

The London Summit: Milestone or Stumbling Block? (ARI)

*David Mathieson**

Theme: The summit of the G20 and international institutions for growth, jobs and stability is to be held on 2 April 2009 in London.

Summary: The heads of government from the G20 countries and others (including Spain) will meet in London on 2 April 2009 to develop what is being called the 'Bretton Woods II agenda'. They will discuss the co-ordination of fiscal stimulus programmes, the supervision of the global financial markets, reform of international financial institutions, climate change and balanced economic development. Although highly important, the success of the summit is not guaranteed. The differing priorities of the various participants and the parlous state of the global economy may mean that even a positive outcome in London has a low impact. Nevertheless, failure at the summit could lead to further instability and raise tensions within and between countries.

Analysis: When the leaders of the G20 and representatives of international financial institutions meet in London on 2 April they will be trying to do three things:

- (1) Coordinate action to revive the global economy.
- (2) Reform and improve financial sectors and systems.
- (3) Agree principles for the reform of international financial institutions (IFIs).

The London summit still has no published agenda but the starting point will be the reports of five working groups which were established by the previous G20 Washington summit in November 2008 on:

- Strengthening transparency and accountability by addressing weaknesses in accounting and disclosure standards.
- Enhancing sound regulation and regulatory regimes through overseeing credit agencies and financial products.
- Promoting integrity in the international market, including prudential oversight and risk management to promote the soundness of financial markets.
- Reinforcing international cooperation by regulating national and international finance laws.
- Reforming international financial institutions (IFIs).

* *Former British Government Advisor.*

These may seem dry, technical issues but in practice both the agenda and the scope of the London summit are turning out to be more contentious.

London 1933 and Bretton Woods

In some quarters the event is being described as part of a 'Bretton Woods II' process to construct a new international financial order. But it is worth recalling, however, that the Bretton Woods conference of 1944 had an important precursor: the London Summit of 1933. This was called in the midst of the biggest economic crisis of the 20th century primarily to avoid a descent into protectionism. And it failed. The American delegation withdrew and the summit broke up without any agreement. Governments went home to adopt the beggar-thy-neighbour policies which further exacerbated the crisis and crippled the global economy.

Many macro-economic policy lessons have been learned from the failures of the 1930s and this time round there is a determination to try to not repeat the mistakes of the past. This does not, of course, rule out making fresh mistakes. Real tensions between the participants are already surfacing and the success of this London summit cannot be guaranteed.

Differences are emerging between countries and blocks about their priorities for solving the crisis. The US is keen to boost global demand as fast as possible: it is pressing for greater fiscal expansion in other countries and more co-ordination of the stimulus packages. Most European governments have announced some fiscal measures to boost demand but they are reluctant to engage in further programmes at this point. France and Germany in particular point out that their levels of government spending are already significantly higher than those of the US and they are now worried about piling up debt through programmes which, in any event, have no guarantee of success.

Several European governments would prefer to make reform of the global financial system a priority for the summit. The EU has a settled position in principle on future regulation and supervision of financial services (the Larosiere report) which probably goes further than anything which could command consensus support in Washington. For their part, emerging countries, particularly those which external surpluses, are looking for a reform of the IFIs which will give them a greater voice in the international global economic and political framework.

Between these tendencies compromises will be necessary, so that whilst the focus in London will be on trying to fix the global economy in the short term the summit will also address the issue of creating a more enduring political economy. Whereas the Washington summit dealt with the immediate threat of implosion, the UK hosts are determined that this summit will try to promote factors aimed at enhancing longer-term stability. The UK has deliberately given the summit a broad remit which includes discussion on climate change and the relationship between emerging and developed economies in order to strike a more equal balance in the future. It is significant that the UK is promoting the summit equally through Downing Street, the Treasury and the Foreign Office (FCO), with Foreign Office and Treasury ministers being given almost equal prominence. London is also devoting considerable resources to the summit –up to £50 million according to some reports–.

The Possibility of Failure

Despite the apparent goodwill, planning and resources, various problems could yet sink the London summit either on 2 April or subsequently. First, without some impulse from the US, the London summit will not succeed and there has already been concern that Washington is not fully engaged with the preparation. This is not a lack of political volition but the fact that the naming and vetting of senior appointments in a new Administration is a slow process (described by the *Financial Times* as 'bewildering'). As a consequence, President Obama has so far appointed only two of the 18 Assistant and Deputy Treasury Secretaries. The senior British official responsible for drawing up the summit agenda recently complained that making contact with the US Treasury is 'difficult' and Washington wits have described Tim Geithner as being 'home alone'.

