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# **THE G20, EMERGING POWERS, AND TRANSATLANTIC RELATIONS**

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# THE G20, EMERGING POWERS, AND TRANSATLANTIC RELATIONS

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# 1 THE GLOBAL ECONOMIC CRISIS AND THE G20

The global economic crisis that began in 2008 is not only the worst since the Great Depression, but also has led to unprecedented efforts to coordinate national economic policy responses. The cornerstone of this coordination is the Group of 20. This Group was originally founded in 1999 at the level of finance ministers in reaction to the Asian financial crisis of 1997/98. However, only with the crisis in 2008 did the G20 first convene the leaders level — on the level of the heads of the executive branch of member countries, this is, presidents, chancellors, and prime ministers.<sup>1</sup> The first summit, in Washington, DC, in November 2008, was followed by summits in London (April 2009), Pittsburgh (September 2009), Toronto (June 2010), and Seoul (November 2010). The principal novelty of the G20 since 2008 is that, for the first time in history, the leaders of the most important industrialized countries and emerging economies are trying to manage the world economy together, thus attempting to establish the G20 as the new “steering committee of the world economy.”<sup>2</sup>

As a result, in light of the global crisis, the G20 is a necessary and innovative achievement. Structurally, the G20 is a unique body in four respects: First, it includes both industrialized and emerging economies, thus overcoming former divisions between the two groups. Second, it tackles all issues important to the world economy in an overarching way, going beyond the restrictions of specialized international organizations such as the IMF (finance), the WTO (trade), and the World Bank (development). Third, since the G20 convenes on the leaders’ level, it has much more clout in fostering shared understandings, delegating tasks to international organizations, and influencing governments’ policies than other bodies that are restricted to technocratic experts or the ministers’ level. Fourth, the G20 has tackled economic policy issues never before addressed on a multilateral level between the 20 most important economies, such as

global imbalances, stimulus and public debt, and exchange rates.

The G20 defines its character and aim by saying: “The G20 is the premier forum for our international economic development that promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. By contributing to the strengthening of the international financial architecture and providing opportunities for dialogue on national policies, international co-operation, and international financial institutions, the G20 helps to support growth and development across the globe.”<sup>3</sup>

The immediate aim of the G20 in the post-2008 crisis years was to ease the impact of the economic crisis by coordinating national stimulus programs, preventing beggar-thy-neighbor policies and protectionism, establishing improved regulation for financial markets, and strengthening international organizations like the IMF. Thus, after two and a half years of coordination on the leaders’ level, it seems appropriate to ask if the G20 achieved its goals, or is the new body perceived as efficient and legitimate?

In addition to shedding light on this fundamental question of the efficiency and legitimacy of the G20, this paper addresses two additional elements of the debate on the G20. First, since the G20 is the first attempt at coordinating policies between industrialized and emerging economies by leaders, how did the inclusion of emerging powers impact the multilateral negotiations in the G20? This question seems crucial, because the integration of emerging powers has stirred an intense controversy in the media, academia, and think tanks. One line of thought portrays the rise of new powers in terms of competition and rivalry vis-à-vis old industrialized countries and stresses that these countries, especially China, do not share “Western

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values.” As a result, this line of thought sees these countries as not fully prepared to participate in the multilateral steering of world politics, that is, as “not ready for prime time.”<sup>4</sup> The other line of thought emphasizes that emerging powers have long been integrated into the world economy through trade, investment, division of labor, and membership in key international organizations such as the IMF and the WTO. Therefore, further embedding these countries in global governance would not only constitute a necessity, but would also strengthen the international rules-based order in line with the interests of industrialized countries, including the United States.<sup>5</sup> Thus, the question arising for the G20 is related to both emerging powers’ performance and their interests: Do emerging powers play a stakeholder role, or do they act (for example, as the BRICs) in concert against “the West”?

Second, this paper addresses the implications of the G20 process for the transatlantic countries, which had coordinated the world economy amongst themselves since 1975 in the Group of 7 (United States, Canada, Germany, France, U.K., Italy, and Japan). The G7 can be seen as the predecessor of the G20, but it rested on much more similar set of national political and economic systems compared to the heterogeneity of systems and legacies of countries participating in the G20. For example, the G20 includes not only market-oriented democracies like the G7, but also authoritarian regimes and state-led economies such as China. Have the decades of previous cooperation and the similarities among the G7 countries continued to tie these countries together in the G20 process, or did the rise of emerging economies and the global crisis lead the transatlantic countries to drift apart?

These three questions on the efficiency and legitimacy of the G20, embedding emerging powers in global governance, and the implications of the

G20 process for the transatlantic countries will be the focus of the analysis in this paper.

