The G20 has launched far-ranging reforms of economic governance institutions and the manner in which key economies should cooperate in the future. Its ambitious aim is not only to stabilize the world economy following the economic crisis of 2007-09, but also to anticipate and, as far as possible, prevent future crises and foster sustainable growth going forward.

A central element of the promised reform is the “Framework for Strong, Sustainable and Balanced Growth,” introduced at the 2009 summit in Pittsburgh, in which the G20 agreed to accept joint and individual responsibility for the health of the global economy. By specifying the key elements of growth, agreeing to assess their policies mutually with the help of the International Monetary Fund (IMF) and other institutions and agreeing to discuss actions required in light of these assessments, the G20 leaders have launched a potentially effective vehicle for delivering on their promises.

In light of past experience, however, there are reasons to be sceptical about commitments to engage in mutual assessment and economic cooperation. Past IMF surveillance, for example, was not particularly effective, while efforts by the G7 and the European Monetary Union to address currency or fiscal imbalances cooperatively often resulted in ultimately cosmetic schemes with possibly counterproductive effects from their lulling players into a false sense of confidence while leaving fundamental issues unaddressed. The G20 will want to avoid this kind of superficiality.

The assessment process established by the G20 includes significant innovations: a requirement for new and timely information, the direct submission of reports to decision makers and the integration of various scenarios and perspectives. These requirements in support of the G20’s objective will augment the efficacy of existing assessment mechanisms of various multilateral institutions. Important questions remain, however, regarding how candid and transparent these G20 assessments will be and how to integrate into the process valuable experience in peer review and principles-based dialogue at institutions other than the IMF. In addition, the Framework does not require country-specific commitments to accompany collective assessments and goals setting by G20 members. The Framework also does not mention what would happen in the event of failure to act on agreed collective commitments.

In this paper, I argue that the assessment process envisaged in the Framework needs to be strengthened if its goals are to be realized. I also argue that the Framework’s fuzziness in spelling out commitments and its inattention to how
commitments will be followed up and how differences can be aired out risk leaving the framework as ineffectual as some earlier cooperative attempts to promote global sustainable and balanced growth. I recommend several innovations to deal with these issues:

- using a common template based on collective promises of the G20, each member should be required to spell out the actions it intends to take to deliver on collective commitments, in light of its own circumstances and ability to deliver, and should institute a formal procedure for follow-on implementation;

- this formal process should also be able to hear complaints from other members regarding the framework’s implementation;

- an intermediary body — a kind of “wise persons’ commission” — should be established between the G20 leaders and institutions, such as the IMF, that provide technical expertise, to ensure that the various assessments are integrated to provide the wide perspective needed for the G20 to be “approximately right,” as well as to ensure the right balance between internal candour and external transparency; and

- discussions should take place on an ongoing basis between the “wise persons’ commission” and G20 finance ministers and heads of central banks about the results of these processes to help broker solutions to deadlocks that stand in the way of mutually advantageous policies.

Introduction

The global financial and economic crisis of 2007-09, which originated in the United States, has been widely blamed on a loose approach to the regulation of financial markets and insufficient management of international economic linkages. Some fundamental questions have been asked subsequently about the future management of the global economy. For example, could the crisis have been predicted, and might international governance mechanisms and early warning systems have prevented the excesses that, in hindsight, contained the seeds of the crisis?

The scope and depth of the crisis met with an unprecedented response: a concerted global effort to provide fiscal and monetary stimulus and to return markets to an orderly state. The most visible innovation that has arisen from the crisis so far is the institution of the G20 at the leaders’ level as the “premier forum for international economic cooperation” among its membership — comprising 19 of the world’s 25 largest national economies ranked by GDP, plus the European Union. Although the many countries that are not among the G20 account for approximately 17 percent of world GDP and include several, such as Singapore, that have key financial centres, the G20 is more representative of the emerging balance of economic power than is the G7/G8 group of industrialized countries, the Organisation for Economic Co-operation and Development (OECD) or even the International Monetary Fund (IMF).

About the Author

Daniel Schwanen is an economist, project leader, author and advisor specializing in economic growth and international policy issues. He holds degrees in economics from the Université de Montréal and Queen’s University in Kingston, Canada. Mr. Schwanen joined The Centre for International Governance Innovation (CIGI) in 2004 and has contributed to the organization in both senior executive and research capacities. His recent work focuses on the challenges of coordinating macroeconomic policies within the G20 and on regional economic governance. Prior to joining CIGI, Mr. Schwanen was an international economist at the CIBC. He subsequently occupied senior positions at the C.D. Howe Institute in Toronto and at the Institute for Research on Public Policy in Montreal, where he researched and formulated influential policy recommendations regarding North American economic integration, Canada’s economic union, and the economics of cultural policies and of greenhouse gas emissions reduction. Mr. Schwanen is a frequent commentator on economic issues, and his work has been regularly cited in the general media as well as in expert journals. Mr. Schwanen received Canada’s Policy Research Secretariat award for Outstanding Research Contribution in 2001. He was one of two experts on APEC’s Review Team for Australia’s individual action plan in 2007. Mr. Schwanen is an alumnus of the Leadership Programme of Japan, the US International Visitor Program and Australia’s Special Visitor Programme.

1 The author would like to thank Manmohan Agarwal, Thomas Bernes, Pierre Siklos and Paola Subacchi for comments on an early draft of this paper; participants at the CIGI conference “International Governance Innovation: Issues for the 2010 Summits,” in Waterloo, Canada, on May 3-5, 2010, who kindly provided helpful comments on a subsequent draft; and Agata Antkiewicz, Badye Essid and Shannon Feldman for ideas and research assistance.

