



G20 MONITOR

# The Chinese 2016 G20 host year

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# TABLE OF CONTENTS

Overview	3
Tristram Sainsbury	
Interpreting the four I's of China's G20 Presidency	11
Zhang Haibing and Wang Yuzhu	
The Global Infrastructure Hub	18
Bill Brummitt and Laura Walsh	
The G20 and IMF reform in 2016	24
Tristram Sainsbury	
Reforming international tax: Is BEPS the end of the starting point?	34
Mike Callaghan	
The G20 and macroeconomic policy cooperation	45
Adam Triggs	
Contributors	



## OVERVIEW

TRISTRAM SAINSBURY<sup>1</sup>

This issue of the G20 Monitor focuses on the state of the global economy and G20 in the initial months of the Chinese G20 Presidency, and offers some suggestions for the path forward for economic policymakers on macroeconomic cooperation, the international financial architecture, infrastructure, and international tax. There is input from academics, ex-G20 officials, and representatives from international organisations.

On assuming the G20 Presidency on 1 December 2015, China outlined ambitious priorities for 2016. **Zhang Haibing** and **Wang Yuzhu** from the Shanghai Institutes for International Studies decode the four I's that make up the Chinese G20 Presidency's core G20 theme of "Towards an Innovative, Invigorated, Interconnected and Inclusive World Economy". The Chinese G20 Presidency comes at an important time for both the G20 and for China. A well-directed and well-coordinated approach that leads to actions across the four I's has the potential to make a substantive contribution to global growth, and expectations are high for the Chinese host year. Zhang and Wang note that although G20 summits are never short of eye-catching themes, the key challenge for the G20 is a familiar one: seeking pragmatic, on-the-ground outcomes that can be delivered to leaders at the Hangzhou Summit in September.

Addressing the large global infrastructure gap has been a high priority of recent G20 presidencies, and seems likely to feature prominently in the Chinese agenda in 2016 as well. However, despite the number of action plans that countries have announced in recent years, it has often been difficult for the G20 to demonstrate that progress is being made in implementing pledged actions and actually improving the investment environment. The G20 should aim to actively address this critique in 2016. The key to attracting private capital into investment projects continues to be project selection and preparation by governments, alongside institutional settings that foster investment.

The Global Infrastructure Hub (the GIH or Hub) is a rare example of the G20's capacity to create international bodies. It is now fully operational and has a potentially important role in the G20's collective efforts to implement its multi-year global investment agenda. **Bill Brummitt** and **Laura Walsh** from the GIH outline the steady progress that has been made since G20 Leaders announced the Hub at the November 2014 Brisbane Summit. The Hub's priorities for 2016 will aim to make tangible progress in long-term efforts to bridge data gaps, build capabilities, and match bankable projects to private sector partners.

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Another topic that is likely to receive much attention during the Chinese Presidency 2016 will be reform of international financial institutions. With a breakthrough in December 2015 after five years of the US Congress failing to ratify a package of IMF quota and governance reforms, **my paper** assesses the current state of IMF reform and next steps for 2016. IMF governance modernisation is an ongoing process that is vital to the IMF's long-term legitimacy and its cornerstone role in the global financial safety net. Notwithstanding the gloss that has come off GDP growth in BRICS countries since 2011, emerging markets remain well under-represented at the IMF and discussions that further progress IMF reform cannot be ignored. In 2016, negotiators at the G20 and the International Monetary and Financial Committee will therefore need to turn their attention towards the next round of IMF quota and governance reform, the 15th General Review of Quotas (15th General Review). The September G20 Leaders Summit in Hangzhou will not see a final agreement on the 15th General Review, but China can use its G20 Presidency to commence negotiations and seek to drive a political agreement among G20 members to extend the IMF's temporary bilateral resourcing until a more permanent resourcing solution can be agreed. Such discussions will not be easy, but if they are handled astutely, they have the potential to insert momentum back into a long-stalled process and demonstrate positive Chinese leadership in setting global rules.

It will be important that China ensures that the G20 delivers on its multi-year economic priorities in 2016. This includes maintaining momentum in the implementation of the international tax agenda, which is entering an important new phase in 2016. One of the G20's most tangible success stories in recent years has been the tax base erosion and profit shifting (BEPS) initiative, which was unveiled by the OECD in October 2015 following an intensive two-year consultation and policy development process. **Mike Callaghan** reviews the outcome of the BEPS 'final' package, which was endorsed by leaders in Antalya in November, examines the public reactions to it, and assesses the challenges and implications of implementing BEPS.

BEPS has changed the world of international tax in a profound way and will change the way multinational corporations and tax authorities operate. However, the future will likely be one of considerable uncertainty as corporations deal with different interpretations and implementation schedules of BEPS outcomes country by country. Implementation will be difficult, and complex, leading to increased disputes. What is more, Callaghan notes that in the post-BEPS world, international tax issues have moved beyond the domain of the OECD, requiring a new, more representative forum for dealing with international tax. In all, BEPS should be seen as very much a work in progress, and G20 policymakers need to treat it as just the beginning of G20 efforts to reform international tax arrangements.

Finally, **Adam Triggs** points out that improving habits of cooperation and maintaining a constructive dialogue on macroeconomic cooperation is the G20's most significant longer-term contribution to the global economy. Triggs argues that the G20's tendency to consider policy issues in isolation from one another has contributed to a mixed G20 record: on macroeconomic stimulus and strengthening the safety net it has done relatively well; on reducing global imbalances, it has made progress but still has more to do; on fiscal consolidation it has done poorly; and on monetary policy it is still undecided whether it wants to do anything. Triggs asserts that the G20 needs to take a more integrated approach when considering macroeconomic issues, starting with broadening the focus of the G20 growth strategies and reinvigorating the mutual assessment process. There remains much to be done; the conversations will take time and progress will be variable. It is important to be realistic in expectations about what can be achieved by China, or any future G20 President.

## THE BACKGROUND TO CHINA'S G20 PRESIDENCY

*The global economy continues to face significant short- and long-term challenges...*

The economic backdrop underpinning the Chinese G20 Presidency can be considered as similar to that faced by recent G20 presidencies. The global economy continues to face significant short- and long-term challenges associated with the sluggish recovery from the global financial crisis, and 2016 is likely to be characterised by disappointing growth and persistently high unemployment. But despite market volatility in early 2016, a crisis of the magnitude of the global financial crisis that consumed the G20's deliberations in 2008 and 2009 or, to a lesser extent, the euro sovereign debt crisis of 2010–12, does not appear as an imminent prospect.

The central forecast that G20 Leaders faced in November 2015 was for low, uneven, and disappointing global growth. In October 2015, the IMF had downgraded its global growth forecasts to just 3.1 per cent in 2015, and warned that there was a 50 per cent chance of growth dropping below the 3 per cent threshold that has previously been described as equivalent to a global recession.<sup>2</sup> Many countries were expected to grow below their potential growth rates, and the growth performance between advanced economies and emerging markets continues to converge. Unemployment in many countries remained uncomfortably and naggingly high, particularly for young people and disadvantaged groups. Further, there has been a loss of momentum in global trade, policy settings are overly reliant on accommodative monetary policies, and the world continues to face financial sector risks.

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<sup>2</sup> Ian Talley, "Recession Risk 'Rising' as IMF Lowers Global Growth Forecasts", *The Australian*, 8 October 2015, <http://www.theaustralian.com.au/business/wall-street-journal/recession-risk-rising-as-imf-lowers-global-growth-forecasts/news-story/0b18b2cb91d283a19890f025068fe2e9>.

These factors are all present in the January 2016 IMF forecasts, which predict that the global economy will grow at 3.4 per cent in 2016.<sup>3</sup> These forecasts are already a downward revision from the optimistic 3.6 per cent that was hoped for in October 2015. They remain contingent on a number of positive settings and events, in particular that major economies continue to benefit from supportive monetary conditions and low commodity prices, and that growth across emerging market economies picks up after a “turbulent summer”.<sup>4</sup>

*...the global economy will grow at 3.4 per cent in 2016.*

#### GDP Growth (per cent), Q4 on Q4

	2012	2013	2014	2015	2016 <sup>(a)</sup>	2017 <sup>(a)</sup>
Total (initial forecasts in brackets)	3.4 (4.5)	3.3 (4.1)	3.1 (4.0)	3.0 (3.8)	3.4	3.6
Of which: Advanced	1.2	1.4	1.7	1.8	2.2	2.0
Of which: Emerging and developing	5.1	4.7	4.5	4.0	4.5	4.9

(a) 2016 and 2017 figures are forecasts.

Source: IMF; Stephen Grenville, “Global Economy: Still Firing, ‘Boringly Normal’ Growth Expected”, *The Interpreter*, 25 January 2016, <http://www.lowyinterpreter.org/post/2016/01/25/Global-economy-Still-firing-boringly-normal-growth-expected.aspx>.

There is a relatively daunting series of known economic risks that have the potential to influence these projections markedly: vulnerabilities around China’s economic transition to more balanced growth; slow or negative growth in other large emerging markets such as Brazil and Russia; debt concerns in several G20 nations and emerging market commodity exporters; financial risks associated with monetary policy movements; and the ongoing EU sagas relating to migration flows, Greek debt, and Brexit. Economic policymakers need to be alert to evolving economic conditions and stand ready to respond to potential events that can cause contagion. However, to paraphrase Martin Wolf from the *Financial Times*, what matters is not so much whether the world will be well managed, but whether a disaster will be avoided.<sup>5</sup> We know that policy mistakes will continue to be made, but not whether these will lead to a regional or global crisis.

For G20 observers, there is a sense of familiarity about the economic preconditions of sluggish, uneven growth and mounting risks; these were

<sup>3</sup> IMF, “Subdued Demand, Diminished Prospects”, *World Economic Outlook Update*, 19 January 2016, <https://www.imf.org/external/pubs/ft/weo/2016/update/01/pdf/0116.pdf>.

<sup>4</sup> IMF, “Global Prospects and Policy Challenges”, Surveillance Note delivered to G20 Leaders Summit, Antalya, Turkey, 15–16 November 2015, <http://g20.org.tr/wp-content/uploads/2015/11/IMF-Surveillance-Note.pdf>.

<sup>5</sup> Martin Wolf, “Why Global Economic Disaster Is an Unlikely Global Event”, *Financial Times*, 5 January 2016, <http://www.ft.com/intl/cms/s/0/db57a57e-b38b-11e5-b147-e5e5bba42e51.html#axzz3yPjMaiib>.



the same sorts of challenges that influenced the start of Australia's 2014 Presidency and the Turkish 2015 Presidency.<sup>6</sup> There is less room for complacency this time around. A crisis seems a more realistic prospect than it was a year ago. Further, a repeat of the downward revision of the  $\frac{3}{4}$ -1 percentage point magnitude seen in recent years would not just lead to slow, steady growth; but rather a level below the 3 per cent 'threshold' for global recession.<sup>7</sup> It is little wonder that the IMF has been calling for increased urgency in actions to raise actual and potential output through a mix of demand support and structural reform.

#### AN UNSUCCESSFUL 2015 LEAVES GROWING QUESTIONS ABOUT THE G20'S LONGER-TERM ROLE

Since 2008, attention has been on the G20 addressing economic challenges in its role as the self-proclaimed 'premier economic forum for international economic cooperation'. Yet the overarching narrative about the G20 is increasingly 'good during the crisis, but less relevant over time'. The G20 has not yet been able to effectively manage the shift from a crisis committee to a 'peace time' steering committee for international policy coordination. As Paola Subacchi of Chatham House suggests, while less is being delivered and implemented, the agenda has continued to expand, raising doubts about the point in keeping up such a cumbersome, expensive and time-consuming forum.<sup>8</sup>

A weak leaders' communiqué from the Antalya Summit was symptomatic of the G20's struggle to respond to pressing economic issues in 2015.<sup>9</sup> The Turkish Presidency claimed progress in its three priority areas of investment, implementation, and inclusiveness. Leaders welcomed an accountability framework for G20 efforts on growth and each G20 member delivered a country-specific strategy to boost domestic investment. If implemented, these strategies are estimated to add 1 percentage point to the investment-to-GDP ratio in G20 countries by 2018. There was enhanced support for youth employment, small and medium sized enterprises, and women's empowerment.<sup>10</sup> However,

*...the overarching narrative about the G20 is increasingly 'good during the crisis, but less relevant over time'.*

<sup>6</sup> Tristram Sainsbury, "Overview", in *The G20 at the End of 2014*, G20 Monitor No 14 (Sydney: Lowy Institute for International Policy, 2014), <http://www.lowyinstitute.org/publications/g20-end-2014>.

<sup>7</sup> Gavyn Davies, "When is a Global Recession Not a Recession?", *Financial Times*, 11 October 2015, <http://blogs.ft.com/gavyndavies/2015/10/11/when-is-a-global-recession-not-a-recession/>.

<sup>8</sup> Paola Subacchi, "Is the G-20 Still the World's Crisis Committee?", *Foreign Policy*, 25 November 2015, <http://foreignpolicy.com/2015/11/25/is-the-g20-still-the-worlds-crisis-committee/>.

<sup>9</sup> Tristram Sainsbury and Hannah Wurf, "Paris Attacks Cast a Shadow over 2015 G20 Summit", *The Interpreter*, 17 November 2015, <http://www.lowyinterpreter.org/post/2015/11/17/Paris-attacks-cast-a-shadow-over-2015-G20-Summit.aspx>.

<sup>10</sup> G20, *G20 Leaders' Communiqué*, Antalya Summit, 15–16 November 2015, <http://g20.org.tr/wp-content/uploads/2015/11/G20-Antalya-Leaders-Summit-Communiqu--.pdf>.

these outcomes were modest, particularly compared with past G20 outcomes. More notable outcomes were those technical, multi-year agenda advances that are progressed by international institutions, with the OECD delivering the two-year tax base erosion and profit shifting package, and the establishment of the Global Infrastructure Hub. Such advances deserve due recognition.

However, the Antalya Summit itself was overshadowed by the Paris attacks. The absence of a substantive overall economic agenda containing a headline outcome, partnered with the urgency of responding to the threat, meant that the summit rapidly became more notable for bilateral discussions and the leaders' focus on security issues. The seven page communiqué, negotiated in the weeks leading up to the summit, remained largely untouched by the political need to react to these developments. Officials signed off the document after a customary period of intense and protracted negotiations. OECD Secretary-General Angel Gurría commented in a public forum held on the sidelines of the summit that this merely served to highlight that officials arguing so passionately over individual words and lines have lost track of what is important.<sup>11</sup>

The forum's central mandate of strong, sustainable, and balanced growth, which has been repeated by successive G20 Presidents, remains frustratingly elusive. Growth is not strong, it is not sustainable, and it is not balanced. Mike Callaghan has previously noted that the credibility of the G20 is ultimately linked to its ability to restore global growth on a sustainable basis.

In Antalya, G20 Leaders reaffirmed the commitment that they made in Brisbane in November 2014 to lift collective G20 GDP by an additional 2 per cent by 2018 relative to the forecasts included within the October 2013 IMF World Economic Outlook.<sup>12</sup> More surprisingly, given the state of global growth, they proudly proclaimed that they had made significant progress towards fulfilling the 1000-plus commitments made in Brisbane. To back up this statement, leaders pointed to analysis they requested from the IMF, OECD, and the World Bank that suggested that half of the multi-year measures had been fully implemented, and that the bulk of remaining measures are in progress. What is more, the implementation to date would raise G20 GDP by around 0.5 per cent in 2015 and 0.8 per cent by 2018.<sup>13</sup>

*The forum's central mandate of strong, sustainable, and balanced growth... remains frustratingly elusive.*

<sup>11</sup> Angel Gurría, speaking at T20 Antalya Summit panel on "Implementing the SDG Agenda: The International Policy Issues", Antalya, Turkey, 14 November 2015.

<sup>12</sup> G20, *G20 Leaders' Communiqué*, Antalya Summit.

