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■ G-20 and Multilateral Economic Cooperation

MFIs and Developing Countries

India has a long association with multilateral financial institutions (MFIs), the most prominent of which are the World Bank and the International Monetary Fund (IMF), frequently referred to as the 'Bretton Woods Institutions'. India was one of the few developing countries that participated in the Bretton Woods Conference, which set up these institutions after the Second World War, even before India formally gained Independence. Its role in multilateral economic cooperation, however, is more recent. Being a less developed country, India's association with multilateral financial institutions, as also its bilateral cooperation with Organisation for Economic Co-operation and Development (OECD) countries generally, was mostly as an aid recipient and borrower. Although India was the fifth largest shareholder in the IMF and World Bank till the early 1970s, their governance structure is dominated by developed, rich donor countries. Originally set up to facilitate the post-War reconstruction of Europe, their role subsequently evolved into providing aid and technical assistance to developing countries.

The 'two-gap model' was for long a core assumption in traditional developmental economics. According to this, the twin deficits of capital (a deficit of domestic savings relative to domestic investment needs) and foreign exchange (the counterpart of the first gap, since the savings gap needed to be bridged through net capital inflows) are amongst the chief constraints on growth in

developing countries. The World Bank over time came to augment the savings gap in developing countries, whereas the IMF provided emergency balance-of-payment (BOP) support, since developing countries were always hard currency constrained and, therefore, vulnerable to external shocks. The economies and, macroeconomic, frameworks of developing countries were also considered to be more unstable. Both the IMF and World Bank, therefore, provided technical advice, and also linked their assistance to policy reforms. The IMF also had a surveillance role to anticipate and forestall external shocks and crises.

However, the last two decades have transformed the global economic landscape and thrown up a number of macroeconomic anomalies as a result of which both the World Bank and IMF were beginning to lose their relevance.

Rise of Big EMEs

First, over the last few decades some Emerging Market Economies (EMEs), mostly small economies, started growing at rates much faster than OECD countries on a sustained basis, even as OECD growth rates began to decline. Over the last couple of decades the really big economies—Brazil, Russia, India, and China (BRIC)—also increased their trend growth to levels significantly above OECD rates. Consequently, the relative share of EMEs in global GDP, which had been declining ever since the Industrial Revolution, started increasing rapidly. The changing economic weights in the global economy are best captured in GDP (gross domestic product) on PPP (purchasing power parity) basis rather than in

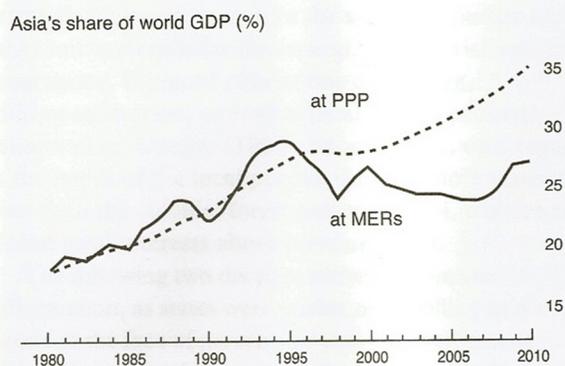


Figure 1 Asia's Share of Global GDP

Source: *The Economist*, 27 February–5 March 2010, p. 71.

terms of market exchange rates (MER). While both GDP MER and PPP captured the changing economic weights, reflected in growth differentials, in the global economy right up to the time of the East Asian Crisis, volatilities in MERs and consequential accumulation of hard currency reserves following the crisis makes the GDP PPP measure the appropriate measure to capture the continuing shifts in economic gravity. This emerges very clearly from Figure 1. While GDP is a flow measure and reserves are a stock measure, the difference in valuation between PPP and MER would be substantially made good if the accumulated stock of foreign exchange reserves are taken into consideration.

By 2007 the share of BRIC countries in global GDP slightly exceeded that of the US in terms of PPP. Both Goldman Sachs (2003) and PricewaterhouseCoopers (Hawson and Cookson 2007) have projected that at current differential rates of growth, both the Chinese and Indian economies would soon rival the US economy in aggregate GDP at PPP (although the gap in per capita GDP would remain significant in the foreseeable future). The current crisis may have advanced the parity point by several years. Their contribution to global growth is even larger. BRIC accounted for 43 per cent of global growth at PPP in 2008. In 2009, their contribution was 37.2 per cent, which meant that their growth substantially compensated for the decline that occurred elsewhere. Be it as it may, what the international financial crisis has brought out in strong relief, manifest in the leading role the G-20 is playing in formulating a coordinated global response, is that the participation of these new systemically important economies is essential to manage an open, globalized economy, and that their role in global economic governance needs to be enhanced.