2 Quotations from the leaders’ statement issued at the Pittsburgh G20 summit on September 25, 2009 (G20, 2009a), are not individually referenced in this paper. They are taken, not in order, from four distinct parts of the statement: “Preamble,” paragraphs 10, 13, 15 and 19; “A Framework for Strong, Sustainable and Balanced Growth,” paragraphs 2, 5 and 7; “Annex: Core Values for Sustainable Economic Activity,” paragraph 4; and “G20 Framework for Strong, Sustainable, and Balanced Growth,” paragraphs 1, 2 and 3.
Although the G20 is a new forum, many of the economic imbalances confronting it and the instruments it envisages using to address them sound all too familiar. To prevent future crises, the G20 leaders must overcome the deficiencies evident in responses to previous crises, in terms of both lessons that went unheeded and governance approaches that did not work as intended. History teaches us that simplistic policy views can too easily obscure common sense approaches; that policy makers, market participants and the general public can be lulled into complacency (see Reinhart and Rogoff, 2009); that mandates and responsibilities can become confused; and that institutions rarely adapt unless a crisis forces them to do so. Another way of stating this in a more distilled format is that financial crises arise due in part to information gaps and in part to insufficient incentives to act on the information available (Caprio, 1998).

In this paper, I explore whether the G20’s “Framework for Strong, Sustainable and Balanced Growth,” launched at the Pittsburgh summit in September 2009 and aimed, among its key objectives, at preventing future crises through coordinated policy actions, can usefully transcend such problems. If the Framework is to be successful, however, an understanding is needed of how this new approach differs from previous attempts at sustained international coordination on questions of growth and macroeconomic stability. The G20 members will also have to find ways to agree on an acceptable balance of effort among them to reach the Framework’s goals and mitigate stresses that might arise from different legitimate visions of what constitutes stability and sustainability. I address these questions by suggesting ways to implement the framework that would make it an effective tool for international cooperation on macroeconomic stability and growth issues.

What the G20 Said

In releasing the “Framework for Strong, Sustainable and Balanced Growth” at the Pittsburgh summit, the G20 characterized it as a compact that commits us to work together to assess how our policies fit together, to evaluate whether they are collectively consistent with more sustainable and balanced growth, and to act as necessary to meet our common objectives.

Specifically, the Framework notes that, while “(e) ach G20 member bears primary responsibility for the sound management of its economy,” each also has a “responsibility to the community of nations to assure the overall health of the global economy,” and that this responsibility would be discharged through a three-step process of (i) agreeing on shared policy objectives (which can evolve as conditions evolve), (ii) assessing the collective implications of their national policy frameworks and identifying risks to financial stability and (iii) agreeing on any actions to meet the common objectives.

The G20 leaders were quite precise in Pittsburgh about what they considered the key elements of strong, sustainable and balanced growth, and what they were committing to achieve with respect to these elements: they would implement responsible fiscal policies...[.]
prevent...excess credit growth and excess leverage...[.]
help prevent credit and asset price cycles from becoming forces of destabilization...[.]
promote more balanced current accounts...[.]
undertake monetary policies consistent with price stability in the context of...exchange rates that reflect underlying economic fundamentals...[.]
undertake structural reforms to increase our potential growth rates and, where needed, improve social safety nets...[and] promote balanced and sustainable economic development in order to narrow development imbalances and reduce poverty.

The leaders elaborated on some of these commitments in their formal statement, including a pledge, “when the time is right, [to] withdraw our extraordinary policy support in a cooperative and coordinated way”; an agreement that, to be credible, these exit strategies “should be designed and communicated clearly to anchor expectations”; and an agreement that demand patterns should be rebalanced between members with “sustained, significant external deficits” and those with “sustained, significant external surpluses.” At the same time, the leaders acknowledged that “there are different approaches to economic development and prosperity, and that strategies to achieve these goals may vary according to countries’ circumstances.” Likewise, with respect to the process of coordinating exit strategies, they recognized that “the scale, timing, and sequencing of this process will vary across countries or regions and across types of policy measures.”

The Framework concerns mainly macroeconomic stability and structural impediments to growth. But it is also clearly linked to G20 commitments on financial regulatory reform (effected through, inter alia, the
establishment of a Financial Stability Board, FSB),3 to a renewed commitment to an open international trade environment and to addressing development and security issues made worse by the crisis. Thus, the Framework is clearly part of an integrated approach to be implemented not only across policy areas but also across institutions, requiring the involvement of the IMF, the FSB and other relevant institutions, such as the World Bank, that have the analytical and policy-enabling capacity to support the direction set by the G20.

Delivering on Commitments and Expectations

Is the G20 likely to be able to meet the high expectations it raised with the Framework and other reform commitments? One obvious absence from the text concerning the Framework in the Pittsburgh statement is a mechanism to follow up on commitments apart from a reliance on the public glare of the annual G20 leaders’ meetings and semi-annual meetings of G20 finance ministers and central bankers. Rather, the focus is on anticipatory assessments, not on surveillance, a term that might appear more constraining. Furthermore, the Framework refers to shared goals and “any action” to meet them, not to compliance regarding such potential actions.

