G20
Mexico & the World

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Food for thought
Mexican president Felipe Calderón explains why food security is at the top of the G20 agenda **Page 5**

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Leaders aim to make a difference

Can participants at the Los Cabos summit be more than interested observers of a global crisis? The precedents are not encouraging, writes **Chris Giles**

No smoke without fire: miners block a motorway with burning tyres near Oviedo in Asturia, Spain during protests against plans to cut coal subsidies AP

Crisis is again stalking the Group of 20 summit. As the leaders of the world's most powerful countries fly to Los Cabos in Mexico, the dark mood that surrounded previous summits in Washington, London and Cannes is back.

In the past week, the eurozone has added Spain to the list of countries needing financial assistance. After this supplement went to press, Greece voted in a second election that is properly viewed as a referendum on its continued membership of the European single currency.

The shockwaves of the developed world's financial and economic crisis are still reverberating around the global economy almost five years since it started in August 2007.

The Los Cabos summit offers the G20 a chance to show whether a gathering of world leaders can play a more constructive role than just important and interested observers of the continued crisis.

Recent history suggests not. Last November at the Cannes G20 summit, the agenda was completely overshadowed by internal eurozone matters, occurring partly at the summit venue, but not part of the formal G20 discussions.

Under huge pressure from financial markets, Silvio Berlusconi, then Italian prime minister, accepted intensive European and International Monetary Fund surveillance of the country's economy, but this failed to quell the storm and he resigned days later.

Greece's situation was even more critical. George Papandreou, its then prime minister, suggested the country hold an in-or-out referendum on the euro, shocking other eurozone leaders who thought this would destabilise the situation further. He was summoned to Cannes, told to think again and quit within a week. Amid this drama, the G20 agreed little.

The danger for the G20 and Mexico, the country sitting in the chair in 2012, is a repeat of the Cannes experience. Held in another tourist resort, Los Cabos, on the southern tip of Mexico's Baja California Peninsula, the summit risks becoming an exercise in firefighting – for Spain and again Greece – rather than fulfilling the G20 ambition of creating strong, stable and balanced global economic growth through co-operation in the world's "premier economic forum".

The global economic situation is serious. The eurozone is on the edge of renewed recession and avoided it only though Germany's remarkable strength. Many European countries are in recession. US growth is again slowing, raising the prospect of further monetary stimulus in the months to come. And emerging economies, the powerhouses of global growth since 2009, are no longer finding expansion so simple. Growth has slowed across all the large emerging economies – Brazil, Russia, India and China – and immediate prospects look weak.

At the heart of the renewed loss of confidence in the global economic outlook, the eurozone is struggling to find solutions to the crisis that are acceptable to all amid a further intensification of the strains that have now required Spain, Ireland, Portugal and Greece to seek loans from other European institutions.

Far from giving two weeks or even two months respite as previous eurozone rescues have usually brought, markets reacted badly within two days to the €100bn bailout of Spain's banks, underlining growing worries about the EU's ability to contain the contagion.

In its recent economic outlook, the Organisation for Economic Co-operation and Development, the international organisation aimed at improving the performance of advanced economies, warned of a vicious circle in the eurozone "involving high and rising sovereign indebtedness, weak banking systems, excessive fiscal consolidation and lower growth".

In such a precarious situation, world leaders, finance ministers and heads of international organisations have all offered their preferred solution to the crisis.

Fearful of the spillovers from a eurozone meltdown to the US economy, president Barack

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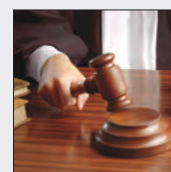

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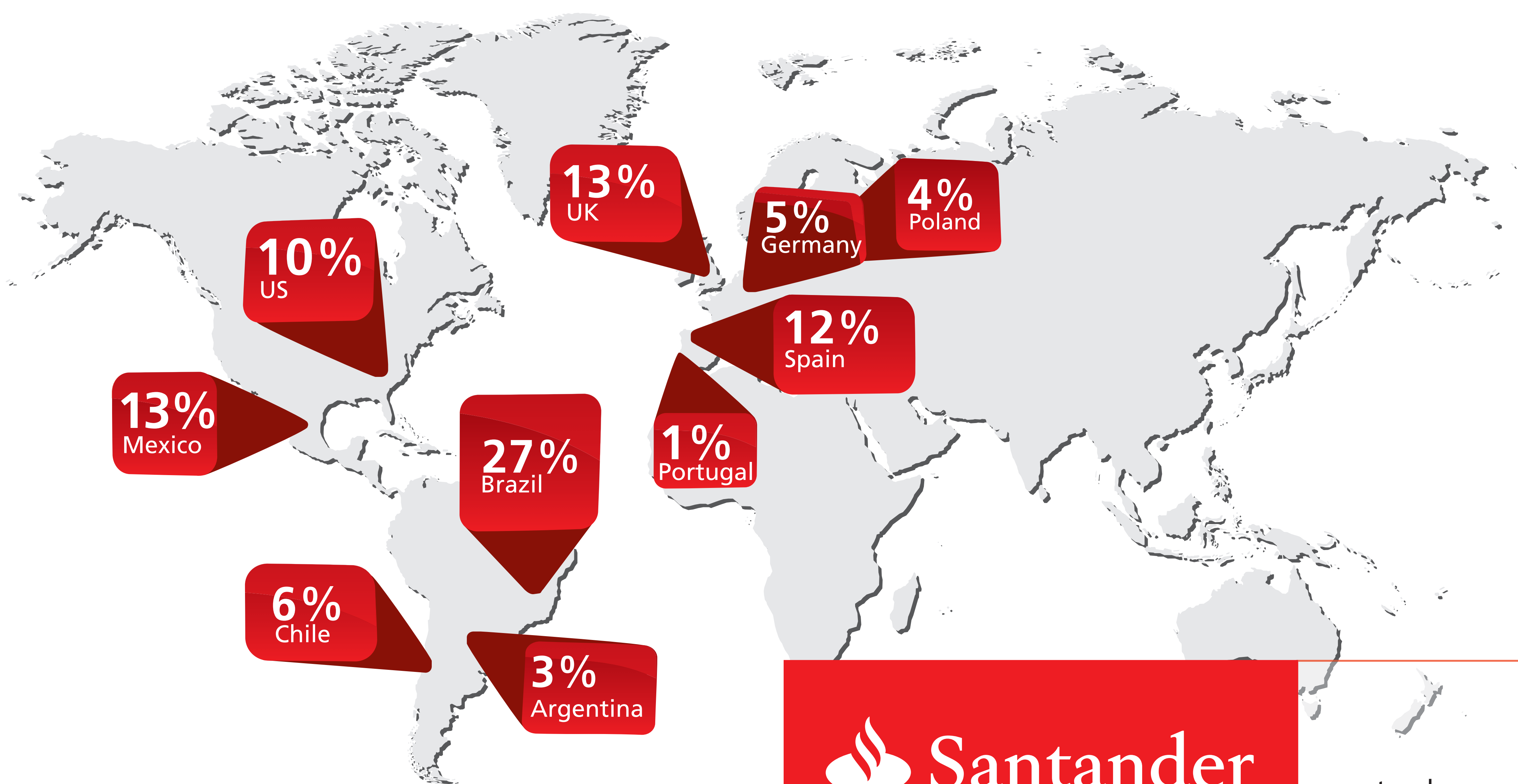
A DIVERSIFIED GLOBAL BANK

Banco Santander with a presence in 10 core markets

Geographical distribution of attributable 2012 Q1 profit:



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Laying down the law: a slowdown in the pace of new regulation would be welcomed by the banking industry Dreamstime

Economic slowdown has put brake on global reforms

Regulation

New rules are behind schedule, as countries focus on growth, says **Brooke Masters**

Since G20 leaders signed up to an ambitious regulatory reform programme in 2009, their gatherings have become a moment to take stock of the worldwide effort to make banks safer and the broader financial system more resilient.

