The Global Economy: Where do we go from Here?

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Media Centre – G7 Ise Shima Summit. Once again the global economy tops the G7 agenda with all the leaders concerned about future economic prospects. It seems little has changed since the establishment of the first G7 meeting in 1975. Then, the world economy faced an uncertain future following the break away from the fixed exchange rate mechanism and movement to floating exchange rates, as well as the 1973 OPEC oil crisis, which heavily restricted the supply of oil and drove up the price on a phenomenal scale, thereby straining developed countries whose growth was largely dependent on foreign oil. The supply shock almost quadrupled the price of oil from $2.90 a barrel prior to the embargo to $11.65 a barrel post-embargo in January 1974. More recently, the 1997 East Asian financial crisis and the 2008 housing bubble have brought the G7 together to attempt to reach a global economic policy consensus. Testing times lie ahead for the current world leaders with spiralling debt, sluggish world growth, deflationary pressure, weak demand and investment, commodity surpluses, tax havens and currency war accusations all threatening to destabilise the world economy. Despite over 40 years of global summit meetings, global economic issues still take centre stage.

Coming together

Past summits have provided the stage for global leaders to meet to discuss world economic problems along with other important issues such as global security. These summits have provided the opportunity to create a united front on specific issues and the description, 'steward of the world economy', is probably how the G7 would like to be known. Over the years each communiqué has stressed principles such as "think ahead" and "act together" in times of adversity. Ultimately the G7 has provided the option for world powers to pool their domestic economic policies and resources to push towards a common goal.

Traditionally G7 members have promoted the principle of free trade and liberalized capital accounts. This is where measurable success can be seen. The 1999 establishment of the G20 finance ministers' meetings as an intended extension of the original, more exclusive concept saw the traditional great powers acknowledge the importance of many developing nations. This indicates the success and flexibility of the forum as well as its desire to further promote globalisation, free market principles and new trade opportunities. However, more cynically, some may argue the G20 represents one last throw of the dice from the historic world powers to control the threat to their long-established reign from the emerging nations.

Possible disputes building up to the summit

Going into the summit, much talk surrounded the 'three arrows' of policy making in terms of fiscal, monetary and structural reform to tackle the highlighted issues on the agenda. But how much room is there for manoeuvre on such policies?

Monetary policy puts interest rates at historic low levels, and huge quantitative easing programmes go beyond the traditional extent of its influence. This has likely driven growth since the financial crash and has attempted to provide banks with the ability to offer borrowing and investment opportunities once more. But how long will this extreme situation last? There is a growing expectation for interest rates to rise in the US for example, which would perhaps signal an end.

Fiscal policy was the centre of attention in the build-up to, and throughout, the summit but divides nations. The US and Japan were pushing for a collective fiscal stimulus package from all G7 members to simulate growth through boosting demand

and encouraging investment. This approach was met with scepticism from notably Germany but also the UK, as highlighted by the Finance Ministers' meeting prior to the leaders' summit. The verdict of the meeting led to an acknowledgement from Japan that some countries are unable to partake in their proposed fiscal stimulus thereby demonstrating a refusal from Germany to conform to pressure for G7 countries to collectively adopt a fiscal expansion strategy.

President Abe's commitment to fiscal stimulus could be limited by Japan's national debt level, which stand at around 200% of GDP and is growing at a debt to GDP ratio of 6% per annum. This indicates the problem is only getting worse. Times of economic prosperity traditionally offer the opportunity to build an economic 'war chest' to be made available for use in times of economic hardship. No such measures were taken in all of the G7 countries. Little attention has been placed upon the Keynesian argument regarding the negatives of fiscal stimulus. Such policy can lead to 'crowding out' whereby the raised borrowing rate from government spending reduces private investment. Or that the suggested rise in consumption tax intended to partly finance the scheme will likely have a negative impact upon consumption and have negative distributional effects. Furthermore, with demand and investment currently flagging, this may in fact compound the issue.

Germany has placed emphasis on structural reforms as the main priority by 'promoting education and innovation'. This is a long-term solution and perhaps goes beyond the quick fixes often preferred by politicians seeking to satisfy their electorates. However, success in this area will not happen overnight and results are not guaranteed. Although there is consensus surrounding structural reform among the leaders, it seems to be an easy answer for politicians to turn to.

Compounding this divide on future options are accusations and tension mounting over exchange rates. The US in particular has been suspicious of the Japanese government over devaluation manipulation. Devaluating currency levels allows for exports to appear relatively cheaper on the world market. Therefore, cheaper exports intend to create an increased aggregate demand within the economy. The Finance Ministers' meeting highlighted the intention to avoid this. Nevertheless, it is probably true that a global environment in which countries feel their neighbours are trying to steal a march on them by devaluation is probably a world that promotes suspicion, and one where barriers to global trade are more likely to surface.

This year's communiqué – something for everyone

Despite all the media hype ahead of the summit suggesting that tensions were running high regarding policy solutions to the world's economic problems, the final communiqué is a conformist outcome. The document is undoubtedly carefully crafted to allow each leader's personal agenda to be met in some way. The resulting leaders' speeches provided each one with the opportunity to claim some heroics on the world negotiating stage with the final communiqué acting as their perfect weapon to this end. 'Abenomics deployed globally' was a key message of Prime Minister Abe's post-summit press conference and a glance at the leaders' declaration confirms this through the inclusion of fiscal elements. This gives Prime Minister Abe the opportunity to proclaim Japan's influence on the summit and satisfy fickle domestic policy. Yet the clever wording of the document allows each leader to claim a victory. 'Abenomics' emphasises fiscal expansion as the key tool for economic prosperity but the declaration does not use wording to reflect this explicitly. Instead fiscal 'tools' or 'strategies flexibility' are cited and do not commit the G7 to stimulus or contraction. This allows each leader to have the autonomy to choose their own option of action without being accused of going against the alleged global 'Abenomics' now in place. The final declaration ultimately suits all leaders, notable Germany, who now has no need to conform to fiscal stimulus proposals that they so actively rejected leading into the summit. This outcome reiterates that of the Finance Ministers' meeting, which highlighted that each country's set of circumstances must be taken into account with regards to economic action.

The group again reiterates its commitment to using all 'policy tools' but this continual reiteration from summit to summit presents a lack of ideas of where to go next. World growth is continually revised down by the IMF (currently down to 2.4% per annum). Monetary policy is at the limits of its capabilities, fiscal policy is constrained by crippling government debt run up by successive governments and supply side options have distant goals and uncertain effects. Developing countries have fuelled world economic growth but with suspicions of a Chinese slowdown mounting the future is bleak. Developed countries' traditional economic policies do not have the influence they once had in the larger, more complex global economy of today with many more significant players.

Some hope for the future

The small glimmer of hope is that leaders have encouraged their ministers to push through the much anticipated trade deals of the Trans-Pacific Partnership (TTP), Trans-Atlantic Trade and Investment partnership (TTIP), Environmental Goods Agreement (EGA), Trade Facilitation Agreement (TFA), Information Technology Agreement (ITA) and Trade in Services Agreement (TiSA), which will hopefully reduce unnecessary tariffs and promote the free trade ideal that has been a historical success of the G7. The communiqué states that the agreed implementation date for the EGA, TFA, ITA and TiSA is by the end of 2016 and this will hopefully hold ministers to account if these targets are not met. Shorter, more time bound and specific aims are what are needed rather than the continual lip service so loved by world leaders.

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