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The State of the World Economy

Robert C. Shelburne, *United Nations Economic Commission for Europe*

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Robert C. Shelburne[1]
Address to the UNWTO Resilience Committee
Internationale Tourismusbörse (ITB)
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I would like to thank the Resilience Committee for having me speak today. I am looking forward to hearing what the other speakers have to say today regarding their regions and to visiting all the exhibits at the ITB.

In preparing this talk for today I realized that there was a potential problem in that the economic situation has not changed dramatically from the time of my previous talk to this group last year. The economic recovery has progressed rather predictably from what was expected last year and thus the immediate outlook today is remarkably similar to what was being projected last year. As a result the most important policy messages are also similar to those provided last year. As such, there may be some repetition from my presentation last year, but I thought it most important to provide the best overview of the current economic situation rather than trying to provide a presentation of all new material. Nevertheless there have been some important new developments, such as the current Greek crisis, which I will get to in a moment.

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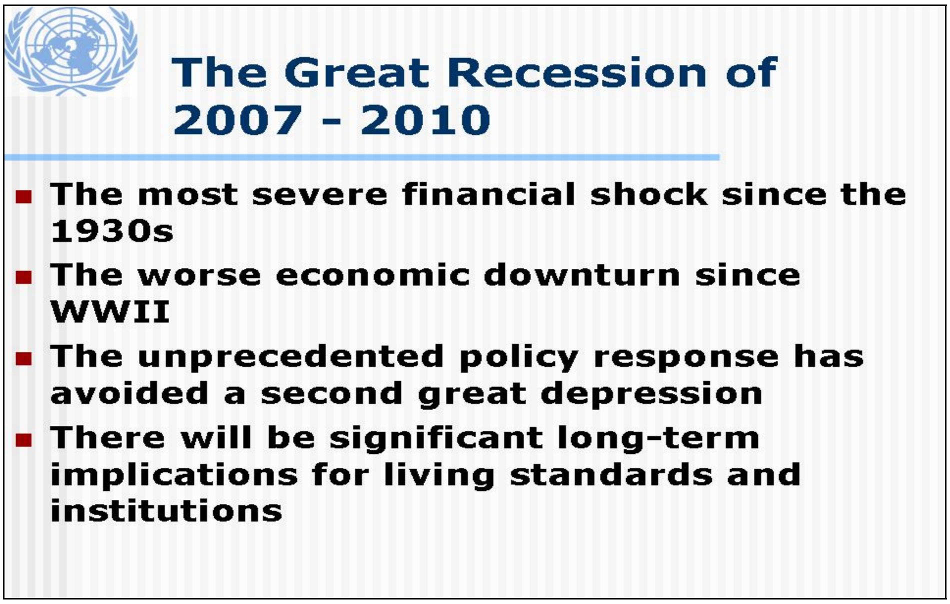
[1] Chief Economist, United Nations Economic Commission for Europe, Geneva, Switzerland. The views are those of the author and do not necessarily reflect the official positions of the UNECE or its member states.



Let me begin by summarizing what we have experienced over the last two years. The current crisis, which will probably be remembered as the Great Recession, is the most severe financial shock to hit the world economy since the Great Depression. In fact some estimates suggest that the wealth destruction that occurred during this current crisis was greater than that which occurred in the 1930s. Although it is difficult to quantify there is a reasonable case for saying that the economic "shock" recently experienced is greater than that preceding the Great Depression. As a result of this shock the world has experienced the worse economic downturn since the Second World War. In all likelihood, the world would have experienced another depression had it not been for the unprecedented and quite extraordinary policy responses that were implemented.

Although a recovery is underway it is clear that this crisis will have significant long-term implications for living standards in much of the world and in the design and operation of both domestic and international institutions. For example in regard to the latter, the G-20 has effectively replaced the G-7 as the main global body for promoting macroeconomic coordination, the resources of the International Monetary Fund (IMF) have been quadrupled (including the SDR increase), and the whole monetary framework in the eurozone is undergoing a significant rethinking now with discussions about bailing out Greece or creating a European Monetary Fund.

It was a quite important policy achievement that the world avoided a second great depression. I believe there were four main reasons.[2] Firstly the macroeconomic expansionary policy responses from around the world were quite large. Interest rates in the advanced economies were lowered to almost zero, and those in many of the emerging markets were also lowered considerably but certainly not to the zero range. The fiscal expansions were also quite large, both in the advanced and emerging world. The UN has estimated that at the world level, the fiscal expansion was about 4.3 per cent of global GDP. Although there are no solid estimates for what the multiplier might be for this fiscal injection, given the low interest rates it is probably not unreasonable to suggest that it might be close to one. Thus the fiscal expansions might have kept global GDP from falling by an additional four percentage points. Estimating a multiplier is all the more difficult if one includes the additional spending resulting from the improved psychological mindset that resulted from the belief that governments were committed to limiting the impact of the crisis.

The second factor was that governments by and large protected depositors in the financial system instead of allowing them to lose their wealth as occurred in the Great Depression. The European governments stepped in to protect bank depositors even though they did not have a legal responsibility to do so, and the US did the same for its money market funds. As financial firms began to fail, without this government support depositors would have quickly drained liquidity from the international financial system and it would have collapsed.

The third important factor that contained this crisis was the existence of a strong safety net in most of the advanced economies. In the 1930s the economic crisis created a humanitarian crisis as the unemployed quickly became hungry and in some cases homeless. This led to social and political instability and contributed to the rise of extremism that ultimately resulted in World War II. The social welfare state has minimized significantly the negative personal repercussions of the current slowdown. Thus although unemployment is close to 10 per cent in many of the advanced

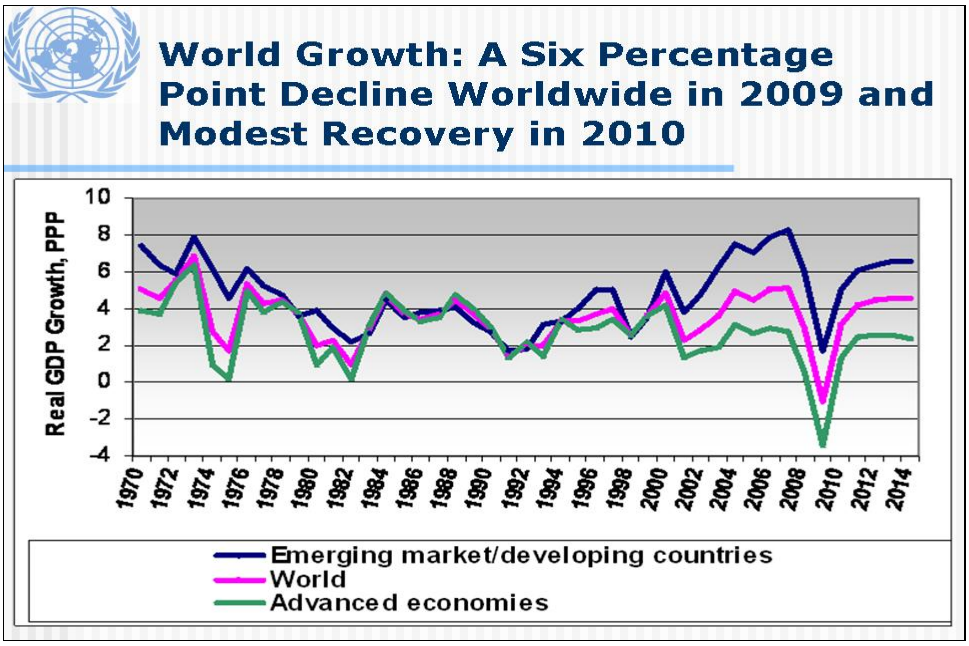
[2] These are discussed more fully in Robert C. Shelburne, The Great Recession of 2007-2009: Analysis and Prospects, a paper delivered at the UNWTO Conference in Astana, Kazakhstan, 2009.

economies as well as the European emerging economies, and this will produce hardship for some, the desperation of the 1930s is nonexistent. I spent my Christmas vacation in Spain, and although the unemployment rate there was close to 20 per cent, it was not at all obvious from a "tourist perspective" that the country was experiencing any particular hardship. There was no widespread begging or homelessness, the stores and restaurants were reasonably filled and there was no obvious increase in crime or political extremism. The social safety nets carried out the role they have been created to do.

