

Michael Callaghan · Chetan Ghate
Stephen Pickford · Francis
Xavier Rathinam *Editors*

Global Cooperation Among G20 Countries

Responding to the Crisis and Restoring
Growth

 Springer

Michael Callaghan • Chetan Ghatе
Stephen Pickford • Francis Xavier Rathinam
Editors

Global Cooperation Among G20 Countries

Responding to the Crisis and Restoring
Growth



Springer

Editors

Michael Callaghan
G20 Studies Center
Lowy Institute for International Policy
Sydney
Australia

Stephen Pickford
Chatham House
London
United Kingdom

Chetan Ghatge
Economics and Planning Unit
Indian Statistical Institute-Delhi
New Delhi
India

Francis Xavier Rathinam
South Asia Research Hub
Department for International
Development (DFID)
New Delhi
India

ISBN 978-81-322-1658-2

ISBN 978-81-322-1659-9 (eBook)

DOI 10.1007/978-81-322-1659-9

Springer New Delhi Dordrecht Heidelberg London New York

Library of Congress Control Number: 2013955068

© Springer India 2014

This work is subject to copyright. All rights are reserved by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed. Exempted from this legal reservation are brief excerpts in connection with reviews or scholarly analysis or material supplied specifically for the purpose of being entered and executed on a computer system, for exclusive use by the purchaser of the work. Duplication of this publication or parts thereof is permitted only under the provisions of the Copyright Law of the Publisher's location, in its current version, and permission for use must always be obtained from Springer. Permissions for use may be obtained through RightsLink at the Copyright Clearance Center. Violations are liable to prosecution under the respective Copyright Law.

The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.

While the advice and information in this book are believed to be true and accurate at the date of publication, neither the authors nor the editors nor the publisher can accept any legal responsibility for any errors or omissions that may be made. The publisher makes no warranty, express or implied, with respect to the material contained herein.

Printed on acid-free paper

Springer is part of Springer Science+Business Media (www.springer.com)

Global Cooperation Among G20 Countries

Contributors

Shankar Acharya Honorary Professor, Indian Council for Research on International Economic Relation (ICRIER), and former Chief Economic Adviser to the Government of India

Abheek Barua Chief Economist, HDFC Bank, India

Michael Callaghan Director, G20 Studies Centre, Lowy Institute for International Policy, Sydney, Australia

Heribert Dieter Senior Associate, German Institute for International and Security Affairs (SWP), Berlin, Germany

Visiting Professor, Zeppelin University, Friedrichshafen, Germany

Holger Fabig Head of Division, G7/G8, G 20, World Economy, Currency Issues, Ministry of Finance, Berlin, Germany

Ewa Orzechowska-Fischer Analyst, International Finance and Development Division, Department of Treasury, Canberra, Australia

Chetan Ghate Indian Statistical Institute-Delhi, New Delhi, India

Atish R. Ghosh Chief, Systemic Issues and Assistant Director, Research Department, International Monetary Fund, Washington DC, USA

Subir Gokarn Director of Research, Brookings India, New Delhi, India

Former Deputy Governor, Reserve Bank of India, New Delhi, India

Abhijit Sen Gupta Senior Economics Officer, India Resident Mission, Asian Development Bank, New Delhi, India

Pierre Jacquet President, Global Development Network, Washington DC, USA

David Kim Senior Lecturer, School of Economics, University of Sydney, Australia

Takuji Kinkyo Professor of Economics, Kobe University, Kobe, Japan

Yannick Kirchhof Economist, Ministry of Finance, Berlin, Germany

Denis Medvedev Senior Country Economist, Economic Policy and Poverty unit, The World Bank, New Delhi, India

Jae-Ha Park Deputy Dean, Asian Development Bank Institute, Tokyo, Japan

Stephen Pickford Senior Research Fellow, International Economics, Chatham House, London, UK

Jyoti Rahman Manager, International Finance and Development Division, Department of Treasury, Canberra, Australia

Francis Rathinam Department for International Development (DFID), New Delhi, India

Smriti Seth Research Analyst, Economic Policy and Poverty unit, The World Bank, New Delhi, India

Rajeswari Sengupta Assistant Professor of Economics, The Institute for Financial Management and Research (IFMR), Chennai, India

Alok Sheel Secretary, Economic Advisory Council to Prime Minister of India, New Delhi, India

Jong Kook Shin Lecturer, Queen's University Management School, Queen's University, Belfast, Northern Ireland, UK

Gurbachan Singh Independent Researcher, and Visiting Faculty, Economics and Planning Unit, Indian Statistical Institute-Delhi, New Delhi, India

