

THE 2016 G20 AND CHINA

Chongyang Institute for Financial Studies,
Renmin University of China

- ★ Publication of the Year by a Globally Well-Known Think Tank
- ★ Analyses of World Economic Order Evolution
- ★ Insights of Games and Cooperation Among the G20 Powers
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Why the G20 Is Still Important

On September 4-5, 2016, the 11th G20 Summit will be held in Hangzhou, the capital city of Zhejiang Province on the southeastern coast of China. At that time, leaders of the 20 most important countries in the world and some specially invited leaders of important economies will convene an annual meeting to discuss the major agenda of global economic governance. This is the first time China will preside over the top-level design of global economic governance. It is also the first time an emerging country will chair G20 Summit for two consecutive years, which is of great significance to the continuity in measures for international economic and financial system reforms.

Since it took over the G20 rotating chair at the end of 2015, China has formulated the theme of “Towards an Innovative, Invigorated, Interconnected and Inclusive World Economy.” This serves as an extension of the theme of the previous G20 Summit held in Antalya, Turkey, that covered voluminous contents related to the three aspects of “inclusiveness, implementation and investments as a powerful driver of growth.”

However, over recent years, there have always been voices questioning the im-



portance of the G20 in the public opinions of the US and the European countries. For China, other emerging economies and many visionary people who are calling for reforming the international economic and financial system, it is necessary to stress again that, today, as the global economy faces a new growth trap, the G20 is regaining the same level of importance as the eruption of the 2008 Financial Crisis. The G20 countries need to be further united and to establish a permanent governance mechanism in order to tackle the new growth trap of the global economy.

The reasons are as follows:

First, stagnation in global economic growth is seriously undermining the development in various countries. Over the past several months, all major institutions have lowered their expectations about global economic growth with a popular belief that the global economic growth rate should be forecast as below 2.9 percent for 2016. This would be the second consecutive global annual growth rate lower than 3 percent, following the 2.4 percent in 2015. We should be aware that between 2008 and 2014, the average annual growth rate for the global real GDP was 3.26 percent. It seems that the G20 goal for global growth set at the G20 Leader Summit in Brisbane, Australia, which was “to lift the G20’s GDP by at least an additional 2 percent” by the end of 2018, may fail. An estimate indicates that to hit the target, the average annual growth rate for the global economy has to be 3.2 percent or above between 2015 and 2018. At present, economic recovery in the developed countries such as the US, Europe and Japan is still weak. In mid-April 2016, the IMF lowered the projected US economic growth rate for 2016 from 2.6 percent to 2.4 percent. The projected economic growth rate for the Eurozone in 2016 was lowered from 1.7 percent to 1.5 percent, and that for Japan from 1 percent to 0.5 percent.

Second, the anticipation of a US Federal Reserve interest rate hike is becom-

ing “a sword of Damocles,” constantly imposing potential threats to the world economy. In October 2014, the US Federal Reserve announced a complete abandonment of the quantitative easing monetary policies, which was followed by a gradually heightened anticipation of a Fed rate hike. “The sword of Damocles” over global economic rebalancing also potentially threatens the G20 policy coordination. Especially since August 2015, guesses about a Fed rate hike are making noises and gathering steam, causing major fluctuations in the global financial market. A large amount of arbitrage capital flew out of emerging market countries. There were excessive fluctuations and disorderly adjustments of exchange rates in many countries, seriously disrupting regional and even global economic and financial stability. On December 17, 2015, the Fed announced the launch of its rate hike process targeting at increasing the federal funds rate by 0.25 percent. Since the beginning of 2016, the Fed has shown hesitations over the rate hike. But the anticipation of a US dollar interest rate hike persists, creating significant impacts on the international bulk commodity market, the international foreign currency market and the international capital market. These all have added to complexity and difficulties of the G20’s task of policy coordination.

