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PERSPECTIVES

Towards the London Summit: Next Steps for the G-20

Outcomes Report

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Prepared by Mark Thirlwell

Introduction

On 5 March, the Lowy Institute for International Policy hosted a high-level roundtable in the run-up to the G-20 meeting of world leaders that will be held in London on 2 April this year. The roundtable was supported by the British High Commission in Canberra and was part of the British Government's efforts to reach out to the wider community for ideas before this critical summit meeting. The discussion brought together a small group of informed Australians from outside government to give their views on what G-20 leaders should deliver at the London Summit.

While the roundtable itself was held under the Chatham House Rule, this report provides an overview and synthesis of what was a lively and wide-ranging discussion.

The global financial crisis and the rise of the G-20

Such has been the magnitude of the current global economic and financial crisis – now so ubiquitous that it has its own acronym, the GFC – that it has already produced a series of dramatic changes in the way the world economy operates. One of these changes has been a significant promotion in the importance of the G-20 in the international economic architecture. As a G-20 member, this means that Australia now benefits from a place at the world economy's new top table.

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was originally established in 1999 to bring together systemically important industrialised and developing economies to discuss key issues in the global economy. The G-20's origins lie in the 1997-98 Asian financial crisis and a desire to reform the Bretton Woods Institutions comprising the

IMF and World Bank. The inaugural meeting of this 'financial' G-20 took place in Berlin on 15-16 December 1999 and was hosted by the German and Canadian finance ministers.[1]

G-20 country membership comprises Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States. The twentieth place is taken by the European Union, represented by the rotating Council presidency (this year, the Czech Republic). Together, G-20 member countries represent more than 85% of global output, about 80% of world trade (including EU intra-trade) and two-thirds of the world's population.

Much as the 'financial' G-20 was a product of the Asian financial crisis, so the new G-20 leaders' meeting is a product of the GFC. The first meeting of G-20 leaders was held late last year in response to the sharply deteriorating global economic climate following the failure of Lehman Brothers. The Washington Summit on Financial Markets and the World Economy took place on 14-15 November 2008. Leaders produced a declaration, announced a package of measures (The Washington Action Plan) and agreed to meet again before the end of April 2009.[2]

The London Summit

The London Summit aims to reach international agreement on:[3]

- Coordinated actions to revive the global economy – to stimulate growth and employment;

- Reforming and improving financial sectors and systems – to deliver progress on the Washington Action Plan to build better financial systems;

- Principles for reform of international financial institutions (IFIs) – the International Monetary Fund, Financial Stability Forum and World Bank.

In addition, there is a commitment that 'economic recovery cannot be at the expense of the environment or the world's poor' and that the Summit 'should take into account making

[1] Information about the G-20 is available from the official web site at http://www.g20.org/about_what_is_g20.aspx.
[2] The Washington Declaration and the Washington Action plan are available at http://www.g20.org/Documents/g20_summit_declaration.pdf.
[3] As set out at http://www.londonsummit.gov.uk/en/summit-aims/.

continuing progress on Millennium Development Goals, providing for low carbon-based growth and ensuring climate security, while protecting the poorest.'[4]

An historic opportunity at a time of great peril

Participants at the Lowy Institute roundtable stressed that the London summit was taking place at a time of great risk for the global economy. Worldwide, confidence in the international economy had evaporated, and public trust in a wide range of economic institutions in general and the financial system in particular had been seriously damaged. The process of financial intermediation – often seen as the 'lifeblood' of activity – had broken down. Businesses were now facing a period of extreme uncertainty, which was undermining incentives to invest and hence growth prospects. Workers were confronted by rising job and income insecurity. While the epicentre of the crisis was found in the developed world, rising unemployment and poverty were threatening to take a heavy toll in the developing world where social safety nets provided much less of a cushion for vulnerable populations. It was therefore extremely important that the London Summit delivered the kind of outcome that could exert some positive influence on this overwhelmingly negative environment.

The discussion also emphasised that it was important that leaders view current events as something much more than the latest in a series of booms and busts in the world economy. The challenges presented by the current crisis were in many ways unprecedented, and as such, required leaders be willing to embrace new and unconventional policy responses. In terms of monetary policy, the United States had demonstrated this recognition, but had so far been unable to do the same when it came to bank restructuring. China, meanwhile, had delivered on the fiscal front, although might need to do more. To date, the EU had been something of a standout in terms of its reluctance to pursue more unconventional policies, and partly as a consequence, several participants noted that portions of the European periphery were now an important additional source of international economic risk.