Anand Sinha Deputy Governor, Reserve Bank of India, Mumbai, India

Paul Bernd Spahn Professor Emeritus, Goethe University, Frankfurt am Main, Germany

Emil Stavrev Deputy Division Chief, Multilateral Surveillance Division Research Department, International Monetary Fund, Washington DC, USA

Chetan Subramanian Associate Professor, Department of Economics, Indian Institute of Management Bangalore, Bengaluru, India

Redom Syed Analyst, International Finance and Development Division, Department of Treasury, Canberra, Australia

Inka Zippe Intern, Ministry of Finance, Berlin, Germany

About the Editors

Michael Callaghan is Director of the G20 Studies Centre at the Lowy Institute for International Policy. Mike has extensive experience on international economic issues, both in the Australian Treasury and the International Monetary Fund (IMF). From 2008 until 2012 he was Executive Director (International) in the Treasury and was Australia's G20 Finance Deputy. Mike also served as the Prime Minister's Special Envoy, International Economy. From 2005 until 2007 he was Executive Director, Revenue Group in the Treasury. Prior to this position he spent four years at the IMF in Washington DC as an Executive Director. Between 1999 and 2000, Mike served as Chief of Staff to the Australian Treasurer, the Hon Peter Costello. Mike has held various senior positions in the Australian Treasury. In 2009 he was awarded the Public Service Medal and in 2013 was made a Member of the Order of Australia.

Chetan Ghate is Associate Professor in the Economics and Planning Unit of the Indian Statistical Institute – Delhi. He is currently a member of the Technical Advisory Committee for Monetary Policy at the Reserve Bank of India. He received his Ph.D. in Economics and M.S. in Applied Mathematics from Claremont Graduate University (USA); Masters in Economics from the Delhi School of Economics (India); and B.A. Economics from Colorado College (USA). He has held faculty positions at the Colorado College, the German Institute of Economic Research, University of Sydney, and Claremont Graduate University. His areas of interest lie in macroeconomic theory and policy. He has published in several leading journals in his field. He recently edited "The Oxford Handbook of the Indian Economy" (OUP) which was selected as one of CHOICE's "Outstanding Academic Titles for 2012". In May 2011, he was a recipient of a Rockefeller Foundation residency in Bellagio, Italy. From 2012-2013 he was the Reserve Bank of India Chair Professor in Macroeconomics at ICRIER (New Delhi).

Stephen Pickford is Senior Research Fellow at Chatham House in London, UK. He has worked on international economic issues for much of his career, and retired from HM Treasury (UK) in 2010, where he was the Managing Director (International and Finance) and the UK's G7 and G20 Finance Deputy. Prior to this he held posts dealing with both European and international finance issues at HM Treasury,

and from 1998 to 2001 he was the UK's Executive Director on the boards of the IMF and World Bank. Previous positions included leading the team responsible for Bank of England independence in 1997, and between 1989 and 1993 he worked on macroeconomic policy and forecasting at the New Zealand Treasury. He was educated at the University of Cambridge, England and the University of British Columbia, Canada.

Dr. Rathinam is a research advisor with the Department for International Development (DFID). His recent research work explores the legal, regulatory and political economy aspects of current financial and banking sector reforms in India. Formerly he was a senior fellow at ICRIER. He has a Ph.D. in Economics from Hyderabad Central University and was a visiting fellow at the Institute for Law and Economics, University of Hamburg, Germany. Dr. Rathinam has published in *Emerging Markets Review*, *Macroeconomics and Finance in Emerging Market Economies*, *Environment and Development Economics*, among others.

Abbreviations and Acronyms

CQS	Calculated quota share
EMDC	Emerging market and developing countries
EU	European Union
FCL	Flexible credit line
G20	Group of twenty
G7	Group of seven
GDP	Gross domestic product
GFC	Global financial crisis
IEO	Independent Evaluation Office
IMF	International Monetary Fund
IMS	International monetary system
NAB	New Arrangements to Borrow
PCL	Precautionary credit line
PPP	Purchasing power parity
RFA	Regional financing arrangements
US	United States
WTO	World Trade Organisation