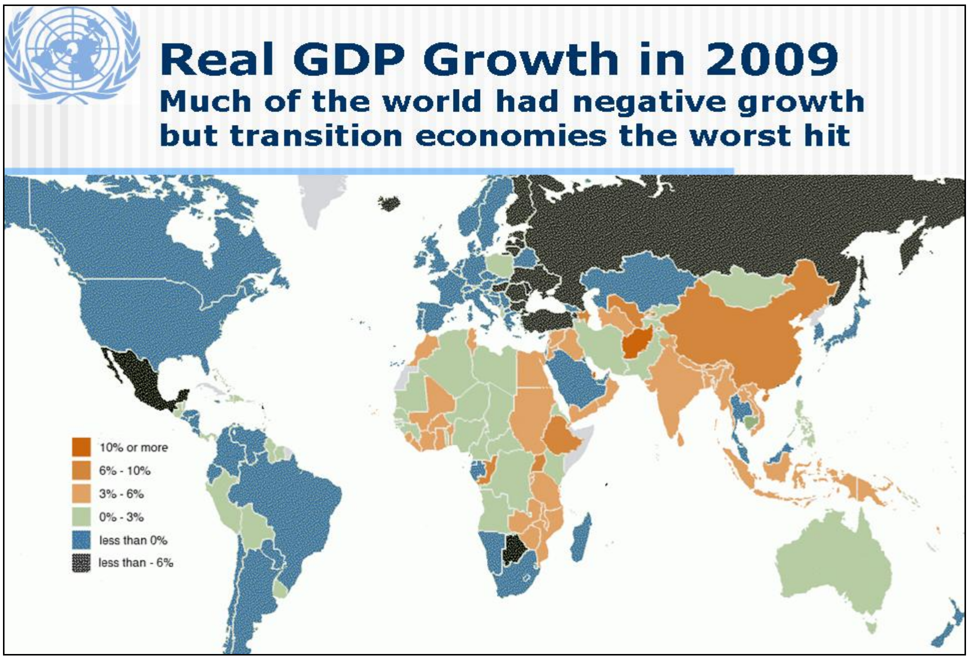
Finally the policy response of the world was by and large coordinated and there were limited "beggar thy neighbor" conflicts. This level of cooperation was the result of the strong presence of international organizations; most of which had been created after WWII for this very reason. In summary the world does appear to have learned some very valuable lessons from the chaos of the 1930s in terms of domestic economic policy making and by creating the international institutions that were needed for maintaining international cooperation and coordination.

So where does this leave us today in terms of the next policy steps to ensure that the recovery can get us back to a period of robust economic growth? First we must recognize that despite a modest recovery, much of the world remains dependent on government life-support and that the private sector is not able at this point to carry the full weight of the recovery. During the depression of the 1930s and in Japan in the 1990s, there was considerable pressure for the government to cut back its stimulus programs out of a fear of big government or large government debt. Over the last several months these pressures have become quite widespread but they must be resisted. Large deficits and projected large debts are a problem, but it is a medium to long-run problem due to demographic issues. Except in a few crisis situations, the currently needed fiscal stimulus should not be prematurely cut back over these longer-run considerations. However due to concerns about the long-run viability of government finances it may make sense to provide a plan for addressing these issues today so that markets understand that there is a long-term solution. Therefore it is totally reasonable for countries to be preparing an exit strategy in terms of their monetary and fiscal stimulus, but that should not include fiscal retrenchment this year or even in 2011. Another policy imperative is that the institutional and regulatory structure of the financial sector needs reform. It was the failure of this structure that created the current crisis and it must be changed significantly if we are to avoid a repetition. The regulatory oversight of the financial system was weak to a large degree because of the problem of regulatory arbitrage, and that remains a key problem now in introducing the needed reforms.

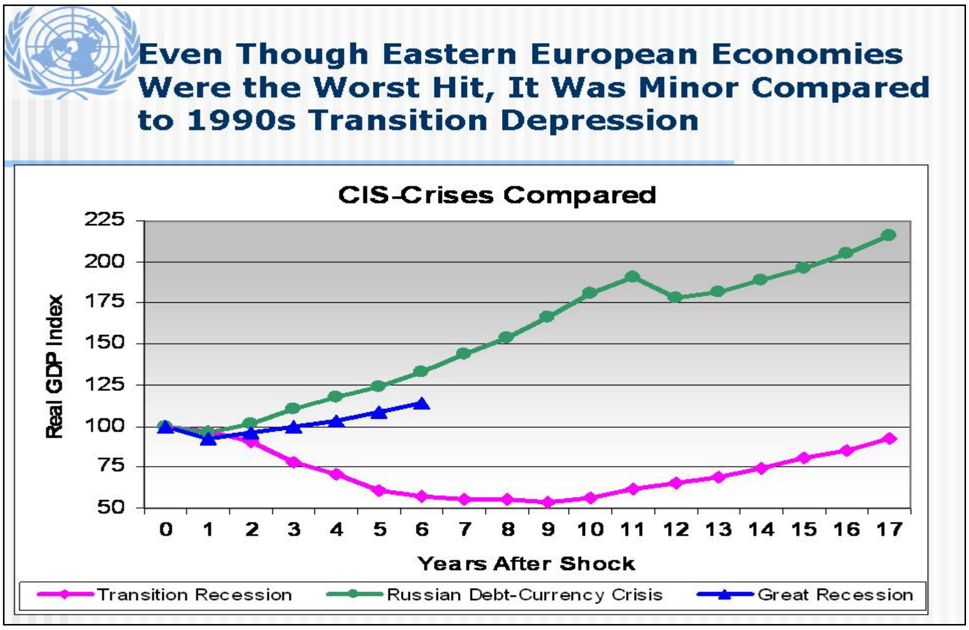
Finally there is the issue of global imbalances. This has temporarily gone off the policy radar screen because of the differential growth rates that have resulted from the global crisis. The downturn in the US has reduced imports and caused the current account (and trade) deficit to narrow. However, once solid growth returns so will the current account deficit. The fundamental problem is that countries have a tendency to believe that their exchange rate is their business but that is not true. The exchange rate is part of the global financial system and rates have to be set in a manner consistent not with what a particular country wants but at a level consistent with global financial stability. But more to the point there is the N-1 problem. If there are two countries there is only one exchange rate so both countries can not set the rate they each want. China's large intervention in the foreign exchange market to depress the value of its currency is sucking demand from the rest of the world. Under some circumstances this might not be a problem but it is now given that the world and especially the advanced economies are suffering from a deficiency of aggregate demand and are having to undertake extraordinary measures to create demand. This is clearly a "beggar thy neighbor" policy equivalent to imposing tariffs. As I will explain in a moment, we have the same problem of imbalances within the eurozone, and Germany has an attitude similar to the Chinese in believing that its real exchange rate is its business.



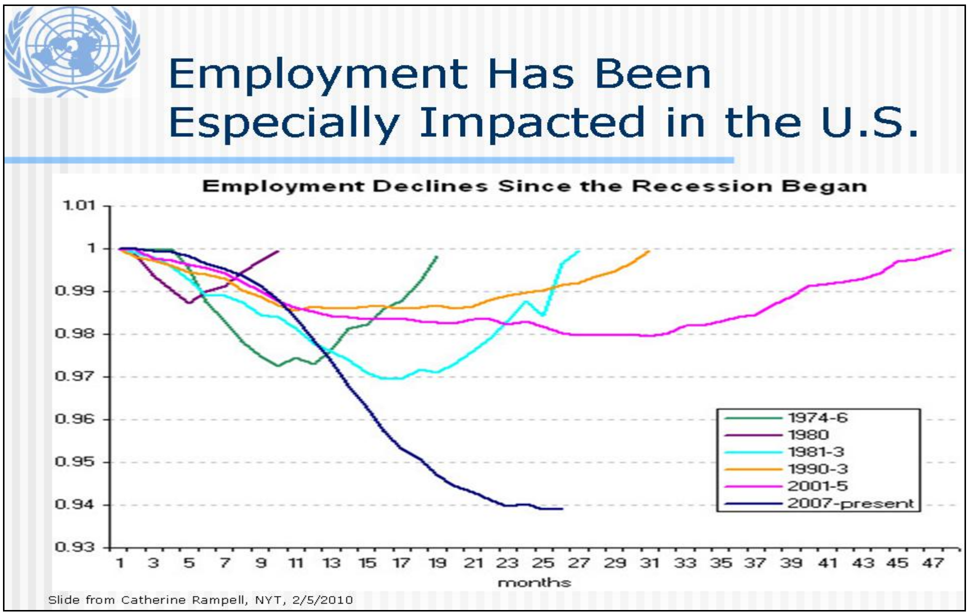
This chart plots the growth rate of the world as well as that of the advanced economies and the emerging/developing ones. Growth in the world economy declined by six percentage points from positive five per cent in 2007 to negative one per cent in 2009. This was the first annual decline in world growth in over 50 years. The advanced economies uniformly went into recessions as their growth fell from three to negative three per cent between 2007 and 2009. The emerging/developing economies had their GDPs also decline by six percentage points from their level prior to the crisis but since they were growing so fast they were still able to grow by about two percent in 2009. As you can see the forecast (largely from IMF projections) for the next several years has the world doing relatively well by historical comparison, the emerging/developing countries doing extremely well while the advanced economies will have growth below their average over the last 40 years.



