The G-20 Framework for Strong, Sustainable and Balanced Growth: Macroeconomic Coordination Since the Crisis

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- Since the 2008 global financial crisis, there have been an increasing number of calls for greater macroeconomic policy coordination among the world's largest economies. The Framework for Strong, Sustainable and Balanced Growth, launched at the G-20's Pittsburgh Summit in September 2009, has provided a mechanism for such co-operation.
- The Framework has achieved some successes: advanced economies have agreed to objectives for fiscal consolidation, and a broad structure for policy coordination has been institutionalized. The Framework has also played a role in promoting the agenda for global financial sector reform, which has proceeded well under the aegis of the Financial Stability Board.
- However, world growth has remained weak in the years following the crisis, and there has not yet been a sustainable rebalancing of global demand. Progress has been slow in terms of developing credible medium-term fiscal plans in some advanced countries and increasing exchange rate flexibility in certain emerging economies.
- The challenge will be to augment the Framework's influence over G-20 policies, notably by enhancing the analysis of international policy spill-overs and strengthening the peer-review process.

In response to increasing evidence of international spillover effects since the 2008 global financial crisis, calls by governments, academics and the public for greater policy coordination among the world's largest economies have intensified. The Group of 20 (G-20), now the main forum for international economic policy coordination, has responded along several fronts. Notably, it accelerated the program for global financial sector reform, strengthened the International Monetary Fund (IMF) and increased macroeconomic policy coordination among its members. This article reviews the G-20's macroeconomic policy coordination efforts, focusing on its Framework for Strong, Sustainable and Balanced Growth (the Framework), which members launched in the wake of the crisis.

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The renewed attempt at macroeconomic coordination represents a clear change in attitudes among policy-makers. The pre-crisis view was that, while coordination could provide some economic benefits, they would likely be small and difficult to attain, and thus probably not worth the effort. Moreover, past experience seemed to suggest that successful policy coordination would need to focus on technical issues, within a restricted group of like-minded countries (such as the members of the G-7), and aim to preserve existing policy regimes (Eichengreen 2011). Yet inaction was no longer an option. The financial crisis highlighted that just as global economic linkages had grown exponentially, so too had the international spillover effects of domestic policies (IMF 2012b). In addition, the costs of continuing the pre-crisis policies were potentially quite significant (Murray 2011). Given the stakes, and despite the mixed history of such initiatives, the G-20 launched the Framework at its Pittsburgh Summit in September 2009, embarking on the most comprehensive attempt at macroeconomic coordination since the creation of the Bretton Woods regime.

The objective of the Framework is to help achieve a strong, sustainable and balanced global economic recovery. This outcome requires a pickup in demand growth in surplus countries to offset the weakness in deficit countries arising from significant public sector and private sector deleveraging. Appropriately paced fiscal consolidation, greater exchange rate flexibility and accelerated structural reforms are needed to achieve this rotation of demand in a context of robust global growth. The Framework seeks to align G-20 policies in support of these goals, strengthening the nascent global recovery in the short run and laying the foundations for robust economic growth over the medium term.

◂ *Strong, sustainable and balanced growth requires a pickup in surplus country demand to offset the weakness in deficit countries arising from significant public sector and private sector deleveraging*

The Origins of the Framework

The design and implementation strategy underlying the G-20 Framework draw on lessons learned from two recent policy coordination initiatives: the IMF's multilateral consultations in 2006 and the G-20's response in early 2009 to the financial crisis.

In June 2006, the IMF launched its first multilateral consultations with five systemically important economies (the United States, the euro area, China, Japan and Saudi Arabia). The objective was to reduce global current account imbalances (IMF 2007). The process was led by the IMF, and political ownership was limited (Blustein 2012). While the joint plans that were laid out were similar to those in the G-20 Framework, countries were unwilling to publicly commit to them, there was no formal tracking of their implementation and the process suffered from a lack of transparency. In the end, the multilateral consultations failed to translate into effective policy action.

