GLOBAL ECONOMY

Addressing the need for sustainable and balanced economic growth, the Global Economy program is a central area of CIGI expertise. Its importance was heightened by the global financial crisis of 2009, which gave impetus to formation of the G20 leaders’ summits — a development for which CIGI experts had advocated.

The Global Economy area includes macroeconomic regulation (such as fiscal, monetary and exchange rate policies), financial regulation (such as requirements on capitalization of banks) and trade policy. We live in an increasingly interdependent world, where rapid change in one nation's economic system may affect many nations. CIGI believes improved governance of the global economy can increase prosperity for all humankind.

ENVIRONMENT AND ENERGY

Planet Earth faces severe and growing stresses as a result of human development and consumption. The Environment and Energy program at CIGI focuses on governance issues related to climate change, geoengineering, alternative energy and agriculture and food security. Ideas and dialogue arising from CIGI’s fall 2010 conference, Climate of Action, are helping to define the program’s ongoing work plan.

As institutional reforms are proposed and non-state and hybrid governance mechanisms emerge, a clear need exists for incisive analysis and relevant policy advice. The program’s overall ideal is to develop innovative policy responses that are adopted to ensure global sustainability.
DEVELOPMENT

This program of CIGI research and policy analysis explores issues such as aid, health, education and equality from an international governance perspective. Researchers will study innovative development programs, including new private-public partnerships. Projects include the Africa Initiative, a five-year undertaking with Makerere University examining policies in health, migration and the crosscutting issue of climate change.

The program supports policy development in line with the UN Millennium Development Goals, which range from halving extreme poverty to providing universal primary education by 2015, and is exploring how the development paradigm may evolve past 2015. Success in these areas of international governance would help to safeguard human rights and result in a more equitable world.

GLOBAL SECURITY

Since humans first began to deploy weaponry in inter-tribal warfare, our greatest danger has been, collectively, from ourselves — and at no time has the risk been greater than in the modern age, with its weapons of mass destruction. CIGI’s Global Security program focuses on a range of issues in peace, conflict and security.

Researchers in this program are exploring the need for United Nations reform, strengthening and reform of the International Atomic Energy Agency, growing concerns about global cybersecurity, and security sector reform in fragile, collapsed or post-conflict states such as Afghanistan, Haiti and Sudan. Impact in this area of international governance will help foster a more secure and peaceful world.
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INTRODUCTION

It is now over two years since the leaders of the Group of 20 (G20) economies met in Washington, in November 2008, to deal with the shock waves created from the global financial crisis. The unprecedented circumstances of that crisis led former US President George W. Bush to call the leaders into session for the first-ever G20 summit. Until that moment, the G20 had functioned exclusively as a group of finance ministers and central bank governors (from 19 countries plus the European Union) consulting on ways to cooperate on the global economy. With the elevation of the G20 to the level of heads of government, much has changed. There have been five summits to address global economic issues, and while the finance ministers continue to meet, they do so under the broad direction of the leaders. The G20 is now the main global forum on economic matters, surpassing the Group of 8 (G8).

The unique potential of the G20 lies in its composition representing both rich-world industrialized economies and the key emerging markets, such as Brazil, China and India, whose size and economic weight mean that they must cooperate together as indispensable participants in global problem solving. Starting with the summit in Washington at the outbreak of the financial crisis and the second meeting in London in April 2009, the G20 dramatically broke new ground as an improvised “crisis committee,” steering the global economy away from potential catastrophe by undertaking coordinated actions to stabilize the financial system, improve financial regulation and stimulate national economies. At the Pittsburgh summit, in September 2009, the leaders reaffirmed earlier commitments to work together and broached new collective actions. It was at Pittsburgh that the leaders declared the G20 to be the “premier forum” for international cooperation among their economies.

Further summits took place in 2010 — the first in Toronto, Canada, in June, the second in Seoul, Korea, in November. The Toronto summit was marked by debate about the speed of the ongoing global recovery and consolidation measures. An item of immense concern to the world’s developing countries was added to the agenda and subsequently taken up with enthusiasm in Seoul: the issue of development. Also at Seoul, the leaders signalled their intentions to cooperate to achieve “shared” growth.

Within a few short years, the G20 has evolved from semi-annual meetings of finance ministers and central bankers, initiated after the Asian financial crisis of 1997, to an apex body of government leaders collectively attempting to grapple with the major economic issues of our time. Both the G20’s agenda and process have been fraught with challenges.

The Centre for International Governance Innovation (CIGI) was among the first to suggest that the G20 should meet at the heads of government level. In the few years prior to the financial crisis, work undertaken by CIGI and its think-tank partners helped establish the feasibility and potential effectiveness of an expanded leaders’ forum. The role of the G20 continues to have a prominent place in CIGI’s research, conferences and publications work, including the dissemination of commentaries and papers on the major substantive and institutional issues.

The commentaries assembled in this volume were published just prior to the Toronto and Seoul summits, respectively, reflecting the debates and critical policy questions under discussion at that time. The authors are drawn from CIGI’s distinguished roster of scholars and practitioners. Significantly, the analyses and concerns presented in these pages remain relevant to preparations for the next summits, in France in 2011 and Mexico in 2012.

Max Brem
February 2011
In normal times, political leaders show very little interest in the arcane details of international financial regulation. The worst global financial crisis since the 1930s has changed that.

When the G20 leaders held their first meeting, in Washington in November 2008, they focused almost exclusively on financial regulatory reform issues. This topic has remained at the centre of every G20 leaders’ summit since, and it will be just as important in Toronto in June. Although some important progress has been made, the G20 has yet to tackle some of the most important, but also most difficult, parts of the reform agenda. These relate mostly to the implementation of macro-prudential regulation.

Before the crisis, international financial regulation primarily concerned the stability of individual financial institutions. The 2008 crisis highlighted the need to complement these micro-prudential rules with macro-prudential ones that protect the stability of the system as a whole.

One example is the proposal to require banks, in good times, to build up buffers that can cushion them in times of stress and thus help to minimize self-reinforcing credit booms and busts. The G20 has endorsed the use of such “counter-cyclical” buffers, but has yet to agree on how to implement them.

The 2008 crisis highlighted very clearly the social and financial costs, both to the taxpayer and the wider economy, when these institutions collapse. The G20 leaders drew the important lesson that these institutions must be subject to special kinds of regulation. At the Pittsburgh summit in September 2009, they concluded that “our prudential standards for systemically important institutions should be commensurate with the costs of their failure.” They set the end of 2010 as the deadline for reaching agreement on how to regulate them.

The urgency of this task has grown. The post-crisis financial landscape is populated by even larger and more interconnected financial institutions.
than before. Further, they are more keenly aware than ever that, due to their systemically significant status, they are backed by local capital that can be mobilized in times of trouble.

The importance of creating international standards on macro-prudential issues — even if only at a principles-based level — cannot be overstated. After the global financial crisis of 1997-1998, policy makers also expressed their desire to address systemic risks. Once the memories of the crisis faded and the urgency of reform dissipated, however, regulators lacked the tools and incentives to address the build-up of systemic risks, despite various warnings from bodies such as the Bank for International Settlements.

Our prudential standards for systemically important institutions should be commensurate with the costs of their failure.

This mistake can be avoided by hardwiring a focus on systemic risks into the international regulatory architecture. Of course, international financial standards are merely “soft law” without enforcement mechanisms, but they are widely followed and may be even more so in the coming years because the Financial Stability Board (FSB), created by the G20, has developed new mechanisms for encouraging compliance, including a new peer review exercise.

If macro-prudential regulations are to be implemented effectively, the G20 must confront a final, and more political, issue more squarely. Macro-prudential regulation requires regulators to take a strong stance against market trends, such as cyclical booms or growing concentration and risk-taking within the financial system. If regulators’ relationships with private market actors are too cozy, this role will not be performed well.

In their reform discussions, the G20 leaders have yet to address the risk of private sector “capture” of regulatory policy making directly. The neglect is odd given how many analysts lay considerable blame for the crisis on this very phenomenon.

International standard-setting should tackle the subject explicitly. For example, standards could be developed to address the problem of “revolving doors” by requiring mandatory public disclosure of all past and present industry ties of regulators, and/or specifying a minimum number of years before regulators can shift to private-sector lobbying and vice versa.

International standards for counter-cyclical buffers could also encourage their adjustment based more on rules rather than discretion in order to help regulators resist private lobbying. Standards that reduce complexity and opacity — such as simple leverage rules, or forcing credit derivatives onto exchanges — will also constrain the ability of market participants to dominate regulatory debates through their expertise. In addition, international regulatory bodies, such as the FSB, could make greater efforts to counter-balance private sector influence by consulting with other societal groups as well.

There is, thus, much to be done on the international regulatory reform agenda at the Toronto G20 summit. 2010 will likely be seen in retrospect as the decisive year that determined whether this post-crisis reform initiative succeeded or failed. Success will only be achieved with strong political leadership coming from the leaders’ level.
As the G20 summit approaches in Toronto, there is much hope that this expanded club of world leaders will enlarge on the steps its members have already taken to promote global prosperity by coordinating their policies in the economic, financial and monetary realms.

The G20, in one of its most important actions to date, established the Financial Stability Board (FSB) out of the former Financial Stability Forum, a small, obscure organization located in Basel, Switzerland, in the Swiss mountains. With the mandate given to the FSB, combined with a reinvigorated and recapitalized International Monetary Fund (IMF), in Washington, DC, there is talk of a new and better coordinated international financial system. Lessons from previous years suggest, however, that some familiar political realities will intrude to challenge the efficacy of this new post-Bretton Woods order, despite the initiatives the G20 has tried to put in place to combat the dangers of contagion and moral hazard in the global economy.

Realism suggests it may not be long before the honeymoon ends and the skirting of responsibilities returns to the fore...countries will tend to row less than their share in the joint movement toward financial stability.

After the financial crises in the late 1990s and early 2000s, the G7 industrialized economies developed a set of international financial standards that, had they been applied, might have helped prevent the crisis that hit the global economy in 2008-2009. Specifically, the G7 asked the IMF (with the assistance of the World Bank) to monitor member countries’ compliance with these standards through the mechanisms of the IMF’s Financial Sector Assessment Program (FSAP) and the Reports on Observance of Standards and Codes. In the aftermath, some of the most important countries, including the United States and a number of emerging economies, insisted that the process of complying with the standards be made voluntary, and delayed or refused (the US and China)
to commit themselves to undergoing the FSAP process — in hindsight, a tremendous folly, given that the US financial system was at the epicentre of the most recent financial crisis. Canada was the first country to submit itself to review under the FSAP and was followed by a range of countries. Some acquiesced because they saw advantage or because they had little to lose or gain; others agreed because they needed access to IMF financing. It has been noted that the main reasons behind the failure to implement the financial standards were that disclosure was voluntary for some and that many emerging market economies had no say in the decision-making process that led to the creation of the standards.

The advent of the G20 with its major emerging market economies should add legitimacy to the FSAP process and improve the mutual stake in coordination. The G20 envisions collaboration between the IMF and the FSB in monitoring member countries’ compliance with international financial standards and on standardizing regulatory mechanisms in banking and other financial services. In the words of Managing Director Dominique Strauss-Kahn, the IMF will be the monitor of the “basic plumbing through which global capital flows”; the FSB will be the coordinator of information on what national regulators are allowing to pass through the drain. The idea is to use the moral suasion of a G20 peer review process, where by countries are encouraged or shamed into fully disclosing even politically sensitive information, all in the interest of maintaining global financial stability.

