What Priorities and Strategy Should the G-20 Adopt for Inclusive and Sustainable Development?

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How to re-energize the G-20: China’s Presidency in 2016 and Its Agenda

SIIS and Friedrich Ebert Stiftung
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The G-20 Presidency is being assumed by China at a historic moment.

In 2014, China became the largest economy in the world PPP terms according to new calculations by the IMF.

Of the 20 entities that constitute the G-20, half are among the emerging economies, which now constitute 50% of the world economy.

Is this a déjà vu moment?
- According to data compiled by Angus Maddison, China had the largest economy for two millennia.
- China and India together accounted for 50% of world GDP in 1820 and China constituted 33% of the world economy at that date, a figure achieved by the US only in 2000.

But, in per capita real GDP terms,
- China’s real GDP per capita is still 28% of the world average in 2014.
- Nevertheless, what can we learn from the historical economic experience?
Lessons from History I


The “economic miracle” of the Song Dynasty (960-1279):

- Agriculture was the backbone of the economy but there was also increasing commercialization, specialization, and urbanization, an extensive system of water transport facilitating trade across different regions.
- Government assisted the private sector in infrastructure investment, harbors, warehouses, and other facilities.
- Reminiscent of the close collaboration between government and business characterizing the East Asian economic miracle of our times?
- A rapid increase in productive capacity: the production of iron and steel exceeded anything observed until the experience of England in the 18th century. (pp. 61-66).

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Lessons from History II


“China is the most dramatic example of having technological knowledge but failing to sustain growth of income per head. The Chinese learned to cast iron a millennium and a half before the Europeans. They had iron suspension bridges, which the Europeans would later imitate. Chinese agriculture was a marvel of high-yield rice fields, with hydraulic engineering performing the irrigation and draining of fields. Chinese agriculture used the iron plow, the seed drill, weeding rakes, the deep-tooth harrow, many types of fertilizer, and chemical and biological pest control. By the time of the Ming dynasty (1368-1644), China had gunpowder, the paddle wheel, the wheelbarrow, the spinning wheel, the waterwheel, printing, paper (even the critical breakthrough of toilet paper), the compass, and triple-masted ocean-going ships. But the Chinese chose not to compete in the world economy with their advanced technology, and they closed their borders. So China remained stagnant through the nineteenth century ...” (pp. 175-176).
External factors also contributed to the overall development of different regions of the world economy historically.

Findlay and O’Rourke (2007) attribute a role to “the restrictive monopolistic trade practices of players such as the Dutch East India Company on the future of the Southeast Asian economy.

“While the mainland states such as Burma, Siam, and Cochinchina ...may have been able to sustain their earlier development ..., it is apparent that the period from 1650 to 1800 was one of at least stagnation if not decline in the living standards of the population of the main Indonesian islands and much of the Malay Peninsula.”

Some see this period as marking the “Origins of Southeast Asian Poverty” (pp. 282-283.)

- An ameliorating factor for Southeast Asia was the presence of trade with China, both overland and through the increasing maritime presence of Chinese merchants.
- By the late 17th century, a shift occurred in trade away from the West and towards China (pp. 282-284).
More Recent Evidence: China

- Typically, sectoral change, labor and capital accumulation, and TFP emerge as the “proximate” causes of growth in discussions of countries’ growth experiences.
- Zhu (2012) examines China’s growth experience both historically and since 1978.
  - He argues that Chinese real GDP started to diverge from that in Western Europe beginning from 1500 but this divergence gained force in the 19th and mid 20th centuries.
  - He further shows that China’s growth and the remarkable catch-up of its per capita after 1978 is essentially due to productivity growth, not capital accumulation.
  - He argues that the reasons behind this productivity growth are “gradual and persistent institutional change and policy reform that have reduced policy distortions and improved incentives...” (pp. 103-104)

- They show that Turkey’s GDP per capita has fluctuated around a value of 25% of Western Europe + US levels during this period.
- They note that there are also three “puzzles” for Turkey’s experience since 1950:
  - a low rate of capital accumulation,
  - a low rate of sectoral transformation;
  - a low rate of growth of TFP.
- They further examine the growth experience of Turkey from the viewpoint of:
  - educational policies and human capital accumulation;
  - its institutional environment and evolution;
  - the role of macroeconomic policymaking.
- Moreover, they note that the incentives of different groups may be relevant for the effectiveness of such factors.
A Brief Look at Human Capital

- The role of human capital on economic growth needs little elaboration.
  - Lucas (1988) and Romer (1990a) develop endogenous growth models in which human capital and endogenous technological progress lead to continuous growth.
  - Romer (1990b) shows empirically that the initial level of literacy affects subsequent investment and hence, growth in a given economy.
  - Barro (2001) finds positive effects of the initial quantity of schooling as well as its average quality on decadal growth in a cross-sectional regression of 100 countries between 1965-1995.

- Human capital may also have an effect on the quality of institutions.
  - This idea goes back to Aristotle and recognizes the impact of an educated citizenry in “resolving their differences through negotiation and voting rather than violent disputes.”
  - As Glaeser et al (2004) note, education is needed for courts to function properly, for corruption to be rooted out, and for the rule of law to be implemented efficiently.
An Education Map

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Institutions

- Define **institutions** as a formal or informal set of rules that constrain human interactions in the economic, political or social sphere.
- The idea that institutions are a key determinant of growth has witnessed a revival [see Douglass North and others]
- The disparity in observed income worker i.e., productivity, across countries may only be explained by differences in social infrastructure [Hall and Jones (1999)]
- “**Social infrastructure**: The institutions and government policies that determine the economic environment within which individuals accumulate skills and firms accumulate capital and produce output.”
- In addition to their role for individual countries, the structure of international institutions also matters for global economic activity.
The role of international institutions in creating a favorable governance environment has received increased scrutiny in recent years, and is especially relevant in a G-20 context. The principal international institutions of economic governance have been the IMF, the World Bank, and the World Trade Organization (WTO). Milner (2005) discusses the normative issues and empirical evidence regarding the role of these institutions.

