# Can the G-20 Save Globalization and Multilateralism?*

***Danny Leipziger***

In the global economy, there has been an ongoing, well-documented, discernable shift in economic power. While the rate of ascent for China's economy over the next 20 or 30 years is not known, the economic events in China for the past 10 years are very well known. It is also clear that other economies—including Korea—have assumed a much larger role in the international economic power structure. This has been reinforced by the recent economic collapse and the fact that the recovery has been driven not by advanced economies, but by emerging market economies. In fact, the emerging markets—the new economic powers as I like to call them—provided a cushioning effect to the downside of the crisis. Coming out of the crisis, many of the advanced economies have fiscal problems, creating a fiscal drag, and this does not bode well for the future growth rates of some nations.

Another factor changing on the international landscape is views held on capital flows. The question has been if nations should be as open to capital flows in the future as they have been in the past. Even within the IMF there has been a shift on what nations should do in the face of large capital inflows. Trade has also been a changing feature of the international landscape. The irony is that the biggest driver of world trade is south-south trade. Many of the arrangements—whether they be FTAs or others—exist outside of the Doha process. So there is a disconnect between where the large increases in trade is coming from and where the political debate is.

The Growth Commission—which I chaired from 2004-2008—dealt with the drivers of growth, and the report issued reinforced the messages coming out of East Asia. That is,

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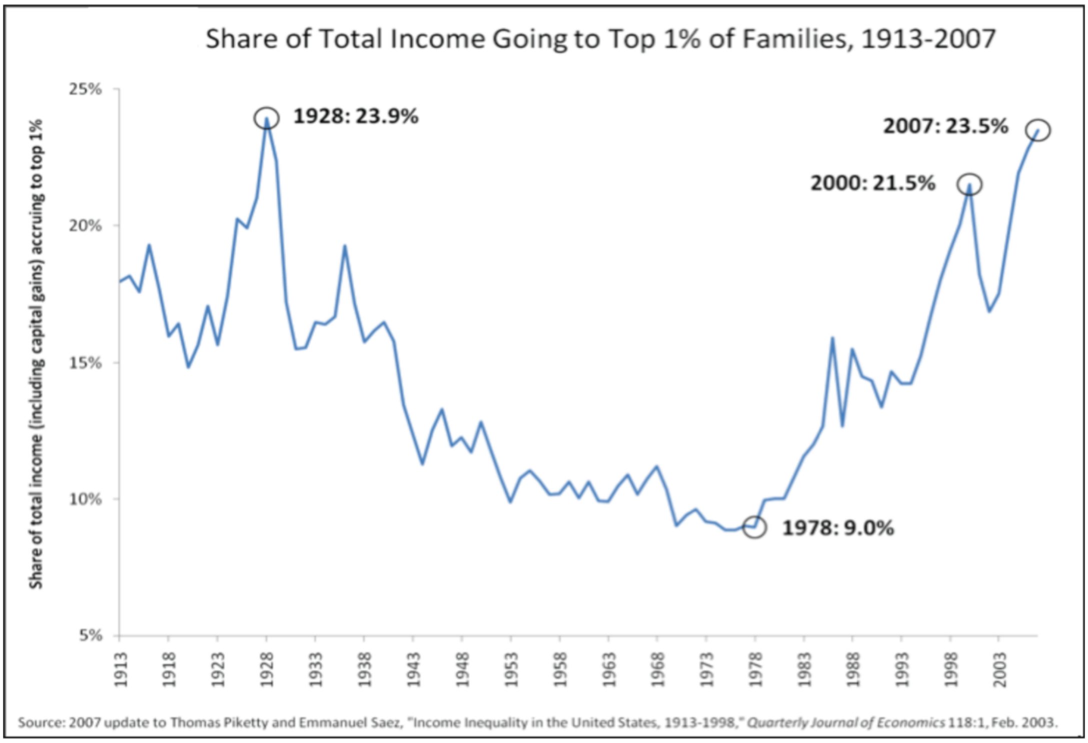
certain ingredients are needed for growth, but the recipes for individual nations may certainly differ. Now coming out of this recession, the question is whether or not these views are changing.

