G20 SUMMIT

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Pressure is on to reverse latest slide

World leaders must work hard to avoid results as watery as the summit's artificial lake, writes **Chris Giles**

As 2010 dawned, optimists hoped that the year would bring a strong economic recovery, agreement on an ambitious package of financial regulatory reforms and progress towards strong, stable and balanced world economic growth for the medium term.

The Toronto summit of leaders of the Group of 20 industrialised nations was billed as the moment the world's leading economies would get down to the serious business of agreeing changes to policy aimed at consigning the financial and economic crisis of the past three years and its causes to history. Countries would pledge with their domestic policies to reduce imbalances in the world economy at the same time as maintaining demand. And as part of the process of financial reform, leaders would sign up to a new global levy on their banks to compensate taxpayers for bailing them out in the crisis.

But with the year approaching its halfway point, events have disrupted the schedule for the G20 leaders as they gather in Canada amid tight security and an artificial lake to improve the backdrop for TV cameras.

Though the G20 "Framework for strong, stable and balanced growth" remains the formal centrepiece of international economic co-operation, unco-ordinated budgetary tightening in response to a European sovereign debt crisis has been the reality. After Greece had to seek budgetary support from the eurozone and the International Monetary Fund in May, market fears forced big additional public spending cuts and tax rises across Europe – in Spain, Portugal, Italy, Germany and the UK among others.

And although the process of financial regulatory reform is continuing until decisions must be taken in November, the chances of G20 leaders agreeing a global banking levy in Toronto died earlier this month when G20 finance ministers met in Busan, South Korea. It became clear that a majority of G20 countries opposed any such levy. When Jim Flaherty, Canadian finance minister, gave a speech after the Busan meeting, his ambitions for the Toronto summit were distinctly modest and a far cry from earlier hopes.

"Our intent is to get a clear agreement on the principles needed to achieve real progress on reducing deficits and debt burdens," he said. "In Toronto we will push for clear, credible, concrete, timely fiscal consolidation plans."

The problem with the G20 process is not that the global recovery has disappointed so far. At the Pittsburgh summit in September 2009, G20 leaders hoped "that world growth will resume this year and rise by nearly 3 per cent by the end of 2010". The IMF now thinks such ambition is too modest and 3.9 per cent growth is possible with faster expansion in advanced and emerging economies alike.

Emerging markets in particular have recovered from the 2008-2009 economic crisis rapidly and are now growing at rates above their historical average.

As the Brookings Institution-Financial Times index of economic recovery shows, most indicators of economic growth are above their normal levels, indicating a rapid V-shaped recovery.

But the fears for the global economy stem from concerns about what might happen from here, not the recovery to date. The Brookings-FT index peaked in March and has turned down since as investors feared the sovereign debt crisis in southern Europe would undermine world confidence.

Some G20 officials worry that business confidence might soon plummet as it did in late 2008, bringing the world economy to a standstill. Tim Geithner, US Treasury secretary, expressed his fears in a letter to other G20 finance ministers. "Concerns about growth as Europe makes needed policy adjustments threaten to undercut the momentum of the recovery," he wrote, adding that the US was in no position to create additional demand to compensate for European weakness, "given the broader shifts under way in the US economy toward higher domestic savings".

Another G20 official told the FT that a sovereign debt implosion would be Act IV in the financial and economic crisis. Comparing it with an opera, he said: "There are not many with four acts which end happily."

The recent signs of a plunge in European business confidence in early June will not lighten the mood.

The IMF is particularly concerned that unless countries with room to create additional domestic demand do so, the recovery will fall short of its potential, millions of jobs will be foregone, and budget deficits will be harder to bring down.

Dominique Strauss-Kahn, IMF managing director, will present simulations in Toronto showing that if the only action on the table is fiscal retrenchment, the world economy would grow at a rate 2.5 percentage points below what is possible.

"What's at stake then in Toronto — the difference between good and bad policy — is 60 million jobs," he told journalists this month.

