POLICY BRIEF

The G20 needs a growth strategy

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THE G20 NEEDS A GROWTH STRATEGY

WHAT IS THE PROBLEM?

Restoring global economic growth and creating jobs has been an objective of successive G20 summits. Australia has also made it a priority for the G20 in 2014. To achieve such an outcome requires a comprehensive and agreed growth strategy. The G20 lacks such a strategy and has failed to provide a clear and consistent message about how members can or are working together to achieve such an outcome.

WHAT SHOULD BE DONE?

G20 leaders outlined the way forward at the St Petersburg Summit in 2013 when they asked finance ministers to develop growth strategies for the Brisbane Summit. A single umbrella strategy, outlining how countries will work together to lift growth and create jobs, should be released at the Brisbane Summit. It should move away from the current focus on rebalancing global growth and embrace a plan for lifting potential growth in all countries. Accompanying this, each G20 member should release their own plan to increase growth in their country, consistent with the umbrella strategy. Leaders need to be directly involved and take ownership of the growth strategy. All aspects of policy need to be covered: fiscal, monetary, financial regulation, structural, tax, trade and development. To engage the public, draft growth strategies should be released for comment prior to the Brisbane Summit.

DOES THE G20 HAVE A GROWTH STRATEGY?

At the heart of the G20 is a commitment by members to work together to restore global economic growth and create jobs. This has been repeatedly stated as the core objective of the G20 at successive summits. It comes as no surprise that a key theme under the Australian presidency in 2014 is to promote stronger economic growth and employment outcomes.[1] A clear strategy is required to achieve these objectives, but it is far from clear that the G20 has one.

THE G20 FRAMEWORK AND THE MAP – AN AMBITIOUS INITIATIVE

The G20 initiative that was meant to encapsulate the cooperative effort to deliver better global economic outcomes is the Framework for Strong Sustainable and Balanced Growth (Framework), underpinned by the Mutual Assessment Process (MAP). These were launched at the Pittsburgh Summit in 2009.

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This was a highly ambitious commitment to action-oriented and peer-driven international economic cooperation. Previous examples of significant international economic policy cooperation are limited. Exceptions include the 1978 G7 Bonn Summit, the 1985 Plaza Agreement and the 1987 Louvre Accord.[2] Typically, instances of successful international economic cooperation have come at times of crisis, such as the 1987 stock market crash that saw G7 countries coordinate interest rate reductions as well as a boost to liquidity. More recently, the 2008 global financial crisis saw the G20 respond with a coordinated program of fiscal expansion, commitments to avoid protectionism, financial regulatory reform, and an increase in the resources of international financial institutions.

