Contents

Introduction to the Think Tank 20 ................................................................. 1
   Kemal Derviş
   *Vice President, Global Economy and Development, The Brookings Institution; Former Executive Head of the United Nations Development Program; Former Secretary of Treasury and Economy Minister, The Republic of Turkey; Advisor, Istanbul Policy Center*

ARGENTINA

Currency Appreciations Come in Different Shapes and Sizes ............................. 3
   Miguel Kiguel
   *Former Undersecretary of Finance and Chief Advisor to the Minister of the Economy, Argentina; Former President, Banco Hipotecario; Current Director, Econviews; Professor, Universidad Torcuato Di Tella*

AUSTRALIA

Opportunity for Asia and the G-20 ................................................................. 6
   Peter Drysdale
   *Emeritus Professor of Economics, Australian National University; Head of the East Asian Bureau of Economic Research; Co-editor, East Asia Forum*
   Soogil Young
   *President, Korea National Strategy Institute; Chair, Korean National Committee for Pacific Economic Cooperation; Chair, Presidential Committee on Green Growth, The Republic of Korea*

BRAZIL

The G-20 and Development: Three Trying Triads ............................................ 9
   Pedro Malan
   *Former Minister of Finance, Brazil; Former President of the Brazilian Central Bank; Current Chairman, Board of Directors, Unibanco*

CANADA

The G-20: Development and the Role of Developing Countries ......................... 11
   Manmohan Agarwal
   *Senior Visiting Fellow, Center for International Governance Innovation*
   John Whalley
   *Distinguished Fellow, Center for International Governance Innovation; Professor, Center for the Study of International Economic Relations, University of Western Ontario*

CHINA

Making Big Deals to Help the World .............................................................. 14
   Qiao Yu
   *Professor, School of Public Policy and Management, Tsinghua University*
FRANCE/EUROPEAN UNION

The G-20 and the Currency War .......................................................... 16
Jean Pisani-Ferry
Director, Bruegel; Member of the French Prime Minister’s Council of Economic Analysis; Member, European Commission’s consultative Group of Policy Analysis; Professor, Université de Paris-Dauphine

FRANCE

The G-20 Seizure of Development: Inspiration, Vision and Action .......................... 19
Jacques Mistral
Head of Economic Research, Institut français des relations internationales; Former advisor to the Directeur général du Trésor et de la politique, Ministère des finances-Paris; Former member of the French Prime Minister’s Council of Economic Analysis

GERMANY

The G-20 and Global Development: Which Road to Take? .............................. 21
Thomas Fues
Director, Development Policy Perspectives on Global Governance in the Context of the U.N. System, German Development Institute
Peter Wolff
Head of World Economy and Development Financing, German Development Institute

INDIA

IMF Reforms Bode Well for the G-20 Seoul Summit, But More Tangible Gains Are Needed .......................................................... 24
Rajiv Kumar
Director General, Federation of Indian Chambers of Commerce and Industry; Member, Central Board, State Bank of India; Former Director and Chief Executive, Indian Council for Research on International Economic Relations; Former member, National Security Advisory Board of India; Former member, Telecom Regulatory Authority of India

INDONESIA

Lessening Pressure on Trade Protectionism by Diversifying Exports .................. 27
Muhammad Chatib Basri
Director, Institute for Economic and Social Research, University of Indonesia

ITALY

The G-20 and Two Scenarios for the World Economy ..................................... 30
Paolo Guerrieri
Professor of Economics, University of Rome Sapienza; Professor, College of Europe, Bruges

JAPAN

A Development Agenda for the Seoul 2010 G-20 ........................................ 33
Shinji Asanuma
Visiting Professor, the Asian Public Policy Program, School of International and Public Policy, Hitotsubashi University, Tokyo; Former Director, Graduate School of International Corporate Strategy; Member, Japanese ODA Policy Board
KOREA

The G-20 Calls a Truce in the Currency War ......................................................... 35
Wonhyuk Lim
Fellow, Korea Development Institute; Fellow, Korea National Strategy Institute

RUSSIA

G-20 Priorities: Heavily Indebted Rich Countries ..................................................... 38
Sergei Guriev
Rector, New Economic School, Moscow

SAUDI ARABIA

Addressing Development at the Seoul G-20 Summit .............................................. 40
Abdullah Ibraim El-Kuwaiz
Former Saudi Arabian Ambassador to the Kingdom of Bahrain; Former Saudi Arabian Executive Director,
Board of the Islamic Development Bank; Current Deputy Chairman, Governing Board of the Oxford Institute
for Energy Studies; Founding member and Deputy Chairman, Executive Committee, Arab Energy Club, Beirut

TURKEY

Challenges to Development in Our Globalizing World ............................................ 43
Izak Atiyas
Professor, Sabanci University
Kamil Yilmaz
Professor, Koç University
E. Fuat Keyman
Professor and Director, Istanbul Policy Center, Sabanci University

UNITED KINGDOM/ EUROPEAN UNION

Currency Wars and the Emerging Market Countries ............................................... 47
Richard Portes
President, Center for Economic Policy Research; Professor, London Business School

UNITED STATES

Development in the G-20: Common Ground? ......................................................... 52
Homi Kharas
Senior Fellow and Deputy Director, Global Economy and Development, The Brookings Institution;
Former Chief Economist, East Asia, World Bank
On November 11-12, G-20 leaders meet in Seoul with Korea as the host—the first time that an emerging or newly industrialized country chairs the meeting. Opinion on what the G-20 has achieved since it started to meet at leaders’ level two years ago is divided. Many focus on the actual summit meetings and on the fact that it has been hard to achieve concrete agreement on key policy issues. No doubt the G-20 is also threatened by the syndrome of grand declarations with weak follow up that we already observed during G7 meetings in the past.

It is important to realize, however, that the G-20 summits have given rise to an elaborate process of preparation, which has led to an unprecedented degree of interaction between policymakers and key civil servants that now involves officials from the large emerging market economies. It is too early to fully evaluate the results of the G-20 finance ministers meeting of October 22-23, but the agreement reached on current account target zones and reform of IMF governance may turn out to be a key step forward in global economic cooperation. For observers of the G7 in the past, one of the valuable side products of the process had been a degree of familiarity fed by frequent brainstorming between key officials that progressively led to greater cohesion and facilitated decision-making, particularly at a time of crisis. Such interaction is now taking place between a much wider group of countries that is much more representative of our 21st century world. I know from personal experience how important it is to know one’s counterparts in other countries and international organizations, how useful it can be to be able to call them up informally, how critical personal trust can be in resolving difficult problems. Such trust does not develop overnight. Even if the G-20 meetings do not yet meet the very high and somewhat unrealistic expectations that have emerged for them, a very serious process of policy discussions and consultations has started and it now involves, as it should, a much broader set of actors. That in itself is real progress.

In today’s world, however, official consultations are not enough. They need to be complemented, fed and supported by discussions among civil society actors, academics and business leaders who can break out of official constraints in the ideas that are tabled and in the approaches taken. At the Global Economy and Development program at the Brookings Institution, we invited a group of friends and colleagues active in think tanks and universities in G-20 countries, and/or actively working on G-20 related issues, to contribute short think pieces at the occasion of the Seoul 2010 Summit. In order to give some focus to these contributions, we encouraged the contributors to relate their comments at least broadly to the development dimension that the Korean hosts have included in the agenda of the summit and to the link between development and key global policy issues.

We have fittingly named the collection of contributions the “Think Tank 20” (TT-20). And while we initiated the process at Brookings, it is a fully cooperative enterprise and we hope that other think tanks and research groups will post the contributions and disseminate them as much as we hope to do. We also hope that this is just the first step in an ongoing effort to accompany the official G-20 process by a network of informal opinion leaders who work independently but in cooperation with each other and whose regular interactions will allow
both an increasingly deeper analysis of the issues and innovative ideas that can add to the debate and be helpful to the global cooperative process.

I would like to express my heartfelt gratitude to all the contributors as well to my Brookings colleagues, notably to Homi Kharas who initiated this cooperation, to Mao-Lin Shen and Eileen Gallagher who accompanied the effort and to Andrea Holcombe who organized and followed up on the interactions. I would also like to thank the members of the Global Leadership Council for their general support of our efforts in the field of global economic governance.
Currency Appreciations Come in Different Shapes and Sizes

Miguel A. Kiguel
Former Undersecretary of Finance and Chief Advisor to the Minister of the Economy, Argentina; Former President, Banco Hipotecario; Current Director, Econviews; Professor, Universidad Torcuato Di Tella

Exchange rate policies that are at the center of policy discussions are introducing new challenges for Latin America. While China is resisting a nominal appreciation, countries like Brazil, Chile and Uruguay have already experienced significant nominal and real appreciations of their currencies. Others, namely Argentina, are suffering a strengthening of their currencies as domestic inflation far exceeds the rate of nominal depreciation.

This trend is causing concern as these real appreciations affect the ability of the countries’ industrial and service sectors to export and grow, which in some cases is associated with the so-called “Dutch disease.”

The currency war discussions and the adoption of policy measures to avoid sharp and rapid real appreciations of the currencies do not clearly distinguish the different forces that could underlie these processes. There are at least three different factors that are important and the policy response should in principle differ depending on the relative importance of each of them: differences in growth and productivity rates, improvements in terms of trade and capital inflows.

The higher rates of growth in emerging markets are part of the explanation. There is ample theoretical and empirical evidence that countries which grow faster experience real appreciations. This movement, however, should be gradual and, in general, the adjustment in relative prices transpires with a stable exchange rate and through increases in domestic prices. The countries that adopted the euro are examples of cases in which the real appreciation took place through inflation.

The second factor—the improvement in the terms of trade—could have larger and more sudden impacts on the real appreciation of the currency, especially if there are large increases in export prices, affecting the current account of the balance of payments. Many Latin American countries are commodity exporters and now face these new policy challenges while the terms of trade gains generate windfalls, representing in some cases 60 percent of GDP from 2004-2008.

If the terms of trade effects are large and not permanent, a real appreciation should be unavoidable in the long term. Policymakers could delay this process by intervening in the foreign exchange market to avoid a rapid nominal appreciation of the currency, and then sterilize the monetary effects of these purchases by issuing domestic debt to avoid an increase in domestic demand and inflation.

However, sterilized foreign exchange intervention is not enough to prevent “Dutch disease,” as it leads to large increases in domestic debt and eventually to higher domestic interest rates that could generate capital inflows and complicate overall macroeconomic management.

The alternative and most effective policy response to the large terms of trade windfalls, which many countries in Latin America have been enjoying during the last decade, is to rely primarily on fiscal policy. This could happen through increases in public sector savings to compensate for the increase in domestic aggregate demand, or by the creation of a stabilization fund, like the ones that Chile or Norway have been using to sterilize the higher export proceeds from copper or oil. In the
case of Norway, it has accumulated funds that are larger than its nominal GDP.

In Latin America, most countries did not use fiscal policy or failed to introduce stabilization funds to counteract the improvements in the terms of trade that took place during the decade. Calculations indicate that in the region there was a tendency to spend rather than to save the fiscal windfall—a policy that favored the real appreciations of the currencies. In most countries, increases in spending were close to, or exceeded, the increases in revenues during the recent boom. For instance, Brazil spent more than 3 percent of the GDP of the windfall in tax revenues.

In Argentina, the government increased export taxes during the boom, mainly on soybean products. These new taxes raised as much as 10 percent of overall government revenues and were equivalent to 3 percent of GDP. However, these revenues were spent rather than saved and hence did not work as a countercyclical policy to avoid further pressures on the currency.

One result of the failure to use countercyclical fiscal policy was the increased effect of the higher revenue felt on domestic aggregate demand, eventually leading to an increase in the price of non-tradeable goods. As a result, even when countries did not allow the nominal exchange rate to appreciate, they faced a strengthening of their currencies in real terms.

Finally, capital inflows are the third and most important factor that has been pressuring the Latin American currencies toward appreciation. This factor also created the largest challenges for macroeconomic policies as they tend to be big relative to the size of the trade flows and they can fluctuate very quickly.

Some of these inflows have been “pulled” by improvements in macroeconomic policies and by the better growth prospects than those of the industrialized countries. Most of these flows were in the form of foreign direct investment and long-term lending, which by and large are perceived as “good” capital inflows since they improve the growth prospects and are not perceived to increase financial vulnerability.

The main headache has been created by the short-term capital inflows that to some extent are being “pushed” by the very low interest rates that prevail in the industrialized countries, and that come to take advantage of the “carry trade” opportunities that the short-term interest rate differentials create. These flows, as experience shows, are likely to be very volatile and could leave as quickly as they came in, leading to large and disruptive fluctuations in the exchange rate.

A reversal of these flows is likely to take place if and when U.S. interest rates rise from the current extremely low levels, which is likely to happen in the next couple of years, and that could lead to the phenomenon that Guillermo Calvo et al have termed the “sudden stops”.

While most economists and policymakers agree that it makes sense to try to limit the fluctuations in the exchange rate, the policy response is not always clear or effective. For instance, the efforts to avoid a nominal appreciation through sterilized intervention in the foreign exchange market could lead to a vicious cycle as they could lead to higher domestic interest rates, which in turn would lead to more capital inflows.

The alternative is to limit the short-term flows through regulation or the imposition of capital controls. There has not been any shortage of imagination in this field, as countries have tried everything on the menu. Unfortunately, all these policies work for a few months at best, but over time they lose their effectiveness as the financial markets find ways to elude them. Countries face great difficulties in closing all the loopholes without severely affecting trade flows and investment.

When countries put controls on short-term flows, investors find that the “financial time machine” can transform 90-day credits into two- or three-year
loans. When there are limits on financial loans, all of sudden the country is flooded with commercial loans. The introduction of a tax on capital inflows can at best have short-term effects, as is the case with dual exchange rate systems that have a fixed exchange rate for commercial transactions and a flexible rate for financial ones.

There are different types of currency wars. This instance with China is the traditional beggar-thy-
neighbor “trade” war, in which countries are concerned about trade surpluses and deficits. In Latin America, the problem is, to some extent, related to large windfalls in terms of trade. But recently, it has been mainly driven by short-term capital inflows that have proved to be very volatile and will likely revert very quickly in response to a rise in U.S. interest rates. It makes sense to try to smooth them, but it won’t be easy.
The most important outcome of the Seoul G-20 Summit will be reassurance from G-20 leaders of strong commitment to macroeconomic recovery strategies and structural changes needed for long-term balanced growth and sustained development. As the most dynamic in the global economy, Asian economies have an especially important role in setting the course ahead for rebalanced and sustainable growth.

The recovery of some industrialized economies is still fragile and will require continuing expansionary measures, within the bounds of debt sustainability (which are a greater constraint for Europe). IMF projections show that global imbalances will rise for some time as growth recovers in the period to 2015. With U.S. unemployment still above 9 percent, Asian economies must rely less on the U.S. consumer for final demand and more on domestic and regional demand as Asia continues to increase in importance as a growth pole in the world economy. In much of Asia and the other emerging economies, strong growth will require moderation of government spending to allow private spending to accelerate without inflation.

Worldwide depression in 2008 was averted due in part to the major economies working together to re-start their financial markets and refraining from systematic resort to protectionism or competitive devaluations. Their actions created the confidence needed to stimulate demand sufficiently to avoid a depression by setting fiscal and monetary policy appropriate to national economic conditions.

In 2010, leaders can agree to continue the coordination of policies, informed by the work they commissioned from the IMF. The IMF’s Mutual Adjustment Process scenarios set out two vastly different prospects for employment and living standards in the next five years:

- either weak recovery, and a second wave of recession, with poor coordination of macroeconomic policy settings;
- or a sustained recovery from the global financial crisis with rising employment, if G-20 governments adopt an approach that is co-ordinated around rebalancing growth.

Sustained and balanced growth will need to be backed by commitment from leaders to carefully calibrate macroeconomic policies, including exchange rate policies and structural change policies that maintain confidence in markets at the same time as they address the fundamental causes of imbalance in national economies as well as the global economy.

Correcting imbalances will require continued macroeconomic policy adjustment and fiscal and structural reform in both countries with current account deficits and those with current account surpluses. In countries with current account surpluses, of which there are several in Asia, the priority should be on substantial restructuring, which is important for national development and made easier given a strong capacity for growth. While current account surpluses are falling in key Asian economies, it will be important to prevent these surpluses growing again. Asian members of the G-20, drawing on their own past experience and success, can help to set ambitions for structural reform and change that are crucial to achieving more balanced and sustainable global growth.
There are two key lessons here: first, rebalancing strategies will not succeed if they are one-dimensional—they need to involve a suite of complementary policy measures; second, they take time to implement. There are no simple measures that can make large imbalances disappear rapidly. But establishing confidence in the direction of change will restore the confidence of investors, consumers and bankers that the recovery is sustainable.

