Global Economy and Development
at BROOKINGS

Regaining Momentum for G-20 Summits

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The Brookings Institution, 1775 Massachusetts Ave, NW, Washington, DC

On October 21, Global Economy and Development at Brookings and the Ministry of Foreign Affairs and Trade (MOFAT) of the Republic of Korea co-hosted a conference to consider the challenges, opportunities and context for regaining momentum for the Group of Twenty (G-20) summits.

The global economic crisis has entered a new and more acute phase with growth lagging in the United States and financial crises in Europe threatening to spillover into the global economy. In the midst of this, the global mechanisms for dealing with these challenges have come under scrutiny. Brookings and MOFAT brought together international experts and policymakers to discuss these issues and how they will affect the G-20 moving forward. The conference's agenda was broken into four sessions:

- **Current Critical Issues in the Global Economy**
- **Responses to the Current Phase of the Crisis**
- **The G-20 and the International Institutional System**
- **The G-20 Agenda: From Cannes to Mexico and Beyond**

This report is a summary of these topics and the discussion that followed.

Current Critical Issues in the Global Economy

The Global Outlook

At present the world economy is on the precipice of a crisis; the forecast for the global economic outlook has been revised to an anticipated slowdown in growth of only 4 percent in the short to medium term.

There exist widespread imbalances in the global economy. Debt and uncontrollable current account deficits are looming in the United States and the European Union, while current account surpluses, large foreign exchange reserves and full capacity utilization are present in some emerging markets and Asian countries. Concomitant to this has been asymmetric growth in world economies over the last two decades; this is manifest in a trend of decoupling growth between advanced and emerging markets. The same cannot be said for cyclical decoupling, there remains a high level of global interdependence and inter-correlation between economic slowdowns in advanced markets and in emerging and developing countries. These systemic imbalances have implications for the structural and policy-based approaches of global organizations like the G-20.

The U.S. Economic Trajectory

The U.S. economy, in terms of output, has been only slowly growing for a little more than two years. As a result, the unemployment rate has fallen only 0.5 percent. Unfortunately, the proportion of the adult population that holds a job – a more crucial indicator of labor market health – has declined half a percentage point during the same period and is at its lowest rate in 40 years. The slow pace of expansion and slow rate of reduction in unemployment, which surprised many forecasters, reflects two key facts regarding the business cycle: the economic decline of 2008-09 was worse than economic statistics indicated at the time, and the recovery has not been as steep on the upside as it was in the drop (that is, it has been more L-shaped).

The deflation in the U.S. housing price bubble has had a substantial impact on the net worth of middle and lower income households. This translates into cautionary spending and increased savings. Furthermore, in contrast to the past, the U.S. economy has not benefited from a drop in interest rates, which makes home buying or building more attractive. At the same time, corporate profit, as a share of national income, and wealth among higher income households through stock and bond holdings has increased. There is a disparity between the household and public sector, which are excessively leveraged, and the corporate sector, which is sitting on a large amount of liquidity. Unfortunately, corporate spending is not nearly high enough to compensate for household cuts in spending to equilibrate their debt and government consolidation. The low level of spending and investment by the corporate sector can be linked to a fear of insufficient demand. Therefore I the United States' economic dilemma is how to stimulate demand in the short term while continuing to pursue medium term fiscal consolidation.

The current consensus forecast for the U.S. economy is for continued growth, albeit slowly. Slow growth could leave the U.S. economy vulnerable to large shocks and change its growth trajectory towards decline.

The Situation in Europe

The current situation facing Europe is "likely worse than has been made out in much of the press." The lingering effects of the 2008-09 global financial crisis have been compounded by the sovereign debt crisis, which now poses the most substantial risk to the short-term outlook for the global economy.

The EU crisis was fueled by unsustainable economic policies driven by low interest rates, unsustainable fiscal policies, and an incomplete economic union. The latter issue has been particularly catalytic; the incomplete architecture of the eurozone area has provided an unprecedented scope for contagion by exposing members of the monetary union to the spillovers of economic policies of other members.

While there is a general recognition of the short-term measures necessary to address the problem – specifically a reduction of Greece's debt, recapitalization of vulnerable banks and the creation of a firewall mechanism for preventing further collapse – there is widespread disagreement among member states on fundamental economic issues, as well as over who should bear the financial burden. Unless resolved, these issues threaten to destabilize not only the eurozone, but potentially the entire global economic system.

