

September, 2007

## **Topics for the Visit of Ricardo Hausmann to Israel**

### **Will the US current account deficit trigger a global crisis? –**

Why is the world willing to lend continuously to the US and to do so at such low interest rates? Why is the US current account deficit apparently so large? Is this a major concern for the stability of the global economy? Hausmann developed a new theory according to which current account statistics may provide a poor indication for the real evolution of a country's net foreign assets. This is due to the fact that knowledge is the dominant driver of economic activity today but it is usually mismeasured, especially in the case of FDI. In addition, the US is a more liquid and safer economy than many of its creditors so when it exchanges financial assets with the rest of the world there is an implicit unreported trade of insurance and liquidity services that expresses itself in an interest differential.

Prof. Hausmann's theory is based on the idea that countries export and import unobserved services in the form of know-how and insurance and they get paid for it, but the statistics do not capture them adequately. Such services that generate revenue but can not be easily seen on measured are dubbed by Hausmann "*dark matter*". The US is a net provider of knowledge, liquidity and insurance. As the world became more global financially, the increasing asset value of these services underlies the spectacular increase in dark matter over the last two decades.

Prof. Hausmann measured dark matter for all countries. He demonstrates that once assets are valued accounting for dark matter the US appears to be a net creditor, not a net debtor and its net foreign asset position appears to have been fairly stable over the last 20 years.

*In preparation for his visit to Israel, Prof. Hausmann will present an assessment of the dark matter of the Israeli economy.*

### **Why are some countries growing so fast while others seem to be going nowhere? Which countries show more promise and which face greater difficulties?**

Prof. Hausmann has developed a new theory on how countries upgrade their production. Countries move from their current products to others that are "nearby" in the sense that they require similar capabilities. Progress depends on how "close" are the alternative products. Countries that are in a "dense" part of the "product space" have an easier task at upgrading their production. His model illuminates why and how some parts of the world will catch up more easily than others. It also gives pointers as to which industries are bound to be developed in different countries.

These findings help explain why some low-income countries often exhibit explosive growth while others have a difficult time upgrading their export package.

These findings have important consequences for economic policy. It is quite difficult for production to shift to products far away in the space, and therefore policies to promote large

jumps are more challenging. Yet, it is precisely these long jumps that generate subsequent structural transformation, convergence, and growth.

Prof. Hausmann and his coauthors applied this model to Argentina, Chile, Colombia, Kazakhstan, Mexico, Morocco, Paraguay, Peru and South Africa.

*In preparation for his visit to Israel, Prof. Hausmann will apply the model also to Israel.*

### **China: Can it keep the growth miracle up? Will it wreck the global economy? Should it be pressured to appreciate the Yuan?**

Prof. Hausmann explores the nature of China's growth and macro imbalances and what should be the domestic and international agenda to keep China moving forward.

China has entered a new era in its development process with a set of challenges largely different from those of the recent past. Some of these challenges such as growing internal and external structural imbalances and increasing income and regional inequality – have been exacerbated by the very pattern and success of high growth since reforms began.

Prof. Hausmann and his co-authors argue that China can deal with these imbalances by encouraging domestic demand through social security reform, regionally targeted fiscal policy, a new urbanization strategy, changes in the management and governance of state-owned enterprises and the promotion of domestic business process outsourcing towards the western provinces.

### **Latin America: finding the path to high growth**

With high commodity prices, cheap international finance and abundant under-utilized resources left by the 1998-2002 recession, Latin America is growing again, but it is doing so at less than stellar rates, especially in Brazil, Chile and Mexico. Meantime, the region has seen the emergence of a new populism lead by Venezuela's Chavez with a strong following in Bolivia, Ecuador and Nicaragua and to some extent in Argentina. The "New Cold War" characterizes much of the divisions in the region. What are the prospects for the new populism? What should market oriented economies do to achieve sustained and shared growth? Where will opportunities arise?

### **South Africa's Growth Engines**

Prof. Hausmann directed a major 3 year study of the South African economy on behalf of its government. Under this initiative, a panel of international experts from leading research institutions worked with South African economists to study the country's constraints to and opportunities for accelerated growth. The project sought to support acceleration of growth in order to create employment and improve the livelihoods of all South Africans.

The recommendations of the project covered the areas of macroeconomic strategy, industrial policy, trade and integration policy, labor policy, competition policy and a

restructuring of the government's Black Economic Empowerment affirmative action  
Furthermore, Hausmann explored export performance in South Africa and concludes that a lagging process of structural transformation is part of the explanation for stagnant exports per capita.

### **Which Countries are Likely to Benefit from the Coming Bio-Fuel Boom?**

Prof. Hausmann and his coauthors explored which countries could benefit from the coming bio-fuels boom? They studied the land availability and land use for alternative bio-fuels technology and assessed the potential significance of this new industry for the different countries of the world.