PERSPECTIVES ON THE G20
THE LOS CABOS SUMMIT AND BEYOND
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THE LOS CABOS SUMMIT AND BEYOND

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A number of issues face leaders at the Los Cabos G20 Summit in Mexico on June 18-19, 2012. The global economy remains fragile, with the continuing crisis in the euro zone creating additional uncertainty and volatility in global financial markets. At the same time, pressing global problems and demographic challenges, which require collective action to resolve and which otherwise would cloud medium-term growth prospects, loom on the horizon. Against this background, the need for effective, credible leadership is paramount.

This series offers expert policy analysis and prescriptions dealing with the discrete facets of G20 work and issues, with an immediate focus on the challenges facing G20 nations as they prepare for their summit.

James A. Haley provides an overview of the economic challenges that the G20 will grapple with in Los Cabos. Achieving the ambitious goal of strong, sustained and balanced growth identified by G20 leaders for the Mutual Assessment Process in Pittsburgh will be difficult. Failure to make progress in this area, he argues, could lead to a disruptive scenario characterized by inflationary pressures in key emerging market economies and the threat of deflation in advanced economies, making painful adjustments to high public debt burdens while struggling with the legacy of financial excesses, failed banking systems and diminished expectations for long-term growth. Moreover, restoring balance to the global economy would generate the resources needed to deal with the range of other challenges that must be addressed by the international community.

Paul Jenkins asks leaders in Los Cabos to put the euro zone on a sustainable track by grasping the economic fundamentals at play, including, where needed, further debt restructuring, and articulating a global growth strategy where interdependencies are recognized. The Mexican presidency has prioritized economic stabilization and structural reforms as the foundations for growth and employment. Daniel Schwanen argues that the G20 should make structural reforms, which are crucial to the G20’s ability to achieve the economic growth needed to create good and sustainable jobs, central to its agenda. To address external imbalances, Manmohan Agarwal presents the case for reforms to the international monetary system and International Monetary Fund (IMF) policies to reduce the incentive for countries to accumulate reserves.

Mexico’s G20 agenda also focuses on strengthening the financial system to promote economic growth. Pierre Siklos proposes an R2P (responsibility to protect) for the financial system, arguing that the G20 should insist that all members individually have a duty to prevent financial crises, while the existence of significant systemic risks create a responsibility to develop principles that can work on a global scale. Bessma Momani and Eric Helleiner, meanwhile, specifically focus on the capacity of the Financial Stability Board and argue that new measures to encourage compliance with international standards should be considered at the Mexican summit.

Thomas A. Bernes and James A. Haley address other issues facing G20 leaders focusing on improving the IMF and international financial institutions (IFIs) more broadly. Five years after the outbreak of the global financial crisis, the need for cooperation is still great. The costs of uncoordinated action are real and the legacy of the global financial crisis is felt across a spectrum of issues. The IFIs were created to support cooperative outcomes to global challenges that are equal to those confronting the international community today. With reforms to restore their legitimacy, credibility and effectiveness, the IFIs can assist the G20’s collective leadership of the global economy.

On the promotion of sustainable development and green growth, Kathryn Hochstetler outlines how green growth can be part of any strategy for economic recovery and growth; leaders should not ignore this opportunity. The timing is also right for the G20 to articulate a feasible and focused vision for green growth ahead of the Rio+20 Green Growth Summit. Colin Bradford addresses options for green growth going forward.

Progress on climate change is also feasible, as Barry Carin emphasizes, if leaders focus on the art of the possible, for example by accelerating the phasing out of fossil fuel subsidies to reduce greenhouse gas emissions and, simultaneously, enhance energy security. To enhance food security, Jennifer Clapp warns that the G20 should not restrict itself to a narrow focus on productivity growth, as the structural economic forces that work against food security need to be addressed to resolve access problems.
Gordon Smith urges that, in the short term, given current political and economic constraints in key member countries, the G20 must continue to systematically work through past agendas. The G20 has proven to be an effective global crisis management tool but steps must be taken to manage the evolution of the process if it is to evolve.

CIGI hopes that, collectively, these commentaries help to illuminate the key policy issues that G20 leaders must address at the Los Cabos summit, and the urgent need for collective action — the imperatives of innovation in international governance — as well as the risks of failure.
The G20 leaders meeting in Los Cabos confront a number of challenges. Most prominent among these is the state of the global economy, which remains dangerously unbalanced, and in which the balance of risks is clearly weighted on the downside. These risks emanate from several sources:

- The euro zone remains in crisis, with underlying institutional and governance weaknesses still to be adequately addressed. Growth in Europe has once again stalled and uncertainty surrounding the euro clouds the outlook. The result has been higher unemployment that, in some euro-zone members, is now at Great Depression levels.

- In contrast, the US economy has continued its steady — albeit tepid — recovery, with unemployment trending down slowly over time. Although there are grounds for cautious optimism, the medium-term fiscal situation is worrying, while in the short term, the threat of a potential fiscal shock, with the expiration of tax cuts and a repetition of the debt ceiling brinkmanship of a year ago, weighs on the outlook.

- New concerns have also emerged about the sustainability of growth in China, Brazil and India, and other dynamic emerging economies that have fuelled global recovery, but which have relied on an export-led growth strategy.

Success at Los Cabos can be measured in terms of credible, effective commitments made to mitigate these risks, including:

- Governance arrangements to facilitate risk-sharing among euro-zone members and to create a euro-zone-wide deposit protection system with clear rules for European Central Bank lender-of-last-resort facilities;

- In the United States, credible commitments to fiscal sustainability that are conditional on the state of the economy, as Larry Summers has proposed, which would anchor expectations regarding future fiscal probity, reducing uncertainty, while guarding against a near-term risk of an unwanted, damaging fiscal shock; and

- Clear commitments to inflation targets and concomitant exchange-rate flexibility in dynamic emerging economies that are currently conflicted by a desire to prevent excessive appreciations of their currencies and the need to contain inflationary pressures emanating from abroad — attempts to achieve both could guarantee success at neither, and impart a deflationary bias to the global economy.

At the same time, leaders will address a range of other issues that have figured prominently in previous summits. Especially noteworthy is international financial regulatory reform, including the implementation of new capital rules, strengthened cross-border resolution regimes, rules and regulation on trading, clearing and reporting of over-the-counter derivative contracts, and a framework for understanding and mitigating potential risks from the so-called “shadow banking system” which operates outside the regulated banking sector. In addition, the diminished growth prospects and heightened public debt burdens bequeathed by the crisis undermine efforts...
to address food security and sustainable development, and to undertake timely, effective action on climate change adaptation and mitigation. All of these issues will take time to resolve.

The immediate challenge is to promote “strong, sustainable and balanced growth” within the G20 through multilateral review of, and consultations on, members’ policies. As articulated by G20 leaders at the Pittsburgh summit, this is the objective of the MAP.

Initially, efforts to cooperate were facilitated by a common threat: faced with a global financial collapse that threatened all, a common, coordinated response was possible. This response was supported by a clear consensus on the part of international institutions, academics and the think tank community, with respect to the appropriate use of extraordinary monetary and fiscal policies. As countries have emerged from the crisis at different speeds, however, the nature of the needed response has changed. The goal is no longer the same policy response at the same time, but policy responses calibrated to individual country’s circumstances. Unfortunately, these differentiated policy requirements are both more difficult to agree on and more difficult to monitor.

Moreover, the extraordinary policies that G20 countries adopted to prevent a catastrophic collapse in output have created new challenges to effective cooperation:

- Central banks in key advanced economies have adopted exceptional measures, including quantitative easing to mitigate the effects of de-leveraging and support growth.
- Meanwhile, the public debt burdens of many advanced economies have increased dramatically, as governments allowed automatic stabilizers to operate, undertook proactive fiscal stimulus to protect output and employment, and as a result of efforts to attenuate the effects of bank failures.

As a consequence of these effects, capital flows have increased to the dynamic emerging economies that are growing rapidly and which offer the prospect of higher returns, while many advanced countries are pursuing fiscal austerity — some, in Europe, under the threat of a possible loss of access to the bond market. For countries that have relied on an export-led growth strategy based on strong consumption in advanced economies, this conjuncture is especially challenging.

The problem is that, for advanced economies undergoing the effects of de-leveraging and fiscal austerity, expansionary monetary policy that results in a depreciation of their currencies and facilitates a rebalancing of global demand is wholly appropriate. But dynamic emerging economies, which are reluctant to absorb the appreciation of their exchange rates and fearful of fuelling asset price bubbles (particularly when some others have tied their currencies to the dollar), have resorted to “prudential regulation” to limit capital inflows and suppress the appreciation of their currencies.

