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Chatham House International Roundtable Summary

Emerging from the Global Crisis and Rebalancing the Global Economy

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Chatham House would like to thank FTI Consulting for their generous support of this roundtable.

This is a summary of the New York Roundtable discussions on the current state of the global economy and policy priorities. The discussions took place against the backdrop of renewed concerns about the eurozone, and the latest IMF forecasts of a weak and fragile recovery in most advanced economies, and significant downside risks for the global economy. They concentrated on policies needed to improve the outlook and to increase the robustness of the recovery. The discussions were held under the Chatham House Rule.

Advanced economies

It was generally agreed that resolving the continuing crisis in the ***eurozone***, which began two years ago, was the most important issue facing the global economy. European governments and institutions have taken a number of steps to address the crisis, but in general these were seen as 'too little too late'. Until a lasting solution is found, it would continue to be a source of uncertainty, with negative consequences for other countries and weighing on business confidence.

All participants agreed that measures taken by the European Central Bank to provide liquidity, and by the IMF and the EU to build bigger firewalls, were important and necessary. But further action is needed by most European countries to reduce debt and deficit levels, and to implement structural reforms to improve prospects for growth. Some participants stressed that these measures needed to be given time to work, and their full and rigorous implementation was essential to regain market confidence. Indeed, pressure from markets was needed to encourage governments to stick to these plans for further action. Others expressed strong doubts whether fiscal austerity and structural reforms on their own were sufficient to address the crisis, and whether they were economically and politically sustainable, given the social and political consequences of a prolonged period of little or no growth. It was also noted that European banks required further strengthening.

Some participants pointed to the need to deal simultaneously with the imbalances between the core and periphery countries arising from competitiveness problems within the single-currency area. The lack of exchange rate flexibility within the eurozone complicated monetary management, especially in the absence of greater coordination or centralization of fiscal policy and the ability to make significant fiscal transfers between countries in the eurozone. Although dealing with these issues would require strong political will, many participants noted that the euro was in essence already a 'political project'.

More generally, there was also broad agreement that many ***advanced economies*** were facing challenges in managing fiscal policy in a low-growth environment. One participant argued that all advanced economies (with the possible exception of Germany) were facing a 'triangle' of interconnected problems that need to be tackled – high fiscal debts, low growth and financial-sector weakness. These problems are particularly difficult with interest rates in many countries at or close to zero; the scope for further conventional monetary policy easing is constrained. In these circumstances cutting primary fiscal deficits too quickly would risk damaging growth, which in turn would put upward pressure on deficits and harm financial institutions.

The ***United States*** in particular, although more resilient than the eurozone, was also seen by many participants as in need of a fundamental change in policy. Housing and credit markets are still not functioning normally, acting as a drag on recovery. Longer-term fiscal prospects were a cause for concern and uncertainty unless fiscal reforms were put in place, including reforms to cut entitlements and reform the tax system. One participant noted that the US fiscal deficit had been eliminated in the 1990s, but only because the economy had grown and strong fiscal discipline was in place.

Implications for emerging markets and developing countries

By contrast, most emerging markets were performing better than advanced economies, not least because they had improved policy environments in recent years, which allowed them more space for counter-cyclical policies (although poor policies, such as in Argentina, were still punished by markets).

China, in particular, continued to grow fast (although there were signs recently that exports were starting to slow and its current account surplus was being reduced). One participant noted that, although its current account surplus would diminish over time, it was natural for China to run surpluses for a considerable period (as the UK had done in the 19th century, and the US for the first half of the 20th century). Also south–south trade (including in local currencies) was expanding quickly, especially intra-regional trade in Asia. One participant called for international financial institutions to start issuing debt in regional currencies in order to help develop emerging market financial systems.

However, ***emerging markets and developing countries*** were being affected by energy price volatility and by spillovers from problems in the advanced economies, especially the policies of quantitative easing undertaken in different ways in the US and Europe. As 'innocent bystanders' these countries still remained vulnerable to shocks from advanced economies. Many had responded by building up foreign currency reserves as self-insurance and buffers against such shocks.

