Istituto Affari Internazionali

A Coordinated Approach to Foster Sustainable Growth and Financial Stability

by Fabrizio Saccomanni and Simone Romano

ABSTRACT

The present global macroeconomic outlook is characterized by low returns and downside risks. Inequality, a backlash against globalization and protectionism are on the rise. Widespread economic and political uncertainty negatively impact consumer sentiment and investment decisions. A more effective policy mix is needed to foster economic growth and reduce inequality. This implies improving the balance between different policy tools at the national level and stronger coordination of national strategies at the international level. On international trade, strong actions are needed to curb the spread of protectionist measures and to restore faith in global trade liberalization by better redistributing its benefits and protecting the weaker members of society. Finally, in order to foster a smooth functioning of the international financial system, financial regulation needs to be stabilized, avoiding regulatory uncertainty, which hampers the supply of credit to the real economy. A broader and more effective international strategy of capital flow management is also needed to orient global financial markets towards monetary and financial stability.

G7 | Economy | Finance | Foreign trade | European Union | Economic governance

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A Coordinated Approach to Foster Sustainable Growth and Financial Stability

by Fabrizio Saccomanni and Simone Romano*

1. Macroeconomic policy coordination

At the onset of 2017, the global macroeconomic outlook is uncertain. Economic activity in emerging markets is expected to pick-up and in advanced economies a modest and uneven recovery is expected to continue. Nonetheless, almost a decade after the outbreak of the financial crisis, economic performances remain unsatisfactory and below potential in many advanced economies. Despite the favourable conditions created by expansionary monetary policies and the fall in commodity prices, growth in many of the seven lacks momentum and appears fragile, with many downside risks looming on the horizon.[1] Persistent high unemployment, stagnating real incomes and living standards, low levels of investment and declining productivity are only some of the key issues which G7 economies need to address, although with a different level of priority in each nation.

Among the most urgent issues, growing inequality has become particularly worrisome because of its economic and political implications. Empirical evidence shows an increase in both income and wealth inequality in recent years, although with important differences across countries. Inequality hampers economic

[1] IMF, *Subdued Demand: Symptoms and Remedies. World Economic Outlook, October 2016*, http://www.imf.org/external/pubs/ft/weo/2016/02; IMF, A Shifting Global Economic Landscape. World Economic Outlook update, January 2017, https://www.imf.org/external/pubs/ft/weo/2017/update/01.

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growth[2] as it negatively affects the lower middle classes, which are the backbone of aggregate demand in advanced economies.[3] Furthermore, inequality worsens expectations, contributing to a spiral of low levels of investment and deflation. Thirdly, it spreads dissatisfaction and scepticism, causing a strong and widespread backlash in civil society against globalization and political elites. This, in turn, leads to a rise in protectionism and populism, adding uncertainty and complicating further the overall situation.

Against this background, there is consensus among international organizations that resolute policy actions are needed, as the risk of "hysteresis" is real, now more than ever: high unemployment and low investment, if not addressed promptly, could become structural, undermining in a permanent way the productive capacity of the economy.[4]

So far, the burden of stimulating aggregate demand and economic activity has fallen almost exclusively on Central Banks, with the risk of paving the way for financial bubbles and distortions. Moreover, the forecasted decoupling of US monetary policy from the European and British ones, due to different cyclical conditions, could provoke destabilizing capital flows and worsen global imbalances. A more balanced policy mix is needed, using all available policy tools (monetary as well as fiscal policy and structural reforms): it should aim at sustaining a cyclical recovery and at strengthening the potential output by addressing structural problems such as the low productivity growth. To achieve this balanced policy mix, a more positive fiscal stance is needed, considering that fiscal space has been growing in some of the G7 economies.[5] A more active fiscal policy, if well designed, will also provide stimulus and incentives for much needed structural reforms.[6] Several factors at work in the present economic environment enhance the effectiveness of fiscal policy: persistent low borrowing cost due to the actions of Central Banks,

[2] "Rising inequality by 3 Gini points, that is the average increase recorded in the OECD over the past two decades, would drag down economic growth by 0.35 percentage point per year for 25 years: a cumulated loss in GDP at the end of the period of 8.5 per cent." OECD, *Does Income Inequality Hurt Economic Growth? Focus on Inequality and Growth*, December 2014, p. 2, https://www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf.

