The World in 2017

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Peter Blair Henry, NEW YORK

Why a sustained rise in capital flows from rich economies to emerging ones is sorely needed

After a decade of decline triggered by the global financial crisis, capital inflows to the emerging world rebounded in 2016. This is good news. A rise in capital flows, if sustained, could provide an extremely welcome boost to growth in both advanced economies that need more high-return investment opportunities and emerging economies that need more jobs. Unfortunately, a new mix of populism and nationalism threatens to keep the world from taking advantage of the opportunity that will open up as the working-age population grows in the developing world and shrinks in rich countries.

In 2017 more than 1.1m new workers will join the labour force each month in the least developed countries. Sub-Saharan Africa will experience the most rapid labour-force growth, but many economically and geopolitically important developing countries in Asia and the Middle East will be close behind.

The trend is just getting started. By 2030 emerging economies will add 1.7m workers a month to their labour force. China, by comparison, added an average of 1.1m workers a month from 1978 to 2011. In other words, to absorb these new workers developing nations must create jobs at almost twice the rate that China did during one of the most extraordinary episodes of economic growth ever seen.

Manufacturing, and the steady capital inflows needed to finance it, will determine whether these future changes in the developing world yield dividends or disaster. Redirecting more savings from stagnating rich countries to productive investments in poor ones would boost global growth and the return on retirement savings for an ageing rich world.

Resist now, regret later

But there is a risk that these mutually beneficial gains will not occur. Despite the recent uptick, capital flows to emerging economies are at their lowest level since the 1980s, when leaders of the then-tamed Third World explicitly prohibited non-residents from investing in their countries. For three decades, freer flows of goods and capital increased living standards and reduced income inequality across countries. Today, however, mounting inequality within countries has provoked a backlash against the integration of global markets.

As the United States became more divided during an election year in which neither of the main presidential candidates openly supported free trade, and the ties binding the European Union became more frayed with Brexit, resentment of redomiciling abroad, when we really need comprehensive tax reform. The threat of punitive legislation against firms that try to move capital to places where it can be most profitably deployed is a big disincentive to financing, building or maintaining factories in the developing world.

There are other headwinds against capital flows to emerging markets. Janet Yellen, chairman of America's Federal Reserve, has signalled a desire to resume raising interest rates. The "taper tantrum" of 2013 suggests that a rise in American rates will stem the current outflow of foreign savings into the developing world. But the ideological forces which may jeopardise a sustained revival of these flows are even more powerful than the Fed.

The migrant crisis in Europe and the rhetoric of America's election have revealed a hostility towards large-scale immigration among the public and politicians. In this climate, there is little political appetite for talk of facilitating the flow of savings from the developed world to poor countries.

But rich countries must embrace the mutual benefits of policies that enable orderly and sustainable capital flows from the developed world to emerging markets (by, for instance, incentivising equity over debt). The alternative is to brace for even greater immigration pressures as millions of young people—especially young men—from Egypt, India, Nigeria, Pakistan and the Philippines enter the labour force without the prospect of meaningful employment and make their way to rich countries, legally or otherwise, in search of work.

A change in policies and attitudes is needed, starting in 2017. Without it, the renewal in capital flows to the developing world will not be enough to meet the need for investment (not least in infrastructure) and employment brought on by an explosion in the growth of poor countries' working-age population—or to offset stagnation in the advanced economies that depend on them.

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