On the plus side, significant progress has been made this year on designing new global rules for everything from derivatives and credit rating agencies to "systemically important financial institutions" (Sifis) and the gathering and keeping of financial data.

But implementation has been slow, and cross-border faultlines are appearing, as national regulators meet to write tough global rules and then go home and implement them in ways that appear to favour their local preferences.

When the International Monetary Fund published a scorecard in April of the six main streams of reform, only one area (forcing banks to hold more and better capital) was judged to be well advanced, and three (derivatives, data, and so-called "shadow banking") were seen to be lagging well behind schedule.

Even on capital, the Basel Committee on Banking Supervision, which writes the global bank safety standards, said this month that only three of the 27 Basel member countries had issued final rules to implement the Basel III standards that are due to begin taking effect in January. Eighteen more have draft rules and six have not put out anything at all.

Meanwhile, events have overtaken some of the goals, with some policy makers in Brussels arguing that a single pan-EU bank supervisor is necessary to restore market confidence in the 27-nation bloc, and China announcing it will delay bank capital rules until next year because of fears its growth is slowing.

In the run-up to the Los Cabos meeting, global regulators meeting as the Financial Stability Board (FSB) have brought out a range of proposals, from a plan to assign every wholesale market participant a unique "legal entity identifier" to proposals to identify and regulate Sifi insurance companies.

But the regulatory "to do" list remains long, topped by cross-border plans for winding up troubled global banks and efforts to channel and control shadow banks – non-banks that also extend credit to the real economy. It is not clear whether participating countries have the will or the capacity to work together on longer-term reforms, analysts say.

Richard Reid, research director of the International Centre for Financial Regulation, says: "The agenda for a G20 summit is likely to be dominated by current events rather than the longer-term, loftier aims that may have been envisaged earlier.

"If economic conditions fail to improve, or they deteriorate, national authorities will be tempted to pursue implementation tailored to their own needs, perhaps at the expense of the desired international, co-operative approach," he adds.

The Basel committee has already raised concerns over EU and Japanese plans to implement the Basel III rules that diverge from the global agreement in ways that loosen the definition of capital for their home institutions.

> 'Regulators have been right to slow things down to get things right'

The need to focus on economic and political issues could make it easier for the G20 leaders to defer to the experts on regulatory policy, some analysts say.

Barbara Matthews, a US-based regulatory consultant, says: "Regulatory policy issues will take a back seat to larger geopolitical and geoeconomic issues, if not full-blown crisis management. Viewed in the most positive light, this could provide regulatory policy makers with breathing room to focus on technical issues with minimal political interference."

But she predicts that the real result is likely to be less benign.

"It is perhaps more realistic to expect that political and economic volatility in response to the situation in Europe will make it increasingly difficult for regulatory policy makers to make bold moves that effectively share regulatory sovereignty on a cross-border basis," she says.

A slowdown in the pace of new regulation would be welcomed by the banking industry, which is struggling to cope with the Dodd-Frank financial reforms in the US, the Basel III capital package and a host of EU directives and regulations.

Laura Cox, regulatory partner at PwC, says: "We remain optimistic that effective regulation based on the key pillars of the G20 financial reforms, such as measures to improve capital and liquidity, bank recovery and resolution and market infrastructure, and [to make] derivatives trading more transparent – can return the banking industry to a place of stability in the longer term.

However, she warns: "But these changes are placing significant strains on banks' resources and profitability, so the industry's lending capacity may be proportionately reduced for the foreseeable future, and perhaps permanently."

As a result, some analysts believe the G20 needs to back off and give the industry time.

Gene Ludwig, founder and chief executive of Promontory Financial Group, the consultancy, says: "Demanding more and more regulation and doing it quickly is not helpful. Much has already been done. What is needed now is growth. The regulators have been right to slow things down to get things right."

There are particular concerns about the FSB's promise to promulgate a package of global rules for shadow banking by the end of the year.

David Strachan, another former regulator who is now co-head of Deloitte's centre for regulatory strategy, says: "In considering new rules for shadow banking, the G20 and FSB need to look at the wider picture.

"Credit creation and intermediation outside the regulated banking system have benefits as well as risks.

He adds: "At this juncture, allowing credit to flow into the real economy through as many diverse channels as possible looks to have net benefits in terms of reducing the overall financial stability threat."

But others warn that watering down or delaying the global rules could backfire over the long term.

Tom Huertas, a former UK regulator now with Ernst & Young, says: "Weakening capital standards will, in the first instance, weaken banks. It may or may not revive lending, and reviving lending may or may not revive the economy. Is that a gamble countries should be taking at this stage?"

Greek chaos casts long shadow again

Eurozone

As at Cannes in 2011, moves to restore trust are being undermined, writes **Peter Spiegel**

Last November, when the G20 heads of state met amid rain in the seaside French town of Cannes, all the best-laid plans for a summit focused on financial sector reform and economic growth were waylaid by a small country in the south-east corner of Europe: Greece.

Just days before leaders were to meet, George Papandreou, then the Greek prime minister, unexpectedly announced he would hold a referendum on a new bailout programme for his highly indebted country, setting off renewed panic in eurozone debt markets and forcing EU leaders to summon Mr Papandreou to Cannes, where he received a thorough dressing-down.

Within a week, the referendum was off and Mr Papandreou had resigned.

Now, eight months later, as G20 leaders meet this week in Mexico, their detailed agenda will again be overwhelmed by the political chaos in Athens.

This time, party leaders in Greece will be sorting through Sunday's election results to determine who will lead the country – and whether a new government can agree with the EU on a new bailout, or will be forced out of the euro.

It was not supposed to be like this.

In the intervening months, EU institutions – most importantly the European Central Bank – moved to calm the turbulent waters that Mr Papandreou had released. In the immediate aftermath, the ECB flooded the European banking sector with €1tn in cheap loans, a move many believe saved the global financial system from a credit crunch that could have rivalled that following the 2008 collapse of Lehman Brothers.

In addition, just a few months later, political leaders in 25 of the EU's 27 members signed a new fiscal treaty that committed them to balanced budgets and tough debt and deficit limits that leaders believed would convince financial markets once and for all that the eurozone would never again get itself into such a highly indebted state.

But when Greek voters went to the polls last month and overwhelmingly chose a motley group of political parties that rejected the terms of their new bailout – led by the far-left radicals Syriza – Greece's membership of the eurozone was called into question, leading to fears of bank runs in Europe's periphery that helped force Spain into becoming the fourth bailout victim since the crisis began two years ago.

Moody's Investors Service, the rating agency, wrote this month: "Spain's banking problem is largely specific to the country and is not likely to be a major source of contagion to other euro area countries, except for Italy.

"In contrast . . . Greece's exit from the euro . . . could also pose a threat to the euro's continued existence."

