POLICY BRIEF

LOWY INSTITUTE
FOR INTERNATIONAL POLICY

APRIL 2006

MARK THIRLWELL
Program Director
International Economy
Tel. +61 2 8238 9060
mthirlwell@lowyinstitute.org

MALCOLM COOK
Program Director
Asia and the Pacific
Tel. +61 2 8238 9070
mcook@lowyinstitute.org

GEEING UP THE G-20

WHAT IS THE PROBLEM?

Globalisation implies a big increase in the payoffs from successful cross-border economic cooperation. Yet the main international institutional mechanisms designed to facilitate such cooperation, the G7 and the IMF, are not up to it. Both the G7's membership and the IMF's governance structure significantly under-represent several key players in the modern global economy, a potentially fatal handicap when it comes to tackling some of the most pressing challenges now facing policymakers. Moreover, neither gives Australia a permanent seat at the top table.

The good news is that an obvious alternative to these waning institutions already exists. The G-20 is a more representative body than either the Euro-centric 'rich country' G7 or an IMF whose governing body is still largely a product of an Atlantic economy-dominated twentieth century. And Australia is a member of the G-20. Despite its great potential, however, the G-20 currently lacks the status and public profile of the G7 and as a result is often perceived to be something of a poor relation.

WHAT SHOULD BE DONE?

Australia hosts the G-20 annual meeting this November in Melbourne. As one of the G-20 members that would benefit the most from its institutional elevation, Australia should use the occasion to continue the process of transforming the G-20 into a more effective and prominent part of the global economic architecture.

To this end, Australia should:

- *Have the short-term goal of solidifying the G-20's existing role in the international economic architecture and the long-term goal of promoting the G-20 as a replacement for the G7 as the steering committee for the world economy.*
- *Press on with its advocacy of the G-20 as a forum for advancing the cause of IMF and World Bank reform in general and of quota reform in particular.*
- *Encourage the G-20 to also focus its attention on medium and long-term economic challenges such as resource security and demographic change, where its breadth of membership offers a perspective unavailable to the narrower G7.*
- *Argue against proposals to upgrade the G-20 to an 'L20'. For now, the idea is a non-starter and would serve only to distract attention from the more pressing task of improving the status of the G-20 itself.*

LOWY INSTITUTE FOR
INTERNATIONAL POLICY
31 Bligh Street
Sydney NSW 2000
Australia
Tel: +61 2 8238 9000
Fax: +61 2 8238 9005
www.lowyinstitute.org

The Lowy Institute for International Policy is an independent international policy think tank based in Sydney, Australia. Its mandate ranges across all the dimensions of international policy debate in Australia — economic, political and strategic — and it is not limited to a particular geographic region. Its two core tasks are to:

- produce distinctive research and fresh policy options for Australia's international policy and to contribute to the wider international debate.

- promote discussion of Australia's role in the world by providing an accessible and high quality forum for discussion of Australian international relations through debates, seminars, lectures, dialogues and conferences.

Lowy Institute Policy Briefs are designed to address a particular, current policy issue and to suggest solutions. They are deliberately prescriptive, specifically addressing two questions: What is the problem? What should be done?

The views expressed in this paper are the authors' own and not those of the Lowy Institute for International Policy.

Introduction: Australia at centre stage

For the next two years, Australia will be one of the main stages for international diplomacy, gifting Canberra a unique chance to shape both the regional and the global policy agenda. This year, Melbourne will host the G-20 and next year Sydney will host the APEC leaders' meeting,[1] two of the most important international policy meetings ever held here. APEC 2007 will likely generate far more headlines, not least because of the glamour endowed by the presence of major world leaders, and will also benefit from a budget that dwarfs the much more modest funding allocated to the Melbourne meeting.[2] Yet while APEC gives Australia a well-known, if now somewhat shop-worn, regional platform, the G-20 offers something potentially more important – the opportunity to have a key voice in managing the global economy.[3] No other forum offers this to Australia.

True, much – but not all – of what the G-20 *currently* offers remains largely in the realm of potential. Indeed, while APEC today may be an institution at risk of fading away, the G-20 faces the perhaps more depressing prospect of failing to live up to its potential. In order to help the G-20 avoid that fate, Australia needs to focus on three important policy challenges.

- First, and most obviously, Australia needs to ensure that this year's G-20 meeting is a success in terms both of content and administration. This will help ensure that the campaign to upgrade the status of the G-20 retains its current momentum.

- Second, Australia needs to continue to establish itself as an important force in the G-20, and therefore as a voice to be heard when advocating institutional change. Delivering a successful meeting this November will of course contribute to this.

What is the G-20?

The G-20 is a consultative body of finance ministers and central bankers that meets annually. It comprises all of the members of the G7, plus the EU presidency and a geographically diverse selection of other major economies (see Tables 1 and 2 in the Appendix for G7 and G-20 membership). Other participants in G-20 meetings, on an ex-officio basis, include the Managing Director of the IMF, the President of the World Bank, and the chairs of the International Monetary and Financial Committee and the Development Committee of the IMF and World Bank.

Established in 1999 as the successor to the American-led G22 group announced at the 1997 APEC Summit, the G-20 was originally intended to be a consultative forum to discuss reform of the IMF and World Bank and to ponder the future of global financial architecture. The G-20 was established in the aftermath of the Asian financial crisis of 1997-1998. The fact that East Asia, until then widely seen as the world's most dynamic and economically successful region, could be so quickly crippled by financial crisis undermined faith in the ability of the G7 and the Bretton Wood institutions to manage the new global economy. With no existing regional or global economic body faring particularly well during the crisis, the G-20 was promoted as part of an initiative to address growing concerns about the potential instability and resultant backlash engendered by globalisation.[4]

Reflecting these origins, the G-20 began by focusing on reforming the IMF and World Bank and addressing the causes of financial crises. However, its agenda has broadened significantly since then, with recent topics of discussion including the fate of the WTO's Doha Round and the issue of energy and minerals security. In other words, its agenda now basically encompasses that of the G7.

- Third, Australia should work towards promoting the G-20 as the premier international body addressing international economic management and cooperation, where its breadth of membership offers a perspective unavailable to narrower groupings like the G7.

