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David Gray/Reuters

INSIGHTS FROM A CFR WORKSHOP

China's G20 Challenge

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In April 2016, the Greenberg Center for Geoeconomic Studies at the Council on Foreign Relations (CFR), in collaboration with the Asia Global Institute (AGI), held a workshop on whether the G20 under Chinese leadership could rise to the growth and structural challenges facing the global economy. The workshop was made possible by the support of the Robina Foundation. The views described here are those of workshop participants only and are not CFR, AGI, or Robina positions. ***The Council on Foreign Relations takes no institutional positions on policy issues and has no affiliation with the U.S. government.*** *In addition, the suggested policy prescriptions are the views of individual participants and do not necessarily represent a consensus of the attending members.*

INTRODUCTION

China's leadership of the Group of Twenty (G20) in 2016 comes at a moment when the role of the G20 itself is being challenged by disappointingly slow global growth and a trend toward regionalism, epitomized by trade deals such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), as well as China's own One Belt, One Road initiative. At the same time, issues such as climate change and growing inequality are creating a rift between industrial and developing nations (and between the rich and the poor within countries) that has hampered progress on global solutions.

On April 6, 2016, the Maurice R. Greenberg Center for Geoeconomic Studies and the Asia Global Institute convened a workshop in Hong Kong with more than twenty scholars and market participants to assess the agenda facing the G20, why the group had fallen short of expectations in recent years, and whether China's leadership in 2016 provides an opportunity for renewal. Participants included experts from academia, industry, international organizations, and think tanks, and brought backgrounds in economics, international relations, technology, and law to the discussion. The workshop addressed questions about China's ability to reinvigorate the G20, in light of its struggle to deal with slowing growth, and manage a complex structural transformation. Participants also addressed whether the G20 is even the appropriate forum to reach consensus on the critical growth and reform challenges facing the global economy.

The dialogue revealed a broad consensus that the G20 needs a stronger and more coordinated approach on fiscal policy, as central banks cannot be expected to carry the full burden of promoting growth. Participants agreed that this unbalanced reliance on central banks to promote recovery carries significant and rising risks.

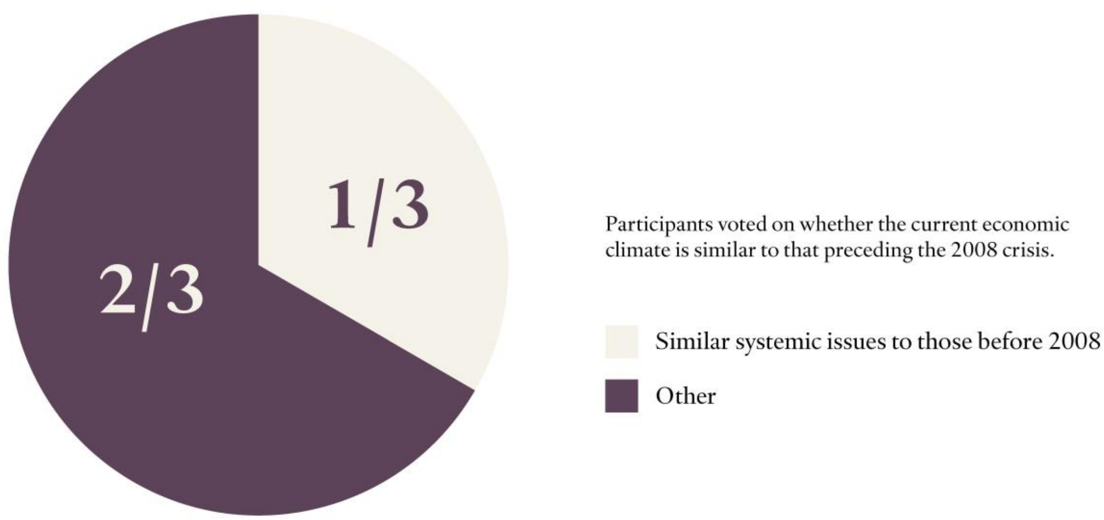
There also was near-unanimous support for greater infrastructure investment, as well as for the G20 taking on a coordinating role on a range of structural challenges that need to be addressed over the coming decade. Stronger and more market-oriented Chinese economic policies were seen by most participants as consistent with this agenda and also as allowing a greater leadership role for China in 2016 and beyond. At the same time, participants recognized that tension within China between supporting growth and accelerating China's structural reform agenda could constrain its ability to join or forge a G20 consensus on sustainable-growth issues.