[3] Ibid.

[4] Olivier J. Blanchard and Lawrence H. Summers, "Hysteresis in Unemployment", in *European Economic Review*, Vol. 31, No. 1-2 (February-March 1987), p. 288-295; Marco Buti and Lucía Rodríguez Muñoz, "Why We Need a Positive Fiscal Stance for the Eurozone and What It Means", in *VOX*, 28 November 2016, http://voxeu.org/node/61309.

[5] "Fiscal space is assessed to have increased significantly in many advanced economies from 2014 to 2016, as the impact of the reduction in interest rates outweighs the estimated fall in potential output growth and the increase in debt limits is larger than the changes in the debt-to-GDP ratio. The magnitude of the estimated increase in fiscal space varies widely across countries. It was above 20% of GDP in seven OECD countries, including Germany and the United Kingdom." OECD, "Using the Fiscal Levers to Escape the Low-Growth Trap", in *OECD Economic Outlook*, Vol. 2016, No. 2 (November 2016), p. 71.

[6] European Commission, *Towards a Positive Fiscal Stance for the Euro Area* (COM/2016/727), 16 November 2016, http://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:52016DC0727.

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idle savings and labour force and financially constrained consumers.[7] All these factors reduce the opportunity cost of public spending, removing the likelihood of crowding out.[8] At the same time though, fiscal sustainability has to be ensured, as some of the G7 economies have reached record high levels of public debt in recent years.

A coordinated approach, both at a national and international level, would increase the effectiveness of the policy mix. At a national level, this implies stricter coordination among fiscal measures designed to support structural reforms, exploiting their mutually reinforcing interactions. At the international level, coordinating these national policy mixes, particularly in support of transnational investment infrastructures and technological innovation, will enhance considerably their effectiveness.[9] This implies responding to global problems with global and shared strategies but, at the same time, tailoring national policies to each country's public finance status.

Countries with more fiscal space should use it to finance growth-boosting but non-permanent programmes. Public investment in infrastructure, research and development and education help to bolster aggregate demand in the short run and to foster higher productivity in the long term.[10] If the nations with fiscal space act collectively, this will bring additional output gains through mutually reinforcing spillovers, compared with a scenario where fiscal expansion is left to individual countries.[11] The old "house in order approach", albeit necessary, has in fact proved to be insufficient to restore sustainable growth. Furthermore, coordination should aim at supporting much needed cross-border investment in infrastructures (transport, energy, ICT).

The positive transnational effects stemming from this shared fiscal boost will benefit growth in other countries as well.[12] Countries with higher public debt,

[7] Giancarlo Corsetti, André Meier and Gernot J. Müller (2012), "What Determines Government Spending Multipliers?", in *Economic Policy*, Vol. 27, No. 72 (October 2012), p. 521-565; Alan J. Auerbach and Yuriy Gorodnichenko, "Fiscal Multipliers in Recession and Expansion", in Alberto Alesina and Francesco Giavazzi (eds.), *Fiscal Policy after the Financial Crisis*, Chicago and London, University of Chicago Press, 2013, p. 63-98, http://www.nber.org/chapters/c12634.

[8] Menzie Chinn, "Fiscal Multipliers", in Steven N. Durlauf and Lawrence E. Blume (eds.), *The New Palgrave Dictionary of Economics*, Online ed., Palgrave Macmillan, 2013.

[9] "Collective fiscal action among the large advanced economies is estimated to bring additional output gains of about 0.2 percentage point on average after one year (through international trade linkages), compared with a scenario where countries act individually." OECD, "Using the Fiscal Levers to Escape the Low-Growth Trap", cit., p. 65.

[10] Ibid.