Another hot topic was that of divergence and convergence. While much effort is expended on convergence—which essentially states that as economies mature, growth rates decline—the challenge in the context of multilateralism is that convergence between nations is accompanied by divergence within nations. This unequal distribution of income creates a force that counters multilateralism.

Turning to the United States, the reality is that neither the stimulus nor QE2 was really able to propel the United States out of recession. Instead, it took a change in confidence and, ironically, this necessary change in confidence was triggered by the extension of tax cuts for the wealthy. This is not exactly what one would expect, but neither fiscal nor monetary policy was doing the trick. One reason for the lack of confidence was that the unemployment rate was extremely high and continues to be so. Two-thirds of households saw their net worth decline between 2007 and 2009, with the middle class being hit the hardest. At the same time—and following up on the point on divergence—the income distribution in the United States has become much more uneven.

President Obama, in his State of the Union, said that the United States needed to focus on infrastructure, education, and innovation. For economists, those are the elements of the production function. I think he was right that the United States has done poorly in terms of education, and there is very high indebtedness—the debt-to-GDP ratio is approaching 100%. At the moment, there is a lot of liquidity in the system which now needs to be reversed. Soaking up this liquidity can only drive up interest rates, so the United States will have some difficulty in finding the right combination to restart growth. Also of consequence for multilateralism is the inequality in income distribution in the United States. As shown in Figure 1, in 2007 the top 1% of the population captured 23.5% of national income. That was the worst disparity since 1928. To add some perspective, in 1978 the top 1% captured 9% of national income.

**Figure 1**




Crossing the Atlantic, it is clear that Europe is paying dearly for over expanding the eurozone, for lax fiscal oversight, and for a fixed exchange rate. Almost all commentators in the media have reached the same conclusion. The current arrangement is very costly for Europe as a whole—and to Greece in particular. For Greece, I think that debt restructuring is the correct answer. First, Europe will have to spend a lot of money, as will the IMF, in trying to deal with imbalances in the southern part of Europe. In the end, these measures are not going to work. In Greece, the fiscal deficit is 10% of GDP, and the fiscal side has to be contracted. There is no other option when monetary policy is determined in Frankfurt, and the exchange rate is fixed. How can Greece possibly grow out of this deficit without policy instruments at their fingertips? The risks presented by diminished confidence in the eurozone are much lower than the risk of continuing to keep countries in a low growth position. One thing that needs to take place is that Germany's surplus needs to decrease. That imbalance is unsustainable.

