GROUP OF TWENTY

GLOBAL PROSPECTS AND POLICY CHALLENGES

G-20 Leaders' Summit
September 4–5
Hangzhou, China

Prepared by Staff of the

INTERNATIONAL MONETARY FUND*

*Does not necessarily reflect the views of the IMF Executive Board.

EXECUTIVE SUMMARY

The global outlook for growth remains subdued. Financial markets have largely recovered from their immediate plunge following the United Kingdom referendum. Recent data, however, show muted activity, slower trade growth, and very low inflation, pointing to an even more modest pace of global growth this year. Despite record-low interest rates, investment continues to disappoint, reflecting demand conditions as well as high corporate sector debt and weak financial sector balance sheets in many countries. Weak investment further dampens underlying potential growth, which is already low due to dismal productivity trends, and demographic factors.

Low and falling growth along with rising inequality make for a challenging policy environment. The weak outlook can further reduce incentives to invest and slow down trade, adding to demand shortfalls and limiting the room for productivity gains going forward. At the same time, income growth has not only been meager, it has bypassed low-income earners in many countries, raising anxiety about globalization and worsening the political climate for reform. These developments threaten to open another negative dynamic, in which political action fails to deliver the structural reforms needed to lift growth and instead turns toward inward-looking assaults on free trade.

The balance of risks remains skewed to the downside. Potential threats to growth include stalled reforms and protracted low inflation that dampens inflation expectations further, raises real interest rates, and, thereby, lowers incentives to invest. China's transition to a more balanced growth path could face difficulties with potentially significant spillovers. In addition, geopolitical risks and uncertainties about the steps to follow the "Brexit" vote continue to threaten the outlook, especially in Europe, where financial institutions are facing a number of challenges.

Sustainably higher and inclusive growth requires more forceful, comprehensive, and well-communicated policies, including greater cooperation on the global policy agenda. Given that many interconnected factors restrain growth, policymakers must work all necessary levers. At the same time, it will be important to explain to the public the benefits of decisive action and, where necessary, provide effective support to those who disproportionately shoulder the burden of adjustment. A comprehensive approach demands:

- *Reforms to raise underlying growth*. Country needs differ, but collectively the G-20 is falling short of its ambition to raise GDP by an additional 2 percent by 2018 ("2 in 5"). More progress is urgent. At a minimum, countries should strive for swift implementation of all announced measures, but in many cases, additional efforts will be needed. These would be most effective when prioritized around each country's reform gaps, level of development, and cyclical position.
- *Shorter-term policies to support reforms and contain risks*. Where demand is still lacking, fiscal and monetary policies can support short-term growth while accelerating the positive impact of structural reforms—for example, by allowing new job seekers to find work faster. With policy interest rates near or at their effective lower bounds in many countries, fiscal policy has an especially vital role to play—including through additional public investment where there is fiscal space, making tax-benefit structures more efficient and equitable, and addressing private sector debt overhangs and balance sheet problems. Both fiscal and monetary policy will be more effective when operating within coherent frameworks that anchor inflation expectations and ensure fiscal resiliency, thereby broadening the scope for countercyclical policies where necessary.
- *Coordinated action to make the case for growth and adjustment*. G-20 leaders should seize the opportunity to explain how the right policies can raise growth, ensure that it is widely shared, and help those who need to adjust to the changing global economy. At the national level, best practice should build worker skills and foster mobility, and can include income policies, among other approaches. Globally, promoting trade integration, reducing external imbalances, and managing spillovers remain essential.