G20 leaders from outside Europe, including Barack Obama, the US president, have in recent weeks urged EU leaders to move more quickly, particularly to shore up its teetering banks – the element of the crisis that most threatens the global economy because of the severe, Lehman-like knock-on effects a series of bank failures in Europe could have elsewhere in the world.

EU officials insist they are moving in the right direction, pointing to the swift decision to rescue Spanish banks – the quickest and most decisive of the four bailouts thus far – and progressing toward a fiscal union to accompany their monetary union.

The next big step will be a report due at an EU summit next week laying out the building blocks for further integration, including a "banking union" that could include a single eurozone banking supervisor with a common deposit guarantee scheme and bailout fund.

The plan will also look at the possibilities for more fiscal integration, including joint eurozone bonds.

But the plan still faces considerable political hurdles, particularly in Germany, which remains resistant to any pooling of sovereign debt or deposit guarantees. Although Angela Merkel, the German chancellor, has made eye-catching pronouncements about her desire for more political union in Europe, senior EU officials say her plan is clear. She will not use German money to help back common eurozone bonds or a bank backstop, unless the eurozone agrees more control over national budgetary decisions.

George Papandreou was summoned to Cannes for a thorough dressing-down from the G20

Brussels has already moved significantly down that path. In addition to the fiscal discipline treaty, the European Commission now has extended powers to dictate fiscal policy to the 17 eurozone countries, which they must follow or risk paying fines.

But officials say that may not be enough for Ms Merkel, who believes Brussels should have even more control. And such control must be backed by democratic legitimacy, Berlin believes, meaning more say by European voters over the make-up of the EU leadership.

Such demands would explain why Ms Merkel has insisted that resolving the crisis will take years, not months.

Such sweeping overhauls would require big changes in European treaties, a process fraught with danger, particularly during a time of nearly unprecedented anti-EU sentiment in the austerity-weary south and bailout-weary north.

Indeed, it raises the question of whether there will still be a euro once EU leaders complete their highly-touted fiscal union.

Like the outcome of this week's G20 summit, those answers lie not in Los Cabos, Brussels or Berlin. They lie in Athens, where its future in the eurozone will dictate whether the EU and the global economy can begin emerging from a two-year crisis.

Time to take action – or risk irrelevance

G20 reform

The danger for world leaders is too much talk and no effective measures, writes **Chris Giles**

Living up to its billing as the world's premier economic forum was always going to be a challenge for the Group of 20.

After a string of failures, the task for the Los Cabos G20 summit is to stop the rot and prevent the organisation becoming irrelevant.

It will be quite a task for Mexico, the host nation.

Since the financial crisis began, the G20 has been seen as the best forum for discussing economic developments and agreeing new directions.

The countries around the table include all the big economies and account for $17 out of every $20 earned in the world. The organisation has met at head of state level since 2008, enabling difficult decisions to be taken. And there has rarely been a more important time to set the global economy on a more stable path.

But there is deep dissatisfaction with the G20, both from participants in the process and external observers, as it has made little progress since 2009.

Paul Jenkins is a fellow of the Canadian Centre for International Governance and Innovation and a former deputy governor of the Bank of Canada.

He says: "G20 leaders have not delivered on their commitments to international policy co-operation ... [resulting in] policy mistakes that could have been avoided, had the gains from collective action to address what are clearly global issues requiring global solutions been forcefully tackled by the G20".

Despite the hype surrounding the April 2009 London summit, when leaders promised a new global economic order, the reality has been sobering.

The G20 originated after the 1997-98 Asian financial crisis, with meetings at finance minister level, but made little impact until late 2008, when world leaders gathered in Washington to discuss the most serious financial crisis since the second world war.

After they agreed to refinance the International Monetary Fund, provide a fiscal stimulus and embark on financial sector regulatory reforms in London six months later, the more difficult task of implementation started.

At the September 2009 summit in Pittsburgh, US, world leaders agreed the aim of the G20 should be strong, stable and balanced economic growth.

Succeeding summits in Toronto, Seoul and Cannes all sought to put flesh on these bones with increasingly meagre returns. At first the explanation for lack of progress was that agreement was harder in times of economic growth than in times of crisis.

But, by Cannes last November, that logic no longer applied. The eurozone had fallen back into a banking and sovereign debt crisis and the G20 was standing far from the action. The same fate risks unsettling Mexico's party, as the summit starts the day after the second Greek election.

> 'Los Cabos faces the real risk of being the nadir of the G20's ability to act collectively'

Professor Eswar Prasad of the Brookings Institution, the Washington-based independent research and policy institute, says: "The Los Cabos summit faces the real risk of being seen as the nadir of the G20's ability to act collectively to ensure global financial stability."

This year, G20 countries can claim to have pledged another $400bn refinancing of the IMF, in April, which finance ministers and central bank governors said in a statement "shows the commitment of the international community to safeguard global financial stability and put the global economic recovery on a sounder footing".

That financial commitment apart – one that was not backed by some leading economies including the US – the co-operative landscape of the G20 is poor.

The global economy is slowing rapidly, making strong, stable and balanced global growth a distant ambition. Although some trade imbalances, such as China's surplus and the US deficit have narrowed, others such as the surplus of oil exporters have grown.

It has the right countries around the table, but the sheer size of the G20 prevents spontaneous discussion, participants say. Sterile debates without any chance of agreement by countries to change policies are the order of the day.

In 2012, the problems appear fundamental. Where countries disagree, the G20 provides a forum for debate, but no mechanism to bang heads together in the collective interest. The omens for Los Cabos are poor.

Yet, none of the depressing history of the G20 deters countries from seeking to chair the group or invite world leaders to summits in their countries.

Officials, often Europeans with deep experience of international summits, say this is more than just vanity on the part of Russia, Australia and Turkey, the G20 hosts in 2013, 2014 and 2015 respectively.

They say that the G20, rather like the European Union, should be seen as a long drawn-out process that is better than the alternative of refusing to discuss difficult economic issues.

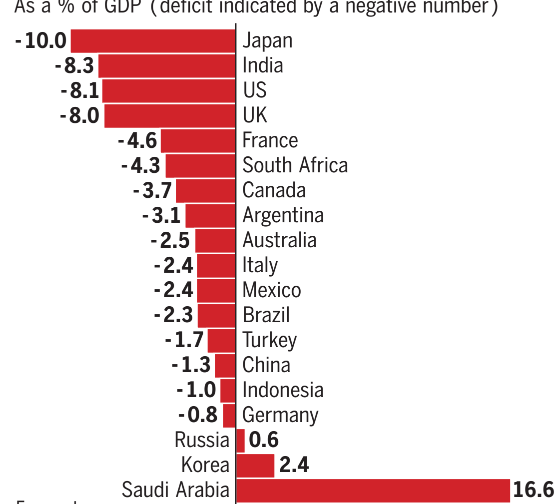
The ambition is valid, the countries around the table are roughly right and incremental progress is made.

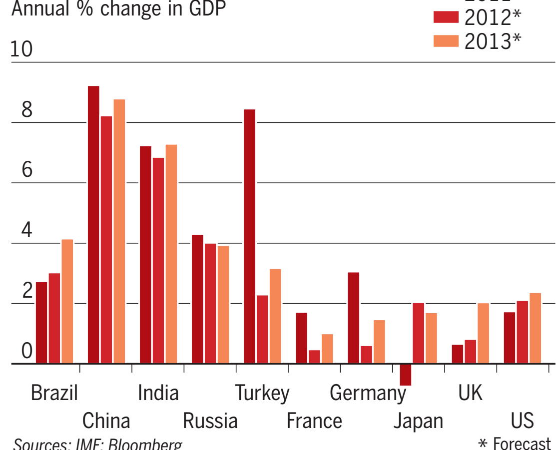
But, just as with the EU and the eurozone, the risk is that the discussions are so slow and progress so limited that crisis will engulf the world economy before the benefits of the G20 have been demonstrated.

