# G-20 After the Crisis: An Indian Perspective

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## Introduction

I would like to thank the organizers of this event for inviting me to deliver this keynote address. While the title of the session is "What India expects from the G-20", I think it would be extremely presumptuous of me to speak on behalf of the country as a whole. I have, of course, been involved with the G-20 process as the Central Bank deputy and, in that capacity have had the opportunity to contribute to the shaping of the Indian position on various issues. So, rather than assert a national position, I would prefer to share some of the thinking that underlies the stance that is taken at various G-20 forums. With this in mind, my presentation is divided into three broad segments. First, I look at what the G-20 did to avert a potentially severe crisis a couple of years ago, which essentially provides the context to whatever role it may play in more 'normal' circumstances. Second, I explore the inherent differences within the group, which will naturally impose limits on what it can realistically hope to achieve by way of global co-ordination on structural issues. Third, I build on these two foundations to try and articulate a general "emerging market economy" position, which, I think, would be reflective of the Indian stance on a range of issues.

## The context of crisis

The G-20 had its origins in a previous crisis that also began in the financial sector and which threatened to spill over from one country to the next. This was the East Asian crisis of 1997-98, the roots of which lay in the increasing presence of foreign capital in economies that perhaps didn't quite have the capabilities to handle it. The fact that one of the factors underlying the crisis - foreign capital - linked the advanced and emerging economies provided the basis for countries from both groups coming together to look for ways to

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minimize the vulnerability of emerging economies on the one hand and global financial institutions domiciled in advanced economies on the other.

Of course, the East Asian crisis wound down, with the affected countries showing strong resilience in the years following. The need for collective solutions, such as those which might have been provided by the G-20 was felt less and less as emerging economies, both those most impacted by the crisis and those which escaped it, found their own, individual buffers against the next crisis. Since the crisis had had no significant macroeconomic impact on the advanced economies, they also had no particular interest in pursuing any collective strategy for structural change, which might have helped to stabilize the global economy and make it less vulnerable to a crisis. Of course, one important outcome of keeping the group going despite the absence of a particularly significant agenda was that the institutional representatives from the member countries got to know each other, making communication during the most recent crisis when the group really came into its own perhaps a little easier and more effective than otherwise.

In effect, then, a group that was born in the wake of one crisis really got the opportunity to demonstrate its effectiveness when another one precipitated. This crisis also had its genesis in the financial sector, which helped retain the relevance of the group's structure, with its core constituencies being finance ministries and central banks. This time round, however, the origins of the crisis lay squarely in the financial sectors of the advanced economies, a factor that has created some special challenges for the group's attempts to deal with post-crisis structural issues, a point that I shall return to later.

My essential point is that the origins and structure of the group made it an appropriate and, eventually, effective mechanism to deal with a crisis that threatened to spiral into a deep global recession. There have been many questions raised about what exactly the group did that contributed to mitigating the impact of the crisis. Some have argued that the measures that each country took to deal with the crisis would have essentially been the same even without the coming together of the G-20. That may well be the case, but I would argue that it was precisely the show of strength and collective resolve of the group that helped reinforce the confidence of global stakeholders that the crisis would indeed be averted. Individual, uncoordinated responses, to my mind, would not have had the same impact on global perceptions that the G-20 solidarity did, even if the policy measures in each country had been exactly the same.

Beginning with the Washington Summit in November 2008 and through 2009, the visible focus of the group on both the proximate aspects of the crisis and the more fundamental causes was, I believe, a major reason for the restoration of global confidence. The economic recovery has been slow and somewhat choppy, but potential disruptions have also been met with collective responses, which have, in turn, reinforced the belief that the recovery can be sustained. Further, the prominence that the group gave to structural reforms of various kinds sent the signal that it was committed not just to dealing with the immediate crisis but to putting in place measures that would significantly reduce the probability of recurrence. As we know from our own experience with structural reform, crisis always presents a window of opportunity to obtain a consensus on reform measures that would just not be possible under normal circumstances. It is for the leadership to grasp this and to push through reforms that meet the needs of changing global circumstances. The group's focus on structural issues was itself an important reason for the credibility it gained for its efforts to manage the crisis.

