THE G-20 SUMMIT AT FIVE
TIME FOR STRATEGIC LEADERSHIP

KEMAL DERVIŞ AND PETER DRYSDALE, EDITORS

Can the G-20 become a steering committee for the world's economy?

Launched at a moment of panic triggered by the financial crisis in late 2008, the leaders' level G-20 is trying to evolve from crisis committee for the world economy to a real steering group facilitating international economic cooperation.

What can and should such a "steering committee" focus on? How important could the concrete gains from cooperation be? How much faster could world growth be? Is there sufficient legitimacy in the G-20 process? How does the G-20 relate to the IMF and the World Bank? How can Australia in 2015, and then Turkey in 2016, chair the process so as to encourage strategic leadership?

The East Asian Bureau of Economic Research in the Crawford School of Public Policy at the Australian National University and the Global Economy and Development program at the Brookings Institution joined forces in putting together this volume and asked opinion leaders and policymakers from G-20 countries to provide their independent perspectives.

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BROOKINGS INSTITUTION PRESS
Washington, D.C.
www.brookings.edu/press

COVER BY SESE/PAUL DESIGN

ISBN 978-0-8157-2591-6

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DERVIŞ/DRYSDALE THE G-20 SUMMIT AT FIVE BROOKINGS

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BROOKINGS INSTITUTION PRESS
Washington, D.C.

THE BROOKINGS INSTITUTION
1775 Massachusetts Avenue, N.W., Washington, D.C. 20036
www.brookings.edu

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Library of Congress Cataloging-in-Publication data
The G-20 summit at five : time for strategic leadership / Kemal Derviş and Peter Drysdale, editors.
pages cm
Includes bibliographical references and index.
ISBN 978-0-8157-2591-6 (pbk. : alk. paper)
1. Group of Twenty. 2. International economic relations. 3. Economic policy—International cooperation.
4. Group of Twenty countries—Foreign economic relations. 5. Group of Twenty countries—Economic
policy. I. Derviş, Kemal. II. Drysdale, Peter.
HF1359.G274 2014
337.1—dc23 2014016991

9 8 7 6 5 4 3 2 1

Printed on acid-free paper

Typeset in Minion

Composition by R. Lynn Rivenbark
Macon, Georgia

Contents

Acknowledgments

The editors would like to gratefully acknowledge the Australian Government's Department of Foreign Affairs and Trade for its support. We thank the authors for their dedication and excellence in research, as well as their collaboration in finalizing the book. We also thank all contributors to the Think Tank 20 series publications (Brookings Institution)—coinciding with G-20 ministerial summits since 2010. Many of the ideas that they contributed over the years have been useful in putting this collection together.

We are especially grateful to Shiro Armstrong, Shane Johnson, Sebastien Willis, and the EABER team of the Crawford School of Public Policy at the Australian National University for their huge input into the organization and success of this project and to Gordon de Brouwer, Heather Smith, and Australian G-20 officials for their advice and comments. We are also grateful to those who have provided invaluable comments in the editing process, including Colin Bradford, Joshua Meltzer, Soumya Chattopadhyay, and Brookings Press staff.

We also thank the participants of the Brookings-ANU workshop in Washington, D.C., on June 10, 2013, and the Brookings-ANU Roundtable and Public Forum in Canberra, on November 14–15, 2013. These events took place with the excellent organizational support of Annick Ducher and Andrea Holcombe in Washington and Shane Johnson, Patrick Williams, and the EABER team in Canberra.

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CHANGYONG RHEE AND ALOK SHEEL

3 The Role of Emerging Economies in Major G-20 Initiatives

In the five-year perspective of the G-20 experience, the decision to include emerging economies in the dialogue to address the global financial crisis proved beneficial for the world economy. Coordinated expansionary policy action by both advanced and emerging economies limited the global repercussions of a financial and economic crisis emanating from advanced economies. Even as the global economy started faltering in late 2007, emerging G-20 economies continued to post strong positive growth. In fact, during the worst of the global crisis in 2009, when the world economy contracted by 4.2 percent, emerging G-20 economies managed to contribute 1.7 percentage points to global growth while advanced G-20 economies subtracted 1.8 percentage points. Since then, the contribution of G-20 emerging economies to world growth has exceeded 100 percent, implying that the group's resilience has helped offset the weakness in the rest of the world. Hence it can be said that the G-20 emerging economies led the recovery process after the global financial crisis.[1]

1. According to ADB (2011), Asia's strong rebound from the global financial crisis stimulated the global recovery. Indeed, during the global crisis period (from the third quarter of 2008 through the third quarter of 2010), growth of exports from a sample of non-Asian developing countries (Brazil, Mexico, Saudi Arabia, and South Africa) and industrialized countries (France, Germany, Japan, United States) to major Asian countries (PRC, Hong Kong, China, India, Indonesia, Republic of Korea, Malaysia, the Philippines, Singapore, Taipei, China, and Thailand) was higher than the growth of their exports to the rest of the world. Both industrialized countries and developing countries thus benefited from Asia's rapid recovery and consequently healthy appetite for imports.

Financial Regulatory Reform

The ongoing G-20 and Financial Stability Board (FSB) debates on reforming global finance so far have been mostly among advanced economies. Emerging market economies (EMEs) were largely bystanders, possibly because their deposit-and-lending-based financial systems are structurally very different from those in advanced economies. The G-20 has a stream for assessing and monitoring the impact of financial regulatory reform on these emerging market and developing economies. However, instead of simply waiting for new rules to be finalized, implementing them mechanically, and taking corrective action, EMEs need to strengthen their involvement in global financial regulatory discussions.