In part, this response may reflect a desire to maintain the current account surpluses that have provided a cushion of foreign exchange reserves. From the perspective of individual countries, this process of self-insurance through reserve accumulation is a sensible, prudent strategy. Indeed, it can be argued that self-insurance has served the dynamic emerging economies well, given the limited impact of the crisis on their economies and the rapid recoveries they have enjoyed. From a global perspective, however, efforts to resist the exchange rate adjustments that are required to facilitate global rebalancing pose a risk of insufficient global aggregate demand. And this, in turn, implies that the real exchange rate adjustments required to facilitate the needed rebalancing must come from inflation in surplus countries and deflation in deficit countries.

Such adjustments would be inconsistent with the goal of strong, sustained and balanced growth. Structural reforms can help facilitate real exchange rate adjustments and reduce the potential costs associated with the adjustment process, but they take time to implement and take effect. In the meantime, the G20 MAP remains the best hope for securing the timely, orderly rebalancing of the global economy that is needed to avoid a disruptive scenario. That will take a shared analysis of the problem and a renewed commitment to cooperation to support the goal of an open, dynamic international trade and payments system.

The IMF can help reanimate this shared commitment and help support cooperative agreements, but only if it is viewed as legitimate, credible and effective by its members. In this respect, the crisis has served to underscore the need for governance reforms to allow the institutions of international cooperation to assist their members in dealing with the challenges they face, and ensure that the global economy remains a source of growth and development. Moreover, the Fund must articulate a clear, consistent message on the role of monetary and fiscal policies in key economies confronting the risk of prolonged economic stagnation. Absent effective global leadership from the Fund, individual national self-interest will prevail and effective international cooperation will remain merely an aspiration.
As we approach the Los Cabos summit, it is easy to be downbeat about the state of the global economy. The G20 goals of a full recovery from the Great Recession and putting the global economy on a sustainable growth path, as outlined in the Cannes Action Plan for Growth and Jobs, are not only far from realization, but they have also suffered serious setbacks due to failures of policy and governance. While finance ministers and central bank governors point to a continuation of a modest global recovery in their recent communiqué, levels of economic activity and employment remain well below pre-recession levels in many countries, markets remain unconvinced about the direction of policies, and downside risks and vulnerabilities dominate the commentary of the International Monetary Fund and the Organisation for Economic Co-operation and Development in their latest global economic projections.

But now is not a time for reflection. Instead, efforts need to be redoubled to have the G20 move forward and have leaders coalesce around the gains that can only be achieved through international policy cooperation. The reasons that brought the G20 leaders together in the autumn of 2008 have not disappeared. What have appeared to some to be domestic economic issues, therefore, requiring a purely domestic response, have in fact represented the full extension of the forces unleashed by the global financial crisis, which require global solutions. The G20 remains the most important “game in town” to put in place the right economic and financial policies. This is not just a one-time effort. It is a repeat game that needs to be played at the global level, this time around with some new team players in the lineup. The problem is that the game is currently being played based on a misdiagnosis of economic fundamentals, fed by failures of governance leading to failures of policy. And with these failures, we are now beginning to see economic risks turn into political risks.

Failures have been most evident in three areas: dealing with unsustainable sovereign debt levels; distinguishing between liquidity and monetary support from central banks; and recognizing externalities and the need for collective action. Los Cabos offers the opportunity for leaders to regroup and recalibrate.

**DEBT RESTRUCTURING**

Unsustainable debt levels have been at the heart of the global financial crisis. In many countries it first materialized as excessive bank lending and private sector borrowing, especially in mortgage markets, but it quickly became a sovereign debt crisis as a result of government bailouts to the financial sector. In other countries it was a sovereign debt problem from the outset, due to years of profligate public finances. It has become imperative to restore impaired balance sheets by setting debt levels on a sustainable track. The policy question is how best to do that.

There are three ways to resolve an unsustainable sovereign debt situation: inflation, growth or default/restructuring of the debt. Austerity alone is not an answer. At the time of the Seoul summit, many felt that Greece would require some form of debt default/restructuring. Inflation was not an option for Greece given the European Central Bank’s (ECB) euro-zone policy mandate. And the degree of fiscal austerity demanded of Greece, together with the constraints of monetary union and rigidities within the economy, meant there was no hope of growth as the solution. The delay in recognizing the fundamental fact that Greece’s debt obligations had to be restructured...
has only made the size of the adjustment Greece has had to endure even larger. There remains, nonetheless, a reluctance to accept the fact that in serious debt situations default/restructuring of the debt represents a tool to help countries get back “on side” with policies that will promote growth and have broad social support. The G20 should promote the development and acceptance of a framework for orderly sovereign debt restructuring. (See: www.cigionline.org/events/cigi-inet-sovereign-debt.) Within the euro zone, authorities need to face the fact that further debt restructuring is inevitable.

These same policy choices apply elsewhere. In the United States and the United Kingdom, the prospect of growth providing the way out of their debt problems is much greater than among the euro-zone countries, given the availability of other tools, especially flexible exchange rates. Still, in both countries a judicious balance between fiscal austerity and the use of other tools to support aggregate demand is required. In the United States, the lack of political cohesion makes this task difficult, while in the United Kingdom the predominant focus on fiscal consolidation is beginning to weigh on the economy. At the same time, given the size of central bank balance sheets in both of these two countries, the risk that inflation will become the “release valve” for reducing debt burdens cannot be entirely ruled out. Given the technical means that the US Federal Reserve and the Bank of England have to exit from expansion of their balance sheets, this risk appears low.

**LIQUIDITY VERSUS MONETARY SUPPORT**

The traditional lender-of-last-resort role of a central bank refers to situations where liquidity support should be provided to financial institutions that are deemed to be illiquid, but solvent. Such support is separate, and different in nature, from central banks’ actions to provide economy-wide monetary policy stimulus. Poor communications and political posturing have greatly confused the situation in the euro zone, where suggestions were made that the ECB should act as the lender of last resort by lending to sovereigns facing a, purported, liquidity problem. Instead, the ECB correctly, though with some delay, took the important step of providing substantial liquidity support (their long-term refinancing operations) to the euro-zone banking system to help avoid a potentially serious negative feedback loop, whereby banks, in the absence of liquidity support, would have had to cut back their lending even more in the process of restructuring their balance sheets.

At the same time, however, discourse about the ECB being seen as lending to sovereigns (monetizing their debt) has, seemingly, made the ECB reluctant to undertake more expansionary monetary policy. With most of the euro zone mired in recession, and the risks on the side of debt/deflation dynamics taking hold, greater monetary stimulus by the ECB must become a policy option. This could involve the ECB operating entirely in secondary markets. With clear communications about its policy intentions and actions, the ECB can do considerably more to shape expectations in support of economic growth.

**INTERNATIONAL POLICY COOPERATION**

While the core functions of public policy continue to be performed at the national level of government, in today’s highly integrated global economy externalities and spillovers must be recognized and evaluated when designing and setting domestic policies. Whether the euro-zone debt crisis, the future course of US fiscal policy or the pace of China’s move to more market-based policies, all have profound implications for the overall performance of the global economy. The depth and breadth of interdependencies that tie countries together demand collective, concerted action on the part of the G20 if we are to have any hope of breaking out of the current economic malaise. To date, G20 leaders have not delivered on their commitments to international policy cooperation. This failure has resulted in policy mistakes that could have been avoided had the gains from collective action to address what are clearly global issues requiring global solutions been forcefully tackled by the G20.

For Los Cabos, there are three priority outcomes that leaders must deliver:

- put the euro zone on a sustainable track by grasping the economic fundamentals at play, including, where needed, further debt restructuring;
- articulate a global growth strategy, where interdependencies are recognized and both advanced and advancing economies play their part; and
- strengthen G20 accountability for commitments already made.

Less than a year has passed since the Cannes summit. In that short period of time, unilateralism and domestic political gridlock has dominated the economic scene. This must change at Los Cabos. Leaders must step up and act in the collective interest if we are to realize what we set out to achieve in the autumn of 2008.
The G20 leaders’ communiqué from the Pittsburgh meeting in September 2009 commits the G20 countries to a “framework for strong, sustainable and balanced growth.” Underlying this communiqué is the commonly shared position, enunciated further in subsequent meetings, that global imbalances accumulated over the years were a central element in precipitating the crisis, and the belief that correcting them is necessary to achieve strong, sustainable and balanced growth. Before the crisis, attention focused on the large surpluses run by China and the resulting substantial reserve accumulation. The problem of imbalances has subsequently achieved renewed salience with the emergence of imbalances among the countries of the euro zone and the lack of an adjustment mechanism to deal with them.

These surpluses are both the result of underlying policies and a symptom of a broader problem with the international monetary system, and with the lack of adequate institutional arrangements within the euro zone.

