Regional Think 20 Seminar

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Background

- Own description of itself from the erstwhile G7
  - G7 focus would be on security issues
  - G20 would be primary forum for international economic issues
- Overdue recognition of the fact that the structure of the global economy was being challenged
  - Natural move (credit to the G-7)
- The issue of legitimacy lingers
  - Does the importance of the G20 derive from the fact that it includes countries with 80% of the world's GDP?
  - Initial accolades have been dented by a weak global economic recovery

Legitimacy concerns has led to a demand for outreach

- Replication of G20 at other ministerial levels
  - Russian Presidency - Finance and Labor Ministers Meeting
- T20, Y20, L20
- NGO/civil society meeting (C20)
  - But who is a representative NGO?
- Outreach to business (B20)
  - This can be a useful forum.
  - Are Bilateral FTA's a good thing?
  - India doesn't have a FTA with the US, but it has with ASEAN, Korea and Japan
  - What are better? Multilateral or bilateral FTAs

Structure of this talk

- Assessing the G20 Macro policy response
  - Policy response tempered by lessons learned from the Great Depression
  - Cooperation versus Coordination
  - What are the welfare gains from policy coordination?
- Assessing the G20 as a Model for Global Economic Governance
  - Country Specific commitments
    - Financial Sector Reforms
    - Development Agenda

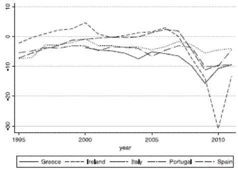
Macro policy response: Cooperation versus Coordination

- Basic rationale for coordination is to counteract externalities and remedy market failures.
  - Without coordination - governments will be tempted to pursue policies that are globally sub-optimal.
  - Uncoordinated approach to economic policy is Pareto inefficient.
  - Coordination will lead to Pareto efficient gains.
    - Not technically correct.
- Policy coordination can take two forms:
  - Rule based or discretion based
  - Attempts to coordinate behavior seem to favor rule based coordination
    - is there an effective mechanism for deterring non-compliance?
  - Discretion based coordination is only superior when there are exceptional events for which the existing set of rules cannot cope.

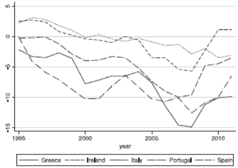
Some examples

- The G20 has focussed on key issues that require coordinated advice
  - Very successful dealing with the GFC of 2008/2009
  - Attempt to organize discretion based coordination at the London Summit of April 2009.
  - But motivation for a coordinated approach weakened after this.
- Other examples where rule-based coordination failed:
  - Stability and Growth Pact
    - Not all countries abided by the rules / no effective mechanism for deterring non-compliance.
  - IMF "multilateral consultations"
- Eurozone sovereign debt crisis has not been handled effectively. Europe's new compact *not* a good example of coordination.
  - Universal balance across current accounts, private sector, and public accounts goes against the idea of a monetary integration

Are fiscal deficits the whole story? Figure (Bird, 2013)



Budget Balance (%GDP), PIIGS (1995–2011).



Current account balance (% GDP), PIIGS (1995–2011).

1. Eurozone Crisis and the Fiscal Compact

$$X - M = (S - I) + (T - G)$$

- Fiscal deficits $(T - G < 0)$ may be associated with crises when they outweigh private sector surpluses $(S - I) > 0$ and the resulting current account deficits are not sustainable.
  - If the supposition is that $T - G = 0$ (fiscal compact) will lead to $X - M = 0$
    - $\Rightarrow S - I = 0$ for all European countries
  - But this is at odds with the basic purpose of monetary integration
    - For some countries, $S - I > 0$, others $S - I < 0$
    - Current account balance requires public sector balances to be in deficit in some countries, and surplus in others.

The takeaway

- In general, extremely difficult to substantiate the causal effects of deficits on output shortfalls.
  - Shortfalls may be more significantly linked to private sector imbalances
    - Output Crises$\rightarrow I \downarrow$, while S remains roughly unchanged $\rightarrow (S - I) \uparrow$
    - Whether fiscal deficits are *excessive* depends on a range of other things
    - Need a more rounded approach
    - Allow for an appropriate mix of expansionary and contractionary policies across Europe
- Fiscal coordination should recognize that imbalances can take the form of *surpluses* as well as *deficits*
  - Recessionary bias of asymmetry
- *Correcting* imbalances will be replaced by *financing* imbalances.

2. Global Imbalances

- G20 spent a lot of time identifying quantifiable targets for measuring excessive imbalances
  - Outward manifestation of these imbalances is the pattern and distribution of BOP deficits and surpluses.
- But it failed to identify to driving forces behind the imbalances!
  - BoP disequilibria are just the "tip of the iceberg"
    - Underlying them are the macroeconomic disequilibria

$$X - M = (S - I) + (T - G)$$

    - CA balances depend crucially on $S \gtrless I$ and the size of this balance relative the size of $T - G$.

The takeaway

- Policies aimed at reducing CA deficits will only be effective if they are simultaneously accommodated by appropriate policies in CA surplus countries: Global BoP adjustment is "zero-sum"
  - Requires international policy coordination
  - Will this happen without a formal agreement?
- Or accommodate differences using "indicative guidelines" (present them as non-binding)
  - Example of discretion based coordination
- No mechanism to put pressure on countries who fail to comply with the guidelines
  - Will this constitute a failure in policy coordination?

G20 and Global Economic Governance

- Country specific commitments
  - Introduced in Seoul
  - Enhanced in Cannes (Cannes Action Plan)
  - Assessment of country commitments (Los Cabos)
- For EMDEs, there are two main shocks post GFC
  - "Sudden stops" of capital inflows and a collapse in export demand
  - How do you deal with negative shocks and unrealistic expectations?

G20 and Financial Sector Reforms

- Much of the G20's debate on financial regulation reflects problems in the US and Europe.
- Regulatory concerns of EMEs are different given their development needs.
- Regulatory philosophy in EMEs (and India) different
  - capital and liquidity standards are high
  - Basel III standards are easily achievable for Asian countries.
  - Excess burden?
- Bank credit (India) is partly driven by financial inclusion
  - misleading indicator of stress in EMEs
- Stringent capital standards (Basel III) may disproportionately affect EMEs
  - Globally active banks may reduce their exposure to EMEs to meet new stringent capital standards

The Development Agenda

- Development is one of the pillars of the G20. Has it added any value to the debate on development?
- "Development is all about enforcement"
- No adequate input on whether MICs or transitioning economies need support. '
- In India, lack of protectionist or dirigiste response in the wake of the GFC
  - Even in China, there is a move back towards state capitalism; in India, the objective (if not the practice) is one of reduced state involvement.
- India's biggest development challenge is the decline of public institutions and state capacity
  - arguably, the difference in China is not their reliance on markets but in the capacity of their government to deliver basic services and build infrastructure.

Concluding Remarks

- How should we think about cooperation, coordination, and commitments?
  - What are the welfare gains from policy coordination (e.g., imbalances, regulation of banks, fiscal policy)?
  - Preliminary answer: cooperation without commitment can be counter-productive!
- Need to anticipate conditions necessary for coordination to work
  - Political Realities. Don't have unrealistic expectations.
- The G20 should not be seen as dictating
  - Forum where issues are discussed
  - Leave it to countries on how to handle commitments politically
- Can something useful be achieved at the regional level?
- Thank you