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PRIORITIES FOR THE G20

THE ST. PETERSBURG SUMMIT AND BEYOND

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OVERVIEW: A PREVIEW OF THE ST. PETERSBURG SUMMIT

Domenico Lombardi

Tail risks for the global economy have receded vis-à-vis last year, but this has not translated into higher growth in many advanced economies. Emerging economies, which have made considerable contributions to global economic growth since the height of the international financial crisis, are slowing down. In its latest round of forecasts in July, the International Monetary Fund (IMF) downgraded its growth projections, especially those for the emerging economies, and the Washington-based institution may provide G20 leaders with a new set of downward-revised projections in St. Petersburg in September.

The forthcoming G20 summit in Russia may, unlike previous G20 summits, be an event with no immediate, significant deliverables. While prospects for global growth may have slightly deteriorated, there are no immediate signs of a re-escalation of the euro-area crisis that took centre stage at the Cannes summit in 2011 and, at Los Cabos the following year, prompted several IMF member countries to pledge a total of almost half a trillion US dollars in an effort to boost the institution's firepower.

Nor can we expect any substantive, meaningful progress on the reform of the IMF, which featured prominently in many of the previous summits. The failure of the United States to ratify so far the reform package that G20 leaders endorsed at the Seoul meeting in 2010 prevents any meaningful discussion on next steps; for example, by facilitating agreement on the fifteenth quota review originally set to be completed by January 2014.

With little international momentum behind this Russian summit, two forces will likely shape the final outcomes of the leaders' gathering. First, there will be a tendency to dilute the agenda by broadening the spectrum of issues that leaders will discuss — or at least claiming to do so in their final communiqué — to include topics such as international trade, sustainable development, the fight on tax evasion and excessive currency movements.

Second, there will be an attempt to shift the discussion towards medium-term deliverables. On fiscal policies, for instance, leaders will hammer out some compromise outlining the need for relatively flexible policies in the short term while being cognizant of a medium-term-oriented fiscal consolidation.

Over the course of the recent ministerial meetings held under the Russian chair, the gap between opposing positions — epitomized by the United States on the accommodative front and by Germany on the rigorist front — has narrowed, given the latest string of disappointing macroeconomic data on the euro-zone economies. It is likely that leaders will commit towards achieving lower levels of public debt in proportion to GDP over the medium term consistently with their country-based economic strategies, while omitting any reference to predetermined common targets.

Having exhausted the conversation on fiscal policies, G20 leaders will switch to structural policies — in particular, labour and product market reforms — as key drivers for growth and jobs in the medium term. Again, there will not be any specific commitments agreed to by the leaders, as follow-up measures will be embedded in country-specific strategies. Leaders will, however, show their collective resolve in supporting such reforms as a way to increase potential growth and employment over the longer term.

While wrapping up in St. Petersburg, participants will already have their eyes on the next G20 summit, in Australia, wondering whether the BRICs and other emerging economies may top the agenda of the gathering in Brisbane in 2014.

LIVING UNCONVENTIONALLY: MORE THAN JUST MONETARY POLICY

Paul Jenkins

The broad contours of the global economy are generally well known. Global growth overall remains modest, with the projections of most international organizations having been revised down over the past six months.[1] In the United States, economic expansion has been steady, reflecting a pickup in private sector demand, but fiscal drag continues to exert itself and growth has been insufficient to make any significant headway in absorbing excess capacity. The euro zone remains mired in recession, with its economic and governance problems still far from resolved. Growth in Japan, in contrast, appears to be on the rebound, at least over the near term. Among the major emerging market economies, growth, while more rapid than among advanced economies, has slowed, with a shift to a lower underlying growth trend than previously thought, especially in China, and with significant regional differentiation. Against this economic backdrop, the political landscape has been changing, with elections and transitions of power taking place in a number of G20 countries with more still to come — notably in Germany in September.

In financial markets, we have recently witnessed considerable volatility, reflecting shifting market expectations about monetary policies, especially in the United States. Looking through this volatility, however, there has been significant improvement in global financial conditions. This is evident in the euro zone, where yields in peripheral economies have come down and, so far, stayed down. In the United States, equity prices have reached new highs, housing prices have started to recover and corporate bond issuance has been robust. Similarly, markets in Japan showed an initial euphoria in response to the dramatic change in policy direction.

The improvement in financial conditions has been strongest in advanced economies, largely in response to policy actions of central banks. Essentially, markets have keyed off those central banks pursuing unconventional policies, particularly those involved in bond-buying programs — the Federal Reserve, the Bank of England and, most recently, the Bank of Japan.

CENTRAL BANK BALANCE SHEETS AND BEYOND

A phenomenal expansion of central bank balance sheets has taken place in the aftermath of the financial crisis, as central banks have aggressively pursued several types of unconventional monetary policy measures. In virtually all cases, it has involved liquidity and credit facilities, as well as outright asset purchases. In some cases, it has also involved forward guidance; that is, policy commitments conditional on *future* economic developments.

The Fed, early on, undertook both dollar liquidity and foreign-currency liquidity swaps, and then began to engage in quantitative easing (QE), which became known as QE1, QE2 and QE3. In terms of asset purchases, the Fed has been active in the market for mortgage-backed securities, while the Bank of England has expanded its balance sheet primarily through purchases of UK gilts. In contrast, the European Central Bank's focus has been on refinancing operations rather than outright asset purchases. Its Outright Monetary Transactions mechanism has yet to be triggered, but the announcement alone had a significant impact on spreads. And the Bank of Japan has committed to doubling the monetary base by the end of 2014, primarily through the purchase of long-term Japanese government bonds, to help end almost two decades of stagnation.

The effectiveness of these unconventional measures has been hotly debated. Central banks have presented evidence that bond yields have come down, estimating the cumulative effect to have been from around 50 to 120 basis points at 10 years, and have argued that portfolio rebalancing, wealth effects and signalling have all been positive for growth. Those on the other side of the debate, however, have argued that these estimates are greatly overstated, and worry about the ability of central banks to unwind unconventional policies without generating significant uncertainty and volatility in markets, along with expressing concern about the risk of asset price bubbles or generalized inflation from prolonged monetary accommodation. These concerns have even led

1 In its July World Economic Outlook, the International Monetary Fund revised down its projection of global growth for 2013 to 3.1 percent and for 2014 to 3.8 percent. Both advanced and emerging economies shared in this downward revision. The Organisation for Economic Co-operation and Development has also revised down its most recent projection for global growth in 2013.

to constitutional challenges about the legality of some central bank actions.

Doing the counterfactual — what would have happened in the absence of these unconventional policies — is difficult, given the limited experience we have had with such measures. The balance of evidence, however, appears to support the view that the global economy would be worse off today if central banks had not taken these extraordinary actions. Financial markets are certainly of this view.

All indications point to the likelihood that we will be living with unconventional monetary policies for some time to come. While Federal Reserve Chairman Ben Bernanke has raised the possibility of a slowing in the *pace* of asset purchases, it would be conditional on a steadily improving US labour market and economy (that is, data determined), and it would still involve an expansion of the Fed balance sheet. Financial markets, being naturally forward looking, have nonetheless already begun to critically assess and react to what some are calling "the beginning of the end of easy money"; we have seen US treasuries back up in response. In the United Kingdom, the continued commitment to fiscal consolidation almost certainly rules out any unwinding of unconventional policies any time soon, with forward guidance becoming the preferred tool. The European Central Bank seems to have also embraced forward guidance. And in the case of Japan, an aggressive expansion of the Bank of Japan's balance sheet has just recently been launched.

Given the state of the global economy, unconventional monetary support should continue to be an important part of the policy mix to promote global economic recovery and growth. But is it enough? While the risks and concerns about the prolonged use of unconventional policies cannot be ignored, the more serious issue comes from a much broader policy perspective: that sustained global economic growth, sufficient to absorb economic slack, has not yet been firmly established.

THE NEED FOR MORE THAN JUST MONETARY POLICY

The challenges the global economy faces require far more than just a continuation of unconventional monetary policies. While more can, and in some case should, be done by central banks, the limits of monetary policy need to be recognized. The time these policies have offered for other policies to be put in place and take hold may be running out.

In advanced G20 economies, we have a deficiency of demand, with unemployment remaining unacceptably high, and still going up in some jurisdictions. Balance sheets remain impaired with pressures of deleveraging and unsustainable debt levels still very evident. Implementation of financial sector reforms is far from complete. And there is a pressing need for real sector structural reforms, ranging from product and labour market reforms to tax reforms to address the challenges of today's global economy.

In the euro zone, the degree and pace of austerity measures needs to be recalibrated and combined with a more concerted effort to recapitalize banks. Any realistic strategy for dealing with the euro-zone crisis must involve substantially more private and sovereign debt restructuring. If the right policy mix is not put in place soon to support recovery, a protracted period of subpar growth will continue, and the stated objective to establish a more effective euro-zone governance structure, such as a banking union, may never materialize. In the United States, the pace of fiscal consolidation must be calibrated so as not to undermine the recovery that appears to be taking hold. At the same time, a clearer path of fiscal consolidation must be laid out if markets are to support the recovery and the private sector is to have confidence in the policy path going forward. When the Fed deems it appropriate to begin pulling back on the pace of its asset purchases, a durable expansion, underpinned by more than just monetary policy, must be a prerequisite if the inevitable portfolio rebalancing that comes with such Fed action is to be absorbed smoothly. Similarly, in the United Kingdom, care must be taken not to overweight what monetary policy can accomplish alone. Restoring the health of the UK banking system must take on renewed urgency. For Japan, a premium must be placed on clear and effective communication to avoid market missteps about the size and timing of its bond-buying program. We have already seen some reversal of initial market euphoria due to a lack of transparency about the plans of the government and the Bank of Japan.

