Global Economy and Development at BROOKINGS

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THE G-20 LOS CABOS SUMMIT 2012: BOLSTERING THE WORLD ECONOMY AMID GROWING FEARS OF RECESSION

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INTRODUCTION

Kemal Derviş

Leaders will head to the G-20 Summit in Los Cabos, Mexico, among renewed serious concern about the world economy. The turmoil that started with the U.S. subprime mortgage crisis has resulted in now almost five years of ongoing instability. The emerging market economies fared much better than the advanced economies and pulled out of the crisis already in 2009, but the slowdown we are now facing in 2012 is again global, demonstrating the interdependence in the world economy. The emerging market economies have stronger underlying trend growth rates, but they remain vulnerable to a downturn in the advanced economies. The center of concern is now squarely on Europe, with a recession threatening most European countries, even those that had reasonably good performances so far. After an encouraging start in 2012, the U.S. economy, while not close to a recession, is also showing signs of a slowdown rather than the hoped for steady acceleration of growth. And the slowdown is spreading across the globe.

At a time like this it would be desirable and necessary that the G-20 show real initiative and cohesion. The essays in this collection look at the challenge from various angles. There is concern that the G-20 is losing its sense of purpose, that cohesion is decreasing rather than increasing, and that policy initiatives are reactive to events rather than proactive. Let us hope that at this moment of great difficulty, the G-20 will succeed in giving the world economy a new sense of direction and confidence. It is much needed.

A Fragile and Fickle Recovery

Eswar Prasad and Karim Foda discuss the fears that continue to loom over a world economy, which remains on life support, largely provided by accommodative central banks. They stress that the G-20 leaders must use the platform of the summit to show that they not only understand what needs to be done but also that they have a concrete plan to take the measures needed to restore growth and stability.

The G-20, the IMF and the European Debt Crisis

Domenico Lombardi examines how new uncertainties have reversed signs of a stabilization in the eurozone following the inconclusive outcome of the Greek elections and escalating pressures in Spain's financial sector. Lombardi states that the upcoming summit should provide an opportunity to finalize agreement on the additional resources that the IMF will need to provide a backstop to an unraveling in Europe, and argues that G-20 leaders must escalate pressure on Germany to move quickly on a mutually-coordinated response to the escalating crisis.

Whither the G-20: Proposals for a Focused Agenda

Johannes Linn argues that the novelty of the G-20 forum has worn off since leaders first met almost four years ago. With legacy issues from previous summits now crowding the agenda, Linn proposes that the G-20 needs a focused agenda that keeps leaders' attention on

the critical longer-term issues, even as it grapples with the short-term crises of the day.

Supporting Financial Innovation and Stability in Africa's Agriculture

Vera Songwe and Mwangi Kimenyi explore the challenge for African countries in sustaining their growth rates in a volatile and uncertain global economy. They stress that the challenge for G-20 leaders will be to ensure that the much needed financial regulation designed to prevent another global crisis does not endanger access to finance for African agribusinesses and farmers.

The G-20 Pivot toward Trade

Joshua Meltzer emphasizes the importance of the international trade agenda for the G-20. He argues that the G-20 needs to provide leadership on how to renew the centrality of the World Trade Organization as a driver of trade liberalization and for developing new trade rules for the 21st century.

The G-20 Has Disappointed on International Financing

Homi Kharas contends that to date the G-20's focus on the international financial architecture has largely been concerned with stability issues rather than growth. Kharas maintains that in order to strengthen and sustain global growth the G-20 should urgently consider whether the existing institutional structure is adequate for promoting the huge flows of capital that developing economies need for critical infrastructure investment.

Why the G-20 Must Prioritize Financial Inclusion to Promote Global Growth

With fostering financial inclusion to promote economic growth as a key agenda item of the G-20 Mexican presidency, Mwangi Kimenyi and Vera Songwe assess the ability of expanding mobile financial services technology to address issues of financial inclusion in developing countries and the role of the G-20 in promoting this agenda.

Green Growth: G-20 Leaders Can Set the Stage for Rio+20

With green growth also a key priority for the G-20 meeting in Los Cabos, Katherine Sierra asserts that G-20 leaders should reaffirm the importance of the green growth agenda. Also, with the Mexico Summit coming just days before leaders gather in Rio de Janeiro to celebrate the 20th anniversary of the United Nations Conference on Sustainable Development, Sierra contends the G-20 must send a strong signal of support that investment in green growth can be good for both economic growth and the environment.

A FRAGILE AND FICKLE RECOVERY

Eswar S. Prasad and Karim Foda

Framing the Issue

As leaders gather later this month for the G-20 Summit in Los Cabos, Mexico, fears continue to loom over a world economy that remains on life support, largely provided by accommodative central banks.

Concerns about spillovers from a worsening of the European debt crisis and slowing growth in key emerging markets are putting a damper on consumer and business confidence. Equity markets have pulled back from a robust performance in the first quarter of this year as the sobering reality of a continued anemic recovery dampens investors' optimism.

At the upcoming summit, leaders of both advanced and emerging market economies must show that they have the political resolve and will to implement the necessary policies in their economies to restore confidence and bolster domestic demand.

Policy Considerations

Following a brief surge in activity, the world economy is once again beset with worries about risks on multiple fronts. Looming risks and the lack of policy space in advanced economies are taking a toll on economic activity as well as confidence.

In advanced economies, there is considerable uncertainty about what room is left for aggressive policy responses to counteract weak demand and, in any case, whether those measures will get much traction. With fiscal policy already in a tight spot and monetary policy out on a limb in these economies, the room to boost domestic demand is limited.

The eurozone debt crisis remains the major source of global risk and will undoubtedly be a top priority item for the G-20 agenda. Many European economies are being forced to restructure their public finances even as they venture to undertake massive structural reforms. This is stifling growth, worsening debt-to-GDP ratios in the short run, and generating an unsustainable political situation at the domestic and pan-European levels.