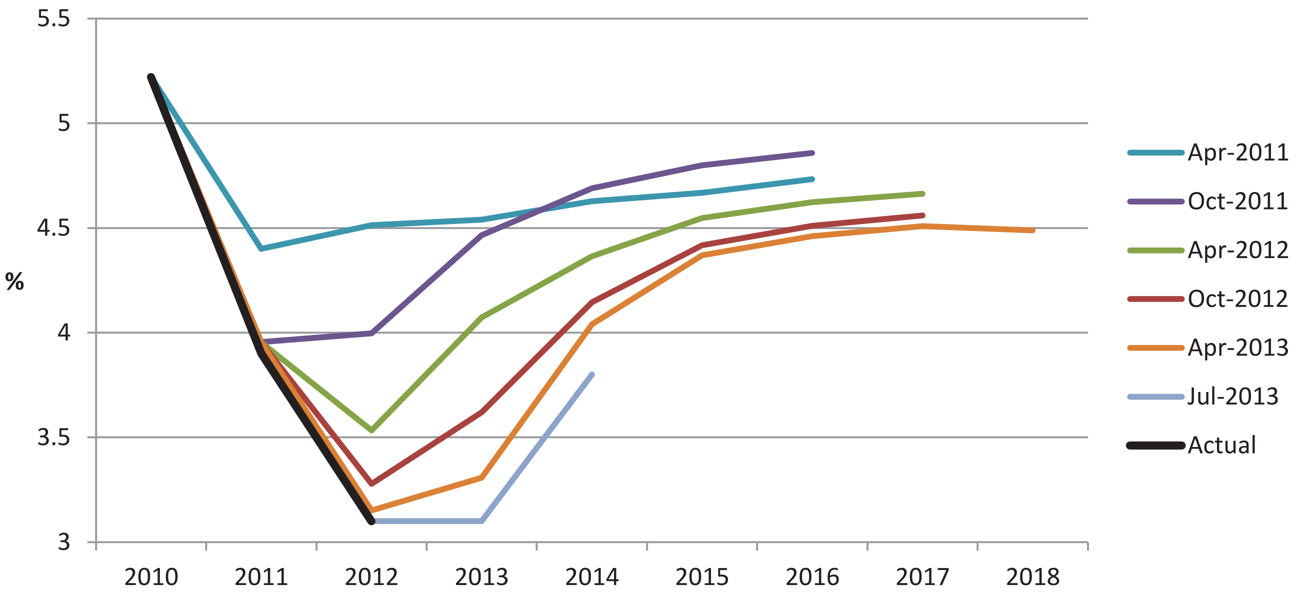
There are a number of reasons why macroeconomic policy cooperation is difficult in ‘normal’ times. Countries find it difficult to agree on the nature of their shared economic situation and on the impact of one country’s policies on others (the extent of spillovers). It may also seem that the costs associated with cooperation exceed the cost of the spillover.[3] Often the economic policies of larger countries can have a significant negative impact on smaller countries, but because the gains from changing these policies might not be great for the larger countries, there is little incentive for them to cooperate.

A purported strength of the G20 Framework is that it involves both the major advanced countries and emerging markets. However, this is also a weakness because it means negotiations have to overcome a greater diversity of interests compared with more like-minded organisations such as the G7. Nevertheless, a clear advantage of the Framework and MAP is that it is country-led, implying greater buy-in by G20 members. This is in contrast to IMF surveillance, which largely involves the IMF providing policy recommendations to Fund members.

HOW SUCCESSFUL HAS THE G20 FRAMEWORK BEEN IN LIFTING GLOBAL GROWTH?

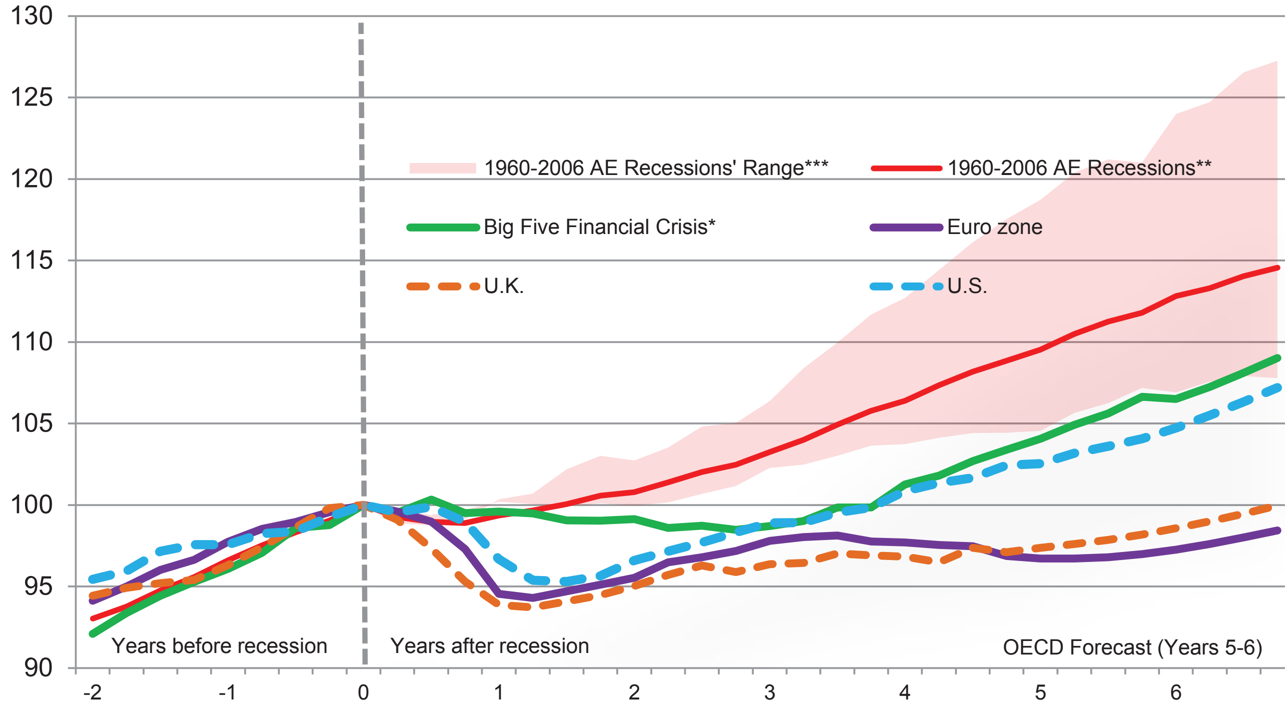
It is not easy to assess the success of the G20 Framework and the MAP, because it is not clear whether the global economy would be any different if there had not been a G20 Framework. Yet given that the objective of the G20 is to promote stronger, more sustainable and more balanced economic growth, the continuing sub-par performance of the global economy suggests that, at best, the achievements of the G20 Framework have been modest. While the IMF has recently revised up its forecasts for the global economy for 2014, this follows six consecutive downward revisions (see Figure 1). Global GDP growth has remained weak since 2010.