One vital component of policies for rebalancing growth is structural reforms that strengthen domestic demand and improve productivity through measures such as:

- strengthened social safety nets including pension and health insurance programs;
- enhanced physical infrastructure that reduces supply bottlenecks to sustainable growth;
- reform of factor markets to remove distorting subsidies to industrial production; and
- investment in the engines of sustainable long-term growth, such as energy and resource efficiency, renewable and clean energies, green transportation and cities, and quality-of-life services like health care and sanitation.

Household demand can be expected to expand as wages rise, labor mobility is enhanced and households are provided with capital income-generating opportunities. The structure and timing of particular reforms will depend on each country’s economic circumstances and institutions.

A second important component is exchange rate policy and greater exchange rate flexibility. Increased exchange rate flexibility is necessary in order to encourage relative price shifts between tradable and non-tradable activities and economic rebalancing. Exchange rate flexibility will assist in shifting the economy toward more productive use of resources and make it easier to control inflation and manage external shocks. The Asian experience in the 1980s and the 1990s shows that major Asian economies have a strong national interest in deploying increasingly flexible exchange rate adjustment for these tasks along with supportive monetary policy. The structure and timing of such reforms will depend on each country’s economic circumstances and institutions decision.

Recent suggestions for a multilaterally-agreed upon exchange rate re-alignment do not suit present circumstances. Indeed, very large one-off exchange rate changes would likely disrupt trade and currency markets and could threaten the stability of the international monetary system.

The idea that exchange rate re-alignments should alone carry most of the burden of correcting national and global economic imbalances is seriously misguided. Reform of structural impediments in national financial, factor and commodity markets will also be needed. Sustained recovery needs flexible exchange rate regimes, not a series of negotiated adjustments. Exchange rate flexibility will sensibly constitute one part of a package of policy measures available to governments.

Effective coordination to underpin future stability of the international monetary system could be undermined by asymmetrical adjustment between deficit and surplus countries. While current account deficit countries cannot sustain their deficits and are forced to run down their reserves or depreciate their currencies, surplus countries can find it politically convenient to maintain nominal values of exchange rates and run up foreign exchange reserves. Cooperative action to avoid this is highly desirable and it will depend on surplus countries having more say and confidence in international monetary arrangements. IMF governance reform is essential to building this confidence.

On the question of making financial market regulation more effective and robust, Asia could make a positive contribution to strengthening global financial system governance by establishing a functioning Asian Financial Stability Dialogue that draws in the whole region and complements the work of the Financial Stability Board. This would
add to the work of building confidence globally in financial market regulation.

The task of avoiding a second round of recessionary pressure on the international economy induced by trade or currency measures highlights the importance of using the window of political opportunity that exists in 2011—prior to major political transitions in a number of countries scheduled for 2012—to complete the Doha round. The Seoul agenda needs to underscore the central- ity of trade policy to recovery and development.

The Doha Round has dragged on for far too long. At Seoul, leaders can agree on a balance of interests and direct negotiators to complete the Doha Round as soon as possible and no later than the end of 2011. The time has come to give trade ministers permission to conclude the Round to lock in the gains already available. They can then address the issue of WTO reform, its negotiating modalities and the problem of bilateral and regional arrangements not being subject to effective discipline so that they serve core global trade objectives at a critical time for openness. Repositioning the WTO so that it can deal with all dimensions of contemporary international commerce is central to the G-20’s development agenda.

The G-20 provides the opportunity for Asian economies to address all these and other problems that need global solutions. Asian economies need to de- cide how best to take up these issues through the G-20, especially by putting forward options which support and complement the interests of other re- gions. Conscious that the G-20 process will work most effectively if there are clear priorities given to the discussion of major issues, it will be helpful to flag and position issues of importance to the region for future meetings and give fuller consideration to issues of global priority through regional meetings. An early opportunity to establish productive interaction between the global and regional processes is the Yokohama APEC leaders summit immediately following the G-20 Seoul Summit. APEC leaders can link the pursuit of their five-part growth strategy to G-20 priorities, with emphasis on rebalancing growth. Careful thought needs to be given to how Asian members can best link their participation in trans-Pacific and East Asian regional arrangements to their individual responsibilities in the G-20 and to the representation of broader regional interests. How regional structures should develop or be re-organized to serve these purposes is an important issue for further consideration.
The G-20 and Development: Three Trying Triads

Pedro S. Malan
Former Minister of Finance, Brazil; Former President of the Brazilian Central Bank; Current Chairman, Board of Directors, Unibanco

The triads referred to in this note are “trying” in the dictionary sense of “severely straining the powers of endurance”; in this case, of the G-20 national governments and their regional and global set of complex interactions.

The first triad is the one stated in 2010 by the G-20 itself as the “highest priority”: (1) to safeguard and sustain the recovery, (2) to strengthen the financial system against risk and (3) to lay the foundations for strong, sustainable and balanced growth. In fact, the G-20 wording mentions the three in one single sentence, indicating rightly so that they should be seen as related.

The second triad is the slightly older one of 2008 at the height of the crisis and it is made of: (1) crisis resolution, (2) future crises prevention and (3) longer-term structural and institutional reforms. Of course, these three also should be seen as related.

The third triad expresses the fact that, although we live in a complex global economy, key political decisions are still taken nationally—even though these decisions are often critically affected by real or perceived regional and/or global constraints. Therefore, the third triad is the (1) national, (2) regional and (3) global interactions so fundamental to the possibilities of moving ahead with the objectives of the other two triads.

Let me start with the items numbered 1 in the first two triads. The pair does not express exactly the same objectives. Safeguarding and sustaining the recovery may not only lead some to believe that the panic of late 2008 and early 2009 is over—which is true—but also that the crisis has been “resolved” and the recovery is well underway in the industrialized world.

But it is increasingly clear that the consequences of the greatest crisis since the 1930s in the developed world are still very much with us in terms of their effects on present and near future economic activity, rates of unemployment and significant uncertainties about the future.

With regard to the items numbered 2 in the first two triads, they are again not exactly the same. In fact, future crises prevention goes well beyond the call for “strengthening the financial system against risk”, critically important as it is. It is true that much progress has been achieved. But there has been no final agreement yet on the basic elements of a “resolution authority” for dealing with systemically important financial institutions with several cross-border operations, which are too big and too interconnected to fail, or to be rescued, or to be controlled by one single national or regional regulator/supervisor.

And “resolution authority” responsibilities as well as a higher degree of international cooperation between regulators and supervisors are essential for both strengthening the financial system against risk and preventing future crisis. But the prevention of future crisis goes well beyond the world of financial regulation, supervision and standard-setting.

This brings us to the items numbered 3 in the first two triads—and to their relations with the third triad. To use the old rhetorical structure of the trade, progress has been achieved even though many serious risks remain. Therefore, there is no room
whatsoever for complacency. In fact, the crisis left deep scars in the real and financial sectors of the developed world. And the nature of their governments’ responses to the crisis, while absolutely necessary to avoid the worst of the crisis, created huge and serious long-term fiscal problems that need to be addressed. This will take years and involve painful political decisions about reforms.

It is a fact that these medium- and longer-term structural and institutional reforms, which are such an essential part of the laying of the conditions for strong, sustained and balanced global growth, depend on the short- to medium-term resolution of items 1 and 2 in the first two triads.

But the fact remains that the items numbered 3 in these triads are the truly fundamental ones for the G-20’s development agenda, if it really wants to have one that is systematically pursued.

It remains to be seen if one wants to look beyond declarations and communiqués signed by an ever-changing composition of individuals that are temporarily occupying the positions of head of state or head of government.

Indeed, it is very important to always keep in mind that behind most if not all international bodies, institutions, organizations and arrangements, such as the G-20, we have national governments with their own diverse, domestic, regional and global interests, priorities and changing views and balancing acts between continuity and change.

“Such is life”, as I wrote in a recent contribution for a Brookings-Korea Development Institute seminar in Seoul, “but so is the fact that the effectiveness, influence and potential role of the G-20 will be, when push comes to shove, no more than what the governments behind it may agree they want it to be”.

I am convinced that most, if not all, of the G-20 members want seriously to move ahead with the first two triads mentioned in this note, especially items 1 and 2 of both. I am also convinced that most, if not all, realize in general the critical relevance of items 3 of both first triads. The G-20 could perhaps help in the truly trying task of attempting to stimulate its members to identify the specific structural and institutional reforms, which are deemed to be essential for each of them. These reforms will be inevitably context-specific. This fact of life, rather than hindrance, could perhaps help to achieve a constructive engagement of its membership.

Giving some more structure and operational content to the idea already agreed upon of a “mutual assessment program” within the G-20 may help to move the process along and represent an important contribution to strong, sustained and balanced growth in the world. It is not easy. It will never be. It is very, very trying. But the G-20, as a group, has truly no alternative if it wants to survive as a relevant, living arrangement with a post-crisis development agenda.
The G-20: Development and the Role of Developing Countries

Manmohan Agarwal  Senior Visiting Fellow, Center for International Governance Innovation
John Whalley  Distinguished Fellow, Center for International Governance Innovation; Professor, Center for the Study of International Economic Relations, University of Western Ontario

Introduction: Development on the Agenda

The G-20 leaders agreed at Pittsburgh last year on a framework for strong, sustainable and balanced growth. The leaders’ meeting in Toronto in June of this year concluded that their monetary and fiscal actions had stemmed the crisis and the world economy was beginning to recover. Furthermore, they were engaged in regulatory reform of the global financial system. The leaders began to tackle longer-term issues and set up a Development Policy Working Group. The working group is to draw up a plan for action for discussion by the G-20 leaders in Seoul followed by discussion of its implementation in France in 2011. The agenda for the Korea Summit includes development. It calls for rebalancing the world economy in terms of reducing the income gap between countries, in particular the developing countries and developed countries. This is different from rebalancing in terms of current account surpluses and deficits.

Growing Interest in the G-20 in Developing Countries

The interest of developing countries in the G-20 process and its potential is growing judging from the press coverage and interest at think tanks. At the same time, there is a wait-and-see attitude as to what the G-20 will be able to deliver. Seven G-20 countries are members of the G-77, the group that speaks for developing countries at the United Nations. Many of these G-77 members question the legitimacy of the G-20 and want all actions channeled through the U.N. The G-20 will affect the dynamics of the G-77 at the U.N. Thus, delivering on development would enhance the legitimacy of the G-20.

Features of Recent Growth in Developing Countries

Rapid growth in many developing countries in the two to three years before the global financial crisis was based partly on a strong export performance as export volumes jumped and commodity prices rose sharply. Many countries could pursue growth-oriented policies while maintaining a viable current account because of rising exports and remittances. For precautionary reasons, many developing countries added substantial amounts to their international reserves despite stagnant aid, though the desire to maintain export competitiveness also probably played a role.

During the financial crisis, developing countries as a whole experienced decreased export earnings and outflows of private capital as well as declines in remittances. However, the larger developing countries, which are by and large members of the G-20, have shown considerable resilience and have returned to a robust growth path. This contrasts with the performance of the developed countries and many smaller developing countries, where there has been a recovery, but one which remains weak and fragile.

The issues before the G-20 Summit at Korea are to fulfill the promise of strong sustainable and balanced growth by spreading robust growth to the weak economies.

Short-Term Issues

The main short-term issues for the G-20 are pushing ahead with the reform of the global financial system and rebalancing of the economies. Reform
of the financial system has proceeded, catalyzing on the work already done by national and international institutions. The developing countries seem to have agreed to the processes and nature of these reforms, as they are based on analysis and experience and also as there seems to be sufficient leeway for individual countries to adopt measures consonant with their needs.

The need to tackle current account imbalances remains problematic and there is no full agreement yet on the means. Immediate fears about an outbreak of currency wars seem to have abated with the recent agreement among G-20 finance ministers to move toward more market-determined exchange rates. However, countries such as Brazil and India are calling for international action to deal with large capital inflows. There seems to be growing recognition by these and other countries that more policy coordination is needed at the international level to deal with issues such as current account imbalances and capital flows. But further development of the necessary international institutional arrangements for undertaking such coordination may be required before agreement on coordination measures can be reached.

**Long-Term Issues**

Rebalancing current account imbalances is a vital issue. Over the longer term, rebalancing will occur when there is a shift to development strategies that place greater reliance on domestic demand. Faster growth in poorer developing countries as called for by the agenda for Korea may need to be supplemented by using surpluses to balance deficits that may result from this faster growth.

**Financing of Higher Levels of Investment**

Growth could be fostered in lagging developing countries by higher rates of investment, financed by the restoration of aid flows and improving the access of these countries to private capital markets. Aid by itself would help maintain a credible balance of payments position and so encourage private flows. Another possible source for increased investments in the poorer countries could be the excess savings of surplus countries. Reduction of, say, the U.S. deficit would be achieved without increased consumption in China, which is possible only in the longer run, but by larger deficits in other developing countries, many of whom are currently running surpluses or very small deficits.

**Aid Effectiveness**

The G-20 should not only look at the quantity of aid but consider ways to increase its effectiveness. Aid for agriculture and infrastructure has been declining in importance.

The G7 has already called for increased aid to agriculture. The Seoul G-20 Summit is likely to call for increased investment in infrastructure. Increased aid for agriculture and infrastructure is likely to raise aid effectiveness, which could be further enhanced through governance reform both in the recipient countries as well as multilateral and bilateral donors. For instance, poverty in the middle-income countries may be more effectively tackled not by more aid but improving its delivery through civil society involvement. Remittances are effective in raising investment levels in the recipient countries and more remittances could be encouraged through reducing the cost of transfers. Strengthening aid for trade and a time frame for untying all aid are other issues that the G-20 could consider.

Foreign direct investment flows are more effective in raising growth than domestic investment. The G-20 should discuss what measures can be taken to increase FDI flows, particularly to smaller poor countries, which have very limited access to international financial markets.

**Growth and Productivity in Agriculture**

Growth in the poorer countries is very closely related to agricultural performance as borne out by the experience of countries in sub-Saharan Africa. Poor
performance of GDP in the 1980s and 1990s and better performance more recently were mirrored by agricultural growth. There has been a substantial slowdown worldwide in growth of agricultural output, causing sharply increased prices in 2007-08 and leading to calls for the need to improve food security. Investment in agriculture could be raised through more foreign aid for the sector. The shift in aid toward humanitarian assistance has been self-reinforcing in that when less aid goes for production, production shortfalls are more frequent or of a greater magnitude, leading to the need for humanitarian relief. In these circumstances, larger allocations for productive purposes can occur in the short run only if the overall amount of aid is increased substantially, since in the short run humanitarian needs must be met. Raising the growth of agricultural output requires raising the rate of productivity growth since there is very limited scope for area expansion. Raising productivity requires better technologies and this in turn requires more support for research. The G-20 needs urgently to put in place the necessary reforms as pinpointed by evaluations of the Consultative Group for International Agricultural Research.

One of the issues in raising productivity in developing countries is that of technology transfer, which is also important for higher productivity in industry and increasingly for reducing emissions and limiting the damage caused by climate change. The G-20 might need to look at rules governing intellectual property rights to examine whether the relative balance between innovators and imitators needs adjusting.

Conclusion

There is growing interest in developing countries in the potential of the G-20 in meeting the needs of international economic governance. But there is uncertainty as to what the G-20 will be able to achieve. Tackling development issues would help in increasing its legitimacy in the eyes of countries excluded from the G-20. There is broad agreement on the need to tackle the issues of economic imbalances, though countries differ on the relative importance of current account surpluses and deficits, the effectiveness of currency movements in dealing with this problem and the large capital inflows into many developing countries. Many of these issues are interrelated and point to the need for more policy coordination. Agreement on restructuring of the growth processes of development so that there is greater dependence on domestic demand might be more easily achieved if the growth rate is raised in many poorer countries, where growth is still weak and fragile. Increases in aid, greater access to private capital for these economies, and the development and spread of more productive agricultural technologies would all contribute to raising the growth rate.
Leaders at the upcoming G-20 Summit in Seoul should make two big deals to reduce the negative beggar-thy–neighbor policies of mixing debt fuel and money ease and create a strategy to enhance global economic development.

