

# The Road to 2020

## Scenarios for a World in Crisis



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# About These Scenarios

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**T**his paper was prepared by Simeon Djankov, Neil Gregory, Michael Klein, and Facundo Martin. The authors are, respectively, Chief Economist, Adviser, Vice President, and Economist in the Financial and Private Sector Development Vice Presidency of the World Bank Group. The paper is based on a scenario workshop held on January 20, 2009, where leading financial and private sector development experts from IFC, the International Monetary Fund, and the World Bank discussed the unfolding crisis. The findings were also presented and discussed with a wide audience of World Bank financial sector specialists at the Financial and Private Sector Development Forum 2009: Markets and Crises: What Next and How? (<http://rru.worldbank.org/fpdforum/>) on February 24–26, 2009. These scenarios will be updated from time to time as events unfold.

This paper is a product of the staff of the Financial and Private Sector Development Vice Presidency of the World Bank Group. The scenarios described in this paper do not necessarily reflect the views of the World Bank Group, its Executive Directors, or the governments they represent. The scenarios described serve as the basis of a planning exercise and are not to be interpreted as forecasts or projections on the part of the World Bank Group or the authors of this paper.

## 2020

The unfolding crisis has already featured some events that were considered unthinkable some months ago—for example, nationalizations in the banking sector of OECD countries. More unthinkables are likely to arise. As the crisis and the crisis response by governments develop, one can hypothesize about where the world might go.

The purpose of this paper is to sketch scenarios taking into account the information currently at hand. In this way, scenarios can provide decision makers with alternative views of the future. Decision makers can test their strategies against the different ways in which the

future might play out. Scenarios provide a framework for debate, leading to better policy making and strategies. They are especially useful in situations where major global changes are under way but there is huge uncertainty over what may happen. Staff of the World Bank Group are providing these scenarios to help governments and organizations prepare for an uncertain future. Being well prepared and open to thinking about different outcomes is much better than continually being behind the curve and having to chase events.

Four scenarios for the development of the world economy over a roughly 10-year horizon are presented. These are called Stuck in the Rut, Dirigiste Capitalism, Capitalist Blocs, and Bounceback. These are not forecasts but merely possible sequences of events. If a particular scenario begins to emerge, policy makers can be ready with optimal strategies to deal with key issues, including what investments may be preferable, what role different institutions can play, and how individual countries may respond.

## Two Fundamental Uncertainties

The exit path out of the crisis, and subsequent global development, depend on two fundamental uncertainties. The first is whether the current crisis is a random event—a black swan—or an inherent part of a market system. Under the first view, the world is sufficiently resilient to pick itself up, dust itself off, and continue as before. Under an alternative view, the more sophisticated and complex the market system becomes, the more violent and unpredictable the crises. Hence, resolving this crisis may provide a welcome relief before another—even bigger—crisis shows up on the horizon. The world is an increasingly violent swirl of chaos and control.

The second uncertainty is about what drives long-run growth and, in particular, whether external (to the firm) finance is a big driving force for growth. One view is that without a sophisticated financial sector the real economy

does not have opportunity to develop. In other words, growth follows finance. The alternative view is that the development of the real economy is not predicated on a sophisticated financial sector, and indeed that such a sector develops only after growth has been sustained for some time. In other words, finance follows growth.

The answers to these uncertainties determine the likelihood of alternative scenarios, as described below. There is a common element among all four scenarios: under each, there needs to be a mechanism to unwind the global fiscal imbalances that will be exacerbated in the crisis.



## Four Possible Scenarios



The four scenarios differ along two main dimensions, the degree of regulation in the economy and the stance toward international trade and investment flows:

1. Stuck in the Rut—restricted trade and heavy regulation
2. Dirigiste Capitalism—open trade but heavy regulation and increased state ownership of the economy, particularly the financial sector
3. Capitalist Blocs—initially restricted trade, but markets with flexible regulation
4. Bounceback—open trade and regulation similar to pre-2008 levels

The scenario Stuck in the Rut envisages a dozen years of slow growth, worldwide, and another global crisis coming around 2020 (table 1). Dirigiste Capitalism anticipates a divided world, with flat growth in rich countries and brisk catch-up growth in emerging markets. In this scenario, China catches up to the United States in total GDP (at purchasing power parity) by 2020. In Capitalist Blocs, the world economic system falls into several regional blocs, but by 2020 it becomes evident that global trade and investment dominate a divided world, and the World Trade Organization (WTO) is used to consolidate a global open market. In Bounceback, the recovery is brisk and the world regains its pre-2008 economic shape, but with heavier regulation in the financial sector.

