

# Rebooting the G20 framework

Instead of targeting global imbalances *per se*, the narrative must change to the structure and direction of such asymmetries



ALOK SHEEL

As we approach the ninth G20 Summit at Brisbane, Australia, in mid-November 2014, the global economy continues its excruciatingly slow and painful recovery from the worst global financial and economic crisis since the Great Depression. It is perhaps an opportune time to revisit the signature contribution of the G20 — the forward-looking framework for strong, sustainable and balanced growth.

Conceived and launched at a time when it was felt that the global economy was firmly set on the path to robust recovery, the initial focus of the G20 framework was to target large, unsustainable global imbalances that were perceived as one of the ultimate causes of the crisis. As the strong recovery of 2010 petered out, the G20 turned its attention to the “strong” panel of the framework triptych that has more of a short- to medium-term focus. This is where matters currently stand, as the recovery remains tepid.

The current downturn in emerging markets (EMs) is cyclical, largely deriving from lower growth in advanced market economies (AEs). The business cycle in AEs, on the other hand, faces structural headwinds to growth in motion prior to the global crisis. These headwinds arise from a failure of economies to adjust to the disruptive and asymmetric effects of ageing, technology, globalisation and anthropogenic climate change. These headwinds, however, also create new opportunities that can not only help mitigate their impact, but also generate new engines of growth.

The G20 framework currently assumes that global gross domestic product can be increased two per cent above current projections over the next five years, and future risks to the global economy considerably mitigated, if countries implement growth-enhancing reforms and move towards external balance.

This may be an eminently sensible framework over the short to medium



ILLUSTRATION BY BINAY SINHA

term. Over the longer term, however, the International Monetary Fund and the G20 need to shift focus from imbalances *per se* to the structure and direction of such imbalances. This must be done in such a manner that the framework has a single storyline consistent with the headwinds and opportunities inherent in demographic transition, globalisation, technology and climate change, all of which are being debated directly or indirectly within various forums of the G20. The long term, after all, passes through the short and medium terms. The means cannot be very different from ultimate objectives.

Ageing vastly changes the structure of the workforce, resulting in a shrinking workforce and burgeoning old-age dependents that can result in fiscal stress. This, however, also creates new income-generating opportunities in poorer, younger societies.

Technological change and globalisation have combined to vastly improve efficiency and productivity that have a deflationary impact on consumer prices

globally. Although “enforced globalisation”, or free trade, during the colonial era widened income disparities between advanced economies and developing ones, the current post-nationalist phase of globalisation has created opportunities for narrowing these income differences. In a globally integrated labour market, returns to labour have fallen, as high-income AEs become uncompetitive in labour-intensive manufacturing that is shifting to EMs.

The global economy, which grew very slowly right up to the 18th century, accelerated at an unprecedented rate over the last three centuries following the spread of the Industrial Revolution. This is resulting in anthropogenic climate change that threatens human existence if mitigating steps are not taken. This requires capping the overall rate of increase in human consumption. The

**In a globally integrated labour market, returns to labour have fallen, as high-income advanced economies become uncompetitive in labour-intensive manufacturing that is shifting to emerging markets**

most equitable way of doing so is by dampening consumption growth in countries with high per capita incomes that have contributed to most of the existing stock of greenhouse gases, to compensate for the inevitable increase in emissions from developing countries to the point that per capita incomes converge, a process already underway.

Adaptation and mitigation of climate change, however, are also spawning new “green” technologies that can be new engines of growth in advanced economies that retain their technological edge.

Accelerated globalisation has exacerbated anomalous global imbalances, with EMs running current account surpluses and exporting rather than importing savings. This is what enabled AEs to grow robustly during the “Great Moderation” through leveraged consumption despite stagnant wages. This

model has arguably broken down with financial re-regulation, leading to a decline in growth in both AEs and EMs.

EMs need structural reforms to rebalance their economies towards domestic demand as their primary engine of growth for a return to high growth. This will also enable them to avoid the middle-income trap. Advanced, ageing economies need structural reforms to de-stress their fisc and become more competitive with EMs in the international market for labour. This twin rebalancing would further narrow per capita disparities between AEs and emerging economies, and entail EMs saving less and consuming more, and AEs saving and investing more.

The framework assumes that growth and development in a globalised world should primarily be based on domestic savings. Developing countries, however, need to run current account deficits to top up domestic savings with external savings to boost investment and growth. The size of the deficit should, of course, be prudent and sustainable so that it can be funded by the market over the medium to long term, and reasonably secured against sudden stops. The counterpart of EM deficits is AE surpluses that can accelerate global income convergence. (Resource-rich countries are in a class of their own since as they are likely to run current account surpluses, irrespective of whether they are developing or developed.)

The American and Chinese imbalances appear incongruous according to the above storyline, while the surpluses of Germany and Japan do not. As developed countries, they should run surpluses to smoothen global developmental imbalances by generating savings for investment in developing countries, and also to limit consumption growth. Of course, if developed countries end up exporting low-technology consumer goods, they could stifle growth in developing countries. But this is patently not the case since both Germany and Japan increasingly specialise in high-technology products and capital goods.

To conclude, the G20 framework needs a rebooted storyline that is thematically and temporally consistent, tying together the disruptive forces of globalisation, technology, demographic transition and climate change for strong, sustainable and balanced growth of the global economy going forward.