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A Proposal for G7/G20 Policy Coordination to Strengthen Global Productivity and Output Growth

by Malcolm D. Knight

ABSTRACT

This paper is premised on the fact that the most important macroeconomic policy issue confronting global leaders at this time is the need to restore, modernize and expand the international network of basic infrastructure that underpins global economic activity. This would help foster stronger long-term productivity growth and per capita output. This paper first outlines key policy elements that are needed within each country to design and implement a successful National Infrastructure Investment Programme (NIIP). It then describes how these NIIPs could be integrated into an Internationally Coordinated Infrastructure Investment Programme (iCIIP), and the complementary roles that the G7 and G20 summit leaders could play in carrying out this vast programme of infrastructure renewal and expansion. The G7, as a tightly knit group of advanced countries, can be instrumental in giving a clear impetus to key elements of the iCIIP strategy. The G20 instead is the appropriate body to set the course of modernization and expansion of a renewed, internationally-integrated network of basic productive infrastructure, and to guide the iCIIP as it is implemented over the next decade.

G7 | G20 | Economy | Finance | Foreign investments

keywords

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Introduction

Since the end of the Second World War, policies to foster liberalization of international trade, unfettered movement of capital among countries, and internationally consistent regulation of financial institutions and markets have contributed to massive increases in global output and brought millions of people out of poverty. However, in recent years public sentiment in a number of advanced countries has turned against this long accepted consensus. Large swaths of the electorates in these countries are convinced that they have gained little from over 70 years of international economic policy cooperation, and US President Trump's administration has focused its early actions on "America First" and trade protectionism.

Yet, ironically, the present juncture presents a unique opportunity for new initiatives of international cooperation, focused on the right economic policies, to be the most productive of any time in the past half century. This essay proposes that the leaders of the G7 and G20 adopt a specific set of internationally coordinated economic policies – a "blueprint" to accelerate global productivity and per capita GDP growth. If implemented consistently over the next decade, this programme could produce a historic win-win outcome, not only in the G20 countries but throughout the world.

Most discussions of international economic policy coordination focus on how monetary and fiscal policy in each country can be adjusted to the economic conjuncture in order to foster stronger global economic performance. But today the central economic issue stems from the repeated failure of many national governments to renew and modernize the basic infrastructure capital that supports

* Malcolm D. Knight is Distinguished Fellow at the Centre for International Governance Innovation (CIGI) and Visiting Professor at the London School of Economics and Political Science (LSE).

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productive activity in their economies. This failure has left a legacy of rusting bridges, obsolescent factories and deteriorating mass transit and freight transport systems.

In 2009 the G20 Summit leaders agreed to implement a structural development programme. Their Pittsburgh Summit Leaders' declaration stated: "Our objective is to return the world to high, sustainable, and balanced growth, while maintaining our commitment to fiscal responsibility and sustainability, with reforms to increase our growth potential and capacity to generate jobs."[1] But as the IMF has noted, little of this programme has been implemented on the ground.[2] This essay is based on the conviction that a renewal of productive infrastructure is essential to fostering stronger long-term global growth and that it would also provide a large stimulus to both aggregate demand and productivity. Our policy recommendation is that governments in a large number of countries should cooperate to put a new international network of basic productive infrastructure in place.

This essay first outlines the key policy elements that are needed within each country to implement a successful National Infrastructure Investment Programme (NIIP). It then outlines how these NIIPs could be integrated into an Internationally Coordinated Infrastructure Investment Programme (iCIIP), and the complementary roles of the G7 and the G20 in carrying it forward as the key element in achieving better global growth performance. We argue that the G20 is the appropriate body to set the broad course of global growth and development, while the G7, as a tightly knit group of advanced countries, can be instrumental in giving a clear impetus to the broad strategy of the iCIIP, particularly addressing the international consistency and interconnectivity of the global infrastructure that will be constructed.

If the G20 countries are prepared to coordinate their national infrastructure investment strategies, macroeconomic policies and regulatory reforms internationally around a core set of agreed iCIIP policies, they will encourage much stronger long-term productivity performance, thus setting the global economy on a course of sustained non-inflationary output growth while simultaneously strengthening their fiscal sustainability.