The world map in the next slide presents this data in a more disaggregated form. As you can see the developing world in Asia and Africa (in tan and green) were largely able to maintain positive growth in 2009. Latin America, North America and western Europe (in blue) had negative growth but avoided a major collapse. However, it was the former transition economies in central and eastern Europe that were the most negatively impacted. That region is a sea of black meaning that their GDP declines were six per cent of GDP or more. The fact that this region was so devastated by the current economic and financial crisis was somewhat surprising in that the residents and financial institutions in these economies owned few of the sub-prime assets at the heart of the global financial crisis. Instead their vulnerability resulted from large declines in exports due to the significant declines in the GDP of their major trading partners, a rapid fall-off in remittances, the collapse in the price of commodities (especially oil), but most importantly from their dependence on external capital markets for financing their economic development. Many of them experienced a classic "sudden stop" once capital markets froze after the bankruptcy of Lehman Brothers in the autumn of 2008. A vulnerability which these economies did not have, that is often associated with a sudden stop of this type, was a fiscal budget deficit; the external borrowing had been largely undertaken by the private financial sector.

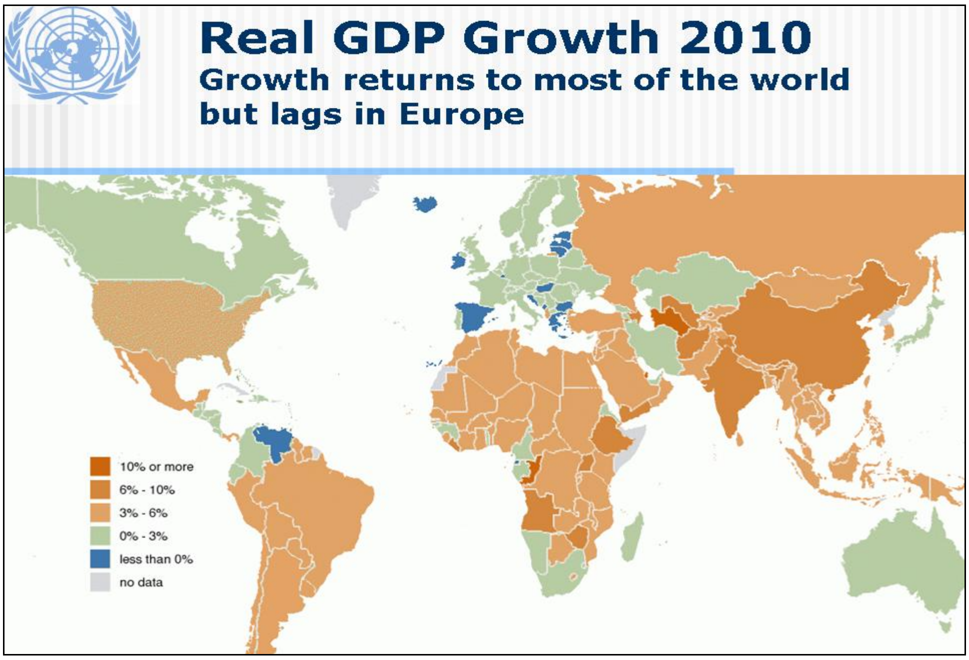


Next let me put this current recession into a little historical perspective starting with the CIS which you see was the most negatively impacted region. [3] The GDP decline in the CIS during this crisis has been quite large, much larger than that experienced by these economies during the 1998-99 Russian debt-currency crisis, but it has nevertheless been considerably smaller than the decline associated with the transitional recession in the 1990s following the move by most of them to market-based economies.[4] The depth and length of the three crises in the CIS are compared in the slide above. As can be seen, despite the severity of the current Great Recession and the fact that it may take 3 or 4 years before income returns to the 2008 level, this crisis is quite minor compared to the 1990s transition.



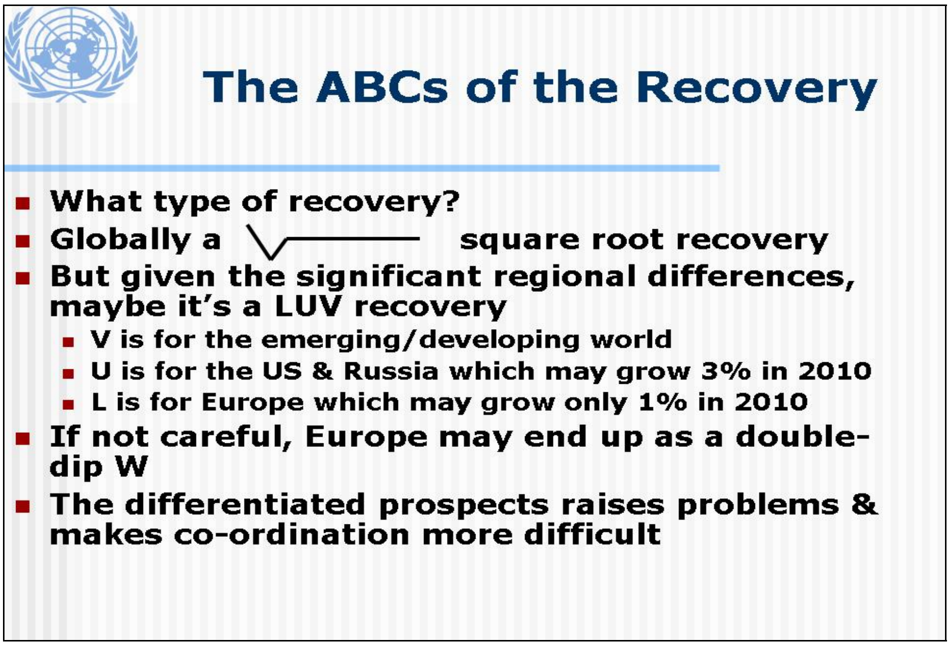
[3] The regional grouping CIS refers to the former members of the Soviet Union minus the Baltic economies and does not refer to the institutional arrangement of that name, which does not include Georgia, Turkmenistan or Ukraine as official members although the latter two are de facto members.
[4] Robert C. Shelburne, The Global Economic Crisis and the Transition Economies, a paper presented at the Project LINK Conference, Bangkok, Thailand, October 27, 2009.

The next slide compares the employment losses in the United States with those during the other major downturns of the last 40 years. Clearly the employment declines this time were much greater; in fact they have been twice as great (percentage-wise) as the next worst recession. The US economy lost 8.4 million jobs (or 6.1% of the nonfarm payroll) during the current economic downturn. Although unemployment actually peaked at 11 per cent during the 1981-83 recession which is higher than the 10 per cent level of this recession, that was because unemployment was already high before that recession began. Thus you can see why this current downturn is viewed to be the worst of the post-World War II period.

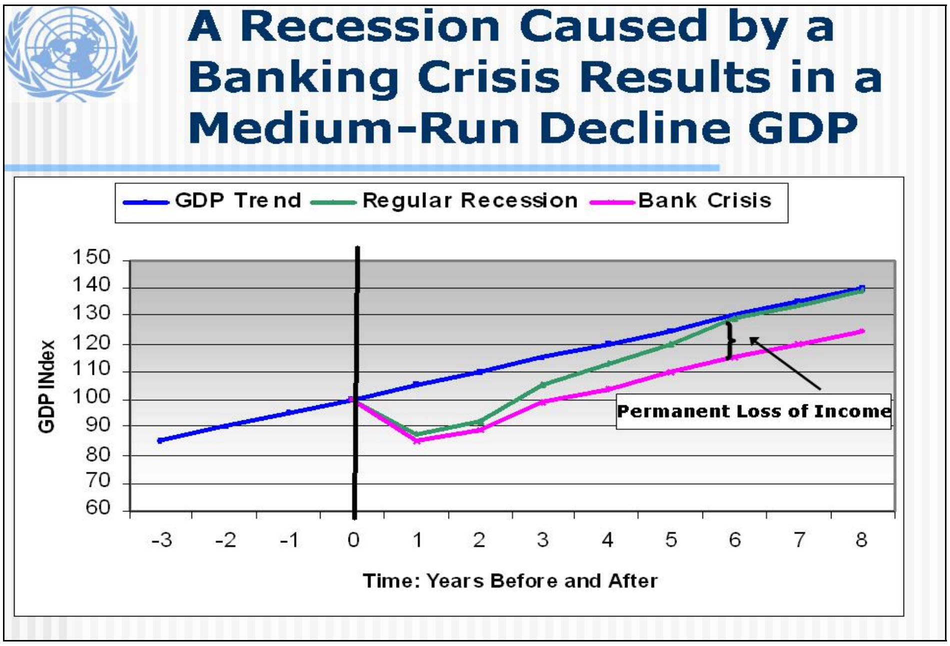


For 2010 a reasonable recovery is forecast for most of the world. In fact, in Asia growth should be quite robust possibly reaching 10 per cent in China and India. Most of Africa and Latin America should have solid growth and even the US may reach three per cent. Russia and Turkey, which were quite hard hit by the crisis, should also bounce back with solid growth of over three per cent and the energy-rich CIS economies in central Asia will be some of the best performers of the year. As you can see, Europe will have the weakest recovery, and some of those more severely hit by the crisis -- Greece, Hungary, Iceland, Ireland, Spain and the Baltics -- will likely have another year of negative growth. Overall the eurozone will be lucky if it can grow by one per cent in 2010.

