The G20 Growth Agenda: Implications for Emerging Economies

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INTRODUCTION

Thank you for the invitation to speak today.

The annual ICRIER Conference brings together important thinking about global economic governance and has had a strong focus on the G20 as that institution has evolved.

Last year, my colleague HK Holdaway spoke here about our ideas behind developing the 2014 G20 agenda. I think it is quite fitting for me to be here now to talk about how the agenda is progressing as we approach the September Finance Ministers and Central Bank Governors meeting in Cairns, and of course the Brisbane Summit in November.

[1] An abridged version was delivered.

[2] I am thankful to Stephanie Gorecki, Matt Crooke, Damien Dunn, David Drage, Blake Ford, Jessica Montgomery, Jyoti Rahman and Iyanoosh Reporter for helping prepare this speech.

Today I want to particularly focus on the relevance of the G20 agenda for emerging economies. My main point is that all G20 members, whatever their level of development, have much to gain from a successful G20 in 2014.

THE IMPORTANCE OF A SUCCESSFUL G20

Let me just take a moment to restate that from Australia's perspective, the G20 is the right group to deal with 21st century issues of economic cooperation and governance.

- It represents around five-sixths of the world economy, three-quarters of global trade, two-thirds of foreign direct investment and two-thirds of the world's population.
- Its membership is broad enough to be relevant, and narrow enough to be effective. It comprises 19 of the world's most 'systemically significant' economies plus the European Union. Importantly, it includes key advanced and emerging economies, making it a grouping that reflects shifting global economic weights.
- Its informal structure allows both flexibility and frankness in discussions.

And as a medium-sized open economy, a successful G20 is very much in Australia's national interest.

- It provides a mechanism for us to understand and even shape spillovers on our own economy arising from development in key economies.
- It enables us to be part of the development of key international standards and institutions, which means our national circumstances can be taken into account.

- It contains Australia's key bilateral partners, including the large emerging economies in the Asian region. I believe that participating in such an important and focussed forum has deepened all of those relationships, including with India.

Hence, the G20 ticks all the boxes in terms of maximising economic outcomes for Australia and furthering important international relationships. I suspect the same is true for India.

A FOCUSSED AGENDA

During Australia's G20 Presidency, we have sought to focus discussions on two key themes.

1. Promoting stronger economic growth and better employment outcomesthrough unlocking private sector-led growth, particularly through investment and trade.

2. Building a more resilient global economy that is able to better deal with threats to global stability. This includes ensuring the governance of international institutions isadapted for the 21st century, and hence is more effective.

This focus was essential. The G20 is at somewhat of a turning point. Its agenda had become large and unwieldy, which risks reducing its effectiveness.

And more than five years after the crisis there is a need for decisive progress on both growth and resilience. This requires the full attention of the G20, from Leaders down.

The global economy continues to deal with legacy issues from the financial crisis that unfolded at rapid pace almost six years ago and left the deep scars of poor growth and financial fragility.

At the same time, the G20 must focus on issues of the future. All members are looking to secure new sources of strong, sustainable and balanced growth to secure future prosperity and development. And we need to deal with new 21st century issues like tax cooperation, energy governance and refreshing our understanding of the vital role of trade.

This agenda has been strongly supported by all G20 members, advanced and emerging. Indeed one of the pleasing by-products of focus has been the lessening of the relevance of these distinctions. We have also introduced innovative formats to promote closer engagement and inclusive discussion between Finance Ministers and Central Bank Governors, and ultimately Leaders. In doing so, we hope to leave the G20 a strengthened and more mature institution.

THE SYDNEY GROWTH AMBITION – THE RIGHT RESPONSE TO CURRENT CHALLENGES

At their February meeting in Sydney, Finance Ministers and Central Bank Governors committed to work together to 'shift the dial' on growth by committing to undertake policy actions to boost their collective GDP by more than 2 per cent by 2018.

