

Global Governance Under the G20: A Chinese Perspective

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Part I. The Indispensable G20

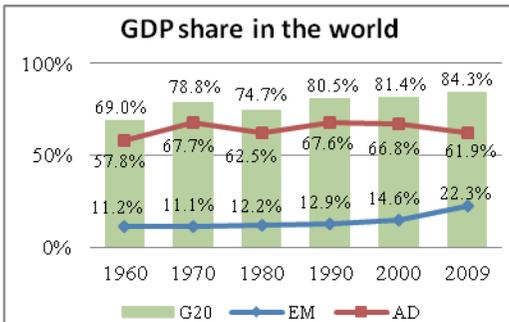
The G20 was created in 1999 as “an informal response mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system” after the Asian crisis. In the first 10 years, the importance of the G20 was far below that of the G7 or G8, although the annual finance minister and central bank governor meetings have never been interrupted. The role of the G20 in the early stage was more like an assistant complementing the IMF in the promotion of international financial stability.

The breakout of the global financial crisis pushed global governance and cooperation to a stronger, more inclusive path. The single G7/G8 is inadequate to solve major problems and insufficient to compel other countries to cooperate. In 2008, the G20 was elevated to the level of leaders of state and government, and has served as a high-level platform for discussing economic analyses and policy responses. There are various reasons to explain why the G20 became more important and more indispensable.

- 1. The increasing interdependence among different domains:** The recent financial crisis exposed the shortcomings of the original system of global governance. Global interdependence has increased since the last century, including aspects such as economic relationships, climate change, nuclear threats and the spread of infectious disease. For example, in a flat world, capital can flow freely in huge amounts across borders, and financial derivatives tie different markets together in novel ways. Financial problems become highly contagious, while the spillover effects become greater and more complicated. Although lots of multilateral organizations, such as WTO, WHO, IMF and BIS, have made a lot of effort, they can only help to solve the issues in their respective domains and often only issues targeted at a specific country. However, most of the new issues cannot only be limited to one country or domain but should be considered in a unified framework.
- 2. The requirement of effectiveness in international affairs:** The global crisis highlighted the importance of the spillover effects in macroeconomic and financial stability and the importance of coordination in different countries' fiscal and monetary policy in demand

management. Fiscal or monetary policies pursued in one country, especially in a systematically important country, do affect other countries. It is hard to deny that the G20 is more effective in dealing with the crisis, although it has not been successful in all respects. The IMF has been devoted to fostering global monetary cooperation, securing finance stability, facilitating international trade, promoting high employment and sustaining economic growth; however, it has not been successful in strengthening the multilateral surveillance processes and few member states have supported these efforts because of comprehensive reasons. At the same time, the World Bank puts emphasis on mainly development issues. That means a vacuum in global macroeconomic coordination has resulted. The G20 provides a chance to balance the internal and external benefit or loss of different policy choices. The Mutual Assessment Process of the G20 countries proposed in 2009 made a big stride in the coordination of macroeconomic policy and in dealing with interdependence.

- 3. Broader representation with efficiency.** With dramatic changes in the world economic structure, communication and coordination among G20 could become more and more important, since it includes almost all the “systematically important” countries which might bring spillover effects to other countries. The G20 represents around 85% of global GDP in market exchange rate terms, and 60% of the global population, as showed in figure 1, while the G7 only represents 60% of the world’s GDP and 10% of the world’s population. Obviously the G20 has a broader representation compared to the G7. Although the UN has a higher representativeness, it also has to deal with lower efficiency. The creation of the G20 represents the beginning of informal consultation among major developed and key emerging market countries, as shown in figure 2. This platform can bridge different opinions, promote mutual understandings so as to form consensus and push to take cooperative measures to fight for common issues.



