The danger in today's good economic news

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Failure to stem the rise of inequality will fuel social tensions and already-resurgent nationalism, producing disruptions that will ultimately lead to losses for everyone. That is why today's good growth news may not be as promising as many believe.

As 2018 begins, things are looking up for the global economy. Over the last six months, growth projections by official institutions like the International Monetary Fund, matched or even exceeded by private forecasts, have been adjusted upward. But not all of the news is good.

To be sure, there are plenty of positive indicators to inspire optimism. The eurozone Purchasing Managers' Index for manufacturing hit an all-time high last month, and even Greece's economy is finally growing. In the United States, growth now appears likely to exceed the IMF's October prediction of 2.3% for 2018.

In the emerging world, China seems to have staved off the risk of a sharp slowdown: while its economy is no longer achieving double-digit growth, its increased size implies that, in absolute terms, today's 7% annual rate exceeds the 10% rates of the past. Turkey, for its part, posted 11% growth in the third quarter of 2017. Even Brazil, which experienced negative growth in 2016, is likely to exceed the IMF's forecast of 1.5% growth in 2018.

As the real economy strengthens, equity values – which, for a time, seemed disconnected from fundamentals – are increasingly being validated. The Financial Times Stock Exchange All-World Index rose by nearly 22% in 2017 – its best performance since the post-crisis rebound of 2009.

As the growth pessimism of recent years fades, some of the warnings that have been made in recent years seem to have become outdated. Northwestern University's Robert Gordon, for example, argued that the US economy was bound to slow down, because today's technological innovations would not boost growth to the extent they had in the past. Harvard's Lawrence H. Summers got a lot of attention for his argument that the world risked sliding toward "secular stagnation," because the interest rate needed to bring desired investment in line with desired savings was below zero.

Yet, while the zero lower bound no longer seems to be a binding constraint, there are potential causes for concern, one of which relates to debt levels. With the advanced economies no longer needing to maintain extraordinary monetary policies, nominal interest rates are set to climb from their current historic lows. As that happens, high debt levels could become problematic, impeding growth by triggering disorderly deleveraging. That said, given low inflation, there is little reason to expect interest rates to rise sharply, and gradual monetary-policy normalization would not necessarily have negative effects on growth or inflation.

But there is another potential obstacle in the path of sustained recovery: the long-term decline in productivity growth has not yet been reversed. Instead, the current boom seems to be demand-led, with private consumption being the biggest driver, though private investment, too, is finally starting to rise. These trends have been accompanied by solid employment growth, which is welcome news, but cannot last forever.

In the longer run, economic performance and potential growth will depend on the supply side and, in particular, on a revival of productivity growth. Techno-optimists claim that technology will fuel the needed gains, as the lag between digital capabilities and their applications in the economy shortens. But it is too early to say, with any evidence-backed certainty, whether they or techno-pessimists like Gordon are right. There are convincing arguments on both sides, though we count ourselves as cautious techno-optimists.

What is not really up for debate is that inequality within countries is rising fast. While individual countries show different levels of inequality, its rise has been evident almost everywhere, with income and wealth increasingly concentrated at the very top. This trend will accelerate as new technologies, regardless of how much productivity growth they generate, continue to increase the skill premium, shift income to frontier firms, and allow new types of near-monopoly, "winner-take-all" positions to develop on a global scale.

Herein lies the biggest danger in today's exuberant headlines about growth. Many believe that rapid growth can act as a virtual panacea for countries' political and social woes, including the rise of populism and nationalism. But if the benefits of rapid growth accrue to the top 5% or 1%, social tensions are bound to rise. And the fact is that it will be difficult to develop policies that can reverse damaging political trends and promote more widely shared growth.

This is not to say that nothing can be done. On the contrary, devising solutions should be a high priority, with the policy debate centering on measures that would help to create truly inclusive economies.

One such measure would be broad-based access to affordable and quality education, including skills upgrading and retraining. The development of regulatory frameworks that encourage competition would also help, as would limiting tax-base erosion. Public research should be funded in a way that gives taxpayers a stake in profitable outcomes. Likewise, infrastructure investments should have explicit equity-related objectives. The goal should be to attack inequality on two fronts: ensuring that pre-tax incomes rise in a more inclusive fashion and strengthening the equalizing role of taxes and transfers.

Given the global nature of markets, many policies will require international cooperation to be effective. With issues concerning international trade, investment, competition, and intellectual property rights increasingly linked, global approaches that can address them in a holistic way have become vital.

Failure to achieve greater inclusiveness – a difficult but attainable goal – would stoke social tensions and fuel already-resurgent nationalism, producing disruptions that would ultimately lead to losses for everyone. Yet today's good growth news risks obscuring that risk, as it threatens to weaken the will to make the needed changes, leaving economies to rely on trickle-down effects.

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