Now, a focus on assessment is probably a logical starting point, once goals have been broadly defined. But the Framework’s absence of explicit commitments to action toward collective goals or any mention of the need to follow up on commitments or of consequences if commitments are not met raises questions about its effectiveness. Perhaps the G20 leaders meant that commitments to act would be essentially collective and that, within the Framework, the G20 would mostly comment on, for example, the progress of it has made, collectively, toward the reaching its goals. The Framework might give G20 governments an additional means with which to justify their individual actions on collective commitments, and existing surveillance mechanisms at the IMF and the OECD could be mandated to comment specifically on countries’ progress toward the Framework’s goals. Yet without national commitments, the Framework’s main use would remain one of mutual assessment and dialogue, while the main incentives for action (such as bilateral pressures) would operate outside it.

What is needed, then, is a mechanism within the Framework that spells out actions to be taken to prevent harmful outcomes and that ensures commitments are implemented — or at least that monitors implementation. Any such mechanism, however, would have to be designed carefully. For example, a mechanism that was seen as intruding on national sovereignty could make individual G20 countries reluctant to take action or even lead them to deny that action was needed, but if action were expressed only as what the G20 needed to do collectively, rather than individually, responsibility might become so diffuse as to result in insufficient commitments.

Obviously, the search here is for an effective system of assessment, commitments and implementation that G20 leaders could also deliver politically from an enlightened domestic perspective. Accordingly, to aid in that search, I review some relevant evidence from a variety of past and existing experiments in multilateral coordination to get a better sense of the pitfalls, but also the possibilities, awaiting the G20 as it seeks to establish an effective and credible Framework.

Assessment

The G20 has agreed that a thorough, candid and balanced assessment of any potential problem is the key to establishing a credible diagnostic for deliberate action. Naturally, central elements of such an assessment are typically highly technical in nature and require extensive analytical and modelling capabilities. This is why the G20 asked the IMF to provide an “analysis of how our respective national or regional policy frameworks fit together” and to develop “a forward-looking analysis of whether policies pursued by individual G-20 countries are collectively consistent with more balanced and sustainable trajectories for the global economy.” Indeed, the IMF’s Article V allows it to provide such technical assistance “upon request,” and the G20’s call for help builds on earlier requests by the G7.

In its call for technical assistance from the IMF, the G20 emphasized that it be timely, forward-looking and integrated with assessments by other multilateral institutions. Moreover, technical assistance and assessments should feed directly into the G20 decision-making process, within an annual reporting cycle. Obviously, action-oriented G20 leaders want timely information they can use to guide their decisions on how to reach the objectives they have set for themselves regarding global growth and stability. But how can such assessments be more useful, in the particular context of the G20 Framework, than they appear to have been in

---

3 The FSB consists of finance and central bank representatives of the G20 plus five other members from systemically important financial jurisdictions, six multilateral and regional institutions and a number of international financial standards-setting bodies.
the past in other contexts? As a high-ranking IMF official recently declared,

what the current crisis showed was the need to improve our understanding of cross-border spillovers, macro-financial linkages within and across countries, and broader systemic risks for the global economy (Kato, 2010: 1-2)

The G20 mutual assessment process is supposed to build “on the IMF’s existing bilateral and multilateral surveillance analysis.” However, the various multilateral assessments regularly conducted by the IMF — such as the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR) — have not received particularly kind reviews in either the academic literature or from the IMF’s own Independent Evaluation Office (IEO). The reports are seen as useful mainly as a source of public information, rather than as a first step toward a more developed multilateral discussion. As one study concludes,

the multilateral surveillance of the IMF is not focused on generating debate about urgent problems and possible cooperative solutions… The limited involvement of the [IMF’s] Executive Board, in turn, implies that the exercise has become focused on the production of the report itself, rather than on the process of coordinating national member states’ policies (Lombardi and Woods, 2008: 717)

Similarly, bilateral assessments have been criticized for being useful sounding boards, rather than tools integrated with multilateral assessments, and for being insufficiently explicit on core issues directly related to external stability, such as exchange rate issues (United States Department of the Treasury, 2009).

These shortcomings, to be fair, are not exclusive to the IMF — the trade policy review mechanism of the World Trade Organization (WTO) has been criticized on the same grounds (Laird, 1999). Nonetheless, they were made particularly salient by the recent global economic crisis. Indeed, even in 2006, IMF members were requesting that the Fund’s very broadly applied surveillance activity focus more on “crisis prevention, global financial stability, and international spillover effects” (Lavigne and Schembri, 2009: 1) — the three elements being obviously closely intertwined. And in 2007, a “Decision on Bilateral Surveillance over Members’ Policies” (IMF, 2007b; hereafter, “the 2007 Decision”) ushered in a renewed focus on “external stability” as the objective of IMF surveillance. Further, as a precursor to the G20 Framework, in fall 2008 the G20 launched an Early Warning Exercise (EWE) in which the IMF and the new FSB would periodically assess systemic risks for the global economy, identify vulnerabilities and assess “risks of unlikely, but not implausible, downside scenarios that…would result in policy recommendations different from those underlying the baseline scenarios in the WEO and GFSR” (Kato, 2010: 4).