The Asian Perspective

Asia has largely managed to escape from the recent twin financial crises due to lessons learned during the 1997 Asian Financial Crisis. Korea, for example, has continued to experience growth, partly due to the improvements in its liquidity since the lessons learned in 1997, including a current account surplus, accumulation of foreign exchange reserves, currency swap lines with China, Japan and the U.S., and official current liquidity of over $400 billion.

Despite the strong performance of many emerging economies in Asia, there has also been a reluctance to increase contributions to international financial institutions. This stems both from lingering resentment of the detrimental impact of IMF policy prescriptions during the Asian financial crisis, and displeasure with the current governing structure and its representational imbalance. These factors have led to debate regarding the need for an Asian Monetary Fund to supplement the work of the IMF to both alleviate and attend to concerns, representational and otherwise, in the region.

Critical Issues Going Forward

Going forward it is important, regardless of the perspective, to address the question of whether these systemic and domestic imbalances are a cause or a symptom of the economic challenges in the global system. From an economic perspective, it may also be necessary to place less emphasis on efficiency and greater emphasis on robustness in the system. During the conversation, an aeronautical engineering analogy was drawn: planes are not constructed to be efficient; they are constructed to be robust and weather the worst storm. Why should the global economy be any different?

Responses to the Current Phase of the Crisis

The Need for a Comprehensive Strategy

Presently, Europe is "the first, second, third and fourth problem in the global economic agenda." In light of the G-20's origins in crisis management, the EU situation presents a test of the G-20's ability to respond to crises in the world economic system.

There is a pressing need for a comprehensive and credible strategy on the part of Europeans to address the current situation.

Four critical elements that need to be countenanced as a part of any effective response include:

- *Dealing with financial crisis countries*. Each of the crisis countries is different, but all need to stabilize their economies and finances;
- *Creating a firewall through the Financial Stability Board and European Central Bank*. This is a stronger concept than ring-fencing, and involves strong measures to contain the problem and prevent contagion;
- *Ensuring solvency of the banking and financial system*. The question of whether the institutions can absorb large losses and remain solvent must be addressed, with triaging of those institutions that are troubled;
- *Addressing existential questions about the European project*. While the incomplete institutional architecture has been a causal factor in the current crisis, restructuring European economic governance in the middle term should not cloud the immediate crisis management process. To do so would be akin to “attending to a leaking roof in the middle of a hurricane.”

If these steps are taken, it could signal credibility in European actions and could stabilize expectations, setting the eurozone on a healthy path. However, to be taken seriously by markets it will be important to ensure any initiative is meaningful, consistent and implementable, and instills confidence.

Obstacles to Resolution – Rollback of the Quota Backstops?
Unfortunately, the focus on comprehensive solutions to the crisis is currently being accompanied by another consideration: the push from some European countries to reopen the 2010 IMF governance and quota agreement and rollback the new arrangements to backstop quotas.

The Communiqué of the G-20 Finance Ministers and Central Bank Governors that emerged from the Paris meeting in October contained two important sentences:

> “We committed that the IMF must have adequate resources to fulfill its systemic responsibilities and look forward to a discussion of this in Cannes. We call for the full implementation of the 2010 quota and governance reform of the IMF, *as agreed*.” [1] [Emphasis added]

Despite the fact that all G-20 countries already agreed to the quota and governance reforms, and subsequently endorsed their implementation in the Paris communiqué, a number of countries have sought to reopen the agreement and revise the arrangements. Most surprisingly, this issue remains on the table in many discussions on the eurozone crisis. Consideration of this proposal, however, is neither appropriate, nor procedurally feasible, as there does not exist the requisite consensus to reopen the agreement. Accordingly, it was suggested that the issue be framed not as a debate regarding IMF financing, but as a question of whether countries will fulfill their international obligations or not.

This debate has strong implications for the G-20’s role in the European crisis. If it continues, it will impact the G-20’s ability to present a strong united front at the summit and show they have reached agreement. This will result in the loss of an important opportunity to strive for a ‘London moment’ and build confidence in the institution,

The Role of the G-20
The European crisis illustrates some of the architectural and compositional problems that the G-20 has to grapple with. There is debate among the European members of the G-20 as to how the Group could be involved in the solution to the European problem; some embrace a role for the G-20, while others would like it at arm’s length. Despite its history in crisis management, the G-20 has not been directly mandated in any role in the current EU crisis for a number of reasons. In particular, the Europeans see the situation as a domestic or regional matter, and are not open to engaging in a forum outside the continent.