**Table 1. Outcomes of Four Scenarios, 2011–20**

Type of outcome	Stuck in the Rut	Dirigiste Capitalism	Capitalist Blocs	Bounceback
GDP growth	Low	Medium	Medium	High
Growth volatility	Medium	Low	Low	High
Trade growth	Low	High	Medium	High
Shape of slowdown	L-shaped	L-shaped for developed countries; U-shaped for most emerging economies	U-shaped	V-shaped

Across all scenarios, Africa has one of the highest growth rates of any region or large economy (table 2). Japan, closely followed by Western Europe, has the lowest. Eastern Europe does better than Western Europe, but does not achieve the 6% average growth of the last decade. This is because credit is less readily available, and growth comes primarily from economic activities moving east. China's growth is faster than that of any other large economy.

The scenarios are meant to be descriptive and not suggestive of which 2020 future is most likely. However, they can be used to gauge perceptions of where the world is going and to formulate strategies based on which scenario emerges.

**Table 2. Growth Scenarios**

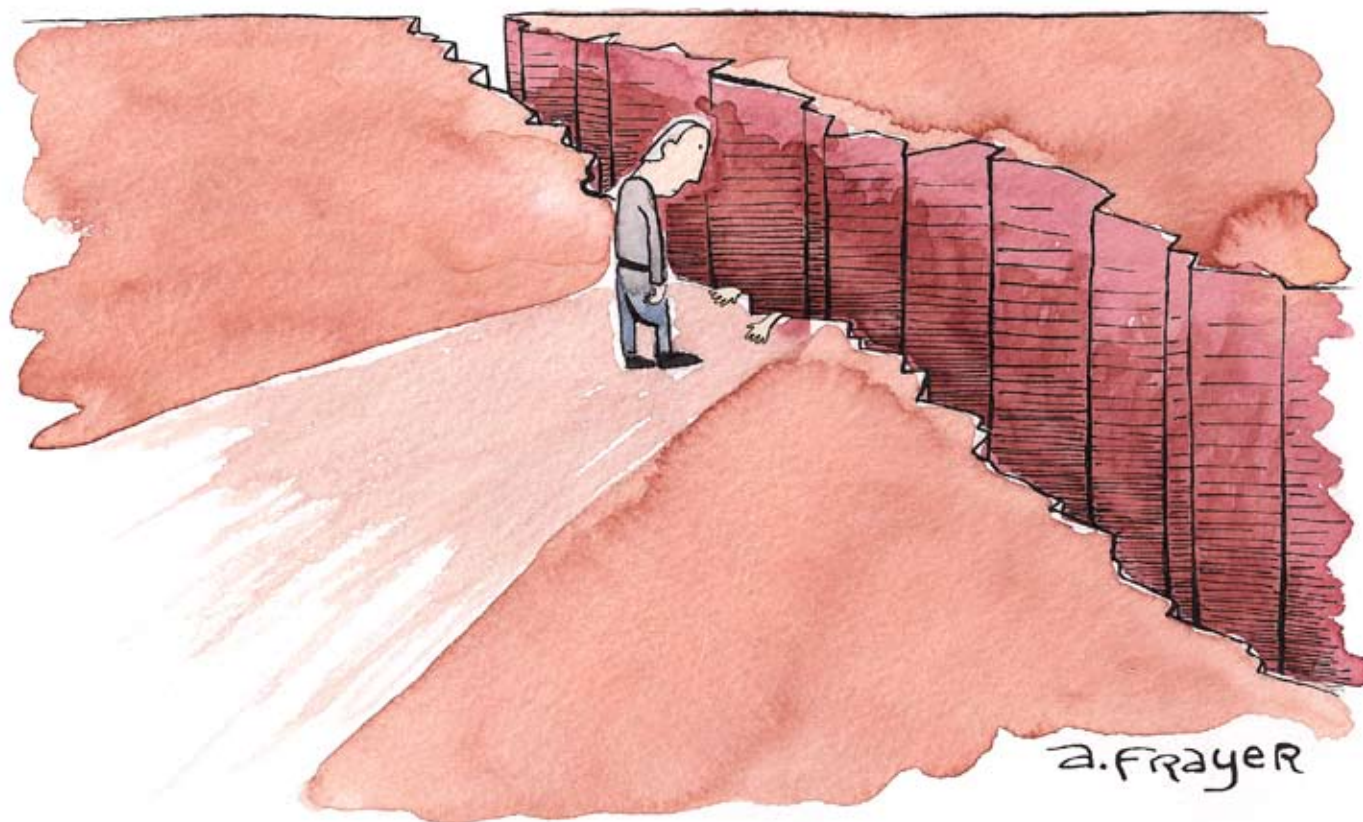
Average annual GDP growth (%)

	Stuck in the Rut	Dirigiste Capitalism	Capitalist Blocs	Bounceback
US, 2009	-5	-3	-3	-2
US, 2010	-3	-1	0	3
World, 2011–20	1.3	2.6	2.6	4.1
US, 2011–20	0.5	1	1.5	3
EU, 2011–20	0	0.5	1	2
Japan, 2011–20	0	0.5	1	1.5
Latin America, 2011–20	1	2.5	2 (AFTA, 4; Mercosur, 1)	5
Eastern Europe, 2011–20	2	3.5	3.5	5
Middle East, 2011–20	2	3	4	5
Asia, 2011–20	2.5	5	4	6
Africa, 2011–20	4.5	7.5	7	8
China, 2011–20	4	7	6	8.5
India, 2011–20	2	5	3.5	6

Note: AFTA = American Free Trade Agreement.



