Envisioning 2016: G20 Summit in China

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Core Agenda: Coordinating/Advancing Globally Agreed upon Goals

- Long standing goal: Maintaining sustainable and inclusive growth
- Implementing new goals of 2015:
  - Sustainable Development Goals (New York)
  - Climate Change (Paris)
  - Finance for Development (Addis Abba)

I. Maintaining sustainable and inclusive growth

- Growth has been anemic: Great Malaise, New Mediocre
- Not a result of inexorable economic laws
- Result of policies, though in the context of changing technologies
  - Austerity
  - Growing inequality
  - Global imbalances
    - With asymmetric responses to surpluses/deficits
  - Low oil prices
    - Global effects arising again out of asymmetric responses

Explaining "new mediocre"

- Dysfunctional financial market
  - Unable to recycle surpluses
  - To intermediate between large pool of long term savers and long term investment needs
    - Partially because of its short term focus
    - Both before and after GFC low interest rates did not lead to more productive investments, but to asset price bubbles and markets mispricing risk
  - Helping create global instabilities—excessive private sector indebtedness
- Need for structural transformation in most countries around world
  - Markets don't manage such transformations well on their own

Diagnosis of the central problem

- **Lack of global aggregate demand**
- Combined with insufficient efforts in each country to support non-traded sectors
- Excessive reliance on debt, financialization
- More broadly, in large parts of advanced countries about a third of a century ago, there began a process of rewriting the rules of the market economy (redesigning tax structures, ill-thought out liberalization) that led to slower growth, more instability and more inequality—just the opposite of what was promised

Restoring global aggregate demand

- Setting a high price on carbon (following up on Paris) will induce investments to retrofit the global economy for climate change
  - A carbon tax would be the best approach: would raise needed revenue even as it redirects economy in right direction
- Increasing government spending, financed by taxes, will stimulate economy
  - Principle of balanced budget multiplier; with well designed taxes and expenditures, multiplier can be quite high
  - Environmental taxes and land taxes will help restructure the economy to create sustainable growth
  - So will government expenditures to promote structural transformation
  - Reformed tax structures (to eliminate corporate welfare, regressivity, distortions) can raise substantial revenue, improve economic performance, promoting sustainable and *inclusive* growth
- Other measures to increase equality will increase global aggregate demand

Global reforms

- Need new global reserve system
  - A global reserve system will reduce need for demand-reducing build up of reserves
  - Current system leads to biases towards surpluses
  - Weaknesses in reserve currency countries
- Need global coordination to reduce global imbalances
  - China's surpluses are in process of being reduced
  - But those in the Eurozone are increasing
  - Will need deep reforms in Eurozone
- Need better ways of recycling surpluses
  - New development banks (AIIB, NDB) move in the right direction
  - But reforms, expansion of World Bank, other MDBs stymied by the US

Supporting domestic demand

- Especially important as world moves to service sector economy, non-traded sector likely to be increasingly important
- Absence of *domestic* demand impairs supply
- Domestic demand is more than private *consumption*
    - Includes investment in environment, people, technology, infrastructure, making cities livable
- Much of this domestic demand will have to be *publicly financed*
- Need balanced approach to finance—debt vs. tax
- There will be **global spillovers** from countries supporting their own economies

II. Climate Change

Attention on short run problems has resulted in long run problems festering—most importantly climate change

- Investments to retrofit the economy for climate change would provide needed stimulus to global economy
- Environment and economic growth are *complementary*
  - Especially if we measure growth correctly
- A carbon price would simultaneously move the world towards a low carbon economy and provide incentives for more investment, increasing global aggregate demand
- And redirect research, away from labor saving innovation—exacerbating unemployment and inequality—towards pro-environment innovation
- Paris meeting was important in creating momentum, so business community realizes that in one form or another there will eventually be a price for carbon
  - Key investments (infrastructure, housing, buildings, power plants) are long term

III. Finance for development

Could simultaneously recycle surpluses, adding to global demand, and promote development, but there are three impediments

- Debt markets: no international framework for debt restructuring
  - Important initiative at the UN, supported by vast majority of countries
  - But US and some European countries arguing against *an international* "rule of law"
- FDI: investment agreements undermine the ability of countries to regulate
- Taxation of multinationals: international tax regime makes raising revenues difficult
  - Race to the bottom
  - BEPS agreement at G-20 left key issues unaddressed

IV. SDGs

- Meeting SDG's will require large scale investments, increasing global aggregate demand
  - Key issue is finance
    - Which is why the finance for development agenda is so important
- Among most important goals are inequality.
- Pro-equality reforms would lead to increased aggregate demand
  - Those at the bottom consume larger fraction of income than those at the top
  - Reducing reliance on monetary policy which has sometimes led to unsustainable growth, instability (in conjunction with excessive financial market liberalization)
- Higher growth in turn would lead to more equality
  - Virtuous circle