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RECENT DEVELOPMENTS, OUTLOOK AND RISKS

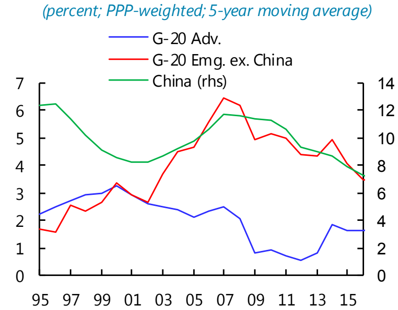
The global outlook remains subdued, with unfavorable longer-term growth dynamics and domestic income disparities adding to the challenges faced by policymakers. Recent developments—including very low inflation, along with slowing investment growth and trade—broadly confirm the modest pace of global activity. The decline in investment, exacerbated by private sector debt overhangs and financial sector balance sheet issues in many countries, low productivity growth trends, and demographic factors weigh on long-term growth prospects, further reducing incentives for investment despite record-low interest rates. A period of low growth that has bypassed many low-income earners has raised anxiety about globalization and worsened the political climate for reform. Downside risks still dominate.

STILL WEAK OUTLOOK

1. **Recent developments broadly confirm the subdued outlook**. High frequency data points to softer growth this year, especially in G-20 advanced economies, while the performance of emerging markets is more mixed. In particular:

- *In advanced economies, recent data point to somewhat weaker growth this year*. In the *United States,* the first estimate of second quarter GDP growth came in at 1.1 percent (over the first quarter, seasonally adjusted and at an annual rate), less than half the level of the consensus forecast, reflecting a drag from inventories but also growing divergence between buoyant consumer spending and disappointing business investment. This outturn suggests that growth in 2016 will likely be weaker than expected. In contrast, the moderation in *euro area* and *Japanese* GDP growth was broadly as expected (with *euro area* growth coming in slightly slower than forecasted). And in the *United Kingdom*, while second-quarter growth surprised on the upside, more recent data foreshadow a sharp slowdown after the referendum. Further ahead, the outlook will be affected by the degree to which the future relationship with the European Union can preserve the benefits of economic integration and trade.

G-20 Real GDP Growth
(percent; PPP-weighted; 5-year moving average)

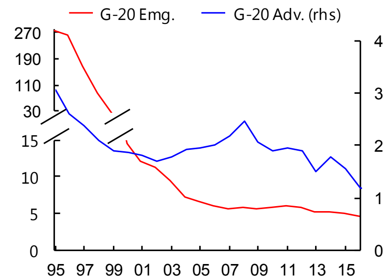


Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

- *Economic performance differs across emerging economies.* In *China*, second-quarter growth remained steady at 6.7 percent as rebalancing continued, with stronger growth in consumption than investment, and services outperforming industry. In *India*, high-frequency data suggest continuing strong growth, underpinned by private consumption. While there are indications that GDP continued to contract throughout the first half of 2016 in *Brazil*, reflecting, among other things, tight financial conditions, the outlook has improved somewhat in recent months, with exports and industrial production reacting positively to currency depreciation and business confidence beginning to return. In *Russia*, the economic contraction has reached a bottom, and the outlook has improved as a result of declining financing costs and better oil prices. In *Turkey*, strong growth momentum appears to have been slowing, and recent political events add further uncertainty to the outlook.

2. **Weak growth is also reflected in low inflation across most advanced and emerging economies**. New IMF research finds that insufficient demand (measured by high cyclical unemployment) and reduced commodity prices are the main drivers of low inflation since the Great Recession. In addition, excess industrial capacity in large exporters also contributes to lower inflation by putting downward pressure on prices of tradable goods.[1] A prolonged period of very low inflation could de-anchor inflation expectations and, with the scope for cuts in nominal interest rates limited, raise the real cost of borrowing and weigh on investment.

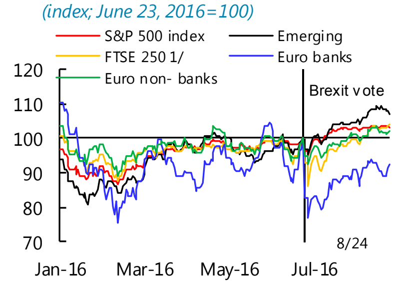
G-20 CPI Inflation
(percent; PPP-weighted; 5-year moving average)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

3. **Financial markets have largely recovered from their lows following the United Kingdom referendum, but potential weaknesses remain in the financial sector**. While political uncertainty remains concerning the development of the relationship between the *United Kingdom* and *European Union*, short-term turbulence has ebbed. Bank equities remain under pressure, however, with particular tensions surrounding *Italian* banks. The European Banking Authority's recent stress test points to possible vulnerabilities under a stress scenario, including for three globally systemic institutions, underscoring challenges to banks' financial health posed by the large stock of non-performing loan—estimated at about 8 percent of GDP (in gross terms) in the *euro area* in mid-2015—as well as weak growth and low interest rates.