Among advanced economies, the U.S. economy remains one bright spot but there are few others that show signs of self-sustaining demand growth. The U.S. recovery is gradually firming up but remains fragile. Output growth has been modest at best but the unemployment rate continues to drop and employment growth has begun to pick up, even if haltingly and at a pace that still leaves total em-

ployment below its pre-crisis level. Equity markets have held up moderately well while credit growth is picking up, helping to give consumer and business confidence a small but noticeable boost.

Japan remains mired in weak growth while the U.K. is now officially in recession. Many countries in the eurozone are in recession as well; France is on the edge of recession, and even the mighty German economy is showing signs of stumbling.

Emerging markets continue to perform better than advanced economies but their growth momentum is also slowing.

China's growth outlook has darkened as the economy continues to be buffeted by domestic policy challenges, an unexpectedly rocky political transition, and uncertainties in the global trade and financial environments. If growth were to slow sharply, China has room to respond with aggressive expansionary policies. A good balance of fiscal and monetary policies is necessary, but there are signs the government may again resort to a credit-fueled investment surge. This would secure short-term growth but could set back the long-term goal of rebalancing economic growth and making it less reliant on investment.

India has hit a rough patch, with industrial production growth hitting a wall, output growth slowing sharply, and the current account deficit widening and leaving the economy vulnerable to capital flow reversals. Brazil, Russia, and most other emerging market economies have also experienced slowdowns in GDP growth, with industrial production growth taking a sizable hit. In many of these economies, monetary policy is facing a difficult balancing act between maintaining growth and holding down inflation, with inadequate support from fiscal policy.

Financial markets around the world posted a strong performance in the first quarter of 2012 as it appeared that significant steps were finally underway to tackle the eurozone debt crisis and the world economy had finally turned the corner. Developments in the eurozone and elsewhere have thrown cold water on this optimism, leading to a weakening of financial market indicators in recent weeks.

Action Items for the G-20

Four years after the financial crisis drove the world economy to the brink of collapse, the pervasive sense of imminent doom had given way to cautious and nervous optimism earlier this year. However, the global economic recovery is still sputtering due to a lack of robust demand, policy tools that are stretched to their limits and unable to muster much traction, and enormous risks posed by weak financial systems and political uncertainty.

A key priority for the G-20 now is to straighten out the mix of policies so that the entire burden of preventing cataclysm as well as supporting growth does not fall on monetary policy. The mix and timing of policies is necessarily country-specific, but in most countries fiscal policy and structural reforms will need to shoulder more of the burden in rebuilding confidence and reviving growth. Leaders must use the platform of the G-20 summit to show that they not only understand what needs to be done in their economies but also that they have a concrete plan to take the measures needed to restore growth and stability.

THE G-20, THE IMF AND THE EUROPEAN DEBT CRISIS

Domenico Lombardi

Framing the Issue

The early and tentative signs of a stabilization of the European crisis have been reversed following the inconclusive outcome of the Greek elections in May and the escalating pressures on the Spanish financial sector. While Germany is now issuing medium-term bonds at almost zero interest rates, spreads on Italian government bonds have widened again despite the stabilization policies implemented in the country.

Meanwhile, the recent G-8 Summit at Camp David has unequivocally underscored the unprecedented political isolation of the German chancellor, Angela Merkel, and her narrowly-conceived approach of strict and rigid austerity in order to address the crisis in the eurozone. While governments throughout the euro area are implementing fiscal consolidation irrespective of their economic conditions, the debt-to-GDP ratio for the single currency area is projected to increase by 3 percentage points in the 2011-13 period due to faltering economic growth—this according to the latest forecasts by the International Monetary Fund. In fact, Italy and Spain will undergo contractions well above 2 percent of their real GDPs this year. And it is likely that next year won't be much different despite optimistic projections by the IMF.

Policy Considerations

Against this backdrop, the upcoming G-20 Summit in Los Cabos will provide an opportunity to finalize an agreement on the additional resources that the IMF will need in order provide a backstop to the crisis unraveling in Europe. At the April spring meetings of the IMF and World Bank, a number of members committed to stepping up the IMF's financial firepower by over $430 billion. Some countries have already indicated the scope of their efforts, with Japan leading the pack with a $60 billion pledge. Other countries, including the BRICs, have broadly indicated their willingness to participate but will be finalizing the extent of their commitment by the summit in Mexico. Unfortunately, the fact that the United States has decided not to participate in this effort, despite being the IMF's largest shareholder, may have exerted a reverse catalytic effect, delaying the decisions of other members to contribute to the pool and reducing the latter's overall size.

As of mid-May, the IMF's forward commitment capacity stands at approximately $380 billion. Once the agreement on additional resources for the IMF is finalized, the fund's overall capacity will increase to slightly more than $800 billion. Although $800 billion seems like a significant amount, it will not be enough to make the IMF a systemic

lender to the euro area although the institution will be in a better position to (re)finance the peripheral economies in Europe as well as other member countries that may be hit by contagion should the crisis deepen.

While agreement on topping up the IMF's finances is widely expected to be finalized soon, it would be a missed opportunity if the upcoming G-20 Summit were to be reduced to an accounting exercise for who should give what. Rather, leaders should assess what strategic role, if any at all, the IMF can play in a systemic crisis, which this time happens to be in Europe. Overarching questions that should draw the leaders' attention include: to what extent should the IMF's lending capacity be commensurate to such a role? And, are the fund's current instruments for addressing systemic crises adequate?