<sup>13</sup> IMF and OECD, "Quantifying the Implementation of G-20 Members' Growth Strategies", Note delivered to G20 Leaders Summit, Antalya, Turkey, 15–16 November 2015, <http://g20.org.tr/wp-content/uploads/2015/11/Quantifying-the-Implementation-of-G-20-Members----Growth-Strategies.pdf>.

*If the G20 cannot live up to its self-proclaimed title of the world's premier international economic forum, there are workarounds.*

The problem is that a 0.5 per cent boost from policy action in 2015 is tantamount to the G20 claiming that we would effectively be in a global recession if it were not for the G20's policy efforts. Such a claim is inconsistent with the prevailing economic narrative that accompanies forecasts by international organisations. Ultimately, the growth strategies rely on a bespoke modelling exercise, and there is a lack of transparency around each country's individual growth commitments. Country actions on trade, competition, labour markets, and investment remain important, but we cannot know with precision how this will translate into growth numbers. As a result, the G20 will struggle to convince financial markets and the broader community that its actions are indeed restoring global growth on a sustainable basis while growth remains disappointing and credible economic forecasts do not acknowledge the contribution of G20 efforts.

More broadly, despite the lack of a strong G20 footprint, 2015 marked a significant year in economic multilateralism and regionalism. The G7 displayed strong leadership on climate change and in the substantive response to the Ebola epidemic, China launched the Asian Infrastructure Investment Bank, the BRICS Bank was established in Shanghai, and the renminbi was included in the IMF's Special Drawing Rights. Further, global agreements (of varying quality) were reached on sustainable development and climate change, and there was long-overdue recognition that it was time to move on from the World Trade Organization Doha round, partly in response to 12 countries agreeing to the Trans-Pacific Partnership. Yet the G20 failed to deliver a sense that it had made a substantive direct contribution to any of these areas, notwithstanding that investment, trade, climate change, and development were among the 11 priority areas for the G20 in 2015.

None of this is to suggest that the G20 should be abandoned. We exist in a highly integrated world and decisions made in one country frequently have spillover effects, both positive and negative, on others. Although macroeconomic cooperation outside of a crisis is difficult, the world needs a global decision body that facilitates cooperation on difficult international economic policy challenges. There remains significant potential for the G20 to boost global growth, create jobs, contribute to public goods, reshape norms, address key economic risks, fundamentally shape existing multilateral institutions, and develop new institutions. Leaders and officials are still invested in the process and continue to attend key gatherings. If the G20 were not in existence today, it is highly likely it (or a comparable body) would need to be invented. But expectations for what the forum can achieve need to be tempered. Further, what 2015 has highlighted is that the G20 is not irreplaceable. If the G20 cannot live up to its self-proclaimed title of the world's premier international economic forum, there are workarounds.

## THE G20 NEEDS MORE POLITICAL WILL

China has started with an ambitious and broad agenda, and has effectively generated a sense that the G20 is back to focusing on pressing economic challenges. Not everything in the priorities document can be achieved, but expectations remain high for the 2016 G20 host year, and the February Finance Ministers and Central Bank Governors Meeting in Shanghai will be much anticipated.

The primary challenge that economic policymakers face in 2016 has been neatly summed up by former US Treasury Secretary Robert Rubin, who has suggested that “the fundamental question for the globe’s economic future is whether elected leaders around the globe, primarily legislators, will finally move forward on fiscal issues, public investment and structural reform”.<sup>14</sup> The core question that the G20 needs to confront in areas of country-specific action is primarily political, not technical. To go beyond business as usual, China and the G20 need to focus on creative solutions that improve both the *supply* of bold commitments to boost growth and employment outcomes and also the *demand* for policy implementation from the citizenry within G20 member countries.

This will not be easy. Demonstrating political will is one area where the forum’s design features limit the G20’s effectiveness. The G20 is not a treaty-based organisation and has no permanent secretariat or enforcement power, and reform actions depend on domestic political contexts. The G20’s strength continues to be in providing strategic leadership to international organisations, and providing political momentum to overcome roadblocks and advance truly global issues in international forums and institutions. Negotiations on such matters are often multi-year processes, and continuity across G20 presidencies is crucial to their effectiveness.

The challenge China therefore faces is to balance the high expectations of 2016 with the natural limitations of the G20, as a forum, that have conspired to constrain its ability to address the primary global economic challenges. It will be important that the 2016 host manage expectations about what the G20 is able to accomplish. China should use its four I’s narrative to explain its economic approach to the world, seek to galvanise better cooperation in response to global challenges, build momentum and continuity on multi-year, cross-border economic issues, and ensure that the G20 remains ready to respond to unexpected events. If it can achieve this, it will go some way towards demonstrating to the naysayers that the G20 can be relevant, show that China can make a positive contribution to global economic governance, and leave a positive legacy for future G20 hosts.

*The challenge China therefore faces is to balance the high expectations of 2016 with the natural limitations of the G20...*

<sup>14</sup> “Could the Economy Tank in 2016? 23 Economic Forecasts for the New Year”, *Politico Magazine*, 3 January 2016, <http://www.politico.com/magazine/story/2016/01/economist-forecast-2016-213499>.

# INTERPRETING THE FOUR I'S OF CHINA'S G20 PRESIDENCY

ZHANG HAIBING AND WANG YUZHU<sup>1</sup>

## INTRODUCTION

China will be in the international spotlight more than ever as it prepares to host its first G20 Summit in Hangzhou in September 2016. The foundation of the G20's agenda in 2016 is "Towards an Innovative, Invigorated, Interconnected and Inclusive World Economy".<sup>2</sup> This ambitious theme not only continues and expands on the three I's of the 2015 Turkish G20 Presidency — inclusiveness, implementation, and investment — but also incorporates Chinese policy preferences and development concepts.

In China's view, the lack of growth has been a major problem for the world economy since the 2008 global financial crisis. As China took over the G20 Presidency, it has sought to promote a new driving force for the world economy by focusing on innovation promotion. Under this framework, G20 members can discuss how to formulate a G20 blueprint for innovative growth and deepen international cooperation in the areas of innovation and the digital economy.

Development has also become a long-term issue for the G20, and China has its own development concepts to add to the discussion. Countries around the world are already working together on the implementation of the United Nations 2030 Sustainable Development Agenda to realise inclusive and coordinated development and to consolidate a new basis for world economic growth. China will also continue to push for the improvement of global economic and financial governance, and for an increase in the representation of emerging economies and developing countries.

G20 summits are never short of eye-catching themes, and expectations are high for the Chinese host year. However, what will be important is setting a G20 agenda that balances international priorities with the host's domestic agenda in order to strengthen economic growth globally. This paper will explore what each of the four 'I' themes — innovation, invigoration, interconnectivity, and inclusive growth — mean for the domestic Chinese context.

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<sup>2</sup> Chinese G20 Presidency, "Theme and Key Agenda Items of the G20 Summit in 2016", in *G20 Summit 2016, China*, 1 December 2015, <http://www.g20.org/English/Dynamic/201512/P020151201039444963631.pdf>.

## INNOVATION

The Chinese G20 priorities document, released on 1 December 2015, recognises that innovation is an important driving force for strong, sustainable, and balanced global growth. It outlines an ambition to add growth to the global economy by promoting innovation-driven development, and encouraging across-the-board innovation in science, technology, and business.<sup>3</sup>

In his opening remarks at the first Sherpa's Meeting of 2016, Chinese State Councilor Yang Jiechi emphasised the link between innovation and growth:

“Efforts should be made to innovate growth models mainly through reform and innovation to create and seize new opportunities and foster medium-to-long term growth potential in the world economy.”<sup>4</sup>

He also stressed that the G20 needs institutional innovation to transition from a crisis response to a long-term economic governance mechanism:

“The agenda of the G20, as well as its mechanisms and ways of cooperation, should always stay relevant in an ever-changing world.”<sup>5</sup>

Innovation helps to achieve higher-quality and more efficient growth by increasing the productivity of capital and labour. With the appropriate institutional frameworks, it can improve the allocation of resources and increase economic dynamism.

Given its own capital and institutional gaps, China regards innovation as an important domestic priority and hopes to foster an innovation-motivated market environment through international cooperation. It is also hoped that the G20 innovation agenda will demonstrate that China is committed to the necessary actions to transform its own economy and overcome a declining marginal output of capital. In doing so, China can contribute more to economic growth outside its borders.

*China regards innovation as an important domestic priority.*

Domestically, in the wake of its free trade strategy, the Chinese Government unveiled a plan to build Shanghai into a centre for international scientific and technological innovation.<sup>6</sup> The most senior policymaker in Shanghai, the General Secretary of the Shanghai

<sup>3</sup> Ibid.

<sup>4</sup> Yang Jiechi, “Strengthen Partnership for a Better Future”, Remarks by State Councilor of the People's Republic of China at the Opening Ceremony of the 2016 First G20 Sherpa Meeting, 15 January 2016, [http://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1331909.shtml](http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1331909.shtml).

<sup>5</sup> Ibid.

<sup>6</sup> Tang Yuankai, “Shanghai: A New Hi-Tech Center”, *Beijing Review*, 23 July 2015, [http://www.bjreview.com.cn/quotes/txt/2015-07/20/content\\_697202.htm](http://www.bjreview.com.cn/quotes/txt/2015-07/20/content_697202.htm).

Communist Party Committee, Han Zheng, reflects the Chinese enthusiasm for innovation:

“The dynamite of innovation lies in reform and the motivation of innovation comes from the market. Only when we realise this can we build a real competitive innovation-driven city. We want to generate a climate that encourages the manifestation of entrepreneurship and innovative spirit by the general public. How can this be like that? It needs to rely on opening up. Just on opening up, not on more regulation!”<sup>7</sup>

*Within the G20 framework, innovation requires policy coordination among member states...*

Of course, there are different opinions around the world in terms of how to achieve innovative growth. Within the G20 framework, innovation requires policy coordination among member states with regard to innovative activities, sharing of innovation benefits, and innovative policy incentives. To achieve the goal of innovative growth, both policy innovation led by the governments of the G20 members and innovation in the approaches to international cooperation is needed. For example, the G20's development agenda is likely to be important for the 2016 innovation agenda. China has indicated that the implementation of the 2030 Sustainable Development Agenda will be central to the G20 focus on development in 2016, and its implementation depends on technological innovation.

The primary challenge that the Chinese G20 Presidency faces will be to define a concrete set of steps that G20 members can take that will translate positive intention and rhetoric into action that actually promotes innovation. Most of the steps required to improve the domestic environment for innovation will lie within the national decision-making processes of member states, and have strong links with existing domestic structural adjustment actions in the areas of trade, competition policy, investment, and labour markets. In addition, the G20 can consider sharing best practices and information on policies to promote and support the science and technology sectors. Just how G20 actions can improve on existing efforts that countries are already taking will need to be clearly articulated.

At the 2014 G20 Brisbane Summit, leaders declared that in the next five years they would undertake actions to add 2 per cent to GDP over five years. This year's Hangzhou Summit needs to focus on continuing those efforts to implement reforms, and also ensure comprehensive growth strategies are innovation-centered. While the G20 has been weak with regard to implementation, the Hangzhou Summit should try to urge all member states to present their own strategic growth plan and commitments to the growth target. Further, innovation has never been a short-term policy option, which means that its effect in stimulating economic growth will take some time. It is still a big challenge for the

<sup>7</sup> Han Zheng, “Shanghai Science and Technology Innovation Center is the Top Issue for the Shanghai Communist Party Committee”, 26 January 2015, [www.thepaper.cn](http://www.thepaper.cn).

G20 to strike a balance between expedient policy actions and long-term economic governance.

## INVIGORATION

For China, the theme of an invigorated economy includes dimensions of both domestic and global invigoration. China's vision of an invigorated economy is one that optimises the allocation of factors of production and resources by overcoming institutional constraints. It is distinct from the concept of economic vitality, which refers to the level of aggregate growth and demand in an economic system during a certain period of time. China's advocacy of an invigorated economy aims at increasing G20 members' total factor productivity (TFP) through institutional reforms.

Global economic imbalances precipitated the 2007–08 financial crisis and, while imbalances are no longer as pressing an issue, more needs to be done to prevent their build-up in the future. Risks persist, for example volatility in financial markets and geopolitical tensions. Both advanced and emerging markets need to be mindful of the impact of national policies on the global economy and cooperate to manage spillovers.

Domestic reforms are the main channel through which macroeconomic coordination is conducted. Domestic economic vitality depends on successful institutional structures and strong policy incentives, which can only be achieved through domestic action. For China, the policy reforms proposed at the third plenary session of the Chinese Communist Party's 18th Congress aim to optimise resource allocations within China as well as the efficiency of market institutions. China's G20 agenda aims to spur the learning and sharing of best practices for domestic reform.

Domestic actions need to be supported at the international level through strong international institutions and rules. An invigorated economy can only be achieved through reforms of the current global regimes in trade, investment, and finance. Importantly, reforms of international economic institutions should not disadvantage the developing world. But in the post-crisis era, this is precisely what is happening. Global trade and investment regulations are impeding the free flow of factors of production, undermining the optimal use of resources, and contributing to the 'structural slowdown' in the developing world. In sum, the key to stimulating world economic growth lies in the promotion of international trade and investment and the building of an open global economy.

In 2016, G20 members should improve policy coordination by overcoming institutional impediments to, and reducing the costs of, flows of factors. This year's summit should concentrate on achieving some breakthrough in terms of two critical issues: one is discussing the impact of low global commodity prices, particularly its effect on commodity

*Domestic reforms are the main channel through which macroeconomic coordination is conducted.*



exporters; and the other is pushing the multilateral trade and investment negotiation processes.

The multilateral trade and investment agenda has always been a major concern of the G20. In the wake of the signing of the Trans-Pacific Partnership (TPP), there is need for discussion about the impact of the TPP on global trade and investment as well as towards the G20's economic goals. This year's G20 summit should aim to make a difference in promoting multilateral trade and investment liberalisation and supporting the World Trade Organization (WTO) as the major forum for multilateral trade negotiation. The G20 could request that the WTO present assessment reports on the potential global impact of the TPP, and also demand more transparency and openness in regional trade and investment treaties. The G20 should keep a close watch on the implications of new trade and investment regulations for developing countries at the lower end of global industrial value chains.

*...“the interconnectivity between growth and development in different countries have become so close that we either stand or fall together”.*

## INTERCONNECTIVITY

China has outlined that “the interconnectivity between growth and development in different countries have become so close that we either stand or fall together”.<sup>8</sup> The speed and connectivity of today's globalised world has broken down national barriers and increased the transmission of both positive and negative economic shocks. This process is ongoing — technological advances, the emergence of new industries, and shifting national policy settings will continue to shape the landscape for economic governance — and policymakers will be under continual pressure to respond to evolving economic events. China's vision is for the G20 to strive to build an open world economy and cooperate to address common challenges.

Further, the return of the manufacturing industry and capital flows to advanced economies is inadvertently undermining global economic interconnectivity, and rule-making through mega-regional trade agreements is, in the eyes of some, reinforcing the tendency toward greater protectionism. The continuation of globalisation depends on whether participants can broadly benefit from the process, otherwise new challenges and crises will not be far away.

China's biggest contribution to the 2016 G20 Summit may be its expertise in infrastructure. The Belt and Road initiative reflects China's advocacy of global value chains through an interconnected growth model. The goals of policy coordination, facilitating connectivity, unimpeded trade, financial integration, and people-to-people bonds demonstrate China's willingness to help countries enhance their industrial capacity and lower costs for Central and South Asian countries by integrating them into global value chains.

<sup>8</sup> Chinese G20 Presidency, “Theme and Key Agenda Items of the G20 Summit in 2016”.

In addition, in 2013 the G20 St Petersburg Summit established the Investment and Infrastructure Working Group, and in 2014 at the Brisbane Summit, leaders announced that the Global Infrastructure Hub would be established in Sydney, partly to mitigate the problem of asymmetric information in infrastructure projects. In the meantime, the World Bank and OECD have published some technical guidelines on issues such as project selection, standardisation of public-private partnerships (PPP), and innovation in financing instruments. At the incoming Hangzhou Summit, China should leverage its advantages in infrastructure building and the ongoing work from the G20 and other multilateral venues. This could help build consensus among G20 member states towards working on a common action plan for global infrastructure building.

