

The Quest for More and Better Growth

The Global Competitiveness Index has been measuring the factors that drive long-term growth and prosperity for over four decades, helping policymakers identify challenges to be addressed and strengths to build on when designing the economic growth strategies for their countries. And while the notion of competitiveness and the economic environment in which economic policy and investment decisions are made have continuously evolved, the past decade has seen a buildup of significant shifts that are fundamentally transforming the context in which policy decisions to foster economic growth are made.

After a long period of low growth following the global financial crisis, the world economy appears to have picked up speed.¹ This is welcome news. Yet despite this gradual improvement, policymakers in many countries are concerned about the prospects for long-term economic development. This is partly because the current expansion appears to be cyclical, bolstered by exceptionally low interest rates rather than by the fundamental drivers of structural growth. Productivity improvements appear to remain sluggish and are not expected to return to the levels experienced in past decades.

In a related challenge, prevailing growth strategies and models of economic progress are increasingly being called into question. In advanced economies, distributional questions have moved to the foreground, occasionally with political consequences. In emerging markets, such questioning could be fueled by the unfulfilled aspirations of a broadening middle class.

However, there is widespread agreement that economic growth is important for human development and well-being. Growth creates the resources needed for better education, health, and security, and for higher incomes. Although growth does not guarantee human development, there are no examples of countries improving the welfare of their populations *without* growth.² Often the deep web of connections that link growth to broader societal values remains unspoken. Instead of focusing on welfare, the measurement of economic progress and consequently economic analysis and policy are dominated by headline GDP numbers, encouraging the confusion of means and ends. Yet economic growth should not be an end in itself. It should contribute to human welfare, be rooted in political legitimacy, and be defined and measured based on a multidimensional notion of economic progress that includes values such as:³

- a broad-based distribution of economic gains,
- environmental sustainability, and
- intergenerational equity for young people and future generations.

Box 1: The Global Future Council on Economic Progress

The evolution of the global economy has been largely motivated and justified by its enormous contribution to economic growth over the past few decades. To the extent that broad-based social inclusion was given any consideration in that process, it was primarily limited to an ex-post re-distribution of any economic gains. With the evolving global political context and the advent of the Fourth Industrial Revolution, that approach will need to change—not only to make globalization work for more people than it has benefited to date, but also to ensure that globalization has a large enough constituency going forward to allow it to continue driving economic growth in the first place. We must shift the economic policy debate and interventions to unlock productivity and deliver broad-based prosperity by *simultaneously* solving for economic growth and social inclusion before the fact, not after it. This must be the case even if it results in a substantially modified form of globalization with potentially dampened growth but more buy-in and inclusion. In order to succeed, we must also establish modern venues and means for deliberating about the impacts of future policy efforts that include a fuller set of stakeholders than currently play a role in driving change.

To that end, the World Economic Forum's Global Future Council on Economic Progress has identified and is exploring four interrelated themes:

- Making globalization more inclusive, which includes proposals to improve skilling, re-skilling, and dealing with job displacements; taxation, social protection, and addressing inequality; financial markets that work for all; competition and avoiding capture; and fostering a new era of international cooperation.
- Unleashing productivity and economic potential in the context of the Fourth Industrial Revolution, which is fundamentally changing the constructs and limits of productivity growth, and raising questions about the future potential for improved well-being and how to best capture and share the rewards of new efficiencies, especially in light of the evolving nature of employment and jobs.
- Promoting and achieving multidimensional inclusion, notably by developing a multidimensional tool that is informed by tested aggregate-level indices of inclusive growth and well-being and that can be used to evaluate the degree to which countries and communities are inclusive at the household level.
- Evolving communications, connectivity, and organizations to incorporate new developments in social media, counteracting self-reinforcing echo chambers and the increasing polarization of ideas, thus expanding the set of channels and messages that resonate with people whose lives are affected in order to improve broad-based engagement and ensure buy-in for sound policy choices.

Contributed by Diana Farrell, Council Co-Chair.