While this approach is a definite step forward, realism suggests that it may not be long before the honeymoon ends and the skirting of responsibilities returns to the fore. The problem is the potential for countries to free ride: countries will tend to row less than their share in the joint movement toward financial stability. The problem of voluntary disclosures by national authorities to international bodies is that there are strong political and market incentives for countries to appear as stable as possible. The crisis in Greece today underscores precisely this problem, and has greatly affected the European Union and the euro zone. International economic coordination will continue to face the reality that national officials and markets will act in their own interests and strive to first satisfy domestic constituents before meeting their international obligations. In some respects, the G20 is entrusting the IMF and the FSB to not only help coordinate information sharing and provide oversight, but also to leverage the technocratic weight of their staffs to keep national and market interests in check. The reality, however, is that neither organization will be immune to external politicking, particularly to challenges of their analyses from powerful members. Moreover, imagine the uproar of legislatures, unions, banking or business interests at the mention of national regulatory changes being imposed by either the FSB or the IMF. Neither organization has the power to challenge national sovereignty. Both organizations will remain dependent on moral suasion. Despite the G20’s ambitions, the IMF and the FSB will continue to be hampered by individual governments’ determination to preserve their respective national interests.

The IMF will be the monitor of the “basic plumbing through which global capital flows.”
WHEN GOOD INTENTIONS ARE NOT ENOUGH

DANIEL SCHWANEN AND PIERRE SIKLOS
MAY 14, 2010

In the midst of the worst global economic crisis since the Great Depression, pledges of a cooperative approach among large economies to address the sources of instability in the global economy were one truly hopeful sign. Since then, the combination of worldwide extraordinary monetary ease and fiscal stimuli has enabled the global economy to escape a slump of epic proportions. In spite of these responses, the world economy has suffered a major economic contraction.

The G20, at its third meeting in Pittsburgh in September 2009, recognized that its members “have a responsibility to the community of nations to assure the overall health of the global economy” and announced a new “Framework for Strong, Sustainable and Balanced Growth.” Within this framework, leaders pledged to pursue responsible fiscal policies, prevent destabilizing credit and asset price cycles, promote more balanced external accounts, undertake structural reform to increase their potential growth rates and, where needed, improve social safety nets.

That is the good news. The bad news is that it is far from obvious that the will to cooperate, re-affirmed on April 23, 2010 by the G20 finance ministers and central bank governors, can translate into positive results going forward. The strident verbal shots taken by some G20 members at the perceived failure of others to address courses of action that apparently contributed to the 2008 crisis are a sure sign that cooperation is easier said than done right. The Pittsburgh summit may thus be remembered as the high-water mark of G20 cooperation on global imbalances, unless officials draw some lessons from past attempts at international economic reform. What are these lessons?

First, there is the danger of overreaching. As an example, the 1922 Genoa Conference failed largely because participating countries fell back on their parochial interests while ignoring political problems that made it exceedingly difficult to come to terms with economic reforms. The sheer magnitude of the economic problems and rivalries in post-war Europe, the emergence of the Soviet Union and United States isolationism, overwhelmed the purpose of the talks. Today, we are witnessing elements of the same phenomenon. A grand redesign of the world’s financial infrastructure was the essence of the London G20 summit in April 2009. Since then, Great Britain has sparred with its European counterparts over controlling executive salaries and derivatives legislation. There is debate on whether draft financial reform legislation in the United States truly addresses the core issues, such as the problem of institutions that are “too big to fail,” and meets Europe’s insistence that hedge funds’ activities should be severely circumscribed. Americans and others may well complain that the European Union (EU) has, so far, been unwilling to tackle its own failure to come up with consistent banking and financial supervision rules. Reform, therefore, may well be limited to patchwork changes that will not reduce the prospects of a future global financial crisis.

Second, the G20 must agree on “core” principles to ensure that all members are accountable to the international community. Just as important, the set of economic principles need to be internally consistent with each other. When the Bretton Woods Conference was held to create a new international financial system at the end of World War II, the leading powers, namely the United Kingdom and the United States, effectively implemented a system based on pegged but adjustable exchange rates, and on domestic policies geared to ensuring that domestic imbalances that threatened international economic stability...
would be avoided. But a central flaw in the setup was ignored, namely that a pegged exchange rate could not be sustained when the country at the centre of the world’s trading system was perennially generating excessive balance of payments deficits. Such global imbalances could not be contained, either because the trigger was a large economy that would not willingly bend to the will of the international community, or because countries could always rest on the imperative of protecting their sovereignty over policy choices. The ensuing failure of Bretton Woods in the early 1970s was followed in short succession by two oil price shocks and a decade of stagflation.

Third, if the G20 is to succeed where previous attempts at cooperation failed, there has to be a clear demonstration of leadership by key members of the group. At present, this means that China and the United States must demonstrate how they plan to manage a mutually coherent approach to the continuing threat from ongoing global imbalances. There is nothing to be gained in asking a body such as the G20 to coordinate a variety of policy variables when nations at the centre of what ails the world economy are incapable of demonstrating any willingness to bear the required burden of adjustment. The history of the EU is an instructive example. When the euro was introduced, Germany insisted on including a Stability and Growth Pact to accompany the rules for monetary stability in the euro area enshrined in the Maastricht Treaty. Germany would, however, soon undermine the very rules of fiscal probity it insisted that other countries meet because it was domestically convenient to do so. It is even more ironic that, as Greece and other euro area countries experience debt problems, Germany continues to insist that the rest of the euro area toe the line of fiscal rectitude when there are no guarantees that Germany will invoke for itself some escape clause in the future. Indeed, the tortuous recent negotiations over financial support for Greece reveal an often neglected aspect of reform, let alone global reform, namely whether the public most affected by the change has the will to tolerate the costs of changes perceived to be large. Matters are exacerbated when the changes are arcane, such as when the subject of reform is the financial system.

The bottom line is that cooperation is essential but not sufficient.
The advent of the G20 leaders’ summit is a major advance in international economic policy governance. The forum has been successful in broadly orchestrating the return to stability in the international financial system by agreeing on fiscal and monetary measures in developed and many emerging economies, and by assigning new responsibilities to international financial institutions. However, expectations of what can be accomplished in steering the world economy onto a stable growth path, particularly in the short term, have to be both realistic and informed by the past history of international economic coordination.

It is useful to remind ourselves that there have been many instances of successful coordination among major economies when the correct conditions have been present. Conversely, there have been situations where the barriers to reaching agreements have been insurmountable. An understanding of these different circumstances can inform a nuanced assessment of what can be expected from the G20 in its expanded economic role.

Historically speaking, international coordination has tended to be successful when the issue at hand has been clear-cut, the solution has been isolated in previous negotiations and the different parties have all stood to benefit from the outcomes. Examples include trade and debt negotiations or the creation of special funding arrangements. For instance, eight successful rounds of multilateral trade negotiations have reduced the average tariff levied on manufactures by developed countries from 40 percent in the early 1940s to under 4 percent currently. Actions benefiting only developing countries, such as the Generalized System of Trade Preferences and funding for soft loans by the International Development Association, an arm of the World Bank, were undertaken because, at the time, economic analysis held that such actions would assist their development.

Ideological differences can prevent economic agreements. For instance, the 1922 Genoa Conference called to discuss the integration of Russia into the European economic system, broke down on the right of governments to nationalize private property. But
Ideological differences can prevent economic agreements.

Despite an unfavourable political atmosphere, agreement was reached at the Genoa Conference on technical matters that became important later. These milestones included the establishment of a committee of central banks to apprise each other of their policies, and the adoption of the gold exchange standard in order to economize on the use of gold — a recommendation that found its way into the agreement that established the International Monetary Fund (IMF). Later, agreements were reached mainly among France, the United Kingdom (UK) and the US on German reparations — the Dawes Plan of 1924 and the Young Plan of 1929.

In the 1960s, agreement was reached on a number of important monetary issues because technical analysis and analytical research conducted at international organizations and universities had pinpointed the main problems and identified possible solutions, and all countries wanted to prevent a collapse of the international monetary system. The result was the General Agreement to Borrow, which required special funding arrangements under the IMF; the issuance of Special Drawing Rights by the IMF; and the operation of the Gold Pool.

By contrast, conferences held to tackle broader issues where the solutions were not obvious have invariably resulted in a stalemate. This has been the case particularly when the issue has involved the impact of monetary factors on exchange rates. The attempt to rebuild the international monetary system in the 1970s after the collapse of the Bretton Woods fixed exchange rate system failed. The differences were papered over and we had what many analysts called a non-system. Forty years earlier, the London Conference of 1933, which was organized to stabilize exchange rates, failed to reach agreement because the US did not want to limit the extent of dollar devaluation.

Agreements are particularly difficult to reach on exchange rates; national interests differ because exchange rates affect large parts of the economy, not only the export sectors but also those industries that compete against imports. Often, the threat of protection is used to achieve revaluation. Prominent examples include Germany and Japan accepting revaluation at the Smithsonian Conference in 1971, or the Japanese acceptance of the Plaza Accord in 1985.

Management of the world economy can run into additional problems. There are no instruments at the international level comparable to domestic monetary and fiscal policy. Leaders cannot make firm commitments to define monetary and fiscal policies because central banks are independent in many countries and fiscal policies require the approval of parliaments. Policies to help the world economy can lead to conflicts with domestic interests, particularly parliaments, which are more geared to the concerns of their constituents and, therefore, to domestic issues. This was illustrated by the conflict that the fledgling US Federal Reserve System faced in the 1920s between the need for a low rate of interest to support England’s continuation on the gold standard, and the need for higher interest rates domestically to restrict speculation. There was substantial coordination between Montagu Norman, governor of the Bank of England, and Benjamin Strong, governor of the Federal Reserve Bank of New York, in the 1920s to keep interest rates low in the US in order to encourage a flow of funds to the UK, helping to keep the UK on the gold standard. Strong was able to coordinate policies even in the face of stiff opposition, including opposition from Congress. Later, governors of the central banks of France and Germany joined the meetings between Norman and Strong.

In light of these historical examples, what may we expect from the G20? Undoubtedly, discussions among the leaders at summits can lead to substantial convergence in views regarding the likely performance of the world economy, and leaders can use the opportunity to exchange views regarding the policies likely to be adopted in their countries. This is a form of indirect coordination that feeds into policy making in the individual countries. Summits also provide leaders with the opportunity to take back to their domestic constituencies (parliaments, financial sectors, the media and other influential groups) the expectations of other leaders about the policies that should be adopted by each of the countries. Such feedback is necessary to help convince national parliaments to adopt more globalist policies.

Interaction at the G20 summit will, therefore, lead to greater consistency of monetary and fiscal policies than will occur otherwise. In addition, the more credible the technical analysis available to G20 leaders, the greater the likelihood of a convergence of views and consistency in policies. In conclusion, regular interaction among G20 leaders, supported by sound technical analysis, will help build trust among the leaders and result in greater coordination of macroeconomic policies over the long term.
International trade is, in effect, the circulatory system of the contemporary world economy. Leaders at the upcoming G20 summits, in Toronto this month and in Seoul in November, will want to spend some of their time discussing international trade, both what they should and should not do about it, individually and collectively, as they attempt to provide leadership and improve prospects for the betterment of the world economy.

Given that the world economic recovery is still fragile and tentative at best, leaders should adopt a two-part strategy with respect to trade. In Toronto on June 26-27, they should firmly commit to resisting new, unilateral protectionist measures as part of their economic recovery/stimulus packages or as part of their economic policies generally, and to abolishing as quickly as possible such trade-restrictive measures as increased tariffs, subsidies or “buy local” purchasing requirements that have been imposed over the past two years due to the economic slowdown.

For some G20 countries, it could be difficult to make good on even such a minimal commitment of this sort if the executive branch does not control the legislative branch; for others, such as Canada, this “do no harm” trade commitment would be easy to follow through on. Nevertheless, as a statement of direction and responsibility, G20 leaders would be signalling that: open, global markets

Why not get started now with strong, forward-looking declarations of support for the trade system?
are indispensable to sustainable prosperity looking ahead; a robust global trading system is a central component of economic, social and environmental policy in the future; and all countries — rich and poor, emerging or already fully industrialized — have a stake in, and responsibility for, the international trade regime.

