PISM | POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

Policy Paper

No. 5
April 2011

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The G20 on the Path to Finding Relevance in the New World Economic Order

One of the features of the recent global financial crisis was the prompt anti-crisis response by national governments and central banks. Through fiscal and monetary policy measures they aimed at combating a severe economic depression. Although the main concern of each government and central bank was saving their own economy and pursuing their own interest, in a more and more interdependent global economy where the effects of a situation in one country and actions taken by governments quickly spread beyond borders, the crisis required an unprecedented scale of coordination by major economies.

After the outbreak of the financial crisis in autumn 2008, the G20 was elevated from a forum of Finance Ministers and Central Bank Governors to a gathering of heads of state. The group took over the role of the main body for consultations and decision-making with regards to an anti-crisis response. Composed of systematically significant states—the biggest industrialized economies and rising emerging powers—it was more representative to form the so-called "world economic government" than the G8. Although officially it had no power to make decisions, the G20 summits served as venues for discussing and defining ways to effectively address the fundamental problems related to the crisis. It also was the source of guidelines for international organisations and bodies that set standards.

Successes in Crisis Management

During the peak of the financial crisis the most acute problems were the condition of the banking sector and the negative impact of the crisis in the financial sector on the real economy. Those problems set the agenda of G20 summits in Washington in November 2008 and in London in April 2009. The main feature of those summits was a collective conviction that coordinated actions discussed and agreed by the leaders of the major world economies could enhance the effectiveness in total and by individual countries to deal with the financial

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and economic crisis. Furthermore, the exchange of information on the planned measures to be implemented as well as an increased sensitivity to impacts beyond borders to some extent constrained "beggar-thy-neighbour" policies.

The immediate necessity was to respond to the liquidity crisis in the banking sector in order to restore credit. Central banks of industrialized countries almost *in unison* lowered basic interest rates, in some cases reducing them to almost zero. When those standard monetary policies turned out to be insufficient, the banks introduced additional instruments to enhance liquidity in the banking system, such as temporary special-lending facilities, special loans to systemically important financial institutions, extension of the range of deposit protection, expansion of the list of eligible collateral or additional securitization of loans by central banks or even recapitalization of some financial institutions.[1] Furthermore, to support liquidity of foreign currencies in domestic markets, many central banks decided to conclude currency swap agreements. The G20 members were unanimous in praising the role those actions played in restoring stability on the financial markets, even though they were aware that support for banks—culprits in the financial crisis—might by unpopular among ordinary citizens.

Another necessity was to restore growth. Dealing with that challenge, G20 states undertook individual actions through fiscal stimulus. The foremost need was for bank recapitalization and solving the problem of bad assets. However controversial was the decision to save the financial sector with taxpayer money, major industrialized economies shared the opinion that when markets failed, the state should support financial institutions to restore confidence in the whole financial system as well as credit actions by banks. The G20 also share the opinion that in order to go back to a pre-crisis growth path, extraordinary budgetary expenditures are needed to create jobs, restore demand and stimulate consumption. Although the London Summit's "Global Plan for Recovery and Reform" didn't include a pledge to create a global stimulus package, member countries agreed to continue fiscal stimulation for as long as necessary for the recovery of their economies.[2]

The G20 deferred to international and intergovernmental institutions for implementation of the decisions made by the group. As a crucial part of crisis-management efforts, the G20 defined guidelines and tasks for such institutions as the World Bank, International Monetary Fund and multilateral development banks. These institutions were mandated to deal with the important short-term, anti-crisis challenges of securing international support for developing and poor countries, which in contrast to developed countries were not financially strong enough to stimulate their economies. At the G20 summit in London, member countries were able to decide on a huge financial program aimed at restoring credit, growth and jobs in the world economy. They pledged to supply an additional USD 1.1 trillion to such institutions as the IMF (USD 500 billion in new resources

[1] Paavonen, T., *A New World. Economic Order. Overhauling the Global Economic Governance as a Result of the Financial Crisis, 2008–2009,* FIIA Report 2010/24, Helsinki 2010, pp 84-85.