Over the years, membership in various international forums has expanded to reflect the changing economic power of the EMEs. Unlike the situation of a couple of decades ago, EMEs are now members of international institutions such as the G-20, the Basel Committee on Banking Supervision (BCBS), and the FSB. However, while the EMEs' presence in international discussions is increasingly accepted, they have yet to make an impact on the deliberations. All eleven relevant rule-making institutions are located either in Europe or in the United States.[2] Among the chief executives of those institutions, only one is from Asia, while the rest are from Europe or the United States.[3] This imbalance demonstrates that EMEs are being effectively excluded from important discussions. While this may be because of the relative underdevelopment of their financial markets, it is important for EME voices to be more heard, because the regulatory structure being put in place will also be adopted by their future financial markets.

Financial panics are invariably preceded by escalating leverage. The primary drivers of leverage in advanced market economies (AMEs) and EMEs are, however, strikingly different. The recent galloping leverage in AMEs was meant to increase returns on capital through increased trading of claims on

2. The eleven institutions are the ten members of the Financial Stability Board (the Bank for International Settlements, the Basel Committee on Banking Supervision, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems, the International Association of Insurance Supervisors, the International Accounting Standards Board, the International Organization of Securities Commissions, the Organization for Economic Cooperation and Development, the International Monetary Fund, and the World Bank) plus the Financial Stability Board itself.

3. The Asian executive is Yoshihiro Kawai, head of the International Association of Insurance Supervisors Secretariat.

real economy assets in an environment of low returns. This led to a rapid expansion of financial assets as a proportion of their GDP. High credit growth in EMEs, like the People's Republic of China (PRC) and India, conversely, was primarily meant to finance high rates of investment and growth. Global production has long been migrating to these countries because of rapid productivity shifts. Their economies are consequently far less financialized. Ever since deposit insurance and the central bank discount window were put in place, deposit-based banking has become less susceptible to financial panics and bank runs, as long as capital is calibrated to cover asset deterioration during business downturns. Unsurprisingly, therefore, even as they were affected by sudden stops from abroad, financial intermediation among EMEs held up even as the Western financial system froze.

Financial regulation in a number of EMEs was already more stringent than in AMEs. After the Asian financial crisis in 1997, many Asian economies also tightened their regulations more than the proposed norms. Their central banks paid special attention to asset bubbles. Their "boring" banking could never afford the outsized compensation that encouraged excessive risk taking in AMEs. Banks were tightly regulated and not allowed to become interconnected with shadow banking, and thus regulators did not need to deal with products that were opaque and had complicated structures. EMEs, therefore, found it easy to sign on to the reforms. Indeed, to the extent that the Western financial system became "safer," they stood to gain. Although they are net savers, much EME financial intermediation is routed through the international banking system, where they park their excess savings. A shock in AME financial systems was, therefore, automatically transmitted to EMEs through sudden stops and attendant currency crises, which derailed their economies from time to time. In the past these stops were usually of their own making (through poor macroeconomic management), but this time it was caused by lax financial regulation in AMEs.

The impact of the ongoing financial regulatory reforms on EMEs has been relatively benign so far. Surprisingly, despite the general decline in cross-border claims on financial assets among AMEs, especially in Europe, capital flows to EMEs are back to precrisis highs.[4] Capital flows to EMEs appear to be more affected by monetary policies in AMEs than by their regulatory reforms. In Asia, for example, aggregate inflows to ten large Asian economies fell to 1.7 percent of GDP during the global financial crisis of 2008–09, from an

4. McKinsey Global Institute (2013); Cho and Rhee (2013).

average of 8.4 percent in the previous three years. But inflows rebounded sharply in 2010–12 to 7.4 percent of GDP. EMEs' chief concerns about their financial systems remain developmental rather than regulatory: increasing financial savings to accelerate growth and development, notwithstanding the fact that in recent years capital was flowing uphill from EMEs to AMEs. This is arguably a temporary, unsustainable phenomenon and will change as the global economy rebalances. AMEs, on the other hand, need major regulatory changes that inoculate them against the risks their financial systems face. History tells us that the relationship between financial depth and growth is not linear but is more like the Kuznets curve, where high growth is associated with greater financial depth only up to a point, beyond which the association breaks down and the risks increase. AMEs need to roll back their more extreme forms of financialization, which expose them to greater risk without a commensurate impact on growth. They also need to focus more on nonfinancial structural impediments to higher growth, such as falling investment and competitiveness, adjustments to demographic shifts, and rigid labor laws that have contributed to the migration of brick-and-mortar economic activity to EMEs. The priority accorded by the eighth G-20 summit to boosting investment was therefore a step in the right direction.

While financial regulatory reforms are expected to be implemented across all jurisdictions, their immediate impact would mostly be felt in the relatively lightly regulated AMEs rather than in the more tightly regulated EMEs. The impact of the new Basel III banking capital adequacy norms, however, will be almost equal across both AMEs and EMEs.

While the rationale for tightening capital adequacy norms for the banking sector in AMEs, where the recent financial crisis originated, is self-evident; the case for immediately migrating from Basel II to Basel III in EMEs is not. The argument in favor of common norms is to avoid arbitrage. This alone is not very convincing, because any capital migrating to a more regulated environment would incur additional costs because regulation is a proxy tax. Ironically, according to a recent BCBS assessment, G-20 EMEs are actually ahead of AMEs in implementing Basel III.[5] This puts them in the vanguard of Basel III–related financial instruments, which are still little understood by markets, thereby introducing new risks in their financial systems.[6] EMEs need to be better engaged at the rule-making stage and at least raise their voices regarding the phase-in of Basel III, especially since the AMEs are lagging behind them

5. BCBS (2013).
6. "Volcker Rule to Curb Bank Trading" (2013).

in implementation. However, the larger question is, How should EMEs balance a regulatory framework with risks in AME financial systems that could extract a high developmental cost through forgone growth?