Since the breakdown of the Bretton Woods system of fixed exchange rates in the 1970s, the International Monetary Fund has played a relatively marginal role compared to the mission that its founding fathers had envisioned; the fund has for the most part helped smaller developing countries in times of financial crisis by providing them with stabilization programs. However, the European debt crisis has changed all this but not the resource constraints that the fund's major shareholders have imposed on the institution. Discussing strategic rather than accounting issues is the very purpose of having the leaders of the major economies come together and the G-20 is now the forum for political leaders to discuss critical IMF-related issues.

Action Items for the G-20

As leaders gather in Los Cabos, they should escalate pressure on Germany toward a mutually-coordinated response to the unprecedented threat to the very existence of Europe's single common currency. There are some early signs that coordinated pressure led by the axis between Paris and Rome may be softening the German position toward Eurobonds. Clearly, G-20 leaders have a stake in the European crisis, as the unraveling of the euro could have long-ranging consequences for the global economy. There are several policy items on which the European position is still unclear: they range from the establishment of a EU-wide insurance deposit scheme to the need to reconcile fiscal consolidation with growth-enhancing measures. If the G-20 still regards itself as the premier forum for international economic consultations, this is the moment to rise to the occasion and exert the utmost pressure on their European counterparts, especially Germany.

Despite the best possible planning, there is a very real possibility that this summit may once again become hijacked by the crisis in Greece given that G-20 leaders will be convening the day following a new round of elections in that country. If the outcome of these elections is such that a pro-European cabinet is again unable to be formed, the summit will inevitably turn into a crisis committee that will have to quickly draw together a plan of action for how the global economy deals with a disorderly Greek exit from the euro and the potentially catastrophic consequences that would ensue. Yet, however unstable and uncertain the situation in Greece may look, the scenario of a Greek exit is one that can still be averted. The cost of keeping Greece in the euro area is much smaller compared to what a disorderly exit would trigger; and euro-area policymakers are well aware of that. Many of their recent statements to that effect are more tactical rather than a reflection of their deliberate intent of triggering a Greek exit from the single currency area.

WHITHER THE G-20: PROPOSALS FOR A FOCUSED AGENDA

Johannes F. Linn

Framing the Issue

Nearly four years have passed since President George W. Bush unexpectedly but urgently called for the first G-20 leaders' summit in Washington in November 2008 to address the global financial crisis. Later this month, G-20 leaders will gather in Los Cabos in the seventh meeting of its kind. Next year's summit will be hosted by Russia. As leaders come together in Mexico in a few weeks, they should have their eyes not only on the immediate decisions facing them, but also on how they want to shape the future agenda of the group.

By most accounts the early G-20 summits—Washington, London and Pittsburgh—were the most successful in addressing the pressing issues of the global financial crisis. However, in some respects this was relatively easy: the crisis was a crisis for all; the agenda was new and no legacy issues had to be kept track of; and for the leaders it was a new experience which made the issues and the dynamics of interest to all of them. Subsequent G-20 summits in Toronto, Seoul and Cannes have faced some challenges in getting leaders to agree, and future summits will likely face even more difficulties in keeping the agendas and discussions focused and effective.

Unfortunately, the novelty of the forum has worn off. Legacy issues from previous summits now crowd the agenda and leaders have the unenviable task to deliver on past promises. Member countries now face widely differing economic problems and forging a coordinated response is therefore difficult. And, perhaps most problematic, domestic political stalemate in key countries in Europe as well as in Japan and the United States has created severe obstacles to effective global economic policy coordination. All this presents serious risks for the G-20 summit as an effective forum for global dialogue and decision-making.

Policy Considerations

Under these circumstances, how should the leaders frame their future agenda to assure an effective G-20 summit? The leaders of the G-20 face three broad imperatives:

First, they need to keep their agenda focused on a few critical items. The tendency is to include ever more items since every leader is under pressure from multiple domestic and international interest groups to address their favorite issue. The fact that leaders issued three summit documents at the G-20 Cannes meeting in 2011—a declaration, a communiqué and

an action program—as well as nine annexes and 10 other reports is a sign of how crowded the agenda has become.

Second, the G-20 agenda needs to maintain continuity with the past and demonstrate follow-through on previous commitments, if the summits are to be seen as credible and effective.

Third, the G-20 agenda needs to focus on issues where leaders feel interested and challenged, on issues where they can make a difference, and on issues where it is critical that they learn about each other's perspectives.

Unfortunately, tensions arise between these three imperatives since legacy issues add to the breadth of the agenda and leaders will prefer to avoid being reminded of unfinished business. Moreover, each leader will want to add her or his priority to the agenda, even if the priority may not be of much interest to other countries. So keeping the summit agendas focused, effective and interesting to leaders will be a tough challenge.

Action Items for the G-20

With these imperatives in mind, what should the G-20 leaders agree to as the key agenda priorities going forward?

1. The Mutual Assessment Process—the approach to international macroeconomic policy coordination agreed to by G-20 members at the Pittsburgh Summit in 2009—is perhaps the single most important item on the G-20 agenda for the leaders to focus on. It is a critical mechanism for sharing information and assuring accountability for the alignment of domestic policies in a difficult and potentially dangerous global economic environment.

2. The global financial regulatory framework needs continued attention, if a repeat of the 2008–09 global financial crisis is to be prevented. After good progress at the first few G-20 summits, it appears that further significant steps are stuck at the national level and have been superseded by a focus on short-term crisis management, especially in Europe.

3. The G-20 carbon fuel subsidy initiative could make a substantial contribution to controlling carbon emissions and should clearly be carried forward, even though it will be politically difficult for some leaders to take forward in their home countries (Russia and the United States).

4. The G-20 must continue its push to contain trade protectionism. So far the world has been spared a significant rise in protectionism. However as economic crises, high unemployment and balance of payments difficulties continue in many countries, the pressure to introduce beggar-thy-neighbor policies will become ever stronger.