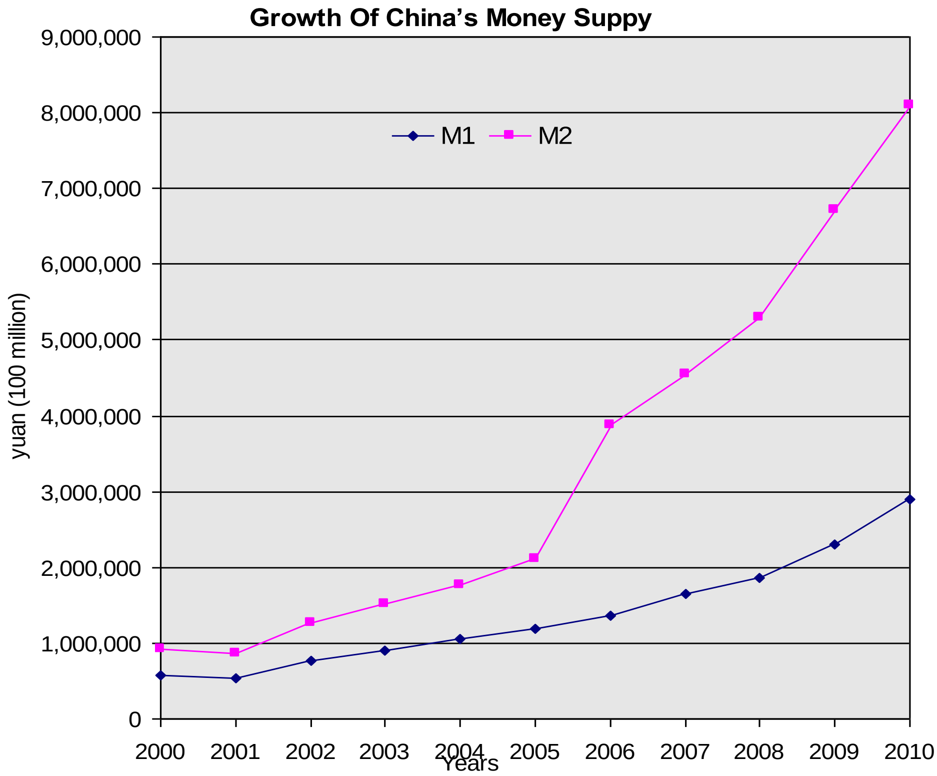
### *China and the Other BRIC Nations*

As for China, its growth rates have been remarkable. The question is if the multilateral system is ready to be managed by the G2. I do not think so. It is true that China's economy of $5 trillion—not on a purchasing power basis but on straight GDP accounting—grows at 10% a year. That is an increase of $500 billion per year. That increment of growth is larger than the GDPs of at least 120 countries in the world. That being said, there is a certain precociousness to growth. That is, I do not think China is quite ready to exercise all of the responsibilities that come with the size of its economy. Before the recession, there were already a number of factors that were changing the international landscape, but the recession and its aftermath accentuated those factors. There will not be a return to the system as it existed before the crisis. Fundamental changes have occurred—there will be much less reliance on flows of capital, much higher levels of indebtedness, greater stress on trade, and different sources of growth going forward.

While everyone focuses on China's exchange rate, this is only one of the many areas where jobs and exports are being promoted. This is not necessarily a bad policy, but it does have implications for multilateralism. So far, the G-20 has not been able to make policy judgments on unsustainable imbalances and exchange rates and have governments take those seriously.

In the near term, there are serious questions about inflation in China. I do not have an answer to that, but it is instructive to look at the supply of money—defined as M2—over the last decade, shown in Figure 2. It has increased eight fold. If growth was 10% a year for a decade, money supply should rise by 100%, but it actually went up by 800%. In this situation, prices have to go up. But up to now, prices have been suppressed and that is now coming to the fore.

**Figure 2**



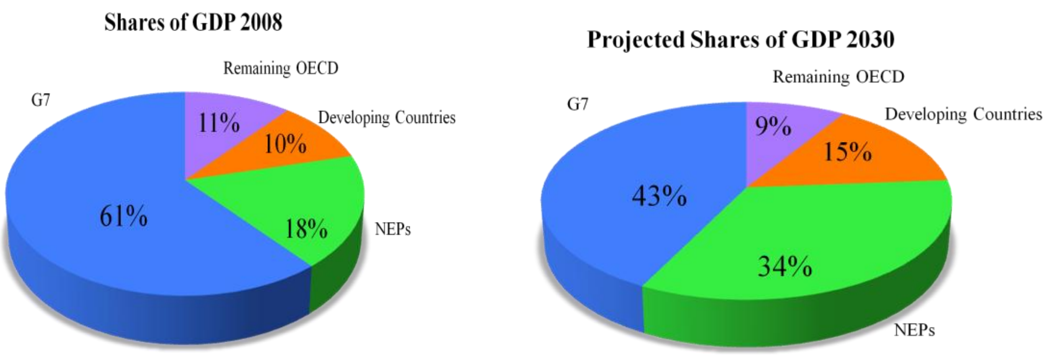

Among the BRICs, there are significant differences. Brazil has attracted a lot of attention recently, in part because it did not want its exchange rate to appreciate and was willing to take action to prevent it. In the past, there was a debate inside the IMF about nations deterring certain kinds of capital flows. Chile did this in the 1980s via a capital import tax. It was roundly criticized for this, but now Brazil has put successively higher taxes on capital imports in an attempt to keep the currency from appreciating. At the same time it has very high internal debt, which means very high interest rates. Of course, Brazil has a lot of natural resources and is doing well because of commodity prices and China's demand, but there remains a lot of internal debate about the industrial policy of Brazil.