Delivering growth is difficult at the best of times, and it is complicated now by various tensions and transformations that characterize the contemporary world (Box 1). Four of these stand out and are likely to shape economic discourse in the year ahead: structural headwinds to growth, the disruptions of rapid technological change, the need for greater economic inclusiveness, and uncertainties about the future evolution of globalization.

STRUCTURAL HEADWINDS AND MEASUREMENT CHALLENGES

Ten years ago, the global financial crisis interrupted a period of sustained economic growth dating back to the 1960s. Since then, despite unorthodox monetary policy and fiscal stimulus packages, advanced economies have

experienced prolonged comparatively sluggish growth.⁴ In emerging markets, the impact of the global financial crisis was lessened in part by interest rate differentials, with advanced economies fueling capital inflows in the form of foreign direct investment, the commodity superboom, and—related to this—the rapid growth of China.⁵ Only recently have advanced and emerging economies begun to show signs of recovery.⁶

We are still in the process of understanding the causes of change in the way economies have performed over the last decade. There are demand-side explanations, focusing on the ways that high savings and low investment tend to depress demand and, hence, growth. Investment has been below historical levels in recent years: between 2008 and 2015, for example, Europe experienced an average annual decline of €260

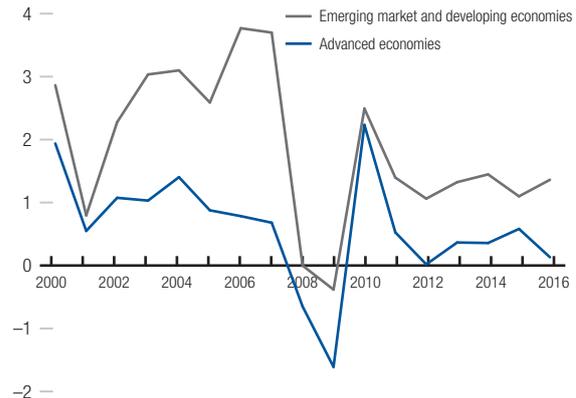
billion in real terms in business, residential, and public investment. In the United States, net business investment was down to 2.8 percent in 2014 from an average of 4.8 percent between 1960 and 2000.⁷

Advanced and emerging markets alike appear to have also experienced a slowdown in productivity, despite significant technological progress.⁸ Figure 1 illustrates how total factor productivity has declined on average in both advanced economies and emerging markets following the financial crisis. Many possible explanations for the productivity slowdown have been advanced. Some argue that today's technologies do not have the same productivity-enhancing potential as inventions of the past,⁹ or, as discussed in the productivity paradox literature, they could take more time to impact productivity and show up in statistics.¹⁰ Other explanations include the long-term effects of de-skilling, particularly among younger workers, in countries where the slowdown led to sustained unemployment; inadequate investment, due to high levels of indebtedness and near-zero interest rates encouraging the misallocation of capital;¹¹ and policymakers relying on exceptionally accommodative monetary policy and shying away from productivity-enhancing reforms.

An additional explanation behind the productivity slowdown is that the traditional GDP measurement fails to account for much of the value created in recent years. Recently the share of goods and services offered at no direct cost to the consumer is increasing. For example, web-based search engines or online information or the value created through social media channels are not priced at the value they create for the consumer, but at the value of advertisements they generate for the companies that run these services. Moreover, as technological progress accelerates, we fail to properly account for the embedded improvements in the quality of products—such as smartphones.¹² Finally, services are inherently more difficult to measure than physical goods, and the share of services in the economy has been increasing. Given that total factor productivity is calculated based on GDP data, the resulting measurement errors could lead to an underestimation of productivity growth. With these several sources of measurement uncertainty, the error in productivity measures could be substantial.