This was based on work from international organisations suggesting that this objective was in our reach with ambitious but realistic growth policies. These include, policies to increase the quantity and quality of infrastructure investment, policies to increase domestic competition and facilitate trade, and policies to improve the way labour markets function and increase the economic participation of vulnerable groups.

Let me elaborate on why we believe this is the right response to current challenges.

The global recovery remains relatively weak, and has struggled to generate a self-sustaining recovery. While there are some positive signs that the US recovery is gathering pace, growth on the whole in advanced economies has disappointed. There has also been a marked slowdown in emerging market economy growth, due to both cyclical and structural factors.

And the world economy is still operating at well below potential. That is, a sizeable gap has opened up between where global output is today, and where it would have been if full employment had been maintained. Compared to where global output might have been if the pre-crisis trend had continued, the global output gap may be as large as 8 per cent.[3] Even allowing for some of the excesses in the pre-crisis period there is no doubt that we have significant ground to make up.

This has a human cost. Unemployment and underemployment are still too high in key advanced economies, and the development aspirations of emerging and developing economies are not being met.

Ultimately, strong, sustainable and balanced global growth will be determined by the productive capacity of our economies. This is why it is important that we make up lost ground not only by expediting the recovery but also by trying

[3] The global output gap is measured against a counterfactual growth path for global GDP based on the April 2008 WEO projections.

to lift the productive capacity of our economies. The Sydney growth ambition aims to do just this.

And by reforming together, the whole is greater than the sum of the parts. We all benefit from positive spillovers from other countries undertaking structural reforms. Indeed, analysis by international organisations suggests that one third of the estimated boost to world output in the medium-term comes from positive spillovers between members.[4] These spillovers, along with the sense of common purpose flowing from a unified international effort, can help with the difficult task of achieving structural reforms.

These considerations alone would suggest an ambitious, collective growth aspiration is warranted. However, the task of generating more sustained growth is even more urgent. It is required to ensure a faster transition to more balanced and sustainable macroeconomic settings.

In particular, we need to take the pressure off monetary policy to carry the recovery in key advanced economies.

Since late 2008, we have seen an extraordinary reliance on monetary policy to support demand, kick start growth, and close the output gap. I believe the use of extraordinary monetary policy responses has by and large been the right course of action for the crisis-hit economies. And Japan is still escaping deflation, while the Eurozone is facing new deflationary risks, suggesting a need to consider the full range of policy instruments in those jurisdictions.

However, there is wide recognition, including in the G20, that sustained low interest rates and extraordinary measures carry risks, and these cannot be fully

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[4] *Macroeconomic and reform* priorities, prepared by IMF Staff with input from the OECD and the World Bank (available at www.g20.org).

mitigated by complementary measures such as macroprudential policies.[5] These risks include those arising in financial markets from the ‘search for yield’, and from potential volatility in international capital flows, including those arising from difficulties in predicting transition paths for policy.

These capital flows are particularly pertinent to emerging economies and, in a different way, for capital importers such as Australia.

Hence, Ministers and Governors in Sydney agreed that a concerted effort across the G20 to introduce growth-enhancing reforms was the appropriate response to current macroeconomic circumstances.

In the advanced economies, concerted structural reform cancreate the right environment where monetary policy can transition more rapidly to more normal settings. Structural reforms can increase profitability, providing a sounder long term basis for asset values. And reforms which increase quality infrastructure investment can assist with much-needed demand and international rebalancing, while increasing productive capacity.

A world where economic growth and asset pricesare driven by fundamental factors such as productivity, technology, demography and comparative advantage is in the best interest of advanced and emerging economies alike.

[5] So called macroprudential policies can address risks emerging in particular financial markets, complementing monetary policy directed at economy-wide objectives. However, we have a limited track record in implementing these policies, suggesting the desirability of taking pressure off monetary and financial policy responses through comprehensive approaches to generating growth.