Along with this pessimism regarding the precarious state of the world economy, however, there was also a strong sense amongst participants that the London Summit presented the world's leaders with an opportunity to reshape the global economic order in a way that had perhaps not existed since the meetings at Bretton Woods in July 1944 that had laid the foundations for the postwar international economic order. There was a general consensus that

[4] Ibid.

the existing international economic architecture had now fallen into a state of severe disrepair, and that a systemic overhaul was required and indeed overdue.

In this regard, participants viewed the elevation of the G-20 to a leaders' meeting as a welcome recognition of the changing economic and political global landscape. The Washington and London Summits needed to be the start of a continuing process that cemented the place of the G-20 in the global architecture, rather than a temporary response to the current crisis.

Furthermore, while there was a recognition on the part of participants that there was some truth to the proposition that a membership of 20 countries (including the EU chair) entailed some costs in terms of unwieldiness and focus, nevertheless, proposals to tinker with the existing membership structure of the G-20 should be rejected as an unnecessary distraction at best, or at worst as an attempt to provide cover for a doomed return to a now-discredited status quo.

Finally, it was noted that the fact that the London Summit was a meeting of leaders should have implications for the ambitions of the meeting: The Summit should be treated as an opportunity to deliver outcomes that required significant political commitments, as opposed to dealing with more technocratic or mechanistic proposals that would be better suited to other bodies.

Debating the agenda: the dangers of too much versus too little

The discussion at the roundtable identified six broad policy areas that encompassed the proposed agenda of the London Summit:

1. Sustaining global growth and employment.

2. Maintaining open markets and resisting protectionism.

3. Reforming financial supervision and regulation.

4. Reforming the international financial architecture.

5. Protecting the world's poor.

6. Safeguarding the environment.

While it was acknowledged that there was clearly a significant degree of overlap between many of these objectives – for example, sustaining growth would help keep markets open, even as open markets contributed in turn to growth – there was also a danger that too ambitious an agenda would derail the Summit. It was repeatedly noted, for example, that previous international meetings had a long history of over-promising and then under-delivering, and that a major explanation for this repeated failing was a recurring tendency to try to do too much. It was important that the G-20 leaders' meetings did their best to avoid falling into the same old trap of replacing concrete action with empty platitudes.

To this end, and given the weakened state of the world economy, many participants felt that there was a strong case to be made for concentrating heavily on the first objective, sustaining global growth and employment, which if successfully achieved would anyway provide a major contribution to some of the other agenda items, including maintaining open markets and protecting the world's poor. The world economy is bleeding, went this argument, and successful triage requires a brutal focus on dealing with the most pressing problem, even if that means putting off other important issues until subsequent meetings.

While this argument had much to recommend it, however, the interconnected nature of the challenges now facing the world economy, and in particular the likely bargaining requirements involved in achieving some of the measures needed to achieve even just the first objective (see below) meant that participants ultimately recognised the case for maintaining a broader agenda.

The need for a 'Grand Bargain'

The discussion at the roundtable canvassed a wide range of proposals and ideas that fell under one or more of the six policy areas listed above. To take just one example, one participant argued that the adverse effect that uncertainty was having on business investment could be at least partially offset by a greater willingness on the part of governments to streamline the approvals process for major investment projects.

One common theme across a number of participants, however, was that the London Summit provided the opportunity to secure some form of a 'Grand Bargain' between the major developed and developing economies, between the major debtor and creditor economies, and between the major deficit and surplus economies (noting that there was a close but imperfect overlap operating between these three sets of categories – that is, some of the biggest developed economies were also the big debtors and those running large external deficits).[5]

One element of this bargain was largely economic. Specifically, participants noted that macroeconomic policy had already responded to the crisis in the form of monetary and fiscal stimulus, with the former now approaching its conventional limits in many of the most affected economies. There was still more scope for fiscal action, but the real capacity for significantly expanding government demand now rested more with those countries running large external surpluses, and which also had relatively strong fiscal positions. So what the world needed was a commitment from the latter group of economies to run significantly more expansionary policies. Participants noted that this would also be important in dealing with the global economic imbalances that had been a significant contributory factor to the GFC. Several participants in the roundtable also argued that exchange rate policies – and exchange rate adjustments – would at least need to be considered as part of this package of measures.

The *quid pro quo* for these changes was identified as a clear admission on the part of many of the leading developed countries – in particular the United States – that the severity of the crisis reflected serious supervisory and regulatory failures on their part, and even more importantly that this *mea culpa* be accompanied by a commitment that these flaws would now be corrected, together with a rapid move to restructure and rebuild financial systems in order that lending activity, and hence economic growth, could again resume.