*China should leverage its advantages in infrastructure building... working on a common action plan for global infrastructure building.*

China has sponsored two new multilateral development banks that both focus on infrastructure investment: the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank. It would be worthwhile to use the G20 platform to enhance the cooperation between the traditional and new multilateral development banks. President Xi Jinping said at the opening ceremony of the AIIB that:

“The AIIB should adapt itself to new trends in international development and accommodate the diverse needs of developing members. It should explore new business models and financing tools, and help member states develop more infrastructure projects that are of higher quality and at lower costs. While developing countries make the mainstay of the AIIB membership, the institution also attracts a large number of developed members. Such a unique strength makes it a bridge and a bond to facilitate both South-South cooperation and North-South cooperation.”<sup>9</sup>

The G20 should also prioritise reform of its internal coordinating mechanism. Currently, discussion about the development agenda has been through the Sherpa track, yet the implementation of relevant policy advice hinges on the Finance track. While the G20 has certainly made efforts to improve the coordination between the two tracks, the coordination of policies between various governmental departments has become a key barrier to implementation. The G20 should make a draft plan on the reform of current consultation and decision-making so as to improve coordination of Sherpa and Finance meetings. The G20 should also consider how to improve coordination between the Development Working Group and the other G20 Working Groups, including the groups working on macroeconomic coordination, energy sustainability, investment and infrastructure, employment, anti-corruption, and climate finance.

<sup>9</sup> “Full Text of Chinese President Xi Jinping’s Address at AIIB Inauguration Ceremony”, *China Daily*, 16 January 2016, [http://www.chinadaily.com.cn/business/2016-01/16/content\\_23116718.htm](http://www.chinadaily.com.cn/business/2016-01/16/content_23116718.htm).

## INCLUSIVE GROWTH

'Inclusive growth' advances equal opportunities and a harmonious relationship between economic growth, society, and the environment. It is a term with diversified meanings and holds different policy implications for global economic governance and domestic economic growth.

The concept of inclusive growth is gaining traction at a time when the Chinese economy is confronting new challenges such as uneven regional development, widening income gaps, and environmental degradation. Inclusive growth has been written into China's 13th Five Year Plan, reflecting the Chinese Government's commitment to a more sustainable growth model. President Xi has been advocating for concepts such as 'inclusive growth' and 'inclusive cooperation' on various occasions. He has emphasised that the development of the world economy and global governance needs the involvement of every country, in particular developing countries, and that the benefits of world economic development should also be shared by people around the world. It is the G20's responsibility to advocate for inclusive growth to promote sharing the benefits of development.

*...focusing on the development agenda and addressing inequality in global economic governance has been the foremost concern for China.*

As the largest developing country in the world, focusing on the development agenda and addressing inequality in global economic governance has been the foremost concern for China. The 2010 G20 Seoul Summit resulted in the Multi-Year Development Action Plan.<sup>10</sup> The Action Plan covers nine areas related to development: infrastructure, human resources development, private sector investment and job creation, food security, flexible growth, financial inclusiveness, domestic resource mobilisation, and knowledge sharing. The 2015 Antalya Summit stressed concern about the development of Least Developed Countries. The 2016 G20 Summit should continue the implementation of the inclusive development agenda based on the outcomes of the past G20 summits. In addition, China can make efforts to encourage member states to take actions and establish plans for implementing the 2030 Sustainable Development Agenda.

## CONCLUSION

As the world's second-largest economy, China is taking on the due responsibility to meet the world's high expectations for a productive 2016 G20 Summit. It sincerely hopes that its advocacy for an innovative, invigorated, interconnected, and inclusive world economy can help coordinate and implement G20 members' national policies for a robust and sustainable growth model for the world economy.

<sup>10</sup> G20, *The Seoul Summit Document*, Seoul Summit 2010, 11–12 November 2010, <http://www.g20.org/English/Documents/PastPresidency/201512/P020151225619908599180.pdf>.

# THE GLOBAL INFRASTRUCTURE HUB

BILL BRUMMITT AND LAURA WALSH<sup>1</sup>

## INTRODUCTION

Under Australia's G20 Presidency in 2014, the G20 agreed to the Global Infrastructure Initiative to help lift quality infrastructure investment.<sup>2</sup> The Initiative reflects the G20's commitment to create a climate that facilitates higher investment, particularly in quality infrastructure and in small and medium sized enterprises. The Global Infrastructure Hub (the GIH or Hub) was established by leaders at the Brisbane Summit in November 2014 as a dedicated resource to help implement the Initiative.

The GIH is one of a very small number of international institutions created by the G20, including the Financial Stability Board and Agricultural Market Information System.<sup>3</sup> The G20 designed the Hub to work collaboratively with governments, the private sector, national, regional and multilateral development banks, international organisations, and other stakeholders. The principal asset of the Hub is the G20 mandate, allowing the organisation to shine a light on the reforms, planning approaches, and risk allocation strategies that will drive public-private investment into the infrastructure sector. The Hub is funded through support from G20 nations including Australia, the United Kingdom, Saudi Arabia, China, New Zealand, Mexico, Singapore, and Korea.

The Hub is now fully operational, with a broad and ambitious mandate. This paper details the Hub's 'reason for being', describes the progress made by the Hub since the Brisbane Summit, and outlines the priorities for 2016.

## REASON FOR BEING: ADDRESSING THE INFRASTRUCTURE GAP

The global financial crisis saw a tightening of spending, and an understandable reluctance from governments and the private sector to invest in large-scale, potentially risky infrastructure projects. Meanwhile,

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<sup>2</sup> G20, "The G20 Global Infrastructure Initiative", September 2014, [http://globalinfrastructurehub.org/content/uploads/2015/10/g20\\_note\\_global\\_infrastructure\\_initiative\\_hub.pdf](http://globalinfrastructurehub.org/content/uploads/2015/10/g20_note_global_infrastructure_initiative_hub.pdf).

<sup>3</sup> The Financial Stability Board was established at the G20 London Summit in 2009 as the successor to the Financial Stability Forum. The Agricultural Market Information System was established at the request of the Agriculture Ministers at the G20 Cannes Summit in 2011 as an inter-agency platform to enhance food market transparency and encourage coordination of policy action in response to market uncertainty.

*...the difference between global infrastructure needs and spending on infrastructure is likely to be anywhere between US\$15 trillion and US\$30 trillion by 2030.*

growth and social transformation continued apace in emerging markets. Developed markets' existing infrastructure continued to age and the need for transformative energy, transport, and communications investments became clearer.

Greater investment in infrastructure is required to lift global growth, expand future supply capacity, support urbanisation, and make further inroads into poverty alleviation. Estimates of the infrastructure deficit vary, but it is generally agreed that if current spending on infrastructure remains the norm, the difference between global infrastructure needs and spending on infrastructure is likely to be anywhere between US\$15 trillion and US\$30 trillion by 2030.<sup>4</sup>

So what is being done about it? The G20 has recognised this is a problem of global dimensions, with large cross-country spillovers and potential gains from coordinated actions. The GIH is a key part of the G20's infrastructure agenda and its work will complement the country-specific actions that G20 countries have committed to undertake in growth and investment strategies. To that end, the Hub will work closely with existing multilateral development banks, international organisations, and the private sector, as well as G20 and non-G20 countries.

## WHAT IS THE G20 MANDATE FOR THE GIH?

The GIH has a four-year mandate from the G20 to lower barriers to investment, increase the availability of investment-ready projects, help match potential investors with projects, and improve policy delivery, including through:

- developing a knowledge-sharing network to aggregate and share information on infrastructure projects and financing between governments, international organisations, multilateral development banks, national infrastructure institutions, and the private sector
- addressing key data gaps that matter to investors
- developing effective approaches to implement the voluntary *G20 Leading Practices on Promoting and Prioritising Quality Investment*, including model documentation covering project identification, preparation and procurement
- sharing best practice approaches to build the capacity of officials and improve institutional arrangements for infrastructure

<sup>4</sup> Richard Dobbs et al., "Infrastructure Productivity: How to Save \$1 Trillion a Year", McKinsey Global Institute Report, January 2013, [http://www.mckinsey.com/insights/engineering\\_construction/infrastructure\\_productivity](http://www.mckinsey.com/insights/engineering_construction/infrastructure_productivity); PricewaterhouseCoopers, "Capital Projects and Infrastructure Spending: Outlook to 2025", 2014, <http://www.pwc.com/gx/en/industries/capital-projects-infrastructure/publications/cpi-outlook.html>.

- developing a consolidated database of infrastructure projects, connected to national and relevant multilateral development bank databases, to help match potential investors with projects.

The strategic vision of the Hub is to transform investment processes and thereby strengthen and enhance the global infrastructure market. Although this is an ambitious goal within a four-year timespan, it is short by government and infrastructure standards. Applying the combined government, legal, private finance, and multilateral development bank expertise of the organisation, the Hub will collaborate closely with other organisations and strive to understand and address constraints to investment. The focus will be on activities that can be scaled up, and directing attention toward where the greatest impact can be made.

## WHAT WAS ACHIEVED IN 2015?

The GIH was registered as a company under Australian law in December 2014. Since then, significant progress has been made. The Hub has become fully functioning, with 15 staff and key leadership positions including CEO Christopher Heathcote put in place in 2015.<sup>5</sup> Meetings of the seven-member international Board were held in April, September, and December 2015. In September 2015, the Board approved the Hub's business plan, which was then endorsed by G20 finance ministers and central bank governors.<sup>6</sup>

In 2015, the GIH was closely involved in G20 discussions on investment issues. The Turkish G20 Presidency provided strong support for the Hub, actively engaging on the Board and facilitating a robust discussion among Ministers on the Hub's business plan in Ankara in September. Pressuring the Hub for short-term, low-impact deliverables at Antalya would have merely added to the G20 paper chase. Instead, Turkey saw the need to focus on the big picture goals of building a pipeline of high-quality projects and developing a knowledge network.<sup>7</sup> This will more closely engage the private sector and help countries navigate the best practice maze.

*The strategic vision of the Hub is to transform investment processes...*

## WHAT ARE THE PRIORITIES FOR 2016?

In 2016, the Hub's priorities will revolve around understanding and breaking down the barriers to investment. This will be achieved through collecting best practice from across the world and making it accessible to

<sup>5</sup> For descriptions of key staff, including CEO Chris Heathcote, see <http://globalinfrastructurehub.org/about/people/>.

<sup>6</sup> For the full Global Infrastructure Hub Business Plan 2015–16, see [http://globalinfrastructurehub.org/content/uploads/2015/10/GIH\\_2015-16\\_Business\\_Plan.pdf](http://globalinfrastructurehub.org/content/uploads/2015/10/GIH_2015-16_Business_Plan.pdf).

<sup>7</sup> G20, *Finance Ministers and Central Bank Governors Communiqué*, 4–5 September 2015, Ankara, <http://globalinfrastructurehub.org/content/uploads/2015/10/September-FMCBG-Communique.pdf>.

all, through data creation, capability building, and matching bankable projects to private sector partners. Through the membership of Vice Finance Minister Zhu Guangyao on the GIH Board, China is already familiar with the Hub's plans. The GIH will continue to engage with senior Chinese officials to lay the basis for strong cooperation, and looks forward to working closely with China throughout its 2016 G20 Presidency, as well as Germany ahead of its 2017 host year.

#### BRIDGING DATA GAPS

*...gaps in information and data...may be acting as a barrier to efficient infrastructure markets.*

The GIH is engaging with a range of global private investors with respect to gaps in information and data that may be acting as a barrier to efficient infrastructure markets, as well as reviewing relevant literature. A joint survey has been commissioned with the EDHEC Research Institute to better understand how infrastructure is performing as an asset class.<sup>8</sup> The survey is expected to reveal investor perceptions of risks specific to infrastructure in various markets, and expectations for required returns. This information is essential to provide a signal to policymakers on trends in private financing costs, including whether there is increasing appetite for exposure to infrastructure risk in emerging markets.

There has been some work to quantify the overall need for infrastructure and the ability to fund this need, although gaps remain.<sup>9</sup> The GIH intends to build on existing knowledge by commencing a review that will result in new information on the overall projected needs for economic infrastructure to 2040, as measured by sector and by country.

#### CAPABILITY BUILDING

The GIH is creating a tool, the Capability Framework, to assess the extent of development and maturity of a country's infrastructure market. The Hub has also started identifying global best practices and aims in order to benchmark existing (country-specific) capability. The Framework will enable national infrastructure bodies to identify priority areas for policy reform, with the aim of increasing the pipeline of projects and attracting more private capital. This will allow countries to target areas which may currently be limiting private investment in their national infrastructure.

In 2016, the Capability Framework will begin with a small pilot study and consultation on the methodology and results, allowing an expansion to cover a broader spectrum of countries and their markets in future years. Further, the GIH is organising a public sector seminar, to be held in Shanghai in the first half of 2016, aimed at introducing the Hub and its

<sup>8</sup> The EDHEC Research Institute describes itself as a leading producer of applied academic research on infrastructure. The Institute is based in Singapore and part of France's EDHEC Business School.

<sup>9</sup> Richard Dobbs et al., "Infrastructure Productivity: How to Save \$1 Trillion a Year"; PricewaterhouseCoopers, "Capital Project and Infrastructure Spending: Outlook to 2025".

Capability Framework to a key client group of heads of public-private partnership (PPP) units from G20 and non-G20 countries. It will also be seeking to facilitate in-depth discussions that will help inform the Framework on issues such as national planning and project selection, non-project risks, and asset allocation.

The Hub is also in the process of mapping an online guide to existing infrastructure initiatives, organisations, and documentation to help better connect existing resources and improve coordination at the national, regional, and multilateral level. The Global Infrastructure Hub Guide to Infrastructure Resources will be organised in line with the Hub's Capability Framework. It will be searchable by region, author, organisation, product type, document type, etc, with scope for comment by both users and resource authors. It will ultimately be a publicly accessible resource on the Hub's website, and work is progressing towards a launch at the April 2016 G20 Finance Ministers and Central Bank Governors Meeting.

#### MATCHING BANKABLE PROJECTS TO PRIVATE SECTOR PARTNERS

In order to improve the visibility and understanding of government infrastructure projects by the private sector, the Hub is aiming to develop a global database that would track projects through various stages from project conception to operation. To ensure that the Hub's activities build on existing initiatives and minimise duplication, the GIH is in active discussions with the Sustainable Infrastructure Foundation on expanding its International Infrastructure Support System project preparation tool for governments to incorporate a consolidated project database or global project pipeline. The GIH is still undertaking a process to determine both the feasibility of the project pipeline concept and the precise role it has in product development and operation.

The GIH intends to collaborate with the World Bank Group and the Government of Singapore to expand on the G20's existing focus on contractual provisions surrounding PPPs. Specifically, the Hub will focus on the development of a new *Report on Recommended Risk Allocation Principles*, to be published as a 'companion piece' to the 2016 edition of the World Bank Group's *Report on Recommended PPP Contractual Provisions*.<sup>10</sup> To this end, the GIH is in discussions with the Government of Singapore to co-host a major conference on risk allocation. Likely to be held in April 2016, the conference would bring together representatives of governments, project developers, lenders, and other stakeholders, with a view to providing inputs into the preparation of sample risk allocation matrices for projects in a number of sectors. These sample risk matrices would be extensively annotated, so as to

*The GIH intends to collaborate with the World Bank Group and the Government of Singapore to expand on the G20's existing focus on contractual provisions surrounding PPPs.*

<sup>10</sup> Previous editions of the *Report on Recommended PPP Contractual Provisions* can be found at <http://ppp.worldbank.org/public-private-partnership/library/wbg-report-recommended-ppp-contractual-provisions>.



provide guidance for their use in countries at various levels of PPP market development. The Hub aims to submit a final version of the *Report on Recommended Risk Allocation Principles* to the G20 during the Chinese Presidency.

Other initiatives with regard to proposed leading practices are also being developed, including potential initiatives related to project prioritisation and identifying infrastructure projects best suited for private sector participation.