So how should we describe this recovery? Last year in my address to this group I suggested the recovery would look like a square root symbol: a rapid decline, followed by a solid rebound in the spring of 2009 that would weaken as the year progressed.



But given the significant geographical differences that I have just described it may be best to describe the current recovery as a LUV recovery. The V is for the emerging markets that have recovered quickly. The U is for the US and Russia that are taking longer but where the recovery seems rather firm. And the L is for Europe which may only grow one percent this year and may have subdued growth during 2011 as well. If European policy makers withdraw government support too rapidly, Europe may end up with a double dip or W recovery. These differentiated prospects raise a number of problems and it makes coordination more difficult. As a result there is likely to be significant exchange rate volatility in the year ahead.



What explains the different strengths of the recovery in these regions? The differences between the developing and advanced economies is best described as the different type of recession one gets depending on whether the source of the recession is a financial crisis or some other more normal factor such as a trade shock or higher interest rates resulting from inflation. If an economy is growing normally along the blue line and experiences a shock at point 0, a recession follows as GDP declines. If it is a normal type of shock the recession that follows is described by the green line. Income falls initially but in the second, third and fourth years the economy bounces back and grows faster than its long-term trend. As a result by the fifth or sixth year the economy is back to where it would have been in terms of the level of economic output. That is not to say that all is forgiven, because the level of output during those five or six years is lower and that means that society consumes less than they would have without the recession. But by year six the level of current output is back to the trend level or where it would have been.

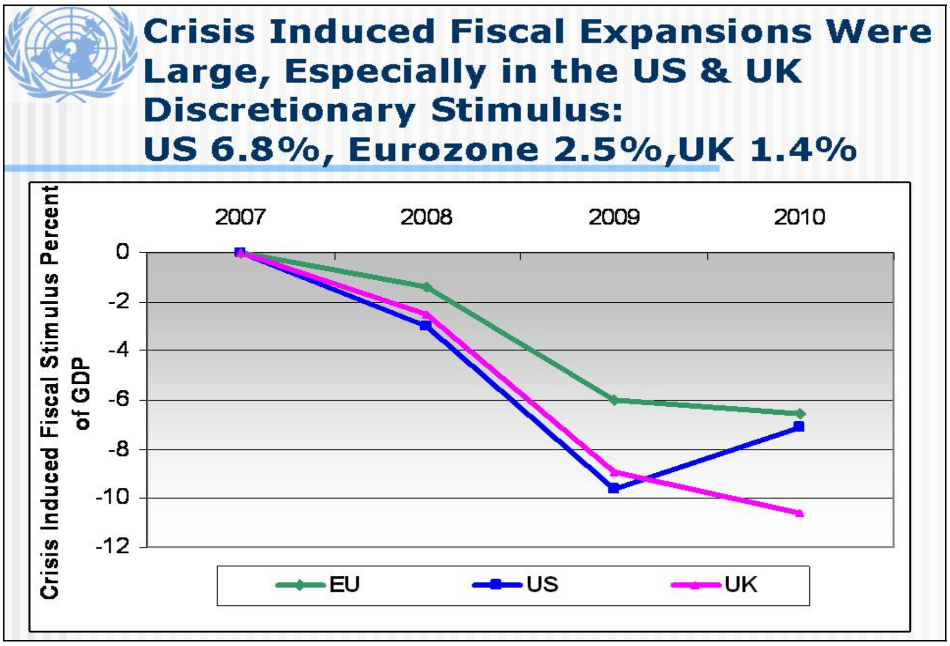
However, a recession caused by a financial crisis (described by the red line) is different. The initial losses are never recovered, although growth returns to the trend (i.e., the slope of the red and blue lines become equal in time). Thus the level of income remains lower indefinitely than it would have been. This I believe best explains the difference between the recoveries in the developing and advanced economies. The advanced economies experienced a financial crisis, as it was their financial industry that took the losses and had to be bailed out by their governments; thus they follow the path of the red line. The slowdown in the developing world was due to external causes such as tighter capital markets, or the slowdown in trade; the solvency of their banks was not endangered, so they follow the green line.

What then explains the difference between the US and Europe? Firstly one might ask why Europe was affected so strongly to begin with; wasn't the crisis made in America? It turns out that, although the sub-prime assets backed US mortgages, a surprisingly large percentage of them were owned by European residents and financial institutions. In fact the best estimates are that the financial losses stemming from this crisis will actually be larger for Europe than for the US. The losses are likely to be $1.5 trillion for Europe versus $1 trillion for the US.[5] In addition, the European banks were much more leveraged than the US banks; as a result, a given loss is much more critical for a European bank as opposed to a US bank. On the other side, however, European real estate markets have not collapsed (except in Ireland and Spain) and as a result households have not lost as much of their wealth; also the European construction industry has not been devastated as is the case in the US. So there are a number of different factors; but on net, I would say the shock was bigger for the US. The difference in outcome then is due largely to the policy response. The US reacted quicker and much more aggressively than the Europeans and as a result they were able to minimize the crisis to a much greater extent.

Why was the policy response relatively weak in Europe? Firstly, Europe is composed of a number of small economies and as a general rule macroeconomic policy is less effective for a small country because so much of it leaks out of the country so fast. As a result you would expect a small country to have a smaller policy response. Although the European Union is almost as large as the US, the actual spending power of the European Commission is quite small. And because the crisis affected the EU members differently and there are significant ideology differences between governments, getting coordinated national responses was difficult. Prior to the crisis the ECB did not really seem to believe in the importance of monetary policy as an anti-recessionary tool. They thought incorrectly that keeping fiscal budgets in line and keeping inflation under two per cent would ensure macroeconomic stability. This proved to be wrong. More fundamentally, the ECB had a small country

[5] Although the majority of this was sub-prime debt, the Europeans, unlike the Americans, took significant losses from emerging market debt that went bad because of the crisis; much of this was east European debt.

mentality. When they created the euro, instead of creating a policy framework for a major global currency, they simply decided to design the ECB after the Bundesbank of Germany. Thus neither the European governments nor the ECB were of the proper mindset for responding quickly to the crisis. In addition, during a crisis a central bank may be called upon to act as a lender of last resort; the design of the eurozone effectively ruled this out. The crisis has thus resurrected the question raised at the euro's birth as to whether countries can share a currency if they do not share a treasury.[6]

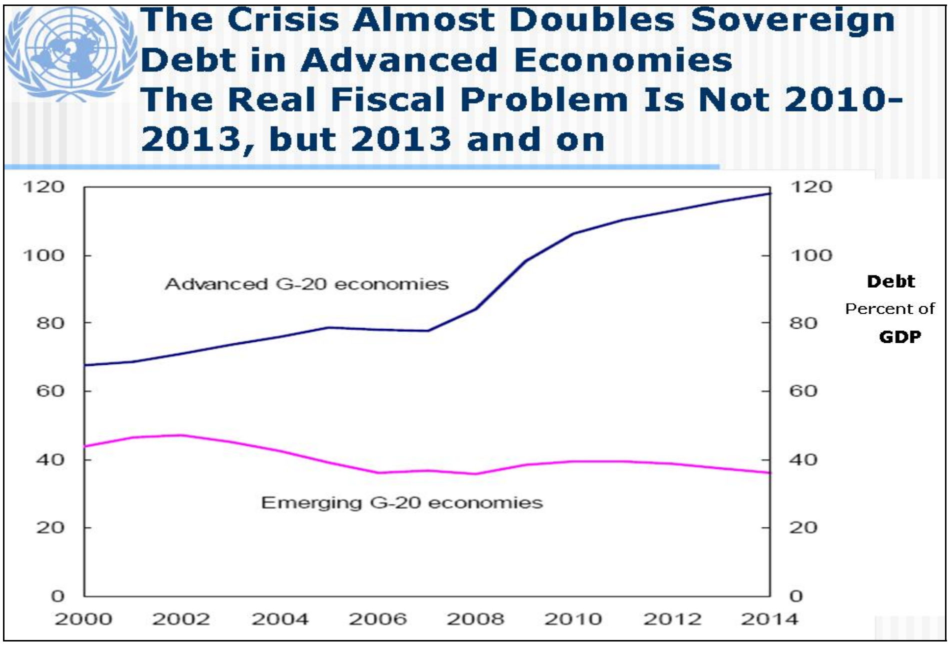


The fact that the fiscal response was weak in Europe is shown above. In terms of actually implemented discretionary stimulus, the US package amounted to 6.8 per cent of GDP; the aggregate eurozone package was less than half of this at 2.5 per cent of GDP and the UK package was only 1.4 per cent of its GDP. Europe does have larger automatic stabilizers and the overall stimulus is harder to estimate. If we take the deterioration (from 2007) in the fiscal position as a proxy for the overall fiscal stimulus, the US and UK had a stimulus of 10 per cent of GDP in 2009 while that of the eurozone was only 6 per cent. Even with a multiplier significantly smaller than one, that difference of 4 percentage points of GDP in additional stimulus is sufficient in itself to explain the better performance of the US economy despite suffering a larger shock.[7] This difference in fiscal stimulus remains in 2010 as well.[8]

