Global Counsel

What Cannes couldn't, and why

14 November 2011

Summary

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- The decoded Summit Communiqué suggests that any early ambitions that the G20 might become a platform for global rule-making – as opposed to a global political forum - look far-fetched.

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The G20 Summit in Cannes last weekend was inevitably dominated by the crisis in the Eurozone but, as the summation of a year's work for the French G20 Presidency, it also told us a lot about the state of global economic diplomacy at the end of 2011. The sweeping French agenda for their Presidency was slimmed down not just by events, but by the hugely difficult reality of consensus building in a group as eclectic as the G20.

In this Global Counsel Insight note, we pick out and decode six important parts of the final communiqué that didn't make most front pages but which shed interesting light on the strategic thinking of the emerging economies and should condition our expectations for the G20 for the future.

Reading between the lines

"We agreed on coherent conclusions to guide us in the management of capital flows drawing on country experiences, in order to reap the benefits from financial globalization, while preventing and managing risks that could undermine financial stability and sustainable growth at the national and global levels."

The French had hoped that their Presidency would produce an enforceable code of conduct for the use of capital controls such as taxes on inward equities investment or minimum holding requirements. The IMF, which has gradually been qualifying its fairly theological opposition to capital account interventions such as this since 2009, obligingly drew up a framework in April 2011. However, the IMF's proposed categorization of capital controls as a "last resort" was interpreted by a number of emerging economies as not only contradicting their own experience, but limiting the freedom they actually already have under the IMF Articles of Agreement. Brazil for one has implemented taxes on foreign purchases of Brazilian equities since 2009 to try and slow the sharp appreciation of the *real* off the back of speculative flows driven by cheap money seeking higher yields outside of the developed world. Brazil, China and others pushed back hard, and the final Cannes communiqué did not use the IMF's work as a benchmark.

Cannes signalled bluntly what has been increasingly apparent over the last two years: key emerging markets will resist any attempts to limit their freedom of movement on capital account intervention and they want the stigma attached to such interventions ditched. The IMF, increasingly dependent on contributions from these economies, is unlikely to stage much of an intellectual defence of the 90s consensus, especially if the empirical evidence of successful interventions grows. The evolution of positions in industrialised countries competing with emerging markets for their own capital and credit over the next decade will make this a debate to watch.

"The SDR composition assessment should be based on existing criteria, and we ask the IMF to further clarify them. A broader SDR basket will be an important determinant of its attractiveness, and in turn influence its role as a global reserve asset. This will serve as a reference for appropriate reforms."

France's big pitch to China for the G20 Presidency was a roadmap for the inclusion of the yuan in the basket used to value IMF Special Drawing Rights, as part of the renminbi's path to reserve currency status. Sarkozy had hoped that a major announcement on the future of the yuan in the SDR basket might be agreed for Cannes. However, current IMF rules require that the SDR be tied only to currencies that are "freely usable" and which make up a substantial share of global trade settlements. This means inclusion even at the next review in 2015 would be unlikely unless the criteria themselves were changed. The US would never countenance relaxing pressure on China for yuan appreciation and market exchange rates.

No less importantly, France's intended compliment probably misjudged China's own short term enthusiasm for SDR inclusion. While there is no question that Beijing would like the kudos of SDR weighting, it remains highly suspicious – rightly- that any roadmap to such status would simply become a lever for the US and others to pressure it on floating its currency. In the short term, China remains much more interested in the highly symbolic granting of Market Economy Status for WTO anti-dumping investigations by the EU. There is also strong resistance among other emerging economies, not least India, for bending the rules as a gesture to China. In Cannes, the SDR criteria stayed as they were, the roadmap stayed unpublished, and the French were probably left wondering why they bothered.

"We support the IMF in putting forward the new Precautionary and Liquidity Line (PLL). This would enable the provision, on a case by case basis, of increased and more flexible short-term liquidity to countries with strong policies and fundamentals facing exogenous, including systemic, shocks…We stand ready to ensure additional resources could be mobilised in a timely manner."

The French were hoping for a large number to put on the expansion of IMF resources, much like the $1trillion stimulus figure that was conjured up for the London Summit in 2009. EU leaders explicitly referenced the IMF in their October 26 Declaration and the French pitched hard for a deal that would expand both IMF resources and the use of SDR allocations to fund the European Financial Stability Facility. The latter fell victim to German Bundesbank resistance, and the former to a failure to agree the detail, not least because of US unease about the political implications for the IMF of large scale new contributions from the emerging economies.