End Beggar-Thy-Neighbor Policies

Recent currency disputes endanger the global economic recovery. Indeed, this is rooted in the prevailing global financial system characterized by an imbalanced oligarchic market structure, where the U.S. Federal Reserve is the market leader of the main transaction means with the European Central Bank, Bank of Japan and Bank of England being the followers. The Fed’s self-discipline is the sole implicit safeguard for this arrangement. Under this structure, if and only if the supply of U.S. dollars is predictable and stable, do current account flows of trading countries—so-called "market fundamentals"—determine exchange rates or prices of respective currencies against the dollar. Otherwise, the discretionary provision of the U.S. dollars governs exchange rate volatility and creates potential currency disputes. Any statement—regardless of official communique or editorial comments—that ignores this key feature but reiterates “insisting in principle of market-determined exchange rates” are hollow and meaningless.

Over the past two years, the U.S. Fed has injected billions of dollars to save the U.S. financial system. Meanwhile, the Fed has also kept printing more money to boost up the inflation expectation and stimulate the sluggish U.S. economy. But one should always remember that no government has the magic to create something out of nothing. Needless to say, the Fed’s provision of global public goods—the stable and reliable U.S. dollar—is subordinated to U.S. domestic interests. In addition, short-term economic goals are most likely to be attained at the cost of international monetary stability in the longer term. Over time, the financial mess could eventually be cleared up through diluting U.S. greenback at best and defaulting it at worst. This may be the optimal option for the U.S. Federal Reserve, but the rest of the world will bear the negative externality as a byproduct—a breakdown of global financial order and the subsequent dwindling of international trade. As such, the easing of monetary policy by the U.S. Federal Reserve has again fueled the unfolding global financial unrest. This cure is illustrated by a Chinese proverb of “drinking poisonous liquid to quench thirst”. History repeatedly shows us these bitter lessons, as exemplified by the collapse of the Bretton Woods system in the early 1970s.

To prevent the world economy from spiraling into an abyss, leaders of the G-20 must take their undeniable responsibility of maintaining global public goods through multilateral compromises. G-20 leaders can make the first big deal in Seoul by agreeing to do the following:

- The U.S. ceases random and discretionary money printing and slowly phases out its near-zero interest rate policy.
- Other major international money suppliers follow these practices and maintain basically stable bilateral exchange rates against the dollar.
- The economies with large trade surpluses, like China, align exchange rates against the
dollar to a certain level and maintain them intact for an intermediate period so long as the main reserve currency power is accountable. This deal may buy the world some time to move out of the recession and redesign the global financial system.

World Savings for Global Development

Over the past decade, the world savings were mainly channeled to finance expenditure in the developed countries, especially in the United States. This situation has not reversed even when the financial crisis started in 2008. For example, the U.S. government transfer payment to persons amounted to $2,096.8 billion in 2009, creating a $1,271.9 billion budget deficit. To finance this huge deficit, the U.S. government issued $1,474.9 billion of Treasury debt, of which the rest world bought $614.5 billion, accounting for 42 percent of the total. This fact reveals that world savings are still fueling U.S. personal consumption indirectly via the U.S. government transfer payment. This is a distorted and unsustainable way of allocating resources.

Leaders at the upcoming Seoul G-20 Summit can make the second big deal to tap into the vast and largely idle foreign reserves to boost global development.

A “debt-equity swap” strategy is able to serve this end. First, reserve-rich countries could allocate a portion of their reserve assets, say 10-20 percent, to set up a World Development Facility (WDF). Under this umbrella, an earmarked amount of U.S. Treasury debt is converted into equities of project investment and the funds are still owned and managed by their respective countries. Second, the WDF would mainly invest in capital-intensive infrastructure in countries of need, including India, Brazil and others. The WDF would also invest in projects of alternative and renewable energies to address issue of global climate change. Third, the WDF would transfer the Treasury bonds to invested companies, swapping the sovereign debt to private equities in the designated places. The bond-taking companies, in turn, may employ receivables as collateral to obtain liquidity in credit markets. The monetary authorities, especially the U.S. Fed, should facilitate the liquidity provision of the debt-equity conversion.

The debt-equity swap will immediately help to revitalize the credit markets of the U.S. and other developed countries. It also offers safe and profitable business to financial institutions, including banks and insurers. The most important advantage is that the WDF will mitigate funds away from consumption financing and channel them to business investment, which is crucial to restart the dynamics of the world economy. If reserve-rich countries converted $1.3-1.8 trillion of fixed-income securities into real investment equal to 15-20 percent of the total, world economic development would move out of bottleneck of financing.
At their meeting on October 23 in Gyeongju, the G-20 finance ministers agreed to recommit to more market-determined exchange rates and refrain from competitive devaluations. At a time when the “currency war” theme has captured imaginations, this is a welcome pledge. But it does not solve the issue for the G-20.

On the face of it, every country seems to be aiming at a depreciation of its currency—or at least at avoiding an appreciation: Japan with unilateral foreign exchange intervention; the U.S. and the U.K. through large-scale purchase of government bonds; China through keeping an almost fixed link vis-à-vis a depreciating U.S. dollar; and emerging countries all over the world through an array of techniques to discourage capital inflows or to ward off their effects on the exchange rate. Only the euro area seems to be bucking this trend, as the European Central Bank has taken the first steps toward an exit from exceptional crisis measures and has allowed a rise in the short-term interest rate. But even it cannot be indifferent to the risks of appreciation; a persistently strong euro would seriously complicate the economic adjustment under way in countries under stress like Spain, Portugal and Ireland.

This looks familiar. Indeed, it took two years after the crash of the 1930s, from October 1929 to September 1931, for Britain to sever the pound’s link to gold and set in motion a currency war. One country after another went off gold, in effect trying to export its unemployment. But it became evident that everybody cannot have a weak currency at the same time and a major lesson from the 1930s is that one of the roles of the multilateral system is to prevent futile beggar-thy-neighbor depreciation.

Two years have passed since the climax of the financial crisis in September 2008. It would seem the same chain of events is being set in motion, with the same delay. This reading is, however, too simple as it ignores two significant asymmetries within the world economy.

The first asymmetry is between the U.S. and the euro area, with the United Kingdom lying appropriately in between. Both have suffered a major financial shock and a major recession. But at this stage of the recovery, policy courses are set to diverge for a series of domestic reasons. The extent of private deleveraging that remains to be done is definitely larger in the United States. In addition as a result of the surprising productivity surge in the U.S. over the last two years, which has not taken place in Europe, the employment situation is much worse, whereas tolerance for unemployment is much lower. The Europeans are more pessimistic about the crisis-induced damages to the supply side, implying a lower perceived amount of slack. Finally, the Greek sovereign debt crisis and tensions over the Irish, Portuguese and Spanish debts have strengthened Europe’s concern over public finances, whereas the most likely outlook in the U.S. is a persistent stalemate. In years to come, there will be much more emphasis on supporting the demand side in the U.S. and this is bound to imply a lower U.S. dollar vis-à-vis the euro. The new round of quantitative easing known as QE2 is just part of this broader picture.

The second asymmetry is between the advanced and the emerging worlds. True, both have suffered from the crisis but not at all in the same way. According to the IMF’s latest forecast, this year real output in the advanced countries will still be below
the 2007 level, whereas it will be 16 percent higher in emerging and developing countries. Looking ahead, advanced countries are set to continue to struggle with the fallout of the 2008 crisis and the dire state of public finances. The IMF also reckons that the advanced countries need to cut spending or increase taxes by 9 percentage points of GDP on average over the current decade if they want to bring the public debt ratio to 60 percent of GDP by 2030. The emerging countries, however, only need minor consolidation to keep their debt ratio at 40 percent of GDP. This implies that the ability of advanced countries to generate domestic demand is likely to be diminished for several years to come, whereas nothing of this sort applies to emerging and developing countries. Here again, an asymmetry of this magnitude would in any sensible model require a significant adjustment of relative prices. The relative price of the goods produced in the advanced countries—their real exchange rate—needs to depreciate vis-à-vis the emerging countries in order to compensate for the expected shortfall in internal demand.

Thus, there is an unambiguous need for a double real exchange rate rebalancing, both within the advanced countries group and between it and the emerging countries group.

The first one is taking place. There has been significant volatility in the dollar-euro exchange rate; the dollar first appreciated as it played the role of a safe haven, then it depreciated, then it appreciated again at the time of the euro crisis and it has been depreciating for a few months now. But as capital flows freely across the Atlantic, any change in expectations about the future policy course is instantaneously reflected in the dollar-euro rate.

But the second rebalancing is not happening. Compared to July 2007, at the onset of the crisis, exchange rates between advanced and emerging countries have not appreciated. On the contrary, they have depreciated. At first sight, this is not easy to assess because we are used to monitoring exchange rates vis-à-vis the U.S. dollar, which itself is a volatile yardstick. But it is possible to compute an effective exchange rate between the major emerging economies and the major advanced economies that takes for each emerging country a trade-weighted average of its exchange rates vis-à-vis the main advanced countries, and then averages over emerging countries. In September, this index was down more than 20 percent with respect to July 2007, both in nominal and in real terms. So the adjustment that needs to take place has in fact not happened at all. After the failure of Lehman Brothers in September 2008, most emerging countries suffered from sudden capital outflows that depreciated their exchange rates and this has not been fully corrected. Furthermore, several important emerging countries target their exchange rates vis-à-vis the U.S. dollar, which is now the weakest of the three major currencies.

It is easy to understand why the adjustment is hampered. For each central bank, the question is not what happens to the emerging countries group as a whole but what happens to its own currency vis-à-vis competitors. Brazil does not want to appreciate vis-à-vis other Latin American countries, Thailand does not want to appreciate vis-à-vis other Asian countries and no one wants to appreciate vis-à-vis China. At the same time, China's export regions fear that a yuan appreciation would lead labor-intensive industries to migrate to Vietnam or Bangladesh. So each and every emerging country resists appreciation individually. This is a typical collective action problem, whereby a change that is in the common interest is hampered by lack of coordination among the players.

Ultimately, economic logic is going to prevail and the emerging currencies are going to appreciate in real terms. The difference is that if the nominal exchange rate remains unchanged, advanced countries will have to go through a protracted period of low inflation or even deflation, which will make the debt burden even harder to bear, and emerging countries will have to enter an inflationary period as capital will flow in, drive up reserves, increase money supply and consequently result in a price increase. For both sides, it would be much more desirable to let the adjustment take place through a change in the nominal exchange rate.
What this analysis implies is that the traditional controversy over the Chinese exchange rate policy is by no means a bilateral U.S.-China trade issue but a bigger global macroeconomic problem between the advanced and emerging countries. This is not to say that the yuan issue is second-order because it is not. But its importance does not come from the trade imbalance between the U.S. and China rather it comes from the fact that Beijing holds the key to a global adjustment involving most of the advanced and emerging world.

One of the primary tasks of international organizations is to help solve collective action problems. The G-20 and the IMF did this at the time of the global recession. The IMF should also take the initiative on the currency front by proposing to the G-20 a conceptual framework for fact-based discussions, by providing an objective assessment of the adjustments that are needed and by facilitating settlement within the multilateral framework. Neither the IMF nor the G-20 can substitute for governments that need to make choices in their national interest. But they can help considerably in the search for a solution.
The G-20 will meet next in November in Seoul and Korea has made development a distinctive issue of this summit. This was an inspired proposal and nothing in the present agenda of the leaders is possibly more significant than this choice.

From 2000 onward, the G8 has invited an ever-increasing number of developing countries to its meetings and used its weight to advance progress on global poverty reduction. The 2005 G8 Gleneagles Summit in Scotland possibly marked the apogee of these efforts, where ambitious goals were agreed upon to increase levels of foreign aid and to secure broader and deeper debt relief. Significant steps forward have been made and traditional aid flows have risen 36 percent between 2004 and 2010.

Despite these efforts and progress, it became increasingly clear that both the G8 summit format and the development framework had to change dramatically. The financial crisis served as a catalyst and made the first change possible and urgent; the G-20 is by definition a more representative and more inclusive group than its older cousin. While the G-20 was initially focused on financial issues and will rightly pursue this agenda going forward, it is more than welcome that the G-20 summits broaden their mandate and specifically express interest in development.

This is particularly welcome under the Korean presidency since Korea really has a powerful message to share regarding development. There is no other country in the world, which was a poor and aid-receiving nation and in just a few decades turned itself into a powerful industrial economy and a donor country. This uniquely successful experience deserves to be shared with other countries and the initiatives of the Korean presidency in this regard deserve to be strongly supported by other nations.

The G-20 must look beyond foreign assistance and embrace a broader development policy toolkit. For years, aid has been the most visible policy used to advance development and it certainly remains useful to initiate the first steps in development. However, development can no more be understood as it was in the past, as a transposition of western recipes. The prescriptive models, which have been used after the decolonization process, are of no help. “Trade, not aid” is an excessively restricted slogan and the developing world needs a more comprehensive agenda that incorporates all the lessons of recorded successes. And there is no nation better than Korea to help design this new framework.

The G-20 should be committed to assist developing countries in achieving their maximum growth potential. There is certainly no “one size fits all” solution to this equation; this is why the Korean presidency rightfully arranged the Development Working Group with a view to incorporate different constraints and visions and to make the best possible use in every nation of well-recognized successes, which initially developed within specific economic and political contexts. No broad intellectual consensus, no vision of development is useful if not focusing on the indigenous capacity-building of nations.

Given this diversity in the development landscape, the G-20 has to focus on its unique economic perspective and more precisely support existing initiatives, such as the U.N. Millennium Development

Jacques Mistral
Head of Economic Research, Institut français des relations internationales; Former advisor to the Directeur général du Trésor et de la politique, Ministère des finances-Paris; Former member of the French Prime Minister’s Council of Economic Analysis

FRANCE
Goals. Development and growth fit well with the objectives of the G-20 because development and growth contribute to mitigating global imbalances. Rich economies are facing a long period of deleveraging; as a result, global demand will more significantly come from emerging markets, massive investments will be needed to increase the supply and transportation of commodities, and low-income countries—like many in Africa—will continue to diversify and enjoy an unprecedented growth. All of these trends are important contributions to solving global economic problems.

So doing, the G-20 format definitely contributes to enhancing the legitimacy of global summits of which the G7, G8 and G8+5 only delivered a few years ago in a diminished version. But nonetheless being a self-selected group, the question of legitimacy remains understandably raised by the 170 other countries not in the group. The addition of development to the agenda is a sure way to reach out to many non-G-20 countries and will be considered as a new stage in the G-20 evolutionary process. On the other hand, it is also important that the G-20 be able to deliver; it should avoid embracing too large of ambitions, but instead rely on its own comparative advantage, which means focusing on challenges that demand effective global collective action.

It is clear in this regard that trade, investment, migration or environmental policies in industrialized countries all influence poor and intermediate countries and can either help or hinder development. It is important to recognize that in times of economic stress, every nation faces competing priorities under strong domestic political constraints. The business of the G-20 is to muster political support at the highest level. Maintaining an open environment for trade is among the most prominent contribution of the summits to supply global public goods. The spirit of international cooperation, which has been the most precious asset to avoid the transformation of the great recession into another great depression, should be extended to align national preferences and policies into supporting the world’s poorest countries.

Should the G-20 take on every aspect of the previous priorities of the G8’s development agenda? It can reasonably be argued that these issues, such as securing pledges to contribute greater amounts of foreign aid, be left to other forums; but it is not so easy to settle this issue. Due to the transformation of what we now understand about “development”, this concept is no more the encapsulating concept it has been for decades in directing the policy of institutions managing foreign aid flows. Action has more and more evolved toward global policies defined by their sectoral dimension. And the result is sort of a chaos, uncertain junction or collision of independent initiatives, incorporating an increasing number of actors and producing high costs and high inefficiencies.

The problem is not new; it has been on the table at the OECD as well as at the United Nations, and a coordination procedure has even been adopted in the form of the Paris Declaration. Unfortunately, experience suggests that the fruits of this approach remain modest. It seems to practitioners that no one on the field is the principal actor. This produces a sense of irresponsibility and there is the danger of every institution setting up the flag. Private institutions are playing by their own rules, defining within themselves what is just and efficient, even if it is far from contributing to capacity-building. Too many resources, men and money are wasted in this process. Is it possible to improve the framework?