[2] *Global Plan for Recovery and Reform,* Statement Issued by the G20 Leaders, London, 2 April 2009.

available for lending plus USD 250 billion for new SDR allocation) and multilateral development banks (USD 100 billion for emerging markets and developing countries plus USD 250 billion to support trade finance). These resources, according to the G20 decision, were made available through more flexible mechanisms to countries in need.[3] Furthermore, the G20 decided to restrain from the introduction of protectionist measures, and mandated WTO, OECD and UNCTAD with the task of monitoring any new trade and investment measures of its members. In response to the G20 request, WTO, OECD and UNCTAD in joint reports notified about any new measures and government programmes (such as economic stimulus packages) not only related to trade and investment, but also about industrial policy measures (support for specific industrial sectors or regulations on public procurement).[4]

A long-term goal of the G20 was the reform of the global financial system to prevent the re-occurrence of a similar crisis in the future. However difficult it seemed taking into account divergent financial regulations, the G20 wanted to use the momentum from the current crisis to create a new global financial order with more effective financial regulation. Apart from the need to change their own financial regulation, the G20 members in that area also referred to international standard setting bodies such as the Financial Stability Forum, Basel Committee on Banking Supervision, International Organisation of Securities Commissions, International Association of Insurance Supervisors, the Committee on the Global Financial System and the International Accounting Standards Board, to develop new mechanisms that would strengthen global financial stability.

The crisis also appeared to be a good moment for the reform of institutions of global economic governance. The G20 agreed on principles for the reform of two major institutions of global economic governance: the World Bank Group and the International Monetary Fund. The objective of the reforms was to enhance the voice and representation of developing economies to better reflect their growing weight in the world economy in recent years. Although it was difficult for some, especially Europe whose relative weight in the World Bank and IMF effectively declined, the G20 fulfilled its pledge in this respect increasing quota shares of developing and transition countries by almost six percentage points in the World Bank Group (4.6 in IBRD, and 6.0 in IDA and IFC) and IMF and agreeing for changes in governance structure.[5] Furthermore, the G20 agreed to reform the mission and mandate of those institutions in order to strengthen their ability to deal with present and future challenges. It also decided to establish a new institution, the Financial Stability Board (from the transformation of the Financial Stability Forum), consisting of G20 members, Spain and the European Commission and with the mission to provide early warnings of macroeconomic and financial risks and take actions needed to address them.

[3] Ibid.

[4] Till 2010 Seoul summit, the OECD issued four reports; all are available at www.oecd.org.

[5] See: *World Bank Reforms Voting Power, Gets $86 Billion Boost*, World Bank Press Release No:2010/363/EXT, Washington, 25 April, 2010, and *IMF Executive Board Approves Major Overhaul of Quotas and Governance,* IMF Press Release No. 10/418, Washington, 5 November 2010.

Lastly, the G20 made itself the premier forum for "its" international economic cooperation,[6] transforming itself into a body that is going to take a key decision for the global economy.

Challenge of Post-Crisis Management

The G20 was effective in coordinating immediate measures for recovery of the world economy, but after the worst symptoms of the crisis were dealt with, the need for common coordinated actions dissipated. Countries emerged from the crisis with different problems and expectations. In some cases, their domestic woes translated intodivergent visions about the direction of actions and reform to be decided by the G20, now perceived—after the successful Washington and London summits—as a forum where key decision concerning the world economy are taken.

During the Pittsburgh summit there was a difference of opinion on the exit strategy from the extraordinary fiscal stimulus. The looming new problem of sovereign debt hung over countries that had implemented huge stimulus packages. However, unevenness concerning the stability of the recovery as well as anxiety about a double-dip recession made some countries hesitant towards terminating their expansive fiscal policies. On the one side, the United States was concerned about the risk to the fragile global recovery and vowed for continuity of budgetary support to stimulate demand and generate jobs. On the other hand, the EU, especially fiscally prudent Germany, opted for a withdrawal of fiscal stimulus based on the understanding that excessive public debt in eurozone countries may threaten the stability of the EMU. The compromise was achieved only during the Toronto summit, where the G20's advanced countries agreed to fiscal plans that assumed at least halving deficits by 2013 and stabilizing or reducing government debt-to-GDP ratios by 2016.[7]