Third, major currencies depreciated overall against the US dollar, causing substantial fluctuations in the exchanges rates. Since the US Federal Reserve’s exit from the QE stimulus program in October 2014, the US dollar index showed a bullish trend whereas currency indices of the emerging markets steepened. In 2015, affected mainly by the anticipation of a Fed rate hike, situations in the international foreign currency market were that the US dollar became the sole well-performing currency in the global currency market, whereas all other major currencies devalued against it. That resulted in significant fluctuations in the exchange rates. As the US economy recovers, expectations of a Fed rate hike may further heighten and the US dollar may maintain its bullish trend. Under such circumstances, sub-



stantial fluctuations in the exchange rate are inevitable. Outflows of a large amount of short-term arbitrage capital will result in substantial reduction in foreign currency reserves. IMF statistics indicate that a total worth US\$4.5 trillion flew from the developed countries to the emerging market countries between 2009 and 2012. The opposite has been true recently due to expectations of a Fed rate hike. Large amounts of short-term arbitrage capital flew out of the emerging market countries. The direct reflection of it is shrinkage of their foreign currency reserves. A rapid decrease in the foreign currency reserves of the emerging market countries increases liquidity risks and causes asset prices to plummet as liquidity tightens. Aggravated by the fragility of the financial systems, the possibility of an eruption of financial turmoil is enhanced.

Fourth, trade protectionism is gaining ground again the world over, and the engine of economic growth reduces its functionality. According to WTO statistics, total global trade volume in 2015 sank by nearly 14 percent compared to the previous year, and the global trade volume is estimated to increase by about 3.9 percent in 2016, still lower than the average of 5 percent during the past 20 years. This was largely attributed to the substantial price plunges of bulk commodities and crude oil in particular, due to the expectations about the dollar and a Fed rate hikes. In the meantime, some developed countries adopted trade protectionist policies, and even voluntarily depreciated their own currencies for the purpose of maintaining competitive export advantages. However, in a sluggish global economy, once a country initiates currency devaluation, it might possibly trigger competitive currency depreciations, which would in turn rapidly diminish the competitive advantages. Steep slips in global trade do not only increase the risks of trade protectionism and currency competition, but also cast shadows over the global economic recovery.

In short, the “growth trap” in the second decade of the 21st century may very

well win itself a name of “the new growth trap” of the global economy. The term refers inclusively to the issue of aging populations of the major economies, the conundrum of new gaps in global wealth distributions, the middle-link obstruction of global technological innovations, geopolitical risks and so on.

In 2008, the “financial tsunami” threatened all countries in the world with a global financial crisis. Driven by realistic development needs of the world economy, the developed countries and the emerging market countries held the first G20 Leader Summit in Washington DC., USA in 2008 to strengthen dialogues and policy coordination, which gave birth to the G20 mechanism of a premier forum for global economic cooperation. The G20 strengthened cooperation in macro-economic policy coordination based on a partnership of sincerity and cooperation, which resolved the short-term risks of the global financial crisis and shaped a consolidated power of global economic growth.

However, it should be emphasized that, over the past eight years, economic trends and policy preferences in major countries are increasingly diverged, leading to an elevated level of difficulties for the G20’s macro-policy coordination. The US economy has demonstrated a trend of recovery, and the button of “tightening up” has been slowly pressed; whereas the Eurozone and Japan need to retain the extreme easing monetary policies as economic impulses. The obviously differentiated economic situations and monetary policy orientations have already triggered turbulence in the international financial market. That is making the global economy face risks of a loss of balance and even a complete entrapment in a growth dilemma.

Accounting for over 80 percent of the total global economic output, the G20 member countries are endowed with an indispensable responsibility for world economic growth. They need to foster communication and coordination in

macro-economic policies, form consolidated policy and action power, prevent negative spillover effects, maintain financial market stability, promote investment and consumption, and work together to lift world economic growth. 2016 is a milestone year of milestone in the process.

