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Let's bring our acts together

G20 Monitor editorial by Ignazio Angeloni

22 February 2011

There is an unequivocal sign that a cooperation mechanism, a policymaking forum, a "G" in short, is losing effectiveness; that its agenda is becoming an end in itself rather than a premise for purposeful action. It is when its press communiquées lose focus and turn into long lists of unrelated wishes, none of which entailing a serious commitment by any of the participants. We have seen this in the past, for example in certain phases of the G7/G8 history, and malicious voices suggest this is already happening to the G20, the young and most ambitious global economic cooperation forum ever conceived. Are the critics right? Should we lose hope and start thinking about something else? The ongoing French presidency, that will convene the next summit in Cannes in November, is a tests. Meanwhile, based on our criterion, the ministerial meeting just concluded in Paris gives little ground to contradict the critics.

As already noted in this Monitor, the first steps of the G20, after the launch of the new formation at the level of heads of state and government (Washington, 2008), had been promising. Pressed by events, in the Fall of 2008 the leaders swiftly put together a sensible list of priorities and an innovative delegation structure, composed of the G20 summit at the top, supported by ministers and governors, and by the Financial Stability Board and the International Monetary Fund conducting technical work in their areas of expertise. More importanly, concrete actions followed, especially in the area of financial regulation.

Then two things happened. To begin with, the crisis ended; or, should we say, its most acute manifestations in the financial markets subsided. As we had expected, the ensuing sense of relaxation weakened the will of policymakers to minimize divergences and agree on concrete actions. Second, the priorities evolved. Faced by the difficulty of agreing on a set of macro-policies to reduce global imbalances, participants turned attention elsewhere: to the reform of the international monetary system (an even more contentious subject, if possible), to the wish of some governments to combat "speculation", notably in commodity markets, to the implications of rising inflation and the exit strategies, and so on.

A good starting point is to recognise that all these issues are linked. All G20 members (even the US now) agree that global imbalances contributed to the crisis, and that something should be done about them now, before new and bigger gaps arise. The state of the international monetary system (IMS) is an angle of the same problem. For surplus and deficit countries alike, global imbalances are a symptom of the inability of the current non-system to define, and enforce, any meaningful notion of "rules of the game". The US were allowed, even encouraged, to neglect their rising external deficit by their ability to issue ever increasing volumes of the only universally accepted reserve asset, the US dollar. On the surplus side, China and others were moved by similar (dis)incentives, with reverse sign; they were even forced, by lack of alternatives, to accumulate surpluses in order to secure precautionary buffers against future adverse shocks. The present system lacks self-regulation, not only with regard to bilateral payment positions but, more importantly, with regard to global liquidity creation.

Here is where commodity price booms link up. In early 2008, when the financial crisis could still be mistaken as mild and the recession had not yet started, commodity prices reached a historical peak, fuelled by five or more consecutive years of global liquidity expansion. After a short halt we are now seeing something similar happening again. Commodity markets are discounting the fact that the international community has found no better way, to exit the recession an prevent double dips, than to reactivate the same mechanisms of the past, made of new and bigger imbalances and an excessive expansion of global liquidity. "Speculation" (whatever it means) may add fuel in certain situations, but the new commodity bubble we are now observing (accompanied, not by chance, by stock market indices again well above historical trends) logically follows from the current global policy setting.

The French authorities were right to include the reform of the IMS among the key priorities of the presidency. The problem is that none of the realistic alternatives can by itself guarantee greater discipline, in a reasonably near future. A multipolar system, with a somewhat more prominent role for the renbinbi and perhaps the euro, would help balance the composition of international reserves but not necessarily ensure a firmer control over their total creation. The same applies to other proposals under discussion that feature an enhanced role for the SDR, either via regular allocations or some form of "substitution account". It is unlikely that a better control of global imbalances can result soon from changes in the IMS. Besides, if effective cooperation is hard to achieve consensually, as we see, it is equally hard to seek it through systemic rules that themselves need consensus to be decided and enforced.

A peer review process, based on a shared methodology and indicators to detect which country is out of balance and should adjust, supported by an adequately empowered IMF, still seems the inescapable starting point. The Paris meeting just concluded opened up with a simple suggestion on the table: using 5 indicators (current accounts, international reserves, exchange rates, public deficits and private savings) to preliminarily identify external imbalances, triggering a more detailed review. After 2 days of discussion it agreed on the following formula to define the relevant indicators: "(i) public debt and fiscal deficits; and private savings rate and private debt (ii) and the external imbalance composed of the trade balance and net investment income flows and transfers, taking due consideration of exchange rate, fiscal, monetary and other policies." One may object to this use of ministerial time, or to the convoluted wording, but this matters little. What is important is to move ahead: complete the agreement with operational guidelines and put the review process to work. This is what the leaders promised in Pittsburgh. Perhaps the parties will end up agreeing on what to do, even if they disagreed on why to do it.

Post scriptum. Two final remarks on other subjects:

1. Financial reform. This is another key topic of the G20 agenda, but was not a majoe focus of the discussion in Paris. Ministers and governors reiterated their mandate to the Financial Stability Board to bring forward its agenda, notably on all aspects of the Basel III framework and on shadow banking systems. All in all, the FSB agenda appears to be on track, though effective implementation in all jurisdictions will be a different matter.

2. Speculation in commodity markets. After the comments heard on the eve of the meeting, it is surprising to see that the word "speculation" was not even mentioned the ministers' final statement. This is unfortunate, not because the subject necessarily justifies policy intervention, but because it would be useful to give more substance to the notion of "potential excessive commodity price volatility", mentioned in the statement. The IMF has already conducted analyses that could be revisited and updated in light of the recent experience, as a basis for a G20 position on this issue.