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China and the United States:
A G2 Within the G20

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OVERVIEW

The case for strong and effective Group of Twenty (G20) leadership is as compelling as ever. But if the G20 is to be as effective in noncrisis times as it was in 2008–2009, it needs stronger Chinese leadership, working informally yet closely with the United States—a Group of Two (G2) within the G20. Debt policy is one area where China and the United States should cooperate this year.

G20 IN UNCERTAIN TIMES

Last week I attended two conferences in Asia on China's leadership in the G20. My takeaway from the discussions: the global economy is increasingly interdependent and interconnected, and faces substantial headwinds that no country alone can effectively address. Concerns include weak global demand, shockwaves from falling commodity prices, and capital flight from emerging markets, as well as the systemic threats from income inequality and unbalanced development, terrorism, and climate change. It is hard to imagine a more consequential time.

Most readers would agree that these challenges call for a strengthened global architecture, anchored by the reinvigorated G20. Yet the moment requires brutal honesty: in important respects, the prospects for effective

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policy coordination are the poorest in decades. Many leading countries are still repairing the damage from the Great Recession, limiting their economic capacity—and will—to respond to longer-term challenges. Perhaps more worrisome, Europe and the United States are experiencing a strong populist wave, particularly among voters frustrated by stagnant income growth and trade's dislocations, which rejects the organizing principles and policies governing global markets and threatens to reverse a generation of

globalization. If the G20 is to recapture the credibility it had when addressing the worst of the financial crisis in 2008–2009, it will require both growth-supporting policies and a stronger appeal to the general public on trade, integration, and strengthened international policy coordination.

I do not wish to be entirely pessimistic here; the world has come a long way since the spring of 1973, when the U.S. treasury secretary met with the finance ministers of France, West Germany, and the United Kingdom in the library of the White House to discuss the international financial system after the collapse of the Bretton Woods agreement on fixed exchange rates. In creating the Library Group, the United States sought a more candid and informal grouping, one less dominated by European countries than the Group of Ten (G10). There were important subsequent efforts to include emerging powers in the discussion, such as the Willard Group, the Group of Thirty-Three (G33), and the creation of the G20 at the ministerial level in September 1999, but the Group of Seven (G7) remained the leading economic policy coordination body. It was not until 2008, when the G20 was raised to the leaders' level, that the goal of “broaden[ing] the discussions on key economic and financial policy issues among systemically significant economies and promot[ing] cooperation to achieve stable and sustainable world economic growth that benefits all” was achieved.

The G20 was extraordinarily effective in 2008–2009, coordinating economic policies, mobilizing emergency rescue funds, and reforming financial markets. It is not surprising that countries come together in times of crisis and coordinate to take actions that would not have occurred under ordinary circumstances. But the effectiveness of the G20 has diminished as the sense of crisis has receded and national interests have reasserted. Coordination is easier in times of crisis; it takes more political will to coordinate without a concrete threat to stability.

Perhaps this degree of coordination is good enough. In stable times, relationships are developed in international forums, knowledge is gained, and preparations are made, forming muscle memories that prepare for future crises. Incremental progress is achieved on common initiatives, such as rule setting and financial reform.

There are at least three reasons why the world should aspire to do better. First, the world's large, systemic challenges cannot defer progress until the next crisis. Second, there are important benefits from better integrating emerging powers into global decision-making. This year saw the long-overdue passage of International Monetary Fund (IMF) reform, the inclusion of the renminbi in the special drawing rights, and the creation of new regional development banks. But there is more that the emerging powers can and should do to lead in building consensus on critical issues.

Third, the world may not be ready for the next crisis. Fiscal policy—the first line of defense against shocks—is constrained by politics and a legacy of deficits and debt. Central banks have aggressively eased monetary policy to support growth but face diminished effectiveness. IMF resources, while ample, have not kept pace with the growth in markets. And populist pressures risk distracting governments at the worst time. All of this has contributed to what former Treasury Secretary Robert Rubin recently termed “secular policy stagnation”—political systems not functioning effectively to address their respective policy challenges.

CHINA'S G20 YEAR

For the G20 to be effective in coming years, China will need to move beyond its own perception of responsibility to represent the interests of emerging markets and take a broader leadership role, working closely with the United States on issues of shared interest. This is not a call for a new secretariat or formal grouping, but rather, “a close working relationship ... that would supplement (not supplant) the existing steering committees, including the G-7/8 and the newly dominant G-20, and the multilateral institutions (notably the IMF and WTO),” as the economist C. Fred Bergsten explained in testimony before the House Committee on Foreign Affairs in 2009.

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Recent progress on climate change is one example of strengthened G20 progress. For September's G20 summit in Hangzhou, China, an agreement is needed on measures to strengthen demand globally (a deal that was sought but failed to materialize at the February meeting on finance ministers and central bankers). China can also play a leading role in fostering better international cooperation on debt restructuring for countries

experiencing repayment stress. My Policy Innovation Memorandum from 2014 called for a revamped Paris Club for official creditors, including China as a member, which would carry out transparent, efficient, and fair restructurings for countries such as Venezuela by recognizing internationally accepted principles of good-faith negotiation.

Of course, crisis prevention is always preferable to crisis resolution, and Chinese leadership can be constructive in creating conditions for countries to approach the IMF at an earlier stage, without the stigma that international support usually carries. The G20 has already called for improving the terms of existing debt contracts. In addition, the G20 could revisit swap-line proposals that were floated during South Korea's G20 presidency.

CONCLUSION

These are modest steps, reflecting a cautious view of progress that can be made in the coming year. The odds are already stacked against the G20, making breakthroughs on the big issues difficult to achieve in the current environment. New standing committees risk ossifying the process further. *G20 needs new ideas and new leadership to move the global economy forward.* Flexible, informal efforts are more promising, including processes anchored on stronger partnerships among the most important countries in the G20, in order to create momentum within the entire group. This is a return to “variable geometry”—relying on different groupings of countries for different purposes—albeit one with an internal G20 component as well. At the center of this effort is a strengthened U.S.-China relationship. Other countries within the G20 may be understandably wary of China's rising role, making effective communication critical. But such an informal arrangement appears essential to getting the G20 back on track.

The G20 remains the preeminent global policy coordination body. It needs new ideas and leadership to move the global economy forward and resist the pressures to reverse course. China should play a central role along with the United States—a G2 within the G20—to support that process with ideas that are ambitious yet realistic, and that can be explained convincingly to the general public.

Looking Ahead: Kahn's take on the news on the horizon

Greece

After months of delay, Greece aims to complete the first review of its 86 billion euro (\$98 billion) bailout program by late April. If successful, the review could facilitate the negotiation on debt relief with official creditors, but a new IMF program remains in doubt.

G20

The second meeting of G20 finance ministers and central bank governors will be held in Washington, DC, later this week. The last meeting in February did not generate bold policy initiatives, and it is questionable whether the April meeting will produce tangible commitments and actions.

South Africa

Despite surviving an impeachment vote, President Jacob Zuma will face continuing political struggles. This will hinder the government's ability to effectively tackle the country's economic troubles, including a weak growth outlook, high unemployment rate, and accelerating inflation.