In India, there is a very high fiscal deficit and some real limitations based on poverty, poor governance—at the local level in particular—and internal infrastructure constraints. But it has a huge market. India is up and coming, but no one expects it to take the path of China. South Africa may not belong in the BRICs at all because it has a lot of economic and social problems. It has very high energy intensity, carbon intensity, and very high unemployment. As an economy it is not huge—it is large for Africa, but not a huge global player. Russia resembles a resource rich economy with relatively poor governance. It may not merit being in the elite group of the G-8 based on rule of law and other issues.

### *The Changing Landscape of Economic Power and Trade*

Pictorially, looking at the G-7 today, as compared to what it may look like in 2030 (Figure 3)—taking estimates from the IMF and OECD among others—the G-7 declines in its share of global GDP from 61% to 43%. The new economic powers, in which I include Korea, will be growing dramatically. The question is how to preserve the important aspects of multilateralism when there is this tectonic shift in economic power?

**Figure 3**




There are some major threats to globalization. The trade regime is essentially broken. The good news is that tariffs are relatively low around the world. The bad news is that

Doha got stuck on the issues of yesterday rather than the issues of tomorrow. So in a way, Doha has become relatively less important substantively, although it remains very important symbolically. Some people have suggested that the WTO become a dispute settlement mechanism, and that Doha be forgotten because it has been going on for too long.

The difficulty with these rounds is that there was always a battle within governments dealing with trade negotiations contrasting the winners and the losers. There was always enough in the winning column to cover the losses. The trouble is that tariffs are very low now and, trade being fairly free, gains from trade have emerged with or without the Doha round. The additional benefits of Doha are seen to be relatively small compared to the commitments that nations have to make.

Another threat to globalization is capital flows. While I do believe in strong regulation, I am not a fan of Tobin taxes because they do not deal with the fundamental problem. Brazil is the case in point—capital import taxes have not fundamentally changed its policy choices.

There are a number of other cross border issues which are important. Some of them have been dealt with in the G-20 but most have not. Most have to do with taxation, corruption, and illegal flows. These cross border issues require multilateral approaches. It is not clear that we have the instruments which are ready to deal with these problems. Then there are the big issues like climate change and migration, for which we do not have any internationally acceptable solutions on the table.

What I want to portray is a system that is changing fundamentally, with a lot of new challenges and threats, and contrasting that with the existing institutions and instruments to deal with these challenges. One institution is the IMF. It has been trusted with a whole host of new responsibilities, including surveillance of imbalances, exchange rates, cross-border risk, etc.

***Multilateralism***

The IMF has been asked to do a lot of things—secretariat for the mutual assessment program, doing financial stability assessments for countries who did not request it. These will be done for the major financial market economies. All of this surveillance is good, but so far there has not been much in the way of enforcement coming out of the IMF.

Multilaterally, there needs to be a much stronger commitment to the trade regime, perhaps moving beyond Doha. It may be that the area of negative returns has been reached on Doha, and another mechanism is needed.