How would a new, G20-driven mutual assessment exercise yield more useful results? According to the IMF, its analysis and assessment would depend on information voluntarily provided by G20 members and collected according to a template that “includes all salient policy commitments as well as projections for key economic variables” (IMF, 2009b: 3). Fund staff would then identify any inconsistencies and incoherence of national assumptions within the G20, analyze the multilateral compatibility of country submissions and the aggregate impact of national policies on global economic prospects and identify what additional policy commitments might be needed to reach the objective. Unlike the WEO and the GFSR, which are “entirely based on the independent projections, analysis, and assessments of the Fund staff and management as discussed and concluded by the Board,” in the context of the G20 Framework “the assessment [would be] undertaken and conclusions drawn by the G-20 members” (IMF, 2009b: 7). Thus, the process established under the Framework requires the provision of new and timely information, with reports presented directly to decision makers — which might well increase their commitment to the assessment process and its outcomes, which would reinforce the effectiveness of the process — and focuses on integrating multilateral and national scenarios with a view to achieving well-defined objectives. Furthermore, the specific objectives set by the G20 could help focus existing IMF multilateral and bilateral surveillance exercises — with the exercises of the two bodies helping to provide valuable information checks on each other (IMF, 2009b: 4-7). Moreover, the EWE and the G20 Framework are likely to be mutually supportive, all the more so since the emphasis on “coherence” and “consistency” in the work the IMF is expected to undertake needs to be balanced by an understanding of alternative views of how things could unfold.

Nevertheless, important questions remain related to focus, to the linking of expertise at the IMF and other multilateral institutions and to transparency.

---

4 External stability refers to “a balance-of-payments position that is not likely to generate disruptive real exchange rate movements” (Lavigne and Schembri, 2009: 7-8).
Some G20 members no doubt see in the Pittsburgh list of commitments a mandate for the IMF to focus on specific indicators of external imbalances that would be politically expedient to highlight at any time. Exchange rates are particularly vulnerable in this respect, and the 2007 Decision makes particular mention of exchange rate policies and potential exchange rate misalignment and manipulation as a major focus of IMF surveillance. But, as Lavigne and Schembri note, it would be unfortunate to “give the impression that it is only through exchange rates and the balance of payments that domestic stability can affect external stability” (2009: 8). Since, for example, financial instability in the United States in 2007-08 provoked global instability without being accompanied by a currency crisis and appears to have been assisted in part by efforts by Congress to subsidize homeownership, a superficial focus only on the exchange rate — or, indeed, on any single variable — could hamper the ability to anticipate future crises and to devise policy actions to prevent them.

In this context, the G20 Framework rests on the view that domestic economic stability will reinforce external stability and, thus, G20 members should be discouraged from focusing on one at the expense of the other when they assess their respective individual policy stances. As Lavigne and Schembri note, the IMF’s 2007 Decision specifies that external stability is a forward-looking concept that demands an assessment of domestic as well as external risks and vulnerabilities...[and]... clarifies that these two types of stability are compatible and mutually reinforcing (2009: 7-8).

Indeed, the general obligations of IMF members can be interpreted as meaning that domestic policies that foster “orderly economic growth with reasonable price stability,” with due regard to their particular circumstances, as well as “orderly economic and financial conditions and a monetary system that does not tend to produce erratic disruptions” are the bedrock of external stability (IMF 2009a, Article IV, Section 1 (i) and (ii)).

The Framework goes beyond treating internal stability as strictly a matter of sound fiscal and monetary stances and explicitly references growth-enhancing policies in general, as well as social policies. Conducting assessments under the aegis of the Framework, therefore, requires the need for an in-depth look at the complex interactions between structural domestic and external policies that goes beyond anything embodied in the 2007 Decision or the obligations of IMF members. A solid assessment of how to pursue these objectives as well as those related to external stability likely would require more than IMF expertise alone could provide to be truly effective.

Sharing Expertise

From this probably arises the G20 Framework’s call for an integrated assessment of global and national scenarios by various organizations. Porter (2007) foresaw the benefits of such a collaborative effort between different international institutions, each contributing according to its own comparative advantage.

In effect, then, the G20 is ordering all hands on deck: “We will work together to ensure that our fiscal, monetary, trade, and structural policies are collectively consistent with more sustainable and balanced trajectories of growth” and, as echoed by G20 finance ministers and central bankers,

We will be assisted in our assessment by IMF and World Bank analyses and the input of other international organizations as appropriate, including the FSB, OECD, [multilateral development banks], [the International Labour Organization], WTO and [the United Nations Conference on Trade and Development] (G20, 2009b: 3).

As the G20 finance ministers and central bankers noted, the OECD is one organization whose input likely would be invaluable as the G20 Framework institutionalizes policy dialogue, including on domestic policy. The OECD’s economic surveys do not bind members to a particular course of action, but they do contain an assessment and recommendations section subject to peer review within the organization’s Economic and Development Review Committee, which includes the entire OECD membership. The surveys’ thorough attention to domestic structural factors and the peer review system thus make these exercises useful ways to discover and ensure the spread of best practices. Already, the OECD has extended its economic surveys beyond its own members to include China, India, Brazil, Mexico and South Africa. Peer review of countries’ structural policies along those lines would be a valuable complement to the work of the IMF.

Keynes is reputed to have said that it is better to be approximately right than to be exactly wrong. The multiplicity of perspectives that would result from the assessment and analysis of different institutions and, I submit, the inclusion of less technical perspectives in envisaging possible scenarios and approaches to the future of national and global economies would give the G20 leaders a better chance of getting things approximately right.
**Transparency**

Finally, there is the question of whether candid assessments under the G20 Framework would run up against calls that have been made for more transparent assessments of individual members’ policies by the IMF. Of course, those who usually know the most about a country’s situation — representatives of that country’s government — should participate in an assessment and even, in the normal course of business, endorse it in some fashion before it is made public; this is how assessments at the IMF, OECD and other organizations are conducted. However, this creates a natural tension between transparency (not just of the process but also of the government of those conducting the assessment) and the ideal of a candid assessment. As Cottarelli (2005) notes, political interference could compromise candid assessment efforts and could even grow worse the more public are the disclosure and the analysis. Indeed, disclosure among peers is a vital component of arriving at a candid mutual assessment, and the lack of it could delay intervention and ultimately deepen a crisis when it erupts (Institute for International Monetary Affairs, 2005: 3).