Stock Market Index
(index; June 23, 2016=100)



Source: Bloomberg, L.P.
1/ Capitalization-weighted index of the 250 most highly capitalized companies, outside of the FTSE 100, traded on the London Stock Exchange.

RISKS AND FEEDBACK LOOPS

4. **Downside risks remain significant, including through global spillovers.**[2] In particular:

- *Financial volatility* could return, triggered by geopolitical tensions or risks associated with the negotiations after the "Brexit" vote. The global growth outlook could be further undermined by a *lack of consensus for reform* or rising real interest rates triggered by a *drop in inflation expectations*.

- The growing clout of emerging markets means that developments there can be felt globally. Possible risks include *turbulent patches in China's welcome transition* to a more sustainable but lower growth path, which could generate significant spillovers, most directly through trade and commodity-market channels.

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[1] IMF, *forthcoming*, World Economic Outlook, Chapter 3, "Global Disinflation in an Era of Low Oil Prices and Constrained Monetary Policy."

[2] IMF, *forthcoming*, World Economic Outlook, Chapter 4, "Spillovers—Transitions and Disruptions."

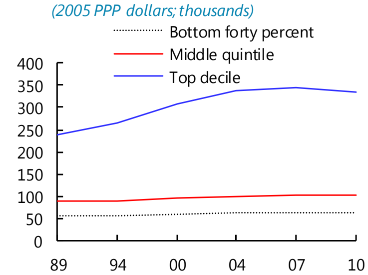
- *Non-economic risks* continue to play a significant role as well: these include acts of terrorism, contagious diseases, and climate-related shocks, such as droughts. While past experience suggests that migration offers potential long-term gains for recipient countries, it can also create social tensions and political backlash. The tragedy of large-scale refugee flows entails not only these strains, but also the humanitarian challenge of absorbing traumatized populations.

LONGER-TERM PROBLEMS

5. **The longer term outlook remains disappointing**. After a strong post-crisis recovery, growth in emerging market G-20 economies has declined over the past five years. Looking ahead, growth rates are projected to evolve broadly in line with the historical (1990–2007) average of around 5½ percent. At the same time, at around 1½ percent, the medium-term growth outlook of advanced G-20 economies is a full percentage point lower than the historical average of 2½ percent. This decline reflects some well-known, deeply intertwined forces, including: demographic factors; a persistent reduction in productivity growth that set in already before the crisis; and the drop in investment, exacerbated by high private corporate sector debt and weak bank balance sheets in many countries. In 2016, the level of G-20 advanced economy investment relative to GDP is expected to be about 2 percentage points lower than on average during 1990–2007. Moreover, in a negative feedback loop, the resulting weakness in the global outlook can further lower incentives to invest and slow trade, which will, in turn, weigh on underlying potential growth.

6. **Widening income gaps add to the challenge**. Not only has overall income growth declined, in many countries it has continued to bypass low-income earners, raising concerns about globalization and making the political climate even more challenging for reform. For example, during the last 30 years, the income going to top earners has been increasing in a number of advanced economies, while it has been stagnant for those at the bottom. Rapid increases in income inequality have also accompanied the growth and convergence process in many emerging economies. Where rising income inequality threatens to feed a political climate that rejects reform and favors inward-looking policies, another negative dynamic can arise, where needed structural reforms stall, global integration is thrown into reverse, and opportunities for higher growth are wasted.

