Looking back, looking forward: The world economy through the World Bank's lens

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Speakers

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Marsh: Thanks for being with us today, Indermit. In January 2024, you warned that the 2020s risked becoming a wasted decade; in the latest Global Economic Prospects foreword, you say they now will be. As you have written, the world is now traversing the weakest phase of economic development since the 1960s. The World Bank has faced up to multiple crises. So your warnings were correct. But what is the value of getting such judgements right if the system cannot take corrective action?

Gill: When I came back from Duke University for the job as vice president for economic policy – that I did for about a year before I became chief economist in 2022 – I found very different levels of satisfaction among the World Bank's three groups of shareholders. The first set, the rich countries, were very happy. The World Bank was paying a lot of attention to climate change, and that was uppermost in their minds. The poorest economies were quite happy too because of a special replenishment of the International Development Agency fund. They got more money in terms of concessional lending and grants. The dissatisfied group was the emerging markets – where about 70% of the world's people lived. Their representatives at the World Bank felt that wasn't nearly doing as much for them as their conditions warranted.
We analysed the growth performance and prospects of emerging markets and we found that they were right. The potential growth rate for emerging markets and developing economies in the 2000s was around 6%. By the 2010s, it had fallen to 5%. Our projections indicated that, for the 2020s, even if things went well, it would be around 4%.

Marsh: So what has happened since in the last four years?

Gill: Things haven't gone well. Emerging market economies have not grown even at their potential growth rate of 4%. There's been a fairly rapid decline in growth prospects. So what has the World Bank been doing? What have the IMF and others been doing? For developing economies, everybody knows that climate change is an important thing, but for most economies, the biggest imperative is climate resilience, not the reduction of emissions of greenhouse gases. Most still have huge development deficits in the quality of education, healthcare, infrastructure and other essentials.

Marsh: And what else has happened?

Gill: In the last five or six years, the deterioration in the international environment that started in the late 2010s has accelerated. We've had a series of shocks starting with the pandemic, then inflation, then conflict, as well as oil price increases and supply disruptions. The World Bank has responded. As a result, I daresay that these countries do feel that the World Bank is doing more for them, but in part because the World Bank has gone back to its core mandate, which is essentially economic growth, job creation and poverty reduction.

Marsh: Would you say a certain fatalism has somehow taken hold? You've listed the number of events that took place. What prevents you from simply becoming simply a low common denominator in all this? We have a second highly polarising Trump administration. The world has changed. Do you simply have to close your eyes and soldier on, given this strong set of 'America First' priorities. How do you navigate this complex passage?

Gill: In two or three ways. First, bad times are actually good for economists. People pay a lot more attention to what I'm saying during bad times than good times. This is true also of Europe. Second, if you look at what has been happening for the World Bank and the IMF, the Trump administration has asked for these organisations to get back to their knitting. This has been a huge positive for us. Third is the trade environment. We use terms like 'trade fragmentation' which connotes regression. But when you look at the ratio of world trade to world GDP, which has risen from about 20% in the 1970s to 60% in the early 2020s, it's no longer increasing but is hovering round 60%. Still pretty good. The real issue is that small economies need to have better trade prospects. For them, trade is the way to improve efficiency, access technologies and so on. We care a lot about the smaller economies, since nearly all poor economies are small.

Marsh: Is some of the headline doom and gloom, also about the influence of the second Trump administration, somewhat overdone?

Gill: Yes. Some good work by Richard Baldwin shows that trade between the US and China has decreased a lot, but trade between other countries and the US, and other countries and China, has increased by a commensurate amount. So overall, things have not become noticeably worse. The main issue is trade policy uncertainty. That needs to be addressed – and quickly.

Marsh: This question of the Global South has been in the air for 25 or 30 years. What is the reality of the power of this batch of nations?

Gill: I've seen it change a lot over the last five years, both at the World Bank and elsewhere. Developed countries have figured out a way to co-operate around issues on which they had common interests, and present a single coordinated view. Emerging market economies were not good at that, and they've got a lot better. So I feel a lot more optimistic about things today than I did five years ago.

Das: I would like to tackle some institutional issues. But first, a compliment. The Bank's flagship analytical work in the last couple of years has evolved impressively, right up to the new World Development Report, on AI and what it means for jobs and development. The analysis has never been the weak link. If anything, under your guidance, it has become stronger – which is exactly my worry. The burden has run in the opposite direction. Public debt service is crowding out health and education across number of countries, just at the time when aid and donor assistance is being cut. So where is the real problem? Is it with the countries that borrowed and leveraged too much? Is it the architecture that pushes global volatility into the weakest balance sheets? And then, what about the creditors, those who give the money?

