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Managing the global economy: G-20 or G-Zero?

The global financial crisis saw the G-20 replace the G7/G8. But is it up to the job?

Can we govern the world economy? Until relatively recently, the closest thing we had to an informal steering committee for the global economy was the G7/G8.[1] But that group's influence was both strictly limited and in secular decline: in an international economic environment increasingly shaped by the forces of the Great Convergence, a body which excluded all of the world's rising economic powers was destined to be unconvincing. The onset of the global financial crisis accelerated this relative decline as, faced with economic meltdown and an urgent need for both the appearance and reality of collective action, the world's leaders quickly decided that the G7/G8 was not fit for purpose.

While there had been a fair bit of discussion about what a replacement body for the G7/G8 might look like (some supported a G-14, for example, and others liked the idea of a more minimalist G-2 or G-3), in the end the world's leaders opted for an 'off the shelf' solution, taking the existing meetings of G-20 finance ministers and elevating them to heads-of-state level.[2] The G-20 membership list did a good job of bringing together most of the leading developed and developing economies and between them its members account for the bulk of global economic activity.

The first G-20 leaders' meeting took place in Washington DC on 14-15 November 2008. By the time of the third summit meeting, held in Pittsburgh on 24-25 September 2009, leaders were ready to announce that the G-20 was the world economy's new peak body. Their summit declaration concluded:

'Today, we designated the G-20 as the premier forum for our international economic cooperation.'

The G-20 is a manifestation of the profound shift in international economic power currently underway, and in that sense, it's plausible to see the Pittsburgh Summit as a key moment in economic history.

But while in *theory* the G-20 is much better placed than the G7/G8 to play the role of global steering committee, will it be any better in *practice*? It certainly got off to a good start, and the first three Summits were all pretty successful. But by late 2010, as the date for the fifth G-20's leaders meeting rolled around, many commentators were already speculating that the group's best days were behind it.[3] In the months and weeks leading up to the November 2010 Seoul Summit, the world economy experienced a series of heated disagreements on issues of international economic policy, including dire warnings of 'currency wars' and rising protectionist pressures. Washington was becoming increasingly critical of Beijing's exchange rate policy, even as China decried the US Federal Reserve's decision to resume quantitative easing. In *theory*, the G-20 should have been the ideal forum to resolve some of these differences. In *practice*, it mainly served to showcase the presence of big divides in the global economy, with Seoul by and large living down to the now diminished expectations.[4] Partly as a result, 2010 was judged by some as a year of relative disappointment for global governance.[5] Two prominent analysts have summed up the resulting pessimism as follows:

'This is not a G-20 world . . . We are now living in a G-Zero world, one in which no single country or bloc of countries has the political and economic leverage – or the will – to drive a truly international agenda. The result will be intensified conflict on the international stage over vitally important issues, such as international macroeconomic coordination, financial regulatory reform, trade policy, and climate change.' [6]

Their diagnosis is a powerful one and it's clear that the G-20 faces a number of significant challenges.

Arguably the <u>first</u> of these is coping with inflated expectations raised by the group's initial success. Forged in crisis, the G-20 benefited from the impetus provided by the 'hang together or hang separately' nature of the times. So, for example, in the run-up to the group's second meeting, the London Summit of April 2009, there were many media references to the failed 1933 London Economic Conference calling on leaders to learn the lesson about the need for cooperation and the potentially disastrous consequences of a public failure to reach agreement at a time of extremely fragile economic confidence.[7] As this constraint has faded, however, it was inevitable that the G-20 would face more normal times of disagreements and bargaining.

A <u>second</u> challenge is that we are in a time of major economic change. The G-20 is of course a product of these changes, but the resultant shifts in economic power make for a much more unsettled pattern of global economic leadership than we have grown used to: the existing powers have less weight than before, while the rising powers are new to the game. Not surprisingly, this complicates international economic management.

A <u>third</u> and closely related issue is the diversity of the G-20. One notable consequence of the Great Convergence is the arrival at the world's new top table of major economic powers which are also developing economies with levels of income per capita significantly below those enjoyed by their advanced-country G-20 counterparts. This big gap in national living standards is manifested in what is sometimes manifested as a clash between hypocrisy and reciprocity:

- *Hypocrisy* is the charge levelled by the emerging powers against the established ones. So, for example, on trade policy: after decades of lecturing the developing world on the benefits of free trade and liberalisation, the rich world has developed cold feet, with rich countries increasingly reluctant to allow additional access to their markets. Similarly, on international finance:

after years of preaching the gains from free capital flows, developed economies seem to have decided they are uncomfortable being recipients of investment from the developing world, sounding warnings about the dangers posed by Sovereign Wealth Funds and other state-controlled investments. And on climate change: after reaping the benefits of energy-intensive economic growth, the developed world now appears to want to restrict the ability of the developing world to seize the same opportunities.

