CENTRE FOR EUROPEAN REFORM

# The real G20 agenda

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*13 March 2009*

Finance ministers from the G20 countries are meeting in London this weekend to prepare for the global economic summit at the start of April. Expectations are high. But what will the summit be about? Judging by recent comments from European leaders, the agenda will include clamping down on tax havens, regulating hedge funds and cutting bankers' bonuses. Most commentators agree that these questions are not the most pressing for restoring financial stability and economic growth. Martin Broughton, president of the UK employers' federation CBI, rightly dismissed them as "red herring issues".

World leaders must focus two things: how best to work together to prevent an even deeper global recession; and how to avoid future crises of such magnitude.

The first issue is as pressing as it is divisive. While the US administration is pushing for more fiscal spending, the Europeans are reticent, and most emerging powers are keeping quiet. Many countries are loath to commit to more budget spending before they know whether and how their existing emergency packages are working. The second part of the agenda is longer term and fiendishly complicated. No-one should expect an unwieldy group of 25 or so (G20 has become a misnomer) heads of state to discuss the minutiae of capital adequacy ratios or cross-border supervision. The G20 is a process, not an event, and this summit is a political exercise, not a technical one.

What the April meeting is really about is maintaining faith in multilateral solutions at a time when the temptation for go-it-alone and beggar-thy-neighbour policies is growing. If leaning on Liechtenstein or forcing disclosure onto hedge funds helps this cause then so be it. But in terms of confidence building two issues appear paramount: the role of the International Monetary Fund and governments' commitment to avoid protectionism.

Since September 2008, the IMF has lent over $50 billion to countries ranging from Pakistan to Ukraine. It urgently needs more cash. The US and EU governments are supporting a doubling of the Fund's resources to $500 billion. They appear less willing, however, to redress their own over-representation in international financial institutions. This would be a precondition for emerging powers such as China to contribute significantly to an increase in IMF resources, and – perhaps more importantly – accept its legitimacy at the heart of the global financial system.

The IMF needs enhanced legitimacy to fulfil other functions that will be equally essential for future financial stability. First, the world needs better surveillance of national macro-economic and exchange rate policies to address the kind of global imbalances that have contributed to the current crisis. The IMF already has such mechanisms in place but they need to be strengthened. Second, the Fund needs to expand its new, $100 billion short-term, conditionality-light lending facility for emerging markets that are well run. It could also encourage such countries to pool their foreign exchange reserves to make them available for emergency lending.

Without easily available emergency finance, emerging markets will conclude that the best insurance against future pain is to accumulate more reserves. They will do this by keeping their currencies down and running big external surpluses. This kind of policy, as practiced by China, has already caused lots of friction. In an environment where global trade is shrinking, it would fuel a nasty protectionist backlash in the West. That is why the G20 summit needs to produce a firm commitment to increasing the IMF's role and resources while setting in train a thorough reform of its governance structures.

There are already some signs that protectionism is rising. World Bank economists have counted 47 new trade restrictions since late 2008. More than a third have been put in place by the G20 countries that pledged to avoid such measures at their November 2008 summit. But the real risk is not a return to a 1930s-style tariff war but what Richard Baldwin and Simon Evenett (in a recent CEPR paper) call “murky protectionism”: industrial subsidies, requests that banks lend to only local companies, or the use of environmental arguments to discriminate against foreign goods and services. Examples abound, such as the ‘buy American’ provisions in the US stimulus programme or Nicolas Sarkozy’s idea that French car companies should make cars only in France. Encouragingly, in these instances international outrage ensued and the governments in question backtracked. The risks, however, remain high.

Therefore, G20 leaders need to broaden the ‘no protectionism’ pledge from last November to cover non-tariff measures. And they need to task international organisations such as the OECD and the WTO with alerting the world to national measures that could be harmful for that country’s trading partners.

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