3. Emerging Issues for the G20

As the crisis has continued to unfold in the months since the G20 Summit in November 2008, certain macro-economic and financial issues not addressed by that meeting now appear at the top of the agenda with respect to both national and broader G20 efforts. This section looks at the ongoing global imbalances, exchange rate mechanisms and the role of emerging economies in the new financial architecture, as well as the risks of increasing trade and financial protectionism as global demand is collapsing.

Executive Summary

Paola Subacchi

As a result of economic and financial hardship, the limits of financial globalization and the tension between domestic agendas and global issues have emerged. Like trade, the exchange rate is both cause and effect of such tension. Much political activity has been directly or indirectly shifted towards the exchange rate in ways that imply new economic and political divisions. Fixing the exchange rate in a world of mobile capital implies forgoing national monetary policy autonomy in favour of greater certainty about the value of the currency. And this raises problems of international policy cooperation.

This section specifically deals with trade and the exchange rate, two issues that are not on the G20 agenda, but that constantly creep out. The section puts together heterogeneous contributions that nevertheless have a common thread in that they look at the 'big picture', rather than focusing on some elements of it. The debate on the crisis has so far been too fragmented, failing to see all the interdependencies in the macro picture and in policy. These contributions also recognize that much of the current crisis was caused by the build-up of global trade and financial imbalances. All, therefore, call for urgent and coordinated corrections to macro-economic policy. An injection of funds to revive trade credits is deemed to be particularly critical.

Protectionism features prominently throughout the section. All authors note troubling trends in this direction over the last year, although none regard them yet as a major contributory factor to collapsing global trade. All, however, see very considerable scope for protectionism to contribute to a second round of falls in trade volumes which feed back to global demand and to the financial sector, making recovery highly unlikely even in the medium term. Uri Dadush, in particular, draws attention to the fact that almost all members of the G20 – notably the largest members including the US, China, the EU, India and Russia – have disregarded the pledge to keep open markets made at the G20 summit in November 2008.

Fredik Erixon and Jim Rollo both stress the potential for WTO-legal protectionism to damage world trade. Whether it be through raising applied tariffs to the bound level (major emerging economies – though not China – could potentially raise tariffs between two- and fivefold in this area) or, as Rollo notes, through antidumping and countervailing duties, the use of various safeguard clauses or measures aimed at protection of the environment increases the risk of protectionism. Agreement to a standstill on the use of such *WTO-legal* measures would constitute an important strengthening of the commitment to a standstill on *WTO-inconsistent* measures at the November 2008 summit. All authors see the need for a strong WTO surveillance function to hold G20 members to their commitments.

Tackling protectionism seems almost a natural fit for the G20, so it is no surprise that most contributors see it as possibly the most significant outcome that could emerge from the London Summit. But the fit is less obvious with regard to negative spillovers resulting from exchange rate misalignments. Stephen Jen is adamant that exchange rates are not one of the issues that the G20 needs to address as a significant structural realignment in the world's external imbalances unfolds. But if we take the view that the G20 should address structural issues as well as short-term ones, then it should set the appropriate framework for some multilateral discussion on the international monetary system. Both Paola Subacchi and Jim O'Neill agree on the need for a smaller caucus to discuss exchange rate misalignments and global imbalances. This group should include, as minimum, the US, a Eurozone representative, Japan and China (Jim O'Neill), or be expanded to include the two countries with the largest foreign exchange reserve accumulation after China and Japan (Paola Subacchi).

Trade and the Crisis: Immediate Challenges and Long-term Threats

Jim Rollo[1]

World trade threatens to implode in the short term as the crisis unfolds. Trade credit has dried up alongside other credit circuits. Even more importantly, the credit crunch has turned into a sharp contraction in real demand worldwide, carrying trade with it. G20 governments must act at the London Summit to coordinate a global impetus to demand and to kick-start trade credit. They must also prevent increased protectionism making a very bad situation catastrophic by freezing new protectionist measures (including WTO-legal measures) and opening themselves to WTO-led surveillance of their trade policies while the crisis lasts. In the longer term the depth of the crisis threatens the model of export-led growth that has brought billions out poverty since 1950. This contribution explores what needs to be done to minimize the long-term costs of getting out of the hole the world economy has fallen into.

The fall in world trade

Following the G20 Summit in Washington in November 2008 the economic situation has been getting worse by the day. The decline in world trade that emerged in the third quarter of 2008 has accelerated. The picture is messy but the following facts give a snapshot of the situation:

- On 9 December 2008 the World Bank forecast a 2.1% fall in world trade in 2009, after an overall 6.2% rise in 2008.[2]
- Also in December, the IMF updated its World Economic Outlook forecasts and suggested that world trade and production shrank by 42% and 15% annualized respectively in the three months to November 2008. By contrast, Kindleberger (1986)[3] estimated that between 1929 and 1930 the fall in world trade was 19%.
- Data for the month of December suggested an accelerating decline, with monthly drops in exports reported by China (-2.8%) the US (-6%) and the UK (-3.7%) by value.
- Korean exports suffered a 12% fall 4th quarter on 4th quarter.
- Japan reported a 44% fall in exports year on year in January 2009 following a fall of 35% in December 2008.
- China reported a 17.5% fall in exports by value year on year, and a 42% fall in imports in January (export prices reportedly increased by 2.3% while import prices fell by 10.6%). February data were even worse than expected, with exports falling a further 25.7%.[4]
- In January 2009 Pascal Lamy reported to the WTO membership that even though year on year 2008 trade was up on 2007, there had been a worldwide decline in trade in November.[5]
- Brazil had hoped to be spared the worst, given the lower export share of its output than for many emerging economies.[6] But by February monthly exports had fallen by a quarter to \$9.6bn against \$12.8bn a year before, though clearly much of this

1. This contribution draws on a forthcoming Chatham House Briefing Paper on the same topic, written jointly with my colleague at the University of Sussex, Peter Holmes. I am grateful for the many insights he has given me but Peter has no responsibility for this version; all errors and judgments are my own.
2. http://web.worldbank.org/external/default/main?contentMDK=20665751&menuPK=3023135&theSitePK=612501&pagePK=2904583&piPK=2904598.
3. Kindleberger, Charles P. (1986), *The World in Depression 1929-39* (Berkeley: University of California Press, 2nd edn), Ch. 8, Figure 10.
4. *Shanghai Daily*, 11 March 2009.
5. Report to the TPRB [Trade Policy Review Board] from the Director-General on the Financial and Economic Crisis and Trade-Related Developments , 23 January 2009, http://www.tradeobservatory.org/library.cfm?categoryID=428.
6. Bloomberg, 2 March 2009, http://www.bloomberg.com/apps/news?pid=20601086&sid=aVcyiuBI_xGQ&refer=news.

was due to prices. Brazilian industrial production has been dramatically affected, falling by around 12% in December.[7] Some analysts attributed this to a fall in domestic investment.[8]

- Meanwhile 4th-quarter German GDP contracted at an annual rate of over 9% and Japanese GDP by more than 11%, reflecting the impact of lower exports on output.
- In mid-March the World Bank released a briefing that predicted that 2009 would see the biggest drop in world trade in 80 years.[9]

These falls are driven primarily by the drop in demand in the OECD countries in particular, and by the drying up of trade credit as financial markets seized up. Protectionism, while on the rise, is not yet the driving force of this decline; but the threat of subsidy wars is real, with support for the auto industry in the lead.[10] So the immediate challenge is to stop and then reverse the decline in demand.

The fall in trade is important in two respects: first, trade is a bellwether of the wider economy and hence of the crisis. Second, trade fluctuations first follow and then amplify fluctuations in output and demand – the more so if countries respond to the crisis with beggar-thy-neighbour trade and exchange rate policies. This trade policy-driven amplification of the fall in output is what Kindleberger[11] identified as a key feature of the Great Depression and is the fear shared by many economists.[12]

It is important for the G20 to acknowledge that there are many WTO-legal means of increasing protectionism and to forswear those as well. Raising applied tariffs closer to bound levels, increased use of antidumping or countervailing duties or safeguard measures, or appeal to environmental protection to justify trade barriers would all contribute to deepening the global downturn. These commitments to standstill must be backed by WTO-led surveillance.

Failure to complete the Doha Development Agenda is a dangerous signal of policy coordination failure

The second important news since the G20 November summit is the abject failure of trade ministers to get the Doha process back on track, despite direct instructions from the G20 leaders in Washington to meet in Geneva in December 2008 in order to do so.

Success at that point would not have changed much directly or soon. Any quick impact on trade requires coordinated macro-economic policy responses to increase global demand. But the symbolism of an agreement in the WTO – which is, after all, the pre-eminent organization of global economic governance – cannot be underestimated. Moreover, the symbolism of continued failure is little short of catastrophic. If the nations of the world, in the face of the greatest peacetime economic crisis since 1929, cannot complete a negotiation already more than seven years in the making and by most assessments unambitious, what chance is there to negotiate policy coordination – let alone the radical changes to global economic governance and regulation required to repair the damage already initiated by the crisis and help guard against future crises?

What should happen in London?

The trade agenda remains the same now as at the G20 summit in November 2008 but it is even more urgent for the G20 to act at the London summit:

- on falling trade volumes;
- by finding funds for trade credit;
- by agreeing a concerted, coordinated and larger monetary and fiscal stimulus than hitherto.

7. 'Output sank 12.4 percent month-on-month in December', http://uk.reuters.com/article/marketsNewsUS/idUKN0349650920090203?pageNumber=1; see also http://www.ibge.gov.br/home/presidencia/noticias/noticia_visualiza.php?id_noticia=1310&id_pagina=1.
8. *Financial Times*, 11 March 2009.
9. *The Guardian*, 10 March 2009.
10. See contributions by Erixon and Stern in this report for details.
11. Kindleberger (1986).
12. www.voxeu.org/reports/protectionism.pdf.

To prevent protectionism accelerating the downturn, the G20 should:

- make a public and high-profile recommitment to a freeze on new protectionist trade policy measures, including explicitly on WTO-legal measures (November rhetoric on trade was unclear on this issue) and on subsidies;
- Task the WTO, with help from the IMF and World Bank, to monitor G20 trade policies;
- Send trade ministers back to Geneva to finish the Doha Development Agenda – if necessary take their passports away and lock them in a room until they agree.