Nevertheless, one of the essential factors in any response to the eurozone situation will be generating sufficient liquidity to enable Europe and its finance institutions to contain the crisis. For the G-20, the key issue is not so much one of the European architecture, which is more of a regional, medium- to long-term problem, but rather one of whether members are willing to contribute resources. In order to ‘stop the drop’ in Europe, a large volume of resources will need to be marshaled, as the G-20 had helped to do during the 2008-09 crisis.

Non-European G-20 members will have to first articulate the limits of their assistance to Europe, prior to any commitment of resources. Unfortunately, there has been reluctance on the part of members to contribute. Nonetheless, there is a sense that the emerging economies are willing to provide lines of credit to the IMF, which can be made available to Europe, conditional on the Europeans offering a comprehensive strategy.

[1] Communiqué of Finance Ministers and Central Bank Governors of the G-20, Paris, France, October 14-15.

Engaging all G-20 members in the crisis response will require recognition that the situation in Europe is a global crisis that requires a broad solution and involvement from all stakeholders. Even Asia economies, which have recovered from the 2008-09 recession, will slow down, if growth is stunted in the U.S. and Europe. Considerations of strong, sustainable and balanced growth are therefore more important now than ever; current account rebalancing and more balanced demand growth can help to counterbalance the lagging demand in Europe and forthcoming fiscal stabilization envisaged by the European policymakers.

While these measures are necessary, and the urgency of the crisis is clear, the response to-date from both within Europe and the G-20 has been less than robust. Action must be taken with the utmost urgency, as the failure to reach, and implement, a credible response strategy in the coming weeks puts the eurozone on the verge of financial meltdown that would reverberate globally.

The G-20 and the International Institutional System

The composition of the international system is shifting to reflect the increasing level of global interdependence. Now more than ever, the G-20 needs to take advantage of its position and work within the international system. Many of the global challenges are now seen horizontally, as opposed to the vertical perspective of the past, and it is no longer feasible or preferable to deal with issues in isolation. The challenge is one of how to create a positive-sum relationship between the G-20 and the international institutions. In absence of this, and of a more cohesive, coherent interaction, there is a risk of issues becoming siloed.

The Institutional Nature of the G-20 Process
The G-20 has a number of comparative advantages in the international system. It better reflects an international structure than other mechanisms; it includes emerging and developing countries; its composition reflects the increasing interdependence and multi-polarity of the global economy; it has a flexible format not overly constrained by bureaucracy; and it allows for informal dialogue among members of different regions of the world.

The institutional structure of the G-20plays a very important role in its operations. Despite the fact that G-20 summits now take place only once a year, much occurs behind the scenes. In recent times, the U.N., OECD and ILO, among others, have enjoyed an increased role in the G-20processes. This institutional arrangement could provide an underpinning for a more effective global system.

The G-20 and the G-7/8
Initially it was thought that the G-20 would replace the G-7/8. However, the continuance of the G-7/8 has been an encumbrance on the G-20, a factor evident, in the issue of timing surrounding the Toronto Summits.

Clear, delineated roles and functions for the G-20 and G-7/8 have yet to be articulated. Thus the question remains as to whether the comparative advantages of each forum can be utilized, or whether the existence of both the G-20 and the G-7/8 make both weaker.

The G-20 and the International Financial Institutions (IFI)
Despite its evolution and growth over the past few years, the G-20 remains dependent on international financial institutions. The G-20 process is based on the strong international institutional structure of the IMF, and the high degree of technical support it provides. In particular, the IMF identifies large imbalances and establishes indicative guidelines. This surveillance and external monitoring is likely to remain important going forward, especially in the absence of a secretariat.

Despite this reliance, the G-20's relationship with IFIs is a symbiotic rather than asymmetric one. The G-20 is committed to strengthening the international financial architecture and ensuring adequate resources are available to the IMF, among others. It also has been effective in pushing the financial institutions to move with expediency on their existing agendas, contributing to global financial stability and growth.

The G-20 and the U.N.
The G-20 and the U.N. are often thought to conflict on the grounds of representativeness and priorities. However, the G-20 and the U.N., in fact, have a more symbiotic relationship than is readily apparent. Though positioned as the premier forum for international economic cooperation, the G-20 needs the U.N. The latter serves as a valuable mechanism to obtain the engagement of the other 172 States, whose cooperation and buy-in is vital in order for the G-20 to be fully effective.

Conversely, the G-20 can be of assistance to the U.N. through the issues it considers and addresses. To the extent that the G-20 can take up some of the big issues, reach consensus, and impart that to the U.N., it will provide a means of helping the U.N. itself remain effective and legitimate.

A Continued Contribution to the International System
In order to maintain a credible role for itself in the international system, the G-20 must collaborate with other institutions and capitalize on its comparative advantages.