Gill: All three are a problem. In terms of the analytical work, in all of the work that is coming out of the Development Economics Vice Presidency, we've explicitly presented the view of developing countries. The 2026 WDR looks at the problem of AI, the opportunities as well as the risks from this viewpoint. We come out in a much more positive place than if you just looked at the payoffs and risks that AI-based technologies present for richer economies. Additionally, when we wrote the 2025 World Development Report on Standards, we found that developing countries had not realised how important standards were for the trajectory of growth. And, when they did set standards, most were going about it in the wrong way. We looked especially at the case of South Korea, which had used standards very well in improving the quality of its products and accessing world markets. Before that, we did a serious report on the middle-income trap that you know about.

Das: And what else?

Gill: We also looked at three big issues. One was climate resilience – we published a policy research report on that because most of the attention had been on mitigation, even though resilience was far and away the more pressing problem for low- and middle income economies. Another one was industrial policy. We have generally been against it at the World Bank, and we thought that we should look at the evidence again on that. And we came out at a very different place than we expected. And the third one is on domestic resource mobilisation. These are all important problems for developing countries.

Das: And on the debt architecture?

Gill: The World Bank should be very interested in this matter, just as is the IMF. The World Bank is in the business of debt. The problem is with all three aspects you mention: debtors, creditors and international financial institutions. For the borrowing countries, the quality of monetary policy in emerging markets has improved a lot – they have narrowed the gap with advanced economies.

But in fiscal policies, the gap is still large. The quality of fiscal policies in developing countries is not nearly as good as it should be. Debt-to-GDP ratios have gone up a lot, partly because interest rates were low for a while. Now you have high debt to GDP ratios as well as high debt service costs, because interest rates have been climbing. Even countries that get concessional financing from the World Bank, the IMF and other multilaterals tend to borrow on markets – and generally to overborrow.

All would be fine if debt transparency, debt sustainability assessments and debt restructuring mechanisms were in order. But that is not the case. The gap between the problem and the potential solutions has been growing. One of my top worries is that now if you get a spike in inflationary pressures because of, say, higher oil and gas prices, and increases in policy rates, you could suddenly see a huge problem of debt, both liquidity as well as insolvency problems. And we have a very inadequate mechanism for fixing this.

Marsh: How can one improve the institutional bedrock for debt management offices? And how do you see the balance between international currencies and domestic currency borrowing?

Gill: The problem is with debt transparency, especially because of new creditors, new official creditors, especially China, but not just China. We have a lot of other creditors, especially private creditors from all over the world, that don't want debt to be transparent, even when it's public. Even today, we are constantly surprised by how much debt a country has – which we find out only after it gets into trouble. Mozambique and Senegal come to mind. Then you have debt sustainability. Here the problem is with the IMF and the World Bank. We don't have a good mechanism for assessing debt sustainability, in part because we haven't modernised it. There have been huge changes in the debt landscape. There has been a switch from bank lending to bondholders. The countries have been not just borrowing abroad but also borrowing at home. You also have non-Paris Club creditors.

Marsh: What about debt sustainability?

Gill: We've been using a debt sustainability framework for low-income countries that is no longer fit for purpose. We should be treating nearly all low- and lower-middle income countries like we do market-access countries and upgrading our debt sustainability frameworks accordingly. But we haven't done that.
And then you got the debt restructuring part. We had the debt service suspension initiative. The original sin was that the private sector did not participate. That was a big disappointment for [former World Bank president] David Malpass, who had proposed the idea of the DSSI; he intended it to include private sector creditors, and that didn't happen. And the G20 common framework is built on the DSSI, so it inherited all the problems of the DSSI.

Das: While we focus on debt and the liabilities, very little focus is placed on absorption. Whatever money goes to these countries, are they able to absorb and implement it?

Gill: I agree. If you're delinquent in terms of keeping your responsibilities to your citizens in spending their money well, or spending money borrowed on their behalf well, you will soon be delinquent to the people from whom you've borrowed. You will be doubly delinquent.

Das: We need a deployment sustainability analysis, not just for debt sustainability. You are a development economist, and you have watched this discipline from its commanding heights in different capacities. Is development economics in good health? And if not, what is going wrong? And if you had a chance, how would you fix it?