# 1. Stuck in the Rut



In January 2009, the US economy enters a period of hope, driven by the post-inauguration glow. The second fiscal stimulus package (\$800 billion) is approved in February 2009. Funding for the International Monetary Fund (IMF) triples.

However, Eastern Europe is reeling. Several Eastern European economies are in a freefall. The Latvian government resigns in February. The IMF package for Ukraine is close to collapse. Romania gets an IMF package in March, and the ratings of nearly all Eastern European economies fall another notch or two.

By June, people in the United States start thinking that “it’s not going to work” (too little, too late in dealing with problems in the real economy), and the political honeymoon ends abruptly. Aggregate demand starts falling again and more high-profile businesses fail (Starbucks and GM close down). Equity markets continue sliding,

the Dow and Nikkei reaching 6,000, the FTSE 3,400, by July 2009.

## A Run to Cash

In October 2009, a large US life insurer fails to pay claims and goes bankrupt. Baby boomers run to cash and there is a big fall in stock markets. The Dow reaches 4,000. Banks are in deeper trouble than expected, with bad assets totaling \$2.5 trillion (even after the various write-downs in 2008 and early 2009).

Confidence falls to bottom levels, and by early 2010 unemployment in the US rises to 12%. Real GDP falls 5% in 2009 and 3% in 2010. Various rescue packages get designed. But policy making is behind the curve—every successive rescue package is less effective than the previous one. “Buy Domestic” signs appear in every country, with large demonstrations against imports in India, France, and Greece.



Developed countries reduce aid flows to Sub-Saharan Africa. Some conflicts persist, such as the situation in the Horn of Africa and the Darfur and north-south conflicts in Sudan.

Applications to business schools plummet; law school applications are on the rise. The US Congress mandates “modesty” courses in the business school curriculum; “Modern Marxism” is the most popular class at INSEAD and the London Business School. Public policy schools see their admissions triple.

Meanwhile, Europe suffers from a dramatic decline in demand from the US and unemployment reaches 15% (over 20% in Spain). Lengthening unemployment lines across Europe lead to sporadic rioting in Toulouse, Manchester, and Hamburg during the summer of 2010, while violence against ethnic minorities increases. Wildcat strikes against immigrant labor spread from the United Kingdom across continental Europe. The European Union becomes less open to free movements of labor and significantly toughens immigration policies.

## The Bailouts Fail

The IMF programs in Ukraine and Romania fail. This puts higher pressure on Austrian, Italian, and German banks, with several—most notably Raiffeisen Bank and UniCredit—walking away from their Eastern European subsidiaries. Eastern European and CIS countries feel a severe hard landing given the sudden stop in capital inflows financing their large current account deficits.

In this scenario, a second IMF package for Ukraine fails to stop output from falling, and in August 2010 a new, populist government is elected. After a second Turkish package in September 2010, the World Bank runs out of cash to help troubled economies. For the next several years, calls to replenish its financing remain unheeded.

In February 2011, Indonesia goes bust. This triggers a chain of sovereign bankruptcies, including midsize emerging economies like South Africa and Argentina.

North African countries, together with Jordan and Lebanon, suffer from lower remittances and trade given the recession in the EU. Even if they benefit from lower oil prices, they have tremendous trouble dealing with a growing population of young and unemployed. Political demands increase and most of the regimes become

unstable. The Gulf Cooperation Council (GCC) countries suffer from low oil prices, and even Saudi Arabia feels the need for a fiscal adjustment after three years of oil prices around \$40–50 a barrel.

China’s aging population is more worried about inadequate social safety nets, which pushes up its savings rate even higher. The country experiences falling consumption, particularly of imported products. This triggers a battery of protectionist measures around the world. In protest, China leaves the WTO in May 2011 and Brazil and India quickly follow. There is a revival of the Chiang Mai Initiative, which calls for deep integration between the economies of the Association of Southeast Asian Nations (ASEAN) and China, Japan, and the Republic of Korea. The proposal is approved.

Latin America and Asia suffer from continual decline in commodity prices and lower demand for manufactured goods. Latin America, the Philippines, and many countries in the North Africa region are hit by lower remittances from the US and the EU. Many migrant workers return, putting extra burden on local labor markets.