The credit crunch: a threat to export-led growth as a development strategy

There is a tendency for the policy implications of trade to be treated at the national and micro-economic level. But there is a two-way interaction between trade and the macro-economy at both national and global levels.

Export-led growth has propelled billions out of post-conflict devastation and poverty by generating historically unprecedented rates of growth. It has also, however, contributed to major instabilities in the global economy, mainly via persistent undervalued exchange rates and consequent global imbalances. Historically, the persistent German trade surplus in the 1960s contributed to the failure of the Bretton Woods system of exchange rate management; the persistent Japanese surplus in the 1980s almost led to an outright trade war with the US and culminated in the episode of policy coordination around the Plaza and Louvre accords; and now the huge accumulation of foreign exchange reserves in East Asia since the late 1990s has contributed to the current crisis. Net importers are and were to blame too as domestic policies were too loose in all of these episodes, but creditors cannot walk away from their responsibilities either.

A worst-case scenario

This is the deepest crisis so far and global imbalances are at the heart of the problem, both as symptom and as cause. Sustained protectionism and competitive devaluations to boost domestic production in net deficit countries remains a real threat. If that were to happen there would be no consumer(s) of last resort function to sustain export-led growth at the rates we have seen since 1950. This scenario threatens a structural slowdown in world trade and output growth. Such a scenario would leave a huge number of new entrants to the global labour market at risk of dire poverty, as the world population surges towards 10 billion over the next generation. The resulting political instability this could stimulate is a frightening prospect, not least when combined with the stresses that could be induced by global warming.

A new global settlement

The degree of policy coordination required to prevent a collapse in world growth rates points to the potential need for new global system. Such a system needs agreed rules or a hegemon. This will not be easy. The Bretton Woods system had both and took twelve years from the bottom of the depression and a world war to design and agree. Any new system will require at least as much commitment in a world of much greater political complexity. Such a system must provide guarantees of open markets, stable macro-economic policy and disciplines to curb the emergence of unsustainable imbalances that impact on importers and exporters. To be effective and legitimate, any new system cannot just be an escape mechanism for the US or any other big economic power to force the costs of its domestic adjustment on to others. It will need to be managed by a new G5/G7 (US, Eurozone, China, Japan, India to reflect economic weight and population, plus Brazil and South Africa or Nigeria because of their regional importance). No major economy can be exempt from monetary and fiscal disciplines if the global system is to resume anything like business as usual.

Conclusions

It is imperative to ensure recognition that shrinkage in global trade is a macro-economic problem that needs macro-economic solutions, and that the allocation of action among actors as well as instruments must be coordinated.

For the longer term the world needs a set of rules on global coordination of macroeconomic policy that smooth the adjustment of the global economy to the emergence of new trading powers and spread the burden of adjustment among creditors and debtors. The lesson of the 1930s is that all nations will become more inward-looking economically and will resort to beggar-thy-neighbour economic policies without such rules.

Failure to move on such rules now will be measured not just in terms of the immediate recession or depression but also in terms of the lost ability of future billions to emerge on the world market and grow their way out of abject poverty. Policy failure now will pull up the ladder on the poorest for decades and possibly generations.

Mounting Protectionist Dangers and G20 Responses

Fredrik Erixon

The global economic crisis has spawned fears of rising protectionism, particularly about a repeat of the tit-for-tat protectionism of the 1930s. Spiralling protectionism then helped to turn a financial crisis into a decade-long depression, and governments had to spend a few decades negotiating in the GATT and other international organizations to undo the protectionist measures.

Yet these fears have not yet materialized. According to the World Trade Organization and its recent survey of protectionist measures in the face of the economic crisis, there is not much evidence of a sharp rush to adopt them.[1] Only a handful of countries increased tariffs during 2008 (Argentina, Brazil, Ecuador, India, Indonesia, Russia and Turkey),[2] and only a limited number of goods were subject to increased tariff protection.[3] None of these measures pose systemic threats to the world economy or to the integrity of the world trading system.

Nor is there reason to believe a malign scenario of spiralling tariff protectionism to be an imminent threat. Certainly, some other countries will increase tariffs to ease conditions for companies suffering from contracting demand. But such tariff hikes are not likely to trigger retaliatory actions, or to cover goods that are significantly traded. There are two restraining factors.

First, countries have bound their tariffs in WTO agreements and understand they will be taken to dispute settlement if they raise tariffs above these limits. A number of emerging countries with significant 'tariff water' – the difference between the bound levels and the applied levels – can raise tariffs without violating WTO commitments. Some emerging markets have already made use of the room for WTO-compliant tariff hikes; others are likely to do so as the effects of the crisis on output and employment grow worse. Table 1 indicates in what countries that may happen.

Table 1: Tariff water in emerging markets

	Tariffs on manufactured imports		
	Average bound tariff (%)	Average applied tariff (%)	Tariff water ratio
China	9.14	8.96	1.02
India	34.94	16.44	2.13
Mexico	34.91	13.33	2.62
Brazil	30.79	12.63	2.44
Turkey	17.03	4.69	3.63
Indonesia	35.55	6.75	5.27
Saudi Arabia	10.50	4.81	2.18
South Africa	15.72	7.85	2.00
Thailand	25.55	8.17	3.13
Argentina	31.84	12.57	2.53

Source: WTO Country Profiles

Second, countries with a significant participation in world trade cannot raise tariffs on a grander scale without damaging the competitiveness of their home firms. A significant portion of all trade today is trade in parts and components, or input goods, and companies have fragmented their supply chains to such an extent that it is difficult to trace the origin or nationality of a particular good. Advanced economies and emerging markets are densely integrated through such production networks. Imports are needed in order to export, and new tariffs on input goods will adversely affect profitability and output higher up in the value-added chain.

1. World Trade Organization, 'Lamy: "We must remain extremely vigilant"', news item, 9 February 2009, available on WTO website: http://www.wto.org/english/news_e/news09_e/tpr_09feb09_e.htm.
2. Trade remedies such as antidumping are not accounted for, as such measures are targeted against specific countries/exporters.
3. Ecuador, however, has imposed tariffs on 900 items.

Yet these two constraining factors do not prevent all forms of protectionism. WTO agreements are more powerful against tariff hikes than other forms of protectionism, e.g. non-tariff barriers and state aid to companies. Patterns of supply-chain fragmentation limit the temporary mercantilist value of a tariff increase, but they do not have the same effect on trade-distorting subsidies to domestic firms. Non-tariff protectionism is often more damaging than tariffs. Tariffs are quantified and companies can calculate their margins and profitability of trade. Non-tariff measures are often opaque and foreign firms have difficulty in assessing the cost such measures impose on existing or potential trade. The uncertainties are bigger.

It is this form of protectionism – creeping rather than spiralling protectionism – to which governments are now succumbing amid the economic crisis. It builds on protectionist trends that were under way long before the crisis hit in September 2008. Efforts by the G20 to limit protectionism and its damaging effects should focus on this trend of creeping protectionism.

Creeping protectionism

Current protectionist trends are similar to those in the 1970s and 1980s. In the 1970s, oil-price hikes and other shocks triggered inward-looking, mercantilist policies, not least in Europe and the United States. Immediate policy responses were not massively protectionist: there was no equivalent of the 1930 Smoot-Hawley tariff.[4] But escalating domestic interventions exacerbated economic stress, prolonged stagnation and, not least, spawned protectionist pressures. Industry after industry, coddled by government subsidies at home, sought protection from foreign competition. The result was the 'new protectionism' of the 1970s and 1980s.

Then, as now, manufacturers of gas-guzzling cars in America faced bankruptcy. The US Congress bailed out Chrysler in 1979. By then the British government had already bailed out Rolls Royce and British Leyland, and Renault was saved by French taxpayers shortly after President Carter signed the Chrysler bailout. Several other sectors (wood and timber, energy and minerals, railways, airlines, shipbuilding) received government subsidies in the 1970s. Many companies were nationalized.

Policies such as 'voluntary export restraints' (VERs), 'orderly marketing arrangements' and other mostly non-tariff barriers were deployed to 'manage trade'. The sectors that received subsidies at home also got protected from foreign competition. Through the 1980s, American car manufacturers were protected by VERs that restricted the number of Japanese cars exported to the US. Europe negotiated a similar agreement with Japan in 1983. To further restrict Japanese exports, some European governments imposed 'local-content requirements' on the cars produced in Europe by companies such as Nissan and Toyota. Many other sectors, including semiconductor and videocassette recorder manufacturers, were also protected by VERs or similar measures. The French government even demanded that Japanese VCR imports enter France via Poitiers, a town hundreds of miles from the nearest port.

Many references could be made to trade-distorting subsidies, increased non-tariff barriers and other creeping protectionism in the 1970s crises. Similarly, in a few years' time we will be able to produce an equally extensive analysis of measures undertaken by governments in 2008–10. The process has already begun.

Governments around the world have bailed out domestic banks and automotive industries. We are not even at the end of the beginning; more subsidies will be handed to ailing auto manufacturers and other sectors are lining up for direct government support. State-aid rules in the EU have been relaxed and certainly enabled suspicious state aid to pass the Commission's examination. The air is thick with governments' nods and winks to banks to lend at home, not abroad, and to car companies to ensure that their subsidies are spent on production and employment at home, not abroad. One hidden part of the United States' bailout of its banks is a restriction on firms to apply for H-1B visas (to employ specialist foreign workers). Other countries have not gone as far as to impose new restrictions on labour migration, but political leaders have echoed calls for 'British-jobs-for-British-workers'-style views.

'Buy America' provisions in government procurement have been attached to the US fiscal stimulus package. Other

4. See contribution by Uri Dadush for details of the impact of this tariff.

governments, for instance Spain and Sweden, have encouraged people to buy nationally produced goods. Government procurement has also been a favoured measure to support domestic manufacturers in Asian countries that are not members of the Government Procurement Agreement in the WTO. Chinese provinces and Indonesia, for example, have singled out domestic steel mills as favoured subjects. Several Chinese provinces have gone much further. In January 2009 the local government in Hunan introduced directions to government offices to buy passenger vehicles and raw materials, including medicines, made or sourced in the province. Non-tariff barriers have also increased in some sectors – from Belgian chocolate and Dutch eggs (China) to toys (India) to auto parts and TVs (Argentina). Apart from introducing new sectoral non-tariff barriers, Indonesia has also limited the number of import entries.

