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Global Roundtable of Chief Economists

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Highlights

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Highlights from the first Global Roundtable of Chief Economists

> "Ready or not, you have to jump on the train, because the train is going faster and faster and faster."
>
> – Entrepreneur Yves Proteau

The first Global Roundtable of Chief Economists was held in Montreal on September 21 and 22 with participants from 17 countries attending. Attendees were development banks and related organizations focused on small and medium-sized enterprises (SMEs). They discussed a range of topics including global and regional economic trends, ways to measure the impact of development banks, and best practices in research. The focus was on exploring avenues for improving financing and other support to SMEs to better help them succeed.

Co-host Pierre Cléroux, Chief Economist at the Business Development Bank of Canada (BDC), struck an inspiring note in his opening remarks. The world economy is changing rapidly and becoming ever more complex for entrepreneurs, he observed. "The role of development banks will be even more important in supporting and helping businesses to adjust to these new challenges and changes."

In particular, economic research at development banks will be vital as we strive to understand and interpret emerging trends and the way the business environment is changing for entrepreneurs and national economies.

Pierre said the conference had three objectives:

- → creating relationships among chief economists and among their organizations
- → enhancing our understanding of how the world economy is changing
- → sharing best practices in research and developing tools

Key global trends

Co-host Ted Chu, Chief Economist of IFC, World Bank Group, kicked off the conference with a presentation on global economic trends.

Ted characterized the current state of the world economy as a glass half-full, glass half-empty situation. On the half-full side, global economic growth has picked up moderately this year. Growth has continued in the years since the 2008-09 financial crisis, despite the 2012 Eurozone crisis and the collapse of oil prices in 2014.

On the half-empty side, growth remains well below levels seen before the financial crisis. In fact, the gap with the historical trend line has increased in recent years and is actually larger today than at the depths of the crisis in the first quarter of 2009. Ted observed the global economy may have found a new normal where growth potential "seems to be permanently lower."

Another big trend Ted identified was a two-speed world economy. Emerging markets—mostly in Asia—now account for the majority of growth, while developed economies remain stuck in the slow lane, contributing just 20% of growth.

Turning to uncertainties and risks, Ted shared the concept of grey rhinos. As opposed to unexpected, high-impact events, popularly known as black swans, grey rhinos are visible, high-probability scenarios that nevertheless are being met with complacency.

He said buoyant markets currently appear to be under-estimating the following grey rhinos:

- a massive debt build-up
- inequality and social discontent
- North Korea
- geopolitical tension between rising emerging powers and stagnating traditional powers

For the moment, the picture appears to be relatively benign, with rising consumer and small business confidence. The threat of U.S. recession is mild at about 20%, although this situation could change rapidly.

In terms of outlook, Ted highlighted the slowdown in productivity growth and the increasing digital transformation of economies. In explaining sluggish productivity, he noted the greatest employment growth has been in low-end service industries where there is little opportunity for productivity gains. He added that the rise of automation, robotics and artificial intelligence is reducing the contribution of labour to economic activity—potentially fuelling social discontent.

Conference participants expressed a wide variety of views on world economic trends during a panel discussion following Ted's presentation.

Jörg Zeuner, Chief Economist at Germany's KfW Bankengruppe, expressed skepticism about the idea that the world economy has entered an era of permanently lower growth. Rather, we are only now coming out of an extended post-crisis adjustment period, he said. "I'm quite happy about the outlook globally, which is pulling everyone along, including the industrialized countries. The U.S. is moving, the emerging markets are moving and Europe is moving."

Armando Gamboa Gómez, Head of Financial Markets Analysis at Mexico's Nacional Financiera, highlighted two challenges that echoed through the conference: the aging of the population in many countries and rising inequality within countries and globally. "Emerging markets are transferring wealth to the developed markets. How can we improve income distribution in the world?" Armando asked.

Mavis Chaile, Chief Investment Officer at the Development Bank of Zambia, discussed recent economic difficulties in her country. Zambia's troubles in 2015 and 2016 illustrate the vulnerability of many developing nations to swings in commodity prices and climatic stresses.

Zambia, like other emerging nations in sub-Saharan Africa and elsewhere, suffered when a slowdown in the Chinese economy led to a collapse in prices for oil and other commodities. Zambia, a major copper producer, saw a sharp devaluation of its currency, sending the cost of imports and inflation soaring. The problems were compounded by low rainfall that hit hydroelectric production, leading to power cuts and lower agricultural yields. Fortunately, firming prices for copper and plentiful rains this year have improved the situation.

Participants engaged in a lively discussion about the extent to which digital technologies will contribute to productivity growth over the next decade.

