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For G-20, a struggle over growth and debt

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TORONTO -- The world's developed countries have built extensive public health systems, promised citizens a paycheck for life and erected a welter of protections around some industries and types of jobs. Now their leaders are conferring over a singular dilemma: how to take some of it back without undermining the economies they are trying to sustain.

In economic terms, it is a bit like creating a perpetual motion machine -- cutting tens of billions of dollars in public spending would almost certainly slow growth but is considered necessary to tame record levels of government debt. And in a series of recent reports, the International Monetary Fund has suggested that it might be just as tricky to demand unheard-of levels of coordination among the world's major economies and require politicians to sustain what might prove to be a painful reform process for several years.

An IMF report to the Group of 20 major economies "has to go through a lot of contortions" to show that developed world debt can be brought down without undermining growth, said Eswar Prasad, a senior economist at the Brookings Institution and former IMF economist, who has reviewed the document. "They have been tweaking their methods -- the message is that you need to have fiscal retrenchment, but if you do it the right way you won't have negative growth effects."

The needed changes range from an overhaul of financial regulations to a retooling of world trade, topics U.S. officials broached at the start of the talks this weekend. President Obama pledged to pursue passage of a U.S.-South Korea free trade agreement by fall in hopes of boosting American exports, while Treasury Secretary Timothy F. Geithner said the pending approval of a U.S. financial overhaul package should be complemented by strong actions by other countries on issues such as the rules for bank capitalization.

The G-20 -- industrialized countries and major emerging powers that include China and India -- meets Sunday amid debate about the risks that public debt in the developed world poses to the global recovery and how to respond to it without creating another set of problems. Heading into the session, even some of the group's closest allies seemed divided.

"This summit must be fundamentally about growth," Geithner said on arriving in Canada, just hours after Canadian Prime Minister Stephen Harper emphasized the "strong consensus on the need for medium-term consolidation plans in advanced countries" -- in other words budget cutting.

Can the two be resolved?

The IMF has published a "Ten Commandments for Fiscal Adjustment in Advanced Economies" that includes an admonition from its top economists to "obey these . . . and chances are high that you will achieve fiscal consolidation and sustained growth."

The document acknowledges that the level of budget cutting being planned by the developed world is risky given the weakness in the world economy. Deep cuts are underway in Greece and Spain, and have been proposed in Britain and recommended for the United States and others to begin by next year.

But the document also contends that a commitment to more-balanced public spending will stabilize bond markets, bring down interest rates as governments borrow less, and encourage more private investment -- all "growth-friendly" results that will help offset any reduction in government budgets.

In addition, the agency says that for the process to work, budget cutting must be accompanied by a broad set of other reforms that would improve economic performance.

Public retirement and health programs are singled out: "You shall pass early pension and health care reforms as current trends are unsustainable" is commandment No. 5. Much of the projected increase in future public spending in developed countries is related to the aging of their populations, and changes such as an increase in the retirement age improve future balance sheets without cutting current spending.

Labor markets need to be overhauled to make it easier for people to find and change jobs or enter new markets; in recent reports on Greece and France, the agency singled out rules that protect retailers, pharmacists and others from competition. Product markets need to be deregulated. Taxes almost certainly need to increase.

And on top of all that, the world's wealthiest nations will still need some help from emerging markets such as China that have benefited from large trade surpluses in recent years and tucked trillions of dollars of currency reserves into the vaults of their central banks. The emerging markets need to boost their own spending and shift to "internal demand" for future growth, and rely less on spending from developed nations, the IMF said.

Synchronizing those efforts on a global scale will be a task in itself. The G-20 asked the IMF to begin the process by collecting economic projections and policy plans from its members, and vetting them to see how they complement -- or conflict with -- each other, and square with the IMF's own forecasts.

According to officials who reviewed the IMF's report, the developed countries appeared too optimistic in their expectations for growth and the recovery of the private sector and too timid in the political decisions being planned to restructure their economies.

That, according to one Canadian official, will be a centerpiece of the weekend's discussions.

"Each country is coming in saying here is what we are going to do," said the official, who is familiar with the talks but is not authorized to speak publicly. The IMF estimates that properly coordinated policies could add about $4 trillion and 30 million jobs to the world economy in coming years, and "we don't want to leave $4 trillion on the table," the official said.

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