Figure 1. IMF World Economic Outlook forecasts of global GDP growth[4]
(Per cent growth)



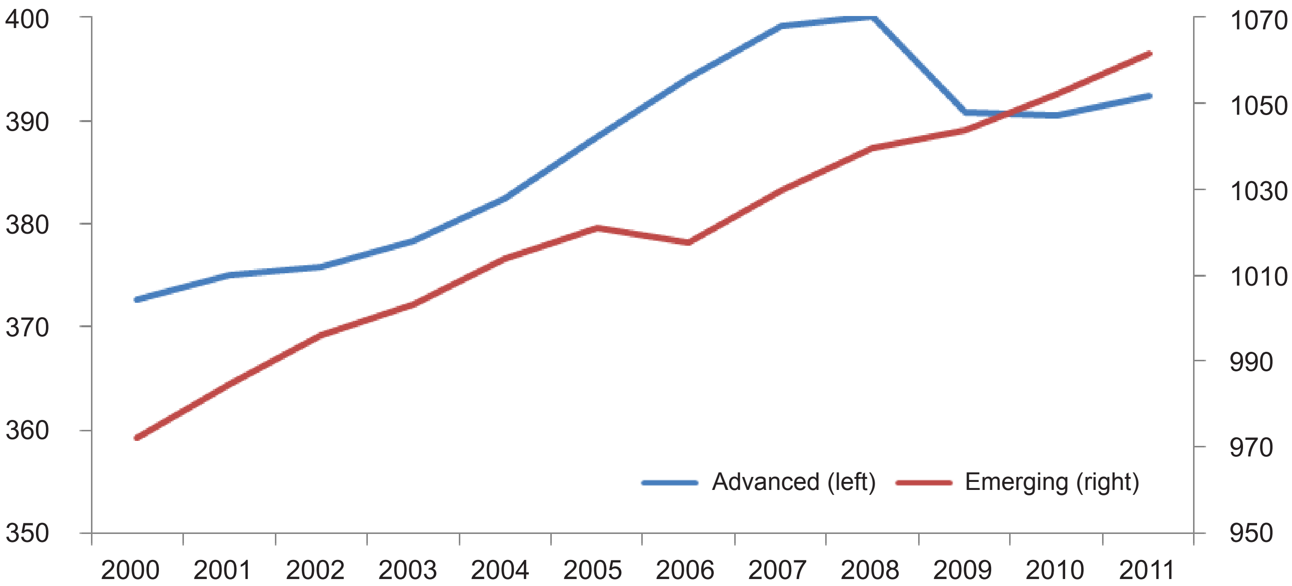
As is evident in Figure 2, the recovery from the 2008 crisis has been more protracted than recoveries from previous recessions and output in many countries has still not returned to pre-crisis levels.