Toronto provides an opportunity for

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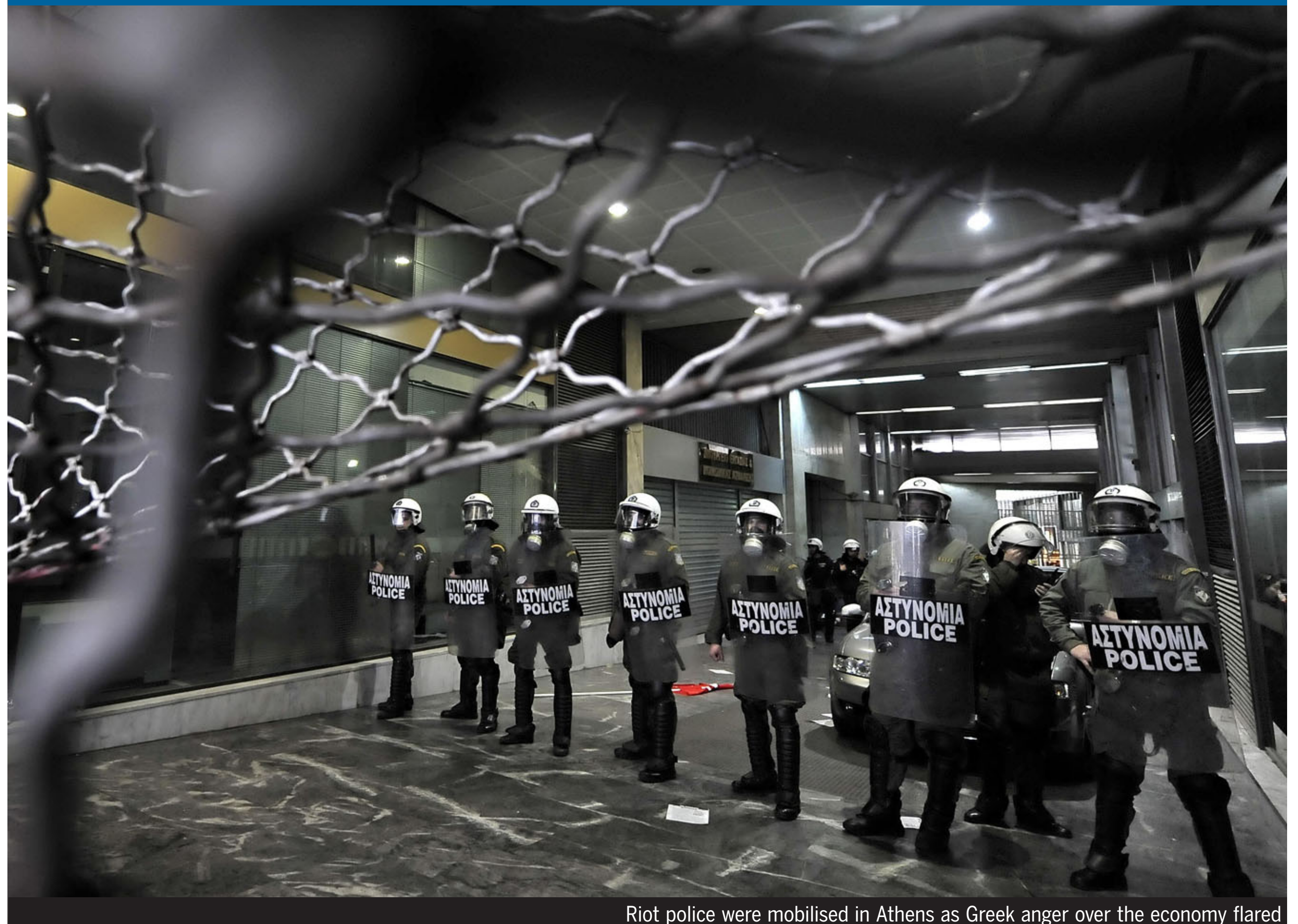
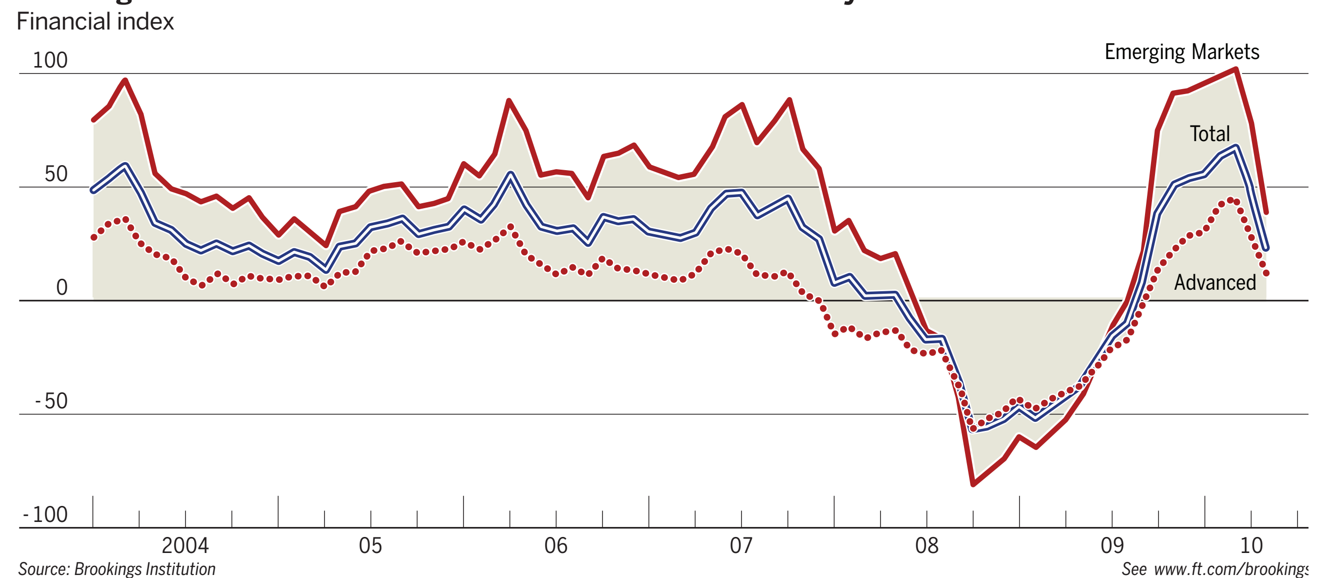
Hopes and fears: crisis in southern Europe undermines confidence



Riot police were mobilised in Athens as Greek anger over the economy flared

Brookings Institution-Financial Times index of economic recovery
Financial index



Source: Brookings Institution

See www.ft.com/brookings

Pressure is on to halt the slide

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world leaders to break the recent downward spiral. Fiscal consolidation is unavoidable across much of Europe, but it needs to be matched by policies to stimulate demand.

They include a revaluation of the Chinese currency, action to boost corporate and household spending in Germany and Japan, and greater safety nets to boost household confidence and spending in oil-producing countries and China.

The test of this summit will be whether leaders can make credible commitments to make these reforms.

This involves considerable co-ordination: one moving alone might suffer: if all move together, collective and individual outcomes are likely to be better.

Although expectations for Toronto are low, there are two reasons for optimism. First, following the crisis, countries know the potential cost of unco-ordinated economic policy; and second, the G20 process is not dictated to countries from the IMF, but is supposed to grow from each country making pledges on its own terms to support collective interests. China's decision last weekend to suspend its currency peg should help the process along.

The Toronto agenda on financial regulation is just as difficult as on the global economy. With main discussions on bank capital, liquidity and leverage scheduled to continue at a technical level, leaders will not have decisions to take on regulation of banks.

There is also no agreement possible on support for a global levy on banks. Canada, which has long opposed such a levy, rallied opposition to the idea at the finance ministers' meeting in South Korea and was pleasantly surprised to find a majority of G20 nations opposing a global levy.

An agreement on the principle that banks should pay for taxpayer support is likely, as is one on technical details of levies introduced by those in favour, including the US, UK, France and Germany. But this is hardly the stuff of grand political gestures that appeal to global leaders.

So there is the possibility the summit will seem to be a backward step in global economic co-operation.

On the economy, events forcing fiscal retrenchment might take precedence and only a thin veneer will cover the gulf between countries' policies for recovery. On regulation, little of note will be agreed.

The danger is that the summit will morph into a public relations exercise in front of an artificial lake. The G20 has quite a task ahead to show it is built around something more substantive.

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Sick market of Europe: Jean-Claude Trichet said the bank funding market 'is not functioning perfectly – that is absolutely clear' Kai Pfaffenbach/Reuters

Focus switches from exit to growth

Strategy

Repeated shocks mean victory is some way off, says **Chris Giles**

The Toronto summit was to be the moment world leaders could declare victory over the financial and economic crisis and announce the implementation of "exit strategies" from the extraordinary policies introduced to quell the crisis, it was hoped. Events, however, have conspired against the Group of 20 industrialised nations.

Instead of the G20 declaring victory, it has been forced to rip up its previous stimulus strategy in the face of renewed market turmoil and unco-ordinated fiscal tightening.

The summit now marks the moment when financial markets have forced an exit from fiscal stimulus before a vigorous private sector recovery is established. Central banks have also reintroduced some of their emergency liquidity measures to prevent the European sovereign debt crisis undermining the banking system, and the European Central Bank has resorted to unorthodox measures that were not contemplated at the height of the crisis.