Several prominent multinationals shed subsidiaries abroad in return for tax concessions in their domestic market. The pattern is set by Ford, which sells its European subsidiaries to the Tata Group. Carrefour sells its subsidiaries around the world to concentrate on the expanding EU market.

The McKinsey Global Institute publishes a report on “the end of globalization as we know it.” *New York Times* columnist Tom Friedman publishes a new book titled *The World Is Round After All*.

Financial institutions remain in bad shape, with a large amount of bad assets still on their balance sheets, and unable to resume lending broadly. Real estate prices have continued falling after their peak in 2007, reaching 45% of mid-2007 levels by December 2011.

Corporate scandals arise in nearly every country as “capitalist greed” is blamed for the falling economy. In several high-profile cases, former CEOs receive prison sentences. China imprisons five CEOs for fraud.

In January 2012, the US and the UK are downgraded to AA, Italy and Greece to BBB, because of the mounting contingent liabilities resulting from the banking sector

support. The US has consistently run a 10% budget deficit (once Freddie Mac and Fannie Mae are consolidated in), which looks increasingly unsustainable.

Far-right groups launch attacks against migrants across Western Europe and Slovakia. In Bulgaria, the far-right nationalists sweep the February 2012 elections.

The maker of Bombay Sapphire gin becomes the world's largest publicly listed company in terms of market capitalization.

In this scenario, President Obama does not run for reelection in 2012, as his approval ratings have fallen to single digits. For the first time in US history, an independent candidate wins the presidential election.

Nouriel Roubini is awarded the 2013 Nobel Prize in Economics. The World Economic Forum suspends its annual meeting because of a lack of sponsors. And the Forbes 400 list of the richest people in the world is edited down to the Forbes 40 for the first time in history.

In 2011–20, emerging and developing economies have managed to grow at around 2.5% a year, while growth in developed countries has reached only 0.5%. Africa grows the fastest, at 4.5%, followed by China at 4%. Asia grows at a respectable 2.5%. The EU and Japan record no growth (table 3).

Heavy metal music makes a comeback. AC/DC's album *Dirty Deeds Done Dirt Cheap* goes platinum in its reissue.

In 2018, the bicentennial of Marx's birth is celebrated around the world.

In 2019, for the first year ever, China records a fall in the working-age population. The demographic pyramid means that China will have an OECD-type population with a developing country income level.

In 2020, the US experiences a severe financial crisis. The outstanding gross public debt has reached 220% of GDP, a level previously reached only in Lebanon. Standard & Poor's rates the US "single A." Because China no longer holds as much dollar debt, the currency collapses.

This is a world where "nothing works." Populism and fear abound. Peace is fragile, moods volatile. The light at the end of the tunnel remains dim.

**Table 3. Growth in the Stuck in the Rut Scenario**

	Average annual GDP growth (%)
US, 2009	-5
US, 2010	-3
World, 2011–20	1.3
US, 2011–20	0.5
EU, 2011–20	0
Japan, 2011–20	0
Latin America, 2011–20	1
Eastern Europe, 2011–20	2
Middle East, 2011–20	2
Asia, 2011–20	2.5
Africa, 2011–20	4.5
China, 2011–20	4
India, 2011–20	2





## SCENARIO 2. Dirigiste Capitalism



**S**timulus packages in OECD countries converge on a set of fiscal expansion and tax rebate policies, protection of weak industries (for example, the car sector), directed lending, and nationalization of financial institutions.

The recession is deep in the liberal market economies: in the US, GDP falls 3% in 2009 and 1% in 2010 and unemployment reaches 9.5%, while in the UK, GDP shrinks 4% in 2009 and 1.2% in 2010. Also, the governments in the US and the UK have conducted procyclical fiscal and monetary policy during the downturn, and these stimulus packages lead to higher interest rates and subdued growth for several years (L-shaped recovery).

In the process of supporting the financial sector during the downturn, governments become owners of large parts of the sector in systems where it was mostly

private. Countries that were on the way to private financial markets slow or halt reforms.

Many central banks in developing countries lose independence after the failure of regulators to deal with the crisis.

Popular outrage at excessive compensation in financial institutions leads to ad hoc, detailed interference in salaries for CEOs and traders in several countries (including the US, the UK, France, and Germany).

### The End of Self-Regulation

Disenchantment with the self-regulatory capabilities of financial markets is widespread. The prevalent view emerges that market-based financial systems exhibit a tendency toward more violent booms and busts.

In the recovery that starts in mid-2010, output growth precedes credit growth, as happened after all major “sudden drops,” including the Great Depression. This gives credence to those who argue that a sophisticated financial sector is not essential. Various forms of government intervention in the financial sector are deemed acceptable in most countries.

In 2011, China continues to stimulate consumption through a mix of government spending and gradual appreciation of the currency. Increases in private consumption are also under way.