In short, I think that it is a reasonable assessment that the global economy would have been in somewhat different shape today if the G-20, or any collective process involving the world's largest economies, had not taken place. The group can certainly draw strength from this as it now shifts focus from dealing with the crisis to dealing with the structural issues that are perceived to have caused it. But, it is precisely at this stage in the process that the challenges to change management arise. As the crisis abates, the common threat perception and collective responsibility inevitably begins to dissipate and the consensus that was visible in the crisis management phase gives way to more individualistic priorities and agendas. How are these manifesting in the G-20?

**Dividing lines**

A number of factors have contributed to the emergence of differences within the group. This should not be surprising in and of itself, given the fact that this is an enormously disparate set of countries. The 20 countries in the group can be classified into categories based on a large number of parameters, each of which implies different policy priorities and, consequently, different approaches to deal with domestic and global conditions. Large or small, more or less affluent, net importers or exporters, commodities producers or manufacturers, aging or young populations - whichever way one looks at it, the composition of the group should not inspire much confidence that it can agree on common approaches to the structural issues that confront the global economy. Let me explore a few of these dividing lines and their implications for the group.

At this juncture, the variability of the recovery across the members of the group is a critical difference. In fact, with some economies having consolidated their domestic recoveries while others struggle to do so, there are legitimate concerns about whether the crisis has actually abated; in other words, whether the primary objective of the group has actually been achieved. Perceptions about the robustness of the global recovery have oscillated quite widely during the past several months and the outlook today is somewhat more negative than it was at the beginning of 2010. But, within this overall shift, while the outlook for several economies has deteriorated, it has remained constant or improved for others. This has immediate implications for the domestic policy priorities of each country. In a group that is ostensibly committed to doing no harm to each other, these differences may pose a challenge.

The most visible dilemma is on the issue of continued quantitative easing by advanced economies whose recoveries are showing some signs of stalling. As the capacity for further fiscal stimulus abates, more so as countries attempt to pull back from huge fiscal overhangs, more liquidity being pumped in appears to be the only avenue remaining for stimulating the economy. From the viewpoint of individual countries, there isn't much choice; not using the instrument significantly increases the risks of the recovery reversing course. Apart from the domestic impact of this, given the relative size of the economies involved, this could clearly have global implications as well. So, it may well be that individual and collective interests are aligned on this issue.

But, while there may be alignment over a somewhat longer time horizon, in the immediate future, there are signs of misalignment. More liquidity, even the prospect of it, in some advanced economies, is spilling over into fast-recovering emerging economies, introducing several complications into their domestic policy environment. Some are worried about currency appreciation and the impact that this might have on their recovery as domestic producers lose competitiveness. Others are worried about the short-term nature of the inflows and the disruption that might be caused if there is a sudden exit in response to a global shock or new developments in the source countries. There are widespread concerns among energy and commodity importers that global liquidity is flowing into commodities and driving up prices, with consequent inflationary implications. In short, the immediate impact of quantitative easing may represent a dividing line within the group, even if, over time, it may be in the collective interest.

Financial safety nets represent another potential dividing line, not necessarily on principle, but on the different approaches that groups of countries have used to develop them. Self-insurance by way of reserve accumulation may be the safest way to protect oneself from global shocks from the viewpoint of individual countries. But, beyond some threshold levels of magnitude, it begins to generate externalities. To return to a point that was made earlier in the context of the East Asian crisis of the late 1990s, the effective choice made by countries affected or threatened by that crisis to build up self insurance capacity was both a response to perceived inadequacies in the collective safety nets available at the time and a contributory factor to some of the imbalances that have been associated with the global transmission of the recent crisis.

