Enhancing Global Coordination

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For several years, globalization has brought many benefits, boosted economic growth and increased welfare while intensifying interconnectedness among countries. The recent financial crisis made this link more evident, proving how closely the markets are tied together as a shock in one major country (the epicenter of the financial system) quickly propagated to the entire world. It has become clear that, given the degree of interconnectedness between different economies, macroeconomic policy actions in one country affect economic welfare in other countries. One of the issues that the current crisis has brought to the fore, and that it is shared by most of academics, analysts and some governments, is precisely that the level of cooperation among countries has to be stepped up both in terms of surveillance and in creating the appropriate mechanisms to encourage the needed policy adjustments.

Since the breakdown of the Bretton Woods system, there has been a proliferation of attempts to discuss and coordinate macroeconomic policies among the major industrial nations and within Europe. Informal discussions in the early 1970s among only a few advanced countries have evolved into regular meetings, involving several layers of leadership.

During the recent crisis, international cooperation successfully coped with the shocks that affected global financial stability and threatened a great recession. The fiscal and monetary policy actions taken by the main developed countries in order to prevent a deeper economic downturn were successful precisely because they were taken as part of a coordinated effort. Also, for the first time in recent memory, emerging markets were able to put in place countercyclical policies. The strengthening of the policy framework in emerging markets in the years prior to the crisis allowed them not only to resist the shock, but also to stage a remarkably successful policy-induced recovery.

Once the emergency passed, and the global economy seeming to find its way back to growth, attention has been drawn to the legacy of the crisis (fiscal problems in the developed markets, inflation threats in the emerging markets, etc) and to the magnification of some of the challenges the global economy was facing. These have to do with the way the system absorbs financial innovation and shifts in capital flows; and the structural internal and external imbalances that had been building for some time, even before the crisis, are increasingly becoming a liability for the sustainability of the recovery. So at this stage, there is an even more compelling case for international cooperation. It should aim to improve surveillance mechanisms in order to avoid the build up of imbalances that could put the system at risk in the future.

Moreover, the G-20 would seem the appropriate forum for these discussions. While it is clear that successful global coordination remains critical for stronger, more balanced and sustainable growth, cooperation depends on the willingness of governments around the world to coordinate. Political will to cooperate can only be achieved if it is perceived as advancing national agendas within a context of shared power and responsibility. It is common that, once emergency conditions have ebbed away, government priorities are no longer necessarily in sync with those from other governments. In addition, economic policy actions can even raise conflicts among countries and global policy coordination usually entails some surrender of sovereignty, which governments are naturally reluctant to give up. Furthermore, there is a lot of debate around various dimensions of international coordination: (1) the type of problems that should call for coordination; (2) the kind of policies to be taken together; (3) the means to enforce the agreements; (4) the role of uncertainty and information sharing and (5) the measurements of the gains.

Given the process of global integration and the experience of the recent crisis, the framework for cooperation ought to be formulated so that it is in the interest of the major players of the global economy to cooperate. One would think that the huge costs associated with the crisis would provide sufficient incentives. Nonetheless, one has to recognize that the costs were asymmetric. Major emerging markets were largely unscathed by the crisis; this asymmetry has accelerated the shift of the center or gravity toward emerging markets and, in some ways, made cooperation more difficult as major surplus emerging markets show great reluctance to engage in adjustment, given the domestic success of past policies. It is important for other emerging markets to actively participate in the process of peer review.

A key aspect to consider when it comes to international cooperation is that it involves commitments by its participants to be effective. Commitment is possible when there is some mechanism that can assure accountability and even some kind of sanctions in case of departure from the agreement. If countries can commit themselves, they can act in effect as a single entity and choose their policies by joint maximization. In this context, one of the G-20 main lines of work regarding cooperation is the formal system that is being established for coordinating and supervising macroeconomic policies. The Mutual Assessment Process (MAP) aims at helping attain the G-20's principal economic goals of strong, balanced and sustainable growth.

At all levels of cooperation, there should be a clear understanding of macroeconomic fundamentals as well as a way to identify sources of instability and misalignment. Here, the agreements made by the G-20 leaders in Seoul at the end of 2010 and the ones taken in Paris this past February seem to be heading in this direction. An important action has been the agreement on a set of indicators or benchmarks that will be monitored to avert future economic crises; they will focus on persistently large imbalances that require policy actions. They will also help move the process of cooperation forward by turning the measures taken by the MAP into more concrete ones.

Such indicators will be used as guidelines and not yet as targets, assessing the progress on reducing imbalances. They will take into account national or regional circumstances, including large commodity producers and will be used to assess the following: (1) public debt and fiscal deficits; and private savings rate and private debt (2) and the external imbalance composed of the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary and other policies. If approved, the list of indicators is expected to be presented in April after the next G-20 meeting. One of the main complexities of these guidelines is that they will need to take into account national circumstances of countries in diverse stages of recovery and with different economic structures. Still, it is crucial to come up with these set of indicators that are efficient in signaling the building up of imbalances that could eventually put the global system at risk. This is not an easy or trivial task. After approving the guidelines, the second step would be to use them to asses the policy adjustments needed in each country in order to adjust internal and external imbalances.

Fostering international cooperation has become a greater challenge in the post-crisis world with countries facing different problems. Nevertheless, sustained growth and global stability is a shared goal that can be achieved through greater reliance on supranational institutions and processes (like the MAP). Within the G-20 agenda, the global imbalances indicators could provide a good start for effective action. The G-20 leaders have also agreed to improve the international monetary system in order to ensure system stability, promote orderly adjustment, and avoid disruptive fluctuations in capital flows, disorderly movements in exchange rates—including being vigilant against excess volatility in advanced economies with reserve currencies—and persistent misalignment of exchange rates. In this context, they also agreed to take measures to deal with potentially destabilizing capital flows and the management of global liquidity.

To conclude, the crisis demonstrated the degree of interconnectedness of the global economy. It also demonstrated the risk of uncoordinated and inconsistent policies both at the macro level and in the sphere of financial sector regulation and supervision. In addition, it confirmed the clear benefits of cooperation when the world was at the brink of debacle. This next step is crucial for the assertion of leadership of the G-20 in creating confidence on the strength and sustainability of the recovery and on the mitigation of future systemic risks. It will be the test of the G-20 as the primary forum for cooperation and for the IMF to assume a central role in the system.