Chapter 2
Prospects for the G20 Leaders Summit on Financial Markets and the World Economy

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Introduction

The Significance of the Summit

On November 14–15, 2008, the most powerful leaders of the world's 20 most powerful countries will gather in Washington DC for the Leaders Summit on Financial Markets and the World Economy. The meeting itself and the performance it promises make it a truly historic event.

Economically, the summit represents a bold response to the American-turned-global financial crisis that is devastating so many economies and lives around the world. It confronts a financial crisis unfolding with a speed, geographic and sectoral scope, and severity never seen before. With most advanced and some emerging countries plunging into a recession that threatens to be long and deep, the summit addresses the urgent need for further fiscal and monetary stimulus and macroeconomic policy co-ordination as a whole. The summit seeks to come to an agreed-upon and accurate understanding of the causes of this unprecedented crisis, the appropriateness and adequacy of the national and international policy responses thus far, and an assessment of what needs to be done in the short, medium and long term to control, contain and conclude the crisis, and to prevent it or a successor from erupting again.

Politically, the summit shows America's attempt to regain the global economic leadership it had abandoned during the past decade of almost uninterrupted prosperity, feeding an all-American approach to free market capitalism that appeared to work for America and was advanced as the model for all to adopt. The G20 summit recognizes that America alone or acting with only a few advanced economy colleagues in the G7 is no longer able to provide adequate and appropriate global economic governance, for emerging powers, led by reserve-rich China, now serve as the growth locomotives able to pull the world out of a deep recession over the medium term.

In the realm of global governance, it is important that American president George Bush chose to confront the crisis by calling the broader group of 20 systemically significant countries together at the summit level for the very first time, rather than rely on any smaller established or ad hoc group or on the broadly multilateral International Monetary Fund (IMF) in Washington or the United Nations in New York. The G20 provides the right combination of powers, with a decade of proven performance from their finance ministers and central bank governors, to devise a new global financial and economic architecture to replace the policies and institutions of the old mid 19th-century order with those appropriate for the tightly wired, globalized 21st-century world. Designed from the start as the first in a series of such summits, the Washington G20 gathering also promised to inaugurate a permanent leaders-level 20 (L20) institution. As its visionary, Paul Martin, had long foreseen, this L20 would reinforce and even replace the smaller G8, born in 1975, with a new, more effective and legitimate centre of global governance as a whole for a transformed 21st-century world.

Schools of Thought

In the immediate lead-up to the summit, its importance and prospective outcomes give rise to a vigorous debate among a wide range of competing schools of thought.

The first school sees the summit as a “dangerous diversion” from a multilateral, development-oriented UN and one unlikely to produce any concrete results. Mary Robinson argues that it would detract from the UN’s Doha conference on development scheduled for November 29, 2008 and would deliver nothing of substance because President-Elect Barack Obama would not be there (Smyth 2008). Waiting for Obama would produce the desired transformational change the president-elect promised, and do so across the wide range of finance, economic, aid, trade, debt relief and global governance issues in the development-oriented way the new president cares deeply about.

The second school sees nothing needed nor likely. Led by Martin Feldstein, it argued there would be no major breakthroughs by way of international regulation (So-hyun 2008). Moreover, none were needed because both the causes of the crisis and responsibility for solving it lay with national financial supervisory systems where leaders could not tell one another what to do. Nor were major changes needed for the Bretton Woods bodies, beyond management, procedural and voting reforms.

A third school saw little expected (Beattie 2008). This was because of the absence of adequate time to prepare, the hosting by a lame duck George Bush looking for a legacy and short-term political popularity, the looming presence of President-Elect Obama, who lacks the 13 years’ experience that Roosevelt had when the original Bretton Woods architecture was invented in 1944, and the differing policy approaches between Obama and Bush.

A fourth school, at the other end of the spectrum, sees the summit as the potential “historic start of the L20” as a permanent new centre for global governance as a whole (Martin 2008; Crane 2008). David Crane argues that “if the G20 proves to be effective in reforming the international financial system, then an L20 becomes a greater possibility.”