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Global Governance System in the “G20 Era”

The G20, also known as the Group of 20, is an international forum for economic cooperation. It was founded by the G8 and 12 other major economies on September 25, 1999, in the US capital, Washington DC. As an informal mechanism of dialogue, its aims are to promote open and constructive discussions, conduct research and encourage cooperation on substantial economic and financial topics among industrialized and developed countries and emerging markets for the purpose of maintaining the stability of the international financial system and sustained economic growth. Covering a large and diverse global area, G20 member states closely reflect the global economy. Collectively, the G20 economies account for approximately 90 percent of the gross world product, 80 percent of world trade, and 70 percent of the world population. After the 2008 international financial crisis, the G20 was officially upgraded as a mechanism for annual summit meetings for heads of states or governments. Ever since, it has served a clear purpose as the “primary platform for global economic governance,” marking the entry of the global governance system into the “G20 era.”

The current mechanism developed through an evolution of more than half a century. During the 70 years following the end of WWII, the fundamental frame-



work of global economic and financial governance has remained the Bretton Woods System, formed in the early post-war era. The system's cooperation mechanism includes institutions such as the G7, the International Monetary Fund (IMF) and the World Bank. Reflection of the major Western powers' views of global governance and manifestation of their behavioral patterns is a salient trait of the mechanisms.

In the mid-1980s, the G7, accounting for more than 80 percent of the gross world product, was able to take on the responsibility of global economic governance. Since then, the G7's economic proportion in the gross world product has gradually declined. Under these circumstances, any cooperative mechanism of global economic governance without participation of countries like the BRICS (Brazil, Russia, India, China and South Africa) would be worthless.

By the end of the 20th century, especially after the 2008 global financial crisis, developing countries and emerging markets have gradually grown to represent more than half of the gross world product, a proportion that continues to rise. As this happened, the old framework of global economic governance was outpaced by the reality of global economic development. As a result, the G20 mechanism came into existence driven by the demands of the reality of the world economic developments.

In 2008, the G20 leaders held their first summit meeting in Washington DC, USA, to discuss collective responsive measures to deal with the financial crisis. In 2009, the G20 Pittsburgh Summit proposed "a framework for strong, sustainable and balanced growth," which established an Action Plan for continuous advancements of the G20 mechanism. At the 2014 Brisbane Summit held in Australia, the Action Plan was detailed as a "comprehensive growth strategy" with the goal of "lifting G20 GDP by more than two percent above the trajectory by 2019." The Brisbane Summit also launched the Global Infrastructure Database and Global

Infrastructure Facility, which established a new executive platform for global economic governance.

In 2015, the G20 host country Turkey expounded on the three principles of inclusiveness, implementation and investment for growth. The three principles serve as pillars for materializing collective growth ambition, making G20 governance functionality more objectified and operable.

In 2016, China officially took over the G20 Summit chair and has decided to hold the meeting in the beautiful tourist city of Hangzhou, Zhejiang Province. This is the first time in history China is going to lead in the top-level design of global economic governance. It has become critically important for China to decide how it is going to analyze the changing global economic situation and pinpoint the areas of growth and risk.

First, the depth and breadth of the global governance issue have increased enormously at present. Financial reforms and economic governance are still the most pressing topics for the G20. In the post-financial-crisis age, fluctuations in global financial markets and growing interconnectedness among economies have led to negative spillover effects on policy. Their influence on the stability of the global economy has manifested with perpetually increasing prominence, making it even more necessary for the G20 to advance its reforms and governance of the financial system in order to prevent any possible systematic risk in the future. To become a more efficient, responsible and influential mechanism, the G20 still needs a synthesized consideration of global patterns while integrating new changes and new issues. This is the reality the G20 must face as a top-level design platform. At the same time, implementation of the comprehensive growth strategies and realization of the pledged growth ambition of the G20 remain the theme of current global economic policies.

Secondly, the importance of open economies becomes increasingly prom-



inent. In today's world, connectivity among different regions and countries has reached an unprecedented level of closeness. Against such a background, all countries should participate in the cultivation of a big global market, prevent protectionism of trade and investment, maintain a multilateral trade system, and construct a global value chain that promotes mutual benefits and win-win situations. Both developed and emerging economies should open up and welcome new global opportunities and challenges. This is in compliance with the trends of the new global order currently in its formative stage.