There is no clear and definitive recommendation to start this revision. One solution could be to reinforce the mandate of U.N. agencies, which could be given a stronger mandate for promoting a notion of general interest, for taking externalities into account and for defining aggregate objectives for different sectors like health and education. Foreign aid is no more considered as the only engine of development, but it remains important in many parts of the world in contributing to the basis of development. This is why the Development Working Group created by the Korean presidency could be mandated to make proposals so that a future G-20 summit could effectively deal with this huge and pressing challenge.
The G-20 and Global Development: Which Road to Take?

Thomas Fues  
Director, Development Policy Perspectives on Global Governance in the Context of the U.N. System, German Development Institute

Peter Wolff  
Head of World Economy and Development Financing, German Development Institute

The economic crisis of 2008 has brought about a sudden and unexpected shift in the world’s summit architecture. Almost overnight, the leading industrialized countries have elevated the G-20 at the level of finance ministers and central bank governors from its reincarnation as a leaders’ forum to the apex of the global system. This is notwithstanding the fact that the G-20’s composition reflects the perception of systemic relevance in the aftermath of the 1997-98 Asian financial crisis. As a consequence, the G8, which has subtly steered the global economy since 1975, has lost its original purpose and now looks like a subordinated caucus of a particular country grouping. Rising powers rightly claim that the G-20 cannot be considered a continuation of the G8 but rather heralds a new era in world politics. In order to symbolically signal their recognition of the irreversible power shift, industrialized countries would be well advised to disband the G8. In order to gain a legitimate place in the global governance architecture, the G-20 should assume a leadership role in global public policy that takes into account the specific needs of developing countries while striving for universal justice. Instead of adding another layer of well-meaning development programs, the G-20’s contribution to global development should strategically focus on framework conditions of the global economy and support overall policy coherence for pro-poor growth and planetary sustainability.

Mission and Identity of the G-20

Currently it is unclear whether the G-20, as a self-selected global steering committee, will develop a shared identity as a guardian of global well-being or rather function as a political space for old-style rivalries and national power struggles. And it remains to be seen to what extent the remaining 173 member states of the United Nations, as well as non-state actors from civil society and the corporate sector, can affect the design, implementation and outcome of global strategies adopted by the G-20. As an unprecedented representation of club governance, the G-20 needs to address its own inherent tensions between effectiveness, legitimacy and accountability. Its members must also find an adequate balance of (legitimate) national self-interest and global responsibilities if they want to be seen as a legitimate driver in the evolution of global governance. While the G-20 has quickly become the leading platform for dialogue and policy coordination in economic and financial matters, the shape and reach of the new summit architecture are still undetermined. Neither the power relations within the group nor the particular mandate it is meant to fulfill in a global perspective have been conclusively settled.

Role of Rising Powers

Rising powers have emerged as indispensable players on the global stage—a key reason for their inclusion in the summit architecture. By joining the G-20, they have voluntarily accepted the privileges and obligations of global leadership. This encompasses the acceptance of fair burden-sharing in the provision of global public goods, which is in accordance with national capabilities guided by the principle of “common but differentiated responsibilities” enunciated by the Earth Summit of 1992. It must be recognized, however, that the normative foundations of global governance are still heavily skewed toward Western norms and interests. In order to become an effective force, the G-20 needs to bridge the gaps between...
different value systems and translate common principles into operational guidelines for the common good. The contributions of rising powers to policy harmonization at this point are still at an incipient stage (Castaneda 2010). This can be exemplified by reference to international standards in environmental protection, human rights, social welfare and anti-corruption, such as the Extractive Industries Transparency Initiative (EITI), the Equator Principles for the banking industry, or the Global Reporting Initiative (GRI) on sustainability in the corporate sector. There is, however, a growing involvement of Southern powers in some areas of norm-creation—witness the new ISO 26.000 standard on social responsibility, where Brazil and China play a leading role.

Challenges to the G-20

Governments outside of the G-20 and many voices from global civil society are deeply suspicious of the summit architecture (Cooper 2010). They insist on the premier role of the United Nations in global deliberations and consensus-building. While the emphasis on the unique legitimacy of the G-192 (referring to total U.N. membership) carries considerable weight, the advocates of universality cannot deny the fact that the world organization is in a state of deep crisis. Wherever one looks, there is no appetite for reform on any of the issues debated in the U.N. system. Regrettably, the U.N. is known for adopting high-flying resolutions on about every concern of humankind but utterly fails regarding their implementation and outcome. Disillusioned by the 2009 Copenhagen debacle on climate negotiations, many observers fundamentally doubt that the unstructured, chaotic multilateral process at the U.N. is able to deliver tangible results in an era of sharpened allocational conflicts over increasingly scarce resources.

From a normative and functional perspective, it would seem desirable to integrate the G-20, or an analogous body, eventually into the U.N. system. A commission of experts recently recommended that the U.N. establish a global economic coordination council that could assume the function of the G-20 (U.N. 2009). A similar proposal was put forward by French President Nicolas Sarkozy and German Chancellor Angela Merkel. While civil society actors have supported the idea, governments so far have generally shied away from empowering the U.N. in economic affairs. Looking at the stalemate in multilateralism, it seems likely that incremental steps of reform will not suffice. Some scholars have therefore called for a grand design in restructur­ing the world order, equal to the historic effort of establishing the United Nations or setting up the Bretton Woods system in the aftermath of World War II (Maxwell/Messner 2008).

G-20 and Global Development

One good thing that can be said about past efforts of the G8 refers to the group’s commitment toward low-income countries, particularly in Africa. The G-20 agenda, in contrast, is conspicuously devoid of such ethical underpinnings, at least for the moment. Responding to growing concerns in the developing world on possible impacts of the new summit architecture on the South, the G-20 has recently begun to turn its attention to the specific challenges of global development and the plight of the poor (Fues/Wolff 2010).

The G-20 can and should become a relevant actor for global development but not follow the road of the G8, which has become famous for announcing a myriad of well-intentioned programs without much effort of implementing them. With this disappointing performance in mind, the G-20 should resist calls in that direction from civil society (Oxfam 2010) and not get caught up in aspirational declarations or operational programs. Instead, and in close consultation with relevant bodies at the United Nations, the new summit architecture should concentrate on a strategic role in designing a global framework for pro-poor growth and sustainability in developing countries. In this approach, the following three steps are of paramount importance:

1. The G-20 should assume responsibility for overall policy coherence in the global economy that recognizes and promotes the
interests of low-income countries, with a particular focus on trade, financial markets, cross-border investment and illicit capital flows.

2. The G-20 should negotiate a consensus on a focused list of global public goods, including the Millennium Development Goals, and should agree on a related order of priorities. In this context, the G-20 should also elaborate a reform proposal for a restructuring of multilateral organizations that allows for optimal synergies and a clear delineation of mandates (Linn 2010).

3. The G-20 should strive for agreement on a comprehensive model of burden sharing in relation to financing for global public goods, including the introduction of innovative financial instruments. This could be the basis for bringing about a “regime change” in international cooperation by moving from official development assistance to global public finance (Severino/Ray 2010).

Beyond such a substantive focus, the G-20 should quickly resolve important institutional and procedural questions, for example by including the U.N. and regional organizations in its deliberations, establishing a permanent secretariat, and providing institutionalized dialogue channels for non-state actors from civil society and the business sector. If the Seoul Summit makes progress on these open questions, the G-20 can become a relevant and effective actor in the global development system.

Bibliography


Cooper, Andrew (2010): The G-20 as an improvised crisis committee and/or a contested ‘steering committee’ for the world, in: International Affairs, 86: 3, 741–75.


IMF Reforms Bode Well for the G-20 Seoul Summit, But More Tangible Gains Are Needed

Rajiv Kumar
Director General, Federation of Indian Chambers of Commerce and Industry; Member, Central Board, State Bank of India; Former Director and Chief Executive, Indian Council for Research on International Economic Relations; Former member, National Security Advisory Board of India; Former member, Telecom Regulatory Authority of India

The historical agreement to reform the “voice and vote,” and subsequently the governance structure, of the IMF at the recent meeting of the G-20 finance ministers will satisfy leaders at the forthcoming G-20 Seoul Summit. There was great concern—until this agreement was announced—that the divergences among members, which had emerged at the Toronto Summit, on almost all the critical issues facing the G-20 would only deepen and widen at Seoul. This would have surely put into question the very future of the G-20. The crucial breakthrough of IMF reforms could not have come without the efforts of the Korean hosts, who have spared no efforts to ensure the success of the Seoul Summit. They have not only worked tirelessly since April with their official counterparts but also with think tanks around the world in an attempt to come up with new initiatives and ideas and to generate an intellectual climate in support of an effective G-20. Clearly, the Koreans have accepted the primacy of the G-20 as a global forum for economic and financial issues; and let us hope that France, who takes over the presidency in November, will continue with this trend. France should not downplay the importance of the G-20 in favor of the G8. The two summits should be independent of each other.

Agreement on the reform of IMF’s quotas and board composition could allow for open discussion on achieving balanced global economic growth. The key to achieving this is for the concerned countries (China, Germany, Taiwan and Singapore, as major surplus economies; and the U.S. as a major deficit economy) to accept their respective responsibilities and implement measures to correct the imbalances that currently characterize their economies. This would not be possible in a bilateral context, as such pressures are either politically unacceptable or seen as a result of divergent analytical understandings of country specific situations, which are used to justify unilaterally adopted policies. But the IMF, with its credibility restored, could make these policy recommendations on the basis of objective and technically-sound analysis undertaken as part of the mutual assessment process for which it has been mandated by the G-20 leaders. The multilateral framework, in which these recommendations will be made, will avoid the politically sensitive loss-of-face for individual governments. It will also reassure them that these recommendations are not aimed at benefiting any particular country at the cost of those which are expected to implement the required policy measures.

To achieve this positive outcome, however, the IMF will have to conduct its mutual assessment process, for which it was mandated at the Pittsburgh Summit, on a country-specific basis. The present practice, despite the mandate to undertake country-specific reviews, is of undertaking the assessment for “a category of economies that includes a group of countries.” This does not serve much purpose. Policy recommendations, that are relevant and effective, have to be made on the basis of county-specific diagnosis and implemented by individual governments. The IMF should now undertake these country-specific reviews and

1 For example, there are at least 17 major economies that have a current account surplus of higher than 3 percent of the GDP, which represents a significant macroeconomic imbalance. The group includes economies as diverse as Saudi Arabia, Russia, Taiwan, Germany and China. Policy measures cannot be recommended for such a diverse group of countries.
submit its findings and recommendations to the G-20. Member countries will then find it more difficult to continue with unilateral policies when faced with findings that have multilateral support. This could represent significant progress as all G-20 members, without exception, will be subject to these assessments and required to implement policy measures to redress any imbalances. If such an agreement for undertaking country-specific mutual assessment is reached in Seoul, the IMF could initiate the review process of the four or five economies with the largest imbalances and present its findings and recommendations at the Paris Summit. We can be sure that such an announcement itself will see much greater stability and restoration of confidence in global markets.

Also, let us hope that the next step in IMF reform—selection of its managing director and senior management on the basis of a transparent merit-based process—will also be implemented sooner rather than later. This should of course be applicable to other multilateral organizations like the World Bank and regional development banks, each of which today has some kind of an opaque quota system in operation.

The introduction of development issues in the G-20 agenda has been pushed hard by the Korean hosts. This faces the risk of overburdening the forum with additional agenda items before it has demonstrated its utility and effectiveness by achieving tangible gains. Perhaps the agreement to reform the IMF provides the forum with sufficient resilience and wherewithal to take on development issues as well. There is a danger that the development agenda being suggested for adoption by the G-20 becomes too large and precludes effective follow up or implementation. It is being suggested that the G-20 oversees practically the entire range of development activities in developing economies. This will include the building of physical infrastructure, human resource development, poverty alleviation measures, raising agriculture productivity, greater effectiveness of development aid, better management of water resources, labor standards and employment issues, and adoption of measures for mitigation of climate change impacts. This is far too ambitious and impractical an agenda for a summit-level forum. Moreover, this completely duplicates the mandates of existing multilateral organizations like the World Bank, regional development banks, and U.N. agencies and organizations.

There are, however, three development issues that the G-20 could be effective in managing. First, the G-20 could take up the issue of global aid architecture and adoption of globally accepted norms for channeling aid flows by old and new donors. This is distinct from the issue of getting the donor countries (it may be noted that China, Brazil, India and South Africa do not like to be included in the category of donor countries although they have substantial aid programs directed toward less developed economies) to agree to achieve the long-established target of committing at least 0.7 percent if not the originally agreed target of 1 percent of their GDP toward development aid. Presently, the issues related to official development aid, such as its quantum, design and direction are overseen by the OECD Development Assistance Committee (DAC), which has tried through the Paris Declaration and the Accra Agenda for Action to devise some global benchmarks for donors. However, large emerging economies like Brazil, China, India and Turkey have emerged as major donors but are not party to the DAC initiatives as they are not OECD members. This prevents effective coordination and in some cases could work against

---


3 It is in fact rather surprising to find the World Bank and regional development banks supporting such an initiative for the G-20 to include the entire gamut of development issues on its agenda as this would simply duplicate the functions of their own respective board of governors where all these countries are represented.
implementation of desirable sanctions against truant governments. On the other hand, nearly all existing DAC members (save perhaps Sweden and Japan) are in violation of their own pledge to allocate 1 percent of their GDP for development aid. There is apparently insufficient peer pressure within the DAC to hold them to their commitment. Such an issue where the global community would benefit from greater coordination between emerging and advanced economies, and which require a degree of name and shame and accountability, would be ideally suited for adoption by the G-20.

Second, the G-20 must take up the issue of developing new norms for technology transfer that are less onerous for the least-developed economies. This can focus on facilitating the transfer of “green technologies” across the entire spectrum of goods and services. The issue of access to necessary technologies and now green technologies has long divided the global community in to “us and them” or between “owners and users.” These divisions are especially harmful for technologies needed to overcome deleterious consequences of extreme poverty and address climate change issues. As a start, it could be agreed that all technologies developed with support from the public exchequer in any country that is a signatory to the U.N. Framework Agreement on Climate Change will be transferred either free or with minimal charges to other countries. Having been supported by public sector resources and not private finance, this will not distort the incentive structures for undertaking new research in other fields of inquiry.

Third, it is becoming increasingly clear that the existing asymmetry between near-complete freedom and flexibility for movement of capital across national borders, and highly-restricted movement of migrants across the same borders, is no longer tenable if globalization is to succeed and deliver on its promise of convergent growth. In a number of studies, restrictions on labor mobility, in contrast to the free flow of capital, across borders have been cited as a major reason for growing income inequalities. As Rodrik says, “economists have remained excessively tolerant of the political realities that underpin the highly restrictive regime of international labor mobility...” The argument against labor mobility across national borders is based on the rather out-dated notion of maintaining a degree of social and cultural homogeneity in a world that is increasingly a global village. We cannot expect to receive the full benefits of globalization if two major factors of production, namely technology and human resources, suffer from restricted mobility. The G-20 will do well to take on these important and admittedly difficult development issues as this will greatly enhance its credibility. It will also start the process of eliminating the asymmetry that currently exists between advanced and emerging economy members of the G-20.

Lessening Pressure on Trade Protectionism by Diversifying Exports

Muhammad Chatib Basri  
Director, Institute for Economic and Social Research, University of Indonesia

History has shown us that protectionism and beggar-thy-neighbor policies were key factors in bringing down the global economy into the Great Depression in the 1930s. We do not want to repeat a similar mistake again. So at the onset of the global financial crisis, G-20 leaders called on each other to refrain from raising new barriers to investment and trade. This commitment has been reaffirmed in almost every G-20 meeting following the Washington meeting in November 2008. Fortunately, so far there has been no significant increase in trade barriers like what had happened during the Great Depression of the 1930s.

The global financial crisis was associated with a trade collapse, which affected many countries in the world. It is natural that a collapse in the trading system combined with acute macroeconomic instability led policymakers to question the relevance of an export-led growth strategy. Given the magnitude and impact of the trade collapse, protectionism has become an obvious concern, especially when the global recovery is still underway.

