CENTRE FOR EUROPEAN REFORM

The G20 summit - a distraction?

by Simon Tilford, 3 April 2009

The good news first. The summit delivered more than expected. The trebling of the funds available to the IMF goes well beyond anything expected and is very welcome. From a European perspective it increases the likelihood of further crises in central and Eastern Europe being handled through the IMF, rather than the EU having to get involved in the politically fraught business of setting conditionality. A renewed commitment to resist protectionism, together with an additional $250 billion for trade finance and $250 billion in special drawing rights are positive moves, as is the agreement to use the proceeds from IMF gold sales to help the poorest countries.

The agreements to extend financial regulation to all systemically important financial institutions and to establish a Financial Stability Board (FSB) to replace the existing Financial Stability Forum (FSF) also represent progress. The FSB will include FSF members along with G20 countries that are not FSF members, Spain and the European Commission. It will be in charge of identifying systemic risks and will collaborate with the IMF to provide an early warning system for future crises. The FSB will also implement FSF principles on bankers' pay and insure appropriate capital adequacy ratios. The deal represents a necessary democratisation of the international financial system.

Now the bad news. The agreement does little to address the immediate challenges facing the global economy – dealing with toxic debt and the contraction of aggregate demand. In this respect, the summit and the grandiose statements accompanying it were probably a distraction. There is little in the agreement that will help "restore confidence, growth and jobs" or "repair the financial system and restore lending", as claimed by the summit communiqué. Over time, the agreement might help to "strengthen financial regulation and rebuild trust" and could help to ‘prevent future crises’. But it is unlikely to help "overcome this crisis."

The absence of additional national measures to stimulate demand comes as no surprise, but it is no less disappointing. Perhaps the most important moment at the summit was when President Obama reminded the world that it can no longer expect the US to provide a disproportionate share of the growth in global demand. While condemning the US for its profligacy and talking about the advent of a fairer, more multilateral world, many countries seem to be relying on the US continuing to perform the role of 'consumer of last report'. This is either hypocritical or parochial or both.

Across much of Europe, the summit agreement is being portrayed as victory over the 'Anglo-Saxons'. This is rather puzzling. The agreement will not lessen the economic crisis facing Europe. Listening to French and German criticism of US proposals for a co-ordinated stimulus, anyone would be forgiven for thinking that the US would have had most to gain from such a package. In fact, the countries that stand to lose most from the collapse in global trade and the prospect of several years of exceptionally weak growth in global demand are the countries running big trade surpluses. The Japanese understand this and the need for stimulus; the German government does not. Europe as a whole will pay the price.

Similarly, the G20 agreement will do very little to address the problem of frozen credit markets. The Europeans are right to stress that strengthened regulatory oversight will be needed in order to put the financial sector on a more stable long-term footing. Indeed, everyone recognises this. But the more immediate problem is dealing with toxic debt. Agreeing to tighten regulation once the recession is over will not persuade financial institutions to lend now. The agreement to "provide significant and comprehensive support to our banking systems to provide liquidity, recapitalise financial institutions, and access address decisively the problem of impaired assets" means little. Too many European governments remain in denial over the extent of the problem, and will not take the necessary action to remove toxic debt from their banking systems.

The deal will not prevent the economic slump in Europe from deepening. This will lead to the further weakening of public finances that many European governments are anxious to prevent. Moreover, even the strengthening of multilateral control over the global financial system might have unintended consequences for some European countries. One systemic risk the FSB is almost certain to flag up is the persistence of huge, structural current account deficits, and the destabilising impact these have on the global financial system. A more regulated global financial system will involve more obligations for the big surplus countries, such as Germany.

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