Creeping protectionism was surfacing before the crisis began and involved other policies than those mentioned above. Antidumping actions have been on the rise again for some time. Global antidumping took a big jump in the first half of 2008, and estimates show the increase continued in the second half.[5] 'Standards protectionism' has proliferated in agriculture and manufacturing, and increasing talk of carbon-based tariffs has magnified protectionist threats dressed up as environmental policy. 'China-bashing' is getting worse, with accusations of 'unfair trade' linked to 'currency manipulation' and bilateral trade deficits. Calls for corrective measures against China are likely to increase as the new US administration has officially labelled China a currency manipulator. In the last few years there has been an increase in the number of investment restrictions and of unfavourable laws on cross-border investment. Countries as diverse as China and France have singled out strategic sectors and national champions to be protected from the embrace of globalization. Protectionist tendencies can be seen everywhere in the energy sector.

A mission for the G20

What can the G20 do to block current protectionist trends?

- ***Avoid sweeping, shallow and non-committal pledges to fight protectionism***. At the Washington summit in November 2008, G20 members agreed to avoid protectionist measures for a year and to instruct their trade ministers to agree on Doha-round modalities before the end of 2008. It took only a few days before tariffs had been increased by a G20 member, and at least 25 per cent of members have increased tariffs since November. At least two-thirds of the membership have imposed measures that are clearly protectionist, even if they are not forbidden by any WTO agreement. Making pledges you are likely to dishonour is a good way of undermining the entire legitimacy of the G20.
- ***Acknowledge the real protectionist threats***. Governments today are fighting the wrong enemy. They argue for a battle against a 1930s-style scenario of spiralling tariffs, whereas such a development is highly unlikely. This Maginot line of anti-protectionism is morally admirable, but it prevents governments from fighting actual protectionism or protectionist threats. Similarly, governments need to acknowledge that the current expansion of fiscal spending – regardless of its merits as counter-cyclical policy – is a potential source of escalating protectionism.
- ***Establish a 'ceasefire agreement' on key protectionist measures: tariffs, trade-distorting state aid, and buy-national policies***. Other measures would ideally be part of a ceasefire agreement too, but it is not political feasible to cover, for example, increased use of antidumping measures. The important task now is to sort out the really bad apples – those that can trigger tit-for-tat developments.
- ***Task a smaller group of countries to propose to the next G20 summit guidelines on how to prevent protectionist threats*** from materializing, and to progress multilateral agreements that strengthen disciplines on the favoured tools of protectionism. This group could include, say, China, the EU, Japan and the United States. Cooperation is needed, but the G20, and even more the WTO, is too unwieldy to allow for clear proposals and leadership from the big countries to emerge from summits or unprepared plenary sessions.

5. See Elisa Gamberoni and Richard Newfarmer, 'Trade protection: incipient but worrisome trends', VoxEU, 4 March 2009, http://www.voxeu.org/index.php?q=node/3183.

Resurgent Protectionism: Risks and Possible Remedies

Uri Dadush[1]

As the global financial crisis intensifies, world leaders are facing growing political pressure to enact protectionist measures. Since the inaugural G20 summit was held in November, nearly all G20 members, including the United States, the EU, China, India and Russia, have taken steps intended to protect their own producers.

While the impact of measures enacted so far is small, the risk of a devastating resurgence of protectionism is real. A resurgence of protectionism today would generate even greater losses than it did in its last surge during the Great Depression, when tariffs were much higher at the outset than they are today and countries were less integrated through complex international production chains.

Counter-cyclical policies and banking bailouts are absolutely necessary to contain the crisis. But they also imply a much expanded role of the state in – and therefore an expanded risk of politicization of – economic decisions. Even when support measures are intended to mitigate the downturn, their unintended effect is often to protect, and such measures can therefore easily be misinterpreted by other governments as protectionist. If, as is unfortunately quite possible, the crisis continues to deepen and becomes even more protracted, the pressures to protect could become overwhelming.

Policy-makers at the coming G20 meetings need to take important and urgent steps to avoid backsliding or, worse, a trade war. Establishing a monitoring function with teeth in the WTO is an obvious immediate step. The G20 must also strengthen the world trading architecture so as to avoid backsliding during future downturns. Reforms of the WTO, not only the World Bank and the IMF, should be the object of a dedicated G20 working group in preparation for future meetings.

Rising risk of protectionism

Intensity of the crisis: Experience of previous crises suggests that the pressure to protect grows in step with the speed, depth and duration of the downturn. The impact of the current economic downturn has been momentous, not just in scale, but also in the rapid pace of its transformation from an isolated US and West European financial crisis into a global meltdown pervading all sectors. In the fourth quarter of 2008, world industrial production fell at a 20 per cent annual rate; these declines have so far continued unabated in the first quarter of 2009. Jobs are being shed in every country; the International Labour Office expects 50 million workers around the world to become unemployed owing to the global recession. The dearth of trade finance, combined with reduced global demand, has had an immediate and significant impact on global trade, which the World Bank predicts will contract in 2009 for the first time since the early 1980s.

The effect of the crisis on developing countries is very recent but promises to be severe in the aggregate, and catastrophic in a few. A sharp decline in external finance to developing countries has already occurred and is predicted to get much worse in 2009. East European countries, many of which have large current account deficits that circumscribe the space for fiscal and monetary policy, lie most exposed. Some are at direct risk for default unless their

1. This contribution was prepared with excellent support from Lauren Falcao, Junior Fellow at the Carnegie Endowment. Merit Janow and Richard Newfarmer provided valuable suggestions. A longer and revised version of this paper is available on the Carnegie website.

neighbours to the west and the international financial institutions provide direct assistance.

Though most forecasts predict recovery sometime in 2010, the unprecedented nature of this episode makes these projections exceptionally uncertain. Recessions arising from financial crises tend to last two years longer than recessions driven by other factors. Assuming this crisis conforms to this trend, by 2010 the US would be only about one-third to one-half of the way through its recession, while in the vast majority of other countries, where the recession is more recent, recovery would be likely to take even longer. Further, lessons from past financial crises indicate that today's global downturn may continue to deepen. Peak to trough decline in GDP during financial crises is most typically around 5 per cent.[2] The Great Depression saw a decline of 25–30 per cent of GDP. To date, the decline in US and European GDP from peak is probably no more than 2–3 per cent. Despite the damaging and pervasive effects that this crisis has already had on the world economy, it is as yet relatively short-lived and shallow in comparison with past crises.

There are reasons to think policy-makers have learnt from past crises, and that this episode will be better managed than most, but there are also reasons to think that underlying problems – both those that caused the crisis and those that limit the scope for policy response – run deeper than in past crises. Debt levels as a share of GDP in the US and the UK have never been higher.[3] New tools such as securitization, credit default swaps and derivative contracts have made financial intermediation more complex than ever before.[4] Capital mobility – which is associated with increased crisis frequency – is at an all-time high.[5] Furthermore, whereas during most crisis episodes countries could rely on world trade demand for support, in this case that demand is fading rapidly.

Growing role of the state and weak WTO disciplines: The size of today's government intervention is unprecedented; the planned US financial bailout packages alone account for 17 per cent of GDP. While the size of the intervention does not by itself create room for protectionism, its non-neutral nature does. Support to domestic banks, finance companies of industrial conglomerates and the auto companies is clearly discriminatory. Furthermore, two-thirds of the most recent US stimulus package is allocated to infrastructure, science, health care and other initiatives. Within each of these categories, policy-makers, not the market, decide which groups will benefit from an injection of government money and which will not, incentivizing groups to lobby to receive a disproportionate share of the benefits. Groups have been particularly successful in lobbying for funds to be allocated to national companies to preserve employment opportunities for citizens. For example, the 'Buy American' provision of the US stimulus package provides a 25 per cent competitive margin for US manufactured goods for all expenditures under the bill.

Even when stimulus packages require, as does the US bill, that provisions be consistent with the country's obligations under international agreements, policy-makers retain the flexibility to discriminate. For example, 75 per cent of iron and steel imports into the United States originate in countries that are not signatories to a relevant procurement code, under either the WTO Agreement on General Procurement or bilateral agreements.

There are many other opportunities to increase protection without breaking WTO law. Developing countries tend to have large gaps between bound and applied rates, and, for several goods, have no bound rates at all. Industrialized nations could withdraw their Generalized System of Preferences, which offers least developed nations lower tariffs than other nations. All nations are also permitted to raise compensating tariffs against a trading partner found guilty of dumping or of implementing distortionary subsidies. Standard-setting bodies have wide discretion. Finally, the WTO still has several salient gaps in its jurisdiction; for example, protectionist

2. Reinhart, Carmen M. and Kenneth S. Rogoff, 'Is the 2007 US Subprime Crisis So Different? An International Historical Comparison.' *American Economic Review*, 98(2) (2008), pp. 339–44.
3. Wolf, Martin, 'Why dealing with the huge debt overhang is so hard.' *Financial Times*, 27 January 2009.
4. See contribution by Robert Rosenkranz for fuller details of credit default swaps.
5. Reinhart and Rogoff (2008).

bailouts and investment restrictions are allowed in many sectors.[6]

Further, while the general expectation is that countries will abide by their WTO commitments, this obviously cannot and should not be taken for granted in the event of a trade war.

Protectionist measures are increasing: While protectionism so far has probably had only a modest effect on trade flows,[7] it is clear that countries are increasingly resorting to protectionist measures. Whereas the trend over the last two decades has been towards increased liberalization, since the financial crisis worsened in November, 55 of the 77 enacted trade measures around the world have been trade-restrictive.[8] Half of these measures are tariffs, which are employed primarily by developing countries that lack the budget to enact costly subsidies. Only a third of the 43 developing-country measures involved subsidies, while all 12 industrialized-country measures were subsidies. Other measures limiting trade included licensing requirements (e.g. Argentina), restricted entry (e.g. Indonesia), tighter standards (e.g. China), and outright bans (e.g. India).[9] Final evidence of protectionism can be seen in the increased number of antidumping complaints filed with the WTO, which, after years of decline, rose by about 15 per cent in 2008.