- One view of their role is that such “institutions constrain the behavior of the most powerful countries and provide information and monitoring capacities that enable states to cooperate.”
- However, obtaining evidence of the role of such institutions is complicated by the presence of (i) counterfactuals and (ii) selection bias.
Milner argues that the current international institutions “were designed to help developed economies create a cooperative and stable world economy in a non-globalized world” [my emphasis].

A variety of scholars cited by Milner argue that the existing international institutions have not had the benefits to developing countries that they were intended to. Some potential reasons:

- The process of globalization or countries’ own domestic policies may have swamped any effect of these institutions.
- The governance structure, voting shares, etc. of international institutions have not kept pace with the economic and political resurgence of the developing world.
- Private financial flows, not public flows, now constitute the majority of the funding sources to developing economies and hence, their interests may also have ascendancy in international institutions.
- Lack of effective monitoring of the international institutions themselves may prevent an accounting of successes/failures.
Macroeconomic Policymaking

- Prudent macro-economic policy-making is usually stressed from the viewpoint of short-term fluctuations. However, long-term sustainable growth may also require measures to
  - keep inflation low;
  - keep budget deficits and debt under control;
  - promote openness in trade;
  - promote financial deepening and financial integration.

- The East Asian countries have been known for prudent macroeconomic policies.
  - Even following the 1997 financial crisis, the economies of East Asia have shown a rapid recovery. Likewise, the East Asian countries, including China, rebounded faster after the 2008 financial crisis.
  - However, the stimulus measures implemented in China during the global financial crisis have been accompanied by rapid credit expansion, leading to an increase in the overall debt-GDP ratio from 158% in 2007 to 282% in 2014.
Macroeconomic Policymaking: Evidence

- Rojas-Suarez (2015) examines the indicators of macroeconomic resilience to external factors before 2007 and in 2014 for 21 emerging economies, including China.
  - The main result of this paper is that initial economic conditions, in particular, the policy decisions taken in a pre-crisis period, matter for financial stability and economic growth in the post-crisis period.
  - Macroeconomic resilience is defined as a situation in which a sharp contraction of economic activity, a severe decline the rate of growth of economic credit and/or the emergence of deep instabilities in the financial sector does not occur in response to a negative shock.

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Indicators of Macroeconomic Resilience

- Two dimensions of macroeconomic resilience and the associated indicators
  1. Ability to withstand a negative shock: cost and availability of external financing
  2. The capacity to implement policy measures to counteract the effects of the shock
- For the 1. dimension, the indicators that matter are
  - CA to GDP ratio: matters if the external shock is a financial shock (i.e. increase in US rates) or a trade shock which may indirectly affect financing through trade finance
  - External debt to GDP ratio: indicator of solvency conditions
  - Short-term external debt to international reserves ratio: indicator of liquidity conditions
For the 2. dimension, the indicators that matter are

- General government fiscal balance-GDP ratio: influences the ability to counteract negative shocks through fiscal measures
- Government debt-GDP ratio: determines the ability to undertake countercyclical fiscal policy
- (Squared) deviation of inflation from its target value: determines the ability to implement countercyclical monetary policy at the time of the shock
- A financial fragility measure: accounts for credit booms or busts

In 2007, Emerging Asia ranks highly but by 2014, there is a deterioration in the overall rankings of some economies of the region, suggesting the need for further prudence.

Nevertheless, China maintains a high ranking of 3 in 2014 (down from 2 in 2007).

Latin America (with the exception of Chile) and Emerging Europe tend to fare badly overall in 2007; there is some improvement in 2014 for the latter but not for the former. Furthermore, among Emerging Asia countries, the rankings of India and Malaysia deteriorate significantly.
Priorities for the G-20 Presidency

- Sustainable and inclusive growth is the product of many interrelated factors, and may have roots in countries’ historical experiences.
- The new G-20 Presidency can formulate new priorities based on these findings.
  1. Openness and trade, especially regional trade, were a primary source of historical development.
     - The G-20 should continue policies that promote openness and equitable trade among its members. The new AIIB is a right step in this direction that will facilitate regional development and trade.
  2. The initial conditions regarding human capital matter for future growth, and countries with favorable demographics can maintain positive growth trajectories.
     - Cai Fang and Lu Yang of CASS argue that China can increase its potential growth rate from 6.7% to 7.5% from 2016 to 2020 by increasing average years of schooling by one year.
     - They also propose a further relaxation of the one-child policy and an increase in the mandatory retirement age.
Priorities for the G-20 Presidency

- There is strong evidence that the institutional environment matters for future growth.
- More tellingly, the role international institutions in promoting development is also gaining increasing scrutiny.
  - The G-20 presidency should work towards reforming the governance of existing international institutions to better reflect the increasing importance of developing or emerging economies in the global economy.
  - Recently, Desai (2015) has proposed that a leading policymaker from Singapore be appointed as the managing director of the IMF as acknowledgement of the growing clout of emerging economies.
- Recognizing the global sources of problems and the global of nature of solutions for individual countries.
  - The global economy has become increasingly interdependent and integrated.
  - The G-20 presidency should work towards implementing macroeconomic policies that recognize this interdependence.
  - Raghuram Rajan, the governor of the Reserve Bank of India, has proposed that developed economy central banks should alert emerging economies to potential policy shifts.


References