The environment for co-operation changed dramatically two years later. Following the collapse of Lehman Brothers in September 2008, policy-makers were able to demonstrate the feasibility and usefulness of policy coordination. Major central banks quickly extended and expanded foreign currency liquidity swap lines[1] to counter widespread U.S.-dollar shortages, and implemented synchronous interest rate cuts in October 2008 in response to the global shock. Buoyed by the success of this joint policy action and

1 Swap lines involved temporary reciprocal currency arrangements between the Federal Reserve and a number of foreign central banks. Two types of swap lines were established: dollar liquidity lines and foreign-currency liquidity lines. For more details, see www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm.

additional commitments made by the G-7,[2] the G-20 came forward at its London Summit in April 2009 with a number of initiatives designed to calm financial markets and re-establish confidence in global policy-making.[3] Initiatives included a dramatic augmentation of the IMF's resources, a concerted push for global financial sector reform and, more generally, a clear commitment that the G-20 was ready to respond as required. A key element was concerted fiscal stimulus: the total amount of stimulus from the G-20 members in 2009 was close to 1.4 per cent of their aggregate GDP, although countries varied widely in terms of the size, speed and composition of measures (Prasad and Sorkin 2009).[4]

Key Features of the Framework

G-20 policy-makers took note of the lessons learned from the two earlier coordination efforts when designing the key features of the Framework, described below:

- **Political ownership.** The Framework is a country-led process, closely linked to political decision-makers. Country commitments are formalized in a G-20 Action Plan presented at Leaders' annual summits. Canada and India co-chair the Framework Working Group, which carries out the background work leading up to the summits.[5] Unlike the multilateral consultations in 2006, the IMF does not play a coordinating role, but instead provides technical assistance to the G-20 as required.
- **Enhanced accountability.** The G-20 leaders established the Mutual Assessment Process (MAP) to monitor and support the implementation of country commitments. Recognizing that the Framework relies solely on peer pressure and disclosure as disciplining mechanisms, the MAP was designed to ensure a candid and productive discussion of progress toward fulfilling policy commitments. In 2012, members agreed to enhance the MAP's accountability framework.[6]

The Mutual Assessment Process was designed to ensure a candid and productive discussion of progress toward fulfilling policy commitments

- **Broad scope.** Unlike the multilateral consultations, the thrust of the Framework is not exclusively on reducing external imbalances; instead, it focuses more fundamentally on putting the global economy on a sound footing. The Framework has both a "near-term" and a "medium-term" focus, working to mitigate risks and stabilize growth in the short run, while also laying the foundations for durable growth over the medium term. The objectives are inclusive enough to involve a diverse set of countries in a wide range of policies.

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2 The G-7 Plan of Action in October 2008 stated that "the current situation calls for urgent and exceptional action," including using "all available tools to support systemically important financial institutions and prevent their failure." For details, see www.fin.gc.ca/activty/g7/g7101008-eng.asp.

3 For more details, see the G-20 London Summit Leaders' Statement (3 April 2009) at www.canadainternational.gc.ca/g20/summit-sommet/g20/declaration_010209.aspx?view=d.

4 The scale of this measure was not far from what the IMF had advised: toward the end of 2008, it called for a fiscal stimulus equal to 2 per cent of global GDP. See "Financial Crisis Response" at www.imf.org/external/pubs/ft/survey/so/2008/INT122908A.htm.

5 The Department of Finance is the co-chair of the G-20 Framework Working Group. The Bank of Canada also represents Canada.

6 The G-20 accountability framework has evolved through several stages. Work on developing indicators to enhance accountability began in 2011, when members agreed on "indicative guidelines" to identify vulnerabilities and imbalances in the G-20. The methodology identified seven systemically important countries that the IMF then examined in a series of country-specific "sustainability" reports. In 2012, countries formally agreed to a set of indicators to monitor and assess progress in the areas of fiscal, monetary and exchange rate policies.