What about advancing G20 economies? As the engine of global growth since the onset of the crisis, their main near-term task is to continue to adjust the macroeconomic levers of policy to support sustained growth. Given the differentiation across countries, these policy responses vary. A complicating factor has been the spillovers from the policies of advanced economies, including the market gyrations surrounding recent Federal Reserve communications about its pace of asset purchases. Still, key variables such as exchange rates have broadly reflected medium-term fundamentals.

The other critical challenge for advancing economies is to engineer key structural changes in recognition of underlying, longer-term global forces at play, including their own rising presence and importance. These policies include those to support a shift of resources to growth-oriented sectors, promote sound and transparent regulations and encourage more reliance on the price mechanism as a way of doing business. In China, recent concerns about the rapid rate of credit expansion and the growing presence of a shadow banking system underscore the importance of placing priority on moving in the direction of interest rate and exchange rate market reforms, even if these are deemed among the hardest to do. Success in all these areas of structural reform also, critically, requires policy platforms with clear roles and responsibilities. It is when there is a lack of clarity, or a perceived vacuum, about policy objectives and frameworks that problems arise.

THE NEED FOR COLLECTIVE POLITICAL WILL

In his report prepared for the 2011 Cannes G20 Summit, "Governance for growth: Building consensus for the future," UK Prime Minister David Cameron said that what was needed above all was "political will" to overcome the obstacles to global growth. Political will is needed at the national level where tough decisions are made and core public policies are carried out. But equally critical, the interdependencies of the global economy, which became even more apparent from the fallout of the financial crisis, demand collective political will if we are to put the failures that led to and propagated the "Great Recession" behind us. Indeed, the challenges facing G20 countries (described above) in sustaining economic recovery and growth can only truly be met if we act together.

More than ever, how individual countries fare in today's global economy rests on having global governance that works. This is what we expect from G20 leaders — to drive international policy cooperation for the benefit of all. It is always easier to be inward looking, point the finger at others and act unilaterally. At the peak of the global financial crisis, G20 leaders showed political will, as well as good will, to act collectively. That need for collective action has not disappeared.

For St. Petersburg, with some leaders, notably Chinese President Xi Jinping, attending their first summit, the world will be watching for three priority outcomes:

- a clear and focussed message reinforcing collective G20 recognition of the importance of international economic cooperation for effective management of the global economy, and a commitment to achieving such cooperation;
- policy actions to promote global economic recovery and growth, where individual country strategies recognize and incorporate the interdependencies, spillover effects and externalities that tie G20 economies together; and
- political direction to achieve full implementation of agreed regulatory reforms to the global financial system.

THE GREAT FRAGMENTATION: THE MAKINGS OF ANOTHER CRISIS OR OPPORTUNITY FOR PROGRESS?

Pierre L. Siklos

WE THOUGHT WE WERE ALL IN THIS TOGETHER

Much has changed since the crisis-driven G20 summits in London and Pittsburgh in 2009. The London summit promised action to strengthen regulation and supervision of financial institutions as well as improved cooperation, notably in launching an early warning "exercise" and work on "exit strategies."[1] The Pittsburgh summit promised an end to an "era of irresponsibility" and noted that the leaders' prompt and aggressive policy response "worked" by planting the seeds of a return to stability following a global economic contraction. Echoing the sentiments of the London summit the leaders also committed their governments to "avoid any premature withdrawal of stimulus. At the same time, we will prepare our exit strategies and, when the time is right, withdraw our extraordinary policy support in a cooperative and coordinated way, maintaining our commitment to fiscal responsibility."[2] The early warning exercise has not shown much promise so far, in part because there is little evidence of commitment to the idea together with academic research that demonstrates the futility of the exercise (for example, see Rose and Spiegel, 2009). Meanwhile, there is growing evidence that premature stimulus withdrawal is precisely what several politicians have undertaken, largely prompted by political imperatives as opposed to relying on purely economic arguments. The tide may have slowed, but it is far from clear that it is reversing in spite of the misunderstanding of the economic principles involved.[3]

Since those heady days, the united stance of the G20 seems to have dissipated. The ministerial meetings in Washington, DC, in April of this year, revealed growing rifts in policy directions. Displays of enhanced cooperation, much less coordination, seem to be taking a back seat to an individualistic desire among individual members of the G20 to find the combination of policies that will enable their economies to reach "escape velocity," the principle borrowed from physics and used by Mark Carney, former Governor of the Bank of Canada and now Governor of the Bank of England, to describe the failure of the US economy to return to normal.[4] Indeed, the feeling that the major economies of the world are mired in slow growth and incapable of developing a balanced or coherent view about the appropriate stance of fiscal policy, further contributes to the impression that the G20 is unable to live up to its early promise to create a forum for economic cooperation and coordination of the Bretton Woods variety, "to achieve stable and sustainable world growth that benefits all" (Kirton, 1999). Instead, the G20 is described by some as a group where "countries fight to be admitted to the club, but do little with membership" (Harding and Giles, 2013).

Disagreement inside the G20 likely reflects the unhappiness with the aftermath of what was, at first, a global push to stimulate economies lest the world repeat the universally feared Great Depression of the 1920s. Nevertheless, it is striking, five years after the London and Pittsburgh summits, how quickly the G20 has given the appearance of not being able to convincingly sing from the same song sheet.

THE CURRENT STATE OF MACROECONOMIC PLAY

As shown in the four Key Macroeconomic Indicator figures below, economies in different parts of the world diverge along key macroeconomic dimensions. These divergences reflect the change in tone in international policy discussions and give rise to what may be termed the "Great Fragmentation." This is meant to convey the idea that the G20 appears to be an orchestra without real leadership or a common purpose. As we shall see, however, not all the news is bad.

Figure 1[5] shows real GDP growth in four regions of the world. Sluggish growth in the advanced and euro-area economies (also one of the advanced economies) relative to Asia and emerging market economies is evident.

1 See www.g20.utoronto.ca/2009/2009ifi.html.

2 See www.g20.utoronto.ca/2009/2009communique0925.html.

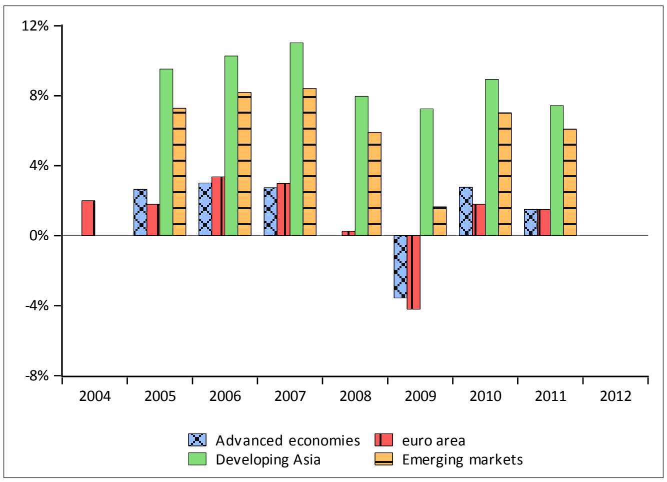
3 This, of course, refers to the publicity surrounding the validity of academic research linking debt levels to economic performance.

4 See www.bankofcanada.ca/2013/05/speeches/canada-works/.

5 Sources for figures are International Monetary Fund (IMF) *International Financial Statistics* CD-ROM (February 2013) and *World Economic Outlook* data set (April 2013). For a list of countries in the various regional groupings shown above see: www.imf.org/external/pubs/ft/weo/2013/01/weodata/weoselagr.aspx#a110.

Nevertheless, it is also remarkable that, except for 2009, real economic growth has not been negative in any region of the world. When this is contrasted with the almost 30 percent decline in the United States' real GDP alone during the period 1929 to 1933,[6] in the aftermath of possibly the largest global financial shock in economic history, the international response to the crisis — in no small part spurred by G20 action — is remarkable. Why G20 member governments have not made more of this is entirely unclear.

Figure 1: Real GDP Growth



Behind these figures, however, are other macroeconomic data that are much less favourable. Figure 2 shows that, in the advanced and euro-zone economies, the gap between actual and potential output — that is, the so-called output gap — continues to be stubbornly negative. Indeed, the cumulative output gap since 2009 in each of these two regions exceeds 10 percent of GDP, and is likely to rise as both the advanced and euro-zone economies are likely to experience a fifth consecutive year of negative output gaps.[7] Data such as these give some additional support to the notion that the world is undergoing a "three-speed" recovery (Blanchard, 2013). No doubt it is these kinds of developments that prompted the Russian Presidency of the G20 to focus on economic growth through various avenues among its priorities for the St. Petersburg summit.

