THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 19 (19) • April 7, 2009 • © PISM

The G20 Plan of Recovery and Reform of the Global Economy

by Artur Gradziuk

The recovery and reform plan adopted during the G20 summit on 2 April in London is meant to stimulate economic growth and specifies the direction that reforms of financial system institutions are to take. It calls for the injection of a further US$1,100bn into global financial institutions and an increase of fiscal packages up to US$5,000bn. The G20 also decided to strengthen financial regulation and supervision and to reform the International Monetary Fund. If the declarations outlined in the plan are carried out, the G20 summit could turn out to be the beginning of a new order in the world economy.

The impact of the financial crisis on the real economy turned out to be more serious than expected at the previous G20 summit, which took place in Washington in November 2008. The International Monetary Fund (IMF) predicts a reduction in the global GDP by 0.5%–1% in 2009, while the World Trade Organization (WTO) expects world trade to decrease by 9%. Countries most affected by the crisis adopted fiscal packages and reduced interest rates. At the London summit, decisions were expected to be taken regarding increased expenditures to stimulate the economy and reform of institutions of the financial system in order to reduce the risk of crisis in the future. The G20 meeting resulted in an ambitious global recovery and reform plan that should help reach these goals.

Growth and Employment. During the past few months, G20 members adopted fiscal packages amounting to almost US$2,000bn. Until now, the majority of this sum has been earmarked for capital injections for the banking sector so as to increase its liquidity and restore lending activity. A portion of these expenditures is used to create jobs (infrastructural projects), to preserve employment in enterprises faced with lower orders and production, and for social programs. Tax reductions have also been introduced. These funds were to reduce the impact of the crisis and to restore growth and jobs, but given the scale of the present problems, new initiatives to increase fiscal expenditures continue to emerge. Despite President Barrack Obama's expectations, a global fiscal package was not adopted, but it was decided that—depending on the needs—fiscal stimulation would be increased and could reach US$5,000bn by the end of 2010. Central banks, which have reduced their interest rates to record low levels, will also continue to conduct a looser monetary policy. Expansive fiscal and monetary policies are to restore the normal functioning of the financial market, especially in the area of lending, and lead to a 2% increase in global GDP by the end of 2010.

Financial Regulation and Supervision. Failures in the financial sector, insufficient regulations and financial supervision are the principal causes of the present crisis in the global economy. For this reason, G20 leaders decided it was necessary to strengthen regulations and supervision so as to limit the risk of a similar crisis in the future. The role of the Financial Stability Council, which represents all G20 members and is set to replace the Financial Stability Forum, is to be of key importance in this respect. Its task will be, among other things, to monitor the implementation of new regulations, to identify risks to financial stability and to formulate preventive measures. Hedge funds and credit rating agencies (which are responsible for the incorrect assessment of collaterized debt obligations) will be subject to regulations to a much greater extent than previously. It was also decided to adopt new principles of pay and compensation for senior executives in financial institutions and to complete work on new and more transparent accounting standards by the end of 2009. Measures have also been announced with regard to so-called non-cooperative jurisdictions (including tax havens) that do not respect international standards for exchange of tax information. The OECD published a black list of non-cooperative countries (including Costa Rica, Malaysia, the Philippines and Uruguay), and a grey list of countries that have committed to apply international tax standards, but have yet to implement them (including Switzerland, Austria and Luxembourg). Although the operating principles of the new financial system cannot be created and implemented in a short time, the G20 summit pointed in the direction of change, calling for the extension of regulation and supervision to all systematically important financial institutions, instruments and markets.

Global Financial Institutions. The most important decisions taken during the G20 summit concerned the International Monetary Fund, which has been in need of reform for many years. The effectiveness of the IMF's policies was subject to doubt following the Asian financial crisis of 1997, when the IMF's conditions for granting assistance (balanced budget, privatization) in fact deepened the crisis. The anti-crisis measures taken by the USA and the EU (increased fiscal expenditures, the state's takeover of shares in private entities) are diametrically different from those recommended by the IMF. Taking into account the incorrect decisions made in the past and the increased significance of the largest developing countries in the world economy, it was decided to reform the mandate, the scope of activity and the governance of the IMF. In order to increase the effectiveness of assistance, new and more flexible lending and conditionality framework were introduced. A reform of IMF quora and vote reforms is to take place by 2011. But the most significant decision concerned increasing the IMF's lending resources by additional US$750bn (500bn through financing from IMF members, and US$250bn from allocation of SDR—Special Drawing Rights, an international reserve asset and the unit of account). These additional IMF funds and US$100bn from international development banks are destined for developing countries and emerging markets that do not have sufficient budgetary means for supporting growth, bank recapitalization, trade finance, debt rollover or supporting balance of payments. The decisions taken at the G20 summit strengthen the role of the IMF considerably in its actions to address global financial crisis, and the announced reforms of this institution are to restore its credibility and central role for global financial stability.

Trade, Investment and Protectionism. According to World Bank analyses, 47 new trade-restricting measures have been introduced by several countries since the Washington G20 summit. The most important of these are subsidies introduced as part of adopted fiscal packages (including US$48bn for the auto industry and EU subsidies to the export of butter, cheese and powdered milk) and tariff increases (such as Russia's on used autos or Ecuador's raised tariffs on over 600 items). Given the emergence of new protectionist initiatives, it was necessary to give assurances that the measures taken to combat the crisis would not lead to the introduction of new barriers to trade and investment. G20 leaders reaffirmed the commitment made in Washington to limit the impact of the negative effects of their measures on trade in goods and services as well as on investment, and to inform the WTO of new measures that could lead to such situations. Since problems with financing trade are among the consequences of crisis, it was decided to support—via international development banks, in the amount of US$250bn—national export and investment credit agencies, so as to restore accessibility to credit for exporting enterprises. G20 leaders also undertook to work for the conclusion of the Doha Development Round. One should remember, thought, that similar declarations were made at other summits, but failed to produce the expected results.

Conclusions. The G20 leaders confirmed in London that—given the scale of the crisis—they were determined to take the necessary steps to stimulate economic growth and were committed to cooperate in this respect. Even though the scale of existing national fiscal packages combined with the declaration to earmark an additional US$1,100bn for international financial institutions is an event without precedent, expenditures on fighting the crisis could grow even more. A decision was made to reform the international financial system and the IMF, something that—combined with the extraordinary forms of state intervention in the economy—could result in setting new principles for the functioning of the world economy. British Prime Minister Gordon Brown announced the end of the Washington consensus and banking secrecy era. Provided the declarations outlined in the plan adopted by the G20 are fulfilled, the London summit could turn out to be the most significant summit of the first decade of the 21st century, one that set the groundwork for a new order in the world economy.