## FUTURE DIRECTIONS FOR THE GIH

As noted when the G20 first established the GIH, it is important that existing work is not duplicated. The Hub has established strong working relationships with the multilateral development banks to ensure its work is complementary and collaborative, and contributing new ideas and tools to maximise infrastructure investment. The Hub will continue to consult widely on its priorities to ensure its work helps to address the infrastructure deficit.

Much of the work of the GIH will require collaboration with both public and private sector partners. The meetings and discussions held so far have been enormously helpful in understanding the views and needs of those involved in infrastructure funding and financing. The engagement program will continue as the work program is delivered. To enhance dialogue, interactive features will be introduced on the Hub's website in 2016, providing a further mechanism for stakeholder input. The GIH is also looking to host further seminars and events targeting a broader audience. Conversations with interested bodies on how the GIH can best deliver on its aims are welcome, and the GIH is looking forward to working across the G20 and beyond to help unlock the potential for infrastructure investment globally.

# THE G20 AND IMF REFORM IN 2016

TRISTRAM SAINSBURY<sup>1</sup>

## INTRODUCTION

In December 2015, the US Congress finally passed a long-awaited package of reforms to IMF governance, a move that was broadly celebrated by the economic policy community. The reforms aim to enhance IMF resourcing and increase the voice and representation of fast-growing emerging markets in the IMF, and are an important step towards ensuring that shared decision-making in global economic governance reflects economic reality. Unfortunately, the five years it took for the reforms to be ratified by the US Congress have damaged the credibility of the IMF, brought the value of a G20 commitment into question, hurt the reputation of US global economic leadership, and delayed further opportunities to modernise the IMF.

In 2016 negotiators at the G20 and the International Monetary and Financial Committee (IMFC) will need to turn their attention towards the next round of IMF quota and governance reform. IMF governance modernisation is an ongoing process, and emerging markets are still well under-represented at the Fund. It is essential that reform efforts continue if the IMF is to be representative and legitimate, and effectively play its cornerstone role in protecting the international monetary system. Specifically, further efforts are needed to reduce European over-representation and increase the voice of emerging markets, particularly China. Key points of debate on the detail will be: how much to vary IMF voting shares to reflect updated economic data; what amendments are needed to the formula used to calculate quota allocations; the level of resourcing the IMF needs in both the short term and into the next decade; and how to ensure that key IMF staff and management appointments are based on merit.

Reaching an agreement on any parts of this reform process will not be easy, especially with the US capacity to demonstrate economic leadership and G20 effectiveness being openly questioned. Given the multi-year process of ratification and arduous domestic process of the 2010 reforms, a final agreed position will be left in the hands of the next US administration. The IMF itself has flagged that the next round of reforms will be completed by the 2017 IMF and World Bank Annual

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*China will need to push the G20 and IMFC to make clear progress on the interrelated areas of IMF quota, governance, and resources...*

meetings.<sup>2</sup> Rather than finalise IMF reforms in 2016, the challenge (and opportunity) for the 2016 Chinese G20 Presidency will be to demonstrate the necessary leadership that builds on existing efforts. China will need to push the G20 and IMFC to make clear progress on the interrelated areas of IMF quota, governance, and resources, and also ensure that IMF resources are sufficient to meet short-term financing needs. If China can achieve this, it will inject momentum into global economic governance reform and make a substantial contribution towards a core G20 priority.

### THE SORRY RECENT HISTORY OF IMF REFORM

In 2010, the G20 and IMF agreed to a series of reforms to update IMF quota and governance arrangements. The deal involves four main elements:

- doubling quotas and IMF permanent capital to SDR 477 billion<sup>3</sup> (approximately US\$650 billion)
- reallocation of quotas towards dynamic emerging markets and developing countries, including fast-growing China, Brazil, and India
- provision for an all-elected IMF Executive Board<sup>4</sup>
- an informal agreement that advanced Europe would reduce their representation on the 24-seat IMF Executive Board by two seats.

These changes are modest. Overall IMF resourcing remains unchanged, with the approximate US\$325 billion increase in permanent resourcing offset by a commensurate reduction from the US\$500 billion in borrowed resources that form the New Arrangements to Borrow (NAB). The proposed shift in quota share from advanced economies to emerging markets is only 2.8 percentage points, even though China becomes the third-largest member of the IMF. This deal was supposed to signal bigger changes to come, including a review of the formula for determining quota allocations that was expected to result in a larger shift

<sup>2</sup> IMF, "Fifteenth General Review of Quota — Report of the Executive Board to the Board of Governors", 16 January 2016, <http://www.imf.org/external/pp/longres.aspx?id=5016>.

<sup>3</sup> SDR, or Special Drawing Rights, are supplementary foreign exchange reserve assets defined and maintained by the IMF. SDR values are based on a basket of currencies comprising the US dollar, pound sterling, euro, yen, and renminbi. As at 12 January 2016, the rate of conversion is US\$1.38 = 1 SDR.

<sup>4</sup> The IMF Executive Board is composed of 24 Directors, who are appointed or elected by member countries or by groups of countries, and the Managing Director, who serves as its Chairman. Also see IMF, "IMF Executive Directors and Voting Power", Fact Sheet, <https://www.imf.org/external/np/sec/memdir/eds.aspx>, accessed 12 January 2016.

in quota shares to emerging markets. The 2010 reform package was hailed as a historic step by the IMF itself.<sup>5</sup>

The excitement wore off and quickly turned into international frustration. The original date for implementation of the reforms by all countries was the end of 2012. Yet by 2012 the make-up of the US Congress had changed from the composition in June 2009 that saw a slim 226–202 vote in favour of reform, and the Obama administration could not get the reforms through the Republican-controlled House of Representatives, which had been opposed to them for a range of irrational reasons.<sup>6</sup> IMF reform was unable to proceed without this US vote. From mid-2013, countries representing over 80 per cent of IMF votes had approved the reforms, but the required threshold for reform is 85 per cent. With its 16.7 per cent share of IMF votes, the US essentially has a veto.

The ongoing delay drew condemnation from the G20 and from BRICS leaders, who have repeatedly stated in official communiqués that it was a source of ‘serious concern and disappointment’. It has been cited as one reason behind the establishment of the BRICS New Development Bank and Contingent Reserve Arrangement. Mike Callaghan has noted that the current US veto means that, regardless of the position of the US administration, the rest of the world remains hostage to the unpredictable workings of the US Congress.<sup>7</sup> US Treasury Secretary Jack Lew has revealed that “as someone who for the last three years has gone to international meetings ... I can tell you that it was ratcheting to the point where it was doing real damage”.<sup>8</sup>

The delays in the US also sparked discussion about what can be done to give effect to the reforms in the absence of US ratification. A set of creative but highly technical ‘Plan B’ alternatives were canvassed, such as ad hoc quota shifts (modest changes to individual countries’ quota that can take place outside a collective agreement); delinking the package of IMF reforms in order to achieve easier ‘quota’ parts of the reform package and pursuing harder ‘governance’ parts later; opening a new round of discussions and aiming to pass both existing and new reviews together; or using the discretionary powers provided to the US IMF executive director (and the implicit consent of the US administration)

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<sup>5</sup> IMF, “G-20 Ministers Agree ‘Historic’ Reforms in IMF Governance”, *IMF Survey Magazine*, 23 October 2010, <http://www.imf.org/external/pubs/ft/survey/so/2010/NEW102310A.htm>.

<sup>6</sup> H.R. 2346 Supplemental Appropriations Act, 2009 includes US\$5 billion to approve a US\$108 billion loan to the IMF as was passed by the US House of Representatives. The US Senate approved the legislation on a vote of 91–5.

<sup>7</sup> Mike Callaghan, “IMF Reforms Pass Congress but Too Late to Salvage US Leadership Credentials”, *The Interpreter*, 21 December 2015, <http://www.lowyinterpreter.org/post/2015/12/21/IMF-reforms-pass-Congress-but-too-late-to-salvage-US-leadership-credentials.aspx>.

<sup>8</sup> Jackie Calmes, “IMF Breakthrough Is Seen to Bolster US on World Stage”, *New York Times*, 6 January 2016, [http://www.nytimes.com/2016/01/07/business/international/imf-breakthrough-is-seen-to-bolster-us-on-world-stage.html?\\_r=0](http://www.nytimes.com/2016/01/07/business/international/imf-breakthrough-is-seen-to-bolster-us-on-world-stage.html?_r=0).

to bypass the US Congress. However, all of these proposals were problematic. The negotiations were politically fraught given that most of the options would reduce US involvement in the IMF, and they were still too modest.

Some academics have suggested exploring options in the broader financial safety net outside the IMF, which includes national arrangements such as reserves, bilateral arrangements such as central bank swap lines, and regional arrangements such as the Chiang Mai Initiative Multilateralisation and the BRICS Contingent Reserve Arrangement.<sup>9</sup> G20 ministers and governors have called for an assessment by the IMF of the global financial safety net architecture by early 2016. The analysis has the potential to be an important input into future discussions by policymakers.

The simple truth is that there was no easy solution to break the deadlock, and all the rest of the world could do was to wait for the US to pass reform.

## WHAT DOES THE PASSING OF REFORM MEAN FOR THE G20 AGENDA IN 2016?

When the 2010 quota and governance reforms were agreed, there was a promise of more reform to come. Specifically, G20 Leaders committed to complete another round of IMF modernisation talks by January 2014 (the 15th General Review of Quotas). However, the 15th General Review could not commence without the 2010 reforms first being passed due to the risk of combining the two rounds of IMF reform and potentially undermining the hard-won compromise of 2010.

Now, with the 2010 reform package passed in December 2015, the 15th General Review will be the focus of G20 and IMFC negotiations in 2016. This review will need to decide the extent of further quota and governance reform, and the resources necessary for the IMF to fulfil its objectives.

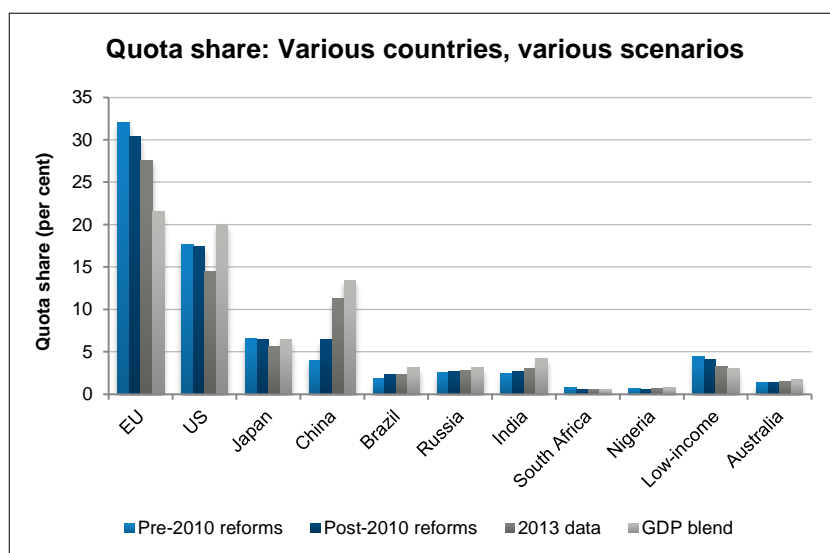
*...the 15th General Review will be the focus of G20 and IMFC negotiations in 2016.*

### QUOTA AND GOVERNANCE REFORM

Decisions need to be made regularly to adjust IMF quota shares in line with updated economic data. Based on the 2010 reform package, advanced economies reflect 57.6 per cent of IMF votes, and emerging market and developing countries the remaining 42.4 per cent. This remains some way away from the economic activity of the first half of this decade, when emerging and developing economies accounted for 56 per cent of global GDP and 79 per cent of global growth (both on a

<sup>9</sup> See, for example, Adam Triggs, "The G20 Is Not Ready for the Next Crisis", *East Asia Forum*, 8 November 2015, <http://www.eastasiaforum.org/2015/11/08/the-g20-is-not-ready-for-the-next-crisis/>.

purchasing power parity (PPP) basis) between 2010 and 2015.<sup>10</sup> According to data published by the IMF in July 2015, a further 6.2 percentage points of shift in quota shares from advanced to emerging market economies would be needed to reflect current economic reality.<sup>11</sup> About 80 per cent of this shift — 4.9 percentage points — would be to the benefit of China, which seems destined to become the second-largest member at the IMF, overtaking Japan. Slower-growing advanced economies in the European Union, which are over-represented relative to the region's economic weight, and the United States, which is under-represented relative to its economic weight, would be expected to contribute the majority of the quota shift.



Source: IMF and author calculations. Pre-2010 reforms are the quotas as agreed in the 2008 reform package; post-2010 reforms are based on 2008 data; 2013 data is to update 2010 reforms for data available for 2013; and GDP blend reflects a hypothetical scenario if quota was 100 per cent GDP (at 60 per cent market exchange rates and 40 per cent PPP).

Such a change would create an interesting dilemma for IMF negotiators. Based on the agreed 2010 reform package updated for latest available data, the US quota share would drop to 14.5 per cent, *below* the 15 per cent threshold required for a veto on the important decisions at the Fund required for a supermajority and well below the US's 20 per cent share of the global economy.<sup>12</sup> It is difficult to imagine the United States agreeing to any outcome that will surrender its veto power, particularly to a voting share that diverges so far from its economic size, and so any

*...a further 6.2 percentage points of shift in quota shares from advanced to emerging market economies would be needed to reflect current economic reality. About 80 per cent of this shift ... would be to the benefit of China.*

<sup>10</sup> IMF, "The Global Economy in 2016", *IMF Survey Magazine*, 4 January 2016, <https://www.imf.org/external/pubs/ft/survey/so/2016/INT010416A.htm>.

<sup>11</sup> Table 1 and Table 2a, calculated using 2013 data and based on the current quota formula: see IMF, "Quota Formula — Data Update", July 2015, <https://www.imf.org/external/np/pp/eng/2015/061915.pdf>.

<sup>12</sup> GDP blend calculation: 60 per cent at market exchange rates, and 40 per cent by purchasing power parity.

agreement to update quota shares based on new data will also need to be accompanied by changes to the formula used for calculating a country's quota.<sup>13</sup>

In 2010, the memberships of the IMF and G20 agreed to a comprehensive review of the quota formula, to be concluded by January 2013. Following an extensive discussion process within the IMF, a quota formula review was duly delivered by the IMF Executive Board on 30 January 2013. However, despite claims that the review made progress in identifying 'building blocks' to underpin a final agreement, it was largely toothless as a stand-alone process given that the quota formula, the 15th General Review, and relevant data were interconnected issues and would all continue to update over time. An integrated package was needed.

The agreed building blocks for a revised quota formula are (with current weightings in brackets):<sup>14</sup>

- **GDP** (30 per cent market exchange rates, 20 per cent PPP). There is agreement that GDP is the most comprehensive measure of economic size and so should be the most important variable. There should also be scope to increase its weight, and perhaps to look to shift the blend towards more PPP, which would increase the weight of emerging market and developing countries and low-income countries.
- **Openness** (30 per cent). Openness benefits smaller, higher-income IMF countries. There is support to retain but examine openness to make methodological improvements. It should play an important role in the formula, notwithstanding conceptual flaws and measurement issues.<sup>15</sup>
- **Variability** (15 per cent). There is support to drop variability from the formula. The measure is meant to be a proxy for demand for IMF resources but suffers serious methodological shortcomings and there is little evidence of a relationship between the variable and actual demand for IMF resources.
- **Reserves** (5 per cent). There is 'considerable' support to retain reserves at its current weight.

<sup>13</sup> The quota formula is calculated as follows:  $Quota = (0.5 * GDP + 0.3 * Openness + 0.15 * Variability + 0.05 * Reserves)^{0.95}$ . Quota shares are not automatically updated in line with data; rather, decisions by the IMF Executive Board are made to update quota shares and/or amend the formula for calculating them, generally every five years.

<sup>14</sup> IMF, "Report of the Executive Board to the Board of Governors on the Outcome of the Quota Formula Review", <https://www.imf.org/external/np/pp/eng/2013/013013.pdf>.