There is a danger that scarce savings in EMEs might be pulled away from the investment necessary to sustain current levels of high growth to cover nonexistent risks. Basel III constitutes a double blow for countries like India. It could constrain the rapid credit growth necessary to sustain high growth, on the one hand. One the other hand, it could aggravate the runaway structural fiscal deficit of a government that would need to come up with substantial additional capital by virtue of its large ownership of the banking sector. The cost of capital is already high among EMEs. The enhanced capital requirements of Basel III are almost guaranteed to keep this cost high in the foreseeable future.

What then is the right lesson to learn from the 2008 global financial crisis? After the subprime crisis there was increasing aversion to capital market development, securitization, derivatives, and investment banking. Should EMEs stop proceeding with capital market development and move back to a bank-dominated financial structure? For many Asian economies that have reached middle-income status, a key constraint to graduating to high-income status is the relative underdevelopment of their financial sectors. To avoid falling into a middle-income trap, authorities must ensure that adequate funds are available to finance their economies' sustained growth and development. This entails sharing financial risks more widely as well as allocating funds more efficiently. In other words, greater sophistication of financial markets is still necessary, but it must be accompanied by measures to keep financial vulnerability in check. With relatively stronger regulatory regimes, EMEs in the G-20 have a big strategic stake in raising global financial regulatory standards and in pushing for regulatory reforms in systemically important economies to ensure greater financial stability going forward.

Macroeconomic Policy Cooperation and the G-20 Framework for Strong, Sustainable, and Balanced Growth

Five years on is a good time to take stock of what macroeconomic cooperation within the G-20 has achieved, and what it has not. First, the biggest success is that the strong, coordinated policy response may have averted a second Great Depression. Over the years, however, this stellar achievement has been somewhat tarnished by the fact that the global economic recovery, particularly

in advanced economies, has been perhaps the worst in the postwar period. Since it was well known to policymakers that recoveries from financial crises can be painful and protracted because of deleveraging, in retrospect it appears that the G-20 and its Framework for Strong, Sustainable, and Balanced Growth (G-20 framework) dwelt far too much on fiscal and monetary stimulus in the earlier stages and too little on the transmission channels and the structural reforms needed to translate this into a robust recovery.

Second, the major external imbalances that the framework sought to address have indeed been reduced.[7] But external imbalances also reflect internal imbalances. In retrospect, the framework, at least in its earlier stages, dwelt far too much on contentious exchange-rate policies and too little on a coordinated correction of internal imbalances through structural reforms. By and large, deficit countries adjusted to the decline in demand not by increasing investment but by increasing consumption. Likewise, surplus countries adjusted by increasing investment rather than domestic consumption.[8] This has left open the questions of whether the imbalances have been reduced because of lower demand and decline in trade and whether they would return when global growth revives.[9]

Third, although the monetary policies of international reserve issuing currencies result in huge cross-border spillovers, there was relatively little coordination on monetary policies within the G-20.[10] This is surprising, since both central bank governors and finance ministers are part of the G-20 deliberative process. Animated discussions took place on fiscal policies, exchange rate policies, the international monetary system, and capital flows. Finance and central bank deputies spent long hours discussing the trade-offs between austerity and growth. This debate was mostly among advanced economies, as EMEs' growth prospects hinged greatly on the recovery of the AMEs. EMEs were mostly united in their fear that a premature exit from stimulative policies in

7. The U.S. current account deficit declined from 5.8 percent of GDP in 2006 to 2.7 percent of GDP in 2012, while the PRC surplus declined from 8.5 percent to 2.3 percent during this period. IMF (2013).

8. Thus investment in the United States declined from 22.3 percent of GDP in 2007 to 19.0 percent in 2012, whereas it rose from 37.4 percent in developing Asia (including the PRC) to 43.3 percent over the same period. IMF (2013).

9. According to IMF (2013), "Policy has played a limited role in narrowing global imbalances." As advanced countries consolidate their public finances, surplus countries may have to live with lower growth if they do not rebalance their economies (p. 13). This seems to be already happening, with the IMF significantly marking down medium-term growth prospects of emerging market economies.

10. Prime Minister of India (2013).

AMES, while private demand remained weak, could choke off their own relatively robust recovery. As concerns over public deficits and debt in advanced economies mounted, however, central banks assumed a growing share of the burden for driving the recovery. The resultant surge in liquidity, and more recently the threat of reversal, made EMEs' exchange rates extremely volatile and threatened their quick recovery from the crisis. G-20 policy coordination in the matter, however, remains extremely weak. The argument that monetary policy is driven by domestic considerations, and thus is less amenable to international policy coordination, applies equally to fiscal policy. Yet it is pertinent to underscore EMEs' ambivalence on quantitative easing. When quantitative easing was first implemented, these countries voiced concern over its cross-border spillovers through a surge in capital inflows and currency appreciation. However, as the tapering of quantitative easing threatened to lead to a sudden stop of such inflows, EMEs made a case for a graduated approach for the same reason: global spillovers. This ambivalence merely reflects the structural weakness of EMEs, which makes them increasingly dependent on international reserve currencies in a globalizing world, a theme addressed in a subsequent section.

Fourth, the G-20 framework has made it difficult for countries to agree on common, enforceable, macroeconomic indicators, rules, or commitments. An attempt to arrive at an agreed threshold for current account balances at Seoul led nowhere. The indicators mandated by the leaders at Seoul to form the basis of country commitments eventually turned out to be no more than each G-20 country's own macroeconomic projections that the International Monetary Fund (IMF) could use for determining the overall consistency of G-20 macroeconomic policies. Countries have also found it difficult to give any forward-looking policy commitments beyond what has already been successfully steered through their own domestic legislative, regulatory, and judicial processes.

