INNOVATIONS IN GLOBAL GOVERNANCE: AUSTRALIA'S G20 PRESIDENCY

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A Special Presentation to the Centre for International Governance Innovation (CIGI) and the Institute for New Economic Thinking (INET)

Delivered by Dr Martin Parkinson PSM | Secretary to the Treasury | 8 October 2014

*****Check against delivery*****

Thank you for the invitation to speak. The aim of today is to give you a sense of some of the achievements under Australia's presidency of the G20 this year. Some of these achievements relate to policy outcomes, some may be considered as process. While the latter may be considered secondary to the key policy outcomes, they represent a significant change in the way that the group operates and go to the future effectiveness of the institution.

The G20's formation in the late 1990s, and its subsequent elevation to a Leaders' Summit format after 2000, was in response to the Asian and global financial crises. These crises highlighted the strong connection between financial and macroeconomic issues, the impact of spillovers and the importance of macroeconomic coordination and cooperation.

When we started thinking about Australia's chairing of the G20, we were conscious that the global economy had not escaped the shadow of the GFC and focus had been lost on some core elements of the G20 agenda. We also believed that high quality engagement between Leaders, Ministers and Central Bank Governors was critical to achieving cooperation, and that without this the G20 could not play its role as an effective "steering committee" for the global economy.

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In preparing this presentation, we have benefited from comments and suggestions by HK Holdaway , Kerstin Wijeyewardene, Jyoti Rahman, Stephanie Gorecki and Pauline Halchuk.

In short, coming into 2014 we recognised the G20 was at a cross roads – if it was to continue to deliver it needed to deliver both substantive outcomes and to give Leaders a reason to *want* to attend. We concluded that change was needed to both the *focus* and *operation* of meetings.

In thinking about how we could improve the focus, we concluded that there were some simple actions that could have a significant impact.

First, there was a need for concrete, practical outcomes that would generate tangible benefits.

Second, we needed to focus the agenda on policies around which we could build a narrative – one that explained how the G20's work was building a better place for everyone. Flowing from this, we concluded the agenda needed to be simplified to a handful of linked policy outcomes that would both satisfy the objectives of Leaders and be understood by the public.

Finally, we believed that we had to incentivise countries to action by raising the cost of failing to deliver. To do this, we needed a high profile and transparent objective against which the G20 could be measured and judged.

We were also mindful that we needed to create an environment that would facilitate productive, honest discussions and where Ministers and Governors could freely exchange views and listen to each other. This led us to thinking about how best to change the operation of the meetings.

We adopted practical and tangible changes to meeting formats to promote genuine discussion. For example, in the Finance track we introduced a Ministers and Governors' only discussion on the politics of reform. Interestingly, they had rarely before talked about *how* to do things, having tended instead to focus on the *what*.

We made room to build personal relationships, such as through retreats and working dinners, which would allow Finance Ministers and Central Bank Governors to talk peer-to-peer without the filters of assorted bureaucrats.

We sought briefer communiques – two pages – so that the work of the G20 could be better understood and more easily accessible to the broader community, not just those 'in-the-know'.

We structured our working relationships with business and community representatives, such as the Business 20, Civil 20, Labour 20, Think 20 and Youth 20, and ensured they understood that they should complement our agenda if they wanted to maximise their impact. As a result, engagement groups have been an integral part of the G20 policy formulation process and added important momentum to the reform agenda.

A focused and linked agenda

We also wanted to take an integrated approach to the year. We wanted the year to build to the Leaders' Summit, with each meeting moving us further down that path – this required a clear sense of the end-point from outset.

To ensure we were operating in a coordinated, integrated manner, we brought the Finance and Sherpa tracks of the G20 closer together by linking discussions of different working groups and, for the first time, holding a joint working meeting of Finance Deputies and Sherpas[2].

At one level you could see this as a simple process change. But its rationale was to ensure all elements of the agenda were clearly linked – to ensure that we had a growth target that was consistent with growth strategies; and that our work on trade, investment, competition and employment were linked in ways that were reflected in those growth strategies.

[2] Sherpas are the personal representatives of Leaders.

We also resisted putting new issues on the table. Instead we focussed on making headway on the issues which the G20 had been debating for some time.

This led us to two priorities:

1. The growth agenda – promoting stronger economic growth and better employment outcomes, particularly through boosting investment, trade and competition. Given the global economic outlook, we needed to focus on both cyclical recovery and medium term growth, and on both the demand and supply drivers.

