THE AUSTRALIAN

Time to open up the world for business

HENRY ERGAS THE AUSTRALIAN NOVEMBER 15, 2014 12:00AM

Illustration: Eric Lobbecke Source: Supplied

FOUNDED exactly six years ago, the G20 is battling to prove its continued relevance. Yes, Australia has never hosted a gathering of world leaders as eminent as that taking place in Brisbane; but the question is whether the enormous effort and expense will ultimately enhance global prosperity.

The signs are not particularly encouraging. International cooperation is at its most effective when governments have an overwhelming interest in devising cooperative solutions to common problems and the clear political scope to do so. But with the leaders struggling to get their own houses in order, their willingness and ability to commit to growth-enhancing reforms is limited.

The political constraints are obvious. As well as inflicting a stinging verdict on Barack Obama's performance, the congressional elections have left him with little room for manoeuvre. While the climate deal with China confirms his penchant for grand gestures, Obama's ability to deliver is even lower now than it was at the 2010 G20 summit, when he loudly endorsed reforms to the International Monetary Fund hat congress still shows no sign of approving.

Yet the US President's position looks rosy compared with the leaders of the EU, which remains trapped in a crisis as existential as it is economic and social. Domestic concerns are also absolutely paramount for China, Japan and India, while it would be foolish to expect much joy from Vladimir Putin.

As a result, the Brisbane Action Plan, with its ambitious growth target and "practical actions to improve productivity and competitiveness", risks being no more effective than its immediate predecessor, the St

Petersburg Action Plan. And instead of progress in tackling structural obstacles to growth, it may be that the only agreements with real bite to emerge from this weekend's meeting are those imposing yet greater regulation.

Nor are those agreements, which cover financial regulation and international taxation, unreservedly good news. While there is a compelling case for better controlling the "globally significant" banks that are "too big to fail", the danger is that the measures being promoted by the G20 will not only stifle innovation but divert an ever greater share of financial activity into the "shadow" financial sector, where it is even more difficult to monitor and regulate.

As for efforts to prevent "base erosion and profit shifting" by tax-avoiding multinationals, the moral outrage in which they are cast should not hide the risk, noted by Tony Abbott at Davos earlier this year, of those efforts serving as an excuse for cash-strapped governments to collude in imposing inefficiently high corporate tax rates. It would be ironic were the primary outcome of this summit, held under the auspices of a government intent on stripping away red tape, a further rise in the regulatory burden. And it would also be disappointing, as the need for genuine structural reform is as pressing as it has ever been.

That much should be clear from the economic outlook. Although the US recovery continues to gather pace, there is considerable debate about whether the American economy can achieve annual growth rates of per capita incomes much above 1 per cent over the longer term. The prospects are even bleaker for the eurozone, whose economy is standing still, with 18 million people out of work and a youth unemployment rate of 23 per cent.

For sure, economic growth is stronger in the developing world; but there, too, a weakening is evident. Growth rates of per capita incomes in the emerging economies, which were of 6 per cent to 7 per cent annually in the period leading up to the global financial crisis, are trending to below 4 per cent.

And even China, which recorded an annual average growth rate of 9.4 per cent over the period from 1988 to 2013, is heading to a growth rate of about 7 per cent, while India (where average per capita incomes are still only $1500) faces serious constraints from deteriorating competitiveness, large fiscal and current account deficits and too high inflation.

Persistently slower, more uneven growth could make existing international imbalances even harder to sustain. The still-mounting tide of public debt in the advanced economies is a crucial case in point.

Merely in the five-year period from 2007 to 2012, the advanced economies' net debt rose by $US16 trillion (equivalent to about one year's entire US gross domestic product), pushing their total stock of public debt to about $US35 trillion. As a result, the advanced economies, which account for about half of global output, are now responsible for more than 85 per cent of the world's public debt.

So far, the emerging economies have played a key role in financing that debt, including by holding a large share of their foreign currency reserves (which exceed $US6 trillion) in American government securities.

However, it hardly makes sense for people in poor countries to bankroll the spending habits of their wealthier counterparts. And that is all the more so as providing those loans imposes high costs on the emerging economies, including in terms of losses on their holdings of advanced economies' debt as their own currencies appreciate.