<sup>15</sup> Conceptual and measurement issues include reliance on gross flows and the challenges posed by intra-currency union trade.

- **Compression factor** (weighting all variables by  $\wedge 0.95$ ). There is agreement on the need to have a compression factor to moderate the influence of size in the quota formula.

One important challenge will be balancing the increase in the share of dynamic economies while still protecting the voice and representation of the poorest IMF members.

The governance aspect of the 2010 reforms is often overlooked. The provision for an all-elected IMF Executive Board was a pragmatic necessity given the complicated manner by which board seats are assigned. A policy of allowing the top five IMF members to directly appoint board members was possible when those five seats were occupied by (in order of size) the United States, Japan, Germany, and France and Britain at equal fourth.<sup>16</sup> However, China's rise to third-largest member pushed France and Britain into a 'tie' for the fifth appointed seat. A stronger rationale was to make all board seats elected positions, rather than allow a sixth seat to be appointed.

More important to the IMF's longer-term credibility, legitimacy, and effectiveness is ensuring that key IMF staff and appointments to the IMF Executive Board are reflective of the true state of the global economy. Addressing the European overweight with the IMF Executive Board remains an ongoing challenge. The 2010 reforms were notable in that advanced European members agreed to reduce their representation by two seats, to 8 out of the 24. However, as Tom Bernes from the Centre for International Governance Innovation notes, there is little rationale that justifies Europe, comprising just 21.5 per cent of the global economy, holding a third of the seats.<sup>17</sup> European seats can be reallocated to emerging market and developing countries. Alternatively, the overall board size could be reviewed with the possibility of reducing the number of seats in the interests of efficiency. Notably, the IMF Articles of Agreement call for 20 seats.<sup>18</sup>

*...there is little rationale that justifies Europe, comprising just 21.5 per cent of the global economy, holding a third of the [IMF Executive Board] seats.*

Further advances might come from simply fulfilling commitments to adhere to a process of merit-based appointment of key IMF staff. At the Antalya Summit in 2015, G20 Leaders reaffirmed an agreement that heads and senior leadership of all international financial institutions should be appointed through an open, transparent, and merit-based

<sup>16</sup> France and Britain have equal shares at the IMF — a position that traces its history back to the original negotiations at Bretton Woods.

<sup>17</sup> Thomas A Bernes, "IMF Governance Reform: A Small Step but Big Challenges Ahead", *The Global Economy* (blog), 30 December 2015, <https://www.cigionline.org/blogs/global-economy/imf-governance-reform-small-step-big-challenges-ahead>. EU GDP calculated as a blend of 60 per cent by market exchange rates and 40 per cent by purchasing power parity, 2013 data.

<sup>18</sup> Edwin M Truman, "Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform", in *Reforming the IMF for the 21st Century*, ed EM Truman, Special Report 19 (Washington DC: Institute for International Economics), April 2006, [https://www.piie.com/publications/chapters\\_preview/3870/09iie3870.pdf](https://www.piie.com/publications/chapters_preview/3870/09iie3870.pdf).



process, and reiterated the importance of enhancing staff diversity in these organisations.<sup>19</sup> In 2016 there will be two key appointment questions that may test the resolve of IMF decision-makers in fulfilling this commitment: replacing the Managing Director, Christine Lagarde, and the First Deputy Managing Director, David Lipton. These are critical positions that are currently and effectively held by a European and an American, respectively, and their replacements will be viewed politically. Lagarde has received wide praise for her performance and many expect she will keep the position. Lipton is due to retire and will need to be replaced. Tom Bernes points out that merit should always be the guiding principle in appointments, but balanced geographical representation plays a role in ensuring IMF legitimacy.<sup>20</sup> The key will be a transparent and competitive selection process that is based on objective criteria.

*Another key challenge of the next round of reform will be ensuring that the IMF has sufficient resources...*

## RESOURCES

Another key challenge of the next round of reform will be ensuring that the IMF has sufficient resources to meet the global financing needs of the next decade.

The pervading logic during the 'great moderation' years immediately preceding the global financial crisis was that advanced economies with floating exchange rates and inflation targeting needed no safety net.<sup>21</sup> An important lesson of the crisis was the folly of this reasoning, resulting in an unprecedented commitment of new resources to the safety net required from 2009.<sup>22</sup> This initially took the form of borrowed resources (including the agreement at the London G20 Summit to triple IMF resources by boosting the NAB by US\$500 billion<sup>23</sup>), accompanied by a new SDR allocation of US\$250 billion. The subsequent quota and governance reform decision in 2010 recognised that greater IMF resourcing was needed on an ongoing basis and put these resources on a more permanent, quota basis. The ratification of the 2010 reforms doubles the IMF's permanent resources to more than US\$650 billion.

Lingering vulnerabilities and the intensifying euro crisis in 2012 then saw agreement to further bolster the safety net with US\$461 billion in bilateral

<sup>19</sup> G20, *G20 Leaders' Communiqué*, Antalya Summit, 15–16 November 2015, <http://g20.org.tr/wp-content/uploads/2015/11/G20-Antalya-Leaders-Summit-Communiqu--.pdf>.

<sup>20</sup> Thomas A Bernes, "IMF Governance Reform: A Small Step but Big Challenges Ahead".

<sup>21</sup> Adam Hawkins, Jyoti Rahman and Thomas Williamson, "Is the Global Financial Safety Net at a Tipping Point to Fragmentation?", *Economic Roundup*, Issue 1 (2014), 1–20, [http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2014/Economic%20Roundup%20Issue%201/Downloads/PDF/01\\_Global\\_financial\\_safety\\_net.ashx](http://www.treasury.gov.au/~media/Treasury/Publications%20and%20Media/Publications/2014/Economic%20Roundup%20Issue%201/Downloads/PDF/01_Global_financial_safety_net.ashx).

<sup>22</sup> Thomas A Bernes, "IMF Governance Reform: A Small Step but Big Challenges Ahead".

<sup>23</sup> G20, *G20 Leaders' Statement*, London Summit, 2 April 2009, [https://www.imf.org/external/np/sec/pr/2009/pdf/g20\\_040209.pdf](https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf).

loans, generally of two to four years duration. Of these bilateral loans, US\$379.7 billion has been subsequently enacted through domestic processes and are available as the IMF's second line of defence. Fortunately, these loans have not been called upon. However, the bilateral loans are due to start expiring from late 2016.

The expiry of the bilateral loans has the potential to introduce unacceptable systemic risk into the global economy, given the reason they are still in place is continued economic vulnerabilities. The loans were justified as temporary because of the supposedly unprecedented events, and were time limited — that is, only meant to last until the next round of quota reform could be agreed. But they provide important reassurance to financial markets that the IMF has the capacity to respond to any issue that it confronts. The G20 should therefore look to negotiate their extension in 2016 on the basis that the 15th General Review will detail a longer-term vision on the Fund's resourcing.

The challenges in negotiating an extension to the bilateral loans should not be underestimated. It will take adroit and concerted leadership from China as G20 chair to make the case and then convince bilateral lenders in Europe, Japan, and emerging market economies (Canada and the United States were not participants in the bilateral lending) of the merit in extending their commitments. For one thing, it will be more difficult to make the case in 2016, given the sense that a near-term global economic disaster is not as imminent a prospect as it was at the height of the 2012 euro crisis.<sup>24</sup> Other BRICS countries are likely to argue that extending loans may delay negotiations on quota and governance reform.

Estimates of the future need for additional IMF resources are also controversial and are plagued by philosophical differences about the appropriate role and scale of the IMF. Decisions to resource the IMF need to balance, for example, the moral hazard of the IMF to both lenders and borrowers, with the public good dimensions to IMF finance, such as a reduced incentive to self-insure through reserves.<sup>25</sup> Further, Carmen Reinhart and Christoph Trebesch recently detailed the tensions between the IMF's traditional role as international lender of last resort, and its more recent behaviour of 'serial lending' in which programs often span decades and there is a much greater risk of the IMF lending into insolvency.<sup>26</sup> Differing views on how much money the IMF needs to perform its role in the international financial architecture, and how far its role should extend, will underpin discussions on whether and how to

*The expiry of the bilateral loans has the potential to introduce unacceptable systemic risk into the global economy...*

<sup>24</sup> Martin Wolf, "Why Global Economic Disaster Is an Unlikely Global Event", *Financial Times*, 5 January 2016, <http://www.ft.com/intl/cms/s/0/db57a57e-b38b-11e5-b147-e5e5bba42e51.html#axzz3yPjMaib>.

<sup>25</sup> Edwin M Truman, "Rearranging IMF Chairs and Shares: The Sine Qua Non of IMF Reform".

<sup>26</sup> Carmen M Reinhart and Christoph Trebesch, "The International Monetary Fund: 70 Years of Reinvention", NBER Working Paper No 21805, December 2015.

replace expiring funds. Ted Truman from the Peterson Institute has argued that a minimum should be to replace the bilateral loans, and that a conservative estimate further increase in IMF resources should need to be at least US\$500 billion to a total of US\$1.25 trillion, if not doubling to US\$1.5 trillion.<sup>27</sup> But it remains to be seen if any kind of financial commitment that involves new and additional resources from the United States will prove politically feasible.

## CONCLUSION

IMF modernisation is an ongoing process, and discussions by the combined memberships of the G20 and IMFC will now need to turn to further changes in IMF governance arrangements and how much resourcing the IMF needs for the next decade. What we are likely to see is a multi-year process that involves gradual moves to increase the voice and representation of emerging market economies, and reduce the over-representation of advanced European decision-makers.

The September G20 Leaders Summit in Hangzhou will not welcome a final agreement on the 15th General Review, but China can use its G20 Presidency to ensure that important progress is made. A focus should be on commencing discussions on the 15th General Review and seeking to drive a political agreement among G20 members to extend bilateral resourcing until a more permanent resourcing solution can be agreed upon. This will not be easy, but discussions that further progress IMF reform cannot be ignored. The G20 Finance Ministers and Central Bank Governors Meeting in Shanghai in February will test the ongoing political commitment to reform. A strong statement of intent should be the benchmark.

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<sup>27</sup> Edwin M Truman, "What Next for the IMF?", Peterson Institute for International Economics Policy Brief No PB-15-1, January 2015, <http://www.iie.com/publications/pb/pb15-1.pdf>.

# REFORMING INTERNATIONAL TAX: IS BEPS THE END OF THE STARTING POINT?

MIKE CALLAGHAN<sup>1</sup>

## INTRODUCTION

In October 2015 the OECD published a series of reports dealing with tax base erosion and profit shifting (BEPS). This was the outcome of work that commenced in September 2013 at the request of the G20. The BEPS outcome was duly endorsed by G20 Leaders at their summit in Antalya, Turkey, on 15–16 November 2015.

The objective of the BEPS exercise is to combat tax avoidance and evasion by multinational corporations. As the OECD notes, the integration of national economies and markets has increased significantly and put strain on the international tax framework designed more than a century ago.<sup>2</sup> Existing tax rules provide corporations with opportunities to exploit loopholes in national tax laws, and the OECD estimates that governments are missing out on tax revenue of between US\$100 billion and US\$240 billion each year through BEPS.

The reaction to the BEPS package has been mixed. Not surprisingly, the OECD was upbeat, saying that the measures would end double non-taxation and lead to a “change of paradigm” that would make tax planning marginal rather than a core business activity.<sup>3</sup> The UK Chancellor of the Exchequer referred to the BEPS outcome as “historic”.<sup>4</sup> The reaction from business was more muted. Many of the major accounting firms acknowledged the significance of the BEPS outcome. However, a number of firms expressed concern that incomplete and inconsistent implementation of the BEPS package by governments would usher in a period of significant uncertainty and major disputes.<sup>5</sup>

*...the OECD estimates that governments are missing out on tax revenue of between US\$100 billion and US\$240 billion each year through BEPS.*

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<sup>2</sup> OECD, “Explanatory Statement: OECD/G20 Base Erosion and Profit Shifting Project”, October 2015, <http://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf>.

<sup>3</sup> Tom Pullar-Strecker, “OECD Tax Boss Pascal Saint-Amans Forecasts Company Tax Rates Will Fall as Multinational Rorts Are Stamped Out”, *Business Day*, 7 October 2015, <http://www.stuff.co.nz/business/72770546/oecd-tax-boss-pascal-saintamans-forecasts-company-tax-rates-will-fall-as-multinational-rorts-are-stamped-out>.

<sup>4</sup> “Osborne Backs OECD Tax Plan”, *Economia*, 12 October 2015, <http://economia.icaew.com/news/october-2015/osborne-backs-oecd-tax-plan>.

<sup>5</sup> Grant Thornton International, “Navigating BEPS: What the Tax Function of Today Needs to Know for Tomorrow”, 28 October 2015, [http://www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/2015/navigating-beps---head-of-tax\\_final\\_hi-res.pdf](http://www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/2015/navigating-beps---head-of-tax_final_hi-res.pdf).

*...tax evasion and avoidance by multinational corporations will not cease with BEPS...*

There are also many critics of the BEPS outcome. A *Wall Street Journal* editorial described BEPS as a “bad tax brainstorm”.<sup>6</sup> The Tax Justice Network, a tax reform advocacy body, was disappointed that the OECD did not tackle some of the central features that allow multinationals to exploit international tax laws.<sup>7</sup> *The Economist*<sup>8</sup> described BEPS as an opportunity missed while Oxfam called it a toothless package.<sup>9</sup>

While there is exaggeration and political rhetoric in many of these reactions, there is also an element of truth in many of them. BEPS is a significant achievement and will change the way multinational corporations and tax authorities operate, and it raises the prospect of even more aggressive tax competition by governments. But its implementation will be difficult and will introduce complexity and increased disputes. Further, tax evasion and avoidance by multinational corporations will not cease with BEPS, despite the ‘final’ label attached to the package of measures released by the OECD.

Combatting tax avoidance is anything but finished, and ensuring international tax laws are compatible with contemporary business operations will be an ongoing exercise. Technology will continue to challenge existing international tax paradigms and the world community will have to confront whether some of the underpinnings of the BEPS measures remain relevant, in particular the continuation of the ‘independent entity’ principle that assumes the parent and subsidiaries in a multinational corporation can be treated as separate legal entities engaged in arm’s-length transactions.

This paper reviews the outcome of the BEPS ‘final’ package and the reactions to it, and assesses the challenges and implications of implementing BEPS. The key point is that the BEPS package presented by the OECD/G20 in October 2015 is a significant achievement, but it is still very much a work in progress.

## THE ACHIEVEMENTS

Whether the BEPS exercise achieves its aim of combatting corporate tax avoidance and designing an international tax system fit for the 21st century remains to be seen. Nevertheless, the magnitude of work

<sup>6</sup> “A Bad Tax Brainstorm”, *The Wall Street Journal*, 8 October 2015, <http://www.wsj.com/articles/the-oecd-s-bad-tax-brainstorm-1444348938>.

<sup>7</sup> Tax Justice Network, “OECD’s BEPS Proposals Will Not Be the End of Tax Avoidance by Multinationals”, Press Release, 5 October 2015, <http://www.taxjustice.net/2015/10/05/press-release-oecd-s-beps-proposals-will-not-be-the-end-of-tax-avoidance-by-multinationals/>.

<sup>8</sup> “New Rules, Same Old Paradigm”, *The Economist*, 10 October 2015, <http://www.economist.com/news/business/21672207-plan-curb-multinationals-tax-avoidance-opportunity-missed-new-rules-same-old>.

<sup>9</sup> Oxfam, “Oxfam Criticises ‘Toothless’ OECD Package”, Press Release, 5 October 2015, <http://www.oxfamamerica.org/press/oxfam-criticizes-toothless-oecd-tax-package/>.

completed by the OECD over the past two years is in itself a notable achievement that will change the international tax landscape.

Many of the issues considered under the BEPS umbrella are not new; they have been on the OECD's work agenda for many years, although progress had been slow. In recent years, though, rising levels of public concern made multinational companies not paying their 'fair' share of tax a political issue in many G20 countries. Several high-profile companies — such as Google, Amazon, and Starbucks — had large operations in several countries but paid minimal tax in those countries. They deployed a range of tax planning strategies, such as the infamous 'double Irish with a Dutch sandwich',<sup>10</sup> to significantly reduce their effective tax rates.

