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The G20-Summit in Korea

REACTIONS FROM THE U.S.

During the G20-Summit in Seoul the expectation was that global imbalances, currency values and financial regulation would bring leaders together to form a consensus on how best to move forward in the lasting global financial crisis. However, when world leaders failed to agree, declaring at the end of the summit that they would work to tackle global economic tensions and vulnerabilities, they heightened rather than lowered the fears of expanding currency wars and trade protectionism.

The summit was an effort to smooth over rifts between export-rich countries and debt-heavy consumer nations. However, right from the onset, leaders such as China and Germany made it clear that they were not afraid to stand up to the U.S. on global economic issues and, in the end, may act on their own. President Obama had to give up on getting others to agree to numerical targets for current account deficits and surpluses. Instead, G20 leaders left their finance ministers to set indicative guidelines to measure large current account imbalances, in consultation with the International Monetary Fund (IMF), but left the details up for discussion until next year.

The official communiqué was brief and vague, reiterating four key points: 1) the commitment to market-determined exchange rates 2) to avoid competitive devaluations 3) to work towards a framework and guidelines for current account imbalances and 4) to avoid trade protectionism. However, the communiqué did not include triggers or mention of measures to be taken, and with countries watching out for their own bottom lines in a weak and uncertain global economy, coordinated economic action is not likely to flourish anytime soon, leaving many to speculate on the worst. As the *Financial Times* wrote recently: “This is not collective leadership but joint abdication of power.”[1]

Global Imbalances

At the end of the summit, the world’s top 20 economies vowed to refrain from "competitive devaluation" of currencies after two days of talks in Seoul. The leaders of the G20 in a joint declaration, also agreed to come up with "indicative guidelines" designed to identify and tackle large trade imbalances affecting world growth. But the agreement fell short of U.S. proposals to set a limit on national trade deficits and surpluses, after opposition from China and Germany, the world's two biggest exporters.

Speaking at a news conference at the end of the summit, U.S.-President Barack Obama said, countries with large surpluses must shift away from an "unhealthy dependence" on exports. "Some countries are running large surpluses, others running large deficits," Obama said. "Put simply, we risk slipping back into the old imbalances that contributed to the economic crisis in the first place and threaten global recovery."

However, many leaders at the summit, especially China and Germany, made it clear to president Obama that central to the debate on trade imbalances is the question of currency exchange rates. U.S. officials say

[1] Cf. http://www.ft.com/cms/s/0/8f33885e-ee90-11df-9db0-00144feab49a.html.

China's currency is artificially weak and gives Chinese exporters an unfair advantage as well as leading to Beijing amassing huge foreign reserves. White House Press Secretary Robert Gibbs said the currency issue was by far the bulk of the meetings at the summit.

Currencies

The United States faces complaints from China, Germany and other nations that Washington is itself pushing down the value of the U.S.-dollar. The Federal Reserve Bank has announced it is to pump 600 billion dollars into the economy so as to stimulate growth, and that has the secondary effect of weakening the dollar. U.S. officials deny that the move represents intervention in exchange rates, saying the market is freely assigning value to the dollar. However, EU officials believe the strategy will not work. "In the U.S., because interest rates are already low and the banks are not willing to lend, we do not think that quantitative easing will have a significant impact," an official said.[2]

Right before the start of the summit, the president said that as two of the world's largest economies, the United States and Germany must make sure to work for balanced and sustainable growth and Chancellor Merkel spoke of the need to send a good signal for global growth. However, Chancellor Merkel dismissed U.S. calls for numerical limits for current account balances, saying she hoped to avoid a confrontation between China and the United States over trade and currencies. "I don't think much of quantified balance of payments targets," she said. "Exchange rates should reflect the real economic strength of a country. (…) Particularly in view of the debate about China we need to find facts and benchmarks to calculate a fair exchange rate."

