International conference
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International Cooperation in Times of Global Crisis: Views from G20 countries

Highlights from the conference

Introductory remarks

Global growth faces both short and longer term challenges. The G20 initiatives have had a dominant focus on short-term actions, whereas sustained growth requires that structural reforms become the centre element of the agenda both for advanced and emerging economies. G20 members have emphasised with different degrees of success growth driving fundamentals such as macroeconomic stability, infrastructure development, trade opening and innovation, and job creation has moved to the centre stage of the discussions. Nevertheless, disparities have increased between the advanced and emerging groups within the G20 countries (as well as beyond). Reducing inequalities favours growth. Policies that reduce inequalities should therefore be an integral and explicit component of the G20 framework for a sustainable growth.
Nevertheless, the expectations for the G20 are nowadays lower than ever before. Four years ago G20 summits were initiated in Washington to save the world economy. Three years ago in Pittsburgh, G20 was designated the "premier forum for international economic cooperation". Today, it is hard to escape the impression that G20 has entered diminishing returns. Under current conditions, it will be a challenge for Russia to take over the presidency. Is the impression correct? Has the G20 indeed failed to deliver what was expected from it?

Lessons from history show that good intentions are not enough. We are still in dangerous times. Perhaps they are even more politically dangerous than in 2008, since domestic politics and diverging agendas are pulling leaders apart. It is therefore high time to assess and frankly discuss the future and how to revive the G20. These are the challenges facing the Russian presidency in 2013.

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Session 1. A lost decade for the global economy?

Are we facing a new lost decade with sluggish growth rates and high indebtedness? Or are we in the midst of a lost decade already? While the panellists agreed on that the advanced economies are indeed facing a lost decade, views on the situation in emerging and developing economies are more diverse. But fast-growing emerging economies cannot compensate at a global level for the sluggish recovery in the remaining countries.

The overall growth recovery from this recession has not been weaker than during previous experiences but there is a stark contrast between below-average recovery in the advanced economies, where output is currently below the pre-crisis trend and above-average recoveries in emerging countries. One of the reasons why these countries are doing better than pre-crisis trends does stem from the fact that their respective growth trends include previous crisis in Asia and Latin America. But due to a high interconnection in between the countries, they a nonetheless not protected against spillover effects. The turmoil in one region will thus affect the economic activity in others. This is directly reflected in the decrease in euro area imports, but also indirectly in intra-region trade in other parts of the world.

The experience from several emerging markets shows that it takes time to get out of debt. Debt weighs heavily on growth in the short run. The situation could nevertheless have been worse without the accommodative monetary policy put in place by several countries, and credits have hold up better during this recession than previously. Deleveraging is painful since governments, households and non-financial companies have all accumulated high levels of debt and not only isolated regions are affected. Political disagreements and different agendas further complicate the deleveraging process. Beyond adjustment three ways come to mind as regards possible avenues to reduce debt levels: fiscal adjustment, default, and inflation. We know little about the distributional consequences of these potential options.

A lost decade is not only limited to macroeconomic stagnation, but it is also about a lack in structural policy action. A transformation of the economic system through reforms is likely to have a significant negative impact on the short-term outcome. The G20 has the possibility to create a good environment for structural coordination. The lost decade in Japan that took place in the 1990s was the result of the burst of an outdated system, and not a cyclical phenomenon. It came after a period of rapid growth supported by the Japanese economic system. This system has nevertheless become outdated, given that the underlying conditions have changed. Technological, globalisation demographic changes have taken place in the country that modified the general structure. The country's recover was foremost helped by the external demand.

The current crisis however offers possibilities to emerging markets such as Brazil or Russia. Maintaining a financial stability and implementing structural reforms enhances risk management and productivity. High energy prices have allowed producer countries such as Russia to build up buffers and to act countercyclical against market volatility.

Looking ahead, the recovery is expected to remain fairly sluggish, mostly due to the roll-back of large fiscal deficits, the deleveraging of household and non-financial corporates, and the capital build-up of banks. For some countries, it will indeed be a lost decade (or even a second decade as in the case of Japan). For others, the strength of the recovery will be a function of fiscal and financial policies. The new economic system should be growth friendly, distortion free, sustainable, incentive compatible and globally consistent.