Figure 2: Output Gap

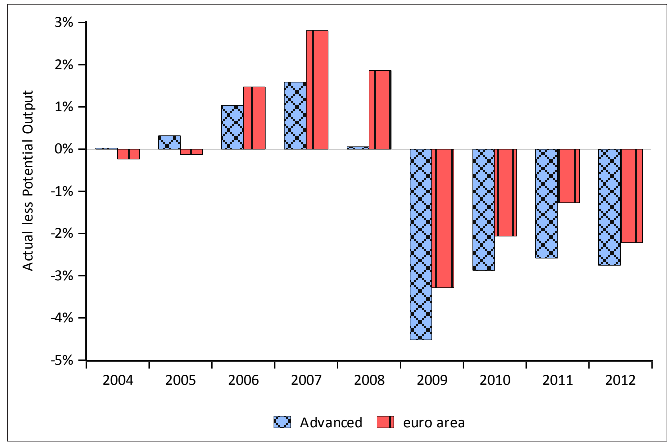
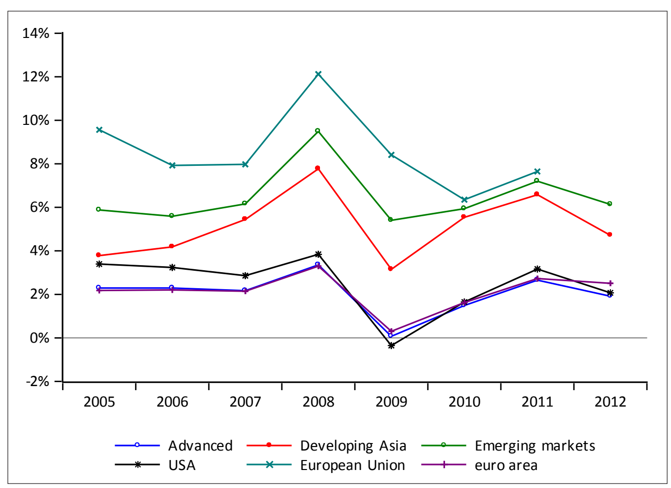


Figure 3 plots inflation performance in the same four regions. Here, too, there is a marked difference between inflation in the advanced and euro-zone economies relative to ones that are experiencing considerably stronger growth. The good news is that, contrary to fears expressed by some that the United States, in particular, is seeking to "export" inflation abroad via an unprecedented loose monetary policy, there is little evidence of this happening so far. Not shown, however, are figures that reveal that while the advanced world is deleveraging, several economies — most notably in Asia — are experiencing surges in debt-to-GDP levels (for example, see Frangos, 2013). Only time will tell whether there will be a resurgence of inflation. Yet, it is clear that inflation worries are top of mind among policy makers in Asia (for example, see Siklos, 2013).[8]

Figure 3: CPI Inflation



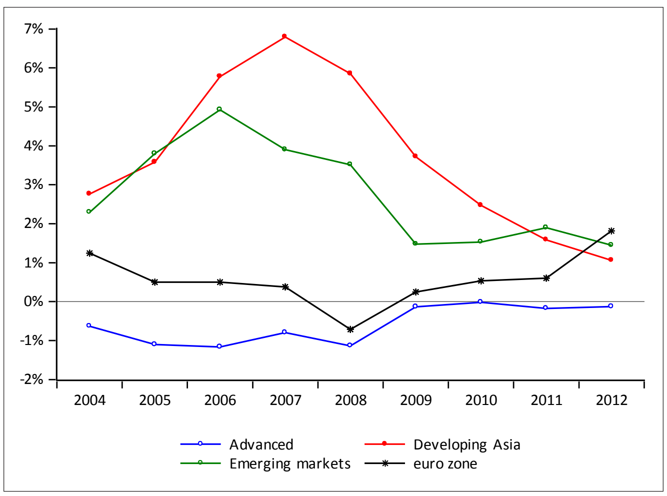
6 Based on figures obtained from Global Financial Data.

7 Because the gap can be larger or smaller depending on whether potential output falls or not during a recession, as is often the case, the poor economic performance in the advanced and euro-zone economies may conceivably be worse that actually shown.

8 For additional information see: http://online.wsj.com/article/SB10001424127887323789704578447080476172420.html.

Finally, Figure 4 reveals that the financial crisis and its aftermath have led to a considerable narrowing of current account balances, again in relation to GDP levels. The so-called imbalances, when the global financial crisis erupted, which policy makers complained were one source of the buildup of disequilibria in the world economy, have largely disappeared from view. To some extent, this outcome has been facilitated by China's loss of competitiveness while competitiveness gains in the United States and Germany have also accelerated the convergence of current accounts to something resembling balance.[9] Of course, imbalances must be understood relative to the context in which they are evaluated. For example, if one examines imbalances within the euro zone, these persist and remain a source of tension not only inside the euro zone, and the European Union more generally, but the spillovers onto the world stage suggest that an important systemic source of risk for the world economy is far from being removed. Indeed, 14 of 27 EU member states are now being subjected to further study based on the European Commission's (EC) most recent alert mechanism report (EC, 2012).

Figure 4: Current Account Balance to GDP



The bottom line is that the current malaise about policy maker's inability to present a united front is primarily a story of diverging economic growth in different regions of the world. The actual situation, at least on the macroeconomic front, is not as dire as it appears at first glance. Yet, one cannot help but recall the words of former Fed Chairman, Arthur Burns, at another perilous juncture in economic history, namely on the eve of the first of two oil price shocks of the 1970s that would produce stagflation for almost a decade: "If cooperative efforts…are long postponed [w]e might find the world divided into restrictive and inward-looking blocks…a world of financial manipulation, economic restrictions, and political frictions" (Burns, 1972).

As will be argued below, the current state of play also reflects fragmentation in other areas, notably in misunderstandings about the potential for each economy to put its house in order to positively contribute to improving global economic performance, fears over the spillover effects from loose monetary policies and continued substantial differences of opinion about the road ahead for financial reforms.

PLUS ÇA CHANGE?

The challenges and risks in implementing policies that will ensure healthy economic growth remain significant, as the IMF has acknowledged (IMF, 2013a). In this environment, there is seemingly more that divides the G20 than unites it in putting international cooperation back on track. However, before one reaches the conclusion that only dire outcomes are possible in the foreseeable future, it is once again worth looking back to 1971 when Bretton Woods was abandoned and policy makers were grappling with what kind of monetary system would replace it. In the same speech by Arthur Burns (1972) cited above, he argues that "[a] major weakness of the old system was its failure to treat in a symmetrical manner the responsibilities of surplus and deficit countries. With deficits equated to sin and surpluses to virtue, moral as well as financial pressures were very much greater on deficit countries to reduce their deficits that on surplus countries to reduce surpluses."

Those words were uttered over 40 years ago. Yet, a look at the euro zone today suggests that the weaknesses that were present then are still with us today. Unlike 40 years ago, however, it is no longer possible to envisage the G3 (United States, Japan and Germany) arriving at an understanding about exchange rates (that is, the Smithsonian Agreement of 1971), even if one believes (and many do not) that the resulting realignment of exchange rates succeeded in halting a "dangerous trend toward competitive and even antagonistic national economic policies" (Burns, 1972). When it comes to international trade, the current environment has led to a curious state of affairs whereby the threat of a currency war seems ever present, whereas within the euro zone, the war is one of attrition with member-state governments seeking to see how far they can go with internal devaluations and fiscal

9 Real exchange rate movements (not shown) confirm the strong appreciation of the Chinese renminbi, while euro and the US dollar real exchange rates have depreciated substantially.

austerity before the alternative of an exit of the euro zone is taken. Indeed, the thought of a currency war initiated by the euro zone as a whole appears inconceivable. After all, individual euro-zone members no longer have the tools to independently depreciate the currency. Such a decision can only be made collectively, and it is unclear how each member of the monetary union can benefit from such action. Meanwhile, financial globalization has ensured that even if gains in competitiveness are sought via more favourable exchange rates, these can be undone by the reaction of financial markets and their ability to move vast amounts of funds with little delay.

It is equally curious that those who warn about the dire consequences of worsening currency wars (for example, Bergsten, 2013) choose to focus mainly on China, exaggerate the degree to which currencies are being manipulated and fail to acknowledge that exchange rate depreciation simply no longer delivers the same benefits that it used to nor can it be expected to help return advanced economies to pre-crisis growth levels. As noted above, China's exchange rate has appreciated considerably. Also, while it is true that some central banks — for example, Switzerland and New Zealand — have shown more enthusiasm about intervening in foreign exchange markets, the amount of forex intervention pales in comparison with what used to be the norm decades ago. Finally, there is considerable evidence (for example, Bailliu, Dong and Murray, 2010) that exchange rate pass-through effects have diminished substantially in recent years, largely because low and stable inflation has become an accepted strategy for delivering good monetary policy.

Of course, to the extent that destructive currency manipulation poses real economic effects, one course of action would be to sanction or fine countries that resort to "beggar-thy-neighbor" policies. Even if this is desirable, there are simply no successful historical examples of a "system" of sanctions of this kind to rely on as a model. If the Europeans can wiggle their way out of comparatively mild restrictions on excessive budget deficits[10] that are, in principle, subject to sanctions, it is very doubtful that the international community can agree on dealing with currency manipulators. The bottom line, at least superficially, is that the current international monetary system does not seem to have improved much over the last several decades.

10 At least members of the European Union have agreed on a definition of what "excessive" means, even if members resort to accounting and other devices to escape the fiscal restrictions they have agreed to. There is even less agreement on what "excessive" means when it comes to exchange rate movements.

MORE UNITES US THAN DIVIDES THE UNITED STATES: SECURING EXISTING GAINS AND THE WAY FORWARD

All is not as bleak as it might appear. Gone are the days when a few large economic powers made decisions with global repercussions without much dialogue with those who were affected by their decisions. In spite of its flaws, the G20 does represent a start at developing a mechanism to deliver good global governance. Paralleling this development is the recognition that low and stable inflation is the essential ingredient of good monetary policy.

There remain, however, two large gaps of a "technical" nature and one of a "cultural" nature that must be filled in order to lay the groundwork for renewed economic growth. The "cultural" gap is likely the most intractable. While some (for example, Shambaugh, 2013: chapter 4) have noted that China is uncomfortable with the notion of "global governance," the same can surely be said of the United States. Whether it is in the area of banking and financial reform or in the appropriate fiscal stance, the US Congress has routinely shown hostility toward global governance principles. Nowhere is this more abundantly clear than when US monetary policy is carried out without much care given to potential global spillover effects, in spite of a growing body of research that suggests that spillovers are significant (for example, Bauer and Neely, 2012). In part, the justification is that the resulting spillovers are thought to be positive, or at least not negative (Bernanke, 2012), while agreements such as the G20's Mutual Assessment Program commit its members "to monitor and minimize the negative spillovers of policies implemented for domestic purposes" (IMF, 2013b).