# 2 EFFICIENCY AND LEGITIMACY OF THE G20

## Efficiency

The efficiency of the G20 is contested and views on its performance depend to a large extent on the expectations of the observers. Critics point out that the G20 has not agreed on any binding rules for the world economy, neither for the participating states nor for the supervision of financial markets, whose regulatory shortcomings are considered the most important cause for the magnitude and the scope of the global crisis. Indeed, the G20 summits since 2008 have been characterized by controversies on most issues (see the cases in section 3) and legally binding commitments have not been achieved. Thus, *The Economist* (March 12, 2009) called the G20 a “talking shop,” with no measurable effects. However, these criticisms seem somehow overdone and unjustified, because the G20 never intended to issue legally binding commitments. Nor did it intend to substitute formal international organizations like the IMF and the WTO, which are based on international law, serve specific purposes, and possess clear decision-making procedures.

As a result, the proponents of the G20 highlight its accomplishments below the level of binding commitments. First of all, it is argued, the G20 reached common understandings as to the need for each state to cushion the crisis via national stimulus programs intended to increase demand and thereby counteract the recession. Obviously, it is difficult to assess the counterfactual, that is, what states would have done domestically in terms of stimulus without the shared understandings in the G20. It can be argued, however, that the G20’s understandings certainly conveyed the impression to participating leaders that all states would engage in stimulus programs and, consequently, that protectionist, beggar-thy-neighbor policies appeared on a smaller scale than previously expected. Overall, the G20 understandings are granted a positive effect both on national stimulus

packages and keeping new protectionist measures relatively infrequent.<sup>6</sup>

In addition to this understanding on policies, the G20 leaders strengthened global economic governance via supporting international organizations. First, the IMF was given \$500 billion in additional resources for credit lines in reaction to the crisis and \$250 billion was allocated in additional Special Drawing Rights (SDR) (see next section on the IMF). The Financial Stability Board (FSB) was enlarged to include representatives of emerging economies and was given the task to create detailed proposals for early warning and supervision. In addition, G20 leaders mandated their national representatives in the Basel Committee (Central Banks and regulators) to negotiate a new agreement, Basel III, primarily in order to make commercial banks safer though increased capital requirements. However, besides the Basel III requirements, the necessary new regulation of increasingly globalized financial markets happened only on the national level (for example through the Dodd-Frank Act in the United States) and on a modest regional level by the EU, but not on the global level, not even among the transatlantic countries.<sup>7</sup>

As a result, on balance, the G20 failed to establish new binding rules for member states and the global financial sector, but, despite this, nonetheless contributed to an easing of the crisis through common understanding on stimulus programs and open markets as well as through a strengthening of established international organizations. The primary challenge for the future of the G20 is to reach an understanding and, preferably, binding commitments on the many issues that still remain unresolved. This seems especially important since the G20 has already moved beyond the immediate cushioning of the crisis by stimulus programs and is tackling a post-crisis agenda in discussing global imbalances, exchange rates, and the reform

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*The G20's efficiency can be enhanced by transforming it into a Global Economic Council.*

of international organizations. Successfully addressing these issues is crucial to reducing the risk and magnitude of future financial crisis and coordinating a stable world economy. The most important post-crisis issues include financial market regulation through “bailing-in” private banks, that is, making banks participate in the costs of rescuing the system; coordinating regulation in order to avoid regulatory arbitrage; preventing a currency war; smoothing out global imbalances; developing strategies to reduce public debt; and reaching a coordinated reform of international organizations.

Institutionally, the G20's efficiency can be enhanced by transforming it into a Global Economic Council (GEC) with a small secretariat and a policy planning unit, thus giving it a reliable long-term perspective and strategic capacity.<sup>8</sup> The GEC should be based on a Charter containing fundamental rules of conduct for the world economy, which should be negotiated to foster (binding) commitments from all participating countries to an open, efficiently supervised, and coordinated world economy. The GEC presidency should rotate among member states in order to allow for the respective country's government to shape the presidency's agenda, gain ownership, and therefore engage more in strengthening the GEC. The institutionalization of a GEC would have the advantage of establishing long-term monitored standards in addition to being based on a Charter, which could be instrumental in bringing members to agree on core rules and sustaining the durability of the G20 process itself. The GEC could thus be established as an institutionalized mechanism for coordination, for supervision of members' commitments, and for delegation of tasks to specialized international organizations such as the IMF, the FSB, and the WTO.

### **Legitimacy**

The countries chosen as members of the G20 are selected in order to give it legitimacy through their economic and demographic weight. The official G20 website states: “The G20 thus brings together important industrial and emerging-market countries from all regions of the world. Together, member countries represent around 90 percent of global gross national product, 80 percent of world trade (including EU intra-trade) as well as two-thirds of the world's population. The G20's economic weight and broad membership gives it a high degree of legitimacy and influence over the management of the global economy and financial system.”<sup>9</sup>

Politically this source of the G20's legitimacy has been contested on several grounds.<sup>10</sup> First, several G20 members, such as China and Saudi Arabia, are governed by authoritarian regimes, which raises the question of how far the leaders in these states legitimately represent their citizens. Second, some of the G20 countries are actually not part of the 20 largest economies, raising the question of why more economically important countries were excluded from the G20 while others were included. Third, while some world regions are heavily represented (most notably Europe with four members plus the EU), others are far less represented (most notably Africa, which is represented only by South Africa). Fourth, the selection process was neither transparent nor a result of a rules-based approach. Rather, it was apparently undertaken in a phone call between the U.S. treasury and the German finance ministry when the group was first composed after the Asian crisis in 1999.