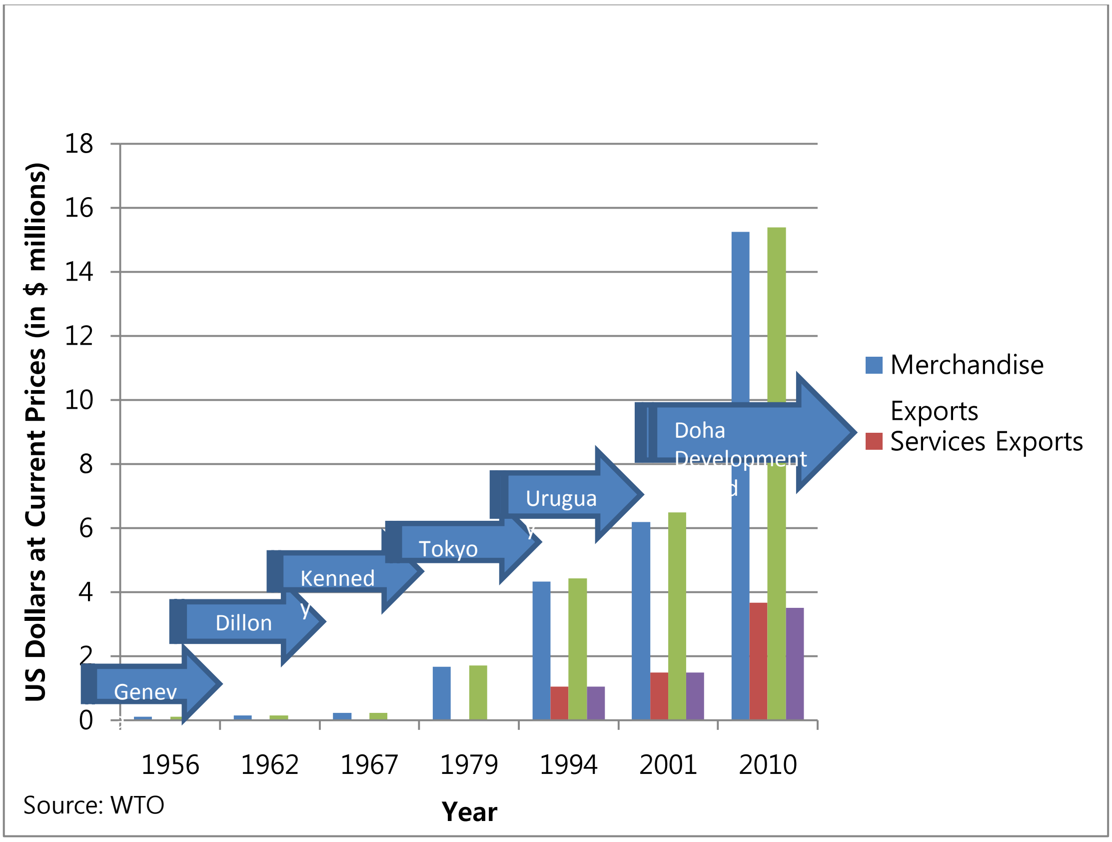
There is a new book out by Danny Rodrick on the paradox of democracy and growth in which he addresses his version of the impossible trinity. Normally, the impossible trinity is sovereign monetary policy, fixed exchange rates, and free capital flows, but his version is democracy, national economic policy, and global economic policy. He argues that two of those three can be done together, but not all three. It is definitely true that there is much greater stress on national governments to deliver in terms of employment, in terms of income, in terms of trade protection. There does not seem to be an equally strong commitment on the multilateral side.

In the past, business was a champion of globalization because the gains from trade were there. It is unlikely that we will see trade gain the momentum it had in the 2000-2007 period, in part because that was a very unnatural period in global economic history. It was unnatural because there were tremendous increases in trade, very high growth, very low interest rates, low inflation, and a lot of it was driven by excessive liquidity. But we need to see how we can get business to once again be a proponent of globalization and multilateral solutions. In the United States, the Pew survey is used as an indicator of public opinion. Less than a decade ago more than 75% of the American public thought international trade was a good thing. One year ago, that number was below 50%. People ascribe many of the domestic ills in the United States to globalization. The reality is that there is off shoring, but much of the job and income loss have nothing to do with globalization, but have a lot to do with internal structure. So we need business to be pro-multilateralism.

At the same time, it must be acknowledged that some of the imbalances, particularly between the United States and China, are not sustainable. Will the G-20 be more capable than the IMF? For many years the IMF properly diagnosed the problem, but there was no enforcement mechanism. I think it also needs to be understood what is acceptable in terms of industrial policy. No one disputes the important role of government in trying to strategically position an economy. I think the green growth agenda and stimulus package aimed at promoting green growth in Korea was a very smart policy. Countercyclical macro measures were needed, but Korea did not just want to repaint bridges. Instead, it wanted to do something that made strategic sense. Investing in green technology made sense because there was a future export market, and there are significant externalities for which the government would want to help shoulder the burden.

I would contrast that with some other aspects of industrial policy which are less enlightened and less horizontal in their nature, and much more protectionist. This picture(figure 4) illustrates two things happening with respect to Doha. First, it is taking too long. It has already been a decade, and at some point it has to be considered as finished. Compared to the GATT and WTO rounds it is taking too long. At the same time there is an increase in the exports and imports of services which are not even covered in Doha, which makes Doha irrelevant. It does have a symbolic importance, but if it cannot be salvaged then we need a new initiative on trade.

