

A Conference on India in the G 20: Macroeconomic Policy Coordination, Regulation and Global Governance

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****Views expressed here are personal and not those of Government of India***

Whodunit?

Recovery

Post-Crisis Order: G20

Whodunit?

- GI: Global Imbalances
- FD: Financial Deregulation

Global Imbalances

- Both Richard Portes (categorically) and David Vines seem to lean towards GI
 - Vines: Leverage actually higher in 1987 & 1998
 - Portes: Deeper than just US-China/AC-DC
 - Vines: Imbalances post EA Crisis phenomenon
 - Export-led growth strategy (BW II) and/or insurance mechanism following EA crisis (stigma).
 - Portes: G 20 barking up the wrong tree!

But

- Financial engineering was new
- Repeal of Glass-Steagall Act in 1999
- Savings not easy to change:
 - Cultural: Merkel's 'Swabian' housewife
 - Structural: Demographic profile (young/old)
- Can't financial system be inoculated against excesses?
- Excess savings or overconsumption?
- Imbalance regime led to record global growth
- What about monetary policy?
- Government policy promoting inclusive finance?

Business Cycles

Banerji and Dua

- Most diffuse, deep and longest synchronized recession since the Great Depression because of trade and financial linkages.
- Preceded by unprecedented global growth.
- Global business cycle downturn began in Italy in August 2007, and most of the 20 major economies tracked by ECRI were in recession before the Lehman collapse.
- Downturn aggravated by 'bullwhip' effect that amplifies the crisis up the supply chain.
- If policy makers were attentive and acted earlier the crisis would have been less severe.
- **Problems with Explanation:**
 - Bullwhip should have caused deepest downturn in China
 - US Fed was actually ahead of the curve
 - Makes it appear that recession would have occurred even without the financial crisis.

Recovery

Recovery Conundrums

- In international markets: Crowding out of EMEs due to funding pressure on international capital markets by ACs
- In domestic markets: Crowding out and pressure on interest rates and inflation if fiscal punch bowl is not withdrawn as private demand picks up.
- Would QE need to be reversed or is this just substituting for deleveraging?

Recovery Assumption

- Both Portes and Vines assume that since global imbalances are the villain of the piece sustainable recovery is not possible without addressing this issue.

Rebalancing ?

- Some rebalancing occurring on account of falling household wealth and deleveraging in deficit economies
- Stricter financial regulation and control on leverage a long-term positive for rebalancing
- Size of Chinese fiscal package
- Increase in IMF resources and new (stigma free) FCL instrument makes insurance policies less likely
- Aggressive fiscal expansion in deficit countries
- Chinese fiscal package investment not income redistribution oriented
- Vines: exploiting external demand for tradable goods easier than developing domestic markets
- No signs of change in currency policies in surplus countries. Portes: CAB of emerging Asia to rise!
- GI and currency issues off G 20 agenda

What More Can Be Done?

- Portes: Dani Rodrik proposal of letting EM currencies appreciate while subsidizing industrial tradables. Trash WTO.
- Increased IMF/FSB surveillance
 - Put pressure on free riders
 - Responsible fiscal and monetary policies in the US because of US\$ reserve currency status and other systemically critical areas.
 - Exchange rate surveillance

But

- This is part of IMF's mandate anyway
- Surveillance needs to be seen as legitimate and evenhanded?
 - G 20 co-operation and pressure?
 - Radical governance reform of BWIs?

BWI Reform

- A.K.Bhattacharya: Stigma attached to IMF borrowing makes EME politicians defensive about IMF borrowing even though most conditionalities intrinsically prudent and unexceptionable.
- In contrast much greater political maturity in engaging with the WTO.
- Difference lies in governance structure
- G 20 and WTO governance structure similar. Could BWI governance structure reflect the G 20 which seems to be acting as the ministerial council driving BWI agenda?
- Such major governance overhaul could lead to a major shift in perception of BWIs
- Radical overhaul will be messy since greater role for major EMEs would need to be counterbalanced by a reduced role for Europe.
- De-hyphenating BW Siamese Twins?

G 20 and the Emerging Post- Crisis Order

Overwhelming Question

- Yet *another* financial crisis or will it **fundamentally change** macro-economic policy, financial management and global institutions?
- Akerlof: **Animal spirits** fired to take risk and innovate (both good and bad) in booms. The opposite – revulsion -- occurs in the bust phase. No different this time.

Co-ordinated Global Action

- Global integration through trade and capital flows made the crisis global in scope
- Realisation that global problems need global solutions
- The institutional structure to handle rapid globalization is weak.
- G 20, a forum of systemically important economies, accounting for about 75-80 % of global GDP, Trade and population emerging as the forum for concerted multilateral action.
- Global agenda set by the **Washington Declaration** of November 15, 2008 and **London Communiqué** of April 2, 2009 issued by G 20 leaders.

G 20 : Background

- Represents 75% of global GDP (PPP), and 81% including the Euro Area. (2007)
- Africa, Central and Eastern Europe and LDCs under-represented .
- Formed at the time of the East Asian Crisis a decade ago.
- Chair rotates annually: ‘Troika’ of last chair Brazil (2008), current chair UK (2009), next chair South Korea (2010). No permanent secretariat.
- Till the Washington Leaders’ Summit meeting only at the Finance Ministers’ level.
- Next Summit meeting on September 24-25, 2009 in Pittsburgh, US. However, permanent status of regular Summit meetings unclear.