By the time of the Seoul summit in November 2010, the pace and course of the economic recovery will be clearer, and policies and regulations regarding the financial sector will have been well discussed and perhaps implemented. The G20 leaders will be able to turn to the more specific, activist parts of their 2010 trade commitments by: ordering their trade ministers and officials to remove as many obstacles as possible standing in the way of an ambitious outcome for the Doha Development Round in 2011, as called for in the September 2009 Pittsburgh Summit Declaration, and report back on progress no later than March 2011; reasserting the importance of development in the trade system and in trade negotiations by taking concrete actions on cotton, agricultural subsidies, aid for trade-related infrastructure and other poverty-reducing measures; and instructing those at home and in international institutions to undertake a concerted, organized program of research and dialogue with all stakeholders (business, environmental, human rights organizations and others) on trade-related issues likely to arise over the coming decade. These latter issues include: trade and climate change; trade and services, including technology- and idea-related services; trade and investment; trade and poverty reduction; and trade and labour mobility.

We know that these and other issues lie ahead and will shape the nature and performance of international trade beyond the economic recovery. We also know that the global economy will return to strong, sustainable, and balanced growth while reducing poverty levels around the world as integrative supply chains are rebuilt in an increasingly open, rules-based market environment. Why not get started now with strong, forward-looking declarations of support from the G20 leaders at the 2010 summits? We will all benefit from these actions if done properly and collectively.
President Barack Obama has played a key, visible role at recent summits: defusing divergent viewpoints between China and France on tax havens at the London G20 summit in April 2009; co-chairing a session on climate change financing at the G8 summit last July in L’Aquila, Italy; hosting the third G20 summit in Pittsburgh in September; and, this past April, convening the nuclear security summit of 47 nations in Washington.

So, yes, the US still considers itself to be a leader, even the leader in summits and in the world. Why not? Just because a unilateralist US president viewed the world as his oyster for eight years and assumed the role of “decider,” forging a new profile for US exceptionalism, does not mean that today, the US under a very different president, must recoil in a corner, plead repentance and pretend it is a shrunken violet — far from it. The world should be glad that the US still thinks of itself as a leader, albeit a different sort of leader.

The fact that the US is still the world’s hegemon on many matters does not mean it is basing its leadership on the notion of being “Number One.” The US is now a number one among many, a leader among other leaders, a country seeking common ground, rather than only the higher ground for it to stand on. The Obama administration seems committed to what we might call “embedded multilateralism,” where US leadership is embedded in the varied mechanisms, formal
institutions, “Gs” and other informal arrangements in which the US works with others.

Whereas the idea of “Number One” was central to the Bush administration, the idea of singularity is anathema to the current administration led by Obama. The idea of duopoly, that the US and China are the two superpowers who will decide everything — a notion more popular in the press than in policy — is as unappealing in official circles in Beijing as it is in Washington. China and the US are fully aware of their respective scale, power and importance, but precisely because of the immense lead that these two countries have in most metrics of power, they both find it more useful to engage in embedded multilateralism than to flaunt their weight, visibly exercise their power and appear hegemonic.

The G20 grouping of countries is an illustration of the value of embedded multilateralism for the US and for China. The G8, with four Western European countries, two North American nations and Russia and Japan, embodies and symbolizes the polarization in global politics between “the West and the Rest” rather than resolves it. The G8+5 (Brazil, China, India, Mexico and South Africa) entailed G8 “enlargement” rather than replacement, and failed to convince the five that they were on equal footing with the eight. The G8+5 was anything but a G13 — not at all.

By contrast, the G20, building off the finance ministers’ grouping created amid the Asian financial crisis in the late 1990s, had 10 years’ experience meeting at the ministerial level when called upon in late 2008 to meet at leaders’ level. The G20 was, and is, a free standing group with a decade of history behind it. No one thinks of the G20 as a G8+12.

From a hegemon’s point of view, the G20 at the leaders’ level — an L20 as The Centre for International Governance Innovation called it even before it came into existence — is an excellent vessel for embedded multilateralism.

The G20 has: six Asian countries while there is only one in the G8; three Islamic countries instead of none in the G8+5; and several mid-powers whose foreign policy hallmarks are multilateralism — Australia, Canada, South Korea and South Africa, to name a few. Think of the advantages of such a diverse group from the vantage point of the most powerful countries. The outcomes that powerful countries are working toward are “embedded” in a broader, more inclusive, more pluralistic setting in which big power politics are contextualized and socialized by the presence of systemically significant countries from all corners of the earth.

The G1 is respected and other participating leaders are aware of US vital interests, but can deal with differences of views and perspectives with the hegemon in the company of others with similar concerns. The G2 dancing duo can work through global imbalances, trade disputes and investment conflicts in a pluralistic setting. There is something more acceptable about doing bilateral business in a forum in which other major countries with interests in the outcomes are present and participating, rather than uninvolved and waiting in their capitals for the news of great power decisions to come down.

Being “Number One” in a multipolar, multicultural, multilateral world is uncomfortable. Being a G2 in such a world is not appealing either. In a twenty-first century world with a global financial meltdown, the threat of planetary burnout, and half the world still poor, the world is really “Number One.” If the global hegemon (for now) or the two great powers play monopoly or duopoly games in the pluralistic world of today, resentment will build, pushback will gain momentum and global leadership will be wrought with conflicts.

If the US is comfortable enough with its continuing status as “Number One” on many matters to not need to assert itself as such, and China is more comfortable, as it seems to be, in working through its relations with the US in a broader setting, then embedded multilateralism would seem to fit the interests of both countries and the world as a whole as well.

This is one of those rare questions where the right answer is really “yes” and “no” at the same time.
In the inevitable frustrations and tensions that occur in bilateral relations, statements have been made and actions taken in recent months that suggest a series of conflicts between the United States and China. For example, at the Copenhagen climate change conference in December 2009, China expressed strong opposition to the US president’s position that international verification of mandatory cuts was a must in fashioning a climate change regime; instead, China insisted that such international verification was a violation of China’s national sovereignty. China expressed strong negative views following the announcement that the US was selling arms to Taiwan. Harsh Chinese words between Google and the Chinese government over the continuing censorship of Google’s Chinese search engine brought yet another conflict between the two countries to the fore. Bilateral tensions have further been raised by insistent demands from the US administration and Congress that China revalue the renminbi upwards, with hints that the US Treasury Department might declare China a currency manipulator. Finally, the Chinese unwillingness to negotiate sanctions on Iran for its refusal to end uranium enrichment also rankled the US.

Unlike other historical rising powers, China is deeply integrated into the world economy and sees itself as part of the current international order.
though the Chinese position on this issue has since shifted.

These public scoldings have filled the airwaves since December 2009. In this charged atmosphere, some analysts suggested that these tensions reflected a change in China’s calculus that it was prepared to accommodate the US. One expert received wide attention: Ian Bremer, president of the Eurasia Group, declared in *The Financial Times* on March 29, 2010, that “Beijing no longer believes American power is indispensable to Chinese economic expansion and the Communist Party’s political survival.” Other experts suggested that China was flexing its muscles with an economically weakened US still seemingly mired in near-recession, while the Chinese had put their recession far behind and had resumed rapid growth.

Then, as quickly as the storm had arisen, the skies began to clear and the prospect of an emerging collaboration, or at the least an improvement of relations, appeared. President Hu announced that he would attend the Washington nuclear security summit hosted by President Obama in April. The two leaders held an hour-long telephone call in which President Hu reportedly called for “healthy and stable” US–China relations. It also appeared that China signalled that it was prepared to discuss sanctions against Iran, which it had apparently refused to do for several months.

How could China’s growing frustration and assertiveness be transformed so swiftly into a willingness to engage in more collaborative behaviour with the US? The answer lies largely in the rather “trigger-happy” reporters and analysts who insist on seeing the US-China global relationship as though it were a kind of horse race — now with one in front and the other racing to catch up. Many experts also mistake Chinese tactical foreign policy moves as somehow reflecting Beijing’s strategic behaviour. In reality, there is little to suggest that China has rethought or altered its strategic stance toward the US and on international relations generally.

For China — the government and the Communist Party — rapid economic growth remains an overwhelming goal and priority. It not only defines a key objective of Chinese policy, but also conditions or limits collaboration with other nations on such key global governance challenges as climate change, energy security, financial reform and macroeconomic policy. True, China may not be fully in accord with the architecture and policies of the current world order, and Beijing remains wary of what it calls US hegemonism; however, there is little to suggest that China aims to overthrow the global system or confront US leadership or even that it desires to dislodge the US from the Asian region. While China accepts that the US is, for now, the only superpower, it insists that China be acknowledged as a great power and that others recognize its paramount concerns in such matters as Taiwan and Tibet.

For China, these understandings and priorities represent strategic interests. Unlike other historical rising powers, China is deeply integrated into the world economy and sees itself as part of the current international order. Beijing has therefore welcomed the expansion of the G8 to include the rising powers through the G20. But participation in this widening leadership circle leaves Chinese leaders unclear about how things will unfold and where they will lead, and thus ambivalent about a leadership role. With such lack of clarity, China will likely oscillate between being a passive receiver of global governance at times, and an active contributor to it in other instances. With its deep economic integration, China may well find that its economy and continued prosperity is too dependent on the global economy to ignore the rest of the world; therefore, China may join in international financial reform and even engage directly in collaboration over global imbalances, though such engagement will inevitably lead to a G20 discussion on the renminbi-dollar exchange rate.

While many G20 countries will likely look to Beijing to act as a global leader — what the US has termed being a “responsible stakeholder”— it is likely that China will fall short of expectations in terms of both ideas and resources. China will step up to the mark on occasion, but not always, and the G20 leaders and others will have to accept that Chinese collaborative behaviour will be slow and, at times, frustratingly cautious. China may well be the part-time global leader.
The G20 presents opportunities and poses challenges for China and other developing countries. As new partners at the global table, they can both raise and pursue issues in the medium to longer term, which are central to their continued growth and development.

China, for instance, needs continued unhindered access to export markets in the Organisation for Economic Co-operation and Development countries, and needs the system to deal with growing numbers of anti-dumping actions and safeguard measures against their exports. The G20 has endorsed a standstill on protectionism. Applying this more strongly than the weak World Trade Organization discipline on trade restrictions is a challenge. China may not wish to maintain the present structure of global financial arrangements in the longer term, and refocusing or even replacing the International Monetary Fund (IMF) by some new global trade and payments entity may be a preferred route. Other developing countries may have similar inclinations. Equally, new rules or arrangements stemming from the Financial Stability Board or the Sustainability Initiative applied uniformly across both developed and developing countries will encounter the issue of sharp differences in financial structures between these economies. Equally, approaches to deal with Africa and other developing countries that are excluded from the G20 may well differ between developed and developing countries.

Developing countries will likely support reforms of the global regulatory and supervisory system.

China has been growing rapidly and it is aware of the increasing power...
provided by its rapid growth. China is developing strong links with other emerging economies in the G20 and is likely to continue its policy of trying to change the rules at the major economic governance institutions in concert with these other developing countries. The relationships between China and India, China and Brazil, and China and Russia are all very complex and often complicated by prior conflicts, but are deepening rapidly. Trade between China and India has grown by 33 times between 1985 and 2007.

China is especially conscious of the potential for the G20 to rewrite the rules governing the operation of the world economy in the medium to longer term, particularly the role of the major economic governance institutions. China, together with other important developing country members of the G20 such as Brazil and India, has the opportunity to shape the rules of international economic governance in ways that reflect its own interests. A major interest of the G7 was to avoid policies that resulted in large misalignments of exchange rates and interest rates. Developing countries would like the institutions of international economic governance to be more responsive to their needs for development, so one may expect a shift in the focus of discussions at the G20 as compared to the G7.

Policy makers in developing countries have, in the past, expressed their disquiet about the limited voice of developing countries currently in the international economic organizations, a view articulated strongly by both India and Brazil. The Chinese have been in the forefront of voicing concerns about the stability of the value of the US dollar in the face of the large deficits in the US budget and the need for an international currency in which countries could hold reserves rather than having to hold dollars. Lack of any other international currency apart from the dollar implies that countries can only fulfill their desire to build up their foreign exchange reserves of US dollars if the US runs a balance of payments deficit. Therefore, the developing view is that if the desire of countries to build up their reserves contributes to the global imbalances, then an end to the global imbalances would seemingly require an alternative international currency.