Thesis

The first G20 summit will likely produce a substantial success across all the core global government domains. It will help hard-pressed leaders manage their domestic politics, define a considerable if constrained core agenda, set principles grounded in basic values of democratic openness, take decisions on some key issues, help deliver commitments made by the G8, G20 finance, the Financial Stability Forum (FSF), the IMF, the World Bank and the World Trade Organization (WTO), and develop global governance by creating its own working groups and clearing the path for an ongoing G20 summit process — and perhaps permanent institution — to be born. Such success will be driven by the equalized vulnerability of America and most G8 countries as well as the emerging economies to the forces unleashed by the American-turned-global financial crisis, but the failure in the response of an IMF still designed for a 1940s world of limited, largely government-controlled financial glows. Success will also be driven by the equalized power within a G20 where non-G7 members China, Saudi Arabia and Russia now have available surplus dollars that the IMF, the World Bank and many G7 countries now badly need. It will be reinforced by the common commitment to economic openness of all members and to political openness of all but two members, by the substantial political capital and control of the key members, and by the power-constricted participation that comes from using the decade-old G20 as the institutional nest.

Prospective Performance

Domestic Political Management

In the domain of domestic political management, the G20 summit will help its leaders manage their policy agendas and publics at home, especially as the latter grow increasingly anxious and angry about the growing financial and economic crisis at hand. Those members are led by Bush, the host, who is eager to show his reluctant Congress and a citizenry that doubts his economic leadership that his recent domestic initiative and longer-term legacy are effective and admirable. Britain's Gordon Brown is in much the same position, and buoyed by an unexpected by-election win in Scotland in the belief that his high-profile economic summitry abroad can help him politically at home. With all G8 economies plunging into, or toward, recession, their leaders need to be seen to be trying to stop the slide. This is especially true for those, led by Japanese prime minister Taro Aso, with coalition governments, who lack full control of their legislatures and who must go to the polls soon. The generally favourable publicity that the unprecedented G20 summit has gained in the lead-up plus the publicity flowing from the preparatory G20 finance ministerial in Sao Paulo suggest that the summit will indeed produce the domestic help these leaders need.

Deliberation

In the domain of deliberation, the summit will set an ongoing agenda that embraces finance and macroeconomics and the closely related issues of trade, development and energy. with microeconomic and social policy concerns such as unemployment will likely be added to this list. The formal, recorded agenda will be as broad as that of the first G7 summit at Rambouillet, France, in 1975, including "east-west economic relations," which has now assumed a new form.

Direction Setting

In the domain of direction setting, the summit, as designed by its American host, will set several key principles to guide the work ahead. These principles will be firmly grounded in economic openness, with a particular emphasis on free markets, open investment and trade, an acceptance of industry-driven supervision and a still-limited if reformed regulatory role for the G20, with its overwhelming majority democratic members (as distinct from international regulators, which are far less democratic than those within sovereign states. The emphasis on transparency and accountability of company executives to their stakeholders and government regulators to their legislators will extend openness into the political realm and reinforce democratic principles as a result. The call for clearinghouses to process hitherto opaque products such as credit default swaps offer enhanced economic openness by creating genuine markets and democratic political openness by giving market participants and government regulators more knowledge and ease of control.

Decision Making

In the domain of decision making, there is likely to be some specific collective action on at least a few items, as the Europeans have urged from the start and as the American hosts have come to agree. The American hosts have already added to their list of summit deliverables a few concrete immediate actions, without specifying what they would be. It would indeed be difficult for the most powerful leaders of the 20 most powerful countries, 18 of them democratically elected, to appear at the end of such a high-profile event to admit that they had taken no concrete decision to address the immediate financial and economic crisis that was causing their citizens such distress.

The concrete actions will come first in those areas that the FSF has ripened since April and asked to be agreed upon before the end of 2008. Of particular appeal from this list are those items advanced at the G7 finance gathering in October and endorsed by the G20 finance meeting in Sao Paulo the week before the G20 summit (see Appendix A). Candidates for an even shorter list come from those items that accord with positions American president-elect Obama has taken before or after the November 4 election and those he started to discuss as president-elect with the world's most important leaders in his wave of congratulatory telephone calls (see appendices B and C).