Gill: One of the nice things that happened around the time that I finished my PhD was that development economics became mainstream. Some of this is attributable to Robert Lucas, who made it OK for the best macroeconomists to look at problems of development economics. Development economics is no longer a special field. It now applies microeconomic principles and macroeconomic foundations to the problems of development economics. Not coincidently, we had a very good phase when economic fundamentals became fairly universal. We agreed that it was the private sector that was driving development; so the investment climate became important. Openness became a standard prescription. And the importance of macro stability was recognised and acted upon: make sure that you don't spend money that you don't have; keep inflation down because that allows for better decision-making and also avoids a tax on the poor.

We had a good run of around 20 years or so of growth because of this consensus. And then the consensus frayed. Partly because of China. Maybe success also bred complacency. People forgot that these macro foundations were necessary even if they weren't sufficient for development success. Trade was important. Private investment was paramount. Low inflation was a sine qua non. For a while, policy-makers felt as if we could defy the laws of economic gravity. That lasted for about a decade, and I think that we are back to our senses now. I feel good about the profession.

Marsh: Can you give positive and negative examples of countries that you've been dealing with?

Gill: I'll tell you about the economies that I believe will be resilient as well as dynamic. The largest lower-middle income country, India. The biggest upper-middle income country, China, And then the largest high-income economy, the US. India has entered a period where its demographics, its debt, its domestic consumption structures, and so on, are the best that they'll ever be over the next two decades. If India takes advantage of it, India could rapidly change things, basically double its per capita income and double it again over the next couple of decades. It would be an economy nearly the size of what China is today.

Marsh: A crowning glory for you in a way, as the founder of the theory of the middle-income trap. If somebody could escape, then what better country than India?

Gill: The country that impresses me is China. It has broken through the middle-income trap. China has been making a lot of steps to improve the climate for private enterprise. It has happened in fits and starts, but it has been happening noticeably. It's much better now than it was before.

And then the US. Everybody looks at US government policies and turns pessimistic. But the strength of the US economy is the private sector. When I talk with my Indian colleagues and my Indian family members, they sometimes say: 'The best days of the US are behind it because it's a declining power.' And I ask them, 'Do you think that the US private sector is in a bad place?' They say, 'No, the US private sector is very dynamic and it's the largest in the world. Because of new technologies, because of the dynamism.' I think it's a very effective counterpoint to detractors of the US.

If you add up the economic output of these three countries, it's nearly half the world's GDP. We say the world economy has taken all these hits over the last 15 years but it has remained fairly resilient. But this is the result of these three economies being good at taking hits and keep plugging on. Once you take these economies out, you actually start to worry. So, for example, if you look at advanced economies, they are expected to grow at around 1.5 to 1.6% this year. But you take out the US, and it drops to half that. Emerging markets and developing countries grew at around 5.2% between 2010 and 2019 but if you take India and China out, that's down to 3.2%. This year we expect EMDEs to grow at 3.6%. Take China and India out and it's a meagre 2.6%.

Marsh: That brings us to Europe.

Gill: I was in Europe the last couple of weeks. Two things struck me. First, Europe has to engineer higher growth rates. It has to be much more dynamic. Ultimately, the growth rates cannot be 0.8-0.9%. It has to be double that – they have to find a way to do it, otherwise Europe will soon become an economic afterthought. Second, I noticed that when Europeans they get together and talk about economic issues, they act as if they're representing a large economy. But in fact they represent 27 mostly small economies. It would be a very different discussion if Europeans behave like a small economy when it comes to matters such as work, trade and technology.

Das: But your three favourite countries are precisely the three countries where political economy factors have also got so much ramped up that it becomes very difficult to disentangle good and bad economics. There are a lot of young and prospective policy-makers on the call. The instruments they're now using are industrial policy, export restrictions, defence spending, drives for self-reliance, bilateralism. Are these the instruments through which countries are going to grow?

Gill: Politics do matter a lot in the short run, but economics trumps politics over long enough periods. In the last few years, I've learned to listen to good political scientists because they're much better than economists at telling us what's going to happen over the short run. Economists are much better at figuring out what's likely to happen over the longer period. But if you're trying to project, for example, what's going to happen in the Persian Gulf over the next two months or so, it's much better to listen to the political scientists. Look at the markets these days. The oil price is a really bad indicator of how soon the troubles in the Gulf are going to get resolved.

Das: So what is the result of these deliberations?