Ongoing financial regulatory reform is another field where consensus is harder to achieve than it was during the darkest hour of the financial crisis. Initially, the G20 indicated the principles of reforms would be geared towards more effective supervision: strengthening regulatory regimes, prudential oversight, better risk management and commitment that all financial markets, products and participants are regulated or subject to oversight.[8] At the latest G20 summit in Seoul, member countries endorsed the main result of the agreement at the peak of the financial crisis: the new bank capital and liquidity framework, the so-called Basel III standards.[9] However, there are areas where international convergence on domestic regulation appears hard to achieve, especially between the U.S. and EU. It concerns such issues as securitisation, derivatives, hesitance of the U.S. to adopt international financial reporting standards, regulating hedge funds and regulating senior executive compensation. Member states also differ in their opinions on proposals for new bank levies and international financial transaction taxes, as well as how to better regulate

[6] *G20 Leaders Statement: The Pittsburgh Summit,* Pittsburgh, 24-25 September 2009.
[7] *The Framework for Strong, Sustainable and Balanced Growth,* , Toronto, 27 June 2010.
[8] Declaration *of the Summit on Financial Markets and the World Economy*, Washington DC, 15 November, 2008.
[9] *The Seoul Summit Document*, Seoul, 12 November, 2010.

systemically important financial institutions.[10] Progress on those issues might slow since the danger of a financial system collapse is diminishing.

Recently, the most controversial topic on the agenda of the G20 is currency policy. The discord between the U.S. and China, in which the former accuses the latter of undervaluing the RMB exchange rate spilled over into a real war of words among other countries. The pledge made at the London summit that countries would refrain from competitive devaluation of their currencies rang hollow, taking into account China's policy of keeping the RMB exchange rate "stable," measures to counter appreciation adopted in some countries (Japan, South Korea, Switzerland and Poland), unconventional monetary policies, such as the Fed's quantitative easing (a USD 600 billion asset purchase programme of November 2010 seen as an attempt to depreciate the U.S. dollar) or the ECB's purchase of euro-area sovereign bonds.[11] The latest debate on the currency issue, aggravated by the words of Brazil's finance minister about a "currency war" proves that in the post-crisis era, countries face different challenges and adopt policies to achieve different domestic objectives. That no solution to the problem was found at the Seoul summit revealed that regulating each others actions to prevent "beggar-thy-neighbour" depreciations is hard to achieve.

The problem of global macroeconomic imbalances topped the agenda of the most recent G20 summit. It stems from large and widening discrepancies in the macroeconomic situations of major world economies that are threatening to trigger uncoordinated individual actions. On one side there are countries with large current account deficits, such as the United States, that should increase their savings and exports. On the other side, there are countries such as China, Germany and Japan with large current account surpluses that are expected to increase consumption and import. The Toronto G20 communiqué calls on advanced deficit countries to take actions to boost national savings and enhance export competitiveness, and for surplus economies to undertake reforms to reduce their reliance on external demand and focus more on domestic sources of growth. The G20's Seoul communiqué only vaguely stated intentions to pursue the full range of policies aimed at reducing excessive imbalances and maintaining current account imbalances at sustainable levels. The U.S. proposal to set a numerical target for current account deficits and surpluses was rejected, and the G20 failed to produce concrete commitments to achieve the goal of reducing excessive imbalances. Instead, the G20 tasked the IMF and other international organisations to develop indicators that will help identify large imbalances that need to be taken care of.[12]

French Agenda for 2011

[10] *The EU Takes On Banking And Financial-Services Regulations,* "EuroWire", Bertelsmann Foundation, October 2010.

[11] Darvas, Z., Pisany-Ferry, J. *The Threat of 'Currency Wars': European Perspective,* Bruegel Policy Contribution, Issue 2010/12, December 2010.

[12] The *Seoul Summit Document,* op. cit.

After the Seoul summit, France assumed the twelve-month presidency of the G20. French President Nicolas Sarkozy, who together with former U.S president George W. Bush was the main architect of G20 summit meetings, obviously pays great attention to the process he *de facto* initiated. At the previous five G20 summits, France was one of the key players, presenting its own proposals regarding issues on the agenda and having a very visible and influential voice in the decision-making process. The presidency of the group gives France a rare opportunity to set the agenda and more assertively present proposals regarding major challenges facing the world economy. In January 2011, France presented the six priorities of its presidency: 1) reforming the international monetary system; 2) strengthening financial regulations; 3) combating commodity price volatility; 4) supporting employment and strengthening the social dimension of globalization; 5) improving global governance; and, 6) development.[13] The success of the French presidency as measured by the ability of the group to reach consensus on the most pressing issues could strengthen the role of the G20 as the main body of international economic governance.