Chancellor Merkel, who rejected and resisted President Obama's call for hefty stimulus spending in the wake of the global financial crisis, feels that time has proven her right. She rebuffed President Obama's call for trade rebalancing measures, confident in the assurance that her refusal to agree to Obama's global stimulus prescription paid off – at least for Germany, whose exports have boomed and whose unemployment rate is well below the U.S.'s 9.6 percent. "Some of what we're seeing, particularly in the case of Germany, is this feeling that 'We were right,'" observed I.M Destler, a specialist in international security and economic policy at the University of Maryland.

With regards to China, Ma Delun, a deputy governor of the People's Bank of China, said he was concerned the Fed's spending spree may undermine efforts to balance out global growth. Ma said that the Fed's program "may add risks to the global economic imbalance, put pressure on emerging markets to adjust their international balance of payments and could also stir the formation of asset bubbles, all of which require our vigilance. "Some speculate that the underlying problem is not an international trade imbalance between nations, but an imbalance within nations — especially inside the U.S. and China. In the U.S., more and more income is concentrating at the top, thereby reducing the relative purchasing power of middle class Americans. That means more pressure on job-creating exports to fill the gap. In China, more and more income is going to the productive sector of its economy rather than to Chinese consumers, thereby reducing the relative purchasing power for the Chinese, relative to what the nation is producing. That means more pressure on exports to fill the gap."

Ben Steil, Director of International Economics at the Council on Foreign Relations, said that before the G20 meeting in Seoul, there was much more pressure on China than on the U.S. in terms of global imbalances of deficits and surpluses. "But given the timing of the Fed's actions just days before the summit, it makes it look as if the U.S. is behaving no differently, and China exploited

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[2] Cf. http://www.euractiv.com/en/euro-finance/eu-brings-germanys-currency-plea-g20-news-499614.

that to the maximum."[3] When China and Germany suddenly found themselves on the same page in their opposition to global measures (as advocated by President Obama) to address trade imbalances, their interests coalesced and it emboldened their defiance. This may be one factor as to why China was again not signaled out at the end of the summit as a currency manipulator.

Uri Dadush, who directs the International Economics Program at the Carnegie Endowment for International Peace, said the system of flexible exchange rates that had existed since 1971, was at risk of breaking down. "At the heart of the problem is the unwillingness of the big players — and here I would single out the U.S., Germany and China — to deal with their own domestic problem." He said that the U.S. needed to stimulate demand in the short run but curb its addiction to borrowing in the long run; that China needs to reduce its reliance on exports and allow its consumers to buy more and save less; and that Germany needs to wean itself off the fixation on frugality and productivity that helped it through reunification in 1990, but that now poses a threat to the economic integration of Europe.

"China wants to preserve the export-led growth strategy and on the other hand the U.S. needs the impetus of a weaker dollar. These are fundamentally incompatible objectives. Each side has become so powerful geopolitically that neither side has the levers to persuade the other to change," said Arvind Subramanian, an economist at the Peterson Institute for International Economics and the Center for Global Development.

Capital Controls

While the majority of discussions focused on the big three – the U.S., Germany and China, some emerging economies were granted a little wiggle room. While moving toward market-determined exchange rates and shunning competitive devaluations, emerging economies such as Brazil (with increasingly overvalued exchange rates that face an undue burden of adjustment) would be justified in taking "carefully designed macro-prudential measures."[4] In other words, they would be allowed to use capital controls to counter capital inflows.

Financial Regulation

Domenico Lombardi from the Oxford Institute/Brookings Institution said that "by failing to agree on numerical targets for current account imbalances, the G20 has not managed to give teeth to its peer-reviewed framework for a strong, sustainable and balanced growth, casting doubt on the credibility of this whole effort. World leaders have thus missed a chance to preemptively act together on the macroeconomic front before markets force them to do so (again). But this should not overshadow their latest, quite ambitious achievements: an agreement on Basel III and a substantial reform package for reforming the International Monetary Fund attained in a relatively short-time window."[5]

World leaders signed off on a Basel III agreement to raise the quality and quantity of bank capital, the centerpiece of their reforms following the global financial crisis. They also endorsed the Financial Stability Boards proposals to tighten supervision of the over-the-counter derivatives market and reduce reliance on credit rating agencies. However, the rest of the agenda was not advanced. The G20 leaders endorsed a series of broad recommendations by the Financial Stability Board to regulate banks judged "too big to fail", but with disagreements over issues such as whether such institutions should be subject to further capital surcharges, additional negotiations are needed in order to devise specific measures.