Since it is impractical to think that all members share equally from the "public good" that is global governance, the G20 might devote more effort to persuading its largest and most influential members that there is more to gain from an international policy regime than the costs borne in monitoring and enforcing it. The G20 might want to heed Woodrow Wilson's advice of long ago, in the dying days of World War I, about how to ensure the peace: "There must be, not a balance of power, but a community of power" (Wilson, 1917).

A secondary issue is whether the size and diversity of the G20 gives rise to problems endemic in large groups of the kind Mancur Olson (1965) discusses in his seminal contribution on the challenges of collective action. Rather than being viewed as an organization where all of its members are treated equally, at least in principle, it ought to act more like a federation where certain blocks, more affected by some policy questions than others, can opt out so long as some minimum established standards are maintained. To assist in creating more confidence in the G20 process, escape clauses could be added that are transparent and set the limits to international cooperation (for example, see Siklos, 2013).

A case in point is the implementation of Basel III reforms (for example, see Bank for International Settlements, 2013). In a sample of banks examined by the Basel Committee, several G20 members have no internationally active banks (Argentina, Indonesia and Mexico). Similarly, the sample includes several other member countries where banks are smaller and are not internationally active (Brazil, China, Saudi Arabia and the United States).[11] To suggest that a "one-size-fits-all" regime will work is neither helpful nor realistic.

Turning to the "technical" gaps that need to be filled, two are most glaring. They are: greater acceptance that international standards for financial supervision and regulation are essential; and an attempt to devise rules for good conduct in fiscal policy. Failure to deal with the first question will once again permit financial institutions to exploit new gaps or, worse still, undo the very benefits of financial globalization — namely, the flow of credit to where it is most valuable will be lost. Forces leading in this direction are already underway (*The Economist*, 2013). This is not to say that a single regime will fit all G20 member states. Nevertheless, since financial structure and the degree of maturity across countries does vary considerably, there ought to be room for idiosyncratic systems, while also seeking to minimize regulatory arbitrage that contributed to the buildup of financial imbalances in the years that preceded the global financial crisis. In the case of fiscal policy, just as central bankers learned the hard way that only a judicious mix of rules and discretion can lead to low and stable inflation, a similar effort needs to be undertaken to find that mix. To be sure, several such arrangements have been proposed and implemented to a greater or lesser extent, but there is, as yet, no common ground on the subject, possibly because existing rules are seen as being too complex (for example, see Schaechter et al., 2012).

While the above represent a list of what the G20 can do, there is also one suggestion for what the G20 should cease doing — namely, relying too heavily on central banks to deal with the challenges they face. Not only does doing so violate any reasonable principle of good global governance by increasingly removing the adoption of policies and decision making to unelected officials, but the recent course of events makes it plainly clear that monetary policy has its limits. Unfortunately, this principle, like some of the others mentioned above, has also been violated time and time again. Paul Volcker (1984), in the early 1980s, warned as much when he stated, "[Industrial nations…nowadays rely heavily — sometimes too heavily — on their central banks and on monetary policy to achieve our economic goals; to promote growth and employment, to blunt the forces of inflation, and to maintain financial stability." Add another lesson that has yet to be fully learned.

11 The banks referred to are the so-called Group 1 banks (capital in excess of €3 billion and internationally active). All other banks are considered Group 2 banks.

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IMF QUOTA AND GOVERNANCE REFORM: POLITICAL IMPULSE NEEDED FOR PROGRESS ON REFORM PROCESS

Thomas A. Bernes

In her spring statement on the International Monetary Fund's (IMF's) work program, Managing Director Christine Lagarde stated that "completing the 2010 quota and governance reform is essential to the Fund's legitimacy and effectiveness.

- **Quota and governance reform.** We have met two of the three conditions needed for the 2010 reform to take effect. The remaining condition is to secure the 85 per cent of the total voting power needed for the Board Reform Amendment to enter into force. The Board will continue to be informed of progress on a regular basis.

- **Review of quotas/new quota formula.** A paper updating quota calculations based on recent data, Quota Formula: Data Update and Further Considerations, will be presented to the Board in June. The Board will also revisit the work program on the 15th General Review of Quotas." (Lagarde, 2013)

This is a polite "Fundese"[1] way to say that progress has stalled on implementing the modest 2010 reforms and on promised future progress. Unfortunately, as the managing director stated, the debate goes beyond the specifics of voting shares and representation, and raises critical questions about the Fund's legitimacy and effectiveness.

The IMF 2010 agreement on reform was hailed by then Managing Director Dominique Strauss-Kahn as historic, although most commentators expressed a more modest view. Nonetheless, it was an important step forward and was achieved, in part, through the leadership of the United States and by their threat to withhold agreement on the size of the executive board if broader agreement was not reached. The IMF quota and governance reform proposed, among other things, a doubling of IMF quotas, a shift in quotas to dynamic emerging markets and under-represented countries, and reform of the composition of the executive board. These measures were meant to both scale up the resources available to the Fund to meet future crises and to rebalance the representation of fast-growing, but under-represented, middle-income countries at the IMF.

In order to come into effect, this agreement requires support from 85 percent of the Fund's membership (usually through national legislative action). Since the United States controls 16.75 percent of IMF voting power, US approval (and by extension US congressional approval) is required for the 2010 agreement to come into force. However, the implementation of the 2010 agreement, which had been due to be completed in October 2012, has suffered a further setback. Both houses of the US legislature have refused to sign off on their government's request to reallocate an existing $65 billion of the US commitment to the IMF (under the New Arrangements to Borrow) into a permanent increase in shareholding.

This request involved no new additional financial commitment by the United States, but simply a transfer of an existing commitment (to be called upon, as needed, in any major future financial crisis) into a different category. However, the request unfortunately coincided with politically sensitive negotiations over spending cuts and was not supported. The failure by the United States to deliver on its agreement after almost three years, seriously weakens the credibility of the Unites States to exercise leadership in the future, and leaves the IMF in limbo on its resources and governance reforms.

As for the January 2013 deadline for revisions to the quota formula, this date also passed without agreement and the process was incorporated into the schedule for the IMF quota review. The new deadline for this review is January 2014, but it is difficult to envisage progress with the previous quota agreement unimplemented.

IMF quota reviews have always been fraught with difficulties. The original agreement established the size of resources that were believed to be appropriate for the Fund to respond to anticipated crises, and an understanding was reached on a division of responsibility among the members at that time, based largely on economic size with a small political overlay to facilitate agreement. The current challenge is that there is no agreement on what the appropriate size of the Fund should be in today's world

1 The term used to describe the often opaque language found in IMF documents.

of freely moving capital, and the current division among members is calculated with a large political overlay.

How does this translate in reality? As stated earlier, the US share is 16.75 percent. China's share today is 3.81 percent. The United Kingdom and France each have 4.29 percent (how long has it been since their economies were equal to or bigger than China's?). Eight constituencies, with a total share of 34.27 percent, are controlled by the Europeans, in addition to Spain's membership in a Latin American constituency. China, the number two country economically in the world,[2] has a share that is less than either the United Kingdom or France, and the Europeans control one-third of the chairs on the executive board. Combined, the United States and Europe control over 50 percent of the voting power. The 2010 package would provide China with a 6.07 percent voting share, while the United Kingdom and France would drop slightly to 4.02 percent, and the 27 countries that make up the European Union would retain 29.4 percent of the voting power.

A February 2013 paper by the G-24 (Intergovernmental Group of 24 on International Monetary Affairs and Development), a developing country grouping at international financial institutions, makes clear the democratic deficit inherent in the current quota formula. The paper argues that the formula is "systematically biased against emerging markets and developing countries," while at the same time, making "the quota for advanced Europe as a group a third larger than its relative weight in the global economy." Amar Bhattacharya, director of the G-24, said that "achieving a more equitable and democratic governance structure is a prerequisite for the legitimacy of the Fund; and its capacity to fulfil its mandate effectively. The governance structure must recognise the growing role of emerging markets and developing countries in the global economy, and ensure that all members including the poorest have an equitable stake in the institution" (Bretton Woods Project, 2013).

Let us ponder for a moment how the current alignment may have influenced recent events at the Fund. First, the election of current Managing Director Christine Lagarde — who comes from Europe, as have all of her predecessors. Despite agreement that the competition should be open and merit-based, another European was chosen. Not to denigrate Lagarde's many qualities, but would the result have been the same with a different voting structure?

2 Ranked number two by *The Economist*.

Let us also look at the IMF's recent involvement with the economic problems facing the euro zone. The Fund's recently released examination of their involvement is to be strongly welcomed for its candid and refreshing assessment of both the substantive and procedural errors of judgment concerning their engagement in Europe. What is missing from this assessment, however, is an examination of how and why these errors were made. Rumours have abounded about the misgivings of many emerging countries to the programs. Even Canada's minister of finance, Jim Flaherty, said Canada's position is that any IMF funding program "should be subject to a more rigorous approval process," echoing statements he made earlier pushing for change in the way the IMF is governed (CBC News, 2012).

Flaherty has lobbied for non-European countries such as Canada to get some type of veto power over any decisions the body makes to bail out Europe. "Because of the large number of European seats on the board of the IMF, some of us, and Canada certainly, is of the view that we ought to have two keys, in effect," Flaherty said (ibid.). "We would have one vote by the eurozone countries and another vote for approval by the non-eurozone countries" (ibid.).

One cannot help but wonder whether, with a non-European managing director and an executive board with a more equitably balanced representation, different decisions would have been reached.

Now, a quota formula based solely on economic weight will not fly, because it would create new anomalies that would discredit the IMF in its policy-making role. For instance, the United States would gain even more voting strength and the impoverished countries of Africa would shrink even further from their already low levels of representation. This would not be acceptable; therefore, the search must be for a formula that is seen by the vast majority of the membership as being equitable.