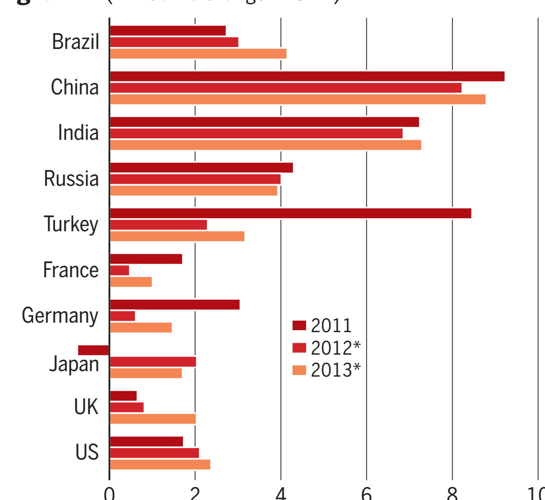
Entering crisis: Angela Merkel at Cannes in 2011 Getty

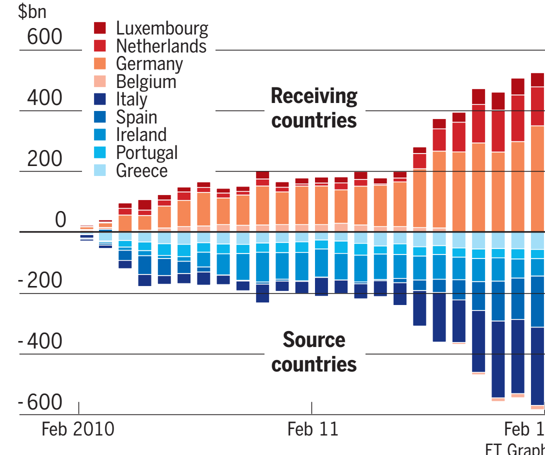
Crisis, what crisis? Global economic statistics provide challenging backdrop to Los Cabos meeting

Photo: Bloomberg









Leaders aim to make a difference

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Obama called on the eurozone this month to step up efforts to integrate and collectivise policies.

He said: "Leaders can lay out a framework and a vision for a stronger eurozone, including deeper collaboration on budgets and banking policy. Getting there is going to take some time, but showing the political commitment to share the benefits and responsibilities of an integrated Europe will be a strong step."

The call for more European integration is aired around the world. Christine Lagarde, head of the IMF, urged "more Europe, not less", particularly in the banking sector.

She said: "To break the vicious cycle of financial-sovereign risks, there simply must be more risk sharing across borders in the banking system," adding that deeper fiscal integration "should go hand-in-hand with these efforts".

The UK, whose economy is already in recession after being buffeted by the eurozone crisis, high energy prices and austerity measures, is most vocal in calling for action, while insisting it will play no part in any eurozone settlement. George Osborne, the chancellor, accused the single currency crisis of "killing off" Britain's recovery.

Most of these calls for action are directed at Germany, which is seen as having deep enough pockets to solve the eurozone crisis, but not the will to integrate quickly. Berlin has moved a considerable way from the stance it adopted in Cannes.

Alongside austerity measures, Germany is willing to agree to France's requests for greater emphasis on growth. It has also accepted that higher German domestic wages and prices will be part of efforts to encourage peripheral eurozone economies to regain competitiveness and help rebalance their trade deficits.

This month Angela Merkel, the German chancellor, also made it clear that she expects the members of a currency union to move closer together, but refused to accept the urgency of the situation that others have stressed.

"I don't believe that there will be one single summit that will decide on a big bang," Ms Merkel told German television this month. "But what we have been doing for some time, and on which a working plan will certainly be presented in June, is to say we need more Europe."

These high-level warnings, encouragement and brinkmanship are likely to dominate this week's G20 summit, making life extremely difficult for the Mexican hosts who will have little control over the process.

> 'Mexico has wisely set the bar very low for expectations of any deliverables from the summit'

With so many external distractions to dominate the summit, Mexico has not packed the agenda.

Professor Eswar Prasad of the Brookings Institution says: "The host country Mexico has wisely set the bar very low for expectations of any deliverables from the summit, especially in terms of long-term initiatives such as reform of the international monetary system".

Instead, it has urged G20 countries to make incremental progress on economic stabilisation, strengthening financial systems, improving the international financial architecture, enhancing global food security and promoting sustainable development.

These are all long-term ambitions on which a continued dialogue at the G20 level is useful and the summit at head of state level brings its own dynamic for action to be taken.

Mexico is also seeking to set the G20 on an incremental path to improve economic co-operation rather than the revolutionary ambitions held by France last year, which were so disappointed in Cannes.

It will, nevertheless, be a challenge for the hosts to escape from the immediate economic crisis and focus minds on longer-term issues when the here-and-now is so urgent.

The best hope for the G20 summit is that the economies of the world, representing more than 85 per cent of global income, can reinforce the urgency of the situation, avoid public disputes and lay the conditions for successful European summits later in June.

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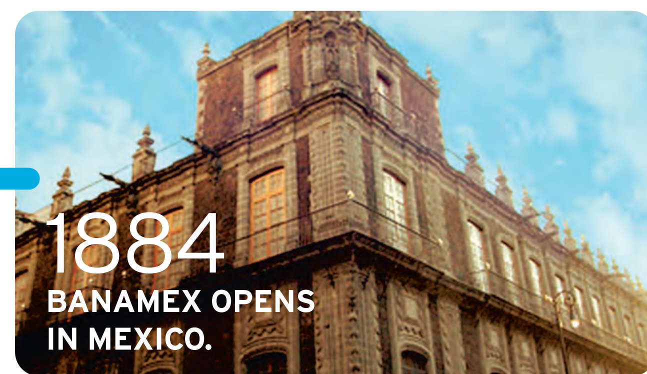

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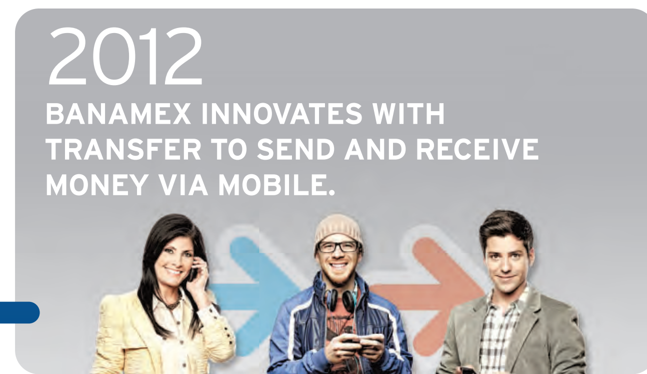

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Power structures Emerging nations seek better balance

The host nation, Mexico, is one of the world's economic success stories.

As recently as the mid-1990s, its economy was in turmoil and required a rescue package administered by the International Monetary Fund and the US Treasury. But since 2006, its economy has grown by an impressive 22 per cent, against just 9.8 per cent for the US. And it is now eurozone countries that are seeking the succour of the IMF.

