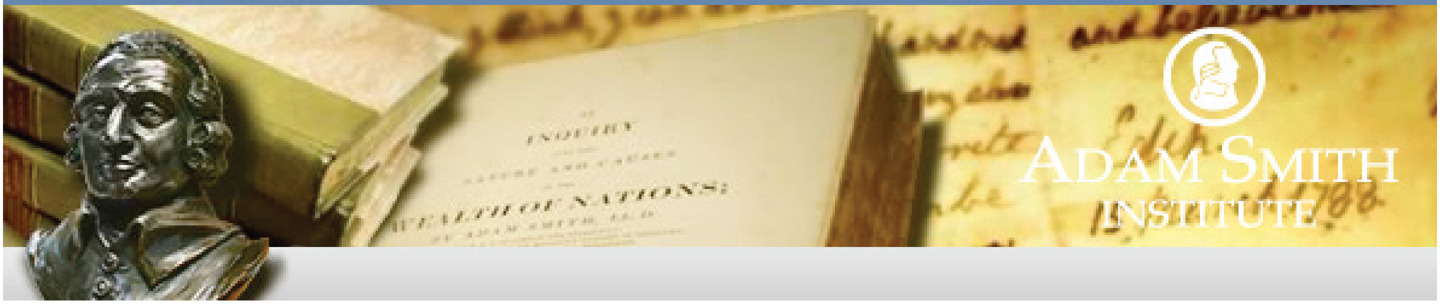

BRIEFING

G20: Less than meets the eye

by Miles Saltiel

Summary

Even for those expecting little from last week's G20 summit (for our views, see What went wrong; an agenda for the G20, ASI, 30 March 2009), the outcome is depressing. There were some worthwhile achievements, but also heroic hypocrisy, unreliable sums, weak promises, meaningless language and self-serving commitments. It can only be that the G20 leaders themselves were more fully seized of their domestic weaknesses than their international responsibilities. In this light, they knowingly involved themselves in a futile exercise in the hope that the world will make its own way out of its current disarray with or without their contribution. But before we lay into every aspect of the G20 outcome, let's recognise such good as did emerge.

Worthwhile achievements

Far from turning their backs on globalisation, the G20 signatories start out by invoking global solutions; and far from rejecting the "Washington consensus", they make much of its institutions: the International Monetary Fund (IMF), World Bank and World Trade Organisation (WTO), together with a ringing commitment to "an open world economy based on market principles" (clause 3). Of course, later on they agree to other less sensible or important matters, but let us take comfort from what they put at the top of the pile. Other encouraging material may be found in clause 12, where the signatories commit themselves to getting out of their emergency stakes in banks; and clause 21, where they commit to reforming the IMF's voting and subscription arrangements. This is a crucial recognition of China's place at the table, albeit coming rather slowly with the deadline set for January 2011. And clause 16's commitment to examine Credit Rating Agencies is much overdue. Sadly, after these meagre accomplishments the balance is bleak.

Heroic hypocrisy

Taken as a whole the communiqué is something of a poseur. Its underlying confusion is shown by the four clauses out of 31 devoted to regulation, with a view to promoting "propriety, integrity and transparency". How seriously can this be taken after a meeting at which China and Russia signed up to open markets, and Saudi Arabia to family-friendly employment policies (clause 28)? Indeed it is hard to overlook the muddle besetting the London meeting. Not just mercantilist Russia and China, but also chippy Brazil and cartel-dependent Saudi Arabia have committed themselves to free markets. Dirigiste Germany and France inserted stirring passages on regulation (clause 16) to divert attention from the home-grown nature of their own banking collapses and their chronic

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incapacity to collect taxes levied at punitive rates, leaving China – China, for heaven's sake! – to defend tax havens. And for the local crowd, the UK played Brown's signature-tune of dodgy figures, with his traditional nod to "hardworking families" (clause 3). And just on this ludicrous phrase, is it a bad thing to wonder how it might play in Riyadh?