Of these measures, WTO Director-General Pascal Lamy finds that the most influential have been OECD countries' support to banks, other financial institutions and the automobile industry.[10] Subsidies for the auto industry now total some $48 billion worldwide, $42.7 billion of which is in high-income countries.[11]

Potentially large losses from protectionism: The potential losses from trade restriction could be huge. The Smoot-Hawley Tariff Act enacted in the early stages of the Great Depression present one estimate of what countries stand to lose by instituting protectionist measures. Following the Smoot-Hawley Act, the effective US tariff rate rose from 13.5 per cent in 1929 to 19.8 per cent by 1933, encouraging retaliation on the part of US trading partners. The combined effect of falling demand and increased protection led to US imports falling from $1.3 billion in 1929 to $390 million in 1932, while US exports fell from $2.3 billion to $784 million. Over the same period, world trade declined by 33 per cent, and the increase in both tariff and non-tariff barriers may have accounted for a little over half this decline.[12]

According to some estimates, Smoot-Hawley's impact on the US economy may have been relatively small, compared with the direct effect of falling demand.[13] However, this was probably due to the relative unimportance of trade in the US economy during this period. In 1929, imports accounted for only 4.2 per cent of GNP and exports only 5 per cent. Today, imports comprise over 14 per cent of GDP and exports 11 per cent. Average US tariffs today are also a fraction of what they were in 1929. Trade shares are much higher in other countries, and tariffs are on average less than a quarter of what they were in 1929. The effect of Smoot-Hawley is therefore a very low estimate of the potential impacts of protectionist measures today.

Another estimate of these impacts is provided by the International Food Policy Research Institute (IFPRI), which examines two protectionism scenarios. In the more modest scenario, countries raise their tariffs to their maximum rates applied during the period from 1995 to 2008. As a result, world trade decreases by 3.2 per cent and world welfare falls by $134 billion. In a more severe scenario in which countries raise tariffs up to their WTO bound rates, world trade decreases by 7.7 per cent and

6. Evenett, Simon J., 'No Turning Back: Lock-in 20 Years of Reforms at the WTO', in Richard Baldwin and Simon Evenett (eds), *What World Leaders Must Do to Halt the Spread of Protectionism* (VoxEU.org 2008).
7. Lamy, Pascal, 'Report to the TPRB from the Director-General on the Financial and Economic Crisis and Trade-Related Developments', JOB(09)/2 9 (2009).
8. Gamberoni, Elisa and Richard Newfarmer, 'Trade Protection: Incipient but Worrisome Trends', VoxEU.org. (2009).
9. Ibid.
10. Lamy (2009).
11. Gamberoni and Newfarmer (2009).
12. Madsen, Jakob B., 'Trade Barriers and the Collapse of World Trade during the Great Depression', *Southern Economic Journal* 67 (4) (2001), pp. 848–68. doi: 10.2307?1061574.
13. Romer, Christina D., 'What Ended the Great Depression?', *The Journal of Economic History* 52 (4) (1992), pp. 757–84.

world welfare drops by $353 billion. IFPRI also examines the ramifications of a failed Doha agreement, finding that the world will lose $336 billion in potential world trade if the negotiations fail.[14]

Who would lose the most from protectionism? All countries would be adversely affected by restraints on their exports or by measures that affected the overseas operations of their multinational companies. Not surprisingly, smaller countries or territories (such as Hong Kong) are typically the most open and most exposed. But large countries such as China and Russia have high export exposure as well, and both the Eurozone and UK have relatively high outward FDI stock as a percentage of GDP, making them vulnerable to retaliation from other nations closing their borders to investment or discriminating against existing foreign establishments. The US is among the relatively least exposed, with an outward FDI stock that comprises 19 per cent of GDP and exports that amount to only 11 per cent of GDP, but its absolute losses would be among the largest.

While the above analysis privileges the mercantilist perspective, by focusing on losses of export markets, welfare losses from countries' own import restrictions would be likely to outweigh losses resulting from new barriers erected by their trading partners. While specific interest groups can gain handsomely from protection, the main victims of protectionism are the countries that engage in it.

Policy recommendations 1: short-term risk mitigation measures

1. The most effective way to defuse protectionist pressures is to reignite economic growth quickly. Acting aggressively on the broader economic recovery agenda, including injecting fiscal and monetary stimuli, removing non-performing assets from bank balance sheets, and helping the most vulnerable countries and groups, is essential. But how this is done is also important. Stimulus and financial rescue policies should aim to be as non-distorting of competition, both foreign and domestic, as possible. Support measures should be temporary and have a clear exit strategy. Furthermore, in so far as the burden of economic recovery policies is shared across countries, and is seen to be fairly shared, it becomes easier to avoid beggar-thy-neighbour trade measures.
2. The moratorium on new trade restraints agreed at the inaugural G20 summit should be reaffirmed through to the end of 2010 and given teeth. This would include explicitly endorsing the WTO's enhanced surveillance role for the duration of the crisis, and requiring the G20 to report immediately all changes in applied tariffs and subsidies to the WTO Secretariat. The reporting requirement should also apply to all presumed WTO-legal measures under contingent protection, including safeguards, countervailing duties, and antidumping initiations and sanctions. The Secretariat would be required to report periodically to the General Council as well as to provide a written account as a background paper for future G20 summits.
3. International consultative groups should be established to monitor support to sensitive sectors, such as banks and automobile companies, to promote the minimization of trade-distorting effects and to encourage such supportive measures to remain strictly WTO-legal. The purpose of these groups would be to exchange information, improve transparency and agree guidelines.
4. The G20 should reaffirm its determination to bring the Doha negotiations to a successful conclusion by the end of 2009.

Policy recommendations 2: Longer-term measures to reduce the likelihood of a resurgence of protectionism in future crises

1. The overwhelming priority of the G20 over the next year should be to reignite economic growth and avoid the spread of protectionism, hence the recommendations above. However, just as thought is now being

14. Bouet, Antoine and David Laborde, 'The Potential Cost of a Failed Doha Round', International Food Policy Research Institute, Issue Brief 56, 2008.

given to strengthening the international financial architecture to prevent a recurrence of the financial crisis, including reform of the World Bank and the IMF, so consideration is required of how the international trading system can be strengthened to avoid a resurgence of protectionism in future crises. Since seven years of Doha negotiations have so far failed to produce even a modest improvement in multilateral disciplines, it is reasonable to ask how the WTO process can be made more effective. With this in mind, the G20 should endorse the launch of a working group to propose WTO reforms.

2. Near-term questions to be addressed by the working group should include:
   (a) how can the WTO's surveillance function be strengthened?
   (b) How can rules on state aid in the event of macroeconomic crisis be clarified and strengthened?
   (c) How can the membership of the plurilateral agreement on government procurement be broadened, ideally to cover the whole WTO membership?
3. Longer-term measures would relate to the functioning of the WTO as an effective negotiating body – one that, over time, can be realistically expected to reduce the rate of bound tariffs and subsidies (thus reducing the gap between bound and applied tariffs and subsidies), reduce the enormous room for discretion in trade in services, and also place tighter disciplines on contingent protection. There are a number of questions here. How can negotiations be made faster, more capable of accommodating diverse interests of members, and more successful in addressing today's most pressing issues? Should negotiations be increasingly based on plurilateral and sectoral agreements rather than on the single undertaking? How can the WTO draw on the energy of regional trading agreements, and better discipline and incorporate them, so as to make progress on overall trade liberalization?

A Grander, Greener Global Bargain: Generating Growth by Refocusing Trade Liberalization on Energy and Green Solutions

Paula Stern

The November 2008 meeting of G20 leaders in Washington, DC was convened to craft a response to the global financial crisis. President George W. Bush was still in office, with two months remaining. Since the November meeting, the financial crisis has become a spreading global pandemic and the entire global economic system is in serious peril. The April 2009 meeting in London is the opportunity for the G20 grouping of developed and developing nations that account for 90 per cent of world GNP and 80 per cent of world trade to address the crisis It is indeed a historic moment for President Barack Obama and other world leaders to reorder global priorities for the 21st century and harness market forces to revive, advance and spread economic prosperity. It is another chance, after many decades of delay, to finally link the energy and the environmental crises and start tackling them systematically and proactively. It is also time for a new generation of leaders to revitalize the institutions which were designed sixty years ago by leaders meeting in Bretton Woods, New Hampshire, and to adapt these institutions to today's hugely challenging tasks.

Since the end of the Second World War, global growth and poverty reduction have been premised on trade growth through greater market liberalization and adherence to the rule of law. Today, however, as job losses climb, pressure is mounting on governments in all countries to take protectionist trade measures that roll back market liberalization and compromise legal commitments based on principles of non-discriminatory national treatment. This contribution offers several concrete recommendations to the G20 for turning this crisis into an opportunity to coordinate global leadership in addressing the economic and trade crisis in such a way that the world's energy needs and environmental well-being are also considered. Linking these goals will help build political support at home to underpin any one nation's commitment to undertake multilateral obligations.

Economic crises, nationalistic measures and global political instability

At their November 2008 summit, the G20 leaders expressed the necessity of 'rejecting protectionism', promising that for '12 months, [they would] refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports.' That clear commitment, however, has not been kept. According to the World Bank, seventeen of the G20 nations have taken new measures that restrain trade or discriminate in favour of national firms.

A US example is the 'Buy American' clause of the American Recovery and Reinvestment Act of 2009, which President Obama signed on 17 February 2009. The final bill took some of the sting out of the originally drafted legislation by stating that the provision must be administered in a way that is consistent with US international trade agreements. The US government has yet to clarify whether money allocated under the stimulus plan to US state governments would be covered by the provision; currently 13 US states do not have procurement commitments under the WTO Government Procurement Agreement (GPA).