The contrast illustrates a broader shift in the economic fortunes of emerging and developed economies since the onset of the financial turmoil.

The collapse in global trade following the bankruptcy of Lehman Brothers in 2008 dispelled any notions of a full decoupling between the fortunes of advanced economies and their emerging market counterparts.

But since then, emerging markets have narrowed the gap between themselves and advanced economies, growing at impressive rates while activity has remained weak in developed nations.

Recent years mark the continuation of a decades-long trend, which has led to nothing short of a revolution in the global balance of economic power.

Danny Quah, a professor of economics at the London School of Economics who has tried to pin down the centre of economic gravity based on global GDP, says it has shifted east substantially since the mid-1980s. According to Mr Quah's research, the world's centre of economic gravity had moved from the mid-Atlantic in 1980 to a location east of Helsinki and Bucharest by 2008. He predicts that by 2050, it will be on the border of India and China. "Within our lifetime, the world's economic centre will have moved to be 10 time zones east of Washington, DC," Mr Quah says.

But power structures still largely reflect the old state of the world.

Though emerging markets have more say in the proceedings of the G20, both Bretton Woods organisations that govern global finance, the IMF and the World Bank, are based in Washington.

The recent appointments of Jim Yong Kim and Christine Lagarde continue a tradition which has seen an American in the top job at the Bank and a European at the helm of the Fund since the institutions' founding in the mid-1940s. Emerging market officials regard this process as outdated, but could not unite behind an alternative candidate for either job.

"Global governance is the key challenge for the international community," says Ousmène Mandeng of UBS. "But there generally seems to be little appetite for leadership among emerging markets – and indeed advanced economies – on the issue."

Emerging markets are set to win some concessions in the running of the IMF. The Fund's board of governors has approved a package of reforms to quotas, which determine voting power. The reforms make China the third largest member country in terms of quota share and will also put Brazil, India and Russia among the top 10.

But many members – including the US, the largest shareholder – are yet to pass the quota reform. With the US presidential elections looming, a Congressional vote is unlikely until January 2013 at the earliest.

The delays over quota reform have created tensions between the big emerging markets and the advanced economies. At the spring meetings this year, Ms Lagarde's attempts to secure at least $400bn in lending commitments, in part to boost confidence that the IMF had the will and wherewithal to tackle the eurozone's problems, met with resistance from Brazil, which wanted greater voting rights in return for additional funds.

The advanced economies' intellectual dominance through the so-called Washington Consensus, a grouping of policies advanced by the Bretton Woods institutions, has also attracted criticism.

Guido Mantega, Brazil's finance minister, has been among the most vocal critics, saying last year in response to the Fund's attempts to soften its rules on capital controls: "Ironically, some of the countries that are responsible for the deepest crisis since the Great Depression, and have yet to solve their own problems, are eager to prescribe codes of conduct to the rest of the world."

Ensuring that Mr Mantega, and his emerging market counterparts, feel their contribution to the world economy is reflected in global power structures is regarded as vital if the Bretton Woods institutions are to remain relevant.

James Ashley, senior European economist at RBC Capital Markets, says: "We cannot freeze time – frameworks which made sense in the immediate aftermath of the second world war are not the same arrangements which in any way best reflect the economics realities of today.

"The rise of China, and other emerging markets, will surely need to be reflected materially in the way in which the institutions function."

Claire Jones

IMF director Christine Lagarde AFP

Change for the better will come – but not yet

Financial system

Trickle of power to developing countries is set to continue, writes **Robin Harding**

A moment of sweeping reform for the international financial system will arrive one day. But it will not arrive at the G20 in Mexico.

Last year, Nicolas Sarkozy aspired to root-and-branch change when he chaired the G20 as president of France, calling for a "new Bretton Woods" and railing against "monetary dumping" on the one hand and the dollar's role as global reserve currency on the other.

But financial stress returned and those ambitions came to grief.

Mexico, by contrast, is taking a more workmanlike approach – and even that may end up overshadowed by another round of eurozone woe.

Felipe Calderón, the Mexican president, has said: "We'll be looking for this meeting, under the leadership of Mexico, to strengthen and establish concrete commitments to strengthen international institutions, particularly the International Monetary Fund, so that it is a strong and flexible tool for confronting the economic crisis." Some of the long-term tensions in the international financial system have relaxed, at least for now.

For example, the crisis reduced global imbalances. China's economic stimulus in 2008 helped to push its current account surplus down from 10.1 per cent of GDP in 2007 to only 2.3 per cent this year; the US went the other way, from a 6 per cent of GDP deficit in 2006, to 3.3 per cent this year.

Nothing fundamental has been resolved – there is still nothing to stop a country that chooses to run a mercantilist policy of currency undervaluation from doing so – but circumstances have changed enough to dull the pressure for reform.

Ideas for diversifying the system away from the dollar, perhaps with a greater role for a currency basket such as Special Drawing Rights at the IMF, are also in abeyance.

The travails of the euro do not make it look a tempting alternative to the greenback, while China's internationalisation of the renminbi still has years to run.

But a third tension – the dominance of institutions such as the Fund by rich countries, despite the growing economic weight of the developing world, will be an issue at Los Cabos.

That is, not least, because of unfinished business from the IMF's spring meetings.

The G20 finance ministers agreed then on a boost to IMF firepower, but some of the largest developing countries pledged only a minimum collective number.

The amounts and the terms, which are crucial, must be firmed up in Mexico.

Those extra resources will arrive in the form of bilateral loans to the Fund, but one reason developing countries are leery of commitment is that they want to be sure that, when the IMF's permanent resources are increased, they will secure a boost to their voting power.

The next review of the IMF's infamous quota formula – the brevity of which is in inverse proportion to the rows it can cause – is on the horizon even though the last round of quota changes is still not complete. Quota determines required contributions, access to resources, and voting power at the IMF.

> The dominance of institutions such as the IMF by rich countries, will be an issue

By January 2013, the Fund's executive board must complete a comprehensive review of the quota formula, in preparation for a revision by January 2014.

Both the formula itself, and the battle to influence it, are measures of a nation's power and weight in the global economy.

Today's formula weights gross domestic product most heavily, followed by trade openness, the variability of capital flows in and out of a country and finally its official foreign exchange reserves.

Most of these variables have been present ever since Bretton Woods. The result is then "compressed", so that small economies get a bit more quota and big economies a bit less.

Changes in GDP will, in themselves, lead to a shift in quota towards China and other developing countries over the four years since the last reform.

The question is, how and whether to change the formula itself?

An initial IMF staff paper on the topic considers the effects of dropping some of the subsidiary variables and putting greater weight on GDP – but its simulations show why reaching an agreement to do so will be hard work for the G20 over the next 18 months.

Large developing countries would like to weight GDP more heavily in the formula and play down some of the other measures.

The variability indicator – which is meant to show countries that are more likely to be recipients than providers of the Fund's resources – seems most likely to go.

But it is the measure of "openness" that provokes the most argument.

It favours Europe because of trade flows between European nations – even though many of those flows are within the eurozone – but removing variability and openness from the formula could cut the European Union's quota from 30 to 25 per cent of the total.

No decisions will be reached in Los Cabos, but with Europe in need of short-term favours, the slow trickle of power towards developing countries in the international financial system is set to continue.