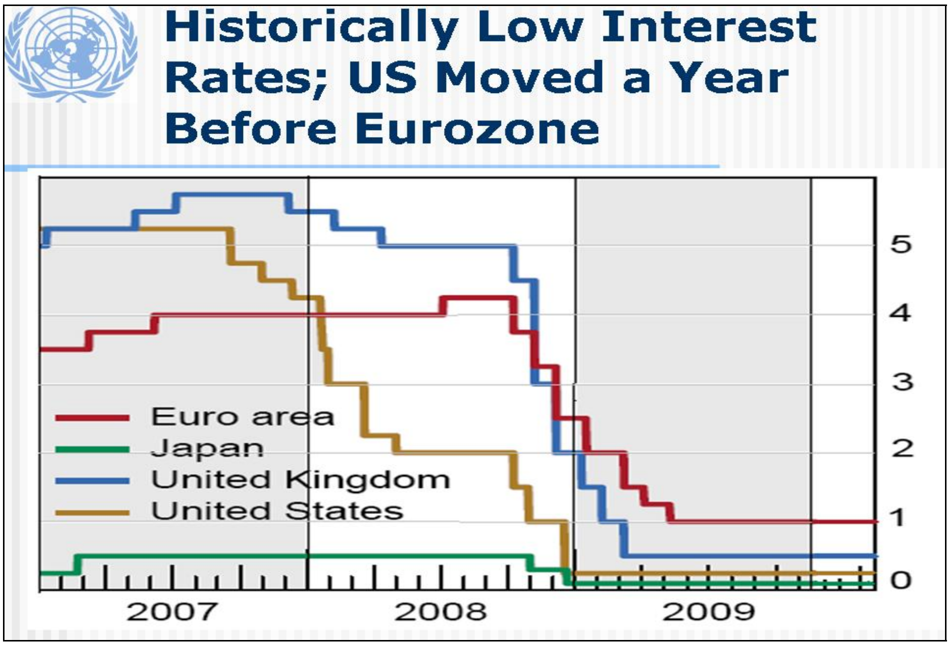
[6] The inadequate design of macroeconomic policy making in the EU has been raised by many, including this author, even before the crisis; see Robert C. Shelburne, Is Europe Sick?, *Global Economy Journal*, 5(3), 2005.

[7] There is major uncertainty about the size of the multiplier. But it varies depending on what type of spending and what type of tax cuts are implemented. In addition it varies depending on the state of the economy with the likelihood that it will be larger when interest rates are near zero. See Robert E. Hall, By How Much Does GDP Rise If The Government Buys More Output?, *Brookings Papers on Economic Activity*, Fall 2009, p. 183-250.

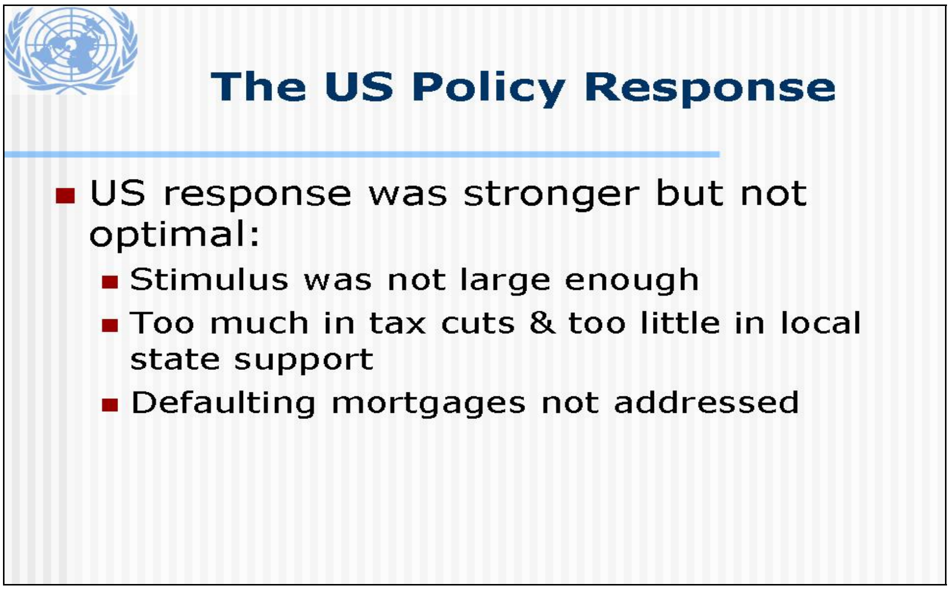
[8] Over half of the US discretionary stimulus program is to be spent in 2010.



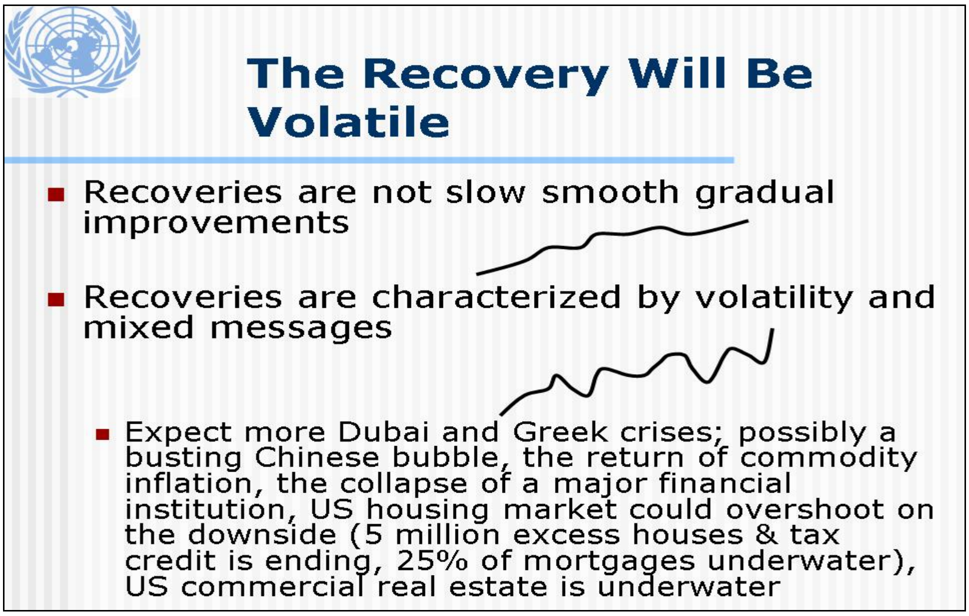
There has of course been a downside to this fiscal stimulus and that has been the higher debt levels that have been created. The debt of the advanced economies is likely to almost double due to this crisis and the debt of the US will increase more than of the eurozone. Although I believe it is the case, only time will tell (after the implications of the larger debt are better understood) if the larger fiscal expansion and faster recovery of the US will ultimately prove to have been the better policy course. Also as you can see, the debt levels of the major emerging economies have not been significantly affected by the crisis.



Monetary policy was also much more expansionary in the US than in the eurozone. At the first sign of trouble in the fall of 2007 the Federal Reserve started lowering interest rates aggressively. They fell from over 5 per cent to only two per cent over the next year prior to the collapse of Lehman Brothers. The ECB however was raising interest rates one year into the crisis as they were fixated on possible imported inflation from the global commodity boom although there was no real evidence that inflationary forces were present within domestic labor markets. After the bankruptcy of Lehman Brothers in the fall of 2008 the ECB also began to rapidly lower rates, but the US had a one year lead on them going into the crisis. Thus given the lags involved, the ECB rate cuts missed the depths of the crisis.[9] The Bank of England fell in somewhere between the US and the ECB. Thus in terms of both the fiscal and monetary response, the US stimulus was bigger and implemented sooner and as a result the US had a more shallow recession.