The analytical debate on this issue will go on, but the practical implication for many countries is to decide on their acceptable mix of insurance options within the overall consideration of doing no harm to other countries. Even while collective options, such as those that have recently been introduced by the International Monetary Fund become more accommodating of individual country requirements, the benefits of self-insurance that many countries experienced first-hand during the recent crisis are difficult to deny. Meanwhile, the perceived link between the building up of individual safety nets and global imbalances makes this issue a dividing line within the group.

Another example of a dividing line is financial regulation. It is now generally accepted that a significant contributory factor to the recent crisis was the opportunity that the existing regulatory and supervision framework in some advanced economies provided for highly risky investments to be made. However, even as this was happening, there are several countries in the group whose regulatory frameworks did not provide such opportunities and whose financial systems emerged from the crisis relatively unscathed. Notably, there seems to be a significant correlation across countries between the degree of damage that domestic financial systems suffered and the speed and robustness of their recoveries.

However, there is little question that there is a strong and inexorable process of global financial integration, which, with all the risks it entails, does have large potential benefits for all countries concerned. One important requirement for realizing these benefits is a set of common regulatory principles, standards and practices across countries. These are necessary to ensure that capital flows across the world based on genuine consideration of fundamental returns and risks and not on arbitrage between different regulatory environments. Certainly in theory, this should not be the cause of any division; there is a clear common and shared interest in the outcome. In practice, however, divisions could arise on what exactly these standards and practices should be; whether they are driven by the specific conditions prevailing in the worst hit financial systems and, therefore, inappropriate and burdensome for the relatively healthy ones; and, the knowledge and human capital requirements to implement them effectively across a diverse set of countries.

I have tried to provide some examples of potential dividing lines, drawing on my experience and observations of the process in the finance track. Let me conclude this segment of the presentation by reiterating the point on which it began. This is an extremely differentiated and heterogeneous set of countries, whose conditions and priorities differ both in the short term and over the long run. It would be extremely naive to expect that such a group would be able to reach agreement on anything beyond the immediate crisis at hand, despite their ambition to tackle structural issues. From this perspective, any consensus on any issue is an achievement. It reflects the recognition that, notwithstanding differences between countries, global integration is a process that can be chaotic and disruptive if not handled in a collective and coordinated way. What is true for crisis management is also valid for the range of structural issues that the G-20, as well as those which other multilateral processes are dealing with.

**An Emerging Market Economy/Indian Perspective**

Against this backdrop, let me now attempt to articulate what I would call an "Emerging Market Economy" perspective, but which also reflects my characterization of the Indian perspective. An important premise in this perspective is the point I concluded the last segment with. The process of globalization has enormous potential benefits for EMEs in all its forms. But, it also brings with it significant risks, such as the vulnerability to shocks which emanate outside their sphere of control. The best way to optimize on the "risk-return" tradeoff from globalization is to adhere to a common set of standards and rules, which, as I said earlier, forces the process to be driven by fundamental factors rather than by regulatory arbitrage, broadly speaking. On the basis of this argument, EMEs will see a clear benefit from engaging in any process that can develop and enforce such common standards and practices. The G-20 is one such process, with the distinct advantage that, being a relatively small group, reaching consensus where it can be found is not too difficult a task.

However, EMEs have significant domestic objectives and challenges and these must take priority in their policy decisions. Many are dealing with the critical challenge of providing a large proportion of their population access to the most basic necessities, let alone education, health and financial services. An integrated and balanced development strategy makes several demands of the financial system. This, in turn requires a careful balancing between rapid expansion in capacity and the kinds of products and services offered on the one hand and safety and prudence on the other. This balancing act, at one level common to EMEs, but at another, differentiated by the vastly different conditions within the EMEs themselves may not be amenable to a reasonable set of common standards, except at a lowest common denominator level, which is then unlikely to serve the purpose of achieving a safe and secure global financial system.

