority of the people whose access to opportunities is blocked by poor education and lack of assets. Urban areas, where two-thirds of the population now live, remain configured along apartheid lines, meaning high transport costs and travel times to look for work.

Alternatives are being proposed outside the ANC. The Democratic Alliance (DA) has an orthodox liberal agenda which emphasizes institutional strengthening without promising any redistribution. Organized big business is working on programs, such as a fund for small and medium enterprises, which seem insufficient to foster changes in South Africa’s highly-concentrated markets. The relatively new Economic Freedom Fighters (EFF) have a (vague) plat-
form of radical economic transformation, including land reform
without compensation at market rates.

At present, the DA and EFF are finding common cause in attack-
ing the ANC. And, the EFF is supporting DA-led administrations
in local government. As the national elections due in 2019 loom
ahead, the rationale for these informal alliances will break down as
the parties compete for disaffected ANC voters. At the same time,
the system of proportional representation and the decline in ANC
support make it very likely that a coalition agreement involving the
ANC will be required at the national level.

On the positive side, there are conditions for improved economic
performance in 2017. The 2015/16 drought is over, meaning an im-
provement in agricultural production. Power outages due to long-
term underinvestment are also a thing of the past. The exchange
rate has depreciated in real terms to better reflect the country’s
productive capabilities, rather than its mineral endowments and
cheap energy. Many other countries in southern Africa have also
recorded good growth and are an increasingly important source of
demand for South Africa’s diversified exports. However, this will
not be enough to divert attention from the fundamental challenges
facing the country.

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of Johannesburg.
The Justice and Development Party (AKP) came to power in 2002 on a platform of anti-corruption and inclusion. It embraced an economic recovery program put together by the preceding government in the wake of a deep financial crisis in 2001. The program entailed major reforms including central bank independence, establishment of a rule-based regulatory framework and independent regulators in banking, telecoms, and energy, enhanced control and transparency of public finances. A modern competition law was already adopted in the 1994 as a condition of the Customs Union with the European Union. Following political reforms undertaken by the AKP government, accession negotiations with the EU started in 2005.

Turkey experienced per capita growth higher than 3% in six consecutive years between 2002-2007, the only such episode since 1961. Evidence suggests that poverty and inequality declined, and the middle class expanded during that period. The share of mid-tech products in Turkey’s exports increased. Various mechanisms were used to nurture well-connected firms in rent-thick sectors such as construction and energy, though their role in manufacturing was more limited. On the one hand, pious businesses grew and challenged the traditional industrial elite, which still has a major share in economic activity. At the same time, prospects of EU accession made the traditional elite feel secure about their property
rights. Overall, there was a general increase in the scope of economic activity governed by formal, predictable rules.

Then the tide started to turn. The government, and Prime Minister Erdogan in particular, started to respond in a more authoritarian manner to emerging challenges, including the Gezi protests of 2013. But probably the most important challenge was the break-up of the coalition with the Gulen movement. The AKP and the Gulenists belong to different traditions of political Islam. The Gulen community never took an openly political form, was organized in the police, judiciary, the army and active in the education industry. Its leader ostensibly expounded a moderate version of Islam, and took care to have good relations with the West, especially with the US (where he lives). The AKP comes from the tradition of the National Vision movement, often associated with Necmettin Erbakan in the 1980s and 1990s, and has been the main political representative of Islamism in Turkey. Conflict within the coalition became especially visible when Gulen-associated prosecutors started an investigation against the head of the National Intelligence Agency, an Erdogan associate, in 2012. This was followed by an attempt by the government to close down Gulenist schools, in turn followed by corruption investigations launched by Gulen-affiliated prosecutors against AKP ministers. The conflict culminated in the coup attempt of 2016 which is widely believed to be at least partly instigated by Gulenist army officers.

There is a (heated) discussion in Turkey about whether the increased centralization of political power was planned by the AKP from the beginning, or whether it developed over time as a response to the unfolding of events. In any case, the coup attempt was followed by extensive purges in the civil service and mass arrests. The government has extensive control over the media and the judiciary. More than 600 businesses, including some among the top 1000 manufacturing firms in Turkey, were reportedly taken over and transferred to the Deposit Insurance Fund for allegedly providing financial support to the Gulen Movement. The scope of rule-based governance of the economy has narrowed down significantly, with regulatory agencies much less independent compared
to the early 2000s and the central bank under increased pressure by the government. And of course, the EU anchor is very weak, if not non-existent.

In the early 2000s, economic growth was driven by structural change, or reallocation of employment from low-productivity agriculture to higher-productivity sectors in manufacturing and especially services. That growth regime entailed collection of low-hanging fruits, although the need to develop skills and innovation was possibly already evident. Now, of course, Turkey is a middle-income country, faced with a different ball game altogether. Overall productivity growth had already slowed down after 2010 and most job creation has been in construction, which has seen productivity declining in the last decade. The predatory nature of the post-coup domestic environment, increased political violence associated with the Kurdish problem, and uncertainties surrounding Turkey’s venture in Syria have taken their toll on the economy.

AKP was known for its developmentalist, “growth-at-all-costs” attitude to the economy, but now prospects look more daunting. Compared to many other authoritarian regimes, Turkey does not have natural resource rents that can be used to finance growth and otherwise reward supporters. With the EU institutional anchor gone, or at least severely weakened, the government will find it increasingly difficult to spur investment, especially by the traditional elite. In an atmosphere where power is centralized, checks and balances are weakened, the rule of law is in decline, and criticism is less and less tolerated, 2017 will be a tough year.