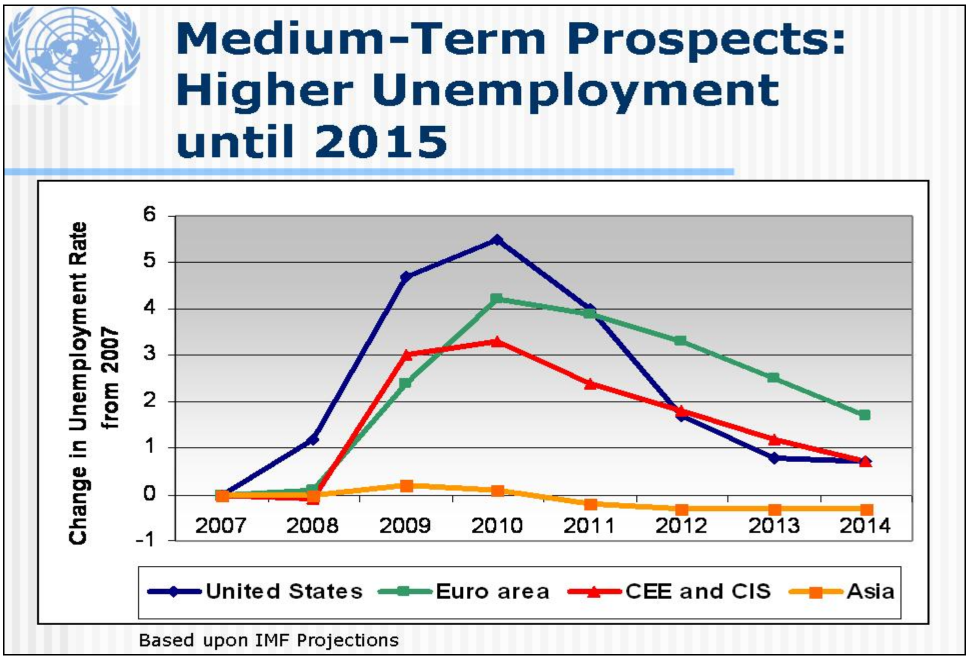


I should, however, point out that the US response was far from optimal. The stimulus should have been even larger, it should have provided more spending support to local and state governments and less in the form of income tax cuts, and the real source of the problem, defaulting mortgages was never properly addressed.

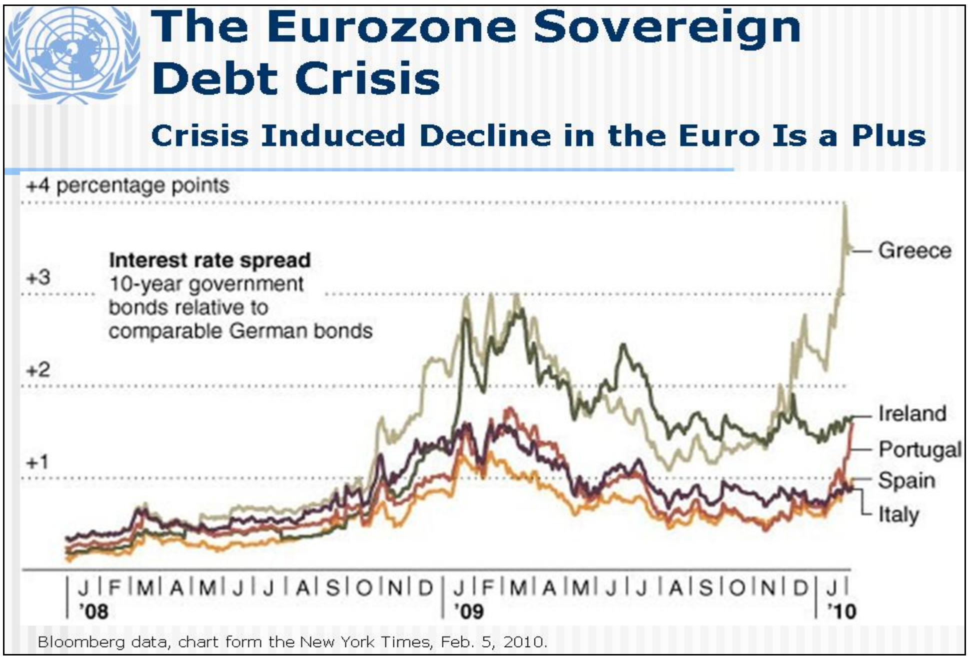


[9] Also while the assets of the Federal Reserve balance sheet increased by 150 per cent, those of the ECB increased by only 50 per cent (between mid-2007 and the beginning of 2010).

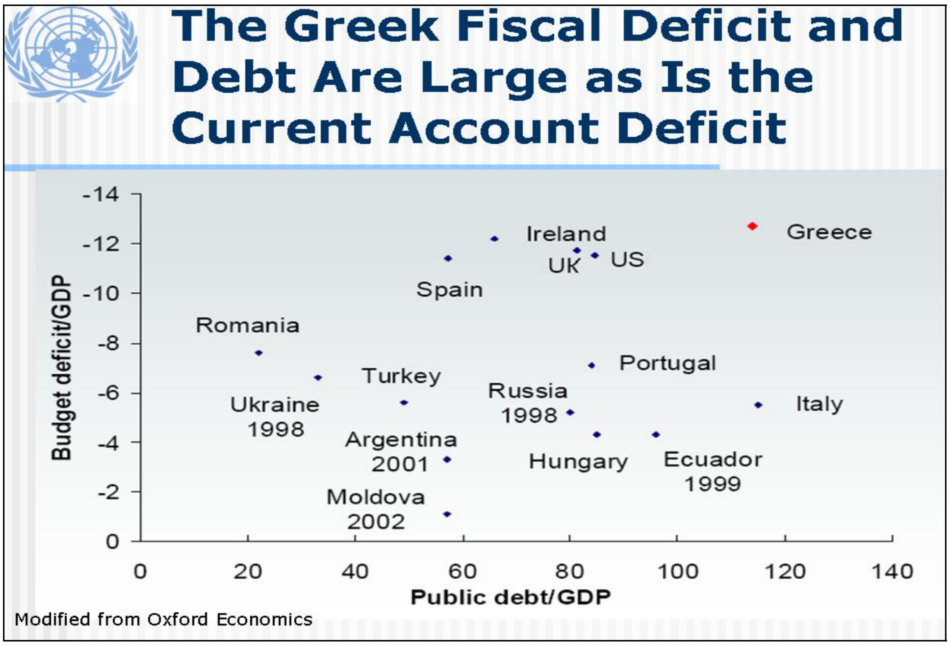
Going forward the recovery is likely to be volatile. Recoveries are not smooth gradual improvements in key indicators but are usually characterized by significant mixed messages with some indicators showing remarkable strength while others suggesting perhaps a double dip recession. Also one should expect a few more minor crises such as Dubai and the current Greek sovereign crisis. It is hard to predict what will happen but there are a number of significant vulnerabilities including a possible bursting of the Chinese bubble, a return to the global commodity price boom, the collapse of another major financial institution, and overshooting on the downside of the US residential property market where 25 per cent of mortgages are underwater, or a major collapse in US commercial real estate. In regard to the latter, I might add that the hotel industry is in particularly bad shape with many loans underwater and more than 10 per cent of loans past due.



The residual effects of the current crisis are likely to be with us for a long time. In the slide above, I have plotted the increase in unemployment that is forecast for the next five years. Even in 2014, unemployment is expected to be higher throughout Europe and North America than prior to the crisis. The US unemployment rate went up much faster and greater than in Europe due to its flexible labor markets but is likely to fall faster as well. And you can see, unemployment in Asia has hardly been impacted as would be expected based upon the GDP growth forecast provided earlier.



