Why Development Now Matters for the G-20

Ashima Goyal

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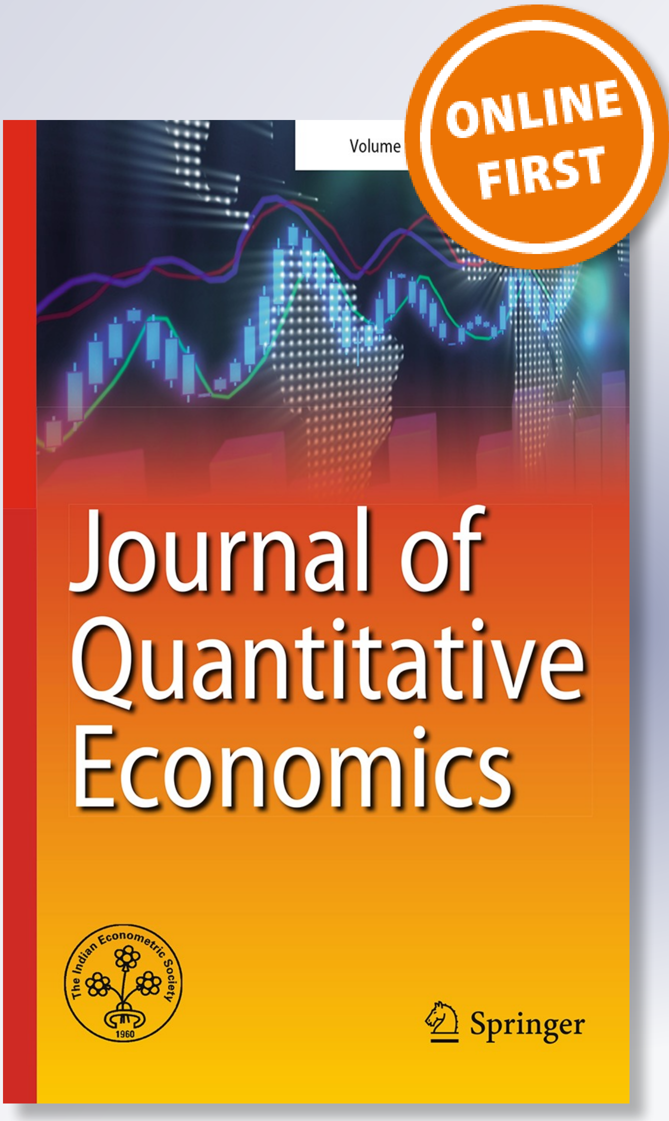

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The G20 Development Agenda: An Indian Perspective. Edited by Parthasarathi Shome. New Delhi: Cambridge University Press. 2015, pp. i–xiii +3–309

Ashima Goyal[1]

This volume, the second Parthasarathi Shome has edited on issues related to the G20, relates to a top of the list item for India—development. After very successful macroeconomic policy coordination immediately after the global financial crisis began the G20 broadened the agenda to include development issues in the Seoul 2010 summit. At that time the recovery seemed to be proceeding well, allowing what some criticised as diffusion and a weakening of focus.

The 2011 Euro debt crisis, however, suggested that the financial reform agenda was still incomplete and needed much more attention. Although emerging and developing economies (EDEs) had recovered well and their growth helped sustain global demand, this second shock hit EDEs harder. For example, Indian growth rates fell below 5 % from above 9 %, and stayed at this level, and Chinese growth rates began to slow. The 2014 collapse in commodity prices hurt commodity exporters among EDEs and the troubles in China, as it struggled with the transition to a more market driven economy, again affected EDEs. The focus in international discussions and in the G20 had been on how essential it was for advanced economies (AEs) to recover in order to sustain global growth. The neglect of EDE demand was ironic because the G8 had expanded to the G20 precisely to give more voice to EDEs whose economic clout was growing.

Even in 2013, when the fear that the US Fed would begin tapering off quantitative easing (QE) led to a surge of capital outflows from emerging markets (EMs), the commentary was largely that the AE recovery could withstand an EM slowdown. But in 2015, it had become clear that EDE growth is a major driver of global growth. Fears are voiced that this third shock will once more fell global growth, because AEs now account for only about 43 % of global GDP in 2015, down from 54 % in 2004.

✉ Ashima Goyal
ashima@igidr.ac.in

1 Indira Gandhi Institute for Development Research, Gen. A.K. Vaidya Marg, Goregaon (E), Mumbai, India

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The successive shocks EDEs have suffered after the GFC suggests not enough was done to protect and encourage EDE growth in the G20. And this is now creating a negative spill over to AEs themselves. Therefore, the G20 development agenda is not diversion, but ought to form one of the centrepieces of G20 action. For this to happen, detailed research is essential to inform debate and enable action. The chapters in this volume that report on in-depth research undertaken in this field, therefore make a timely contribution.

In an excellent overview of the book, and a description of the evolution of the G20 development agenda, Shome and Rathinam make the point that G20 created a political thrust enhancing the existing global development architecture. The development agenda of the G20 came to focus in practice on commodity price volatility, food security, infrastructure, and green growth.