Emerging markets remain interested in open trade. They are, after all, net exporters to the US. As emerging markets stimulate domestic consumption, net capital flows to the US slow. The US savings rate turns up, with consumers saving and the government trying to reduce debt. The US seeks exports to other countries as an engine of growth.

Three approaches to reform of financial sector regulation are tried in various countries. The US tries improvement of market infrastructure with some attempt at anticyclical measures, requiring banks to increase capital ratios during good times to “save for a rainy day.” France, Canada, and Spain go a step further and try full-fledged macro-prudential regulation, adjusting capital requirements as necessary to moderate credit growth and leverage. China and India continue to reform some market features, try forms of macro-prudential regulation, but maintain outright limits and prohibitions on various activities, including capital controls.

Developing economies follow the China-India model, where financial markets are allowed in a framework of government controls, with somewhat arbitrary application. State-owned development banks become the largest financial institutions in most emerging economies. These give loans to specific industries and projects—marking the rise of industrial policy. New state-owned agricultural banks pop up everywhere.

Efficiency in capital allocation falls significantly as lending becomes politically driven, and this is combined with increases in unemployment and in the size of the informal economy. Migration and remittances fall and business start-ups decline as a result of increases in regulation.

## A Void in Global Leadership

The IMF and the World Bank have a limited role. The traditional donors, the Europeans, have fiscal issues. There is no clear global leadership. Various talking clubs still exist. China develops more Asian approaches (monetary, Chiang Mai-based; political, ASEAN Plus Three). Development aid is dominated by the Asian Development Bank following a fourfold capital increase in January 2012.

Russia becomes more interlinked with China, and less with Europe. Eight new gas pipelines are built to China starting in 2012. This allows Russia to play the European Union and China against each other. Africa and Latin America depend again on resource exports to China and India.

Joseph Stiglitz gets a second Nobel Prize in Economics in 2013, for his work on market failures.

In the end, driven by the interests of exporting countries such as China, the world’s open trading regime survives with some setbacks, while global saving-investment imbalances adjust by 2015.

Reprivatization of banks proceeds slowly in Europe. Even the US government still has major stakes in banks by 2015. And many economies practice some form of “protectionism” through the financial sector (preferential support to domestic institutions, lending targets for domestic borrowers, limits on lending abroad).

At the Grammys in 2016, REM makes a huge comeback with its song “It’s the end of the world as we know it (and I feel frantic).” The Ayn Rand fan club holds a memorial service, and the only person to show up is former Federal Reserve Chairman Alan Greenspan.

Innovation at the frontier is hurt by difficulties in restarting venture capital and capital markets more broadly. In the past, the US economy has traditionally supported new firm entry on a large scale. New firms destroyed value on average, but some entrepreneurs were wildly successful and started new industries or products. This is now gone.

The general antimarket climate has promoted more regulation of innovation, for example, in biotechnology. The EU suffers most from this development, with a “lost decade”

in the 2010s. The less cautious attitude in China and Russia leads to a relative shift of innovation to emerging markets.

The EU grows by an average 0.5% a year in 2011–20, and the US by 1%, while China becomes the driver of world growth by averaging 7% a year (table 4). India reverts to a pre-1980s controlled economy, with a growth rate of 5% showing that a democracy that tolerates financial repression can also work. Other countries with space to catch up do it at reasonable 4% rates. Africa grows the fastest, at 7.5%, as emerging markets need its natural resources. Latin America manages 2.5% growth. Eastern Europe grows at 3.5%.

**Table 4. Growth in the Dirigiste Capitalism Scenario**

	Average annual GDP growth (%)
US, 2009	-3
US, 2010	-1
World, 2011–20	2.6
US, 2011–20	1
EU, 2011–20	0.5
Japan, 2011–20	0.5
Latin America, 2011–20	2.5
Eastern Europe, 2011–20	3.5
Middle East, 2011–20	3
Asia, 2011–20	5
Africa, 2011–20	7.5
China, 2011–20	7
India, 2011–20	5

Climate change gets tackled through nuclear energy.

Attempts to make macro-prudential regulation work end up with mixed success. The US experiences another crash in 2019 as the unwinding of global fiscal imbalances starts with Asia dumping US treasuries. The macro-prudential regulators manage to limit the growth of systemic financial risk, but run into practical difficulties and political pressures, which undo some of

their achievements. The result is volatile low growth in the US.

By 2019, 10 years after “the year of collapse,” China and India are back to growth rates of 10% and 8%. They can catch up by importing and adapting innovations (in technology and management) already made elsewhere. One consequence of the “death of distance” and the massive changes in information systems in the world is that countries can learn more, and faster, at moderate cost. As long as trade is broadly functioning, developing countries can import critical components and make major productivity leaps.

By 2020, countries learn that financial controls can go hand in hand with promoting competition in product markets and controlled expansion of financial systems. The key to firm growth is in any case finance from retained earnings—not finance external to the firm. The Dirigiste Capitalism scenario features competitive product markets, controlled financial system development, and openness to trade combined with severe restrictions on financial flows.