[11] Jan in 't Veld, "Public Investment Stimulus in Surplus Countries and their Euro Area Spillovers", in *European Economy Economic Briefs*, No. 16 (August 2016), http://dx.doi.org/10.2765/413616.

[12] Olivier Blanchard, Christopher J. Erceg and Jesper Lindé, "Jump-Starting the Euro Area Recovery: Would a Rise in Core Fiscal Spending Help the Periphery?", in Martin Eichenbaum and Jonathan A. Parker (eds.), *NBER Macroeconomics Annual 2016*, Vol. 31 (2016), http://www.nber.org/chapters/c13784. For example, at a Euro zone level, Jan in 't Veld finds that a fiscal stimulus taking the form of a 1 percent GDP increase in public investment, if pursued simultaneously in

in turn, should refrain from engaging in expansionary fiscal policy, continuing with their debt consolidation. They should reorganize their tax and expenditure programmes towards a more growth-friendly set up, in a budget neutral way, for example by shifting tax burden from labour and enterprises to corporate profits, leaving the deficit unchanged.[13]

The G7 countries have the opportunity to take the lead on promoting an internationally coordinated policy mix which exploits the interaction among fiscal policies, structural reforms and monetary policies, on both national and international levels. This will have a beneficiary impact on growth and will help to tackle the problem of inequality. A quicker economic pace would in fact entail lower levels of unemployment, higher public revenues and lower public expenditures. This would provide more space for redistributive programmes and structural reforms aimed at reducing inequality without jeopardizing the economic activity. These measures have to be designed and implemented primarily at a national level. Nonetheless, international coordination is crucial as well. Moreover, there is a concrete opportunity for agreement on specific deliverables with a huge impact: G7 countries should lead the international effort to tackle base erosion, tax avoidance and profit shifting.[14] These practices, that favour the wealthiest to the detriment of the poorest part of society, can be tackled only through an international effort. Taking a clear stand in this direction will help to reduce inequality by providing more resources for public programmes such as health care, education and transfer which, in turn, would foster aggregate demand and productivity.

2. International trade

The deceleration of trade growth in recent years is a cause for concern that should be addressed by the G7. Recent research by the IMF[15] and the Bank of Italy[16] shows that between 1985 and 2007 real world trade grew on average by 7 percent, twice as fast as global GDP, whereas since 2011 the volume of world trade in goods and

Germany and the Netherlands, would raise GDP by 0.85 percent in Germany and 0.7 percent in the Netherlands within that same year, for a total of 1.3 percent over 10 years. The effect on the economies of other European countries, such as France, Spain or Italy, will be positive as well, with a boost of 0.3 percent of their GDP or higher. Jan in 't Veld, "Public Investment Stimulus in Surplus Countries and their Euro Area Spillovers", cit.

[13] The need for a fiscal stimulus to be credible represents a further reason for countries with high public debt to avoid engaging in expansionary fiscal measures. Empirical evidence shows that if economic agents expect an increase in government spending to be coupled in the near future with a more than proportional increase in taxes or public expenditure retrenchment, as it is more likely to happen in countries with high levels of public debt, the effect of the fiscal stimulus is detrimental. Lilia Cavallari and Simone Romano, "Fiscal Policy in Europe: The Importance of Making It Predictable", in *Economic Modelling*, Vol. 60 (January 2017), p. 81-97.

[14] François Bourguignon, "Inequality and Globalization: How the Rich Get Richer as the Poor Catch Up", in *Foreign Affairs*, Vol. 95, No. (January/February 2016), p. 11-15, http://fam.ag/1QqWXgn.

[15] IMF, *Subdued Demand: Symptoms and Remedies*, cit.

[16] Alessandro Borin et al., "The Cyclicality of the Income Elasticity of Trade", in *MPRA Working Papers*, updated March 2017, https://mpra.ub.uni-muenchen.de/77418.

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services has grown by around 3 percent, barely keeping pace with real GDP growth. Moreover, world trade growth fell short of expectations in each year of the period 2011-15, as systematic forecast errors were made by the IMF, the OECD and the WTO.