The increased political focus on the need for governments to address such apparent tax avoidance saw the G20 call on the OECD to develop a plan to deal with what became known as base erosion and profit shifting. In July 2013 the OECD released a 15 point BEPS Action Plan and a timetable to deliver reports on seven action items by September 2014 and the remaining items by October 2015. The BEPS Action Plan was correctly described as ambitious. The OECD had to turbocharge its work on international tax. The result was an intense period of work for all in the public and private sector working on international tax. The OECD released 1500 pages of final reports, which were preceded by lengthy consultation documents, and it received over 12 000 pages in comments from corporate tax professionals.

In addition to the volume of work advanced in a relatively short period, another achievement was that BEPS was conducted as a joint OECD and G20 exercise, with the non-OECD G20 members — such as China, India, Brazil, Russia, and South Africa — participating on an equal basis with OECD members. Moreover, there were a range of initiatives, which were strengthened over the course of the project, to include developing countries in the exercise. In the end more than 60 countries were directly participating in BEPS work. This change in the arrangements for dealing with international tax issues was significant because previously it had been largely the domain of the OECD. The BEPS project was a major change in the governance arrangements for international tax, one that expanded beyond the OECD to directly involve emerging markets and developing countries.

When the BEPS Action Plan was released, the OECD said that it called for "fundamental changes to the current mechanism and the adoption of new consensus-based approaches".<sup>11</sup> Many feared that a consensus-based body such as the OECD could not advance fundamental changes

*The BEPS project was a major change in the governance arrangements for international tax...*

<sup>10</sup> The double Irish with a Dutch sandwich is a tax avoidance technique involving the use of a combination of Irish and Dutch subsidiary companies to shift profits to low or no tax jurisdictions.

<sup>11</sup> OECD, "Action Plan on Base Erosion and Profit Shifting", July 2013, <http://www.oecd.org/ctp/BEPSActionPlan.pdf>.

to international tax standards in a relatively short timeframe. In some respects these fears were evident in the final BEPS reports, although the areas where agreement has been reached probably surprised many of the sceptics.

There is a clear distinction between the measures contained in the final reports in terms of the extent of agreement reached and the level of political commitment for implementation.

The BEPS reports that present agreement on 'minimum standards' have the highest level of commitment by countries. The expectation is that all countries that participated in the BEPS exercise will change their domestic laws to implement the minimum standards. The issues (referred to as BEPS action items) where agreement was reached on minimum standards were:

- *Countering Harmful Tax Practices* (Action Item 5). For intellectual property regimes such as patent boxes, the consensus reached was to allow taxpayers the benefit of concessional tax rates only to the extent they have incurred qualifying research and development expenditure giving rise to the intellectual property.
- *Preventing Treaty Abuse* (Action Item 6). New minimum standards to prevent such practices as treaty shopping, where a non-resident of a jurisdiction benefits from a tax treaty concluded by that jurisdiction.
- *Re-examining Transfer Pricing Documentation and Country-by-Country Reporting* (Action Item 13). A new standard approach to transfer pricing documentation, including a common template for country-by-country reporting. Importantly, multinational corporations will have to report annually for each tax jurisdiction where they do business, the amounts of revenue, profit before tax and tax paid and accrued, and other data including employees, capital, retained earnings, and tangible assets in each jurisdiction.
- *Improving Effective Dispute Resolution* (Action Item 14). Stronger dispute settlement arrangements were agreed, including a commitment by a number of OECD countries to mandatory binding arbitration.

For a number of other action items, the level of agreement reached was described as settling on a 'common approach'. This appears to mean that a minimum standard could not be agreed but the parties are still hoping that such a standard could be reached in the future. The BEPS issues where countries agreed on a common approach include:

- *Neutralise the Effects of Hybrid Mismatches* (Action Item 2). A common approach to deal with tax benefit mismatches, such as claiming a deduction in one jurisdiction but no tax being paid in another jurisdiction.

- *Limit Base Erosion via Interest Deductions* (Action Item 4). The agreed common approach to ensure that an entity's net interest deductions are directly linked to the taxable income generated by an economic activity. An interest deduction cap, over a certain percentage of profits, is recommended, although the exact ratios and implementation are left to national governments to decide.

A further category of agreement involves items identifying 'best practice', although there is no obligation on the countries to adopt these practices. This category includes:

- *Strengthening Controlled Foreign Corporation (CFC) Rules* (Action Item 3). Agreement was not reached over the policy for CFC regimes, with a set of best practice recommendations intended to provide building blocks for an effective CFC regime.
- *Mandatory Disclosure Rules* (Action Item 12). Provides an overview of existing mandatory disclosure regimes and recommendations for countries wishing to implement or amend mandatory disclosure rules. There were also recommendations on developing and implementing more effective information exchange and cooperation between tax authorities.

BEPS outcomes for some of the other action items are also most appropriately classified in the 'best practice' camp. The *Transfer Pricing* outcomes (Action Items 8 to 10) will result in a number of changes with the aim to align transfer pricing outcomes with value creation. These guidelines are not applied by all OECD members. In a similar way, the outcome of the work on *Permanent Establishments* (Action Item 7) involves changes to the definition in the OECD's Model Tax Convention as to when enterprises will be considered to have a taxable presence in a country. For a number of countries, the OECD Model Treaty and Commentary are largely automatically incorporated into existing tax treaties through interpretation by national courts or reliance on national tax administrations. But this is not the case in all countries. In particular the US courts have not followed this approach and rely less than other jurisdictions on the OECD's Model Treaty. The outcome of the work on *Treaty Abuse* (Action Item 6) will also result in changes to the Model Tax Convention.

The final issue on the BEPS Action Plan was the development of a *Multilateral Instrument* (Action Item 15), which would be an alternative to separately amending over 3500 bilateral tax treaties that may be affected by the BEPS outcomes. Negotiations for such an instrument have begun with the aim to reach an agreement by the end of 2016. A surprising aspect of the BEPS exercise is the level of country interest in the negotiations of a multilateral instrument, with 94 countries signalling that they want to be involved.

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*...the US Congress has taken a rather hostile stance towards BEPS, seeing it as an attack on US multinational corporations.*

## THE IMPLEMENTATION CHALLENGE

The BEPS outcomes are ‘soft’ law. Nothing is binding on participants, and implementation will require each country incorporating the BEPS recommendations into domestic law. Moreover, some of the BEPS measures will only be effective if countries move together — such as the common approach to neutralising hybrid mismatches. The expectation that there will be consistency and convergence as each country implements the BEPS measures, particularly when countries could not reach a consensus on minimum standards, is an ambitious call.

There is scepticism that there will be a coordinated take-up of the BEPS reforms by countries. Stella Amis from PricewaterhouseCoopers notes “there’s likely to be a period of uncertainty with mismatches in timing and approach”.<sup>12</sup> This is particularly likely in areas where the OECD could not reach consensus on minimum standards and could only settle on an outline of ‘best practice’. In addition, because countries have significant discretion in implementing many of the BEPS outcomes, some may claim that they are strengthening their laws in line with BEPS when the reality is different. An example is Australia’s response to the BEPS outcome involving limiting interest deductions.<sup>13</sup> On the release of the BEPS report, Australia said it had already tightened its thin capitalisation rules. Yet while Australia had recently changed its thin capitalisation rules, its approach is markedly different to that outlined in the BEPS package.

There is, however, a good chance that measures that are seen to be clearly in the national interest of a country will be implemented. One example is the sharing of financial information through the country-by-country reporting requirements. Several countries including Australia, the Netherlands, Poland, and Spain have already passed legislation or have proposed draft legislation that seeks to implement the reporting standards, and many others have announced their intention to do so in the near future.

There is particular scepticism in terms of how far the United States will go in implementing BEPS outcomes. To date, the US Congress has taken a rather hostile stance towards BEPS, seeing it as an attack on US multinational corporations. Earlier in 2015 the Chairman of the Senate Committee on Finance and Speaker of the House of Representatives sent letters to the US Treasury Secretary, Jack Lew, voicing concerns over country-by-country reporting, including whether the US Treasury had the authority to implement it without legislation.<sup>14</sup>

<sup>12</sup> “Profession Welcomes OECD Tax Plan”, *Economia*, 5 October 2015, <http://economia.icaew.com/news/october-2015/oezd-publishes-final-details-on-beps-package>.

<sup>13</sup> Thin capitalisation rules determine limits on how much interest paid on corporate debt is deductible for tax purposes.

<sup>14</sup> Deloitte, “OECD Releases Final BEPS Reports”, United States Tax Alert, 6 October 2015, <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-unitedstates-6-october-2015.pdf>.

The extent to which the United States implements the BEPS measures is likely to extend to what it can do without having to go to Congress to get authority. Against that background, it may not be surprising that Treasury has claimed that current US rules are largely consistent with most BEPS outcomes.<sup>15</sup> In addition, the critics of BEPS claim that the United States was responsible for a significant weakening of many parts of the BEPS outcomes, such as the outcome on CFCs and interest deductibility.<sup>16</sup>

While there is an understandably high level of scepticism when it comes to the implementation of the BEPS package, it is noteworthy that there is a commitment by G20 countries to keep working on an equal footing to monitor the implementation of the BEPS measures. It will be interesting to see how comprehensive and effective this peer review is when it comes to tax, because to date such peer reviews and accountability reports in other areas have not been a strong point of the G20. Nevertheless, countries are saying the right thing.

## THE CRITICS

Many of the critics of BEPS acknowledge that some of the outcomes will, if implemented, strengthen existing rules combatting corporate tax avoidance and will give tax authorities better tools. However, organisations such as the BEPS Monitoring Group, a network of tax justice organisations, add the proviso that it all depends on whether the authorities “have the capacity and will to use [these new tools]”.<sup>17</sup> Moreover, there is criticism that the subjective and discretionary nature of many of the outcomes will make them hard to administer.

A criticism of BEPS is that it did not address what many say is the core problem, namely continuing to treat the components of a multinational firm as separate entities engaging in arm’s-length transactions. Specific fundamental arguments are that BEPS failed to develop clear rules on the attribution of profit, and that the application of tax laws continues to rely on the ‘fiction’ that components of a multilateral corporation can be considered as separate entities that engage in arm’s-length transactions when it comes to the application of tax laws. For example, the Tax Justice Network argued that there is a need for “clearer and simpler rules for apportioning profits of multinationals, instead of leaving this to be decided by the ability of the various players to understand and take

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<sup>15</sup> Ibid.

<sup>16</sup> Global Policy Forum, “Monitoring Group Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project”, 7 October 2015, <https://www.globalpolicy.org/component/content/article/272-general/52817-overall-evaluation-of-the-g20oecd-base-erosion-and-profit-shifting-beps-project.html>.

<sup>17</sup> Ibid.

advantage of complex rules”.<sup>18</sup> The claim is that the ‘rich’ countries, especially the United States, stubbornly defended the dysfunctional arm’s-length principle of transfer pricing and resisted all alternatives. The BEPS Monitoring Group argued that “the lack of clear direction, political concerns to preserve tax breaks considered to benefit national ‘competitiveness’, and the need for consensus among a large group of countries, have led to a package tending to the lowest common denominator”.<sup>19</sup>

## IF BEPS IS EFFECTIVE, TAX COMPETITION WILL INCREASE

The basic premise behind the BEPS project is that corporations should pay tax where economic activity takes place. A consequence of the ability of corporations to lower their effective tax rates through profit shifting and other devices has meant that the location of the economic activity has not been as responsive to headline tax rates as it otherwise would have been. For example, the US federal corporate tax rate is 35 per cent and the total corporate tax rate is around 40 per cent, after allowing for state and local income taxes. By comparison, the corporate tax rate is 30 per cent in Australia, 20 per cent in the United Kingdom, 22 per cent in Germany, and 12.5 per cent in Ireland. The average corporate income tax rate in Europe is 22 per cent.

US companies have been able to offset the impact of relatively high domestic corporate tax rates by virtue of the ‘deferral’ system the United States uses to tax foreign subsidiaries of multinationals and their ability to transfer profits to lower tax jurisdictions. To the extent that BEPS is effective, profits will increasingly be taxed where the economic activity takes place. As such, the incentive will be for corporations to shift economic activity to those jurisdictions which have lower corporate tax rates. Countries with relatively high corporate tax rates, such as the United States and Australia, will come under increasing pressure to reduce their rates. The head of the BEPS project in the OECD has acknowledged that tax competition will increase, stating:

“Today, you have the choice of paying 40 per cent tax in the US, 12.5 per cent in Ireland or 0 per cent in Bermuda. Well, you just pick up the right tax lawyer and you get zero in Bermuda. That will change. These types of schemes are over and then you are back to fairer tax competition between countries.”<sup>20</sup>

*To the extent that BEPS is effective, profits will increasingly be taxed where the economic activity takes place.*

<sup>18</sup> Sol Picciotto, “What Will BEPS Fix, and Who Will Gain?”, Tax Justice Network, 13 October 2015, <http://www.taxjustice.net/2015/10/13/what-will-beps-fix-and-who-will-gain/>.

<sup>19</sup> Global Policy Forum, “Monitoring Group Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project”.

<sup>20</sup> Tom Pullar-Strecker, “OECD Tax Boss Pascal Saint-Amans Forecasts Company Tax Rates Will Fall as Multinational Rorts Are Stamped Out”.

The challenge throughout the BEPS exercise is determining where economic activity takes place in order to impose tax liability. There will be ongoing work on trying to improve profit attribution rules, but it is likely that the focus will be on linking 'value-creating' activities to the number of employees and value of assets a corporation has in a particular jurisdiction. The country-by-country reporting requirements identify this information. A local tax authority might compare the headcount to the amount of tax being paid in its jurisdiction and conclude that it is missing out on its share of the overall tax take. Of course, simply dividing tax take by employees is an imprecise measure for identifying where value creation takes place. However, with intellectual property being a key driver for generating value in a firm and representing a major component of the value of a firm's assets, tax authorities may take particular note of where a firm locates its IT designers in order to determine where economic value is being created.

*The focus on corporate tax avoidance and the BEPS exercise is already changing business behaviour.*

The focus on corporate tax avoidance and the BEPS exercise is already changing business behaviour and will continue to do so. In giving advice on the implications of BEPS for companies, the accounting firm Grant Thornton noted:

"To demonstrate and justify that the tax being paid reflects where you've created value, there needs to be sufficient people, intellectual property generation and risk bearing capacity in the tax location."<sup>21</sup>

## BEPS REMAINS WORK IN PROGRESS

The package of reports published by the OECD was described as 'final' reports. However, the BEPS Monitoring Group was more accurate when it described the October reports as the 'end of the first phase'.<sup>22</sup> BEPS is anything but finalised. The explanatory statement that accompanied the 'final' package of BEPS reports noted that the OECD and G20 countries will extend their cooperation on BEPS until 2020 to "complete pending work and ensure an efficient, targeted monitoring of the agreed measures". An end date cannot be placed on cooperation between the OECD and G20 on international tax issues; cooperation will have to be ongoing. Further, international tax cannot return to being an OECD-centric exercise. The involvement of developing countries will have to be extended and regularised. The OECD/G20 BEPS project will have to evolve into a new, more representative forum to deal with international tax.

<sup>21</sup> Grant Thornton International, "Navigating BEPS: What the Tax Function of Today Needs to Know for Tomorrow".

<sup>22</sup> BEPS Monitoring Group, "The BEPS Project: End of the First Phase", 5 October 2015, <https://bepsmonitoringgroup.wordpress.com/2015/10/05/the-beps-project-end-of-the-first-phase/>.

The BEPS measures have introduced a period of uncertainty for corporations. While the pre-BEPS rules may have been deficient, they were a known quantity. The post-BEPS world will see corporations deal with variations in how the measures are interpreted by jurisdictions and in the timing of their implementation. An International Business Report Survey conducted by Grant Thornton found that 75 per cent of participants would welcome more global cooperation and guidance from tax authorities on what is acceptable and unacceptable tax planning.<sup>23</sup> Governments and tax administrators in all countries will come under increasing pressure to provide greater clarity on how the new rules will be applied and to ensure that jurisdictions are cooperating in the implementation of BEPS.