Chinese policy makers, though expressing their conviction that an alternative international currency is needed, have not acted to disrupt the foreign exchange markets and there has, for now, been only a small reduction in their holdings of US government treasury bills. The Chinese policy makers have behaved responsibly in sustaining the current system and have done nothing to jeopardize its working. Many developing countries, including China, have been diversifying their reserve holdings and holding fewer dollars, but very gradually. Other developing countries are likely to adopt a similar approach as they favour multilateralism.

Developing countries will likely support reforms of the global regulatory and supervisory system. Until recently, the US and China had not participated in the Financial Sector Assessment Program (FSAP) managed jointly by the IMF and the World Bank, that sought to improve supervision of the financial and banking systems and of capital markets and insurance companies. The FSAP also seeks to assess the resilience of the system to shocks. Developing countries have argued that the assessment should extend to all countries, and now the US and China have agreed to be covered by the FSAP.

In the years ahead, the G20 policy makers in developing countries are likely to consult extensively with both developed and developing countries as they seek feasible reforms in the system of international economic governance. China can be expected to be at the centre of negotiations on reshaping the international governance system. With strong economic links to both developed and developing countries, and a strong interest in a well-functioning international economic system, it can play a pivotal role in determining the outcome.
SMALLER DEVELOPING COUNTRIES AND THE G20: ENSURING THEIR VOICES ARE HEARD

ROHINTON MEDHORA
MAY 14, 2010

Born amid turmoil, first as a forum for finance ministers and central bankers in the aftermath of the Asian financial meltdown in 1997 and now as a meeting of heads of government during the current global economic crisis, the G20 must balance twin imperatives — to be broadly representative of the global community yet efficient in decision making and implementation. This background is important, because the G20’s current membership in effect reflects the countries “that mattered” to resolve a financial crisis over a decade ago. A grouping more representative of a global governance system devoted to current circumstances will have to deal with the questions of perceived European over-representation and the exclusion of Egypt and Nigeria. However that issue is resolved, small developing countries are not going to be part of the membership discussion. For them, the goal must be to ensure that their concerns are addressed in whatever configuration of the G20 emerges in coming years.

Resentment among countries excluded from the core should not be underestimated.

A number of proposals, all imperfect, have been advanced to deal with this gap in representation, as fully one-third of the world’s population (albeit representing only 10 percent of the world’s economic output and 25 percent of world trade) is currently unrepresented in a forum hailed as the shape of things to come.

One option is to have the G20 comprise regional constituencies or rotating members from regions. It is not clear that this would be acceptable in many parts of the world, or that if it were, whether it would necessarily result in a superior set of discussions and outcomes. Regional powers are seldom seen as dispassionate in advancing regional issues. It is even less likely that the regional powers would agree to have the region represented by someone other than themselves. Would, for example, India or South Africa be willing to represent their neighbours? Would their neighbours agree to this arrangement? Would India and South Africa agree to rotating membership wherein one of their neighbours held the regional seat for a fixed period?
A variant on the above is to have regional institutions — for instance, the United Nations Economic Commissions or their non-economic counterparts such as the Organization of American States or the African Union — join the G20. In addition to raising the number of members by five or six, it is not clear that many of the possible candidate institutions have the political heft to represent groups of countries in what are essentially political negotiations on complex subjects. Besides, since these institutions contain large and small members, it will be awkward and, in some cases, constitutionally impossible for them to represent only their small members that are not included in the G20.

Another option is to have all G20 decisions ratified by the UN General Assembly. This is appealing as it recreates, at the international level, the bi-cameral legislative process found in many countries, one that reflects both “universality” and “power.” Much would depend on how the G20 might react if the rest of the world voted down one of its decisions, or, more likely, achieved a majority vote through the usual arm twisting and blandishments, but with a considerable use of time and resources.

Variable geometry holds more promise; here, a core group of about 13 countries would be joined by another 10 or so, which would be selected depending on the issue at hand. As long as the remit of the G20 remains, as it currently is, on purely economic matters, there is not likely to be much variety in membership. But if, for example, the G20 were to tackle climate change, overfishing or intellectual property, it is possible that in some instances at least, mid-sized developing countries would find themselves around the table. Still, the resentment among countries excluded from the core should not be underestimated.

Alas, none of these proposals adequately addresses the question of “voice” for smaller developing countries for exactly the reasons that the G8 and the UN General Assembly, at two extremes, are also deemed to have failed in this regard. International relations are fundamentally driven by power and the imperative to deal with crisis. In these circumstances, voice has to assert itself — because it must if the world is to be truly well governed — through subtler means.

A weakness in the current G20 is that discussions are held without an adequate analytical basis on fiendishly complicated issues such as financial sector regulation and climate change. If a mechanism were found to present the range of views and options on any given issue, then this might go some way in bringing the concerns of small developing countries into G20 deliberations. Ideally, this mechanism would not consist of a new, permanent international bureaucracy, but rather use modern technology and creative organization to bring together, for example, networks of think tanks under a light secretariat that marshals the analyses into something G20 leaders and their officials might use.

Small developing countries should not have to rely on their traditional benefactors in the G8 to bring forward their concerns, which in any case, are then sometimes framed unsatisfactorily in terms of benevolence and foreign aid. The inclusion of large, articulate poor and recently poor countries in the G20 fold goes some way in ensuring that hitherto marginalized voices in global discussions are more directly present around the table. (The delegations from India and China each represent at least as many poor persons as in all of Africa.) The G20 process itself might create a dynamic in which smaller developing countries find a way to have their views heard, through some variant of the options listed above. A sound analytical basis for negotiations coupled with a model for giving voice that emerges willingly is going to be superior to one where representation is mechanical and mandated.

The G20 has a limited window of time to demonstrate that it is representative and effective in ways that the G8 and the UN are not. There is a pressing need for a forum where important issues may be discussed frankly and critically by those who have the means to address them — and other countries must believe that their interests are also being taken into account.

The views expressed in this note are those of the author alone, and do not necessarily reflect those of Canada’s International Development Research Centre.
The G20 was born out of the global financial crisis and, understandably, the bulk of its agenda has been focused on financial reform. It is important to remember, however, that in the midst of the financial crisis there was also a global food crisis. The early stages of the financial crisis in late 2007 and early 2008 coincided with sharp rises in food prices. Rapidly escalating food prices at that time directly reduced poor people’s ability to buy food and led to food riots in nations as diverse as Haiti, Egypt and the Philippines.

Many experts attributed the food price spikes at least in part to the widespread movement of investors into agricultural futures markets, which promised higher returns at a time of financial instability. These speculative investments played a role in driving extreme volatility on international food markets, and poor countries that import food were hard hit.

Although international food prices have fallen from their peaks in mid-2008, hunger has only become more pronounced in the developing world. Today, more than one billion people go to bed hungry every night, over 200 million more than in 2008.

Hunger has deepened because developing countries that rely heavily on imported food have found that they have been unable to finance sufficient imports due to the tightening of credit on world financial markets. As a result, food prices have remained high in some developing countries, even as they have fallen in rich countries. On top of this, the overall decline in incomes triggered by the global economic crisis further affected the food security of the world’s poorest people, who spend 50–80 percent of their income on food.

At Pittsburgh in September 2000, the G20 summit leaders recognized the gravity of this situation. On the margins of its pledges to reform financial markets and promote freer international trade, the G20 promised to invest in the promotion of food security. It called on the World Bank to oversee a trust fund of US$20 billion that had been pledged for food security at the G8 meeting in L'Aquila in June 2009. But the G20 could do much more to combat hunger by linking its food security initiative more tightly with its broader economic agenda.

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countries through increased access to technology. This thrust meshes well with the World Bank's most recent agricultural strategy, which focuses on increasing food production in the developing world. Because so many poor countries are now dependent on food imports, building their agricultural sectors to be more self-reliant is clearly an important goal.

However, the narrow focus on a productivity approach to food security misses a big part of the picture. Food security is shaped very much by global economic relationships that directly affect people's ability to access food.

The G20 leaders have expressly called for strengthened regulation over energy futures markets in order to address excessive oil price volatility. A similar case can be made with respect to agricultural commodity futures markets and food price volatility. Concerns about agricultural price volatility are already a driving force in financial reform proposals within the United States, but the G20 has yet to make that link on a broader international scale.

A second issue where the broader linkage could be made concerns the relationship between the international trading system and the vulnerability of developing countries to food price fluctuations. Dependence on imported food in the world's poorest countries has grown over the past 30 years. Huge agricultural subsidies in rich countries have driven down world grain prices for most of that period and pushed many developing country producers out of business.

In Pittsburgh, the G20 endorsed an "ambitious and balanced" conclusion to the Doha Round of international trade talks that have dragged on since 2001. A key aspect of the Doha trade agenda is to reduce the subsidies that rich countries pay their farmers, but progress has been very slow. This issue is in fact one of the key sticking points holding up the entire negotiations. The global food crisis of 2008 should remind political leaders that this issue needs to be addressed in a way that reduces the negative impact on developing countries' agricultural sectors.

The G20 leaders' current view of food security is far too narrowly focused on investment to boost agricultural productivity. The prospect of more food production in developing countries is welcome, but it does not guarantee access to food for those who are hungry. The broader economic context is a key determinant of access.

Unless it explicitly incorporates measures to address food price volatility and the inequities in agricultural trade, the G20 food security strategy is likely to make only partial gains in the fight against world hunger.

The prospect of more food production in developing countries is welcome, but it does not guarantee access to food for those who are hungry.
G20 MEMBERSHIP AND PROCESS: THE UNSPOKEN ISSUES
ANDREW F. COOPER
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Since its elevation to the leaders’ level in November 2008, the G20 appears to have consolidated its position as the hub of economic governance. Moving from its initial role as an improvised “crisis buster,” the forum has begun to take shape as a global “steering committee.” Notwithstanding its immediate institutionalized success, there are now a number of thorny and largely unspoken questions that need further attention. These challenges are especially evident with respect to both the membership and the process of the G20.

From its origins, the G20 suffered from some deficiencies concerning its size and geographic makeup. Although some have claimed that the makeup of the G20 reflects the structural shifts in global power at the start of the twenty-first century, the hold of Eurocentrism jumps out in its composition. In addition to the “big four” established members of the G8 (the UK, France, Germany and Italy), the President of the European Commission also gained entry. Moreover, from the first G20 summit in Washington, DC, the door has been left open for other European entrants. Spain has been the most successful of these additional countries, eventually obtaining the status of “permanent guest.”

This overrepresentation of Europe is exaggerated by the image of the G20 not being inclusive of enough emerging countries. To be sure, all of the so-called BRIC countries (Brazil, Russia, India and China) are members of the G20. But after that, membership is determined not by the current position of individual countries, but by the legacy of the last major wave of financial shocks. For the composition of the G20 at the leaders’ level is a carbon copy of the format of the G20 with respect to finance ministers created in the wake of the Asian crisis in the late 1990s.

The issue of regional imbalance is reinforced by the under-representation of the African continent. Whereas all three North American Free Trade Agreement countries as well as the two anchor countries of MERCOSUR

The G20 should very much be seen as a work in progress.
— Brazil and Argentina — are included in the ranks of the G20, Africa’s participation is minimized. The only country from the entire African continent at the “high table” is South Africa. Regional representation came about only at the second G20 summit in London through an invitation to the chair of the New Partnership for Africa’s Development (NEPAD), at the insistence of the UK host.