Ultimate success in this third ambition would not only produce a body better placed to manage the challenges posed by today's global economy, but would also secure Australia a seat on this international economic steering committee. Failure, on the other hand, would leave the task of managing globalisation in the hands of institutions that, by virtue of their skewed membership, are increasingly ill-suited to the job, and which allow Australia no permanent voice.

Reviewing the architecture: who manages the world economy?

Like beige safari suits and wide ties, international policy coordination is out of fashion. Instead, the prevailing belief – at least in most of the major Western capitals – is that the pursuit of national economic self-interest will naturally deliver reasonable outcomes at the global level. Still, even if this intellectual environment means that the current degree of cross-country policy coordination is limited, there does remain a core international economic architecture. This comprises the two Bretton Woods institutions, the International Monetary Fund (IMF or 'the Fund') and the World Bank, as well as the G7 and the World Trade Organization (WTO). The G7 and the IMF take the lead in terms of international macroeconomic policy, the World Bank is the pre-eminent global development institution, and the WTO looks after international trade.[5]

> ***How the G-20 works***
>
> While the annual meeting of G-20 finance ministers and central bank governors is the central event in the G-20 calendar, it is not the sum total of the G-20 process. It is preceded by two deputies' meetings and a series of workshops, reports and case studies on specific subjects that help prepare the groundwork for the main event.[6]
>
> Unlike the IMF or World Bank, the G-20 has no permanent staff of its own. Instead, organisational responsibility each year devolves to whichever country is chairing the meeting. The chair establishes a temporary secretariat for the duration of its term which co-ordinates the group's work and organises its meetings.
>
> The G-20 chair rotates between members, and is selected from a different regional grouping of countries each year. The chair is also part of a revolving three-member management troika of past, present and future chairs. This troika helps ensure continuity in the G-20's work and management across host years.
>
> In 2006, the G-20 chair is Australia, and in 2007 it will be South Africa (see Table 6).

While all of these bodies have important roles, the IMF and the G7 are at the top of the pile when it comes to guiding the broad direction of the world economy. The G7 has the greater leadership or strategic role, while the IMF is the key implementing institution.

The IMF is a product of the historic July 1944 conference held at Bretton Woods in the United States and of the lessons learned during the economic dislocation of the interwar period. Bretton Woods aimed to rebuild a world economy that had been destroyed by the First and Second World Wars, and

it was to help with this task that the Fund (together with the World Bank) was established in 1945. Like the G-20, Bretton Woods was the child of crisis.

From the 25 countries that signed the IMF's articles of Agreement in December 1945, the Fund has since seen its membership grow to 184, giving it a virtually global membership.[7] Today, the IMF talks to virtually every government in the world about economic policy. It has become the main venue for international discussion of the settings of national economic policies, and it is also the institution that analyses those issues that have implications for the health of the international financial system and the world economy as a whole.

The IMF is run by its members on the basis of a weighted voting system, whereby the number of votes wielded by a country is linked to the size of its quota, which is the subscription a country pays when it becomes a member. Quotas in turn are determined by a complex system of five formulas that links quota allocation to various measures of an economy's presence in the world economy, including GDP, reserves and current account receipts and payments.[8] There is a rough correlation between the size of an economy (GDP) and the size of its quota, and hence its share of votes. The United States (US) currently has 371,743 votes (about 17% of the total votes), while tiny Palau has just 281 votes (0.013% of the total), for example.[9] However, the fact that GDP is only one of the variables taken into account means that the relationship between country size and quota is currently quite a limited one, a failing that has become increasingly apparent as quota distribution has failed to track the growing role in the world economy played by several major emerging market economies.

All IMF members are represented on the Board of Governors, but as this typically meets only once a year, an Executive Board implements most of the IMF's daily work. This consists of 24 Executive Directors and is chaired by the Managing Director. The Fund's five largest shareholders — the US, Japan, Germany, France, and the UK — as well as China, Russia, and Saudi Arabia, all have their own seats on the Board while the other 16 Executive Directors are elected for two-year terms by groups of countries, known as constituencies. Table 3 lists the Executive Directors and the votes they command.

Since the Executive Board is mainly focused on the day-to-day running of the Fund, in theory the major *policy* issues up for discussion are considered twice-yearly in another committee of Governors called the International Monetary and Financial Committee, or IMFC. The IMFC has the same national representation as the Executive Board. In practice, however, IMFC meetings are largely staged, set-piece affairs, and little of substance is decided there. Indeed, in the words of our colleague Stephen Grenville, the discussion at the IMFC has all the dynamism and spontaneity of a lip-synced pop-singer.

The real action in this regard takes place at meetings of the G7, making it the closest we currently have to a 'steering committee for the world economy'.

The G7 is an informal group of finance ministers and central bank governors from the US, Japan, Germany, UK, France, Italy and Canada (see Table 1). While the IMF was conceived in the 1940s, the G7 has its origins in the 1970s (originally as the G5), when the major industrial economies, realising the need for more policy coordination in a world of floating exchange rates, started to get together on an ad hoc basis to discuss major economic and financial issues. The G7 formally dates from 1986, when the Canadian and Italian Finance Ministers were invited to join the original five members. Since 1987, G7 finance ministers and central bank governors have met regularly to monitor and

assess developments in the world economy and the international financial system, and to discuss the future of the Bretton Woods institutions.

There is also a heads of state counterpart to the G7. In 1997, this leaders' meeting became known as the G8, to reflect Russia's participation. Until then, G8 Foreign Ministers and G7 Finance Ministers had met in conjunction with G8 Summits, but in 1998 the group introduced a 'leaders only' format, and there remains a clear distinction between the G8 Summit process and the G7 Finance Ministry and Central Bank process.

Membership in the G7 has remained unchanged since the late 1980s. In 1992, Russia was invited to observe the G7 meeting but a US proposal to include Russia as a full member was rejected (although Russia is a member of the G8). More recently, the G7 finance ministers and central bank governors have met informally with their Chinese counterparts, first in Washington in October 2004 and then again in London in 2005. India also received and accepted an invitation to the London 2005 meeting.

Cracks in the foundations: why the current architecture is past its sell-by date . . .

Unfortunately, the effectiveness of the current international architecture is undermined by the fact that these leading bodies – the IMF and the G7 – face serious legitimacy deficits and growing fears for their relevance.