5. The G-20 should build on the Seoul Summit's development initiative. But here the challenge is to stay out of the weeds of excessive detail. Delivering on earlier commitments in the areas of infrastructure and agriculture and food security will be important, but beyond that the G-20 should primarily focus on issues of improved governance in the global development institutions.

Aside from these longer-term agenda items, each summit will have to confront key issues of the day. Just as the Cannes G-20 Summit agenda was overtaken by the European crisis, so will the upcoming Los Cabos Summit. By next year, there may well be another critical short-term issue, which the summit host will have to be ready to accommodate at short notice. This is as it should be since it is often the short-term crises where opportunities for a face-to-face exchange are critical and where the greatest progress can be made at summits, as the early G-20 summits have demonstrated.

Finally, one item that should not be on the G-20 agenda for the foreseeable future is the membership issue. While much debated among experts, it is difficult and divisive, and there are no simple answers. Hence, it would only distract leaders from the critical short- and longer-term issues they need to grapple with.

In conclusion, if the G-20 is to continue to contribute to effective global economic management, it needs a focused agenda that keeps leaders' attention on the critical longer-term issues, even as they grapple with the short-term crises of the day. The worst mistake would be to overload the agenda with ever new issues, forget to follow through on important past commitments, and deal with issues that are secondary yet divisive.

SUPPORTING FINANCIAL INNOVATION AND STABILITY IN AFRICA'S AGRICULTURE

Vera Songwe and Mwangi S. Kimenyi

Framing the Issue

When leaders of the G-20 countries meet in June, they will be focused on how to restore growth to the world economy. The election of a new French president and the Greek debt crisis have finally brought the discussion on the need for growth to the fore. However, memories of the causes of the worst financial crisis since the Great Depression will continue to loom large and the decisions made will need to include discussions on improving global understanding about vulnerabilities affecting financial systems and on initiatives to promote financial stability.

To date, there is a global consensus that emerging markets have managed the global financial crisis well and that bank deleveraging had a limited impact on the financial sector in Africa. Despite their positive growth since 2009, African countries are in search of ways to sustain their growth in a continuously volatile and uncertain environment. They are looking for ways to stimulate domestic and regional demand, to organize markets for primary commodities better, and to increase access to finance for the non-banked.

This is especially important because a focus on agriculture has led to substantial increases in production for a number of commodities on the continent. For example, between 2008 and 2010, the Ivory Coast and Cameroon increased the production of green coffee by 47 and 31 percent respectively. Ghana and Ethiopia increased production of maize by 27 and 17 percent respectively, while for rice paddy, Cameroon and Ghana increased production by 34 and 63 percent respectively. Tobacco production has increased by about 40 percent in the main producing countries in Africa, such as Nigeria, while production of groundnuts, beans and tea have all increased on average. Farmers are now faced with the issues of storage and marketing.

Policy Considerations

Similar to what happened in the United States between 1848 and 1920, improved production is creating a need for production differentiation and a need to improve quality, storage, marketing and transportation systems is creating new markets in Africa including organized spot markets, forward markets for warehouse receipts, and an increasing number of futures markets. This process of innovation has led to rapid financial innovation in Africa

which if well managed could provide access to finance for millions of African farmers and businesses.

New financial instruments bring promise for the hundreds and millions of farmers, both commercial and subsistence, in sub-Saharan Africa. However, the unregulated use of some of these products is at the origin of the global financial crisis. The challenge for G-20 members will be to ensure that the much needed financial regulation designed to prevent another global crisis does not endanger access to finance for African agribusinesses and farmers.

Action Items for the G-20

G-20 policymakers will need to focus on four issues:

First, in addition to working on providing additional resources for increased production, the G-20 should also focus on developing a sustainable and inclusive agriculture trading market. Specifically, G-20 nations should help Africa put in place failsafe market infrastructure for agriculture commodity trading. Development partners should support a simple system of forward trading by working with countries to improve storage infrastructure and strengthening the legal environment for contracting. This combination would help to support the development of a warehouse receipt system across the continent, thereby providing farmers with better access to financing and an ability to smooth their incomes.

Second, as the agriculture market moves from a forward to a futures market, there will be a need to support the development of transparent, efficient and standardized trading via regulated clearing houses. If Africa's agriculture sector is going to leapfrog on financial innovation, African farmers must be protected from the errors of Wall Street. This means that the rules on over-the-counter derivatives must be enforced at entry on the continent to provide greater transparency. While this may constrain some trading by reducing the flexibility of farmers and other agents in the market, it will ensure that farmers and other traders have enough time to understand the instruments available to them in a secure and regulated environment. Standardized products will also allow for increased competition in the provision of such services, while also increasing the farmers' access to such products and services at competitive prices.

Third, the G-20 should support the development of credit agencies. The development of a warehouse receipt system and other related financial products will allow individual farmers or cooperatives to access banking sector credit using the warehouse receipts as legal tender. As a result, large parts of the previously unbanked segments of the population, especially women, would have the ability access financial institutions and build credit. To support this process, it will be important that countries develop credit bureaus that allow for the capture, storage and sharing of information across the sector. Assisting countries to improve their infrastructure for sharing credit information will allow for competition and open and equal access across the banking sector, thus enabling more farmers to have access to finance, including women.

Fourth, the G-20 should ensure that financial innovation related to the agriculture sector in Africa is monitored closely. There are a growing number of important regional banks which will manage the accounts of farmers as activity picks up. These banks could quickly become the systemically important financial institutions of Africa. With 70 percent of the rural population in Africa depending on agriculture for its livelihood, a crisis in the sector could quickly weaken financial institutions on the continent. Therefore, as the G-20 through the Financial Stability Board (FSB) works to develop tools to identify and anticipate shocks to the global financial system, it would be important to assist the banking sector in Africa in this particular field.

