OPINION:

At the G20, look beyond the usual suspects

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Small economies offer new insight into how to respond to global economic & political challenges

Compared to this time last year, when investors were unnerved by the turbulence of China's equity markets and the volatility of the yuan, there is an air of tranquillity in world markets today. No doubt this comes as a relief to China, as it prepares to host the G-20 summit in Hangzhou next week.

But when the rest of the world comes to look back at the summer of 2016, it will be viewed not as a period of respite but as the moment it became clear that the policy responses of the world's economic leaders were inadequate to meet the challenges the global economy faces.

Markets may be eerily calm now, but the underlying challenges remain: weak growth, stalling globalisation and a crumbling political consensus. The policy solutions from the G-20, the International Monetary Fund and the major central banks of the world are not working.

The problem is that these institutions remain committed to the same failing playbook. Meanwhile, the world around them changes. What we need is a new approach. And we can start by looking at the policy innovations coming out of the world's smaller countries.

Small, dynamic economies have been managing the process of globalisation incredibly well over the past few decades. They have been at the vanguard of policy innovation, implementing first what later become mainstream ideas in the rest of the world.

Consider the origins of inflation targeting and fiscal responsibility in New Zealand and Chile, the establishment of sovereign wealth funds in Singapore and the UAE, public-sector management reforms in Sweden, as well as an emphasis on bilateral and regional free-trade agreements. It was a group of smaller countries – Brunei, Chile, New Zealand and Singapore – that laid the foundation for the Trans-Pacific Partnership.

By investing heavily in education and skills development, and creative labour market policies, countries such as Switzerland and Denmark have kept unemployment low. These countries have ensured that the benefits of globalisation and growth are more broadly shared among its citizens compared to many larger countries. Moreover, countries like Israel and Finland have become innovation powerhouses on the back of heavy R&D investments.

The acute exposure of these smaller countries to a tumultuous global environment makes their experiences particularly instructive now, serving as canaries in the coal mine of the global economy. Faced with negative interest rates and soaring housing prices, pressures on labour markets and income distribution, as well as sluggish export growth, they have had to adapt to structural changes in the economic and political environment. There is also a clear sense that the familiar political geometry of the recent past, such as the cohesion of the European Union and the commitment to an open, liberal international order, is changing.

In such a global environment, many smaller countries are responding not with protectionism but with innovation in labour-market policy, in education and in infrastructure. For example, the Netherlands and Denmark are actively exploring how to capture value from the Fourth Industrial Revolution. Small countries have also been forced to stay focused on productivity and keeping their economic house in order.

Among the bigger countries of the world there has been much less sign of policy innovation. It's as if they are running out of intellectual and political steam. While the EU's three largest economies plough on with 'more Europe', it's the smaller countries that are challenging this notion, moving the balance away from federal solutions and down to the national level.

Faced with a stagnant economy, for instance, France and Italy have avoided the pain of deep structural reforms on labour and taxes. Ireland and Estonia, meanwhile, have had little alternative but to become leaner, through fiscal consolidation and structural reform. In Switzerland, businesses have restructured their businesses to weather the storm of a stronger currency, something that tested the Eurozone countries in 2013-14.

Over the past week, Denmark and Finland announced ambitious tax-cut plans to stimulate growth.
And Ireland is about to embark on a fight for the right to set its own sovereign tax laws following the European Commission's Apple ruling.

The experience of smaller countries is instructive for larger countries, particularly as events beyond their borders increasingly have a disproportionate impact on their domestic economies. As the leaders of the G-20 countries gather next week, they should look to the innovations of David rather than follow the well-trodden path of Goliath.

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