- *Reciprocity* is the requirement of the developed world. On trade policy, for example, the bargaining dynamic that is at the heart of the WTO process means that rich countries now expect at least the biggest developing economies to be active participants, and not free-riders. On capital flows, the talk is of level playing fields and equal treatment. And on climate change, any credible agreement requires commitments from the largest future emitters as well as the largest past ones. The big developing economies are often inclined to respond to these requests with the counter-argument that they are still, after all, developing countries, and therefore cannot be expected to take on the same burdens as the developed world. While this defence has an element of truth, the reality is that demands for reciprocity are the unavoidable price for these economies' new status as emerging powers.

A fourth challenge arises because of the divided nature of the post-crisis world economy.[8] On one side of the divide is found the 'new normal,' where many developed economies are struggling with slow growth, high unemployment, and large government debts and deficits. On the other side, the forces of the Great Convergence continue to operate, with many developing economies struggling to manage the problems of success, including overheating, inflation and asset-price bubbles. Not surprisingly, these quite different policy problems and priorities can make it harder to find common ground.

A fifth difficulty reflects another feature of the post-crisis economic environment, one that can be described as the return of geo-economics.[9] This is shorthand for a general shift to treating many economic issues in terms of an underlying assumption about zero-sum outcomes, with policymakers concerned about *relative* gains and losses. This again makes international economic cooperation much harder to deliver.

Given this list of challenges, the presence of discord at G-20 summits really shouldn't come as a surprise. In fact, it's pretty much an unavoidable design feature of the new international economic order. Indeed, the real surprise is that observers appear to have been surprised by the degree of difference among G-20 members. By bringing together a broader and significantly more diverse group of countries than the G7/G8, the G-20 inevitably increases the scope for disagreement, since the range of policy interests and priorities is now much greater. While that makes it much tougher to reach any kind of consensus, it's the inescapable consequence of a more multi-polar world.

Until quite recently, much of the discussion around the international economic architecture has tended to concentrate on the issue of representation: of updating membership lists and rejigging voting weights in light of the shifting balance of global economic power. This was necessary and important and it's a task that has yet to be completed. But also it's only one part of a much bigger story. In particular, as the new architecture is put in place and the membership lists are updated then the new arrangements actually have to deliver workable agreements. For the reasons listed above, delivering those agreements is going to be no easier, and probably quite a bit harder, than producing the new architecture in the first place.

The Great Convergence means that we are now in a G-20 world, and we need to make the best of it. That means making the G-20 work. The only realistic alternative on offer – a G-Zero world – is likely to make for a much worse option.

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[1] The G7 is the group of finance ministers from a collection of leading developed economies, comprising Canada, France, Germany, Italy, Japan, the UK and the US. The G8 is the corresponding group for heads of state, comprising the G7 membership plus Russia.
[2] The G20 comprises the membership of the G8 plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa and South Korea, and Turkey to make 19. The twentieth member is the EU. For background on the G-20 see for example Mark Thirlwell and Malcolm Cook, *Geeing up the G-20*. Lowy Institute Policy Brief. Sydney, Lowy Institute for International Policy, April, 2006.
[3] See for example Alan Beattie, Bric nations grow weary of G20 rhetoric. *Financial Times*, 20 October 2009.
[4] See for example Financial Times, G20 show how not to run the world. *Financial Times*, 12 November 2010.
[5] Financial Times, A bad year for global governance. *Financial Times*, 29 December 2010.
[6] Ian Bremmer and Nouriel Roubini, *A G-zero world: The new economic club will produce conflict, not cooperation*. Comment, Foreign Affairs, 31 January 2011.
[7] Can world leaders learn lessons from 1930s at G20 summit?, *AFP*, 23 March 2009.
[8] See IEC#5.
[9] Mark Thirlwell, *The return of geo-economics: Globalisation and national security*. Lowy Institute Perspectives. Sydney, Lowy Institute for International Policy, September, 2010.