Intervention of FM at the G20 Finance Ministers' and Central Bank Governors' Dinner meeting

Date: **22.09.2011** Time: **7.30 P.M.** **Venue:**

GLOBAL ECONOMY & FRAMEWORK

Mr. Chairman,

Thank you for the opportunity to give a brief on the progress in the Mutual Assessment Process. Since we have had a detailed presentation by my Canadian colleague, Jim Flaherty, I will limit my briefing to raise some important issues to guide our discussion today.

First, it is worth considering whether we are giving excessive weightage to the balance and sustainable elements of the Framework, and too little to strong growth. The question of growth is particularly relevant at this juncture, when the recent developments in the global economy are cause for serious concern. The Framework exercise was initiated on the assumption that the global economy was recovering reasonably well from the economic and financial crisis, and hence the G 20 needed to turn its attention to medium to long-term issues. Rebalancing global demand would make growth more sustainable, and even stronger, going forward, especially if there has been permanent demand destruction in some parts of the global economy. However, our medium term action plan for Cannes may not seem credible unless it addresses short-term growth and stability concerns as well. For instance, how credible would commitments for medium term consolidation look if we are seen embarking on a fresh round of stimulus? Several structural reforms to boost productivity could also have an adverse impact on short-term growth. The Cannes Action Plan, therefore, may have to link the medium term to the short-term as well.

Second, Growth also needs to be made **more broad based** and especially strengthened in developing countries in general. The Framework exercise therefore needs to focus more sharply on the development aspect. In this respect, I would like to underscore the suggestion made by our Prime Minister at the Seoul Summit that global imbalances should be leveraged to address developmental imbalances. If we need to add demand to the global economy to offset the moderation of demand by industrialized countries as they contract final output, perhaps a good way of doing this is to expand infrastructure investment in developing economies. Many developing countries have developed the capacity to grow rapidly but are constrained by poor infrastructure. Financing infrastructure development in these economies could contribute to sustainable global growth.

Third, the focus of the Framework on systemically important economies derived from the fact that global crises in the past, including the recent one, emanated from large economies. However, as we work to redefine elements of the MAP process in the G 20 countries we are faced with a new crisis arising from imbalances in relatively small economies in the periphery of the Euro Zone which has spread to countries which were well outside the periphery. This is because, given the highly interconnected nature of financial markets, large imbalances even in a small economy in a large currency union can destabilize global markets.

The issue arises whether, in trying to anticipate threats to the global economy, we should expand our agenda to consider the nature of the stresses in the Euro Zone and policy options for handling them. The need for doing so arises because of the highly interconnected nature of the world and to the potentially destabilizing role that expectations in financial markets can play. If expectations were always determined by what we call "macroeconomic fundamentals" – essentially the imbalance indicators identified in the MAP process – it would be one thing. However, expectations can change suddenly and when they do countries that are otherwise seen as solvent can suddenly appear insolvent. Given the importance of the Euro Zone for global financial markets it is necessary to consider whether the MAP should include some surveillance of the Euro Zone.

Fourth, we need to take stock of whether we have made substantial progress since the Toronto Summit when our leaders agreed on policy options for groups of countries, i.e. for advanced surplus, advanced deficit, emerging surplus, emerging deficit and resource rich economies. While it was not spelt out which country fell in what group, each G 20 country knew to what category it belonged, and the broad direction in which it needed to move.

Since then, what we have done is to first come out with a set of multiple indicators of measuring imbalances, on the basis of which we have identified seven countries that are seen to have “exceptionally large” imbalances and which are systemically important. The G 20 countries, including all the systemically important ones, have presented their national projections on major indicators. The IMF has compiled these projections and given us a comparison between what they imply and what the IMF thinks is feasible based on their global models. They have concluded that the improvements in imbalances projected by the individual G 20 countries are consistent with an overall view of the world economy which is over optimistic. If that optimism now seems excessive we need to know what changes would be needed in individual country projections.

Fifth, there appear to be some difficulties involved in making forward looking commitments. The MAP national policy template submissions of G20 member countries indicate that there is a broad congruence of ideas and recommendations for directing the future course of policy coordination, including on the need to focus on seven systemically important economies. Member countries recognize the need for further cooperation to achieve the goals of strong, sustainable and balanced growth as committed by our Leaders. The Framework Working Group deliberations have also underscored the need for countries to be more ambitious in their commitments. Countries have made forward looking projections in their templates, but these are not commitments, and are subject to periodic updates like all macro-economic models. The commitments are contained in the written part of the template and are in the form of objectives and policy changes. How commitments can be measurable is an issue.

There are three related issues here. **Firstly,** some commitments asked for are ***outcomes*** over which governments do not have full control, such as fiscal deficits and current account imbalances. They **control** only specific policies, such as tax rates and expenditure, which may influence but not fully determine final outcomes which are the result of a complex interplay of several variables. It is important to distinguish between 'outcome' variables and 'control' variables in making prescriptions. **Secondly,** countries may be only willing to commit only what they have ***already made public*** so far. Are countries in a position to make measurable, forward looking commitments beyond what is approved by their national Parliaments? **Thirdly,** is there a danger of such measurable commitments leading to ***naming and shaming***, that could be acrimonious and divisive, something that the G 20 has so far avoided? The Framework makes clear what each country is expected to do, and the extent to which this ultimately ***feeds into domestic policies is subject to periodic mutual assessment.*** How and in what manner, and should we, and can we, be more ambitious and move beyond the current path?

I know I have raised more questions than provided answers. The questions are, I think, relevant and important. I now look forward to colleagues providing the answers.