Do we need a global ‘central planner’ and ‘optimal’ economic policy for all?

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Abstract

Recently we see a growing interest to and debates on the role of international associations like G20 or BRICS in the global economic renewal and global economic governance. Along with this there is a lot of issues related to establishing new international financial institutions like the New Development Bank or the Asian Infrastructure Investment Bank. However, in our view, all these discussions are based on the experience of the preceding economic crises and false theoretical backgrounds. In the paper we consider the necessity of current processes as a natural response to a new *systemic* crisis and the probable *secular stagnation* in the global economy. We argue that because the situation is completely new for both academic economists and policy makers the appropriate response to the global economic challenges is to give more *competition* and *independence* to international institutions and national policies. Correspondingly, the role and tasks of G20, or BRICS, as well as role of the World Bank, the IMF, or the WTO should change. We see all those organizations rather as venues for presenting and discussion of domestically oriented national policies and cooperation of international financial organizations than ‘central planners’ aiming at elaborating jointly agreed policy favorable for all member countries.

Introduction

The Group of Twenty was set up in 1999 in response to the financial crises of the late 1990s and as a sign of increasing awareness of the fact that the developing countries were inadequately represented in the ongoing discourse on world economic issues and in global collective decision making. The idea was initially launched by the ministers of finance of the Group of Seven (G7), who thus acknowledged the necessity of a dialogue with the developing economies on key economic and financial policy concerns. At present, G20 consists of G7 and EU member states, as well as Australia, Argentina, Brazil, India, Indonesia, the People's Republic of China (PRC), Mexico, Russia, Saudi Arabia, Turkey, the Republic of South Africa (RSA), and the Republic of Korea.

The G20 represents a format for international meetings of the ministers of finance and central bank governors of 20 economies: 19 major advanced national economies and the European Union (EU). In total, G20 accounts for 90% of world gross national product, 80% of world trade (including intra-EU trade), and two thirds of the world’s population. From 2008 onwards, the format of G20 has been altered, and meetings in the framework of G20 have become G20 Presidents’ Summits. This happened because of the threats posed by the world financial and economic crisis. Under the conditions of that global crisis, G20 vividly demonstrated its advantages over G7 as a venue for high-level discussions. As a group representing both developed and emerging economies, G20 is better suited to respond to the changing balance of forces on the world arena in the early 21st century.

The importance of G20 for Russia and major developing economies is further emphasized by the fact that, as a means for active participation in global regulation mechanisms and world economic policy, G20 appears to be one of the most promising among the existing cooperation format for the following reasons.

First, Russia's position with regard to economic policy (even during the period of her participation in G8) has always been very limited, because any attempts to put forth decisions aimed at adjusting the balance of interests of the developed countries on major issues could be seen in a negative light as an unduly confrontational standpoint put forth by a representative of the developing economies. At the same time, it seems impossible that G7 may expand over the next few years to include, say, China.

Second, the format of G20 allows for the establishment of a variety of new coalitions, be they between developed or developing countries, or grouped on a regional or some other basis.

In such a situation, for Russia and the other countries, in spite of the already existing alternative associations (BRICS, APEC, etc.), there is still some space for balancing the related interests, as well as possibilities for launching initiatives in the framework of discussions on individual economic issues, provided that such initiatives enjoy general support.

At the same time, in recent years the issue of the role that can be played by G20 as a self-sufficient international organization, its goals and the mechanisms for implementing its decisions on supranational and national levels has been referred to with increasing frequency. Thus, in particular, the G20 Brisbane Action Plan adopted in 2014, towards the end of Australia's presidency, sets out the joint and individual actions to be taken by the G20 member nations in order to achieve, by 2018, a GDP index 2% above its current growth trajectory. Meanwhile, in the C20 report 'Mapping G20 Decisions Implementation. How G20 is delivering on the decisions made', initiated and produced in the run-up to Russia's G20 Presidency in 2013, it is demonstrated that the actual implementation of G20 decisions at the national level leaves much to be desired. Another example of how G20 decisions are being ignored at the national level is the situation with regard to the redistribution of IMF country quotas, when the US Congress failed to ratify the G20 decision on the proposed reform package.

In this connection several questions have arisen, the answers to which we will attempt to provide later in this paper:

- Do the goal and the mechanisms for its achievement proclaimed in the Brisbane Action Plan adequately correspond to the challenges currently faced by the world economy?

- Is global coordination of economic policy indeed possible?

- Can the multitude of inter-national associations and decision-making centers be viewed as the *New Normal*?