Unreliable sums

The communiqué parades a total of $1.1tn of something or other which can be expressed in figures. However, even the most casual scrutiny reveals this to be a comparatively paltry $25bn (if that) of hard cash for subsidised loans and credit guarantees, as shown below:

Worse still, on examination the banner headline figure of $5tn of fiscal stimulus (Clause 7) advertises its inadequacy at 6.3% of Gross World Product.[1] Compare this to the findings of Reinart and Rogoff, who report high and low estimates of fiscal load over six bank crises.[2] The average of high estimates equals 18.8% of Gross Domestic Product (GDP); the average of low estimates equals 6.7% of GDP. Presumably this is why the US wanted more funds committed.

Weak promises

Clause 15 calls for domestic regulation to be beefed up, but the immediately following clauses undermine national self-determination (see below, "Self-serving commitments"). Clause 24 inveighs against protection and provides for the WTO and other bodies to report quarterly on derelictions. This is as specific as any commitment in the document, so if it is true that China — the country with the greatest interest in free trade — found it insufficient, we have little reason to take comfort from anything at all in the document. And perhaps bringing in several bodies paves the way for turf-battles. Clauses 25 to 27 make disappointingly weak commitments to the poorest countries and the aborted Doha round of trade negotiations. Clause 26 gives the game away by using the grisly phrase "with regard to existing modalities", which conveniently takes us to our next topic: meaningless language.

Meaningless language

Clauses 7, 9 and 11 pledge the G20 to "do whatever necessary"; this ignores the disagreeable prospect of incapacity. Clause 8 on central banks and clause 9 on banks note recent events, but make no new commitments. In short, the pivotal issue of bank recapitalisation has been given a classic hospital pass to the national governments who have to come up with the cash. This is understandable, but the communiqué's silence reminds us of what we already know. We are some way from a solution to the problem of toxic assets, with prices still undetermined and bank directors paralysed by the threat of class actions for selling out too cheap.

Clause 13 calls for "candid" IMF surveillance of national economic policy. This has been routine for decades and is routinely ignored. Similarly, clause 16 calls on the IMF to offer early warning of future crises;

Claim	Meaning	Reality
The IMF's funds are to be increased by $500bn.	Underwriting commitment Half promised unconditionally; balance to be ratified	No new public cash
New SDR allocation of $250bn.	Underwriting commitment	No new public cash
A fund of $10bn for the world's poorest nations.	Already largely announced. To be raised from the private sector, rather than contributed by governments.	No new public cash
Ensure availability of $250bn for trade finance.	Already largely announced. Outputs, by the way of hoped for trade flows, rather than input.	Public cash of <$25bn to subsidize loans and credit guarantees.
IMF to raise some $6bn by selling gold reserves, lending proceeds to poorest nations over next 2-3 years.	One public asset is substituted for another.	No new public cash. Leads to $2-3bn p.a. for 2-3 years.

[1] GWP taken as $78.4tn. Source: https://www.cia.gov/library/publications/the-world-factbook/geos/xx.html

[2] Banking Crises: An Equal Opportunity Menace, Carmen M. Reinhart, University of Maryland, NBER and CEPR, Kenneth S. Rogoff, Harvard University and NBER, December 17, 2008. The crises studied were Argentina, 1981; Chile, 1981; Ghana, 1982; Japan, 1992; Norway, 1987; Philippines, 1984; Spain, 1977; Sweden, 1991; and US (S&L), 1984

once again the Bank of International Settlements has done just that since its inception in 1930, to total indifference. We have already piled into clause 28 on labour policy, so let's merely note that clause 29 goes one better than clause 22 by adding "green" to "sustainable".

Self-serving commitments

With four contiguous clauses and well over a sixth of the total text, no topic attracted as much ink from the G20 as regulation. Unsurprisingly, none shows more evidence of gored oxen. The heart is clause 16, which — as mentioned above — undermines national regimes by setting out its own agenda.