To begin with, a meaningful reform of the international monetary system—the foreign exchange system and the mechanisms and institutions regulating international monetary exchanges—is not only hard to achieve but even harder to start. Among various issues raised by President Sarkozy or French Finance Minister Christine Lagarde are the need for stricter regulation of potentially destabilizing massive international capital flows, internationalisation of the currencies of the major emerging economies to shift away from a reliance on the U.S. dollar as the world's reserve currency, discussion about how to include RMB in the Special Drawing Rights basket (which could encourage the Chinese currency to move closer to its true market value) and the future role of SDR.[14] In case the problem of global imbalances goes unresolved, France is expected to press for work on indicators measuring those imbalances with a view to achieve a consensus on the adoption of country-specific economic policies that would lead to rebalancing global growth.

However, with respect to the need for reform of the international monetary system, countries have different views and priorities. Some of them focus on the role of the U.S. dollar, although it is would be risky to assume that any decision by the governments of G20 states will substantially decrease the role of the dollar--most transactions are made by private entities anyway. Others concentrate on the issue of capital flows, but here again opinions varyon the merits of capital flow liberalization and distortion to the global economy and stability of the financial system that could be caused by capital controls. Yet another group of countries is concerned with global imbalances. Although the G20 Finance Ministers that met on 18-19 February 2011 agreed on a set of global imbalances indicators to be monitored by the IMF,[15] the meeting also revealed the difficulty in reaching consensus. The U.S. pushed for numerical targets and binding commitments while China wouldn't agree to

[13] *The Priorities of the French Presidency*, official website of the French G8-G20 Presidency, www.g20-g8.com.
[14] Hollinger, P., Daneshkhu, S., "Lagarde outlines France's G20 hopes", *Financial Times*, 13 February, 2011.
[15] Communiqué, Meeting of Finance Ministers and Central Bank Governors, Paris, 18-19 February 2011.

include foreign exchange reserves to the list of indicators. Even if the G20 succeed this year in drawing up "indicative guidelines" for actions to reduce excessive imbalances, any commitments for actions to be taken will probably be weakened by the clause "taking into account national circumstances" present in every G20 communiqué.

France keeps pushing for the strengthening of financial regulations, the issue that topped the G20 agenda in 2008 and 2009. Most of the recognized necessary changes to fix the financial sector were worked out by assigned institutions (FSB, IMF) and agreed to at previous summits. The key item on the agenda this year will be the so-called global systemically important financial institutions (G-SIFI). By the G20 summit in November 2011, the FSB and relevant national authorities must prepare the list of G-SIFI (about 20 global banks) that will be the subject of higher capital requirements and stricter oversight. After completing the task of new G-SIFI framework regulation, the G20 plans to prepare new rules for all SIFI and non-banking institutions. Although France aired the idea of a tax on financial transactions, it is rather doubtful it will find broad support for this initiative.

Quite a new item on the G20 agenda (although vaguely referred to at the 2009 Pittsburgh summit) is a French proposal to combat commodity price volatility. The focus is on energy and agricultural commodities. France would like the G20 to define global regulations to prevent market abuses and price manipulations. Among the proposals are the establishment of a central clearinghouse to register global agricultural transactions, the standardisation of derivatives' trading rules in over-the-counter markets, and the adoption of rules that would impose position limits on traders in commodity markets, similar to regulations already in place in the U.S. Another goal is to create an agriculture database that would gather information from various sources about the level of commodities stocks, thus providing reliable data on supply and demand trends.[16] The idea can count on support from the U.S and European countries, in spite of being a more challenging task than similar data-gathering mechanism on oil, due to the more diverse sources of production and data gathering methods. France also wants to deal with a problem of export restrictions, securing agreement by major commodities exporters to not interrupt supplies in case of natural emergencies. To reach consensus on new regulations concerning the commodities trade, France will have to overcome the reluctance of such countries as Russia, Argentina, Brazil or China.