Putting growth back on a sustainable path will require reforms to build up human and physical capital and leverage new technologies. One possible contributor to recent declines in aggregate productivity has been a reallocation of resources toward less-productive sectors; to reverse this trend, policymakers will need to remove regulatory rigidities that hinder structural adjustments.¹³ Recent evidence also shows a large productivity dispersion across firms within industries, including

Figure 1: Total Factor Productivity 2000–2016
PPP, GDP-weighted



Source: IMF 2017.

between frontier technologies and older technologies; policies and institutions that help firms transition toward higher-productivity areas will also generate growth.¹⁴

INNOVATION CHALLENGES

The pace and disruptiveness of technological change are creating unprecedented opportunities and challenges that are set to be amplified by the convergence of digital, physical, and biological technologies that are characterizing the emerging Fourth Industrial Revolution.¹⁵

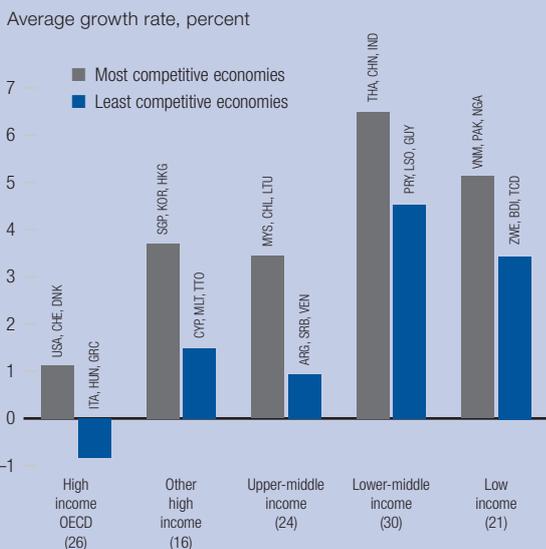
These emerging technologies have immense potential to be a source of growth, but their future evolution is uncertain. A key challenge is how to unlock their potential in a way that benefits society as a whole given that they can profoundly reshape the national and global distributions of income and opportunities and lead to significant structural transformations. The effects of future technologies are unknown, but policy challenges related to current technologies illustrate the magnitude of the shifts. Job losses are expected as technology transforms manufacturing and services in the coming years, raising questions about how quickly new jobs will be created and about the future of economic development models based on exporting labor-intensive manufacturing products. At the same time, technological advances are creating significant value for consumers, more than is currently reflected in national statistics.¹⁶

The technology frontier is expanding quickly, with recent breakthroughs in self-learning artificial intelligence fueled by the rising amounts of data being generated by mobile phones and sensors on machinery and equipment.¹⁷ Small and remote players can disrupt the status quo, while ever-tighter interconnectedness

Box 2: Global Convergence and Competitiveness

The Global Competitiveness Index (GCI) aims to measure factors that determine productivity, because this has been found to be the main determinant of long-term growth. But does strong performance on the GCI in fact predict future growth? Comparing the results of the GCI in 2007 with economic growth over the following 10 years suggests that it does. Within each income group, the three most competitive economies in the 2007 GCI have since grown significantly more strongly than the three least competitive countries. In the case of high-income economies, the three least competitive economies actually had negative growth (Figure 1).

Figure 1: Competitiveness and 10-year average growth rates, 2007–2016



Source: Calculations based on the results of the Global Competitiveness Index 2007–2008 through 2016–2017.

Note: The three-letter economy codes refer to the ISO Country Codes. These are: ARG = Argentina; BDI = Burundi; CHE = Switzerland; CHL = Chile; CHN = China; CYP = Cyprus; DNK = Denmark; GRC = Greece; GUY = Guyana; HKG = Hong Kong; HUN = Hungary; IND = India; ITA = Italy; KOR = Republic of Korea; LSO = Lesotho; LTU = Lithuania; MLT = Malta; MYS = Malaysia; NGA = Nigeria; PAK = Pakistan; PRY = Paraguay; SGP = Singapore; SRB = Serbia; TCD = Chad; THA = Thailand; TTO = Trinidad and Tobago; USA = the United States; VEN = Venezuela; VNM = Vietnam; ZWE = Zimbabwe.

The comparison also shows evidence of convergence, with lower-middle and low-income economies growing at faster rates than high-income and upper-middle-income economies. The most competitive countries in the lower-middle and low-income groups are catching up more quickly, showing the importance of a comprehensive competitiveness agenda for reducing between-country inequality.

is creating increasingly complex systems. As a result, technology is making the political and economic environment more asymmetric and uncertain.¹⁸ It is difficult for policymakers to predict future developments or work out how best to shape them.