**Figure 4**




Who is able to deal with multilateral problems? The G-7 is one option, but the problem is that a number of the countries are faced with bad policy choices having to do with low growth and high debt. Europe is seemingly consumed with its internal issues, but also has some demographic concerns which make it less able to deal with the problems on a global scale. The United States has tremendous problems with employment, income distribution, and indebtedness. Japan, even before the recent crisis, has been in a low growth trap for 15 years. Japan's very high internal indebtedness and demographics essentially doom it to continue its low growth outlook. There are some parallels that Korea may want to take note of. The demographic factors that have stymied Japan's growth are beginning to show in Korea. So, to be provocative, I often say Canada is the country to bet on in the G-7. With climate change and global warming, it has resources, size, good management, good policy at immigration, and survived the financial crisis well.

The BRICs are an interesting political grouping, but the trouble is that they are so different. There is very little that connects them other than the term 'BRICs.' When these nations do meet, they try to issue a joint statement, which are always very general, lowest common denominator statements.

The G-20 is an interesting grouping of 19 countries plus the EU. It did well in dealing with the stimulus programs and restoring global confidence. I think the G-20 gets good marks for its actions in 2009 and 2010, but, it should be realized that it is still a club—more representative than the G-7—but still largely uncoordinated. It has no implementation capacity. It has tried to use the IMF for some of the macroeconomic implementations, and I think it could use places like the World Bank to bring about change on climate change. The amount of investing that is necessary for climate change mitigation and adaptation is huge and it will not come from public or private sources. If the capital of the World Bank were doubled, a big dent could be made on these issues. The real verdict on the G-20 has to do with implementation—will it be effective in dealing with problems?

There are issues of imbalances and cross-border regulation. Too-big-too-fail is not the issue, but rather regulatory arbitrage. Will the Financial Stability Board (FSB) be able to solve these issues, even without implementation capacity? We are now being managed globally by associations, and the question is who will actually do the analysis and implementing. The IMF could do much of it, but it has not yet established itself in some parts of the world as a reliable partner.

What are needed are smart, supranational solutions that give us better options. At the moment the EU is inwardly focused, the United States' political problems limit what it can do, and China has yet to step up to the plate. But to be fair to China, when it enters the OECD it will do so at levels of per capita income much lower than other nations.

***The Role of the G-20***

Korea has received extremely high marks for its role in the G-20. It cannot be blamed for the results because much of what happened at the summit related to politics at home. Obviously, the QE2 announcement a month before the summit was not very helpful in trying to deal with the imbalance problems involving China. It gave China an easy out because everyone was busy attacking the United States for flooding the world with dollars and creating unwanted capital flows. Nevertheless, Korea has a number of advantages in the G-20. Its role in green technology and the environment is strong and can be parlayed into something stronger. Korea is a very good example of business and government working together. We are past the point where people worry about the size of government. Instead, the worry is how effective government can be. Education is excellent in Korea, and innovation-led growth has been excellent. But the Achilles heel in Korea is the demographics.

In the United States, blue collar workers have been losing real wages for 15 years or more. I do not think that is the case in Korea, but I think there is a certain level of disquiet in terms of distribution. I put Korea with Canada and Australia in the G-20 of countries who "punch above their weight." Certain nations deeply believe in multilateralism.

What will France do for 2011? Well, maybe they will put their finance minister into the IMF. But France is part of the EU—the EU has at least one-quarter of the chairs of the G-20—but they have to get beyond the problems of Europe. I think there are a lot of issues that need to be dealt with like financial market regulation, oil markets, the development agenda. These are all things that France needs to deal with, and one has to question whether or not France will be able to do that. Or will they be dominated by their European concerns? The keys to success going forward in the short-term are restoring confidence, more win-win outcomes need to be created as many economies are below their potential growth rates.

In terms of who is in charge, there are all of the "G" possibilities: The G-7, the G-8, the

G-0, the G-2. But none of these are very appealing, and the G-20 is therefore the only game in town. There is very little choice if we believe in globalization and multilateralism. Let's hope that it can be effective and the right way can be found to implement much needed measures.

**Questions & Answers**

**Q** Many people say that exchange rate fluctuations in response to international shocks are much better than adjustments in consumption or in terms of growth changes in individual countries. Any comment on this?