As for Indonesia, many believe that its relatively insulated economy is the reason why it has performed relatively better than other economies during the global financial crisis (Basri and Rahardja, 2010). This then brings to the surface the question of whether an export-led growth strategy is still relevant, bearing in mind that what saved Indonesia from the dreadful effects of the global financial crisis was its domestic economy. This is not only specific to Indonesia because data shows that many countries that are supported more by their domestic economies are proven to have a better performance compared to countries that are extremely dependent on exports during the global financial crisis. This phenomenon has led to lively discussions among commentators, politicians and some policymakers in Indonesia about the importance of relying less on exports and focusing more on the domestic market. Often the advice given to Indonesian policymakers from these discussions is to pay less attention to the “openness” to trade and investment and instead concentrate more on protecting the domestic economy against external volatility. This experience is influencing these groups to embrace somewhat more nationalistic or protectionist views for a new reason. As often captured by print media, there seems to be a thinking that Indonesia should limit openness and integration with the global economy to prevent itself from being dragged down by the global economic slump. This view adds to the existing view that openness exposes Indonesian firms to unfair competition. Political pressures against more openness sometimes influences policymakers to implement more inward looking policies and to rely less on exports. So what is the relevance of a strategy of facilitating exports and openness to economic growth?

Amidst that debate, a study by Basri and Rahardja (2010) indicates that exports are in fact an important source of Indonesia’s economic growth. Exports have a large effect in supporting economic growth, albeit less stable compared to domestic demand. Therefore, a strategy safeguarding a balance between the domestic economy and global orientation, such as becoming a part of a production network and promoting export-oriented growth, must become a part of the development strategy of the national economy. Strengthening domestic demand can be done without resorting to protectionist policies. The study by Basri and Rahardja
also shows the strong link between exports and strength in the domestic economy. They argue that it is likely that commodity exports play an important role in driving consumption in Indonesia. The economic activities in resource-rich provinces increased as a result of the commodity boom that had occurred in the previous years. This development was reflected by relatively high credit growth in resource-rich provinces several years ago. The growth of third party funds in commodity-producing regions also experienced a slow increase. This fact strengthens the argument that the economy in resource-rich provinces improved as a result of the commodity boom; and during the crisis period, residents in those areas were capable of making use of their accumulated savings to support their consumption during the global financial crisis. In addition, services exports played an important role because surprisingly strong exports in tourism, creative designs and workers' remittances are likely to have direct links with private consumption.

With that evidence, an inward looking strategy is not the right choice. This is also true for the countries that do not have a large domestic market like Singapore. Thus, a strategy to facilitate exports will provide relevant results for the Indonesian economy or countries with small domestic markets. If a strategy facilitating exports is still relevant for Indonesia, will that strategy be able to reduce volatility in Indonesia's economic growth?

A study by Haddad, Lim and Saborowski (2010) shows striking results of a positive connection between export concentration and the total effect of openness on volatility. The more concentrated exports are, the higher the total effect of openness on volatility is. The implication is that the effect of growth volatility as a result of the choice of an export-led growth strategy in the economy would diminish through export diversification. This study provides an exit road for Indonesia to still safeguard an export-led growth strategy as long as an export diversification policy is carried out. Therefore, it is very important to examine the experience of export diversification in Indonesia.

Basri and Rahardja (forthcoming) show that Indonesia can still do more to diversify its exports. It is true that the reform package on trade liberalization in the 1980s dramatically increased Indonesia's export product diversification. A set of policies that reduced barriers to entry, improved trade facilitation and reduced bureaucratic inefficiencies unlocked business opportunities in Indonesia's non-oil sectors. As a result, Indonesia became one of the platforms for a footloose manufacturing industry. The process was also accompanied by a global quota arrangement on textiles and clothing, measures discouraging exports of raw agriculture commodities and relatively low global commodity prices that made exporting manufactured products more attractive than exporting commodities. Our findings also suggest that Indonesia has increased exports of existing products to some new markets, which is part of the extensive margin. However, we also find that extensive margins driven by the discovery of new products and exports to new markets are still quite low.

Recent efforts to diversify exports in markets and products have been increasingly more challenging. Competitiveness issues are constraining Indonesian manufacturers and limiting their returns as they face an increasingly competitive global market. Booming commodity prices and the
appreciation of the rupiah’s real exchange rate have increased the opportunity costs from investing outside of the commodity-related businesses and lowered the margins for manufacturers to compete globally. Interestingly, declining performance of Indonesia’s manufactured exports also coincides with the appreciation in the real exchange rate and rising exports of resource-based commodities. The increased price of commodities raises export revenues and increases pressure for real appreciation of the rupiah. Meanwhile, the increase in the price of commodities could also have increased factors of production intensively used in commodity sectors, such as labor and capital, squeezing profitability in traditional manufacturing sectors that are facing competitive world prices and the strengthening rupiah. In addition, the threat of a “currency war” may complicate the situation. The loose monetary policies and measures of advanced economies prop up the carry trade and consequently lead investors to buy assets in emerging economies, thereby creating pressure on exchange rate appreciation which may hamper Indonesia’s efforts on export diversification and may trigger protectionist pressures.

Indonesia’s past experience and dependence on oil commodities reminds us that there are risks in its economy. Therefore, in the future Indonesia has to issue policies to diversify exports. There are several policies to be carried out, such as development improvements in the financial sector, improvements in the logistics system or connectivity, reduction in dependency toward primary exports, safeguarding competitiveness from exchange rates (preventing Dutch disease), improvements in R&D and the quality of products, increasing the role of the services sector as well as improvements in promotion and marketing. If these policies are smoothly implemented, Indonesia will maintain an export-led growth strategy while also supporting domestic consumption. Ultimately, export-dependant countries can still safeguard an export-led growth strategy as long as an export diversification policy is carried out. This export diversification strategy will also help to ease the pressure on protectionism.
The G-20 and Two Scenarios for the World Economy

Paolo Guerrieri  Professor of Economics, University of Rome Sapienza; Professor, College of Europe, Bruges

We Are Very Far from Rebalancing the World Economy

It is quite clear that the effects of the 2008-09 global financial crisis are far from over. Since mid-2009, the global recovery has been the cyclical result of massive stimulus combined with short-term inventory corrections. Once these factors weaken, as is already happening in many countries, economic growth will weaken as well. Although a double-dip recession is unlikely, the process of adjustment will bring to the fore many structural problems left over from the crisis, including the fragile banking sector and the need for fiscal austerity. Among these structural problems, the key issue is that global imbalances are rising again.

Although the recent global downturn has led to a natural rebalancing of economies, the latest estimates from the IMF and OECD suggest that world current account imbalances are likely to remain substantial through 2015. Along with the large Asian surpluses, the German and new European countries’ surpluses will probably increase the U.S. current account deficit.

The Risk of a New Financial Crisis

This is very far from the rebalancing strategy agreed upon by the leading G-20 economies as being critically important for sustaining global expansion. And it is a very risky trend since current and expected account deficits and surpluses are indeed a fundamental threat to global macroeconomic and financial stability in the medium and longer term. The higher imbalances themselves could favor a new financial crisis, just as they were the fundamental contributing factor of the last crisis.

Global imbalances need to be viewed in the context of the shift in economic power from the West to the East. The West—or at least countries like the U.S., the U.K. and Spain—need to spend less and save more. In contrast, regions like the Asia Pacific need to save less and spend more. What is needed globally is for both debtor and creditor countries to rebalance their economies. A shift in the mix of international saving and consumption flows would be the only effective way to neutralize the imbalances. The incentives to change are indeed very high, yet the obstacles to change are even more formidable.

Too Soon for Asian Decoupling

There is a lot of optimism in this post-crisis recovery era that China’s, and the rest of Asia’s, economic growth will spill over and benefit the rest of the world and help rebalance the world economy. Asia has changed dramatically in the past decade. Most East Asian economies have staged a rapid recovery from late 2009 and are going to register robust growth in 2010. Furthermore, the global economic crisis has prompted East Asian governments to reflect on the recalibration of development models. Equally important, the crisis has generated renewed incentives for East Asian governments to push for deeper and broader regional cooperation, particularly in the domains of trade and financial policy management.

An optimistic scenario to follow these changes include Chinese and East Asian growth that are increasingly driven by domestic demand and intra-regional markets, absorbing more exports from outside and thus easing the balance of payment problems of the United States and Europe. But...
that is a forecast of medium- to long-term growth. Policies proposed by China to rebalance economic activity toward private consumption are only the beginning of a multi-year process and need greater political will. That leaves the region still very dependent on external demand.

The Global Collective Action Problem and the New Multi-Polar World Economy

Currently, the long-awaited global rebalancing is still very far from being realized. Even more so since the world economy operated under a “market-led international monetary system” in which incentives incorporated in it either do not induce any correction of the imbalances or favor serious asymmetry in the global imbalances adjustment process.

Over the 15 years before the crisis, the macroeconomic arrangement benefited both the United States and Asia. In this system, the United States could finance persistent current account deficits by exploiting the role of the U.S. dollar as the international reserve currency; surplus countries could avoid any adjustment by pegging their currencies to the dollar. The United States thus played the $n$th country role in the system by widening its current account deficits to accommodate the sum of ex-ante external surpluses and deficits of other $n-1$ countries given the zero sum game of the countries’ balance of payments at the world level. Exchange rate manipulation remained mostly unregulated in this international monetary regime and there was a complete absence of effective remedies against it. In the medium to long run, the macro-system was clearly unsustainable.

Similar macroeconomic imbalances are challenged today because neither the U.S., with its huge debt accumulation, nor any other country is able to play the $n$th country role in the current international macroeconomic regime. It means that a well-known, serious asymmetry exists in the adjustment process for global imbalances in the current international monetary system. Current account deficit countries must adjust as they run out of foreign exchange reserves and/or financial market-imposed discipline. Surplus countries, however, do not feel pressure to reduce their current account surpluses or to prevent their currencies from appreciating. Therefore, persistent surpluses of China, Japan, Germany and most of Asia will not be mitigated anymore and will produce a lack of global aggregate demand and deflationary bias on the world economy.

There is a classic “collective action” problem in the current multi-polar global economy since exported growth (neo-mercantilism) is justified at an individual country level. However, at a systemic international level, these mercantilist strategies can generate a world depressionary and deflationary bias. And this is not a cyclical phenomenon but a key feature of the new multi-polar global economy. Current macro imbalances could have penalizing negative effects upon world demand and growth, inducing a game of competitive devaluations which most economies are playing today. Unless a long-term solution is jointly worked out, currency and trade conflicts will worsen and they will become increasingly hard to reverse.

Scenario One: A Painful and Prolonged Pause in Global Growth

In the short to medium term, the resulting lack of global aggregate demand relative to supply—or equivalently, the excess of global savings relative to investment spending—will lead to a weaker recovery of global growth with most economies growing much less than their potential growth rate.

In this instance, current macro imbalances could have penalizing negative effects upon world demand and growth, thus fueling increasing currency and trade tensions among major countries. Even more so since debt-ridden Europe must now come to grips with a fiscal consolidation, economic growth may be restrained for a long period of time.

According to Dominique Strauss-Kahn, IMF managing director, “national and global growth would be slower than many countries hoped because too
many were relying on exports to underpin expansion.” In a world in which all countries are trying to obtain as large a share as possible of deficient aggregate demand, such conflicts are inevitable. This could lead to risky and worrisome currency and trade tensions between the West and the East, as the former takes action to protect hard-pressed workers while the latter relies on export-led growth as the antidote to poverty and a massive overhang of surplus labor. In the end, the negative consequences for global economic growth would be huge and all nations would suffer.

**Scenario Two: International Macroeconomic Cooperation for Global Growth**

To avoid beggar-thy-neighbor policies and initiatives, each country should recognize that macroeconomic cooperation is critical. This relates to the aforementioned problem of asymmetry between surplus and deficit countries, which in turn is rooted in the mercantilist attitudes of key major countries. Keynes worried about the potentially damaging effects of global current account imbalances and the fact that market forces were not very effective in compelling surplus countries to adjust.

International macroeconomic cooperation is crucial to achieving higher global growth and is better than most of the other potentially negative alternatives. We should try to restore some shared rules of the game for international macroeconomic adjustment. In this perspective, the agreement reached at the 2009 G-20 Summit in Pittsburgh, the “framework for strong, sustainable and balanced growth,” is fine in terms of broad principles but it lacks specifics and enforcement mechanisms.

We need to endorse a strengthened surveillance regime for the IMF to induce coherent mutually compatible macro policies and allow real exchange rates to adjust. Formal thresholds for current account balances are needed—perhaps similar in some ways to the recent U.S. proposal discussed by G-20 finance ministers—beyond which countries would have to correct these imbalances and adjust their policies. In this regard, the IMF should have some sort of enforcement rule incentives and mechanisms. Otherwise, we are going to repeat past mistakes where peer pressure hindered significant results.

Finally, without a greater perception of IMF legitimacy, members of the institution will be reluctant to embrace the mutual consent of the peer-review processes that is necessary for the IMF to be able to meet its regulatory challenges in the future, including the global adjustment process. That in turn will need root-and-branch reform of its governance structure to reflect the changing realities of the world balance of economic power. It is very encouraging that agreement was reached by the G-20 on a reform of the IMF to give a bigger voice to developing countries.
The G-20 has met several times already and yet the meeting of this group is still a new attempt in some ways. The G-20 was reborn in the middle of the world financial crisis and has since been struggling to deal with its aftermath, particularly in restructuring the international financial system and entrenching a global economic recovery. We are nowhere near the point where we can confidently say that these issues have been successfully dealt with and so the G-20’s preoccupation with these immediate policy issues is certainly understandable.

However, if the G-20 is to become an important and commanding part of the global governance structure, it must start paying attention to major policy issues that emerging and developing countries face in their pursuit of development and poverty reduction. In the past, the G-20’s predecessor, the G7 and G8, would go through the rituals of making official statements that expressed support for development targets like the Millennium Development Goals, which I must agree with Jagdish Bhagwati are no more than a set of “aspirational do-good targets” (Finance and Development, September 2010). They would make promises of increasing aid, which would often turn out to be empty or, worse, “fulfilled” by gimmicks such as double-counting and other “creative” official development assistance accounting practices. I think with the G-20 being comprised of several emerging and developing countries, it should aid and directly tackle the policy issues for growth and development.

I am sure there will be many such issues requiring global or international attention and my colleagues of the Think Tank 20 (TT-20) will certainly raise them. On my part, I would like to propose two issues for the G-20; one issue requires urgent and immediate resolution and agreement among the international community and the other will require a longer time to resolve but is nevertheless important for the smooth functioning of the global economy.

The first issue is the international exchange rate policy and regime. This issue is currently being hotly debated in anticipation of the G-20 discussions of global imbalances and the necessary remedial measures that surplus and deficit countries should take for the good of the global economy.

However, the debates are too preoccupied with and narrowly focused on the immediate U.S.-China trade problems and the flexibility and inflexibility of the Chinese yuan. The days when the “bipolar” doctrine was regarded as an international norm are long gone. Although most people believe that exchange rates should reflect economic fundamentals, they also often recognize that foreign exchange markets often allow rates to deviate substantially from such fundamentals-based rate levels and for fairly long periods of time. The Asian financial crisis and the current world financial crisis have amply shown that one reason for such exchange rate volatility and overshooting and/or undershooting is short-term capital movements of an enormous magnitude—“sudden surges and stops” caused not so much by changes in the economy’s fundamentals but by external factors and investor sentiments. They are particularly disruptive to “small and open emerging and developing economies”. Managing these capital flows and their attendant exchange rate volatility have become very important to macroeconomic stability and growth of these economies. Yet, I don’t think policymakers
have at their disposal a set of effective policy instruments to do so.

Given the highly technical nature of the problem, the G-20 should mandate the IMF and perhaps the World Bank to study and recommend a set of well-considered “international standards” or “best practices” in dealing effectively with disruptive short-term capital movements. Some out-of-box thinking will be needed for this task, going well beyond the orthodox economic policy thinking.

The second issue that requires the G-20’s attention is related to another kind of cross-border movement, namely labor migration. Labor migration is not a new phenomenon, but its enormous increase in magnitude—which is one aspect of the recent globalization trend—is entirely new. There are conventions dealing with cross-border movements of goods and services, and the World Trade Organization is an institutional framework for international regulation; there are also conventions regarding capital movements embodied in the IMF agreement and the IMF is the regulatory body. In contrast, there is no international institution that looks after international labor migration. The International Labor Organization and the United Nations Refugee Agency are involved in certain issues relating to international labor migration, but their mandates are limited in scope and authority.