In a preview of her presentation on Day 2 of the conference, Lucia Cusmano, Senior Economist at the OECD Centre for Entrepreneurship, SMEs, Local Development and Tourism, said her organization has identified a large and growing divide between a relatively small group of "frontier firms" and a much larger group of laggard firms. The frontier companies are able to rapidly adopt digital technologies and make big productivity gains, while the laggards suffer from stagnating or falling productivity.

Ted Chu said he believes productivity gains from digital technologies are having a significant impact in only a small slice of the economy. In the services sector, Ted offered the example of Uber. The company has achieved dramatic productivity gains over the traditional taxi industry in business processes. However, when it comes to the drivers—by far the largest part of the Uber ecosystem—there has been little in the way of productivity gains.

Other participants expressed confidence that digital technologies will produce major gains in productivity and economic growth. Jörg noted Germany's labour force will shrink by 15% over the next 15 years and digitization "is coming at just the right time to replace a lack of skilled labour."

Edoardo Reviglio, Chief Economist at Italy's Cassa depositi e prestiti, said he's concerned Europe is falling behind other economies in the adoption of digital technologies. Philippe Mutricy, Director of Evaluation and Studies at Bpifrance, shared this view for France and offered the results of a survey to underline the urgency of the situation. It found 40% of French SMEs do not want to digitize their operations, a percentage that represents 40,000 businesses and 3 million workers. "At Bpifrance, we assume these SMEs will die within three years if they don't achieve digitization," Philippe said. In Germany, one in five SMEs consider themselves ahead of the game in the effort to digitize, Jörg said.

Elsewhere, Mavis from Zambia said digital technologies "are fast creeping into countries like ours." She said the spread of mobile phones has allowed for growth in business activity through such things as online loans, money transfers and electronic payments. "Business is being done at the click of a button on a cellphone."

Pierre Cléroux observed that banks are increasingly being asked to finance non-tangible assets as digital technologies take on more importance. In Canada, 20 years ago, 80% of business investment was in tangible assets, such as equipment and buildings, he noted. Now, more than 60% of investment is in non-tangible assets, such as software. "To be competitive, companies have to invest in technology, which is much more difficult to finance, and this is a challenge for financial institutions, including BDC."

David Schwartz, Director, Donor Partnerships Division at the International Development Research Centre of Canada, said he has observed in his travels that many countries are not adequately preparing their young people to participate in the new economy. He's met with a number of leaders of large corporations in different sectors who are unable to find recruits with the skills they need. "That's a real problem, especially when you connect it to demographics, where you've got bulges in Africa and many other countries around the world."

Measuring the impact of development banks on SMEs

In the afternoon, the conference turned to the critical issue of how best to measure the impact of development bank activities on SMEs. In the discussions, two major areas of concern emerged: the quality and availability of data, and the difficulty of constructing reliable control groups to assess the impact of bank interventions.

Ricardo Bebczuk, Chief Economist at Argentina's Banco de Inversión y Comercio Exterior (BICE), led off with a penetrating analysis of the challenges of impact measurement. "Development banks tend to look great on paper," Ricardo said, "but in practice, they face colossal challenges in living up to their promise."

One of the problems he zeroed in on is the difficulty of identifying enough firms to build a broad, reliable control group. For example, he questioned whether banks could identify enough firms whose sole source of funds is the development bank. In Argentina the answer is no. Ricardo said BICE clients often have credit with several other institutions.

In Argentina, as in other Latin American countries, development bank researchers face severe challenges in accessing public and private data on both clients and non-clients, Ricardo said. The many constraints include the reticence of clients to share information and privacy laws.

Matt Adey, Director of Economics at the British Business Bank, said his team focuses on one key metric: additional turnover (sales) at SMEs as a result of financing facilitated by the bank, converted into gross value added in the economy.

In evaluating the impact of BBB, the team looks at several elements.

- Would the SME have received financing without BBB involvement?
- Is the turnover growth attributable to the financing received (versus a control group)?
- Is economic activity elsewhere displaced by the growth of the SME?

Here again, Matt identified the construction of a control or "counterfactual" group as a key challenge. "That really is the art rather than the science. You've got to get the art right to get that matched group."

In response to the presentation, Ditte Rude Moncur, Head of Research and Analysis at Denmark's Vækstfonden, echoed Ricardo's remarks, saying her bank finds it problematic to construct a control group of credit-constrained businesses, given there's no way of knowing whether those businesses are accessing credit from other sources.

Ditte said her bank is turning increasingly to self-assessments by clients, asking such questions as: "How much of this money could you have raised without us? How much of the growth you are seeing is actually from the capital you got from us?"

Hikaru Fukanuma, Lead Economist at Japan Finance Corporation's Research Institute, presented a study he co-authored examining the effects of special loans made available to SMEs after Japan's devastating earthquake disaster in March 2011.

