

## ***HARMONY AND INTERDEPENDANCE IN THE G20***

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1/ - The G20 has gone through a very successful period in 2008 - 2009.

- It has adopted a very ambitious agenda for financial regulation reform. This was underpinned by the creation of the FSB where emerging economies play a major role, including in the steering committee. This may be seen as a model and inspiration for future governance and reforms for instance in the IMF.
- It has also managed to implement a joint strategy for fighting the recession. All this was done in a spirit of cohesion which played a major role in re-establishing confidence in a critical period.

2/ - There are more challenges in the period ahead as economic situations diverge and countries have to adjust to the aftermath of the crisis. There is both a resumption of global growth and increased international capital market volatility. Differences in economic situations and conflicting ambitions can lead to tensions. This would, in turn, impact global confidence and endanger the recovery. In such circumstances, it is advisable to avoid trying to micro - manage policy coordination. On the contrary, G20 countries should focus on crucial and long term issues that will determine the strength and sustainability of global growth in the decade ahead.

3/ - The main issue for the G20 in 2010 – 2011 will be the rebalancing of the world economy. Obviously rebalancing does not mean the same thing for everybody. Some observers focus on current account imbalances which are deemed to be the cause of financial crisis and should therefore be redressed as a priority. Evidence for that is flimsy and debatable. At the very best, the crisis and international imbalances is the "product of common causes". At the root of the crisis there are deep structural causes in our global growth model which need to be addressed.

4/ - Many analysts would see future growth as constrained by supply factors. The scarcity of natural resources and environmental pressures would combine to create insufficient supply. But demand constraints will be as - if not more -pressing and deep structural changes may be necessary to avoid .permanently insufficient demand in the world economy. This may sound paradoxical to day when, in most emerging world, demand seems to be, if anything, excessive and leading to inflationary pressures. But the composition of demand is heavily tilted towards investment and this equilibrium may not be sustainable over the long run. So, looking at the real economy, the main "imbalance" may be in the level and distribution of world consumption. To oversimplify, we are coming out of a period where the "East" was producing and the "west" was consuming. This will not be possible anymore.

5/ - Looking at the last decade, a major proportion of the *increase* in world consumption has originated in the US. During the same period, the real wage of the medium US household has stagnated. In fact, US consumption has been fuelled purely by wealth effects and a decrease in savings. This is not going to happen anymore. The burst of the housing and credit bubble has reduced households' wealth by more than 30% . It is bound to increase their saving ratio. According to studies by the IMF, in particular, this could go back to its 1990 average of 7% wich would reduce the contribution of domestic demand to GDP by a full 3%. There is no

obvious reason for the dynamics of real wages to change so it is unlikely that consumption will grow again at the same rhythm.. We cannot longer count on the US as the "consumer of last resort".

6/ - In all advanced economies and especially in Europe there is an urgent need for fiscal consolidation. Whatever one may think of the appropriate rhythm for exiting public support, market discipline will act powerfully to impose strong consolidation of public finance in a relatively short period of time. Estimates are in the order of 3 to 6 % of GDP correction to stabilize debt / GDP ratios. And this of course will negatively affect demand, at least in the short run.

7/ - So, there are possible downward pressures on global demand. And they may be strong. Pure size effects will play a role. A decrease of 1% in US consumption has the same effect on the world level than a 7% increase in Chinese consumption.

At the same time there are two powerful sources of growth in global supply. US economy remains extremely innovative and productive. And, in the emerging world, increase in active population will act as a further boost.

8/ - A key issue for global rebalancing therefore, is the future dynamics of consumption

- In western countries, consumption can be seen as the ultimate objective of economic activity, as well as the fundamental measure of welfare. Other countries may have different preferences. In a speech one year ago, Governor Zhou pointed to the fact that “ East Asia countries are influenced by Confucianism, which value thrift, self-discipline, ... and anti-extravagancy “. And it is true that “Latin American countries have similar levels of national wealth as the East Asian countries but lower savings ratios “. So, preferences do matter.
- Nevertheless, it is striking that the share of consumption in GDP has been steadily and strongly falling in all Asian countries over the last decade. For India from 64% to 57% between 2000 and 2008. For China, from 46% to 35%.
- Investment can substitute to consumption. Growth has been mainly supported in emerging Asia by a surge in investment, often spurred by public policies. In advanced economies, investment needs will appear as depletion of existing capital makes replacement necessary. Everywhere in the world "green technologies" will act as a booster. But this will only work for a time. Ultimately, lasting and self sustainable growth can only come from an increase in consumption.
- Finally, consumption - led growth is generally more conducive to job creation, an important point for many emerging economies where the workforce is growing fast. Employment growth is small as compared to GDP growth: 1% a year in China, 2% in India, 1.7% in Korea. This is indication of capital / labour substitution, which may be good for labour productivity but may also lead to excess capital and waste.

9/ - Achieving a successful rebalancing of the world economy therefore will necessitate both a better mutual understanding between countries and strong structural changes in our economies. Rebalancing of the world economy will not come mainly, if at all, from short term stimulative measures. There are deep forces at work It is important to disentangle the

evolutions which result from different - and legitimate - preferences from those which result from policy induced distortions. This is the main challenge the G20 will have to face.

I could identify several issues on this agenda. Let me mention three:

- Aging, which is a common challenge in most advanced and emerging countries alike, and has an important impact on saving behaviour
- The importance of corporate saving, again a common feature in many advanced and emerging economies. Again, as pointed out by Governor Zhou, corporate savings has been the main driver of the overall increase in savings in China. By the same token, the share of corporate profits in GDP has significantly increased in most advanced countries in the past decade. There are obviously specific national factors. But global forces may also be at work. It is a valid question whether those changes in the primary income distribution exert downward pressure on consumption.
- Finally, domestic financial systems do play a role in determining and allocating savings. An important issue is whether countries will diverge or converge in their approach to financial regulation. This is a good moment to ask the question since the crisis has dispelled any notion that some systems are intrinsically superiors to others.