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Subir Gokarn: From Pittsburgh to Antalya

The G-20 may have to revert to its crisis management role, but in more complex conditions

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The G-20 finance ministers and Central Bank governors meeting took place last Friday and Saturday in Ankara, Turkey. The group's summit meeting will be held in Antalya in mid-November, seven years after the 2008 summit in Pittsburgh. That event was particularly significant because it created a powerful blueprint for collective action to deal with a potentially catastrophic financial crisis. In the seven years since Pittsburgh, many critics have painted the G-20 as a group desperately seeking an agenda. However, a fair assessment of its activities would have to acknowledge two sets of accomplishments on the economic and finance tracks.

First, there is little question that the strong message of collective and co-ordinated action emerging from Pittsburgh and the subsequent measures taken by several countries prevented a global meltdown. It is a moot point whether the collective response may have been excessive and even harmful to global growth and stability. In that situation it was always better to be safe than sorry.

Second, the group has set in motion a series of structural changes aimed at increasing the overall stability of the global financial system. The process has been difficult and contentious, but at its core is the recognition that an inter-connected financial system requires a degree of regulatory co-ordination and harmonisation.

The current global scenario may well compel the group to revert to its crisis management role of 2008. This time around, the epicentre of the turmoil appears to be China, the second largest economy in the world. Recent developments in its asset and currency markets have unquestionably rattled global investors and even markets like India, which are currently facing favourable macroeconomic conditions, have not been immune.

While the nature of the initial shock is very different from the one in 2008, no country can afford to take the chance that this one will not also transmit through the global system, causing setbacks to growth and stability. Inter-connectedness through both finance and trade channels and also links between these two channels suggest that a shock in a large economy can quickly transmit through multiple routes. The G-20 agenda between Ankara and Antalya must unquestionably focus on collective and co-ordinated action to prevent contagion through both channels.

One very strong component of the Pittsburgh strategy was the forswearing of protectionist measures by countries to buffer domestic producers. Given that the crisis situation did not persist for very long, this resolve was not really tested. In the current situation, given China's significance in global trade flows, this may well be the issue on which global co-operation stands of falls. If one outcome of the situation is an aggressive export push by China, vulnerable economies, including India, which is a large destination for Chinese products, must have the flexibility to use instruments already legimitised by the World Trade Organisation to protect their interests.

But, it is important to remember that these instruments were designed for a scenario in which one or a small number of countries was facing threats from import competition. It is not clear that the world as a whole will benefit if several large economies use these instruments simultaneously. This clearly poses a dilemma for the group as a whole; how does it stop individual countries doing what might be in their individual interest but not necessarily in the collective one?

The Ankara meeting did suggest partial solutions to the dilemma. Specifically, there was an explicit call to refrain from competitive devaluation of currencies, which could precipitate currency wars and, inevitably, protectionist measures by individual countries. The fact that the Chinese yuan has stabilised after its three per cent depreciation suggests that, at least for the moment, it will not trigger another round of currency instability. Of course, this does not preclude the possibility that other export-promoting measures will not be initiated, in which case, the consensus against protection will be tested.

Unlike in 2008, when the collapse of financial institutions precipitated the crisis, there is a clear trade nexus with the 2015 situation. India's merchandise export performance has been telling us for several months that all is not well globally. The US may be recovering at a reassuring pace, but large parts of the global economy are stagnant or in recession. Softening of energy and commodity prices, which was earlier seen as an outcome of withdrawal of excess liquidity, particularly by the US Federal Reserve, is now being taken as an uncomfortable indicator of sluggish or declining global demand. These are conditions ripe for individual acts of self-preservation and a breakdown in the global consensus.

Against this backdrop, the challenge for the Antalya summit is in some ways more complex than it was for the Pittsburgh gathering. The relatively uneven pattern of recovery after the 2008 crisis has left the global economy clearly performing far worse than it was seven years ago. Capital flows have become much more skittish and volatile during this period, with short-term horizons dominating allocations. Between now and the summit in November the G-20 will have to focus on finding ways to preserve the solidarity of the consensus.

At this point, the collective position against competitive devaluation might have the best that the group could do. But, it may not be enough in the context of the overall global economic situation. It needs to now consider the scope for countries to protect domestic producers within the broad WTO safeguards framework. Finance Minister Jaitley's statement suggesting the need for a comprehensive global safety net points the group in the right direction. However, the mechanics and implementation of safety nets after the 2008 crisis have proved to be difficult. The International Monetary Fund's new credit lines have hardly been used, while bilateral swap arrangements are very limited in number. Plurilateral arrangements, of which the BRICS Contingent Reserve Arrangement is the latest, are yet to be tested.

So, post the Antalya Summit is it going to be "this time it's different" or "the more things change, the more they remain the same"?

The author is director of research, Brookings India and former deputy governor, Reserve Bank of India. The views are his own.