Moreover, from the perspective of national self-interest, neither of these bodies gives Australia a permanent seat at the top table. Australia is of course not a member of the G7. In addition, at present Australia is represented by a Korean Executive Director at the IMF, and provides the alternate to the Korean director. This will change from November this year, when Australia will once again provide the lead director. Even then, however, the risk is that the sheer diversity of the constituency that the Australian director will have to represent (see Table 4) means that Australia's own views will be muted.

The most fundamental shortcoming of the current international economic architecture, however, is that it fails to adequately represent the make-up of the new global economy. Most of the existing structure was created at a time when the centre of world economic gravity spanned the Atlantic Ocean and was anchored by Western Europe and North America. In the last two decades, the geographic distribution of economic power has shifted, with a much larger role both for key emerging markets and for the Asian region. One consequence is a now pressing need for dramatic renovation.

In the case of the IMF, for example, it has long been recognised that several major emerging market economies, including Korea, China, Mexico, Turkey and Brazil, are under-represented relative to their current weight in world output.[10] Moreover, on a regional basis, East Asia currently has a smaller voice in the IMF than is warranted by its economic size, a discrepancy that has become more evident over time with the region's growing economic weight. Australian Treasurer Peter Costello made this shortcoming the focus of his comments as the host–in-waiting at the 2005 G-20 meeting in Xianghe, China.[11] Despite the steady rise in the economic importance of Asia, the distribution of IMF voting power remains weighted in favour of the old 'Atlantic' economy – Canada has the same number of votes as China. At an aggregate level, for example, the EU has roughly 31% of votes in the IMF, while the ASEAN+3 economies have just 13% between them. Compared to their respective shares in output, this leaves the East Asian bloc

significantly under-represented and several other regions including Western Europe, Africa and the Middle East looking over-represented (see Chart 1 in the annex).[12] The IMF's perceived European bias is further aggravated by the Fund's unwritten rule that the Executive Director must be a European national.

Chart 1 also highlights the fact that the apparent degree of under-representation for ASEAN+3 is much greater when world output is measured using purchasing power parity (PPP) rates than when market exchange rates are used. While there are strong grounds for believing that PPP measures are the most appropriate way to compare economies, the current consensus in terms of IMF quota reform is that market exchange rate measures are the appropriate metric, since they better capture the capacity of members to provide resources to the Fund and to repay any borrowings.[13]

These problems with representation are a major shortcoming for the IMF, since they serve to undermine the legitimacy of the institution and increase the risk that under-represented members will look for alternative regional venues where their voices may be better heard.

Moreover, the Fund is also struggling with the need to define its current role in the new global economy. Originally created to manage a now long defunct system of pegged exchange rates, the IMF has had to reinvent itself several times in its history. Now, confronted with a global economy in which private capital flows have relegated official financial flows to a minor role, and where a growing number of economies feel that they no longer need to pay heed to Fund advice, the question of what the IMF is for is once again being raised. Answering that question rests with the membership, but if the answer is to be a sustainable one, then the representation issue must also be confronted.

While strengthening the legitimacy of the IMF and giving the institution a new strategic direction are both important policy objectives, they would not necessarily ensure that the international economy benefited from an effective steering committee. Due in part to the failings of the IMFC, this is the role that effectively resides with the G7 at present.

Although its smaller size and more informal nature mean that the G7 may be a far more *effective* body than the IMFC, at least in terms of producing meaningful policy discussion, the problem of declining relative representativeness is even more acute here. This is most obviously the case in terms of the distribution of world population. Even in the 1970s and 1980s, the G7 members accounted for less than one-fifth of world population, while today they account for barely 10% (Chart 2). True, population size is, at best, a very weak proxy for economic weight. But it is a much stronger one for global legitimacy. The fact that the world's most populous countries have no voice in the premier international economic body is problematic, and likely to become more so over time.

Still, the world economy is not and should not be run as a democracy, and the G7 *does* do a better job of representation when it comes to world output. Measuring world GDP using US$ market exchange rates, the G7 membership still accounts for more than 60% of world output, although this share has shrunk in recent years. On a purchasing power parity (PPP) basis, the G7's share is much lower, at closer to 40%, and once again a declining trend is evident (Chart 3). The G7's falling share of world economic aggregates is also visible in other economic indicators, including trade (Chart 4).

Numbers are only part of the problem. A more important shortcoming is that the skewed membership of the G7 means that its ability to tackle

some of the most pressing issues in international policy is strictly limited. For example, recent G7 communiqués have addressed a series of important challenges facing the world economy. The list includes global imbalances and exchange rate flexibility; oil prices and energy security; the future of the Doha Round of world trade negotiations; development and debt relief; emerging market risk; the future of the IMF and World Bank; and security and terrorism. On most of these issues, the membership of the G7 can expect to have only a limited influence at best.

One particularly egregious example of this failing is the series of communiqués issued by the G7 on global imbalances and exchange rate flexibility. A large part of this message was clearly intended for China and the rest of emerging East Asia, with its large current account surpluses and quasi-mercantilist exchange rate policies. But these economies are not members of the G7 (although as noted above, China has been invited to attend some sessions). Similarly, discussions on energy security are hampered by the fact that there are no longer any significant energy exporters in the G7. Again, when it comes to world trade, the group does not contain any members of the 'other' G20 (that is, the G20 (trade), a group of developing countries that has been playing an important role in the Doha Round negotiations since the 2003 WTO ministerial meeting at Cancun).

Renovation needed: why the world economy still needs a steering committee

Is the declining relevance of the current international economic architecture really a big deal? Why not just scrap an anachronistic G7 and instead rely on the workings of national policies and markets to deliver the appropriate economic outcome – after all, isn't that pretty much what happens now?[14] Such prescriptions neglect the basic reality of living in an increasingly interdependent world economy.

In particular, one crucial feature of the modern world economy is the presence of spillovers or 'externalities' from *national* policies or events that influence the *international* economic environment. For example, one country's decision to devalue or revalue its exchange rate will influence the relative competitiveness of other economies: witness, for example, the huge amount of attention that has been focused on the future of China's exchange rate policy. Thus many believed that the Asian financial crisis which sired the G-20 would have been much more traumatic if the Chinese had let their currency depreciate, while today policymakers debate the contribution of a Chinese exchange rate adjustment in dealing with global imbalances. More dramatically, a serious financial crisis in one economy can spread through contagion effects to other economies in the same region, or further, with the Asian financial crisis and its aftermath again a powerful example.