One emerging challenge that will require policymakers' attention is the growing concentration in some market structures as a result of network effects.¹⁹ This will likely have macroeconomic impacts on productivity, growth, and inequality.²⁰ Economic concentration is also linked to political power and influence, creating the risk that policies will be skewed in favor of incumbents. Policymakers will need to renew their focus on antitrust regulations—and increase their understanding of the impact of new technologies and business models on costs, production functions, and industry structures—to preserve dynamic markets, broad-based participation, and the power of creative destruction.²¹

DISRUPTIVE INEQUALITIES

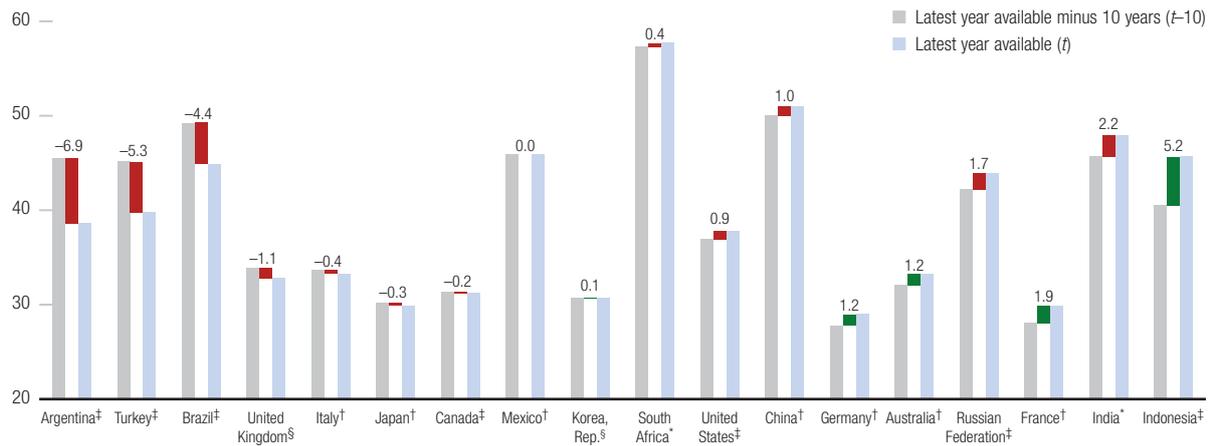
There are already clear signs that technology is contributing to labor market polarization, with a drop in the number of middle-skilled jobs and growth in both low- and high-skilled jobs.²² In many countries, distributional considerations have emerged as one of the most pressing challenges for policymaking on competitiveness and growth.

Globally, inequality has decreased over recent decades, because the growth of the very poor and highly populated economies of Asia has been substantially larger than the growth rates of the advanced economies, bringing about what economists have dubbed “the great convergence” (Box 2). Within countries, however, inequality has on average increased.²³ In many advanced economies, income inequality has widened or plateaued at a high level in the last two decades—often with large regional discrepancies, for example between rural and urban areas—as richer households pull away from their middle- and lower-income peers. The trend is more mixed for emerging economies, though absolute levels of inequality remain much higher there than in advanced countries. In countries where data allow comparisons, wealth is significantly more unequally distributed than income.²⁴ Figure 2 shows the level of inequality and evolution over past years for selected economies.

The combination of stagnating economies and rising income inequality has led to considerable political disaffection and tension around the world. In some countries this has begun to undermine the smooth functioning of political institutions and processes, complicating the formulation and implementation of policy. In advanced economies, frustration has focused on the relative gains made by those at the top of the

Figure 2: Income inequality and its evolution over past decade in selected countries

Gini Index, Income inequality = 100

Source: SWIID (Standardized World Income Inequality Database), available at <http://fsolt.org/swiid/>.