There is thus a case to be made for keeping some important assessment work behind closed doors to encourage full and candid information exchange. Of course, the conclusions of the process should be made public, but the analysis could percolate through the WEO, country reports and other publications that are already part of the public face of multilateral and bilateral assessments. Such public reports, as a rule, should be consistent with confidential information or analysis made available to the G20 as part of the Framework, but without necessitating their public disclosure. And, naturally, the public would be able to get a sense of the information and analysis in the leaders’ commitments and emphasis that come out of their summits.

How, then, should the assessments of various organizations be integrated to provide the wide perspective needed for the G20 to be “approximately right” and to ensure the right balance between internal candour and external transparency? This task should devolve to a non-political intermediary between technical staff and specialized institutions, on the one hand, and political leaders and national policy makers, on the other. This intermediary could be a kind of wise persons’ commission, at the service of G20 governments, comprising a roster of experienced and knowledgeable individuals not positions of conflict pertaining to matters likely to be on the agenda of discussions under the Framework. Members of this commission could have privileged access to confidential information collected under the Framework process, comment on whether the process exhibited the right degree of candour, consult widely — perhaps with a public advisory committee and an international committee of legislators — have discussions with G20 finance ministers and central bankers and encourage them to go forward by helping to broker resolutions of deadlocks preventing mutually advantageous policies. Members of such a commission would serve for a fixed term, and there could be reserved seats on it for the largest G20 economies, with others participating by rotation. There should also be seats for non-G20 countries. Commission members could, for example, be selected by a two-thirds’ vote of G20 finance ministers from rosters of candidates submitted by any country for this purpose.

**Commitments**

As noted earlier, the basic causes of financial crises are not simply informational problems, but also the lack of incentives to act on the available information. Does the G20 have sufficient incentives to act on its mutual assessments?

Not every multilateral or bilateral assessment or surveillance exercise is formally meant to be a prelude to action — the OECD economic surveys being a case in point — but, in principle at least, the G20 Framework is action oriented, with finance ministers and central bankers having agreed to develop a basket of policy options to deliver [the objectives of the G20], for the Leaders to consider at their next Summit in June 2010; and…to refine our mutual assessment and develop more specific policy recommendations for Leaders at their Summit in November 2010 (G20, 2009b: 3)

In practice, however, achieving a thorough and credible mutual assessment among governments and obtaining commitments and joint action toward common goals will be a politically delicate and difficult undertaking.

The G20 leaders have taken the boldest steps yet in that direction, but it should be noted that the major industrial economies have long insisted on the importance of joint efforts to address global economic and financial instability and of the need for cooperation to strengthen multilateral surveillance of economic policies. Arguably, greater commitment and accountability along those lines would have served the world economy well over the past couple of decades, but multilateral consultations themselves are nothing new: in 2006, for example, the IMF launched a process aimed at much the same imbalances as the G20 is focused on now and that produced “policy plans” that were subscribed to by the countries and regions involved...
in the consultations (IMF, 2007a), but their practical impact on actual policy, if any, is hard to detect.

The question, then, is how to translate the results of consultations and assessments into action. On this score, even the IMF’s 2007 Decision emphasizes that surveillance is cooperative and “must be based on dialogue and persuasion rather than the strict policing of obligations” (Lavigne and Schembri, 2009: 3). Nevertheless, the idea of individual policy plans, preferably reinforced by IMF bilateral surveillance and dialogue/peer review as conducted at the OECD and in other forums, is an important one. Without such plans, the joint nature of the responsibility to act under the G20 Framework could end up superimposing a specific collective-action problem on what is already a general political-incentive-to-act problem.

Having said this, the ultimate goal of the exercise is not coordination per se, but to arrive at stronger, balanced and more sustainable growth. Cooperation (such as that in mutual assessments) toward that goal is useful, but specific coordinated outcomes are only one way of translating cooperation into results. Indeed, coordinated action does not always produce the best outcome — there are many cases of “hard” coordinated commitments and rules having been implemented with dubious effect. Even with the best will or incentives5 in the world to coordinate, the prevalence of wrong assumptions, or the imposition of wrong assumptions by one player in the system powerful enough to impose them, can lead to an outcome that might be inferior to what would have been achieved by a non-coordinated approach.

In this vein, the G20 Framework seems to suggest that coordination does not work well when assumptions of the various players about the global economy are inconsistent — this is reason enough to try to make the assumptions more consistent. But what if the consistent assumptions — or the information underlying the assumptions — are wrong? If there is a mistake in the information, or in the consensus based on the information, then coordinated policies that are consistent with the consensus might well yield inferior results for both the countries implementing them and the global economy. This dilemma concerning the link between information/analysis and the incentive to act is summarized in Table 1.

5 Under “incentives” one could include cases where one country must act when faced by the power of another country or institution to coerce or cajole it into doing something it would otherwise not do. One reason to pay attention to incentives G20 members face is that appropriate incentives to act in the jointly defined interests of the group might be a more efficient way to address global issues than would attempts by one or more important countries to exercise power in a confrontational way or, conversely, than would attempts by smaller countries to “free ride” on the stability provided by others, as Greece seems to have attempted within the European Monetary Union.