Such spillovers create the possibility of policy coordination failures. For example, in the early 1980s, many economies in the developed world tightened monetary policy in an effort to stamp out high inflation. Unfortunately, with each country tightening policy, the collective result was that each individual country ended up tightening policy 'too much' once global monetary conditions were taken into account, producing a greater fall in economic activity than had been anticipated. Moreover, this bout of uncoordinated tightening sharply increased the debt servicing costs of many heavily exposed developing countries and helped trigger the 1980s 'debt crisis' that crippled Latin America for a decade. A better result for all concerned could have been achieved if some form of international coordination had been in place.

Even in the absence of efforts to coordinate, or just exchange information about, national macroeconomic policies, countries still need to come together to agree on the standards, regulations and international rules of the game that smooth the operation of cross-border flows of goods, services, capital and labour.

In an interdependent world, national economic welfare is a product not just of a country's own economic policies (and policy mistakes), but also of the economic policies that are pursued elsewhere, and of the established rules of the game. As the degree of international economic integration increases, there will be an increase in the number and magnitude of spillovers between economies, and hence in the potential payoffs from successful international cooperation and standard setting. Since international economic integration – globalisation – is one of the defining features of today's global economy, this provides a strong case for *strengthening* the international economic architecture rather than dismantling it.

Renovators' delight: the case for the G-20

Given the need for an effective global steering committee and the G7's declining suitability for that role, the pressing policy requirement for the world economy is to find an appropriate alternative.

The good news is that a potential replacement for the G7 in the form of the G-20 – an institution officially endorsed by the G7 itself in a bout of self-reflection about its own shortcomings – already exists. G-20 membership encompasses that of the G7 and so retains the accumulated membership strengths of that grouping. But critically, it also includes representatives of the major emerging markets that the forces of globalisation are now turning into increasingly important players in the world economy.

The greater breadth and diversity of G-20 membership gives it some clear advantages in terms of legitimacy. By way of contrast to the relatively non-representative G7, the G-20 membership accounts for more than 60% of the world's population (Chart 5).[15] This 'legitimacy gap' between the two groups will become even greater over time, as the ongoing global demographic transition will continue to see a sharp decline in the share of the developed economies in world population.

The G-20 also does a better job than the G7 of capturing the shifting geographic distribution of economic weight in the world economy. True, as we have already seen, G7 members continue to account for a healthy share of the world economy, but that share is declining. Measuring world output using US dollar exchange rates shows the G-20 membership now accounting for almost 80% of world output, compared to closer to 60% for the G7. The gap is more apparent on a PPP basis, where the G-20's share of world GDP (again almost 80%) is almost double the share of the G7 (Chart 6). In coming years, the gap between the two groups is, again, set to increase, as economies such as China, India and Brazil (all G-20 members) continue to increase their share of world output. Other economic indicators, such as trade, tell a similar story, with the G-20 capturing a significantly greater share of world activity in its membership (Chart 7).

More than numbers explain why a generational change from the G7 to the G-20 is a good idea. As argued in the review of the G7 above, an important determinant of a club's membership composition should be whether the membership is suited to dealing with the issues that the club cares about most. Looking at the issues highlighted by the G7's recent communiqués, the G7 membership is now failing this test, since on many of these issues the group either has little power to influence the outcome, or represents only one side of a debate.

In contrast, a review of the same list – global imbalances and exchange rate flexibility; oil prices and energy security; the future of the Doha Round of world trade negotiations; development and debt relief; emerging market risk; the future of the IMF and World Bank; and security and terrorism – shows that the G-20 membership is much better placed to tackle the issues.

For example, in terms of global imbalances and exchange rate policy, the G-20 includes China and Korea as key representatives of emerging East Asia; with regard to energy security issues, the G-20 includes significant energy exporters such as Australia, Indonesia, Saudi Arabia and Russia; and in respect of the Doha Round, the G-20 also includes key members of the now important 'other' G20 group of developing countries (see Table 5).

Moreover, the G-20 is also the natural venue to discuss the future of the Bretton Woods institutions. All of the permanent representatives on the IMF Executive Board are G-20 members, and the group also brings together the leading emerging markets that have a key stake in the future of the IMF and Word Bank.

Another important strength of the G-20 grouping is that it combines this breadth of membership with a manageable size. Clearly, there is a trade-off to be made between the size and diversity of a club's membership and the ease of reaching a decision. The G7 does benefit from its small size and relatively homogenous membership, but this comes at a high and rising cost. In today's global economy, the G-20 represents a much better trade-off.

Construction problems: the case against

The benefits that the G-20 offers in terms of legitimacy have as their downside the problems associated with increased group size and diversity, including the likely greater difficulties of reaching concrete decisions. Experience suggests a strong inverse relationship between the size and diversity of international organisations and their ability to deliver more than hot air. The G-20 can be seen as one point along a line representing the trade-off between the benefits of relatively small groupings and the need to be legitimate, and it is open to debate whether it is the best point. G7 summits are already large affairs, and adding another set of countries adds considerably to the organisational burden. Promoting the G-20 as an eventual successor to the G7 would cut against those proposals that would concentrate the world's steering committee into a *smaller* grouping such as a G4 (comprising the US, Japan, the EU and China).[16] Similarly, it is possible to question whether the current membership of the G-20 is the appropriate one.

There is also growing discussion in G7 circles of keeping that group relevant by adding a small number of new members, with China, India and Brazil the front-runners.[17] The invitations to China, India and others to join some G7 meetings can be seen as testing the waters for G7 expansion into the developing world. Thus, instead of the G-20, the new steering committee for the world economy could be some form of G7+.