Another strand of the Grand Bargain discussed by participants was more strategic in nature, although still linked to economics. The roundtable discussion emphasised that leaders at the London Summit should explicitly recognise the changes in the balance of economic power in the world economy, and acknowledge that those changes required a concomitant shift in the nature of the governance of the world economy, with the effective promotion of the G-20 a necessary but not sufficient first step. This element of the Grand Bargain would both form part of the *quid pro quo* required to secure the economic deal outlined above, but also had the potential to send the kind of powerful signal about a change in the international economic regime that could contribute to improved global confidence.

[5] The overlap is imperfect because, for example, some major developed economies like Germany and

How to craft a global deal

While the broad outline of a Grand Bargain – coordinated stimulus concentrated in those economies most able to deliver it in return for financial reforms and a change in the global economic order – could be identified readily enough, the subsequent discussion suggested that the detail of such a global deal would need to encompass many of the policy areas identified in the agenda for the London Summit.

Open Markets

Thus the kind of international cooperation needed to sustain the Grand Bargain would require all of the G-20 participants to refrain from protectionist measures. A swing to protectionism would not only undermine economic and political cooperation, but would threaten the key priority of encouraging growth and employment. It would also damage the goal of helping to protect the world's poor.

In this regard, some participants noted that at the Washington Summit, leaders had committed themselves both to supporting open markets and to delivering a framework agreement for the Doha Round of world trade talks. Yet since that meeting it has been estimated that as many as 17 of the G-20 economies have enacted policies which have the effect of restricting trade at the expense of other countries, and a framework agreement has so far failed to materialise.

Participants felt therefore that it was important that leaders reiterate their commitment to open markets at the London Summit.[6] Ideally, this would involve a binding commitment to deliver a conclusion to the Doha Round, even if this was a lowest-common-denominator version, since this would deliver an extremely positive signal about the importance of supporting international trade. However, given past failures in this regard, and a real question over whether delivering on the Round would actually be feasible for the leaders, it was suggested that a useful alternative (or possibly a complement) would be to establish a G-20 surveillance mechanism to monitor a comprehensive 'standstill' agreement on protection (with the latter including, for example, a commitment for no increases in any MFN applied tariff rate other than for technical adjustments; no increases in any customs fees, excise duties or consumption taxes applying to imports; no new export subsidies in any form; and no new buy local preferences at any level of government for goods or services contracts).

Japan have been running sizeable current account surpluses in the current decade.

Discussion at the roundtable also stressed that the importance of sustaining open markets did not only apply to trade, but that leaders should commit to avoiding financial protectionism and raising new barriers to migration. With regard to the former, it was noted that private sector capital flows to emerging markets were expected to contract sharply this year (with the Institute for International Finance forecasting that private capital flows to emerging markets in 2009 were likely to be down 82% from their value in 2007) and that this 'sudden stop' might require the substitution of official flows from the IMF and others, which in turn was likely to require an increase in financial resources for the IFIs. Participants also pointed to the dangers of financial mercantilism – banks to restrict their lending to domestic markets only – and felt that the rapid restructuring of damaged financial institutions, by nationalisation if necessary, and then their return to normal lending activities was a crucial step in tackling this risk.

With regard to migration, the discussion noted that the downturn had already produced some worrying signs of xenophobia in some countries, and participants felt that it was important that G-20 leaders should stress that already-restricted international labour flows should not be subject to further policy-induced contraction.

Reforming financial supervision and regulation

Several participants at the roundtable argued that the world now needed a return to 'boring banking' and for changes to the incentive structures governing financial sector remuneration.

More generally, with financial sector supervisory and regulatory failure at the heart of the GFC, participants at the roundtable spent some time discussing the need for reforms in these areas. While it was recognised that the crisis had identified a number of important shortcomings with the Basel 2 framework, however, there was no appetite for the kind of prolonged wrangling that had preceded that initiative. Instead, there was some broad agreement on the nature of some of the reforms that would be required – including a greater emphasis on liquidity, a downgrading of the roles of the ratings agencies and internal risk models, more focus on macro-prudential supervision and the problems of pro-cyclicality in the regulatory framework – and a hope that such reforms could be swiftly bolted on to existing structures.

[6] Some participants felt that fears of a general swing back to large-scale protection were overdone.

There was a feeling that many of these issues could be best tackled at the level of institutions like the Bank for International Settlements (BIS) and the Financial Stability Forum (FSF), although this would also require a significant membership expansion in the case of the latter body, with leaders at best able to give a general steer, such as that delivered in the Washington Action Plan. That said, participants also felt that a credible commitment to delivering financial reform on the part of the developed world was likely to be required by those developing countries now suffering collateral damage from the GFC as part of any Grand Bargain that involved changes in their own macro-policy settings.