The issue of membership is made even more sensitive still by the nature of ownership in the G20 process. Up to now, all of the major hosting decisions have been made by the G8 members. US President George W. Bush called the G20 into action at Washington, DC. UK Prime Minister Gordon Brown personally invited NEPAD to the London summit. US President Barack Obama orchestrated the G20 process at Pittsburgh, Pennsylvania, deciding to have back-to-back G20/G8 summits in Canada at the end of June 2010 plus a stand-alone summit in South Korea in November 2010. Canadian Prime Minister Stephen Harper determined the location and timing of the Muskoka/Toronto summits. French President Nicolas Sarkozy lobbied hard not only for additional European representation, but also for the G8 hosting cycle to continue following South Korea in November 2010. South Korea also has the opportunity to systematize other forms of regional representation. One of the hidden success stories of the G20 process has been the South African initiative to engage the regional “Committee of 10” finance ministers ahead of the G20 meetings, providing an indirect form of access to a cluster of other African countries. This approach could be replicated in other regions or sub-regions.

World leaders turned to the G20 for action at the outset of the economic crisis because it is big enough to be representative while at the same time small enough to be effective. Expanding or overloading its membership will certainly affect both attributes negatively. Yet, if the issue demands it, ample space and flexibility for twenty-first century forms of outreach to countries on a functional basis should be employed. This could be done through meetings with a troika of Sherpas or careful use of variable geometry on key issues. The existence of a permanent G20 secretariat would facilitate such a process enormously.

As witnessed by its organizational dynamics, asymmetric leadership and “unfinished” agenda, the G20 should very much be seen as a work in progress. Indeed, it is the very agility of the G20, in format and delivery, which accords this forum so much promise, especially as it solidifies its role beyond a short-term “crisis buster” to the “premier forum” for international economic cooperation. Given the scope of the G20’s ambition, refining the structure so that it combines a core membership with some degree of accessibility will only enhance its credibility.

The issue of membership is determined not by the current position of individual countries, but by the legacy of the last major wave of financial shocks.
In response to the Asian financial crisis in 1997-1998, finance ministers from about 20 major industrialized and emerging countries met to discuss ways to promote global financial stability and conditions for sustainable economic growth and development. The G20 finance ministers’ and central bank governors’ forum was created at that time. Just over a decade later, in December 2008, leaders of the G20 nations held their first summit, in Washington, DC, to deal with the global financial crisis. In follow-up summits in London and Pittsburgh, the so-called “Washington Consensus” was pronounced dead and the International Monetary Fund (IMF) received a new mandate for comparative analysis. After decades when failures of coordination within and between countries — even within the increasingly integrated European Union (EU) — were met with benign neglect, governments had to face together a global financial crisis that their nations could not address alone.

Notwithstanding the leaders’ joint appearances at the recent G20 summits, industrialized and emerging-market economies have rarely developed coordinated national policy responses to international economic problems, even though their economies are mutually interdependent. This creates a paradox whereby nations are left to deal with a global crisis on their own through domestic policy actions — “together alone.” This paradox is as global as the crisis itself.

The latest developments in the euro zone prove that this paradox is ever-present in the interaction between globalization and governance. Policy coordination at the European level was supposed to be strongest, even before the 2009 Lisbon Treaty gave a formal role to the finance ministers of euro zone member countries alongside that of the EU and its Commission. Over-borrowing of euros by some member countries resulted in higher interest rates for them compared to those in Germany, a problem that became especially pronounced for Greece as it approached near-default on its debts and that was also threatening several other European countries. There followed a lengthy tug of war between Greek government actions and a financial response by global and regional bodies, a situation that only perpetuated market uncertainties and was not eliminated by the final EU-IMF “rescue package.” Ambiguity in response to crisis, especially when not based on proper consultation, is rarely constructive, particularly in a “together alone” pattern, as illustrated by the lack of clear definition of responsibilities between an individual country and the EU.

Paradoxically, economic policy coordination is stifled when it is most needed: countries facing global and regional crises are left to address uncoordinated governance through individual measures. The same problem of coordination failure that we find at the international level occurs on the country level as well, among different government departments and agencies. Governance innovation around coordination of policies is discouraged internally and externally by widespread “groupthink” among stakeholders, which prevents them from finding win-win solutions or implementing them when found. This damaging tribal mentality or groupthink cannot be ignored in a highly interconnected and globalized world.

In the renewed mandate that the G20 has given to the IMF, the latter will play an important role in assessing the performance of G20 members against their collective commitment to economic cooperation as defined...
Peer Pressure to Meet G20 Commitments: A Promising Innovation?

It would be a major governance innovation if the proposed peer review and new IMF mandate succeed, and if “peer pressure by commitment” becomes the primary G20 coordination mechanism.

Even if the possible G20 peer review goes beyond a comparison of exit strategies from the current stimulus programs, it is not likely to have a significant impact in some other areas. In particular, it will not enhance monitoring of the Millennium Development Goals (MDGs), a major area of failure at the G7/G8 level. The February 2002 Monterrey Consensus on international financing for development promoted mutual accountability as the principle on which the MDGs rest; however, joint monitoring and joint assessment among nations and international institutions such as the IMF, the Organisation for Economic Co-operation and Development and the EU. If this happens, it will more likely be possible to hold nations to account on the progress of the MDGs as well as in other areas. Wider discussions of the proposed G20 assessment framework may help broaden the use of “peer pressure by commitment.” This would not surprise those who believe that paradoxes are a threat but also an opportunity for innovation.

Governance innovation around coordination of policies is discouraged internally and externally by widespread “groupthink” among stakeholders.

Nations are left to deal with a global crisis on their own through domestic policy actions — “together alone.” This paradox is as global as the crisis itself.

actions on development have always suffered from the lack of effective follow-through mechanisms. This is most apparent in Sub-Saharan Africa, not so much because most impoverished states are located there, but rather because this is a traditional area of influence for the EU. The EU has rarely managed to speak with one voice and this has allowed international organizations to minimize their collaboration both on global issues and on the ground, with devastating consequences in failing states where the payoff to cooperation could be greatest.

It is high time to experiment with
As the global financial crisis fades, so does the sense of urgency about tackling the shortfalls in global governance that were highlighted by the crisis. Close observers warn that the opportunity provided by the crisis to push through the needed measures to stabilize the global financial system, to reform the global architecture and address global imbalances is dissipating. Many now suggest that the G20 needs to be transformed from a global “crisis committee” to a global “steering committee.”

As a crisis committee, the G20 leaders’ process has accomplished much over the past year-and-a-half. The value-added of the G20 process — in contrast to the G8 summits of late — was demonstrated at the London summit in early April 2009, and the follow-up Pittsburgh summit in October last year, when the leaders of the G20 pledged US$1.1 trillion in new commitments for emergency financing to respond to the crisis. The primary achievement of London and Pittsburgh was the collective action of the leaders in restoring confidence in the global economy, especially for institutional investors and financial lenders.

As the financial turmoil turned into a broader crisis of economic confidence, it was essential that “the 20” kept their focus on crisis management. It was essential for world leaders to restore confidence by demonstrating that there was “someone out there, in charge.” Importantly, the G20 leaders focused on identifying concrete and realistic goals, which were aimed at giving a sense that “the beginning of the end” of the global crisis was at hand.

Central bankers and financial officials have taken on the yeoman’s work of re-regulating global finance — working out the details of the financial regulatory reforms in their respective national contexts. Responsibility for providing international coordination on re-regulation has been delegated to the Financial Stability Board. It is fair to say that the G20 leaders’ process has done a commendable job in providing direction on financial re-regulation to date — a work plan has been approved and reforms have been set in motion.

Less success has been achieved, however, on the other big issue for restoring the stability of the world economy: global macro-imbalances. Here, the aspiring global steering committee is facing political gridlock. The reality is that fallout from the global crisis gave a sense of focus and urgency to the “immediate agenda” of the G20 on issues such as financial re-regulation, exit strategies and anti-protection, that are directly related to containing the crisis. However, it is much more difficult to build new consensus on the “underlying agenda”: those issues indirectly related to the financial crisis such as global imbalances. Moreover, it is questionable how much effort has actually been directed at building a new consensus — rather than applying pressure to adjust on the surplus countries. There is even less consensus among the G20 on the “momentum agenda” issues — items that have less direct bearing on the financial crisis, but frame the G20’s work program. Examples of these are climate change financing, development aid, global financial safety nets and the Doha Round.

The G20 faces political gridlock on the issue of imbalances in particular. A group within the G20 now appears...
to be going public with their pressure tactics. Some governments are trying to induce their desired outcomes by advancing future scenarios that warn of continued low growth, return to crisis and a global trade war, if the necessary adjustments are not made. The drawback in so doing — regardless of the minor diplomatic gains — is that it may damage the new performance legitimacy that the G20 has just built by delivering on crisis management and financial re-regulation. For example, China — a not insignificant member of the 20 — has started to suggest returning to more formalized institutional arrangements, such as the International Monetary Fund, to deal with the longer-term stability issues such as exchange rates and imbalances.

Through track one and track two channels, Beijing is sending the message that it may be time to return to established institutions, procedures and rules for inter-state bargaining, rather than continuing along the informal G20 track. This suggestion, either intentionally or otherwise, highlights the relative limits of the G20 process. It indirectly suggests to mid-ranked powers that they may want to consider restraining their own diplomatic ambitions and to avoid pushing to expand the G20 agenda to the point where some great powers, such as China, may begin to disengage or downgrade their involvement in this summitry process, especially as the global crisis subsides.

In the eyes of many of those who support a shift of the G20 to an expanded agenda, the main dilemma for the G20 in focusing on the underlying and momentum items is figuring out how best to construct broader and more inclusive consultation mechanisms to ensure that the views of the “excluded” countries are taken into account in G20 decision making. In fact, the opposite perspective may be true. As the G20 enters into the realm of underlying systemic issues, especially global financial and trade imbalances, effective resolution may actually require that fewer states be at the negotiating table. From the standpoint of effective bargaining, it is reasonable to ask “how many countries really need to be at the table to bring dramatic shifts in the situation of imbalances.” The uncomfortable answer (for many in the G20) may actually be four or five major surplus and debtor countries — with the EU representing collective European interests. A similar argument in favour of fewer actors could be made for climate change discussions, especially on emissions controls and technology transfers. In such a scenario, a new “G4/5” would want to consult with the broader G20 in order to ensure that appropriate burden-sharing arrangements are worked out for the system as a whole — to ensure effective implementation.

On the imbalances story, signs of hope are emerging — though not at, or only indirectly related to, the G20 level. The US and China, leading actors in the saga, have been repositioning, bilaterally, over the past weeks. In late March, the US Treasury announced that it would delay for three months a report on China’s currency policy originally set for release in early April. China, in turn, offered to join talks on sanctions against Iran. And Beijing has provided assurances behind closed doors that it intends to reintroduce greater flexibility in the renminbi-dollar exchange rate. These moves are concrete steps to defuse tensions, to give each party time to work out solutions that do not appear to be driven by the other side. They also give both sides time to work out substantive trade-offs as well as reassurances that only these two great powers can provide to each other.

For Canada, host of the G20 summit in Toronto, these shifts at the G2 level improve the chances of holding a successful summit at the end of June. For mid-ranked countries and multilateralists, the issue is how best to support the constructive shifts that have taken place at the bilateral level — although it is completely understandable that the mid-ranked powers would also want to be adequately consulted and help shape the deals that are forged so that their national interests are adequately taken into account. Such an approach, overall, would symbolize recognition that the countries in the G20 are going to have to “move together,” as another CIGI commentator has emphasized.

For those who support the G20 process, it is important to do so in a manner that avoids damaging the new-found legitimacy of this global summitry process. Its members can avoid this danger by: staying focused on delivering tangible results on financial crisis management; building on the new consensus on imbalances that is being brokered by the great powers; offering innovative solutions for further refining the accommodations that are reached among the few, in order to ensure appropriate burden sharing; and avoiding the temptation of excessive expansionism.