- **Action Plan commitments.** Each of the G-20 countries has identified policy commitments that they are integrating into their national economic plans. The following are the core G-20 commitments as they evolved through the Action Plans of Seoul (2010), Cannes (2011) and Los Cabos (2012):
  - **Fiscal consolidation to ensure debt sustainability in advanced economies.** At the Toronto Summit in June 2010, G-20 advanced economies set specific fiscal targets: cutting 2010 deficits in half by 2013, and stabilizing or lowering debt-to-GDP ratios by 2016.
  - **Greater exchange rate flexibility.** G-20 members with current account surpluses pledged to "enhance exchange rate flexibility to reflect underlying economic fundamentals"[7] and move more rapidly toward market-determined exchange rate systems. China, in particular, promised at the Cannes Summit in 2011 to reinforce its medium-term rebalancing toward domestic consumption with "ongoing measures to promote greater exchange rate flexibility to better reflect underlying economic fundamentals, and gradually reduce the pace of accumulation of foreign reserves."[8]
  - **Structural reforms in all countries.** In advanced economies, commitments consisted of ongoing reforms to the global financial sector, coordinated by the Financial Stability Board (FSB), as well as labour and product market reforms. In surplus emerging-market economies (EMEs), reforms focused on reducing excessive savings and unlocking domestically driven economic growth.

Assessing the Framework

This section examines the G-20's progress in implementing the Framework against three benchmarks: (i) achieving the objectives of strong, sustainable and balanced growth; (ii) implementing fiscal policy commitments; and (iii) meeting commitments on exchange rate policy.[9] We end this section with an assessment of the Framework mechanism itself, abstracting from actual coordination outcomes. While other aspects of the Framework, such as structural reforms, are also deserving of macroeconomic analysis, their progress is difficult to assess in the short run or compare across countries.[10] A notable exception has been FSB-led efforts to reform the global financial system, where significant progress has been made in developing new minimum global standards to address the key regulatory weaknesses exposed by the financial crisis. The crucial next phase of this reform process is consistent, timely and full implementation of these standards at the national level by G-20 members (Carney 2012b).

7 See the G-20 Toronto Summit Declaration at www.canadainternational.gc.ca/g20/summit-sommet/2010/toronto-declaration-toronto.aspx?lang=eng&view=d.

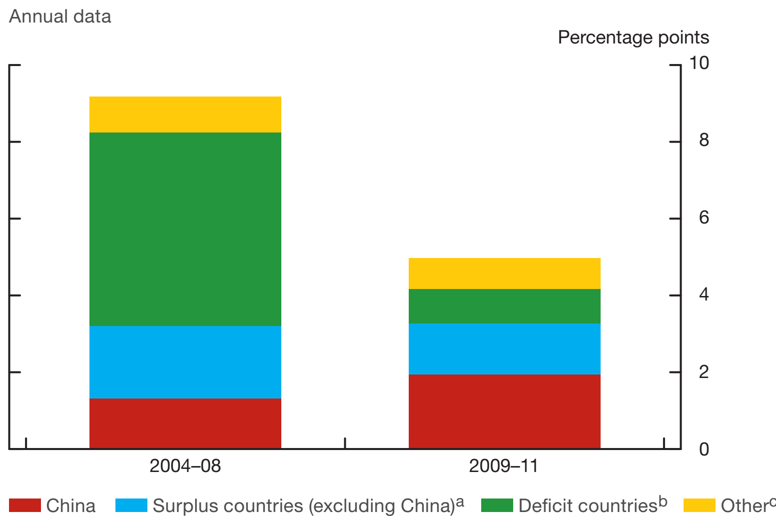
8 See the G-20 Cannes Action Plan for Growth and Jobs at www.canadainternational.gc.ca/g20/summit-sommet/2011/cannes.aspx?menu_id=72.

9 Our assessment complements Murray (2012), which provides a recent comprehensive overview of the Framework process from the perspective of a policy-maker.

10 An ongoing challenge for the MAP is to clarify which structural reforms will have the greatest impact on global economic growth and to establish an effective means of assessing their implementation. The Organisation for Economic Co-operation and Development (OECD) is providing significant assistance to the G-20 in this respect.

Chart 1: Contribution to G-20 nominal domestic demand growth by region

Annual data



Note: a. Surplus countries (excluding China) are Argentina, Germany, Indonesia, Japan, Russia and South Korea.
b. Deficit countries are Australia, France, India, Italy, Mexico, South Africa, Spain, Turkey, the United Kingdom and the United States.
c. Other countries are Brazil and Canada.

Sources: National statistical databases

Has strong, sustainable and balanced growth been achieved?