Even the toned-down version of 'Buy American' is the basis for concern that the clause, while WTO-compliant, still licenses discriminatory treatment against countries that are not signatories to the GPA – most prominently Brazil, China and India. Ironically, this could be an incentive for these prominent countries to sign up to the GPA. However, if other nations are less artful than the United States in drafting similar bailouts, their trading partners would be within their rights to retaliate by raising their bound tariffs to levels well above the applied/actual tariffs they may have in place today. In his report on 24 January 2009, WTO Director-General Pascal Lamy stated that the effects of raising these tariffs could cut the value of global trade by up to 8 per cent. The stakes are particularly high for developing countries that have pursued export-driven policies; they are the only countries experiencing continued, albeit anaemic, growth in 2009, in spite of the burdens from dragging commodity prices, slowing tourism and shrinking remittances.

In this recession, protectionist measures are likely to differ from the across-the-board tariff hikes that the United States imposed under the Smoot-Hawley Act of 1930 (which economists believe helped turn a deep recession into the Great Depression). While developing countries are deploying tariff measures that also provide government revenue, most protection is not as clear cut today. Instead, many developed and some emerging economics such as China are introducing domestic subsidies (so-called 'bailouts') which, like tariffs, are a common instrument that can distort trade. Because few of the 153 WTO members keep their commitments to notify the WTO biannually when they have adopted domestic subsidies, these constitute an opaque and underappreciated threat, and one that is more likely to come from the relatively richer countries that have more power to subsidize.

Other measures are likely to take the form of so-called 'contingency protectionism', including countervailing duty measures against subsidized imports, antidumping complaints and safeguard actions. These measures grew out of bargaining among negotiators during previous rounds of multilateral liberalization. They are legitimate temporary actions when executed according to WTO rules, but they have the same impact of reducing overall trade. As such, they increase global trade friction and together could swamp the WTO dispute settlement mechanism.

US unemployment numbers have reached a peak not seen for more than a quarter of a century – the last time the major economies engaged in such high-stakes trade skirmishes, if not actual trade wars. Today, the risk of global instability from trade wars is even greater. This is not just because this dual recession/financial crisis is the worst since the Great Depression. It is also because globalization has expanded, and so many more nations rely on trade for investment and growth. The increased complexities of global supply chains have further exacerbated the potential for unanticipated second- and third-order effects.

Economic turmoil in Latvia, Ukraine and Iceland has already rocked governments. When governments bend to domestic political pressure to resort to nationalistic measures, this can lead to tit-for-tat responses that weaken economies and can trigger even greater instability. Ominously, the linkage between national security and economic policy was highlighted by Admiral Dennis Blair, Director of National Intelligence in the US, in his February testimony before the Senate Select Committee on Intelligence: 'The primary near-term security concern of the United States is the global economic crisis and its geopolitical implications,' Admiral Blair emphasized. Because of these concerns, the Obama administration has asked the Central Intelligence Agency Director to include an Economic Intelligence Briefing in his daily White House report that highlights threats to world stability.

When the US faced a serious industrial recession in the 1980s, the major manufacturing giants in the auto and steel industries mounted successful protectionist campaigns which inspired industries including semiconductors and machine tools to do the same. Protectionism feeds on itself domestically as well as internationally. As a result of steel and auto protection last time, for a decade the world was saddled with so-called OMAs (Orderly Marketing Agreements) limiting auto trade between two of the world's great economic powers, the United States and Japan. In addition, the United States negotiated Voluntary Restraint Agreements (VRAs) with 27 nations on a wide range of steel products. The VRAs had morphed out of hundreds of subsidy and dumping complaints filed at the Department of Commerce and USITC (the US International Trade Commission) by US steel companies and workers. Steel users in America paid the price for this protection. They paid more for steel and lost manufacturing jobs to countries that paid less. Machine tool manufacturers took hits, and so did parts makers. Everyone paid.

Global economic leadership challenge to the new US administration and G20

President Obama's administration is surely cognizant of the leadership role that the United States must play to restart the US domestic economy. In his first months in office, the new President has managed to pass a domestic economic recovery stimulus package, increase financial help for banks and automobile companies, start an assistance programme for perhaps nine million families with shaky home mortgages, issue a blueprint for banking reform, and propose a budget plan. The G20 meeting in April will signal whether and how President Obama and the United States will step into the global economic leadership role that America has played since the dawning of the post-war Bretton Woods era.

What should President Obama and the G20 propose to propel the global trade engine, which has generated prosperity for sixty years? The answer: a grander, greener global bargain.

Recommendations for catalysing a sustainable trade agenda

The November 2008 G20 did not fully anticipate that the world would be gripped so rapidly by such a dramatic global economic recession. So its work programme was more focused on the financial crisis and architectural reform of the International Monetary Fund and multilateral banks. The November Declaration on Financial Markets and the World Economy does include a 'commitment to an open global economy'. However, the November pledge against taking protectionist measures could be used to generate deeper consideration of the role that the WTO can play both alone and in cooperation with the IMF, World Bank, and other multilateral banks.

Nor did the November G20 recognize that the crisis that threatened world stability the year before was driven by skyrocketing prices for food and fuel, and that it could happen again. The newly formed G20 is the forum that should acknowledge the linkage between energy, climate change, national security, trade, economic growth and instability, and take the lead to weave together a tighter, more coordinated, disciplined global trade agenda.

1. ***Anti-protection pledge***: The G20 should extend its November pledge against protectionist measures beyond its initial 12-month period and empower the WTO to monitor adherence and issue quarterly public reports.
2. ***WTO surveillance***: The G20 should task the WTO to monitor the industrial support programmes that its member states are undertaking. US and European support programmes for the automobile industry, amounting to at least $40 billion and growing, are the most prominent, but measures have also been taken by China and Japan.

   The WTO can play a bigger role in making transparent and disciplining the execution of these support programmes or 'bailouts' to limit damage to the world trading system. According to the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), each member country is committed to notify the WTO when it adopts a domestic subsidy that can be trade-distorting. Today, information is available for less than half of the WTO membership. Transparency can encourage domestic decision-making to reflect national economic, more than special interest, considerations. And transparency might help to avoid a return to a 1980s-style situation, when rounds of subsidies, countervailing duties and other measures resulted in industrial deals that carved up global markets.

   The G20 could enhance the role and authoritativeness of the WTO by providing it with the necessary resources to work and issue timely public reports in this area. The WTO and the IMF should also be directed to share resources to facilitate rapid fact collection and analysis in the WTO surveillance of every WTO member nation, without exception.

3. ***Trade financing***: WTO Director-General Lamy has taken a positive step in this key area of concern by creating a global liquidity pool to cover the shortfall in financing; this will be a critical lubricant for world growth. The WTO is coordinating with the World Bank and the IMF, which are best suited to perform this function.
4. ***A grander, greener global bargain where trade rules apply to energy***: The G20 should send a proactive liberalizing signal to the world. The question is how. Should the G20 call for a revival of the Doha Development Round of multilateral talks? I have my doubts. The new US administration is hard pressed to manage its legacy from the previous administration. To try to revive the moribund talks after seven and a half years of negotiations may be fruitless and distract from other politically pressing priorities. The Doha Round has scant support in Congress, which holds the constitutional power to regulate foreign commerce. Leading US business and farm groups have called on President Obama to push advanced developing countries such as India and Brazil to offer 'balance and greater ambition' to these efforts, and have said that otherwise there is 'no basis for another ministerial meeting'.

    There are other ways to maintain and expand the benefits of trade. The G20 should link its action programme to the work of global leaders preparing for the UN's Copenhagen climate change summit in December 2009, to advance economic, trade and climate change goals. The G20 should breathe life into other WTO activities than sponsoring the Doha Round, including:

    a. Making a down payment on a greener, grander bargain by pledging to undertake WTO-sponsored plurilateral, sector-by-sector agreements to reduce trade barriers on clean energy goods and services. Such a sector-specific undertaking by G20 members might snowball into broader WTO commitment, just as a US–Japan bilateral in the 1990s formed the basis for the WTO's Information Technology Agreement.
    b. Empowering the WTO to monitor and publicize industrial and agricultural measures that are trade-distorting, impoverishing and environmentally degrading. The Director-General has recently expressed interest in undertaking greater surveillance in the future. The WTO surveillance function should be directed to look not only prospectively but also retrospectively into laws and regulations that G20 nations have accumulated when they are particularly egregious from the point of view of trade, poverty reduction and sustainability. If a nation thought that it might be subject to surveillance, that could tip a decision to alter its domestic policies. Examining the ethanol tariffs which are part of a broader US biofuels subsidy policy would make a strong impact, particularly on Brazil.
    c. Shining a light on the fact that WTO rules do not cover trade in energy, and recognizing that since energy is the lifeblood of the global economy, it should not remain outside the world trade system for another thirty years. The agriculture stalemate at Doha should be telling trade negotiators that this may be the moment to shift their efforts away from agriculture so that they have more time and resources to focus on energy. This could be a way to end the long WTO negotiating stalemate with India and other countries.

On 15 November 2008, members of the G20 'committed to the rule of law, respect for private property, open trade and investment, and competitive values'. Virtually every member of the G20 is a member of the WTO. They should pledge to initiate negotiations to apply the WTO rules to the energy sector. The members of the G20 which are also members of OPEC should play by the rules of the marketplace, with no exceptions.

The United States, China and other G20 members

The G20 membership of developed and developing nations reflects the shift in economic power in the world. For a variety of different reasons, some G20 members may not be willing to take tough decisions to be part of a collective action. In such a case, individual nations including the United States and China should be prepared to work opportunistically with those countries within the G20 that will act. The past multilateral trade rounds depended on the US working together with Canada, Europe and Japan: the Quad. The G20 is an experiment that still requires leadership and focus. The United States has traditionally played that role, often with important help and cooperation from key European friends. Is the US ready to play this role?

There are two hopeful political developments suggesting that President Obama is laying a good political basis to advance a positive trade agenda that is also consistent with his administration's climate change goals. One of the least noticed components of the American Recovery and Reinvestment Act of 2009 was the reform of the Trade Adjustment Assistance (TAA) programme, which expanded assistance to service-industry employees as well as workers in manufacturing. The passage of changes to the TAA had eluded Congress for the entire eight years of the Bush administration. The TAA reforms were three years in the making and are the result of significant bipartisan cooperation in the Congressional committees responsible for trade. The passage of TAA reform is a key domestic political precondition for any bipartisan trade-liberalizing initiative. In addition, President Obama's budget plan contemplates redirecting trade-distorting agricultural subsidies away from subsidizing production and towards conservation goals.