Contents

Global Cooperation Among G20 Countries: Responding to the Crisis and Restoring Growth	1
Michael Callaghan, Chetan Ghate, Stephen Pickford and Francis Rathinam	
The G20 Since 2008: Some Reflections on the Experience and the Road Ahead	23
Subir Gokarn	
Part I Eurozone Crisis: Short-Run Challenges and Options	
Overcoming the Euro Area Crisis—Reforms and Results	35
Holger Fabig, Yannick Kirchhof and Inka Zippe	
Predicting the Euro: A Practitioner's Perspective	59
Abheek Barua	
Monetary Integration in Europe and the Drawbacks of Centralization	67
Heribert Dieter	
Reflections on the Euro Crisis.....	73
Pierre Jacquet	
Part II Rebalancing the Global Economy	
The G20, IMF and Global Imbalances: The Policymakers' Perspective	83
Michael Callaghan	
Global Imbalances: Causes and Policies to Address Them.....	95
Emil Stavrev	

Exchange Rate Flexibility and Economic Rebalancing in China	101
Takuji Kinkyo	
Global Imbalances and Financial Fragility	109
Jong Kook Shin and Chetan Subramanian	
Part III Financial Sector Regulation	
Financial Regulatory Reforms: Not Far Enough, or Too Far?.....	121
Stephen Pickford	
Asian Perspectives for Financial Regulatory Reforms after the Asian Financial Crisis	135
Jae-Ha Park	
The Challenge of Financial Stability and Regulation from a European Perspective	143
Paul Bernd Spahn	
Financial Regulatory Reforms: Striking a Balance	153
Anand Sinha	
Part IV A New Framework for Reforming the International Monetary System	
Reforming the International Monetary System: an Institutional Perspective	161
Jyoti Rahman, Ewa Orzechowska-Fischer and Redom Syed	
Strengthening the International Monetary System	179
Emil Stavrev	
Systemic Sudden Stops, Credit Lines, and Funding Liquidity	185
Gurbachan Singh	
Part V Capital Control Policy and Emerging Market Economies (EMEs)	
Policy Trade-offs in an Open Economy and the Role of G20 in Global Macroeconomic Policy Coordination	201
Rajeswari Sengupta and Abhijit Sen Gupta	
Managing the Risks Associated with Volatile Capital Flows	221
Atish R. Ghosh	
On an Asian Monetary Union: What does the Evidence Tell us?	231
David Kim	

Part VI Austerity and Growth

The Macroeconomic Policy Response to the International Financial and Economic Crisis and the G20	241
Alok Sheel	
Austerity, Growth, and Public Policy.....	281
Denis Medvedev and Smriti Seth	
India and Fiscal Austerity	287
Shankar Acharya	
Erratum	E1
Index.....	293

Global Cooperation Among G20 Countries: Responding to the Crisis and Restoring Growth

Michael Callaghan, Chetan Ghate, Stephen Pickford and Francis Rathinam

1 Introductory Chapter

Since the unfolding of the 2008 global financial crisis, the G20 has played a major role in coordinating macroeconomic policies of major economies and reviving the world economy.¹ As the world's primary forum for international economic cooperation, its objectives have been to ensure more sustainable and balanced growth, achieve economic and financial stability and reform the prevailing international financial architecture. In the wake of the crisis, there was a sense of urgency and strong agreement to enact extraordinary policy measures to fend off the collapse of the real sector because of the "collapse of confidence" in the financial sector. The G20 performed spectacularly in this regard: global gross domestic product (GDP) contracted less than expected in 2009 and rebounded faster than expected in 2010.²

¹ The global financial crisis of 2008 required a more legitimate and representative forum than the G8 if it was to effect global macroeconomic and financial policy coordination to ward off imminent depression. It was in this context the G20 Leaders Summit was born.

² World Economic Outlook (April 09) predicted that world output would contract by 1.4% in 2009 and grow about 2.5% in 2010. However, the actual outcome was -0.5% in 2009 and a 5% growth in 2010 (Ahluwalia 2011).

M. Callaghan (✉)
Lowy Institute for International Policy, Sydney, Australia
e-mail: mcallaghan@lowyinstitute.org

C. Ghate
Indian Statistical Institute, New Delhi, India
e-mail: cghate@isid.ac.in

S. Pickford
Chatham House, London, UK
e-mail: stephenjpickford@gmail.com

F. Rathinam
Department for International Development (DFID), New Delhi, India,
e-mail: rfancisxavier@gmail.com

These coordinated actions were widely credited for forestalling a second Great Depression, with the G20 declaring victory at their third summit at Pittsburgh in September 2009 ("It worked").

Since 2009, Indian Council for Research on International Economic Relations (ICRIER), along with its partners, has been organizing a high-level annual conference that brings together academics and key policymakers from G20 member countries and International Financial Institutions (IFIs) to deliberate on a range of issues related to the G20. The previous three ICRIER conferences in this series, held prior to the Toronto, Seoul and Cannes G20 summits, had deliberated on the then G20 agenda. Succinct summaries of these conferences have been published and widely circulated among IFIs, think tanks and government officials in both India and abroad. The proceedings served as inputs to policymakers participating in the summits. ICRIER hosted its fourth G20 conference on October 7–9, 2012, at New Delhi in partnership with the Asian Development Bank Institute (ADBI), Department of Economic Affairs (DEA, MoF), International Monetary Fund (IMF) and Konrad-Adenauer-Stiftung (KAS).