Under pressure from emerging economy clients, IMF officials were very quick to make it clear that if it were approved by the IMF board, the new Precautionary and Liquidity Line would offer liquidity support for fundamentally strong sovereigns, a characterisation that ruled out Italy and Spain. With no detail on how to expand IMF resources, and no real appetite among non-Eurozone sovereigns for underwriting the EFSF either bilaterally or through the IMF, there is little for peripheral Europe in this communiqué, and probably little to come.

"We agree that, over time, new sources of funding need to be found to address development needs. We discussed a set of options for innovative financing highlighted by Mr Bill Gates … we acknowledge the initiatives in some of our countries to tax the financial sector for various purposes, including a financial transaction tax, inter alia to support development."

Development campaigners read a lot into Bill Gates' high profile endorsement of a Financial Transaction Tax ahead of Cannes, but the reality is that the French and the Germans have failed to generate any significant traction for a tax at the G20 level. Sarkozy made innovative financing mechanisms to fund development goals a key theme of the French G20 Presidency, and momentum for a revived version of a Tobin tax was key to this. In Cannes, only Ethiopia, South Africa, Brazil and Argentina offered public support and the idea looks dead in the water. The UK's official position is that it supports the concept if implemented at a global level, but it has made no secret of its opposition. France had to fight hard just to get a reference into the communiqué.

"We stand by the Doha Development Agenda (DDA) mandate. However, it is clear that we will not complete the DDA if we continue to conduct negotiations as we have in the past. We recognize the progress achieved so far. To contribute to confidence, we need to pursue in 2012 fresh, credible approaches to furthering negotiations…"

One of the most interesting pieces of phrasing in the Cannes communique concerned the Doha Round of world trade talks, which had US pressure to abandon the Doha Round written all over it. "Fresh credible approaches" is US code for giving up on the multi-package grand deal that covers multiple areas of the trade agenda, from trade rules through tariff reductions for goods and new market access for services firms. Because of the complex nature of the trade-offs involved, giving up on a package deal has typically been regarded as the same as declaring the Doha mandate launched in 2001 untenable. The Doha Round, in the form that most people would understand it, is no almost certainly dead.

Fresh and credible approaches are likely to mean a couple of early harvest agreements from the existing negotiation: a development package of measures for Least Developed Countries and an updating of the WTO's rulebook and trade dispute processes. They will also mean the emergence, in time, of small groups of countries pushing ahead in specific sectors for others to follow if they choose – either in or out of the WTO machinery itself.

The WTO Ministerial in December will no doubt put a brave face on matters, but in Geneva there is real concern that, of the two traditional engines of negotiated trade liberalisation – the EU and the US - the US has effectively given up on the WTO as a negotiating forum in favour of a focussed regional approach, especially in Asia. The US' Trans-Pacific Partnership is designed to draw China's neighbours into liberalisation that China will feel compelled to join. Whether this is credible itself is another story.

"The G20 is unique in bringing together the major economies, advanced and emerging alike, to coordinate their policies and generate the political agreement necessary to tackle the challenges of global economic interdependence. It is a Leader-led and informal group and it should remain so."

Tucked away at the end of the communiqué is a statement on the future of the G20 that represents the burial of aspirations on the part of some G20 Members, including France, to see the G20 transformed into a permanent part of the institutional architecture of global governance. This would have meant resources of its own and a secretariat, which Paris generously offered to host. British Prime Minister David Cameron, reflecting general British scepticism of anything that sounds like an international bureaucracy with a life of its own, used the UK's contribution to the Cannes Summit on Global Governance to see off the prospect of the G20 morphing into something closer to the OECD. The G20 will remain informal, political, resourced by national capitals and "leader-led" will unfortunately enter the lexicon of global economic diplomacy.

Leader-led but going where, exactly?

One candid Indian correspondent described the Indian delegation returning to Delhi from Cannes with the relieved air of an irritating international obligation dispensed with. In general, the decoded Summit Communiqué suggests that any early ambitions that the G20 might become a platform for global rule-making – as opposed to a global political forum - look far-fetched. Under the rhetoric, on the questions of their freedom to control capital flows and currency policy, strengthening the rules-based trading system and buying in to a Western-dominated IMF there is little on which the emerging economies are willing to limit their freedom of manoeuvre. The first signals are already that the Mexican agenda for their Presidency in 2012 will be modest. That, at least for now, is likely to be what leader-led means.

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