In 2020, China’s GDP (at purchasing power parity) equals that of the US. At growth rates of 7% or higher, Chinese GDP more than doubled in the preceding decade. Exchange rates have adjusted, and the dollar is no longer the world’s reserve currency. Central banks increasingly buy the renminbi. Globally, the US and China are the clear rivals. G2 meetings now drive the global agenda. China negotiates the reintegration of Taiwan (China).

This is a world where the economic development model is clear: follow the path of China or India. Optimism reigns in emerging markets. Darker moods persist in rich countries. The global power shift is visible.





## SCENARIO 3. Capitalist Blocs



**D**uring the second half of 2009, extensive government support stabilizes the banking systems of G7 economies. Deleveraging continues, under the watchful eye of bank boards heavily influenced by the wishes of governments that are now majority shareholders or outright owners. In the United States, France, Germany, Japan, and the United Kingdom, banks are directed to give priority to domestic lending over cross-border lending, and to specific industries.

Immigration enforcement is stepped up in the US, including through high-visibility mass deportations from California to Mexico.

Government-sponsored housing associations grow rapidly in the US, buying up vacant properties to rent as homeownership declines and renting increases in popularity.

### The Rise of Protectionism

Government support packages include a range of trade protection and subsidy measures that end up before the WTO. These include consumer subsidies in the US to buy more energy-efficient cars and appliances, which apply only to US-manufactured products, and domestic procurement rules for infrastructure projects such as new railcars in France.

In this scenario, successive G20 summits achieve limited progress. Despite commitments to global coordination, governments remain afraid of committing taxpayers' money to support financial institutions and consumption in other countries.

Investor appetite to hold US treasuries wanes as the long-term fiscal deficit weighs heavily on market sentiment. As confidence in domestic assets recovers outside



the US during 2010, US long-term interest rates begin a steady march upward despite continued quantitative easing that keeps short-term rates down.

Adjustments to mortgage contracts shield US borrowers from the impact of higher interest rates, but US businesses face higher long-term borrowing costs, partly offset by more generous tax concessions to encourage investment. The US dollar declines sharply in August 2010 as a result of a reversal in the capital account—caused by lower demand for US treasuries and outflows of hedge fund and pension fund capital seeking higher returns in emerging markets.

Emerging market equity prices stage a sharp recovery in October 2010 as China, India, Russia, and the Gulf states redirect foreign exchange reserves and sovereign wealth funds to support domestic equities. Cross-border capital flows remain low, and foreign direct investment (FDI) flows stay close to home—90% of new FDI is within the EU and accession countries like Croatia and the former Yugoslav Republic of Macedonia.

## A Breaking Point in the Balkans

But the fiscal costs of supporting domestic banking systems weigh most heavily on smaller EU countries. The breaking point comes in December 2010, when the parliament of Greece fails to ratify the second EU rescue package, worth \$60 billion. This package comes with stringent conditions on financial sector and public sector reforms, which are deemed political suicide by members of parliament.

Worries quickly spread across Europe. Several Greek banks with large operations across Eastern Europe walk away from their foreign subsidiaries, causing bank runs in Bulgaria and the Balkans. As a result, Raiffeisen Bank comes close to bankruptcy and the Austrian government is able to rescue only its domestic operations.

Other European banks also pull back from lending in Eastern Europe. Governments in Eastern Europe are unable to prevent a flight of deposits to EU banks, leading to a collapse of domestic currencies. The EU agrees to accelerated membership in the EU and the European Monetary Union for Albania, Bosnia, Croatia, FYR Macedonia, Montenegro, and Serbia, and the euro is made legal tender.

The EU succeeds in sanctioning members that attempt to introduce discriminatory subsidy measures, helped by the implicit threat of withdrawal of European Central Bank support for assets of domestic banking systems, but the number of trade disputes before the WTO skyrockets.

The arbitration system breaks down. Throughout 2011, the EU and the new American Free Trade Agreement (AFTA)—made up of the North American Free Trade Agreement (NAFTA), the Central American Free Trade Agreement (CAFTA), and the Andean Pact—are engaged in extensive tit-for-tat bilateral trade sanctions.<sup>1</sup> The WTO president resigns in protest. There is no agreement on a replacement for over a year.

In February 2011, a new, pro-Russian government is elected in Ukraine and signs a EuroAsia Union agreement with Russia. Armenia, Belarus and the Kyrgyz Republic soon join. Russia signs new military and economic cooperation agreements with Kazakhstan, Tajikistan, and Uzbekistan.