According to the IMF, the causes of the trade slowdown lie in the "overall weakness of economic activity and, in particular, the slowdown in investment growth".[17] Other factors, however, have also played a role: "the slowdown in the pace of trade liberalization and the recent uptick in protectionist measures are holding back international trade in goods" and "the apparent decline in the growth of global value chains".[18] Similar conclusions are reached by the Bank of Italy's economists who have found that "income elasticity of trade is affected by business cycle conditions" and that the recent weakness of trade (slower pace of trade growth) can be explained by the reduction in income elasticity of trade "because the secular decline of trade barriers has been gradually fading away in the last 15 years".[19]

The outlook for international trade is not very encouraging. Current projections by the IMF and other international institutions envisage only a moderate pickup of economic activity and weak investment growth over the medium term due to both cyclical and structural factors; slow trade growth is thus likely to continue. Little support is to be expected from multilateral trade liberalization agreements. The Doha Round of negotiations under the WTO aegis has been stalling since 2009 with limited prospects of a revival. Trade restrictive measures have increasingly been taken in the recent past even by G-20 countries, despite their repeated commitment to resist protectionist pressures in any form. A joint monitoring report to the G20 by the OECD, the WTO and UNCTAD (21 June 2016) indicated that 145 new restrictive measures had been introduced by G20 countries in the previous six-month period, the highest number since the global financial crisis.[20] The report further recalled that the Group had introduced a total of 1,583 new measures since 2009, covering 6 percent of their total imports, and removed only 25 percent of previously introduced measures. The outlook for regional trade agreements has been further clouded by the failure of the negotiations between the US and the EU on the Trans-Atlantic Trade and Investment Partnership (TTIP), as well as by the decisions of the UK to exit the European Union and of the new US Administration to withdraw from the Trans Pacific Partnership (TPP) with a number of Asian countries. A more fundamental disruption of the world trading system cannot be ruled out at this stage, if the US were to introduce new high tariffs on trade with China and Mexico, and possibly with other important trading partners. This may trigger retaliations of various kinds, potentially leading to the cancellation of the North American Free Trade Agreement (NAFTA) by Mexico and, possibly, Canada.

[17] IMF, *Subdued Demand: Symptoms and Remedies*, cit., p. 65.

[18] Ibid.

[19] Alessandro Borin et al., "The Cyclicality of the Income Elasticity of Trade", cit., p. 26, 27.

[20] OECD, WTO and UNCTAD, *15th Report on G20 Trade and Investment Measures*, June 2016, http://www.oecd.org/daf/inv/investment-policy/15th-G20-Report.pdf.

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The policy implications of this scenario are complex. As trade is linked to the overall level of economic activity, a macroeconomic strategy focusing on the promotion of growth and investment, as outlined in Section 1 of this paper, would lay the foundations for a sustained recovery in international trade. However, a more determined effort would also be needed to stop the spread of protectionism and to rebuild a more efficient and equitable world trading system. Following the failure of the Doha Development Agenda, after 14 years of inconclusive negotiations because of deep disagreements among developed and developing countries on a broad range of issues, there is a need to redefine the post-Doha agenda for the WTO. While the Nairobi Ministerial meeting of the WTO in December 2015 de facto ended the Doha negotiating process, there are strong indications that the WTO, thanks to its institutional structure and legal foundations, should remain the negotiating framework for the multilateral trading system and that new ways should be found to continue with a more focused and pragmatic approach to pursue the objective of trade liberalization.[21] This new approach should take into account the lessons of past mistakes and promote a greater political and social consensus on the benefits of free international trade.