The 2010 decision to expand the work of the FSB to members beyond the G-20 was the right one. Now the FSB regional consultative group for sub-Saharan Africa must balance its activities to ensure that the quest for growth and financial inclusion in the region, especially in the agricultural sector, does not lead to a crisis down the road. The recent announcement by the G-8 of additional resources for agriculture with private sector support is welcome. The G-20 and G-8 should work with African countries to ensure that some of these resources go toward building and strengthening a framework for inclusive and competitive access to finance in the agriculture sector.

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THE G-20 PIVOT TOWARD TRADE

Joshua Meltzer

Framing the Issue

The international trading system is undergoing systemic challenges—from the unsuccessful Doha Round of trade negotiations to the potential proliferation of free trade agreements (FTAs) among the world's largest economies. Driving this dynamic is the failure of multilateralism over the last decade to produce new market access and to develop new rules to address key challenges such as green growth and food security. This comes at a time when the nature of the world's economic challenges makes multilateral solutions more, not less, important.

Action by the G-20—representing 85 percent of global GDP and 80 percent of world trade—has already proven to have important impacts on global affairs, including trade. During the 2008-09 financial crisis, G-20 leaders expressed their commitment to maintain open markets and—combined with directions to the World Trade Organization, the Organization for Economic Cooperation and Development, and the United Nations Conference on Trade and Development (UNCTAD)—to monitor and report trade restrictions. This commitment by G-20 leaders ultimately helped avoid a repeat of the trade protectionist policies that characterized the Great Depression of the 1930s. In 2010, the G-20 supported concluding the WTO Doha Round. Though, it is now clear that the Doha Round cannot be completed in its current form.

As the financial crisis recedes, the G-20 needs to provide leadership on how to renew the centrality of the World Trade Organization as a driver of trade liberalization and for developing new trade rules for the 21st century. The WTO is the only multilateral rules-based institution responsible for governing world trade and has already delivered significant global benefits, including reduced trade barriers and an effective settlement mechanism for handling trade disputes. However, in order for the WTO to remain the main driver of trade liberalization and to effectively respond to new international economic challenges, G-20 leaders will need to provide the organization with much needed political direction and support.

Policy Considerations

The G-20 leaders' summit has never had trade as a core of its focus. Instead, the G-20 has approached trade issues from the perspective of how can trade contribute to restoring global economic health and financial stability. For instance, the G-20's emphasis on maintaining open markets for investment and trade was about avoiding the same protectionist trade measures of the Great Depression, which significantly worsened the economic situation.[1] Their commitment to open markets was justified as domestic political pressures during the recent financial crisis led some

countries to increase their trade measures to protect their domestic industries.[2] The G-20's call for the WTO, OECD and UNCTAD to monitor such policies limited the reversal of open trade policies. However, the ongoing economic crisis in Europe has maintained the danger that countries will engage in additional trade protectionism and therefore continued leadership by the G-20 is needed.

The G-20 has also provided some leadership on the WTO Doha Round. At the 2010 G-20 Seoul Summit, leaders directed their negotiators to "promptly bring the Doha Round to a successful, ambitious, comprehensive and balanced conclusion".[3] However, this call for action has not translated into results. Reasons include the impact of China's growth on world trade, the failure of key countries to invest the political capital needed to conclude the Doha Round, and the reality that many of the most pressing world trade-related challenges of the last decade are not part of the Doha Round.

Yet, the fact that a push by G-20 leaders in Seoul was unable to produce an outcome on Doha reveals the depth of its challenges. It also calls attention to the need for increased focus by the G-20 on trade issues and in particular on how to renew the World Trade Organization as the central forum for liberalizing trade. This will require creative thinking about how to progress multilateral negotiations and a willingness to try new approaches. For instance, the "single undertaking" approach that requires all issues to be agreed upon before a WTO round can be finished has been an impediment to making progress on Doha and should be reconsidered. One alternative is more plurilateral agreements among countries keen to make progress; these are not new to the WTO and their use should not be stymied by a small group of detracting countries.

Substantively, there is a long list of international trade issues that can only be adequately solved multilaterally within the WTO. These include the impact of state-owned enterprises on international trade, food security, promoting green growth, and the significance of access to the Internet as a driver of trade, in addition to achieving new market access in areas such as services.

A G-20 trade discussion should also focus on strengthening the WTO as an international institution responsible for global economic governance. The G-20 could take immediate action to strengthen the WTO Secretariat by expanding the oversight role that the WTO so successfully played during this recent financial crisis. The WTO should also have a more active role in future discussions about a new multilateral round of trade negotiations by providing research on new areas for trade liberalization.

Action Items for the G-20

In some respects, the creation of the G-20 was itself a recognition that some of the key global economic challenges cannot be solved, and do not require participation, by all countries. However, the G-20 contributes to global governance by providing the leadership that underpins the key multilateral institutions responsible for global economic governance such as the World Trade Organization. To fulfill this mandate, the G-20 should undertake the following:

- Initiate a frank discussion on how to reinvigorate multilateral trade negotiations at the WTO.
- Determine what actions need to be taken to conclude the current Doha Round.
- Identify the new and emerging international trade issues of priority.
- Discuss the role of large emerging economies in international trade and the leadership role that the largest economies will be expected to play.
- Consider the role of the single-undertaking in a future WTO Round, including whether some issues should be addressed through plurilateral agreements.
- Take immediate action to strengthen the WTO Secretariat, including a more formal oversight role in monitoring and reporting increases in trade barriers.