Discussions in the fourth conference focussed on six key areas of concern facing the G20:

1. The eurozone crisis: short-run challenges and options
2. Rebalancing the global economy
3. Financial sector regulation
4. A new framework for reforming the international monetary system
5. Capital control policy and emerging market economies
6. Austerity and growth

The overarching theme of the conference was the scope for cooperation and coordination amongst the G20 across several key policy areas.³ Several issues relating to cooperation and coordination in macroeconomic policy were discussed: the relative efficacy of rules versus discretion-based coordination⁴; how to achieve cooperation across a diverse set of countries especially when cooperation also requires loss of national interest; has the G20 process run its course; how can the process be made

³ There is a large theoretical literature on the international coordination of macroeconomic policy. See Pilbeam (2006) for a textbook treatment. The principal argument in favour of international coordination is that governments will be tempted to pursue suboptimal policies without it. In short, there will be a failure to internalize the externalities, with the uncoordinated approach leading to Pareto inefficient outcomes. Bird (2012) however argue that policy coordination does not necessarily imply Pareto efficient gains as individual countries may perceive that they would lose from coordinating macroeconomic policy when they subvert domestic policy preferences for policy outcomes that are seen as jointly superior. Further, the bargaining position of individual countries is unlikely to be equal in securing a coordinated outcome.

⁴ International policy coordination can take two broad forms: discretion-based cooperation or rule-based coordination. While many examples of policy coordination favour rule-based coordination, discretion-based cooperation is typically superior given extreme unanticipated events for which the existing set of rules cannot cope (Bird 2012). From this standpoint, the London summit of the G20 in April 2009 was an attempt to organize discretion-based coordination.

more inclusive; can the G20 regain its stature as a problem-solving group; how can the G20 strengthen its key function of providing crisis management mechanisms; and given that the basic rationale for the creation of the G20 leaders' process was to manage shocks transmitted by and through the group, how can it best do this.

In addition, broader issues surrounding the role of the G20 in macroeconomic policymaking were also discussed. For instance, many participants felt that the G20 was an informal and political body that brought together the biggest economies in the world as a problem-solving group that looked to the future. To be effective, it should remain a leader's forum. Some participants felt that there were two sub-groups in the G20—the BRICS and the G7/G8. These groups brought a flavour of the past North/South divide, which may limit the sense of a common purpose among G20 members. For legitimacy, various participants felt the need for G20 countries to work more closely with non-G20 countries. Legitimacy would also involve a stronger and more independent accountability process, with regional arrangements linked to the G20. Other points mentioned included a lack of resource commitments by G20 members, that initiatives by the chair were over-emphasized and the credibility of the G20 was hampered by delay in implementing commitments.

Finally, participants felt that there is further scope for cooperation in other areas such as the consultation process and addressing the pace of IMF reforms. Pre-determined policy options undertaken by the G20 through a consultation process did help in feeding back into national policymaking processes.⁵ This suggests that the role of the G20 as a coordination mechanism will be crucial. Further, the process of reforming international financial institutions has been slower than what the dynamic emerging economies would like. Reforming the composition of the IMF Executive Board to better reflect the changing economic power of member countries would help enhance the IMF's credibility in surveillance and policy advocacy.

1.1 Format of the Volume

Invited contributions from participants in the conference have been divided into six sections which directly mirror the conference agenda. Each section contains one lead chapter by a conference participant which provides an extensive review of the issues of concern for that section. These lead chapters are supplemented by shorter notes by other participants in that session of the conference.

The volume opens with an introductory chapter by the editors outlining the scope of the material covered and synthesizing the rich and broad discussion during the conference. The keynote address delivered by Subir Gokarn (Former Deputy Governor, Reserve Bank of India) constitutes a special opening chapter to the volume.

⁵ For example, the Chinese 12th 5-year plan document pretty much reflected what the global community wanted of it.

1.2 Overview of Keynote Address

In his keynote address, *Subir Gokarn* argues that a number of stress points have emerged in the global economy. Given these, he poses the question whether the G20 can regain its stature as a “problem-solving” group, or whether it is just a “wartime” grouping that only works when a crisis is at hand.