Commodity prices recover slowly from April 2011 on, providing some relief to Russia as well as to Africa, the Middle East, and Latin America. Renewed Chinese investment in African extractive industries helps African growth, which remains sluggish in other sectors, at 2% a year, insufficient to make headway in reducing poverty. In the Gulf states, the cranes remain still, and Dubai skyscrapers half built. Political tensions in the Middle East continue to impede regional economic cooperation. The economy is stagnant.

At a major summit to launch the Asian Monetary Fund in June 2011, ASEAN members agree on a common external tariff and measures to increase intraregional trade. The following year, ASEAN signs a free trade agreement with the African Union as China continues to invest heavily in Africa and increases its influence on domestic politics.

Oliver Hart wins the Nobel Prize in Economics in 2013, for his work on incomplete contracts and optimal bankruptcy regimes. An archaeologist finds a handwritten book,

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1 This formation of AFTA is triggered by the increased fear of drug trafficking from Mexico, which compels US officials to provide support to the Mexican government and increase economic ties.

believed to have been penned 230 years earlier by Adam Smith, titled *The Weathering of Nations*.

The regional fragmentation has not allowed time for the imposition of dirigiste measures in the real economies of most regions. Instead, AFTA remains a largely free market economy, with the remaining regional groupings varying in terms of state control over the economy. Regional currencies are increasingly used as reserve money, with the dollar, euro, ruble, and renminbi becoming the four major currencies.

Financial markets are repressed, with growing trade and capital restrictions. The World Bank and the IMF are marginalized. Instead, regional development banks become powerful, and regional monetary funds, fashioned after the Asian Monetary Fund, are set up.

In banking, regional franchises develop. These support small international teams that syndicate select issues.

In 2015, India and China sign a historic peace agreement, leading to the construction of a trans-Himalayan railway linking the two countries directly. Bilateral trade increases rapidly as Indian programmers start taking Chinese language classes, Chinese motorists flock to buy the Tata Nano (now assembled in western China rather than India), and Indian consumers load up on Chinese flat screen TVs.

Growth in the Asian region recovers slowly, helped by continued growth in China and India of 6% and 3.5% a year (table 5). Regional growth averages 4% a year during 2011–20. China's growth is held back by bad asset problems in its financial sector stemming from the indiscriminate lending of 2008 and 2009. Africa grows the fastest, at 7%. Eastern Europe grows at 3.5%, on the back of industries (chemicals, plastics, glass, car parts) moving east from Belgium, Germany, the Netherlands, and Italy.

**Table 5. Growth in the Capitalist Blocs Scenario**

	Average annual GDP growth (%)
US, 2009	-3
US, 2010	0
World, 2011–20	2.6
US, 2011–20	1.5
EU, 2011–20	1
Japan, 2011–20	1
Latin America, 2011–20	4 (AFTA), 1 (Mercosur)
Eastern Europe, 2011–20	3.5
Middle East, 2011–20	4
Asia, 2011–20	4
Africa, 2011–20	7
China, 2011–20	6
India, 2011–20	3.5

Latin America remains splintered, lacking regional leadership and a willingness to cooperate on economic policy. Growth recovers along with commodity prices, but remains sluggish at 2% a year in 2011–20. Latin America grows at two speeds: countries inside AFTA grow at a respectable 4% a year thanks to increased trade with the US, while countries on the outside grow more slowly at 1% a year.

The global economy is back on a steady growth path of around 2.5% a year, with distinct differences in growth among regional cooperation blocs: ASEAN countries grow at a healthy 4%, Africa at 7%, Latin America at 2%, North America and Western Europe at 1–1.5%, Eastern Europe at 3.5%. Within regions, countries that have gained access to new markets through the expansion of regional trade blocs do relatively better than others.

In 2018, an innovation in the biotechnology sector creates a boom in Russia. Chinese and American firms quickly buy patents to the new technology and spur high growth in their countries too.

After a decade of fragmented trade and investment, free markets prevail globally. Countries remember the benefits of multilateral trade and investment. The WTO is revived and the Bucharest Trade Round is launched in 2020.

This is a world where it has become clear that “there is no alternative” to market-friendly development. Hope returns. US leadership continues, and the need for multilateralism has been reaffirmed.



# 4. Bounceback



**T**he increase in US retail sales in January and February 2009 turns out to be a sign of good things to come. The low prices have spurred consumer demand for durable goods and cars.

Markets hit bottom in July 2009 and start to recover in August. The recovery is driven by the anticipated success of the third stimulus package in the United States, announced in October and worth \$1.1 trillion, and the successful coordinated fiscal stimulus launched by the G20.

The stimulus to aggregate demand helps the production cycle and leads to the recovery of commodity prices starting in October 2009.

Asset prices first stabilize and then recover. The money waiting on the sidelines starts coming back. Equity recapitalization of the banking sector by

governments ends up being decisive in the recovery. Citibank posts profits in the first quarter of 2010. The transformation of Goldman Sachs, Morgan Stanley, and AIG into bank holding companies allows them to gather deposits. These deposits become 25% of the portfolio by May 2010. Bank lending resumes.