G-20 Advanced: Evolution of Average Household Income 1/
(2005 PPP dollars; thousands)



Sources: Luxembourg Income Survey/New York Times Income Distribution Database (2014); and IMF staff calculations.
1/Mean equivalised income of Canada, Germany, Italy, United Kingdom, and United States.

LACK OF AMBITIOUS REFORMS

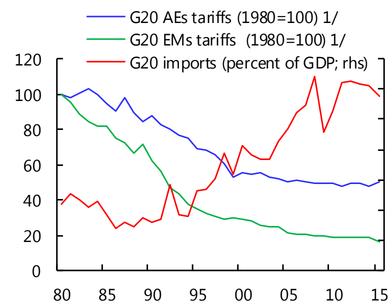
7. **A lack of structural reforms and public investment, including among G-20 countries, is a key reason behind low growth**. At the Brisbane Summit in 2014, G-20 leaders pledged to lift their collective GDP by an additional 2 percent by 2018 ("2 in 5"), and they committed to additional measures during the Antalya Summit and in preparation for their Hangzhou meeting. However, the assessment of IMF, OECD, and World Bank suggests that:

- Implementation has been modest since Antalya. As of now, only about 55 percent of the Brisbane and 45 percent of the Antalya key commitments have been fully implemented.

- Of the new commitments proposed for Hangzhou, about two thirds have been assessed as new. Even if fully implemented immediately, however, they would have only a minimal impact by 2018.

- With 2018 drawing closer, the Brisbane goals seem out of reach. Overall, the fully implemented measures are estimated to increase collective G-20 GDP by close to 1 percent by 2018, well short of the "2 in 5" ambition. Even under the extreme assumption of full implementation of all outstanding commitments, the lasting impact on the level of G-20 GDP would be only around 1½ percent. These calculations take into account the positive spillovers from the simultaneous implementation of measures across all G-20 members. About 60 percent of the expected increase by 2018 is due to commitments by G-20 emerging markets, which represent about half of aggregate G-20 GDP.

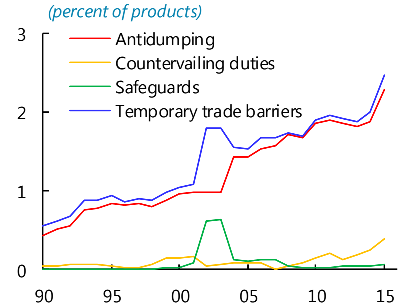
G-20 Tariffs and Imports
(simple average)



Sources: UNCTAD Trade Analysis and Information System; WTO Tariff Download Facility; forthcoming Chapter 2, October 2016, IMF, *World Economic Outlook;* and IMF staff calculations.
1/ Index; the level of tariff rates is higher in emerging market economies than in advanced countries.

8. **Lack of determined policy action has also contributed to the slowdown in international trade—which, in turn, likely has negative effects on growth.** Recent IMF research suggests that during 2012–15, the growth of goods and services imports slowed in most countries. While three-fourths of this drop can be traced to weaker economic activity, notably weak investment, the waning pace of trade liberalization and a recent uptick in protectionist measures have added to the downward momentum.[3] Such reductions in global trade can feed back to lower GDP growth. For example, trade allows economies to specialize in producing goods and services in which they have a comparative advantage, and to exploit economies of scale and scope. Moreover, trade can improve productivity at the level of individual firms by—among other things—providing opportunities for learning, spreading technological innovations, and increasing the incentives to invest to access new markets. Thus, slowing trade risks inhibiting a key growth engine for the global economy. All this would come against a backdrop of global external imbalances that widened modestly in 2015, for the first time since 2010.[4]

Temporary Trade Barriers
(percent of products)



Sources: Bown (2015); World Bank Temporary Trade Barriers Database; forthcoming Chapter 2, October 2016, IMF, *World Economic Outlook*; and IMF staff calculations.

[3] IMF, *forthcoming*, World Economic Outlook, Chapter 2, "Global Trade: What's Behind the Slowdown?"