These shortcomings have been addressed via the G20's outreach strategy, which tries to counter criticism by inviting additional countries especially from the developing world to the G20 summits. Doing so cannot, however, change the arbitrary character of participating countries' selection,

nor has it led to any rules-based selection process and sustainable inclusiveness. As a result, the over 170 members of the United Nations that are not permanent members of the G20 remain excluded and the legitimacy of the G20 remains limited.

If the G20 is to evolve into a fully legitimate “steering committee for the world economy,” it has to find other strategies. One obvious, possible strategy would be to broadly model the G20 membership along the lines internationally accepted for other global economic governance institutions, such as the IMF. Even though the specific influence in the IMF remains contested (see next section), its basic representational principle is accepted globally. In the IMF, the 187 members are represented in the executive board with 24 seats according to their economic weight (GDP, quotas) and their participation in the world economy (trade, openness, etc.). In order to give all countries and regions access to decision-making in the executive board, the economic heavyweights occupy a seat alone (such as the United States, China, Japan, Germany, U.K., and France). Economically smaller members share a seat in the executive board as a group, whose largest members occupy the group’s seat or alternate in directing the group’s seat. Brazil, for example has been the largest member of the group of Latin American countries, thus having to coordinate with a constituency of countries as members of the same representational group.<sup>11</sup>

This mechanism of representation emphasizes criteria for individual countries’ global weight, creates constituencies by integrating smaller economies, and therefore manages to include all countries wishing to participate in the steering of the world economy. Of course, like in the IMF, the specific G20 criteria (for example, should GDP be measured in dollars/market price or in purchase power parity?) and the voting procedures (for example, should the United States be the

only country with a veto, as is the case in the IMF?) will continue to stir controversies, but the representation and, thus, the legitimacy of the G20 would be greatly enhanced by modeling its representational structures similarly on those of the IMF. In the G20, the ten global economic heavyweights could, for example, obtain individual seats in the executive board, while the smaller members would share a seat in regional groups and its economically largest two members would alternate in representing the group in the board. The G20 presidency could then rotate among the 20 members, which represent individual seats or constituency groups in the executive board.

In addition, since increased legitimacy also means increased acceptance, the G20 decisions would also be much more widely accepted. As a result, the decisions of the G20 are more likely to be implemented by those countries that are not members of the G20 now. This does not only refer to the many small countries in the world, but also to the many economically important countries that are also not members such as Spain, Iran, Poland, and the Netherlands (by GDP in measured in purchase power parity) and Thailand, Nigeria, Bangladesh, Egypt, and Vietnam (by population). Other countries that are full G20 members now, but possess less economic weight than some of the outsiders (such as Argentina and Saudi Arabia) would have to be downgraded to share a seat in a G20 executive board with others. These changes could enhance the legitimacy and increase the efficiency of the G20 in steering the world economy.

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# 3 EMERGING POWERS AND TRANSATLANTIC COUNTRIES IN THE G20

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How have the transatlantic countries and the emerging powers behaved in the G20 since 2008? Given the existence of previous alliances, such as the G7, the BRICs, the “developing countries G20,” and the IBSA Group (India, Brazil, and South Africa), antagonism along the lines of these (partly) long-standing groups was to be expected. The G7 industrialized countries have attempted to coordinate the world economy since 1975 with regard to a wide range of issues stretching from currency and exchange rates to trade and financial market regulation. BRIC (Brazil, Russia, India, and China) was a term originally coined by Goldman Sachs, but the countries involved quickly started meeting at summits and attempted to coordinate their positions on a wide number of issues similar to the G7.<sup>12</sup> The “developing countries G20” was founded at the WTO summit in Cancun in 2003 explicitly to counterbalance the dominant influence of the industrialized countries, especially of the United States and the EU, on trade matters.<sup>13</sup> IBSA frequently met over the last decade in order to coordinate policies ranging from trade to technology as well as to emphasize the necessity of South-South coordination independent of the industrialized countries.

In light of these previously existing alliances and the different levels of development between industrialized and emerging economies in the G20, it was plausible to expect divergent positions to appear along these lines and alliances within the G20. However, the negotiations in the G20 since 2008 revealed a different pattern. On most contentious issues, some of the industrialized countries aligned with some of the emerging economies in ad hoc groupings on both sides of the respective policy divide. Apart from the general understanding on national stimulus programs and the mandates issued to technical bodies such as the Basel Committee, most policy issues were highly contested between spontaneous ad hoc groupings.