Session 2. How many international lenders of last resort?

Since the start of the euro area crisis, there has been an extension of the notion of lenders of last resort to governments. A number of overlapping schemes exists, on both a regional and global level. The crisis and recent years' turmoil on the financial markets have led countries to implement diverse forms of macroprudential measures and capital controls, and a fragmentation in between European banks. Due to these obstacles on both the domestic and global level, a first-best solution with only one international lender of last resort does not seem to be within reach. The conclusion of the panellists was therefore that we have to settle for a second-best option with several international lenders co-operating at a global level, with one main international lender being under the control of the Federal Reserve.

Lenders of last resort, providing funding when nobody else willing to lend, help avoid liquidity crises. Under the new regime that emerged during the global financial crisis, the Federal Reserve is a provider of global liquidity, and it de facto sits at the centre of a network of bilateral swap agreements. Although the European Central Bank intervenes at a regional level, the Fed alone does today play the role of an international lender of last resort for global liquidity. Given that the IMF resources are too limited to cover the demand for international liquidity, it cannot play this role in full.

However, the role of the US dollar will likely decline over the next decades due to the decline of the fiscal backing of the reserve currency and the US share of world GDP. The role of the emerging markets will continue to increase. We are therefore moving towards a more multipolar world. In order to smoothen the transition process, the system of swap lines should be formalised according to some of the panellists, but not institutionalised according to others. In the case of the ECB, swap lines were decided on very specific circumstances and should remain exceptional as stressed by one of the panellist.

Another argument in favour of international lenders of last resort is the danger of spill over effects and contagion, and it is the example of where the G20 could play a crucial role. *"If spreads are made in Athens and in Berlin, there is not really much Madrid or Rome can do about it."*

The operations put in place by the ECB are other means to provide liquidity in times of need. The OMT (Outright Monetary Transaction) and ESM (European Stability Mechanism) schemes are nonetheless crisis management tools, only temporary substitutes for a fiscal solution and should be institutionalised. The two instruments should not however be considered as lending of last resort. The purpose of the OMT is to avoid the fragmentation taking place between European countries. In the future, banking unions are the alternative in Europe to overcome further fragmentation. In addition, the conditionality behind the ESM contradicts the basic logic behind a lender of last resort.

Systemic crises increase the incentives for centralisation. In order to achieve a broad-based prevention and protection, there should be a pre-scanning process with country prequalification and triggers based on excessive EMBI (Emerging Market Bond Index) jumps.

There is no incentive to come up with alternative mechanisms as long as the countries feel protected by a lender. Today resources are not at the right place. We will therefore still need the contributions of the Federal Reserve. It is important however not to make the lenders of last resort a permanent feature of the financial architecture.

Session 3. From debt to equity – The changing patterns of international financing

It is no secret that many sovereigns are in need of a deleveraging. While sovereigns show a large financing need, corporates are unusually cash rich at the moment. The total estimated amount of cash withhold in the EMEA region is equivalent to the total financial needs between now and 2015. The problem does therefore not stem from a lack of funds, but from good investment opportunities. Many Latin American countries have switched US dollar denominated bonds in favour of local currency domestic bonds over the past decade, and there has been a larger appetite for equity than for bonds. The opposite trends can be observed in several advanced economies as well as in South Korea.

Sovereigns in both advanced and emerging economies have high levels of financing needs, but these are significantly different in magnitude. Between 1995 and 2010, international assets (defined as the foreign holdings of residents) rose from 50% of global GDP in 1995 to 150% of global GDP in 2010. In 2012, total sovereign refinancing needs amount to approximately USD 13 trillion yearly, which corresponds to 17% of world GDP. The total issuance amount of corporates however is much lower, which shows the global imbalances in terms of financing needs.