It is time for the G-20 to start discussions about how to manage labor flows across national borders with a view to establishing a policy framework that would be internationally accepted by both sending countries and receiving countries. Currently, each country manages labor migration by policy instruments of a primitive nature—be they national quotas and by employment and professional categories—without any attempt for international harmonization. The way labor migration is managed today is almost like the way international trade was managed in the past before the GATT/WTO. Moreover, as the number of migrants exponentially increases, there needs to be an arrangement for their protection both legally and through economic safety-nets, which is based on some kind of minimum international standards. Taxes and subsidies, if well conceived and administered, could be good instruments to influence the volume and nature of labor migration. As in some free trade agreements, well-structured migration programs relating to temporary and permanent migration may be helpful in the regulation of cross-border labor movements. With the objective of establishing some form of international conventions, the G-20 may consider mandating the WTO—the only international organization with experience and capacity in managing similar areas (goods and services)—to start up a study group among its members.

In the end, the G-20 should not be allowed to become just an extended and bloated version of the G7 and G8. It should not be a club of the powerful, as the G7 was a club of the rich. If it is to become a core part of the global governance structure, it should take on the important issues related to international development. Since it was reborn in the midst of the world financial crisis, its leaders are naturally compelled to deal with the urgent economic recovery issues at hand. However, for the G-20 to properly deal with the important issues of global development, it should be given a robust development agenda from the very beginning. I hope very much that the TT-20 will be helpful in the creation of this development agenda for the G-20.
The G-20 Calls a Truce in the Currency War

Wonhyuk Lim  Fellow, Korea Development Institute; Fellow, Korea National Strategy Institute

A specter of a lost decade is haunting the United States and China. With its core inflation rate eerily tracking the path of Japan’s in the 1990s, the U.S. faces the risk of falling into sustained disinflation, if not deflation. Persistently high unemployment, combined with the ongoing financial crisis, makes the situation in the U.S. potentially worse than it was in Japan, which managed to maintain employment and social cohesion during what was often called “a happy recession.” China fears that a rapid appreciation of its currency would precipitate mass unemployment and bankruptcies, as Premier Wen Jiabao warned on October 6 at the EU-China Business Summit in Belgium. China is also determined not to fall for “Plaza Accord II” and repeat Japan’s mistake—namely, agreeing to a drastic revaluation of its currency, adopting loose monetary policy to buffer the exchange rate shock, turning a blind eye to rapidly rising asset prices, and waiting for firms and financial institutions to grow out of their problems in the wake of the asset price collapse. These fears and anxieties provide the backdrop of the debate on quantitative easing and the undervaluation of the Chinese yuan, two key issues that have framed “the currency war” of the past several weeks.

A two-speed recovery in the increasingly integrated global economy further complicates the picture. While leading emerging economies are currently faced with the risk of overheating, advanced industrial nations, including those with reserve currencies, are concerned about falling back into recession. If leading emerging economies put on the brakes, global aggregate demand would be reduced, with an adverse effect on external demand for advanced industrial nations. On the other hand, if the United States and other reserve-currency countries resort to quantitative easing to fight deflationary pressures, a substantial part of the increased money supply is likely to “leak out” overseas in search of higher yields. As IMF Managing Director Dominique Strauss-Kahn noted in Shanghai on October 18, massive capital flowing into emerging economies could lead to “exchange-rate overshooting, credit booms, asset-price bubbles and financial instability.” And emerging economies may have to adopt capital controls to help moderate the vast flows.

To manage the two-speed recovery and promote “strong, sustainable and balanced growth” around the globe, macroeconomic policy coordination is more needed than ever before.

As much as international coordination is critical to recovery, however, it is far more important to get domestic policy right by crafting political consensus. Even in this age of globalization, large economies—whether advanced or emerging—still derive most of their aggregate demand domestically, and a country like the U.S. finds it difficult to narrow its output gap (estimated by the Congressional Budget Office to be 6.3 percent of potential GDP in the second quarter) unless its domestic demand recovers. At the same time, due to the liquidity-trap conditions, loose monetary policy is likely to be largely ineffective in generating additional demand. Under these circumstances,

---

advanced industrialized nations with high unemploy-
ment and underutilized capacity should adopt a
greater fiscal stimulus designed to create jobs and
improve infrastructure at home, to crowd in pri-
ivate-sector investment after households and firms
repair their balance sheets and recover their busi-
ness confidence. The widely publicized second
underwater tunnel connecting New York City and
New Jersey may be an example of a productivity-
enhancing infrastructure project that would
support employment and aggregate demand.
Unfortunately, the U.S. and other advanced
industrialized nations instituted a rather insuffi-
cient fiscal stimulus even though the bond market
has been signaling with extremely low interest rates
that the U.S. and other advanced economies should
undertake much more aggressive fiscal expansion.
In particular, advanced industrialized nations
should do more to reduce high unemployment,
which has such a corrosive effect on consumer
confidence and business sentiment. If prolonged,
“structural” unemployment will become a self-
fulfilling prophecy as workers’ skills depreciate.

China and other leading emerging economies
must deal with exactly the opposite kinds of
problems faced by the U.S. and other advanced
industrialized nations. When the global financial
crisis of 2008 broke out, many emerging
economies saw their currency values plummet
as investors took flight to the so-called safe-
haven currencies—with some selling their assets
in emerging markets to make up for the losses
they suffered in advanced industrialized nations.
Maintaining capital controls, China put a halt
to the appreciation of the yuan, which had risen
by 21 percent over a three-year period since the
adoption of a currency basket system in July 2005.
With the stabilization of global financial markets
and faster recovery in emerging economies than in
advanced industrialized nations, currency values
now have to readjust. Exporters in emerging
economies, who have become used to making easy
money, may not welcome the prospect of currency
revaluation, but emerging economies facing
inflationary pressures should take steps to avoid
overheating. They should not be afraid of making
this adjustment. China suffered no economic
catastrophes when the yuan gradually appreciated
by 21 percent from 2005 to 2008. If anything, it
became an economic powerhouse over this period.
Going back further, Korea used the currency
revaluation and wage increase in the late 1980s as
an opportunity to upgrade its industrial structure.
Similar adjustments, in coordination with major
economies, could be mutually beneficial.

The G-20 finance ministers and central bank gov-
ernors met in Korea’s ancient capital of Gyeongju
in late October to address these policy challenges.
They agreed to “move toward more market
determined exchange rate systems that reflect
underlying economic fundamentals” and “pursue
the full range of policies conducive to reducing
excessive imbalances and maintaining current
account imbalances at sustainable levels.” They also
agreed that persistently large imbalances would
warrant “an assessment of their nature and the root
causes of impediments to adjustment as part of the
Mutual Assessment Process,” in cooperation with
the IMF. Although the idea of placing symmetric
numerical caps on current account imbalances
was floated, the ministers and governors failed to
produce specific targets just yet.

---

1 Japan offers useful lessons on quantitative easing and fiscal expansion after the collapse of asset prices. Richard C. Koo, chief economist at the Nomura Securities and author of Balance Sheet Recession, notes that since the asset prices collapsed in 1990, Japanese households and firms have been deleveraging, despite near-zero nominal interest rates, to repair their balance sheets. Today, the corporate leverage ratio of debt to capital has fallen to 1.78, from 4.05 during the height of the bubble, but “just like the millions of Americans who never borrowed money after the Great Depression, there is tremendous aversion toward debt in Japan, even with zero interest rates.” He argues that in the face of deflationary pressures, “Japan has managed to maintain its GDP above the peak of the bubble for the past 20 years because the government stepped in to borrow and spend the surplus savings in the private sector.” See Richard C. Koo, “Now Isn’t the Time to Privatize Japan Post: Far from crowding out private lending, the bank is crowding in by financing stimulus spending,” The Wall Street Journal, April 19, 2010.

2 The target indicator for fiscal consolidation, the debt-GDP ratio, has both a numerator and a denominator, and it does little good for the ratio if GDP rises more slowly than debt in the process.
This agreement represents a major accomplishment in policy coordination as it enables the G-20 to move beyond the narrow focus on the yuan-dollar nominal exchange rate and adopt a fair, gradual and multilateral approach to global imbalances. First, the agreement recognizes that both excessive surpluses and deficits should be fixed, subject to country-specific factors such as natural resource endowment and the asymmetry between reserve-currency and non-reserve-currency countries. In fact, it calls on advanced economies, including those with reserve currencies, to be “vigilant against excess volatility and disorderly movements in exchange rates.” Also, the agreement implicitly acknowledges that while the exchange rate is an important variable, it is not the only variable that affects the savings-investment balance. It explicitly recommends “fiscal, monetary, financial sector, structural, exchange rate and other policies” to deal with imbalances. Second, instead of calling for a big-bang adjustment, the agreement has a medium-term framework to deal with persistently large imbalances, “assessed against indicative guidelines to be agreed.” Third, the agreement recognizes the danger of politicizing global imbalances as a bilateral problem between the U.S. and China and instead defines it as a multilateral issue to be resolved through the Mutual Assessment Process.

Some critics, however, have argued that the agreement lacks teeth and needs specific numerical targets to be effective. Although the behind-the-scene bargaining over numerical targets is likely to be intense, there is a good chance that the G-20 will agree to indicative guidelines by the time of the Seoul Summit on November 11-12. As for “teeth,” the fundamental problem is that you cannot name and shame great powers because they are shameless and powerful. The effectiveness of the IMF surveillance work and the Mutual Assessment Process will be limited to that extent. However, it will be still useful to have a multilateral mechanism that considers both excessive deficits and surpluses as problems, and provides the basis for gradual (not glacial) adjustment. In fact, it is worth noting that one of the major factors that triggered the currency war was the slow adjustment of the yuan in the months following China’s announcement to increase its flexibility on June 19, just before the Toronto G-20 Summit. When the yuan appreciated by only 1 percent over the next three months, the economic issue of exchange rate adjustment turned into a much larger problem of trust and China had to face increasing pressure from other countries to keep its word as another G-20 Summit approached. Although great powers always have the option of ignoring other countries, the holding of summits and ministerial meetings at regular intervals ensures that the G-20 is far more likely than stand-alone international organizations to follow through on the members’ commitments.

The recent G-20 agreement does not force its members to adopt all the necessary macroeconomic policies or resolve their domestic political problems, but at least it helps to shift the policy focus away from the yuan-dollar nominal exchange rate and to larger and more fundamental issues. As such, the agreement qualifies as a step forward. With international coordination taking shape, it is now up to individual nations to craft domestic political consensus to get their policy right.

4 In its initial discussions with the U.S., China and others, Korea used the standard 5 percent of GDP threshold for current account imbalances. At Gyeongju, U.S. Treasury Secretary Timothy Geithner was reported to be interested in setting the cap at 4 percent. As Gavyn Davies, among others, has noted, a cap of 5 percent catches only Germany among the top 10 economies at the moment, but 4 percent gets China as well as Germany; whereas 3 percent catches the U.S. and Japan as well. Interestingly, it was not China, but rather Germany, Brazil and Japan who led the opposition to numerical targets at Gyeongju. In fact, Yi Gang, deputy governor of China’s central bank, stated on October 9 that the Chinese government aimed to reduce the current account surplus to 4 percent of GDP or below over the next three to five years.
The agendas of the G-20 summits as well as those of other meetings of world leaders are dominated by issues that matter to the current state of the global economy, including fiscal stimulus, currency wars, global imbalances, capital requirements and bankers’ bonuses. However, the summits pay much less attention to the issues related to long-term growth and development. Yet, these issues have been known for years and their importance has been building up slowly. The recent crisis has shown that discussion of some of these issues should not be postponed any further. The most important of them is the shaky fiscal position and the looming bankruptcy of pension systems in industrialized countries.

We have known for a while that we do not really have a solution to the problem of solvency of pension systems in the United States, Europe and most transition countries. We have also known that excessive government debt is a threat for long-term economic growth. There is no single answer to the question of what level of debt is dangerous and critical; it certainly depends on the country-specific characteristics. For most countries, a debt level of below 60 percent annual GDP is probably safe while a debt level of about 100 percent of GDP is threatening—and this is already a reality for many industrialized countries.

During the recent crisis, many countries implemented unprecedented fiscal stimulus packages and brought budget deficits and debts to levels that were previously described in the development economics literature as “debt overhang”. These debt levels are already so high that they are going to slow down growth either through increasing interest rates crowding out investment, through higher taxes imposed by governments to reduce budget deficits or through high inflation. But if growth continues to be slow, many countries will not be able to grow out of their debt. Consequently if and when another global economic crisis happens, these countries will enter a recession with existing high debt levels. Even if these countries understand the urgent need for a sizeable fiscal stimulus, they may be unable to undertake it; markets will not lend to them at reasonable interest rates and high interest rates would only deepen the contraction. Therefore, such debt will eventually undermine the ability of country governments to handle another recession.

We have almost never witnessed this problem in recent decades. The debt overhang issue used to only be a problem for poor countries, particularly the heavily indebted poor countries. But there have been exceptions. For example, in the 1980s, the Soviet Union was a high middle-income country with a reasonably low debt burden. But just a few years of loose fiscal policy coupled with an adverse terms-of-trade shock (a drop in the oil price) removed the country from the map. The sharp decrease in global oil prices reduced government revenues and brought about a recession in the country. In order to spend their way out of recession, Soviet leaders borrowed at enormous speed, which resulted in a situation where nobody would lend to the Soviet Union anymore and the country went bankrupt.

Certainly, the U.S. and Europe are very different from the former Soviet Union. In particular, the U.S. dollar and euro are international reserve currencies that are hard to replace in any foreseeable future. During the recent crisis, global investors...
ran to the dollar for safety even though the dollar rates hit the zero lower bound. Yet, if fiscal deficits are not cut, government debt will continue to increase and grow faster than GDP. This will make the frightening debt overhang scenario a reality and financing the huge public debt will eventually crowd out private investment and undermine long-term growth. And with debt levels so high, it is not clear how the U.S. and EU will be able to fight off the next recession.

Why is fiscal consolidation policy an issue of global governance? In principle, countries can and should cut their budgets on their own and they should have incentives to do so. However, there are substantial free-rider problems. First, because the debt overhang now concerns countries that issue reserve currencies, this also impacts other countries that hold international reserves. Second, there are substantial cross-border spillovers of fiscal consolidation. If one country cuts its budget deficit and reduces its borrowing in the market, interest rates fall. Therefore, capital may leave the country for a neighboring country with less responsible fiscal policies. In the latter country, as the capital inflows reduce interest rates, the government will be happier to keep running the budget deficit. Thus, mutual commitments and coordination are important.

The solution to the problem of fiscal deficit is straightforward—albeit difficult to implement. Rich countries should bring their deficits and debts down (e.g. to the Maastricht Criteria). As the Maastricht Treaty is hard to enforce within Europe—even with the recent proposals of peer review of budgets—it will also be virtually impossible to enforce within a loose club such as the G-20. But, in order to make sure that this is not dismissed and forgotten, it is important to keep bringing the issue of fiscal consolidation policy to the top of the G-20 agenda every time the group meets.
Addressing Development at the Seoul G-20 Summit

Abdullah El-Kuwaiz

At the last G-20 Summit in Toronto, leaders committed themselves to coordinate a plan to support growth, declaring that they “are committed to taking concerted actions to sustain recovery, create jobs and achieve stronger…growth.” The Toronto Summit declaration went on to say that the “G-20’s highest priority is…to lay the foundation for strong, sustainable and balanced growth.”

How can this strong commitment be translated into action, which is specifically tailored to developing country needs, at a time when aggregate growth of developing countries is higher than that of industrialized countries?

The answer may lie with international institutions, particularly the International Monetary Fund, World Bank and World Trade Organization. However, these institutions need to become more relevant in helping developing countries identify development priorities and implement the right programs to achieve these priorities. While these institutions lost some of their relevance during the last two decades, they have regained both relevance and influence as a result of the global economic crisis, the drying up of liquidity in the international banking system and the increase in the resources available to them. Therefore, they are now able to play a more proactive role in global development.

For the G-20 to positively impact economic growth and development in developing countries, especially the poorest ones, two important areas should be highlighted: development financing and promoting freer world trade.

Challenges and Opportunities in Development Financing

In the area of development financing, a number of challenges can be identified:

- Except for China, official development aid is drying up because of the sovereign debt and the ever-expanding fiscal and external deficits facing most donor countries.
- International banks are cash-strapped as a result of the crisis. Even in cases where they have enough liquidity, they are reluctant to lend to some developing countries because of the new Basel III capital requirements.
- The international banking system may face a crowding out situation when financing government debt outstrips private financing. This is mainly caused by the excessive needs of financing by deficit-stricken industrialized countries, which is leaving little room for developing country lending.