The most likely candidates are action on bank capital adequacy requirement, to give the principle of reducing the pro-cyclicality bias some practical effect. A second is a requirement that that rating agencies should be registered, at least at the national level. A third is that that credit default swaps and other such instruments and players should have a central clearinghouse, so that a real market can operate and do so in a more transparent way, for market participants and government authorities alike. In keeping with this calculus and choice, by November 5 the U.S. indicated that actions could include those related to increasing transparency, improving risk management, improving co-ordination among regulatory authorities, and adopting more consistent and convergent rules in accounting or capitalization.

As these lists suggest, the specific actions are highly likely to come from these core financial issues, on which G20 authorities have long been working, rather than in the most visible classic fields of monetary and fiscal stimulus. Even those central bankers with the room to reduce their interest rates more, and the desire to do so in simultaneously common or actively co-ordinated fashion, are reluctant to give the appearance of doing so upon the direct instructions or invitation of their political heads. In the fiscal stimulus field, most of the big countries, whether an established economy or an emerging one, have already announced their major stimulus packages, most notably China with its US$586 package — unveiled while G20 finance ministers and central bank governors were meeting on November 8.

An additional candidate for concrete collective action is a new facility and resources from the IMF and the World Bank, designed to help the emerging and developing economies cope with the distress they now face. Both bodies have already been active in this direction. Gordon Brown has travelled the Middle East to secure the greater funding the Bretton Wood bodies need. And some emerging economies with surplus financial resources could see advantage in responding this way at this time — at a summit in Washington that George Bush hosts and that President-Elect Obama watches.

Delivery

In the domain of delivery, the summit will advance the implementation of the many outstanding commitments made earlier in 2008 by the G8 Plus Five summit in Japan in July, the G7 finance ministers, and the FSF, the IMF and World Bank at their spring and fall meetings (notably on the second stage of institutional reform), as well as the WTO from many years before.

From the WTO in the field of trade, the summit will call rather strongly for the long-overdue Doha round to finally get done. From an early stage Britain's Brown has called for the summit to do this. Subsequently, host Bush called for the summit to affirm trade liberalization as well. At Sao Paulo, the finance ministers of Brazil, Russia, India and China — the BRICs — put the "get Doha done" demand in the communiqué they issued on the eve of the G20 ministerial. Moreover, the November 14–15 summit combines all the 20 at the leaders level, the only level at which the critical decisions can be made. The developing countries' club of trade ministers (also sometimes known as the G20) has proven it can stop any action, but it cannot deliver anything better than Doha, and thus it leaves poor countries with the pre-Doha status quo. All cash-strapped countries have an incentive at least to get Doha done for development. And a free-trading Bush has a particular incentive before he leaves and a new president and Congress, both presumed to be more protectionist, come in.

Developing Global Governance

In the domain of developing global governance, the G20 summit will issue instructions to other international institutions, create working groups with their own schedules, and define a process for subsequent G20 summits that could well lead to a permanent new institution being born.

The G20 working groups, at the official and perhaps also the ministerial level, will include representatives of the multilateral IMF and the World Bank, along with smaller bodies such as the FSF. This is in part to bring the work of both the IMF and FSF more closely together, without asking the FSF to be subsumed by the IMF.

The summit will endorse the G20 ministerial decision to strengthen the latter by moving from consensus into policy action. But it will probably not endorse any of the broader proposals, advanced by Brazil, to have the G20 finance meet twice a year (just before the spring and fall meetings of the Bretton Woods bodies), hold more emergency meetings or create a virtual centre for crisis monitoring and prevention. Nor will it ask the G20 finance to expand to include a Spain that has slipped into the Washington summit for a single moment to replace France as the representative of all the 27 members of the European Union. There is no evidence thus far that Spain, focused on its own national status and self-proclaimed role as a national model for the world, will even attempt to play this pan-European role.