Figure 2. Recovery from financial crisis[5]
(100 = first quarter of real GDP contraction)



This weak economic growth has had an impact on labour market outcomes (Figure 3), with the ILO reporting that unemployment has increased by 28 million from 2007 to 2012 and has risen by a further 5.1 million in 2013, to more than 202 million worldwide.

Figure 3. G20 employment[6]
(persons employed, millions)



It is also not clear that the existence of the Framework and the peer review process has actually influenced the policy choices of countries. Jonathan Ostry and Atish Ghosh from the IMF offer a negative view:

> "While it is too soon to make a definitive assessment, evidence to date does not suggest that any of the large countries have made significant adjustments to their economic policies in response to peer pressure under the MAP".[7]

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In addition, the joint resolve evident in the G20's immediate response to the global financial crisis in 2008 and 2009 appears to have dissipated. As Ostry and Ghosh note:

> "Incentives for collective action … seem to be waning now given the distance from the darkest days of the crisis, as well as political economy factors specific to each country/region and the multi-speed global recovery".[8]

In recent years, the G20 has struggled to deliver a clear, consistent message as to how members are or should be cooperating to restore growth. The focus has been more on areas of disagreement than those of agreement, such as the debate over 'growth versus stability' or the impact of quantitative easing and concerns over currency wars.

DEFICIENCIES IN THE FRAMEWORK AND THE MAP

A problem with the Framework and MAP is that their structure, operations and purpose were not sufficiently spelled out and agreed when they were launched. These issues have not been resolved in the course of the operation of the Framework and MAP. What constitutes strong, sustainable and balanced growth was never clarified. The Framework evolved on the basis of treating strong, sustainable and balanced growth as three separate objectives, rather than one objective with three components. The interconnections between policies and objectives were not sufficiently recognised. For example, rigorous fiscal consolidation was portrayed as necessary to achieve sustainable growth without taking into account the impact of such policies on growth in the short-term.

What constitutes 'balanced' growth remains particularly vague. Charged by G20 members to assess the consistency of member policies with the Framework, the IMF interpreted 'balanced' growth as broad-based growth across countries. There has, however, been an increasing tendency to see balanced growth as the reduction in current account imbalances. At a broader level, the aim of balanced growth could be seen as ensuring that all citizens benefit from stronger growth. This would encompass narrowing the development gap between countries and improving income inequality within countries.

The MAP has evolved over time. At the outset, the focus was on shifting demand, both internally and externally, so that deficit and surplus countries could adjust imbalances relatively smoothly and avoid a 'hole in demand' if the deficit countries acted unilaterally. The aim was to 'rebalance' global growth. As the crisis abated and global growth appeared to be strengthening, more attention turned to medium-term fiscal consolidation. However, at the Seoul Summit in 2010, the focus of the MAP was very much on reducing external imbalances. Following a poorly received attempt to pursue a target in relation to current account imbalances, the compromise was an agreement to develop 'indicative indicators' to identify members with imbalances that required further assessment. As Hamid Faruqee and Krishna Srinivasan have observed, this shift in the MAP away from shared growth objectives to a focus on external sustainability may have 'in retrospect derailed fledging buy-in by key surplus countries'.[9] Nevertheless, this is an area where there has been progress, with a significant reduction in external imbalances since the crisis, as evident in Figure 4.

Figure 4. Current account imbalances[10]
(Per cent of G20 GDP)

It is not clear, however, whether this reduction in imbalances has been due to temporary factors, particularly a weakness in demand, or a more permanent change. The IMF believes it reflects both. Part of the adjustment has been healthy, reflecting the correction of financial excesses that existed prior to the crisis as well as some demand rebalancing in key emerging surplus economies.[11] In particular, China's current account deficit has fallen from 10 per cent of GDP in 2007 to around 2.5 per cent in 2013.