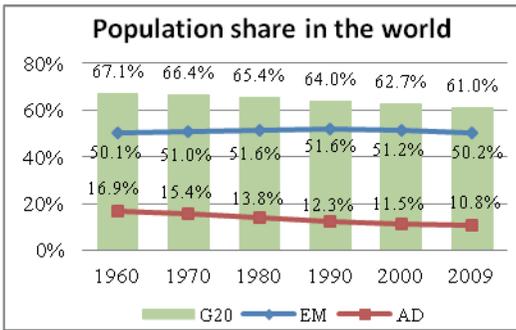


Figure 1: The G20 share in world GDP (Market exchange rate) and population

Data source: World Bank April, 2011

Note: EM - emerging market economies. AD – Advanced economies

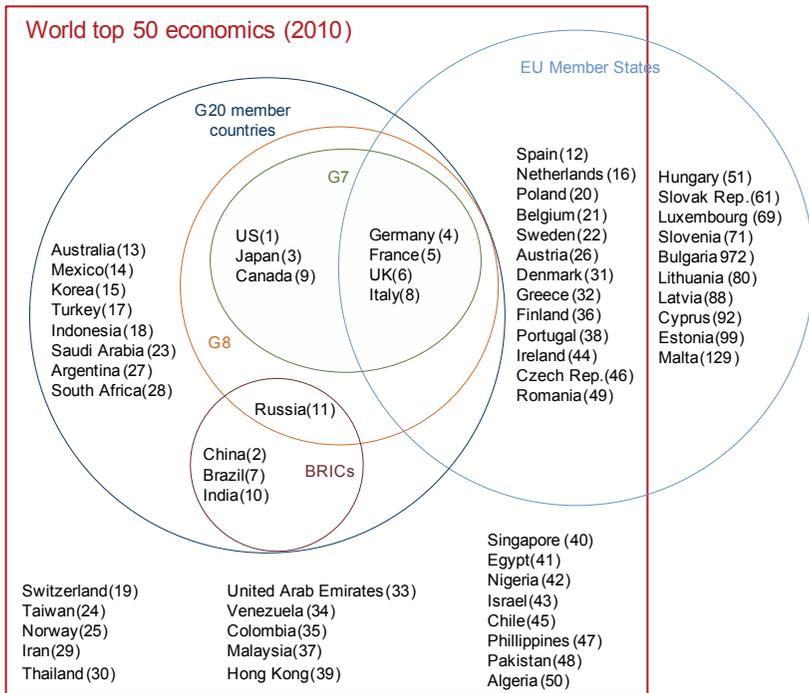


Figure 2: The top 50 economies' GDP ranks (market exchange rate basis) in parenthesis

Source: IMF, World Economic Outlook database, May 2011; Boao forum for Asia, The development of Emerging Economies Annual Report 2011, April 2011.

Part II. China's View on the G20

Although the process of the G20 is not so rigorous, it still reflected mutual hope of effective international coordination. The G20 represents a major attempt to rebuild the global regulatory system, improve surveillance, and enhance cooperation. Supporting the G20 also matches China's diplomatic strategy of "keeping a low profile and taking a proactive role when feasible". Since 1999, China has actively participated in all G20 meetings, and has made its due contributions to the reform of international financial architecture and global economic development. Generally, the attitude of the Chinese government towards the G20 is positive.

- 1. A chance to participate in global coordination.** Considering its importance in the global economy, as a responsible country, China has to take part in global governance. The G20 offers a good opportunity for emerging economies to participate effectively in global governance. From the Bretton Woods system to the G7, then to today's G20, the role of China has changed from passive state to proactive state, from peripheral to core. China looks to the G20 as the most important and representative multilateral global governance platform. As Hu Jintao said in 2011, "The G20 is now transforming from an effective mechanism in tackling the financial crisis to the premier forum for international economic cooperation." With the appearance of the G20 summit, the mission of the G20 has moved from international economic issues to global governance and international relationship. The themes under discussion include: 1) global governance—the initiative and reform, 2) response to the global economic crisis, 3) energy security and climate change, 4) international security challenges.
- 2. A chance to adapt to and learn global governance.** The period of China actively participating in the top level of global governance is very short. We do not have enough experience and preparation for that. For example, unlike the members of the G7/G8, the official representatives from the G20's emerging economies have less experience with the peer review processes (or Mutual Assessment Process), which have facilitated policy coordination. The emerging countries have become an important engine driving world economic growth, and the Western-led system is undergoing some changes due to the rise of emerging countries. It should be noted that the basic notion of "South Weak, North Strong" has not radically changed. Emerging economies are still in a weaker bargaining position in the G20. However, as a member with equal status as other countries in the G20, China can better understand the other countries' economic policy and grasp the latest changes in the world economic frontier.