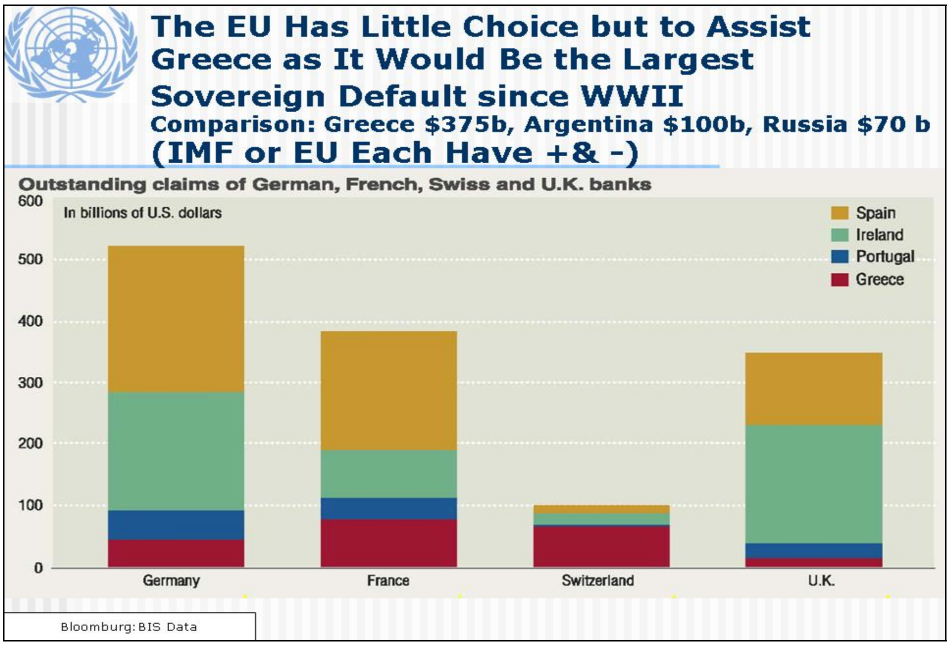
Let me briefly turn to the crisis of the moment; that being the sovereign debt crisis affecting the so-called PIIGS.[10] As you can see the interest rate spreads (over German bonds) on these countries' debts have increased throughout this crisis. But it has been the recent increase in the spread for Greek sovereign debt that has given rise to the current crisis. The spread reached over four per cent recently which meant that the interest rate on Greek debt was twice that of German debt.



There are several factors for this, including the fact that the Greek government had been using some deceptive practices for some time to cover up the extent of their problems. Markets don't like bad surprises. But the primary reason Greece has been the focus of market speculation is that Greece has the worst fundamentals. It has the

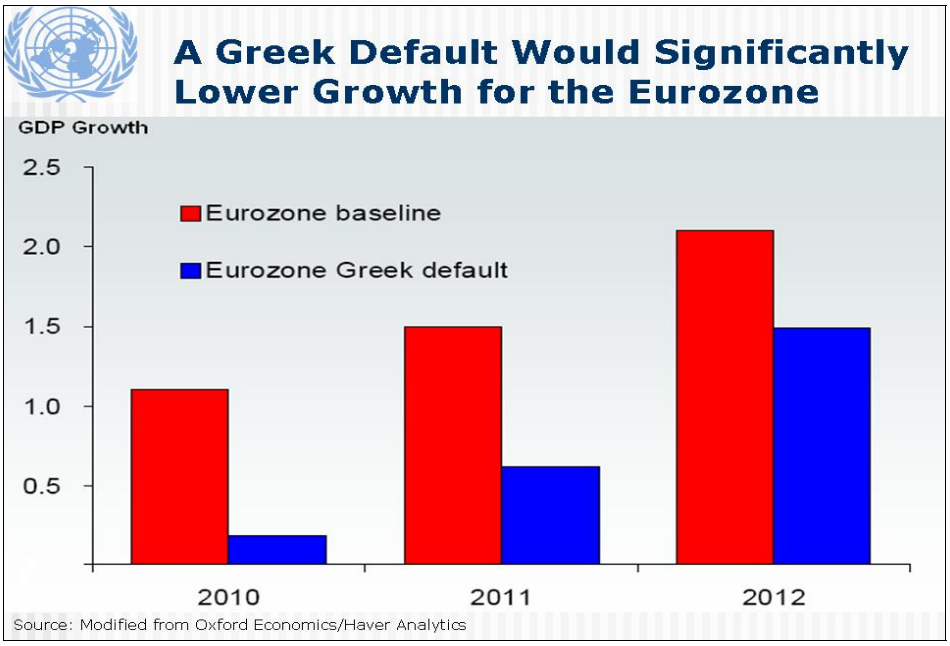
[10] That being Portugal, Ireland, Italy, Greece and Spain.

largest budget deficit (12.7 per cent of GDP) and the highest debt ratio to GDP (114 per cent of GDP) of any relevant country, as you can see in the figure. In addition Greek debt is forecast to increase rapidly over the next several years so that by 2012 it could be over 150 per cent of GDP. I have left a few countries off this table, such as Japan which has a debt level of almost twice its GDP, but there are good reasons (which I will not go into) why they are different.[11] It should be noted that the Greek situation is considerably worse than that of some other countries that actually did default such as Argentina in 2001 and Russia in 1998. Although the US and UK also have large deficits and debts and are not totally immune to a sovereign crisis, their situation is different because their debt is in a domestic currency that they can print if necessary. Greece can not print euros and thus they are like an emerging market economy with debt denominated in foreign currency. Their only option is default, devaluation or deflation. Given that almost anything will be done to avoid the first two, deflation is the likely solution but that is going to prove to be a long, costly process.



The EU has little choice but to assist Greece. To allow Greece to default would be a serious policy mistake, yet the assistance that the other EU economies seem to be offering is quite meager and is very likely to be inadequate. A Greek default would be the largest sovereign default since World War II. By comparison, Greek debt is now approximately $375 billion while Argentina defaulted on only $100 billion in 2001 and Russia on $70 billion in 1998. Approximately 80 per cent of that debt is owned by foreigners and is concentrated in the holdings of German, French and Swiss banks. A default by Greece would likely create sovereign debt problems for several other economies such as Spain and Portugal and a large part of their debt is held by these same banks.

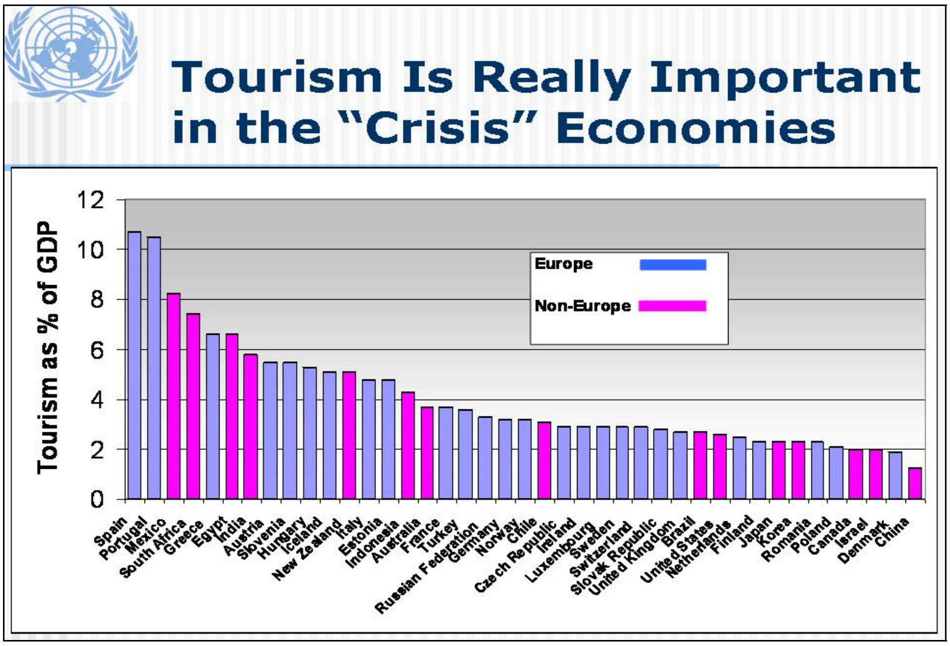
[11] More specifically, most Japanese debt is held domestically by its central bank and its high saving domestic residents. Japanese residents hold on net large quantities of foreign bonds; thus they are a creditor nation not a debtor nation such as Greece. As such Japan does not have an external debt problem and the current situation with the PIIGS is as much about their external debt as it is about their government debt. Nevertheless Japan does have problem that needs addressing.



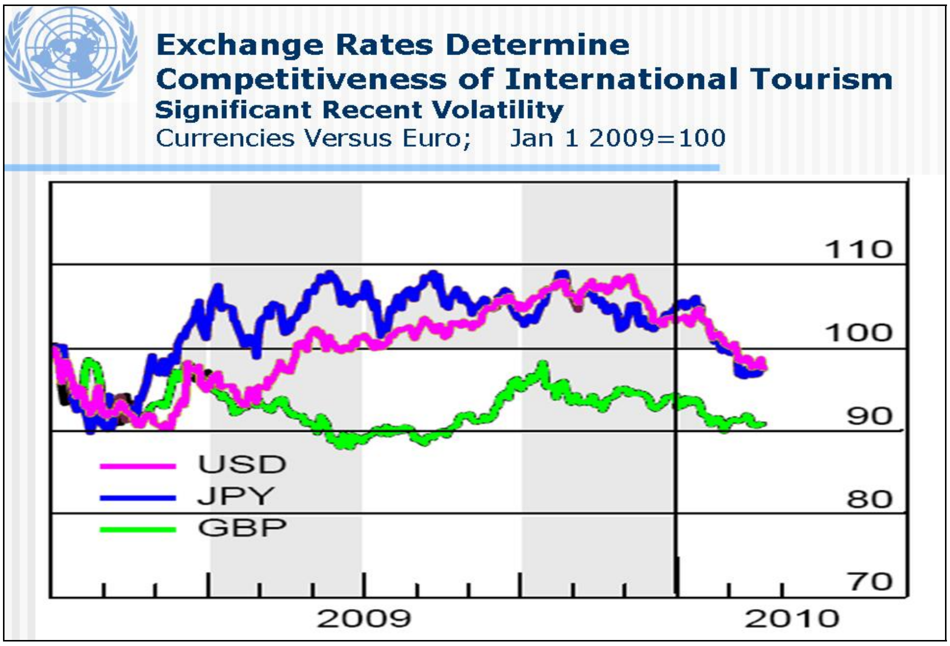
Forecasting models estimate that a default by Greece would lower the growth rate of the entire eurozone by one percentage point for the next three years and lower world growth by one half a percentage point for the next three years. The European emerging economies which are especially dependent on capital inflows would be particularly negatively impacted by a Greek default.