Second, developing countries started running huge current account surpluses and became net savers, exporting rather than importing capital. This was reflected in their huge reserve build-ups. Even some developing countries, like India, that retained a domestic savings gap (admittedly a modest one in the case of India) built up large foreign currency reserves that cushioned them against sudden capital stops/external shocks. It is a moot point whether this reserve build-up was the result of a conscious insurance mechanism based on experience gained during the East Asian Crisis, or the by-product of an export-led model based on holding down exchange rates in what is sometimes described as 'Bretton Woods II'. There is a widely held view that it was this 'imbalance', or net export of capital from developing countries that ramped up leveraged consumption in developed countries, which: (i) sustained high growth rates based on external demand in several developing countries and (ii) lowered the cost of capital and led to many of the financial excesses leading up to the global financial meltdown. The recent crisis has changed the prevailing view that IMF lending was solely for developing countries. Post-crisis the largest borrowers from the Fund are in developed countries, including those in the Euro area, a measure of how the world has changed.

The outcome of these developments was that IMF started running out of clients, and World Bank lending started shrinking in relative terms. The decline in IMF lending was more of a demand-side problem, as private capital flows plugged whatever foreign currency gaps several developing countries had, except in those conflict-ridden/failed states from where private capital shied away. In the case of the World Bank, however, it was more of a supply-side issue. India has always had, and continues to have, a huge pipeline of infrastructure projects which World Bank lending has been unable to saturate.

MFI's and the Global Financial Crisis

The response to the recent global crisis under the aegis of the G-20 expanded the roles of the World Bank, particularly that of IMF. World Bank lending was expected to expand to plug the investment gap left by the withdrawal of private capital, while IMF was expected to increase its war chest to address BOP crises caused by the flight of foreign capital.

As things turned out, while IMF's resources were trebled to address external shocks more effectively, the permanent increase in World Bank resources was modest. There were perhaps two reasons for this. First, the traditional donors and majority shareholders were in a fiscal crisis as a fall-out of the global financial

crisis. Second, the major recipients of international assistance, such as China and India, were on a fast growing trajectory. It appears that the World Bank is being repositioned to provide assistance to smaller and poorer developing countries. Therefore, while India will continue to remain one of the biggest borrowers from multilateral development banks in the foreseeable future by virtue of its size, its developmental needs, and low per capita income, these institutions are unlikely to significantly contribute to the country's resource mobilization efforts. This could change, however, if multilateral development banks are substantially recapitalized to enable them to intermediate global savings for infrastructure investment in fast-growing emerging markets on a large scale. India's bilateral cooperation with OECD countries, meanwhile, has also shifted from aid to investment.

On the IMF side, however, the position is quite different. India has built up huge foreign currency reserves which cushioned it from the twin shocks of a sharp increase in the current account deficit and reversal in capital flows during the recent crisis. The magnitude of the external shock was perhaps greater than in the early 1990s which led to a major BOP crisis. Over the longer term, capital flows into India are expected to fully finance its current account deficits, while its sizeable reserves would insulate it from periodic sudden stops. Given India's long-term growth prospects, she may expect to continue being a major recipient of capital inflows. India is, therefore, more likely to be a contributor to IMF's resources in the future through its substantial reserves rather than a borrower. India contributed about \$14 billion dollars to the recent increase in IMF's resources.

EMEs and Global Governance

It was becoming abundantly clear even prior to the recent crisis that growing trade and investment linkages were blunting time-tested macroeconomic policy tools through spillover effects; that globalization needed new and appropriate policy tools, institutional structures, and coordinated action for its effective management; and that the bigger, fast-growing EMEs needed to be given a greater voice in global economic governance. Outside the European Union (EU), policy coordination was limited to informal consultations amongst the G-7, comprising a small club of major developed countries, and the OECD, which accounted for a major share of global GDP. While The World Trade Organization (WTO) and Multilateral Investment Guarantee Agency (MIGA) coordinated trade and investment policies, including binding legal commitments, international financial institutions like the IMF and the World Bank, and global standards setting

bodies, like the Financial Stability Forum, the Basel Committee on Banking Supervision, the International Audit Standards Board, and International Organization of Securities Commission (IOSCO), were exclusive clubs of G-8/OECD countries that set their agenda.

