# Two Years of G-20 Summits: Adagio Spiccato (ARI)

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**Theme:** The G-20 summit in Seoul has taken steps towards a global financial reform,[1] the internal reform of the IMF and the establishment of a new development agenda.

**Summary:** After two years of summits bringing together heads of state and government, the G-20 is slowly and fitfully reforming the international economic order. In Seoul, three new initiatives have emerged: part of the financial reform, the governance of the IMF and a development agenda. In the list of matters pending, there is yet another postponement –although with renewed vigour for 2011– that of coordination of macroeconomic policies to correct global imbalances, and concluding the Doha Round of trade talks under the WTO.

## Analysis:

*Introduction*

The fifth summit of the G-20, in Seoul, marked a new step in the reform of the international economic order, with major changes that have been in the works in recent months. Since the first summit in Washington in November 2008, the G-20 has focused its efforts on three main fronts:

- Reform of the international economic order: the main progress in South Korea was reform of the governance of the IMF, giving greater weight in decision-making to emerging and developing countries. Additionally, more emphasis was placed on concluding the Doha Round of the WTO talks in 2011, with a more assertive accent, and a specific development agenda with drive of its own, called the Seoul Consensus, has been set as a new front for the G-20.

- Coordination of macroeconomic policies: after a year-and-a-half of consensus on the need for macroeconomic impetus, the G-20 is having a hard time deciding on exit strategies. In Toronto, the debate centred on exiting from fiscal policies, while in Seoul the focus was on monetary and exchange rate policies. The leaders failed to establish explicit recommendations on monetary policy for countries –except for a generic commitment to flexible exchange rates and refraining from competitive devaluations–, and a US proposal to set quantitative limits on current account imbalances was not accepted. But the meeting was not a total loss. One step forward was that member countries made public the policies to which they have committed (including Spain) and there was agreement to strengthen the Mutual Assessment Process in 2011 with the goal of setting a common diagnosis as to what constitutes a global imbalance and how it should be corrected.

- Reform of the financial sector: Seoul reaped the fruits of the regulatory reforms that have been negotiated at the Basel Committee on Banking Supervision and

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1 The opinions expressed in this article are personal and do not reflect those of the Bank of Spain.

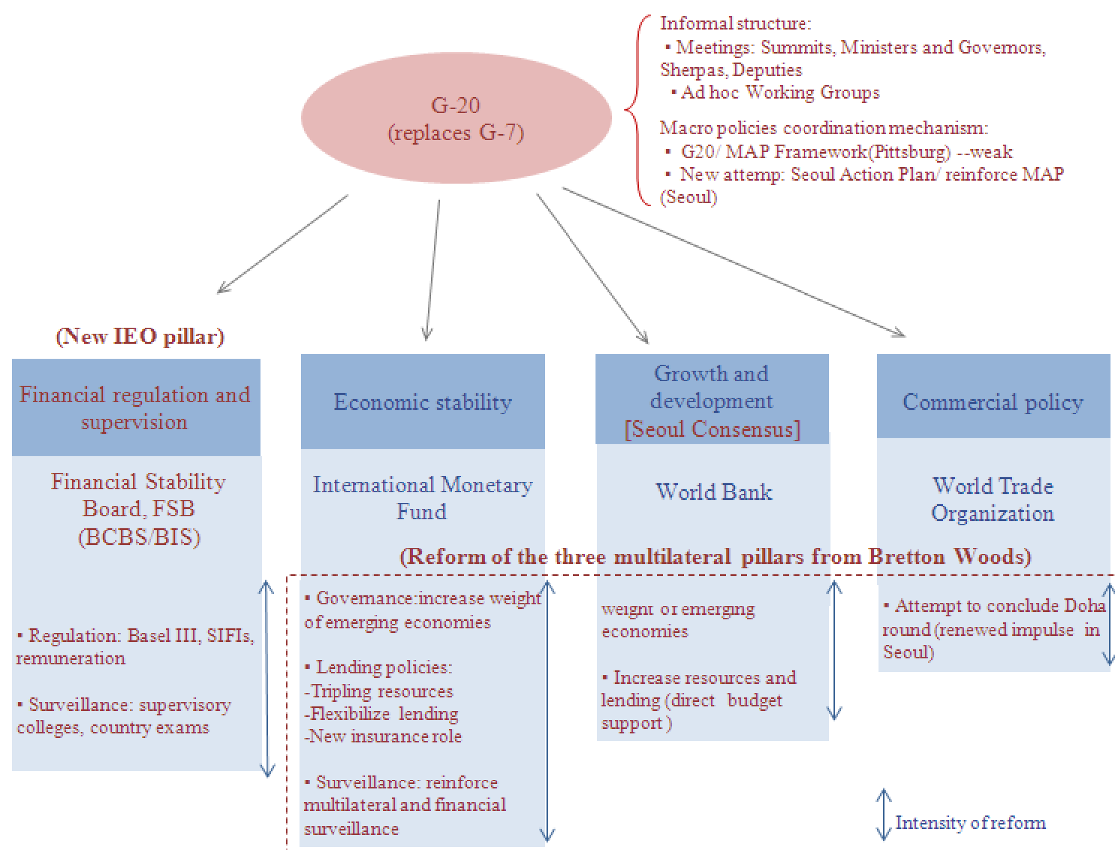
the Financial Stability Board. The new regulations, known as Basel III, were endorsed, and support was expressed for the work under way to impose stricter regulations for systemic institutions, which will conclude in 2011. The G-20 also embraced new fronts in which more regulatory and oversight efforts are needed, including the framework of macro-prudential risk management, the idea of addressing specific problems in emerging countries and the monitoring of non-banking sectors.