**THE INTERNATIONAL MONETARY SYSTEM AND RESERVE ACCUMULATION**

The postwar international economic governance arrangements agreed at Bretton Woods, included provision of credit by the International Monetary Fund (IMF) to finance the temporary current account deficits of its members, in order to prevent countries adopting restrictive trade measures to manage their balance of payments. Once the immediate postwar problems of European reconstruction were resolved, the IMF enabled members to manage their temporary current account deficits, a task that capital controls and limited private lending to sovereign borrowers — both a response to events in the interwar period — made easier.

International capital market developments over the past 30 years have enabled a growing number of countries to borrow from private sources to finance current account deficits. But access to private capital markets may cease when a country encounters balance-of-payments difficulties or in response to shifts in investor confidence. Then, the only lender is the IMF. Its ability to assist its members, however, is constrained by the fact that private lending typically dwarfs its own resources, so the IMF has often had to counsel a degree of adjustment effort that seems disproportionate to underlying imbalances.

Indeed, in the wake of the Asian financial crisis, many policy makers in developing countries consider the conditions imposed by the IMF to be too onerous — that the IMF has not struck a judicious balance between financing and adjustment. As a result, many countries, not just China, have resorted to reserve accumulation as a form of self-insurance. IMF governance needs reform to reanimate its central role in reserve pooling, and guard against policies that are destructive to national and international prosperity.

**WHAT IS AN ADEQUATE RESERVE LEVEL?**

Before any significant capital account liberalization occurred, reserves equivalent to three months’ worth of imports were considered adequate. The international community responded to the special needs of commodity key points:

- Create a facility to provide short-term financing to cover transitory balance-of-payments deficits unrelated to domestic policy shortcomings, similar to the original design of the Compensatory Financing Facility (CFF). Such a facility would, of course, require adequate safeguards to prevent its use to defer needed adjustment. More fundamentally, however, reinvigorate the role of the IMF as facilitating reserve pooling, to eliminate the need to hold costly reserves, the return on which is below the social return on public investment in schools, health care facilities and transportation infrastructure in most developing countries.

- To enhance the effectiveness of the IMF in reserve pooling, it must be viewed as legitimate, credible and effective. Otherwise, members will eschew its advice and undertake self-insurance through reserve accumulation.

- It is critical that IMF governance reforms address the legitimate concerns of its members — it must reflect the shifting relative positions of its members.
exporters that needed larger reserves because of more volatile exports by establishing the CFF at the IMF in 1963. Under the CFF, loans with no conditionality were provided to countries facing a balance-of-payments deficit because of a large drop in export earnings from primary commodities. Later, loans were provided under the CFF when large cereal imports caused the deficit. Still later, when the scheme was further modified so that it resembled ordinary borrowings from the IMF with conditionality, interest of developing countries in the facility waned. The greater volatility of food prices in recent years will likely increase the temptation of developing countries to build up reserves to pay for food imports.

With much larger short-term borrowings by developing countries following capital account liberalization, reserve adequacy was to be guided by the so-called Guidotti-Greenspan rule, reserves should cover a country’s short-term debt. The rationale was that in uncertain times, short-term inflows are subject to reversals and “sudden stops,” and reserves should be able to accommodate the outflow. Yet, reserves of developing countries have risen beyond even the Guidotti-Greenspan rule, while reserves of developed countries have remained in the range of 20 to 30 percent of imports or three to four percent of GDP (IMF International Financial Statistics).

A possible explanation is that subsequent capital account liberalization allowed residents of a developing country to invest abroad. Then, uncertainty regarding a country’s exchange rate resulted not only in withdrawal of short-term capital, but residents of the country could convert their domestic money into foreign currency, and take it outside the country. Consequently, reserves must cover not merely a country’s short-term liabilities, but also transfers by residents; therefore, the appropriate indicator against which to measure reserves is the money supply.

CONCLUSION

The international economic architecture erected at the close of World War II included the IMF, which provided short-term balance-of-payments financing to countries facing temporary trade imbalances to obviate the need for countries to adopt trade-distorting measures to manage their balance of payments. In effect, the role of the IMF was to assist its members smooth the adjustment process and thereby avoid policies destructive to national and international prosperity. But with countries liberalizing their capital accounts and accessing private capital markets for balance-of-payments financing, the ability of the IMF to assist its members to strike the right balance between financing and adjustment was impaired.

Developing countries, the main borrowers from the IMF in the three decades before the current financial crisis, were able to avoid having to borrow from the IMF — and the conditions attached to IMF assistance — by building up reserves through running current account surpluses; the phenomenon of reserve buildup is more widespread than merely a feature of Chinese policy.

IMF policies need to be adjusted to reduce the incentive for reserve accumulation.
Throughout its Mutual Assessment Process (MAP), the G20 is seeking to address macroeconomic imbalances that pose the risk of globally significant misallocation of capital, thereby threatening global growth prospects. But the “sustainability reports” produced by the International Monetary Fund on G20 economies flagged by indicators of imbalance agreed upon under the MAP, are replete with descriptions of structural factors in each economy that are at the root of macroeconomic imbalances.

These structural factors can include taxes, incentives, regulations, social programs, trade and competition, or other microeconomic policies or measures affecting the allocation of skills and resources in an economy. Because they affect public finances as well as the economic incentive to save, invest and consume, and, in the end, determine the sustainable growth rate of an economy, these structural factors affect the ability of the G20 to address the macroeconomic imbalances flagged by the MAP.

It is thus logical for the Mexican presidency to have made “economic stabilization and structural reforms as foundations for growth and employment” its number one priority. By raising the potential for future output and income growth, structural reforms can have beneficial macroeconomic impacts, such as reducing long-term unemployment, reducing the risk of inflation stemming from stimulative monetary policy or reducing the burden of private and public debt loads, in turn easing pressure among lenders to de-leverage. Structural reforms can also help smooth the adjustments necessary in countries experiencing large external surpluses or deficits, where those adjustments are difficult or impossible to effect via nominal exchange rate appreciation or depreciation.

As useful as they are to support long-term growth and rebalancing, such reforms can generate social stresses. They often involve changing domestic political economy arrangements that have protected or supported incumbents against potential challengers — who are often younger, dynamic and innovative, but are unable to convert growth potential into jobs and income as a result of structural barriers.

These barriers are often deeply embedded in the specific institutions and political economy of each country and, therefore, it is not only difficult, but often undesirable to coordinate internationally the specifics of structural reforms. Reform must be from the bottom up, and accepted for its own sake in each country. Nevertheless, the importance of structural factors for strong, sustainable and balanced economic growth in each country — in which we all have a stake — means that international cooperative forums, such as the Organisation for Economic Co-operation and Development (OECD) or Asia-Pacific Economic Cooperation (APEC), are spending a lot of time and effort discussing and assessing each others’ structural policies through mechanisms such as checklists or peer review processes.

The reality is that the line between what are considered strictly “external” policies that can be coordinated across countries and “internal” policies that are not amendable to such beneficial coordination, has increasingly become blurred. Structural reforms in each country would make external coordination easier, and vice versa. Processes
that encourage structural reform such as those in place at the OECD and within APEC should be encouraged by, and linked to, the G20 MAP, focusing on the structural impediments to resolving the imbalances highlighted by the MAP.

To be sure, in more dire economic times, governments that find structural reforms politically difficult to implement will be tempted to resort instead to continued monetary stimulus and/or continue to accumulate public debt at rates that, for many of them, are unsustainable. But the limits of the ability of monetary and fiscal stimuli to raise output are becoming increasingly evident. There is a need for more business-led growth instead.

Unfortunately, businesses in many G20 countries are now net lenders to the rest of the economy, in contrast to a more normal situation in which they borrow to invest in expectation of future growth in revenues. As I have argued in earlier commentaries, more G20 engagement with business and a more credible program of reforms focusing on removing barriers to productive business investment — which may, in some countries, mean introducing more robust corporate governance arrangements — would help clear up growth prospects and, thus, pave the way for a boost in business investment, which is so crucial to the global recovery.

A focus on structural reform does not mean abandoning the quest for strong social programs. Indeed, structural reforms are crucial to putting existing social safety nets, such as public pensions and health care, on a fresh footing — expanding in countries where gaps force households to save exceedingly, being made financially sustainable in countries where the public is increasingly less confident that these programs will be there for them in the future and, in turn, increasing public support for reforms.