Endnotes

[1] G20 London Summit Leaders' Statement, April 2009, para 22

[2] WTO, OECD and UNCTAD Reports on G20 Trade and Investment Measures (May 31, 2012)

[3] G20 Seoul Summit Document, November 2010, para 43

THE G-20 HAS DISAPPOINTED ON INTERNATIONAL FINANCING

Homi Kharas

Framing the Issue

The G-20 is in trouble. After successfully orchestrating a coordinated fiscal stimulus in 2009, the G-20 turned to longer-term issues to strengthen and sustain global growth. The instinct was right. The global economy appeared to have an imbalance between the demand for capital, largely in emerging and developing economies, and potential supply, with long-term risk capital concentrated in advanced economies. Adjusting the international financial system to encourage an intermediation of capital flows into appropriate and productive investments was clearly needed to achieve a structural global rebalancing that would deliver stronger and more stable growth.

In practice, little has happened. Capital flows to developing economies have been "hot" portfolio investments, and their volatility and impact on exchange rates may have served to reduce rather than increase infrastructure investment. Huge public resources have been marshaled for the International Monetary Fund, but mostly these seem destined to construct a firewall around Europe, and the destabilizing accumulation of massive foreign exchange reserves by developing countries has continued. Increases in the capital of multilateral development banks have been approved, but they are modest in size and needed governance reforms are slow in coming.

Developing economies today are struggling to find the resources to invest in infrastructure. Their populations are growing and urbanizing at the fastest rate in history. They must upgrade construction standards to account for future climate change. Their economic progress depends on efficient logistics to link them with the global economy.

At the same time, advanced countries are struggling under the yoke of austerity. However, the pendulum seems to be swinging toward adjustment packages that include more room for growth. Public deficit financing for aggregate demand management is important, but so is smart government spending that raises long-term productivity growth, such as on infrastructure.

All this needs money—an estimated $1 trillion annually in additional investments and maintenance for developing countries alone, over and above the current infrastructure investment rate of $0.8-0.9 trillion per year; this is according to the G-24, an intergovernmental group that coordinates developing countries on development

issues. Mostly this money is needed in low and lower-middle income countries (categories that exclude China, for example), and is destined for power generation, transmission and distribution.

Policy Considerations

The G-20 should urgently consider whether the existing institutional structure is adequate for promoting the huge flows of capital that are required. At present, its focus on the international financial architecture has been largely concerned with stability issues rather than growth. For example, the G-20 has committed to implement agreed-upon governance and quota reforms before the IMF and World Bank annual meetings in October, to a comprehensive review of the quota formula by January 2013, and completion of a new round of quotas by January 2014. The G-20 successfully mobilized pledges for $430 billion in new money for the IMF to build a firewall of sufficient size around the eurozone's problems, but these pledges were conditioned on completion of the quota reform program— a step that is already behind schedule due to upcoming elections in major G-20 countries. In addition, the scale of resources may be insufficient unless vulnerable countries are prepared to do their part in accepting reforms and austerity. That is more likely if their path forward is eased by adjustments in surplus countries as well.

The G-20 has not, however, paid equivalent attention to the problem of insufficient long-term capital for public investment. Advanced countries have approached infrastructure investment with the idea that public-private partnerships will be a panacea. Yet, the experience so far has not been encouraging, except in selected areas such as telecommunications. Private investment could contribute perhaps 20 percent of the overall infrastructure financing needs of developing countries, leaving a sizable funding gap that cannot be completely filled with domestic resources in most poor countries.

The intellectual case for a big push on infrastructure is strong. It could support global growth and structural change, especially urbanization, in an environmentally responsible fashion. It could provide a stimulus to global aggregate demand. It could promote regional integration, especially in sub-Saharan Africa. It is critical for raising agricultural productivity and food security, and more broadly could be an instrument for more inclusive growth.

Official financing has failed to respond to these challenges. For the past 15 years, the scale of net official flows to developing countries (excluding IMF loans) has hovered around 0.5 percent of developing country national income. Recent capital increases of multilateral development banks do not appear sufficient to change this in a significant way.

For these reasons, there are now discussions about a new development bank to provide additional resources for public investment. Those discussions have highlighted the institutional deficiencies of the existing framework. There is a need to modernize international financial institutions in terms of their mandates, membership and governance, and modalities if the infrastructure challenges are to be met. New mandates could prioritize funding "green" infrastructure and agricultural productivity in an environmentally responsible way. Membership could be updated to tap into new capital sources such as sovereign wealth funds, as well as rebalancing the shareholdings of emerging and developing economies to reflect their true weight in the global economy. Modalities could be broadened to include a range of risk-reducing and leverage-inducing instruments, such as guarantees, mezzanine structures, fund-of-funds and partnerships.

The G-20 is unlikely to take up the issue of a new development bank—that was already discussed at the BRICS Summit in New Delhi in March 2012. But the G-20 should take seriously the issues raised, namely the need to modernize and focus the mandates, membership and governance, and modalities and instrumentalities used by multilateral development finance institutions.

To be fair, there is a willingness to experiment and take small steps forward. Several G-20 members are likely to pledge additional resources for agriculture and food security, for example. The International Finance Corporation, the Asian Development Bank and the U.K.'s Department for International Development are launching a Climate Public-Private Partnership Fund to use public sector seed capital and policy dialogue capabilities to attract large pension fund capital to invest in resource efficiency and

low-carbon infrastructure assets and services in Asia. But these efforts fall short of a more complete assessment of the institutional gaps in the existing financial architecture.

Action Items for the G-20

The G-20 needs to update the international financial architecture in a more balanced way:

- It has mobilized substantial resources for stability and austerity through the International Monetary Fund, but it needs to move on sharply increasing resources for infrastructure development that can promote growth in an inclusive way. This can be as useful for advanced economies that must jump-start growth and raise productivity as for emerging and developing economies trying to sustain growth.

- The pace of modernization of the international financial institutions should be accelerated. The agreed-upon calendar for IMF reforms is at risk, threatening the credibility of the political decision-making process. Reforms in multilateral development banks are proceeding even more slowly and should be given priority.