At the G20 summit in Pittsburgh last September, national leaders committed themselves to a "strong policy response until a durable recovery is secured". But their finance ministers, meeting earlier this month in Busan, South Korea, were forced to accept that "recent events highlight the importance of sustainable public finances" and "those countries with serious fiscal challenges need to accelerate the pace of consolidation".

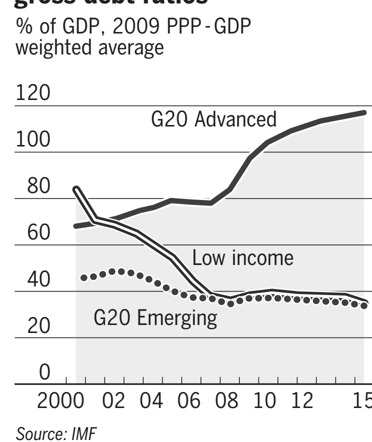
Instead of a co-ordinated exit "when the time is right" – first withdrawing the extraordinary support for the financial system, then tightening fiscal policy and finally raising interest rates – the latest market concerns have forced the G20 to tighten fiscal policy earlier than many countries had wanted and to reintroduce liquidity support for banks when they had hoped such emergency measures were a thing of the past. The chances that monetary policy will return towards normal this year have consequently receded.

The International Monetary Fund, having been the champion of fiscal stimulus, has now returned to its roots of orthodoxy. "It is now urgent to start putting in place measures to ensure that the increase in deficits and debts resulting from the crisis, mostly from the loss of output and revenues, does not lead to fiscal sustainability problems," it says in its May fiscal monitor.

But sorting out the public finances is not easy in advanced economies. Professor Eswar Prasad of Cornell University says: "Noble intentions by advanced economies to bring their budget deficits under control are rubbing up against the political and economic difficulties of fiscal retrenchment at a time when the world economy continues to be buffeted by adverse shocks."

And some see the exit from crisis measures into recovery as far off. Jeffrey Sachs, director of the Earth Institute at Columbia University, argues in the Financial Times: "Now we face a world economy with weak aggregate demand in the US and Europe, bulging budget deficits, sovereign debt downgrading and consumers unwilling to borrow."

General government gross debt ratios
% of GDP, 2009 PPP-GDP weighted average



Source: IMF

The retreat from the exit has been particularly evident in continental Europe. The bank funding market is so sick in Europe that the ECB has been forced simultaneously to reintroduce its offer of fixed-rate unlimited funds for European banks, while also finding itself the repository of record deposits, parked overnight in its vaults. Not without reason did Jean-Claude Trichet, ECB president, say this showed "that we have a market which is not functioning perfectly – that is absolutely clear".

By mid-June, the ECB announced it had taken the unprecedented step of purchasing €40.5bn of government bonds to stop its ultra-loose monetary policy losing traction in countries where investors have lost confidence in government paper.

Across the world, US dollar swaps have also been reintroduced to keep dollar liquidity flowing when US markets are shut. The combination of all these events suggests the declaration of exit from the crisis has been postponed, at least until the Seoul summit in November.

But all is not lost. Though many of the events of the past month have been unwelcome and have undermined exit strategies, the world economy and the recovery from crisis are neither entirely bleak nor completely derailed.

As the IMF and the G20 have noted, the world economy is recovering, and faster than expected so far. Optimists point out that though the planned exit has changed, the process towards a stronger and more stable world economy has not been derailed. "It is encouraging that there is broad agreement on the need for strong action by the advanced economies to rein in fiscal deficits and by both emerging and advanced economies to take necessary steps to rebalance global growth patterns," says Prof Prasad.

The balance of exit between monetary and fiscal policy might have changed radically since late April, with expectations of rises in interest rates significantly delayed, but the broad return to global expansion continues.

Most important, therefore for world leaders in Toronto, is to continue on their quest for policies that foster strong and more balanced growth in the years ahead, even if the sequencing of their exit from crisis measures has had to change.

Greece effect cuts Europe down to size

Eurozone

Any positive fallout will not come soon, says **Ralph Atkins**

Until early this year, eurozone politicians could claim justifiably that the global economic and financial market storms had originated beyond its shores. But the weather map changed dramatically when scares over Greece's public finances escalated within just a few weeks into a full-blown crisis that threw into doubt Europe's 11-year old monetary union.

Weaknesses were exposed on a number of fronts. Greece had allowed its public finances and international competitiveness to deteriorate over many years – and compounded its difficulties with misleading statistics that hid the true size of its public sector deficit.

"Contagion" effects spread across southern Europe, where deficit to gross domestic product ratios had also soared, with investors driving up the risk premium demanded on, for instance, Spanish and Portuguese bonds.

Greece highlighted apparent flaws in the eurozone's construction. The country had enjoyed the low interest rates and stability brought by membership – which allowed strong growth before the global financial crises of the past few years. But, with hindsight, it was living well beyond its means. At the same time, Germany's focus on improving its own competitiveness set the bar ever higher for its southern European rivals – creating the possibility that they are now trapped with a lethal combination of massive public indebtedness and weak growth prospects.

Worries that the eurozone might fall apart still seem overblown: the economic costs of, for example, Greece exiting the monetary union would be massive; and the political links that bind Europe's monetary union together remain strong. The eurozone is also set to expand, with Estonia due to become its 17th member next year. There is also a good chance the crisis will end up deepening – not weakening – Europe's economic integration.

But for now the underlying weakness in the eurozone is raising fears that the region will fail to provide any impetus to global economic growth in coming years. German and France exited recession last year ahead of the UK and US, but subsequent eurozone growth has been lacklustre.

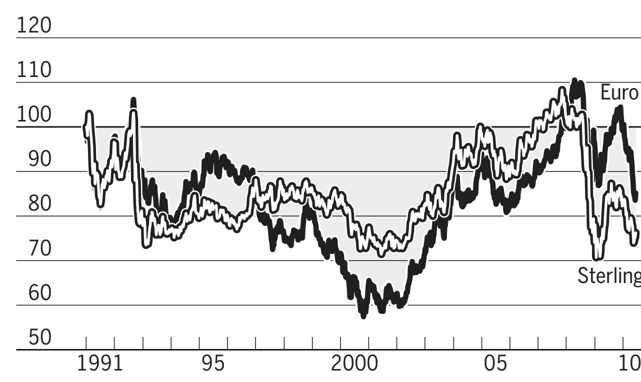
> 'This crisis has brought the economic part of Europe back to the political part'

European Commission forecasts released in May saw eurozone GDP rising by less than 1 per cent this year – compared with almost 3 per cent in the US.