[4] IMF, 2016, External Sector Report.

POLICIES

Sustainably higher and inclusive growth requires more forceful and comprehensive policies. With multiple interdependent factors holding back growth, policymakers have to work all necessary levers—structural policies (including to promote financial stability and trade), fiscal policies, and monetary policy. Depending on country needs, comprehensive action will combine structural reforms with demand support, anchored by coherent and well-communicated policy frameworks. Where interest rates are at or near their effective lower bounds, fiscal policy must play a larger role. At the same time, policymakers can raise confidence by explaining to citizens the benefits of reform and, where necessary, providing effective support to those who disproportionately shoulder the burden of adjustment. Efforts to advance global trade integration, lower financial stability risks, and address geopolitical spillovers remain vital.

HIGHER INCLUSIVE GROWTH

9. **It will take stronger efforts to raise flagging underlying growth rates**. While countries' reform and public investment needs differ, the G-20 is collectively falling short of its "2 in 5" ambition. Hence, more progress is urgent. It will not happen without quick implementation of all announced measures and significant additional efforts to boost productivity, especially in advanced economies.

10. **Structural reforms—prioritized to maximize impact and combined with complementary macroeconomic policies when needed—are essential**. Recent IMF research shows that structural reforms are most effective when they directly address an economy's known structural policy gaps and take account of its level of development, its position in the business cycle, and the available macroeconomic policy space. For example, some labor market reforms benefit employment more when demand is already strong—as this helps job seekers find work faster—or when fiscal and monetary policies can provide support. Other measures, such as lowering barriers for new firms to enter product and services markets, tend to have immediate demand benefits by raising investment and are, therefore, less dependent on the state of the business cycle. The IMF prepared detailed country-by-county recommendations along these lines on the occasion of the Finance Ministers and Central Bank Governors' Meetings in July 2016.[5] A combination of structural reforms and more expansionary demand policies in surplus economies can also help reduce global external imbalances.

11. **Pushing forward with the right reforms and policies helps ensure that the economy's rewards are widely shared**. Important steps include:

- *Targeted measures to achieve higher and more inclusive growth and facilitate adjustment.* For example, well-chosen public investment in education holds the potential to raise underlying growth and, at the same time, increase the human capital and earning potential of low-income earners. Public support for re-training and facilitating worker mobility can help those who bear

[5] IMF background paper "Priorities for Structural Reforms in G-20 Countries" for the G-20 Surveillance Note for the Finance Ministers and Central Bank Governors' Meetings, July 23–24, 2016, Chengdu, China.

the burden of adjusting to reforms or to other changes, such as those related to technology and globalization.

- *Reforms that help growth and create fiscal space*. Reforms that create fiscal space are particularly valuable in this context, as they not only promise to lift growth but also create resources to support structural adjustment where necessary. IMF research shows that in the past, product market reforms in advanced economies boosted GDP levels enough to reduce debt-to-GDP ratios by an average of 4 percentage points. Similarly, better public investment management will make government spending more effective and free up resources—for example, rigorous and transparent processes for the appraisal, selection, and approval of projects boost public investment efficiency, especially in *emerging markets*.

- *Steps to share growth more widely*. Where inequality-related strains threaten to reduce the political will for necessary structural reforms, changes to the tax-benefit system (including more progressive income taxation) and income policies (such as an expansion of the Earned Income Tax Credit and higher minimum wages in the *United States*) can help ensure that growth is more inclusive. Strengthening social safety nets can play an especially important role in *emerging markets*. Both tax and expenditure policies need to be carefully calibrated to balance equity and efficiency goals—for example, by phasing out income support only gradually with higher income, to avoid negative effects on labor market participation.

