REINVENT THE G-20

EXPERT VIEW

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This weekend, the heads of governments of the major economies of the world, the Group of Twenty (G-20), will gather in Antalya, Turkey, for their annual summit. The G-20 has 10 members from the industrialized world and 10 members from the developing world. The former include Australia, Canada, France, Germany, Italy, Japan, the US and UK (excluding Australia, the richest nations that constituted the original G-7) plus Russia and the European Union. The latter include Argentina, Brazil, China, India, Indonesia, South Korea, Mexico, Saudi Arabia, South Africa and Turkey. These 20 countries account for 85% of the world income, 65% of the world population and 80% of the world trade.

The G-20 was established in 1999, at the initiative of the G-7, as a more broad-based international forum. It was conceived as a meeting space with finance ministers and central bank governors from other countries, which might be useful, even necessary, in a world economy characterized by increasing openness, interdependence and integration. But G-7 retained its primacy. The G-20 was a supportive subsidiary. At the time, it would have been impossible to anticipate the transformation that came about less than a decade later.

The financial crisis in the US, in late 2008, spread through contagion across the world. Its transmission to the real sectors of economies was also rapid as it led to a sharp contraction in output and employment. The downturn moved quickly into a recession. In mid-November 2008, George W. Bush, nearing the end of his term in office, organized a G-20 Summit in Washington, D.C., inviting heads of governments to discuss the possibilities of a coordinated response to the global economic crisis. The contraction in world trade was far greater than the contraction in world output. Beggar-thy-neighbour policies, reminiscent of the 1930s, would have made it worse.

In retrospect, there can be little doubt that such an outcome was pre-empted, in large part, by counter-cyclical macroeconomic policies that were an integral part of strong national action and some international coordination following the G-20 Summit. The fiscal stimulus and the monetary easing across countries were an integral part of the expansionary, counter-cyclical, macro policies in both industrialized and developing countries. This was reinforced by an international effort, through the G-20, to coordinate macroeconomic policies across countries. It would seem that the G-20 began life on a high note.

Indeed, the next two years were a golden age for the G-20, when it had biannual summits for heads of government: London in April 2009, Pittsburgh in September 2009, Toronto in June 2010, and Seoul in November 2010. The Pittsburgh summit decided, in effect, to replace the G-7 with the G-20. The counter-cyclical policies, in the form of fiscal stimulus and monetary easing, and the international coordination of macro policies were both sustained. In the absence of such collective international action, the consequences of the financial crisis, and the great recession that followed in its aftermath, would have been distinctly worse. The G-20 appeared larger than life. It was too good to last.

The message from the G-20 summit at Seoul, in November 2010, was growth-friendly fiscal consolidation. It was a return to orthodoxy through the back door. Slowly but surely, apart from a few exceptions (the US and Japan), the stimulus came to an end in industrialized nations, transition economies and developing countries. There were no further cuts in interest rates or easing of credit, just as there were no more cuts in tax rates or increases in government expenditure. In fact, monetary tightening and fiscal retrenchment began almost everywhere.

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This change in policy stance was clearly premature. The consequences of a return to orthodox macroeconomics were only to be expected. Indeed, recovery in the world economy is slow, uneven and fragile. And the prospects remain uncertain.

In the industrialized countries, the US and Japan are the exceptions. There is some recovery in output but not as much in employment. This is attributable essentially to counter-cyclical macroeconomic policies in both countries where monetary easing has continued and there is no fiscal retrenchment. In the European Union countries, not just economies in crisis, but also countries such as Germany, the UK and France, decisions to sharply reduce fiscal deficits have been implemented. The solution might turn out to be worse than the problem. Of course, some market economies in southern Europe and some transition economies in eastern Europe continue to be in deep trouble. The social costs of adjustment programmes dictated by the EU and the International Monetary Fund, particularly in Greece, are alarming; it is simply not sustainable in terms of democratic politics.