STRUCTURAL REFORMS CRITICAL TO THE GROWTH ASPIRATIONS OF EMERGING ECONOMIES

So the emerging economies have a key immediate interest in the achievement of the Sydney 2 per cent growth ambition in terms of generating a stronger global recovery and reducing macroeconomic risk.

Many emerging economies are, however, recognising the centrality of such reforms for achieving their own long term growth aspirations.

The rapid economic growth of this group of countries is a remarkable story, and one of the most important economic developments to occur in recent history. Yet after a period of high growth, the economic performance of some emerging economies has been disappointing of late. This growth slowdown is occurring in the absence of balance of payments shocks such as the ones that were more common in the past. Questions are being asked as to whether some of these countries are at risk of falling into the so-called middle income trap.[6]

Avoiding that trap is, however, easier said than done. The World Bank estimates that of 101 middle-income countries in 1960, only 13 became high

[6] The central thesis is that during the initial stages of development low-income countries compete in international markets by producing labour-intensive, low-cost products using imported technologies. Large productivity gains can be achieved initially through the reallocation of labour from low-productivity agricultural sectors to higher-productivity manufacturing sectors. Once these countries reach a middle-income level, the pool of underemployed rural workers drains, wages begin to rise, which erodes competitiveness. Productivity gains from sectoral reallocation and technological catch-up are after a time exhausted. Wages then stagnate (or get trapped) between $16,000 to $17,000 (in constant 2005 international prices), hence the term 'middle-income' trap (Eichengreen, B, Park, D and Shin, K, 2011, 'When Fast Growing Economies Slow Down: International Evidence and Implications for China' NBER Working Paper 16919).

income by 2008.[7] A comprehensive suite of growth-oriented policies can assist in avoiding the risks of a structural slowdown.

Many key emerging economies are in the process of implementing wide-ranging reform programs, including in the areas nominated for action in Sydney. Indeed, the Indian authorities have emphasised this is the right response to the recent structural slowdown experienced here. China and Mexico have also announcedcomprehensive reform programs.

This is why the Sydney growth ambition has struck a chord across the G20 membership. And it has contributed to a large improvement in the quality of discussion on these structural policy issues this year. There is a wide recognition that we are truly all in this together.

THE COMPREHENSIVE GROWTH STRATEGIES

The mechanism for delivering this growth ambition will be the presentation of comprehensive growth strategies to the Leaders' summit in Brisbane in November. We are looking for specific country policy commitments to which we can hold each other accountable. Taken together, the comprehensive growth strategies are an opportunity to demonstrate that the G20 means business.

They provide an opportunity for the G20 to contribute much needed business and consumer confidence by showing a determination to improve growth potential and contribute demand.

[7] These economies include Hong Kong SAR (China), Japan, the Republic of Korea, Singapore, and Spain (Agenor P.R, Otaviano C, and Jelenic M, 'Avoiding Middle-Income Growth Traps', *Economic Premise* , Number 98, World Bank, November 2012).

One of the areas we are looking for tangible commitments is in terms of measures to improve investment, which remains well below pre-Crisis trends—by as much as 18 per cent in the G20 according to some estimates.[8] In particular, we would like to see a boost to infrastructure investment given its potential to boost productivity. All G20 countries are determined to find ways to increase the quality of infrastructure investment, and the opportunities for private sector involvement.

This is an agenda that chimes with members at all levels of development, and has particular resonance in the Asian region given the large infrastructure gaps here.

Fundamentally, G20 countries need to focus on improving our domestic investment environments for private sector investors. And we need to improve the quality of public investment, as well as opportunities for public and private collaboration. And, in the context of restoring our public finances, we need to rebalance our fiscal spending from current to capital expenditures.

We know there is demand, and we also know that private capital is waiting for the right investment opportunity. More often than not, the barriers to greater investment are within countries, and it is not the lack of funds *per se* that inhibits infrastructure investment. Rather, key inhibitors include unfavourable regulatory conditions, financial regulations, a lack of depth in long-term financing markets, constrained public investment, and a lack of capacity to plan and deliver projects.