But how can this be achieved? There is a mind-numbing debate currently taking place over various adjustment factors. One of the most important debates concerns the issue of "openness" and the extent to which it should be used to modify the results. The European Commission position, for instance, given at the October 2012 annual meeting of the World Bank and the Fund in Tokyo, argues that "GDP and openness should remain the main variables in the quota formula" (Rehn, 2012) and that openness should carry an increased weight. While this sounds meritorious — who would oppose openness — in fact, this brings into account intra-European trade, which is one of the factors leading to European overrepresentation.

Intra-American or intra-Canadian trade is not counted. Why should Europe be different? The answer is, of course, that it helps them maintain their privileged position.

Paulo Nogueira Batista, IMF executive director for Brazil and 10 other countries, decried the lack of a deal after two years of negotiations and warned that the IMF would lose credibility unless it changed. He said governance reforms had practically ground to a halt since 2011, when the Fund failed to enforce voting changes agreed in 2010. "Now we have an attempt to paper over the fact the review of the quota formula has not been completed either," Nogueira Batista said in a statement. "The IMF is approaching what we could call a 'credibility cliff'" (Wroughton, 2013).

In early February, Russian President Vladimir Putin stated at a finance ministers' meeting in Moscow his belief that "at the upcoming Russian summit, the G20 will be able to agree proposals for a new formula for calculating quotas that will take full account of the modern distribution of forces in the global economy" (Putin, 2013).

One can only hope that Putin is correct — but it is hard to see the breakthrough that would allow the power beneficiaries of the current system to give up their present positions. And a pious statement by the IMF that the commitment remains and progress is around the corner simply lacks credibility.

The G20 needs to make a clear commitment to make progress on revising the formula, adopting GDP as the main criteria, but also including a formula to protect those developing countries that would suffer the most. This may need to be accompanied with a new double-majority voting procedure. Without a strong, and specific, political impulse at the G20 summit in Russia, it is almost impossible to envisage any progress being made on this issue at the IMF. And without legislative action by the United States to allow the 2010 agreement to come into force, the January 2014 target date for a new quota increase will not happen.

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WHAT HAS THE EUROPEAN DEBT CRISIS TAUGHT US ABOUT CRISIS MANAGEMENT? CONSIDERATIONS FOR THE G20

Susan Schadler

The economic crises that began with Greece and spread through Ireland and the southern periphery of Europe were path-breakers. They occurred in countries embedded in a major currency area (the euro zone), they dispelled the notion that debt crises are the provenance of emerging market countries and they have proved remarkably resistant to global bailout assistance. Now, as G20 leaders prepare to meet in St. Petersburg, Russia — more than three years into the crisis and without an obvious endgame in view — a serious question they should consider is whether these are the first of a bigger, more complex and more-difficult-to-resolve kind of crisis that will define the future global landscape.

The global economy and its supporting institutions have hobbled through the challenges thrown up by the European crisis. Many factors have contributed to the slow recovery of the worst-hit European countries, but faults in crisis management are certainly one of them. The mistakes do not have to be repeated. These are early days for choosing the key issues that need attention, but the process must begin with issues that are now obvious. This note raises five aspects of crisis management that need the attention of global economic leaders.

THE EURO AREA DEBT CRISIS — ESSENTIAL FACTS

The basic contours of crisis management in the euro area were set with Greece. Initially, the intention of European leaders was to handle and finance the crisis internally. After the size of the problem — both the adjustment and the financing required — became clear, the European Union turned to the International Monetary Fund (IMF). That request came late. A large amortization payment due six weeks later brought the threat of a disorderly default to the doorstep. European demands put to the IMF were stark and difficult to reconcile: Greece must stay in the euro area; there would be no debt restructuring, which, it was thought, would deprive Greek banks of funding channels and stir up intensely feared contagion to other weak euro area countries; and the IMF would negotiate, monitor, and contribute one-third of the financing of the adjustment program in a joint relationship with the European Commission and the European Central Bank — a grouping known as "the troika."

To be part of this arrangement, the IMF had to change its own framework for exceptionally large loans. The IMF determined that even with the unusually strong fiscal and structural adjustment policies planned, a rigorous forward-looking analysis raised significant doubts about whether public debt would be sustainable without a restructuring. In other words, IMF funding would not be a bridge to a level of debt that could be financed and repaid, it would only extend the period of uncertainty about how debt would be lowered to manageable levels. Since being on a track to debt sustainability is one of the criteria that a large borrower must meet, the IMF had to introduce a waiver (the systemic risk waiver) of that criterion to approve the loan. Greece restructured its privately held debt two years later.

Greece paved the way for handling other debt crises in Europe. Although the facts surrounding each of the four countries (Greece, Ireland, Portugal and Cyprus) that received official bailouts for their creditors differed, the basic parameters for handling the crises were similar: each country should stay in the euro area, restructuring would not (initially) be countenanced, the IMF participated in the troika and lending proceeded on the back of the systemic risk waiver, without a high probability of debt sustainability. Greece remains the only country to have restructured its debt — all except Ireland continue to experience falling output and employment.

WHERE DOES THE EURO AREA CRISIS LEAVE US? FIVE EARLY ISSUES FOR ACTION

The IMF needs arm's-length protection from pressures that prevent it from openly considering and advocating actions that fix a problem early, at its source.

Again focussing on Greece, two fundamental problems were at the root of the crisis — unusually high and rising public debt and weak competitiveness. The adjustment program aimed to address these issues through severe fiscal retrenchment and structural reforms. But this strategy was not realistic in view of the depth of the problems and the lags in responses to, in particular, structural policy. In turn, the optimism embedded in the initial three-to-five-year forecasts (for example, of GDP, employment and exports) contributed to an unrealistic picture of the costs of the strategy. Ultimately, after private holdings of debt had fallen substantially, debt had to be restructured, while the slow pace and response to structural reforms meant that the real sector strategy had to shift from a structural-reform-led to a recession-led improvement in competitiveness.

Admittedly, the constraints posed by membership in a currency union were formidable, but almost every crisis has its own set of constraints that seem immutable at the outset. The critical role for the IMF as an outsider with enormous experience in handling crises is to force a reality check on the parties closer to the crisis. Reconsidering the management and decision-making structure of the IMF so as to strengthen the arm's length distance from the intense political pressures that inevitably surround a crisis is critical.

The IMF needs to provide more thorough analyses of spillover effects.

The fear of contagion arises in all crises, most intensely in regional partner countries. These fears are warranted, as all serious twenty-first-century crises have spillover effects. A critical error in handling the euro area crisis was succumbing uncritically to the view that financing a program without a high degree of credibility would minimize spillover effects. For example, the program for Greece approved in May 2010 did not satisfy markets' desire to see a clear endgame to Greece's large debt and competitiveness problems. Without providing such clarity, the strategy of lending to Greece without a high probability of sustainability actually exacerbated negative contagion to other weak peripheral countries.

Having the IMF undertake a rigorous and transparent analysis of likely spillovers from alternative strategies for crisis resolution is the best approach for choosing spillovers with the lowest costs. Of course, these would involve many judgment calls on likely responses to different courses of action. In the case of Greece, for example, spillover analyses of the actual strategy chosen, a restructuring strategy and a temporary exit from the euro strategy, to name a few alternatives, should have been carried out and made public. Unless the IMF is able to get all strategic options on the table with a clear analysis backing each, it will not perform the essential function of a more objective participant in program negotiations.

The IMF must be protected by a sensible framework for lending into crises.

The IMF changed the framework governing exceptionally large loans in order to go ahead with assisting Greece, Ireland and Portugal. The framework consisted of four criteria that a country must meet to receive exceptional access: it must have a balance of payments need; a high probability of debt sustainability in the medium term; good prospects for regaining market access; and a program of policies that is likely to be successful. To approve the Greek loan, the option of a *permanent* waiver was introduced into the second requirement — that related to debt sustainability — when there are risks of international systemic spillover effects. The use of the waiver effectively undermines the avowed role of the IMF — to lend as a bridge to market access. Without sustainability, market access is unthinkable.

The waiver should be eliminated. It was established in the heat of the moment of an impending Greek default. This critical and permanent change in IMF policy was not discussed by the Fund's executive board, but merely made part of the approval of the Greek program. It makes little sense. Sustainability is always basic to the objectives of an IMF lending arrangement and no more so than for a country important enough to have international spillover effects. Moreover, that the IMF continues to invoke the systemic risk waiver three years after the start of the crisis for Greece, Ireland and Portugal, speaks to the licence the waiver gives for delaying crisis resolution.

That said, it is important for the IMF to have some flexibility or discretion in its initial response to severe crises. In the case of Greece, it is arguable that a default in mid-May 2010 (which was the likely outcome of the absence of IMF participation) would have been unduly costly. The IMF should have the option to lend very large amounts for short periods even when conditions do not meet the four criteria for exceptional access. This could take the form of an emergency financing facility with maturities capped at a short period (say under six months) that would provide a bridge to a longer term, strategically tight program that meets the four criteria.

Debt restructuring arrangements are still precarious and need formalization.

That the Greek restructuring of privately held debt in early 2012 worked so well was fortunate. The decision on the parameters of the restructuring was reached in October 2011, a negotiating group lead by the Institute for International Finance (IIF) was formed and a deal was reached in February 2012. Although the fate of the negotiations was a cliffhanger, a large writedown with a small number of holdouts was achieved. Creditor coordination problems were mostly successfully overcome. But the circumstances were special. Most debt was issued under domestic law, and retrofitted collective action clauses (CACs) were put in place to secure adequate participation. Holdouts in the foreign law debt were eventually paid off.

These special features of the Greek deal leave doubts about future restructurings. Problems, well rehearsed during the 2001-2002 debate over the Sovereign Debt Restructuring Mechanism remain potent obstacles to smooth restructuring as the lingering problems with Argentina's creditors show. CACs, which are now common in bond contracts, continue to be too narrow to ensure timely participation of all creditors. And while the IIF did a commendable job in negotiating the Greek restructuring, it is an organization of bankers without formal channels of representation by hedge funds and other non-bank bond holders. If a full bankruptcy-type body is not favoured, at the very least a new look at CACs is needed.