There may be merit to some of these arguments, but the case for the G-20 remains a strong one. One important advantage of the G-20 is that it already exists and is broadly representative: any alternative arrangement – with a different membership list – would face two big disadvantages. First, reaching agreement on just which countries should be involved would almost certainly be a painful and long drawn-out process. Second, it would add yet another new body to an international financial architecture already burdened by a proliferation of bodies and approaches. For example, along with

the G7, the G-20 and the IMFC, other bodies (in various states of health) include the G10, the G15, the G24, the G30 and the G77.[18]

Again, while a G7+ model might represent a potential alternative to the G-20, it may not be an attractive option for the prospective members. China, for example, would face the prospect of being lectured at by a bunch of developed economies over its exchange rate policy, which might not be an enticing prospect. It is notable that while China has attended some G7 meetings, Beijing declined an invitation to attend the April 2005 G7 gathering. The G-20, with its more diverse membership and fewer political overtones, may be a less prestigious forum than the G7 (at least for now), but it may also be a more welcoming one. Indeed, the current process, by which some of the larger G-20 members who are not G7 members are invited to attend G7 meetings on an ad hoc basis, is in many ways a rather condescending one. The G7's 'guests' are only invited to attend a small portion of the overall proceedings, making them at best second-class temporary members.

The building inspectors' report: Today's G-20

Despite its great potential, today the G-20 remains something of a poor relation to the G7, lacking the status and clout of the older body. The annual G-20 finance ministers' meetings have a low public profile and even suffer from name confusion, with the G-20 brand increasingly identified with the newer grouping of developing countries in the WTO. The most recent G-20 finance ministers' meeting in Xianghe on October 15-16 2005 barely registered in the international (or Australian) media: President Hu Jintao's opening speech gained the most attention while the actual forum deliberations remained largely unreported.

There is a case to be made that this low profile is not all bad. Operating largely under the radar screen means that the G-20 can avoid some of the drawbacks associated with higher profile meetings. Arguably, there is less need for political posturing and media-friendly sound bites, and more scope for informal, substantive discussion.

Moreover, the G-20 does have some modest achievements to its name. It already serves as a valuable mechanism for building up informal relationships between policymakers, which has an important – but admittedly hard to quantify – effect on international policy discussions that often only comes to the fore during crises when swift, coordinated policy responses are required.[19] Australian policymakers and officials, for example, have been able to use the G-20 to help forge ties with their counterparts in other member economies. This has been the case with China, where as part of the management 'troika' that runs the G-20 meetings process, Australia had an important role in helping with last year's meeting in Xianghe. Of course, this kind of benefit is routinely attributed to just about every international gathering of policymakers. But from Australia's perspective the breadth and weight of the G-20's membership does offer access to a useful spectrum of policymakers beyond that provided by regional bodies.

The G-20 has also made efforts in the direction of the adoption of internationally recognised standards in areas such as fiscal policy transparency, and it has sought to make use of the wide range of experience provided by its membership to improve policy. One example of the latter is the G-20 Accord for Sustained Growth.[20]

The most important focus of current G-20 work, however, is the reform of the Bretton Woods institutions, particularly the IMF. Ultimately, any decision on Fund reform rests with that institution's

membership and the IMFC. Nevertheless, the nature of the G-20's membership makes it a natural forum in which to hammer out the outlines of an agreement to improve IMF legitimacy, and to think about the Fund's long-term strategic direction. The 19 country members of the G-20 between them currently account for 15 of the IMF's 24 executive directors, for example (Table 3), and G-20 members include many of the economies that are most under-represented under the current arrangements.

Home improvement: What can Australia do?

2006 is Australia's year to chair the G-20. Australia should use the opportunity provided by hosting November's meeting in Melbourne to advance the cause of the G-20 as an alternative to the G7. As one of the members that would benefit the most from its institutional elevation, Australia should seize the occasion to improve the chances of transforming the G-20 into a more prominent part of the global economic architecture. What can Australia do to advance this program?

The immediate task is to focus on the short-term goal of solidifying the G-20's existing role. Two objectives apply here.

- First, and perhaps most obviously, Australia needs to deliver a successful meeting in order to maintain both the momentum behind the case for the G-20 and to sustain the positive aura that currently exists around the organisation. This not only involves the current meeting, but also continuing with Australia's good work in the existing management 'troika' by working with South Africa to ensure that next year's meeting is also a successful one. Newer organisations like the G-20, as it has already discovered, can gain much momentum from smoothly run summits and lose much from shambolic ones.
- Second, delivering a successful meeting goes beyond logistics. As chair, Australia will also want to help the G-20 deliver concrete progress on a key element of the current work program: the reform of the Bretton Woods institutions. In particular, if November's meeting can deliver significant progress along the path to quota reform, and so go some way to addressing the problem of IMF legitimacy, this would represent both a significant win for the group itself, and be of great benefit to the health of the international financial architecture overall. Australia, as a country which will not gain directly from quota reform, is well placed to help broker a deal (although the fact that Australia won't resume its place on the IMF Executive Board until late this year does complicate this task somewhat).

This short-term goal should be supplemented by the longer-term vision of establishing the G-20 as an eventual replacement for the G7. Importantly, this may be almost as much about focusing on things that the G-20 should *not* be doing, as thinking about what it *should* do.

- Australia should encourage the G-20 to remain broadly focused on areas where its core competencies are relevant: international economic and financial issues where the expertise of finance ministries and central banks can be brought to bear. Any push to go too far beyond this mandate runs the risk of inflicting the same kind of overstretch that has done so much to undermine the focus, and hence the credibility, of other international organisations such as APEC.
- That said, the lines between what constitutes economic and financial policy, and what constitutes foreign or security policy, are becoming increasingly blurred in today's global economy. Australia should therefore encourage

the G-20 to continue to focus on issues such as resource security and demographic change which, although not solely the purview of central banks and finance ministries, nevertheless pose significant medium and long-term challenges to the international economy. These are subjects where the G-20's breadth of membership means that it is better placed to deliver a comprehensive response than less representative bodies like the G7. A successful demonstration of its comparative advantage in this way will encourage finance ministers and central bank governors to continue to value the forum and help promote the G-20's long-term claim as the pre-eminent body for managing the global economy. Moreover, the multi-year nature of these issues will provide a degree of continuity across different G-20 chairs.

- Australia should support the G-20's playing a leading role in setting out the strategic direction for the IMF and World Bank, a task for which its broader membership is again much better suited than the G7. Reforming the governance of the Bretton Woods institutions is only one stage in renovating the international architecture.