[8] *Macroeconomic and reform priorities*, prepared by IMF Staff with inputs from the OECD and the World Bank (available at www.g20.org).

Long term investors require a degree of certainty to invest over a 20 or 30 year period. They get this through policy and regulatory frameworks within countries that are sound and well accepted. Governments can assist by providing the investment community accessible information and transparency of processes, so that investors can effectively assess the inherent risks around infrastructure projects.

In addition to member actions to improve our investment environments, the G20 is working to develop a package of collective measures. These actions are essentially aimed at reducing the cost of infrastructure investment by improving information available to markets and governments. We need to consolidate data on bankable projects and increase that pipeline. Greater standardisation of documentation and approaches can also assist in developing infrastructure as an asset class and enhancing the flow of institutional investment.

The Australian Presidency is interested in the G20 developing a mechanism with dedicated resources and technical expertise to coordinate and give additional impetus to this work. The B20 has also called for the development of a 'knowledge hub' to enhance public and private sector infrastructure performance.

These actions will complement the G20's focus on enhancing support for infrastructure investment in the World Bank and the regional development banks.

This investment agenda is shared across the G20. My own Government has placed enormous emphasis on lifting infrastructure investment.[9]

And I see the Indian Government has a strong emphasis on building infrastructure and improving the investment climate for businesses in the recent Union Budget.

But investment is not enough to generate growth.[10] It needs to be complemented by other actions across the G20 to generate private sector sources of growth, and in particular actions to enhance domestic competition, free up trade movement and improve labour markets.

One area that warrants attention is improving the participation of vulnerable groups in the economy. Female labour force participation is much lower than men's in many countries.

In part, this reflects cultural preferences but it also reflects economic incentives. We should not allow perverse economic incentives or a lack of institutional support to undermine a significant reservoir of untapped productive potential in these economies.

This is going to become particularly important in coming decades, as population ageing places downward pressure on labour supply in many countries including some emerging countries. This will undeniably have material implications for living standards, economic growth and public

[9]The Australian Government is investing in an Infrastructure Growth Package which includes reforms aimed at increasing investment in infrastructure, by both governmentand private investors. Several policy measures will add to infrastructure investment by: unlockingfunds from State-owned assets and prioritising investment in new infrastructure; improving projectprioritisation, selection and coordination; and removing ineffective regulation that is unduly hinderingproject delivery and private participation.

[10] Warner, A (2014), 'Public Investment as an Engine of Growth', IMF Working Paper no. 14/148.

finances. An increase in female labour force participation could help to mitigate these effects.

MACROECONOMIC COOPERATION

The development of comprehensive growth strategies will bring enhanced focus on structural policy responses to current economic conditions. This will complement and extend the traditional G20 focus on macroeconomic cooperation.

The G20 has shown that it works best when it works together to a common purpose. This was acutely evident in 2008 with the onset of the Financial Crisis. As bad as it was, the Crisis would have been much worse if not for the leadership and actions taken by the G20, which moved quickly to help stabilise financial markets and support the global recovery.

The G20 is now facing different issues that are challenging macroeconomic cooperation. As I have indicated above, handling the various monetary policy transitions is an immediate challenge.

We have seen significant progress on this front throughout the year. For the first time the G20 has acknowledged that monetary policy should be set in a way that is mindful of global impacts. At the same time there has been a common recognition across the G20 that the primary response to international fragilities is for G20 members to ensure domestic economic policy settings are sound.

These are simple enough sounding words, but for various reasons they would have been difficult to say a year ago. Their inclusion in public communication reflects a new more cooperative tone within the G20 discussions on macroeconomic issues.

And of course, the integrated way in which the G20 is seeing macroeconomic and structural policies, through the growth strategy process, is itself a form of macroeconomic cooperation.

