

WHAT SHOULD THE G-20 DO? OPENING STATEMENT FOR PANEL DISCUSSION

by
Danny Quah
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It is always an honour and pleasure to be on stage with Will Hutton, Mick Cox, and David Held. Collectively, we are here to discuss what needs to be done by the G-20—comprised of finance ministers and central bank governors from 19 among the world's largest economies, together with the EU.

The G-20 will, of course, be meeting here in London early next month. This April meeting follows on the *G-20 Leaders Summit on Financial Markets and the World Economy* in Washington DC November 2008. That November meeting had produced general principles and a rough plan; part of what will happen in this April meeting is to assess what has been achieved and to evaluate what concrete next steps to take.

1 WHY THE G-20?

The G-20 grew out of the G-33 and before that the G-22, formed in the wake of international financial crises 10 years ago. Before these were even a glimmer in anyone's eyes the world of course already had the G7, the group of finance ministers from the seven industrialized nations—Canada, France, Germany, Italy, Japan, the UK, and the US.

Not widely commented on but profoundly remarkable is how, in the course of the current global economic crisis, the G-20 has quietly eclipsed the G7 as the closest thing we have to a guardian of the international financial system and the world economy,

Now everyone might have these constituents already memorized but for what I want to say, it is useful to recall that the G-20 adds to the original G7 economies, the BRICS (Brazil, Russia, India, China, and South Africa); representation from Central America (Mexico), the Southern Hemisphere

(Argentina, Australia), Northeast Asia and Southeast Asia (South Korea, Indonesia), MENA (Saudi Arabia, Turkey); and finally the EU as a single bloc. In this extension, the G-20 has come to include 90% of world GDP, 80% of world trade, and two-thirds of the world's population.

There are many good things to say about any international policy-making body engaging more than before the emerging economies - not least those economies typically growing at rates 3-4 times that G7 countries usually do, and economies routinely contributing as much as the US does to world economic growth in dollar terms (even evaluated at market exchange rates, not purchasing power parity). For one, it is a simple recognition of the shift in the centre of gravity of global economic activity. But more importantly, I will argue, resolving the current global economic crisis entails treating the emerging economies not just as an afterthought but instead fully engaging them centrally in the international policy-making process.

2 WHAT HAS THE G-20 ALREADY AGREED, WHAT SHOULD THEY DO?

Out of the November 2008 meetings and subsequent discussions, it is a fair guess that four principal planks will inform the G-20 meetings in April:

1. Boost global demand — coordinated across nations, with both deficit and surplus countries playing well-defined roles. Use both fiscal and monetary instruments. Prevent contagion spilling into emerging economies.
2. Improve financial markets and restore trust and confidence in them. Build a better early warning system; provide transparency; improve supervision and cross-border regulation; raise management responsibility.
3. Strengthen world trade; steer clear of protectionism
4. Keep an eye beyond the current financial turmoil: Continue towards meeting Millennium Development Goals; combat global climate change.

Items 1. and 2. are easy to sign up to, so long as policy-makers pay mind to the dangers of overshooting on them. Similarly, 3. greatly appeals but faces populist and nationalistic pressures to not deliver.

In the perception of some observers, item 4. has been criticized as an unnecessary and distracting afterthought—I will return to it later. For now, it is plain that the guardians of the world economy want and need to boost global aggregate demand without putting in place the ingredients for future international financial crises.

My goal here is not to go over again the blame game of who is responsible for what part of global imbalances and how those led to the current financial crisis. The facts are already relatively well-known. The US economy shifted from approximate trade balance in the early 1990s to a current account deficit of \$900bn by 2006: That last year the US was consuming more than it was producing to the tune of one Indian GDP. Over this time the US bilateral trade deficit against China showed a parallel movement as the overall US trade deficit; so too the US bilateral trade deficit against the EU and the oil-exporting economies. Throughout these two decades, the US bilateral trade deficits against China on the one hand and against the EU and the oil-exporting economies on the other were each roughly a constant fraction of the overall US trade deficit.

The world therefore partitioned into a bloc of large deficit countries on the one hand (the US, the UK) and a bloc of large surplus countries on the other (China, the oil-exporters, the EU [mostly Germany]). Whether prudent savings out East *caused* profligate consumption in the West, or the other way around, the end-result is that massive international capital flows led to global imbalances that, in turn, through bad judgement and irresponsible behaviour, produced extreme financial leveraging. The unwinding of this superstructure, off of US subprime mortgage defaults, froze credit channels, crashed housing and property markets, and reduced incomes, output, and trade worldwide.

Boosting aggregate demand and restoring trust in financial markets, therefore, must at some level of abstraction be absolutely the right things to do.

A difficulty is that, all else equal, boosting demand in deficit countries worsens their deficit position and therefore exacerbates global imbalances. Fixing credit channels in the West alone will only bring the global economy so far.

Therefore, getting surplus countries to boost their domestic demand seems to be a doubly effective recommendation: world demand will rise and global imbalances will unwind. The deficit countries will see exports rise and deficits fall; and the boost to external demand will lift incomes.