Hikaru said JFC does not have access to non-client data and therefore the study used a questionnaire to gather information on client SMEs affected by the earthquake. "This study about the earthquake recovery loan was a kind of try-out to create a comparison group using a questionnaire," he said.

In break-out discussion groups following the presentations, Ted Chu found a fundamental challenge in comparing research results among banks is the lack of a common definition of what constitutes an SME. He also noted a wide variety of experience with surveys. Banks in developed countries tend to have long experience with surveys while those in many emerging nations have a more limited history. For example, Mongolia has no surveys, he said.

Best practices in conducting SME research

Justin Sturrup, Deputy Managing Director of the Bahamas Development Bank, kicked off a session on best practices in conducting SME research. Justin noted his bank, like many in smaller countries, has limited resources for research. Justin illustrated his bank's approach with a case study in which the bank investigated the factors behind a 78% rate of delinquency among boutique hotel operators and ways to address it.

Using an informal research approach, the bank found an important correlation involved managerial experience in operating a hotel. It adjusted its policies and reduced delinquency rates.

Justin acknowledged certain weaknesses in this "quick and dirty" approach, but it's inexpensive and effective. For more complex problems, the bank consults with experts or hires a consulting firm.

Next, Sylvie Ratté, Senior Economist at BDC, presented BDC's Business Productivity Benchmarking Tool. BDC developed the tool in collaboration with Statistics Canada in response to a serious productivity problem among Canadian businesses.

It's a free, online resource that takes about five minutes for entrepreneurs to use. By plugging in a few numbers from a tax return, entrepreneurs can compare the productivity of their business to that of others in their industry, based on five indicators: overall productivity, revenue per employee, profit per employee, labour productivity and capital productivity.

About 16,000 entrepreneurs have opened the tool and 2,000 have completed it. The BDC team is considering how to improve the completion rate.

Next, Baptiste Thornary, Head of Macroeconomic and Evaluation Analysis at Bpifrance, presented Le Lab, a virtual "think tank" created in 2014. Le Lab has three main activities. First, it publishes studies generated by Bpifrance's economics department. These are designed to sensitize entrepreneurs to strategic issues such as accessing international markets, growth strategies and digitization, as well as the realities of life as an entrepreneur. They are concisely written and published in pocket-sized booklets to meet the needs of time-pressed entrepreneurs.

Second, Le Lab holds annual calls for study proposals from academics who want to use Bpifrance's data to conduct research on SMEs. Finally, Le Lab prepares and distributes an annual publication that brings together data and information on SMEs.

Several participants were impressed by Le Lab's booklet format for publishing studies, as well as the concise, simple language used. That led to a discussion about the importance of disseminating research in a format that entrepreneurs can easily digest and effectively using social media and other communications channels to reach as many of them as possible.

Perspectives of a Canadian entrepreneur on Industry 4.0

Yves Proteau, Co-President of APN of Quebec City, gave a fascinating and inspiring presentation on his company's efforts to integrate digital technologies into its operations. APN manufactures metal parts, primarily for use in the aerospace industry.

Since 2004, it has invested heavily in sophisticated software, smart machines, robots, digital sensors, and employees with advanced technical and engineering skills. The result is a digitally connected and smart operation where processes are monitored and controlled in real time to optimize work-flow, quality and output. Sales and productivity have risen sharply.

Yves supported Pierre Cléroux's assertion that banks have to adapt their lending to the new economic realities. Yves called that Financing 4.0. "Financing tangible assets is easy. Financing software is tough."

Enhancing the contributions of SMEs

OECD Senior Economist Lucia Cusmano presented on the topic of increasing the contribution of SMEs in a globalized and digitized economy. She noted that the theme at this year's OECD ministerial meetings was making globalization work for all. "We're seeing a backlash to globalization and technological change," she said. "There is widespread concern that globalization and digitalization might be working for the few and not the many."

A return engagement

In a closing discussion, participants agreed the roundtable had been a valuable and productive experience. The conference accepted Edoardo Reviglio's invitation to hold the second Global Roundtable of Chief Economists in Rome in about a year's time. Ted Chu also suggested that data collection coordination among members should be carried out through the year.

Business Development Bank of Canada

BDC is the only Canadian bank dedicated exclusively to entrepreneurs. It promotes Canadian entrepreneurship with a focus on small and medium-sized businesses. BDC provides businesses in all industries with financing and advisory services. Its investment arm, BDC Capital, offers equity, venture capital and flexible growth and transition capital solutions.

International Development Research Centre

Part of Canada's foreign affairs and development efforts, IDRC invests in knowledge, innovation, and solutions to improve the lives of people in the developing world. Bringing together the right partners around opportunities for impact, IDRC builds leaders for today and tomorrow and helps drive change for those who need it most.

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