November 2, 2011

G-20 Is at Its Best When the Stakes Are Highest

By ESWAR PRASAD

ITHACA, NEW YORK — With the global economy on the ropes and gasping for oxygen, the world's eyes will be on the leaders of the Group of 20 countries as they gather in Cannes for their economic summit meeting. The challenges they face are enormous.

The G-20 moved to center stage two years ago, when the global financial system faced a meltdown. This group was in fact formed much earlier, in 1999, as a forum for finance ministers to jointly tackle the aftermath of the 1997-98 East Asian financial crisis. Given the increasing economic might and influence of emerging markets, a balanced group comprising the main advanced and emerging market economies is certainly more relevant than the hitherto high-profile Group of 7 advanced economies.

G-20 countries produce about 90 percent of global economic output, generate four-fifths of world trade and account for two-thirds of the world's population. All countries have an equal "vote," although the group does not have any formal powers and works largely by consensus and moral suasion.

Despite its economic heft, during the first decade of its existence the G-20 barely registered on the public's radar and created few ripples in international policy circles. The onset of the global financial crisis changed all of that.

Faced with a calamity, the G-20 rose to the occasion, turning itself from a talking shop into a group that acted in concert to keep the global financial system from collapsing. Whether or not countries were coordinating their policies or just protecting their national interests is beside the point. In the midst of the crisis, it certainly inspired some confidence to see world leaders working together to pump government stimulus into their economies, prop up their financial systems and add to the firefighting capacity of institutions like the International Monetary Fund.

Once again, with the European debt crisis threatening the fragile global recovery, the G-20 is leading the charge to bolster the world economy and stabilize financial systems. Indeed, the group seems to work best when the world economy is approaching the brink of disaster, which naturally creates a sense of common purpose and shared interests.

Other than battling crises, the group has become the de facto agenda-setting body for global economic and financial policies. This broader role has generated existential questions for the G-20, not just about its effectiveness but also its legitimacy and role in the international monetary system.

The G-20 certainly serves as a useful forum for coordinating policy actions when the interests of its members are congruent — when their backs are all against the wall. But the group seems less effective at resolving conflicts among its members or helping to overcome domestic political gridlock that is hindering effective policy making in some of them.

Rifts within the group tend to become exposed in calmer times, making it harder for the G-20 to take a more coordinated approach to longer-term objectives like unified financial regulatory standards and reform of the international monetary system. For instance, at the Seoul summit meeting a year ago, currency wars broke out into the open, drowning out talk of strengthening the global financial safety net. The United States accused China of using unfair exchange rate and trade policies, while China and some emerging markets blamed loose U.S. monetary policy for worsening inflation and asset market bubbles in their economies.

This points to a fundamental problem. The G-20 has little leverage over the policies of its members, especially the larger economies. When one country's economies policies may have adverse consequences for the rest of the world, the group is reduced to finger-pointing and acrimony. Moreover, the group has no instruments to nudge its members to confront hard domestic choices, which allows problems to fester and threaten both domestic and global financial stability. Recently, the G-20 has been limited to jawboning Europe to face up to harsh realities and take decisive action to tackle the spiraling debt crisis that has ripple effects far beyond Europe's borders.

All of this suggests that, belying its immense potential, the G-20 may be better equipped to cope with the aftermath of crises rather than forestall them. Indeed, since the group works mostly by consensus, a small coalition can block longer-term policy actions favored even by a majority of the group. Coalitions within the group are fluid and issue-specific, but they tend to be more effective at blocking rather than advancing consensus on specific policy issues.

The G-20's broader legitimacy is also open to question. The group has assigned to itself the role of formulating policies on matters ranging from financial regulation to combating climate change. Shouldn't the G-20 be broadened and made more inclusive rather than let this small self-selected group, which excludes the majority of countries, make decisions on behalf of the world?

While the G-20 is by no means a perfectly representative group, making it more inclusive and representative could bolster its legitimacy but destroy its effectiveness. Its smaller size allows it to be nimbler than institutions like the United Nations and the I.M.F. It is relatively new, not burdened by a complex bureaucratic structure, and includes the key players on the global economic stage, giving each of them an equal voice.

Given its membership and flexible structure, the G-20 can be a potent force that promotes economic welfare by improving domestic and global macroeconomic and financial stability. This calls for visionary leadership from these countries and an understanding that there is a commonality of long-term interests that needs to be recognized and acted upon, rather than being sidetracked by short-term policy conflicts.

G-20 leaders must rise above the temptation to put narrow domestic interests and political expediency above long-term benefits to the global economic system. Otherwise, the enormous potential of the G-20 in preventing rather than just coping with crises will go unrealized. The choice is clear.

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