What role will China play? This contribution has not examined exchange rate policies, nor the destabilizing role played by trade deficits or trade surpluses, nor the traditional role played by the United States as the consumer of first and last resort for countries such as China that are pursuing export-driven growth strategies. China has been a great beneficiary of America's open market for imports, and has stunned the world by its rapid economic rise and influence. Will China now implement economic policies to demonstrate that it recognizes its critical national stake in maintaining the global trading system? China would seem to have national interests compatible with multilateralism and globalization. The great export superpower has the potential to be a great consumer, for example. Its initial $586 billion stimulus suggests it knows it needs to spend on domestic consumption, including providing health services to its people. It remains to be seen how much this can be linked into broader G20 efforts, but it certainly needs to be considered.

Moving Towards a Better-balanced Global Economy

Jim O'Neill

This contribution covers two broad areas of relevance: what are the critical issues the G20 did not address in November 2008 that are affecting the global economy, and what policy prescriptions address these challenges? The key issues considered include global imbalances, the monetary system and the exchange rate mechanism.

While we must all hope that we will never see another crisis of the dimension of today's, it is important to recognize that financial economical crises do, and will, occur, and whatever the G20 tries to adhere to, no policies can be devised that would altogether avoid some cyclicality for the world economy. The G20 meeting should therefore aim for realism. Indeed, one of the most critical goals that the November G20 mentioned – and which should be easily attainable – is the system of governance. This will be considered further below.

Other contributions to this report focus on the need for remedies to stop the world recession through appropriate monetary and fiscal policies, as well as by introducing better regulatory policies to govern the financial system. While the moves under way to stimulate economies through aggressive monetary and fiscal actions are to be welcomed, and the tone of coordination is pleasing, the reality is that monetary and fiscal policies are generally the domain of domestic economic policy. There is a limit to what the G20 can achieve. The same, to a degree, is also true of the regulatory framework for each of our major financial institutions. Depending on where it is located, the specific activity of the institution is likely to have a system of governance that best fits with the social policies and culture of the country in question. That said, and where commonality of interest can be shared, an enhanced framework of capital usage by banks and other financial institutions may be feasible. Guiding our financial systems to raise more capital in times of buoyancy, thereby helping to reduce the need for such measures in less buoyant times, would seem attractive to all. Similarly, policy-makers need to introduce a system of risk indicators and warning indicators so that, supplementary to the goals of low inflation, policies can be introduced to prevent the excesses that led to the current turmoil. Many of the proposals for the G20 made in the recent report by the Issing Committee[1] are to be welcomed here.

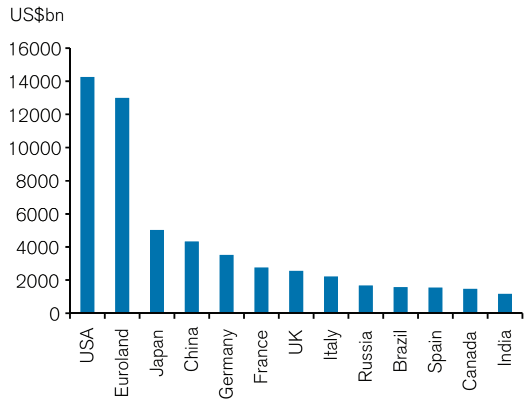
One small but important point linked to the committee's recommendations, especially with respect to the need for better 'risk warning indicators', is that there is also a clear, broader need for better economic data in many countries. For instance, if Korea can very usefully report its previous month's trade data on the first day of the following month, why cannot the US do this? Similarly, detailed data on consumer activity, which ironically some of the biggest commercial banks must have, could be reported more speedily.

Until the Cape Town G20 November 2007 meeting, and the Washington November 2008 meeting, the G7 and G8 remained the primary fora for international cooperation to deal with the world's challenges. In my judgment, neither the G7/G8 fora nor the G20 are optimal. A revamped G7, or one reduced to a G4, consisting of the appropriate economic policy representatives from China, Japan, the Eurozone and the US, is the most viable body to address the major challenges of foreign exchange misalignments and global imbalances. Ideally, a mechanism should also be agreed to avoid any stigma attaching to changes in the membership of the G4 over time as a result of changes in economic performance. It is conceivable that, just as

1. See *New Financial Order: Recommendations by the Issing Committee*, 2 February 2009, http://www.bundesregierung.de/Content/DE/__Anlagen/2009/02/2009-02-09-finanzexpertengruppe,property=publicationFile,property=publicationFile.pdf.

Canada and the UK should not be members today, perhaps Japan should not be in the future. Furthermore, it is conceivable that India, another so-called BRIC, or other as yet unidentified countries, might need to be at that table at some point in the future. Figure 1, showing the size of the major economies at the end of 2008, provides ample evidence to support the relevance of such a G4 today.

Figure 1: The world's largest economies, end-2008



Source: Goldman Sachs Global Economics Research

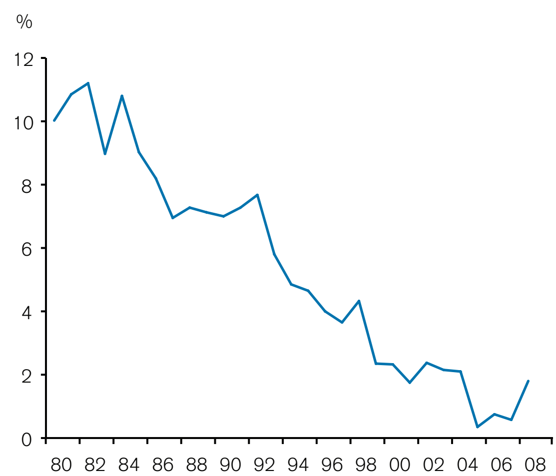
To supplement the G4, a G8 widened to a G13 by the inclusion of Brazil, China, India, Saudi Arabia and South Africa, as proposed by World Bank President Robert Zoellick, would also be necessary. Such an arrangement would help achieve an optimal world economy, including in critical policy areas such as energy usage, alternative energy and environmental issues, as well as addressing free trade issues and world poverty. I sincerely believe that a G4 supplemented by a G13 would help navigate the kind of challenges the world has faced this decade and indeed could have been better prepared for.

In reality, of course, not just the host for the G20 (the UK) but many of those 'excluded' would not agree to these quite simple changes. But without them, I fear that other substantive steps cannot be achieved. The G7/G8 policy is clearly not representative and, in any case, the EMU participants, France, Germany and Italy, all adhere to the same currency and are, in a general sense, governed by the same fiscal framework. Even more importantly, although many policy leaders willingly assert the need for reform of the IMF and World Bank, a better ownership structure – and purpose – for the IMF will probably not be achievable unless the EU countries, and especially the EMU participants, agree to be represented jointly. Perhaps the G20 remains the most practical forum in the near term, but without a dismantling of the G7/G8, a sensible reform of the IMF cannot be achieved.

Linking this specifically to what the November G20 meeting failed to focus on, I believe, as do many others, that much of today's crisis was caused by the build-up of global imbalances, both in terms of the external balance of payments (especially in the US and China) and the closely related domestic savings–investment imbalances. Throughout this decade, many of us identified a number of variables that might lead to considerable problems, including the large rise in the US balance-of-payments current account deficit to close to 7 per cent of GDP at its peak; the related deterioration in the broad (my definition, including net portfolio and FDI flows) basic deficit in US balance of payments to 2–3 per cent of GDP; the decline in the US personal savings rate to zero; the large increase China's current account surplus to 8–9 per cent of GDP; and the persistence of a Chinese savings rate in the vicinity of 40 per cent of GDP. Germany and Japan, among other countries, have played their own role in the build-up to these global imbalances. The general broad (again my definition) surpluses of China, India, Brazil and other large emerging-market countries are another related aspect of the imbalance problem. Seen in this light, many of the prescriptions in the November 2008 G20 statement would not deal with the underlying causes. The clearly massive problems that have emerged from the regulatory shortfalls can perhaps be regarded as symptoms rather than causes. They do, of course, need to be addressed urgently, and, as mentioned above, the recommendations outlined by the Issing Committee are sensible; nevertheless, the underlying causes need more thought and, perhaps, more attention.

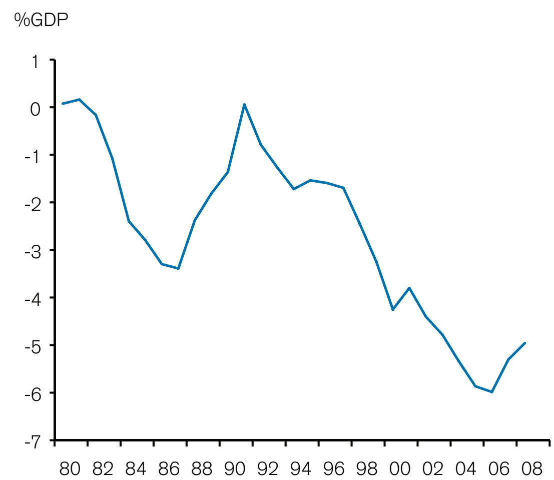
In this context, the thrust of policies in the different G20 countries needs careful consideration. Monetary and fiscal policies in the US need to maintain the rise in the personal savings rate that has occurred, while such policies in the largest savings countries, such as Germany, Japan and especially China, need to encourage private-sector demand. If further thought is not given to these differen-

Figure 2: US personal savings rate, 1980–2008



Source: Bureau of Economic Analysis

Figure 3: US current account balance, 1980–2008



Source: Bureau of Economic Analysis

tial policies, little will be achieved in terms of addressing underlying imbalances.

In fact, it should be recognized that there are some good signs on the US side of the equation. As Figure 2 shows, the personal savings rate has started to rise, and Figure 3 shows that the external current account deficit has started to decline as a share of GDP.