- Australia should oppose any suggestions to upgrade the G-20 to a leaders meeting (L20).[21] While the case for an L20 may make sense in the long term, at present there seems to be no realistic prospect of leading G-20 members such as the United States and Japan agreeing to such a proposal. Moreover, the strongest advocate of this policy, former Canadian Prime Minister Paul Martin, has been removed from the board as a result of Canada's recent elections. As a result, efforts to push for progress in this direction would be both futile and counterproductive, serving only as a distraction from the potential embodied in the G-20 as a tool of international *economic* policy. Overt pressure for an L20 could also increase the G7's interest in limited internal expansion. Similarly, Australia should also oppose any external proposals to involve civil society groups in the evolution of the G-20.[22] The best way to increase the legitimacy of the international economic architecture is by giving greater say to more representative bodies like the G-20, not by increasing access to civil society.

Conclusion

Relative to the G7, the G-20 offers important gains both in terms of legitimacy and in terms of effectiveness. Its greater diversity and breadth of membership means that G-20 is well placed to replace an increasingly anachronistic G7 as the peak international economic body. Australia's hosting of the G-20 meeting in Melbourne this November provides it with an important opportunity to advance this objective, the achievement of which would be good both for the long-term quality of international economic policymaking, and for securing Australia a voice in the running of the world economy. By encouraging the G-20 to become the natural venue to discuss key issues such as IMF reform, Australia can help upgrade the current international economic architecture and increase the status of the G-20 itself.

Appendix

Table 1: G7 membership

	Population (mns)	GDP (US$ b)	GDP (PPP $b)
Canada	31.9	1,106.2	1,111.8
France	60.0	2,113.4	1,811.6
Germany	82.6	2,799.8	2,498.5
Italy	57.6	1,718.9	1,694.7
Japan	127.8	4,672.3	4,009.3
UK	59.4	2,196.8	1,825.8
US	293.5	12,452.4	12,332.3
Total	712.8	27,059.8	25,284.0
share of world total	*11.2%*	*61.7%*	*42.5%*

Sources: IMF world economic outlook database for GDP. World Bank Development Indicators online for population. Note data for population are for 2004, GDP estimates are for 2005.

Table 2: G-20 membership

	Population (mns)	GDP (US$ b)	GDP (PPP $b)
G7 Total	712.8	27,059.8	25,284.0
G7 share of world	*11.2%*	*61.7%*	*42.5%*
Argentina	38.2	177.3	516.9
Australia	20.1	683.8	638.7
Brazil	178.7	789.3	1552.5
China	1,296.5	1,909.7	8091.9
India	1,079.7	746.1	3602.9
Indonesia	217.6	270.2	863.7
Korea	48.1	799.7	1099.1
Mexico	103.8	758.0	1064.9
Russia	142.8	772.1	1585.5
Saudi Arabia	23.2	314.2	337.3
South Africa	45.6	234.1	532.0
Turkey	71.7	353.2	570.7
G-20 total	3,979	34,867.6	45,740
G-20 share of world	*62.7%*	*79.5%*	*76.8%*

Sources: IMF world economic outlook database for GDP. World Bank Development Indicators online for population. Note (1) data for population are for 2004, GDP estimates are for 2005 (2) Table does not include the EU.

Table 3: IMF Executive Directors and voting shares[23]

Country	Number of constituents	Share of votes (%)	G-20 Member?
United States	-	17.08	Yes
Japan	-	6.13	Yes
Germany	-	5.99	Yes
France	-	4.95	Yes
UK	-	4.95	Yes
Saudi Arabia	-	3.22	Yes
China	-	2.94	Yes
Russia	-	2.47	Yes
Belgium	10	5.13	
Netherlands	12	4.84	
Mexico	8	4.27	Yes
Italy	7	4.18	Yes
Canada	12	3.71	Yes
Norway	8	3.51	
Korea*	14	3.33	Yes
Egypt	13	3.26	
Malaysia	12	3.17	
Tanzania	19	3.0	
Switzerland	8	2.84	
Iran	7	2.47	
Brazil	9	2.46	Yes
India	4	2.39	Yes
Argentina	6	1.99	Yes
Equatorial Guinea	24	1.41	

*Australia's group

Source: http://www.imf.org/external/np/sec/memdir/eds.htm

Table 4. Australia's constituency at the IMF

Country	Number of votes	Share of total votes (%)
Australia	32,614	
Kiribati	306	
Korea	16,586	
Marshall Islands	285	
Micronesia	301	
Mongolia	761	
New Zealand	9,196	
Palau	281	
PNG	1,566	
Philippines	9,049	
Samoa	366	
Seychelles	338	
Solomon Islands	354	
Vanuatu	420	
Total	72,423	3.33

Source: http://www.imf.org/external/np/sec/memdir/eds.htm

Table 5. G7, G-20 and G-20 (trade) Memberships compared (in order of GDP)

G7	**G-20 (finance)**	**G20 (trade)****
United States of America	European Union *	China
Japan	United States	Mexico
Germany	Japan	India
United Kingdom	Germany	Brazil
France	United Kingdom	Indonesia
Italy	France	Saudi Arabia
Canada	Italy	South Africa
	China	Thailand
	Canada	Argentina
	South Korea	Venezuela
	Mexico	Pakistan
	India	Chile
	Australia	Philippines
	Brazil	Egypt
	Russia	Cuba #
	Turkey	Nigeria
	Indonesia	Guatemala
	Saudi Arabia	Uruguay (Cont...)

G7	G-20 (finance)	G20 (trade)**
	South Africa	Tanzania
	Argentina	Bolivia
		Paraguay
		Zimbabwe

Source: IMF (2005)

* The sitting president of the European Union is a member of the G-20 (finance) and the European Union's combined GDP is larger than that of the United States.

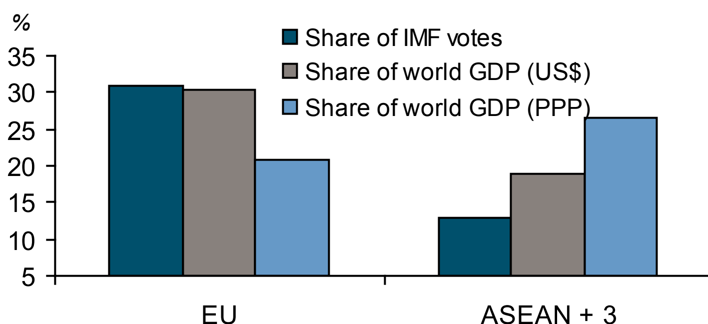
** The G-20 contains 19 countries, while the number of members of the G20(trade) has changed over time, with membership often numbering more than 20.

