Crisis Kills G-20 Progress

The G-20 summit at Cannes was supposed to produce a specific plan to contain fiscal deficits and boost domestic demand but financial dramas, like the unfolding crisis in Greece, dashed those grand ideas.

by Eswar Prasad (/contributors/eswar-prasad.html) | November 5, 2011 12:00 AM EDT

France's vision for its G-20 presidency (/cheats/2011/11/03/europe-gives-greece-ultimatum.html) was to lead the way to a new world with new ideas.

The communiqué issued by the G-20 (http://www.reuters.com/article/2011/11/04/g20-communique-idUSP6E7K902Z20111104) at the end of its intensive discussions in Cannes belies this grand promise. Instead of new ideas to promote global financial stability, the G-20 has offered grandiose but vague promises for the future, which are unlikely to inspire the confidence that financial markets were looking to G-20 leaders for. Indeed, a careful reading of the communiqué turns up mostly a set of slogans and promises rather than specific action plans.

One of the key items on the agenda was to develop a specific action plan to promote the long-stated goal of balanced, sustainable, and strong growth. The rebalancing effort that was to make growth sustainable involves measures to contain fiscal deficits in countries with large levels of government deficits and debt. Given the political gridlock on Capitol Hill, the U.S. is obviously in no position to make a commitment to rein in its rising debt. And the weak economic recovery makes this hard task even harder in other deficit countries like the U.K.

On the other side, countries running large current account surpluses are expected to boost their domestic demand to promote global rebalancing. In the case of China, this would be helped along by a more flexible currency. Instead, the Chinese have offered only to eventually allow their currency to fluctuate more freely and reduce restrictions on cross-border financial transactions, with no timeline specified.

French President Nicolas Sarkozy (L-R), German Chancellor Angela Merkel, U.S. President Barack Obama, and British Prime Minister David Cameron talk prior to the G-20 summit in Cannes, France, Nov. 3, 2011., Peer Grimm, DPA / Corbis

In short, the global rebalancing agenda has fallen victim once again to short-term exigencies and the reluctance of major economies to make specific commitments to advance this agenda.

Of course, this G-20 summit was upstaged by the unfolding drama of an explosive situation in Greece (/articles/2011/11/03/the-greek-financial-crisis-seven-great-reads.html) and its potential for infecting the world financial system. The dramatic political developments in Greece sucked a lot of air out of the discussions in Cannes and shifted the focus to dealing with short-term risks rather than longer-term reforms.

The G-20 has made it clear that, for its own sake as well as that of the world economy, Europe needs to put its own house in order quickly and with forceful measures. The G-20 has collectively taken a stance that pouring more money into Europe, either through direct funding or through the IMF, is not the right approach. There is merit to this logic. The political rather than purely economic nature of any solution implies that it must come from within Europe, which remains wealthy enough to deal with its own problems.

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Italy has agreed to subject itself to closer IMF monitoring (/cheats/2011/11/04/italy-gets-imf-oversight.html) , which is certainly a positive step. The move could buy some breathing room for Italy in the short run and help bolster market confidence—if it undertakes the right belt-tightening measures to bring down its debt and also frees up restrictions on its labor and product markets that are holding down Italian competitiveness. This remains a big if.

And what has the role of the U.S. been at this G-20 summit? President Obama came in with a weak hand, with political paralysis in Washington hurting an already feeble U.S. recovery. While the U.S. has been in no position to broker a grand deal of any sort, it has tried to play a constructive role in prodding Europe to face up to some harsh realities and get its own house in order. The U.S. has been unable to push the global rebalancing agenda forcefully; it would not be credible for Obama to promise decisive action on the U.S. deficit, as his hands are tied.

That left the IMF as one topic on which the leaders sensed an opportunity to make a tangible announcement of progress. However, the consensus on adding to the IMF's resource pool to expand its firefighting abilities seems to have fallen apart. Countries like the U.S. cannot conceivably contribute to additional IMF financing, and emerging markets such as China would have a hard time explaining to their domestic audiences why they should help support a wealthy continent that cannot look after its own affairs.

This week's meetings have highlighted the urgency and difficulty of the situation facing world leaders and the political challenges to tackling fundamental problems and tensions in the world economy. The big question is whether world leaders will return home emboldened to take tough policy measures to promote global financial stability or find their hands tied by domestic political constraints and give in to the temptation to continue muddling through.

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