CHALLENGES TO GLOBAL GROWTH

More than seven years after the collapse of Lehman Brothers and the peak of the global financial crisis, the world continues to suffer from slow and declining growth. Given this weak recovery, some workshop participants feared that the effects of the crisis were not fully over. However, although concern about financial fragility was a recurrent theme during the meeting, when asked for a show of hands, only one-third of participants agreed that "systemic financial issues similar to the ones that led to the 2008 financial crisis" were the biggest threat to the global economy and

financial stability. For others, growth or long-term structural headwinds appeared to be the dominant concern.
Those who identified growth as more pressing an issue than crisis avoidance expressed frustration that leaders of the G20 economies have consistently failed to agree on better, more growth-oriented policies, having overemphasized monetary solutions and underemphasized fiscal measures and structural reforms.

Figure 1. Experts Divided on Current Economic Climate



Source: Survey of workshop participants.

Some participants noted that central banks have spent considerable monetary firepower without boosting growth, yet the banks are reluctant to further test the limits of their mandates by pursuing actions that veer into fiscal policy, such as taking on more credit risk or making helicopter drops (that is, an expansion in government spending financed directly by the central bank).

Leaders of the G20 economies have overemphasized monetary solutions and underemphasized fiscal measures and structural reforms.

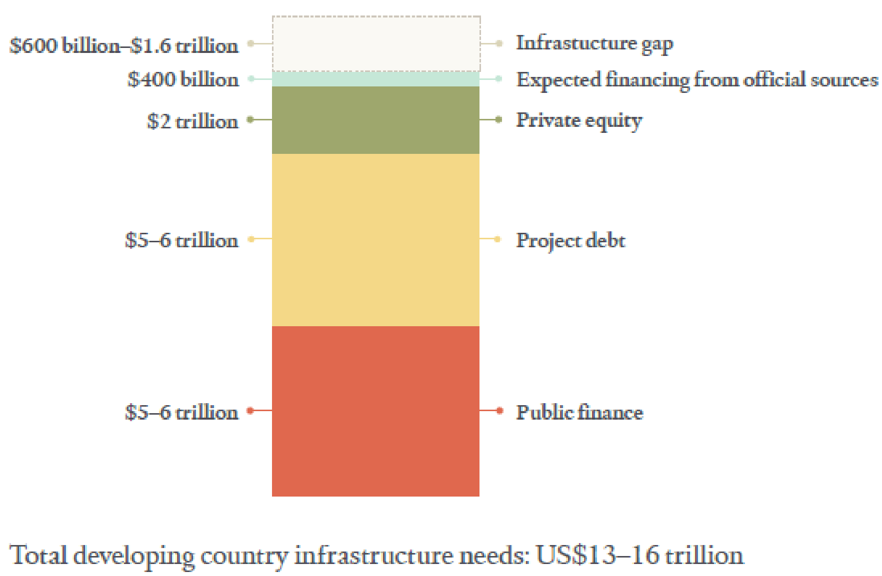
Not everyone agreed. The European Central Bank (ECB) was criticized for its reluctance to do more to promote growth, but its defenders at the workshop argued that restructuring the banking system is a more appropriate priority. The fundamental problem, they said, is that firms are not asking to borrow more and, with interest rates and market risk premiums near zero, investors are not being adequately compensated for taking on additional risk. These participants argued that there is an urgent need to normalize risk premiums to get credit flowing again and prevent Europe from enduring a phenomenon similar to Japan's lost decades.

Brokering such differences of opinion, argued several participants, is where a rejuvenated G20 could play a meaningful role as a coordinating forum for global efforts directed at precisely the types of problems that are best addressed in unison. Some participants noted that G20's weakness has created incentives for smaller groupings to break out and has been reflected in a renewed focus on the Group of Seven (G7). While a less diverse group might be able to achieve its goals on issues such as exchange rates (because G7 currencies are dominant in international financial markets), the participants argued, the group is less of a force with regard to problems that involve the emerging markets or go beyond narrow macroeconomic dimensions such as infrastructure, protectionism, climate change, and inequality. Several participants agreed that setting an agenda that gets the world's biggest economies working in sync is clearly a daunting task but one that the G20 should be able to do.

BUILDING RECOVERY

As several participants mentioned, there was no better example of the case for policy coordination than in the area of infrastructure. One of the puzzles of the postcrisis response from governments is the failure to capitalize on very low rates on long-term bonds even as most countries face a clear infrastructure shortfall. "It's almost incredible when you think about it," noted one participant, "because that investment generates aggregate demand in the short run and growth in the longer run." From this perspective, underinvestment in both the public and private sectors has contributed to stagnant wages and growing inequality, which in turn have bred political polarization and populist rhetoric that favors protectionism and closed borders.