There is some debate now about whether the IMF should be part of the solution. I don't think it is absolutely necessary but the IMF brings additional money, expertise and perhaps an objective viewpoint and thus in my view its involvement would be a plus.

Although ensuring continuing financing for heavily indebted governments such as Greece is the most immediate concern, the longer-run adjustments in terms of budget retrenchment and real exchange rate depreciation that will be needed in these economies are substantial. For example, Greece has already increased national sales and excise taxes, cut public sector bonuses, and frozen pensions. Greece proposes to reduce its fiscal deficit from over 12 per cent of GDP in 2009 to three per cent by 2012 and it is estimated that a price deflation of 20 per cent will be required to adjust its real exchange rate. As a result these high-debt economies face significant spending cuts, higher taxes and most likely wage and price deflation for years. Even if these adjustments can be made, which is somewhat problematic, economic growth in these economies is likely to be low or below trend for an extended period of time. With government and consumer spending being cut, investment is likely to be lackluster also, so the only source of growth will be from external demand from the export of goods and services. Tourism is of course from a balance of payments perspective an export, so this sector has an important role to play in the solution to Greece's problems. Of course to become more competitive, it will be necessary to reduce costs which means lower Greek wages. Not all of the adjustments will have to come from lower wages if the industry (as well as all the export industries) can improve quality and implement cost-saving innovations.



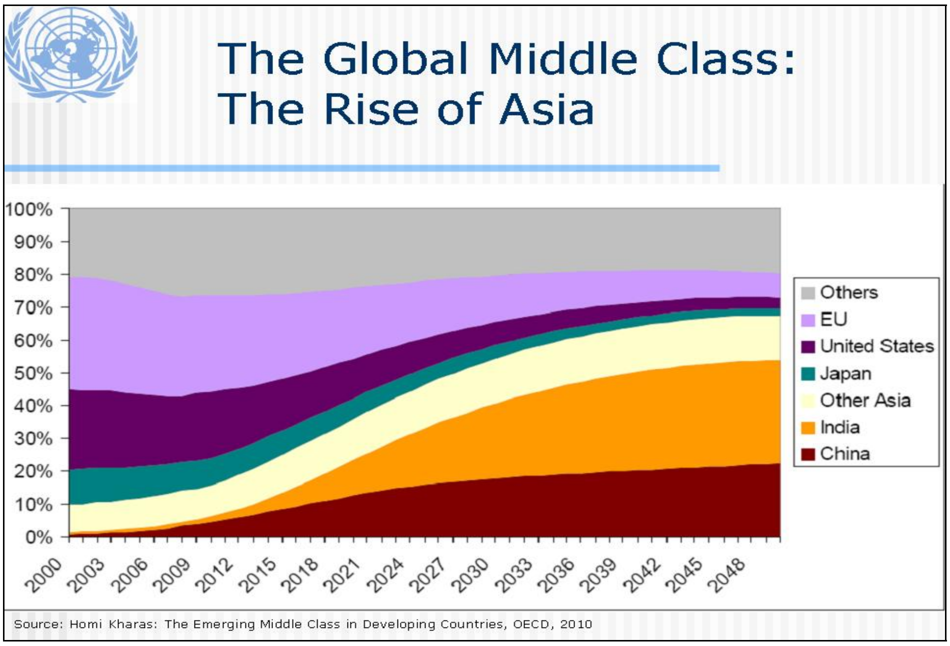
The next slide provides the size of the tourism sector as a percentage of GDP. What really stands out is the fact that the crisis economies are all at the extreme left of the chart, that being that they have the largest tourism sectors. This just emphasizes my earlier point that tourism will have a very important role to play in helping these economies address their debt problems. This should be pointed out to national policy makers because the tourism sector, which is made up of a lot of small enterprises, needs government support to address market failures and externalities, if it is respond optimally to this challenge.



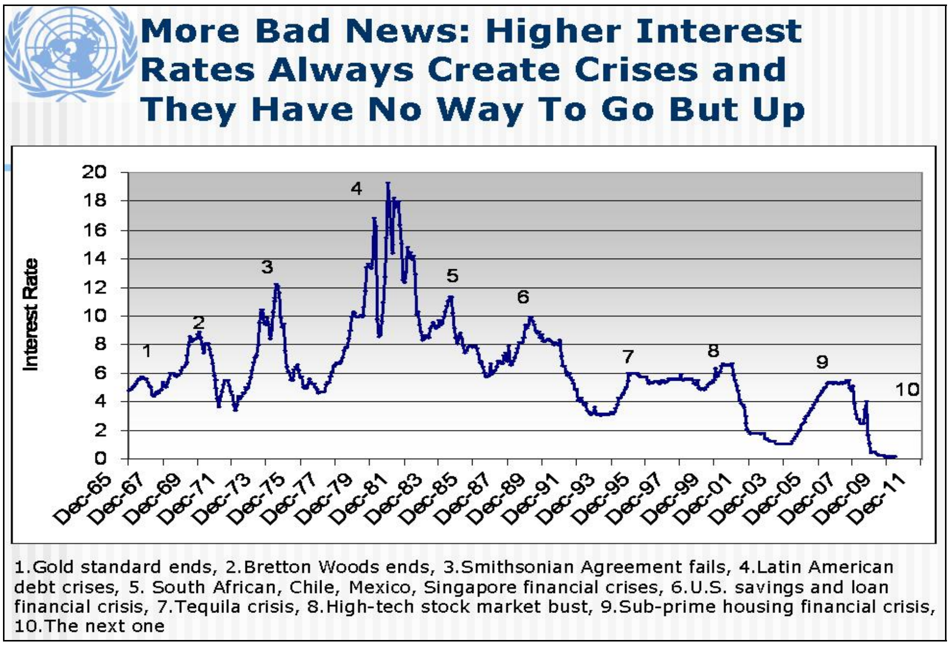
The whole "Greek tragedy" has had a quite important silver lining; that has been the decline in the value of the euro. Europe suffers from a lack of demand and given their dislike of deficit-financed government spending, increasing net external demand through increased exports (and reduced imports) is their only real option. And a depreciation of the euro is accomplishing this. There may be some disadvantages from this in the future but in my opinion this has been a big net plus for the region and could be the critical factor keeping Europe from having a double dip recession. The declining value of the euro will be an important additional factor increasing European tourism, as research as shown how tourism flows are sensitive to exchange rate developments.[12]

[12] Some evidence of this is reported in chapter 1 of OECD,*OECD Tourism Trends and Policies 2010*, OECD, Paris, 2010.

As I have emphasized to this group before, there is the current economic crisis but that should not blind one from the long-run challenges facing the industry. Tourism has been growing faster than GDP so the future prospects for the industry are good. However, the industry needs the proper government support, a strong national lobbying organization and the proper international coordination (which is provided by the UNWTO) because the industry is characterized by a number of market failures that can only be addressed with collective action. Like all industries there is a need to innovate and adapt to changing market conditions whether they be on the supply side (i.e., the internet) or the demand side (i.e., adventure travel, etc.). This industry like all others will have to adapt to the challenges presented by climate change.



One area that I think is particularly important is the need to recognize that your customer base will change dramatically over the next decades with the more rapid growth in the emerging economies. As the incomes of these populations increase they will want to travel. In the slide above, the changing sizes of the global middle class are plotted. While India, China and emerging Asia have a very small share now, in twenty years they will account for almost half of the world's middle class.



And finally I should warn you that once this crisis is over, another one is likely to be around the corner. Every time in the past 50 years that global interest rates have gone up significantly there has been a major crisis of some sort. These are plotted on the chart above. Interest rates are now at historically low rates and will be going up over the next few years. Firms today are making investments that will be unviable once interest rates go up. So don't become too optimistic. Sorry for the bad news.

Thanks for you attention.