G 20 : Countries

Developed Countries

- USA
- UK
- European Union
- France
- Germany
- Italy
- Australia
- Canada

Developing Countries

- China
- India
- Indonesia
- South Korea
- Russia
- Saudi Arabia
- Turkey
- South Africa
- Argentina
- Brazil
- Mexico

G 20 Crisis Response

- **Leaders' summit**
 - Washington DC, November 15, 2008
 - London, April 2, 2009
 - **Pittsburg, USA, 24-25 September 2009**
- **Sherpas' process**
 - Back to back with Leaders' Summits
 - Conference calls: January 14 and February 5, 2009
 - Face to face meeting London, February March 5-6, 2009
 - **July 30-31, 2009 and September 10-11, 2009**
- **Finance Ministers and (finance and central bank) Deputies Process**
 - Sao Paulo, November 13-14, 2008
 - London, January 31-February 1, 2009
 - London, March 13-15, 2009
 - **Basle, 27 June, 2009**
 - **London, September 3-5, 2009.**
 - **St. Andrews, UK, November 7-8, 2009**

G 20 Working Groups

- The Washington Declaration laid out the broad agenda, both **short-term** (palliative) and **long-term** (preventive).
- G 20 Troika formed **4 WGs** to address the actionable points.
- **Macro-economic issues** handled directly at the Finance Ministers and Leaders levels
- **WGs co-chaired** by Developed and Developing Countries (India co-chaired WG I on financial regulation)
- **India formed 5 mirror groups** that injected India's views into the G 20 working groups.
- **Modus operandi**: Conference Calls, E-Mail groups, One or two face to face meetings
- **WG Reports published** at <http://www.g20.org/366.aspx>
- **Future Role?** Reviewing outcomes?

WG I: Strengthening Transparency and Enhancing Sound Regulation

- Focus on Five Broad areas:
 - Pro-cyclicality and capital buffers
 - Strengthening OTC structures
 - Broadening regulatory boundaries
 - Compensation schemes
 - Transparency in valuation and accounting
- Detailed work being done by specialized agencies
 - FSB, IMF, IASB, BCBS, IOSCO, etc.

WG II: International Co-operation and Market Integrity

- Immediate expansion of FSF on clear metrics
- Governance issues relating to other international bodies such as IASB, IOSCO, Supervisory Colleges
- Cross border crisis and planning management structures covering systemic institutions, including exit strategies and harmonizing host/investor country interests.
- Improving analytical tools for identifying macro-financial vulnerabilities and closer collaboration between FSF and IMF on early warning systems.
- Issues relating to market integrity: money-laundering, tax havens and off shore centres.

WG III: Reforming the IMF

- Strengthening IMF early warning and surveillance in an even handed manner.
- Broad consensus on expansion of IMF resources in the short run, to address the sharp decline in capital flows to EMEs.
- Broad consensus on comprehensive governance reform, including open selection of MD, and quota review, over longer run.

WG IV: World Bank and Regional Development Bank (RDB) Reform

- Consensus on timely countercyclical response to crises through flexible, instruments, front loading and dynamic provisioning.
- Broad support for an immediate and substantial general capital increase of the ADB, and to review capital expansion of other MDBs.
- Broad agreement on major governance reform, including selection process of institution heads.

Macro-economic Issues

- Handled directly at the Sherpas/Leaders' level
- Centred on
 - Co-ordinated fiscal and monetary stimulus
 - Restoring Trade Finance
 - Raising additional resources for IFIs
 - Countering growing protectionist tendencies
 - Climate change
 - Labour and Employment issues

G 20 Leaders' London Declaration

- Additional **\$ 1.1 trn resources** to restore growth and credit
 - \$ 500 bn new borrowing by IMF
 - \$ 250 bn new SDR allocation
 - \$ 100 bn additional lending by MDBs
 - \$ 250 bn trade finance facilities
- Agreement on **extending oversight and regulatory boundaries** of financial institutions.
- Crackdown on **tax havens**
- Renewed pledge to eschew and roll back all forms of **protectionism** and push ahead with Doha round.
- Co-ordinated and sustainable **fiscal and monetary stimulus**
- Time line for reform of **governance structure of BWIs.**
- FSF and other international financial **code setting institutions to be made more inclusive.**

Pitfalls before the G 20

- **Loss of credibility:**
 - London declaration a more detailed and specific version of the original Washington version. Would need to deliver before the third summit in Washington DC.
 - Countries going back on what they have agreed (trade, regulatory reform, governance reform)
 - Poor developing countries and Eastern-central Europe underrepresented in G 20
- **Broadening of agenda and possible loss of focus:**
 - climate, Labour, trade, etc.
- **No institutional framework to implement/enforce coordinated response.**
- **Undercurrents and Caucuses within G 20:**
 - Developed versus developing countries. (Differences on IFI reform)
 - BRIC EMES versus African and smaller developing countries (Poorer countries underrepresented)
 - US versus China (Imbalances and currency issues off the G 20 agenda!)
 - Anglo-Saxon versus Europeans (Differences on extent of regulation, stimulus & IFI reform)

Looking Ahead

- Will global imbalances unwind in the foreseeable future?
- Is the era of leveraged hyper growth over, and is this providential for the global environment?
- Is tighter financial regulation here to stay?
- Will there be major changes in monetary policy rules?
- Will the Dollar remain the international reserve currency?
- Will there be greater convergence of the Anglo-Saxon and European forms of capitalism?
- Acceleration or deceleration of globalization from here on?
- Will G 20 supplant the G 7 in importance?
- Will the governance of BWIs change radically?