The G20 leaders will likely endorse or decide on the expansion of the FSF to include emerging economies, as the G20 finance ministers and central bankers agreed in their communiqué on November 9. They could well provide guidance on how, how fast and how far the expansion of the IMF/World Bank voice and vote, and reform of the mandate, mission and management of those institutions should go. They should also, at least, signal the path for subsequent G20 summits, with the next one probably taking place in Paris between February and April 2009. But they will not speak about whether the G8 summit or G7 finance ministers forum should be expanded in any way.

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Appendix A: Priorities for Action on Financial Regulation

From the "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience: Follow-Up on Implementation," October 10, 2008. Bold indicates priorities repeated in the G20 finance communiqué from Sao Paulo on November 9, 2008.

Principles (7 from FSF, 5 repeated by G20)

- **Less leverage**
- **Misaligned incentive immunization**
- **Strengthened prudential and regulatory oversight**
- **Transparency to identify and manage risks**
- **Integrated global financial markets preserved**
- Level playing field across countries
- Deeper integration with other major economies

Actions (12 from FSF, 6 repeated by G20)

A. By End of 2008

- Bank capital and liquidity standards and oversight strengthened
- Risk management standards in financial institutions
- Valuation practices
- Accounting standards

B. Additional Issues

- Emergency arrangements international interaction and consistency
- Pro-cyclicality in capital regimes, loan-loss provisioning, compensation and valuation-leverage interaction
- Scope of financial regulation and unregulated institutions, instruments and markets
- Macroeconomic oversight-prudential supervision integration

C. Accelerated Implementation

- Central counterparty clearing for over-the-counter credit derivatives
- Accounting standards for inactive markets and off-balance sheet activities and risks

D. Additional Calls

- Credit rating agencies' differentiated information/ratings for structured products
- Private sector monitoring implementation

Appendix B: Barack Obama's G20-Related Priorities

A. Financial Regulation

- Principles for national regulatory crackdown
- Consolidate/streamline U.S. regulatory agencies
- Stronger liquidity, capital and disclosure requirements on financial firms
- Federal oversight for unregulated hedge, mortgage, derivatives and rating firms
- Stronger penalties for market manipulation and predatory lending
- New financial market oversight commission to advise regularly on risks

B. Economic Stimulus

- Immediate U.S. fiscal stimulus of $60 billion for food, unemployment, state government subsidies
- Follow-up U.S. fiscal stimulus once inaugurated through a front-loaded tax cut for families earning under $250,000 per year, homeowners not itemizing deductions, savings accounts, college fees and farming and an alternative minimum tax adjustment for the middle class, plus increased taxes on the top two marginal rates, capital gains and dividends
- Allow judges to change home loans on primary residences

C. Financial Support and Subsidies

- Supported $700 billion rescue package and $250 billion to recapitalize banks
- Homeowners refinancing troubled loans
- Considers another $25 billion loan aid to auto industry

D. Climate Change and Clean Energy

- $150 billion over 10 years in clean energy technology investment
- Greenhouse gas emission reductions
- Reduced U.S. oil consumption, encouragement for energy conservation and efficiency and for low-carbon wind, solar, nuclear and renewables

Appendix C: Barack Obama's International Summit Agenda

Country	Length of Call	Leader	Issue
Japan	10 minutes	Taro Aso	Climate change, North Korea and Afghanistan
Germany	Unknown	Angela Merkel	Financial crisis, climate change, Iran's nuclear disputes, Afghanistan
United Kingdom	Unknown	Gordon Brown	Reforming financial system
France	Unknown	Nicolas Sarkozy	Reforming financial system
Canada	Unknown	Stephen Harper	Unknown
Mexico	Unknown	Felipe Calderon	Drug smuggling and immigration
South Korea	Unknown	Lee Myung-Bak	Financial turmoil and North Korea nuclear disarmament
Australia	Unknown	Kevin Rudd	Global finance crisis and climate change
Israel	Unknown	Moshe Katsav	Unknown

Source: Yahoo News, November 2008.
Notes: Countries listed have engaged in discussions with President-Elect Barack Obama.