The G20 in the aftermath of the crisis: a Euro-Asian view[1]

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A changing landscape

In 2009 the global economy switched from recession to recovery. However, the pace of the recovery has been very different in different parts of the world, with the divergence between emerging and mature economies becoming greater than expected. Europe and emerging Asia are in this respect in clearly opposite situations, while the Japanese situation is closer to that of Europe than to those of its neighbours (Figure 1 on the next page).

In the midst of the crisis, fiscal expansion was the order of the day for all countries, but exit strategies now involve a differentiated approach. Meanwhile, global imbalances have been reduced but they remain a major issue (Figure 2 on the next page). These developments have a bearing on the implementation of the which came out of the Pittsburgh G20 summit in September 2009. Peer assessment of national macroeconomic and structural policy programmes however remains essential.

One striking novelty of this ambitious approach is that macroeconomic policy is now fully interconnected with structural reforms. The traditional approach to international coordination tends to focus on macroeconomic policy, whereas structural reforms are mostly left to national decisions and are implemented depending on political opportunity windows[2]. In Europe, there is a (very moderately successful) coordination of structural reforms, but they are essentially targeted at the promotion of growth and employment and bear no relationship to any external rebalancing agenda. In the G20

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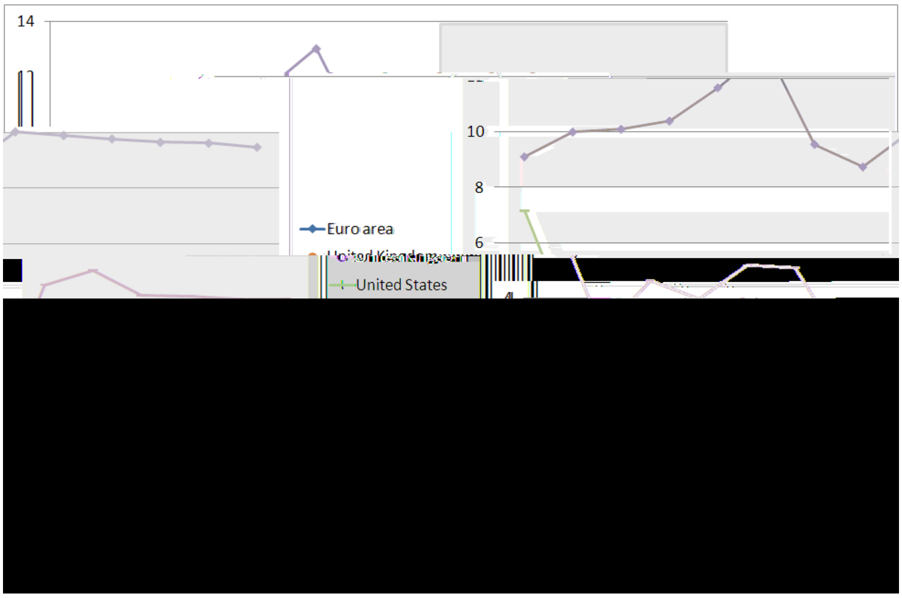
[2] This is not an entirely accurate description as G7 coordination in some instances included an emphasis on structural reforms, but the content of these reforms was mostly left to national decisions.

framework, however, structural reforms are contemplated alongside macroeconomic policies as ingredients for the rebalancing of growth.

Additionally, global issues such as the role of the International Monetary Fund or the reform of the international monetary system, are increasingly debated because the goal is to create a framework in which national policies are subject to appropriate incentives.

Figure 1: GDP growth in selected countries and areas (percentage per year)



Source: IMF WEO, April 2010.

Figure 2: Current account balance in selected countries and areas (percent of GDP)

Source: IMF WEO, April 2010

Budgetary policy

For Europe, the question today is how to restore fiscal sustainability while carrying out growth-enhancing structural reforms. It is now recognised that macroeconomic surveillance has failed in the EU over the last decade, in part because it was not effective enough and in part because it was excessively focused on public savings, while neglecting private behaviour. For instance, while the real estate bubble was building up in Spain, public action to curb the surge in prices was dismissed by the Spanish authorities on the grounds that it would distort private behaviour. With the bursting of the bubble and the global crisis, the fall in GDP and tax revenues were so pronounced that public finances suddenly moved from a two percent of GDP surplus in 2007 to an 11 percent deficit in 2009. The cases of Ireland and the United Kingdom are even more spectacular, as gross public debt increased stepwise because the governments had to massively recapitalise the banks.