As a result, continental Europe has lost global stature. Richard Haass, president of the Council on Foreign Relations in the US, warned in a Financial Times video interview that Europe was already punching below its weight as a global power. "What this crisis has done has brought the economic part of Europe back to the military and political part," he says.

How the eurozone's challenges are tackled will thus have importance for the rest of the world. On the first – bringing public finances in the eurozone's southern "peripheral" member states back under control – progress has been made.

Euro and sterling
Against the dollar ($ per currency, rebased)



Source: Thomson Reuters Datastream

Greece is embarking on an ambitious reform programme under the auspices of the International Monetary Fund and the European Union, entailing not just putting its public finances in order but also liberalising its economy.

Financial markets remain sceptical about its chances of Greece avoiding default; but eurozone policymakers express confidence that the targets are achievable – if only because of the disastrous impact of a default for Greece, which might well have to leave the eurozone.

Other eurozone countries have also stepped up fiscal consolidation programmes. Eurozone finance ministers have committed themselves to overall neutral fiscal policies this year and a "clearly restrictive" stance from 2011, with consolidation "frontloaded" in some member states.

The European Central Bank, meanwhile, helped calm financial markets with an emergency programme to buy government bonds of the most distressed eurozone countries, which has gone some way to restoring the functioning of markets. It has not been a risk-free strategy, however. Jean-Claude Trichet, ECB president, has faced a barrage of criticism in Germany, where the ECB's move was seen as rewarding irresponsible fiscal behaviour by governments and creating inflation risks.

The speed at which the ECB will be able to wind down its asset purchases will depend on the effectiveness of the political response to the crisis. This month eurozone leaders have put in place a €440bn stabilisation fund capable of offering emergency assistance to eurozone members. A debate has started on toughening the surveillance of economic policies and public finances, and on tougher sanctions.

But on prevention. France's instinct for greater economic co-ordination and government involvement has clashed with German preference for "stability orientated" policies that encourage fiscal prudence and do not blur boundaries between fiscal and monetary policies.

For now, the eurozone's gradual economic recovery remains on track. Germany's export-led economy appears to be firing back into action, and might have seen GDP growing by more than 1 per cent in the second quarter.

But significant risks remain. Weaknesses in the eurozone banks have been exacerbated by their exposure to the debt crisis, and could curtain the flow of credit into the real economy. Economists at Commerzbank in Frankfurt warn of a possible Lehman Brothers-style "uncertainty shock", in which a loss of economic confidence undermines investment and spending decisions.

Even on a best-case scenario, the eurozone's recovery will be slow and bumpy.

Beijing earns plaudits for behaviour in crisis

China

Some structural weaknesses are being addressed, writes **Geoff Dyer**

The best summary of the bearish case for the Chinese economy was made, as it happens, by China's Premier Wen Jiabao, who in 2007 described the country's development model as "unsteady, unbalanced, unco-ordinated and unsustainable".

China has made a remarkable recovery from the global financial crisis, growing by 8.7 per cent in 2009, fuelled by a decisive and huge fiscal and monetary stimulus programme.

But with investment in infrastructure acting as the main driving force behind growth, and exports soaring while the currency remains pegged to the dollar, the question remains about whether Mr Wen's diagnosis still stands.

The principal themes of China bears are over-investment and overheating.

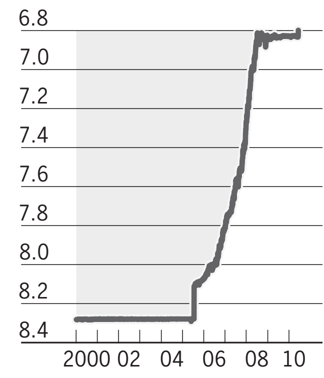
China's investment rate as a proportion of gross domestic product, at more than 40 per cent, was exceptionally high before the stimulus plan and it was even higher at nearly 50 per cent last year. Too much investment means the new projects are likely to be inefficient and end up creating overcapacity.

Critics also warn that the surge in bank lending last year, which doubled on the year before to Rmb9,600bn ($1,412bn), could end up in a pile of bad debts.

Victor Shih, an economist at Northwestern University in the US, has tried to track the lending and calculates that local governments now have debts of Rmb11,400bn – well above the official figure of Rmb7,400bn. He says Rmb3,000bn could end up as non-performing.

The other main sign of overheating is the housing market, where many cities have seen rapid increases in prices since the start of last year. Government housing price figures have shown record year-on-year rises over the past two months.

Chinese Renminbi
Against the dollar (Rmb per $)



Source: Thomson Reuters Datastream

However, the government has tried to prevent overheating. It has scaled back the pace of new bank loans since last autumn, restricted approvals for new infrastructure projects and ordered banks to reduce exposure to local government investment companies. In the housing market, the authorities have introduced a slew of policies to limit speculative buying.

Some previous critics believe the authorities have done enough in the short term to prevent the investment boom from running out of control. Yu Yongding, an economist at the Chinese Academy of Social Sciences who warned last year about the risks of over-investment, says that the current situation is much more manageable.

"In the long run, we need to make deep reforms in the economic structure, but in the short run the government has effectively used monetary policy to bring down investment," he says.

The flipside of an economy relying too much on investment is one where consumption plays too small a role – in recent years, consumption has accounted for only a third of GDP. Yet there are signs this is beginning to change. Household consumption grew strongly last year, despite the crisis.

Some analysts believe a structural shift is under way. Li Daokui, a professor at Tsinghua University and a member of the Chinese central bank's monetary policy committee, says: "Chinese consumers are beginning to consume."

The last piece of the Chinese rebalancing equation – and the most controversial – is China's exchange rate. Amid growing international pressure, not just from the US but also India and Brazil, China abandoned its currency peg with the dollar and began appreciating the renminbi on June 21, although the central bank stressed that any changes in the exchange rate would only be very gradual.

Although the policy shift appears to be enough to prevent the renminbi from dominating the G20 summit, China could still come under attack in the US Congress in the next few months if the pace of appreciation is slow.

Yet if pressure does increase again, Beijing can point to the sharp drop in its current account surplus. Before the crisis, China was running a current account surplus equivalent to 11 per cent of GDP but that dropped to 6.1 per cent last year. And in the first five months of this year, it has fallen further – even if exports have started to pick up sharply, rising 53 per cent in May, year-on-year. Officials argue that the big surpluses are being brought under control.

China's economy still has a lop-sided quality to it and its role in global rebalancing could start to become more politically controversial. But there are also signs of progress in the shift to a more sustainable growth model that Mr Wen demanded three years ago.

Harper puts recovery at heart of agendas

G8 and G20

Canada's premier has sought to minimise tensions between the two groups, says **Bernard Simon**

Stephen Harper's theme for the G8 and G20 meetings in Ontario is "Recovery and new beginnings".