Note: GINI coefficients are for the latest year available over the previous decade: *2002–2012; †2004–2014; ‡2005–2015; §2006–2016.

domestic wealth and income distributions, as well as those made by foreign workers in a globalized world. This has prepared the ground for populist movements and politicians on both the left and right of the political spectrum, who have proposed a return to more isolationist and interventionist policies.²⁵

How to address income inequality forms an integral part of the World Economic Forum's economic progress agenda. The Forum's *Inclusive Growth and Development Report* proposes a set of policies and institutional features to ensure a more inclusive outcome of the growth process and a multidimensional measure of economic progress, the Inclusive Development Index (see Box 3 on pages 6–7).²⁶

TRADE PRESSURES

Trade and investment flows have been important drivers of economic growth in the past, but the relationship between globalization and growth remains imperfectly understood. Policies that revive growth will require a better understanding of the interactions between trade liberalization, factor liberalization, technological change, and domestic policy frameworks across dimensions of economic progress such as employment, income, inequality, health, and education.

This is important because growth in international trade has not recovered to pre-crisis levels—after falling close to 15 percent in 2009 it is currently growing more slowly than global GDP. Global investment has also

stagnated since the crisis.²⁷ Uncertainty about the future evolution of the global economic order is likely to continue to weigh on international trade and investment flows. Many countries have experienced a popular backlash against further liberalization as a result of concerns about the negative impact of globalization on living standards, particularly in advanced economies, and claims that it adversely affects fundamental socio-political values such as national identity and sovereignty.²⁸ New forms of protectionism are emerging, with an increase in the use of laws, regulations, standards, border controls, and other forms of non-tariff protection.²⁹

Two other factors have been mooted as additional contributors to the post-crisis slowdown in trade that may change influence economic policy decisions. One hypothesis is that there are now diminishing returns from dividing production into global value chains spanning numerous jurisdictions, which has been a key driver of trade in recent decades. Technological developments such as 3D printing may further reduce trade in the future by moving the production of physical goods closer to consumers. Another hypothesis is a change in consumer preferences, because younger people strive less toward owning internationally traded physical assets and prefer to consume locally produced services such as leisure.

LOOKING TO THE FUTURE

Rising to the challenge of sustainable and equitable economic progress will require ingenuity and application from diverse stakeholders across the world as well as

Box 3: Inclusive Development Index

The Inclusive Development Index (IDI) was introduced by the World Economic Forum in 2017. It attempts to benchmark the socioeconomic development of countries in a way that provides a more nuanced vision for inclusive economic progress.

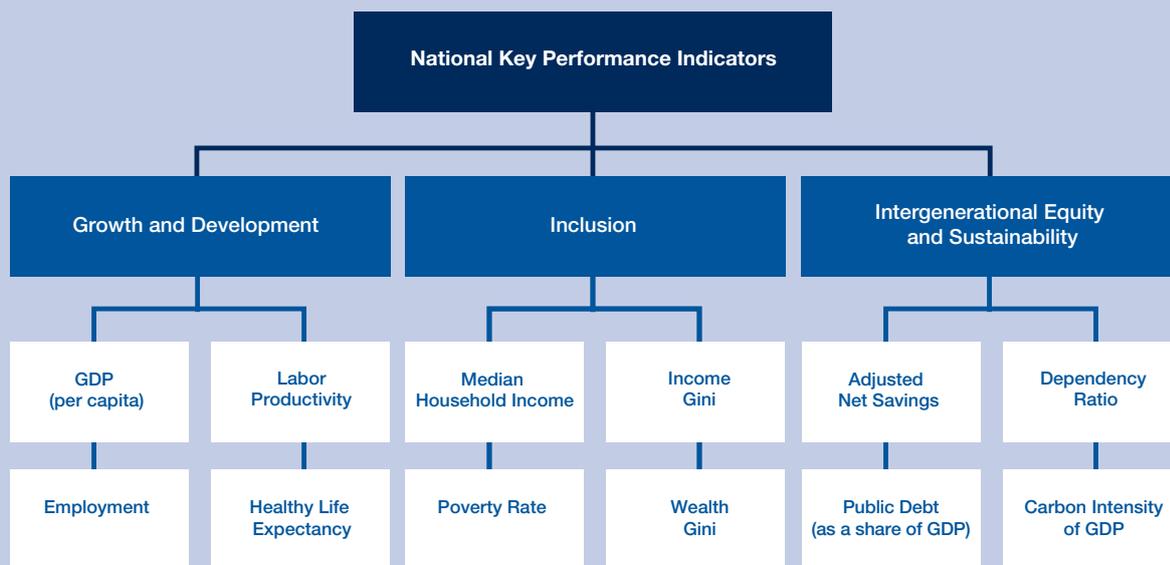
The IDI ranks countries based on 12 key performance indicators of inclusive development (Figure 1). Providing a more multidimensional measure of economic development than GDP growth alone, the IDI has three pillars: *Growth and Development*, including GDP per capita growth, labor force participation and productivity, and healthy life expectancy; *Inclusion*, including median household income, poverty, and two inequality measures; and *Intergenerational Equity and Sustainability*, including adjusted net savings (which adjusts for factors such as natural capital depletion and human capital investment), demographic dependency ratio, public debt, and carbon intensity.