While the effective implementation of BEPS will require close cooperation between countries, particularly in areas such as hybrids, there is also likely to be increasing disputes as tax jurisdictions seek to increase their tax take from multinational corporations. Further, enhancing dispute resolution arrangements will need to be a priority in the post-BEPS world.

A major outcome of BEPS is the introduction of country-by-country reporting by multinational corporations. The sharing of information on tax-related activities of corporations is intended to be available solely for the use of tax administrators. However, there is a high probability that at some stage a jurisdiction will make this information public. This could occur, for example, in a high-profile dispute between a country and a major multinational. One way or another, the trend will be for greater transparency on international tax. This will be a good thing and will significantly influence the behaviour of multinationals, but the process could be traumatic for both corporations and tax administrators.

Organisations such as Oxfam, the Tax Justice Network, and *The Economist* have called for greater international effort towards the apportionment of the tax liabilities of multinational corporations across jurisdictions based on tangible indicators such as the number of key personnel working in each jurisdiction. The follow-up work outlined in the BEPS package on transfer pricing is likely to do just that and focus on seeking to establish clearer rules for the attribution of profit. This is also the case with the ongoing work on taxing the digital economy (Action Item 1). The result is that the follow-up work from the BEPS 'final' reports is likely to result in a fundamental rethink of some long-standing approaches towards international taxation.

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<sup>23</sup> Grant Thornton International, "Navigating BEPS: What the Tax Function of Today Needs to Know for Tomorrow".

## CONCLUSION

The work on BEPS and the strengthening of financial regulation are the two standouts when it comes to tangible outcomes from the G20. The volume of work on international tax produced over the past two years under the BEPS umbrella is a major achievement. Furthermore, the extent to which agreement has been reached has also surprised many critics. It is a demonstration of the ability of the G20 to provide political direction and impetus to an international organisation, in this case the OECD.

Although it has already changed the world of international tax in a profound way, BEPS is very much a work in progress. The age of aggressive tax planning is over, but the future will likely be one of considerable uncertainty as corporations deal with different interpretations and implementation schedules of BEPS outcomes by countries. BEPS will also likely result in increased tax competition between countries, with economic activity in the post-BEPS world being more responsive to a country's headline tax rate. And international tax issues have permanently moved beyond the domain of the OECD and will involve on an ongoing basis the non-OECD members of the G20 along with developing countries. A new, more representative forum for dealing with international tax will emerge. In addition, the follow-up work from BEPS will continue to challenge some of the long-standing principles of international tax. BEPS is not the end of reforming international tax arrangements, it is only the beginning.

# THE G20 AND MACROECONOMIC POLICY COOPERATION

ADAM TRIGGS<sup>1</sup>

## INTRODUCTION

The need for macroeconomic policy cooperation was the driving force behind the creation of the G20 as a leader-level forum in response to the global financial crisis. Leaders identified “inconsistent and insufficiently coordinated macroeconomic policies”<sup>2</sup> as a root cause of the crisis, and responded with the largest coordinated policy response in history. But since then, the G20’s record on macroeconomic policy cooperation has been poor. Within just a few years, the term ‘macroeconomic cooperation’<sup>3</sup> has gone from being the G20’s core mandate to being an almost controversial fringe topic.<sup>4</sup>

This paper tracks the G20’s efforts on macroeconomic policy cooperation since 2008 and assesses how effective the G20 has been in achieving its objectives. Issues are grouped into five themes: macroeconomic stimulus; fiscal consolidation; the global financial safety net; monetary policy; and reducing global imbalances. While the G20 has been relatively effective in cooperating on macroeconomic stimulus and the global financial safety net, it has much more to do in reducing imbalances, has failed on fiscal consolidation and, for cooperation on monetary policy, remains confused, controversial, and ultimately non-existent.

The problem with the G20’s approach to macroeconomic policy cooperation, and a key reason it has struggled on macroeconomic cooperation, is that it tends to take a partial-equilibrium approach by

*Within just a few years, the term ‘macroeconomic cooperation’ has gone from being the G20’s core mandate to being an almost controversial fringe topic.*

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<sup>2</sup> G20, *Leaders’ Declaration*, Washington Summit, 15 November 2008, para 4, <http://www.g20.org/English/Documents/PastPresidency/201512/P020151225609230748803.pdf>.

<sup>3</sup> Tamim Bayoumi argues ‘cooperation’ is a less intrusive term than ‘coordination’, aligns with what most policymakers would accept, and is more consistent with domestic mandates. This paper adopts Bayoumi’s approach, even though many of the policies discussed below would qualify as ‘coordination’ and the G20, in 2008 and 2009, frequently used the term: see Tamim Bayoumi, “After the Fall: Lessons for Policy Cooperation from the Global Crisis”, IMF Working Paper WP/14/97, June 2014, <https://www.imf.org/external/pubs/ft/wp/2014/wp1497.pdf>.

<sup>4</sup> Tamim Bayoumi (ibid) notes that “the history of global fiscal policy cooperation after the crisis is a good example of how impressive initial cooperation diffused over time”.

considering each policy issue in isolation. This leads to policies that are inappropriate, that encourage disagreement within the membership, and ultimately result in commitments that are short-lived as economic circumstances change.

Instead, the G20 needs to take a general-equilibrium approach when considering these issues by considering all macroeconomic policies together and their collective impact on both the demand-side and supply-side. In particular, the G20 needs to strengthen the macroeconomic focus of its growth strategies and reinvigorate the mutual assessment process by seeking greater engagement from ministers, sherpas, and high-level officials. Under the current trajectory, China's host year could achieve strong outcomes on the global financial safety net. But unless it takes a more integrated approach to macroeconomic issues, the G20 is unlikely to achieve more than business as usual.

*...the G20 needs to strengthen the macroeconomic focus of its growth strategies and reinvigorate the mutual assessment process...*

## THE G20 AND MACROECONOMIC STIMULUS: NARROWLY DODGING A DEPRESSION

In responding to the global financial crisis, G20 Leaders identified that "a broader policy response is needed, based on closer macroeconomic cooperation".<sup>5</sup> This cooperation had three components.<sup>6</sup>

The first was liquidity support to stabilise markets through measures such as currency swap lines, tripling the IMF's lending capacity, a new allocation of Special Drawing Rights (SDR), increased lending capacity for the multilateral development banks, and increased support for trade finance.

The second was the use of conventional monetary policies to support demand. In a joint statement in October 2008, six central banks announced "unprecedented joint actions" in reducing policy interest rates.<sup>7</sup> Other central banks quickly followed suit.

The third component was fiscal stimulus. Almost all G20 countries announced fiscal stimulus packages, albeit of varying sizes.<sup>8</sup>

The G20's actions are widely recognised as having contributed to preventing the Great Recession from becoming a Great Depression.<sup>9</sup>

<sup>5</sup> G20, *Leaders' Declaration*, Washington Summit, para 7.

<sup>6</sup> Tamim Bayoumi, "After the Fall: Lessons for Policy Cooperation from the Global Crisis".

<sup>7</sup> Board of Governors of the Federal Reserve System, "Joint Statement by Central Banks", Press Release, 8 October 2008, <http://www.federalreserve.gov/newsevents/press/monetary/20081008a.htm>.

<sup>8</sup> G20 stimulus packages totalled 0.5 per cent of global GDP in 2008, 1.4 per cent in 2009, and 1.3 per cent in 2010. See IMF, "Meeting of the Deputies", Note by the staff of the International Monetary Fund, 31 January 2009, <https://www.imf.org/external/np/g20/pdf/020509.pdf>.



In 2009, the IMF said these actions “helped avert a global financial meltdown” and estimated that fiscal stimulus alone would lift the level of G20 GDP by 1.25 to 2 per cent in 2009 and by 1.5 per cent in 2010.<sup>10</sup>

Nonetheless, there are those who say cooperation was insufficient. The Brookings Institution’s Eswar Prasad shows that the G20’s fiscal stimulus fell short of what the IMF originally recommended by about one-third.<sup>11</sup> The IMF’s Tamin Bayoumi shows that the minutes and press releases from central banks after the initial response to the crisis made no references to the impacts of their actions on other economies, suggesting any cooperation on monetary policy was short-lived. There is a related argument that G20 countries had an incentive to stimulate their economies regardless of what other countries were doing, although this is disputed. For example, Oxford’s David Vines highlights important political and economic benefits from countries acting together.<sup>12</sup>

## FISCAL CONSOLIDATION: CONTROVERSIAL AND INEFFECTIVE

In 2010, the nature of macroeconomic cooperation shifted markedly from fiscal stimulus to fiscal consolidation. Conscious of the substantial increase in the global stock of debt and the escalating crisis in Europe,<sup>13</sup> Canada’s Prime Minister, Stephen Harper, had fiscal consolidation firmly on the agenda, both domestically and as G20 President. With strong support from Germany, France and the European Union, the G20 announced the ‘Toronto commitments’ where advanced economies agreed to halve their deficits by 2013 and stabilise or reduce debt-to-GDP ratios by 2016.

But the global recovery proved much slower than forecast and it became clear many countries would fall short of their commitments. From 2011 to

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<sup>9</sup> See IMF, “Update on Fiscal Stimulus and Financial Sector Measures”, 26 April 2009, <http://www.imf.org/external/np/fad/2009/042609.pdf>. See also G20, *Leaders Statement*, Pittsburgh Summit, 24–25 September 2009, <http://www.g20.utoronto.ca/2009/2009communique0925.html>.

<sup>10</sup> IMF, “Meeting of the Deputies”.

<sup>11</sup> A number of authors have shown the G20’s fiscal stimulus fell short of what was required. See Eswar Prasad and Isaac Sorkin, “Assessing the G-20 Stimulus Plans: A Deeper Look”, Brookings, March 2009, <http://www.brookings.edu/research/articles/2009/03/g20-stimulus-prasad>, and David Vines, “The G20, Global Growth, and International Macroeconomic Cooperation”, The 13th HW Arndt Memorial Lecture, 17 September 2014, <https://crawford.anu.edu.au/acde/events/arndt/>.

<sup>12</sup> David Vines (ibid) shows that coordinated stimulus helped defeat free-rider effects through fiscal leakages, which was important for its political feasibility domestically. The coordinated loosening of monetary policy similarly helped reduce the risk of a loss of confidence or currency attack.

<sup>13</sup> Over the course of 2010, yields on ten-year Greek bonds doubled from 6 per cent to 12 per cent. See Bloomberg, “Rates & Bonds”, <http://www.bloomberg.com/markets/rates-bonds>.

2013, the G20 shifted into the 'austerity versus growth' debate<sup>14</sup> where those in favour of 'growth', led by the United States, argued aggregate demand was too weak to warrant consolidation. The US view ultimately prevailed. In 2013, each member articulated a St Petersburg Fiscal Strategy, which had no firm targets. The Toronto commitments were effectively abandoned and the G20 was happy to move on to other issues.<sup>15</sup>

Overall, the G20 has not been effective in meeting its targets. The only countries on track to achieve the Toronto commitments are Germany and the United States.<sup>16</sup> Interestingly, Germany and the United States were both forecast by the IMF to fall short of the Toronto commitments back in 2010 while Australia, Canada, France and the United Kingdom were all forecast to achieve the targets but ended up falling short.

The St Petersburg fiscal strategies are similarly not looking hopeful. Using IMF forecasts to 2020, only Canada and Germany are reducing their stock of debt (although by 2019 the United Kingdom and Italy are also forecast to be marginally below 2012 levels). Consequently, the IMF continues to express concern that many G20 countries are yet to announce credible fiscal consolidation plans.<sup>17</sup>

## THE GLOBAL FINANCIAL SAFETY NET: PROGRESS, BUT MORE TO BE DONE

The global financial safety net<sup>18</sup> represents an institutionalised form of macroeconomic cooperation by assisting countries in trouble and preventing contagion. In 2009, the G20 agreed to triple the IMF's lending capacity to US\$750 billion. In 2010, it agreed to reform the IMF to better align outdated voting shares with the current economic reality. With an intensifying crisis in Europe in 2012, the G20 agreed to bilateral pledges of US\$461 billion to boost the IMF's funding. As part of a comprehensive work program over many years, the G20 has also supported new lending facilities at the IMF, reviewed the composition of the SDR basket

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<sup>14</sup> See Jack Lew, Press Conference, G20 Finance Ministers and Central Bank Governors Meeting, Sydney, 23 February 2014, [http://www.g20australia.org/news/transcripts/united\\_states\\_secretary\\_treasury\\_jack\\_lew\\_press\\_conference\\_sydney](http://www.g20australia.org/news/transcripts/united_states_secretary_treasury_jack_lew_press_conference_sydney).

<sup>15</sup> The word 'fiscal' appeared in the leaders' communiqués only once in 2014 and 2015, both times reiterating this same, new flexible commitment to "implement our fiscal strategies flexibly, taking into account near-term economic conditions, while putting debt as a share of GDP on a sustainable path".

<sup>16</sup> Calculated by comparing the IMF's forecast deficits from 2010 with the IMF's current forecasts for 2016.

<sup>17</sup> See IMF, "Now is the Time: Fiscal Policies for Sustainable Growth", *Fiscal Monitor*, April 2015, <http://www.imf.org/external/pubs/ft/fm/2015/01/fmindex.htm>.

<sup>18</sup> The global financial safety net is essentially the resources provided by the IMF and other institutions reserved for fighting crises and preventing contagion. See Adam Triggs, "The G20 is Not Ready for the Next Crisis", *East Asia Forum*, 8 November 2015, <http://www.eastasiaforum.org/2015/11/08/the-g20-is-not-ready-for-the-next-crisis/>.

and developed principles on cooperation between the IMF and regional financing arrangements.<sup>19</sup>

But while the G20 should be commended for its efforts, the safety net remains too small, too fragmented, and too unresponsive. While there is disagreement on what constitutes the safety net, adding together the multilateral resources of the IMF, the regional resources of the European Stability Mechanism (ESM), the Chiang Mai Initiative Multilateralisation and BRICS Bank, and the bilateral resources of currency swap lines, a rough estimate is that the safety net is around US\$2.75 trillion in size.<sup>20</sup> While this is seven times larger than it was in 2003, it is likely to be too small to deal with a major crisis. Only US\$1.08 trillion of the safety net is currently available since the rest is either not paid in or is tied up in existing programs, and this could be quickly exhausted. Greece, for example, represents just 0.25 per cent of global GDP but, if shouldered alone, its bailout to date would have exhausted 70 per cent of the IMF's capacity. A country like Spain, which represents just 1.5 per cent of global GDP, would exhaust the entire capacity of the IMF and the ESM.<sup>21</sup>

*...while the G20 should be commended for its efforts, the safety net remains too small, too fragmented, and too unresponsive.*

The efficient size of the safety net will depend on relative costs and benefits. The cost is primarily the opportunity cost of how this money could otherwise have been spent or invested by the contributing country. The benefit is reduced country risk premiums which, as shown by analysis from the Australian National University and Brookings Institution's Warwick McKibbin, can be substantial given their significant influence over global capital flows.<sup>22</sup> Through this framework, a safety net big enough to bail out a large economy such as China would no doubt be inefficient, but so too would a safety net that is too small to bail out even a small economy.

<sup>19</sup> Such as the European Stability Mechanism and the Chiang Mai Initiative Multilateralisation.

<sup>20</sup> Because public data on currency swap lines is difficult to source, and the size of these swap lines expand during times of crisis, this estimate uses the currency swap lines extended by the US Federal Reserve from 2008 as a proxy. The estimate excludes domestic foreign exchange reserves which, although important, are domestic, not global, and hence are no more part of the global financial safety net than a country's fiscal or monetary policy space. See Adam Triggs, "The G20 is Not Ready for the Next Crisis".