MACROECONOMIC AND FINANCIAL POLICIES TO SUPPORT DEMAND AND REFORMS

12. **Several policies can be deployed now to support reforms and contain risks**. Where demand is still lacking, there is scope for macroeconomic policies to help short-term growth while advancing the impact of structural reforms. In *Europe*, the resolution of non-performing loans should be accelerated through a combination of stricter supervision, insolvency reform, and the facilitation of secondary markets in distressed debt. This process will benefit from continuing macroeconomic support—including, for example, through the use of tax incentives and by providing protection for vulnerable households. Safeguarding banking system stability is also a priority. In *Japan*, the recently announced additional fiscal stimulus is set to boost demand (along with expansionary monetary policy), but it also provides an opportunity to accelerate the impact of much-needed structural reforms, in particular in the labor market. In many *emerging markets*, financial market reforms have the potential to assist the effective transmission of monetary policies while allowing for sustainable credit expansions.

13. **Where inflation is still well below targets, monetary policy should remain expansionary, using all available instruments**—for example, in *Japan* and the *euro area*. In the *United Kingdom*, a range of recent monetary and other policy measures by the Bank of England will support the economy and thereby mitigate downside risks. In the *United States*, monetary policy should continue to remain data-dependent, while downside risks to the outlook confirm the case for a very gradual upward path for the federal funds rate.

14. **Where monetary policy operates near or at the lower bound, growth-friendly fiscal policy has an important role to play**. Indeed, a strategy of deploying all available tools can counter damaging perceptions that the policy space to use individual instruments might be limited. Taking advantage of the current low interest rate environment and depending on the availability of fiscal space, there is a case for more public investment. Other helpful measures include adjusting the composition of spending toward public investment and moving the revenue structure toward indirect and other taxes relatively less detrimental to growth. In a number of countries, it may be appropriate to devote fiscal resources to reduce private sector debt overhangs and repair financial sector balance sheets.

- For example, in *Germany*, the room available under the fiscal rules should be used to finance identified needs in public investment and growth friendly structural reforms. At the same time, centralized investment at the *euro area* level should be expedited and expanded in order to stimulate domestic demand while raising potential growth across all member countries.

- *India* has recently taken important steps toward a national goods and services tax which, when fully implemented, promises to boost tax buoyancy and growth, including by enhancing the efficiency of the internal goods and services market.

15. **Macroeconomic policies are most effective when deployed within coherent frameworks.** It is crucial that fiscal frameworks limit long-run public sector balance sheet risks, while allowing for counter-cyclical demand support and rising deficits when the economy is weak, but ensuring that fiscal space is rebuilt when growth is robust. Credible monetary frameworks that anchor long-run inflation expectations can accommodate spikes in inflation rates over the short to medium term. In this context, the recent formal adoption of a symmetrical inflation target by *India* should provide a robust institutional foundation for maintaining price stability. Where inflation targeting frameworks are already established, improving the transparency of instruments and policy objectives can provide further assurance that contractionary shocks will be absorbed.

16. **Policymakers should also address medium-term financial stability risks.** These include rising challenges to financial institutions from low growth and interest rates, increased vulnerabilities in emerging markets, and greater systemic market liquidity risks. Advanced economies must deal with crisis legacy issues by accelerating the resolution of non-performing loans, and take structural measures to safeguard banking sector stability. For insurance companies, a more macroprudential approach to supervision will help contain risks. Emerging markets should foster a smooth deleveraging process for over-leveraged companies, including by strengthening macroprudential and supervisory frameworks, encouraging swift and transparent recognition of non-performing loans, rebuilding bank buffers, and enhancing insolvency frameworks.

COMMON CAUSES

17. **The G-20 should make the positive case for globalization**. Domestically, the key to sustainably higher and more inclusive growth is to combine structural reforms and demand support within coherent policy frameworks, while remaining sensitive to the distributional impact of policies.

At the global level, revitalizing trade can make a critical contribution—by helping to spread knowledge and technology, raise productivity, and multiply the incentives for innovation and new product development. G-20 leaders can champion this agenda by presenting a clear and persuasive narrative showing how the right policies will not only raise growth, but also ensure that it is shared by all, including those who shoulder the burden of adjustment to a changing world economy.