But should the emerging economies' willingness to provide that financing decline, the advanced

economies' challenges in terms of cutting public spending, raising taxes or both will become even tougher and more urgent.

Structural reform is indispensable to address the threats that scenario poses. To begin with, without far-reaching changes to entitlement programs, it is difficult to see how the advanced economies can bring public expenditure under control.

For example, were per capita incomes in the US to grow at an annual rate of only 1 per cent, current entitlement spending would take the ratio of public debt to American GDP from 70 per cent today to nearly 90 per cent by 2024; and while that increase could be averted by raising taxes, the sheer magnitude of the tax hikes required mean that route is as politically hazardous as it would be economically costly.

At the same time, structural reform would lift growth rates, bolstering prosperity while contributing to fiscal repair. And the resulting growth dividend would certainly not be limited to the advanced economies.

Studies suggest, for example, that China and India could lift their productivity by 50 per cent simply by reducing to US levels the very large efficiency differences between their best performing and worst performing firms. The gains would be even greater for Latin America, where shifting resources more promptly from less productive to more productive producers would add one percentage point to the long-run growth rate.

As our own experience shows, trade liberalisation, which exposes domestic suppliers to greater competition, is among the best ways of ensuring those potential improvements in productivity are realised.

However, the Doha Round of global trade talks is stalled to the point of paralysis. Nor can it be resurrected without deep reforms to the World Trade Organisation, whose rules mandating what amounts to unanimity are poorly suited to a world in which the number of negotiating parties has increased from 23 at the start of postwar trade liberalisation to 160 today. With the Doha Round in limbo, the result has been a proliferation of regional and bilateral agreements that bring important benefits but risk Balkanising international trade.

Unfortunately, the G20 seem unlikely to secure progress on that front. For Australia, with its strong interest in a non-discriminatory, rules-based world system, that is a worrying prospect, as is the continued delay in implementing vital, now long agreed, changes to the governance of the IMF.

None of that is to dismiss the Brisbane Action Plan or the proposed infrastructure hub. Individual countries' pledges in the action plan can help maintain focus on the need for reform, while the hub will facilitate innovative funding of infrastructure investment. And neither is likely to do any harm, which is more than can be said for some earlier summits.

After all, the record of multilateral co-operation, especially on macro-economic policy, is decidedly mixed.

From Jimmy Carter's "locomotives" strategy at the 1978 G7 summit, which sought to force countries into unsustainable fiscal and monetary policies, through to the 1985 and 1987 Plaza and Louvre accords, which triggered the beginnings of Japan's asset bubble, and on to the poorly judged and even more poorly implemented fiscal stimulus that emerged from the inaugural G20 meeting in 2008, the history of

summiteering brings Edmund Burke's warning, that "they who truly mean well must be fearful of acting ill", sharply to mind.

Yet prudence cannot be an excuse for inaction.

Despite their diversity of beliefs and interests, the G20 leaders have a shared stake in getting economic growth back on track; and they know their people deserve far better than the current outlook promises.

But without credible engagements to open up markets, pursue fiscal repair and effect an orderly return to predictable monetary settings, our economies will not deliver the continued prosperity communities demand and legitimately expect.

If today's summit can help renew the reform momentum required to achieve its growth target, the G20 will have more than earned its keep.

×

Share this story

Facebook *(http://facebook.com/sharer.php?u=http://www.theaustralian.com.au/opinion/columnists/time-to-open-up-the-world-for-business/story-fn7078da-1227123610923&t=Time to open up the world for business)*
Twitter *(https://twitter.com/intent/tweet?url=http://www.theaustralian.com.au/opinion/columnists/time-to-open-up-the-world-for-business/story-fn7078da-1227123610923&text=Time to open up the world for business)*
LinkedIn *(http://www.linkedin.com/shareArticle?mini=true&url=http://www.theaustralian.com.au/opinion/columnists/time-to-open-up-the-world-for-business/story-fn7078da-1227123610923&title=Time to open up the world for business)*
Google *(https://plus.google.com/share?url=http://www.theaustralian.com.au/opinion/columnists/time-to-open-up-the-world-for-business/story-fn7078da-1227123610923)*
Email *(mailto:?body=http://www.theaustralian.com.au/opinion/columnists/time-to-open-up-the-world-for-business/story-fn7078da-1227123610923&subject=Time to open up the world for business)*