The G-8 nevertheless felt the need to invite the big emerging countries to their summits as special invitees through what came to be known as the 'Heiligendamm process'. This initiative that sought to institutionalize a high-level dialogue between the G-8 and the five most important emerging economies known as the O-5 (Outreach-5)—China, Mexico, India, Brazil, and South Africa. Following the institutionalization of the G-20 at the summit level this process has become defunct. Separately, BRIC also started meeting at the summit level to coordinate policies and emerged as a sort of counter to the G-8. This acronym for Brazil, Russia, India, and China (BRIC) was originally devised by the investment bank Goldman Sachs to describe the block of large developing economies with the greatest potential. Since 2009, BRIC has been meeting annually at the summit level. In 2011, BRIC was enlarged to BRICS with the inclusion of South Africa.

The global financial crisis has put the rise of major developing countries in sharper relief. They were less affected by the crisis, and have returned to former levels of high trend growth, even as recovery in OECD countries is weak and fraught with serious downside risks. Their fiscal and monetary frameworks are under pressure, even as the frameworks in major developing countries have held up well. The global financial crisis has, therefore, underscored the need to associate major developing countries in global economic governance on an equal footing.

Rise of the G-20

This transnational consultative process is spearheaded by the G-20, comprising systemically important developed and developing economies on an equal footing, and representing over 80 per cent of global income, trade (including intra-EU trade), investment flows, greenhouse emissions, and population. Its decisions, therefore, have the potential to influence global outcomes. Set up as a multilateral finance ministers' forum during the East Asian Crisis, it is only over the last few years, in the wake of the recent global financial crisis, that it has started becoming abundantly clear that the G-20, or a similar inclusive group, was likely to emerge as the premier forum of international economic dialogue, policy coordination, and decision making even beyond the crisis. A formal declaration

to that effect was made at the third G-20 summit in Pittsburgh, USA, in 2009. G-20 leaders will now meet each year at the summit level. The bigger EMEs have now become too systemically important to be excluded from any meaningful or effective international economic consultative process to manage globalization. India is one of the bigger economies within the G-20.

The new G-20 style of global economic governance is to take up important issues and engage in a policy dialogue through working and expert groups, with technical inputs from relevant international institutions such as IMF, the World Bank, WTO, Financial Stability Board (FSB), and OECD, who attend G-20 meetings, and arrive at a consensus. These institutions were always expected to scrutinize the policy frameworks of both developed and developing countries, but the main focus was on developing countries as the prevailing orthodoxy was that they were the sources of instability in the global economy, and on account of the governance structure of the IMF in which the majority shareholders were from developed countries, and the borrowers from developing countries. The governance structure of the G-20 is very different, as it operates through consensus rather than vote share. Such surveillance, henceforth, is likely to be more even handed, especially since the source of the recent crisis lay in developed rather than developing countries, and because developed and developing countries are equally represented. Unlike the Article IV process, which is internal to IMF, G-20 surveillance is member country led and owned by the group, with IMF providing technical inputs and advice.

G-20 Governance and Decision Making

The G-20 is a self-styled informal grouping of countries. Unlike in WTO or the UN, its policy recommendations are non-binding consensus documents that all G-20 countries commit to feed into domestic policy. This rather loose and flexible style of governance proved surprisingly effective in the matter of coordinated stimulus measures to combat the recent crisis, where the G-20 arrived at a consensus on what needed to be done collectively. Each country went back and did what was appropriate for its circumstances. While no specific country commitment was asked for, or given, this consensus fed into domestic policy, and all countries used both monetary and fiscal policies on an unprecedented scale and in a coordinated manner. In this way the G-20 may have averted a second great depression. In the matter of raising resources, where commitments are made, these are on a purely voluntary basis and according to country circumstances as interpreted by each country, and through moral suasion.

Coordination beyond this, to addressing long-standing structural problems in the global economy, is more challenging, and may seem too ambitious presently for countries may find it difficult to give forward-looking policy commitments. They would first need to navigate domestic legislative processes and independent regulators, including central banks and judicial authorities, over which governments have little control. Countries can only commit to what has already been successfully navigated through these processes. Seeking firm, forward-looking commitments, or pointed criticism of policy frameworks of other countries on the lines of the EU, or even the OECD style of functioning, may be difficult and divisive at this stage. In this sense, the G-20, and the full welfare benefits of globalization are still hostage to sovereignty associated with the Westphalian notion of the nation-state, even as globalization is fast undercutting its economic rationale. That political integration lags far behind economic integration is painfully apparent even in the EU, which has travelled farthest in the direction of policy coordination, where the lag in fiscal integration, one of the last major symbols of sovereignty, threatens the integrity of monetary integration.