The Canadian prime minister, who is hosting the summits, told the World Economic Forum in Davos earlier this year that "the discussion should be less about new agreements than accountability for existing ones. Less about lofty promises than real results."

However, expectations for real results are modest. The Ontario meetings are now widely seen as a stepping-stone to the G20 summit in South Korea in November. "Many of the really critical timelines are for later in the year", Mr Harper told the Financial Times this month.

Citing regulatory reforms for the financial sector, he said: "We're working closely with the Koreans on…trying to ensure that whatever we do at our summit enhances hitting the timelines that we have in line for [the one in November] as well."

The scope for meaningful results at the G8 is limited by the need for the rich-world countries to avoid the impression that they are presenting their emerging-economy colleagues with a fait accompli.

This month's G8 meeting was expected to be the last of its kind. But France, next in line for the chairmanship, has recently said it will keep the group running in 2011.

Mr Harper has sought to play down potential tensions between the two groups by distinguishing between the G20's focus on economic issues and the G8's role in other areas such as terrorism, piracy on the high seas, climate change and nuclear proliferation.

The G8 "remains a fairly coherent group of countries that, broadly speaking, share value systems, share interests, and where leaders are able to have much more informal and frank exchange on a range of issues", Mr Harper says.

His own pet issue in Ontario will be a co-ordinated initiative to improve the health of mothers in developing countries. "The statistics remain quite shocking in terms of death in childbirth and death in the very early years of infancy," Mr Harper says. "Many of the things that can be done to prevent that are actually well-known and not expensive."

His Conservative government has earmarked C$1bn to set up a fund for this, but it has stirred up a hornet's nest at home by excluding abortion initiatives.

Regarding the G20, Mr Harper has singled out three areas where, in his words, "actions have been and will remain vital": financial sector reform, fiscal policy and global trade strategies. In each, he has presented Canada as a model that his guests would be wise to follow. The relative health of Canada's banking sector has helped Ottawa – supported by Japan, Australia and Brazil – to deflect a US and European proposal for a global banking levy to finance future bailouts.

Instead, the Canadians are pushing for banks to protect themselves by raising "embedded contingent capital", in other words, debt securities that would convert into common shares if an ailing bank needed to raise new equity. Critics have questioned however, whether investors would have an appetite for such potentially risky instruments.

Mr Harper is eager to shift discussion on fiscal policy to a co-ordinated "exit strategy" from the massive stimulus measures of the past two years.

"Obviously there's a balancing act between tackling fiscal challenges and at the same time not doing it in a way that would cause some short-term shocks to the system," he says.

International Monetary Fund studies being circulated among G20 members show that "if everybody does the optimal policies, even though they may feel it will hurt them, everyone actually ends up better off… That's the kind of discussion we want to have."

On trade, Canada has urged the G20 to scrap all "nuisance" customs tariffs below 5 per cent.

Mr Harper has matched his words with deeds. His government announced in March that it would unilaterally dismantle within the next five years all remaining tariffs on machinery and equipment and on goods imported for further manufacturing in Canada.

All but 381 of 1,541 industrial-input items still subject to customs duties were eliminated immediately. The measure is expected to save Canadian importers C$300m a year in customs duties.

The government is also pursuing an active bilateral trade liberalisation strategy that includes talks on a comprehensive free-trade deal with the EU and exploratory discussions on a pact with India.

Free-trade deals have recently been put in place with Colombia, Panama and Jordan.

Nevertheless, the G20 has so far shown little enthusiasm for following the Canadians' lead.

'Balancing act': Canadian prime minister Stephen Harper is hosting the two meetings Charlie Bibby

Canada rises above the crisis

Economy

The country does have its areas of vulnerability, says **Bernard Simon**

The host of the G8 and G20 summits may be forgiven a smidgen of self-righteousness during the leaders' forthcoming meetings in Ontario.

Canada's economy and banking system are in better shape than most other summit participants, and Stephen Harper, the prime minister, has made no secret of his eagerness to capitalise on that performance.

He told the Financial Times this month: "Canada was one of the few developed countries that did not have a crisis in its financial sector… We're very optimistic and bullish about the future of our own country."

For once, Canada has been able to plough a different furrow from its southern neighbour, even though the US makes up three-quarters of its foreign trade. "The Niagara River was a Berlin Wall as far as financial contagion was concerned," says John Kirton, director of the G8 research group at the University of Toronto's Munk Centre.

Canada sank into a brief recession in 2008, but its growth rate in the first

Paul Volcker: Canada's good fortune is 'partly a cultural thing'

quarter of this year, at 6.1 per cent, was double that of the US. House prices in Toronto and Vancouver have hit new records in recent months. In another break with the past, the jobless rate north of the border, at 8.1 per cent, is well below the US's 9.7 per cent.

On fiscal policy, Mr Harper's minority Conservative government has a more realistic chance than the US of balancing its books within the next few years, even as it cuts personal and corporate taxes.

According to preliminary finance department data, Ottawa ran a record deficit of C$47bn in the year to March 31. The finance minister Jim Flaherty projects a similar shortfall this year.

But at 3.4 per cent of gross domestic product, Canada's deficit is more manageable than that of many summit partners. The debt-to-GDP, at 35 per cent, is the lowest among leading industrial economies.

Mr Harper has insisted that a two-year stimulus package of spending and tax breaks will come to an end as scheduled in March. A big chunk of last year's deficit was also due to Canada's one-off contribution to the bail-out of General Motors and Chrysler.

On the banking front, Ottawa has provided liquidity support but no direct capital infusions. All six of Canada's biggest banks have maintained their dividends. Two – Royal Bank of Canada and Toronto-Dominion – are among only half a dozen banks worldwide that still enjoy a Moody's triple-A credit rating.

The banks owe their strength mainly to their vast and stable domestic retail business, and their limited exposure to the toxic securities that landed many US and European counterparts in trouble.

Paul Volcker, former head of the US Federal Reserve and an adviser to President Barack Obama, told the Financial Times earlier this year that Canada's good fortune is "partly a cultural thing – they are more conservative".

That conservatism was in evidence in the mid-1990s when the Liberal government of the time laid the groundwork for today's manageable public finances with spending cuts that turned a worrying deficit into 12 consecutive years of surpluses.

Canada's centralised and co-ordinated system of bank regulation has also played a critical role, keeping institutions in line with strictly enforced capital requirements, quality of capital rules and leverage ratios. The superintendent of financial institutions maintains a close relationship not only with bank officials but also with their boards.