Hence, a lesson from the crisis is that it is a mistake to focus only on public sector balances, since the private sector may not save in an optimal fashion: fiscal, tax and regulatory policies can help to provide the right incentives for private savings, particularly regarding pensions and house prices.

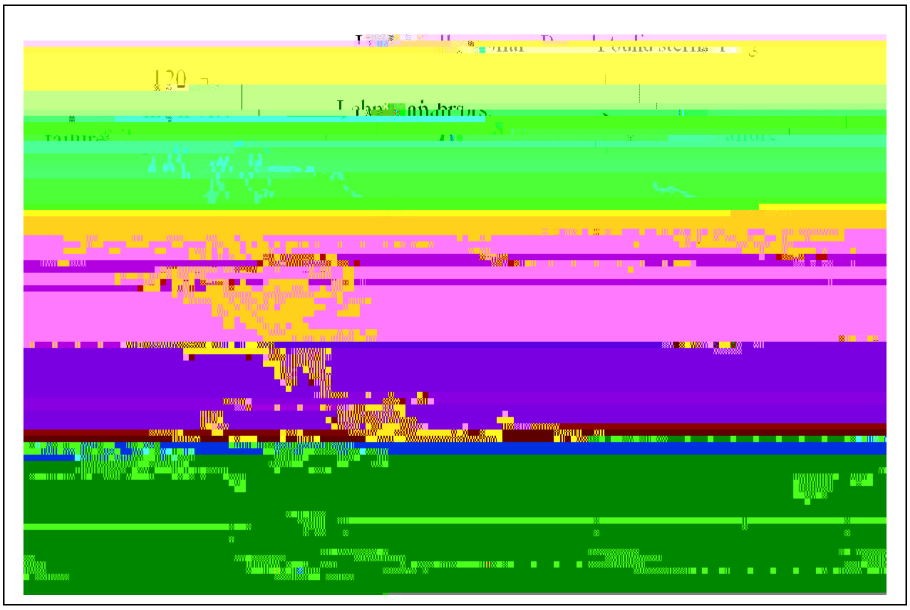
The international monetary system

Whether the international status of the US dollar and the exchange-rate regime of China have been major causes of the global crisis is still hotly debated in academic circles. The most common view is that the crisis resulted from a mix of misguided micro and macroeconomic policies, including interest rates that were too low, which may have partially resulted from the functioning of the international monetary system.

As to the agenda, the debate is still relatively quiet. The most widely held view among economists is that the US dollar will remain the dominant currency for a long time. Although they admit a move to a multi-polar system is likely in the long run, this appears to them as a remote prospect.

One reason for such a view is that the euro is not considered to be a compelling competitor to the dollar. When the dollar supplanted sterling[4], the move was consistent with the relative dynamics of the two

Figure 5: Nominal effective exchange rates of the US dollar and sterling in the crisis



Sources: Federal Reserve, BIS. Last observation: 9 March 2010. Note: nominal effective exchange rates (US: 27 currencies; pound sterling: 58 currencies)[6]

The debate on the comparative stability of a multicurrency monetary system compared to a system that relies mostly on a single currency has not been resolved so far. The theory of hegemonic stability argues that a system organised around only one currency may be more stable insofar as the country issuing the international currency accepts to internalise externalities and take on more than its share of the burden of maintaining global stability[7].

The problem with this theory is that it can hardly be argued that the US has been doing more than its share of maintaining global stability. Additionally, its share in world GDP is declining, which reduces the scope for the stability of a system based on the US dollar[8]. Conversely, a multipolar system may yield more exchange-rate instability due to higher substitutability across key currencies. However such instability may be easier to live with due to enhanced portfolio diversification and possibly regional arrangements.

Governance

At the Pittsburgh G20 summit in September 2009, it was decided to make the G20 the main international coordination forum for economic policy and financial regulation. Was this a good decision in view of the fact that the agenda from the previous summit in London in April 2009 had still not been entirely implemented? The G20 in 2009 succeeded in organising a common response to the crisis and initiated an ambitious revamping of financial regulation. However the momentum for cooperation has

6 From the presentation by Frank Moss, 'Global currency constellations'.

7 See Charles Kindelberger (1973) , University of California Press, and for a critical discussion, Barry Eichengreen (1987) 'Hegemonic stability theories of the international monetary system', NBER 2193

8 Jean Pisani-Ferry (2009) 'China and the world economy', Bruegel