The G20 after Toronto: Now for the hard part

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The Toronto meeting of G20 leaders on June 26-27 was a stop on the road to Seoul. Leaders took a few significant steps forward but not enough has yet been accomplished to avoid another crisis and there is danger of renewed complacency. Much, therefore, is riding on the work that leads to decisions in Seoul.

Among its accomplishments, the Toronto meeting was a deadline that elicited progress on the key objective of restoring strong, sustainable, and balanced world growth. Central to that goal, deficit countries like the United States must save and export more and borrow less while surplus countries like Japan, Germany and China must consume and import more. In preparing for the meeting both the United States and China moved in this direction. President Obama, in a pre-meeting missive to leaders, committed his administration to reduce the US fiscal deficit to a sustainable 3 per cent of GDP by 2015 and the Peoples' Bank of China dropped its de facto peg to the US dollar. Now both must follow through with policy changes in the United States after the November mid-term elections and by changes in domestic policies and institutions in China to shift production to services and raise domestic consumption.

Another accomplishment was agreement to the Canadian host's proposal to halve fiscal deficits by an ambitious 2013 target date and to stabilise or reduce debt-GDP ratios by 2016. While some economies may still need further short-term stimulus (not least to save bankrupt US states) there is no excuse *not* to adopt a credible medium-term plan for fiscal consolidation as has been agreed.

Additionally bilateral meetings produced some desirable developments: the Obama invitation to Chinese President Hu for a state visit; the Obama commitment to implement the two-year old

Korea-US FTA by the time of the Seoul meeting; and a Canada-India breakthrough on civilian nuclear relations.

But crunch time comes at Seoul on November 11-12 when major decisions will be made on a new capital framework, on financial supervision, financial safety nets and on how to deal with systemically significant institutions. They intend to complete the IMF quota and governance reforms by then but shrank from more than a review of Doha negotiations and the way forward. Seoul deadlines were mentioned nearly twenty times in the 9-page communiqué and its 20 pages of annexes on growth, financial sector reform and reforms of the international architecture.

Between now and Seoul much work is needed to avoid another crisis and greater public awareness is needed of the dangers of complacency. Restoring private sectors as the engine of growth should not just rely on infusions of government cash but on potentially painful structural changes to raise productivity. Such changes include freeing up labor markets, reducing costly entitlements, deregulating the production of services to make those industries more competitive and greater exchange rate flexibility in East Asia. These kinds of changes received little official attention.

The serious consequences of inadequate action were spelled out in two ways that need more public prominence. First, leaders received the results of the IMF's Mutual Assessment process which pointed out that global output could be US$4 trillion higher in the medium-term if lthey choose a more ambitious path of reform than the programs and plans reported to the IMF. Second, Canada's central bank governor warned publicly of the huge cost to the global economy if G20 governments fail to rebalance global growth. The Bank of Canada estimates that by 2015 a worst-case deflation scenario in which debt–strapped economies (read the United States, Europe and Japan) cut spending and other countries fail to pick up the slack will cost as much as 10 per cent of global GDP that would be realised in a scenario in which the needed rebalancing between surplus and deficit countries occurs.

These estimates graphically illustrate what is at stake for the G20. Things are not returning to normal. Not only is more determined follow though required to rebalance global growth but greater determination is needed to reform the serious structural problems in the financial sector revealed by the global crisis. Better regulation and realistic capital requirements are needed that replace casino-like behavior with a more sustainable relationship between finance and the real economy.

As Canada found, intense lobbying by the Prime Minister was needed to achieve the fiscal commitment in Toronto. South Korea's Prime Minister may have his own goals for the first G20 summit to be held in Asia but the serious financial sector reforms being recommended by the experts at the BIS and FSB will need a laser-like focus and his own personal efforts to ensure they are adopted at Seoul.

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