Cuba is not a member of the IMF. GDP figures relating to its ranking taken from ALADI (Latin American Integration Association).

Table 6. G-20 Chairs

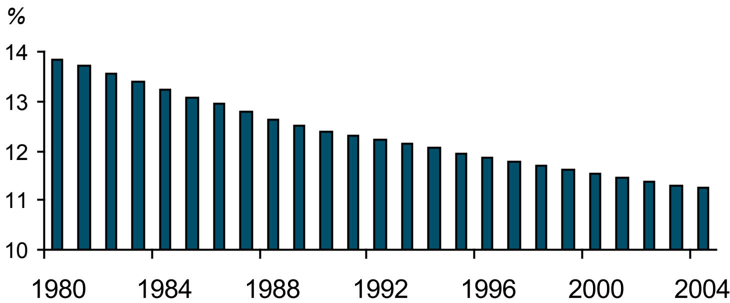
Year	Country
1999-2001	Canada
2002	India
2003	Mexico
2004	Germany
2005	China
2006	Australia
2007	South Africa

Chart 1



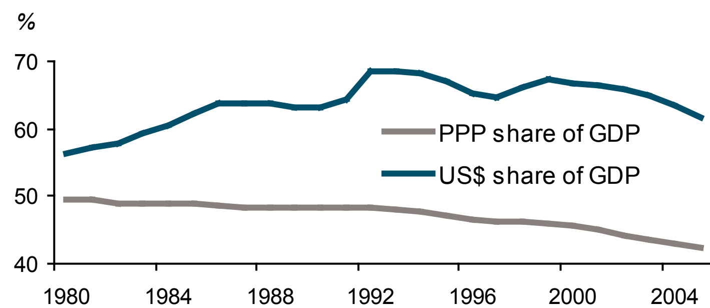
Sources: Data on the share of IMF votes comes from http://www.imf.org/external/np/sec/memdir/members.htm. Data on the share of world GDP is calculated from the IMF September 2005 World Economic Outlook database, available at http://www.imf.org/external/pubs/ft/weo/2005/02/data/index.htm.

Chart 2



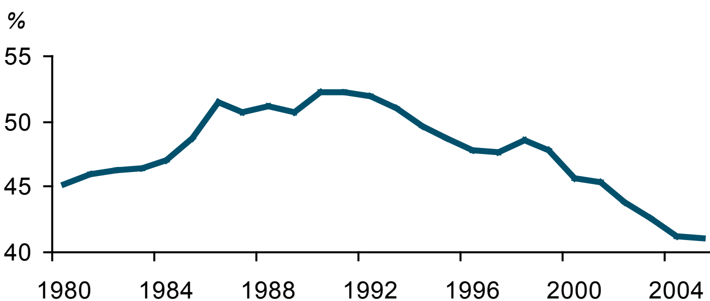
Source: World Bank World Development Indicators

Chart 3



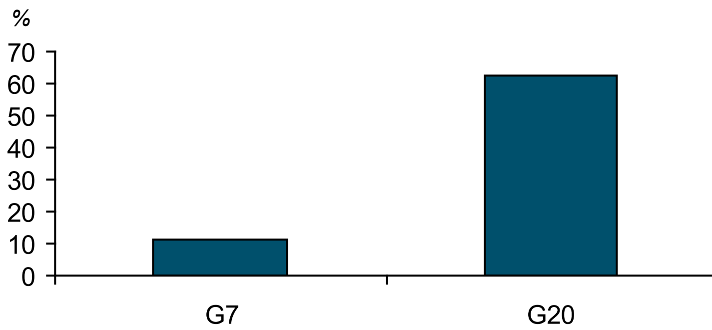
Source: calculated from http://www.imf.org/external/pubs/ft/weo/2005/02/data/index.htm.

Chart 4



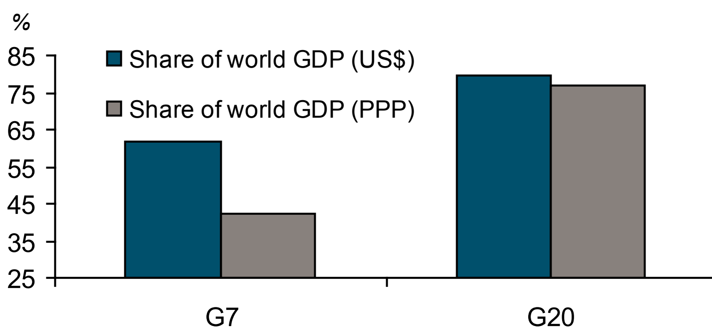
Source: WTO international trade statistics

Chart 5



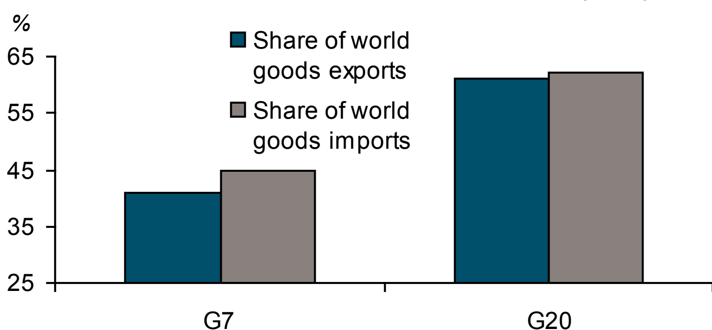
Source: World Bank world development indicators

Chart 6



Source: September 2005 IMF World Economic Outlook database

Chart 7



Source: WTO international trade statistics

Notes

[1] For one view on how Australia should approach APEC 2007 see Allan Gyngell and Malcolm Cook, *How to Save APEC*, available at http://www.lowyinstitute.org/Publication.asp?pid=305

[2] The federal government's budget for hosting APEC 2007 is approximately $215,000,000, more than ten times the allocation for G-20 2006. See http://www.G-20.org/Public/index.jsp for details about Australia's role as G-20 host this year.