This ARI focuses on those reforms and reviews the progress made over the past two years. It also examines the main challenges facing the G-20 looking ahead to the future.

*Reform of the International Economic Order*

The G-20 has been the impetus behind very significant changes in the international economic order. The first of these is the very creation of the G-20 as the primary forum for international economic cooperation and its top-level configuration in summits of heads of state and government of its member countries. But the G-20 has also promoted change in the three multilateral pillars of the international economic order that were designed under the Bretton Woods accords, and also adds a new one on financial regulation and oversight. These are illustrated in Figure 1.

**Figure 1. New International Economic Order from 2009**




Several elements of the reform of the international economic order are worth noting: (1) the institutional informality of the G-20 and strength of the nation-state; (2) profound overhaul of the IMF; (3) guarding against protectionism; and (4) the new development strategy, known as the Seoul Consensus.

(1) The institutional informality of the G-20 and the strength of the nation-state. The Pittsburgh summit in September 2009 formalised the transfer of power in economic issues from the G-7 to the G-20. The G-20's capacity for action is based on an informal institutional structure based on working groups addressing specific issues, and meetings at the secondary political level (deputies and sherpas) which allow for making progress on proposals. That said, as Pedro Solbes and Carlos Westendorp put it, 'the G-20 is not the United Nations'. This structure is efficient when it comes to decision-making, but raises clear problems of lack of legitimacy because not all the world's countries are involved. Although the G-20 brings together more than 80% of the world's GDP and 62% of its population, the absence of developing countries stands out and criteria are imposed in a top-to-bottom fashion that eludes procedures for multilateral decision-making. The French Presidency of the G-20 in 2011 has already said that one of its goals is to give the G-20 a more formal structure. It would be good for this process of formalisation to include accountability mechanisms.

Meanwhile, the G-20 also shows that international relations based on the nation-state remain alive and well. In this context, alliances among countries are needed to gain sufficient momentum for guiding overall decisions. Such is the case of the so-called BRIC countries (Brazil, Russia, India and China) which have enhanced their cooperation since 2009 with yearly BRIC Group summits. They have also attained a specific weight within the G-20 by adopting common positions on many issues (while also allowing for shifting alliances on issues such as the currency war, for example, in which China and Brazil had opposing interests). There is a lesson here for Europe, which is failing to keep pace because of the difficulties it is facing in satisfactorily coordinating common positions, both among the EU as a whole and among the five countries that attend G-20 meetings (Germany, France, Italy, Spain and the UK). Under these circumstances, for Spain it has been a huge success to have been able to participate in all the G-20 meetings since the 2008 summit (despite not being a formal member, as it did not participate when the G-20 was constituted in 1999).

(2) Profound overhaul of the IMF. Dominique Strauss-Kahn is not exaggerating when he speaks of historic change at the IMF. The G-20 has truly brought about a shift in direction in all policies at the IMF. At the summit in South Korea, the G-20 confirmed an increase in the weight assigned to emerging and developing economies in decision-making, through a transfer of voting shares of about 6%. Also, two IMF executive board constituencies usually held by Europeans will go to representatives from emerging and developing countries. As part of the governance package, IMF quotas were doubled, a step which facilitated the balancing of the changes in the quotas of the 186 member states and maintenance of the IMF's nature as an institution based on quotas. Nonetheless, in terms of the budget, the real landmark came at the summit in London, with the trebling of the IMF's resources. Indeed, most of the new quota increase will be charged to the increase in the resources of the New Arrangements to Borrow (NAB), which was decided in London.