3 EMERGING ECONOMIES CANNOT BE AN AFTERTHOUGHT

But why should the surplus countries suddenly agree to save less and import more?

The argument often heard is that while the current global economic crisis began in the financial centres of the US and the UK, its aftermath will be far worse in the emerging economies. So it is actually in their interest to consume more, export less, and generally spend more to reduce their massive financial reserves.

However, the experience of many emerging economies is that in a financial crisis they don't want to be caught without backup resources. The East experienced a humiliating and sobering such episode in the 1997 Asian financial crisis, and will try very hard not to be caught out again.

Something else is needed.

And, anyway, what are the facts on the cross-country aftermath of financial and economic downturns? What exactly is at stake for surplus countries that might convince them to deviate from a savings-intensive and export-led growth strategy that they have run the last two decades?

It is relatively well known that world GDP now runs about US\$50 trillion a year. The US, on the one hand, and the UK and the Euro area, on the other, each accounts for about one-quarter of the world economy.

In counterpoint to this, consider the following.

Over the last quarter of a century—about the same time period as when the US economy nose-dived into massive trade deficit—economic growth in China brought 627 million people out of extreme (\$1/a day) poverty. This number is about double the entire population of the US, and exceeds poverty reduction in all the rest of the world combined.

The US economy last experienced recession in 1991 and 2001. In the first of those US output actually fell, the same way it will do this year. But in 1991 China contributed to world economic growth *three* times at market exchange rates what the decline in US GDP turned out to be; East and Southeast Asia contributed *twenty* times; and the Middle East, North Africa, and South Asia (the MENASA economies) contributed double. In 2001 China contributed to world economic growth nearly one and a half times what the US did, again at market exchange rates; East and Southeast Asia, nearly double; MENASA, 60%.

So, longer term, in their development and export strategy China and East Asia have arguably done more for improving the human condition than pretty much everyone else. And, in recent US recessions, China and the rest of East and Southeast Asia and the MENASA economies have more than respectably held up their end of world economic growth.

Of course, as is true every other time as well, this time, this current recession is different. Emerging economies now face sharply declining export demand, falling commodity prices, and rapidly shrinking FDI. In the category of bad news, Taiwan's exports in 2009 January are 40% lower than a year ago. In South Korea the decline in industrial output in 2008 December over the past year is the steepest on record. Russia's industrial output fell 20% in January from the previous month. Japan's industrial production fell by 21% in the three months to 2008 November, and its GDP fell last quarter by the steepest rate of decline since 1974.

Even China's exports fell 13% in the fourth quarter of 2008—but actually this means they are only 3% lower at the end of 2008 than a year before. This is hardly a catastrophic collapse. And, remember, even without a global economic and financial crisis, China's economy was already having a rough 2008, with paralyzing ice storms last February, the massive Sichuan earthquake in May, and then the tight grip of the Beijing Olympics in August.

And in the category of relatively positive news, the Shanghai stock market has continued to rise since China's 4-trillion renminbi fiscal stimulus announcement last November; it was up 13% by mid February from the start of the Chinese New Year. In surveys Chinese purchasing managers' confidence levels have risen every month since November. Total bank loans in China rose 19% at the end of 2008 from 12 months before, and continued their climb in January. New cellphone subscriptions in India reach a record of 11 million in January 2009, as rural customers—who don't typically own land or hold extensive financial portfolios, and so are unaffected by plunging stock markets and real estate prices—continue to see the benefits from digital mobile telecommunications. Malaysia's financial system has only 0.3% of its banking capital exposed to the US subprime mortgage market, and profits remain high.

Sure export demand is down everywhere but, with some notable exceptions, many of Asia's financial structures are now relatively stripped of short-term foreign-currency denominated commercial bank loans.

4 CONCLUSION

This quick overview of the global economy suggests that the emerging economies—the surplus side of the global imbalance equation—should not be treated simply as an afterthought, neither in understanding why the global economy has reached the state that it has, nor in working out possible resolutions.

Simply jawboning the surplus countries to boost aggregate demand will not work. Take China for one. Chinese consumers have savings rates not dramatically different from consumers elsewhere. Instead, it is the corporate sector and the government together that provide the bulk of high savings in China. If a nation saves more because it confronts high national risk, the international community needs to remove that perception of threat and insecurity before consumption and imports will rise. Improving social security provisions for Chinese citizens is doubtless a good thing in general; I see no compelling case, however, why it would automatically lower China's aggregate savings.

Remember I had said I would come back to item 4. the Millennium Development Goals? Putting MDG centre stage is now no longer just an incidental last item on the ToDo list that the G-20 will get to if it has time and resources left over. Instead, MDG should here be interpreted to provide emerging nations greater economic security. Emerging nations need to be made to feel engaged with international financial institutions, and that those institutions are on their side and will support them in the face of economic difficulties. With the greater participation of emerging and surplus countries in the G-20, as opposed to the G7, this turn-around will slowly happen.

And it will be about time.