Gill: You end up with debates such as those on industrial policy. I find that it helps to break these problems down to its components. What do we mean by industrial policy? Three things. First, you may be supplying some missing public inputs, through special processing zones, industrial parks and so on. This often makes sense, though there are some rules you should obey. Second, the importance of market incentives like export incentives, import restrictions and wage subsidies. We found such schemes often go wrong because they create vested interests and deadweight losses. But there are some countries that have done this well – countries like South Korea. Third, macroeconomic interventions like dual exchange rates and currency undervaluation. That's where we find things generally go wrong, and we should try to steer countries away from those things.

Marsh: A question from the audience. If mitigation is the priority in advanced economies and climate resilience is the priority in developing countries, are MDBs still solving yesterday's problem?

Gill: I didn't want to be interpreted quite like that. There are developing countries where mitigation should be important, but you can count those countries with your 10 fingers. The answer is that development ought to be taken up by every country with equal vigour. That will lead to greater climate resilience. In terms of mitigation, Professor Michael Greenstone of the University of Chicago has a good way of putting this. Don't start with global climate change. Start with air pollution; start with pollution of all kinds. This is a very important problem for pretty much every developing country. Then talk about reliable and affordable energy. That's a problem with everybody. And only then talk about global climate change. That's a very good way to have a conversation with people in developing countries. It is worth reading or listening to his 2024 Distingushed Lecture at the American Economic Association.

Marsh: The US is one of the three hegemons. Do you think that, in its own self-interest, the US will take a less aggressive line about climate change in the future, simply because, as the Earth is getting warmer, it is starting to lead to more hazards? Also for the US itself.

Gill: Two observations. First, if one looks past the headlines at the policy positions of the US Department of Energy as well as other departments, I find them much more sensible today than five years ago. There is no climate denial there; there is climate common sense. Second, I have just come back from China. I compared the air quality in Hangzhou, where I was, and Washington D.C. When I looked at the maps, in one case it was green, and the other case, it was red, except it was red in Washington and green in Hangzhou. But ask people what they think of China and you'd come away with the view that China is polluted and polluting. If you are trying to rush these matters through the MDBs and others, it actually resulted in policy dissonance. Take the G20 report on climate change from a few years ago, including what the MDBs ought to do about it. The report called for $3tn more per year to address climate and development imperatives: around $2tn towards climate mitigation, and $1tn towards development. But the report would have $2tn borne by the developing countries and $1tn by the international community. Out of this, half should be the MDBs, and the other half should be the private sector. So there was a mismatch between what we were expecting these developing countries to do, which is to act first in the global interest rather than their own interest, and the money for this purpose, which mainly was to be their own money. The reports were always too rosy about what the private sector would do. They claimed that the private sector would come up with better terms and for longer maturities and so on. I don't want to pick on that report. A lot of reports during the last few years have engaged in wishful thinking, and I'm quite sure we'll see this again in a few years. Meanwhile, economic development has slowed to a crawl.

Das: The Global Economic Prospects report shows that convergence has stalled. The poor countries are no longer catching up with the rich ones. To overcome the middle-income trap, you had a formula: 'Invest, infuse and innovate.' I struggle to think how that formula will work in the current climate, where there is so much polarisation, on technology, on financing and on using national strategies as an instrument.

Gill: Convergence has stalled, and even reversed in parts of the world. When we were writing on the middle-income trap in the World Development Report, we found for the median middle-income economy, per capita income as a share of US levels was around 6% in the 1980s or 1970s. Fast forward to 2024, it was still about 6%. India and China have a long way to go, but at least the two largest economies have been catching up.

Das: So how did they do it?

Gill: China has been very good about encouraging investment, despite lots of waste because of high savings. China has been very effective in infusing its economy with new technologies from abroad by becoming much more open to FDI and knowledge exchanges over the last 40 years. Now China's problem is to grow the third part, innovation, and I don't believe that many of the steps that China has taken during the last 10 years are helping to do that – at least nearly as effectively as it did with investment and infusion.

Das: And India?

Gill: It is moving from investment to infusion, but much more slowly – outside of digital services – and less strategically than China or South Korea did. Trade is still rather restricted. India has to become a lot more ambitious about bringing new technologies and infusing them economy-wide. It faces a tougher global environment than what China did 20 years ago, but India is a lot less threatening to advanced economies because it has a much better balance between consumption, investment and net exports than China had in the 2000s, and even what China has now.
Overall, the picture on trade is not as bad as the press it gets. Regional trade agreements have increased. While at the global level, trade is slowing down or becoming more contentious, at the regional level things are looking better. Emerging economies have to become more open to trade with each other – at the moment they impose twice as many trade barriers on each other as they face in advanced economies.

Das: Where do you see grounds for hope?