Secondly, at the moment the evolving summit agenda looks like a series of *ad-hoc* proposals without any unifying thread. Winston Churchill once asked a waiter to take away his dessert because, he said, 'this pudding has no theme'. The G20 runs the same risk. The summit negotiations are in danger of being crowded out by a multiplicity of demands, from more coordination of the fiscal stimulus packages, to control over fiscal paradises or hedge funds to reform of the IMF. There is a danger of first-order issues being 'crowded out by second order priorities' and the whole summit achieving very little.

Thirdly, the summit is based on the G20 organisation but this has no independent secretariat nor was ever conceived as an instrument for dealing with global economic crisis: it has been adopted (or hijacked) as the first best forum available. Formally the G20 is a grouping of Finance Ministers and Governors of Central Banks who have met together over the last decade (following the Asian crisis in the late 1990s) to discuss largely technical issues concerned with trade and finance. It is only with the current crisis that heads of government are now getting far more involved in the highly political decisions being taken: the Washington meeting of the G20 was the first ever G20 heads of government summit. London will be the second. As a grouping the G20 is developing 'on the hoof'. There are seven or eight other countries that are lobbying to be admitted on a permanent basis –including Spain–. Theoretically the G20 could expand further although this seems unlikely as such a group would be too unwieldy to be effective. Some fear that this is already the case and would like to see a much smaller grouping of, say, a G4 (the US, the EU, China and Japan) surrounded by a more representative G20-30. This would be a trade-off between an organisation small enough to be efficient against one large enough to be representative. The important point is, however, that it is an evolving institution in terms of size, structure and objectives. Everything is open to discussion and nothing is fixed.

If the London summit does fail it might happen in one of three ways: (1) important topics are broached, such as reform of the IMF, but no agreement is possible and the summit breaks up in disunity; (2) that there is a high degree of apparent unity around a final communiqué which is so bland that it is effectively meaningless; and finally (3), that countries sign up to a communiqué, on issues such as countering protectionism, which they have no intention of honouring.

Domestic and Global Stability

On its own, a failure in London would not necessarily be a mortal blow to a global economic recovery. But it would coincide with a new phase in the crisis and leave a void at a moment when a strong prop is needed to help support the world economy and political stability. The financial crisis of 2007 gave way to an economic crisis in 2008 and

this might turn into a social and political crisis in 2009. If world leaders emerge from London without a solid plan it would not only curtail economic recovery but feed a perception that political leaders are unwilling or unable to meet the challenges posed by the crisis. The resultant loss of credibility could increase geo-political tension for the rest of this year and could come in two forms: (1) domestic social and political stress *within* countries; (2) rising tensions *between* countries.

Although the impact of the crisis will be asymmetrical, it is now clear that few countries will emerge politically untouched by the crisis. Governments in Latvia and Iceland have already fallen as a direct result of the crisis and it is arguable that Barack Obama became US President in January because of his more coherent response to the crisis at a critical moment in the campaign last September.

Other countries are bracing themselves for social unrest that could arise from increasing frustration at the failure of the government (and the economy) to provide employment, welfare or protect the value of savings. The International Labour Organisation estimates that unemployment will increase to over 50 million in 2009 and as the Dutch Finance Minister, Wouter Bos, commented, this crisis has killed the myth of 'happy' globalisation beneficial to all involved. Young people coming on the labour market for the first time will find themselves particularly hard hit: the concept of ever increasing expectations with each generation improving on the material benefits of the previous one could now be at an end. Older middle class people are also at risk: whilst people in work may benefit from low interest mortgages, older savers have seen the value of their investments decline.

The crisis has also triggered civil unrest in countries such as China, Greece, Ireland, France and Russia. There could be worse to come: in the UK a senior London policeman warned of a possible 'summer of rage'; he particularly identified the possibility that the middle classes could join the protests if home re-possession and unemployment hit their lifestyles.