Corporates on the other hand are unusually cash-rich at the moment. Since end-2009, the amount they have internally accumulated is significantly higher than the amount they have issued. A company may choose not to be AAA rated, even though a better grade is possible due to costs associated to the balance sheet. The curve distribution in the US over corporate ratings shows that the bulk of the corporate issuance is several notches below AAA. This does not mean that the companies cannot be AAA, but rather that they optimise the rating which is adequate given the features of their balance sheets. Thus not only AAA corporates are cash rich. This means that corporates around the world are actually withholding cash without investing it. The total estimated amount of cash withhold in the EMEA region is equivalent to the total financial needs between now and 2015. The problem is therefore not a lack of funds, but rather the absence of good investment opportunities. Despite huge funding needs, sovereigns are unlikely on a global level to crowd out the corporate sector on bond markets. This does, nevertheless, not exclude a fraction of corporates from being hurt.

Sovereign and private deleveraging is a must. The questions is how much and how fast. We can expect a quicker deleveraging in the periphery of the euro area due to the financial assistance programmes.

What may be needed is an internationally supported trade finance mechanism. One of the first forms of financing to be hit during crisis and sudden stop is trade financing since it is a form of financing that is easy to stop and that is constantly is rolled over. Regional and global contagion in Latin America was less pronounced through the finance channel than through the trade channel.

During the 2000s, the emerging market economies witnessed declining debt ratios, compensated by FDI (Foreign Direct Investment) inflows and equity investments. Commercial banks have been retrenching from investment. Their general model is going more towards liquidity intermediation and short-term financing. If comparing the total composition of financing in advanced emerging markets with non-financial centres advanced economies (Australia, Canada, New Zealand, Norway and Sweden), debt financing has been decreasing over time, both in levels and as a share of GDP. Many emerging markets, and in particular Latin American countries, have instead deleveraged their fixed income debt. The peripheral advanced economies on the other hand, have not only increased the volume of foreign financing, but also the share of debt financing.

What are the underlying explanations for these opposite trends? In the case of Latin America, there has been a de-dollarization and a domestication process over the last years. Many Latin American countries have symmetrically increased domestic debt and decreased external debt. Over the past ten years, undertook policies of replacing dollar and foreign currency denominated debt by local currency denominated domestic debt. They build local bond markets to replace the unsafe, dollar denominated debt.

Turning the focus over to Asia, regional reliance on the US dollar has decreased since the full opening of domestic equity market following the 1997 crisis. During the past decade, the EU surpassed the US as the largest funding source in South Korea. The current turmoil in the euro area has nevertheless reduced this share. Asian banks have also increased their role in the region, notably in trade finance that previously was largely provided by EU banks. Foreign capital is searching for a substitute for euro zone treasury bonds. Several sovereign wealth funds have turned to Korea bonds, a phenomenon not observed a few years ago. On a general note, the crisis has led to a change in the weight of stocks and loans in many Asian economies. While stocks and loans are decreasing, bonds are becoming increasingly important, especially in South Korea.

Session 4. Energy and natural resources in a globalised economy

The general opinion that emerged during the session is that we are moving towards a world where single fuels such as gas and coal are less important. Renewable energy sources will instead grow faster than any other sources of energy and their contribution to total consumption will increase. The demand for energy will continue to increase over the coming two decades. In 2030, the world is projected to need 40% more energy than in 2010.

The global energy mix is changing. The contribution of renewable energy sources to growth in energy consumption will be more than the contribution of oil. Renewables will contribute 34% to total growth. They do on the other hand grow from a very low level and the need for coal and other fossil fuels will nevertheless remain. The result is a more equally redistributed contribution in between different energy sources. What drives energy demand is the growth in per capita income, and a majority of total growth comes from non-OECD countries. The energy demand from emerging market economies is projected to increase during the coming years. Around 96% of total increment between 2010 and 2030 will come from this set of countries. We are moving towards much more complex and interconnected energy systems. The energy markets are probably the most interconnected global market besides the financial sector. These growing complexities have led to increased risks and more interference effects.

In 2008, there was a dramatic decline in energy consumption due to lower economic growth, which had a significant impact on the improvement in efficiency and the timing of new investment projects. Governments got increasingly concerned about their long-term energy security and therefore less preoccupied with the environmental implication of their continuous reliance on fossil fuels since the key goal was to get their energy kick-started again so the cheapest fuel is the preference.