Since these divergences provide an answer to the question on the performance and the driving forces for both emerging powers and the transatlantic countries, five contentious issues will be sketched out in more detail in the following section: stimulus and public debt, global imbalances, exchange rates, financial market regulation, and governance reform in the IMF. Since assessing all 20 countries of the G20 is beyond the scope of this paper, the focus here will be on two emerging powers (Brazil and China) and two transatlantic countries (United States and Germany), as well as other countries when indicative for the analysis. The United States represents a “liberal market economy” whose institutions and public attitudes show less trust in governmental regulation and more trust in market forces than do those in Germany, which represents a “coordinated market economy.”<sup>14</sup> Brazil is considered a democratic country, whose market economy is state-influenced, while China is taken to have an authoritarian regime and a state-led economy.

## **Stimulus and Public Debt**

In addition to the industrialized countries’ rescue of their respective banking sectors, all countries of the G20 initiated domestic stimulus programs in response to the crisis. These stimulus packages were diverse, with some focusing on deficit spending and loose monetary policy (the United States), some on tax cuts (U.K.), others on automatic stabilizers (Germany), and still others on infrastructure (China and Brazil). All aimed, however, at increasing domestic demand in order to cushion the impact of the recession that followed the outbreak of the crisis in 2008. All countries operated by increasing public debt, but the levels of deficit spending varied strongly, according to the structural and ideational background in each country. For example, while the United States (and the U.K. during the government of Gordon Brown) strongly advocated continuing big deficit

spending, Germany was already demanding an exit strategy from loose fiscal and monetary policies in 2009, due to fears about inflationary pressures, fears that were also shared by Brazil and China. While the United States resented that others would benefit from its stimulus, Germany, China, and Brazil were especially concerned with the U.S. policy of quantitative easing (QE2, involving \$600 billion), since this was expected to reduce the value of the dollar and thus threaten these countries' competitiveness on world markets and China's huge holdings of dollar-denominated bonds.

In the G20 negotiations, U.S. treasury secretary Timothy Geithner and White House economic advisor Lawrence Summers strongly demanded that all G20 countries should engage in higher deficit spending and argued that quantitative easing was only aimed at the U.S. job market. The German finance minister, Peer Steinbrück, in contrast, called for an end to loose fiscal and monetary policy as early as Summer 2009. The Chinese and Brazilian government joined Germany in criticizing the mounting U.S. debt and monetary easing.<sup>15</sup> The transatlantic differences can be explained by the traditional German fear of inflation ("Inflationstrauma"), its high savings rate, and policy-orientation towards price stability. This ideational predisposition traditionally lies at the core of governmental policies and was enshrined in the tough Bundesbank statutes.<sup>16</sup> On the other hand, in the United States, private and public debt has traditionally encountered higher acceptance among citizens and policymakers, as exemplified in the lower savings rates and a higher acceptance of private debt than is the case in Germany. As for the emerging countries, an anti-inflationary attitude in Brazil and a high savings tradition in China contributed to these countries sharing the German critique of deficit spending and loose monetary policies. In addition, a core motivation of the emerging countries' criticism of the U.S. policy was

the fear of losing competitive edge for their exports, which was to be expected if the dollar weakened as a result of quantitative easing and public debt in the United States. This, in turn, leads directly to the G20 discussions on "global imbalances."

### **Global Imbalances**

The debate on global imbalances started off with an initiative by U.S. Treasury Secretary Timothy Geithner, which proposed a 4 percent cap on a country's current account surplus/deficit, targeted at those countries with a high export surplus such as China, Japan, and Germany. While Geithner maintained that other countries, especially China with its undervalued renminbi, would use the open U.S. market to export their economies out of the crisis at the expense of U.S. workers (Geithner 2010), China countered that it needed high export growth for domestic reasons, such as preventing unemployment, and criticized the United States for devaluing the dollar with QE2. Also rejecting the U.S. proposal, in 2010, German Finance Minister Wolfgang Schäuble emphasized that his country's export surplus was purely the result of its competitive edge since it was not manipulating its currency, the euro. Finally, other successful exporters such as Brazil, Australia, and Japan also rejected the U.S. demands.

Thus, the two ad hoc groupings emerging from the issue of global imbalances left the U.S. initiative without much support at the G20 Seoul Summit in November 2010. The G20 finance minister meeting in Paris in February 2011, however, subsequently agreed on a number of specific indicators to be monitored with regard to global imbalances. These include domestic private savings and borrowing, public debt and fiscal deficits, trade balance, and elements of balance of payments such as net investment flows. Although no numeric targets were set, monitoring of these indicators was agreed upon. China prevented exchange rates and currency

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reserves from being included as indicators, but was persuaded by the French and German finance ministers to agree to the inclusion of the balance of payments aspects. Thus, the G20 successfully managed to reach a shared understanding on global imbalances by enlarging the initially trade-focused proposal with indicators that mattered most for the grouping originally opposed to the U.S. demand, that is, debt, deficit, and savings. Of course, this agreement stayed well below anything that could be considered as binding, but it does provide a shared understanding that allows for “blaming and shaming” in the case of indicators being disrespected.