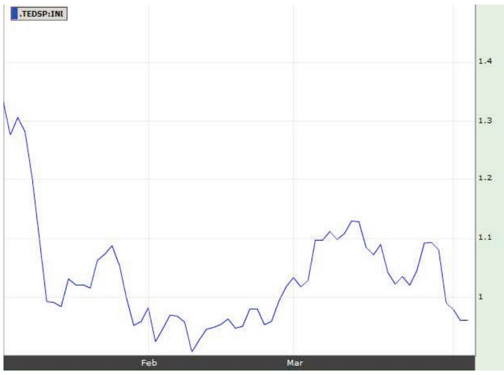
Every nation with a weak banking system (which means every nation) is served by the postponement of new capital adequacy rules until "recovery is assured", by which time they will be neither necessary nor enforceable. In reality, the market is taking care of this. British interests are served by identifying "instruments" as calling for new treatment, presumably new exchanges, with luck to be located in London.
France and Germany are able to claim a pyrrhic victory against the hedge funds which shorted their banks, but they ended up accepting text first used ten days earlier by US Treasury Secretary Geithner. This was to the effect that "systemically important" such funds qualify for regulation. As best as is known, none currently exists. France and Germany also tried to mollify their tax collectors by making a song and dance about offshore havens. This is certainly easier than bringing down nominal tax rates to levels at which they are paid voluntarily.

Meanwhile, accountants all over the world will be rolling up their sleeves at the prospect of counter-cyclical reserves for banks, new schemes for valuing securities and the unification of accounting rules — this last about as likely as the second coming. To push this all along, the G20 signatories have set up a Financial Security Board — a far tougher-sounding proposition than the "Financial Security Forum" it replaces. This tells us that all is to play for in committee.

Conclusion

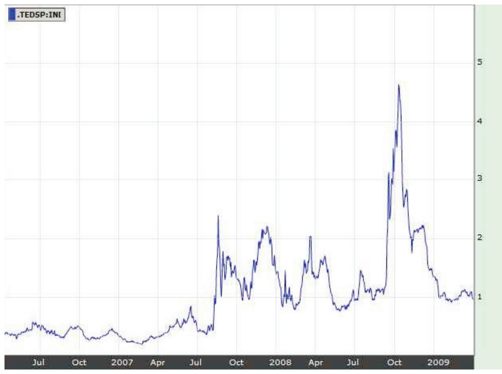
So what did the G20 leaders think they were doing? Were they trying to reassure the markets? If so they achieved little, with our preferred indicator, the spread between rates on US Treasuries and Eurodollars (the TED spread), showing that the meagre one-day improvement on Thursday was not followed through on Friday. The spread did fall by 12 basis points (one hundredths of one percent) from 1.08% to 0.96% last week, including half a basis point on the day after the conference. But this is still five percentage points above the recovery levels seen earlier in the year (0.91% on 10 Feb) and between twice and four times the normal levels of between 0.20% and 0.55% prior to the banking crisis.

TED Spread — three months



Source: *Bloomberg*

TED Spread — three years



Source: *Bloomberg*

We have the suspicion that the G20 leaders themselves are more concerned about their domestic weaknesses than their international responsibilities. This means that they turned up in London for the equivalent of a complicated photo-op. They did make useful progress in a few areas, but overall they convey a sense that there is little they can do to affect events. And they are right. The world economy will have to trade its own way out of its current confusion – as it always does.

Miles Saltiel read PPE at Oxford and wrote his MA dissertation on Japanese business and government at Sussex. In 1979, he joined GEC-Marconi, where he worked for seven years on corporate finance and recoveries. In 1986 he went into investment banking, joining the WestLB Group in 1996 to become Head of Equity Research for emerging markets. In 1998, he assumed responsibility for London-based Tech Research, and in 2000 was voted one of the UK's top 50 in the New Economy. In July 2002 he left the WestLB group, where he was the senior tech banker, to found the Fourth Phoenix company to provide research and associated services. He has written extensively for London think-tanks on the credit crisis.