- What is the role, and where is the place of G20 as the decision-making center within this new system of relations?

The 2007-2009 Crisis and the Great Recession

As said earlier, G20 in its present-day format has taken shape from 2008. The Washington summit (15 November 2008) was the first ever meeting of G-20’s leaders. The meeting was concluded with the Summit Declaration, which outlined the major steps to be taken in order to overcome the world financial crisis and an action plan designed to reform the international financial system. Therefore, if the role of G20 in the modern global economy is to be properly estimated, and its decisions are to be made more effective, one should begin with an analysis of

the causes and specific features of the 2007-2009 crisis and proceed towards the post-crisis development of the world economy.

That crisis was triggered by the events in the US housing mortgage market in 2007, followed by the collapse of the financial derivatives segment in the USA and Europe. The financial crisis was developing along rather traditional lines, rapidly spreading across the banking system. However in the autumn of 2008, the crisis unexpectedly hit also the real sector, and then the entire system of public finance in the USA, the European Union and Japan. The declining demand and production in the real sector across the advanced economies coupled with cuts on their investment programs resulted in global shrinkage of the demand for natural resources and commodity imports from the developing economies, thus spreading the crisis beyond the ‘golden billion’.

So, that crisis was a **systemic** one. In this sense, it is similar to the crisis of the late 1920s – early 1930s (the Great Depression in the USA) and to the crises of the 1970s in the developed industrial countries, which were associated with a new phenomenon, theretofore never observed in any economy or heard of in the field of real-world economics – stagflation. In both those cases, the upshot of each crisis was a remarkable breakthrough in the understanding of economics, with the elaboration of a new conceptual and modeling apparatus for describing the processes evolving in the economy. Consequently, these developments made it possible to formulate and provide a rationale for a new type of economic policy (an anti-crisis policy, as well as a long-term post-crisis development policy) – something that would no longer fit into the framework of (until then) traditional approaches. This is the postulate which, in our opinion, must also be taken into consideration in the course of the current discussion of the economic policy measures to be implemented both at the national and supranational levels (including in the framework of G20).

So far, academic science **has not been ready** to provide an adequate explanation of the causes and mechanisms responsible for the emergence of the latest crisis, or to formulate the grounds for elaborating an efficient economic policy. It should be admitted that we are continuing to analyze the situation and make our decisions on the basis of theoretic notions that rely on the experiences of earlier systemic crises. It is noteworthy that it was the idea of the economic science having progressed far enough to provide adequate explanations for every process observed in the economy, and of the choice of an optimal economic policy course being a purely ‘technical’ task, that became one of the reasons why the aggravation of fundamental problems went unnoticed in the economies of the USA and the European Union during the period of Great Moderation (1990s- 2000s).

Besides, this was the first systemic crisis observed in conditions of a **truly global economy**. The world economy in its current form differs even from the economy of the 1970s by the scale of its interconnections. First, from the 1980s onwards, many manufacturing industries were transferred, on a large scale, from the developed industrial countries to Latin America, China and other Asian states. Second, the emergence of latest information technologies removed all barriers in the way of international financial operations and capital movement between countries; the financial market has acquired a global dimension, and so it only takes seconds to circulate financial information and news across the globe. Third, the flows of energy resources and mineral raw materials have become diversified. Oil, natural gas, coal, metals and other natural resources have become the main items of international trade, and their flows have in many cases become much more multi-directional than they used to be in the 1970s. Fourth, the very principle of international trade has been transformed – the simple exchange of goods (based on the countries' individual advantages) gave way to global value chains. Sometimes, dozens of countries participate in each of these chains, and so a crisis in one of them inevitably has a direct impact on all the other participants.

However, the anti-crisis policy that has so far been pursued by the governments consists predominantly of measures designed either to mitigate the cyclical fluctuations in economic activity, or to overcome the effects of previous systemic crises. The fiscal expansion in 2007-2008 and loose monetary policy undertaken since late 2008 were measures that could work well in the situation of a systemic crisis similar to the Great Depression of the 1930s. The subsequent fiscal consolidation, structural changes in the tax system, tougher regulation of the labor markets were the upshot of the recommendations elaborated in the late 1970s and early 1980s. Government support for private corporations and banks that are faced with financial troubles but are 'too big to fail' and stimulating of private demand are measures indicative of a typical countercyclical policy. Nevertheless, as the current crisis is a 'new systemic crisis', the effect of all these measures turns out to be rather low, or in any event insufficient for getting back on the path of long-term sustainable growth.