In a recent paper,[2] I showed that in any of three scenarios – 'bad', 'better' or 'best' – the US current account deficit will decline further (see Table 1).

What is less clear is whether similar evidence exists in other countries. Moreover, the 'desired' scenario for US current account improvement is the 'best' one. This is, in reality, what the US would and should like, and it would be consistent with a better world economy. If the US current account deficit stayed on the 'best' path – namely, around 3 per cent of GDP, with strong real export growth and 'softish' import growth – this would mostly likely occur in an environment where global domestic demand expansion was led from outside the US. In that regard, and pertinent to the G20 meeting, the expansive fiscal – and monetary – measures adopted in China, Germany and Japan should be welcomed. However, further thought needs to be given as to the effectiveness of these measures in stimulating their rates of domestic consumption. For example, do the Chinese authorities have a strong view on what causes their very high rate of domestic savings? Since their own measure to stimulate growth, announced late in 2008, a lot has been heard about plans to introduce state medical insurance to 90 per cent of all rural citizens by 2011. Has

Table 1: US trade outcomes – three scenarios

	Bad scenario		Better scenario		Best scenario	
	Exports	Imports	Exports	Imports	Exports	Imports
	-8.4%	-14.7%	+12.0%	+7.4%	+11.8%	-0.12%
Monthly trade deficit (US $bn)	-25.7		-36.8		-24.5	
% of GDP	-2.2		-3.1		-2.1	

Source: US Census Bureau, Goldman Sachs Global ECS Research

2. Jim O'Neill, *The Outlook for the Dollar in the Next Decade*, Goldman Sachs Global Economics Paper No. 180, 17 February 2009, https://360.gs.com.

research been published on the macro consequences of these policies? Are they likely to reduce the savings rate? More broadly, these are the kinds of questions that the major savings countries need to be asking themselves, and sharing with the IMF and G20. They are especially pertinent now that more evidence is available about Q4 2008 GDP growth – or the lack of it. Within the widespread weakness, it is striking that both Germany and Japan (along with a number of other Asian exporting countries) saw their GDP decline more than the US, despite the fact that they are supposedly not suffering from the same excesses. Clearly, they are highly vulnerable to external weakness. Policies need to be introduced that not only shift this dependency but somehow contribute so much to domestic demand that there is a significant impact on the import growth of those countries. Of course, these issues bring us back full circle to the questions raised about what the G20 can or cannot realistically expect to achieve collectively.

There is one other area where I believe the G20 could reasonably have a genuine chance for coordination, and this is with respect to policies to address climate change and encourage alternative energy use, and the case for further procyclical fiscal policy expansion. Many of the G20 leaders – especially given the change of administration in the US – appear to broadly share a goal of reducing CO_2 emissions in the atmosphere; how much will become apparent by the time of the Copenhagen Summit in December 2009. If they are eager to demonstrate their commitment to lead the world's population down the path of improved energy efficiency and seek alternative energy sources, plans could be coordinated through this channel, for instance through some kind of coordinated taxation policy to raise fuel taxes on large vehicles, together with subsidies or even 'gifts' to enhance home insulation, and other measures. Although it would be difficult for the G20 to agree a plan of action by 2 April, an announcement of such plans, along with proposals for reformed international governance, might be the best demonstration that our leaders are using this current grave crisis to adapt to the challenges of the future, as well as those of today.

Regionalism and Monetary Consolidation

Paola Subacchi

Global imbalances and the eruption of the global financial crisis have shown the limits of financial globalization and the tension between domestic agendas and global issues. Like trade, the exchange rate is at once cause and effect of such tension. Much political activity has been directly or indirectly shifted towards the exchange rate in ways that imply new economic and political divisions. Fixing the exchange rate in a world of mobile capital implies forgoing national monetary policy autonomy in favour of greater certainty about the value of the currency. And this raises problems of international policy cooperation.

A new monetary order is required that would require currency consolidation in three main regional blocs, each using a particular currency and featuring a high level of intra-trade. Two of these blocs are already in place: a *de facto* dollar area in the Americas and a single currency union in Europe. The missing one is Asia, where economic integration has been deepening steadily in recent years through the market-driven forces of cross-border trade, foreign direct investment and finance. The G20 should provide a forum for debate relative to the international monetary order while a sub-group limited to the main currency areas would monitor exchange rate arrangements and decide on changes in these arrangements.

A patchy picture

The world economy remains characterized by diverse, uncoordinated exchange rate arrangements, even if stronger economic integration in the last twenty years has resulted in some monetary consolidation, especially following the creation of the single currency union in Europe. In the ten years since its launch the euro has become the second international currency, after the US dollar.

Greater openness to the rest of the world, with a shift from inward-looking import substitution and public-sector investment to outward-looking export promotion and private-sector investment, and growing regional inter-dependence have turned Asia into a key region in the world economy – this is evident even in the current crisis. Partly as a consequence of the crisis of 1997, however, the region presents broad diversity in exchange rate regimes, with no exchange rate policy coordination in place. The two dominant countries, Japan and China, diverge widely in terms of exchange rate regimes, the former being close to a pure float, the latter having a heavily managed, crawling peg regime linked to the US dollar. All other Asian economies adopt intermediate regimes of managed floating with the US dollar as the most important anchor currency. They adjust their dollar exchange rates in line with changes in the bilateral exchange rates of currencies in their baskets, in order to maintain stability in their nominal or real effective exchange rates.

The US dollar plays an important role in Asia both as an anchor currency and – as its very high weight in foreign exchange market trading suggests – as a vehicle currency, mediating exchanges of various currencies. For example, conversion of the Japanese yen into the Korean won is done typically through the US dollar: first the yen is converted to the dollar and then the dollar is converted to the won. This mediating role is usually explained by the low transaction cost, owing to economies of scale and the 'public good' nature of the dollar: people prefer to use dollars because almost everyone else uses them too.

Why exchange rate coordination?

Given Asia's focus on external trade, it makes sense to stabilize the exchange rate *vis-à-vis* the currencies of its main trading partners – the dollar first, and the euro next. Regional interdependence, however, has increased in recent years, in particular in East Asia, where intra-regional trade has been growing. This deepening regional economic integration and the rising business cycle synchronization suggest that in order to maintain intra-regional exchange rate stability, policy coordination would be more appropriate than the traditional policy of pegs to an external anchor, while regional monetary cooperation is apt to intensify as regional integration deepens.

The absence of a common policy framework in Asia means that countries tend to pursue their own domestic objectives regardless of the possible adverse impact on neighbouring economies. Within such a system there is a built-in incentive for each country to err on the side of currency depreciation so as to gain and maintain competitiveness *vis-à-vis* its neighbours. A regional framework for exchange rate regime coordination needs therefore to be developed in order to reduce spillovers and avoid 'beggar-thy-neighbour' types of problems.

How can such coordination be achieved in the region? Exchange rate policy cooperation is not easy. It normally implies several levels of collaboration, from a minimum of information-sharing to the maximum represented by common monetary policy; the provision of mutual support, normally in the form of lending facilities, and a common anchor are intermediate levels.

In the case of Asia, monetary policy coordination requires a gradual, three-step approach complemented by stronger cooperation in the areas of finance and trade. The first step would be for the regional economies to discuss exchange rate issues as part of enhanced economic surveillance. This would imply the development of an index to measure volatility of exchange rates, as well rationalizing policies on the exchange rate and capital account.

The second step would be for those economies to coordinate informally on exchange rate regimes by moving towards greater exchange rate flexibility *vis-à-vis* the US dollar, and then gradually towards the same exchange rate regime. Given the different levels of development among countries in Asia, the most suitable initial regime is the adoption of a managed float, which would offer the additional advantage of moving China to a more flexible regime.[1] This level of policy coordination should be relatively easy to achieve and manage.

The third step would be to secure a credible regional monetary anchor through a combination of some form of national inflation targeting and a currency basket system. Since the Japanese yen has only a limited degree of internationalization, and the Chinese yuan lacks full convertibility, the challenge here is to find a suitable currency basket, particularly for regional currencies.[2]

Choosing the US dollar as the region's sole monetary anchor is no longer the best policy. East Asia now has strong economic ties with the world's major economies and regions, so that dollar-pegs can be too restrictive. Research shows that in GDP terms the area covered by the US dollar has declined from 53 per cent of the world economy in the early 1970s to about 45 per cent in 2005–07.[3]

Choosing either the yen or the yuan, or both, as a monetary anchor on the basis of the size and importance of Japan and China would be an obvious choice. However, it would not be advisable, given Japan's relative economic decline and the yuan's limited international role – although a peg to the yuan would be desirable from a trade perspective. Other East Asian economies, however robust their monetary policies, are too small for their currencies to take on a meaningful international role. This clearly makes it desirable to introduce a mechanism for intraregional exchange rate stability based on a currency basket, as no single currency is capable of playing a monetary anchor role, at least in the near future.

As Japan would maintain its current free float, the other economies in East Asia, including China, should adopt, at least as the first step, a basket system based on the three main currencies – dollar, euro and yen. By so doing, they could enjoy more stable effective exchange rates, with less susceptibility to dollar–yen and dollar–euro fluctuations than a standard US dollar-based system. Korea and Thailand, in recent years and without any formal commitment, appear to have already adopted a similar regime.

1. China's yuan revaluation in July 2005 and its shift to a managed crawling peg is already a step in the right direction.
2. There would be another step towards full coordination, which would imply the creation of a regional system similar to the Exchange Rate Mechanism (ERM) in Europe. However, given the lack of economic convergence and political agreement, this is not a feasible option.
3. Masahiro Kawai, 'Toward a Regional Exchange Rate Regime in East Asia', *Pacific Economic Review* 13 (1) (2008), pp. 83–103.

This system could then be replaced with a basket in which a weighted sub-basket of regional currencies, including the yen, yuan, won, etc., is substituted for the yen.

The solution: exchange rate cooperation?