It is, therefore, unsurprising that both the Mutual Assessment Process (MAP) and accountability assessments have repeatedly underscored that, while policy coordination has achieved tangible results, the framework outcomes have nevertheless fallen far short of the G-20's objective of strong, sustainable, and balanced growth. However, some degree of caution is warranted in placing unrealistic expectations on the budding G-20 process going forward. In particular, it is important to draw a distinction between coordination and commitment.

In its early stages, the G-20's focus was on coordinating policies—developing a consensus on what needed to be done, with each country contributing what it could, depending on individual country circumstances. The G-20 has been much less successful as it moved toward trying to obtain country commitments. The spirit of cooperation quickly evaporated amid "naming and shaming," which some members of the G-20 had warned against in the early deliberations.

The sovereignty of internal policies of nation-states has been recognized at least since the seventeenth-century Treaty of Westphalia. G-20 leaders have nevertheless incrementally committed themselves to more intrusive policy coordination within a relatively short time. This is in itself a remarkable development, considering the IMF's earlier experience with multilateral surveillance.[11] It is even more remarkable that leaders of the world's biggest developed and developing economies are talking to each other on equal terms and signing common documents on mutually agreed objectives and commitments—in contrast to taking vastly different positions in forums such as the United Nations and Bretton Woods.

The question is, How can the G-20 nudge countries' policies in mutually agreed directions and hold sovereigns accountable for commitments given, especially since these commitments are not legally binding and there is no enforcement mechanism? What gives cause for optimism is that economic interests are becoming increasingly aligned through globalization. Global business cycles and economic interests have begun converging through cross-border trading and financial spillovers. Domestic policy actions in a fast-integrating world, with growing market and policy spillovers, are increasingly linked to global outcomes. Domestic business cycles are becoming more and more globally aligned. If rebalancing does not take place, growth will decline everywhere; but if rebalancing is uncoordinated, the outcomes could be even worse. Policy cooperation—and beyond that policy harmonization or convergence—would be a win-win result. This harmonization is of course the work of specialized multilateral forums like the World Trade Organization (WTO) (trade), the BCBS (financial regulation), United Nations Framework Convention on Climate Change (UNFCCC) (climate policies), and the Global

11. The IMF's Consultative Group on Exchange Rate issues has been evaluating the exchange rates of industrialized countries and, more recently, of major developing countries as well. Its measurements indicate that exchange rate misalignments and current account gaps tend to be persistent even over the medium term. See Abiad, Kannan, and Le (2009).

Forum (tax). However, given its systemic importance, the G-20 could give the decisive push where required if its leaders are firm in their resolve, as they were at the high point of the global financial crisis.

If this resolve weakens as the recovery takes hold, it is because the trust necessary for effective policy coordination will take some time to be on a firm footing. From an EME perspective, this trust is at least partly contingent on the willingness of advanced economies to give them a greater voice and share in global institutions, in which the G-20 has made a good start. Beyond this, agreement on enforceable rules-based policy coordination would run into issues of sovereignty, as it has in the European Union, where the benefits and hazards of such cooperation and harmonization are most clearly manifest. G-20 countries are therefore finding it difficult to make forward-looking commitments beyond what has already occurred in the domestic policymaking space.

The eurozone and the European Union are pushing the envelope of the nation-state, and to a great extent, the challenges facing the G-20 are similar, with economic integration moving far ahead of political integration. At this juncture a new political economy and institutional structure is needed to manage globalization, built on mutual trust, peer pressure, and cooperation. Leaders will no doubt learn how to do so as they go along. Seen from this perspective, the G-20's policy coordination through its Framework for Strong, Sustainable, and Balanced Growth is a brave new experiment in pushing the political boundaries of globalization to harvest this cooperative dividend.

Governance Reform of the World Bank and the International Monetary Fund

While in London in 2009 the enlargement of the resources of such international financial institutions as the IMF was agreed upon relatively easily, given the urgency of the crisis, the consensus on governance reform of these institutions turned out to be much harder to implement. This was to be expected, because this was a zero-sum game, with both the major gainers and losers represented in the G-20.

At the 2009 Pittsburgh summit, G-20 leaders committed to "a shift in IMF quota share to dynamic emerging markets and developing countries of at least 5% from over-represented countries to under-represented countries using the current quota formula as the basis to work from" and "a significant increase of at least 3% of voting power for developing and transition countries" in the

World Bank.[12] The leaders also recognized the need to address other issues, such as the size of IMF quota increases, the size and composition of the IMF executive board as well as enhancing its effectiveness, and the IMF governors' role in the institution's strategic oversight. However, the devil was in the details, and the details were intentionally left ambiguous to allow room for further negotiation. For example, the definitions of "dynamic emerging economies" and "over- and under-representation" can be interpreted differently. It was also well known how difficult it would be for the IMF board to agree on the all-important new quota formulas that would determine winners and losers in this negotiation. The announcement was perhaps an "advance payment" to the emerging economies for their flexibility on issues such as trade policy, exchange rates, climate change, and IMF contributions. In other words, in Pittsburgh the leaders agreed to open the debate, but the really difficult decisions were postponed.

G-20 members endorsed the World Bank reforms in Toronto in 2010, thereby increasing the voting power of developing and transition countries by 4.59 percent (3.13 percent as agreed at the Pittsburgh Summit plus 1.46 percent as agreed during the earlier phase of reforms since 2008). The members also reaffirmed their commitment to secure a dynamic formula to establish equitable voting power for under-represented World Bank members.[13]

In sharp contrast to the IMF, reform at the World Bank made significant progress without much difficulty. This might be because the reform effort was initiated even before the G-20 summits began. It may also have been politically easier for AMEs to reduce their quota at the World Bank, as the fast-growing crisis increased domestic pressures to cut development aid. By contrast, there appears to be greater discord about the proposed IMF governance reforms, perhaps because much more is at stake for AMEs, particularly in terms of members' representation in global macroeconomic policy management and surveillance, with an increasing proportion of IMF assistance going to European countries.