In sum, the G20 should pay increasing attention to how it can advance its growth-oriented structural reform program, whether as part of the MAP or by creating a separate accountability track for it. While structural reform commitments by G20 members can and should be made very much “from the bottom up,” the important task is to elicit those commitments and, in general, to ensure a more central and rigorous place for structural reforms in support of the strong, sustainable and balanced growth, which the G20 has pledged to deliver.
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The surface, the global push to implement measures to stem future systemic crises like the one that first gripped the global economy in 2007 has made considerable progress. In a letter released on April 20, 2012, Bank of Canada Governor and Chair of the FSB Mark Carney summarizes the progress made since the November 2011 Cannes summit. The letter emphasizes the fact that agreement has been reached on general principles to strengthen the resilience of the global financial system, to properly regulate and supervise systemically important financial institutions, and develop the necessary oversight of the shadow banking system. Nevertheless, the continuing crisis in Europe, the recurring worries over whether existing financial “firewalls” are large enough to forestall another global financial crisis and the weakness of the global recovery, suggest that, almost five years since the start of the “global” financial crisis, a safer and stronger global financial system has not yet been achieved. Mark Carney’s letter is also notable for its insistence that “focused attention, sustained effort and effective cooperation will be needed by all of those involved to achieve the promised deliverables” by the time of the next summit in Los Cabos, Mexico. To make matters worse, we are nowhere near a state where reforms under consideration are “timely, complete and globally consistent.” Comments such as these do not inspire much confidence.

Part of the difficulty is the sheer complexity of the issues involved, as policy makers still struggle to define what financial stability means, let alone identify institutions that are systemically important. Instead, politicians appear to believe that ever larger “firewalls” will protect the world from another financial crisis and the attendant spillover effects in the real economy. Such an approach is, unfortunately, grossly misplaced. Observers and policy makers are not even able to agree on how big an adequate firewall should be and, in any event, this does not solve the problem of weak banks, inadequate institutions for supervision and a confusing regulatory regime. Quite the contrary — we are witnessing a race to see how far governments are willing to go in defending policies that both markets and the public at large are refusing to accept. If this were not the case, why is it that the crisis continues even after politicians and policy makers insist that the latest measures will solve everything?

Dealing with systemic risks involves recognizing that some of the policies put in place by central banks to support the banking system in the short term, may actually weaken the financial system in the long term by creating “zombie banks,” as well as make banks appear more susceptible to sovereign risk as they load up on increasingly risky sovereign debt. Indeed, the networking, interconnectedness and herding phenomena built on private claims that brought the role of systemic risk to the forefront of the debate over financial system stability is now being recreated around government debt.

Unconventional policies, such as the European Central Bank’s long-term refinancing operations, provide some breathing room, but unless behaviour changes, these reflect the inability or unwillingness of governments and their central banks to adopt the many laudable goals set out by the FSB. Together with a loss of faith in the ability of governments and policy makers to address the current...
economic and financial malaise, there is little reason to believe that any progress report delivered in Mexico in June will assuage the continuing global economic gloom. If the world’s largest economic bloc, namely Europe, is incapable of agreeing on a credible way forward to implement a unified system for banking supervision and regulation, which surely must parallel a system with a single currency, then what hope is there for Mark Carney’s call for global cooperation on financial reforms?

Consequently, there exists an urgent need to shift attention away, asking — borrowing from John F. Kennedy’s inaugural speech — not only what governments can do to create a safer financial system, but what markets will themselves contribute to achieve such an outcome.

How can financial markets, and the public more generally, be persuaded that a change for the better is imminent? Communication must be improved. The G20 and the FSB, the body it established, must regain control over the reform agenda it appeared to set so effectively in 2008 at the height of the financial crisis. The early momentum was lost to disagreement, competing proposals, incoherent progress in reforming financial systems, and an uneasy and misguided shift in responsibility to the International Monetary Fund (IMF), which sought to fill a void, not carry out a mandate assigned to it by the G20. The G20 should declare as a strategic imperative the responsibility to protect (R2P) the financial system by insisting that all members individually have a duty to prevent financial crises, while the existence of significant systemic risks create a responsibility to develop principles that can work on a global scale. Rather than work on “minimum” acceptable standards (the current strategy), the FSB should develop a set of principles that not only represent best practice, but that all member countries should aspire to. Instead, in an effort to protect their sovereignty, there is once again opposition to proposed reforms as these are seen to represent a threat to domestic objectives. The foot-dragging extends to reforms of the outmoded IMF Charter. The Charter still reflects its post-World War II roots, dominated by the United States and Europe. The realities of a world where emerging markets, among others, play a much more important role economically has yet to take hold even if, in principle, the concept is understood as one that needs urgent attention. Hence, we are left with an institution that is not credibly able to represent the international community in the area of financial cooperation. No firewall, however large, can change the perception that IMF governance is broken.

Of course, the notion of a R2P may well raise cynicism of the kind levelled at the United Nations R2P initiative in 2005. Partly Canadian inspired, the initiative focused on protecting populations from genocide, war crimes, ethnic cleansing and crimes against humanity. There are, however, at least three reasons to be more optimistic about an R2P for the financial system. First, the G20 is far more representative than the UN’s Security Council. Second, no one is suggesting that failure to implement a sound financial system would result in military intervention. Third, the actual work of defining and creating the conditions for a resilient financial sector is left to technocrats, not politicians. That said, it is politicians who must cede some sovereignty to the G20 and, by implication, to the FSB. Of course, history has shown that this is much easier said than done. Nevertheless, it may be that a body such as the FSB, suitably structured and provided with the necessary resources, can, in cooperation with other international institutions such as the IMF, acquire and disseminate the necessary information to assess the state of reforms worldwide and, if necessary, shame those whose policies do not measure up to best practice. This would also require that member states eventually achieve a level of transparency, accountability and governance that enhances trust in the intention of policy makers to strengthen and improve the resilience of the global financial system. The effort must be global, because increasing the power and responsibility of individual central banks may actually have had the unintended consequence of giving the illusion of improvements in ensuring stability in the financial system. However, without assurances or the means to publicly demonstrate that, when it comes to global finance, we are all in this together, it is difficult to believe that global financial markets will interpret existing efforts as the consequence of a desire for collective action.

**ENDNOTE**

1. These are banks whose survival is overly dependent on holding high quality government debt. As a result, zombie banks are less likely to perform their usual function of providing credit to the private sector.
Since the international financial crisis of 2008, the G20 has devoted extensive attention to the improvement of international financial regulatory standards. Having agreed on a wide range of new standards, the G20 is now facing growing questions about whether these will actually be implemented at the national level in a consistent manner. In addition to recommitting themselves to adopt these standards, the G20 leaders should use the 2012 Mexican summit to strengthen the capacity of the Financial Stability Board (FSB) to address this issue.

Compliance challenges are not new in this sector of the world economy. In contrast to international trade law, international financial standards have long taken the form of non-binding “soft law” with implementation left to the discretion of national authorities. Not surprisingly, implementation of international regulatory standards has often been uneven in the past.

In the post-crisis period, compliance problems have intensified as the scope of international regulatory standards has expanded dramatically to cover a much wider range of issues and sectors. The heightened domestic politicization of regulatory issues in the wake of the crisis has also made it more difficult for regulators to know whether commitments made in international meetings — either by themselves or foreign regulators — will be respected at the domestic level.

In addition, the diffusion of international financial power to emerging market economies is undermining the ability of dominant financial powers to set global norms, and is encouraging new competitive deregulation dynamics. Private financial interests are also becoming increasingly bold in resisting G20 regulatory goals in areas such as tightening regulations on over-the-counter (OTC) derivatives or the global systemically important financial institutions (G-SIFIs).

When the G20 leaders created the FSB in April 2009, they included in its charter some new mechanisms for encouraging compliance with international financial standards. Membership in the body comes with a requirement to implement such standards and to participate in a new FSB-led peer review process assessing compliance. Members have also agreed to undergo surveillance assessments under the International Monetary Fund and World Bank’s Financial Sector Assessment Program every five years.

These provisions are useful, but they also have some weaknesses. The FSB’s capacity to support extensive peer reviews has been constrained by the very limited size of its staff, who all have had to be seconded temporarily from other organizations like the Bank for International Settlements, because the FSB lacks a formal legal standing. More generally, the consequences of failing to comply with FSB requirements were not specified in the FSB’s charter. Because the creation of the FSB was not a product of a formal international treaty and it has not been approved by any legislature, its charter imposes no “hard law” obligations on its member countries.

As the challenges of implementing G20 commitments have grown, the significance of these weaknesses in the FSB has become increasingly apparent. The G20 leaders responded at the Cannes summit in November 2011 with several initiatives. One was to change the composition of the FSB’s influential Steering Committee, in order to...
give more weight to finance ministry officials who have a critical role to play in steering national legislative initiatives as well as to jurisdictions that have been less well represented in the past.

The G20 leaders also committed to exploring how to provide the FSB “with legal personality and greater financial autonomy.” If the FSB is registered as a corporate entity in a country’s domestic law, it will finally be able to hire permanent staff. Greater financial autonomy will also strengthen its capacity to hire staff and maintain the kind of high technical standards and independence that are necessary to support successful peer reviews.