On the positive side, more resources are becoming available to the IMF and World Bank to modify its programs to accommodate least-developed countries. For the IMF, two areas of immediate concern are to expand the newly-created flexible credit line, which carries no prior conditionality, as well as the access and conditionality of the precautionary credit line.

Another important area of concern for developing countries is the need for more democratic
representation in World Bank and IMF decision-making bodies. Addressing these concerns means:

- Removing the United States’ effective veto power over decisions, which currently stands at around 17 percent in the two Bretton Woods institutions;

- Re-adjusting Europe’s over-representation in the IMF’s 24-member executive board; currently (Europe has nine executive directors including Switzerland);

- Increasing the quota, voting power and composition of the IMF executive board to include emerging and other developing countries; and

- Promoting more open and merit-based selection of senior management, including the IMF’s managing director.

While the World Bank has adopted a decision since 1988 to increase its capital and shift its voting power in favor of developing countries, this process should be accelerated.

There also needs to be an increase in development financing for the least-developed countries. Even though the World Bank recently increased its resources to the Global Food Crisis Response program to $2 billion, the program should be increased and expanded even further in order to respond to growing food security concerns. The World Bank should also initiate new programs to help least-developed countries revitalize their agricultural sectors. More funds from the International Development Association—the lending arm of the World Bank—should be redirected to programs that are most relevant to the least-developed countries, including climate change adaptation, gender equality, fragile states and aid effectiveness. In its capacity, the G-20 should encourage shifting development aid from the bilateral level to multilateral institutions with specified targets and programs, such as fighting poverty, eradicating infectious diseases, tackling local environmental problems and implementing programs that increase access to affordable clean energy (like the Saudi-inspired Energy for the Poor Initiative).

**Promoting a Freer World Trade Regime**

Everybody recognizes that freer world trade is in the interest of all parties, particularly developing countries. Therefore, it is essential to successfully conclude the Doha Development Round, especially on the issue of agricultural subsidies. The Doha Round is becoming ever more important with the world beginning to face serious problems in food supply.

In addition, emerging and other developing countries are now more compliant than industrialized countries with the rules of the WTO. This issue has to be urgently addressed by the upcoming G-20 Summit in Seoul.

During the 2009 London G-20 Summit, leaders fell short of committing to a deadline for the conclusion of the Doha Round due to objections by the United States. Industrialized countries have subsequently been busy signing bilateral trade agreements. The contradiction between a credible multilateral trading system and simultaneously undermining it with bilateral free trade agreements must stop.

**Additional Issues to Consider**

While solving the challenges of development financing and concluding the Doha Round of the WTO negotiations are critical for the G-20’s agenda for global development, there are three additional issues that should be considered:

- Debate is now flaring up around currency realignments. This issue dominated the discussions during the latest annual meeting of the IMF and World Bank and will be a major agenda item for the Seoul G-20 Summit. Reforms to the world monetary system, which was previously neglected at prior G-20 summits, will certainly force leaders to act this time around. The present rivalry among trading partners to devalue currencies
directly or through quantitative easing will destroy the present trade regime since somebody ultimately has to lose and that will most likely be least-developed countries.

- Developing countries will also be affected by the outcome of the ongoing debate between those who support growth through allocating more public funds to stimulate the economy and those who argue for tackling the deficit first. If stimulus programs are stopped, growth will be retarded and developing country exports will be impacted. On the other hand, if the industrialized countries continue to inject more funds into the economy—the major part of which will most likely be through quantitative easing—developing countries, whose currencies are not convertible, will be the biggest losers.

- The issue of energy, especially oil and gas, is always on top of the agenda in major international economic meetings. The emphasis has been mainly on the security of supply. Major oil and gas producers have taken it upon themselves to ensure continuity and reliability of supply to fuel world economic growth. They direct investments to increase oil production capacities sometimes at the expense of their vital development programs in order to fulfill this commitment and to ensure that enough excess capacity is in place to fill any possible interruption in supply. There is a need for demand predictability to justify their investment in this vital sector, sometimes at the expense of other development needs.
Challenges to Development in Our Globalizing World

Izak Atiyas  Professor, Sabanci University
Kamil Yilmaz  Professor, Koç University
E. Fuat Keyman  Professor and Director, Istanbul Policy Center, Sabanci University

W e expect two sets of challenges will retain prominence over the next decade, differentiated with the respect to the timeframe one has in mind. In the short run, conflict over trade and exchange rate policy and the associated imbalances in global flows of goods and capital will remain as a basic threat to the resumption of growth and global macroeconomic stability. The interesting question here seems to be whether the G-20 has the capacity to play any role in the resolution of this conflict. Over the medium to long term, however, the main challenge that the developing world will continue to address will be the quality of economic governance. In particular, there will be a strong need to prioritize; given the complex way in which institutions come about and change over time, are there any policy actions or reforms that can accelerate the emergence of good institutions of economic governance? We elaborate on these two sets of issues in this article.

The Prospect of Currency Wars

Where is the world economy heading? This is a question on everyone’s mind. While the threat of global depression was averted thanks to enormous fiscal stimulus programs and unforeseen monetary expansion, the recovery in industrialized countries has been rather slow. This is not very unusual. It is similar to what happens in systemic crises—crises that threaten and shake up a country’s economic system. A typical recovery after a systemic crisis has two characteristics. First, to the extent that the country’s debt burden is high—be it public, private or external—the recovery will be slowed down by worries about the debt sustainability or what is called the debt overhang. Second, the recovery is almost always jobless. That is, even after the economy starts growing, the unemployment rate is stuck in its new plateau for some time.

What differentiates the current recovery from previous recoveries in advanced countries is the epicenter of the crisis. The financial crisis basically originated in an advanced economy, the United States, and has significantly shaken the financial markets of another advanced economy, the European Union. During the recent emerging market crises, the capital outflows from these countries led to substantial depreciation of the domestic currency. While capital outflow made things worse during the climax of the crisis, it also made the recovery faster. The rapid currency depreciation would have eventually led to recovery through its expenditure switching effect. As the domestic currency declines in value, the country’s exports mostly to advanced economies gain momentum while its imports decline. Both lead to an increase in demand for domestic products and hence lift the whole economy with it.

The 2008-09 global crisis did not lead to a substantial devaluation of the dollar. To the contrary, during the climax of the crisis, as the major global vehicle currency, the U.S. dollar appreciated against other major currencies as all financial players were scrambling to stay liquid in the face of increased financial risk. As the global depression was averted, the U.S. dollar started to lose against other currencies. This trend was reversed at least against the euro when the Greek sovereign debt problem was allowed to turn into a euro crisis.

Recent developments in the currency policy area show that the slow recovering industrialized countries are trying to find ways to grow again. Once
the crisis was averted, they start thinking more about what they could do to accelerate growth in the recovery stage. The fact that China continues to keep its currency undervalued pits three advanced economies (the U.S., the EU and Japan) against each other. When domestic demand starts to increase slightly, most of this extra demand spills over to China as Chinese goods continue to be more competitive. As the expected appreciation of the yuan against the dollar, the euro and the yen does not take place, these countries are pressed hard to follow policies that will at least turn their bilateral trade in their own favor.

As the euro debt crisis reached its climax in May through July, the euro depreciated substantially against other currencies. This definitely helped those European countries that rely heavily on exports, particularly Germany. As the euro depreciated, Germany’s exports increased substantially, whereas U.S. exports stalled and the trade deficit expanded rapidly to reach $130 billion in the second quarter. As the upward tendency in the trade deficit continues, the U.S. Congress and the Obama administration increased pressure on China to revalue its currency.

Chinese officials continue to protest U.S. pressure, arguing that if China were to slow down there would be domestic backlash. In order to fulfill existing high expectations, the Chinese government claims that China must grow at a 10+ percent rate a year. While China looks at binding domestic constraints, it is completely ignoring external constraints that will also soon become binding. If the current exchange rate policy continues while U.S. imports surge, U.S. exports will slow down and unemployment will continue to increase or at least not decrease. Consequently, Americans will ask for retaliation against China in the form of trade restrictions.

As a result, the EU, Japan and many emerging market economies will also have to rely on restrictive trade policies. If China continues to rely on its undervalued yuan for the long term, its trading partners will have to use policy measures that will curtail this. Such a policy response in the end may to lead currency and trade wars between the significant players in the world markets. All countries have to do their best to avoid such an outcome. When South Korea used an undervalued currency policy, it was not as harmful to other countries, especially at a time of growth. China is different from South Korea and other emerging market economies. Through its exchange rate policy, it inflicts substantial job losses in many industrialized and emerging market economies. In the “new normal” age of global economic relations, macroeconomic imbalances either through exchange rate policy or through loose monetary policy or excessive private consumption cannot be tolerated for a long time.

The challenge ahead for think tanks from G-20 countries is to discuss the possible mechanisms to coordinate exchange rate policies across industrialized and emerging market economies. One conclusion we can reach from the recent great recession is that keeping the value of some currencies artificially low for a long period while others are freely floating will lead to imbalances that cannot be sustained in the long run. Those countries with fixed exchange rate policies should be asked to undertake periodic adjustments in their exchange rates to partially reflect their balance of payments position. As the currencies that are already in a free float regime automatically adjust in response to developments in the balance of payments accounts, a coordination in exchange rate policies will help the long-term orderly growth of the world economy. As the U.S. and other hard-pressed industrialized countries undertake expansionary monetary policy, depreciation of their respective currencies will allow them to recover from recession. In the medium-term, as the U.S. economy starts to recover and the monetary policy is tightened, the pendulum will swing back and the dollar will start to appreciate.

Can Reforms Accelerate Institutional Change?

In the long-term, we view institutional reforms as a major pillar for achieving development goals. Many economists and political scientists believe
that institutions of economic governance—that is protection of property rights, enforcement of voluntary contracts, and provision of public infrastructure and services that support private economic activity—are important determinants of long-term growth. Institutions themselves are the consequences of the distribution of political power, which itself is largely determined by political institutions. From a policy perspective, the problem is that institutions have a lot of inertia and change is slow. In many formally democratic developing countries, political institutions do not favor the creation of institutions of good economic governance but of patronage and clientelism and not of a merit-based bureaucracy but of politicization and political favoritism.

The question then is: are there a subset of reforms and measures that would facilitate the transition to better institutions of economic governance?

In this regard, the Turkish experience suggests a number of potential areas of reform. It shows that despite democratization attempts and market-oriented reforms that have been taking place since the 2001 economic crisis, the rather weak internal democracy of political parties and the politicized bureaucracy of market regulatory institutions continue to form a serious blockade to the sustainability of long-run growth.

To start with the structure of political parties, the current constitution, the political party and election laws make it almost impossible for the rank and file to rise within a party and form a serious opposition to the incumbent party leader and his cadres. The charismatic leaders can take the whole party apparatus under control and govern the party single-handedly. Once the party forms a single-party government, then the whole country will be governed by the decisions of a single person. Such a set up has very damaging consequences for governance in general and economic governance in particular, and obviously is not sustainable in the long run. This structure inhibits contestability at the level of political parties. It implies that acquisition of power within the party occurs not on the basis of competence to do good public policy, but on the basis of affinity to the leader. More generally, it creates mechanisms of adverse selection whereby competent politicians may indeed not be allowed to reach above a certain level in the party hierarchy for fear that they may one day pose a challenge to the power of the incumbent leader. Further, it creates incentives for political competition to be carried out on the basis of patronage and clientelism rather than good economic governance.

The Turkish experience also suggests that the questions of the quality of the bureaucracy in general and of regulatory agencies in particular are closely linked to the political structure described above. Since the 2001 economic crisis, Turkey established several market regulatory institutions. The objective was ostensibly to delegate regulatory authority from the ministries to the agencies so that regulatory interventions would not be distorted by day-to-day political favoritism. However, most, if not all, of these regulatory institutions are heavily controlled by the party/parties in power. Bureaucrats are not necessarily appointed on the basis of merit, but rather on the basis of political loyalty. When political loyalty becomes the critical factor influencing the appointments, the bureaucratic apparatus becomes completely under the tutelage of the politicians. Such a system carries the risk of making the whole bureaucratic apparatus inefficient. This is so for two reasons: first, appointments not based on merit reduce the average quality of bureaucrats, which in turn reduces regulatory quality and competence. This is called the selection effect. Second, in a non-merit based system of public management, appointed bureaucrats have lower incentives to produce good public policy and higher incentives to please their political patrons; this is called the incentive effect.

In the Turkish case, both effects are visible in regulated industries such as electricity and telecommunications. In these sectors, the regulatory agencies should function effectively on a daily basis to have a real impact on competition in service markets, which in turn have significant implications for the competitiveness of the manufacturing industry.
and the long-run growth prospects of the whole economy. It is, therefore, critical to depoliticize at least the bureaucratic apparatus of the regulatory institutions. However, one should also be careful in making sure that the de-politicization of bureaucracy does not lead to the other extreme case of creating technocratic/bureaucratic elites that have complete autonomy. Hence, encouraging the merit system should be reinforced by mechanisms that increase transparency, accountability and allow citizens to express their voice.

This is already a tough list of reforms. Further, there may be potential conflicts between the need for reform and short-term political interests of governments. This raises a number of questions: are any of these reforms “more binding” than others? Can they be prioritized? Is there a sequencing aspect? Would some initial success facilitate success in others? Addressing such questions may provide significant benefits in the quest for better institutions of economic governance.
The headlines shout “currency wars”. The United States believes China engages in “currency manipulation”. It hesitates to declare this to the U.S. Congress, and the secretary of the Treasury says “competitive non-appreciation” instead. China accuses the United States of excessively loose monetary policy, flooding the world with liquidity. There is some truth in both charges, but some exaggeration.

This is one of the key issues facing the G-20. Exchange rate pressures, global imbalances and rebalancing, spillovers and the desirability of policy coordination—these are at the center of the economic interdependence between the developed and emerging market countries (DM and EM). All this is in the context of a weak American recovery from the Great Recession, the risk of deflation, and the likelihood of more quantitative easing by the U.S. Federal Reserve. These domestic issues and the inability to get direct action on exchange rates has led the United States to propose targets for current account imbalances. The wheel goes around, and these proposals bear some resemblance to those of Keynes at Bretton Woods, which the United States then opposed.

Policymakers in both DM and EM are aware of the trilemma, but they are not fully conscious of the international repercussions of quantitative easing (QE) by the largest economies when they are at the zero lower bound (ZLB) for interest rates. This note will explore these issues.

The U.S. dollar has in fact already experienced a real effective exchange rate depreciation of over 10 percent since early 2009, almost bringing it back to the low of early 2008. The Federal Reserve Bank of St. Louis has calculated that much of this is due to QE: the Fed’s $1.725 trillion asset purchases resulted in a 6.5 percent depreciation of the dollar. The Bank of England has estimated that its QE resulted in a 4 percent depreciation of sterling. So domestic QE does seem to have substantial international implications.

But the October 23, 2010 communiqué by G-20 finance ministers from their meeting in Gyeongju, South Korea, while condemning “competitive devaluations”, avoids direct discussion of this spillover of monetary policy—which some might call a “competitive devaluation”:

Specifically, we will…

- continue with monetary policy which is appropriate to achieve price stability…

- move towards more market determined exchange rate systems that reflect underlying economic fundamentals and refrain from competitive devaluation of currencies. Advanced economies, including those with reserve currencies, will be vigilant against excess volatility and disorderly movements in exchange rates…

Richard Portes
President, Center for Economic Policy Research; Professor, London Business School
As long as QE does not lead to “disorderly” exchange rate changes, the monetary authorities can ignore its international effects. I will examine whether this view is justified.

What is happening on the ground? The Bank of Japan has intervened to limit appreciation of the yen and may do further QE. The Bank of England is actively considering additional QE beyond the £200 billion asset purchases it has already made. The European Central Bank seems reluctant to expand its balance sheet still further, but it may be forced to buy more Greek, Portuguese, Irish and Spanish bonds if the markets turn against any or all of these sovereign debtors. And if the euro were to appreciate substantially against the dollar, threatening the weak European recovery, the political pressure on the ECB for some form of intervention would be hard to resist. Meanwhile, the only uncertainty about further QE by the Fed is how much and at what speed.