Between the Toronto and Seoul summits, negotiations were held right up to the last minute of finalizing the summit documents. An internal consensus among G-20 members that the deadline should not be missed to maintain the credibility of the summit ramped up peer pressure to end the politically difficult negotiation on time. The problem lay not simply in reflecting political differences between advanced and emerging economies, as opinions differed

12. G-20 Information Center (2009).
13. G-20 Information Center (2010a).

even within the AMEs (the United States and Japan versus Europe), within Europe (large versus small European countries), and even among EMEs.

The most sensitive issue remains the revision of the IMF formula for calculating members' voting power. For example, EMEs take the view that a larger weight should be given to GDP in purchasing power parity (PPP) terms to reflect their greater economic weight, whereas European economies (which have vast intraregional trade flows) and Japan want greater emphasis on openness and past contributions to the fund. The EMEs, which accounted for only 31.0 percent of global output in PPP terms in 1980, increased their share to nearly half—49.6 percent—in 2012. However, in terms of total trade, these economies will continue to lag behind AMEs, having accounted for only 38.1 percent in 2012. Reducing the weight of the openness measure would significantly scale back European countries' power in the IMF, while raising that of the PRC, India, and Brazil.

After serious political haggling at the Seoul summit, agreement was reached to shift more than 6 percent of IMF shares to dynamic EMEs. G-20 leaders also agreed to double IMF quotas. The deadline for the comprehensive review of the quota formula was set for January 2013 and the completion of the next general review of quotas for January 2014. In addition, the leaders also committed to reform the composition of the IMF executive board by reducing the chairs assigned to advanced European economies by two and possibly assigning a second alternate chair for all multicountry constituencies. The board's composition would be reviewed every eight years.[14] At the Cannes and Los Cabos summits, G-20 leaders reiterated their commitments to the deadlines set at the Seoul summit.[15]

However, the deadlines for implementation of the 2010 amendment on quota increases and governance reform (October 2012) and the completion of the comprehensive quota formula review (January 2013) were both missed. The required U.S. approval of the agreement suffered a setback when Congress failed to sign off on the reallocation of its existing $65 billion IMF commitment into a permanent hike in its shareholding.[16] IMF members also continue to disagree on the revised formula for calculating members' voting power. With little agreement within the G-20 on currency, trade, and climate change issues, AMEs may now be of the view that the advance payment has not delivered the grand bargain they had in mind.

14. G-20 Information Center (2010b).
15. G-20 Information Center (2012).
16. Bernes (2013).

At the St. Petersburg summit, no new deadline for implementation of the 2010 IMF quota increase and governance reform was specified, but the target for agreeing on the quota formula was integrated with the January 2014 deadline for the fifteenth General Review of Quotas.[17] Since G-20 countries are also the major shareholders of the IMF, successful completion of these reforms will test the credibility of the forum.

Global Safety Nets, Capital Flows, and the International Monetary System

The global financial crisis of 2008 forced G-20 leaders to reconsider the effectiveness of the existing global crisis management system led by IMF credit-support facilities. This was precipitated by several new important events. First was the realization that financial crises not only affect EMEs but could also wreak havoc in AMEs. As a result, the financial support needed could be extremely large and could test the limits of IMF lending programs. Second, the crisis demonstrated that EMEs could suffer from a serious global liquidity shortage, no matter how sound their macroeconomic management. In fact, ever since the East Asian crisis a decade earlier, EMEs had become aware of the threat of such external spillovers, which, combined with their unhappy experience with IMF programs, provided the incentive to rely increasingly on reserve accumulation as a self-insurance mechanism and on regional safety nets such as the Chiang Mai Initiative. Whether or not reserve accumulation was a conscious self-insurance mechanism, or merely the flip side of a model of export-led growth, it nevertheless helped cushion the sudden stop that followed in the wake of the global financial crisis. At the same time, it became clear that rising global imbalances, and its flip side of excess reserve accumulation, were signs of defiance of the global financial safety-net architecture—signs that needed to be confronted. Otherwise, global imbalances would remain a permanent threat to the stability of the international monetary and financial systems.

In the past sudden capital flow reversals were typically seen as a problem internal to EMEs, such as macroeconomic mismanagement and weak financial systems. For this reason, the IMF and the international community had traditionally advocated structural reforms and sound macroeconomic policies to guard against financial crises in these economies. The 2008 crisis, however, originated in the AMEs, against the backdrop of the U.S. subprime crisis.

17. G-20 Information Center (2013a).

These events resulted in tightened liquidity conditions, initially in the financial centers of AMEs, which were then transmitted to EMEs, causing dramatic reversals of capital flows.

The flip side of sudden stops is sudden surges of capital. This is precisely what followed the sudden stops of the financial crisis, in the wake of the aggressive and unconventional monetary response to the crisis in the AMEs, leading to sharp appreciation in the currencies and asset markets of a number of EMEs. Exchange rates and financial volatility in emerging markets now came to be increasingly associated with the structure of the international monetary system.

To counter these external shocks, several global crisis response mechanisms were proposed to supplement domestic policy measures. The IMF was now willing to contemplate temporary capital controls as a last resort to deal with such surges, which was reflected in "coherent conclusions" arrived at by G-20 countries at the Cannes summit.