Finally, the G20 leaders announced the creation of new “Coordination Framework” for monitoring and public reporting of the implementation of international financial standards, with a special emphasis placed on the issues that have been highest priority since the crisis: Basel capital and liquidity frameworks for banks; OTC derivatives reforms; compensation practices; policies towards G-SIFIs; resolution frameworks; and shadow banking. At this time, the FSB Secretariat also produced a new “status report” on the progress of implementation involving four grades (or “traffic lights”).

Each of these initiatives is useful and should be reinforced at the Mexican summit. What is still missing, however, is a clearer statement of the implications of non-compliance with international standards for FSB members. Improved monitoring, public reporting and peer reviews of levels of implementation are all well and good, but they need to be backed up with concrete consequences for those members found to not be meeting the FSB requirements.

Given the nature of the FSB and the standards themselves, it seems very unlikely that WTO-style sanctions against non-complying jurisdictions would be applied against FSB members that are non-complying. But other measures should be considered by the G20 leaders at the Mexican summit, such as the removal of certain privileges within the FSB itself. For example, in an earlier CIGI publication, Tony Porter suggested that membership on the Steering Committee, peer review teams, Standing Committees or working groups of the FSB could be conditional on levels of compliance with international standards. As a start, the G20 leaders could commit this kind of principle vis-à-vis compliance with a high-profile initiative, such as the implementation of the Basel III standards that begins in 2013.

Growing concerns about implementation problems are undermining confidence in the G20’s accomplishments in the area of international financial regulatory reform. Just before the Cannes summit, the outgoing FSB Chair Mario Draghi even acknowledged: “we have a long way to go to fully and consistently implement the reforms we have committed to and the policy measures already agreed.”

The G20 leaders have an opportunity in Mexico to rebuild confidence in the international regulatory reform process by strengthening the capacity of the FSB and its ability to encourage governments to implement the international standards they have already endorsed.

ENDNOTES


Much attention of late has been focused on the underdeveloped governance structure for managing the euro zone, which has been trapped in an ongoing economic and financial crisis for some time. This attention is deserved, as good governance establishes clear delineation of responsibilities and accountabilities and provides for clear decision-making rules. Europe’s failure in recent years to address its governance gaps has significantly contributed to its inability to come to grips with the economic challenges it faces today. It provides the world with a painful example of the costs associated with neglect and inaction.

But alas, Europe is not alone in its failure to evolve its governance mechanisms to deal with current economic realities. The failure of the International Monetary Fund (IMF) to modernize its governance framework was identified some time ago as an impediment to allowing it to enjoy the broad support and play the central role envisaged for the organization when it was established. At a time when the IMF could be exercising a leadership role in ensuring the policy coordination and implementation among major economies necessary to achieve economic growth and financial stability, the failure to address its governance issues is denying the Fund (and the world) such an opportunity — at a cost to all of us.

In 2008, the IMF’s Independent Evaluation Office (IEO) issued a report on IMF governance that called for “major changes in the governance of the Fund to strengthen its relevance and accountability and allow it to continue to play a central role in global financial and monetary matters into the future.” The report went on to say that “Improving its governance is widely recognized as a critical element in enhancing the Fund’s relevance, legitimacy, and effectiveness.” A report prepared the following year by a high-level panel chaired by Trevor Manuel, then minister of finance of South Africa, echoed most of the conclusions and recommendations of the IEO report.

The G20 picked up the challenge and at its 2010 meeting in Seoul pledged to implement a two-step reform of the IMF’s governance. In their communiqué, leaders stated: “Today, we welcomed the ambitious achievements...on a comprehensive package of IMF quota and governance reforms. The reforms are an important step toward a more legitimate, credible and effective IMF, by ensuring that quotas and Executive Board composition are more reflective of new global economic realities, and securing the IMF’s status as a quota-based institution, with sufficient resources to support members’ needs.”

While many observers questioned whether the agreement reached was sufficiently ambitious (particularly as it failed to address at all many of the reform suggestions identified in the IEO and Manuel reports), many considered it at least a small step forward. The reforms reached were:

- Shifts in quota shares (individual country shares in the IMF) to dynamic emerging market and developing countries and to under-represented countries of over six percent, while protecting the voting share of the poorest, to be completed by the annual meetings in 2012.
- A doubling of quotas (IMF financial resources). There was, however, to be a corresponding rollback of a back-up facility (the New Arrangements to Borrow [NAB]), when the quota increase became effective.
- Continuing the dynamic process aimed at enhancing the voice and representation of emerging market and developing countries in the IMF’s decision-making process.

Proposed reforms are in a state of limbo; the euro crisis has distracted policy makers from making progress.

The Mexican G20 hosts are in an unenviable position. It may be better for G20 leaders, if they are serious, to recognize their failure to achieve the progress committed to so far, and instead commit to real progress on a realistic timeline.

Key Points

- At a time when the IMF could be playing a leadership role in promoting necessary policy coordination and implementation among major economies, its failure to address governance issues is denying it and the world the opportunity to play a larger role in helping to achieve economic growth and financial stability.
- Proposed reforms are in a state of limbo; the euro crisis has distracted policy makers from making progress.
- The Mexican G20 hosts are in an unenviable position. It may be better for G20 leaders, if they are serious, to recognize their failure to achieve the progress committed to so far, and instead commit to real progress on a realistic timeline.
developing countries, including the poorest, through a comprehensive review of the quota formula by January 2013, to better reflect the economic weights, and through completion of the next general review of quotas by January 2014.

- Greater representation for emerging market and developing countries at the executive board, by reducing the number of advanced European chairs by two, and the possibility of a second alternate for all multi-country constituencies.

- Moving to an all-elected board, along with a commitment by the IMF’s membership to maintain the board size at 24 chairs, and following the completion of the 14th General Review, a review of the board’s composition every eight years.

While these details may seem (and are) highly technical, the net effect was to have been a significant shift of voting power and representation (and therefore influence) away from the developed countries to the emerging markets and other developing countries, thereby engendering a broader sense of ownership and trust in the IMF.

However, the impact of the euro crisis distracted policy makers from making progress on the reforms, and by the time the subsequent 2011 summit in Cannes took place, leaders were humbled to simply saying, “We will expeditiously implement in full the 2010 quota and governance reform of the IMF.”

A complicating factor in making headway on IMF reform is that many of the proposed changes require parliamentary approval in most IMF member countries. At their spring meetings in April, the IMF was reduced to simply stating that these governance reforms were behind schedule and experiencing significant delay. The necessary approval has not been forthcoming (nor even requested) in many countries. The laggards include most European countries (including Germany) as well as the United States and Canada. In fact, only nine of the core 19 members of the G20 have taken action on the approval process.

Some cynical observers have said Europe is dragging its feet because it doesn’t want to dilute its influence at a time when it has become the biggest borrower from the IMF. This argument obviously does not apply to the non-European countries. Why then this failure to implement agreements? Whatever the reasons, is it any surprise that the credibility of G20 governments is found wanting?

Once again we have seen the appointment of a European head of the IMF, and many are questioning whether the IMF has played an appropriate role in the ongoing European crisis (or simply fallen in line with European wants). Even the Canadian Minister of Finance, Jim Flaherty, has publicly raised the question of whether the IMF voting rules should be radically changed to temper current European dominance, which the stalled governance reforms were, in part, meant to address.

The IMF governance reform project has not progressed and, in some aspects, may have gone backwards. This leaves the Mexican G20 hosts in an unenviable situation. These reforms cannot remain in a state of limbo, as this will only continue to sap the legitimacy of the IMF. At the same time, simply repeating their continuing commitment to do what they have already said they would do, and haven’t, strains credibility at a time when the global economy can least afford it. Perhaps some honesty and straight talking should be the order of the day — it may be better for the G20 to recognize its failure to achieve the progress to which it had committed, and instead pledge to make real progress on a realistic time frame — perhaps by the end of 2014. But this should only be done if leaders are serious. More hollow words will only engender more cynicism. And more wasted time will only delay the strengthened, independent and unbiased global institution that the world economy requires.
The Los Cabos summit comes at a critical time. Indeed, it is tempting to assert that it marks a crossroads in terms of leadership of the global economy.

The global crisis has tarnished the cachet of leadership enjoyed by the advanced economies, which dominated global institutions and international decision making for the past half-century. Europe is consumed in a paroxysm of the euro’s making. Japan continues its decades-long flirtation with secular stagnation and a burgeoning public debt burden. And the United States is seemingly paralyzed by political polarization and Congressional gridlock, even in the face of an unsustainable medium-term fiscal path and the near-term risk of a disruptive fiscal shock. Only Canada, of the G7 group of countries, having avoided the worst of the financial excesses that afflicted others, can lay claim to recognition for sound economic and financial stewardship.