[1] See paragraph 3 of "A Framework for Strong, Sustainable, and Balanced Growth", *G20 Summit Leaders' Statement*, Pittsburgh, 25 September 2009, http://www.g20.utoronto.ca/2009/2009communique0925.html#growth.

[2] See International Monetary Fund (IMF), *Subdued Demand: Symptoms and Remedies. World Economic Outlook Update, January 2017*, http://www.imf.org/external/pubs/ft/weo/2016/update/01.

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1. Addressing the obstacles to stronger global productivity growth

Over many years the network of basic infrastructure on which productivity growth in innovative and rapidly expanding private sector firms depends has been allowed to depreciate and become obsolete in the US and other advanced countries. Air traffic control systems, electricity grids, road and rail networks, bridges and tunnels, mass transit systems, port facilities and marine navigation aids, educational facilities and financial settlement systems are just some of the infrastructures that are crucial to underpinning productivity growth in the broader economy. But these infrastructures are crumbling – they have become "out of sync" with the infrastructure needs of the private sector.

The first obstacle to a sustained strengthening in productivity and output growth is the persistent weakness of fixed capital formation in the advanced countries, and – the other side of the coin – excessive corporate sector saving. The second is deep uncertainty among private sector firms about how the regulatory framework governing their industries will change in the future. Third is high volatility in financial markets owing to uncertainty about whether the strategies employed by reserve centre central banks for exiting from the unorthodox monetary policies of the past nine years will be well coordinated, and how these strategies will affect different countries' interest rates and exchange rates.

A key reason for low investment is that the planning, financing, construction and operation of essential elements of each country's productive infrastructure network has been a government responsibility in the past, because it was difficult to charge user fees that could yield a market rate of return on investment sufficient to attract private sector firms.

Politicians have priorities other than modernizing the infrastructure the economy needs. Too often the horse trading that occurs when politicians try to deal with rising fiscal deficits has fallen disproportionately on the expedient of postponing infrastructure projects that are needed to maintain and expand each country's national capital stock.

Years of such "bandaid" political solutions have led to inadequate and outmoded infrastructure. We face the paradox that while there have been few past historical periods when technological innovations were brought to the marketplace as rapidly as they are now in those industries where they can be quickly monetized for private profit, much of the network of basic productive infrastructure that is needed to support economic development has become decrepit and outmoded to such an extent that it comes nowhere near to matching what is needed to support private sector productive activity.

The present is an ideal time to focus policy on stimulating domestic demand directly by rebuilding and modernizing basic infrastructure in a number of countries. Clearly, the way infrastructure is planned and put in place must change

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if this obstacle is to be overcome.

The main objection to a policy of strongly increasing investment in basic infrastructure is that many countries already have large fiscal deficits and high ratios of debt to GDP – they cannot "afford" to undertake needed infrastructure investment without further damaging their long-run fiscal positions.

However, this objection is much less relevant now than it would have been a decade ago. Today spending on basic infrastructure no longer requires a commensurate increase in the fiscal deficit. In times past it was difficult to charge for basic infrastructure through user fees. Twenty years ago, cars on US toll roads had to stop at frequent pay booths, causing massive traffic delays and congestion at times of heavy traffic. But modern technology has eliminated problems such as this by making it feasible and inexpensive to charge users of most types of basic infrastructure the full cost of the services provided. Examples abound – such as electronic systems that automatically charge vehicles for their use of the road without any significant slowdown in traffic circulation. One could point to dozens of similar innovations that have made it possible to charge for the services provided by basic productive infrastructure. This, in turn, means that while the government should be involved in determining what public infrastructure is needed, its construction and operation should be undertaken to the greatest extent possible by the private sector, and rendered profitable by levying user charges.

This essay proposes that each G20 country establish a National Infrastructure Investment Program (NIIP) and that the NIIPs be closely coordinated internationally through an Internationally Coordinated Infrastructure Investment Programme (iCIIP) in which the G7 and the G20 would play separate but complementary oversight roles. The next two sections describe the NIIP and the iCIIP.

2. National Infrastructure Investment Programmes (NIIPs)

The goal of each country's NIIP would be to focus on building an integrated network of infrastructure in which the main projects support private sector production, thereby establishing the basis for faster productivity growth in key sectors. Each NIIP should have the following essential elements:

1) The overall design of the NIIP – decisions on the priorities for investments in productive infrastructure – should not be planned directly by politicians. Instead, the government should establish a high-level Commission of specialists in the design, construction and management of large integrated capital investment projects.