As a result, in 2011-2012 it became obvious that the world economy, while having exited from the acute phase of the crisis, was giving no sign of returning to its previous trend, transiting instead into a state of unstable growth in the developed countries, characterized by gradually declining (while still positive) growth rates in the developing economies. Besides, the key problems of the latest crisis – long-term misbalance of state budgets, government debt overhang, deflation threat, high unemployment rate, a potential for asset bubbles in the financial markets, lack of motivation for investing in new long-term industrial or infrastructure projects – remained

unsolved. This state of the world economy was named ‘the Great Recession’; meanwhile, there are reasons to believe that here we are faced with another, more serious challenge.

Secular Stagnation

In our opinion, the movement pattern of GDP rates in many countries after 2008 point to the likely onset of a long phase characterized by low growth rates across the world economy, with a possible transition to the so-called secular stagnation model. The mechanism of that model’s evolvement can now be imagined only in purely hypothetical terms; moreover, as said earlier, academic science presently is unable to provide a well-substantiated explanation of the currently observed processes, and besides, no empirical data in confirmation of their reality has been available so far – the period of low growth rates has been too short for that. So, the statements offered in this section should be regarded only as an invitation to a discussion, although they are actually quite compatible with the observable current trends.

There are several dimensions to the discussion on secular stagnation that is currently underway in economic literature.[1] The first question is whether this stagnation has to do with the potential or actual GDP index. The factors that can push down the growth rate of *potential* GDP have been known since the 1980s, and they have been present throughout the entire period of rapid economic growth in the 1990s and the 2000s. These factors are as follows: slowdown in the rate of population growth in the developed countries (or even negative population growth in some countries); population ageing; higher education participation natural ceiling achieved practically by all developed countries; outsourcing development and transition of industrial production facilities from the developed to developing economies; rising alternative costs associated with environmental issues. The first two factors will determine a slowdown in the growth rate of labor market supply, while the next factors will make slower the growth rate of capital and total factor productivity. Over the period of the 1990s and the 2000s, the effects of these factors were neutralized thanks to the developing services sector, consumption culture boost, prolongation of working life, and the redistribution, in the course of manufacturing new products, of value added between the developed and developing countries in favor of the former – while the latter host the relevant production entities. Besides, it can be said that, in terms of growth rate of *potential* GDP, it is the *quality* of growth that is the focus of attention.

The factors that in recent years have been responsible for the slowdown in the growth rate of *actual* GDP are the excessive pressure on the economy exerted by government and private debt; restrictions on migration inflows introduced in the developed countries; and the termination of the technological cycle effect associated with information and communication technologies.

[1] See, for example, Teulings and Baldwin (2014), The Brookings Institution (2014).

Nevertheless, this dimension reflects the key issue of how to identify the current situation – first of all in the developed industrial countries. If we should follow the movement of actual GDP, there will be no secular stagnation as such: we will be observing just one more period – longer than usual but nevertheless cyclical – of economic slowdown, which can be expected to end as a number of problems are successfully resolved. But if there is a slowdown in the potential GDP index, this is a sign of secular stagnation, and it will be necessary to look for special recipes to reverse the situation.

The second dimension of the discussion on secular stagnation has to do with the question of whether that hypothesis is true only for the advanced economies, or if it applies to every country of the world. In our description of the factors conducive to a slowdown in the rate of economic growth we were oriented primarily to the developed countries group. However, a declining rate of growth in the developed countries will inevitably affect also the rate of growth in the developing countries. The main channels for this impact are the already mentioned outsourcing of production components, the demand for end product that is mainly concentrated in the developed countries, the necessary transfer of technologies and capital from the developed to the developing countries, and globalization of the world financial market which now, in view of the global economic activity slump, is capable of redirecting capital flows from the developing countries towards investment in risk-free assets (that is, assets in the developed countries). Thus, as far as the movement of *actual* GDP in the developing countries is concerned, the influence of the *actual* GDP indices of the developed countries remains the main determining factor.

In 2009-2010, the theory of a 'decoupling' in the world economy was put forward, stating that despite the economic crisis in the developed countries, China together with some other major developing economies could become a decisive driving force in their own right in the global economic system. In the course of time it has become clear that this theory has failed the reality test in the real world. However, some developing countries, especially those who are members of the BRICS, the OECD or the G20, certainly do not have any serious constraints to a rapid growth of their *potential* GDP. Likewise, as far as their economic growth is concerned, the aforementioned limiting factors are by no means insurmountable obstacles. This situation has arisen from the fact that over recent years a considerable majority of developing countries have maintained relatively high GDP growth rates – as if being impervious to 'secular stagnation'. However, the current model of economic development implies that as the level of GDP per capita increases, these rates gradually decrease, which means that in the course of time the

aforesaid developing countries will inevitably have to face the problems that are currently typical only of developed economies.