Measures to advance equality

- Global measures
  - Global agreement on tax competition, tax avoidance (*beyond BEPS)*
  - Coordinated expansion of global economies would generate more tax revenue, that could be used for inclusive-growth expenditures
    - Another virtuous circle
  - Global agreement on financial sector regulation
    - Recognition that excessive deregulation had led to instability
      - Instability had led to more inequality—vicious circle
    - Regulatory competition has led to a race to the bottom
      - Which is why global cooperation is required
    - Financial sector also source of much of global inequality
    - Some, but limited, progress in regulation

Coordinated domestic measures

- More progressive tax and expenditure policies

- *Rewriting the rules of the market economy* to make the economy more balanced, fairer would result in better distribution of market income, and faster growth
    - Inequality not just the result of market forces—markedly different levels of inequality in economically similar countries

- In *virtually all* countries, raising taxes on land and other natural resources ("inelastically supplied") would raise substantial revenues, increase growth (less diversion of savings to unproductive uses)

- Lowering taxes on corporations would *not* increase investment, since most investment is debt financed, and interest is tax deductible (lowering taxes raises *net* cost of capital, and thus discourages investment!)

- China also taxes globally (like the U.S.) but should now take strong actions to avoid the tax avoidance practices in the U.S. and elsewhere (e.g., by booking profits in Ireland and not repatriating at all).

- China needs to implement a comprehensive integrated income tax that is progressive.
    - Currently, capital income taxed relatively lightly (dividends are subject to a flat tax of 20% and capital gains are in fact hardly taxed at all).

Beyond austerity

- Rethinking budgetary rules and frameworks
  - Capital Budgeting
    - Balance sheet perspective especially important when cost of funds is low and returns to investments are high
  - Stabilization Funds, especially for natural resource economies
    - To manage real exchange rate, smooth consumption and investment
  - Using development banks to promote investment
    - If fiscal constraints still binding, use principle of balanced budget multiplier
    - If expenditures and taxes well chosen can be high
- Well designed taxes would also address key issues of instability, and environmental degradation (climate change)
- Balanced budget multiplier implies that raising taxes and spending in tandem stimulates economy

Key idea

- In a globally integrated world, what one country does has affects on others
- Global spillovers
- This is obviously true in the case of environmental policies
- But it is also true in the case of macro-economic policies

V. Reforms in the global decision making process

- Global economic integration has outpaced than of global political integration
- Whenever there are spillovers, externalities need for collective action
- But we have no good framework for doing so at the global level
- Global economic policy too often reflects power and special interests
  - Not necessarily focusing on areas where global cooperation and harmonization are necessary
    - Excessive harmonization of IPR rules
    - Harmonization on rules that reflect special interests, with insufficient democratic accountability—different from what might emerge from a more global democratic process
    - Especial concern that new trade agreements will impair ability of governments to perform essential regulatory functions in a democratic way
  - Focus is on harmonizing *down, to lowest common denominator*

G-20 should focus on reforms in global decision making process

- How to increase representativeness
  - Under-representation of small and poor countries
  - Important, even if they have little weight in global economy
- How to increase legitimacy
  - UN is the international body with global legitimacy
  - IMF has similarly more legitimacy within its remit
- Danger of "club" getting together to make decisions for all
  - Undermines credibility of other organizations
- Alternative: Global Economic Coordinating Council
  - Operating under the UN, IMF

Rethinking global decision making

- Variable geometry
  - Recognizing that it will be difficult to get close to unanimity on many issues
- "Coalition of willing" –for instance on climate change
  - With cross-border taxes to induce others to cooperate
- May not be able to get all to agree to new global reserve system
  - Again coalition of willing—advantages will induce others eventually to join
- Thinking carefully about where externalities are most important
  - Absence of collective risk bearing induces high level of savings, reduces global aggregate demand
  - Global rules favoring capital increase inequality, with adverse effects on global aggregate demand
  - Global instability creates inequality, leads to high savings, both of which contribute to deficiency in global aggregate demand

Concluding comments

- China's leadership of G-20 distinctive moment
  - China has provided leadership in the UN in making sure voices of less developed countries and emerging markets are heard
- Important that this be extended to economic matters
- World is at a critical time, with weak global economy
- In 2015, world reached consensus on major issues
- G20 should build in that consensus
  - Identifying areas where coordination, externalities, spillovers are especially important
- To advance common global goals of sustainable and inclusive growth for the entire world