In so doing, the G-20 can 'ACT' to contribute to progress in the international institutional order; that is, it can:
- **A**ccelerate the process (by prioritizing issues and engaging relevant institutions)
- **C**oordinate across the various international institutions on siloed issues
- **T**riage the plethora of international institutions in operation (addressing the sheer number of institutions dealing with any one issue)

The G-20 is a mechanism designed to enhance global institutions, not replace them. The key will be for the G-20 to find a way of delineating its role in the international system and take advantage of the potential for collaboration with other institutions to increase their effectiveness and generate global goods.

The Existential Questions

The Role for the G-20
The world is currently in the middle of an economic power transition. The U.S. no longer represents the key organizing element in the global economic system nor possesses the wherewithal to lead the international response to emerging challenges. Furthermore, the global governance architecture is asymmetric and heavily weighted towards historical power arrangements, which are becoming increasingly inapt. At the same time, rapidly rising powers and emerging markets are not stepping up to fill the gaps. Instead, the current situation can be classified as a 'G-Zero' world, where there is a vacuum of global leadership.

The question remains as to whether this is a role the G-20 is capable of filling. In 2009, it was hailed as having come up with coordinated solutions to a global crisis. While the G-20 has played an important role in the resolution of past crises, it has been criticized as having lost its coherence and sense of common purpose, instead becoming more of a talk shop.

In order to overcome these criticisms, the G-20 needs to be revitalized, and called on to serve as a global steering committee. To do this, however, it will be necessary to address the barriers to effectiveness that currently exist.

Legitimacy vs. Effectiveness
The G-20's legitimacy has been questioned on the basis of a lack of representativeness and informality of structure. However, both of these characteristics exist by design. The G-20 was not created to be universal, but rather to be efficient and effective. Similarly, its informal nature is one of its strengths, allowing the G-20 to act in a more swift and flexible manner. It was generally agreed that a focus, on representational rights and legitimacy issues would be to the detriment of the Group's core tasks. While effectiveness and legitimacy are not mutually exclusive, a stronger focus on the former in the current global climate could generate results that will have spillover effects in terms of increasing legitimacy and enhancing credibility.

Agenda Consolidation vs. Expansion
Though its origins, as well as its past successes, lie in crisis management, the nature of the G-20 has been evolving. Over time, an increasing number of issues have come under the purview of the G-20 umbrella. At present, the Group faces the question of whether to continue an expansionary agenda or whether to consolidate and refocus on the core group of economic considerations it was formed to address.

The wide differences of opinion among participants as to the future of the G-20's agenda reflect the complexity and controversy of the issue. On the one hand, it was argued that focusing exclusively on a narrow financial agenda would be an opportunity missed, and there is great value, and even an obligation, in taking up the hybrid economic issues like climate change, development, nuclear security, and food security. On the other hand, there was suggestion that expansion is wholly inappropriate, and what is necessary is a reversion to a narrow focus on crisis management and financial considerations.

A strong case was made that it is possible to both attend to the G-20's core mission of stewardship of the global economy, aggregate growth generation and financial stability, and still have attention enough to address other pressing issues. The most important consideration in such an approach would be the criteria for issue inclusion. Rather than evaluating issues based on how close they fall to the G-20's core financial mandate, it was suggested that they be evaluated based on their degree of difficulty. Agenda items are not equivalent in the effort required and their current progress towards resolution. Therefore, selection on the basis of political feasibility, sufficiency of progress, and short-term achievability may allow for demonstrable success on the part of the G-20 in important areas that will serve to build confidence and generate momentum.

A collection of successes achieved through tapping into the "pure political will" of which the G-20 is a reservoir, will be beneficial not only in terms of generating global public goods, but in terms of restoring the credibility of the G-20 as a global steering committee. The anti-corruption scheme serves as example of this potential. In that instance, political will was leveraged with a minimum need for attention, which rippled through the system to the technical level, allowing useful action to be taken both internationally and domestically in terms of legislation and ratification, among other things.

It was also acknowledged that issue consolidation is difficult in practice given that the scope of the agenda has already been widened. Furthermore, consolidation is unlikely to take place at the Presidency level – to do so was likened to "asking the host country of the Olympics to subtract a sport." However, the G-20 cannot try to solve issues that are not ready to be solved. Such a course of action would be fatal at this difficult moment. This is the risk of issue pluralism; overloading the system and not producing any meaningful results in even the core areas could undermine the credibility of the system and the process as a whole.