The G20 leaders’ process is at an important crossroads in its development. A measure of self-restraint is key to ensuring the continuing success of this innovation in global summitry.
THE G20 AND CLIMATE CHANGE: THE QUINTESSENTIAL GLOBAL GOVERNANCE ISSUE
GORDON SMITH AND PAUL HEINBECKER
JUNE 9, 2010

No one said stopping and reversing climate change, the mother of all tragedies of the commons, was going to be easy. There are precious few examples in which humanity has managed to come together in its own enlightened self-interest or “enlightened sovereignty” as Prime Minister Stephen Harper has put it, to collectively change course on such a major governance issue. Even so, unless you believe in rolling the dice on your future and your children’s future, and doing so with considerably worse than even odds, you are right to be deeply worried at the lack of progress in global negotiations at “Nopenhagen.”

You should not take any solace from “climategate.” Despite the alleged transgressions of some scientists associated with the issue, the consensus about the science itself is that it is very sound. There is growing interference with the climate system.” We might be looking at 1.3 degrees Celsius already.

The United Nations (UN), with its 192 members, is too big and unwieldy, and too sensitive to conflicting interests and ideologies, to reconcile the regional differences on its own. The five countries that came together to cut the basic deal in Denmark — Brazil, China, India, South Africa and the US — are too narrow a group to attract the requisite followers. The European Union, Japan, Mexico, South Korea and, not least, Canada, are too important to an equitable and sustainable solution to be left on the sidelines.

What is required is a group big enough to include all nations whose cooperation is indispensable, but is still small enough to facilitate reaching agreement.

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What is required is a group big enough to include all nations whose cooperation is indispensable, but is still small enough to facilitate reaching agreement.
It is not at all clear how the Copenhagen Accord and the Kyoto Protocol can be married into an effective negotiating process, one that can make real progress in a meaningful timeframe. The Copenhagen deal lacked binding targets and timetables for the nations that signed on. The commitments on targets and timetables inspired by the deal are uncoordinated in terms of approach, baselines or units of measurement. There are no commitments on monitoring or verification.

Copenhagen’s promises of finance for mitigation and adaptation are a little too vague and back-end loaded to be taken at face value; however, the Copenhagen glass was not empty. Some very helpful progress was made in that more than 70 countries, of which 35 were developing countries, including China, India and Brazil, pledged to take “nationally appropriate actions.” Furthermore, sub-national actors ranging from cities to states and provinces to trans-regional groups, including the Regional Greenhouse Gas Initiative and the Western Climate Initiative in North America, not waiting on senior government decision making, are entering the climate arena and waging social redesign campaigns aimed at significantly reducing carbon footprints.

These disparate actions ultimately need to be brought together. If the world is not to become a crazy quilt of regulation and trade protectionism masquerading as climate sensitivity, and if the “deal” is to be legitimate in the eyes of the rest of the world, it will have to be brought into the legitimizing processes of the UN. But first, the deal has to be created: how to marry the top-down and bottom-up processes and get to “yes”?

What is required is a group big enough to include all the nations whose cooperation is indispensable, but is still small enough to facilitate reaching agreement — that is, a group effective on substance and efficient in negotiation. There are two alternatives which happily can add up to one solution: the Major Economies/Emitters Forum (MEF) and the G20. The MEF has the requisite vocation — reducing emissions — and the G20 has the requisite focus: economics and finance. The G20 is, by its own declaration, the world’s premier economic forum. Thanks to Lord Nicholas Stern of Britain, a compelling case has been made about the drastic economic consequences of failing to deal with climate change in good time.

The next economic crisis might well be driven by an inadequate response to climate change. The Leaders’ G20 was created to deal with the recent economic crisis stemming from sub-prime loans and totally inadequate regulation of financial institutions. The next economic crisis might well be driven by an inadequate response to climate change. If that is to be avoided, the elements of a climate change deal will need to include financing, energy policy, research, technology transfer, adaptation, perhaps global public health, surveillance and monitoring.

It is true that the G20 has especially critical economic functions to play right now. It needs to stick to its knitting and deal with the fallout from the financial crisis. Both the Canadian and Korean hosts of the two 2010 G20 summits are on record as wishing not to overburden the agenda by the additional and very controversial climate change task. Nevertheless, the G20 can

A further, not-trivial factor is the simple fact that there are too many summits. For heads of government there is no commodity more precious than their time, and they cannot afford to meet several times to discuss several issues under several rubrics. Nor do they need to do so. For both substantive and procedural reasons, we would propose that to address the climate change deadlock, the MEF morph into the G20. After all, all the MEF countries are already in the G20, so it shouldn’t be difficult. We have seen from the “Great Recession” that the G20 can deal successfully with global-scale problems. We need it now to focus its efforts on the quintessential global governance issue — climate change — that could doom us all if we can’t find the means to agree to change course. Just like a mind, an effective global forum is a terrible thing to waste.

The G20 and the MEF are not the G8, a group from the developed West and North. Both comprise the main emerging dynamos of the world economy, and all of the regions as well.
The Sherpa teams organizing the next G20 summits are in a position to design a win-win package deal to help break the climate change deadlock. Realistically, there is little hope of an agreement on binding emission targets. Nor will there be large financial transfers from developed countries. Progress requires leadership — a small group of countries must agree to move forward together — Graham Allison’s “many-lateralism” or Stewart Patrick’s “minilateralism.” A small group of key countries could have significant impact if they agree to a “Grand Bargain” involving cooperation on research and development (R&D), future standards, security of supply and measurement of emissions. Forget targets and transfers for now.

The consensus rule required by the United Nations Framework Convention on Climate Change is a recipe for paralysis. Establishment of new norms requires a flexible process. We need a critical mass, not unanimity. We cannot let the laggards set the agenda. We need a group of powerful high-emitting countries to agree and move forward — the laggards can adjust later. If China and the US agree, and several other high emitters join them, the rest will eventually follow. In any case, most of the problem would be addressed.

The US Congress will not ratify any treaty that includes targets for the US unless it also contains binding targets for developing countries. Emerging and developing countries will not accept binding targets unless there are several years of verified reductions by developed countries. The consequence is that a binding global agreement on emission reductions will not happen in the next few years — nor will a binding global agreement on fiscal harmonization, as carbon taxes and cap and trade systems cannot be forced on countries.

“The perfect is the enemy of the good.” Given the larger deadlock, can we make significant headway without binding targets and fiscal transfers? Yes. A “Grand Bargain” could establish an energy security compact, organize a royalty-free, multi-billion-dollar global R&D collaborative and set up future greenhouse gas-related product and process standards on selected traded goods. It could legitimize future border tax adjustments on goods below the standards. The “Grand Bargain” could institute a credible emission monitoring and reporting system. (Verification will come later.)

There are several examples of successful global collaboration that
could serve as a model for the energy R&D and technology transfer initiative:

- **ITER**, an international experiment to produce commercial energy from fusion, consists of member countries that share every aspect of the project: science, procurements, finance and staffing, with the aim that, in the long run, each member will have the know-how to produce its own fusion energy plant (www.iter.org).

- The Consultative Group for International Agricultural Research (CGIAR) generates cutting-edge science through a “strategic partnership whose donors support 15 international centers, working in collaboration with many hundreds of government and civil society organizations as well as private businesses around the world... The new crop varieties, knowledge and other products resulting from the CGIAR's collaborative research are made widely available to individuals and organizations working for sustainable agricultural development throughout the world” (www.cgiar.org).

- The China Greentech Initiative interactive website “designed to facilitate the collection, analysis and sharing of research on the evolving greentech market in China... is an open source, commercial collaboration of over 80 of the world's leading technology and services companies, entrepreneurs, investors, NGOs and policy advisors” (www.china-greentech.com).

- The Asia Pacific Partnership on Clean Development and Climate includes Australia, Canada, Japan, China, India, Korea and America. These countries work together and with private sector partners to accelerate the development and deployment of clean energy technologies.

A global royalty-free R&D collaborative could be worked out more easily if it were limited to pre-commercialized R&D. If R&D results were entirely royalty free, financed by rich countries, then it may count as technology transfer and help induce large developing emitters to take action. A G20 R&D collaborative would be a natural extension of Korean President Lee Myung-bak’s proposal to establish a think tank to serve as a global hub of ideas, new technologies and new policies for the Asian Green Growth initiative (www.greengrowth.org).

Future product and process standards could be agreed on high-carbon-content traded goods, not a universal product-by-product standard. They would be enforced, over time, by border tax adjustments on goods “below the standards.” With sufficient notice, this would be feasible for basic industries like cement and aluminum, and for high-volume industries that are highly integrated across borders. Ultimately, a monitoring and reporting system, with verification, possibly based on peer review around commonly agreed refined standards, will be the core of an agreement on truly global action. This package is more than enough to get started and, albeit difficult, much easier to negotiate than binding targets or fiscal transfers.

Stewart Patrick writes that the case for a coalition is more compelling if “the contingency is discrete, no standing international framework exists, institutions are paralyzed by discussions... bureaucratic inertia prevents prompt decisions.” In real life, complex agreements are negotiated first in small groups. The US and China together are responsible for 40 percent of current global emissions. Can we imagine that a deal could emerge from the future US-China Strategic and Economic Dialogue?

Do the US and China have sufficient complementary or congruent interests, beyond financial interdependence, defined by their respective domestic realities? The list of common interests is impressive. Both countries desire global financial stability and to maintain the value of the US dollar. With respect to climate change, both want to develop technologies for “clean coal” and carbon capture and sequestration, and adaptation strategies in low-lying coastal zones. Both want to mitigate European protectionism. Both have interests in nuclear non-proliferation, in preserving safe international shipping. China faces desertification, drought, smog and other forms of pollution that could threaten internal

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A binding global agreement on emission reductions will not happen in the next few years.
The US and China together are responsible for 40 percent of current global emissions.

stability. The US must reduce its dependence on hydro-carbon imports.

On the negative side is Chinese Premier Wen Jiabao’s statement that: “Global issues should be decided by all nations in the world, rather than by one or two countries.” Apparent obstacles include the different interests, affluence, political ideology and diplomatic style of the two countries. Deng Xiaoping is often quoted to underline China’s fears that a global leadership role entails responsibilities that it isn’t ready for:


Both China and the US are “over promoters of sovereignty.” In real life, the US decision-making system is dysfunctional. Stewart Patrick’s description of the Bush administration’s perception of the UN as “hopelessly dysfunctional, unaccountable, and obsolete, prone to lowest common denominator policy making, working at cross purposes with US interests” — would also be a fair representation of the freedom of action of the US government domestically. These discrepancies, and tensions such as censorship of Google and arms sales to Taiwan, seriously diminish the likelihood of a G2 coalition leading the way. Given the dysfunctional world of US politics and China’s view of its priorities, it is inevitable that these will continue to be sources of tension that may well throw a wrench in any G2-led advance on this issue, especially when combined with the Chinese view that global problems have to be solved globally. But that’s why we have the G20 — to allow purely bilateral issues to be finessed while addressing global issues.

Rather than the G2 acting alone, the G20 is a more credible scenario for an effective coalition. Should the Canadians or Koreans so decide, they could devise the parameters for a package deal that would consist of security of supply, investment in a global R&D collaborative, standard setting to be supported by border tax adjustments and a monitoring/reporting framework. (Although Il SaKong, the principal responsible for Korean preparations, is on record as writing: “Don’t dilute the focus by adding other heavyweight issues.”)

Alternatively, France, the 2011 chair of both the G20 and the G8, could flesh out a package deal that is in the selfish national interest of both China and the US, enroll them, and then sign on the European Union and Japan. The G20 could refine and bless the package. It could then be brought to the UN process.

It will be more feasible to reach an agreement on binding targets and on economic instruments if we have several years of confidence building and cooperation on security of supply, investment in a global R&D collaborative, standard setting and a monitoring/reporting framework. A small number of key countries can reach agreement on such a package. Then, maybe, it will be possible to reach a binding universal agreement assigning country-by-country emission trajectories, introduced over time.

In the absence of leadership, the waters will continue to rise.

REFERENCES


Going into the Seoul summit, the G20 agenda for financial regulatory reform is both depressingly familiar and surprisingly new. The G20 leaders are unlikely to reach any dramatic breakthroughs on the familiar items, but they could leave a lasting legacy by prioritizing the new.