#### **“Currency War”?**

The danger of a “currency war” was first articulated by Brazilian Finance Minister Guido Mantega in 2010, who feared competitive devaluations between the U.S. dollar and the Chinese renminbi. Prior to his statement, the United States had been criticizing the continuous undervaluation of the renminbi as an unfair distortion of trade conditions, since the undervaluation allowed Chinese to obtain advantages for their exports in the U.S. market. As such, the United States argued the Chinese exchange rate policy constituted an unfair distortion of competition. For example, U.S. Treasury Secretary Geithner noted in 2010 “We believe it is very important to see more progress by the major emerging economies to more flexible, more market-oriented exchange rate systems.”<sup>17</sup> At the G20 Seoul Summit in November 2010, Chinese President Hu Jintao responded: “Nations that issue the world’s key reserve currencies should adopt responsible policies and keep exchange rates relatively stable.”<sup>18</sup> German Finance Minister Schäuble joined the Brazilian critique of U.S. and Chinese currency manipulation, pointing to QE2 as a means to weaken the U.S. dollar by stating: “It’s inconsistent for Americans to accuse the Chinese of manipulating exchange rates and then to artificially

depress the dollar exchange rate by printing money.”<sup>19</sup>

So, two more ad hoc groupings can be identified with regard to exchange rates. On one hand, the United States and China found themselves in an involuntary camp in being criticized for manipulating the value of their currencies for domestic reasons, that is, to increase exports (United States and China) and to protect domestic industry from imports (United States). On the other hand, the successful exporters Brazil and Germany headed the ad hoc grouping, which feared competitive devaluations and a distortion of world trade, and criticized the United States and China. The G20 did not reach a joint understanding on this issue and the ad hoc groupings did not follow any preexisting alignments. The G7 countries United States and Germany were situated in opposing camps in the same way that the BRIC countries China and Brazil found themselves on opposite sides.

#### **Financial Market Regulation**

With regard to financial market regulation, three issues will be addressed here, which exemplify the proceedings during the G20 process since 2008: the bank levy, the financial activities tax, and Basel III.

A levy on banks was proposed by the United States, Germany, and France in order to bail-in the private sector for future crisis. This was deemed necessary since taxpayers had to bear all the costs of bailing-out banks in the crisis of 2008, while banks were able to resume high profit margins immediately after the crisis. This proposition was rejected by an ad hoc grouping composed of Brazil, China, Canada, and Japan, whose banks did not suffer much under the crisis because these countries’ financial systems had been more strongly regulated prior to the crisis. In addition, the emerging economies of China and Brazil had suffered

less and recovered faster from the crisis than industrialized countries in Europe and the United States. Therefore, the opposing grouping argued that a bank levy would constitute an unnecessary and harmful distortion of competitive conditions for their banking systems. No understanding was reached in the G20, but the United States and European countries managed to agree on a common proposal.

A tax on financial market transactions/activities was proposed by France and Germany and aimed at the stabilization of global financial flows, especially concerning volatile short-term capital flows. This proposal has been contested in the G20 since 2008 and was opposed by both the United States and the U.K., who feared for the profitability of their large financial sectors. Commercial banks in all industrialized countries lobbied strongly against the tax, fearing losses in their most profitable business fields. Apparently, the lobbying was able to capture the governmental position in the United States and the U.K., though it failed to do so in Germany and France where the banking sector contributes less to total GDP and where public opinion shows less trust in market forces than in the United States and the U.K.<sup>20</sup> No G7 cohesion existed on this point and no common understanding was reached within the G20.

Financial market regulation was not only discussed directly in the G20, but also delegated by the leaders' summits to specialized bodies. The Financial Stability Board (FSB) was tasked with detailing an early warning system for crisis and regulatory propositions and its membership was enlarged to include the emerging economies. The Basel Committee on banking standards was equally enlarged via the inclusion of emerging economies' representatives and mandated to develop new banking standards, especially related to higher capital requirements. Even though the banking lobby managed to water down the final result, the

Basel Committee came up with enhanced banking standards in the Basel III Accord within a short time in 2010.<sup>21</sup> Since implementation was stretched out until 2019, its effect remains to be seen. Delegating tasks to a specialized technical body does seem to have produced results faster than on the leaders' level. However, the watered-down substance, the elongated implementation deadline, and the questionable compliance of participating countries, especially China, does not bode well for the effects of Basel III with regard to crisis prevention and absorption.

#### **IMF Governance Reform and Special Drawing Rights**

The reforms of the programs and the governance of the International Monetary Fund have been a contested issue since the Asian financial crisis of 1997-1998. Emerging powers have demanded a greater say in IMF governance through an increase in their quota and voting shares as well as an increase in the number of their seats on the Fund's executive board. In response to the IMF's conditions for its loans during the Asia crisis, which were perceived as inadequate, many emerging economies — not only in Asia — started building up huge currency reserves in order to obtain a shield against financial turmoil (especially currency speculation and stock market crashes) without having to turn to the IMF for emergency aid. Until 2008, the debate about the reform of the IMF had only produced marginal results.