[3] We have made the case for a more prominent role for the G-20 before. See for example Time to push the G-20 vision, *Australian Financial Review*, 19 April 2005, and G7 should step aside for more representative body, *Australian Financial Review*, 29 September 2004. Our colleague Stephen Grenville has also presented similar arguments. See Building a new financial order, *Australian Financial Review*, 21 November 2005.

[4] John Kirton, *From G7 to G-20: Capacity, leadership and normative diffusion in global financial governance*. Honolulu, 2005, International Studies Association Annual Convention.

[5] It is of course possible to quibble over exactly which institutions should be included here. Other important international economic or financial institutions include the Bank for International Settlements (BIS) and the Organisation for Economic Co-operation and Development (OECD).

[6] See http://www.G-20.org/Public/AboutG-20/index.jsp

[7] For more detail about the origins, structure, membership and governance of the IMF, see http://www.imf.org/external/pubs/ft/exrp/what.htm

[8] The variability of current account receipts and the ratio of current receipts to GDP are also included.

[9] Quotas are reviewed (and sometimes increased) at regular intervals of at least every five years. The last review – completed in 2003 – left quotas unchanged. The next review (the thirteenth) is scheduled to be completed by January 2008.

[10] Some developed economies are also significantly under-represented relative to their economic weight in the world economy, particularly Japan and the United States.

[11] Hamish McDonald and Tim Colebatch, Costello's G-20 agenda. *The Age*, 17 October 2005.

[12] ASEAN plus three comprises the ASEAN membership (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) plus the big three of China, Japan and Korea. Most of the under-representation of ASEAN + 3 relative to output reflects the underweighting of the '+3' in IMF quotas. For a detailed discussion of the IMF quota and voting system, and relative country representation, see Treasury Working Paper 2004-03 by Karen Taylor, Craig Tipping and Adam McKissack, *IMF quotas, representation and governance*, 2004. http://www.treasury.gov.au/documents/929/PDF/Treasury_Working_Paper_2004-03.pdf

[13] PPP rates are constructed exchange rates that equate the cost of a typical basket of goods across countries, by making adjustments to take into account the fact that the price of non-traded goods and services will differ across countries. Typically, such prices tend to be significantly lower in emerging economies, so these sorts of adjustments mean that measures of global output using PPP exchange rates give much higher weights to developing countries like China and other members of the ASEAN+3 than do output shares measured using US$ rates. There is a continuing debate over the relative merits of

using GDP measures based on market exchange rates or PPP rates. For a strong argument that PPP measures are the appropriate choice when making cross-country comparisons, see Ian Castles and David Henderson, International comparisons of GDP: issues of theory and practice. *World Economics* 6 (1) 2005.

[14] This was also the argument made by advocates of floating exchange rates during the heyday of the Bretton Woods system of pegged exchange rates. 'Floaters' argued that removing exchange rate pegs would restore monetary policy independence and at the same time provide shock absorbers to external shocks. While floating did restore a large degree of monetary policy freedom, disappointment with some aspects of the reality of floating rates after the breakdown of the Bretton Woods regime nevertheless prompted efforts at policy coordination to manage exchange rates in the form of the Plaza communiqué (1985) and the Louvre accord (1987).

[15] Note that for this comparison between the G7 and the G-20 and the ones that follow, the G-20 numbers are actually for the G19, since we restrict the comparisons to the individual economies involved, and do not include the EU in the G-20 figures. If the EU as a whole is included, G-20 member countries represent around 90 per cent of global gross national product, 80 per cent of world trade (including EU intra-trade) and roughly two-thirds of the world's population.

[16] C. Fred Bergsten, *A new steering committee for the world economy*. Washington, 2005, Conference on IMF reform. Such a group might make sense in terms of discussions about coordinating global exchange rates, for example. If some variant of the G4 proposal did take effect, however, it would presumably be more likely to replace the G7 than the G-20, since technically only Canada would be left unrepresented from the original G7.

[17] Seema Desai. *China and the G8*. 2005: www.openDemocracy.net.

[18] Details on some of these other groups are available from their web sites, including http://www.g24.org/, http://www.group30.org/, and http://www.g77.org/

[19] As an example of this benefit in action, linkages within East Asia and between Australia and the region built up through the little-known EMEAP (Executives' Meeting of East Asia-Pacific Central Banks) meeting of central bankers played an important role in the regional response to the Asian crisis.

[20] See http://www.G-20.org/Public/Publications/Pdf/2004_G-20_accord_for_sustained_growth.pdf

[21] The case for an L20 has been made several times. See for example John English, Ramesh Thakur and Andrew F Cooper ed *Reforming from the top: a leaders' 20 summit*. United Nations University Press, 2005.

[22] For advocates of this view, see for example chapter 20 in English, Thakur and Cooper.

[23] Not included in this table are the votes of Somalia. Also excluded are Zimbabwe and Liberia, whose voting rights have been suspended. Total vote shares may not sum to 100% due to rounding.

About the Authors

Mark Thirlwell is Program Director, International Economy at the Lowy Institute for International Policy. Mark is a graduate of Cambridge University and has an MPhil degree in economics from Oxford University. Before joining the Institute, Mark worked as an economist for the Bank of England, JP Morgan and the Australian Export Finance and Insurance Corporation.

He is the author of the Lowy Institute Papers ***India: the next economic giant*** and ***The new terms of trade.***

Dr. Malcolm Cook, Program Director, Asia Pacific Region at the Lowy Institute for International Policy, completed a PhD in international relations from the Australian National University, and holds an MA in international relations from the International University of Japan and an honours degree from McGill University in Canada.

Before moving to Australia in 2000, Malcolm lived and worked in the Philippines, South Korea and Japan and spent much time in Singapore and Malaysia. Before joining the Institute in November 2003, Malcolm ran his own consulting practice on East Asian political and economic policy risk analysis.

He is the author of the Lowy Institute Paper ***Balancing act: Taiwan's cross-strait challenge***.

LOWY INSTITUTE
FOR INTERNATIONAL POLICY

WWW.LOWYINSTITUTE.ORG