Bilateral swap arrangements between the U.S. Federal Reserve and central banks and the IMF's flexible credit line (FCL) were used during the crisis to counteract the impact of sudden stops. While these were important tools, and were put to good use by a number of countries, both mechanisms had significant shortcomings. Bilateral swap arrangements have their limitations as credible and secure sources of foreign currency liquidity because of their temporary, ad hoc, and political nature. The FCL, for its part, has certain advantages over the IMF's other lending facilities, such as the standby arrangement, in that the FCL provides precautionary financing with less stringent conditionality. Nevertheless, since use of the IMF's resources has, until recently, been primarily associated with crisis resolution, a lingering stigma inhibits some countries from accessing the FCL. This points to the need for a mechanism that can break the first-mover problem, in which countries hesitate to approach the IMF for financial support because of a fear of being stigmatized, and therefore penalized, by financial markets.

Perhaps in part because of persistent deficiencies in the existing global financial safety nets, a number of emerging market countries continue to rely on the accumulation of foreign exchange reserves as a form of self-insurance against sudden outflows of international capital. The fact that countries with larger reserves generally fared better in the recent crisis may, in the absence of credible alternatives, further incentivize EMEs to accumulate greater reserves, despite the significant opportunity and operational costs. Not only are the costs of such policies borne by the individual countries holding them, there are also important implications for the global economy. Increasing reserves

incentivizes the buildup of global imbalances, and holding excess reserves diverts resources from other productive uses with potentially higher returns, including consumption and investment, which could contribute to global growth. Moreover, as the Republic of Korea painfully learned as it rushed to tie up a bilateral swap with the U.S. Federal Reserve following the collapse of Lehman Brothers, it is difficult to assess what level of reserves is adequate to quell market fears. These observations underscore the imperative for strengthening global financial safety nets.

It is unsurprising therefore that it was under the Korean presidency that the issue of financial safety nets was first brought up within the G-20. While central banks were mostly resistant to the idea of supporting EMEs through bilateral swaps by printing money, it was surprising that these economies were also initially not supportive of the focus on the global issue of financial safety nets in the G-20 amid concerns that such discussions would open the door for criticism of their large accumulation of foreign currency reserves.

The G-20 initiative led to some improvement in the IMF's lending facilities by enhancing its crisis prevention tool kit with the introduction of the multicountry flexible credit line and the precautionary credit line, which was eventually replaced by the precautionary and liquidity line. However, according to the IMF's own assessment, members' use of the new credit lines remains fairly limited because of the stigma associated with their use.[18]

At the Cannes and St. Petersburg summits discussions on strengthening global financial safety nets continued, but the nature of the discussions changed significantly to cooperation between the IMF and regional financing arrangements. The focus on these arrangements gained importance as the European crisis worsened, leading to the establishment of the European Stabilization Mechanism and the European Financial Stability Facility. It may be recalled that when Asian countries raised the possibility of establishing the Asian Monetary Fund and the Chiang Mai Initiative in the immediate aftermath of the Asian financial crisis of 1997, the initial reaction of the international community and the IMF was negative. The international community is finally paying attention to this important topic. Ways to better coordinate the multilateralized Chiang Mai Initiative and the IMF are currently being actively discussed in Asia. The IMF and the G-20 can no longer ignore such regional arrangements, although much work remains to be done to coordinate regional financing arrangements with global institutions.[19]

18. IMF (2011).
19. See Rhee, Sumulong, and Vallée (2013).

Going forward, the G-20 needs to have a fuller and more candid debate on the international monetary system, one that goes beyond financial safety nets, capital flows, expanding the special drawing rights basket, and reviewing the IMF's reserve currency basket, all of which are simply manifestations of the underlying global reserve currency issue.

The Development Agenda

The G-20 development agenda is one of the main agenda items in G-20 summits, together with the G-20 framework. As the first non-G-7 country to host the summit, the Republic of Korea placed development on the G-20 agenda at a time when the global economy appeared to be recovering strongly from the global financial crisis. The objective was to demonstrate the G-20's leadership as a premier forum for international economic cooperation—a leadership that actively engaged all stakeholders in the global economy, not just the members of the G-20.

However, initially the inclusion of the development agenda was not considered favorably by G-20 members, for two main reasons. First, a focus on development would simply duplicate the work of such institutions as the World Bank and the Asian Development Bank. Many G-20 members were of the view that the focus of the G-20 should be limited to those economic and financial issues that the G-20 could address in concrete terms. Second, a focus on development would require expanding overseas development assistance commitments that the AMEs were already struggling to meet. It was therefore decided that the G-20's development discussions should focus on concrete deliverables and otherwise play a steering role in determining the priorities of development policies. At the 2010 Toronto summit, the G-20 established the Development Working Group to create a development agenda. This was followed by the adoption of the Seoul Development Consensus for Shared Growth during the Seoul summit in November 2010.[20]

Though not well recognized, the Seoul Development Consensus introduced new insights into the international development dialogue. It recognized that growth is overwhelmingly the biggest contributor to poverty reduction. It also attempted to ensure the correct emphasis in international development efforts on economic factors—such as infrastructure, private investment, and skills—in achieving poverty reduction through growth. In

20. G-20 Information Center (2013b).

addition, the inclusion in the G-20 of such countries as the Republic of Korea, the PRC, India, and Brazil—that is, countries with varying development models—was a recognition of the fact that there is no single model for growth and development. Further, the development agenda advocated a "client-oriented approach" based on extensive inquiry into what developing countries themselves wanted. The Seoul Consensus thus reflects the view that low-income countries should be equal partners in achieving a resilient and balanced global economy and that addressing bottlenecks in infrastructure investment, and especially bottlenecks to regional infrastructure, is extremely urgent and must be given top priority.

However, once the Development Working Group started to collect G-20 member countries' priorities for the development agenda, it realized that these issues were too diverse and complex to reach consensus. After three months of intensive negotiations under the Korean chair, the G-20 drew up a multiyear action plan, with the following key pillars of development: infrastructure, private investment and job creation, human resource development, trade, financial inclusion, growth with resilience, food security, domestic resource mobilization, and knowledge sharing. Many critics point out that these are too many goals to have meaningful deliverables, but it should be noted that the Development Working Group had to deal with more than a hundred to begin with.