This changed with the 2008 crisis and the engagement of the G20 on this issue. G20 leaders decided that their governments would allocate \$500 billion in new resources to the IMF in order to help crisis-ridden countries, to set up new lending programs with more flexibility on the conditions for borrowing, and to allocate \$250 billion in new Special Drawing Rights (SDR) to the IMF. In addition, intense negotiations evolved around a

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shift in quota and voting shares and regarding the seats in the executive board from industrialized countries towards the emerging powers. The quota and voting share shift, which totaled 6 percent of all shares was negotiated successfully among G20 countries in 2010, but China, Brazil, and India were ultimately disappointed with regard to its size of the shift.

The changes in the executive board, in contrast, led to a rift between the United States and European member countries. While both sides agreed that emerging powers should obtain more seats, they disagreed about the specifics. The United States wanted Europe to give up seats but refused to give up its veto, a condition that was demanded by European member states in the IMF. The latter had suggested that the threshold for structural decisions in the IMF should be lowered from 85 percent of all votes to 75 percent, making the United States' share of 17 percent — the largest in the IMF — no longer sufficient to veto structural decisions. In 2010, the United States prevailed, using a procedural tool to force the European members to accept fewer seats without giving up the U.S. veto. The number of seats in the executive board had been expanded from the original 20 to 24 in previous decisions and this expansion had to be renewed with 85 percent of all votes in November 2010. The United States threatened not to support a renewal, which would have had the consequence that smaller shareholders, such as Brazil and India would have lost their seats (representing constituencies of countries) in the then downsized 20-seat board. Industrialized, and especially European member countries would then have been even more (over-) represented than on the 24-seat board. In order to avoid blame for such a potential outcome, European member countries agreed to give up two seats without the United States being compelled to give up its veto.<sup>22</sup>

An additional issue regarding the IMF was debated in the G20. Prior to the London summit in April 2009, Chinese Central Bank Governor Zhou Xiaochuan launched the idea of transforming the SDR of the IMF into a new reserve currency, which could be used instead of the U.S. dollar.<sup>23</sup> SDR are the IMF's basket accounting unit and comprise the U.S. dollar, sterling, euro, and yen. The idea of transforming SDR into a potential reserve currency and of adding new currencies (such as the renminbi) to its basket if they are fully convertible was endorsed by France, Germany, Brazil, and India with the aim of making currency reserves and world trade more independent from the dollar and thus from U.S. economic and monetary policy in order to increase the stability of the global economy.<sup>24</sup> Germany's finance minister supported this idea by stating that an expansion of the basket that comprises the SDR would help stabilize the global currency system. While in principle open to an inclusion of the renminbi in the SDR basket, if it were to become fully convertible, the United States rejected the proposal for transforming the SDR into an alternative reserve currency fearing a loss of the supremacy of the dollar. In speaking before the U.S. House of Representatives on the risk of the SDR replacing the dollar as the world's leading reserve currency, Secretary Geithner stated: "The SDR is not a currency; it is a unit of account and it can't provide the role that many people would aspire to it, and there is no risk of that happening."<sup>25</sup>

Thus, the question of whether to strengthen the SDR and to transform it in the long-term into a possible reserve currency remains contested. France, Germany, and Brazil in principle support the idea under the condition of the renminbi's full convertibility. The United States remains opposed. The split between continental European countries and emerging powers on one side and the United States on the other defined the lines of the controversy. Some analysts, such as Fred Bergsten

of the Peterson Institute of International Economics and Benassy-Quere et.al of Bruegel Institute,<sup>26</sup> maintain that while benefitting from the power of the dollar and the possibility of controlling the value of the leading currency in the short and medium-term, the United States would largely benefit in the long-term from avoiding currency competition through an inclusion of the renminbi in the SDR and through a transformation of the SDR into a possible reserve currency.

However, this process of embedding emerging powers currencies (renminbi, real, rupee) into a jointly determined SDR and of upgrading the SDR into an alternative reserve asset should be accompanied by bringing all currency providers in line with international rules for stable and reliable exchange rates and currency availability. Common rules on currency convertibility, usability (liquidity), deep capital markets, central bank independence, transparency etc. might still be negotiable with emerging powers in the coming years. This window of opportunity for negotiating compromises with China, Brazil, and India for a long-term systemic stability and an equally long-term soft-landing of the dollar as the leading global reserve currency might close in 10-15 years, when these countries achieve more independence from the dollar by establishing themselves as financial power houses (as suggested by China's ambitious plans for 2020) and by having further increased trade between emerging economies in their own currencies.

### Conclusions

This short sketch of G20 negotiations presents six core findings.