**A** I think that the current system of allowing exchange rates to float is the right system. Of course, there can be externalities when a lot of money is released into the system, as the Federal Reserve did recently. That being said, when Chile put controls on short term capital I was one of the few in favor. I felt that a small country like Chile, which is very open, could defend itself better if it were not subjected to hot money. If Brazil had just focused on short-term capital I would have been equally sympathetic. I think the problem is that if you put capital taxes on other types of capital inflows, portfolio and others, that is essentially using intervention rather than domestic policy. I think Brazil had high interest rates for other reasons. So, I think exchange rates should find their equilibrium, but some countries do literally need to defend themselves against speculative, short-term capital flows. I think the IMF has made a major shift, perhaps an over-adjustment, to being sympathetic to these capital taxes. I would limit it to flows of less than a year.

**Q** Can you clarify what would be beyond the Doha round?

**A** I think the trouble with Doha is that there are not enough benefits to completing the round. Just the issues that no one wants to deal with are left. I do not have the full solution, but some argue that the WTO should be turned into an adjudication mechanism. I am very pessimistic on the completion of Doha. Ten years is long enough. In the meantime, most of the new trade is either under FTAs or under a different arrangement, so Doha is largely irrelevant except for the symbolism.

**Q** How do you see the relationship between the value of the RMB and trade imbalances?

**A** I think the point has been made that these imbalances are going to exist, and one way to reduce these imbalances is to adjust the exchange rate. Whether it is because of international pressure or because of inflation in China, an appreciation of the exchange rate could be seen as a positive long-run step. But I see a disconnect between the central bank governor of China arguing that the dollar should not be the center of the financial system at the same time the Chinese currency is being managed very actively.

**Q** What are the prospects of restructuring the debt of some European nations?

**A** Leaving the euro zone is a very large step. That is the absolute end game, and Greece does not have a good track record in managing its own monetary policy so I would try to avoid that. But one step short of that is a debt restructuring. I understand that some of the debt is held by German banks, but the only way to get Greek growth restarted, given that the exchange rate is off the table, is a radical restructuring of the debt. Even the soft restructuring being discussed is a classic IMF problem. The inevitable is being delayed, and a lot of money is going to be spent for no reason. Yes, a haircut will bring losses but at the end of the day Greece has the potential to restart growth. Without that, I do not see that Greece has any chance of getting out of their problem. If they have no chance, then the EU and the IMF will be spending a lot of money so that in 2013 or 2014 they face the inevitable and have to restructure the debt.

The role of the IMF in all of this is interesting. Does the IMF need a European head to understand the problems of Europe? I think the opposite could be true. Greece should not be treated any differently than Brazil, Mexico, or Indonesia. But I want to stress, that unless the debt is restructured, there is no sustainable outcome for Greece.

**Q** Who do you think is qualified to lead the IMF? Is Dr. SaKong Il being considered?

**A** I think Dr. SaKong is a very well-qualified candidate to lead the IMF. A think tank in Washington DC did a survey, and on the list were 15 names. Dr. SaKong was on that list. There has been a lot of talk prior to Dominique Strauss-Kahn resigning that the leadership positions at the World Bank and the IMF should not be reserved for Americans and Europeans. Many nations within the G-20 have stated their general appreciation for that. But, that is just talk. Are the Europeans really ready to give up the IMF chair? Are the Americans deeply committed to giving up with World Bank chair?

The forces that will determine where the person comes from are odd this time because the presidency of the IMF did not come up in a natural way. With more time to think about it, I think the emerging economies could have coalesced around one or two candidates. But because it happened so abruptly there are now at least ten candidates. Like in any voting pattern, this plays into the hands of the established power structure because the emerging markets have not had the chance to provide their best candidates. Maybe that will still happen, I don't know.

I think it is unfortunate that the leaders of Europe say that at this important time, a European is needed to lead the IMF. I do not think that is in the spirit of the G-20 and multilateralism, and it may actually be wrong. It might actually be better for a non-European to deal with the European problem because this would provide some distance from the reality.

**Q** Was the IMF too soft on Greece?

**A** Well, what can the IMF do? Yes, the IMF imposed very harsh conditionalities in Korea. But Greece does not have monetary policy. So the only thing the IMF can tell them to do is to fix their fiscal position.