18. **Restoring the role of trade in supporting economic growth requires a determined global policy effort**, to further reduce trade costs and roll back the recent increase in temporary trade barriers (see Annex). Regional trade agreements can help advance policy in certain "frontier" areas (such as regulatory cooperation or investment) and contribute to advancing reform more generally. But progress in regional agreements alone is not enough: it is important to move ahead also with an ambitious agenda in the World Trade Organization's (WTO) and its unique reach and well-developed legal and institutional structure, to help ensure coherence across the global trading system. To make trade work for all and make a convincing case for trade liberalization, policymakers should address the concerns of those who are adversely affected, including through effective support for re-training, skill building, and occupational and geographic mobility. In addition, tax policy coordination could address concerns related to tax base erosion.

19. **Another joint task on the global agenda is to manage spillovers.** Salient challenges include:

- *Coordinating the response to negative geopolitical shocks:* The international community has a crucial role in facilitating financial and other support for countries most affected by, among other important setbacks, epidemics, famines, armed conflicts, and refugee surges.

- *Adjusting to migration*. Both refugee and economic migration can have a significant impact on receiving and sending countries. Swift labor market integration in recipient countries is key for harnessing potential growth gains, enhancing migrants' net contribution to the fiscal accounts, and reducing possible social tensions. Depending on the underlying drivers of migration, source countries need policies to address "brain drain" and maximize the benefits from remittances and diaspora networks.

- *Managing economic transition.* China's rebalancing and convergence to more sustainable growth will ultimately benefit the global economy. Along this transition, many trading partners will have to adapt to structurally lower demand and its impact on commodity prices. China can help, including by accepting moderately lower near-term growth, bolstering financial-sector resilience, and clearly communicating policy intentions.

- C*ompleting the international regulatory agenda*. This task requires a global effort, across both advanced and emerging markets. Key outstanding challenges include: improving regulation and oversight of nonbanks; ensuring regulators' capacity to resolve globally systematic financial institutions; and strengthening the resilience of central counterparty clearing for derivatives.

- *Strengthening the international financial architecture*. Given the high interconnectedness of the international financial system, and still excessive external imbalances in some regions, policymakers should strive for a better coordinated and adequately resourced global financial safety net and strengthen frameworks for preventing and resolving sovereign debt crises.

ANNEX. Reinvigorating Trade to Promote Global Economic Growth

The slowdown in global trade, especially since the global financial crisis, can be explained significantly by weak economic growth and investment, but also by a slow pace of global trade reforms—compared to the 1990s and early 2000s—compounded by a recent increase in protectionism. Reinvigorating trade reform would help to boost productivity and growth, with especially large benefits possible from frontier trade policy areas such as services, electronic commerce, regulatory cooperation, and investment and trade complementarities. After a decade of stalemate, governments should quickly establish an agenda for multilateral trade negotiations that addresses these and other key issues. Finding a way forward may require using the diverse alternatives within the WTO including plurilateral agreements. To make trade an engine of growth for all, enhanced policies to help those adversely affected are needed.

Six years after the world economy emerged from a deep recession, a return to broad-based, robust global economic growth remains elusive. Getting the global economy back on track requires a more potent policy mix across macroeconomic and structural policies. But in trade policy, where cooperation is especially critical, far too little has been achieved.

Global trade growth has fallen significantly. The volume of goods and services trade has grown only 3 percent a year since 2012, under half the rate in the two decades before the crisis. Seen differently, from the mid-1980s into the 2000s trade grew at double the pace of GDP; in the past four years it has barely kept pace. Such prolonged weak trade growth has few precedents.

The trade slowdown has been broad based. It has occurred in most countries. And while it has especially affected trade in goods—falling for 85 percent of product categories, with trade in capital and intermediate goods falling most sharply—it has also affected trade in services.

Forthcoming IMF analysis shows that much of the slowdown since the crisis reflects shifts in the level and composition of growth, including weak investment. As highlighted in Chapter 3 of the April 2016 WEO, the slow pace of trade and other structural reforms may be one of the reasons behind weak investment and growth.