The IMF's relationship with regional partners in debt crises needs clearer boundaries.

The troika arrangement has been a novel test. Cooperation between the IMF and regional groups has frequently occurred, but joint responsibility for negotiating, monitoring and financing an adjustment and reform program had not, until the European crises. And, though the logic of the joint effort is clear when the crisis country is a member of a currency union, it has presented problems. Apart from obvious differences in institutional perspectives and responsibilities of the European and IMF teams, there has persistently been at least the appearance of a more direct channel for political influence. Although crises of the severity of Europe's are unlikely in other currency unions including multiple IMF members, the troika will set an example that could well be viewed with interest in future crises in other regions.

The IMF needs a clear set of principles to guide any future cooperation with regional groups during crisis resolution. These need to partition responsibilities, reinforce the senior creditor position of the IMF (perhaps even formally) and fortify the constraints on the IMF's discretion in lending into crises.

Action on these five issues is critical to avoiding the mistakes that have led to prolonged crises in Europe, and is an important matter for leaders at the G20 summit to consider. The list of issues requiring action will surely expand as the European crises are eventually resolved and studied further; at this stage, however, a minimum list is clear:

- The management and decision-making structure of the IMF needs to be re-examined to foster some arms' length distance from direct political pressures.

- Prior to approval of any lending arrangement, the IMF should be required to carry out and release to the public rigorous analyses of international spillover effects from different strategies for addressing the crisis.

- The option for waiving the requirement of debt sustainability in exceptionally large lending arrangements should be revoked. The very high costs of leaving markets to guess how debt sustainability will be restored are an unacceptable drag on the resolution of a crisis.

- Formal arrangements — whether through enhanced CACs or a bankruptcy-style process — for debt standstills and restructuring are needed.

- Procedures for cooperation between the IMF and regional institutions in debt crises should be codified, with an aim of enough separation between the two to ensure institutional integrity.

DEVELOPMENT IN THE G20: WHITE ELEPHANT OR CORNERSTONE?

Barry Carin

INTRODUCTION

According to Thai legend, albino elephants were regarded as holy. If a Thai king became dissatisfied with a subordinate, the king would give him the "gift" of a white elephant. Keeping a white elephant was very expensive and, in most cases, would ruin its owner, as they would have to provide special food for the elephant as well as access for people to worship it. It may be that the development issue has a similar dimension for the G20. Does the positive value added by consideration of the development issue outweigh the burden? Is development a linchpin of the G20 agenda, since sustainable growth and prosperity in this interconnected world is dependent on the experience of developing and emerging countries? Or, is the development area a Potemkin village of intransigent issues?

This article reviews how development was treated at the last three G20 summits and then explores the wisdom of keeping global development on the G20 agenda rather than having it "mainstreamed" across the G20's core work.

In general, the G20 adds an issue to its agenda if there is a vexing problem with major implications for all its members that is unlikely to be resolved elsewhere. The G20 role should be clear, with prospects for strengthening other international institutions and for a probable positive outcome that would enhance G20 credibility. Applying these criteria, does development merit a place on the G20 agenda?

The G20 has several types of initiatives or "tools" at its disposal. It can simply pronounce its view or commit to act domestically. Since G20 communiqués are widely publicized, they are able to focus attention on an issue and may influence events. The G20 shapes the future research agenda, framing terms of reference and inviting groups of G20 ministers or international organizations to prepare a report for consideration at a future G20 meeting. It can mobilize resources as it did at the 2009 London summit to deal with the financial crisis. The G20 can create a new institution — witness the Financial Stability Board. What is the prospect for any of these "tools" to be applied to global development issues?

DEVELOPMENT ON THE G20 AGENDA?

Should development be on the G20 agenda? While global development and poverty is of concern to all G20 members, and the existing body of international institutions could be criticized for ineffective results, the issue is whether the G20 would be able to do better. Is there a set of potentially successful G20 initiatives that would add to its credibility? Based on this criterion, it appears that development should not be on the G20 agenda. Why, then, did Korea put development on the G20 agenda? Why did France and Mexico follow up to include it in their presidencies? Why is Russia keeping it on the agenda?

The G20 presidency has the significant prerogative to add an issue to the summit agenda. There are different explanations for the Korean decision in 2010. Perhaps the Koreans — keen for the G20 to succeed — were responding to the need to ensure the sustained legitimacy of the G20 and to build a medium-term role for it beyond that of a crisis control centre (Schulz, 2011). Citing the growing interdependencies among countries, possibly the Koreans put development on the agenda to demonstrate a concern with the economic performance of non-G20 members. The Koreans felt they could provide value added to the development discourse, based on their remarkable historical performance, emphasizing growth and infrastructure development. The objective was, perhaps, to move global development discussions beyond the aid focus and make self-sustaining growth based on progressive capacity development the key feature. Additionally, France and Mexico supported the idea, increasing the potential for the success of Korea's initiative.[1]

The "Seoul Development Consensus for Shared Growth"[2] was characterized as a departure from the discredited "Washington Consensus."[3] The Seoul Development Consensus allows a role for state intervention; it presumes

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1 See www.guardian.co.uk/global-development/2010/oct/04/south-korea-development-g20-summit.

2 See www.g20.utoronto.ca/2010/g20seoul-consensus.html.

3 See www.iie.com/publications/papers/williamson0204.pdf and http://developmentinstitute.org/member/diazfrers_consensus/DiazFrers_script.pdf.

that solutions should be tailored to the requirements of individual countries, with developing countries taking the lead in designing packages of reforms and policies best suited to their needs. It has six core principles: focus on economic growth; global development partnership; global or regional systemic issues; private sector participation; complementarity; and outcome orientation. The principles are all uncontroversial— except perhaps for some grumbling about being business-friendly. There are nine "pillars" — the key ingredients of self-sustaining growth: infrastructure; private investment and job creation; human resource development; trade; financial inclusion; resilient growth; food security; domestic resource mobilization; and knowledge sharing.

The priorities of the French presidency in 2011 were: restoring economic confidence in the euro zone; the international monetary system; the social agenda; financial regulation; and the development agenda. While acknowledging progress under the nine Seoul pillars, development priorities at Cannes were: food security; infrastructure; and the financing of development. The French have always had a special interest in innovative financing. Concerning development financing, President Sarkozy asked Bill Gates to submit proposals to the heads of state and government at Cannes. The Gates report was to include a "menu of options" for innovative financing mechanisms of which G20 members would be invited to choose at least one for implementation.[4] A separate briefing on France's priorities for their G20 meeting highlights included "Development, with a particular focus on food price volatility and Africa" and "Fighting corruption, including promoting transparency in extractive industry revenues."[5]

The performance at Cannes was deemed unsuccessful for failing to come up with a new development story concerning the links between economic growth and social objectives: "The G20 development agenda has had so far limited added value to ongoing global development processes. It lacks both institutional strength and a convincing narrative. Moreover, short-lived celebrity initiatives, such as the financing report submitted by Bill Gates, cannot distract from the weak performance of the G20 as a development driver" (Schulz, 2011).

The Mexicans retained a focus on development during their 2012 presidency. Their approach was to follow up the pillars in the "Multi-Year Action Plan on Development" with an emphasis on infrastructure and green growth. Mexico introduced a more structured approach to preparation with two "tracks" (see chart). "The Sherpas' track focusses on political, non-financial issues, such as: employment, agriculture, energy, the fight against corruption and development, among others" (G2012 México, 2012a: 5; and G2012 México, 2012b). This two-track approach is problematic — it depreciates the impact of the Sherpas' track. Most of the potential action options in the development area require the expertise and assent of the "finance track."

The Russian 2013 presidency focus is on four of the nine pillars — food security, financial inclusion, human resource development and infrastructure. In each of these four priority areas, there are constraints on the work of the Development Working Group (DWG) — the relevant policy areas are outside its sphere of influence. For example, in the food security area, regulation of commodity futures markets, the reduction of agricultural subsidies and biofuel mandates are outside the DWG's purview. For financial inclusion, regulation or promotion of micro finance is outside its mandate. For human resource development, authority for subsidies and tax incentives belong to the finance ministry. In the infrastructure area, the effective instruments are all financial, for example, local currency bond markets, role of sovereign wealth funds and increased multilateral development bank lending. On balance, the DWG is seemingly restricted to being a harmless discussion forum attempting to reach a common understanding about good practices.