The third dimension has to do with the issue of living standards convergence between different countries. As demonstrated in a recent study by Dani Rodrik,[2] a long-term trend of living standards convergence had been stably observable approximately up to the mid-20th century; thereafter, inter-country inequality was no longer on the decline, or even began to increase. In fact, we can observe a growing differentiation between the developing countries. On the one hand, there is a sufficiently large group of major developing countries (China, Korea, Russia, Brazil, Chile, Argentina, Mexico, Turkey, etc.) confidently catching up with the developed countries in terms of absolute size of their economies and their per capita GDP rates (especially if these indices are estimated on the basis of purchasing power parity (PPP), which reflects the relative price level differences between countries). So, if the convergence hypothesis is tested on the basis of GDP weighted indices, the result will be positive.

At the same time, if observed over longer periods of time, the majority of developing countries, including the so-called low-income countries and many countries that rely on their raw materials exports, display either low unstable rates of economic growth or rapid population growth rates – factors that prevent them from successfully catching up with the developed countries. With regard to these countries we can state with confidence that the convergence hypothesis will not work – and this is also true for the major developing economies.

For these countries, secular stagnation represents an even greater problem than it does for the developed countries, because practically the only chance for them to escape from the poverty trap is through boosting their economic development. The more successful ones among the developing countries are limited in their opportunities for replacing the developed economies in their relations with the poorest countries because, firstly, their own wellbeing rate has not yet become sufficiently high; and secondly, they, as a rule, are well provided with their own raw materials and cheap resources.

The convergence hypothesis is closely linked to the fourth dimension of the discussion on secular stagnation – the increasing inequality issue. This theme became the focus of special attention after the publication of Thomas Piketty's book,[3] where he underlined the fact that in the modern world, beside inequality between countries, there is also an increasing trend towards disparity in the distribution of income, and especially savings. Importantly, the latter is

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[2] Rodrik (2011).
[3] Piketty (2014).

characteristic not only of the developed countries, but also of the topmost group of the developing economies.

Inequality in the distribution of savings, according to Piketty, plays a major role in the currently observed slowdown in economic development. The concentration of the bulk of savings (generated, among other things. also by incomes from global operations) in the hands of a fraction of the population creates domestic market conditions where the supply of resources is higher than the demand for investment. This disparity pushes down the interest rates. However, in face of dwindling economic activity and low inflation rates, monetary authorities are deprived of opportunities for creating incentives for growth by offering low interest rates (the nominal interest rate cannot go below zero - the so-called zero lower bound).

Long-term stagnation leads to preservation of the existing trend towards increasing inequality, because slow (or declining) growth rates provide fewer opportunities for people with low or below-average incomes to boost their standard of living, while wealth accumulation by the middle class also becomes a longer process. At the same time, if the economy is not shattered by acute crises with bankruptcies of major companies and replacements of the former corporate elites, wealth accumulation rates by the richest stratum will not shrink. Therefore, if the world economy has indeed entered the phase of long-term stagnation as described by Piketty, these trends will only become more prominent, spreading into a broader range of countries and making it even more difficult to put an end to stagnation.

Competition and Independence

So, if we are indeed confronted by a secular stagnation triggered by a systemic crisis of a new type, it will be necessary to develop some new economic policy approaches both at the national and supranational levels. We have already noted that the anti-crisis policies pursued by many governments were not appropriate for dealing with the current crisis because they were essentially replicas of the most successful recipes applied during earlier systemic crises. A similar observation can also justifiably be applied to our present discussion of economic policies (or coordination of country policies) at the supranational level (in the framework of G7, G20 or BRICS): it can hardly be worthwhile to coordinate or jointly develop something that used to lead to success under fundamentally different conditions, or simply because this is the only thing that we are familiar with. The success of coordinated actions of G20 member states in 2008-2009 was possible exactly because at that time it was necessary to halt a ‘traditional’ financial crisis in its acute phase; however, as soon as that phase had become a thing of the past, the positive effect of international interaction began to diminish.