In the end, global governance will be probably the most challenging area during the French presidency. And probably the most challenging priority of the French presidency concerns global governance. The level of ambition is high.[17] First, France wants to accelerate negotiations about reform of the UN Security Council. Its proposal to increase the number of permanent and non-permanent seats for the interim period is one of a few ideas on the table. Although the G20 features potential new, permanent UNSC members, the complexity

[16] Priority *Areas, Commodity Price Volatility*, www.g20-g8.com.
[17] Priority *Areas, Reforming Global Governance*, www.g20-g8.com.

of the problem means the discussion probably will extend beyond the French G20 presidency. Second, the vision for opening the G20 to the world is not clear. France presumes to develop the dialogue of the group with other organisations, including the United Nations, regional organisations and representatives of various groups, such as elected officials, enterprises, labour unions and different faiths. The idea to consult those who are out of the G20 process might be beneficial, but if the G20 wants to strengthen its legitimacy as a world economic government, it needs to come up with a way to introduce the results of these consultations into actual decisions. Third, after reform of the World Bank and IMF, France wants to discuss the reform of other international organisations. Here, after an arduous process of finding final consensus on reform of the World Bank and the IMF, through broad consultation and smart, widely acceptable stakeholder proposals, the G20 may prove its role as a facilitator of adjusting existing structures of international bodies and their activity to new global realities. Finally, France intends to discuss the future of the G20 itself. France's ambition is to consolidate the importance of the group as a major forum for international cooperation. One of the proposals for discussion is setting up a permanent secretariat, a step towards institutionalization of the G20. Taking into account the extension of the topics on the agenda from one summit to another, a professional secretariat could improve the continuity of the process, monitor whether the commitments are met and enhance institutional memory of the group. Still, support for that idea is now uneven when some countries might prefer the G20 to remain a forum for rather informal consultations, not a body that makes binding decisions.

In Search of Unity

The sight of the G20's coordinated approach to the management of the world economy was exciting. Nevertheless, the short history of meetings with heads of government shows that coordination of national economic policies might have been easy when every economy experienced the deepest recession of late. But varying rates of economic recovery and the post-crisis situation are leading to different policy responses by G20 members. The atmosphere of "required cooperation" is waning. The future of the G20 as a world economic government not only in times of crisis depends on the will of the most influential member—the United States. It seems the U.S. perceives the forum as the right body to discuss major problems of the world economy. However, its main concern is the state of the domestic economy and decisions such as the quantitative easing of November 2010 prove that the U.S. will not hesitate to pursue its objectives as it sees fit, even to the detriment of international economic cooperation. On the other extreme is China, with its own economic policy objectives. As a country whose actions have more and more profound impact on the world economy, China is expected to be more responsive to the expectations of other countries (recently regarding its exchange rate policy and global economic imbalances). But it is hard to assume that China will relinquish its own interests for the sake of better international cooperation. Taking into account the divergent objectives of other

G20 members, France will have a hard task in working on the unity of the group to face major challenges for the world economy.

Another challenge is the delicate issue of membership. The G20 formula to some extent fit the idea of giving emerging and developing economies more say in the institutions of global governance. However, other countries aspire to be present at the table during the discussion of major world economies. Such aspirations held by Spain, the Netherlands and Poland raise the question of European Union representation. Do those countries feel that the EU is not representing them well at G20 summits? The G20 consists of EU members France, Germany, Italy and the United Kingdom, but also features the EU as such. Which countries does the European Union represent at the G20: all 27 states or the 23 member states that are not individual members of the group? Looking at the activity of France, Germany and the UK at the G20, participation of the EU representatives during the summits seems rather insignificant. So, France should also consider improving the formula for European Union participation in order to strengthen the voice and influence of Europe in the G20. Enhanced coordination within the EU, especially involving the remaining 23 members in the process of drafting positions towards issues tackled by the G20, would be a boost for the idea of a cohesive common external policy and the vision of a Global Europe. It could placate fears of being excluded on the side of those EU members not present at the G20 table, thus strengthening the legitimacy of the EU voice and enabling it to pursue its own financial and economic agenda in a more effective manner.