Different world: The IMF was conceived in 1944 at the Bretton Woods Conference EPA

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Leaders seek a long-term solution to hunger pains

Food prices

The focus is on security of supply rather than aid, writes **Javier Blas**

Until 2007, the cost of maize had barely featured on the radar of the world's most prominent leaders, who are usually more interested in global geopolitics.

But this lack of interest in food commodities changed abruptly – and it happened in Mexico, which is hosting the G20 summit in Los Cabos this week.

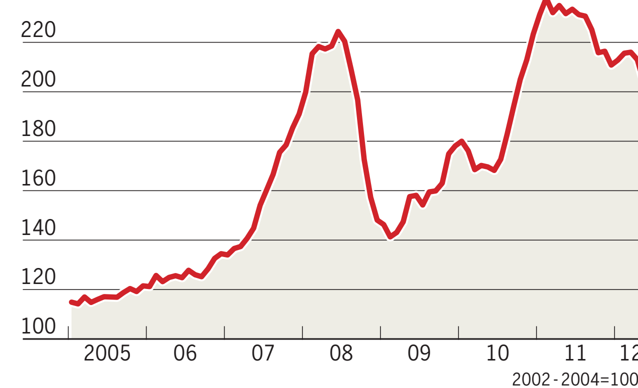
The rise in maize prices triggered a steep increase in the price of the tortilla, a local staple. The tortilla riots that followed were the beginning of what become the 2007-08 food crisis.

Since then, Mexico and other G20 countries have been concerned that rising and volatile agricultural commodities prices are a growing problem for the global economy.

Food security, long only a concern for aid advocates and farming ministers, is now hotly debated among G20 leaders.

"The sharp increase in food prices has put agriculture back on the political agenda," says Frank Rijsberman, head of the Consortium of International Agricultural Research Centers, a network backed by donor countries such as the US, the UK and Germany.

The G20 will receive a stark assessment of the situation. A group of UN institutions, including the World Bank and the Food and Agriculture Organization (FAO), have written a report for the group's leaders warning that "global agriculture will face multiple challenges over the coming decades".



FAO Food Price Index

Monthly change in international prices of a basket of food commodities

Source: UN

The report says the farming industry must, among other things, produce more food, contribute to overall development and poverty alleviation, confront increased competition for alternative uses of finite land and water resources, and adapt to climate change.

Food prices have recently stabilised, but they remain much higher than in the past. The FAO food index was most recently at 204 points, compared with its level of 127 in 2006. The index has been close to 200 points for the past two years.

Five years after the initial rise in food prices, the policy response to the challenge is evolving. The initial reaction of the G20 – and its predecessor, the G8 – was to fight the emergency created by rising food costs.

The supply uncertainties and price spike of 2007-08 – the first food crisis in 30 years – pushed millions of people in sub-Saharan Africa and Asia into poverty and triggered riots that led to the collapse of the governments in countries from Haiti to Madagascar. The spike in wheat and barley prices after the crop failure in the former Soviet Union countries of Russia, Ukraine and Kazakhstan in mid-2010 further aggravated the emergency.

The number of people chronically hungry rose after the 2007-08 food crisis to roughly 1bn, according to the FAO, dealing a mortal blow to the target of halving the number of the world's hungry by 2015.

This increase has forced global leaders to wake up to the reality that food aid will cost much more than in the past. The World Food Programme, for example, spent $3.6bn last year helping hungry people, up 44 per cent from a pre-food crisis level of $2.5bn. Spending peaked in 2008 at $5bn.

Agriculture is back on the political agenda, says Frank Rijsberman

But as the era of high food prices appears to be here to stay, the focus of the G20 is slowly shifting from fighting the emergency to addressing the long-term problem.

The shift started in 2009, when the G8 and several other countries launched the so-called "L'Aquila Food Security Initiative" – named after the Italian town where the summit was held – which focused on long-term investments in farming in the developing world.

The G8 initiative underscored Washington's new approach to fighting global hunger under President Barack Obama, reversing a two-decades-old policy focused almost exclusively on food aid.

Hillary Clinton, US secretary of state, said at the time: "For too long, our primary response [to fight hunger] has been to send emergency [food] aid when the crisis is at its worst," adding: "This saves lives, but it doesn't address hunger's root causes. It is, at best, a short-term fix."

The G20 is now deepening the shift towards investment in long-term agriculture, particularly in Africa.

The economic crisis, which is forcing G20 members to tighten their belts in every spending area, is a serious obstacle. The White House is pushing for more involvement by the private sector.

The idea will be debated at Los Cabos, according to G20 officials.

The report by the UN institutions warns: "Investments by the private sector in the developing world remain small, and agricultural research continues to be mostly funded by governments."

But the shift from public support to greater involvement by the private sector has its critics. Campaigners are worried that the poorest areas in Africa will be forgotten. The reality is that, without private investment, public money may not reach those same countries either, because of budgetary constraints.

Way ahead 'is openness, not protectionism'

Free trade

John Paul Rathbone says the country is a stalwart defender of open borders, in contrast to some of its neighbours

International trade is under attack. Recession has tested many countries' commitment to keep their borders open, as politicians, beholden to domestic audiences, have succumbed to the temptation of throwing up trade barriers for short-term economic gain.

That is a fair enough summary of the current state of global trade. But not in Mexico, one of the most stalwart defenders of free trade in Latin America – or indeed the world.

"We have to be very clear that the way forward is not protectionism, but openness," Felipe Calderón, Mexico's outgoing president, told a gathering of chief executives during April's Summit of the Americas. "The way forward remains commerce, as it has been for millennia."

It was a passionate and rare public statement by a leading international politician in favour of free trade. In today's economic climate, it is hard to think of any other G20 leader who would stick out his or her neck so far on the issue.

It was also a thinly veiled criticism of some of Mexico's partners. These include the US, where there are protectionist measures in Congress and, especially, two Latin American countries that have large Atlantic coastlines and where nervousness about deindustrialisation has recently triggered mercantilist instincts.

In February, for example, Brazil moved to shield its car industry from Mexican competition; the country's vintners also want protection from Chilean imports. Argentina, a prodigious inventor of eccentric policies, has meanwhile required importing businesses to sell something – anything – to foreigners worth as much as what they buy from them.

The contrast between these approaches and the attitude of big Latin American economies with a Pacific coastline – Mexico, Colombia, Peru and Chile – is stark. All have strong free-trade instincts, perhaps because they have a sharper sense that the world's economic centre of gravity is shifting towards Asia and the Pacific.

Mexico, for example, is one of the most open of the world's leading economies. In 2010, trade accounted for almost 60 per cent of its gross domestic product, compared with China at 48 per cent, the US with 22 per cent and Brazil at 19.

Look to the future, and the contrast is even starker. HSBC reckons Mexican trade, which totalled $700bn last year, will rise to almost 70 per cent of GDP this year and 85 per cent by 2017.

In some ways, this makes Mexico a regional standard bearer for open trade – although one could argue it has little choice. The country sits next to the world's largest market, to which it can supply goods within 48 hours. It is also less

Enrique Pena Nieto of the opposition PRI has an agenda including more competition in the economy

rich in commodities than, say, Brazil. Both factors point to Mexico's strategic need to become adept at manufacturing and facilitating trade.

Thus, its exporting vocation has been further boosted by a plethora of trade agreements, and by fostering supplies of skilled and semi-skilled labour. Some 110,000 engineers graduated in engineering and technology in 2010, more than double the number in 1999, according to Inegi, the national statistics agency.