For all these safeguards however, Canada is by no means assured of a never-ending upswing. As a big producer of oil, natural gas, forestry products and potash, among other resources, it remains vulnerable to volatile commodity markets. Its automotive industry, still the biggest manufacturing sector, is almost totally reliant on US car buyers.

The Canadian banks have not always been as prudent as they were during the last boom. They have burnt their fingers in the past through heavy exposure to such volatile sectors as commercial real estate, energy and emerging markets.

As far as public finances go, the Toronto-based Institute for Competitiveness and Prosperity noted in a recent report on Canada's long-term prospects that "huge federal and provincial deficits will necessitate fiscal belt-tightening".

Mr Harper admonished his G20 colleagues a few weeks ago that "we must deliver firm, credible plans that will put our countries on a path to fiscal sustainability. We can confront our fiscal challenge with clear and realistic plans for fiscal consolidation, or we can wait for markets to dictate the terms for us."

Yet Mr Harper's own minority government has presided over a surge in public spending since it took office four years ago. The prime minister has yet to prove that he is willing and able to practise what he preaches on fiscal restraint.

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Important staging post on road to Seoul

Regulation

Brooke Masters says this meeting will shape finance for years to come

The G20 meeting in Toronto is unlikely to result in significant breakthroughs on the regulatory front, but the behind-the-scenes conversation could be critical to shaping global reforms due to emerge this year.

Most regulatory and political experts say decisions about how to make the financial system safer and deal with cross-border banks and other institutions seen as "too big to fail" will probably be taken in November in Seoul.

"It will be a positioning meeting rather than a decision-making meeting," predicts John Liver, partner at Ernst & Young. "Seoul is the key date in terms of finalising things."

But the leaders will be talking among themselves in Toronto about the timing and nature of these reforms, and the consensus – or lack of it – will help shape finance and banking for years to come.

Steve Culp, global managing director for risk management at Accenture, says: "2010 will be critical, as it will determine whether the co-ordinated approach, agreed during last year's G20 summits and related global finance sessions, solidifies the co-ordinated direction – or fractures."

Toward that end, the leaders will also be taking stock of how the participants have implemented prior agreements.

Stephen Harper, prime minister of Canada and the host of the meeting, told the Financial Times: "We're not looking for leaders to come and make a whole bunch of new commitments. We're looking primarily for accountability, that we act upon the agreements already reached."

The G20 leaders are unlikely to drill down too deeply into issues such as the quality of bank capital and forcing banks to write "living wills" that would make it easier to break them up in case of failure.

Technical committees are working out these proposals, and politicians are unlikely to tinker with details at this stage.

Giles Williams of KMPG explains: "The thing politicians don't want to play around with are the preventative measures because they are too technical."

Several significant forces in the G20 are also in the midst of their own reforms.

The US is finishing up a big financial reform bill. The UK's new coalition government has just outlined its approach to financial regulation. And the EU is about to create several pan-European bodies to oversee systemic risk, banking, insurance and markets. That uncertainty may also make it hard for the group to commit to specific reforms.

"Either nothing happens or very little happens," says Tom O'Riordan, of the law firm Paul Hastings.

Instead, the G20 leaders will probably urge the Basel Committee on Banking Supervision, a global body of regulators and central bankers, to press ahead with proposals for tightening the definition of tier one capital and liquid assets, and reducing dependence on short-term funding.

'More stable, less leveraged banks would . . . improve the terms on which banks could raise funds'

Nout Wellink, Chairman, Basel group

The committee is due to meet again in July and hopes to finalise its proposals in time for the G20 to consider them in Seoul.

Hanging over the G20 discussion in Toronto will be growing concerns that if government spending cuts and increased regulation hit at the same time, the fragile recovery could be derailed.

"If you are going to have capital stringency on top of government budget cuts, you have the recipe for a mini-crisis. It's not something the market can bear," says Mr O'Riordan

The Institute of International Finance, a banking group, unveiled a study this month which calculates that the Basel proposals could cut economic growth by 3 percentage points in the US, eurozone and Japan over the next five years.

But some regulators say the impact will be much less, perhaps 1 point. The Basel committee expects to issue its own impact statement this year.

Nout Wellink, chairman of the Basel group, says its study will include not only the costs of increased regulation, but also the benefits of a more stable banking system.

"On the one hand, higher capital requirements and liquidity standards could increase the cost of funding. On the other hand, more stable, less leveraged banks would raise average ratings, improve the terms on which banks could raise funds, and lower the required return on equity," he said in a recent speech.

Some European leaders are expected to press for the rules to be watered down, while the US and UK are more likely to argue for keeping the tough rules but extending the transition period to blunt the impact.

That debate remained unresolved when the finance ministers met this month, but Ernst & Young's Mr Liver predicts the G20 leaders will try to be more definitive, at least on the timetable.

"They will come up with some language that is more explicit on the transition period. There is going to be a tone of impatience," he says.

Back to a future that did not work the first time around

Policy co-ordination

The IMF may end up with a near-impossible task, says **Alan Beattie**

The search for true global co-ordination in macroeconomic policy has been going on for some time. Indeed, it predates the global financial crisis. From about the middle of the first decade of the 21st century, there were attempts to get the governments of the world not just to keep growth going, but to do so in a way that did not store up problems

Now, with the same problems re-emerging, a similar suggestion has once again been wheeled out. But with the diagnosis of the problem by the key players still differing sharply, and even this week's exchange rate move by China not likely to make a big difference in the short or medium term, the most likely outcome seems to be more of the same stalemate.

During the past decade, the rising surpluses of emerging Asia in general and China in particular found their counterpart in a swelling current account deficit in the US – and one or two other consumption-driven economies playing a supporting role in boosting domestic demand, notably the UK.

This vendor finance arrangement – China lending the US money by buying Treasury bonds that could then be used to purchase Chinese exports – may have created growth in the short term. But there was widespread fear it was a short-term equilibrium that could collapse at any moment with a slide in the dollar or US asset prices, or a sudden retrenchment by US households.

Accordingly, the machinery of global economic governance was moved into place to have a go at reducing the imbalances. The referee given the task of umpiring this game of global co-ordination was the International Monetary Fund. It would be a considerable exaggeration to say that these efforts were a roaring success.

China and the US squared off around a table, with the eurozone; Saudi Arabia and Japan were brought in to give the appearance of multilateralism.

But what soon became clear was that the problem with global rebalancing was not a failure of co-ordination – it was a simple disagreement about the causes of the imbalances in the first place.

The US pointed the finger at China's fixed exchange rate; Beijing blamed low US savings. Although China did start allowing its currency to crawl higher between 2005 and 2008, it did not solve the bilateral surplus problem with the US and did not produce a grand rebalancing bargain.