At their meeting on October 23, the G20 finance ministers and central bank governors prioritized a number of regulatory issues for discussion at the leader’s summit. The familiar items included a ritualistic commitment to implement all reforms endorsed already by the G20 in an internationally consistent and non-discriminatory manner, such as those relating to over-the-counter derivatives, compensation practices, accounting standards and credit rating agencies.

The G20 finance officials also endorsed initiatives that follow-up on past summit commitments such as the Basel Committee’s new bank capital and liquidity framework and the Financial Stability Board’s (FSB) new recommendations to improve supervision. In addition, they backed the FSB’s ongoing work to try to mitigate risks posed by “systemically important financial institutions” (SIFIs).

The Seoul summit is unlikely to produce any dramatic new developments relating to any of this familiar terrain. Not so long ago, some hoped the G20 leaders might use the Korean summit to hammer out an agreement on the all-important issue of how to regulate SIFIs, but the prospect seems distant now. We are still quite far away from an international consensus on this issue — a few days before the G20 finance officials meeting, the chair of the Basel Committee reported that the Committee’s work in this area would not be complete until mid-2011. If any agreements are reached in Seoul on SIFIs, they will likely be pitched only in terms of very general principles.

While the Seoul summit may say little dramatically new on these conventional issues, the G20 finance ministers have placed some new topics on the summit’s international regulatory policy making through the G20, the FSB and other bodies, their distinctive contribution to regulatory debates has not been very noticeable. The Seoul summit may be remembered as the moment when they finally made their mark.

As if to reinforce this prospect, the G20 finance ministers urged “further work on macro-prudential policy frameworks, including tools to help mitigate the impact of excessive capital flows.” The focus on macro-prudential policy is familiar; one of the accomplishments of the G20 summits has been to encourage regulators to look beyond merely the stability of individual firms to broader systemic risks. Until now, however, the G20 had not discussed cross-border capital flows within its macro-prudential regulatory agenda.

This neglect has been criticized by analysts who see the management of capital flows as a key macro-prudential regulatory tool for developing countries. They note that many financial crises in the developing world have been preceded by excessive capital inflows that have exacerbated domestic financial bubbles (also recently experienced by the US).

In this context, efforts to discourage capital inflows in boom times — either by controls or more market-friendly measures — can play a useful counter-cyclical macro-prudential role. Since
The Seoul summit is unlikely to produce any dramatic new developments relating to familiar terrain.

Many financial crises in the developing world have been preceded by excessive capital inflows that have exacerbated domestic financial bubbles.

These markets have been blamed for recent commodity price volatility, including that which contributed to the global food crisis of 2008. The other is the need for “increased outreach” to include more perspectives of “emerging market economies” in international regulatory discussions. This advice applies particularly to the FSB and some of the other international standard-setting bodies whose country membership remains quite narrowly constituted.

There are still other “development” issues that could receive more attention within international regulatory policy making. The G20 leaders could encourage greater international efforts to help regulate illicit capital outflows from low-income countries. They could also support more orderly sovereign debt-restructuring mechanisms at the global level — particularly since the Europeans are considering the establishment of such a mechanism regionally.

The Seoul meeting looks set to become the first G20 leaders’ summit to add significant “development” content to the international regulatory reform agenda. If this result is realized, the Korean hosts will have met their goal of acting as a bridge between North and South. We will finally be able to say that the inclusion of more developing countries within the core of global economic governance is beginning to have an impact on the content of international financial regulation.
The global financial crisis coincided with and was preceded in some degree by a legitimacy and governance crisis in the International Monetary Fund (IMF). The G20 leaders need to address this crisis or it will fester again.

The G20 has described itself as the premier forum for international economic cooperation. The IMF sees itself as the premier institution for international economic cooperation. What is the difference between them? The G20 was born out of the recognition that the G7 industrialized countries no longer reflect economic reality. The G20 is a self-appointed informal group with no permanent secretariat or legal framework. By contrast, the IMF is a treaty-based formal organization with a membership of 187 countries that have obligations to it.

In the period before the financial crisis, a debate was already under way about the future role of the IMF. Many observers saw the IMF as ineffective and lacking in even-handedness, given the origins of the global financial crisis, while they saw a role for the Fund supporting the emerging markets. The emerging economies, on the other hand, saw the Fund as biased and questioned its policy advice. There was no agreement on what the role of the IMF should be.

Since the global financial crisis broke in 2008, the two groups with the least amount of time for the IMF — the emerging markets and the G7 countries — have been working together in the G20, which became the principal coordinating body, whereas the IMF has simply implemented what it has been asked to do. We have seen through the G20-led “mutual assessment process” to promote macro-economic cooperation that, due to the tensions around its role and even-handedness, the Fund’s role has been limited to that of a technical adviser. Where, then, does this leave the IMF as an institution, and where does it leave the countries outside the G20?

Countries are unwilling to make the necessary political choices because it is unclear why they should do so.
In 2008, two reports — one by the IMF’s Independent Evaluation Office and another by the Committee on IMF Governance Reform chaired by Trevor Manuel, then South Africa’s finance minister — strongly identified the challenges of effectiveness, efficiency and legitimacy facing the IMF.

Dominating the debates have been the issues of quotas (country shares) and representation on the IMF’s executive board (chairs or seats). On quotas, there was agreement two and a half years ago to bring about a 2.5 percent shift to dynamic emerging market and under-represented countries, and a subsequent agreement in principle on a further 5 percent shift, but with no agreement on distribution. Even the 2.5 percent shift has not been implemented because the required legislation has not been passed in the individual countries.

Europeans currently hold one-third of the seats on the executive board, but given that Europeans represent far less than one-third of the membership, this clearly is an issue to be addressed. On both quotas and chairs, it is obvious to most observers that the current situation is inequitable and seriously undermines the legitimacy of, and support for, the IMF. It is time for this situation to be changed.

At the meeting of the G20 finance ministers on October 23 in Gyeongju, Korea, agreement was reached in principle to further adjust quotas (by 6 percent) and chairs (with Europe giving up two seats), with details to be worked out by 2012. Assuming the details will be worked out successfully (not a given), one has to question whether this is too little, too late. Europe will still retain six seats (25 percent of the board) and many observers have questioned whether a board of 24 can ever be effective. A truly historic agreement will need to go much further, and this papering over may simply make the current unpalatable situation only slightly less so.

Even if these long-standing issues can be resolved, not much is likely to change unless there is a clear and widely shared view on the role and functioning of the Fund. It is the absence of such agreement that makes the current stalemate so tolerable — countries are unwilling to make the necessary political choices because it is unclear why they should do so.

This is the agenda required of the G20 going forward if it is to clarify the role of the IMF and its relationship to it. Countries must decide what role they want the IMF to play. It can be done, but some tough decisions will be required.

ENDNOTES

1 See “Governance of the IMF: An Evaluation.” Available at: www.ieo-imf.org/eval/complete/eval_05212008.html.


3 A member’s quota determines the amount of its subscription, voting weight, access to IMF financing and allocation of Special Drawing Rights (SDR).

4 The IMF’s executive board is composed of 24 directors and the managing director, who serves as its chair. Five (US, Japan, Germany, France and Britain) of the 24 directors are appointed, and the rest are elected by member countries or by groups of countries. Available at: www.imf.org/external/np/sec/memdir/eds.htm.

With the G20 in agreement that fiscal stimulus will shift to fiscal consolidation over the medium term, the question of how to address the risk of another downturn in global demand will be on everyone’s mind during the G20 summit in Seoul.

In this context, there has been a recent focus on the risk that currency market swings could result in competitive devaluations and protectionist measures. Such actions could deal a serious blow to the hope for a strengthening global economy. In response, many commentators have again called on China to revalue its currency by allowing for more exchange rate flexibility. Others point to the likelihood that the United States will undertake additional monetary stimulus by engaging in further quantitative easing — printing money to buy securities — which, by its nature, injects a significant amount of US dollars into the global economy, thereby putting downward pressure on the US dollar. With the yuan still effectively tied to the US dollar, this translates into upward pressure on the currencies of many other countries. These countries, in turn, worry about the negative impact on their competitiveness.

The less-than-successful results of past attempts at “rebalancing” trade and capital flows through exchange rate intervention, such as the Plaza and Louvre accords of 1985 and 1987, The G20 needs to look well beyond nominal exchange rate misalignments if it is to achieve its goals.
rather than by better recognizing and addressing the fundamental reasons for growth-threatening imbalances, should afford a considerable note of caution about any single-minded focus on the nominal exchange rate values of the yuan or the dollar at the G20 summit. This history underscores the essential need, which G20 finance ministers and central bank governors affirmed in October, for cooperation in addressing the continued fragility of the global economy because of the high degree of interdependence among economies. It also makes clear that the G20 needs to look well beyond nominal exchange rate misalignments if it is to achieve its goals under the G20 Framework for Strong, Sustainable and Balanced Growth, established at the Pittsburgh summit.

In the absence of a clear and accepted analytical framework for understanding the nature of interdependencies and spillovers, we do not know when cooperation, which can range from informal arrangements such as consultation and exchange of information to more formal mechanisms such as the G20 mutual assessments, needs to evolve into more formal coordination of policies. Effective cooperation and coordination of policies must be based on a better understanding of policy interactions, if a mutually determined set of multilateral objectives is to be realized. Mechanisms to follow-up on commitments are also needed.

Even with the current absence of an agreed and comprehensive analytical framework, there is still a great deal that G20 countries can do to assume their responsibility, agreed to in Pittsburgh, for the health of the global economy. This is because national interests often coincide with the collective interest, something that G20 needs to emphasize and exploit more strongly in Seoul.

National interests often align with the collective interest, something the G20 needs to emphasize and exploit more strongly in Seoul.

For example, given the circumstances today, there is little disagreement about the fact that monetary policy in both the US and Japan needs to keep the threat of deflation at bay, while China needs to prevent inflationary bubbles and pressures more generally. These priorities would normally result in market pressures towards an appreciation of the yuan vis-à-vis the dollar and the yen.

Countering these pressures by limiting the flexibility of the yuan, Chinese authorities will either gradually import what they do not want — reflationary US monetary policy — or continue to aggressively accumulate assets (notably US dollars) which will likely decline in value. The question is whether this policy is good for China, and the answer is that, in the long run, it surely is not — just as Europe’s misreading of imbalances within its currency union and unsustainable US and Japanese fiscal deficits also hurt their respective growth prospects.

Structural policy changes are often the most difficult, because they typically require demanding adjustments on the part of significant segments of the population who rely on unsustainable policies to support their income. Yet, these policy changes are required to achieve the balanced, sustainable growth desired by the G20.

As G20 leaders in Seoul consider the Action Plan submitted to them by their finance ministers and central bankers in fulfillment of the Pittsburg Framework, what can the leaders undertake to instill confidence that this Framework will provide meaningful sustainable and balanced global growth going forward? The key is for countries to agree to politically credible commitments, where national interests are seen as coinciding with the collective interest.

At the end of the day, the policy mix that needs to emerge from Seoul should be one that sees countries taking measures understood to be both in their own best interest and the best interest of the global economy. The G20 can provide the forum and framework within which nations encourage and commit themselves, in a very public way, to vigorously pursue such measures.
The G20 has sought to reduce systemic financial risk by improving the resilience of financial institutions, making financial markets more robust, and reducing interconnectedness among financial institutions and between institutions and markets. To bolster the global financial system, the G20 leaders in Toronto in June called for strengthening global financial safety nets to address capital flow volatility, financial fragility and crisis contagion.

Financial safety nets enable countries with good polices to insure against bad outcomes, especially when caught as innocent bystanders in financial turmoil. In response to the recent crisis, the International Monetary Fund (IMF) introduced a new Precautionary Credit Line (PCL) and made improvements to its existing Flexible Credit Line (FCL) for countries that meet rigorous pre-set qualification criteria. The improved FCL eliminates caps on access to IMF resources for short-term liquidity and lengthens the required repayment period. The PCL is for those countries that do not meet the high FCL standards, but are able to meet a weaker set of qualifying conditions.