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The IMF notes, however, that part of the adjustment also comes from low internal demand in advanced deficit economies.[12] Nevertheless, the IMF foresees a largely durable narrowing in global imbalances.[13] Whether large external imbalances re-emerge depends on the size of countries' output gaps (the extent to which current growth is below potential growth). The IMF's assessment is that output gaps in advanced economies are not large, consistent with the evidence that large financial crises tend to involve durable losses in the level of output relative to pre-crisis trends. Hence, the Fund's forecast is that as output gaps close, global imbalances will move sideways. If correct, this means that while global imbalances may decline, growth will remain at rates below pre-crisis levels. Consequently, the G20 needs a growth strategy that moves beyond a focus on reducing external imbalances to embrace the importance of lifting potential growth.

Another important deficiency in the MAP is that not all the priority reforms needed to foster growth are covered. Comparing the policy commitments identified in the St Petersburg Action Plan with the policy recommendations contained in the most recent IMF Article IV (surveillance) reports for G20 members, there are some overlaps, but many gaps. Moreover, a report on the G20 structural reform commitments prepared by the OECD and the World Bank notes that there is limited overlap in the reforms contained in the St Petersburg commitments with the top five country-specific policy priorities outlined by the OECD in its *Going for Growth exercise*.[14] The OECD and World Bank conclude:

> "the moderate degree of overlap between the G20 and OECD *Going for Growth* priorities suggest some scope for identifying commitments that are more favourable for growth than current commitments".[15]

In the absence of any enforcement mechanism, the main incentive for compliance of commitments made under the Framework is domestic public pressure. But for this to happen, the action plans and accountability assessments prepared in the G20 process have to get public recognition. There is no evidence that this is happening. This is not surprising. The St Petersburg Action Plan and supporting documentation was 187 pages long. It was technical, repetitive and conveyed no clear messages. No leader, or likely any G20 minister, would have even read this material in full.

THE PATH TO A COMPREHENSIVE 'G20 GROWTH STRATEGY'

The G20 needs a clear, consistent and comprehensive narrative to explain to the public how countries are cooperating on their respective policies to lift growth and create jobs. It needs a clear 'growth strategy'. How can this be achieved? It will not come from the way in which the Framework and the MAP have developed to date.

Leaders outlined a way forward at St Petersburg when they requested their finance ministers to develop "comprehensive growth strategies for presentation to the Brisbane summit".[16] Australia has said this commitment would be "encapsulated in a Brisbane Action Plan" and would include "practical actions to improve productivity and competitiveness, strengthen investment in infrastructure, encourage trade, make it easier to do business and boost employment". [17]

This broadening of the policy focus is welcome, but the proposed approach raises concerns that the problems that are evident with the Framework and the MAP will be repeated. The desire to identify 'practical actions' or 'concrete commitments' to demonstrate progress is understandable. But it is important to make sure that is not at the expense of having first developed a comprehensive and agreed strategy on how to strengthen growth and create jobs. The specific policy measures should be presented as part of the implementation of a coherent strategy. Another 187 page 'action plan' that mainly lists the policy measures that countries are already implementing or have already announced outside of the G20 process will not constitute a coherent growth strategy.

The 'growth strategy' has to be more than rhetoric. The challenge is to get agreement on the direction of policies, and in particular cooperation between individual country measures that are required to promote growth. Getting agreement on a meaningful growth strategy will be hard, but it is vital.

If the Brisbane Summit is to strengthen the Framework and the MAP, and ensure that the G20 has a clear 'growth strategy', it should take the following steps:

- An **'umbrella' G20 growth strategy** should be released at the Brisbane Summit, outlining how G20 countries are working together to lift growth. Alongside the umbrella G20 growth strategy, **each G20 member should release its individual growth strategy**, which outlines its plan for increasing growth, consistent with the umbrella strategy. A separate Brisbane Action Plan can provide the detailed measures that countries are implementing as well as the accountability assessments. But this should also be a concise document.