The relevance and credibility of the G-20 depends on its ability to fulfill the commitments it has adopted. Therefore, completing its core tasks should remain a priority. Nevertheless, where there exists the political will, urgency and feasibility to solve other issues in the short to medium term, it would be to the G-20's benefit to take them up.

Regaining Momentum: From Cannes, to Mexico, and Beyond

A Critical Moment

In light of the current critical issues, and in particular the crisis in the eurozone, it appears that the world is balancing on the precipice of global economic decline. The outlook is similarly precarious for the G-20; Cannes could be the tipping point between emerging as a credible platform for resolving global issues or being relegated to the position of "talking shop." It is clear that the upcoming summit will be a crucial test for the G-20.

The French Agenda

In the lead-up to the Cannes Summit in November, France has outlined a definitive agenda. Continuing on from the 2010 Seoul Summit, the Cannes Summit will deal with the *Framework for Strong, Sustainable and Balanced Growth*, financial regulation, and development. It has also added to the work program the issues of international monetary system reform, commodity price volatility, food security and governance. While the work program has been effectively established, meticulously planned and partially executed, the Summit is in danger of being overwhelmed by the EU zone difficulties. This demonstrates the importance of a comprehensive and credible solution to the European challenges. It is for this reason that the key to success, both for the Cannes Summit and for the G-20's credibility, lies in the ability to respond to the eurozone crisis. Unfortunately, it appears that this will form the standard by which both the Summit and the Group will be judged.

The Plan for Mexico

At any one time, the G-20 summit agenda revolves around three different elements: the commitments from previous summits, the priority of the Presidency, and the complexity of contemporaneous considerations. While two out of three of these factors cannot yet be anticipated, Mexico has begun substantive work in preparation for its upcoming Presidency and for the 2012 Summit. Already a number of key components of the Mexico agenda have been articulated. With an overarching emphasis on "focusing on the basics," Mexico plans to promote strong, sustainable and balanced growth, continue with work on international financial institution reform, address international monetary system issues and financial regulatory reform.

Mexico will also consider other issues for emerging and developing countries where it may possess a comparative advantage, such as the commodity crisis, food security, green growth, and other challenges for economic growth. The Mexican approach will include outreach to civil society, international institutions, IFIs, and regional groups. Also under consideration are meetings with groups in the private sector. While it is impossible to predict exactly what the global economic and political climate will look like in 2012, a strong foundation for the Summit has already been laid by Mexico.

The Framework for Growth

Both in terms of the current crisis and the agenda for the upcoming Summits, the framework agenda remains a critical part of the G-20's work. In order to establish strong, sustained growth, there is a need to establish strong demand by encouraging action from surplus economies and fiscal restraint for those with current account deficits. A key component of this will be exchange rate flexibility. Countries with the policy space and current account surpluses should take action towards short-term and investment-demand growth. This will require involvement of the Asian countries, some of which are already at or above full capacity utilization. The challenge is to translate what is currently intellectual agreement on the importance of shifting the sources of global demand growth under the G-20 framework agenda, into action by individual countries.

The Way Forward

In order for the G-20 to continue to prove its relevance and maintain a role for itself in the international system, it must rise to the current challenges.

The pressing global economic issues, while attributable to the weakness of the global economy, are also a reflection of the inability of the political process to deal with the challenges as they emerge. Economics and politics cannot be viewed in isolation, and a considerable test lies in determining how, in a democracy, the right compromises can be made at the national and international level. One means of addressing this problem is through utilizing the unique leadership platform the G-20 represents. Issues of political leadership have been, to date, insufficiently addressed by the G-20. And yet the problems that affect the Group may derive from the distinction between the need for political leadership on the one hand and the need for economic management on the other. Although it would require radical thinking, there is potential to distinguish between the high-policy, grand-strategy track and the technical financial issues. This would involve a strategic division of labor between Heads of State and Ministers of Finance, so that the latter remain effective and focused and the former are able to present a cohesive message without "drowning in currency wars." By "letting the leaders lead," and "managing the message," the G-20 could buttress its credibility, gain support of national parliaments and deliver concrete achievements, all the while addressing the triple crisis of confidence in markets, trust in leaders and faith in institutions.

It was concluded that as a first step in regaining momentum, the G-20 should seek to focus on the key issues, strengthen the process, and communicate progress to the public. This should necessarily involve consideration of how the G-20 can solidify its position as a steering committee on issues of global importance. Such a strategy will be important in ensuring it maintains a relevant and credible place in the international system and contributes to the generation of global public goods. Though Cannes may prove to be a defining moment, the G-20 need not sit back and wait for its fate to be determined.