In contrast, dynamic emerging economies outside the core of the global financial system quickly returned to the path of rapid growth from which they were temporarily diverted. That growth path is consistent with slow, steady convergence on the income levels of the more advanced economies. In this respect, the integration and rapid growth of key emerging economies over the past several decades is a true globalization success story. But the gradual convergence of income-per-capita levels is only part of the story: given differences in populations and population growth rates, several key economies — China, India and Brazil — can expect to continue to increase in relative size (in comparison to the more mature advanced economies) for some time.

**HISTORICAL PERSPECTIVES**

For much of the past 65 years, the United States provided the leadership to promote international adjustment in a manner that was broadly consistent with financial stability and economic growth. That leadership — firmly entrenched by the Bretton Woods agreement that established the governance arrangements for the global economy at the close of World War II — is being questioned in the wake of the global financial and economic crisis. Of course, the global crisis was not the fault of only the United States. But, arguably, it was exacerbated by a failure of the United States to exercise the global leadership expected and required of a global economic and financial hegemon prior to the crisis.

Under the Bretton Woods system, other currencies were tied to the dollar; the dollar was pegged to gold. Other members of the system chafed under the “rules of the game” that gave the United States an “exorbitant privilege” in terms of the role of the dollar, but benefited from US growth, investment and, not incidentally, the US security umbrella. The foundation on which the stability of the system rested was sound fiscal policy consistent with long-term price stability. When cracks appeared in those foundations, as they did in the late 1960s, stresses...
emerged in the system and the Bretton Woods exchange rate system collapsed. The G7 process emerged in the 1970s from the economic uncertainty that followed.

More recently, US fiscal deficits incurred prior to the crisis and the lax approach to financial regulation fuelled the financial market excesses that undermined global financial stability. And, in its wake, the global crisis has created pervasive uncertainty that clouds the outlook for the global economy.

Leadership is required to orchestrate global efforts to deal with the lasting effects of the crisis, avoid dysfunctional policy choices and address the shared challenges ahead. In this respect, we are, arguably, in a time of transition in global leadership. The last such period was the inter-war years of the last century. At that time, the United Kingdom’s ability to coordinate the international community was impaired by war debts; the United States was unprepared or unwilling to assume the mantle of leadership. As a result, when the global economy was stressed by financial crises in the late 1920s, the international response was inadequate. The resulting economic stagnation led to the polarization of societies and the radicalization of politics, with tragic consequences for millions.

**THE CHALLENGE OF COLLECTIVE LEADERSHIP**

The question today is whether the G20 is capable of providing the collective leadership that is required to deal with the formidable challenges that its members must address. With dynamic emerging economies growing in economic size and exercising their voices in international fora, the United States handicapped by fiscal challenges and political paralysis, and most other advanced economies preoccupied by their economic, financial or monetary challenges, neither the United States alone, nor the G7 collectively, has the capacity to project its will on the rest of the international community. This is evident in a number of areas, including multilateral surveillance and the issue of global adjustment in which each player thinks the others are the problem, providing the resources for the provision of critical public goods and reforms to the international financial institutions (IFIs).

The G20 has assumed de facto responsibility for global economic and financial management, but collective leadership is difficult — the more so the larger the number of players, reflecting a fundamental trade-off between effectiveness on the one hand, and representation on the other. Moreover, the creeping expansion of the G20 agenda beyond the core economic and financial base is worrying. The legitimacy of the G20 was established by the unprecedented degree of cooperation members demonstrated to prevent a catastrophic collapse in global output, employment and trade. While broadening the agenda allows all members to claim success on an issue of their interest or to “commit” to actions they were going to do in any event, it does not address the real economic problems in the global economy, which gave the G20 process legitimacy. The Mexican presidency is to be commended, therefore, for ring-fencing this tendency.

That being said, the combination of adjustment challenges in the advanced economies and potential frustration over voice and representation in key dynamic emerging markets could pose a risk to the global economy. Most disconcerting is the possible retreat from the cooperative arrangements built on the foundations of the Bretton Woods conference. This would be hugely disruptive. Fortunately, however, the cornerstones of those foundations remain — the IFIs are the key institutions of international cooperation, assisting their members through the provision of key public goods. And in this respect, they have demonstrated their usefulness in the midst of the crisis by helping mobilize a concerted international response to the threat of economic collapse. But, going forward, fundamental governance reforms are required to ensure they are viewed by their members as legitimate, credible and effective. In some respects, that is the real challenge of collective leadership that leaders should address at Los Cabos.

**CONCLUSION**

Managed well, the process of financial and economic integration that has created the dynamic emerging economies can provide a sound foundation for global growth that would benefit all in a “positive sum” global economy. Mismanaged, the result could be a zero — or worse, negative — sum game of beggar-thy-neighbour policies. The experience of the last “hand-off” in global leadership, from Pax Britannia to Pax Americana between the two world wars of the last century, vividly illustrates the tragic consequences of getting it wrong.
When the G20 meets in June, many of its members will still be looking for a way out of the economic crisis of 2008. After four years of economic uncertainty, high unemployment and dismal prospects, industrialized countries in particular also find themselves divided over what strategies to try now. More austerity and belt-tightening? Another shot of stimulus? Whichever path they choose, they should not ignore the opportunity to move towards a green economy. Green economy strategies — which seek to achieve economic growth that is more environmentally benign than conventional growth — are varied enough that there are types that will suit both economic approaches. The G20 can thus agree on a green economy orientation while allowing participant countries to make their own choices about how to handle the challenging global economy of 2012.

The stimulus approach is the best known, as several countries announced green economy stimulus packages at the onset of the crisis. This version of the green economy draws heavily on public resources, offering preferential credit, loan guarantees and green procurement programs as positive incentives to encourage investment and expansion in favoured green economic activities. Alternative energy is a popular target, as are a wide variety of environmental goods and services. At a time when private investment and consumption are low, this kind of public green stimulus can have positive spillover effects into the rest of the economy, generating growth and employment, and stimulating innovation. It comes at comparatively low costs if the government has reserves or low borrowing costs in recession.

Some of the most enthusiastic adopters of green stimulus packages are the emerging powers of the G20, with Brazil, China and South Africa (and, to a lesser extent, India and Mexico) seeing an opportunity to redirect their economies into the next growth sector. South Africa’s Minister of Trade and Industry Dr. Rob Davies, introducing his country’s first large renewable energy initiative during the climate negotiations in Durban last December, called green energy the coming “third industrial revolution.” Davies said this publicly funded initiative was part of his country’s effort to be a producer rather than consumer of the products of that next revolution.

The green economy is less often associated with austerity, perhaps because many of its products are more expensive than those produced using conventional methods. Yet some green economy principles and tactics are very compatible with an approach that is trying to cut rather than increase spending. Environmental requirements and incentives to improve the use of resources, for example, can save money as well as the environment. Energy audits and improvements in energy efficiency often quickly pay for themselves. Minimizing waste and maximizing recycling are other green economy principles that fit well with an austerity approach, harkening back to old-fashioned virtues such as thrift and living within one’s means.

Austerity approaches generally seek to limit state spending to only critical public goods. Towards this aim, the austere green state should implement policies that require private actors to internalize the environmental costs of their economic activities, rather than leaving them for the state to cover with higher health care, cleanup and other bills. Price and market mechanisms like taxes and tradable permits are unpopular in economic downturns, but they are part of the larger process of making sure costs are paid appropriately in the marketplace, rather than being picked up by an ever-larger and more indebted state.
At the G20 Informal Meeting of Ministers of Foreign Affairs in February, Mexican President Felipe Calderón Hinojosa told the assembled ministers, “Perhaps what we have to do here in Los Cabos is to emphasize the word ‘growth’ and minimize the word: ‘green,’ so that no one is scared off by environmental issues...We are going to insist on this issue.”

As this commentary explains, green growth can be part of any strategy for economic recovery and growth.

ENDNOTE

1 A full transcript of President Calderón’s speech is available at: www.g20mexico.org/en/speeches/221-mensaje-al-grupo-del-g20-por-parte-del-presidente-felipe-calderon.
A key challenge at Los Cabos will be articulating a vision for green growth that is focused and feasible, yet integrates with other economic, development and multilateral governance reform initiatives already undertaken. The danger is that otherwise, especially at Rio+20 later the same week, green growth will mean everything and nothing—wish lists will prevail over strategic leadership. By putting energy and economics at the centre of the definition of green growth, the G20 could make a major contribution to the global understanding of what green growth means.

The G20 will need to provide a strategic vision for green growth that is compelling to all stakeholders and constituencies, which not only needs to be focused, but also comprehensive, inclusive, synergistic, multi-layered and multi-dimensional. This will require it to embrace:

- the big industry dimensions of green energy;
- the ongoing evolution of the development paradigm embodying green development;
- the sustainable development concerns of green environment; and
- the micro and macroeconomic dimensions of the green economy.