The author observes that the emphasis of the G20 has shifted from immediate crisis management to addressing some of the structural factors that were widely seen to have played a role in causing and spreading the financial crisis. This has made the G20 a testing ground for providing a viable solution to macroeconomic policy coordination amongst heterogeneous economies. But the ease with which consensus across the group was found in “wartime” is not being replicated in “peacetime.” Given the relatively large number of issues over which coordination is required, the number of possible coalitions and the membership of each country in multiple coalitions raise concerns about the sheer complexity of the coordination process.

2 The Eurozone Crisis: Short-Run Challenges and Options

The Euro crisis has loomed as a major threat to global recovery since 2011. A number of uncertainties, including concerns over whether Greece might have to exit the euro (see Buiter and Rahbari 2012), the crisis in the euro periphery and the fear of a prolonged recession in the euro area, made markets nervous.⁶ One reason for market anxiety—and recurring shocks—is the abysmal crisis management by European policymakers. Solvency problems in the periphery countries were initially treated as a liquidity problem, and the proposed support was inadequate, misguided and arrived late.⁷ Another problem in Europe was that no orderly mechanism existed for allowing struggling banks to fail (as there was in the USA)⁸. Participants in the conference felt that several risks remain elevated and crucial questions unanswered, such as:

- Why are financial markets still nervous about prospects in the eurozone?
- What reforms are needed to prevent the implosion of the European currency union?
- What is the efficacy of unlimited liquidity as a response to a banking capitalization crisis?

⁶ Since 2012 however, coordinated implementation of bank liquidity support, including in particular the Outright Monetary Transactions operation by the European Central bank, along with capital regulation in the euro area and well-guided national policies, has helped calm financial markets.

⁷ First the crisis in Greece was denied, then diagnosed and treated for a liquidity problem while it was a solvency problem. Further, ECB worsened market sentiments as it demanded preferred creditor's status after buying Greek bonds on the secondary markets.

⁸ For example, the Federal Deposit Insurance Corporation has closed 448 banks since 2008.

- To the extent that debt mutualization is necessary in the euro area, how it could be managed, especially in terms of moral hazard, and how quickly could it be implemented.⁹
- How Grexit or, more broadly, the collapse of the European currency union would play out?
- What are the ways to achieve better fiscal coordination and risk sharing among euro area countries in the medium to long run?
- How would fervent fiscal conservatism in Europe affect European growth prospects and the government finances of member countries, and what would be the impact on the rest of the world (especially EMEs)?
- How can national economies support growth in the short term while maintaining long-term commitments to achieving sustainable fiscal positions?

In the lead chapter entitled “Overcoming the Euro Area Crisis: Reforms and Results,” *Holger Fabig, Yannick Kirchhof and Inka Zippe* argue that considerable policy initiatives have been implemented including establishment of the European Stability Mechanism (ESM), a sterilized open-ended bond purchase programme by the European Central Bank (ECB), fiscal consolidation programmes in member countries and the possibility of the direct purchase of sovereign debt by the ESM. Effective fiscal consolidation¹⁰, an early warning system to manage potentially harmful internal macroeconomic imbalances, and the Europe 2020 strategy¹¹ for strong and sustainable growth have resulted in a marked decline in current account deficits, increased exports and improvement in the competitiveness of the periphery, while wages have increased in France and Germany. An intergovernmental treaty (the Fiscal compact) has been introduced as a new, stricter version of the Stability and Growth Pact. By signing the treaty, 25 countries have committed themselves to introducing uniform, long-term budgetary rules into their national legal systems, preferably at constitutional level. The *European Semester* has also been adopted by the European Council and launched in 2011, with a central task to coordinate economic policies and structural reforms. This improves the integration and implementation of fiscal and economic reforms in the eurozone. The authors also note progress regarding budget balances in the euro area. In particular, structural budget deficits fell on average in the euro area from 6.3 % in 2009 to 3.3 % in 2012. Another key reform step has been the deepening of European banking sector integration. In this

⁹ Some argue that debt mutualization should be partial, i.e. the EU should put in place a mechanism for internal transfer where less creditworthy nations should compensate the more creditworthy ones and for monitoring fiscal progress of member countries, and also ensure that the national governments remain responsible to reduce deficits.

¹⁰ Nominal budget deficits declined from 6.4 % in 2009 to 3.2 % in 2012 for EU as a whole, while structural deficits corrected for the business cycle declined from 4.6 % to 2.1 %.

¹¹ Europe 2020 is a strategy adopted by the European Union to address the shortcomings in the growth models of European countries targeting specifically education, research and innovation, social inclusion and poverty reduction, and climate/energy for achieving smarter, more sustainable and more inclusive growth.