Four years after the crisis, there has not been a strong recovery and global output remains well below its potential level

Four years after the crisis, there has not been a strong recovery and global output remains well below its potential level. While recoveries following a financial crisis are often slow and protracted (Reinhart and Rogoff 2009), policy is not powerless. An appropriate mix of policies could facilitate the global recovery.

Chart 1 shows the average contribution to the growth of G-20 nominal domestic demand by surplus, deficit and "other"[11] countries during the pre-crisis (2004–08) and post-crisis (2009–11) periods. The growth rate of total G-20 demand has fallen sharply in the post-crisis period, driven mostly by the severe slowdown in deficit economies, while aggregate growth in surplus economies has remained virtually unchanged. Any decline in global current account imbalances has mainly been the result of cyclical factors.[12]

The G-20 countries at the epicentre of the 2008 crisis (the United States and the United Kingdom) and the euro-area crisis (Spain and Italy) are the sources of most of the contraction in G-20 demand. Among surplus economies, domestic demand growth has increased in China since the pre-crisis period, while it has fallen, in aggregate, in others. Overall, global growth has been neither strong nor balanced.

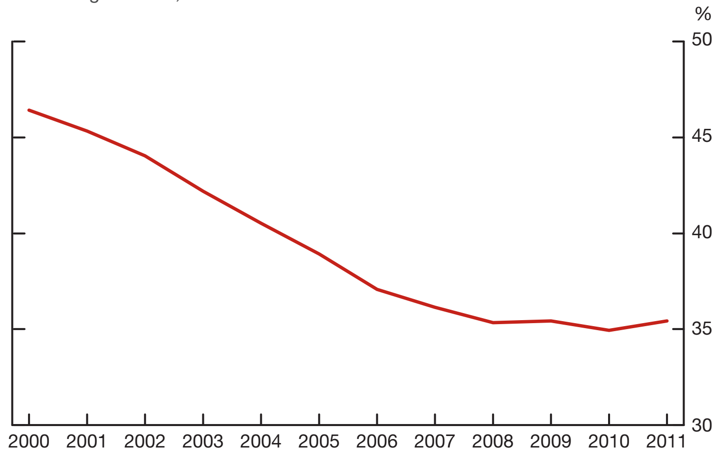
The economic outlook also remains challenging as formidable headwinds in the form of private sector and public sector deleveraging and heightened uncertainty continue to weigh on domestic demand in advanced economies. There is also good reason to be concerned about the sustainability

11 Only those countries that have been consistently in surplus or deficit before and after the crisis are categorized as "surplus" or "deficit" countries. The remainder are categorized as "other." The sample does not include Saudi Arabia because data were not available. Spain is included since it is a permanent invitee in the Framework process and makes commitments in line with the G-20 Action Plans.

12 In other words, the recent reduction in global current account imbalances is not due to a surge in imports by EMEs, but to a severe decline in exports to advanced economies and in trade flows more generally.

Chart 2: China's consumption

Percentage of GDP, annual data



Source: National statistical database

Last observation: 2011

of domestic demand growth in some EMEs. For example, the pace of economic activity in China since the crisis has been heavily dependent on rapid growth in investment spending, which now accounts for almost one-half of Chinese GDP. Investment has been boosted by strong increases in productive capacity in the export-oriented manufacturing sector, a surge in spending on public infrastructure and a booming housing sector. Meanwhile, consumption as a share of GDP has continued to fall, reaching 35 per cent in 2011 (**Chart 2**), which is well below that of other EMEs, even after controlling for different stages of economic development.

Have countries implemented their fiscal policy commitments?