For Spain, the crisis will be the first stress-test of their multi-cultural society: in the last decade or so the number of immigrants has now grown to around 10% of the national population. In previous recessions a high level of family-based social cohesion has helped Spaniards survive the worst without significant unrest. But as a result of the economic, social and geographical mobility engendered by the boom of the last 15 years this has now declined. Family ties are weaker and there is more social fragmentation, all of which have made the traditional social 'shock absorbers' less robust. Although it has proved resilient in the past, the Spanish models of family and community will be stress tested as never before by the current crisis.

Some have warned darkly that this could be the beginning of the road which led to the ugly regimes of the 1930s, but in reality this seems unlikely. The ideologies then posited as alternatives to market capitalism and liberal democracy have since been utterly discredited. Failure at the G20 would be a considerable setback but this will not in itself propel the world back to the pre-World War II era for two reasons.

First, governments now do intervene to a far greater extent in the economy than they did in the first half of the 20th century: for instance, many countries in the developed world now have systems of redistributive taxation and comprehensive welfare schemes which will prevent many people from falling into extreme poverty. And despite the deregulation and the 'Reganonimics' of the last quarter century, *laissez faire* economics have been

abandoned –even Mrs Thatcher explicitly rejected the term to describe her policies (and not just because it was French)–. This is underscored further by governments’ reactions to the current crisis. There may be important differences of emphasis within the G20 about the scope, depth and coordination of the fiscal stimulus packages, but most countries have adopted them in one form or another.

Secondly, the international mechanisms established to promote global economic stability (for example, the IMF, World Bank and EU) are evidently in need of an overhaul. But again, they are in place to help the most distressed economies. One important and realizable task of the London summit will be to ensure that some of these institutions are now ‘fit for the purpose’ both to meet the current crisis and the challenges of the 21st century. It seems that the IMF in particular will benefit from the summit and be given the extra funds that it urgently needs for its stability programmes.

The summit should also address the problem of how to deal with the tensions which might be generated between countries as a result of the crisis. Dennis Blair, the new Director of National Intelligence in the Obama Administration told the US Senate that, in his view, the crisis now poses a greater threat to US national security than al-Qaeda. He argued that economic forces could lead to huge migratory flows, the overthrow of governments and undermine the focus on Afghanistan. Any of these, he warned, could threaten global stability. He argued that ‘time is probably our greatest threat. The longer it takes for the recovery to begin, the greater the likelihood of serious damage to US strategic interests’.

The avoidance of such friction is paramount and, arguably, the most important task of the London summit will be to salvage the idea that globalisation remains a positive force worth pursuing. In the short term this evidently means avoiding protectionism and further barriers to trade. In the longer term the summit must tackle the reform of international institutions so that they reflect emerging geopolitical realities and can adequately deal with the challenges of the 21st century.

Reform has long been desirable but it is now essential in the light of the parlous state of the global political economy. Henry Kissinger describes the current crisis as a ‘catalyst’ for change in the structure of the international order: he argues that ‘the nadir of the existing international financial system coincides with simultaneous political crises around the globe. Never have so many transformations occurred at the same time in so many different parts of the world... The financial and political crises are in fact closely related because during the period of economic exuberance a gap had opened up between the economic and political organisation of the world’.

Until now that gap has been bridged, but with the US acting as a lone superpower this is no longer tenable. The limits of US hegemony have been exposed by its inability to control Iraq and Afghanistan, whilst the failure of the US financial model has triggered a national crisis of confidence. The US’s own National Intelligence Council Report on Global Trends in 2025 recently concluded that ‘A global multipolar system is emerging with the rise of China, India and others... The unprecedented shift in relative wealth and economic power roughly from West to East now underway will continue... The US will continue to be the single most dominant country – but will be less dominant’.

Conclusion

What is to be Done?

The London summit presents the existing global political and economic elite, led by the US and Europe, with an important chance to recognise these long term global trends. They should use the opportunity to demonstrate that they are willing to initiate reforms to global institutions, resist protectionism and better coordinate their fiscal policies. They should also indicate that they will take the Copenhagen summit on climate change later this year very seriously indeed and start taking the tough decisions which they have talked so much about.

None of this will be easy and using the summit as a moment of opportunity will require firm political leadership. Even with a decisive outcome, the short term future of the global economy will remain uncertain. But it is clear that failure to achieve some progress in London could make the fragile position very much worse.

David Mathieson
Former British Government Advisor