- Some reforms, such as on the use of new instruments to increase leverage and update modalities for public-private partnerships, are policy choices that do not require legislative approvals. These can be fast-tracked to deliver immediate results.

WHY THE G-20 MUST PRIORITIZE FINANCIAL INCLUSION TO PROMOTE GLOBAL GROWTH

Mwangi S. Kimenyi and Vera Songwe

Framing the Issue

Financial inclusion is one of the key pillars of the G-20's development agenda. Past G-20 summits have acknowledged that a key driver for broad-based and inclusive economic growth is access to financial services such as bank accounts, savings institutions, formal payment channels and insurance services. At the 2009 Pittsburgh Summit, G-20 leaders committed to improving access to financial services for the majority of the world's poor by launching the Financial Inclusion Experts Group (FEIG) to "scale up the successful models of small and medium enterprise (SME) financing… [and] identify lessons learned on innovative approaches to providing financial services" (G-20 Leaders Statement). At the Toronto Summit in 2010, the G-20 launched the SME Finance Challenge, aimed at getting the private sector to offer suggestions for how public finance can best leverage private finance to promote financial inclusion. The summit also endorsed the "G-20 principles for innovative financial inclusion" that embody a comprehensive action plan by different actors to enhance financial access (see Principles for Innovative Financial Inclusion).

At the Seoul Summit later that year, the G-20 launched the Global Partnership for Financial Inclusion (GPFI) and an SME Finance Innovation Fund—both implementation mechanisms for the G-20 financial inclusion action plan (see Seoul Summit Leaders' Declaration). As the G-20 leaders meet in June, increasing financial inclusion should remain a priority. Today, the majority of people in developing countries—up to 2.5 billion people— still do not have access to any form of formal financial services according to the GPFI, and financial exclusion is particularly pronounced in sub-Saharan Africa where less than a quarter of the people aged 15 and over have a formal bank account (World Bank 2011); a lack of access to financial services is also a significant barrier to the participation of women and youth in the economy.

With rising unemployment, especially among youth populations, a promising strategy to absorb the millions of unemployed in poor countries is through the promotion of small and medium-sized enterprises (SMEs). Data show that SMEs represent 45 percent of all jobs in the developing world but a big constraint to their growth is limited access to financial

services. Of the estimated 25 to 30 million formal small enterprises in the developing world, roughly half lack access to formal banking services (GPF 2011a).

New technologies, particularly mobile financial services, are making it increasingly easier for the poor and unbanked to access financial services at relatively low cost. In Kenya, for example, about 86 percent of those with mobile phones use them to make financial transactions (World Bank 2012). Utilizing mobile financial services is a promising strategy to increase financial inclusion but a number of policy issues must be addressed to increase its potential.

Policy Considerations

While mobile phone use has increased rapidly in Africa over the last decade, the potential to adopt mobile financial services remains largely unexploited. According to the World Economic Forum, "[o]nly a few smaller countries have seen adoption of mobile financial services reach more than 10 percent of the adult population." A World Bank study also reveals that 12 percent of people in sub-Sahara Africa have made a financial transaction via mobile phone in the past year. But in every other region in the world, that number is smaller than 5 percent (World Bank 2012). There are many country-specific barriers that prevent the "graduation" from the standard and traditional uses of mobile phones to the penetration of mobile banking technology.

Therefore, policy considerations for G-20 leaders at the summit in Mexico should focus on the various constraints that hinder the adoption of mobile financial services technology. One particular concern relates to managing the risks associated with the integrity of mobile financial services, which are basically the result of the dynamic and decentralized nature of the industry. Second, many countries do not have the capacity to effectively establish the necessary institutions and regulations to optimize the expansion of mobile banking and financial services. Even in those countries where mobile banking and financial services have expanded greatly, there is still room to increase its use in other areas such as insurance, savings and loans.

A third critical issue that could increase the efficiency and lower the cost of mobile banking is interoperability between provider platforms. Specifically, platforms for mobile financial services are often different between providers and should therefore be redesigned to be compatible with each other.

Action Items for the G-20

Building on the Mexico G-20 GPFI, at the upcoming summit in Los Cabos, the G-20 should undertake the following actions to further expand access to mobile banking and financial services:

- Support the creation of new financial products in the mobile financial services sector by encouraging stronger partnerships between indigenous savings groups, formal banks and the mobile financial services industry (World Economic Forum 2011).
- Assist with global knowledge sharing on mobile financial services between countries by facilitating the free flow of experiences, best practice and technology from countries such as Kenya and Indonesia (GPFI 2011b).
- Assist developing countries in establishing appropriate regulatory frameworks that allow for innovation and competition while reducing the risks of systemic defaults and the risks associated with electronic money transfers such as money laundering and financial terrorism.

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GREEN GROWTH: G-20 LEADERS CAN SET THE STAGE FOR RIO+20

Katherine Sierra

Framing the Issue

The 2010 Seoul Summit first introduced the concept of green growth to the G-20 agenda. With job creation at the center of the global recovery, green growth strives to simultaneously accelerate growth and job creation while also meeting the world's environmental and social challenges. The green growth agenda aims to do this by using technology and innovation as key levers to drive job creation and create new competencies. Specifically, the agenda looks to find new sources of growth through innovation-oriented policies that capitalize on new technological advances—particularly in clean energy and innovations that take advantage of information and communication technologies. These aspirations were echoed last year in Cannes, where G-20 leaders committed to implement policies to spur the innovation and deployment of clean and efficient energy technologies. Green growth will once again be on the agenda for the G-20 leaders when they meet in Los Cabos, Mexico.

The upcoming G-20 meeting in Los Cabos comes just days before leaders gather in Rio de Janeiro to celebrate the 20th anniversary of the United Nations Conference on Sustainable Development. Green growth is also on the agenda for that meeting (the Rio+20 Conference), and G-20 leaders can send a strong signal of support to those gathering at Rio that, despite difficulties, investment in green growth can be good for both economic growth and the environment.