Exchange rate policy coordination is a gradual process that can be strengthened within the existing policy dialogue among the region's finance ministers (such as ASEAN+3) and central bank governors (such as EMEAP, the Executives' Meeting of East Asia-Pacific Central Banks). Greater political support for economic policy coordination could even eventually lead to further institutional integration capable of supporting intraregional exchange rate stability. Indeed, Asia as a whole may not be an optimum currency area, but several sub-groups of the region's economies may form currency areas.[4] For this to happen, substantial convergence will have to be achieved across countries in the region in terms of economic, financial and structural conditions, performance and policies.

Even if regional institutions do become pivotal, there is a role for the G20 policy dialogue, as exchange rate regimes are not a matter solely for countries in the region. The accumulation of reserves by Asian countries is already causing controversy at the international level and raises the issue of both the relevance and the governance of the IMF. Moreover, the dollar may weaken as a result of the current crisis and the rapid slowdown of the US economy, putting upward pressure on the other main currencies and pegged currencies. This process may be destabilizing unless accompanied by closer policy coordination and more intensive exchange rate management.

Failure to incorporate the exchange rate policy dialogue within the G20 process may result in Asia drifting towards inward-looking regionalism. A great deal of regional financial cooperation is already in place through the Chiang Mai Initiative – a network of credit arrangements connecting the East Asian countries – the Economic Review and Policy Dialogue, and the Asian Bond Markets Initiative. Strengthening these initiatives through further enlargement and a reduction in the link to the IMF could set Asia apart in the international economic dialogue. It is therefore critical to provide a window within the current process to discuss Asia's policy options. At the same time, greater collaboration and harmonization needs to be encouraged between the region's finance ministers and central bank governors as well as among the region's financial supervisors and capital market regulators.

4. See Shingo Watanabe and Masanobu Ogura , 'How Far Apart Are Two ACUs from Each Other?: Asian Currency Unit and Asian Currency Union', Bank of Japan Working Paper Series No. 06-E-20, November 2006.

A significant compression in the US current account deficit is likely in the coming years

Let the Exchange Rates Find Their New Equilibrium

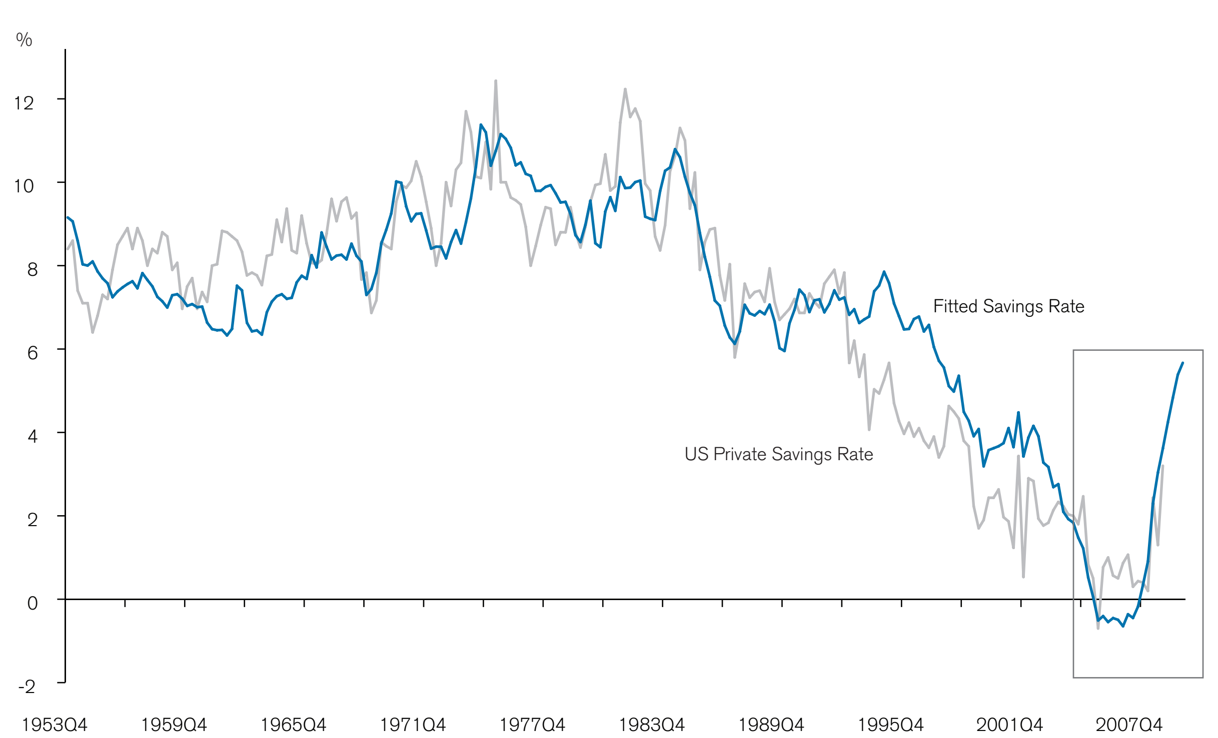
Stephen L. Jen

There are some issues that the G20 needs to address, but in my view exchange rates are not one of them. A significant structural realignment in the world's external imbalances is unfolding, and currency flexibility should be permitted to allow exchange rates to find their new equilibrium levels.

The immediate and medium-term outlook for the global economy remains unclear. However, a sharp compression in the US current account deficit is likely to be one of the most important trends in the coming years, with obvious implications for the rest of the world. During the past cycle, the US ran very large current account deficits (US$7 trillion in 2008 dollars, which coincidentally is similar to the total size of foreign reserves in the world). These are not likely to be repeated in the years ahead. The declining (since 1985) and low (especially during 2004–08) private savings rate in the US was mostly a function of the bloated housing and equity wealth, and not a reflection of irrational behaviour by US consumers. Now that this wealth has been eroded, the rate is likely to rise from roughly zero in recent years to 5.7 per cent by end-2009.

Figure 1 shows the actual US private savings rate. Further expected declines in housing and equity wealth suggest that the US private savings rate will continue to

Figure 1: US private savings rate, 1953–2008



rise, potentially to the 8–10 per cent range that prevailed up to the mid-1980s. This should, in turn, facilitate a compression in the US current account deficit that will only partially be offset by public dis-savings.

As a footnote to this discussion, the popular argument of the last few years that the US dollar should be used as a tool to normalize global imbalances may have been misplaced. Recent developments suggest that the underlying causes of, and therefore the cure for, global imbalances are more closely related to factors that contributed to the housing and equity bubbles than to misaligned exchange rates. Fixation on exchange rates, rather than financial and regulatory policies that mattered for asset prices, may have misled policy-makers.

Narrower savings deficit will pose a challenge to many emerging-market economies

While it is important to ask how long and how deep the current recession will be, perhaps an even more important question is what the *configuration* of the global economy will be in the 'new' world. Specifically, what will be the growth trends for the previously export-dependent economies (including those in Asia and Latin America), which had been buoyed by the unsustainable US current account deficits? Will their potential growth rates be lower than in the past years? To the extent that global demand for oil had been artificially boosted by these US deficits, indirectly raising the world's demand for energy products, oil-exporting countries will also be adversely affected by this coming structural compression.

Fair values of EM currencies changed?

Fair value (FV) calculations are regression-based. If the world has indeed changed, FVs based on historical and traditional variables are no longer valid. Further, these models usually only include real variables and not the 'balance sheet' variables that are so important now. In response to the structural balance-of-payments shift, if authorities in countries worldwide no longer know where the FV or the equilibrium values of their currencies will be, they will have difficulty in justifying heavy level-defending interventions. If anything, there is now an incentive for those in authority to let exchange rates find their new equilibrium. This point also applies to emerging-market countries with hard pegs: when the fundamental FVs change, pressures on these pegs could reflect genuine gapping down of the shadow FVs, rather than speculation.

Issues for the G20

1. ***Domestic demand in Asia***. The benefits of Asia's adopting a development strategy centred on domestic demand are clear, but it is less clear how this objective can be achieved. There are a number of reasons why China's private-sector savings rate is so high, apart from a cultural proclivity to save. Redesigning a viable social safety net that will be appropriate for the demographic trends in China will take time. The G20 is an appropriate forum for a clarification by the capital surplus nations on how they plan to stimulate domestic demand to offset the rise in savings in the US.
2. ***A more modest goal for the G20***. There have been a number of proposals in the media that may not be deliverable. What are the realistic objectives of the G20 in the current environment? The G20 should exercise care to manage and not to inflate investors' expectations. It should be seen, first, as the preferred forum to enhance communications among the members, just as much as a platform for coordinated actions. Second, it may be difficult for the G20 to agree on collective action: if the G7 could not reach an agreement on concrete coordinated policies, what can be expected of the G20? In turn, the G7's actions are limited by the difficulties experienced by the members of the EU/EMU in reaching an agreement on important issues. Third, as general deleveraging continues, investors are likely to ask whether the world can remain 'multi-polar' and to find the answer far from clear. What we have learned so far in this crisis is that the world is coupled to and reliant on the US. Unless the US financial markets and economy stabilize, it is difficult to see the rest of the world

stabilizing. Are we, then, in a way, not moving back to a 'G1'-dominated world?

3. ***Eastern Europe–Eurozone the next flashpoint?*** The Eastern Europe–EMU/EU nexus is a serious and inadequately addressed issue. In contrast to much of the rest of the world, Eastern Europe has a typical balance-of-payments crisis. How Western Europe deals with this crisis will have implications for the Eurozone and the euro itself. Important structural ambiguities in the EMU that were intentionally put in place to enhance fiscal prudence in the member countries now need to be clarified. In general, there are acute trade-offs between the measures that may need to be deployed to deal with complications related to the balance-of-payments crisis in Eastern Europe and the long-run implications of such measures for the Eurozone.

4. ***Fix versus flex – the long-standing debate on the preferred currency regime***. The G20 should exercise care not to impose too much rigidity on exchange rates. While exchange rate *volatility* may at times become excessive, and interventions may be needed, currency *flexibility* is desirable as the long-term economic fundamentals experience significant changes. Further, the international community needs to have a consistent stance on how it confronts countries' choices of exchange rate regimes. On the one hand, fixed exchange rate regimes are seemingly celebrated in Europe (e.g. in Latvia or Spain), regardless of whether the parities are consistent with the external balances. On the other hand, they appear to be criticized when Asian countries try to peg to the dollar.