Such an approach would not only be consistent with, but also build on and enhance, major elements in the G20 summit lexicon, namely:

- the G20 Framework for Strong, Sustainable and Balanced Growth;
- the G20 Infrastructure Investment Plan;
- the G20 Seoul Development Consensus emphasizing economic growth and infrastructure investment; and
- the G20 ministers of foreign affairs’ support for linking green growth to development and the Millennium Development Goals.

A new green growth vision would also need to address and include a continuing focus on the big energy dimensions of green energy, such as the transition from coal to natural gas production, now driven in part by significantly lower natural gas prices; the possible “renaissance,” despite Fukushima, of nuclear energy as a major clean energy source; technological innovation for carbon storage and sequestration; the ongoing work of G20 summits to reduce fossil fuel subsidies; and the debate about the implicit and explicit price of carbon.

Creating such an approach would position G20 leaders as articulating a green growth vision that, as an economic strategy, is consistent with the mandate, history and priority of G20 summits on global growth. It would also enable G20 leaders to connect with their publics in a more direct way, by focusing on the micro-elements of Jeremy Rifkin’s five pillars of “The Third Industrial Revolution” (TIR), which are proposed here as the core elements of a global green growth strategy:

- increased supply of renewables;
- innovative buildings as mini-power plants;
- electrical storage technologies;
- electrical vehicles; and
- integrative smart grids.
These five TIR pillars are powerful elements in urban development strategies for the future. By 2030, seven out of 10 people will be living in urban areas. These five elements empower families, farms, firms and factories to take control of their energy future, rather than relying on big government, big industry and big banks to do it for them. Taken together, they are a mobilizing force at the local level, where people live and work.

An agreement at the G20 summit at Los Cabos on a global green growth strategy that embraces these dimensions could make a significant contribution to the Rio+20 Green Growth Summit held later that same week, providing a foundation and focus for further deliberations and enhancements from an environmental perspective. By the end of the Los Cabos summit, this sequence might lead to a global green growth vision for the world, which could be comprehensive and compelling enough to simultaneously make a difference for the future of the planet and humanity.
When the G20 put food security on its agenda for the 2011 Cannes summit, many analysts were initially optimistic. As the world’s leading economies, the G20 has the potential to make important economic policy changes that could help improve access to food for the world’s poorest people.

In 2012, optimism about the G20’s ability to deliver on this front has begun to fade. There has not been much action since the Cannes summit and, in the run-up to the Los Cabos summit, the discussion has shifted toward a narrower focus on productivity growth and away from broader economic policy reforms that can contribute to food security. Both are important and should remain on the agenda.

International economic policy coordination is widely seen as crucial to addressing high and volatile food prices, an ongoing problem since 2008. Financial regulation could stem speculation on agricultural commodity markets. Improved trade policies could reduce restrictions on exports that were associated with price spikes, as well as reduce subsidies in the rich, industrialized countries that have discouraged small farmers in developing countries from producing more. Reforms to market-distorting biofuel policies could help to reduce upward pressure on food prices.

The source of many of these economic policy problems that contribute to food insecurity are the G20 countries, and they should take the lead on addressing them in Mexico in 2012 and beyond.

The G20 leaders missed their opportunity at Cannes, where it looked, at first, as if they might tackle these issues. The Action Plan on Food Price Volatility and Agriculture put forward by the G20 agriculture ministers in June 2011, advocated measures to promote greater investment, more balanced trade policy and better market information, policy coordination, risk management and financial regulation. But there was resistance to making meaningful policy changes, because the proposed measures threatened domestic interests within a number of G20 countries.

In the end, the leaders endorsed only minor reforms to financial policies that might affect commodity speculation at Cannes. They also stalled on meaningful trade reforms. And they promised only further study — rather than real action — on biofuel policies. The only significant output of the Cannes summit with respect to food security was the unveiling of the Agricultural Market Information System. This initiative seeks to improve the collection and dissemination of market data. The idea is that more information on production and trade will calm food price volatility — an assumption that many question.

This year, under Mexico’s leadership, food security remains on the G20 agenda, but there is a strong risk that the momentum on the economic policy reforms identified in advance of the Cannes summit will be lost in the discussions at Los Cabos. Mexico made clear in a recent G20 discussion paper on food security that follow-up on the 2011 action plan is important; however, Mexico’s food security focus thus far has been on measures to improve agricultural productivity, rather than address the structural economic forces that work against food security.

Indeed, a recently released interagency report to the Mexican G20 presidency focuses exclusively on measures to enhance agricultural productivity growth. Its 10 recommendations are clustered around information and education systems, agricultural research and innovation,
increased investment and risk management. Only one recommendation touches on trade policy, which is virtually identical to the trade recommendation in the 2011 action plan. With the Doha Round appearing to be permanently stalled, the prospect of this recommendation being fulfilled is dim.

The deputy agriculture ministers of the G20 countries met May 16-17, 2012, to put together recommendations for the leaders’ summit, which will be held in Los Cabos in June. These recommendations included an emphasis on crop research, technology transfer, public-private investment partnerships and the promotion of sustainable agriculture.

The shift in the G20 discourse on food security, from addressing price volatility (which fundamentally relates to access to food) to productivity (which fundamentally relates to availability of food), is not surprising. Politically, it is much easier to call for more information, more technology and more investment than it is to get the governments of 20 powerful economies to commit to significant economic reforms.

Promoting improvement in agricultural productivity is certainly worthwhile, and should be included in any strategy to improve food security. But productivity measures alone are not sufficient to address world hunger. After decades of research on the subject (not least of which is the seminal work of Nobel-prize-winning economist Amartya Sen), it is now clear that the problem is as much one of access to food as it is one of availability of food.

Economic policy reforms can go a long way towards addressing access problems by reducing price volatility and promoting more balanced agricultural growth in both rich and poor countries. Such reforms should not be sidestepped by the G20 in favour of production measures alone.

It is not too late for the G20 to refocus its efforts on economic policy reforms that will enhance access and thus improve food security for the world’s poorest people. Devising appropriate economic policies that affect access is as important as increasing food production.
Perspectives on the G20
The Los Cabos Summit and Beyond

LOS CABOS AND CLIMATE CHANGE: THE ART OF THE POSSIBLE

Barry Carin

KEY POINTS

• Climate change will compete for attention at the G20 with economic and financial crisis issues, likely receiving little agenda time.
• Any Los Cabos climate initiative will need to be recognizably consistent with each G20 country’s national interest, contribute to a range of priorities and be phased in at politically feasible rates; Mexico could have a real impact on climate change by strategically selecting initiatives.
• By championing initiatives that are seemingly irrelevant to climate change — for example, prioritizing girls’ secondary education and public health campaigns to reduce obesity — the G20 can promote positive progress on climate change.

Advocates all want to get their pet topic discussed at the G20. Economic and financial crisis issues will dominate. Employment and commodity price volatility are next in line. Development, corruption, tax havens and anti-money laundering, drug trafficking and transnational crime, protecting the marine environment and resuscitating trade negotiations will all compete for attention. Climate change will receive very little agenda time.

The French presidency was a disappointment. Only four of the 95 paragraphs of the Cannes Summit Final Declaration were on climate change; two paragraphs were on fostering clean energy, green growth and sustainable development; and one paragraph was on inefficient fossil fuel subsidies. The G20 reaffirmed the commitment to rationalize and phase out inefficient fossil fuel subsidies, asked finance ministers to report back next year and ritualistically endorsed low-carbon strategies for green growth and sustainable development. The final declaration included the usual platitude of being “committed to the success of the United Nations Conference on Sustainable Development in Rio de Janeiro in 2012.” The only semi-substantive commitment on “Pursuing the Fight against Climate Change” referred to “operationalization of the Green Climate Fund.” It reiterated the Copenhagen goal of mobilizing US$100 billion per year from all sources by 2020, requesting finance ministers to report on progress at Los Cabos: “We reaffirm that climate finance will come from a wide variety of sources, public and private, bilateral and multilateral, including innovative sources of finance... We underline the role of the private sector in supporting climate-related investments globally, particularly through various market-based mechanisms and also call on the MDBs [multilateral development banks] to develop new and innovative financial instruments to increase their leveraging effect on private flows” (G20 Leaders, 2011).

The devil is in the detail. The Cannes outcome combined obfuscation about “private” finance with the classic snowplow technique of procrastination. So, can we expect anything better from the Mexican presidency? Can Mexico mediate substantive progress on climate finance?

An assessment of the US capacity to meet its share of the US$100 billion pledge concludes that it is not going to happen, that “raising new public funds for climate finance will be extremely challenging in the current fiscal environment and that many of the politically attractive alternatives are not realistically available absent a domestic cap-and-trade program or other regime for pricing carbon. Washington’s best hope is to use limited public funds to leverage private sector investment through bilateral credit agencies and multilateral development banks” (Houser and Selfe, 2011).