While a more ambitious style of global governance will take some time to take shape, the G-20 is a major advance from the time when there was little communication, and much acrimony, between the G-8 and the G-77. At this stage the issue really is monitoring and assessing whether the general direction of G-20 member country policies is heading in a mutually consistent and agreed fashion over the medium to long term, and how the G-20 processes can help countries navigate their domestic legislative, regulatory, and judicial processes such that mutually agreed policies are adopted. It is important to bear in mind that commitments in the G-20 are broad and do not constitute legally binding treaties.

Major governance reforms in international financial and regulatory bodies, such as the World Bank, IMF, and the FSB, are being made to accommodate major fast-growing developing countries. However, until these countries are adequately accommodated in important institutions of global governance in a manner resembling the G-20 it is difficult to see G-20 countries developing the level of mutual trust that would allow them to cede sovereign space on the lines of the EU, or even the OECD. The Bretton Wood twins reflect the economic reality prevailing at the end of the Second World War and major governance issues need to be sorted out if they are to regain global pre-eminence. The voice and participation reforms in the World Bank and IMF recently done under the aegis of the G-20 are relatively too modest

to induce major developing countries to assume equal responsibility for global outcomes. There is presently some concern that the expanding agenda in the G-20 mostly reflects the concerns and perspectives of developed countries; and that negotiations that are stalled in more inclusive and legally binding bodies such as WTO and UN organizations are double tracked in the G-20.

Beyond the Washington Consensus

To carry its global reform agenda forward, the G-20 has tasked international financial, regulatory, and code-setting bodies to formulate appropriate best practices in their respective areas; it has also initiated a mutual assessment process to make global growth more balanced, sustainable, and strong in going forward and also to prevent similar crises in future. This growing G-20 macroeconomic policy and regulatory consensus, which incorporates the perspective of major developing countries, is recasting the old and largely G-8 centric Washington Consensus reflected in the documentation of the IMF, World Bank, and the OECD.

What this new consensus will be remains to be seen. Through its various working groups, workstreams, and communiqués the G-20 is slowly but surely developing an OECD-like 'acquis' that reflects the current consensus amongst major developed and developing countries on critical global economic issues. The G-20 has to a great extent delivered on its promises on the crisis resources front and, through international code-setting bodies like the FSB and the Basel Committee on Banking Supervision (BCBS), is contributing substantially to arriving at a consensus on revamping financial sector regulations. It is less clear how much of this would be eventually implemented, since nothing is legally binding, and there is no global super-regulator. Financial sector regulation will be nationally legislated and implemented for the foreseeable future. Likewise, both monetary and fiscal policies are crafted and implemented nationally even though global consensus and coordination on their general direction is being attempted through the G-20. The third G-20 leaders' summit at Pittsburgh also put in place a peer review of macroeconomic frameworks of their economies to abate global imbalances and to raise and sustain global growth. It is, however, still to be seen how effective the peer review process would be.

The credibility and future of the G-20 grouping now seems to rest substantially on the perception of its ability to deliver on its own ambitious and rapidly expanding agenda that, encouraged by its success in delivering in crisis situations, may presently be racing ahead of the nation-state. The G-20 leaders' declarations and working

Table 1 The G-20

G-20 country	Gross domestic product			
	PPP* 2010 (%Share)	Rank	MER** 2010 (%Share)	Rank
EU	20.43	1	25.88	1
USA	19.74	2	23.30	2
China	13.58	3	9.34	3
Japan	5.80	4	8.68	4
India	5.47	5	2.44	11
Germany	3.96	6	5.27	5
Russia	2.99	7	2.33	12
UK	2.93	8	3.57	7
Brazil	2.92	9	3.32	8
France	2.89	10	4.11	6
Italy	2.39	11	3.27	9
Mexico	2.11	12	1.65	14
Korea	1.96	13	1.60	15
Canada	1.79	14	2.50	10
Indonesia	1.39	15	1.12	17
Turkey	1.29	16	1.18	16
Australia	1.19	17	1.96	13
Argentina	0.87	18	0.59	19
Saudi Arabia	0.84	19	0.71	18
South Africa	0.71	20	0.57	20

Source: IMF (2011).