Policy Considerations

The green growth agenda is still in an early stage of development. Its concepts are being tested in a few national contexts, with Korea and Mexico being notable examples. Numerous cities in G-20 countries are also looking to the agenda to create jobs while enhancing economic and environmental performance. International organizations, like the Organization for Economic Cooperation and Development (OECD), the United Nations Environment Program (UNEP) and most recently the World Bank with its latest report "Inclusive Green Growth", are articulating the case for green growth. The Global Green Growth Institute, an international think tank based in Korea, was created to promote these concepts by supporting the development of national strategies and related capacity building.

Though despite summit declarations, implementation has not yet taken off in a concerted way. This is in part because the agenda has been crowded out by continued financial and economic crisis in the eurozone; lack of political consensus in the United States; resistance to some elements—like reducing fossil fuel subsidies; lack of international financing for developing countries to support implementation; and concerns from some developing countries outside of the G-20 that the agenda signals a new form of conditionality.

Green growth advocates call for strategies that emphasize efficiency and productivity as important foundational goals. Demand management policies that price energy and water at levels reflective of externalities are needed, starting with the removal of fossil fuel subsidies and policies that price carbon. Green growth's efficiency goal will be critical as the next generation of infrastructure to support an additional 3 billion people who will be living in cities by 2050—mostly in Asia and Africa—is put into place. Valuation of natural capital in economic accounts will help policymakers make better trade-offs between hard infrastructure investments and solutions that use ecosystems to provide services, such as fresh water sources and natural buffers against water-related disasters. Market mechanisms, such a basin-wide water markets, can provide the signals needed to manage resources—especially in water stressed regions.

While these policies have been in the sustainable development toolkit for decades, they have not been widely implemented. G-20 leaders have also pledged to rationalize and phase-out over the medium term fossil fuel subsidies but with little follow-through. And missing is a global commitment to actions that will lead to a price on carbon sufficient to incentivize the necessary investment and innovation to meet the global climate change challenge. At the same time, subsidy regimes that have been put in place in the absence of these incentives are under pressure from the continued impact of the recession and its attendant fiscal deficits, as well as by pressure from the current euro crisis. In addition, policies that price water and environmental services to reflect the true costs of natural resources are not yet in place.

Despite these barriers, green growth advocates are trying to make these policies more attractive by leveraging new technologies to lower costs and transform business models. Renewable energy technologies are the most often discussed, but breakthroughs and advances in information and communications technologies (ICT) may be just as important. Municipal leaders are experimenting with "smart city" systems that use ICT to manage water and transportation systems more efficiently while reducing resource use. Smart grids can help manage the flow of renewable energy into the grid and can also make distributed energy systems possible. Innovations in irrigation system technology can help meet the growing demand for food while also removing a major source of inefficiency in agricultural energy and water use. Developers are experimenting with the use of energy efficiency and local renewable energy generation technologies to create zero-emission commercial buildings and housing.

Green growth innovation-oriented policies should include: public and private investment in research and development; strategies that nurture coalitions between research institutions and entrepreneurs, like business incubation centers and an enabling environment for venture capital; targeted and transitional subsidies to help innovations move out of the "valley of death" between invention and commercialization where new technologies often falter; and especially for developing countries, financial mechanisms to help commercialize investments in new technologies by backstopping the initial risks as a way of promoting early adopters.

Innovation to support sustainable development is also being supported by a fresh generation of local leaders and multi-stakeholder coalitions. These include the C-40 Cities Climate Leadership Group, a coalition of cities from developed and emerging economies who are committed to taking action. New public-private financing models are being developed like the Joint Initiative on Urban Sustainability, which is being launched by the United States and Brazil to bring together investors and cities to secure innovative financing for sustainable infrastructure investments. The Sustainable Energy for All Initiative—a global coalition between of government, business and civil society under the auspices of the U.N. Secretary General—is

looking for breakthrough action on energy access for the poor, renewable energy and energy efficiency. A common thread among these groups is the way they are capitalizing on new green technologies; creating new business models that give incentives to the private sector to find innovative sustainable development solutions; and using limited public funds to leverage private investment and finance.

Action Items for the G-20

At the summit in Mexico, G-20 leaders should continue to reaffirm the importance of the green growth agenda, while signaling support for a few key areas and providing encouragement to the leaders coming together for Rio+20:

- **Pricing natural resources.** G-20 leaders can stress the importance of climate negotiators making progress toward creating policies that set a price on carbon, either through a tax or market mechanism. Leaders should also recommit to implementing the G-20 agreement to eliminate fossil fuel subsidies, setting out more concrete implementation pathways. In addition, the G-20 should commit to introducing natural capital accounting into their own country's economic accounts and pledge to build consensus on this more broadly at Rio.

- **Leveraging international finance.** G-20 leaders should urge key multilateral funders, like the multilateral development banks and specialized funds like the Green Climate Fund, to direct their resources to country-driven green growth investments. Multilateral and bilateral funders should more aggressively support the innovation agenda by leveraging private sector action through mechanisms that reduce risk. And, with the generational opportunity to change the emissions trajectory of cities given rapid urbanization, and the importance of cities as drivers of innovation, financial mechanisms to meet the large sub-national needs for green infrastructure investment should be given priority.

- **Investing in innovation.** G-20 leaders should pledge to step up investment in research and development in their own countries as well as invest in building the R&D capacity in the least developed countries. This could be done through a combination of direct international support through competitive grants as well as support for business incubation centers and financial mechanisms to encourage venture capital in the least developed countries. The G-20 leaders should signal their intent to pursue further liberalization of trade for environmental goods and services so as to also support the diffusion and impact of new technologies.

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