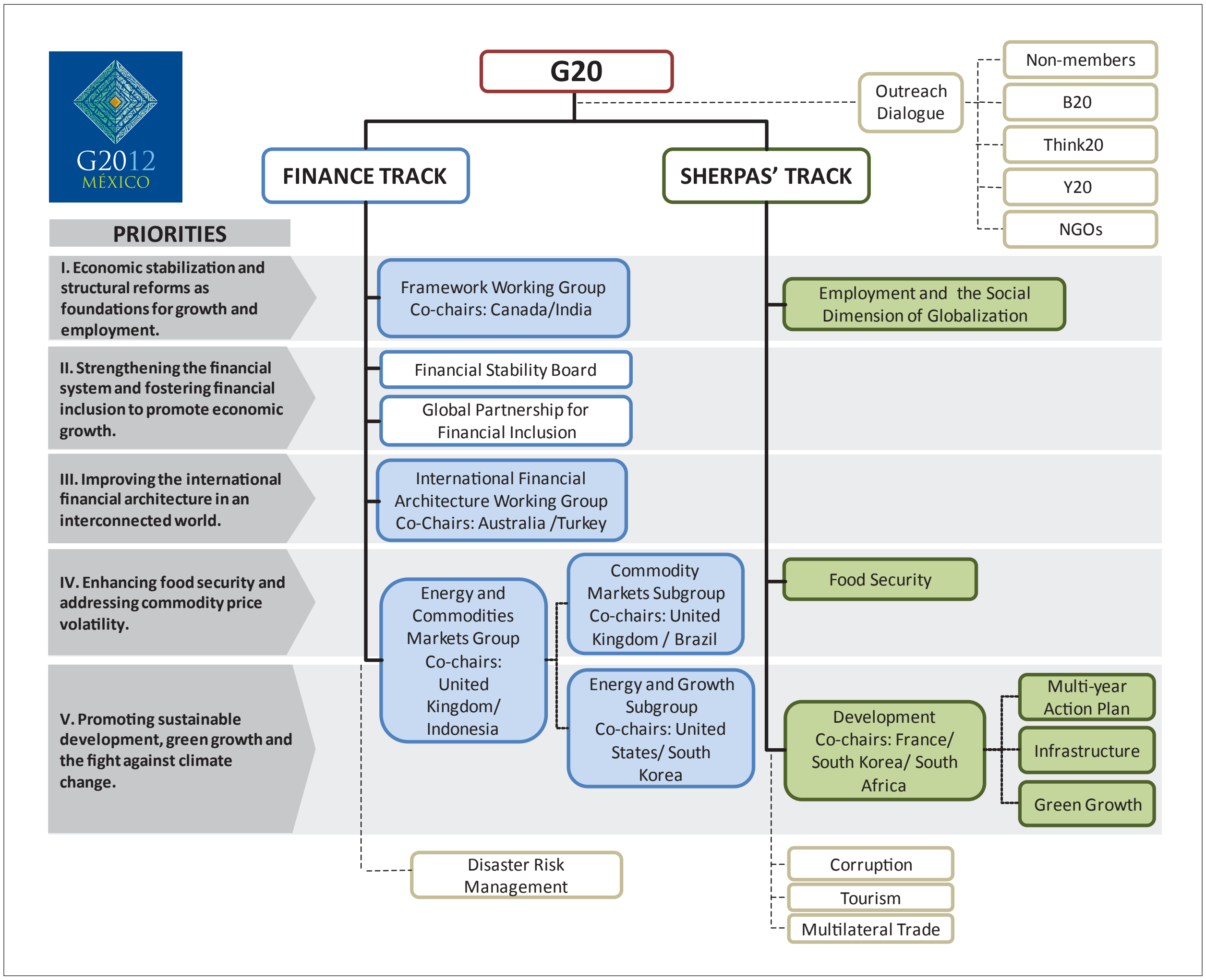
THE G20'S TOOLS

The G20 has the power to shape the global discourse — its pronouncements are reported widely. But in the development area, the G20 is a secondary player — it has significant competition in shaping the global discussion. The president of the World Bank is pushing the eradication of poverty by 2030. The United Nations will monopolize the debate for the next 18 months discussing the Rio+20 sustainability goals and the post-2015 successor to the UN Millennium Development Goals.

4 See www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_164645/lang--en/index.htm.

5 See www.pnowb.org/sites/default/files/France%20G20%20priorities%2023JUN11.pdf.

Structure of the G20 Preparatory Process



Source: www.g20mexico.org.

The G20 can influence the future research agenda, posing specific questions and issuing remits to be reported on at future G20 meetings. But, in the development area, the G20 faces a crowded field. Its reputation is handicapped by the poor performance on its request for a report on fossil fuel subsidies, where commitments to a first class product did not result in implementation. International organizations will be reluctant to divert resources to respond to the G20 if they see little prospect for action.

The G20 can commit to finding the resources for a global problem. At the 2009 London summit, it committed to mobilizing resources to deal with the financial crisis and for the International Monetary Fund. But in the financing for development area, the G20 appears impotent. The G20 discourse on financing is not, however, limited to resources for development. The G20 "Study Group on Climate Financing" issued an insignificant report of little value.[6] The jury is out on whether the G20 can make a meaningful contribution to mobilizing domestic resources or even on addressing illicit capital flight.

The G20 is able to create a new institution to fill a gap in the global governance architecture for development, as they did with the Financial Stability Board. In the development area, the issue is not gaps in governance. It is difficult to argue that a gap exists for development. There are, perhaps, too many development organizations – the multilateral development banks, United Nations agencies, the Organisation for Economic Co-operation

6 See www.g20mexico.org/images/stories/canalfinan/deliverables/greengrowth/Climate_Finance_Study_Group_report.pdf

and Development's Development Assistance Committee, the national aid and international cooperation ministries, and countless non-governmental organizations and funds. The organizations and agencies lack coherence, but none of these actors will accept an overall executive institution. In theory, the G20 could be the executive institution to ensure coherence in decision making and financing, but the G20 members have very different approaches to development and no actual resources available to initiate pilot or demonstration projects.

CONCLUSION

One easy option for the Russian presidency to minimize expectations is to report on past commitments and then request ideas on new institutional arrangements with respect to food security and financial inclusion, which would be reported at future summits. A more ambitious alternative would be to recall the September 2011 statement of the G20 meeting on development with the ministers of finance and the ministers responsible for development cooperation: "The G20 development agenda is central to the issues facing the G20. Development issues and global economic issues can no longer be treated in isolation… At a time when economic uncertainties regarding world growth are on the rise, and global imbalances must be eliminated, economic growth can contribute to global economic recovery by creating new focal points of growth and helping to reduce disparities" (G20 DWG, 2011).

Development ministers are not responsible for the substantive policy prescriptions that enable development — all the policy tools are found in other ministries. Trade access, infrastructure, agricultural development, tax policy, funding for education and human resources development, policies on commodity and food price volatility, and anti-corruption, are all policy instruments wielded by other ministers. The role of the G20 and the potential contribution of the G20 DWG would be to highlight the crosscutting dimensions of the various other policies and their impact on development. G20 development ministers and the DWG must be "pests" and "interfere" in the other G20 working groups, championing development interests and promoting ideas that shape other policies with full consideration of their importance for developing countries.

The Russian presidency this year, and the Australians in 2014, have a choice. They can assess development as a white elephant, build a Potemkin village and try to avoid the complexities by "mainstreaming" development on the G20 agenda. Or, they can agree with the September 2011 G20 statement that "development issues and global economic issues can no longer be treated in isolation." To ensure that future G20 decisions will not trivialize development, the DWG assessment of the impact of all G20 policies would become an integral input in all tracks of the G20 process. Joint meetings of ministers of finance and the ministers responsible for development cooperation would become a keystone of the G20 process.

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POLITICAL DIMENSIONS OF RUSSIAN G20 PRESIDENCY DESERVE A CLOSER LOOK

Gordon Smith

The political dimensions of Russia hosting the G20 in September are generally overlooked, but they deserve more attention. The success of the St. Petersburg meeting is very important to Russia politically, and to President Vladimir Putin personally. Putin would like to show Russians that he is a world-class leader and that Russia should be taken seriously. He wants to use the summit to demonstrate that he can make a positive contribution to the governance of the global economy. Putin's desire to use the G20 meeting for his own political validation provides other members of the G20 with some leverage.

From President Putin's point of view, the June G8 summit held in Lough Erne, Northern Ireland, was not a happy experience. He faced serious isolation for his position on Syria, to the point where Canadian Prime Minister Stephen Harper stated that the G8 now looked more like the G7+1. That remark would have hurt — given that Russia worked very hard during the 1990s to be fully included in the summit process. Putin will want to recover.

To understand the political dimensions of G20 summitry, one has to go back more than 20 years to the end of the Cold War. The G7 — the heads of government of the leading industrialized countries — had, after almost two decades, become a kind of self-appointed global steering committee. The G7 developed out of the need for enhanced coordination of global economic policy; leaders will, however, discuss whatever problem is currently on their mind, including security and political questions.

As the Cold War wound down in 1991, the G7 invited Soviet Union President Mikhail Gorbachev to join for part of its meeting. It was not a meeting of the "8," but rather Russia was invited to meet with the G7. It evolved into a G7+1. These geometric distinctions and progressions are important.

At the 1991 meeting, G7 leaders discussed the transformation of the Russian economy away from its focus on military production, towards one driven by the incentives of a market economy with Mikhail Gorbachev. This meeting set the groundwork for Russia (the Union of the Soviet Socialist Republics dissolved at the end of 2001) to become a member of the International Monetary Fund and the World Bank (eventually, in 2012, Russia also became a member of the World Trade Organization). The political dimensions of the G7 outreach to Russia were, and are, clear.

It took six years for Russia to become a full member of what came to be called the G8 (after the 1997 summit). I was Sherpa for Canadian Prime Minister Jean Chrétien for the G7 summits held in 1995 (which Canada hosted), 1996 and 1997. I vividly recall that the extent of Russian participation in these summits was intensely debated in the preparatory meetings. Finance ministries were, by and large, against it — arguing that full membership for Russia was not justified by the size and functioning of its economy. Although less explicit, there was also a doubt whether Russia would live by the unwritten "club rules." The Sherpas discussed this quite explicitly when they met as the G7; however, when they met as the G8, the discussion was, unsurprisingly, much more indirect.

It was clearly important to Russian President Boris Yeltsin to be included as a full member of the G7, and the Russians kept knocking on the door. They saw the G7 as a "club" — and they wanted in. This provided, and still provides, some leverage to existing members.

Of course, membership was a card to be played at just the right moment. The invitation to Russia and its eventual full inclusion was advocated on explicitly political grounds. Strobe Talbott's book *The Russia Hand*[7] describes US President Bill Clinton's (and Strobe Talbott's) strategic management of the relationship with Russia. Clinton used carrots and sticks — incentives and disincentives; clearly, one of the major incentives was to offer progressively more time to Yeltsin to participate at the summits. Yeltsin had to learn that the G7 was not the place for a long speech — his first inclination — but that what was important was participation in an unstructured give-and-take conversation.