As the G-20 presidency rotated, the importance attached to the nine key pillars varied. The French and Mexican presidencies emphasized infrastructure and food security, but the latter included green growth as part of the agenda. Facing criticism that the development agenda was simply too long and lacked concrete deliverables, G-20 leaders asked the Development Working Group at Los Cabos to establish an assessment and accountability process before the summit in St. Petersburg. The objective was to enhance transparency, identify best practices and lessons learned, draw conclusions, and determine next steps. The first accountability report was released in August 2013. Meanwhile, during the Russian presidency, the G-20 decided to narrow the nine development pillars to four pillars—food security, infrastructure, financial inclusion, and human resource development.

Evaluation of the G-20's development agenda varies. Some see the agenda as enhancing the group's legitimacy, since the development issue is relevant beyond the G-20 and actively engages all stakeholders in the global economy. Ethiopian Prime Minister Meles Zenawi's comment that the Seoul Development Consensus embodies the African consensus is proof that the development agenda has the potential to make the G-20 more inclusive and representative.[21] Conversely, a succession of crises—the global financial crisis, the Europe sovereign debt crisis, and financial market turmoil brought about by talk of tapering U.S. quantitative easing—has constrained the efforts of traditional donors. Also, the initial concern about the expansion of topics is not unfounded: each host has had its own preference for development topics and introduced other ministerial channels beyond the nine pillars identified at the Seoul summit. In this regard, the decision at the St. Petersburg summit to reduce the number of pillars and strengthen the assessment and accountability mechanism is timely. Moving forward, it is important to limit the scope of the development channels and prevent the proliferation of other ministerial channels while strengthening the legitimacy of the remaining development channels through concrete deliverables.

Trade, Climate Change, Energy, Tax Avoidance, and Corruption

The G-20 agenda has expanded since the third summit, in Pittsburgh, where there was a sense that the worst of the crisis was behind us. Climate change, energy, food, fuel subsidies, and illicit outflows were added to the G-20 agenda at this summit. The intention of the G-20 leaders was never to shift international negotiations on these contentious issues to itself but rather to arrive at a broad understanding among systemically important economies about legally binding agreements. This understanding could be reached by implementing what had already been agreed on to arrive at nonbinding agreements.

The G-20's experience in these noncrisis areas has been mixed. The G-20 has spectacularly failed to deliver on two major initiatives to accelerate legally binding agreements in the parent forums, namely the Doha round of trade talks at WTO and climate change negotiations through the UNFCCC. It has, however, enjoyed more success in accelerating implementation of, and building on, what had already been agreed, as in the case of some WTO commitments, anticorruption, and tax evasion. The outcomes in the third area, that is, nonbinding agreements such as phasing out fossil fuel subsidies, are on the whole disappointing because of ambiguities in the formulations, including the measurement of subsidies and the absence of a time line for compliance. On the whole, these initiatives may have distracted the G-20 sherpas from devoting more time to crisis management. At any rate some high-profile failures have raised doubts about the effectiveness and credibility of the G-20

21. *Korea Herald*, July 7, 2011.

forum despite its very substantial achievements in handling the global financial crisis.

The G-20 moved quickly to agree on trade standstills, committing G-20 countries to not roll back existing levels of openness. That international trade has remained largely open, and that protectionist measures have been relatively minor despite a deep recession and a protracted period of tepid global growth, are testimony to the G-20's cooperation in crisis management.[22] This success, however, has been marred by its notable failure to push the Doha round to an early conclusion in the WTO or to prevent the slide toward bilateral, regional, and plurilateral trade agreements.

The spectacle of G-20 leaders resolving to push the Doha round to an early conclusion, summit after summit, and then having trade ministers repeatedly fail to do so at Geneva, severely dented the credibility of the G-20. It could perhaps be argued that the G-20 was too sanguine about the prospects of further liberalizing trade, about which there were already deep divisions between developed and developing countries within the WTO during a severe economic downturn when the natural instinct was to raise rather than lower trade barriers. Leaders could instead have taken credit for preventing the world from retreating behind protective barriers, as it did during the 1930s, arguably tipping a steep recession in economic activity into the Great Depression. The results were there for all to see, for after having initially fallen more steeply than during the Great Depression, global trade bounced back smartly.[23] In retrospect, however, since the G-20 devoted so much of its energy to retrieving the Doha round, the overall perception is that it failed to revive the flagging multilateralism and the movement toward plurilateralism in international trade agreements. Going forward, the big issue at the Brisbane summit could be whether the G-20 will persist with its efforts on Doha or nudge G-20 countries

22. While a large number of minor trade restrictive measures have accumulated over time, in the aggregate, they affect only about 3.5 percent of world imports and 4.4 percent of G-20 imports. WTO's measurement of protectionism, however, does not include new forms of protectionism, such as a fiscal stimulus that differentiates between domestic and foreign or nonresident investors, local production requirements, visas and residence permits, financial support to domestic companies, and central bank measures to enhance the functioning of credit markets and the financial system that influence international capital movements in complex ways. As a result, while global exports/GDP ratios have not declined, they have nevertheless stagnated. OECD/WTO/UNCTAD (2012); Evenett (2013a, 2013b); "The Gated Globe" (2013).

23. According to IMF (2013), except for a slight dip during the deep recession in 2009 and early 2010, the ratio of global exports to global GDP (measured at market exchange rates), which had risen sharply during the preceding boom, did not decline.

toward plurilateral agreements, such as the transatlantic and transpacific agreements, being negotiated near Geneva.