3. **A chance to represent the Chinese position and build China's external image.** To China, the international order is based on the consensus of sovereign countries. Bilateral and multilateral agreements and treaties between sovereign countries are the most important ingredient of the international order. Therefore, as president Hu said in Seoul last year, "we should stick to the country-led principle, take into full account the different national circumstances and development stages of various members, and appreciate and respect each country's independent choice of development path and policies". The G20 gives China more chance to express itself and to improve its soft power. The Chinese position in the G20 is promoting reform and contending for rights and interests under the principle of "the golden mean", which means: if pushed right to the extreme, it becomes wrong. In China, the thoughts of Confucius, as a golden mean, have influenced lots of Chinese, as well as Chinese diplomatic policy. Although China is not willing to be considered as a threat, its peaceful rise is still deemed as a challenge to some countries.
4. **A way to facilitate the adjustment of the domestic economic structure.** In the 12th Five-Year Plan, China will put more emphasis on internal markets and domestic demand than ever before. In other words, China will gradually turn from an export-led growth pattern to a domestic consumption growth pattern. However, the process is not easy. Domestic vested-interest groups are not readily willing to change and make some concessions. Under the framework of the G20, China could find a chance to drive the adjustment with the help of external strength. Therefore, China would offer support to move forward on international economic and financial cooperation.

Part III. Case Analysis: China's Approach to Indicative Guidelines

Although officially it had no power to make decisions, the G20 summits have served in discussing and defining solutions for fundamental global issues. The Mutual Assessment Process (MAP) was started in September 2009 at the Pittsburgh summit as a major achievement. In the first year, the MAP approach was only based on a "peer review" process, in which each country was required to spell out its future plans for macroeconomic policies. In a letter to the G20 finance ministers before the Gyeongju meeting, Timothy Geithner urged member countries to cap current account surpluses or deficits so as to rebalance the world economy. Then in the Seoul meeting, indicative guidelines were proposed to "serve as a mechanism to facilitate timely identification of large imbalances that require preventive and corrective actions to be taken" as a complement to the MAP.

According to the Paris meeting communiqué, “The G20 Finance Ministers and Central Bank Governors meeting in Paris agreed on a set of indicators that will allow us to focus, through an integrated two-step process, on those persistently large imbalances which require policy actions.” In this meeting indicative guidelines were decided, including: trade balance, net investment income flows and transfers, public debt, fiscal deficits, private savings, and private debt. After two months of discussion, the final quantitative method was decided and published in the Washington meeting in April. The seven systemic imbalance countries (China, India, Japan, France, Germany, UK and US) were decided as well although the list was not published in the meeting’s communiqué.

China tries to play an active role in the FWG (framework working group), although it may not be looked at as a popular collaborator in the discussion. For example Chinese officials did not make concession on: 1) replacing current account with disaggregated indicators such as trade balance and net investment income flows and transfers; 2) excluding real exchange rates and international reserves as indicators of imbalance.

Current account is composed of trade balance, net investment income and transfers. The different parts of the current account reflect respectively external performance in the trade channel, factor income channel and transfer channel. Since different countries have different patterns in the current account, we should treat them in different ways.

The surplus in the current account is not completely an intended outcome of monetary or trade policy. As Olivier Blanchard mentioned in the paper “Current Account Deficits in Rich Countries” in 2007, the deficits in rich countries are mainly driven by private saving and investment decisions and typically financed through equity flows, foreign direct investment flows and own-currency government bonds. The optimal policy, such as exchange rate policy, may or may not imply a reduction in the deficit or surplus.

With the change of growth pattern (as planned in the 12th Five-Year Plan), the acceleration of population aging, the rising of labour cost, the improvement of domestic market environment, and the more flexible exchange rate, the decrease of surplus in the current account would be a spontaneous process. The exchange rate is only one of the factors, and is not necessarily the crucial one. The experience of Japan is a good example. Although exchange rate matters to the external balance, the adjustment result was not always as anticipated (in figure 3).