The financial safety nets issue is also one on which a distinct EME perspective may emerge. The difference in concerns between advanced and emerging economies is heightened in the current environment in which increasing liquidity in some advanced economies is driving possibly short term capital flows into emerging economies. In such a situation, self-insurance needs to be given due consideration. When economic fundamentals are sound, would reserves not constitute the most effective way of dealing with reversals in short-term capital flows? If self-insurance were done away with, reliance on external insurance mechanisms might conceivably have two negative implications. One, procedure and due diligence might take time, thereby diluting the effectiveness of the safety net. Two, global investors may suspect that something is fundamentally wrong, aggravating the pressure of exit.

I have used the issues of financial regulation and safety nets to illustrate my point about the balancing act that EMEs need to perform between addressing domestic priorities and aligning with a meaningful set of global standards or mechanisms. However, this can be taken as a more general issue for EMEs as they engage in global forums on a whole range of issues on which the benefits of integration have to be viewed in conjunction with the pursuit of domestic policy objectives.

Essentially, from the emerging market perspective, the value of the G-20 process lies in how effectively it is able to accommodate this need for balance. As I have tried to argue through this presentation, both on short-term and long-term issues, the differences and divergences between countries in the group are wide and, perhaps, inevitable. This puts the group at an immediate disadvantage when it comes to addressing issues, because, given the differences, even agreeing on a common objective, let alone a common approach may be a difficult, if not impossible task.

However, it is reassuring that, in the face of these inherent handicaps, the group seems to have made significant achievements, which go beyond the immediate compulsions of crisis management and address some of the key structural issues. The underpinning for this progress, as I have alluded to earlier in the presentation, is the recognition by all parties involved that the process of globalization has potential benefits for everybody as long as it is controlled in some way. The basis of control is, as the G-20 demonstrates, common principles, on which are based common, or at least compatible standards for both conduct and enforcement. But, control does not mean homogenization. As long as common standards can be reconciled with differences in practices and institutions, which allow individual countries to effectively address their domestic priorities, the arrangement is eminently workable.

Just as each country needs to maintain a balance between acceptance and adherence to global standards, the group needs to accommodate a possibly thin and blurred line between conformity and autonomy. Its effectiveness on all the issues that it seeks to address, but particularly on the structural ones, will depend heavily on this accommodation. Every member of the group must feel that there are some tangible benefits from continuing to associate and in turn, that perception depends on the space that the is available to pursue legitimate domestic priorities, which do not impinge on the interests of the other members of the group.

By this benchmark, the group has done quite well. In the midst of significant differences, some of which I have pointed out, meaningful consensus on, for example, safety nets, financial regulation and reform of the International Monetary Fund suggest that it has found a way to accommodate the balance on a number of significant issues. The nature of this consensus has been widely reported on and debated in the wake of the recent Finance Ministers and Central Bank Governors' meeting in Gyeongju, Korea, so I do not want to go into the details here. The point I want to emphasize, though, is that the common feature of both the process of arriving at consensus and the agreements themselves was precisely the acceptance of common principles and standards, which do not come in the way of allowing each country to organize its internal systems in ways that it thinks is best.

This is not to say that there are no disagreements or unresolved issues within the group. It would be naive to expect that there wouldn't be. However, as in the case of all collective activity, the presence of disagreements, even intractable ones, does not in any way undermine the legitimacy of the process. It should be judged by what it is able to achieve, not by what it is not.

**Concluding Remarks**

At the very least, the G-20 provides a compact forum for knowledge and experience sharing between the largest economies in a structured way. The network that it creates certainly facilitates co-ordination on policy actions, should an occasion for this arise. In this respect, it is certainly a useful and effective crisis management mechanism.

But, from an emerging market perspective, its utility can and has gone beyond crisis management. These countries do recognize that the benefits of globalization will not be fully realized and the risks will be heightened in the absence of some meaningful collective activity. The effectiveness of this collective activity is, in turn, enhanced by its emphasis on common principles and standards, its recognition of national autonomy in deciding on policy priorities and strategies and, very importantly, its insistence on the principle of "do no harm". A realistic assessment of the performance of the group over the past two years would suggest that, while it may not have had equal success on all fronts, its achievements are significant and, in many ways, a vindication of its approach.

I would like to thank the organizers once again for inviting me and thank you all for listening.