2. The resilience agenda – building a more resilient global economy that is better able to deal with threats to global stability. This includes ensuring the financial system is safer, safety nets are well resourced, that governance of international institutions is adapted for the 21st century, and that citizens have confidence in the integrity of our tax systems.

The importance of macroeconomic cooperation

The global financial crisis exposed regulatory weaknesses and inconsistencies in financial sector regulation.

Financial institutions were over-leveraged and unable to absorb losses or be easily wound up – resulting in government bail-out and a backlash against 'too-big-to-fail'. The crisis also exposed structural and fiscal weaknesses in key advanced economies. Unprecedented monetary policy easing was appropriate, but more was required to put the global economy on a firm recovery path, yet fiscal policy, in many countries, was close to its limits.

Any remaining flexibility, in either monetary or fiscal policy, needed to be used to the maximum extent to support recovery. Easy monetary policy triggered risk-taking behaviour. There were concerns of mispricing of risk, and potential for sudden reversal including in international capital outflows from emerging market economies. At the same time, markets were reluctant to support efforts to stimulate activity through easier fiscal policy due to a poor track record in many countries, and high sovereign debt levels.

The heart of the G20 is macroeconomic cooperation. It is the first thing Ministers and Central Bank Governors talk about when they meet, and is a key part of the Leaders' discussion. The Australian presidency set out to deepen the G20's macroeconomic cooperation this year and we have succeeded to a significant degree.

Discussion of fiscal and monetary policy settings has been constructive and engaging. Finance Ministers and Central Bank Governors have made important progress identifying individual and collective responsibilities with less finger-pointing.

If you look closely at the Finance Ministers and Central Bank Governors' communiques you will see that important progress has been recorded. For example, you will see agreement about 'being mindful of global impacts' of monetary policy settings, and giving emphasis to the importance of the full range of domestic policy responses to promote resilience, underpinned by strong global safety nets. These fairly innocuous sounding words represent a new tone within the room.

We have made real progress, though further work remains.

The G20 growth agenda

One of the key outcomes of the G20 this year has been to set an outcome for growth.

In Sydney, Finance Ministers and Central Bank Governors agreed to develop concrete measures over the year to lift investment in infrastructure, boost trade, enhance competition and grow employment; areas with the greatest potential to lift growth. We laid particular emphasis on creating the right policy conditions to foster greater private sector engagement.

In Sydney, in an unprecedented move, Ministers and Governors agreed to an ambitious goal of lifting G20 GDP by more than 2 per cent above the implied trajectory by 2018. It is fair to say that there was some cynicism about this target at the time, including from some officials. Indeed, in a number of countries, Ministers embraced this target over the nervousness of their officials. Yet in Cairns, members delivered strategies that could achieve 1.8 percentage points of additional growth, and agreed to see what more could be done to reach the 2 per cent target.

How is the growth agenda related to the issues of macroeconomic and financial cooperation?

First, and most obviously, many of the gains in concerted structural reform come from positive spillovers – so this is very much a G20 issue involving cooperative policy action. Just as important are the 'policy spillovers' that come from sharing experience with policies – Ministers and Governors learning from each other's experiences.

Second, with monetary policy stretched and limited room to move on fiscal, we need other policies to take the pressure off these instruments. That means policies to both lift demand in a prudent way – in particular quality infrastructure – and remove supply constraints to growth. This can assist in a more balanced approach to growth, and more balanced and sustainable macro policy settings.

Third, with asset valuations stretched in many cases, and evidence of excessive risk taking, structural policies that lift long-term growth potential can help resolve this situation in a more favourable way. This situation cannot last – either underlying asset values and risks will reassert themselves in potentially disruptive ways, or we can lift the underlying profitability and flexibility of our economies.

With the worsening of the growth outlook in Europe, there has been a distinct shift in the debate – with more emphasis on the need to implement structural policies that impact on both demand and supply. This has rekindled a useful discussion about the role of fiscal policy, following the stand-off that has characterised recent years. And so in Cairns there was renewed focus on how the composition of budgets could be altered to facilitate more 'growth friendly' consolidation.

Of course, the focus of cynicism has now shifted to whether the growth agenda commitments will ever be implemented. And while it is reasonable to ask that question, it also needs to be recognised that, in Cairns, Ministers and Governors also agreed to monitor and report on implementation – a key part of "raising the cost of failure" mentioned earlier.

