Much hype, little substance

Great expectations often end in great disappointment. The Group of 20 Finance ministers, Central Bank Governors and Heads of States (G-20) London summit on Thursday (2 April 2009) has become an interesting case in point, kudos to the G-20 leaders notwithstanding.

US President Barack Obama described it as a “turning point”. It may have been one for the grouping, but it was not for the ailing global economy. There was hardly anything new in the measures announced at the end of the summit.

Even the US$1.1 trillion pledged by the summiteers to spur economic recovery needs to be taken with a pinch of salt, for the devil lies in the details. It comprises US$250 billion to stimulate trade and US$100 billion to help the world’s poorest countries, in addition to a tripling of resources for the IMF (International Monetary Fund).

Upon scrutiny, it appears that trade-boosting portion refers to the already existing credit guarantee schemes in developed countries. And, not all of the extra cash made available to IMF will be lent out.

Although the leaders took pride in the on-going fiscal expansion to the tune of US$5 trillion to stimulate their fledging economies, which they claimed would raise global output by four per cent, they fell short by failing to commit themselves to new coordinated stimulus packages that would put the battered world economy back on track.

Agreement was reached on creating a new financial supervisory system to cover all financial institutions, including the hedge funds, thanks to the European pressure, but it remains unclear what sort of supervisory institutions will be created or how much muscles they will have. It is doubtful that these institutions will be able to rectify the dysfunction of the financial system.

The summit failed to address the thorny issue of the so-called “toxic assets” of the banking system, the root of the current global financial crisis. These refer to bad loans that will never be repaid. Hopes of the London summit emerging with a formula to write off the banks’ toxic assets were dashed by the lack of consensus.

China’s proposal to create an alternative to the US dollar as the world’s reserve currency did not fly, not only because it is fraught with pitfalls but also because the proposal was too vague. China’s “super-sovereign reserve currency” proposal had fallen short of details other than suggesting a move to a new currency similar to the SDRs (special drawing rights) of the IMF, which are accounting units, not real money.

Nonetheless, China did make an impression by extending US$40 billion to the US$500 billion in new funds pledged to the IMF. China could take comfort in the pledge by G-20 nations to review developing country representation in global financial institutions, although its own request for increased voting rights at the IMF remains unanswered. China’s 3.7 per cent of IMF voting rights pale in comparison with the European Union’s 32 per cent and the US’17 per cent.

It is fairly obvious that the centre of gravity is moving away from the West, although the London summit has failed to recognise this tectonic shift. The G-20 is made up of 19 countries, comprising the rich G-7 and 12 major developing countries, with the European Union adding one more.

Global imbalances call for global efforts to rebalance the world economy. While it is well understood that countries like the US need to save more and the emerging countries like China need to spend more, this is not the time for countries to save more or spend less. Be that as it may, the global economic malaise cannot be undone by increased expenditure alone. It calls for serious institutional and policy reforms, which the London Summit did not address forcefully.

The G-20 has failed to acknowledge the fact that conventional macroeconomic policy instruments are breaking down, with monetary policy becoming increasingly impotent, fiscal policy exhibiting fatigue and exchange rate policy falling into disarray. It is not fully understood that the current exchange rate misalignment is a serious impediment to the recovery of the world economy is not fully understood, let alone acted upon. The London summit has missed a golden opportunity to map out a plan for a soft landing of the US dollar.

But there will be more opportunities down the road for the G-20 to consider these and other pertinent issues. Already there are plans for another gathering of the G-20 members later this year.

However, it is not a question of how often they meet, but how much they accomplish at the end of the day. The G-20 has, thus far, met twice in the present climate, in Washington D.C. last December, and in London earlier this month.

Already the G-20 has an image problem, which casts a pall on its credibility. Not many would take the G-20 commitments seriously, given the gaping gulf between words and deeds. It is noteworthy that the G-20 promise in Washington D.C. not to erect new trade barriers was subsequently broken by 17 members under domestic pressure.

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Despite its shortcomings, the G-20 does represent an important forum. One must not forget that the G-20 is only an infant, taking baby steps. To be credible, it must learn not only to talk, but also to walk the talk.

All said and done, the G-20 London summit was a milestone for British Prime Minister Gordon Brown, as he skillfully navigated the summit through difficult waters and provided a space, on the margins, for the US to renew arms control negotiations with the Russia.

Adapted from “Much hype, little substance at G20 meet”, New Straits Times, 8 April 2009