[3] Cf. http://www.reuters.com/article/idUSTRE6A80MB20101109.

[4] Cf. Alex Richardson: *Factbox: Outcome of the Seoul G20 summit,* Reuters, November 12, 2010.

[5] Cf. Michael Hughes: *Death of Washington Consensus*, The Examiner, November 12, 2010.

International Monetary Fund

With regards to the International Monetary Fund, the G20 leadership endorsed a package of reforms produced by their finance ministers prior to the summit, reflecting the shift in the balance of global economic power. Under the agreement, more than 6 percent of voting shares at the IMF will shift to emerging market economies such as India and China. Global leaders said that the agreement on shifting over 6 percent of voting power will increase the Fund's credibility and effectiveness, as it mirrors the new world economic order.

Trade

While slow-growing industrialized economies such as the U.S, want to export their way back to relative economic health, they increase the tensions over currencies and imbalances. At the summit, the leaders made broad pledges not to pursue protectionist policies and to work toward concluding the long-stalled Doha round trade liberalization talks. In a blow to both the summit host and to President Obama, both the U.S. and South Korea failed to agree on a stalled free-trade agreement. This was mainly due to disagreements over access for U.S. carmakers to the lucrative South Korean automobile market, but nonetheless spelled a bad ending to a summit lacking in victories for President Obama.

The Midterm Effect

The global defiance that President Obama encountered in Seoul comes down to two issues. The first was President Obama's thrashing at the polls. Seen globally as a less potent figure since his party's midterm losses, it seemed easier for world leaders to tell President Obama that they did not agree with him when the American people had just done the same. "It would be naïve to say the election results don't have an impact, because it does hurt him, I'm just not certain that if the election had been more positive for Obama, he would have done much better in winning global support for his economic views," said I.M. Destler from the University of Maryland's School of Public Policy.[6]

The second was the defense of the 600 billion dollar move by the U.S. Federal Reserve to buy up government bonds (which the President had no control over), rejecting critics' claims the U.S. is also waging a currency war by intentionally devaluing the dollar. This move prevented President Obama from winning international backing for his effort to pressure China to raise its currency value. While the U.S. has accused China of currency manipulation, the quantitative easing instituted by the Fed has only made President Obama's case that much more difficult.

Conclusion

Prospects for common action are very tough at the moment and are unlikely to improve soon, as each nation is looking out for its own self-interests. The U.S. dollar has to stabilize, as the world's major reserve currency, and the U.S. economy must regain strength. A president in a position of power might have a better chance – unfortunately, President Obama has to play the cards he was dealt.

Stewart Patrick from the Council on Foreign Relations had this description of the G20 outcome: "Three big take-aways from the Seoul summit; First, confidence in U.S. global economic leadership continues to wane. The Fed's decision to embrace more 'quantitative easing' undercut President Obama's position at the summit. Second, the G20 is not an effective forum to pressure China, at least to date. U.S. officials had hoped to marshal support from countries hurt by an artificial undervalued yuan. But — as at the June G20 meeting in Toronto — China deftly turned the tables, joining others in attacking U.S. monetary policy. Third, internal politics — including in the United States — will constrain G20 collaboration moving forward. Barack Obama arrived in Seoul immediately after his party

[6] Cf. Howard LaFranchi: *Why world leaders smacked down Obama at G20 summit*, Christian Science Monitor, November 12, 2010.

was trounced in midterm elections, making his G20 counterparts skeptical of his ability to deliver on global commitments and, indeed, undermining his willingness to make bold moves that might backfire wither with his Democratic base of the Republican majority in Congress."

With the 2012 presidential campaign ready to start, and a Congress locked in partisan struggle, the chances for President Obama to reach a global economic agreement, let alone a compromise, look dimmer by the day.