Figure 2. Tackling the Infrastructure Investment Gap in the Developing World



Source: Workshop participants, World Bank, AIIB, ADB, NDB.

One speaker estimated that the developing world would need $13 trillion of infrastructure investment to support potential growth over the next fifteen years. In contrast, official sources such as the World Bank, the new Asian Infrastructure Investment Bank (AIIB), and other regional development banks have roughly $400 billion of financing available.

Participants debated the reasons for the shortfall in investment. On the face of it, there is no shortage of capital in the world given the size of assets controlled by pension funds, insurance companies, and other fixed-income investors, all of which would welcome a new opportunity for countercyclical diversification in an investment universe beset by deflation and negative interest rates. Some participants argued that investors are currently not participating in infrastructure investment because the risks are too high due to poor project preparation, low tariffs, and a host of legal, tax, and regulatory obstacles. In their view, there need to be more and better-targeted technical assistance and policies to make infrastructure finance a more attractive and distinct asset class.

NEW ECONOMY, NEW PROBLEMS

A major conclusion from the discussion was that new technology, despite all its benefits, caused labor dislocations and inequality, with some participants arguing that robotics, artificial intelligence, and virtual reality may make many of today's jobs and skills redundant. In their view, the G20 needs to fully acknowledge this issue and perhaps initiate a discussion as to how gains from technology could be more broadly shared.

Even China, which benefited from tremendous growth in the high-tech industry during the past decade, faces a looming employment crisis. With forty-five to fifty million people in the country employed in the mobile phone industry, one workshop participant worried that the transformation of that industry could see tens of millions of job losses. Two-thirds of global orders for industrial robots are from China, and components that were once assembled by workers are increasingly being built directly onto semiconductor wafers.

Several participants argued that the One Belt, One Road initiative—an infrastructure-led development program to connect China with its neighbors—will help align supply with demand at the global level, as the more competitive Chinese tech companies use the policy to expand their operations into Central, South, and Southeast Asia. These participants noted that China is also addressing their overcapacity challenge through the Made in China 2025 initiative, which sets the goal of moving China up the manufacturing value chain, particularly in precision manufacturing, biotechnology, semiconductor design, and electric vehicles. The challenge is that this move requires a fundamental transformation in incentives, skills, education, and, especially, intellectual property rights. Indeed, several participants contended that an effective Chinese rebalancing from manufacturing to consumption and services would provide a healthier basis for global growth over the next decade, and beyond.

THE G20 IN A MULTIPOLAR WORLD

Workshop participants asked some difficult questions about the role of the G20 and its willingness to broker agreements on thorny issues, with some even accusing it of no longer being a "high-energy" organization compared to its more glorious days in London, Pittsburgh, and even Toronto. Many participants asked if the G20 was too big to have a cohesive agenda, while others questioned whether the agenda was big enough. A more optimistic view was that the group used noncrisis times to build relationships and common understandings that would serve as the basis for a rapid response when the next crisis happens. But the majority view was that the G20 needs to break out from the "local politics" that beset each country and be more ambitious.

In the end it may take China and the United States finding ways to cooperate at a level deeper than they have so far managed.

There was a strong sense that China is the right country to host the G20 at the right time—something that was not as easy to say about recent G20 leaders such as Turkey or Australia. As a major developing country holding the presidency, China has a strong incentive to show the world that it can play an effective role on the global stage, especially at a time when global agreements are being overshadowed by mega-regional deals such as TPP and TTIP, to which China's own initiatives on AIIB and One Belt, One Road might be seen as competing platforms. Some participants expressed concern about the decline of multilateralism and called for a more active campaign by the G20 to make the case for greater participation.

One of the systemic threats of mega-regional trade deals, observed a participant, is that they are overlaid with geopolitics, and this dynamic brings a risk of exclusion and regulatory divergence that will be difficult to repair. There has been a shift to murky protectionism, the participant argued, which is preferential and discriminatory. These problems will not go away easily, and the G20 as an agenda-setting and coordinating body is an appropriate venue for dealing with them. It should not ignore such issues, though in the end it may take China and the United States finding ways to cooperate at a level deeper than they have so far managed, and by doing so setting the stage for a more activist G20.

There was hope around the table that, with U.S.-Chinese leadership, a renewed G20 was possible. Such cooperation was on display at the 2015 Paris climate conference. And, noted some participants, as a G20 member, China has shown leadership in embedding the sustainable development goals in its thirteenth five-year plan and asking other member nations to integrate those goals into their own plans. However, if the G20 is to again become effective as the world's leading governance forum, it would need to move beyond these issues to a broader, more activist agenda of supporting growth and structural reforms.