The agenda for building global economic resilience

An important part of the financial regulation agenda this year has been to give a final push to completing key aspects of the core reforms that responded to the causes of the global financial crisis. The G20, through the Financial Stability Board (FSB), has delivered on:

1. **Building more resilient financial institutions** through the development and implementation of Basel III standards.

2. Addressing '**too-big-to-fail**' with the release of a proposal for consultation to improve the loss absorbing capacity of global banks.

3. **Reducing shadow banking** risks by largely finalising the policy framework for shadow banking and committing to monitoring for systemic risks emerging in that sector.

4. Making **derivatives markets** safer by improving transparency and reporting.

The policy task on these issues has now largely been delivered.

The important work now is to ensure this large policy agenda is implemented. It is, though, equally important to monitor new risks as they emerge – as risks will inevitably occur in different areas, in part due to the response to regulation itself.

This highlights the need for adaptive bodies that bring together cooperation on financial and macroeconomic issues. Individual countries have largely put these in place, such as the Council of Financial Regulators in Australia. The G20, along with the FSB, are critical institutions as they bring together key policy makers with international responsibility for macroeconomic and financial policy.

Reform of international institutions

This links with the final important area of action for the G20, which is reforming and keeping current the international institutional architecture.

I expect some important progress by the Summit in improving the representation of emerging market economies in the FSB, which is important given the evolving international economic and financial reality.

Obviously there is disappointment that IMF reform has not progressed, and the stalemate here is a significant blockage in moving toward in a more effective and legitimate global architecture.

The G20 has agreed this year to look at alternative options to improve IMF representation if the United States does not pass the 2010 reforms by year-end. Similarly, the group is working on other fronts to improve international institutions. We have pushed ahead efforts to modernise the **international taxation rules**. We are emphasising the importance of the **international trading system** and have started a discussion on **energy governance**.

Similarly, there has been close cooperation between the Finance and anti-corruption streams which are working to strengthen investment environments by improving transparency of the public sector and beneficial ownership of commercial entities.

Concluding comments

By way of conclusion, it might be instructive to make some points directly relevant to the conceptual issues you have discussed today – that is, where the G20 is at with macroeconomic and financial cooperation.

There are general 'constants' in this debate that, while they have sharpened with the extraordinary measures take in response to the crisis, are still essentially recognisable in debates of previous decades. That is, the focus of countries on domestic macroeconomic objectives and the tension between these and impact on other economies. However there are several new features of the debate which represent distinct departures from the 'Washington Consensus' of earlier times.

There is widespread agreement on the need for firm and comprehensive financial market regulation but regulation that balances the focus on stability with the imperatives of growth.

There is recognition that targeted capital controls, sometimes referred to as macro-prudential policies, are sometimes appropriate, especially for emerging market economies, and that a framework to assist policy makers to deliver such controls is valuable.

While there is agreement, for example, that exchange rate flexibility can be an important adjustment mechanism, there is now more acceptance of the validity of intervention in periods of significant volatility.

The importance of international safety nets has been emphasised, and the world community has expanded them considerably.

But, as discussed, there is a useful debate going on about how to effect macroeconomic cooperation.

This needs to deepen. We need to improve our practice of macroeconomic cooperation so countries have more confidence in others' policy settings, and are better prepared for possible shocks. We need to deepen and facilitate greater sophistication in the discussion of regulatory responses such as macro-prudential policies and their efficacy in assisting macroeconomic management – this is only likely to come with more experience.

With respect to global safety nets, countries are still keeping large amounts of self-insurance (inefficiently high reserves) due to a lack of trust in, or willingness to use, international mechanisms. We need to think hard as an international community about whether we can do better in overcoming these concerns.

We also need to address the appropriate long-term size of the safety net. This is an important issue in light of likely ongoing fragilities in advanced economies, and the growing financial and economic importance of emerging economies which have traditionally been the source of financial shocks. The transition of the Chinese capital account in a more open direction is a game changer here.

While there are enormous benefits from these global shifts, they suggest to me the need to permanently maintain a higher global safety net than pre-crisis. The size and composition of the safety net are important issues for future discussion.

Hopefully, the improved macroeconomic cooperation evident this year can be a good foundation for taking these difficult debates further.

Thank you.