Joint commitment can kickstart growth

The return to the G7 structure enables leaders to focus on a key strength of the forum

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Once again, the leaders of the major industrial countries are meeting at a time of uncertainty in their own and the world's near-term economic outlook. Data for the fourth quarter of 2013 had indicated that perhaps the major economies were at last experiencing solid economic expansion. Unfortunately, developments during the first quarter of 2014 dashed those optimistic expectations. And, for the fourth straight year, expectations of a sustained, strong recovery in the United States were shattered with the release of weaker than anticipated first-quarter real growth in gross domestic product (GDP).

Economic forecasts prepared by the International Monetary Fund for its April meetings had also indicated an optimistic outlook for 2014 and 2015. Unfortunately, these projections were completed before the release of the disappointing data on GDP growth in the US during the first three months of this year and the weaker than expected economic performance in Europe during the early months of 2014.

At the time of writing, the European growth outlook is particularly cloudy, as the Ukrainian situation has raised worries regarding the future cost (and availability) of natural gas and oil from Russia. Furthermore, Europeans are deeply concerned about the potential use of further economic sanctions against Russia in response to the crisis. These worries are undoubtedly holding back both consumer and business spending. Yet despite these uncertainties, Germany continues to expect a significant strengthening of GDP growth this year after a lacklustre 2013. Domestic demand is picking up as industry and consumer confidence grows. Germany will lead the eurozone in terms of real growth performance with a rate between 1.5 and 2 per cent. But, for a change, the United Kingdom's rate of real growth will head up Europe: it is likely to approach three per cent this year. However, despite these real growth performances in the UK and Germany, European unemployment is expected to remain high by historic standards with levels of youth joblessness disturbingly high and long lasting.

The bright spot among the G7 economies this year is Japan. It is apparent that the three-pronged macro and micro policy approach that Prime Minister Shinzo Abe has put into place has affected the real economy and, more importantly, business and consumer expectations. Business seems to be willing for the first time in many years to look inward for investment opportunities instead of only looking abroad for profitable investments. Given the large sums of cash available to major Japanese firms, this new confidence in the domestic economy could be very important for stimulating domestic demand.

The G7 leaders have not focused on tackling structural problems for years. It is time for them to do so in Brussels

Unfortunately, for the first time in years, the BRICS grouping of Brazil, Russia, India, China and South Africa is not likely to provide much strength to the global economic outlook in 2014. China is adjusting to slower GDP growth, partly as a result of a slowdown in exports and partly as a consequence of conscious government policy choices to restrict the domestic economy. While real growth will remain strong by world standards, it will represent a continued slowing of GDP growth in China – and could result in changes in domestic policy management if the slowdown is sharper than currently anticipated. India is likely to see growth pick up at the margin if the global growth strengthens and Indian exports expand faster than in recent years. Given the downside risks for global growth, this mild optimism could be excessive. Russia – given an already weak domestic situation – faces uncertainty over the effects of business and consumer confidence due to economic sanctions.

G7 cooperation and coordination

With a return to the original G7 structure for this year's economic summit, the leaders have an opportunity to return it to its original strength. In earlier days, the annual summit process focused on macroeconomic policy actions that could strengthen the near-term outlook among the participating countries. In the past,

A weaker than expected economic performance in Europe throughout the first quarter of 2014 was compounded by worries prompted by the Ukraine crisis

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leaders used their finance ministers to lay the groundwork for a substantive communiqué at the summit. Their joint commitments fortified consumer and business confidence, which in turn enhanced – at the margin – the near-term economic performance.

In recent years, the original principle of the summit process has fallen out of practice. In earlier periods, the leaders of the major industrial economies urged their finance ministers and central bankers to engage in a process of economic policy 'coordination and cooperation'. The concept was straightforward. With economic authorities working in concert, the effects of macroeconomic policy changes could reinforce each other and the sum of the effects would be greater than if policy actions were undertaken in isolation.

The industrial economies face domestic rigidities that dampen domestic demand and employment growth. While the Organisation for Economic Co-operation and Development has attempted to tackle structural problems for years, the G7 has not focused on them since the late 1970s.

High levels of unemployment

It is time for G7 leaders to focus on structural problems in their joint communiqué in Brussels. All participating countries face large unfunded national pension schemes. With aging populations and continued high levels of unemployment, unfunded liabilities are growing faster than is acceptable. By sharing their commitment to stabilising pension plans, confidence levels would be strengthened in all G7 members. Similarly, labour force retraining is a critical problem facing the G7 area. Technological innovation has rendered large portions of national labour forces untrained for work. No single country has yet developed a successful retraining programme for the 21st century. By working jointly, the G7 members could tackle this glaring problem.

Aside from these structural issues, leaders should address other labour market rigidities and the need for tax reforms in many countries. They could, for example, instruct their finance ministers to seek to unify corporate tax rates and principles in order to end tax evasion by corporations moving profits to tax havens. Finally, leaders need to strengthen their commitment to reducing trade barriers, whether in the area of goods, services, investment, intellectual property protection or labour mobility. Leaders could endorse the breadth of the Trans-Pacific Partnership now being negotiated and suggest that it may provide the next model for trade liberalisation discussions. Leaders could also endorse the transatlantic negotiations. ■