Among the four chapters that take up this agenda, Kirit Parikh has a thorough discussion of structural impediments to India's growth prospects. The analysis of the deeper causes of the poor finances of state power distribution companies is rich and informative. While underlining the usual constraints, he makes the point that India is well placed for innovation that can help it avoid a possible middle-income trap.

Excessive commodity price volatility has been a key source of adverse shocks in this period. Chakrabarthi, Rathinam and Varadi's empirical work on Indian commodity markets does not find financial factors to have played a negative role. Their policy suggestion for the G20 therefore is to focus on ensuring free trade and preventing policy flip flops regarding derivative use. Their result is not surprising, however, since financial markets are both underdeveloped and well regulated in India. But extreme volatility in international dollar oil prices over 2004–2015 does suggest aggravation from financial factors.

The US Commodity Futures Modernization Act (CFMA) passed in 2000, lightened speculative position limits, among other deregulations. 'Swap dealers', who facilitate OTC investment in exchange-traded funds tracking commodity indexes, were granted exemptions from speculative position limits. This coincided with the large-scale index-based investment as pension funds diversified their portfolios after the dot com crash. Over 2004–2008 open interest in oil derivatives more than tripled and the number of traders doubled. The sums involved were very large. That oil prices crashed immediately after the GFC, and their subsequent volatility, was a sign that prices were deviating from fundamentals.

Large QE created liquidity soon drove up oil along with other asset prices after the GFC. As restrictions on bank's proprietary trade led to the large investment banks exiting commodity trades, however, commodity market speculation reduced. Moreover, sustained high oil prices brought about a rise in supply, weakening OPEC's market power. Chinese demand also slowed, but was not the primary reason for the sharp 2014 fall in oil prices. Chinese growth had slowed to 7.7 in 2012 from 9.3 the previous year without reducing oil prices. Better prudential regulation in commodity markets, such as position limits could have mitigated oil price bubbles and their fallout. The UK also imposes no position limits, although major EDEs like India and China do so. If G20 ensures regulatory coordination with near uniform margin requirements and position limits across countries, this could allow the power of markets to be harnessed while moderating their excesses.

Renu Kohli's chapter is on a very important topic—that of recycling global surpluses for infrastructure investment in EDEs. She makes the right policy prescriptions, such as setting up a central special purpose vehicle or regional funds for low-cost long-tenure financing, and correctly identifies the win-win nature of such interventions as they both expand capacity and create global demand. But it would have been useful to have some political economy analysis of why the World Bank has not delivered on this despite the obvious benefits. The irony is that many of the savings surpluses are in EDEs and continue to be invested in deeper AE financial markets, instead of financing infrastructure where it is most needed. Since the current global development architecture has not delivered competing institutions need to be created. The proposed Asian Infrastructure Investment Bank promises to trigger helpful competition in this field.

D.K. Srivastav in his assessment of international burden sharing uncritically buys into the argument that the deeper structural roots of the GFC were persistent balance of payment surpluses in EDEs that financed deficits in AEs. The argument that these deficits invested in safe US treasuries created a shortage of safe assets and forced US financial entities into a risky search for yield, however, has obvious flaws. First, Asian demand for US treasuries was much smaller than the amount the US Fed has been absorbing subsequently in its QE. Second, it is the job of financial regulators to prevent excessive risk-taking—but they were asleep on the job. Third, an efficient financial sector would have recycled the surpluses to where they were most productive—infrastructure investment. That it did not do so and instead created risky bubbles again points to flaws in financial markets, and the necessity of creating such institutions and innovative financing mechanisms. The last is a valid lesson the chapter draws. It usefully explores some of these mechanisms and the best use for funds that are raised.

The third and final section of the book takes up the G20 'green' agenda. Mehra and Datt contribute a careful empirical study of Indian energy subsidies, and reform agendas to balance equity and efficiency. Prodipto Ghosh examines whether India should join the International Energy Agency, and concludes in favour of limited engagement in the absence of governance reform at the agency. The strategic assessment of benefits and losses and the conclusion make a broader contribution to the question of how EDEs should engage with many global institutions where their voting shares remain below their growing economic power.

Shome and Goldar bring a valuable EDE perspective to the G20 'green' agenda, arguing for measures to ensure the vulnerable are protected from climate change, and the necessary capabilities are built. In their view a global carbon tax could have double mitigation value if it is used to fund environment friendly infrastructure.

A. Damodaran explores the issue of finance for adaption to or mitigation of climate change, and which one should get more funds, in more detail. His topic is an example of areas where G20 can be most productive—that is, wherever coordination is required across countries. All countries acting together can have a much larger impact on climate change, while countries acting on their own could not be effective. Moreover, if one country is able to free-ride on another's actions so will others and coordination will fail. A problem in building a consensus is differing preferences and requirements across AEs and EDEs. He examines strategic actions and likely outcomes under public, private, and market-based funding modes.

Although G20's major potential contributions are in cementing global coordination in a number of areas, this is easier to do when the proposed action can be shown to benefit most countries. In many areas, including development, a consensus could not be built because of the perception that measures that EDEs wanted did not benefit AEs much. This perception is now changing and may allow more purposeful action on the development agenda effectively laid out in this book.