Since the Asian financial crisis of 1997–1999, some countries have sought to self-insure themselves against balance of payments crises by accumulating large foreign exchange reserves. The case for such pre-emptive reserve accumulation may have lessened recently, given the greater availability of IMF resources and the Fund's new credit lines. Even more liberal access to Fund resources may be sought at Seoul, and such actions can only contribute to resolving the problem of current imbalances.

The key design element for financial safety nets (FSNs) is that agents remain responsible for their own decisions. Overly liberal access to an FSN can create moral hazard, which is why, traditionally, domestic safety nets dealing with banks have limited relief under the three pillars of deposit insurance, lender of last resort (LLR) and wind-up or resolution rules. For example, governments insure deposits only under a certain amount; large depositors are assumed to have the capacity to monitor banks' performance. Access to LLR facilities should, by the canons of central banking, be at a penal rate, and central banks should lend only against “good” collateral. Shareholders and, to a lesser extent, bondholders may suffer large losses in restructurings under resolution procedures. In addition, authorities attempt to limit the risk of moral hazard through regulation and supervision.

At the international level, the moral hazard concern arising from...
uncapped access to the IMF's FCL and the lengthened repayment period are mitigated by the fact that borrowing countries must meet the pre-qualification standards and the IMF executive board must approve the application. Access to the facility is not automatic. The possibility of moral hazard arising from the lower standards set for the PCL is limited by the lesser amounts available under the PCL and, perhaps, the desire of countries to graduate to the FCL.

Moral hazard has been a central concern during the global financial crisis. At the national level, for example, governments have extended deposit insurance and expanded the range of assets that central banks accept as collateral. Questions have followed regarding how governments will return to more normal deposit guarantees, and how central banks will remove the assets they acquired during the crisis from their balance sheets. This adjustment back to relatively normal conditions must be accomplished without shaking the confidence of markets.

Internationally, several funds have been set up at the regional level, in Europe and Asia, to assist countries facing capital outflows or countries in need that cannot access global financial markets. The rules governing the operation of these regional funds, and the relations between these funds and the IMF, should be clarified to reduce the possibility of moral hazard arising from access to different funds with differing requirements.

As is well known, recent financial crises have ensued as a result of excess lending to particular economic sectors, usually housing. As G20 leaders review efforts undertaken so far to achieve global financial stability, it may be worthwhile examining how general macro policy instruments in the monetary or fiscal fields can be supplemented to control sector-specific lending exuberance without pushing the overall economy into a recession. The question to be studied is whether strengthened regulation and supervision, along with global financial safety nets, is sufficient for global financial stability, or whether additional policy instruments or special regulations are necessary to curb excessive lending within specific sectors of the economy. This should become part of the G20’s considerations.

Financial safety nets enable countries with good polices to insure against bad outcomes.

The extension of IMF resources and its credit lines strengthen the IMF’s role as a lender of last resort. The G20 now has to deal with the third aspect of the global financial safety net, namely the wind-up of international private financial institutions — for example, the banks in Iceland — and the risks posed by systemically important financial institutions known as the “too-big-to-fail” problem.
The decision to put development on the agenda of the Seoul G20 summit marks a new stage in the progress of the self-described “premier forum” for managing the world economy. The Korean hosts deserve credit for this accomplishment. They lobbied skillfully for it and have proposed a vision of the G20’s comparative advantage in dealing with development. This vision focuses on the “economic” dimension of development, emphasizing sustainable, balanced and enduring growth, and building resiliency. Aid discussions are excluded and better left to other arenas such as the United Nations, World Bank and the G8.

By expanding the formal agenda to include development, the G20 speaks to the concerns of emerging markets and other developing economies within the G20 itself, but also to the majority of the 172 countries that are not members of the G20. The initiative goes some way to boosting the legitimacy of the G20, which is a self-selected grouping.

Furthermore, by confronting the issue of development, the G20 can gain some momentum for itself beyond its response to the global financial crisis. The G20 leaders’ original and concerted focus on stabilizing the world economy has weakened as the financial crisis has faded. Development is seen as a momentum-building item that can restore a sense of longer-term purpose and even urgency to the G20 process.

Korean strategists preparing the summit have stated unambiguously that there is no “one-size-fits-all” formula for developmental success; that a variety of development models and approaches should be considered; and that developing countries must lead in designing and implementing their strategies tailored to their own circumstances.

Nonetheless, in discussions for Seoul conducted by the G20 Working Group on Development (G20 WGD) through a broad-based consultation with developing countries and global and regional organizations, a plan with eight key pillars has been identified:

1. Infrastructure;
2. Private investment and job creation;
3. Human resources development;
4. Trade;
5. Financial services;
6. A G20 platform for knowledge sharing;
7. Resilience and food security; and
8. Governance.

The Korean hosts have positioned themselves in a bridging role at this summit.
This plan essentially advances a new "G20 approach" to development that incorporates elements of the model traditionally advanced by bilateral Western donors in the Organisation for Economic Cooperation and Development Development Assistance Committee (DAC OECD) and the development lessons from China and other countries that some are calling the "rising donors." The timing is not coincidental. The validity of the development policy advice put forward by traditional donors has faced serious questioning in recent years. Although the challenge to the traditional donors precedes the global financial crisis, it has further intensified in the wake of the financial crisis.

Given that such major emerging nations as Brazil, India and China (BIC) have come out of the global crisis earlier than many of the most advanced economies, and seem to have suffered less, it is not surprising that other countries (both developed and developing) are looking more closely at their experiences and drawing lessons-learned and best practices. The rising influence of these states in international development thinking is part of the broader shift in the global order taking place today.

A tell-tale sign of their increasing influence on development thinking is that the G20 WGD has identified infrastructure as the first pillar in its proposed plan. The priority that "should be attached to large-scale infrastructure and energy sector development versus a "pro-poor growth" approach that emphasizes targeted public-sector spending in the social sector, particularly health and basic education for the poorest of the poor and those living in remote and disadvantaged areas, has been an issue in the ongoing policy scrum between China as development partner and the traditional donors. The BICs’ growing influence in the development debate is also seen in the WGD’s identification of financial services — including access to public financing models for enterprises of all sizes — as crucial to determining outcomes in many parts of the developing world. The state development banks of China and Brazil are leading reference points.

The eight-pillar plan is an effort to promote a paradigm shift and a new consensus on development. This is not an easy goal because it requires bridging differences from competing approaches and models of development, taking from the old and the new. Similar challenges as well as competing institutional interests constrain the other development-related proposal that the Korean hosts are advancing at Seoul: a "global financial safety net" to support countries facing liquidity or currency crises in times of international financial or monetary crisis.

By confronting the issue of development, the G20 can gain some momentum for itself beyond its response to the global financial crisis. The Korean hosts have positioned themselves in a bridging role at this summit; what is interesting is that the major rising states also see themselves as "bridges" in the North-South divide, presenting themselves as advocates for the needs and concerns of the least developed and low-income countries at global discussions. The Republic of Korea host rightly believes that its remarkable experience of moving from a low-income to developed country in only one generation contains unique lessons for other developing countries.

The summit in Seoul will be a litmus test of whether, or to what degree, “the 20” can agree on policy prescriptions and priorities for a new and shared agenda on global development. At a time when significant differences in developmental preferences exist, it will be the first serious effort to strike a new consensus on global development. Success on this item will increase the G20’s legitimacy and sustain momentum of the G20 process. A promising sign is that the major emerging countries appear to want to support the success of the first G20 leaders’ summit to be held outside the old trans-Atlantic power base.

ENDNOTES


2  To read Choong Yong Ahn’s article, see: www.globalasia.org/V5N3_Fall_2010/Choong_Yong_Ahn.html.

3  For discussion and overview of the WGD’s draft plan, see: www.globalasia.org/V5N3_Fall_2010/Choong_Yong_Ahn.html.

4  See the article at: www.yorku.ca/ycar/programmes_projects/BRICS.html#network.
The G20 is at a crucial crossroads. Having lost the “fellowship of the lifeboat” prevailing during the acute phase of the financial crisis, G20 countries are increasingly at odds — in their diagnoses of the global recession, in their prescriptions for recovery and, in particular, on exchange rate policies.\(^1\) The G20 has, however, made undeniable progress on several fronts — including on International Monetary Fund (IMF) reform — and launched work on other areas, including development.

As the financial crisis diminishes in terms of urgency, the G20 finance ministers will return to their former roles and G20 leaders will move on to a broader agenda, development and trade issues, and global governance institutions, and eventually security and climate change deadlocks. Korea and France will play a critical role in establishing the legitimacy and effectiveness of the G20, as they serve as hosts and preside over the meetings.

What is the future of the G20 process? Institutionalization of the G20 will have several dimensions — membership, chairmanship and the preparatory process — including the questions of a secretariat and norms for outreach and consultation.

The thorny issue of seats at the G20 table seems settled. The solution arrived at, under Korean leadership, is for each summit host to invite up to five guests. The Sherpas “…set a tradition that the invitations should be made on a consensus of G20 members, not in the host country’s own desire.”\(^2\) The Koreans invited Ethiopia (representing the New Partnership for Africa’s Development), Malawi (representing the African Union) and Vietnam (representing the Association of Southeast Asian Nations). Spain and Singapore will also be guests. Leaders of seven international organizations — including the United Nations (UN), the International Labour Organization and the World Trade Organization — as well as the IMF, the World Bank, the Financial Stability Board (FSB) and the Organisation for Economic Co-operation and Development are invited; this will help express the needs of countries not represented at the table and provide more regionally balanced representation. It will be up to the French in 2011 and the Mexicans in 2012 to decide on the five additional guests.

With respect to chairmanship, the troika “bucket system” of the G20 finance ministers will likely be adopted, rotating across groups. France (from Group Four) will chair in 2011 and Mexico (from Group Three) in 2012, with the 2013 chair coming from Group Two.
With respect to the G20 preparation process, there is a clear need for a professional secretariat in order to provide institutional memory, continuity for monitoring and follow-up of commitments, as well as to support outreach and consultation. Bureaucratization and the loss of leaders’ control must be avoided or risk the loss of the leaders’ commitment. In an August speech, President Sarkozy mentioned the need for a G20 secretariat. Il SaKong, the senior Korean responsible for the Seoul summit, stated recently that the November meeting will lay the ground for institutionalizing the G20 forum, including the establishment of its secretariat. One option is for a conventional secretariat of about 20 — it could be located in Seoul, Toronto, Paris or Beijing. An unconventional approach would have Sherpas from the troika countries (that is, from Korea, France and Mexico in 2011) serve as co-secretaries-general to ensure direct accountability to the host countries, avoiding the danger of independent bureaucrats capturing the process. Staff could be recruited on secondment from troika countries for three years (for example, Koreans would serve in 2011, 2012 and 2013). (Seconded staff need not be restricted to troika countries — it would make sense to encourage the best available people for three-year terms.)

With respect to outreach and consultation, Korea is well placed to bring the concerns of developing countries to the G20 agenda. Korea demonstrated sensitivity through emphasizing the financial safety net issue to help safeguard emerging markets from systemic instability and actions focusing on closing the development gap. With the FSB, Korea co-hosted a Financial Reform Conference to elicit views from developing markets. Korea has also institutionalized a G20 Business Summit (November 10-11) and the G20 Civil Dialogue (held on October 15, with 100 representatives from 70 non-governmental organizations from 40 different countries). In September, 45 minister-level delegates were invited to the Korea-African summit. Korea accepted the 3G proposal (the Global Governance Group — 28 small non-G20 countries led by Singapore) to invite the UN secretary-general. President Sarkozy’s foreign policy adviser will be dispatched to New York immediately after the Seoul summit to engage the “G172.” Future hosts will no doubt continue these outreach activities.

Process is substance. The effectiveness of the G20, and its legitimacy, will depend on its process. We will have a much clearer picture of the future G20 process after the Seoul summit.

ENDNOTES


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