The G-20 experience with issues relating to climate change is eerily similar. Climate negotiations have long been stuck in the UNFCCC on the issue of equitable distribution of costs between, on the one hand, developed countries responsible for the existing stock of emissions and, on the other, developing countries whose share in current flows is rising rapidly. Several attempts have been made in various G-20 work streams, including working groups in both the finance and sherpa channels, to arrive at an understanding on reworking the Kyoto Protocol, especially issues relating to the financing of adapting to and mitigating climate change. However, the differences between the positions of the developing economies and those of the advanced economies have proved intractable. Despite several hours of animated deliberations across several summits, the G-20 has very little to show in terms of any breakthrough on climate change negotiations, with developing countries mostly unwilling to engage on the issue because they are wary of undermining the position of their climate change negotiators in the UNFCCC. Developing countries insist on qualifying any statement on climate change issues by reiterating the primacy of UNFCCC principles, in particular the common but differentiated responsibilities of developed and developing countries. Mexico's attempt to tie its priorities for the Los Cabos G-20 summit to a green growth approach generated misgivings among other G-20 developing countries, as this is a contentious issue in UNFCCC climate change negotiations.

The G-20 has enjoyed greater success in persuading member countries to commit to ratifying and implementing international agreements that have already been agreed upon in parent forums, such as those on corruption and tax evasion. The anticorruption initiative, for example, draws on some elements in the Pittsburgh communiqué. The basic idea is to implement and build on such mechanisms as the Financial Action Task Force, the United Nations Convention against Corruption, the Extractive Industries Transparency Initiative, and the OECD Anti-Bribery Convention.

With the relaxation of controls on foreign investment, foreign exchange, and capital flows globally, there has been a surge in cross-border transactions bringing into focus issues of tax evasion and illicit flows that pose serious challenges to the global economy, security, and fiscal management. The G-20 has been a key driving political force to counter tax havens and noncooperative jurisdictions to prevent migration of systemically important financial activities. The threat of naming and shaming, the continuous peer reviews, ratings, and countermeasures, including tax penalties on parties in transactions with tax havens, all appear to be working. The restructuring of OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes to include most financial jurisdictions within its ambit has also helped. It has consequently been effective in pushing countries to enter into bilateral agreements on tax information exchange and, subsequently, to sign the multilateral agreement on automatic exchange.[24] The Financial Stability Board is separately assessing compliance of countries with international standards on cooperation and information exchange among supervisors. However it is still to be seen to what extent this is leading to more effective exchange of information between tax authorities and supervisors.

Conclusions: The G-20 from an EME Perspective

The G-20 is not a simple coalition between the G-8 and the EMEs. Indeed, as the above examples demonstrate, coalitions among G-20 members vary depending on the issues at hand.

While there is no clear evidence that the G-20 reflects non-G-20 members' views better than other international organizations, it is undeniable that the group is a better representation of the reality of the growing economic power of EMEs. Because the latter are equal partners in the forum, they are much more willing to engage with AMEs in a nonconfrontational manner unlike in other multilateral forums where their representation is limited and they have little sense of ownership. The G-20 also appears to be more effective than other larger and more representative multilateral institutions, such as the United Nations, in reaching consensus among its members. Also, since it includes all of the large and systemically important economies, a consensus within the G-20 has the potential to impact global outcomes. This was clearly in evidence in the group's initial stages, when a coordinated policy response by G-20 countries may have averted a second Great Depression. The G-20, therefore, has the potential to become an effective institution for policy coordination to manage the spillovers associated with globalization—or as a global solution to a global problem. However, it needs to expand its outreach to reflect the views of non-G-20 countries as well as to improve its legitimacy.

Overall, there are five important takeaways from the experience of G-20 summits in the past five years:

24. OECD (2013).

First, the G-20 was more effective in the early stages when the global economy was in a deep crisis but less so in coordinating policies during the recovery to get growth back on a sustainable track through structural reforms. There has also been more coordination on fiscal and structural policies than on monetary policies, even though EMEs in particular are the most affected by spillovers.

Second, the finance channel has delivered more concrete outcomes than the sherpa channel, perhaps because the former is involved in readily actionable issues, while the latter is focused on political issues on which consensus cannot easily be reached. Debates in the sherpa channel tend to reflect an impasse in the parent forum, as in the case of climate change finance, the Doha round, and development. The agenda of the finance channel has also not expanded greatly. Most agenda inflation has been through the sherpa channel, but this is largely in response to host countries' preferences. Often, host countries display their leadership by introducing issues on which agreement is hard to secure. A mechanism is needed to prevent such wanton agenda expansion. Nevertheless, the sherpa channel has been effective in accelerating implementation of what has already been agreed to in the parent forum, such as confronting corruption and tax evasion and meeting WTO commitments.

Third, the combination of an expanding agenda and nondelivery risks a credibility problem for the G-20, with most issues being carried forward from summit to summit, along with new additions. These are often couched in ambiguous and excessively long summit documents, which conceal sharp differences among members.

Fourth, while the G-20 has a conscious policy of "outreach" to non-G-20 countries, it needs to reach out more effectively to non-G-20 members to ensure that their voices are heard in global discussions.

Fifth, and finally, the G-20 is more effective when a consensus is reached on what needs to be done collectively but less effective when country-specific commitments are requested and individual countries held accountable. While there is no doubt regarding the need for strengthening the peer pressure mechanism through better monitoring mechanisms to make the G-20 more effective and credible as the premier international steering group on global issues, this mechanism also raises issues of trust and sovereignty that are still unresolved in even more integrated bodies such as the European Union. The G-20 in its new incarnation is a very young organization, and unrealistic expectations should not be placed on it. While its track record may not be stellar, it has nevertheless delivered much more than other multilateral organizations. Its leaders will no doubt improve its effectiveness in reaching consensus.

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