Bank regulators pursue with new zeal the revision of liquidity risk management and the quality of contingency plans.

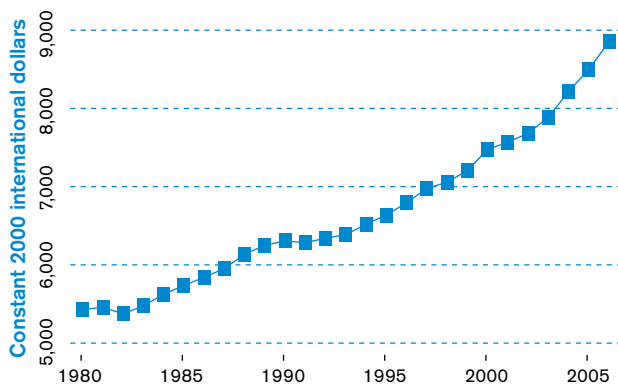
The insurance industry stages a fast revival, thanks to the emergence of acquisition opportunities and high demand for retirement products.

## The Return to Stability and Prosperity

By mid-2010, governments run campaigns on the return to stability and prosperity, using the growth trajectory

before the crisis as proof that the system needs only tinkering and not a major overhaul (figure 1). Ample production capacity means trade can ramp up quickly without triggering wage or price inflation.

**Figure 1. World GDP Per Capita (PPP), 1980–2006**



Source: Authors' calculations based on World Bank, World Development Indicators database.

By 2012, the bailouts end up turning into big profits for taxpayers, allowing policy makers to resume normal monetary and fiscal policies. Housing prices rise 6% on the year. There are no more fears of lack of regulation in financial markets, and there is lower leverage in the new equilibrium. Financial globalization as measured by cross-border capital flows is half the 2007 level, at 20% of global GDP.

Investments in infrastructure come onstream, adding to the upturn but also raising inflationary pressures.

The unwinding of consumer and credit card debt in the US is on pace. The personal savings rate jumps from 0.6% in 2007 to 6.5% in 2010 and 8% in 2012.

Population growth in the US triggers sustained recovery in the housing market. Although subprime mortgages are not available, low interest rates and lowered house prices make housing affordable.

## International Cooperation Prevails

The earlier trends toward protectionism, nationalism, and nationalization subside. The Doha Trade Agreement is signed in November 2012.

In 2013, the World Bank's lending falls for the first time in five years, from \$35 billion a year to under \$15 billion. The main lending focus of the World Bank becomes climate change. Global warming is being tackled, and international cooperation increases in many areas, as it has proved it works in dealing with the financial crisis.

The IMF is charged with conducting surveillance reviews of all countries. The World Bank is tasked with providing capacity-building programs for effective financial regulation. The first such program is run in Minneapolis, home of the largest US bank holding companies.

President Obama is reelected in a landslide in 2012. Prime Minister Gordon Brown is reelected as well, after selling RBS at a large profit and producing a budget surplus by 2012.

Larry Summers gets the 2013 Nobel Prize in Economics. Nassim Taleb, author of the best seller *The Black Swan*, publishes a new book, *I Shot the Black Swan*.

Venezuela earns the top spot in the annual *Doing Business* reformer rankings in 2014, as volatile oil prices have led to the return of a reformist government.

At the Grammys in 2016, the Chinese solo artist Mei Wi wins the most awards.

The US economy grows 3% a year on average in 2011–20, while the EU and Japan grow at 1.5–2% (table 6). China resumes its fast trend and grows at an average 8.5% a year in the same period, while India grows at around 6%. Africa and Latin America benefit from higher commodity prices, growing at 8% and 5%. Peace has also given Africa opportunity to catch up. Eastern Europe benefits from the shift of industrial production eastward, growing at 5%.



**Table 6. Growth in the Bounceback Scenario**

	Average annual GDP growth (%)
US, 2009	-2
US, 2010	3
World, 2011-20	4.1
US, 2011-20	3
EU, 2011-20	2
Japan, 2011-20	1.5
Latin America, 2011-20	5
Eastern Europe, 2011-20	5
Middle East, 2011-20	5
Asia, 2011-20	6
Africa, 2011-20	8
China, 2011-20	8.5
India, 2011-20	6

By 2020, the new financial system that develops looks similar to the pre-2007 one, but with a dominating equity market and smaller banks. Reprivatization has gone well in all G7 economies, and governments now own less than 10% of bank assets.

Financial innovation is curbed, but previously boutique investment banks like Lazard soon create new products and start growing fast. The products replenish private pension funds in developed economies and move money to emerging markets, where growth is now robust.

This is a world where the crisis of 2009 is almost forgotten. Belief in the invincible market model is high. US leadership continues, amid worries about the future of a multipolar global system.