Under these circumstances, there is an opportunity for the G7 to try to forge a common position on the trade agenda in view of the next WTO Ministerial Meetings scheduled for December 2017 in Argentina. A first item on the agenda could be the ratification and full implementation of the Trade Facilitation Agreement already negotiated under the Doha process: it would make a significant contribution to reducing trade costs by cutting tariffs and other barriers. Moreover, while the position of the US on trade issues is still unclear, the other G7 countries should commit themselves to an early conclusion of the trade agreements between the EU and Canada (CETA) and between the EU and Japan. This would give a strong signal to the markets that the EU, in particular, is not resigned to remaining passive in the face of mounting protectionist pressures and is ready to negotiate free trade agreements with any willing partner. It is however crucial that any new such agreement is accompanied by explicit and concrete measures to protect the affected segments of society from the impact of liberalization on their jobs and living standards. An active employment policy which includes social shock-absorbers, re-training programs and tax incentives to mobility should be pursued; moreover, consumer protection measures should ensure adequate health and safety standards are adequately implemented. In addition, any dispute among partners in the agreements should be brought before a supranational arbitration body (such as the World Bank Centre for the settlement of investment disputes) rather than before national jurisdictions of either partner.

The spread of protectionist measures would inevitably have repercussions on the exchange rates of the countries involved, raising the risk of competitive devaluations and currency manipulations in the current context of large and growing global

[21] Simon Lester, "Is the Doha Round Over?", in *Free Trade Bulletin*, No. 64 (11 February 2016), https://www.cato.org/node/62813.

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balance of payment imbalances. If unchecked, destabilizing exchange rate movements could trigger sudden capital outflows leading to trade retaliations and financial restrictions, thereby undermining the flow of trade and investment. The IMF has the mandate to exercise surveillance over the exchange rate policies of its members. Surveillance should be conducted in a truly multilateral context, identifying the direction and intensity of external spillovers of exchange rate movements of major currencies and promoting cooperative strategies to carryout needed exchange rate adjustments while avoiding destabilizing overshootings from agreed equilibrium levels. The G7 could take the initiative to achieve a more effective cooperation on exchange rate policies among its members and with key members of the G20 within the IMF surveillance procedures.

3. Global financial stability

Since the Global Financial Crisis (GFC), the restoration of financial stability has been treated in the fora of international cooperation as an issue to be addressed through a fundamental reform of the global financial architecture, i.e. by strengthening the regulatory system covering the activity of banks, non-bank financial intermediaries and financial markets. The Financial Stability Board (FSB), established at the initiative of the G20, has been in charge of the formulation and implementation of financial reform and has achieved substantial results in enhancing the resilience of financial systems and in removing their main weaknesses and vulnerabilities. There is widespread agreement among policy-makers that the progress has been significant, although additional work remains to be done, such as completing the reform program. It is however essential that at some point the reform process comes to an end and that the global regulatory regime is stabilized. Although financial activity is constantly evolving, regulatory uncertainty can be detrimental to the supply of credit to real economy. Recent developments, at both international and national levels, point to the need for an agreed clarification of future regulatory changes.

Reform of the financial architecture is necessary but not sufficient to ensure global financial stability. In the prevailing regime of free capital mobility that has been in force since the inception of financial globalization in the 1980s, the strategy to cope with financial boom and bust was essentially the traditional "house in order approach" as embodied in the so called "Washington consensus". This implies the pursuit by each country of sound non-inflationary monetary and fiscal policies, accompanied by deep structural reforms to ensure the proper functioning of markets for goods, services and factors and the resilience of banks and financial intermediaries; freely floating exchange rates would take care of any remaining external imbalance. The G7 countries have traditionally been the staunchest supporters of this approach, periodically reaffirming that fiscal and monetary policy should be oriented towards meeting domestic objectives using domestic instruments and that countries should not target exchange rates. In this context, the absence of institutional arrangements to promote ex-ante, stability-

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oriented and compatible macroeconomic policies by the major countries has left to financial markets the task of promoting, ex-post, adjustment of payments disequilibria through changes in exchange rates enforced by capital movements. In other words, the post-Bretton Woods International Monetary System (IMS) has become dependent on the behaviour of the global financial markets.

