

Catch 22 for the G20?

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The Seoul summit of G20 leaders on November 11-12 will be the first such global economic meeting to be hosted by a non-G7 country. In their continued focus on the significant agenda for collective action set at Pittsburgh in September 2009 leaders face a Catch 22: the tensions and political uncertainties generated by subdued growth in turn are weakening the collective will to cooperate on the policy changes needed to restore confidence and future growth.

To the continuing agenda (global recovery, rebalancing growth, financial regulatory reform and governance reform at the IMF) the Korean hosts have added two new issues: financial safety nets and closing the development gap.

Progress on financial regulatory reform is clear. US and UK leaders, at the crisis epicenter, must respond to visceral public anger toward banks whose activities so severely damaged the real economy that full recovery will take years. Regulators raised the amount of capital banks must hold to cope with future bad debts but phased in these changes over the next decade. Measures are still needed to get taxpayers off the hook for future financial rescues and resolve problems in institutions with extensive cross-border ties, however, and at Seoul leaders will add a capital surcharge on the largest banks. Taken together, these actions will leave banks with smaller profits and less free capital to invest. Banks will be safer but will another financial crisis be prevented? Continued financial innovation suggests the answer is 'no'; already there are signs of financial activity migrating to the 'shadow' financial sector of hedge funds and private equity players beyond regulators' reach.

With weeks remaining before the summit there is more to do on other issues. The argument over IMF governance reform must be resolved. The central task of rebalancing global growth depends on political will and an agreed process of peer review. The IMF's mutual assessment process got off to a good start at the Toronto summit in June by mapping out needed changes. G7 governments engaged in a similar exercise in the 1980s using the IMF to prod them along with its technical advice. Today IMF credibility is damaged by its perceived role in the Asian crisis. Leaders have restored its financial resources sufficiently for it to provide financial safety nets but its support of the mutual assessment process is analytical. A more active role could help move rebalancing along.

At Seoul action is required. The G20's credibility is at stake. A Bank of Canada study shows a \$7 trillion potential shortfall in global economic output by 2015 if G20 governments fail to cooperate on adjustment and leave it to market forces. Current account surplus countries agreed at Toronto to shift reliance from foreign to domestic demand through such measures as infrastructure spending, changing the incentives for households' precautionary saving and increasing exchange rate flexibility. Political will is needed to cooperate rather than self-insure by managing exchange rates and accumulating foreign exchange reserves. Bilateral tensions

between the United States and China over their adjustments (a credible plan for fiscal consolidation in the US and more exchange rate flexibility in China) do not help.

G20 credibility is on the line for another reason as well. It is remarkable that trade does not appear on the Seoul agenda. Yet what could be more important to closing the development gap than completing the Doha development round at the WTO to expand market access for developing countries selling into growing world markets?

Trade specialists can identify a package of measures that would conclude Doha. The issues are sufficiently technical that leaders cannot intervene directly. But they must give the go ahead to complete the package. The five key players, the United States, Europe, China, India and Brazil, are all G20 members. Major political transitions or elections scheduled in a number of countries in 2012 suggest that a unique window of opportunity is open to complete the negotiations in 2011 that will then close.

The Catch 22 for Seoul is that leaders who should give more weight to the global interest are preoccupied with their own political issues. Determined leadership by the summit Chair could change this. President Lee Myung-bak should pick up the phone or get on a plane, whatever it takes, to twist arms and encourage agreement on one package that balances interests sufficiently to conclude the Doha round and another package of evidence of policy changes that will rebalance global growth. A smaller outcome in Seoul not only increases the chances of more crises but suggests the G20 is a talk shop when it comes to preventing them.

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