Regional Think 20 Seminar

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Lowy Institute for International Policy, May 22-24, 2013
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 focused 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
1. Eurozone Crisis and the Fiscal Compact

Are fiscal deficits the whole story? Figure (Bird, 2013)
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.
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 \( S \geq I \) 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 disproportionally affect EMEs
  - Globally active banks may reduce their exposure to EMEs to meet new stringent capital standards

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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