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The G8/G20 in Canada—what can we expect?

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The G20 meeting this weekend in Canada has a heavy agenda and high expectations. Leaders face a serious challenge to demonstrate determination to follow through on the September 2009 Pittsburgh summit's framework for strong, sustainable and balanced growth.

Prior to that June 26-27 meeting Canada also chose to host a G8 side show. Its challenge is to avoid any appearance of being an executive committee meeting before the G20. Canada's leaders, attached to the cosier size of the G8, selected a maternal and child health focus but muddied the waters with grudging restrictions on abortion.

The central focus at the G20 will be to change the composition of world growth as recovery takes hold: current account deficit countries should save and export more and consume less while surplus countries should consume and import more. Some of the required measures will not be popular at home as they impact consumer and trade interests that are vested in the unsustainable status quo.

Yet with Europe a drag on world growth and the US consumer no longer the engine a determined effort to rebalance is essential to take up the slack. What needs to be done?

The best strategy to ensure G20 momentum is for the largest countries to lead by example. A credible medium-term plan of fiscal consolidation would make the United States the natural leader of the Mutual Assessment process. This is unlikely until after the November 2010 mid-term elections, however, when the bipartisan National Commission on Fiscal Responsibility's report comes due.

The Chinese authorities have a rebalancing strategy that includes nominal exchange rate appreciation, shifts domestic demand towards consumption and shifts job generation more towards labour-intensive production in services as well as manufacturing. They need to follow through. Unfortunately, the euro's recent depreciation against the dollar has put unanticipated pressures on exporters' margins. So has recent labour unrest. Further delay in nominal appreciation will be inflationary and renew international tensions.

The European stabilisation fund and unprecedented central bank intervention have bought Greece time to restructure its finances. But serious questions remain about economic governance in the euro zone where deeper coordination is required to restore and maintain fiscal prudence. Clearly future economic growth will have to be sought by raising productivity through politically-difficult and long-delayed structural reforms in a slow-growth environment. Germany as the large surplus economy should stimulate domestic demand to facilitate such changes.

The G20 Co-chairs, Canada and South Korea**,** both have successes from which others can learn.

Few realise that Canada completed a major fiscal adjustment in the mid-1990s when it moved from a deficit of 8.7 per cent of GDP to a small surplus helped by public support for consolidation, a growing world economy and a flexible exchange rate.

South Korea is a graduated emerging market economy which has recovered from severe crises a decade ago. Others can learn from South Korea's strategy to reduce export dependence through domestic investments in human capital, technology and a 'Green Korea' strategy of energy conservation, clean energy R&D and energy efficient transportation.

Other East Asian economies could contribute more to global demand by reducing export incentives and increasing exchange rate flexibility; increasing domestic demand by deregulating services and encouraging green and other needed infrastructure projects; and supporting household consumption as the economies adjust by creating social safety nets.

None of these recommendations is a slam dunk because most imply painful macroeconomic and structural adjustments. But the G20's credibility to restore global growth is on the line.

The outlines of a successful summit began to appear this past week as President Obama, in a June 16 letter to G20 leaders, committed to reduce the US deficit to 3 per cent of GDP by 2015 and stabilise the debt-to-GDP ratio. On June 19-20 the People's Bank of China committed to greater nominal exchange rate flexibility. Follow through is needed in both countries, and from the Europeans, or renewed global imbalances will threaten global stability.

If growth in the heavily-indebted advanced countries continues to be modest threats of protectionism and political pressures to turn back globalisation will rise. Few have much room to manoeuvre in the face of still-high unemployment.

Thus, the second G20 summit, and the first to take place in Asia in Seoul in November, may turn out to be extraordinarily fortuitous if President Lee Myung-bak achieves further progress by persuasion and example.

We cannot afford more of the deadlock and inertia of Doha and Copenhagen. To prod governments to act – and to prevent backsliding – the IMF's Mutual Assessment analysis should be published (the April 2010 World Economic Outlook provides a more general but no less urgent assessment). Name and shame tactics helped mute protectionist actions during in the heat of the crisis. Such tactics, or a high-profile independent wise persons group, may be necessary to rally public support.

The stakes for the G20 are high. There must be forward momentum or its credibility and effectiveness will ebb away. And the burdens of global financial crises on future generations will only grow.

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