China, for its part, continues to resist both political and market pressures for more rapid nominal appreciation of the yuan. The East Asian countries that have effectively pegged to its currency (or nominally to the U.S. dollar) stand firm. Others have experienced substantial appreciation (Indonesia, Malaysia, Thailand and Korea). Brazil had a massive appreciation in 2009 and imposed a transactions tax on capital inflows, which has just been raised. Since the inflows have continued, intervention has accumulated large reserves, monetary aggregates are rising rapidly, while inflationary pressures have led to interest rate increases. Thailand has also imposed a tax on foreign holders of domestic securities, and Indonesia is considering capital controls. Singapore has widened its exchange rate band. Countries from Israel to India and South Africa are facing similar pressures: capital inflows, exchange-rate appreciation and inflationary risks.

Monetary expansion in the DM has confronted the EM with the trilemma. If they resist currency appreciation, they lose monetary control and get inflation and asset price bubbles (as well as political pressure over trade competitiveness). The alternatives are equally unpalatable: reverse the trend of the past two decades toward freeing capital markets and thereby encouraging financial development; or accept exchange-rate appreciation and loss of competitiveness. The conventional prescription is to permit the appreciation—after all, it raises real incomes and competitiveness is underpinned by rapid productivity growth—and switch away from export-led growth to more reliance on domestic demand. But many countries, China most vocally, are concerned that significant appreciation will hit marginal exporters, slow growth and create unemployment.

In this context, we now explore the implications of QE, first in a small open economy (SOE), then for a big country, then for a set of big countries. We assume the interest rate is constrained at the zero lower bound, there is a “liquidity trap”, economic activity is weak and there is some threat of deflation.

In the SOE, when the central bank brings the interest rate to the ZLB, the exchange rate depreciates. At the ZLB, the monetary authorities can threaten to intervene or actually do so to keep the exchange rate down. In this case, the weak currency is not “competitive devaluation”—it is just a normal part of an easy monetary policy. In any case, for a SOE, there is little effect on the rest of the world (RoW). And if the monetary easing raises domestic demand, including demand for imports, that is good for the RoW. Hence, there is no beggar-thy-neighbor aspect of policy.

Now consider a single large open economy. The analysis is due to McCallum (2000) and Svensson (2001)—the latter proposed the “Foolproof Way” of avoiding deflation and restoring growth in Japan. The authorities need to create inflationary expectations, and they must accept a short-run inflation rate above their long-run target. So they should go to a price level target, with a jump: bring down the exchange rate, if necessary with (unsterilized) intervention. This also expands the monetary base and their holdings of (typically) short-term...
foreign government securities (U.K. and Germany). If the exchange rate does not depreciate, then the markets do not expect inflation—the policy has failed, or the extent of intervention has been inadequate and should go up. It is very important to note that this is not QE; the authorities are not purchasing domestic long-term assets.

There are spillovers, of course, and they are beneficial. Escaping the liquidity trap at home does not hinder the RoW from achieving their monetary policy objectives, unless they too are in a liquidity trap. And if they are, then expansion in the home country (escape from the liquidity trap) raises the world natural rate of interest and hence alleviates the RoW liquidity trap.

Now move to a world of big countries, all at the ZLB. Ideally, all should inflate in a coordinated fashion, so that exchange rates are not affected. Uncoordinated policies could bring currency volatility. This destabilizes markets, creates a highly uncertain environment for business and raises pressures for trade policy interventions. With simultaneous QE, there might not be first-order effects on the exchange rates between the big countries. And simultaneous QE could achieve simultaneous expansion, which would have first-order effects on the natural rate of interest, helping to restore more normal monetary conditions.

Although simultaneous QE in all big economies might wash out in exchange rates, there are also many SOEs—including the EM countries. What happens in such a world? Some of the additional liquidity in the QE/ZLB economies flows to countries with higher interest rates. Their currencies appreciate, and expected appreciation attracts more capital flows. (Yes, the carry trade is indeed profitable, uncovered interest parity is violated.) Global liquidity goes up, foreign exchange reserves rise in those smaller countries which intervene to try to resist appreciation. The big economies are exporting bubbles to the RoW. But global rebalancing should be achieved by raising consumption in the RoW, rather than investment in financial assets and real estate.

Meanwhile, if one large economy does not participate (e.g., the euro zone), then its currency will also appreciate, with accompanying political and trade tensions. And volatility between exchange rates of large countries is more harmful than if it is confined to small countries.

Here, it is very important to see that simultaneous QE is not the same as simultaneous exchange-rate intervention. In the latter case, central banks will typically hold reserve increments in foreign short-run debt (as noted above). If all do this, the net effect is that of domestic open-market operations in short-dated government securities. At the ZLB, these securities are perfectly substitutable for money. There is a liquidity trap, so exchange-rate intervention at the ZLB achieves nothing—whereas QE does seem to have an impact on both interest rates and exchange rates (see e.g. Joyce 2010).

If the large DMs do more QE, however, then the flow of liquidity to the EMs may force them to respond. They may try to resist exchange-rate appreciation by intervening in the foreign exchange markets. Here we do have competitive devaluation—the “currency wars”. And if the EMs do not sterilize the intervention, or if sterilization is at least partly ineffective, then they experience inflationary pressures. So capital controls look tempting—but experience suggests they may not be very effective.

This is why we see statements like “the U.S. will win this war”; it will either inflate the rest of the world or force their exchange rates up against the dollar (Wolf, 2010). But there is a potential downside for the U.S. Substantial dollar depreciation will weaken the global position of the dollar, as it did in the late 1970s (see Chinn and Frankel, 2007).

Now consider fiscal austerity at the ZLB. Suppose one large economy implements a fiscal contraction with all countries at the ZLB. Normally, Mundell-Fleming would say that fiscal contraction lowers the interest rate, hence brings exchange-rate depreciation, hence contraction abroad (and at home too, where the increase of net exports does not fully compensate for the fall in net government
expenditures). But at the ZLB, there is no effect on the interest rate, so no depreciation through that channel. But there is still a risk premium in the uncovered interest parity condition. Expected depreciation equals the risk premium, then where this is the combined risk premium on the exchange rate and on the interest rate bonds. Then all depends on whether austerity raises confidence: does the risk premium rise or fall with expectations of future economic activity, and how does austerity affect those expectations?

If fiscal consolidation does not raise confidence in the home economy, then the RoW takes a double hit: a fall in activity in the home economy and exchange-rate appreciation against it. How might the RoW respond? Exchange-rate intervention—another salvo in the currency wars!

So what policies may we expect, and what will be their consequences? Bergsten (2010) and Gros (2010) have proposed “unconventional” ways in which the U.S. might try to force China to allow faster appreciation of the yuan. Bergsten suggests “countervailing currency intervention”, in which the U.S. would buy yuan in response to Chinese purchases of dollars. But this supposes that China’s capital controls can be circumvented—possible for marginal flows, but not for the $1 billion per day that China is currently buying. Gros suggests that the U.S. and Japan, which has complained about Chinese purchases of Japanese government bonds, could “limit sales of their public debt henceforth to only include official institutions from countries in which they themselves are allowed to buy and hold public debt”. But this could apply only in the primary market—the secondary market for U.S. government debt is wide-ranging and anonymous, not likely to be controllable in this way. And even if it were feasible, the interest-rate and exchange-rate effects of such a policy, not to mention the response to such “financial protectionism”, are sufficiently unclear as to make it highly risky.

The Fed will proceed with QE. It will not accept foreign constraints on its monetary policy. Its decisions will be determined by its view of how best to achieve its mandated goal: maximum employment with price stability, which the chairman has just defined as “about 2 percent or a bit below” (Bernanke, 2010). He also observed that actual inflation was significantly lower. There is nothing in the mandate about effects on the RoW except insofar as these effects might feed back onto economic activity and inflation in the U.S. They might, for example, if Fed policy were to affect the currency composition of EM central bank portfolios. If a major further expansion of the Fed’s balance sheet were to provoke a shift out of dollar assets, U.S. Treasuries in particular, that would indeed affect U.S. interest rates and the dollar exchange rate. But so far, the Fed’s policymakers, including the chairman, have shown no concern for this possibility.

The markets, however, do respond. “Brazil’s benchmark Bovespa stock index hit a new high for the year on Friday as U.S. Fed Chairman Ben Bernanke said current economic conditions warranted further monetary policy easing” (Reuters, October 15, 2010). And if U.S. monetary policy eases further, it will get the exchange rate depreciation that it wants—it will indeed win the currency wars. The U.S. can, after all, devalue the dollar. But there are costs: a wave of trade protectionism is not excluded, although low probability; more likely are capital account protectionism, in the form of EM capital controls; and damaging exchange-rate volatility, including among the large countries, if QE is not coordinated (simultaneous). Moreover, in the longer run, this could substantially weaken the hegemony of the dollar in the international financial system.

John Connally, then U.S. Treasury secretary, famously said the dollar is “our currency, but your problem.” Like most aphorisms, the obvious truth in this remark conceals complexities: the “exorbitant privilege” that accrues to the issuer of the major international currency is not to be conceded lightly. And the consequences for EM and the global economy of a shift to multi-polarity in international finance, like the shift of weight toward EM in global growth and economic impact, will be very far-reaching.
References


Development in the G-20: Common Ground?

Homi Kharas
Senior Fellow and Deputy Director, Global Economy and Development, The Brookings Institution; Former Chief Economist, East Asia, World Bank

The Lack of Common Ground on Financial Issues

There seems to be more that divides the G-20 than unites them. Exchange rate parities, quantitative easing, fiscal consolidation, sovereign debt, financial regulation and IMF governance reform are a few topics that are spurring acrimonious debate rather than coordination. The agreements reached at the finance ministers’ meetings are more a patch than a breakthrough, which is better than an open disagreement, but lacks significant change.

The sense of common purpose, which served the global community so well in Washington, London and Pittsburgh, is in danger of disappearing. Some hard-nosed analysts are asking whether the G-20 has actually achieved anything different from what countries would have done on their own accord when faced with the global financial crisis.

The Seoul G-20 Summit was supposed to move the group forward from a crisis-response group to a crisis-prevention body. Like many international gatherings, the G-20 is being asked by a worried and skeptical public “what have you done for me lately?” Regarding jobs—one of the most important issues for the general public—the G-20 seems impotent and irrelevant. The G-20 has made significant progress on particular issues, such as rules for financial regulation, but their publics are uninterested.

Development as a Common Purpose

The reality is that the G-20 needs a purpose that people care about and that it can act on by reaching agreement to make a difference. So far, the grand issues of global rebalancing and fixing international financial markets and institutions fall short on one or both of these two requirements.

Development cooperation—to improve the lives of the world’s poorest citizens—could be where the G-20 finds common ground.

On September 22, President Obama signed a new U.S. Presidential Policy Directive (PPD) on Global Development, the first of its kind by any U.S. administration. The PPD outlines a 21st century development policy that asserts that a successful pursuit of development is essential for a just and sustainable international order—the very goal of the G-20. The PPD emphasizes that the new U.S. approach to development should be broad-based, long term and coherent across trade, investment, finance and aid.

Development is one of the few remaining areas in U.S. politics that continues to enjoy bipartisan support, due to its large popularity. A 2005 Program on International Public Attitudes (PIPA) survey found that 71 percent of Americans were in favor of giving up to $50 per household to alleviate poverty if other rich country households did the same. Other polls found Americans strongly in support of solving international problems together with other countries. A large majority of Americans believe the U.S. should take a major role, but not the leading role, in trying to solve international problems.

People in other G-20 countries also genuinely care about development. Despite the economic situation, a new poll of 26,500 Europeans from June 2010 shows that 89 percent of Europeans remain
staunch supporters of development cooperation (responding that development cooperation is fairly important or very important to them) and support the EU strategy to increase development assistance as promised toward a target of 0.7 percent of national income. About 30 percent of Europeans are personally involved in development cooperation by donating time or money. This reflects the strong ethical value basis for European development aid that transcends economic cycles.

The emerging economies of the G-20 are also strongly in favor of development cooperation and have rapidly growing international programs. South-South cooperation is one of the most exciting new developments in the international aid architecture.

Thus, there seems to be substantial evidence that the public in G-20 countries strongly care about and support development cooperation and believe that cooperative international programs are the best way of going about this.

**Tangible Results on Development Can be Achieved**

The G-20 can help to improve development cooperation. At the aggregate level, it would be useful for the G-20 to understand the implications of their collective policies on growth and poverty reduction, based on an analysis by the World Bank and macro scenarios of the IMF.

The G-20 should adopt a menu of important development topics with interventions that are ready for discussion now, including:

**Infrastructure:** A G-20 initiative, building on regional studies, could provide a systematic review of country and cross-border infrastructural needs (such as the World Bank maps highlighting the requirements to complete effective infrastructure networks in Africa) and promote new forms of public-private partnerships to generate the resources required. The G-20 could also encourage international financial institutions to review the concept of “fiscal space” to identify where there may be room for greater public sector infrastructure spending, especially in countries with access to capital.

**Human Resource Development:** Current international initiatives emphasize access to schooling rather than quality. Access is improving, and progress has been good on achieving the MDG on primary school completion and on gender parity in education. But learning levels are low: 94 percent of grade 2 students in Mali cannot read a single word, and half of grade 3 students in Uganda also fail this simple test. The need for international and national action on improving education quality is fundamental for balanced global growth.

It may be appropriate for leaders to consider a new Global Learn to Earn initiative in Seoul. Many G-20 members (including developing countries) already support education. Several have participated in Early Grade Reading Assessments and can share how to use such tools. These efforts call for the G-20 to collaborate with other national governments.

**Trade:** Several G-20 members have already adopted duty-free, quota-free access for least-developed countries. Aid for trade is another area where the G-20 can help, providing the soft and hard infrastructure necessary to facilitate the movement of goods from factories and farms to ports and to help countries link to global and regional supply chains. The G-20 should be cautious not to substitute its own deliberations on trade from the formal negotiation process taking place under the Doha Development Round.

**Private Investment and Job Creation:** Promoting cross-border investment, and the application of science and technology toward development issues, will lead to more jobs in recipient countries, but needs to be done in a prudent fashion. There is a danger of a “race to the bottom” as countries seek to ease the cost of doing business. A G-20 understanding of the cost/benefit of regulation in different environments could help countries compete for investment in a healthy way.
**Finance for Development:** The rules for financial stability and new financial regulation have been developed by the Financial Stability Board without significant developing country representation. Several global issues remain unresolved: the desirability of some form of Tobin tax or other innovative financing modalities; the quantity and quality of official development assistance (ODA) in an environment of weak fiscal balances; and possibilities for leveraging ODA through public-private partnerships. Already the G-20 has formed expert working groups to develop proposals relevant for developing countries on inclusive and innovative finance, including finance for small and medium enterprises.

**Food and Energy Security:** Food and energy price spikes have been severe and resulted in significant development setbacks in recent years; but many international institutions are not permitted to use market-based hedging mechanisms to reduce the vulnerability of their operations. For example, the World Food Program currently buys all its food on spot markets, but its needs are greatest when food prices rise sharply. The new Global Agricultural and Food Security Program, set up under G-20 auspices, provides a number of options for innovative finance and new public-private partnerships to support country-led programs.

**Governance:** Stronger institutions that reduce the scope for corruption and assistance on tax reform to increase domestic resources for development can also be addressed through collective action by the G-20. Tax avoidance and illegal capital flight cost developing countries billions of dollars each year, with transfer pricing a particularly troublesome practice. Programs like the Stolen Assets Recovery initiative require global collaboration to deny safe havens for stolen assets.

**Knowledge Sharing and Learning:** The G-20 should indicate its support for the agenda-setting work of the Busan High-Level Forum on Aid Effectiveness in 2011. High on the agenda is improving aid-recipient country ownership of the development process. But one cannot own what one does not know. At a minimum, G-20 countries should commit to becoming more transparent about their development engagements.

The factors above are indicative of a menu-driven approach to the G-20 development agenda. The G-20 should agree on such a menu and review progress and the need for action before each meeting. The idea of a menu approach is to adopt a limited set of topics to be followed over several meetings to maintain continuity and focus, and avoid leaping from topic to topic. Not all topics will require leaders’ input and discussion, but leaders should be alerted on the progress of each topic and invited to discuss options when expert groups have determined that additional action is required.

A serious approach to development provides the best possibility for a “win” for the Seoul Summit—an agenda that will resonate with the G-20 public and yield tangible results when programs are implemented. The G-20 badly needs such a cause to overcome its growing credibility and legitimacy deficits.
The views expressed in this publication are those of the authors and should not be attributed to their affiliated organizations.