



G20, Not G7*

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A striking outcome of the global financial crisis has been the substitution of the G7 for the G20 as the key forum for international coordination. There is something like a paradox in such substitution since the agenda of G20 meetings has so far focused on financial regulation issues, which are of more concern for G7 than for non-G7 G20 countries. Indeed, it has so far been much more specific on financial regulation than on trade, global imbalances or the reform of Bretton Woods institutions, where the views of non-G7 G20 countries are highly needed.

One obvious reason for focusing on financial issues is the urgency to tackle the financial crisis itself and to fill the holes of regulation and supervision in order for such crisis not to happen again. However, another reason is that there is much more consensus on the financial agenda than on other global issues. Indeed, the G20 seems to have reached an agreement on three general principles (i) fill the loopholes in financial regulation and supervision, (ii) correct the pro-cyclicality of capital requirements and accounting rules, and (iii) provide implicit public insurance to “too-big-to-fail” institutions but make them at least partially internalize the potential cost for the taxpayer. True, the technicalities of such reforms are still lively debated, but there is a common view on the principles. This is not the case of other issues that are, or could be on G20's agenda: trade, global imbalances and global governance.

There are three main reasons why the G20 may find it difficult to produce detailed statements on these three issues: lack of consensus, lack of consistent views, and interconnectedness of the three topics.

The *lack of consensus* is especially striking in the case of global imbalances. There is no consensus among economists on the causes of global imbalances, neither on their role in the crisis. Some claim that the excess of savings over falling investments in East Asia is one important reason why long-term interest rates were so low for so long, encouraging leverage, pushing house prices up and giving incentives to asset managers to seek high-yield products. Some object that while US macroeconomic conditions were indeed conducive to the crisis, they were fundamentally determined by domestic developments. Furthermore, they observe that the US current-account deficit as a proportion of world GDP actually diminished from 2005 to 2008. There is, however, a common understanding that global imbalances should be fixed, for different reasons. One of them – not the least – is that they may constitute an obstacle to a sustained recovery of global growth in a context where falling US consumption needs to be replaced.

Although there seems to be some agreement that global imbalances need to be reduced, the 'how' question is much debated, which may explain the reluctance of the G20 to make clear statements. In particular, it is difficult to imagine how a double rebalancing of growth, from the public to the private sector and from deficit to surplus countries, could be achieved without significant real exchange-rate adjustments. The US advocates a further appreciation of the renminbi, but Chinese experts are puzzled by the fact that the 2005 decision to move to gradual appreciation was in fact followed by a rise in the country's external surplus. Furthermore, China fears that an appreciation of the renminbi could trigger a massive capital loss on its accumulated reserves in US dollars. At the same time, a gradual appreciation of the renminbi may not be advisable either since it could trigger speculative capital inflows into China. All in all, there should be a combination of, on the one hand, monetary reforms (currency convertibility, making the exchange rate more flexible, liberalizing capital flows) and, on the other hand, structural ones (allowing banks to extend loans according to borrower rather than political criteria, accelerating the provision of safety nets, discouraging excess capacity, cutting export subsidies). The G20 can hardly go as far as designing the complete growth strategy for China.

The *lack of consistent views* is especially striking in the case of trade. On the one hand, trade has been one of the key drivers of the crisis propagation to emerging countries. Consistently, the G20 has been very keen in repeating that protectionism should be avoided and the Doha round concluded as soon as possible. On the other hand, many G20 members, especially emerging ones, have been raising new protectionist measures during the crisis. And G7 countries may not be sufficiently aware of the fact that giving in to the domestic protectionist temptation in the face of growing unemployment will not encourage East-Asian countries to remove existing distortions in favor of their tradable sectors, in terms of distortionary taxation and/or undervalued currencies.

This brings us to the last difficulty, which comes from *interconnectedness* between trade, imbalances and the reform of global governance. For instance, a key driver of global imbalances has been the accumulation of foreign-exchange reserves by some emerging countries, particularly in East Asia. One rationale for this is self-insurance against balance-of-payment crises - a major motivating factor for many small and medium-size countries, especially in Asia where trust in the International Monetary Fund was severely undermined by the experience of the late 1990s. The softer and more flexible conditionality recently adopted by the IMF in Central and Eastern Europe is widely regarded as resulting from a change in the IMF's approach to crises, more in line with a role of the global insurer. But it can also be interpreted - and is indeed interpreted by some - as resulting from Europe having a greater stake than Asia in the governance of the Fund. Hence, this is unlikely to convince Asian countries to return to the Fund (and give up their self-insurance policies)

unless IMF governance undergoes in-depth reform. This is where macroeconomic reform meets reform of the Bretton Woods institutions.

Unfortunately, the reform of the IMF will take time. The G20 has asked for a new revision of IMF quotas by January 2011, but has not made precise suggestions neither on the way this should be achieved, nor on other IMF governance issues such as the majority threshold (that presently gives the US a veto right) or the respective roles of the Board and of the management of the Fund. There is a risk that global governance issues lag behind, hindering progress on other major economic issues such as sustainable growth recovery.

*This paper draws on the discussion among participants in the Bruegel-CEPII-ICRIER conference on 'International Cooperation in Times of Global Crisis: Views from G20 countries' held in New Delhi on 14-15 September, 2009, summarized in Bénassy-Quéré, A., Kumar, R. and J. Pisani-Ferry (2009).

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