- First, the G20 tackled issues either not touched by other international organizations or previously only discussed in exclusive clubs such as the G7 and BRIC meetings. The G20

openly debated crucial policy answers to the global crisis, produced some agreements, and diverged on other issues. Overall, this is a major achievement compared with policy coordination prior to the leaders' level summits not only with regard to the thematic scope, but also concerning the participation of emerging as well as industrialized countries. In addition, several important steps were taken by the G20, which either had been on the international agenda but not been settled prior to the crisis (such as the IMF reform), or could not have been dealt with to the same global degree in other bodies (such as the coordination of national stimulus programs). Overall, the G20 performed well at the height of the crisis in 2008-2009 in agreeing on stimulus programs and in strengthening international organization, then disagreed on many issues due to diverging domestic preferences. However, the move towards shared understandings on topics on which members had disagreed upon previously (like on indicators for global imbalances in 2011), shows that the G20 continues to offer a valuable venue for steering the world economy.

- Second, on many issues, antagonistic ad hoc groupings formed that included industrialized as well as emerging economies on both sides of the divide. These ad hoc groupings were based on shared positions (e.g. financial transaction tax, exit to high public debt, fear of "currency war") or joint rejection of criticism (e.g. global imbalances). The ad hoc groupings superseded previous alliances, since they brought industrialized and emerging countries together, thus substituting alignments such as the G7, the BRICs, and the "developing countries G20" in many cases.
- Third, the case studies demonstrate that emerging powers performed like industrialized countries in articulating their national interests

*The United States would largely benefit in the long-term from a transformation of the SDR into a possible reserve currency.*

*Transatlantic countries found themselves in opposing ad hoc groupings in most instances.*

and beliefs about global economic governance, without obstructing or facilitating agreements more than industrialized countries. Both emerging and industrialized countries were reluctant in compromising domestic interests and ideational beliefs. Thus, emerging powers can be seen as stakeholders in the G20 process in the same way as old industrialized countries. Embedding emerging countries in global governance therefore proved economically necessary in light of their rising share in trade, finance, and monetary affairs, as well as politically adequate in light of their pragmatic issue-oriented behavior in negotiating the steering of the world economy.

- Fourth, the transatlantic countries found themselves in opposing ad hoc groupings in most instances. This reflects different material interests such as export-orientation, high savings rates, etc. on one hand and consumption-driven import-orientation, low savings, etc. on the other. In addition, this split in positions also resulted from different ideational preferences, such as higher trust in market forces and acceptance of public and private debt versus higher trust in regulation and fiscal prudence. However, these transatlantic differences — especially between the United States and continental European countries — should not be overstated since all of these countries share the interest and belief in market economy and democracy. The difference is one of emphasis between the “varieties of capitalism” of “liberal market economies” and “coordinated market economies,” which are rooted in different sectoral economic interests (e.g. financial and export sector), diverging ideational beliefs dominant in the respective societies, and different national institutions.
- Fifth, since the leaders’ summits started in 2008, the G20 negotiations have demonstrated an

unprecedented heterogeneity and flexibility in global economic governance. The issue-based, flexible composition of the ad hoc groupings clearly shows the weaknesses of previously existing alliances and thus plausibly indicates a new era of economic governance, in which issue-specific national interests and ideational predispositions shape the agenda more than long-standing groups.

- Sixth, no antagonism between an emerging powers’ grouping and an industrialized countries’ grouping could be detected. This bodes well for further cooperation between both sides and — with regard to global economic governance — underlines that emerging powers are pragmatically pursuing their individual economic interests as well as ideational goals in the same manner as industrialized countries. Furthermore, international relations in the G20 have shown that all participating countries are open to temporary ad hoc alignments based upon issue-specific cohesion.

# 4 POLICY RECOMMENDATIONS FOR THE TRANSATLANTIC COUNTRIES

## Strengthening Transatlantic Cooperation

For the transatlantic countries, the ad hoc groupings in the G20 present a special challenge, since these countries have often found themselves on opposing sides in the negotiations. Therefore, the most important recommendation is to better coordinate positions among transatlantic countries prior to the G20 negotiations. For this purpose, the G7 should be revitalized, and not downsized to deal only with issues other than global economic governance (such as security and environment). The G7 is a tested venue for policy coordination among industrialized countries since the 1970s and has frequently been meeting at leaders' level, which seems necessary given the need to overcome specific differences on specific positions in order to enhance long-term cooperation. Frequent consultations in the G7 could be used to negotiate compromises if the transatlantic countries wished to elaborate a coordinated position in the G20, which would give it greater clout there.

This intensified policy dialogue on global economic governance in the G7 cannot, of course, eliminate differing economic interests and ideational beliefs, but it could enable these countries to reach common positions on global governance. Given the fundamental proximity of their economic and political systems, the governments of the transatlantic countries should be able to focus less on serving short-term domestic political concerns and more on the long-term advantages of stable, efficient, and legitimate global economic governance. In order not to trigger the building of balancing counter-alliances in the G20 (such as by the BRIC countries), an enhanced G7 coordination should aim at "leadership by example" through mediating between different national positions (for example on exchange rates, imbalances, and IMF reform), bringing the own house in order (for example with regard to public debt), and by

transcending domestic pressures in favor of a stable and coordinated global economy.