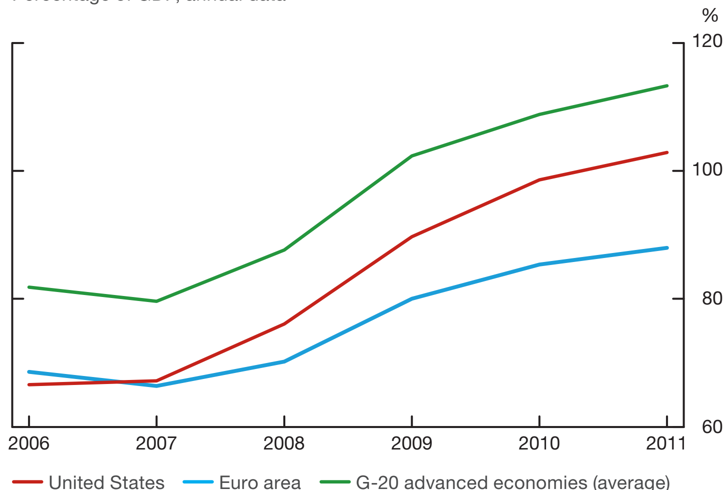
Most advanced economies are on track to meet the fiscal commitments established at the Toronto Summit (IMF 2012a). Notable exceptions are the United States and Spain,[13] which are unlikely to cut their 2010 deficit levels in half by 2013. The November 2012 communiqué of the meeting of G-20 finance ministers and central bank governors recognized that the United States should calibrate the pace of its fiscal tightening in a way that ensured public finances were placed on a sustainable long-run path while avoiding a sharp fiscal contraction (the "fiscal cliff") in 2013. More generally, advanced economies are now focusing their commitments on medium-term debt stabilization, with countries agreeing to specify by the 2013 Summit a credible medium-term path for their debt-to-GDP ratios, accompanied by clear strategies and timetables to achieve them. Debt stabilization will require robust consolidation efforts by many advanced economies, given the elevated levels of their public debts (**Chart 3**).

Ultimately, it is difficult to quantify the extent to which the Framework has influenced budgetary policies. The crisis in the euro area has forced rapid consolidation on many economies. Of the countries that have not experienced severe market pressure to consolidate, the United Kingdom and Canada have largely complied with their commitments. In contrast, neither the United States nor Japan has yet established credible medium-term fiscal plans.

13 Japan, which is by far the most domestically indebted G-20 country, did not commit to the Toronto targets.

Chart 3: General government gross debt in advanced economies

Percentage of GDP, annual data



Sources: International Monetary Fund, *World Economic Outlook* (October 2012) and *Fiscal Monitor* (October 2012)

Last observation: 2011

There is a growing awareness that a date-based target like the Toronto agreement may not be flexible enough to deal with changing economic conditions and country-specific circumstances. As a result, there are increasing calls for an amended G-20 fiscal agreement, one that solidly anchors long-term commitments but affords greater short-run flexibility.

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Have countries met their exchange rate commitments?

If implementation of the G-20 fiscal commitments can been characterized, in some cases, by rapid short-term consolidation and a shortage of well-articulated longer-term plans, the response to the exchange rate commitments can be described as the opposite: limited short-term increases in flexibility, but significant promises regarding future developments.

Chart 4 plots monthly reserves-to-GDP ratios against real exchange rates in EMEs over time. Horizontal movement on the chart captures reserve accumulation, while vertical movement captures exchange rate appreciation.

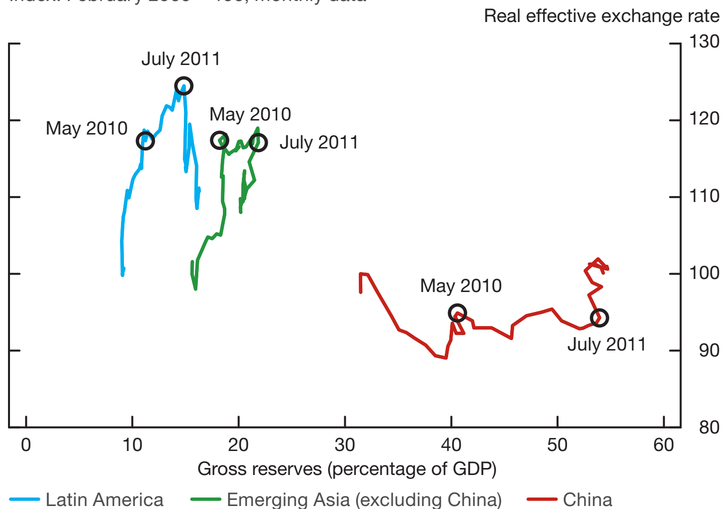
While the real exchange rates of Latin American and most Asian EMEs (excluding China) strengthened considerably in the initial stages of the recovery, appreciation slowed in mid-2010, owing to more active foreign exchange intervention and tighter capital controls. Most EME currencies started to depreciate in mid-2011 when the euro-area crisis intensified.