- The G20 growth strategy should move away from the current MAP focus on rebalancing global growth, and embrace a plan **for lifting potential growth in all countries** – advanced, emerging and developing. This would recognise that the prolonged nature of the financial crisis has lowered potential growth in many countries. If the IMF is correct and output gaps have narrowed, growth will not return to pre-crisis levels. The challenge is to raise potential growth in all G20 countries. This will require structural measures. It will not be achieved with fiscal expansion or accommodating monetary policy alone.

- Lifting potential growth will require a plan that incorporates **all aspects of policy** – fiscal, monetary, financial regulation, structural, tax, trade and development. While many of these issues have been on the G20 agenda, they have been considered in isolation and have not been part of the MAP, which has largely focused on counter-cyclical macroeconomic management. The G20 needs a comprehensive growth strategy.

- The strategy should be concise but it must go beyond rhetoric. The **difficult issues and risks should be confronted** and the strategic priorities for the coming year highlighted. For example, the growth strategy should move beyond such statements as those in the St Petersburg Action Plan that "advanced G20 countries agree to maintain a flexible approach in implementing their fiscal strategies" and "we remain mindful of the risks and unintended negative side effects of extended periods of monetary easing".[18] These are words designed to cover a variety of competing views. The growth strategy must explicitly acknowledge that the aim is to rebalance the macroeconomic policy mix by reducing the need to rely on accommodative monetary policy in order to offset the drag on growth from fiscal consolidation. The growth strategy should also acknowledge such risks as the dangers of deflation and the importance of avoiding the premature withdrawal of monetary support, along with the potential capital volatility that could come with the unwinding of quantitative easing.

Lifting potential growth will require a plan that incorporates all aspects of policy

- Increasing investment, including in particular **infrastructure investment** (both publicly and privately funded), is central to lifting potential growth. Labour and capital inputs, along with how efficiently they are used, are the drivers of economic growth. But the focus should always be on lifting high quality infrastructure investment that will contribute to a sustainable increase in growth and not just increasing investment for a short-term boost in demand. Improving the efficiency of existing infrastructure should also be included as part of the growth plan. The challenges countries face in raising high quality investment will vary, and accordingly, there will need to be country-specific solutions. These should be highlighted in each member's growth strategy.

- As noted, fostering economic growth will require increasing the supply and quality of labour inputs. Consequently, effective **labour market programs** and policies to increase skills and participation must be key components of the growth strategy. In addition, the importance of **liberalising product markets** and facilitating competition along with greater private sector investment should be highlighted in the growth strategy.

- Dealing with **inequality** has to be part of each country's strategy to achieve stable and sustainable growth. As IMF research has highlighted, rising inequality is linked with greater economic instability. Focusing on achieving inclusive growth is also important in gaining public support for reform initiatives.

- It is essential that countries focus on the **highest priority reforms** needed to lift growth potential. Towards this end, countries should commit to tackling the priority reforms recommended by the OECD and other international bodies.

- One of the challenges is demonstrating how G20 members are cooperating to strengthen growth, given that many of the required policy measures are largely domestic. The answer is to highlight areas in the growth strategy where international cooperation is vital. Such areas include **advancing multilateral trade liberalisation**, dealing with **tax evasion and avoidance**, and **regulating banks that operate globally**. With respect to trade, the strategy should highlight the key areas where members need to work together to expand international trade – such as strengthening the standstill against protection, removing barriers for trade in services, expanding the WTO Information Technology Agreement and promoting greater compatibility between regional trade arrangements and the WTO rules. Similarly, the growth strategy should note the existing focus of G20 members on combating tax evasion and avoidance and on strengthening the stability of financial systems.

Dealing with inequality has to be part of each country's strategy to achieve stable and sustainable growth.

- **Leaders need to be directly involved and should take ownership of the G20 growth strategy**. The lead will have to come from the chair, the Australian prime minister. Most importantly, preparing a growth strategy should not be left to officials and confined to the Framework Working Group. The growth strategy should not be absorbed into the Brisbane Action Plan. It is important to first have a clear strategy before getting into the detail of specific measures. This has been a problem with the way the Framework has developed to date.

