G20 Governments Need to Do More to Support Aggregate Demand

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Tristram Sainsbury proposes that G20 Finance Ministries be more active in supporting demand to complement structural reform efforts.

Challenge

The key question facing the 2016 Chinese and 2017 German G20 Presidencies is how to restore a sense of credibility to G20 claims that its members are actually acting to achieve the G20’s goals of strong, sustainable and balanced growth.

The world economy faces some serious challenges. The world is not, in the initial months of 2016, in a crisis. But growth is not strong, sustainable or balanced, and 2016 is likely to be characterised by disappointingly low growth and persistently high unemployment. There are also a relatively daunting series of known risks that could materially affect short and longer-term growth prospects. Risks continue to mount, and much of the world remains vulnerable to shocks.

The global policy response leaves much to be desired. In particular, the global economic policy mix continues to rely too heavily on actions by central banks that have unknown longer-term consequences, and the G20’s structural reform narrative is struggling to deliver growth outcomes.

Proposal

The G20’s current approach to the fiscal/monetary policy mix needs to be reconsidered. A crucial way to take pressure off central banks is for fiscal policy to take up more of the slack. In particular, governments need to move forward on fiscal issues and well-targeted investment that boosts both supply and demand potential. Governments around the world also need to demonstrate more political will (and greater urgency) in implementing difficult structural reforms. Given the challenges in implementing structural reform, it should be accompanied by more supportive near term fiscal policy where appropriate and provided there is fiscal space.

In Ankara in September 2015, G20 Finance Ministers and Central Bank Governors recognised that monetary policy alone cannot lead to balanced growth. In Shanghai in February 2016, Ministers and Governors stated that they would use all policy tools — monetary, fiscal and structural — to achieve G20’s goals of strong, sustainable, and balanced growth.

The implied hope is that governments will individually take the initiative to do more domestically. But beneath the impressive-sounding statements, finance ministers have done little to lift pressure off central banks, and not much to assure financial markets their governments actually have the political will necessary to advance substantive structural reform, especially given this has proved near impossible in recent years.
The global policy mix has, if anything, tilted more towards monetary policy over the since G20 Finance Ministers and Central Bank Governors’ statements in September 2015. Since the US Federal Reserve lifted interest rates in a much anticipated move last December, all the action has been the other way. The Bank of Japan has launched negative interest rates and the European Central Bank is on course for more aggressive monetary easing. Speculation is rising about further monetary policy easing across multiple G20 nations. This could have consequences for longer-term financial stability.

A crucial way to take pressure off central banks is for fiscal policy to take up more of the slack. Former US Treasury Secretary Robert Rubin has argued that the fundamental question for the globe’s economic future is whether elected leaders around the globe, primarily legislators, will finally move forward on fiscal issues, public investment, and structural reform. The G20 needs to demonstrate more political will.

The G20’s preoccupation for structural reforms in recent years has run up against Jean-Claude Juncker’s famous refrain that ‘We all know what to do, we just don’t know how to get re-elected after we’ve done it’. So it seems that part of the solution may need to be for further demand support from countries that have the fiscal space, a topic that has been highly challenging in the G20 context, given that in recent years G20 members have been unwilling to explore fiscal stimulus because they were fixated with fixing their budget and debt positions.

Estimates of fiscal space are highly contestable, although the first chart in a recent IMF staff discussion note provides an interesting indicator of the relative fiscal position of various countries. The paper argues that reducing debt in the ‘green area’ – an area that includes many advanced G20 countries – are likely to be normatively undesirable as the costs involved would be larger than the resulting benefits.

Ahead of the G20 Shanghai meetings, there was a broad chorus of economic experts and commentators advocating for the G20 to place fiscal policy more prominently in its members policy mix, including from the IMF, the OECD, The Economist, members of think tanks, academia, and financial market analysts.

There is an inherent tension for the G20 in this space: actions to boost domestic demand are country-specific. The core question that the G20 needs to confront in areas of country-specific action is primarily political, not technical. To go beyond business as usual, the G20 also needs to focus on creative solutions that improve both the supply of bold commitments to boost growth and employment outcomes and also the demand for policy implementation from the citizenry within G20 member countries.

Demonstrating political will is one area where the forum’s design features limit the G20’s effectiveness. The G20 is not a treaty-based organisation and has no permanent secretariat or enforcement power, and reform actions depend on domestic political contexts. The G20’s strength continues to be in providing strategic leadership to international organisations, and providing political momentum to overcome roadblocks and advance truly global issues in international forums and institutions.

So the task of greater demand support is highly challenging, particularly in the absence of a crisis trigger to focus minds. There is no guarantee of success. But it is important to remember that the credibility of the G20 is ultimately linked to its ability to restore global growth on a sustainable basis. Amid increasing questioning of G20 relevancy, if the forum cannot demonstrate meaningful progress in China’s 2016 and Germany’s 2017 G20 Presidencies, then it will struggle to maintain the self-anointed title of premier international economic forum.

There is one train of thought that argues that the best thing that the G20 can do is provide an avenue for conversation among financial ministries on macroeconomic policy. Focusing more on aggregate demand as a route to a more balanced global macroeconomic policy mix then is actually the big picture, concrete, strategic message that needs to permeate around G20 ministries in 2017.

Success would be countries with fiscal space, including 2017 G20 host Germany, using that space, rather than waiting for further rounds of unconventional monetary policy stimulus, and at the same time risking little progress on necessary structural reforms and little to show in terms of growth and employment. But the message needs to be carefully caveated – boosting demand is not to be a substitute for structural reform. Rather, actions should be targeted at complementing the passing of reform and in investing in quality investment projects.

Given the G20’s strength in providing strategic leadership and political momentum, it is natural to look for concrete, actionable suggestions for international organisations. But as previously noted, this is a matter of political will, and not technical advice. For example, there are the IMF Article IV consultations, national budgetary documents, country development plans, World Bank Debt sustainability assessments, and regular IMF, OECD, World Bank and FSB analyses on a regional or global basis. And this is just the start of available advice. We can talk about need for closer links between good advice and policy, but this comes up against long-standing discussions about the traction of...
international organization advice. It goes to the heart of the G20 as a forum dealing with economic issues. G20 countries have to want the G20 to succeed in its ambition from strong, sustainable and balanced growth and take responsibility for that domestically.

In a highly constrained space, the G20 has turned in recent years to incremental change in its mutual assessment and peer review process, first through Australia’s 2 per cent growth strategy which focused attention on beneficial structural reform actions and the regular reporting of progress towards this goal, and then on Turkey’s focus on implementation and a process to further enhance G20 accountability. Macroeconomic cooperation outside a crisis is hard, and these efforts to improve cooperation should be acknowledged. There are two potential courses of action. One could be to abandon the mutual assessment process entirely, as an exercise that depends on country specific action. This would be effectively raising a ‘white flag’ on a G20 focus on fiscal policy. The other is for Germany to look to make further process improvements Progress will be incremental. David Lipton’s remarks at the G20 in Korea in 2010 that the ‘G20 is trying to do what the IMF has failed to do over 50 years’ are worth remembering. Ultimately a process of naming and shaming great powers is of limited effectiveness. But the G20 can do more to engage citizenry in the process. This means greater transparency; greater public scrutiny of nominated actions from G20 leaders, finance ministers and central bank governors, and opening up country growth efforts and strategies to evaluation by independent experts.


OECD, OECD Global Interim Economic Outlook, February 2016

IMF, Global Prospects and Policy Challenges, surveillance note presented to G20 Finance Ministers and Central Bank Governors’ Meetings, 26-27 February 2016, Shanghai, China.