Gill: I'm very optimistic about artificial intelligence. I'm very positive about the way that countries like India and Saudi Arabia are viewing AI. They're welcoming it the same way as they did with previous rounds of technologies such as the green revolution in agriculture and information and communications technology.
AI has the potential to return the global economy to growth rates of the 2010s in a modest take-up scenario, or even the roaring 2000s in the high case. Electricity increased productivity growth or GDP growth by about 1 percentage point per year. For ICT, it was around half of that. Our early estimates indicate that for AI the productivity growth bump will be between those two figures. Many of these gains will come only in the 2030s, but they will come if these countries play this right.

Marsh: In the US, does the same thing apply? Does the Kevin Warsh scenario hold up, [i.e. an AI boom will hold down inflation and allow lower interest rates]?

Gill: I'm very positive about the potential of AI for the US and for China as well. I'm even more positive about it for countries whose approach is not big investments done by a few hyperscalers. These hyperscalers have to show investors that this money is worth it. The way that they do that is by changing the structure of how things are produced to make it more efficient. That usually means spending less on other factors of production like skilled labour. In advanced economies that raises legitimate concerns about greater unemployment of college graduates, or falling labour shares in national income.
But that's not the model for most other countries. For the other countries, AI investments are smaller and more diffused. AI is more likely to complement human capital and help small businesses and farms do better rather than replace skilled labour – at least for 90% of the economy.

Marsh: Will the hyperscaler boom end in tears?

Gill: It will end in tears for some, for sure. It will end in victory in the contest for others. But if labour and capital markets work they way they do in the US, those that lose the race will free up talent and capital, and the others get to grow. So there will be tears of defeat in the stock market for the firms that lose the race to get new technologies into the market. But I believe there will be mostly tears of joy in the real sector.

Das: In the 30, 40, 50 countries that World Bank monitors closely, the poor crust, the lower crust, there is a big issue about the cost of AI absorption. Where is that money going to come from? A lot of young people are listening to you now, the new generation of policy-makers and development economists in different countries. What is your advice to them?

Gill: If they are from developing countries, I would tell them that when they look at the international debates on particular issues, on development, on climate change, on artificial intelligence, don't assume that these debates translate one-for-one into what they are doing. Not all of those insights, the worries, the potential, carry over to developing economies. You have to work out all of this for yourselves.

And, despite what you hear from heterodox economists about what led to China's success – industrial policy, command-and-control of markets etc. – they should not forget the importance of fundamentals: a better investment climate for small and medium sized firms, conservative fiscal and monetary policy and ever greater openness as the economy develops.

This doesn't mean that everything is settled. There is lots to debate in social policy and industrial policy, and perhaps even financial sector strategies. In the more successful developing economies like South Korea, China and India, these are the live debates; monetary, fiscal, investment climate and trade policy debates are largely settled.

Marsh: China is one of those three countries among the winners. It seems to me the US is making life for China relatively easy for the time being because it looks as though China is the globalising force, the believer in multilateralism and so on. But China is also getting bad press. There are global imbalances, the undervaluation of the renminbi, etc. Is this going to lead to a trade war with Europeans?

Gill: Among the big global imbalances is the issue of the fiscal deficits in many advanced economies, including the UK. One cannot have big fiscal deficits during good times and fiscal deficits during bad times and big fiscal deficits in between, and expect this will not end in tears. Then there is this issue about China relying on external demand. Domestic consumption as a share of GDP in China is abysmally low at about 40%: in a $20tn economy, that's only $7tn of consumption. In the $30tn US economy, domestic consumption is more than $20tn.

So there has to be a switch. Policy-makers in China keep talking about a switch to more domestic consumption-driven growth, but low wages and salaries and low consumption are a feature of the growth model of the Chinese Communist Party, much of China's success over the last 30-40 years has been because it liberalised its markets for farm products, manufactured goods and consumer services. These products now are being intermediated through markets in China, and that gave them a huge gain.

China now has to do the same thing for factor markets: capital, land and labour markets. Until China’s policy-makers do that, they're not going to solve this problem of these imbalances. Because if you have gross inefficiencies in those three markets, you're going to have to build an export-oriented model on forced austerity elsewhere, and that will end up with low wages and low consumption. This is going to be difficult to fix, but it will have to happen soon.

Marsh: That could cause some political problems, even in a one-party state. We've come to the end of our time. We could go on for much longer. I want to thank you, not only for your time here, but also for your friendship and your collegiality not just during these four years, but also well before. I'm sure that we will carry on debating all these matters, and maybe even finding some solutions.