The Commission's first task should be to prioritize the types of infrastructure that are most productive for the economy as a whole, how much should be built each year, and the sequencing of construction of the key projects in the country's renewed and expanded productive infrastructure network.

2) Each national Commission would provide its government with recommendations on the priorities of the infrastructure investment programme for the NIIP and their sequencing, its proposals for how the private sector could finance the needed infrastructure projects, and the output pricing mechanisms that would induce private firms to undertake the projects of the NIIP in a coordinated fashion on a for-profit basis. Following receipt of the Commission's recommendations the government would have six months to approve or modify the proposed NIIP.

3) A crucial element of the government-approved NIIP is that it must give private sector firms confidence that they can expect to earn an economic rate of return on their investment in basic infrastructure while meeting the performance requirements specified by the Commission. To the extent that each country's NIIP focuses on getting private sector firms to implement the key infrastructure projects, it can be implemented with a much smaller impact on fiscal deficits than in the past so that it does not impede fiscal consolidation.

4) Since the infrastructure investment projects will take several years to plan and a longer period to build, construction of key pieces of infrastructure in each country needs to be carefully sequenced to avoid bouts of excess demand that could create unwanted surges in inflation and excessive weakening of the external current account. The Commission should also be responsible for proposing this schedule to the national government.

5) Another issue is the need to invest in basic infrastructure that is crucial for broad socio-economic development but where externalities make it difficult to find pricing mechanisms that will attract private sector involvement in the project. Here the government's role in financing infrastructure is likely to remain central – examples are capital investments in education, resource management, pollution control, basic research, security, and mitigating climate change. But even in these areas of basic infrastructure the government can use more novel pricing and financing mechanisms to increase private sector involvement in infrastructure projects. For example, inducements could include public-private partnerships, "build, operate and transfer" arrangements, or government guarantees of private sector debt issues.

6) Finally, to give the private sector the confidence it needs to build and operate a large portion of the NIIP infrastructure, the government must ensure that its legal and regulatory framework gives strong economic incentives for corporations to undertake the key fixed investments, as well as a commitment to a stable legal and regulatory environment that gives confidence to firms that the profitability expected at the time the project is initiated will not be undermined by unanticipated future changes in the legal and regulatory framework.

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3. Proposal for an Internationally Coordinated Infrastructure Investment Programme (iCIIP)

In today's interconnected global economy it will be essential that the NIIPs of individual G20 countries are coordinated internationally.

First, given the tight production and communication linkages in the global economy, the infrastructure constructed in each country – freight and passenger transport systems; energy delivery; land, air and maritime transport facilities; telecommunications networks; physical and cyber security systems; financial system infrastructures, etc. – needs to interconnect with that in other countries as seamlessly as possible and adopt consistent technical standards. The international network of infrastructure also needs to be designed with appropriate redundancy across countries, to assure the robustness of the overall production system.

Second, it will be essential for G20 governments to continue to coordinate their economic and financial policies to address the international spill-overs from differences in the pace of infrastructure investment and demand stimulus across countries and over time.

Third, international coordination will also be important to avoid stimulating demand excessively in a large number of countries at the same time, thereby intensifying global demand pressures, raising inflation and interest rates, and exacerbating the risk of an unsustainable boom in global output.

For these reasons it is essential that the renewal, expansion and modernization of global productive infrastructure be coordinated under an iCIIP. This will increase the efficiency of the global economy and optimize the stimulative effects of infrastructure investment on global productivity and output growth.

During the period of a decade or more when major national infrastructure investment projects are being put in place more or less simultaneously in a large number of countries, national implementation rates will need to be sequenced internationally through the iCIIP. Otherwise, the stimulus to aggregate domestic demand in those countries that are implementing the most ambitious infrastructure initiatives could push up their real exchange rates, sucking in more imports and reducing the stimulative demand effects of their infrastructure investment programmes on their domestic economies, causing their external current account positions to weaken, and increasing their reliance on foreign capital inflows.