### Table 1: The Policy Coordination Dilemma

<table>
<thead>
<tr>
<th></th>
<th>Result with Correct Information + Consensus</th>
<th>Result with Flawed Information or Consensus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coordination</td>
<td>Likely good</td>
<td>Likely bad</td>
</tr>
<tr>
<td>Lack of coordination</td>
<td>Plausibly bad</td>
<td>Plausibly good</td>
</tr>
</tbody>
</table>

Note that the policy coordination dilemma occurs because of the absence of a highly stable automatic adjustment mechanism among the players, such as the one in effect under the classical gold standard from 1880 to 1914, which operated without the need for players formally to coordinate. As Gallarotti explains, negotiated international policy coordination is, from the point of view of global economic stability, a second-best relative to the existence of such a mechanism. Coordination is rendered necessary by the political transformation “from a laissez-faire economic culture under the gold standard to a politicized economic culture in the 20th century” (2004: 8). In turn, in the context of multilateral coordination such as the G20 exercise, this observation of Gallarotti’s leads to another important one: “If negotiations are going to deliver the kinds of economic stability and performance intended, leaders and diplomats will have to increasingly infuse their diplomacy with a greater understanding of how domestic politics can condition international economic relations” (2004: 6). Therefore, the domestic situation of each participant intrudes on discussions that concern implementing coordinated commitments, even more so than it did in the case of shaping a credible mutual assessment. Indeed, the mutual assessment phase ideally would be useful not only for the information and analysis it would provide on the global economic situation and prospects, but also for understanding others’ incentives to act.

It might be useful to examine how these general observations played out in specific earlier attempts to coordinate policies or rules internationally and to suggest lessons that the G20 could draw from those experiments.

The 1985 Plaza Accord (under the aegis of the G7) offers an example of coordinated interventions to achieve a temporary adjustment in key US dollar exchange rates, arguably under an implicit threat of US protectionism and plausibly at the long-term expense of at least one country that engaged in the intervention — namely, Japan. The result was temporary relief for the country that demanded the coordination, while fundamental imbalances (fiscal in one country, structural in others)
The experience of the European Monetary System (EMS), which preceded the current European Monetary Union (EMU), is also instructive in that it was an exercise in coordination in an environment that was clearly multipolar, yet still anchored by one major currency, much like the world now emerging. Launched in 1979, the EMS linked the currencies of its members via the European Currency Unit (ECU). The value of the ECU vis-à-vis external currencies was based on a basket of the members’ currencies, with individual members’ weights in the basket set relative to their importance in intra-European trade. The arrangement eventually foundered in 1993 because, in the end, it attempted to hold exchange rates at levels that did not adequately reflect either the economic reality of the members or the fast-changing world around them (exemplified by German reunification and the rapid growth of foreign exchange markets, which rendered inadequate the flexibility allowed for each member’s currency around the ECU).

Leadership had its privileges for Germany in this system, allowing it, in principle, to shift the burden of needed adjustments in its domestic policies onto smaller partners (proportionately more so than the smaller partners could shift their burden onto the bigger members). At the same time, the smaller nations initially saw the adjustment burden as acceptable, since belonging to the EMS seemed to provide a guarantee of stability while encouraging desired economic integration. But this became unbearable when, contrary to the belief that Germany would do the “right” thing following reunification — that is, suffer more inflation domestically for the good of the European Community as a whole — the Bundesbank retained its low-inflation policies and kept increasing interest rates, in effect exporting deflation, recession and unemployment to its partners.

The more recent history of the EMU is also instructive. When the euro was introduced, Germany insisted that a Stability and Growth Pact accompany the rules for monetary stability in the euro area enshrined in the Maastricht Treaty, which launched the European Union. Yet, Germany breached the very deficit limits it had insisted other countries meet when it became domestically convenient to do so. Since then, of course, the fiscal debacle in Greece has demonstrated to all EMU members and to the marketplace that membership in the wider currency area, while it might promote intra-EMU trade and project an image of stability for a while, is not a substitute for fiscal sustainability and productivity-enhancing reforms. Furthermore, Greece’s EMU membership relied on systematic underreporting of the country’s deficits and debts while providing temporary shelter from what would otherwise have been a more ongoing market-imposed fiscal restraint (Buiter, 2006: 18-19). It turns out that, for these and other reasons, the Stability and Growth Pact might fit in the “likely bad” quadrant in Table 1.

These examples of the real world’s overtaking rules suggest that the G20 should not attempt to impose hard and fast rules to implement its Pittsburgh list of commitments or be obsessed with the value of any one variable, unless the effectiveness of rules or proper value of the variable have been validated by a long discovery process. Indeed, we live in a world where economic models and rules that were once thought adequate are being revised in light of recent experience. We know that a view of what is adequate capital in the banking system, or what constitutes a prudential level for a country’s international foreign exchange reserves, or of whether emphasis should be put on regional rather than global cooperation, has important consequences, but in many cases it is no longer always clear what rules or even rules of thumb, should apply to such parameters. For example, just as the Asian and other developing economies put a major emphasis on self-insurance and regional surveillance after the 1997 crisis — a crisis which also sharply called into question the typical advice then provided by the IMF — they might now review some of these stances as they are called to a renewed global partnership with more mature economies (see Institute for International Monetary Affairs, 2005; Chin, 2010). As a mirror image of those changes in Asia, the crisis of 2007-09 should induce Western economic policy makers to be more modest about the adequacy of their own systems and make them focus more on their own role in preventing dangerous imbalances in a fast-changing environment.

