Should the G20 have a global growth target?

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The global recovery is strengthening but remains weak. A global growth target, pursued by the G20, could significantly strengthen this recovery process. But such a macroeconomic target needs to be supported by microeconomic reforms.

In advanced economies, demand is now growing more rapidly than in the previous three years, but output remains below potential. And the growth of potential output itself is low, due to reduced investment, low profitability and low demand. In emerging-market economies, there is a slowdown in growth following a withdrawal of foreign capital and the associated external turbulence. The resultant tightening of financial conditions is reducing growth of demand in these economies too.

G20 trade ministers from industrialised and emerging economies gather for a one-day meeting in Sydney, Australia, 19 July 2014. (Photo: AAP)

Macroeconomic policies are not sufficiently supportive. Advanced countries are undertaking fiscal austerity — particularly the US, the UK and Germany — and seeking to grow their demand by raising exports. Long term interest rates are rising because of fears about the effects of the tapering of quantitative easing. In China, domestic demand is still not expanding rapidly enough, and in other emerging markets such as India and Brazil policies are tightening because of external difficulties. The world faces a ‘new normal’ of low growth.

Many distinguished economists from emerging markets have called for international cooperation in setting macroeconomic policies. For example, Rakesh Mohan, the former Deputy Governor of the Reserve Bank of India, has complained that the tapering of quantitative easing has been carried out without sufficient regard for international spillovers and has called for the US Federal Reserve to ‘be aware’ of the interests of other countries. But in the words of the Australian Treasurer, Joe Hockey:

‘There is no doubt that the Fed needs to be aware of these international implications in detail, and be mindful of them. ...[And yet] ultimately, the Fed has to operate in a manner that is consistent with its domestic mandate.’

Is cooperation possible and, if so, of what kind? Countries have a wider range of instruments than the purely macro-economic. Those which cannot offer a different macroeconomic response may instead be able to adopt the global growth strategy that is presently being developed by the G20.

The possibility of a global growth strategy was put forward in a document titled Macroeconomic and Reform Priorities, prepared by International Monetary Fund staff for the meeting of G20 finance ministers and central bank governors held in February this year. That meeting identified a ‘global growth strategy’ as a cooperative process in which countries would be asked to contribute a set of particular policy changes which, taken together, might raise global growth by 2 per cent by 2018. This has effectively become a global growth target.

The document identifies a number of possible changes to macroeconomic policy and a broad range of additional reforms to supply-side policies which...
might be undertaken in G20 countries. The suggestions include promoting competition, particularly in the services sector, as well as reforms to training programs to address skill mismatches. Consideration is also being given to the taxation and social protection of low-income workers, along with the effects of labour-market institutions on job creation and participation, and policies to support technological catch-up. Success in these domestic reforms will enable countries to better support the development of global value chains.

Addressing obstacles to investment, notably in infrastructure, is another focus. Impediments include regulatory conditions and a lack of depth in financial markets. Progress in this context will depend on a satisfactory division of expenditure and of risk-sharing between the public and the private sectors.

These microeconomic reforms are likely to bring with them the ability to adopt more expansionary macroeconomic policies. Increased infrastructure investment will lead to significant increases in public expenditure, and the ability to create valuable infrastructure assets is likely to induce a moderation of fiscal austerity. Similarly, supply-side reforms in emerging market economies are likely to reduce national risk premiums and external difficulties, which would in turn enable other countries to implement more accommodating policies.

Countries have until June to consider what actual reform policies each might offer as part of a global growth strategy. These proposals will be peer-reviewed at a meeting of finance and central bank deputies in Melbourne in June. A meeting of finance ministers and central bank governors in Cairns in September will set out the agreed global growth strategy, which will form the basis of a Brisbane action plan to be approved at a G20 heads of government meeting in November.

Will the proposed reforms actually be implemented?

It is clear that any reforms will be driven by domestic political agendas. There will always be those who stand to lose from reform. But the international climate can influence domestic political calculations. This was true throughout Asia in the 1990s in the early days of the Asia Pacific Economic Cooperation (APEC) process, when a sense of opportunities abroad fed into the ability to galvanise liberalisation at home. Back then, the prospect — and better still the reality — of liberalisation by others abroad, especially when they were important regional trading partners, was used persuasively by trade policy officials and politicians as they embarked on the contest with protectionists at home over liberalisation. This leverage was useful during the period, from the mid-1980s to the eve of the Asian financial crisis in 1997, when virtually all Western Pacific economies embarked on far-reaching unilateral liberalisation in the high tide of internationally oriented growth in East Asia. It became easier to liberalise in a climate in which many other countries were doing the same thing.

What is happening can be described as a similar process of ‘concerted unilateral reform’. In effect, each country is able to be ‘mindful’ not only of the interests of other countries but also of the opportunities created by the actions of other countries. These opportunities will change the way in which each country can pursue its domestic mandate. The existence of a global growth strategy may well act as an inducement to national reform strategies. It does seem likely that such an approach will support a process of global cooperation and enable faster growth in the global economy.

The reform process will be carried out within the structure of the G20 Mutual Assessment Process, or G20MAP. This was developed so that countries could continue the successful cooperation in macroeconomic policymaking that occurred at the G20 meeting in London in April 2009.

But the G20MAP has run out of steam. This is partly because its initial aim was to deal with global imbalances, in particular balance-of-payments disequilibria. A number of deficit countries — including the US — and surplus countries — including Germany and China — disagreed about how to resolve these questions. As discussed above, countries may not have the incentives necessary to change their macroeconomic policies in the global interest.

The new approach described here — combining microeconomic reforms with a macroeconomic strategy and doing this within the framework of a global growth target — offers new hope. It has given countries new incentives to cooperate in the setting of their policies, including their macroeconomic policies. This strategy is likely to revive the G20MAP and lead to higher global growth.

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