Following the financial crises in Asia, Latin America, Russia and eventually in the core of the world financial system, the United States, the attitude towards the house-in-order-approach has changed considerably. Moreover, new problems have emerged as a result of the policies followed by the major countries to cope with the impact of the GFC: monetary spillovers, boom and bust, and currency wars have become the main focus of the debates on global economic governance.[22] Most emerging market economies (EMEs) have openly adopted a more interventionist approach. While aiming at keeping their house in order, they have resorted to capital controls and foreign exchange market interventions to limit capital inflows and undesired movements of their currencies; they have also accumulated large holdings of foreign reserves as a precautionary buffer against sudden capital outflows.[23] The G7 countries have also recognised that excessive volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability and efforts have been made by G7 Central Banks to improve transparency and communication in order to limit external spillovers of their monetary policy actions and destabilizing capital flows.

International financial organisations have increasingly focused their attention on the issue of capital flow management. In an important policy document the IMF thus formulated its "institutional view" on the subject: "Capital flows can have substantial benefits for countries [...] At the same time, capital flows also carry risks". The IMF recognized that "rapid capital inflow surges or disruptive outflows can create policy challenges. Appropriate policy responses [...] involve both countries that are recipients of capital flows and those from which flows originate". The policy advice was the following: "a key role needs to be played by macroeconomic policies, including monetary, fiscal and exchange rate management as well as by sound financial supervision and strong institutions. In certain circumstances, capital flow management measures can be useful".[24]

The BIS has concentrated its analysis on financial cycles in major countries and their international repercussions, pointing to the "excessive financial elasticity" of domestic monetary and financial regimes, which is amplified in the context of the

[22] Fabrizio Saccomanni, *Monetary Spillovers? Boom and Bust? Currency Wars?, The International Monetary System Strikes Back*, Speech at the BIS Special Governors' Meeting, Manila, 6 February 2015, http://www.bis.org/publ/othp22.htm.

[23] Julia Leung, *The Tides of Capital. How Asia Surmounted Financial Crisis and Is Guiding World Recovery*, London, OMFIF Press, 2015.

[24] IMF, *The Liberalization and Management of Capital Flows: An Institutional View*, 14 November 2012, p. 1-2, https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/The-Liberalization-and-Management-of-Capital-Flows-An-Institutional-View-PP4720.

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current IMS because of its "inability to prevent the build-up of financial imbalances, in the form of unsustainable credit and asset price booms that overstretch balance sheets, thereby leading to serious (systemic) banking crises and macroeconomic dislocations".[25] The BIS advice is to incorporate financial cycles systematically in national policy frameworks; this implies that: "policies – monetary, fiscal and prudential – should respond more deliberately to financial booms, by building up buffers, and respond less aggressively and persistently to busts, by drawing the buffers down. This calls for longer policy horizons than those currently in place".[26]

So far only limited progress has been achieved in establishing a comprehensive policy framework for the management of capital flows. Research has been focused on reviewing the experience of countries: (i) in the use of capital flow management measures (CFM), i.e. of measures designed to limit capital flows with various administrative measures (including taxes and regulations) and (ii) in the use of macro-prudential measures (MPM) designed to limit systemic risks with prudential measures to increase resilience of the financial system to shocks.[27] These surveys have been valuable because they have, *inter alia*, stressed the need for additional work on the integration of CFM and MPM and to ensure their international consistency.

However, in recent contributions to the preparatory work of the G20, international organizations have once again stressed the need for a broader approach to the issue. In particular:

1. The IMF calls for a more consistent global approach to handling capital flows to improve the effectiveness of national policies, noting that more work is needed to gauge spillovers and the potential to minimize them. Strengthening the Global Financial Safety Net (GFSN) is also important, ensuring adequate resources to the IMF and addressing the sizeable financing gaps affecting many countries.
2. The BIS reiterates its suggestion to control financial cycles through a macro-financial stability framework, encompassing prudential, monetary and fiscal policies. In the context of the monetary policy strategies, the special responsibility of large jurisdictions that are home to international funding currencies is to be taken into account.
3. The OECD maintains that the benefits of free capital mobility outweigh the cost of financial instability and puts the emphasis on structural reforms to enhance the resilience of economic systems and their productivity. In this context, the OECD Codes of liberalization of capital movements could be considered a

[25] Claudio Borio, "The International Monetary and Financial System: Its Achilkes Heel and What to do About It", in *BIS Working Papers*, No. 456 (August 2014), p. 1, http://www.bis.org/publ/work456.htm.