Along with governability, the IMF has made an about-face turn in its lending policy. In March 2009, access to traditional facilities was doubled, their conditionality was reduced (the structural execution criteria were eliminated), and the IMF recovered its insurance function through the Flexible Credit Line, which grants loans when countries have balance of payments difficulties, as opposed to the traditional criteria of need –and without conditionality (there are *ex-ante* qualification criteria to have access to the loan)–. Since the autumn of 2008, the IMF has granted loans worth up to nearly US$200 billion. To this

should be added the increase in loans granted through development banks, which in 2012 are expected to reach US$71 billion, double the level of 2008.

The Seoul summit consolidated the IMF's insurance function by endorsing the increased flexibility approved by the IMF in August 2010 –the boost in levels of access to the FCL and activation of a second precautionary facility for countries that find themselves on less solid ground–. The meeting also did this by encouraging the IMF to make progress in developing a global safety net by strengthening its cooperation with regional funds. Using a common simile that compares IMF lending policy to that of a doctor who visits a patient (a country) when the person is already sick (mired in an economic crisis), the Fund is strengthening its loans with the functions of preventive medicine.

(3) Guarding against protectionism. On international trade, the G-20 has been more preventive than active. The financial crisis led to a dramatic fall in world trade in 2009 (12%), as a result of a drop in aggregate demand. There were fears the situation could worsen even more if countries resorted to protectionist trade measures that might set off a chain reaction. The countries of the G-20 committed to avoiding taking this kind of measure and tasked the WTO with overseeing the pledge. According to the most recent report by the WTO, protectionist tensions have been restrained, and measures taken since the start of the crisis have affected only 1.5% of trade flows. It is expected that the final volume of trade figure for 2010 will surpass pre-crisis levels. The risk of protectionism seems to come now from the monetary front, in the form of competitive currency devaluations. On the active side, it has not been possible to give a definitive nudge to the Doha Round of talks, which have hit a deadlock nearly 10 years after they started. The Seoul summiteers insisted on the importance of concluding the Doha round, using language that was more assertive than that employed in the past.

(4) A new strategy for development, the Seoul Consensus. Until now, the G-20's development agenda has focused on generic support for the UN Millennium Objectives and encouragement of concrete measures such as financial inclusion through a framework to improve access to financial services for small and medium-size companies and for the world's poorest people (microcredits). In Seoul, leaders approved a new development strategy that is complementary to the UN goals, known as the Seoul Consensus. It sets a series of high-priority areas in a multi-year action plan with six principles for development policy: (a) growth as a necessary condition; (b) the absence of single formulas (each country must develop its own strategy); (c) the G-20 will set priorities as to global or regional systemic issues; (d) the importance of participation by the private sector; (e) tangible results; and (f) to have G-20 efforts complement those of major international economic actors in development policy. For now, the Seoul Development Consensus for Shared Growth is a fledgling plan and it will be particularly important for it to join in with multilateral efforts for development, in particular those led by the UN, so as to avoid duplication.

*Coordination of Macroeconomic Policies*
This is probably the main Achilles' heel of the G-20. For the first year-and-a-half after the collapse of Lehman Brothers, the coordination of macro-economic policies within the G-20 was easy. In fact, there was no real coordination as such: it was little more than a *laissez-faire* attitude in which each country applied the expansive and financial rescue plans it deemed opportune on the basis of a broad consensus that Keynesian-style stimulus measures were needed to avoid the errors of the Great Depression in the 1930s. The difficulty comes when countries have to negotiate the coordination of exit strategies.

Following game theory, the international coordination of macro-economic policies tends toward a non-cooperative Nash equilibrium because of the disparity in countries' interests and differences in diagnosis and modelisation of the economic situation, and as a result of this, the effects and policies necessary to correct imbalances.

At the Toronto summit of June 2010, disagreement emerged among major economies as to the diagnosis of the world's economic problems, and the scope and pace of fiscal exit strategies. In Seoul the debate centred on monetary and exchange rate policies, and was enlivened by the second wave of quantitative easing by the US Federal Reserve, which involved a monetary injection of US$600 billion.

The problem is not new, and has been around since before the crisis in terms of what are called 'global imbalances', and now redefined in exchange rate terms as a 'currency war'. To sum up, these imbalances refer basically to the high US current-account deficit financed by the countries of Asia –especially China– and by the oil-exporting economies, which generate excess savings and accumulate an excess of currency reserves. These imbalances have played a major role in the accumulation of systemic risk and a source of instability for the international economic order to the extent that they contribute to maintaining flows of capital towards the US (and Europe). This helps keep interest rates low and the value of the dollar above its theoretical equilibrium, or autarky, value.