<sup>21</sup> This would depend on the size and length of Spain's financing requirements which, out to 2020, are around US\$670 billion according to Bloomberg: see Mark Gilbert, "Europe's Debt Time Bomb", *Bloomberg View*, 20 May 2014, <http://www.bloombergvie.com/articles/2014-05-20/europe-s-debt-time-bomb>.

<sup>22</sup> It shows that even relatively small changes in country risk premiums can have large real consequences — consistent with the experience of countries during the Asian economic crisis. See Warwick McKibbin, "International Capital Flows, Financial Reform & Consequences of Changing Risk Perceptions in APEC Economies", Paper prepared for the Institute of Policy Studies conference on "Experiences of Economic Reform Within APEC", Wellington, New Zealand, 12–14 July 1999, <http://www.brookings.edu/views/papers/mckibbin/19990710.pdf>.

The increased size of the safety net has also come at the cost of increased fragmentation and reduced responsiveness. While it previously consisted solely of the IMF and bilateral resources, the IMF now represents just 50 per cent of the safety net. At a time of crisis, this means markets are reliant on an ad hoc cooperative arrangement being agreed between multiple institutions which, among other things, compromises the IMF's ability to be consistent in its approach from one crisis to the next. The haphazard joint response by the IMF, European Commission and European Central Bank to the European debt crisis is evidence that this can be a slow and costly process. This fragmentation also conceals the true size of the safety net and creates a false sense of security since many countries do not participate in regional initiatives or bilateral swaps which are nevertheless considered part of the 'global' safety net. Australia's former G20 finance deputy, Barry Sterland, has similarly argued that these regional initiatives weaken the safety net because, outside of the IMF, imposing conditionality on allies and trading partners can be politically difficult.<sup>23</sup>

*...regional initiatives weaken the safety net because, outside of the IMF, imposing conditionality on allies and trading partners can be politically difficult.*

## MONETARY POLICY COOPERATION: CONFUSED, CONTROVERSIAL AND NON-EXISTENT

Monetary policy influences multiple economic variables, and the G20's focus has shifted between those different variables at different points in time. In 2009, the focus was on exchange rates and refraining from competitive devaluations. In 2010, the focus expanded to current account imbalances and the importance of market-determined exchange rates in reducing them. As the United States, United Kingdom, Japan, and the European Union began implementing unconventional monetary policies, the focus shifted to spillovers, interest rate differentials, and the role of capital flows. This was brought to a head in 2013–14 with the so-called 'Taper Tantrum',<sup>24</sup> after which the G20's focus shifted to ensuring improved forward guidance from central banks to prevent financial volatility.

The G20's cooperation on monetary policy has consisted of agreeing to high-level principles in its communiqués, such as the importance of careful communication, market-determined exchange rates, refraining from competitive devaluations, and avoiding negative spillovers. Beyond this, the G20 has been unable to agree on what further cooperation, if any, would be appropriate. Monetary policy discussions have, at times, been bitter and acrimonious. Countries, particularly China and the

<sup>23</sup> See Barry Sterland, "Priorities for Australia's Presidency of the G20 in 2014 and the Role of the Global Financial Safety Net", Speech to the Seoul G20 Conference, 18 December 2013, <http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2013/Priorities-for-Australias-Presidency-of-the-G20>.

<sup>24</sup> The Taper Tantrum refers to the sharp outflows of capital from emerging market and developing economies in 2013–14. These outflows were triggered by remarks from the US Federal Reserve Chairman which implied that the US quantitative easing program could be tapered in the near future.

United States, have been hostile and adversarial. A lack of any formal or institutionalised cooperation has left many countries feeling hard done by, particularly emerging market economies which have called for institutionalised measures like re-establishing currency swap lines with the US Federal Reserve.

Assessing the effectiveness of G20 monetary policy cooperation is difficult. Spillovers from unconventional monetary policies, the 2013–14 Taper Tantrum, poor communication from the US and Chinese central banks, public outcries of “currency wars”,<sup>25</sup> and a “breakdown of international cooperation”<sup>26</sup> suggest the G20 has not performed well. Whether competitive devaluations have occurred, and whether the policies of one country have, on balance, negatively affected others, remain hotly contested issues.

## GLOBAL IMBALANCES — REDUCED, FOR NOW

Since 2000, there has been widespread concern about imbalances between the United States and other countries in terms of public debt, trade flows, capital flows and, above all, current accounts.<sup>27</sup> In 2008, G20 Leaders identified unsustainable global macroeconomic outcomes as a root cause of the crisis. In 2009, they developed the G20 Framework for Strong, Sustainable, and Balanced Growth, with a particular focus on addressing global imbalances, describing it as “a compact that commits us to work together to assess how our policies fit together”, one that is committed to establishing “a pattern of growth across countries that is more sustainable and balanced”.<sup>28</sup>

In October 2010, US Treasury Secretary Timothy Geithner penned a letter to G20 finance ministers recommending they commit to keeping current account surpluses and deficits within 4 per cent of GDP. While Geithner’s targets were politely rejected, leaders agreed in Seoul that indicative guidelines should be established to measure and monitor global imbalances. These indicators, agreed in 2011, were used by the

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<sup>25</sup> As per Guido Mantega, the then Finance Minister for Brazil: see Jonathan Wheatley and Peter Garnham, “Brazil in ‘Currency War’ Alert”, *Financial Times*, 27 September 2010, <http://www.ft.com/intl/cms/s/0/33ff9624-ca48-11df-a860-00144feab49a.html#axzz3w89RegGR>.

<sup>26</sup> As per Raghuram Rajan, Governor of the Reserve Bank of India: see Kartik Goyal, “Rajan Warns of Policy Breakdown as Emerging Markets Fall”, *Bloomberg*, 31 January 2014, <http://www.bloomberg.com/news/articles/2014-01-30/rajan-warns-of-global-policy-breakdown-as-emerging-markets-slide>.

<sup>27</sup> For an explanation of how these imbalances emerged, see Yu Yongding, “Rebalancing the Chinese Economy”, *Oxford Review of Economic Policy* 28, No 3 (2012), 551–568. There remains disagreement as to the extent to which these imbalances are a problem: see Olivier Blanchard and Gian Maria Milesi-Ferretti, “(Why) Should Current Account Deficits be Reduced?”, IMF Staff Discussion Note 11/03, 1 March 2011, <https://www.imf.org/external/pubs/ft/sdn/2011/sdn1103.pdf>.

<sup>28</sup> G20, *Leaders Statement*, Pittsburgh Summit, paras 14 and 15.

IMF to identify countries with persistently large imbalances and to make policy recommendations through the G20 mutual assessment process.<sup>29</sup>

Since the crisis, the large deficits in the United States and the surpluses of China and oil-exporting countries have more than halved. But despite progress in reducing imbalances, the IMF has repeatedly warned that this decline has been driven primarily by demand compression in deficit economies, rather than policy adjustment. The IMF has noted a particular lack of progress in the last two years and warns that imbalances could widen again if key policy commitments are not met.<sup>30</sup>

## THE NEED FOR A GENERAL EQUILIBRIUM APPROACH

On an issue-by-issue basis, the G20's attempts at macroeconomic cooperation have been mixed. On macroeconomic stimulus and strengthening the safety net it has done relatively well. On reducing global imbalances, it has made progress but still has more to do. On fiscal consolidation it has done poorly, and on monetary policy it is still undecided whether it wants to do anything. As with many areas of its agenda, the G20 has struggled to get traction outside of a crisis. But the fundamental problem with the G20's approach to macroeconomic policy cooperation, and a key reason it has struggled on these issues to date, is that it consistently takes a partial-equilibrium approach when considering macroeconomic issues. Rather than taking a general-equilibrium approach, which considers all macroeconomic policies together and their collective impact on both the demand-side and supply-side, the G20 tends to consider each policy issue in isolation.

Fiscal consolidation, for example, cannot be considered in isolation from monetary policy, the broader recovery or the impact on the supply-side. When monetary policy space is limited, fiscal multipliers tend to be larger which exacerbates the negative short-run impact of fiscal consolidation on GDP.<sup>31</sup> Similarly, many argue the Toronto commitments were made too early in the recovery and were too rigid and inflexible to take the pace of the recovery into account.<sup>32</sup> But the naysayers of fiscal consolidation, notably the United States, also take a partial-equilibrium approach by focusing solely on demand. Warwick McKibbin, Andrew

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<sup>29</sup> In short, the IMF's recommendations were that the major surplus countries (China and Germany) needed more consumption and investment, respectively, while the major deficit economies, including the United States, needed to boost private savings and public savings through fiscal consolidation, while other deficit economies also need structural reforms to rebuild competitiveness. See IMF, "Imbalances and Growth: Update of Staff Sustainability Assessments for G-20 Mutual Assessment Process", October 2015, <https://www.imf.org/external/np/g20/pdf/map2015/map2015.pdf>.

<sup>30</sup> Ibid.

<sup>31</sup> See David Vines, "The G20, Global Growth, and International Macroeconomic Cooperation".

<sup>32</sup> Ibid.

Stoeckel and YingYing Lu<sup>33</sup> show how the release of savings locked up in government debt can stimulate investment and build the supply-side of the economy, particularly when it is coordinated across countries to minimise the impact of capital outflows on investment and the capital stock.<sup>34</sup> The downfall of the Toronto commitments was that their partial-equilibrium approach ignored these broader considerations, leading to inevitable debate within the membership and, once economic circumstances changed, their abandonment. While the St Petersburg fiscal strategies were designed to take these broader considerations into account, they have moved to the other extreme where countries are afforded so much flexibility that they are devoid of any tangible, measurable commitment.

The safety net also needs to be considered in a broader context. It is not a panacea for all ills. It is, and should remain, a last resort. There needs to be an equal focus on domestic reforms to build sound macroeconomic frameworks to cushion against economic shocks and ensure flexible responses. The safety net must also be considered in a broader institutional context, particularly the next stage of IMF reform, the rise of regional financing arrangements, and strengthening collaboration between the two.

*So long as the G20 is at risk of asymmetric shocks (which it is), countries are best served by having as many policy instruments in their arsenal as possible.*

For monetary policy, the conventional wisdom is that there are no significant benefits from international coordination.<sup>35</sup> So long as the G20 is at risk of asymmetric shocks (which it is), countries are best served by having as many policy instruments in their arsenal as possible. The fundamental challenge facing the G20, as explained by Rakesh Mohan and Muneesh Kapur from the IMF and Reserve Bank of India, respectively, is the complete lack of agreement on the objectives of monetary policy and how those objectives interrelate, as well as the size, direction, and transmission mechanisms of spillovers.

Finally, the G20 needs to end its Geithner-style obsession with current accounts and take a holistic approach to global imbalances. The IMF's indicative indicators are a step in this direction. But so long as the G20

<sup>33</sup> Warwick J McKibbin, Andrew B Stoeckel and YingYing Lu, "Global Fiscal Adjustment and Trade Rebalancing", *The World Economy* 37, Issue 7 (2014), 892–922.

<sup>34</sup> Consolidation can also boost consumption and investment through Ricardian effects of lower future taxes and an improved business environment and lift confidence through reduced risk premiums (ibid). John Taylor, for example, finds that fiscal consolidation in the United States could be a net positive for US GDP in both the short- and long-run, if undertaken correctly: see John Taylor, "The Economic Effects of a Fiscal Consolidation Strategy", Testimony before the Committee on the Budget US House of Representatives, 17 June 2015, [http://budget.house.gov/uploadedfiles/john\\_taylor.pdf](http://budget.house.gov/uploadedfiles/john_taylor.pdf).

<sup>35</sup> See Rakesh Mohan and Muneesh Kapur, "Monetary Policy Coordination: The Role of Central Banks", in *The G20 at Five*, eds Kemal Dervis and Peter Drysdale (Washington DC: Brookings Institution Press, 2014). Mohan and Kapur explain the conventional wisdom that the global economy is best served by central banks focusing on fulfilling domestic inflation and output objectives, with central banks being one-objective, one-instrument institutions (focusing on price stability and with short-term interest as the only policy instrument).

remains paralysed on fiscal consolidation and monetary policy, it will see these imbalances partly re-emerge as the recovery strengthens.

## IMPLICATIONS AND RECOMMENDATIONS FOR CHINA'S PRESIDENCY

Based on the G20's history and current trajectory, there are several opportunities for China's Presidency. First, the safety net should feature prominently. The IMF reports back to finance ministers early in 2016 on the adequacy of the safety net, one-third of the IMF's funding (bilateral loans) will start to expire,<sup>36</sup> and the G20 will need to discuss the next stage of IMF reform following the ratification of those agreed in 2010. None of these will be easy, but there is scope for pragmatic, incremental steps on these fronts.

Few countries want to revisit the issue of fiscal consolidation in 2016, although Germany may reintroduce the topic for its host year in 2017. Discussions on monetary policy cooperation will likely continue to focus on careful communication as markets watch to see what the Fed does next. With fiscal consolidation and monetary policy on the backburner, the G20 is unlikely to make progress on reducing global imbalances. And on crisis response, the focus is now on the growing downside risks among the emerging market economies which, if they materialise, will have implications for G20 discussions on cooperation and global governance.<sup>37</sup>

Achieving more than business as usual requires China to put macroeconomic discussions in a general equilibrium context. To this extent, the growth strategies represent both a threat and an opportunity. They are a threat because, with a greater emphasis on the supply-side, the growth strategies have, to some extent, distracted the G20 from the importance of macroeconomic policies for growth, as well as the broader mutual assessment process.<sup>38</sup> But as an opportunity, the growth strategies have the potential to bring together macroeconomic policies and supply-side structural reforms within a single framework. This allows countries to trade off policies against one another and expand the frontier of what the G20 can achieve. By expanding the G20's peer review to include ministers and higher-level officials, the mutual assessment process can be reinvigorated and given more prominence.

*Achieving more than business as usual requires China to put macroeconomic discussions in a general equilibrium context.*

<sup>36</sup> See Adam Triggs, "The G20 is Not Ready for the Next Crisis".

<sup>37</sup> See *BIS Quarterly Review*, September 2015, [http://www.bis.org/publ/qtrpdf/r\\_qt1509.htm](http://www.bis.org/publ/qtrpdf/r_qt1509.htm). See also NN Investment Partners in James Kynge and Roger Blitz, "Surge in Emerging Market Capital Outflows Hits Growth and Currencies", *Financial Times*, 18 August 2015, [www.ft.com/cms/s/3/00b81130-45c5-11e5-af2f-4d6e0e5eda22.html](http://www.ft.com/cms/s/3/00b81130-45c5-11e5-af2f-4d6e0e5eda22.html).

<sup>38</sup> See criticisms raised by Jack Lew on the inadequate focus on demand in Hugh Carnegie, "US Treasury Secretary Jack Lew Calls on Germany to Boost Growth", *Financial Times*, 7 January 2014, [www.ft.com/cms/s/0/3adfc4be-77a6-11e3-807e-00144feabdc0.html](http://www.ft.com/cms/s/0/3adfc4be-77a6-11e3-807e-00144feabdc0.html).



Finally, this approach furthers the G20's incremental progress in achieving intellectual consensus on macroeconomic issues. Disagreement on the impact and objectives of macroeconomic policies remain at the heart of most of the G20's difficulties. Improving habits of cooperation and maintaining a constructive dialogue on these issues is one of the G20's significant longer-term contributions to the global economy, but there remains much to be done. These conversations will take time and progress will occur in fits and starts. It is important, therefore, to be realistic in expectations about what can be achieved in any single year.

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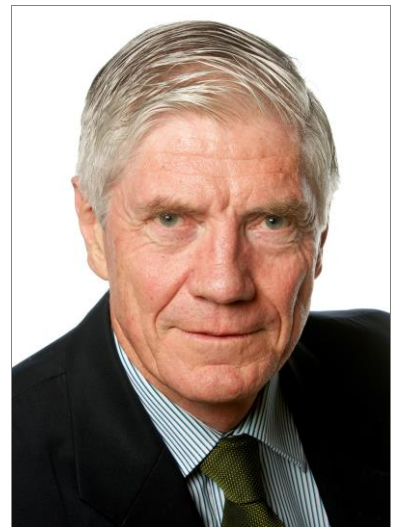


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