As a result, the country has steadily diversified its trade partners and moved up the value chain, as Mexico-based manufacturers have become ever more efficient and skills-rich. The country now even exports cars to China.

Analysts agree it is unlikely this attitude will change after Mexico's July 1 presidential election.

Politically, Enrique Pena Nieto of the opposition Institutional Revolutionary Party (PRI), who leads in the polls, is pushing a reformist agenda that seeks to break down barriers to growth rather than erect new ones. Indeed, top of his list are domestic reforms to encourage more competition in Mexico's internal economy.

The country is also benefiting, as the relative competitive advantage of Chinese manufacturers is eroded by rising wage and labour costs there. The continued shortening of North American supply chains will see Mexican industry ever more tightly integrated into the region.

Nor is it the only country in the region with free trading instincts. Alongside Canada, Mexico is angling to join the trans-Pacific Partnership (TPP) which is being pushed by Washington to form a grand Asia-Pacific trade area. At the same time, Chile, Colombia and Peru want to form with Mexico an "Alliance of the Pacific".

Whether these Latin ambitions will come to anything is another matter. But at least the approach is businesslike. This year, for example, the presidents of Mexico, Colombia, Peru and Chile discussed their proposed trade alliance via a "virtual summit".

That might be a fancy phrase for a "videoconference". But it marked a welcome change in a continent that has often seemed overly fond of grandstanding presidential summits that are filled with patriotic fervour but rarely produce much of substance.

The Mercosur trade bloc, for example, which groups Brazil, Argentina, Uruguay and Paraguay, was once held up as an emblem of regional trade integration.

Yet today it has become bogged down in disputes – including, in May, a "chip war" after truckloads of frozen fries, produced in Argentina and normally destined for Brazilian-based hamburger chains, clogged the two countries' borders.

Indeed, if you put aside the smiles and diplomatic niceties, since 1995 trade within the bloc has grown less than among countries outside it, or even between individual Mercosur members and other Latin American countries.

Meanwhile, Mexico, under Nafta, has become an exporting powerhouse.

Cooling-off period: a bartender pours drinks at the Pueblo Bonito Rose resort hotel in Los Cabos AFP/Getty

Venue makes alluring backdrop for talks

Los Cabos

There are plenty of distractions for delegates – if they get the time, writes **Adam Thomson**

When the thousands of international delegates, government ministers and heads of state land in the Mexican resort of Los Cabos this week for the G20 summit, they will first see the craggy, sun-baked mountains that form the spine of the Baja California peninsula.

Then, they will catch a glimpse of the alluring dark blue sea beyond, before disappearing for the rest of their stay into windowless meeting rooms in hotels and in the region's new conference centre *(see accompanying article online)*.

This is not how most international visitors spend their time in Los Cabos – and with good reason.

What until 50 years ago was a sparsely populated and isolated tip of rocky desert separating the Pacific Ocean from the Sea of Cortés has grown into the country's smartest tourist destination.

Anchored by the two neighbouring towns of San José and Cabo San Lucas, it is home to Mexico's best golf courses, prestigious fishing tournaments, and three of its best hotels, including one in the world's top 50 according to Travel+Leisure.

Los Cabos is a class apart from Puerto Vallarta, Acapulco and the touristy Cancún. Take the One & Only Palmilla, a hotel where even the most stressed executive cannot help forgetting the pressures of life back home.

In the mornings, take breakfast by one of the pools and look out for one of a dozen types of whales. After that, lounge by the pool where staff clean the lenses of your sunglasses every couple of hours and hand out iPads with pre-installed audio books.

Given all the attention, it is hard to leave. But if you do, and you head north across the Tropic of Cancer, you will get a taste of how this 1,200-km-long arid peninsula was colonised.

Along with most of the other urban settlements on the Baja peninsula, the town of Santiago was originally established in the early 18th century as a Jesuit mission – though the native Pericú Indians ransacked it 10 years after its foundation, killing the resident priest.

Today, the small agricultural town built around a desert oasis is the gateway to Baja's Sierra de la Laguna Biosphere Reserve, an 11,300-hectare national park that was created in 1994.

At elevations that exceed 2,000m, the reserve is one of those rare places where nature itself seems to get confused. Here, subtropical, alpine and desert landscapes sit side by side.

However, most tourists to Baja – mainly US residents and Canadians – go for two things: fishing and golf.

Rubén Reachi, the state's tourism minister, calls sport fishing "the first pillar of tourism in the region". That is apt, given that the Sea of Cortés' teeming ocean life was the most important catalyst for the region's initial development as a tourist destination in the 1950s and 1960s.

> The 'marlin capital of the world' attracts sport fishing enthusiasts all year round

Known as "the marlin capital of the world", Los Cabos first attracted wealthy yacht owners from California. Back then, there was hardly any infrastructure and sailing was the main way of getting there. Today, by contrast, it attracts sport-fishing enthusiasts from all over the world and year round.

The calendar is packed with competitions, but the annual highlight is the Bisbee's Black and Blue Tournament, named after the giant black and blue marlin that inhabit the waters surrounding the peninsula.

More than 200 teams typically take part each year to compete for $4m in prize money.

Golf is a much newer arrival to the region, but already there are several world-class courses designed by famous names.

Since it opened in 1994, Cabo del Sol has gained a reputation as one of the most scenic courses in the western hemisphere, and Jack Nicklaus, its designer, called the 16th, 17th and 18th holes "the best three finishing holes in all of golf".

The Cabos' Diamante Dunes golf course is arguably even better. Ranked at 58 in the world last year by Golf magazine, and hailed by Golf Digest as Mexico's best course, the Dunes is an intoxicating combination of ocean and desert dunes.

Of course, many residents of California and the US southern states have already discovered the beauty of Los Cabos.

But with plenty of publicity from its role as host to the G20 summit, Baja's appeal could soon become much more international.

Why food security comes first

Viewpoint
FELIPE CALDERÓN

The Arab Spring is referred to as the first "internet revolution", as Facebook and Twitter helped foment insurrections that ended several autocratic regimes. But a bigger factor in the overthrows may have been rising food prices that made people even more desperate than usual.

In fact, all around the world, people are having more trouble putting food on their tables.

Increasing demand in emerging markets, droughts and floods because of climate change and unregulated speculative pressures in commodity markets have provoked a wave of price volatility that has put many of the poorest on the brink of starvation.

Indeed, concerns about the current shape of the global economy are pressing and demand immediate action. But for Mexico, as president of the G20, this should not make us neglect the long-term issues affecting the lives of billions around the planet. We will have failed if we manage to get the richest nations back on track while the poorest still experience famine.

That is why my country insisted on placing food security at the top of the G20 agenda, alongside the restoration of economic growth and global financial reform.

Mexico, as host of the G20 summit at Los Cabos this week, will push hard for effective and immediate actions to tackle this issue.

I am certain the G20 can reach agreements that allow us to promote a new green revolution, one that focuses on unleashing the potential of small producers instead of the great global conglomerates that have led previous increases in output. Some steps can be taken immediately to this end:

● First, we must develop mechanisms to encourage more private investment in agriculture and fisheries, but this must be done in ways that take into account the needs and development objectives of rural communities. Public investment must be targeted at the creation of public goods, such as infrastructure, that will support and encourage private investment.

● Second, mechanisms must be strengthened for risk management in agriculture to enable small farmers to withstand droughts and price volatility. Small farmers do not have the same capacity to absorb losses or use futures contracts as larger ones, so we must develop country and regional programmes to protect them. The G20 can be a forum to share international experiences and build capacity in lower income countries.