Note: * Purchasing Power Parity; **Market Exchange Rate.

group recommendations are consensus documents, the products of long, hard-nosed negotiations, whose careful choice of words and constructive ambiguities frequently mask underlying stresses and geopolitical undercurrents. As a result, the G-20 track record on reaching agreements was good, even as its track record in implementing what was agreed on was not. There are clearly divided developed and developing country perspectives on reforms of the Bretton Woods institutions, especially between the Europeans and the bigger EMEs. There are also nuanced differences between the Anglo-Saxon model of a relatively lightly regulated market capitalism with low tax rates, and the more Statist, tightly regulated social capitalism based on automatic stabilizers and higher tax rates that has led to differing perceptions on discretionary fiscal stimulus and the extent of regulatory reforms required. The regulatory reforms' priorities in developed countries are pitted against the developmental priorities in developing countries. Most important, there is the tension between the United States and China on the issue of global imbalances, exchange rates, and the global reserve currency. These differences need to be harmonized for the G-20 to emerge as the new institutional structure to coordinate macroeconomic policies, address structural

problems in the global economy, and collectively assume responsibility for global outcomes.

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■ Indira Gandhi

Indira Gandhi was born in Allahabad on 19 November 1917. She became the third Prime Minister of independent India, 48 years later, on 19 January 1966. By then, she was a well-known figure on the Indian political scene. She had been a minister (holding the portfolio of Information and Broadcasting) in her predecessor Lal Bahadur Shastri's cabinet from June 1964 to January 1966. Prior to that, in 1959, she had been elected President of the ruling Congress Party. However, a much more important political consideration among the leaders of the party in electing her Prime Minister was her popularity in the country as the daughter and companion of her father Jawaharlal Nehru, the first Prime Minister of independent India. Nehru was an iconic figure, who was universally admired for his leadership during India's long freedom struggle against colonial rule in close association with Mahatma Gandhi.

Indira Gandhi was Prime Minister for as many as 16 years in two spells—from 19 January 1966 to 23 March 1977, and from 14 January 1980 until her death on 31 October 1984. Both politically and economically, the 16 years of her rule were probably the most eventful years in India's post-Independence history. Politically, the pre-eminent political party, the Congress, split in 1969 as a result of internal differences. India was faced with severe crises in several states, particularly Kashmir, Punjab, Assam, and Kerala. Border tensions with Pakistan had also become intense particularly during the Bangladesh war of independence in 1971. Relations with the United States had deteriorated sharply after the war with Pakistan in 1965. As a punitive measure, the US had decided to suspend aid to India during one of the worst droughts and balance-of-payments crises in the mid-1960s.

Worst of all, Mrs Gandhi decided to promulgate, by Ordinance, an internal Emergency in June 1975 without adequate cause and without any prior consultations with the ruling party or Parliament. The Emergency deprived Indians of all their fundamental freedoms. Press censorship was imposed, the Constitution was amended to make the government and its leaders unaccountable for their actions, and political leaders in opposition were put behind bars. Fortunately for India and its people, the Emergency ended in 1977 after fresh national elections were announced. In March 1977, the ruling Congress Party was decisively defeated as a result of public anger against the excesses of the Emergency. The new government that came into power in 1977, however, did not last long because of internal dissensions. Mrs Gandhi became Prime Minister again after elections in January 1980.

From an economic policy point of view, the two periods of Indira Gandhi's rule (that is 1966–77 and 1980–4) were vastly different. The first period was perhaps the darkest in India's history. In addition to repeated droughts in the mid-1960s, India was also trapped in severe and prolonged balance-of-payments crises. It did not have sufficient access to external and other capital flows due to suspension of US assistance and the impact of the US decision on other bilateral and multilateral donors. In order to cope with the extremely difficult economic situation, the wide-ranging government controls on the economy were further intensified and expanded to banking, insurance, real estate, and several other sectors. One of the most significant steps, which was taken at the initiative of the Prime Minister despite the opposition of the then Finance Minister Morarji Desai, was the nationalization of 14 commercial banks by an ordinance. This move set the pace for further expansion of government ownership in the economy through takeover of weak or sick private-sector units and nationalization in strategic areas, including wholesale trade in food grains (which had to be reversed after only a few days). Import, export, production, and investment controls became all pervasive. Even the most inconsequential economic activity required specific government approval.

The economic consequences of expansion and intensification of government controls were far-reaching. The annual growth rate during the first period of Mrs Gandhi's regime was less than 3 per cent and population growth was more than 2 per cent. As a result, there was very little growth in per capita incomes. The pace of industrialization plummeted and balance-of-payments crisis became even more severe. The rate of growth in industrial output was virtually half of the growth rate of