A world in which policy paradigms are shifting so quickly might well compound the problems caused by the “two unfortunate incentives” that public officials have, according to Cass Sunstein: that of giving undue attention to worst-case scenarios and that of paying no attention to them at all (cited in Ghosh et al., 2009). In this world, the G20 leaders might not know precisely when they are facing a problem or when to expend the political capital to act before the problem becomes serious.

For example, experts and non-experts alike continue to marvel at the strength of the US dollar in the face of the
United States’ continued accumulation of current account deficits and its shift from being the largest creditor nation to being the largest debtor (see James, 2007). There is now a strong sense that the large and persistent US current account deficit and the correspondingly large and persistent Chinese current account surplus played a nefarious role in the recent crisis. Yet, the importance of current account imbalances on the international agenda has waxed and waned since the United States’ “desire to use its dominant position in international financial markets” effectively spelled the end of attempts to introduce cooperative capital controls to preserve the stable exchange rate of the postwar Bretton Woods system (Helleiner, 1994: 101-102). In an earlier phase, after much hand-wringing in the G7 in the 1980s concerning the problem of current account imbalances, the Bank for International Settlements suggested that it has to be asked whether the earlier anxiety about the sustainability of [these] imbalances was justified, at least to the extent that pre-emptive action was urged….Presumably, if the matter is to receive more attention, the limits of sustainability will have to be more clearly in view (1989: 7, as initially reported in Ostry, 1990).

The G20 is now rediscovering, in light of the recent crisis, the limits of sustainability, but it has not yet said how it intends to step back from the apparent brink. It would seem obvious that a clear demonstration of leadership by key members of the group is necessary to break the apparent deadlock over major imbalances. Currently, this means there is “nothing to be gained in asking a body such as the G20 to coordinate a variety of policy variables when nations at the centre” of structural imbalances, China and the United States, do not demonstrate willingness to correct them (Schwanen and Siklos, 2010).

An initial conclusion is that dialogue and approaches rooted in national perspectives on global leadership, and emphasizing leadership, responsibility and principles, should supplement the language of rules or discussions around quantitative estimates of imbalances. The Canadian financial regulatory model — which Canada’s superintendent of financial institutions describes as based on frequent and effective communications and “using our brains” with respect to such issues as understanding and managing risk (Dickson, 2009) — and the peer review systems of the OECD and other organizations such as Asia-Pacific Economic Cooperation demonstrate the usefulness of such an approach in the environment we are experiencing now.

But emphasizing dialogue and principles, and expecting leadership from its more systemically important members, should not mean for the G20 to abandon the focus on the tough issues, including the balance of responsibilities among its members. To help focus the discussion, the G20 could use the kind of language already employed in other contexts. For example, language from the WTO could be adapted to ask whether the rate of accumulation of Chinese external reserves is more than necessary to meet legitimate Chinese policy objectives regarding insurance against shocks, or whether the United States’ macroeconomic stance is structurally unsound at the moment, as Bergsten (2009) claims, in effect imposing an unfair burden on other countries. Again using the language of trade commitments, I recommend that each G20 member be required under the Framework to produce a “positive list” of measures it intends to take to ensure strong, sustainable and balanced growth according to its own domestic policy vision. For example, each country would announce publicly its specific steps to ensure a sustainable fiscal situation, as opposed to simply promising to reduce its deficit by a certain amount. By requiring that the measures listed be organized under headings reflecting collective G20 commitments, this approach would not only spell out the actions the government of a country intends to implement, but also link these actions specifically to the country’s acknowledged responsibility for global economic well-being. Such a process would lead to specific commitments — perhaps even competitive announcements of measures — without being coercive or intruding on the economic sovereignty of individual nations.

Implementation

Even if G20 members made commitments under the Framework that went beyond the general collective or ad hoc pledges that too often characterized G7 and G8 meetings, simply reporting on the implementation of policy commitments voluntarily identified by each country might not be sufficient to ensure the Framework’s effectiveness. The policy world is replete with rules and commitments that are not met, for various reasons, despite surveillance mechanisms specifically geared to ensure their application.

One egregious example of an ineffective surveillance mechanism is that of the EMU’s Stability and Growth Pact, referred to earlier, which stipulates the maximum budget deficit as a share of GDP that should not be
breached under normal circumstances. Member states are required to report to the European Commission their planned and actual deficits twice a year, and they must submit annual stability and convergence programs. The Commission assesses these submissions and forwards them to the ECOFIN Council, comprising the finance and economic ministers of member states (see Fischer, 2001). The Council then may issue an early warning against the occurrence of an excessive deficit. If a country breaches the agreed-upon threshold, it triggers the Excessive Deficit Procedure and the Council then recommends that the member state take effective corrective action within six months, in the absence of which the Council may impose pecuniary sanctions.

Despite this process, however, and although many countries have been “reported on” over the past several years, it is striking that the enforcement mechanism has never been used — although the Commission, as distinct from the Council, has tried to enforce it. The problem, of course, is that the very governments that breach the deficit threshold are at the same time accused, judge and jury (Buiter, 2006: 3). Thus, peer review risks becoming an exercise in collective justification for the collective failure to meet the rules — indeed, the definition of what constitutes “normal circumstances” has been considerably relaxed since the Stability and Growth Pact’s inception. But, as the earlier discussion suggested, enforcing the rules blindly might not have made sense either, given the profoundly changing economic context. Rules can indeed be harmful when confronted by a reality that differs from the one that gave rise to them. Bringing the lessons of this case back to the G20 is again an argument for a principles- and dialogue-based approach to implementing the Framework, rather than one based on rules.