The US-hosted 1997 summit, held in Denver, was described as the "Summit of the Eight," since agreement to call it the "G8" could not be reached beforehand. That was one step too far, or at least too fast, for several countries. Again, this underlines the importance of the political dimensions of these seemingly small distinctions of language. The commitment to meet in the future as the

7 See Strobe Talbott (2002), *The Russia Hand*, New York: Random House.

G8, beginning with the 1998 UK summit, was a decision made by the leaders in Denver.

Of course, the G7 still meets at the level of finance ministers and senior officials. The Russians may be invited to participate at the end of these meetings, but they do not particularly like this arrangement. One would think the G7 countries might have learned that there is a downside to inviting people into the room partway through a meeting, as they inevitably have to wait in an anteroom beforehand. But the G8 seems not to have learned that lesson. When the G7 became the G8, an invitation was extended to the BRICS (Brazil, Russia, India, China and South Africa) countries to participate in part of their meetings. The result was increased resentment at being excluded, rather than satisfaction from being at least partially included. No one, and especially a head of government, likes to feel they are receiving second-class treatment, joining the party only for dessert and coffee.

The G20 began its life at the level of finance ministers. The purpose of the G20 was to be more inclusionary, in recognition of new global economic realities. The G20 has been cautious to not enlarge its agenda. It may be the steering mechanism for international economic issues (see other articles in this series for how well it is doing), but it has stayed clear of the major political issues of the day. That is partly out of a belief that it should remain focussed on its central responsibilities and stated commitments, but also because a number of countries either don't want a broader global steering committee at all or because some feel such a committee already exists in the form of the UN Security Council (again, there are arguments about its effectiveness).

When the G20 started to meet at the head of government level in 2008 (in Washington, DC), many people believed the G8 would disappear. That has not happened. Nor have the G7 finance ministers stopped meeting, despite the fact that they also meet as the G20. Heads of government are finding the burden of attending an ever-increasing number of international meetings very heavy. The result is that while leaders used to meet for the better part of two days, that is no longer the case. The meetings and opportunities for informal discussions to take place over drinks and dinner are much reduced. Moreover, at the G20 meeting, with so many heads of state, plus invitees, and heads of international institutions "at the table," the room dynamics have changed — and not for the better. There can be as many as 500 people in the room. There are reasons why the invitees and the international institutions are present, but there is a cost as well — less time for building intimate relationships amongst leaders being the major one.

The Mexican presidency of the G20 made serious efforts to have more time in less formal meetings, to thereby engage participants in stimulating discussions. These seemingly logistical issues can be crucial to the success or failure of summits. If an agenda is too technical, it is unlikely to engage the interests of most leaders. Summits are at their best when leaders discuss what is on their minds. They are not useful when leaders are reading prepared statements. Let us hope the Russians maintain and build on the Mexican G20 success in this regard. Much will depend on the Sherpas, and on contacts directly between leaders in the run-up to the summit.

Typically, the host country puts forward an initiative. It is interesting that Russia has put forward "fighting corruption" as a priority this year. One can argue that fighting corruption is essential for the international economy to properly function and grow, so adding this initiative does not really involve enlarging the agenda. The measures proposed include:

- "interdicting" foreign bribery;
- combatting money laundering;
- denial of entry for "corrupted" officials;
- training; and
- financial transparency and disclosure for public officials.

These are all worthy objectives, although they are not new ideas. We can only hope the specific initiatives that are decided are effective, and commitments go beyond simply paying lip service.

One way for the G20 to ensure it has an innovative, productive agenda would be to focus specifically on other emerging corruption-related issues that have a clear impact on the global economy. Cybercrime is one such issue that is a major problem (and Russia is in the middle of it). One hopes that Russia will commit itself not only to fighting corruption, but also cybercrime. Both are integrally important to the health of the global economy.

Not yet on the G20 agenda, but worth consideration, are the broader issues of Internet governance. The Internet is an increasingly important part of the global economy. It permits relatively cheap communication of voice and of data, as well as extraordinary access to information. It clearly contributes to economic growth, although some have suggested that the cost of cybercrime may cancel this out. The costs must include not only the value of what is stolen, but also the mounting costs of designing and redesigning Internet security software and hardware.

The G20 countries are, however, badly divided on Internet governance, and have been for many years. One potential outcome is that the global integrated Internet would be no more. Cybercrime would be a place to begin to engage in discussions of Internet governance. There are important divisions as to whether the present so-called "multi-stakeholder" governance of the Internet can be improved or whether the Internet should be "managed" by the International Telecommunications Union or some newly created body of the United Nations. The key split is between those who highly value "freedom" of the Internet and those who believe that sovereign governments should "control" the Internet. The waters have been muddied by leaks from the US National Security Agency. There is agreement, however, that more must be done to ensure that developing countries have enhanced access to and, more generally, benefit from the Internet.

While there is an argument that the world needs a more comprehensive global steering committee — a body that would address global political issues such as Syria, Iran and North Korea — and suggest the G20 is ready-made to step into this role, it is clear this is a jump too far for the G20 at this time. Nonetheless, these political issues will be addressed in bilateral meetings in September, as they are front and centre in leaders' minds. I would argue that having the G20 address cybercrime and Internet governance more generally would not enlarge the agenda, but would, in fact, contribute to strengthening the global economy.

In any event, it is too late for much else to happen this year. Summit preparations are already too far advanced. But there is always next year. G20 summits are about high politics, not just economic policy. Leaders, above all the leader of the host country, need to show they are leading. This is especially important for President Putin in 2013. My idea is that leaders, with Australia's support, or even better, at Australia's initiative, could decide in St. Petersburg that in 2014 they should discuss inter alia the future of the Internet and how it should be governed. That would be an excellent political and economic outcome from the Russian-hosted G20.

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Barry Carin has served in a number of senior official positions in the Government of Canada and played an instrumental role in developing the initial arguments for the G20 and a leader's level G20. A Senior Fellow at CIGI, Barry brings institutional knowledge and experience to his research on the G20, international development, energy and climate change.

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Paul Jenkins provides strategic advice to the Global Economy Program, including activities related to CIGI's partnership with the Institute for New Economic Thinking and broader macroeconomic issues. His own research focusses on international policy coordination and financial stability, with a particular interest in the G20. From 2003 to 2010, he served as Senior Deputy Governor of the Bank of Canada.

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ABOUT CIGI

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; global security; the environment and energy; and global development.

CIGI was founded in 2001 by Jim Balsillie, then co-CEO of Research In Motion (BlackBerry), 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 (BlackBerry). 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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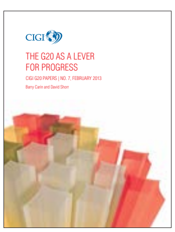
POLICY BRIEF

The Sovereign Debt Forum: Expanding Our Tool Kit for Handling Sovereign Crises
CIGI Policy Brief No. 28
Richard Gitlin and Brett House
August 2013

The world lacks a simple and effective mechanism for articulating and agreeing on the terms in resolving sovereign debt crises. The creation of a sovereign debt forum (SDF) is proposed in this policy brief. The basic features of an SDF are considered, in the hope of catalyzing discussion by sovereigns, creditors and other stakeholders toward future action on an SDF.

PAPERS

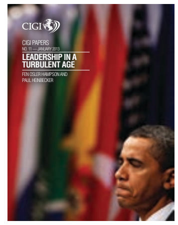


The G20 as a Lever for Progress
CIGI G20 Papers No. 7
Barry Carin and David Shorr
February 2013

The failure of many observers to recognize the varied scale of the G20's efforts has made it harder for the G20 to gain credit for the valuable role it can play. This paper offers five recommendations for the G20 to present a clearer understanding of how it functions and what it has to offer.

Sustainable Development and Financing Critical Global Public Goods
CIGI Papers No. 10
Barry Carin
January 2013

The idea of a "Green Super Fund" can be framed as a positive sum game, with a win-win-win allocation that would garner widespread global support and ultimately be accepted by all the major players.



Leadership in a Turbulent Age
CIGI Papers No. 11
Fen Osler Hampson and Paul Heinbecker
January 2013

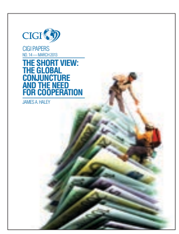
Sound economic policies, which are in short supply in most key nations of the world, are fundamental to national security and international leadership. The United States must work alongside others — and accept that others will sometimes work together without it — to deal with a wide range of persistent and emerging global problems and issues.

Another Fine Mess: Repairing the Governance of International Financial Regulation
CIGI Papers No. 12
Pierre Siklos
January 2013

Five years after the onset of the global financial crisis, policy makers seemingly continue to believe that the severity of any crisis-led downturn can be divorced from its source. Credibility in new international regulatory frameworks must begin at home with a determination for monetary policies to work together.

Strengthening International Financial Institutions to Promote Effective International Cooperation
CIGI Papers No. 13
Thomas A. Bernes
February 2013

The current global financial crisis resulted from the failure of major economies and global institutions to address emerging fault lines in global financial markets and global institutions. No single country has the ability or resources to fix things on its own — a near-unprecedented degree of collective action is required.



The Short View: The Global Conjuncture and the Need for Cooperation
CIGI Papers No. 14
James A. Haley
March 2013

Successfully addressing both short- and medium-term policy challenges requires policy horizons much longer than the myopic orientation adopted by too many, this paper argues, and it will take global economic leadership to secure the cooperation that is needed to strike a judicious balancing of adjustment burdens.

AT THE SUMMIT

Domenico Lombardi **Susan Schadler**

Domenico Lombardi, Director of CIGI's Global Economy Program, and CIGI Senior Fellow Susan Schadler will be at the International Media Centre throughout the G20 Leaders' Summit on September 5-6, 2013 in St. Petersburg. They will both be available for media interviews and briefings.

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