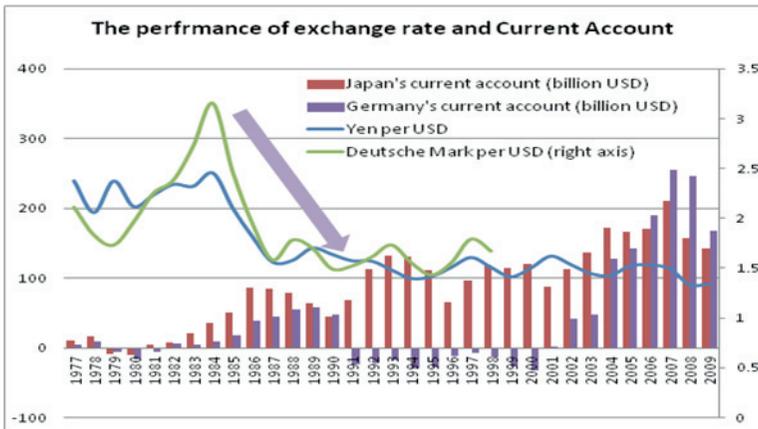


Figure 3: The relationship between exchange rate and current account
Data source: IMF, 2011 April

The international reserve is a by-product of trade imbalance, a result of an unreasonable international monetary system. In other words, if we solve the external imbalance, the situation of the international reserve would be changed as well. Actually emerging economies look at the international reserve as a double-edged sword. On the one hand, it is a necessary requirement for maintaining internal financial stability and resisting external shocks. On the other hand, these countries could be held ransom by the key reserve currency-issuing countries because of the high reserve and have to help maintain the stability of the currency.

Although officials gave the doctrinal reasons to explain their thoughts, one of the reasons is to take care of or balance the related interest groups. As an inexperienced participant and responsible country, China is very cautious in every step. Actually, most of the global governance activities or any other international rules (institutions) are non-neutral. Any institution will bring different gains and losses to different countries, so it is hard to find a neutral institution. Therefore, China's worry is understandable.

Part IV. Conclusion

The current international order reflects the political and economic reality after the Second World War in the form of the UN and the Bretton Woods institution. The appearance of the G20 reforms the situation, and better reflects the changes since the end of the Second World War. However, in the next decade, China's priority will be to continue to focus on domestic issues; thus, the basic approach to global governance is to minimize loss, rather than maximize profit.

The G20, the G7/G8, and the BRICS are overlapping multilateral leaders' forums. Today's world is becoming more interdependent and more complicated. In my personal view, the future of the G20 is mainly dependent on the attitude of the G7/G8. France hosts both the G20 and G8 summit in the same year. In a certain way, the opinion of France could impact the relationship between them.

The BRICS have a bright prospective; nevertheless, it is only three years old, and its influence is far behind that of the G7/G8. In spite of existing internal differences, the E11 countries (emerging 11 countries in the G20) have more common interests compared to the advanced countries. The performance of the G7/G8 plus Australia and EU will highly decide whether emerging economies can grow in strength to balance the influence of the G7/G8. From the current point of view, although an internal E11 negotiation platform may improve the efficiency, China does not plan to build a new or extended emerging economies union or coordination mechanism under the G20.

Comparing to the G7/G8, the G20 is more representative; however, there is a huge difference between the developed economies and developing economies in values and priorities. Besides, the G20 lacks the necessary coordination and cohesion at the beginning stage. The consensus decision-making approach may not be a best choice for a large group with 20 or more representatives especially when the group has to arrive at some results on some specific issues. Although, as James M. Buchanan proved, a consensus decision-making process is the most democratic and fair decision-making process, this way would also mean low efficiency and effectiveness. A successful global platform needs to strike a good balance among three respects: legitimacy, efficiency and effectiveness. The G20 could use this decision-making way to build the basic rules and regulations. Or, in other words, the G20 should consider using different decision-making processes to deal with different levels of issues.

In short, whether the G20 can smoothly transform from tackling the crisis, whether the G20 can play a crucial role in future global governance, whether the G20 can grow up as an effective world coordination platform, all of this depends upon on the wish for cooperation by 20 economies and need a large amount of common efforts.

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