Nevertheless, the emphasis on principles, dialogue and voluntary national commitments in support of the G20 Framework should not limit our calling G20 members robustly to account with respect to their stated individual and common responsibility for the health of the global economy. Here, the problems with the EMU suggest that there should be more room for advice independent of governments to be brought to bear on matters of coordination. At the moment, the calling to task of G20 members, when it is made in public, is done chiefly through what has sometimes been described as “finger pointing” by some members. This involves criticizing policy directions taken by other members that are felt to endanger global economic health (see, for example, Atkins and van Duyn, 2009; Giles and Beattie, 2010). This mud-slinging risks getting worse as countries seek to implement coordinated “exist strategies” from the recent extraordinary fiscal and monetary stimulus, which could be much more controversial than implementing coordinated stimulus packages at a time of global crisis.

If the G20 Framework is to be credible, discussions of these complaints, which relate directly to the G20’s goals, should be brought within it, though not through a WTO-like enforcement of legally binding obligations, which in this case are nonexistent. In any event, many types of obligations undertaken under the Framework would not lend themselves to WTO-like dispute settlement system allowing for “tit-for-tat” suspension of benefits. If, for example, the United States did not act with sufficient vigour to boost domestic savings, would China get a pass on, say, stimulating domestic spending? It should be possible, however, to implement a formal mechanism — perhaps through the wise persons’ commission mentioned earlier — that would examine complaints within the ambit of the Framework without impinging on national sovereignty or other prerogatives of important economies. The legitimacy of the mechanism would be founded on the basis that countries’ responsibility first and foremost for their own economic health and to their own citizens cannot be dissociated from their responsibility for the global economy’s health overall.

Grounds on which complaints could be raised would have to be defined carefully as corresponding to the goals of the Framework. These could include:

- the pursuit of policies that are not sustainable domestically and that are accompanied by large external imbalances (including an unsustainable public debt path);
- actions that appear to risk accelerating inflation or that encourage the persistent misallocation of capital that threatens to spill over into another country (including concerns about large and persistent growth in credit of questionable quality);
- the pursuit of other questionable microeconomic policies at the intersection of trade and macroeconomic stability issues that appear to defy comparative advantage (including protectionism or exercising control over currencies or other policy variables leading to a long-term misallocation of resources);
- financial protectionism — for example, when a country attempts to direct bank lending to itself through restrictions on lending elsewhere — or other attempts to insulate an economy that hurt others through, say, unnecessary controls on capital flows; and
- otherwise not acting in good faith on its G20 undertakings.

7 There should be no question of the complaints process having terms of reference that are outside supporting the G20’s objectives as expressed by the leaders themselves.
Technical assistance from the IMF or any other source of expertise could be included in the complaints mechanism, and other countries could have intervener status in the assessments. While no action would flow directly from the reports thus delivered through the complaints mechanism, reference to their conclusions and recommendations would be compulsory material for future monitoring by the IMF and OECD under the Framework, as would an assessment of their collective implications at future G20 meetings.

Conclusion

The G20 political leaders have taken on the task of moving the global economy toward a new balance of global responsibility that is commensurate with the shifting balance of economic power, while reducing economic volatility and risk in a way that also sustains economic growth. It is, of course, conceivable that the Framework introduced at the Pittsburgh summit will prove only a passing phase, a temporary political convenience that usefully helped leaders’ intentions to coalesce at a time of global crisis.

If, however, the Framework is to provide a more credible assessment of the global economic situation going forward, and if it is to enhance the likelihood that G20 members will act on this assessment consistent with the objectives they have stipulated, the G20 must be able to count on a wider and deeper independent assessment process, take the step of enunciating national commitments and establish a process to evaluate disputes and differences. It is possible to accomplish these goals in a context that entirely preserves countries’ economic sovereignty, while emphasizing their responsibility for global sustainable growth and stability.

Works Cited


Gallarotti, Giulio M. (2004). Confronting the Impediments of International Economic Cooperation: Domestic Politics and International Monetary Relations. Available at: http://www.g8.utoronto.ca/governance/gallarotti_g8g.pdf


About CIGI

The Centre for International Governance Innovation is an independent, nonpartisan think tank that addresses international governance challenges. Led by a group of experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate, builds capacity, and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events, and publications, CIGI’s interdisciplinary work includes collaboration with policy, business and academic communities around the world.

CIGI conducts in-depth research and engages experts and partners worldwide from its extensive networks to craft policy proposals and recommendations that promote change in international public policy. Current research interests focus on international economic and financial governance both for the long-term and in the wake of the 2008-2009 financial crisis; the role of the G20 and the newly emerging powers in the evolution of global diplomacy; environment and energy, including climate change; and issues related to global and human security.

CIGI was founded in 2002 by Jim Balsillie, co-CEO of RIM (Research In Motion) and collaborates with and gratefully acknowledges support from a number of strategic partners, in particular the Government of Canada and the Government of Ontario. CIGI gratefully acknowledges the contribution of the Government of Canada to its endowment fund.

Publications Team

Senior Director for Publications: Max Brem
Publications Coordinator: Jessica Hanson
Media Designer: Steve Cross
Publications Assistant: Matthew Bunch