## Embedding Emerging Powers

Since emerging powers did show themselves to be pragmatic stakeholders in the G20, neither allying against industrialized countries nor blocking compromises that otherwise would have been agreed upon, they should be further embedded in global economic governance. Transatlantic countries should support a further integration of emerging countries into a rules-based international economic order and use this process to negotiate and expand these rules. For example, with regard to the inclusion of emerging countries' currencies into the SDR basket, the integration process can be used to deepen the rules for SDR currencies such as full convertibility, transparency, regulation, central bank independence, etc. A further shift of voting and quota shares as well as executive board seats in the IMF might also be accompanied by a renegotiation of the quota-formula and of establishing underlying rules for the world economy and its governance.

## Institutionalizing the G20

The G20 was not conceived to deliver binding rules, but instead to reach shared understandings and enter into negotiations between different national interests and policy approaches to improve coordination in steering the world economy. For this purpose, the G20 has been relatively successful in the two and a half years of leaders' summits. In order to further foster this process and increase the chances for common understandings, the G20 should be institutionalized as a leaders' Global Economic Council (GEC), with a small permanent secretariat and policy planning unit. This GEC should be based on a Charter as a code of conduct for the world economy. Its negotiation should establish the fundamental principles of the world economic system on core issues such as openness,

*Transatlantic countries should support a further integration of emerging countries into a rules-based international economic order and use this process to negotiate and expand these rules.*



regulation, stability, and sustainable development. The GEC should have the responsibility to coordinate and delegate tasks to international organizations such as the IMF, set standards for national policies for example with regard to exchange rates and imbalances, and ensure the global supervision of all financial market products and actors, as originally proposed but not yet accomplished by the G20. With the transformation of the G20 into a Council, the present weaknesses in efficiency and legitimacy could be addressed by enhancing representation, for example, through regional constituencies for smaller economies. The Global Economic Council should not become a new bureaucracy, but facilitate further accomplishments of the G20 in integrating new and old economic powers, negotiating financial market regulation, and cushioning the impact of crises by giving the G20 a sustainable institutionalized future.

# 5 ENDNOTES

- <sup>1</sup> The members of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, United Kingdom, United States, and the European Union.
- <sup>2</sup> See Hillman 2010.
- <sup>3</sup> See the official site of the G20 at [http://www.g20.org/about\\_what\\_is\\_g20.aspx](http://www.g20.org/about_what_is_g20.aspx).
- <sup>4</sup> On this line of thought, see Castaneda 2010 and Hart/Jones 2010.
- <sup>5</sup> On this argument, see Ikenberry 2008 and Hachigian/Sutphen 2008.
- <sup>6</sup> See Overseas Development Institute 2010 and Patrick 2010.
- <sup>7</sup> See Atlantic Council 2010.
- <sup>8</sup> This proposal is based on ideas brought forward by Jennifer Hillman 2011 and the Palais-Royal Initiative 2011.
- <sup>9</sup> Quoted from [http://www.g20.org/about\\_what\\_is\\_g20.aspx](http://www.g20.org/about_what_is_g20.aspx).
- <sup>10</sup> See for example Vestergaard 2011.
- <sup>11</sup> Contrary to some claims, “Europe” cannot occupy a single seat, because the EU is not an actor with regard to the issues at stake at the G20 and the IMF. European member states partly have different positions on these issues and did not transfer powers to the EU commission with regard to the G20 agenda (as they did in the area of trade).
- <sup>12</sup> On the BRICs, see Brawley 2007 and Roett 2010.
- <sup>13</sup> On the “developing countries G20,” see Schirm 2010, 209-212.
- <sup>14</sup> On these “Varieties of Capitalism,” see Hall/Soskice 2001.
- <sup>15</sup> On the four governments’ positions, see *The Economist*, March 12, 2009; *Handelsblatt*, June 16, 2009; *Wall Street Journal* Nov 13, 2010.
- <sup>16</sup> See Schirm 2011, 56-57.
- <sup>17</sup> Geithner 2010.
- <sup>18</sup> Quoted in *Wall Street Journal* Nov 13, 2010.
- <sup>19</sup> Quoted in *The Economist*, “The ghost at the feast,” Nov 12, 2010.
- <sup>20</sup> See Schirm 2009 and 2011.
- <sup>21</sup> See Woods 2010.
- <sup>22</sup> See Alan Beattie, “Europe pressed to surrender IMF board seats,” *Financial Times*, Sept 23, 2010.
- <sup>23</sup> See Wheatley 2009 and Chin/Thakur 2010, 127.
- <sup>24</sup> See Neogy/Anishchuk 2011 and Reuters March 23, 2011.
- <sup>25</sup> Quoted in Somerville/Wroughton 2011.
- <sup>26</sup> See Bergsten 2011 and Benassy-Quere et.al 2011.

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