Reforming the financial architecture

While some of the initial discussion on the need for triage suggested that plans for reform of the IFIs should be set aside in favour of dealing with the immediate outlook for the world economy, subsequent debate confirmed that in practice IFI reform would need to be part of any Grand Bargain.

In part, this reflected the fact that one reason that many developing economies had chosen to run large external surpluses (and hence accumulate large stocks of foreign exchange reserves) was that this was part of a policy of self-insurance that in turn reflected their unwillingness to put their trust in the IMF. This was particularly the case in East Asia, where the legacy of the 1997-98 financial crisis means that a number of regional economies were unwilling to rely on the Fund to protect them from crisis. In order to overcome this deep-seated reluctance, and hence to encourage a shift in their national policy priorities, a wide-ranging reform of the IMF was required.

It also reflected the urgent need for the IFIs to be in a position to compensate for the likely dramatic falling away of private international capital flows. Without a very substantial increase in their resources and fundamentally-reformed governance, they will not be able to play this role.

More generally, participants felt that reform of the IFIs was an integral part of the same process of responding to the new international economic order that had resulted in the emergence of the G-20 itself.

Discussion at the roundtable suggested several possible approaches to IMF reform in particular. Some of these suggestions emphasised the importance of symbolic changes, such as the case for a declaration from the Europeans and the United States that both would, with immediate effect, waive their informal 'right' to have one of their nationals head up the IMF and the World Bank respectively, and instead open up the process to a transparent and competitive recruitment process. They would also announce that for the first such recruitment round, they would ask their nationals not to put themselves forward as candidates. At the same time, the European countries could announce that they would offer a significant reduction in their voting shares to be reallocated to the major developing economies in order to rebalance the Fund's voting structure to something more closely resembling the current international economic order. Another suggestion was to relocate the IMF from its current headquarters in Washington DC to a major emerging market capital city – perhaps New Delhi.

Other suggestions sought to combine the importance of symbolism with effective governance changes, such as replacing the oversight of the IMF currently exercised by the International Finance and Monetary Committee (IMFC) by the G-20 itself.

Urgency or sustainability or both?

There was a lively discussion at the roundtable regarding the desirability of the London Summit tackling climate change and the Millennium Development Goals (MDGs).[7]

Some participants stressed that the G-20's pressing need to dealing with the current economic and financial crisis argued for leaving these longer-term issues to one side, pointing out that, in the case of tackling poverty at least, restoring global growth and employment was anyway probably the most important short-term contribution that leaders could make. Similarly, some participants felt that the appropriate venue for dealing with climate change was the meeting at Copenhagen already scheduled to be held later in the year, and that asking the G-20 to add this issue to an already packed agenda risked crowding out time that should be devoted to the urgent problem of dealing with the economic and financial crisis.[8] The opportunity cost of an expanded agenda was, they suggested, too large.

Other participants took a quite different view, however. They argued that the broad membership of the G-20, and especially the inclusion of a significant developing country representation, meant that it was both appropriate and important that the meeting considered issues relating to global poverty. In particular, it was pointed out that the GFC would also be a crisis for the world's poor, and that the London Summit represented an important

[7] For a list of the eight MDGs, see http://www.un.org/millenniumgoals/bkgd.shtml.

opportunity for leaders to reaffirm their commitments to existing aid budgets and development assistance at a time when budgetary pressures were growing in many countries.

Some discussants also felt that such was the level of public concern regarding climate change, that it would be impossible for leaders not to make this part of the agenda. They also argued that leaders should be thinking about *sustainable* growth, and therefore that it was vital that the Summit take environmental issues into consideration.

Delivering the right message

As the roundtable drew to a close, participants returned to the opening discussion regarding the fragility of the current global economic situation and in particular the widespread sense of global pessimism, and hence the need for the G-20 leaders' meeting to deliver something that could help restore international confidence. If the London Summit proved unable to do this, they felt, this would be another blow for the world economy. It would also be destructive of the credibility of the G-20 itself. In particular, several participants worried that the G-20 could not afford a 'dud' meeting if it wanted to secure its place in a new structure of global governance.

To this end, it was felt that the nature of the final communiqué of the London Summit would be very important. It would have to be crafted in such a way that it reached beyond the usual platitudes associated with such documents to offer both something of substance and a vision of real change. Participants at the roundtable felt that if the Summit could deliver a genuine Grand Bargain which combined some measurable policy commitments along with the kind of symbolic change that announced a fundamental change in the way the world economy operates, this could have a very positive effect on confidence. At the same time, however, they recognised the scale of the challenge the Summit faced in delivering along these lines.

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[8] Details on the Copenhagen Summit are available at http://en.cop15.dk/.

About the Author

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