This finding, recommending alchemy, will be hard for emerging economies and developing countries to swallow. For the foreseeable future, China, India, Brazil and South Africa will insist on “new and additional” resources in the context of United Nations Framework Convention on Climate Change negotiations. European and other developed countries are unlikely to make significant real commitments while the United States dithers.

Mexico must avoid the fatal quicksand of trying to set binding national emission targets and the embarrassment of spotlighting the imaginary future annual US$100 billion of financial transfers. Any Los Cabos climate change initiative will have to be recognizably consistent with each G20 country’s national interest, contribute to a range
of priorities — fiscal consolidation and environmental and economic growth — and be phased in at politically feasible rates. Mexico should highlight the economic case for taxing “bads” and subsidizing “virtues.” Imposing carbon taxes would allow offsetting the reduction of taxes on labour and capital, and bring down debt levels — a message that could enjoy broad appeal across the political spectrum and across the G20 membership. The most obvious candidate is to accelerate the phasing out of fossil fuel subsidies to reduce greenhouse gas emissions and, simultaneously, enhance energy security, providing immediate vital fiscal gains.

We must accept the political reality that change will be gradual and any other initiatives must be well prepared. Los Cabos can invite G20 portfolio ministers or working groups, international organizations, and even leaders to present recommendations at a future G20 meeting. Work can be commissioned on a package of several complimentary elements. The G20 can mobilize the existing international financial institutions to catalyze “no regrets” investments, establish a new international research and development (R&D) “Manhattan Project” and promote stringent process standards.

Mexico could have a real impact on climate change by strategically selecting initiatives — pursuing the art of the possible. The G20 should create an international decentralized institution to collaborate on energy R&D and develop open-source technology, where financial contributions can be spent in one’s own country, thereby finessing political constraints. Imagine the impact if the G20 agreed on a schedule of 2020 product and process (for example, cement and aluminum) standards for selected high-carbon-content traded goods, enforced over time by border-tax adjustments on goods “below standards.” (Such an agreement is more likely in a G20 context rather than through the World Trade Organization.)

Furthermore, the G20 can “do good by stealth,” championing initiatives that are seemingly irrelevant to climate change, which will have very beneficial consequences. Two examples are highlighting the priority of girls’ secondary education and public health campaigns to reduce obesity. Any emission target will be easier to achieve with lower population growth — female secondary education, which has many positive economic consequences, also decreases fertility rates. Obesity accounts for substantial health care spending; adverse economic effects include absenteeism and lower productivity. A healthy lifestyle campaign would pay indirect dividends to climate change. A population that is overweight needs more energy — production of extra food requires machinery and transport systems that emit greenhouse gases (Edwards and Roberts, 2010).

Los Cabos can indeed catalyze positive progress on climate change, if Mexico thoughtfully designs a judicious package.

ENDNOTE

1 In a speech to the Copenhagen Climate Change Conference on December 17, 2009, US Secretary of State Hillary Clinton stated: “And today I’d like to announce that, in the context of a strong accord in which all major economies stand behind meaningful mitigation actions and provide full transparency as to their implementation, the United States is prepared to work with other countries toward a goal of jointly mobilizing $100 billion a year by 2020 to address the climate change needs of developing countries. We expect this funding will come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources of finance.”

WORKS CITED


In considering the evolving role of the G20, it is worth reflecting upon the factors that shaped the group’s original mandate. As the first decade of the new century progressed, it became increasingly clear that the international balance of power had shifted, but the institutional framework, which sought to manage the global economy, had not adapted to reflect this new reality. The financial crisis of 2008 forced the leading economic powers (notably the United States, where the crisis originated) to confront the need to integrate the emerging economies more effectively into international economic decision making.

Once convoked, the G20 did a creditable job of framing solutions to the financial crisis. Decisions taken at the London summit in 2009, and subsequently confirmed at Seoul the next year, laid out a constructive agenda — unfortunately, much of that work program remains incomplete. In the years since the first summit in November 2008, the G20 has proven itself as a crisis manager, but it has yet to lay the foundation for a role as an ongoing coordinating committee for the global economy. It remains an open question whether this transition will be feasible in the short term as a practical matter. For the moment at least, the political will among G20 leaders to deal with underlying systemic issues seems distinctly limited.

A number of factors are currently constraining accelerated G20 development, notably, political and economic circumstances in key members — the United States, the European Union and China.

The G20 has proven its effectiveness, especially as a global crisis management tool. In the years ahead, steps should be taken to manage the evolution of the G20 process to take account of the legitimate need for occasional, unavoidable agenda “hijacking” as well as a gradual, substance-driven broadening of the agenda.

The key objective for the G20 in the short term should be to maintain steps already taken, which means systematically working through the London and Seoul agendas and reorganizing the meetings’ format to give as much opportunity as possible for leaders to speak directly and informally to each other.

In the absence of any impetus provided by these three major actors, little forward movement can be expected in the G20’s evolution. Both symbolically and substantively, the IMF funding issue is illustrative of the conflicting pressures assailing the G20 as a group of states with divergent national interests. In April, the new IMF Managing Director, Christine Lagarde, approached the G20 countries as part of a major effort to increase the Fund’s lending capacity. Lagarde was able to engineer a significant increase in new pledges of more than $430 billion, doubling the IMF’s lending power and meeting its aim of erecting “a stronger global firewall” to contain future financial crises (notably in Europe, although not restricted to that region).

The list of non-subscribers to this effort was, however, reminiscent of Sherlock Holmes’ dog — which didn’t bark. Both the United States and Canada refused to contribute, maintaining that the European countries had sufficient resources of their own. Even more telling, the BRIC countries (Brazil, Russia, India and China) made conspicuously unspecific pledges, pending the outcome of the painfully slow negotiations over increasing IMF voting rights for the developing world. Clearly, the realignment of international economic power remains inadequately recognized at the heart of this central institution of global governance.
Some have cited the “hijacking” of G20 summit agendas by the need to respond to current crises as an inherent weakness of the G20 approach. Another closely related question concerns the G20 meeting agendas — specifically, whether these agendas should continue to deal primarily with systemic financial/economic matters or whether they should be expanded to include consideration of other (albeit related) topics such as climate change, energy or development. In fact, agenda hijacking and agenda broadening are both reflections of the nature of G20 summitry itself. Simply put, if the leaders of the 20 most powerful countries in the world meet together, the clear expectation is that they will deal with the most important issues of the day. That, in turn, means if a specific crisis emerges at the time of a summit, then the leaders will be expected to deal with the matter, and the summit will necessarily have been “hijacked” by events. Similarly, and slightly more long term, although the arguments in favour of maintaining an agenda focus on financial and economic issues may make technical sense, as other large issues come to the fore (or other major international deadlocks emerge), leaders will want to expand the range of issues they discuss at G20 meetings, for understandable political reasons.

Officials and ministers may try to avoid both hijacking and agenda broadening, but they will likely fail. Once gathered together, leaders will talk about whatever they want, efforts of the Sherpas to maintain focus notwithstanding. That being said, there are ways of managing the evolution of the G20 process that take account of the legitimate need for the occasional, unavoidable hijacking, and of the gradual, substance-driven broadening of the agenda. The key in both cases lies with a combination of careful preparation and planning on the one hand, and maintenance of the leader-driven nature of G20 events on the other.

The single most important reform of the G20 process, at this stage, would be to concentrate the proceedings more clearly on the leaders themselves. This means, among other things, drastically reducing the number of people “in the room,” restructuring agendas to provide maximum time for leaders to have informal exchanges, and working hard to ensure effective follow up to leaders’ decisions.

Even though there is current fussing over the contention that the G20 finds itself somewhat becalmed as an evolving process, a clear measure of its success is the high probability that if the G20 ceased to meet tomorrow, some new version of it would undoubtedly have to be cobbled together. The membership might be somewhat smaller in the new group, but the need for the world’s most powerful economic actors to work together at the highest level would not simply vanish. In particular, the requirement to include the emerging powers in a meaningful way would be essential.

The G20’s evolution may slow through 2012 (although hopefully it will pick up speed again in 2013), but the group’s usefulness seems unquestionable. The key objective in the short term should be to maintain the steps already taken, which, as a practical matter, means systematically working through the London and Seoul agendas and reorganizing the format of the meetings to provide as much opportunity as possible for leaders to speak directly and informally to each other.
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The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI’s interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI’s research programs focus on four themes: the global economy; environment and energy; global development; and global security.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion, and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario.

Le CIGI a été fondé en 2001 par Jim Balsillie, qui était alors co-chef de la direction de Research In Motion. Il collabore avec de nombreux partenaires stratégiques et exprime sa reconnaissance du soutien reçu de ceux-ci, notamment de l’appui reçu du gouvernement du Canada et de celui du gouvernement de l’Ontario.

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