For example, the new Trump administration in the US is committed *both* to implementing a very large project to renew and expand basic infrastructure, *and* to a policy of "America First" and increased trade protectionism. These policies are mutually inconsistent. If the Trump administration embarked on a massive infrastructure renewal programme while simultaneously tightening restrictions on imports into the US, the domestic demand stimulus would likely result in

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a large appreciation of the US dollar against other currencies. This would offset the positive employment and output effects of the infrastructure initiatives and increase inflationary pressures that could price US labour out of world markets. In sum, for the US to combine massive infrastructure investment with increased protectionism would be exactly the wrong policy mix, both for the US and for the global economy. The sorely needed renewal of *global* infrastructure must be internationally coordinated under an iCIIP agreed by global leaders at the Summit level.

4. The roles of the G7 and the G20 in the design and implementation of the iCIIP

The G7 and G20 are the obvious groups where the key decisions on iCIIP can be taken, and the G7 and G20 Summit meetings should have complementary roles in the governance of the international infrastructure renewal process.

The complementarities of the G7 and the G20 in this area are clear. Since the G7 is a small, close-knit group of the largest advanced economies, G7 Summits should focus on the broad principles and framework policies of the iCIIP. In particular, the G7 leaders should address: (i) ensuring consistent international standards for the interconnectivity of the key infrastructures of the iCIIP; (ii) outlining the modalities for international coordination of basic infrastructure investments; and (iii) building up the international consistency of legal and regulatory frameworks both across countries and over time.

Taking account of the general principles discussed in the G7, the G20 Summit process would agree on the modalities for overseeing the planning and implementation of the iCIIP. It would require considerable resolve on the part of the G20 leaders to reach agreement on how to design and oversee the operational structure needed to implement such a vast internationally coordinated network of infrastructure investment projects. However, the G20 has experience in this area through its programme to reform the global architecture of financial regulation, which has been progressing since the first G20 Summit in November 2008.[3]

A particular challenge will be for the G20 leaders to reach a shared view on the appropriate ways of inducing the private sector to build, finance and operate the new infrastructure network. Since infrastructure projects take a long time to plan and build, another key challenge for the G20 will be to maintain its focus on these issues throughout the life of the iCIIP, which is likely to be a decade or more. The financing of the projects in the iCIIP will also need to be phased in over an extended period to avoid a bubble of corporate bond issues and other private sector financing, and to mitigate inflationary pressures. The G20 Programme also needs

[3] See Malcolm D. Knight, "Reforming the Global Architecture of Financial Regulation: The G20, the IMF and the FSB", in *CIGI Papers*, No. 42 (September 2014), https://www.cigionline.org/node/8318.

to be flexible enough in its implementation that it can incorporate unexpected new productive technologies as they come on stream. Successive G20 Summits will give political impetus to the design of the iCIIP at the highest level, and to the oversight of its implementation over the next decade or more.

The detailed technical work of sequencing the key projects in the iCIIP and the task of keeping its implementation on track should be undertaken by an International Forum of experts in the management of complex infrastructure programmes, appointed by the G20 Summit. This Forum would then have a mandate to call on the relevant official international economic, financial and development institutions to assist with elements of the iCIIP in their specific areas of competence.

Since it will take at least a decade to bring the iCIIP to fruition, it will be essential to coordinate policies internationally in other areas – particularly macroeconomic policies, trade liberalization and regulation. There is not space here to discuss these supporting policies, although they will be crucial to the ultimate success of the iCIIP. Other papers presented at this conference deal with the roles of the G7 and the G20 in coordinating these supporting policies.

Conclusion

This essay has suggested ways in which the G7 and the G20 can interact in a complementary way to reinforce cooperation in renewing and expanding the global stock of basic productive infrastructure capital. We have argued that each G20 country should initiate an NIIP and that the national programmes should be coordinated by an iCIIP in which the basic principles of cooperation are discussed by the G7 and agreed by the G20. The G20 would establish the overall design and organization of the iCIIP, develop the modalities for putting it in place, and designate the official institutions that should be involved in monitoring progress in the construction of a renewed international network of basic productive infrastructure. These proposals are obviously highly ambitious, but an internationally coordinated infrastructure programme of this sort will be essential if the broad goal of strengthening productivity and output performance in the global economy is to have a reasonable chance of success.

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Via Angelo Brunetti, 9 - I-00186 Rome, Italy
T +39 06 3224360
F + 39 06 3224363
iai@iai.it
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