● Third, we must promote capacity building through training producers and organising communities. We must also boost research into technologies to increase the earth's productivity and develop crops more resistant to diseases, drought and herbicides. Then, the G20 should create knowledge transfer mechanisms and knowledge banks that could push advances into operation quickly on a massive scale.

● Fourth, the operations of agricultural markets should be improved by increasing transparency and the quality of information for traders to reduce price swings and uncertainty. The volatility of global commodity markets has made it harder for small farmers to predict prices, and sometimes even contributes to a reduction in production. Small farmers may opt to leave fields fallow if they think they are going to lose money on the crop.

Luckily, we have made a start. The G20 developed important initiatives under the French presidency in 2011, and countries agreed to work together in the areas of research and development; promoting investment; improving market transparency and the quality of information; strengthening international policy co-ordination; developing risk management tools; and improving the operation of agricultural commodities markets.

In addition to ensuring the proper implementation of previous commitments, we are working on the development of specific recommendations to increase agricultural productivity worldwide.

To implement changes and have real impact, we are focusing on solutions that can be implemented quickly in poor and remote rural areas of the planet. We need to begin a new era that gives priority to the democratisation of knowledge that can take the world to a new level of development – one that is equitable and sustainable.

To accomplish this, governments must accept they cannot go it alone. That is why we are working with the business community, through the B20 process, in which entrepreneurs from all over the world are submitting recommendations on how to improve food security by strengthening public-private partnerships.

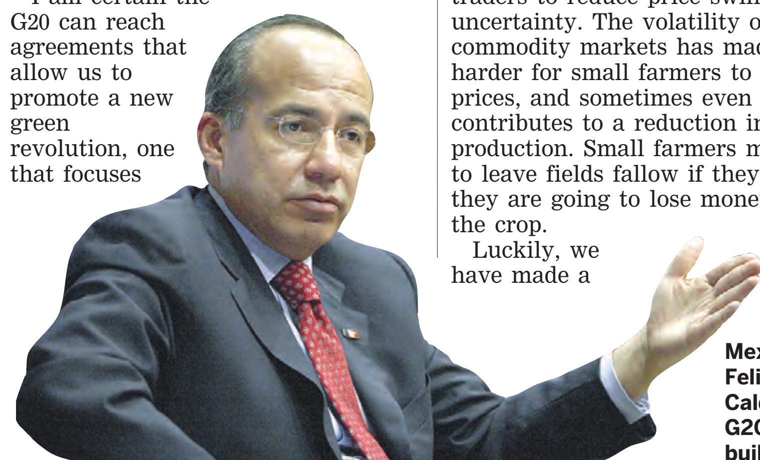
We must also listen to the voices of civil society, and that is why the work with renowned international foundations that are deeply involved in the issue of food security is of special importance during Mexico's presidency of the G20.

The G20 must build permanent bridges with countries that face the greatest challenges in food security, and demonstrate that co-operation between the world's largest economies brings benefits to the entire international community.

That almost 1bn people in the world remain undernourished is unacceptable.

The time has come for food security to be considered one of the most important tasks humanity must address in the 21st century, and this year's G20 meeting will be a strong step in that direction.

Felipe Calderón is president of Mexico



Mexico's Felipe Calderón: G20 must build bridges

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First signs that drug crime is on the wane

Security

Adam Thomson finds a police and military build-up and better intelligence may finally be working

Baja California Sur, the Mexican state that is temporary home to thousands of people arriving in Los Cabos for this week's G20 summit, is normally a quiet and peaceful place, far removed from the country's bloody conflict with drug cartels.

But today, the tip of one of the world's longest peninsulas is buzzing with police, army and navy, who have set up checkpoints – complete with gamma-ray machines for inspecting vehicles – on all the region's highways. Look out to sea and you can even see the marines' gunboats surveying the coastline.

Marcos Covarrubias Villaseñor, the state's governor, says: "We're providing state, federal and municipal forces, so that people arriving in the advance parties from the participating countries feel safe as soon as they arrive."

It may feel very militaristic, but it is also indicative of the wider build-up of security forces throughout Mexico since centre-right President Felipe Calderón made fighting organised crime, in particular the country's drug cartels, a priority.

And, for the first time since Mr Calderón came to office, that beefed-up security may be having its desired effect.

According to police statistics, the number of murders during the first three months of this year fell more than 6 per cent compared with the same period of 2011 – the first quarterly fall in homicides since 2007.

Moreover, each of the past three quarters has recorded fewer murders than the previous one – for the first time since Mr Calderón took office.

Pooling their resources: Mexican federal police in riot gear during a crowd control drill at Los Cabos AFP/Getty

That, in turn, has driven the murder rate so far this year to about 17 per cent below its peak during the second half of last year.

The reduction has the government cautiously optimistic that the steep upward trend of violence over the past few years may finally have flattened out and may even be gradually heading in the right direction.

On a recent trip to the northern industrial city of Monterrey last month, Alejandro Poiré, the interior minister, said that perhaps "we are not at the beginning of the end, but we may be at the end of the beginning".

Mr Poiré was talking specifically about the northern state of Nuevo León of which Monterrey is the capital. But many observers believed that he might well have been thinking about the country as a whole.

Alejandro Hope, a security expert with Mexico City's Mexican Institute for Competitiveness and a former official at Cisen, Mexico's intelligence service, says several factors could be behind the apparent change in trend.

One of them, he says, is the sheer number of security forces compared with at the beginning of Mr Calderón's six-year term. Mexico now spends about 1.2 per cent of its gross domestic product on security – a figure that includes the armed-forces budget. By the end of this year, that will be about double what the previous administration spent.

> Each of the past three quarters has recorded fewer murders than the previous one

Just as important, says Mr Hope, there are some clues that the government's intelligence is starting to work better.

Evidence includes the fact that several relatively high-level arrests made in previous months were carried out without firing a single shot.

"The state has a much greater capacity now [to deal with organised crime] than it did when all of this started," he says.

Indeed, the rise in violence over the past five years took almost everyone by surprise. Government statistics show the most recent overall murder rate was about 22 per 100,000 inhabitants on a rolling 12-month basis.

That may be lower than Brazil, with about 25, or Colombia with more than 30, but it is about three times higher than the rate when Mr Calderón took office.

That increase, which has dominated international press coverage of Mexico and terrorised residents, in particular in the north where cartels fight it out for control of the main drug-smuggling routes into the US, implies that it could be many years – Mr Hope estimates almost 10 – before Mexico returns to the same levels as 2007.

That, he admits, is a long time to wait. But already, there are some examples of how the violence is dropping rapidly.

Just a couple of years ago, Ciudad Júarez, the dusty and sprawling industrial city that borders El Paso, Texas, was on its knees. A bitter fight between at least two rival gangs produced an average of 263 murders a month in 2010, according to police figures.

Today it is at about 100 – hardly acceptable, but at least much lower than at the city's worst point.

Experts say that none of this is likely to make much of a difference on the popularity of the present government, as it prepares to leave office on December 1 this year. Presidential elections are scheduled for July 1.

According to the Mitofsky polling company, Mr Calderón currently has an approval rating among the population of 52.4 per cent – considerably less than his predecessors during the same period of their terms in office.

But if the trend continues, it would at the very least be a welcome present for the next administration.

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