Thirdly, there is a growing need for an innovative economic growth formula globally. Coming out of the global economic crisis, we still need to prevent the global economy from being a quagmire in mediocrity. The G20 is searching for a panacea of global economic growth. The innovative development formula could be adaptive to varied domestic situations in different countries to solve problems the global economy currently faces. The G20 should provide an international mechanism of guarantee and support for such a development formula by coordinating relations on economic factors between the mid short-term and mid long-term, as well as implementing structural reforms to improve productivity and drive the formation of new industrial revolution. Ensuring an effective implementation of its policies is also a significant way for the G20 to wield its influence.

The G20 is in the middle of accomplishing these missions when it hands over the rotating chair to China. It should be noted that China is completely capable of and confident in working with international actors to find a path for healthy and sustainable development.

Between 2008 and 2014, China contributed about 39 percent of the total global growth. When the international financial system demonstrated a tendency to capitalize completely on a fictitious economy rather than the real economy, China's real economy maintained comparatively steady and stable development. One of

China's precious lessons in handling economic crises is that the development of the financial sector must serve the needs of the industrial sector. We believe that it should become the core value of global financial governance that the financial sector should serve the industrial sector, and development of the industrial and the financial sectors should go hand-in-hand and shoulder-to-shoulder. We hope all sides involved will work to control the over-virtualization in the financial sector to make sure that funds flow into the real entity industry for expanding production and increasing employment. At the same time, efforts should be made to promote international cooperation for the emerging industries and cultivate new points of growth in the world economy. We should fully rely on scientific and technological progresses as the engine of world economic growth. In this way, we can bring the world economy out of crisis and realize the ambition of collective prosperity.

After the end of the Cold War, the concepts of the "end of history" and the "clash of civilizations" once dominated Western thoughts of governance. The "end of history" hypothesis argues that the political and economic system of Western capitalism has become "the final form of human society." The Western theory of domestic governance advocates principles of "no-target and multiple-agents." Such principles led to non-interference policies towards the proliferation of derivative products in financial markets that eventually evolved into the 2008 financial crisis. The "clash of civilizations" hypothesis believes that conflicts of different civilizations have become the primary contradiction in the international order. Resulting from these policies is the American "global anti-terrorism war." The US itself was mired in the Middle East. Some of its opponents have turned into organizations like ISIS in today's world, posing even more serious challenges for global governance. After the outburst of the global financial crisis, both concepts of the "end of history" and the "clash of civilizations" face a dilemma. Western countries are too exhausted from handling domestic "emergencies" to propose any new systematic governance theories.



In the wake of this, China is capable of suggesting some better rounded and more balanced ideas for global governance. The methodological pattern of the “Four-Pronged Comprehensive Strategy” guiding the current domestic governance practices in China could be transplanted to global governance. That would mean a multitasking strategy that takes into consideration the four major factors of objectives, means, guarantee mechanism and an agent in realization of long-term sustainable development.

As the chair country of the 2016 G20 Summit, China needs to put forward solutions for a series of important issues: exploring new ways for realization of strong, sustainable and balanced growth, furthering reforms of the global economic governance system, perfecting a global infrastructure initiative, innovating trade and investment methods, and realizing a more inclusive pattern of development. There should also be new ideas for the theme, organization and event arrangement of the summit meeting.

The first topic should be constructing a new economic growth framework. Based on the previous meetings, the coming G20 will propose a new comprehensive growth framework that is more sustainable as a solution to the global problems of low growth rate, high debt ratio, and high unemployment rate. The framework would need a solid basis in economic, financial and international political theories as well as support of wide-ranging international cooperation.

Secondly, it is necessary to establish a global economic coordination system. A truly effective global governance scheme is not an amalgamation of policies from member states. It should, instead, deploy a comprehensive coordinative strategy, combine competition and cooperation, and be able to produce results of integrative effects. This requires mutual trust on the part of the G20 member states to dig deeply and combine ideas from all sources. The plan should be one that says one plus one is more than two.