When some economies score significantly better on the IDI than others with higher GDP per capita, this suggests they have done a relatively good job of making their growth processes more inclusive. Examples include economies at very different stages of economic development, such as Cambodia, the Czech Republic, New Zealand, the Republic of Korea, and Vietnam. By contrast, when economies rank significantly lower on the IDI than peers with lower GDP per capita, it indicates that their growth has not translated as well into social inclusion; examples include Brazil, Ireland, Japan, Mexico, Nigeria, South Africa, and the United States.

IDI data can be compared over time to show whether an economy is becoming more or less inclusive (Figure 2). Of the 103 economies for which data are available, 51 percent saw their scores decline over the last five years. This attests to the legitimacy of public concern about translating economic growth into broad social progress and underlines

(Cont'd.)

Figure 1: National Key Performance Indicators for Inclusive Development



Source: World Economic Forum 2017.

Box 3: Inclusive Development Index (cont'd.)

the challenge facing policymakers. In 42 percent of countries, the IDI overall score decreased even as GDP per capita increased. In three-quarters of these cases, wealth inequality was a chief culprit; across all economies, it rose 6.3 percent on average during this period.

Efficient markets and macroeconomic stability are essential for economic growth. But how well growth benefits society as a whole depends on the framework of rules, incentives, and institutional capacities that shape the quality and equity of human capital formation: level and patience of real-economy investment, pace and breadth of innovation, effectiveness and flexibility of worker protections, coverage and adequacy of social insurance systems, quality and breadth of access to infrastructure and basic services, probity of business and political ethics, and breadth and depth of household asset-building.

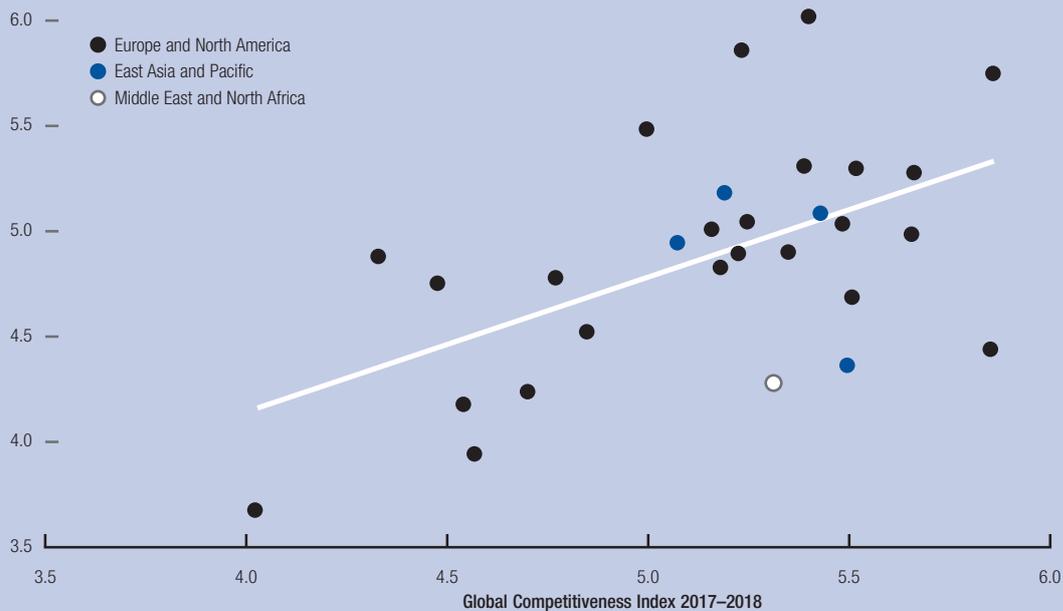
Because many of these factors promote socioeconomic inclusion as well as growth and competitiveness, there is no