China has followed a different path, using large and sustained sterilized intervention to prevent or slow the appreciation of its real exchange rate over much of the period. In mid-2011, the trend changed, with the downturn in both global exports and capital inflows requiring less reserve accumulation, and the increased flexibility of the Chinese exchange rate regime allowing for greater appreciation of its real effective exchange rate.[14]

14 The daily bands around the yuan/dollar bilateral exchange rate were widened from 0.5 per cent to 1 per cent in April 2012.

Chart 4: Real exchange rates and reserves in emerging-market economies

Index: February 2009 = 100, monthly data



Note: Latin America refers to Argentina, Brazil and Mexico. Emerging Asia (excluding China) refers to India, Indonesia and Korea. Countries are weighted using 2011 GDP in purchasing-power-parity (PPP) terms.

Sources: Bank for International Settlements and national statistical databases

Last observations: China, September 2012; all others, October 2012

Exchange rate policies are an important part of the Framework. Greater exchange rate flexibility is essential to allow market-driven exchange rate appreciation (depreciation) in surplus (deficit) economies. Such moves would encourage shifts in relative prices and favour a rebalancing of global demand toward greater domestic absorption in surplus nations and stronger net exports in deficit countries. There have been conflicting views, however, among EMEs and advanced economies concerning the need for greater exchange rate flexibility. Many EMEs believe that excessively loose monetary policies in advanced economies, particularly in the form of quantitative easing, have caused a "wall of capital" to hit them, necessitating the use of capital controls and active foreign exchange intervention to protect their economies.[15] Most advanced economies have argued that excessive inflows would recede if EME currencies were more flexible, and that what little impact quantitative easing had on capital flows, and thereby on export competitiveness through currency appreciation, was more than offset by the positive trade and confidence spillovers from appropriate expansionary monetary policies in advanced economies (Bernanke 2012).

Greater exchange rate flexibility is essential to rebalance global demand toward greater domestic absorption in surplus nations and stronger net exports in deficit countries

There may also be a burden-sharing issue. It is not surprising that the G-20 has seen only modest progress on exchange rate commitments. Historically, this has been a very difficult area for coordination, because, at least in the short run, exchange rate adjustment is perceived by some to be a zero-sum game, where one country's gain in competitiveness is another's loss. However, a more complete analysis overturns this perception, since exchange rate adjustment is ultimately beneficial for all countries (it is a "win-win" game). Indeed, many costs associated with delayed real appreciation are often not adequately considered. For instance, sterilized intervention to resist appreciation in real exchange rates often leads to domestic imbalances and distortions (such as an unsustainable composition of demand

15 EMEs essentially argue that loose monetary policies and quantitative easing have led global investors to "search for yield" in more risky investments, such as EME assets or commodities. The resulting large capital inflows into EMEs, which could lead to overheating pressures and/or speculative bubbles, would be subject to rapid reversals once perceptions of global risk changed.

and financial sector distortions). Moreover, exchange rate flexibility helps to achieve the appropriate adjustments without forcing difficult changes in the overall levels of domestic wages, prices and output (Friedman 1953; Carney 2012a). Delayed exchange rate flexibility may also induce other countries to adopt more expansive polices than would otherwise be the case, possibly entailing considerable spillovers and risks.

Although the G-20 has had limited overall success with the Framework's exchange rate commitments, certain developments have been encouraging. China has made a modest move toward increased exchange rate flexibility and there has been a decline in reserve accumulation in some countries. However, the extent to which such developments reflect significant structural shifts in policy, rather than merely cyclical factors, is not yet clear.

Institutionalizing a mechanism for policy coordination

When assessing the Framework, it is important to differentiate actual coordination outcomes from the quality of the coordinating mechanism. The Framework's main contribution is the institutionalization of a process for global macroeconomic policy coordination, which has several important benefits. First, the Framework has provided a formal and multilateral channel for G-20 countries to share, and possibly adjust, their policy plans. The MAP enables member policy-makers to candidly voice concerns, pose questions and provide explanations about their policies. Importantly, the Framework allows members to discuss longer-term systemic issues that may not be easy to address in other international forums that focus primarily on current issues.