Cooperating on issues such as this which go to the heart of national sovereignty is always difficult.However, I believe the G20 has made good progress this year in this area.

RESILIENCE

Of course a focus on growth must go hand-in-hand with achieving resilience. Our efforts to boost growth could be in vain if we do not also make the global more resilient to deal with future shocks.

The financial regulatory response to the global financial crisis has been a key G20 agenda item.

The focus has naturallybeen on responding to the issues laid bare in the financial shocks emanating from North Atlantic economies.The effectiveness of this response matters for all economies.

Australia, in common with many emerging economies, was an ‘innocent bystander’ in the Crisis – we share an interest in arrangements that reduce the risks, and the severity, of financial shocks emanating elsewhere. We have all also learnt more about what can go wrong in financial markets —from undercapitalised institutions, poor bank resolution regimes and the like — and hence all have an interest in sensible global standards.

This year, under Australia's presidency, the G20 is focussed on delivering on the core commitments made in response to the vulnerabilities exposed by the Crisis.[11] This is not an easy task and there is a considerable amount of work to do, much of which is taking place within the Financial Stability Board (FSB).

A comprehensive policy response will support financial stability. It will also provide a more certain and stable environment in which market participants can operate.

Of course, this does not in any way mean the task of financial stability is complete. The effort moves squarely to implementation and monitoring, and a constant scanning of potential emerging risks as financial markets adjust, including to the regulation.

The global financial architecture will become increasingly important in steering financial regulation in the transition from crisis response to steady state of operation. Hence it will be important to ensure the FSB's representation and processes ensure it remains effective, inclusive and attuned to global issues and vulnerabilities that reflect the diversity of its membership. Mechanisms for monitoring implementation and any unintended impacts also become important.

The G20 has also been looking to emerging issues that will be important for the future resilience of the global economy.

Well-functioning domestic and international tax systems are essential to domestic economies, global trade and maintaining community and business trust in governments.

[11]These are building resilient financial markets, ending too-big-to-fail, addressing shadow banking risks, and making derivatives markets safer.

We are making good progress on what is in many ways unprecedented work. The G20-OECD project has meant this is happening in the context of a wide set of countries, the first time both key advanced and emerging economies are discussing these issues as equal partners.

There is significant political momentum behind the G20's tax agenda and there are high expectations that we will start to deliver tangible actions to combat tax avoidance and evasion this year.[12]

Another theme of the G20 has been modernising global governance to better match the current distribution of economic strength. We see this as the final part of the resilience agenda providing emerging economies with a greater say in global institutions is critical to the legitimacy and effectiveness of these institutions.

Progress on this item has been uneven. On the plus side, the emergence of the G20 as the pre-eminent forum for global economic cooperation itself provides an importantvoice for emerging economies. At the same time the G20 must continue to maintain pressure to progress IMF reform. And Australia is also interested in commencing discussion about appropriate energy architecture for the 21st century.

[12] In 2014 we aim to:

- make substantial progress under the ambitious two year Action Plan on Base Erosion and Profit Shifting , by delivering against 7 of the 15 action items.
- set out a clear pathway for implementation of the Common Reporting Standard; and
- work with developing countries to ensure they benefit from efforts to strengthen our tax systems.

CONCLUSION

I have sought to demonstrate that this year's G20 agenda is relevant for the whole membership, and that emerging economies have much to gain from successful outcomes across that agenda.

All members will gain from a concerted effort across the G20 to remove structural barriers to growth. The Sydney 2 per cent growth ambition has potential to galvanise action across the G20, to the benefit of the global economy. We have the potential to make important progress in improving global economic resilience.

More generally, a focused agenda built around common interests and inclusive engagement is strengthening the G20 as the premier body for global economic cooperation.

I believe this is good for the global economy, and is strongly in the interest of Australia and emerging economies such as India.

Thank you.