When getting down to the discussion of the possible approaches to managing the process of world economic renewal in the framework of international associations, and bearing in mind that we do not know the best ways to overcome the current systemic crisis, we should like to offer a hypothesis based on the necessity to stick to two principles – competition and independence. This hypothesis hails from the ideas put forth by the Austrian School of Economics, by Schumpeter and Hayek, of the usefulness of new companies with a strong competitive potential springing up in times of crisis, which actually can become the main drivers of post-crisis development.

We understand *competition* as the importance of the emergence and coexistence of new international financial institutions or simultaneously operating parallel international organizations. Their diverse forms and interaction (or competition) are the key precondition for the creation, in a natural process and on a market basis, of a new post-crisis configuration of the world economic order. The necessity to do away with a unipolar economic world relying on a single currency reserve system and dominated by Bretton Woods institutions has now become clear to all, including the major advanced economies, but it is really impossible to 'appoint' new institutions. We believe that competition between reserve currency baskets, broad diversification of capital and commodity flows, parallel development of the World Bank, the New Development Bank (or BRICS bank), the Asian Infrastructure Investment Bank (AIIB) and other regional development banks, the IMF, pooling of reserves of BRICS, and the WTO and regional or bilateral free trade agreements are a natural phase in the development of the world economy and world economic order. This is the New Normal of international institutional development, and in the present situation we should welcome the multitude and versatility of such organizations and institutions, and allow time for the new configuration to properly crystallize.

We understand *independence* as the right of each country to seek and implement a specific economic policy considered to be the best form of responding to the current crisis. In spite of the seemingly apparent advantages of a single coordinated economic policy of the Washington Consensus type (as seen in the framework of pre-crisis paradigm of development which relies on the known mechanisms), it will still be necessary to allow countries to focus primarily on their own domestic problems and be 'egoistic' in their choice of appropriate instruments. The current moment is not quite suitable for the emergence of a 'central planner' on a global level. Only competitive policies and trial and error by individual countries will make it possible for academic economists and policy makers to elaborate new approaches in explaining the latest systemic crisis and make recommendations for a new type of economic policy needed for putting an end to both the crisis and secular stagnation. In our opinion, we must be prepared to live and

work under the conditions of a ‘multi-speed’ global economy where the difference in ‘speed’ of each national economy is not a problem that needs to be solved but the necessary precondition for a successful search for a new sustainable development path. In this sense, the value of the coordinated action plan aimed at accelerated economic growth that has been for years elaborated by G20 and consolidated by the Brisbane Summit’s decisions (and that many G20 states failed to comply with already within the first year of its implementation) appears to be dubious indeed.

Conclusions and Implications Concerning G20

In this paper, we attempted to put forth our vision of the situation in the world economy (as it has been evolving in recent years) as a manifestation of new systemic crisis that differs from all the previous ones and an entry in a period of secular stagnation. The response to this challenge, in our opinion, must be based on the principles of competition and independence, as well as on the diversity of national economic policies and international organizations and institutions.

So, we believe that the roles of G20, BRICS, APEC and other major international associations should be altered accordingly. In this connection, their role in the framework of the suggested approach will become much more prominent than it is at present, and will also be fundamentally transformed.

International associations, instead of providing venues for coordination and elaboration of coordinated economic policy, must become a venue where countries (and first of all ‘large’ economies in the sense adopted in the economics – that is, countries capable of influencing prices and interest rates on world markets) can inform the other participants in a given association of their economic policy plans, thereby enabling all of them to elaborate their own internal policies with due regard to the decisions made by the other players. Of course, coordination of economic policies by different participants can also take place in the framework of international associations (and this is a suitable format for such activities), but we believe that such coordination can be more productive if it takes place amongst individual groups of countries, where it is not necessary to achieve compromises acceptable for all, or to conduct lengthy negotiations in order to bring into conformity the standpoint of all the participants.

However, there will also be demand for the coordinating role of international associations like G20 or BRICS, which will serve as a venue for meetings, discussions of joint projects, and coordination (if and when necessary) of the activities of competing international organizations and institutions. Besides, the task of regulation and unification (or standardization) of the rules of game to be applied in international markets remains equally important (and it has not yet been successfully accomplished).

Summing up, we should like also to emphasize that it will be important for international associations to maintain their specialization, and in particular for G20 to give priority to economic policy issues proper. We understand that the 'diversification' of the G20 agenda has been caused, among other things, by the low efficiency, in the eyes of many countries, of the other existing international associations and organizations (beginning with the UN); however, in our opinion, an attempt to more effectively solve various global problems by placing them on the agenda of an organization that still enjoys a prominent status and high profile will, more likely, result in a poorer performance of that organization, rather than in the achievement of adequate solutions to the said problems.

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