The Framework's main contribution is the institutionalization of a process for global macroeconomic policy coordination

Second, the G-20 Framework process increases policy transparency in all countries. By providing more accessible information on policy commitments and medium-term global economic projections, the Framework can be used to harness market discipline to create incentives for co-operation.

Finally, the value of the Framework lies less in arranging the details of coordination (these will be determined by circumstances) than in ensuring implementation over time, once the urgency that initially drove coordination has passed. By providing the means of assessing sustained co-operation through the MAP, the Framework has made medium-term coordination both credible and feasible.

Improving the Framework

Room for improvement nevertheless remains in the actual design of the Framework. This section identifies two major areas—spillover analysis and peer review.

Better spillover analysis

One way to motivate policy coordination is to clarify the costs of failed or delayed policy implementation. The current lack of co-operation on exchange rates may stem from the common perception that the costs to the domestic economy of not co-operating are low, especially for the larger G-20 nations. This could change, however, if the international spillover effects of domestic policies are greater than the G-20 collectively perceives them to be, as simulations by de Resende et al. (2012) suggest. A better appreciation of these spillover effects may cause countries to be more willing to absorb some short-term costs to prevent a worse outcome over the medium term. Moreover, greater focus on "non-co-operative" or

“downside” scenarios would better reveal the opportunity cost of failed policy implementation. To its credit, the IMF has applied the latest in modelling technology to measure the effects of increased co-operation on global outcomes. Nevertheless, spillover analysis is in its infancy and recent research by the IMF suggests that cross-border spillovers could be underestimated (IMF 2012b).

Effectively informing members of the costs of inaction may require a somewhat more assertive role for the IMF. While it cannot take on the coordinating role it had attempted to assume in the 2006 Multilateral Consultations, the IMF can work proactively with the co-chairs of the Framework Working Group to stimulate discussion through thought-provoking analysis and assessments.

Stronger peer review

The current peer-review process is not functioning as well as it could. The G-20 is a heterogeneous group, with significant differences in views and priorities, making mutual assessment difficult.[16] To address this challenge, members agreed in 2012 to an enhanced accountability assessment process that would be country-owned and -led, based on the members' assessments and with the input of independent third-party evaluations. Members endorsed a rigorous “comply-or-explain” approach: if countries are off course in meeting their commitments, then authorities should explain the reasons for these developments and describe the measures they plan to take to get back on track. The full application of this “comply-or-explain” approach will be critical if the peer review is to function effectively.

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Several additional changes to the peer-review process would also enhance its efficiency:

- **Increased precision of commitments.** Current G-20 commitments are often not as clear as they could be in terms of the measures being proposed and the time horizons, and often lack clear benchmarks to track progress.
- **Increased focus on domestic demand.** Coordination of policies to promote sustainable domestic demand growth may help to avert the perceived burden-sharing problem. The G-20 should clearly outline how fiscal, monetary, exchange rate and structural reform policies can combine to sustainably revitalize domestic demand in member economies.
- **Increased exchange rate transparency.** The IMF could draw on its External Balance Assessment to produce regular reports for G-20 members on policy issues directly related to real exchange rate adjustment, such as foreign exchange intervention, changes in capital controls and sterilization policies. Countries could commit to report intervention activities in a timely manner and to clarify the parameters of their exchange rate regimes. Enhancing the transparency of exchange rate policies within the MAP is a firm yet non-accusatory way to increase pressure on countries to promote market-determined exchange rate flexibility.

16 For example, an OECD-style peer review of countries by a small number of members is unacceptable to many in the group.

Conclusion

The G-20 Framework is an ambitious undertaking that has achieved mixed results so far in terms of policy coordination. There have been some successes, including the Toronto commitment to ensure fiscal consolidation in advanced countries and broad agreement on a reasonable set of mutually consistent medium-term policies. However, it is clear that the Framework has yet to deliver strong, sustainable and balanced growth.

The challenge will be to enhance the Framework's influence over members' policies. Part of the solution lies in increasing the depth of spillover analysis and the effectiveness of the peer-review process. While such procedural changes are no guarantee of policy coordination, a more effective Framework would increase the chances of success.

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