The commodity price booms during the past decade offer both great possibilities but also challenges to natural resource rich countries. Several new gas and oil producers have appeared, in particular in Latin America and Africa. Russia is the example where the share of oil and gas revenues in the total government revenues is very high, which in turn makes it more vulnerable to external shocks.

There is evidence that the 2000s price boom has also been followed by large public investment programs (sometimes financed by collateralized loans). One of the speakers raised the question that we may be in the presence of a developing countries debt crisis in the making.

Session 5. Can the G20 escape diminishing returns?

While the G20 is perceived to have been effective in managing the crisis in 2008-2009, its efficiency in coordinating policies thereafter has been less evident. During the discussion, two different approaches emerged. While some of the panellists agreed with the general consensus on the entity's current ineffectiveness, others underlined that we may have initially put the bar too high and that we are merely going through a few bad years.

Numbers show that the attendance of the meeting has been decreasing since the Washington Summit in November 2008. A critical element to make the G20 achieve their goals is that the leaders actually attend the meetings.

Since both the surveillance and technical instruments are there to coordinate macroeconomic policies, the problem comes from a lack of political leadership. There is a feeling of disappointment that since 2010, the G20 has not been able to fulfil the need for peer pressure and guidance in turbulent times. The size of the group and the countries' heterogeneity also reduce effectiveness since it gathers economies with different policy agendas. While some said we are not better off than five years ago, others were of the opinion that the G20 has done relatively well compared with previous situations. One participant pointed out that the G20 will not be able to fix all the current problems and imbalances.

Nonetheless, the power in between the countries needs to be redistributed in order to grant higher importance to emerging market economies. China, India and other emerging markets are increasing their share in world GDP and should thus have a greater say in the negotiations. A proposal to reform the IMF quotas and governance was already agreed on during the G20 meeting in Gyeongju in October 2010, and the package of reforms was approved by the IMF Board of Governors in December 2010.

A clear recommendation from several of the participants was not to make statements and commitments that cannot be delivered, in order to preserve credibility of the entity. The outlined actions should separately be of a size that easily can be implemented. Moreover, make the concluding statements easily accessible for the public with a clear message on the future objectives. There is an urge to find a remedy for the current mismatch between the agenda and declarations of the G20 and the concerns of the people, the latter being oriented towards enhancing employment and equity.

What is to be expected from the G20 in the future? The entity's advantage is to bring together both advanced and emerging economies – which offers greater possibilities on a global level compared with the G7and G8. A general conclusion from the conference was that the G20 has been able to kick-start agendas, but the follow-up has been poor. The exception was during the crisis when the leaders achieved cross-country coordination. Taken together, this raises the question of how to better connect the G20 with the work of international organisations.

Session 6. A global level playing field?

With declining domestic demand due to sever austerity measures, external trade has become a major factor to boost growth. How can the G20 contribute to level the global playing field? It can change the landscape of the actors, the forms that trade takes and the change in the nature of obstacles to trade. With tariffs now being fairly harmonised between countries, the main obstacles remain the national non-tariff barriers which keep gaining in size.

G20 is the forum to find the political balance and remedy for these developments. The trade agenda of the G20 should be restricted to trade-investment issues, monitoring trade protection measures, setting the agenda of trade negotiations, green goods and to supervise the implementation.

This is not the time for big agendas, but changes should be done in small portions in order to increase the probability of achieving consensus. The future legitimacy of the G20 entity is a function on its ability to deliver meaningful progress on the core agenda, i.e. economic growth and financial stability; including international trade. The G20 should also further involve the business community in its decisions.

Recent years' discussions on currency manipulation should not be considered a trade-related issue, but rather a matter to be addressed by the IMF. The WTO cannot intervene until the Fund establishes a breach and an explicit manipulation.

From a country-specific view, South Africa seems more enthusiastic to the BRICS initiative than to the G20, mainly due to a feeling that the playing field will not be levelled. Regional trade liberalisation on the other hand has been much more welcomed.

Looking ahead, international trade flows are going to be largely reshaped. Projections show that in 2050, the share of financial services in world consumption will increase, while the share of food will decrease. In 20 years, China will surpass EU as the major food producer. Trade flows of food and energy will reverse between the US and Asia. These changing patterns mean that trade (and especially export) liberalisation is today needed more than ever before.