Some participants argued, however, that as emerging markets continued to grow relatively quickly, their exchange rates should rise. But others pointed out that many emerging markets did not yet have strategies in place to maintain competitiveness if their exchange rates appreciated; and capital inflows were potentially destabilizing, requiring countries to sterilize these flows and/or introduce capital controls.

Business prospects

Many participants noted that, in some ways, the business outlook was more positive than was suggested by the economic news. There was a great deal of private-sector money available for investment, including for energy investment. This would create a great number of new jobs. Despite the economic problems in the eurozone and the US, for example, there were potentially profitable investment opportunities, such as in shale gas.

However, the degree of economic uncertainty and the lack of stable long-term policy frameworks described above, as well as current political uncertainties (with elections looming in a number of countries), were seen as holding back investment. For example, in energy markets, a number of governments were seen as having changed the 'rules of the game', as Germany had done over nuclear power. Other factors constraining private investment were skills shortages, and the ability of internationally active companies to operate seamlessly across international borders.

Companies were increasing their investment in emerging markets, responding to more favourable conditions there. But in some cases their ability to do so was limited by the absorptive capacity of those markets.

National policies and international coordination

National policies were seen as having a substantial role to play in facilitating a stronger global recovery and strengthening resilience to shocks. Policies within specific eurozone countries and in the US were viewed as key in this regard. But there was also an important role for international coordination of policy responses.

There was general agreement that the G20 had played a significant part in the global response to the financial crisis in 2008 and 2009, building up the IMF's resources and setting a new international agenda for financial regulation. But since then both its role and the collective will of its members had diminished. National interests were becoming more important to G20 governments, and international interests less important.

Participants saw a number of reasons behind this development. As the crisis has receded at a global level, the need for cooperation appears to be less urgent. And as specific economies have stalled while others have recovered, national interests have also diverged more. Moreover, the issues on the table have come to be seen as being more complex and less tractable than was initially appreciated. The eurozone crisis is one such example. Countries outside Europe want the eurozone to do more to help itself collectively. But inequalities between the eurozone's members are leading to a breakdown of political cohesion within Europe and to delays in instituting collective policy adjustments.

Some participants saw this as a cause for concern, calling for more effective international coordination mechanisms. National policies had international spillovers, and in some cases were creating problems for other countries. Addressing these problems through institutions such as the IMF and G20 was necessary to avoid a 1930s-style situation. Participants argued that a globally coordinated solution should also produce better outcomes for all. Even if the gains turned out to be small, in the current circumstances they were worth trying to achieve. The G20's framework for strong, sustainable and balanced growth had made some progress, but it should be extended to addressing issues of unemployment, inequality and social cohesion, including through structural reforms.

Others saw the trend towards greater focus on national interests as inevitable. In their view, the first duty of every government is to implement sound policies in its national self-interest, and only then to try to avoid negative spillovers to other countries. Ensuring good policies in all countries would itself be a major achievement. And, even if an internationally coordinated set of policies were feasible, it would be difficult to ensure that the benefits were spread equitably between countries.

Nevertheless there was agreement that there are some areas where international cooperation is crucial. First, efforts to reduce global imbalances will only succeed if pursued at the international level, with the involvement of all major parties. Second, guaranteeing more resources for the IMF (and the accompanying conditionality for borrowing countries) would help protect the international community from country-specific shocks. And third, ensuring that the global financial system – the 'sinews' of the global economy – starts to work effectively again, and ensures the free flow of finance across borders, is essential for global recovery.

CHATHAM HOUSE INTERNATIONAL ROUNDTABLES

Chatham House International Roundtables are held in key locations around the world to explore topical issues of critical importance to global prosperity and security.

The structure of these Roundtables reflects the essence of Chatham House's approach – informal discussion among a small group of senior international and local political and business leaders. They provide an ideal environment in which to facilitate the development of shared ideas on how best to confront pressing challenges and harness emerging opportunities in international affairs.

The Roundtables are held under the Chatham House Rule and a non-attributable summary of the discussion and policy ideas is published online.

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