Although as a result of the crisis the size of the imbalances has fallen, as stated by Oliver Blanchard and Gian Maria Milessi-Ferretti, it is not clear that the ideal scenario will emerge for gradually reducing the US current account deficit and re-gearing growth in China (and emerging economies in general) toward domestic demand with a re-valued renminbi and lower global reserve demand. The challenge for the G-20 –and in this case, especially for the G-2 of the US and China– is to reconcile internal objectives with the external effects of macro-economic policies that are determined first and foremost by domestic economic and political factors. The IMF already tried this in 2006 with failed multilateral talks (a kind of *ad hoc* Gs). The Pittsburgh summit tried to do it through the Framework for Strong, Sustainable and Balanced Growth, the main component of which is the Mutual Assessment Process, or MAP. Seoul tried again with the Seoul action plan, the main thrust of which is to strengthen the MAP in 2011 so as to achieve a framework for analysis and common diagnosis through indicators as to what constitutes a large imbalance and how it should be corrected. There are reasons to be optimistic as the G-20 is determined to seek coordination at the highest political level and the transparency of the process has improved. On the other hand, when there has been a serious problem such as that triggered by the Greek debt crisis, immediate consolidation measures have been taken, and in Toronto, deficit-reduction and debt-stabilisation objectives for 2013 were agreed. Meanwhile, albeit slightly, peer pressure is showing some positive symptoms, even in China, which has come to the last two summits allowing a small revaluation of the renminbi as a goodwill gesture.

*Reform of the Financial Sector*

Reform of the financial sector has been a central element of the G-20 agenda since the first action plan was approved in Washington, a blueprint that has been enriched with plans passed later in the summits in London, Pittsburgh and Toronto. One particularly important step was taken in London with the creation of the Financial Stability Board as the main forum for coordinating and regulating global financial regulation and oversight. The board became a new pillar of the international economic order.

The Seoul meeting reaped the first fruits of the work that the G-20 assigned to the FSB and the Basel Committee on Banking Supervision with the approval of Basel III. These new banking regulations enhance transparency and consistency at the international level and establish stricter liquidity and core capital requirements, raising the minimum reserve level of the latter from 2% to 4.5%. They also set an additional protective cushion capital requirement of 2.5% and liquidity standards (both short and long term) to restrain the system's excessive leveraging. These measures will go into effect gradually starting in 2013 and ending in 2018. The FSB and BCBS have also devised new rules for risk management and oversight, including standardisation of over-the-counter derivatives contracts, as well as guidelines for executive remuneration, what information should be made public and market discipline and on less dependence on credit ratings agencies.

Two major issues that were not resolved in Seoul remain pending: developing international accounting standards and, above all, defining and establishing additional requirements (beyond those set in Basel III) that will be demanded of global systemically important financial institutions (known as G-SIFIs). The G-20 called on the FSB to press on with its working agenda in 2011 to reach an agreement so that G-SIFIs have a greater capacity to absorb losses, are subject to more intense oversight and resolution plans that ease the probability of them failing and the impact if they do. The difficulty that the FSB must resolve is to avoid homogenous norms and calibrate just how systemic these institutions are. The idea is to adjust requirements to suit different kinds of SIFI.

The G-20 also laid out the next issues it will have to keep addressing in 2011, including: (a) considering the specific risks facing emerging countries –with less developed oversight and more exposure to outside risks–; (b) boosting regulation of non-banking sectors to keep operations from migrating to non-regulated parts of the financial system (*shadow banking*); and (c) strengthening the systemic dimension of regulation and prudential oversight (macro-prudential regulation), an area in which it will be especially important to coordinate the parallel work being carried out in various institutions such as the IMF, FSB and BIS. Finally, it will be necessary to enhance global supervision, which is relying on the work of colleges of supervisors (for the SIFIs), the FSB country-assessments and the financial oversight work of the IMF, which has established mandatory stability assessments of the financial system for systemic countries.

**Conclusion:** The G-20 is designing a new international economic order at an *adagio* pace but with substantial reforms that aim to increase the role of emerging economies in the very design of said order and strengthen the multilateral institutions that stem from Bretton Woods, something which, paradoxically, clashes with the institutional informality and the non-multilateral nature of the G-20 itself. Many of these changes are taking place fitfully (*spiccato*), on the basis of certain decisions by the G-20, which in a single meeting quickly concludes debates which had deadlocked in multilateral organisations, in some cases for years (such as the reform of the governance of the IMF, approved in South Korea). So far, the G-20 is proving to be relatively effective, but in the future it will need to improve its legitimacy.

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