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Next November will be the 70th anniversary of the UN resolution that divided a small disputed territory – Eretz Yisrael or Palestine – into two states, one Jewish and one Arab. The first has been in existence since 1948, though without secure and recognized borders and facing the stubborn opposition of a large part of the Arab-Islamic world; the second does not exist yet as a sovereign and territorially contiguous state. In June 2017 it will also be 50 years since the Six Day War that Israel fought against a coalition of Arab states in an attack that could have been fatal to the country’s future. In its wake began a regime of military occupation of the West Bank and Gaza (the Sinai was returned to Egypt by virtue of a peace treaty; Israel withdrew unilaterally from the Gaza Strip).

If an agreement is not reached on the borders, the Jewish settlements, and the status of Jerusalem, the very notion of “two states for two peoples”, introduced in the 1980s and reaffirmed by the Oslo treaty of 1993, is likely to evaporate into the dream world of mythology. At the current juncture, the Israeli-Palestinian conflict is practically “relegated” to the backstage, overshadowed by the tragedies of contemporary Middle East: mass killings and humanitarian disasters in Syria and Iraq, Islamist terrorism, political fragmentation, and mass youth unemployment.

The Palestinians have committed appalling errors, ranging from
suicide terrorist attacks against Israeli civilians to the ineffective war between guerrillas from the Gaza Strip. Today they have become largely powerless, divided between the West Bank and Gaza, between the Palestinian National Authority and Hamas, ostracized by the Arab world, with the leadership of Abu Mazen hanging on by a thread. They are not citizens of the state in which they live, be it the West Bank or the Gaza Strip, where they have not exercised their voting rights for 10 years, nor do they vote in the elections for the institutions of the country – Israel – which effectively controls their daily existence.

However, it is a mistake to maintain that the conflict between Israel and Palestine is not very relevant for the parties concerned and for the rest of the world today and that the status quo can be sustained indefinitely. The prevailing belief in Israel that the conflict can be “managed” in “low-intensity” ways, with no need to resolve it, is illusory, as is the idea that against the backdrop of the regional disorder it suits Israel not to adhere to a peace initiative and wait for events to unfold. The human and material costs of “non-peace” are indeed enormous, as attested by the horrors of the Gaza conflict in 2014, a series of attacks that bloodied the streets of Israel and the West Bank for months, and the growing threat of eroding democracy and the very coexistence between Arabs and Jews in Israel.

Then there is the deep division between the two communities, the Jewish-Israeli one and the Palestinian-Arab. In the psychology of Palestinians, Israel is the occupier, the aggressor; to the Israelis, Palestinians are the homicidal enemy, ungrateful and intractable, undeserving of either trust or political and statehood rights. This is a major setback with regard to the Oslo philosophy, whose premise was the mutual recognition of rights: the right of Israel to a future of peace and security, the right of the Palestinians to an independent state.

Yet even within the shambles of the Middle East, a window of opportunity can open up if the negotiations between the two parties are backed up by a regional agreement that provides support at the economic level. This would allow to reintegrate Palestinian refugees, partly into a future state of Palestine and partly into Arab
countries, as well as provide Israel with the necessary security assurances. To this end, Israel should accept the offer of peace and normalized relations that was put forward by the Arab League in 2002 and reaffirmed in recent years, in order to counteract its increasing diplomatic isolation and seize the opportunities offered by an objective convergence of interests with the Palestinian Authority and Arab states, especially Saudi Arabia, Jordan, Egypt, and the UAE, to oppose Islamist extremism on the one hand and the Iranian threat on the other.

Finally, great uncertainty surrounds the commitment of other actors: the United States, the EU, Russia. In the troubled history of the conflict between the Arabs and Israel, the intervention of “third party” mediators has been crucial. But at the current juncture, it is unclear what they could contribute. Russia, allied with Iran and Hezbollah, is winning a devastating war in Syria that has potentially dangerous consequences for Israel; Europe is shaken by a series of “disunity” crises; in the United States, an isolationist President is about to take office and appears to be more willing than Obama to accept the expansion of Israeli settlements, the de facto annexation of significant parts of the West Bank, and Jerusalem as Israel’s capital.

Unlike what seemed possible prior to the US elections, it now appears to be very unlikely that in the last part of his mandate Obama will propose, with a United Nations resolution, the parameters of a “two-state” solution, mirroring those indicated by Bill Clinton in 2000 after the failure of the Camp David negotiations, or at least that he will decide to not exercise the US veto on a resolution proposed by others condemning the settlements. This would have been a bold “legacy” for Obama, the American president who has done more than any other to ensure Israel’s security and secure peace between the warring parties.

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In ancient Greek, “nomisma” means the real value of things. It is in this spirit that Nomisma has monitored and analyzed local, national and global economic trends for more than 35 years, gaining strong recognition as one of Italy’s leading economic think tanks and consultancies. Nomisma’s development has reflected its interdisciplinary vision of the economy, paying particular attention to agribusiness, industry, real estate, territorial development, international cooperation, public services, energy and sports.
We know that they are changing fast, but we have little idea of where the winds are blowing and how the times will be. So Nomisma has asked prominent experts from around the world to identify major trends that will shape the global agenda in 2017. Will debt dynamics prove unsustainable and precipitate a new crisis? What can be done to reignite growth in productivity and living standards? What about the future of jobs and the jobs of the future? Which topics will dominate the political agenda in key geographies in the industrial world and emerging economies?

Contributors