[26] Jaime Caruana, *Global Economic and Financial Challenges: A Tale of Two Views*, Lecture to the Harvard Kennedy School, Cambridge, 9 April 2014, http://www.bis.org/speeches/sp140409.htm.

[27] IMF, FSB and BIS, *Elements of Effective Macroprudential Policies. Lessons from International Experience*, 31 August 2016, http://www.bis.org/publ/othp26.htm; IMF, *Subdued Demand: Symptoms and Remedies*, cit.

valuable instrument of international coordination to avoid negative spillovers.

Against this background, it should be possible to design a unified approach – taking into account the proposals of the three institutions – to monitor potential sources of international financial instability and to promote coordinated policy responses to forestall the impairment of the global financial system. As noted by Timothy Geithner, financial systems have become more resilient since the GFC, but the world is not really safer *vis-à-vis* the dangers and the costs of systemic crises.[28] Geithner makes the case for "strengthening the Bagehot arsenal" by which he means "to rebuild more room for discretion in the emergency tool kit, and keep that in reserve, not as a substitute for strong prudential safeguards, but as a complement".[29]

The institutional context for the performance of monitoring and coordination functions can only be within the G20, possibly delegated to a more restricted and streamlined sub-set of members with systemic responsibilities, with the analytical support of the IMF, the BIS and the OECD. The G7 can obviously play an important role in this exercise. This issue goes beyond the purpose of this paper. But it is important that international cooperation to ensure global financial stability should not limit its role to advising countries on the design and implementation of capital flow management or macroprudential measures. Cooperation should also be extended to orienting global financial markets towards monetary and financial stability; this would imply that the G7/G20 provide some form of "multilateral forward guidance", signalling to markets the determination to counter unwarranted changes in market interest rates and exchange rates, which may give rise to destabilizing capital flows.

Conclusion

At the G7 meetings to be held under the Italian presidency, the leaders and Finance Ministers of the Seven should aim at reducing the current high level of policy uncertainty on a global scale, which is bound to have a depressing impact on economic activity, trade and employment. After Brexit, the election of Donald Trump and with the prospect of unsettling electoral developments in Europe, there is a need for clear signals as regards the risks to the macroeconomic outlook, international trade negotiations and global financial stability.

Regarding the macroeconomic outlook, this paper proposed that a more balanced and coordinated macroeconomic policy mix should be adopted to lift up the burden of stimulating the economy from Central Banks' shoulders. To this end,

[28] Timothy F. Geithner, *Are We Safer? The Case for Strengthening the Bagehot Arsenal*, Per Jacobsson Lecture at the 2016 Annual Meetings of the International Monetary Fund and World Bank Group, Washington, 8 October 2016, http://www.perjacobsson.org/lectures/100816.pdf.

[29] Ibid., p. 27.

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fiscal incentives should be used to promote productivity-enhancing reforms and investment in infrastructures and new technologies, using these policy tools in order to exploit their mutually reinforcing effects. The coordination of these national policy strategies on an international level is advisable in order to enhance their effectiveness.

With respect to international trade, we argued in favour of a new generation of multilateral trade agreements with significant social shock absorbers, adequate health and safety standards and independent arbitration procedures. These trade agreements will contribute to set a base of common rules to better govern globalization, protecting the ones who are negatively affected by it. This is necessary to resist and fight back rising protectionism and the backlash against globalization that is spreading in advanced economies.

Finally, we noted that reform of the financial regulatory system is a necessary but not sufficient to ensure global financial stability and advocated the establishment of a comprehensive framework for the management of capital flows, involving monetary, fiscal and macroprudential policies.

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