inherent trade-off between the two: it is possible to be pro-equity and pro-growth at the same time. Governments need to recognize this, and rebalance policy priorities accordingly, if they are to respond more effectively to decelerating growth and rising inequality.

The social frustrations increasingly being expressed, through the ballot box and on the streets, have an essential validity—the implicit income distribution system within many countries is severely underperforming or relatively underdeveloped. This is due to a lack of attention rather than an ironclad law of capitalism. Inequality is largely an endogenous, not exogenous, challenge for policymakers; addressing it with urgency needs to be prioritized to sustain public confidence in the capacity of technological progress and international economic integration to support rising living standards for all.

Figure 2: Competitiveness vs inclusive growth performance in advanced economies, scores from 1 (worst) to 7 (best)

Inclusive Development Index 2017



Source: Data from the Global Competitiveness Index 2017–2018 and World Economic Forum 2017.

Note: Malta and Cyprus are excluded from *The Inclusive Growth and Development Report 2017* because of data limitations.

a truly collaborative approach. The competitiveness agenda that lies at the heart of the Global Competitiveness Index (GCI) is an important starting point, and not only because long-term productivity and growth generates the resources for wider societal goals. The competitiveness agenda, as part of the wider economic progress agenda, has intrinsic as well as instrumental value for human development and well-being: for example, health and education are among the 12 pillars of the GCI.

The following two chapters highlight the results of the 2017–2018 GCI, as well as key trends from a thematic and geographic perspective. Chapter 2 looks back over the last 10 years to identify the key legacies of the global financial crisis, while Chapter 3 analyses GCI results by region and in selected economies.

NOTES

- 1 IMF 2017.
- 2 See Baumol 1986 and updates of The Maddison Project Database at <http://www.ggdc.net/maddison/maddison-project/home.htm>.
- 3 These dimensions are captured in the Inclusive Development Index, presented in Box 3.
- 4 For a comparison of recent recessions in the United States, epicentre of the Great Recession of 2007–09, see Federal Reserve Bank of Minneapolis 2017. An explanation of the spread of the Great Recession can be found in Bacchetta and Eric van Wincoop 2013.
- 5 UNCTAD 2009.
- 6 IMF 2017.
- 7 McKinsey Global Institute 2016.
- 8 IMF 2017.
- 9 Gordon 2014.
- 10 McAfee and Brynjolfsson 2017.
- 11 IMF 2017.
- 12 Boskin et al. 1996.
- 13 McMillan and Rodrik 2011.
- 14 Andrews, Criscuolo, and Gal 2016.
- 15 Schwab 2016.
- 16 For a new measurement approach using Massive Online Choice Experiments, see Brynjolfsson, Eggers, and Gannameneni 2017, referenced in the Economist 2017b. See also Boskin et al. 1996.
- 17 McAfee and Brynjolfsson 2017; Ito and Howe 2016.
- 18 Ito and Howe 2016.
- 19 See De Loecker and Jan Eeckhout 2017, cited in Schechter 2017. See also Chen 2016.
- 20 De Loecker and Eeckhout 2017.
- 21 The Economist 2017a.
- 22 Darvas and Wolff 2016; OECD 2017.
- 23 Sala-i-Martin 2006; Lakner and Milanovic 2016.
- 24 OECD 2017.
- 25 For an analysis of the sources of populism, see Rodrik 2017.
- 26 World Economic Forum 2017.
- 27 Hoekman, ed. 2015.

28 For a recent review of the link between trade and inequality see Helpman et al. 2017.

29 Baldwin and Evenett, eds. 2009.

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