The analysis also finds that trade has slowed more than can be accounted for by weak growth and investment alone. Recent trade growth is 1–1¾ percentage point a year *less* than would be expected based on the historical relationship between trade flows and economic activity. Together the prolonged slow pace of trade reform and a recent increase in protectionism may have halted or even reversed declines in overall trade costs, and contributed to declining trade growth.

There is a strong case to revive the virtuous cycle of reducing trade costs and raising trade and growth. Trade reforms foster competition, technology transfer, and productivity gains, and augment other structural reforms, boosting growth. Reinvigorating trade integration should become a central component of the global policy agenda, focusing on trade policy areas most critical to growth and on demonstrating to the public the contribution of open trade policy to jobs and prosperity.

Trade policy cooperation supported increased trade in the past. Developing country reforms and such initiatives as the expansion of the European Union and European Economic Area, the Uruguay Round (1994) and creation of the WTO, and China's WTO accession (2001) strengthened the global trade policy landscape and contributed to a period of strong growth in trade, productivity, job creation, and economic prosperity.

A slow pace of global trade reform in the past decade contrasts with that experience. At the same time, new trade restrictions imposed since the global financial crisis are not innocuous, and could weigh on global trade if they become more widespread.

Building public support for trade should be a policy and communications priority. Trade is not an objective but a tool to improve lives. G-20 countries can do more to show how trade is bringing innovation, higher living standards, more and better jobs, and reduced global poverty. But—and where policy may fall short—governments should also help the individuals and communities that face the burden of trade adjustment so that they also share in the benefits.

Addressing "frontier" trade areas would go far in restoring the role of trade in driving global growth. Issues such as tariffs and agriculture are vital to many countries and to reach a negotiating balance, but some areas have great potential to raise productivity and growth. These include:

- *Regulatory cooperation to reduce trade costs.* The large trade frictions that result from regulatory differences have led negotiators to begin to bring regulatory cooperation matters into trade agreements. Apart from certain areas like financial regulation, where cooperation is being pursued through the FSB, IOSCO, and other bodies, there is great scope to build on the provisions in regional agreements and to bring them into the multilateral system to be applied more broadly on a multilateral or plurilateral basis.

- *Investment and trade complementarities*. Policy barriers still obstruct much foreign direct investment (FDI), despite that trade and investment go together in the operation of global value chains. FDI governance is fragmented among some 3000 bilateral investment treaties and other agreements, leaving a confusing landscape for investors.

- *Services and digital trade*. Services comprise two thirds of global GDP and employment, and a quarter of global trade (nearly half on a value-added basis), while innovation in electronic commerce (e-commerce) has reshaped the trade landscape. Barriers to services trade and to e-commerce remain large, however, and reforms have tremendous potential to promote global trade, productivity, and growth.

The WTO is the ideal venue and structure for a trade policy agenda focused on global growth. Regional trade agreements (RTAs) have certain advantages and can lead the way on frontier issues, but lack the WTO's institutional and legal framework and near-global membership. Without similarly ambitious advances at the global level, a further proliferation of RTAs risks evolving into a system in which traditional trade matters are overseen in the multilateral trading system and regulatory and other frontier matters are negotiated elsewhere. It is important to integrate into the WTO the many advances taking place outside it.

With further trade integration being key to global economic prospects, there is an urgent need to agree on a way forward for global trade. Fifteen years of WTO Doha negotiations suggests that alternatives to large-scale 'single undertakings' may be needed. Indeed, progress has been made in the WTO recently through the Trade Facilitation Agreement, revised Agreement on Government Procurement, expanded Information Technology Agreement, and the ministerial decision to eliminate farm export subsidies.

These demonstrate the diverse alternatives within the WTO architecture, including WTO plurilateral agreements. Tackling the frontier trade policy issues at the global level, rather than just the regional level, may require further use of such flexible approaches.