Half a decade and a global financial crisis later, and much the same problem still persists. While the global recession temporarily reduced the imbalances, as US consumers finally did some saving, the revival of demand has seen them start to grow again.

With the Greek crisis also hitting the eurozone and pushing the euro lower, the world economy is heading straight back to the situation it was in before: Germany, Japan and China in massive surplus and the US in deficit.

The latest iteration of the plan to have the IMF save the world is a growth monitoring exercise started at the Pittsburgh G20 summit last September. Countries were to come up with plans for growth and submit them to the fund, which would monitor them for compatibility and feasibility.

This was in itself a somewhat watered-down version of what the US had tried to impress on countries earlier in the year, setting global targets for discretionary fiscal stimulus as a share of GDP – a plan rejected by European governments, which pointed at the automatic fiscal stabilisers of their larger welfare states.

Initially, the fear was that the individual plans would fail the "adding-up constraint" – that is, too many would be relying on export growth and too few on domestic demand, with the result that there would be nowhere for all the exports to go. In the event, the IMF says, the plans submitted do not suffer from this problem.

The problem of too many exporters and not enough consumers has become more acute

But given the events over the past few months in Europe, the problem of too many exporters and not enough consumers has become more acute.

China sprang something of a surprise over the past week, apparently allowing the renminbi to resume its appreciation. But by cautioning against anyone reckoning on a big rise in the currency, the People's Bank of China heavily played down expectations that it would do much to rebalance the global economy.

The Greek crisis has not just pushed down the euro, thus increasing the export orientation of the eurozone recovery. It has also caused some worried governments to start fiscal consolidation sooner rather than later, concerned that the bond markets will punish them with wider yields if they do not. Even the UK, where there are no apparent signs of distress in the bond market, has started planning big cuts now.

The net effect of all this fiscal tightening, assuming it is also reflected in the countries' external accounts, could be to return the world economy precisely to the situation it was in before – too many countries saving too much and trying to export, and too much left to the US consumer.

If that does happen, one thing is certain: the IMF will be called in yet again for another improbable attempt at getting the world's governments to achieve the coordination they have thus far signally failed to do.

Rebalancing act: China's latest exchange rate move is unlikely to make a big difference in the near term Bloomberg

An idea that was hot, but now is not

Bank levy

Chris Giles explains why there may be little progress

There was a moment in the spring when the idea of a uniform global levy on banks was fashionable.

The US launched a Financial Crisis Responsibility Fee to ensure US taxpayers were repaid for bailing out the banks.

The UK and France imposed taxes on bonuses. Germany called for a financial transactions tax.

And the International Monetary Fund gave the idea of a uniform global banking levy its blessing. Expectations that a levy would be agreed at the G20 by the end of the year were high.

But at the Group of 20 meeting of finance ministers and central bank governors in Busan, South Korea, this month, the chances of agreement on a global banking levy faded away in a marathon negotiating session that lasted until 5am.

The opposition, led by Canada but supported by Australia, Japan, China and other emerging economies in the G20, ensured that there will be no deal in Toronto, nor at the Seoul summit in November.

Jim Flaherty, Canada's finance minister, told reporters: "The debate on ... bank levies has been a distraction from the core issues and it has been apparent again from our meetings that most of the G20 members do not support the concept of a universal levy."

As far as Dominique Strauss-Kahn, managing director of the International Monetary Fund, was concerned, the idea of a uniform global tax had always been "controversial" and the Busan meeting merely showed it had never been a realistic G20 objective.

The communiqué attempted to disguise the rift that had occurred and the end of the road for a uniform global banking levy.

It stated that there was "a range of policy approaches" that countries would adopt to protect taxpayers, but added that this range would be determined "taking into account individual countries' circumstances and options".

Officials made it clear that the language implied countries had leeway to do what they liked.

The G20 did nevertheless agree that where taxpayers have had to support banks, the principle should be that the financial sector should pay that money back.

The finance ministers' communiqué stated: "The financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution."

It is not only the dissenting countries such as Canada that are pleased at the death of the uniform banking levy idea: many regulators saw it as an unwelcome distraction from the serious business of Basel reforms to bank capital, liquidity and leverage.

Nout Wellink, chairman of the Basel committee on banking supervision told the FT in May that a levy "might be a hindrance" to regulatory efforts to make the system safer.

"We should first finalise the Basel package and then see whether it's still useful to have an additional levy or tax, or whatever you want to call it," he said.

But such is the political need in many countries to have a punitive tax on banks that the US, UK, Germany and much of the European Union still want individual banking levies.

Mr Strauss-Kahn welcomed this at the G20 meeting in Busan. "The problem is not uniformity but it is consistency. You may have different things in different parts of the world," he said.

Without naming Canada, he said countries that did not want to impose a tax on banks because they had not suffered a banking crisis were being too "optimistic", as the probability was that they would suffer a crisis one day.

The result of the wrangling is that countries are still going ahead with their plans but few expect any banking levy to be large or to raise a significant sum.

'The debate on bank levies has been a distraction from the core issues'

The G20 is set to agree a series of principles so that countries imposing banking levies find they are compatible with one another and that problems such as the same activity being taxed in two or more jurisdictions are avoided.

But even in the EU, where the principle of a banking levy is agreed, its implementation in practice is hampered by differences of opinion on the purpose of such a levy.

Michel Barnier, EU internal market commissioner, says he is not abandoning the idea of using money raised by a levy on the banking industry to establish an EU-wide network of domestic funds that could be used to resolve financial problems at individual banks in the future.

"We will persist in this matter," says Mr Barnier.

But Britain, among others, worries that creating an explicit link between a levy and a fund to bail out banks would create the impression that banks had paid for their explicit state support and would take greater risks as a result.

But given the opposition of Canada, the Toronto summit is highly unlikely even to make progress on resolving the remaining difficulties of introducing voluntary banking levies where countries agree on their merits.

S Korea looks forward to its own party

Seoul

Lee Myung-bak is staking his place at the top table, writes **Christian Oliver**

Even before North Korea torpedoed a South Korean warship in March, killing 46 sailors, there was a highly emotional dimension to Seoul's agenda for its presidency of the G20 leading economies this year.

As the first non-G8 nation to chair the G20 since it gained global prominence, Seoul is styling the November summit as a giant coming-out party, where it can show off how far it has come since the 1950-1953 Korean War, when the country was, in effect, destroyed.

Sixty years on, South Korea wants to cast itself as a bridge between developing and developed nations, plotting fresh ideas for international development, drawing on its own rise from dire poverty. Most importantly, it says it knows how to engage both the US, its main military ally, and China, its main trade partner, in the key debates. In the policy domain, it wants to steer the creation of "financial safety nets" that discourage countries from amassing reserves and causing global imbalances.