Most large developing countries—the emerging markets which constitute the other half of the G-20—that had fared distinctly better than industrialized countries and transition economies in the aftermath of the crisis, have experienced a distinct slowdown in growth. For China, the slow recovery in the US and the persistent recession in the EU is an overwhelmingly important underlying factor as exports to these markets were a critical driver of its growth.

But the slowdown elsewhere in emerging markets is significantly attributable to their own mistakes. Macroeconomic policies are back to being pro-cyclical. High interest rates have stifled private investment, while attempts to reduce fiscal deficits have squeezed public investment and curbed domestic demand, which have dampened growth. Strong exchange rates to sustain portfolio investment inflows as a means of financing persistent current account deficits have affected export performance adversely so that dependence on these inflows has become even greater. India is an almost perfect example of this story. Given this reality, it is no surprise that the impending announcement of a phased withdrawal of quantitative easing in the US is a source of sleepless nights for governments and central banks in these countries.

It would be reasonable to ask: what has the G-20 been doing for the past five years about the persistent Great Recession in the world economy? The simple, even if harsh, answer is that it has been asleep at the wheel. And its focus has been on form rather than substance.

The annual G-20 summits, which bring together heads of governments, are now established practice. The venues were Cannes, France, in 2011; Los Cabos, Mexico, in 2012; Saint Petersburg, Russia, in 2013; and Brisbane, Australia, in 2014. From Antalya, Turkey, this weekend, the location moves to China in 2016, Germany in 2017 and India in 2018. The G-20 rotates its presidents every year, much like the EU. India is slated for the presidency in 2018, when Narendra Modi hopes to play host to world leaders.

There is an attempt to expand geographical outreach. The permanent invitees to G-20 summits include: country-groups such as the African Union (AU) and Association of Southeast Asian Nations (Asean); international organizations such as the United Nations (UN), World Bank (WB), IMF, World Trade Organization (WTO) and International Labour Office (ILO); institutions such as Financial Stability Board (FSB) and the Organisation for Economic Cooperation and Development (OECD); and even a solitary country, Spain.

There is an effort to stretch subject jurisdiction. The ministerial meetings of the G-20 are no longer limited to finance ministers but extend to foreign ministers, trade ministers, labour ministers and even agriculture ministers. The discussion themes in summits also move from year to year.

It would seem that the G-20 is building an extensive superstructure for its activities at the expense of its core base. The objectives are unclear. The agenda is diffused. The focus is missing. Sigmund Freud might have described it as hyper-activity.

The time has come for some introspection on the part of G-20 leaders. The formation must engage in a critical evaluation of its recent past and carve out its future role. There are some obvious problems that must be resolved through suitable correctives.

First, the G-20 is characterized by a democratic deficit similar to what exists in most international institutions: the veto for permanent members of the Security Council in the UN, the principle of one-dollar-one-vote in the IMF and the WB, or decision making behind closed doors of the WTO green room despite the principle of one-country-one-vote. The G-20 is neither representative nor consultative. It is clearly not representative with a membership of 20 countries in a world of 196 countries. It is not consultative because it has no institutional means of consulting non-member countries.

Second, there is a mismatch between the mandate it wants and the jurisdiction it has. In the process, it might erode the effectiveness and relevance of the existing international institutions that are not strong enough to perform their roles. Foreign ministers should meet at the UN, trade ministers should meet at the WTO, labour ministers should meet at the ILO. G-20 heads of governments should use their collective thinking and authority to push for decisions, through their ministers, but in the concerned institutions.

Third, with its expanding agenda, the G-20 runs the risk of becoming much like an overloaded elevator that is neither functional not safe. And yet another talking shop serves little purpose in a world where the solution to so many pressing problems lies in international collective action.

The conclusions that follow are simple. The G-20 needs a clear focus on international coordination of macroeconomic policies and regulation of international financial markets, which makes its difficult task almost impossible. At the same time, the G-20 provides an institutionalized meeting space to discuss the voids in institutional arrangements sorely needed for global economic governance. Its political will could then provide the basis for conceptualizing and creating the missing institutions.

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