- The intended audience for the **G20 growth strategy should be the domestic populations of each G20 member**. The current G20 action plans are technical exercises that receive no public airing. As a result there is little or no pressure on member governments to implement them. The G20 needs a clear narrative that explains to its citizens how members are cooperating to lift growth and create jobs. This will in turn create domestic pressure on member states to implement their commitments under the strategy. The draft umbrella strategy and each member's individual growth strategies should **be released for public comment prior to the Brisbane Summit**. Public scrutiny of a draft strategy will help ensure that they are meaningful documents.

CONCLUSION

The G20 has made impressive contributions to global economic governance, particularly in the aftermath of the global financial crisis. Today, however, its relevance is increasingly being questioned. As the only international grouping that brings together developed and developing countries it is important that the forum is effective. But it can only do so if it demonstrates its relevance to addressing the key problems facing the global economy. Formulating a meaningful strategy for increasing economic growth and creating jobs is essential to the future of the G20. As chair in 2014 Australia should lead that effort. It will not be easy but at this stage in the G20's evolution it is essential.

NOTES

[1] Department of the Prime Minister and Cabinet, G20 2014: *Overview of Australia's Presidency,* (December 2013): https://www.g20.org/sites/default/files/g20_resources/library/G20Australia2014conceptpaper.pdf.

[2] At the 1978 G7 Bonn Summit, members agreed on mutual 'concerted' cooperation in five areas – economic growth, energy, trade and development. In the 1985 Plaza Agreement, the G5 countries agreed to intervene in currency markets to reduce the value of the US dollar and, in turn, the size of the US trade deficit. Finally, the 1987 Louvre Accord involved concerted joint action by the G7 to stop the depreciation of the US dollar along with the coordination of fiscal and monetary policies.

[3] Jonathon D. Ostry and Atish R. Ghosh, *IMF Discussion Note: Obstacles to International Policy Coordination, and How to Overcome Them*, (Washington DC: International Monetary Fund, 2013).

[4] G20, *St Petersburg Action Plan*, (6 September 6 2013): http://www.g20.utoronto.ca/2013/2013-0906-plan.html.

[5] Ibid. *Big Five financial crisis include Spain (1977), Norway (1987), Finland (1991), Sweden (1991) and Japan (1992). ** Recessions (two straight quarters of contraction in G20 advanced economies since 1960). *** Range limits are average of best/worse three advanced economy recessions 1960-2006.

[6] Ibid.

[7] Ostry and Ghosh, *IMF Discussion Note*.

[8] Ibid.

[9] Hamid Faruqee and Krishna Srinivasan, "The G20 Mutual Assessment Process - a Perspective from IMF Staff," *Oxford Review of Economic Policy 28*, no. 3 (2012).

[10] G20, *St Petersburg Action Plan*.

[11] IMF Research Department, ed., *Imbalances and Growth: Update of Staff Sustainability Assessments for G20 Mutual Assessment Process*, (Washington DC: International Monetary Fund, 2013).

[12] Ibid.

[13] Ibid.

[14] OECD and World Bank, *Pursuing Strong, Sustainable and Balanced Growth: A Note on G20 Structural Reform Commitments,* http://www.oecd.org/g20/topics/framework-strong-sustainable-balanced-growth/OECD-WB-Evaluation-G20-structural-policy-commitments-2013.pdf.

[15] Ibid.

[16] G20, *G20 Leaders' Declaration*, (September 2013): https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf

[17] Department of the Prime Minister and Cabinet, *G20 2014: Overview of Australia's Presidency*.

[18] G20, *St Petersburg Action Plan*.

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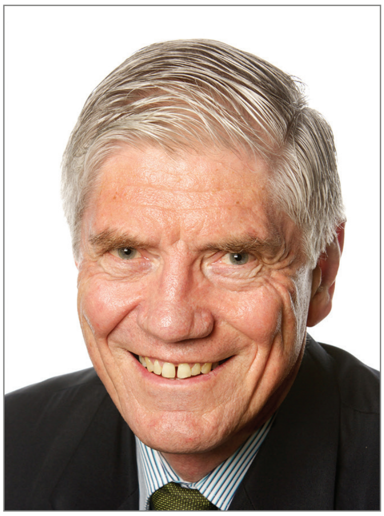

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