If securing concrete results on such issues were not enough of a challenge for the South Korean debutantes, North Korea has appeared as a cloud on the horizon that could remind the world that Seoul's future remains perilous.

Earlier this year, it had seemed Lee Myung-bak, the president, could try to engineer a summit to keep North Korea sweet during Seoul's year in the sun. November's summit is still distant, but South Korea can only hope that Pyongyang does not raise tensions further and deter world leaders from a summit in Seoul, a city that could be obliterated in minutes by North Korean artillery.

South Korea's security services say they are focusing on trying to break spy networks that could be used to launch terrorist attacks at the G20 meetings. Kim Jong-il, North Korea's dictator, has historically been deeply resentful of his more successful cousins hosting big events such as the Olympic Games in 1988 and the football World Cup in 2002.

Faced with the resurgent threat of Pyongyang, South Korea's G20 agenda is now evolving into a broader picture of how Mr Lee wants to present South Korea on the global stage.

The G20 is Mr Lee's way of portraying Asia's fourth-biggest economy as the nation that has got it right and wants to be part of the club.

North Korea, he argues, is the outcast. "All nations are working together for the sake of co-prosperity and peace in the global community. The entire world is changing. Changes are taking place faster than ever. But what is the situation in North Korea? Nothing has changed over the last 60 years," he said in a speech last month.

Although Mr Lee's speeches after the sinking of the warship have been measured, his rhetoric on the G20 before that was prone to hyperbole. He cast South Korea as the "only country to have transformed itself from a passive follower to an active agenda setter".

The most clearly defined part of this agenda involves pressing the G20 to adopt a worldwide programme of currency swaps. Seoul, itself a large reserve holder, has deep experience of using massive currency swaps with the US, Japan and China to soothe investors' fears.

Lee Myung-bak: 'Nothing has changed in North Korea in the last 60 years'

Shin Hyun-song, the president's adviser on international economy, describes such swaps as "prisoners to circumstances" that depend on countries agreeing bilaterally to the terms. South Korea is trying to orchestrate an international (and permanently available) framework for surmounting liquidity shortages.

Mr Shin admits there are challenges such as moral hazard and determining whether there is a role for the International Monetary Fund. Some countries also suspect the US Federal Reserve will seek to avoid large commitments to such a scheme.

Many international economists also doubt that the accumulation of reserves is really a sign of a lack of safety nets, as Seoul argues. Several analysts argue reserves will only fall when big reserve holders build up larger domestic markets.

South Korea has built up expectations that it will bring fresh impetus to discussions on international development, and address Africa in particular – which South Korea's G20 sherpa, Rhee Chang-yong has described as "the greatest global imbalance".

South Korea certainly has deep experience lifting itself out of poverty. Average annual incomes have soared to about $20,000 from less than $100 in the 1960s.

Still, South Korea insists it will not be trying to export its own growth model, which was forged principally through a military dictatorship and used high tariffs to protect infant industries.

South Korea says it wants to help create a model that should shift the world away from targeting final goals such as clean water and hospitals. It would instead focus on the vital intermediaries that fuel growth such as education and infrastructure.

South Korea is keeping its development agenda under wraps until after the Canadian summit. But Mr Shin says Seoul will focus on ideas of permanence, showing that development is different from aid and requires long-term commitments.

"The message is that we are here for good and putting down roots," he says.

Pantomime villain fails to materialise

Protectionism

Alan Beattie on why a trade slide did not prompt an outbreak of tariffs

If comparisons between the state of the world economy and the Great Depression are a useful indicator of how the recovery is progressing, ministers and central bankers from the world's leading economies should be feeling a lot better than a year ago.

The analogies between the (still substantial) unemployment lines of today and the mass joblessness of the 1930s have become mercifully less frequent.

And one area in which the drawing of parallels has dropped away almost completely is that of protectionism. In the months after the collapse of Lehman Brothers in the autumn of 2008, a precipitous collapse in the volume of world trade had observers reaching for their history books, noting that the drop-off in commerce was, if anything, faster than during the 1930s.

With protectionist rhetoric becoming increasingly prevalent, there was real concern that the world could soon see a return to the out-and-out protectionism of the Great Depression. In particular, worry-warts kept repeating to each other, we could be on the brink of repeating the infamous Smoot-Hawley tariff act of 1930. This raised trade barriers in the US and set off a flurry of tit-for-tat retaliation around the world.

Just as the protectionism of the 1930s undid much of the liberalisation of trade during the "Golden Age" of globalisation from 1880 to 1914, the fear went, so the protectionism of the new Great Recession might reverse the rapid integration of markets in goods, services and capital since the end of the Cold War.

But despite – or perhaps because of – all the eyes trained on the wings, the pantomime villain of protectionism signally failed to appear. Monitoring projects were set up by the World Bank, the World Trade Organisation and other bodies. But they recorded only modest increases in the use of traditional forms of trade barriers – import tariffs and emergency so-called "anti-dumping" measures and "countervailing duties" used against imports deemed to be unfairly priced or subsidised by the exporting country's government.

A study by the World Trade Organisation and other official agencies commissioned by the G20 and published earlier this year was sanguine, saying that at most 0.4 per cent of world trade had been affected by import barriers imposed during the previous six months.

"The trade and investment policy response to the global recession has so far been relatively muted," the study said. "Most G20 members continue to manage successfully the political process of keeping domestic protectionist pressures under control, despite a difficult environment for some of them where employment levels and new job opportunities are shrinking."

Meanwhile, trade itself rapidly recovered, and on current trends is likely to be back to pre-crisis levels by the end of next year.

> Some have argued that the trade barriers being used today are more subtle and insidious

Whether the lost years of growth will ever be made up is another matter, but policymakers in the dark days of late 2008 would have been mightily relieved if they had known today's outcome in advance.

But some have argued that the forms of protectionism being used today are far more subtle and insidious, and are not captured by traditional measures of trade barriers.

Simon Evenett, a professor at St Gallen University in Switzerland, runs a monitoring service called Global Trade Alert and differs sharply from the assessments of the WTO and others. "No doubt to the embarrassment of those who systematically talked down the incidence of protectionism during 2009, the evidence continues to mount as to the extent to which governments discriminated against foreign commercial interests," Prof Evenett says.

His database records less obvious forms of government intervention that may restrain trade even if the intent is not absolutely clear. These include: bailouts for car industries around the world, which are generally skewed towards domestic companies; increased difficulty for companies in obtaining licences to export to, or produce in, a foreign country; and government procurement rules that increasingly favour home companies over foreign rivals.

By this measure, Prof Evenett says, protectionism has been high and rising. His most recent report is published this week, but the previous one found that "since the first G20 crisis-related summit in November 2008, the governments of the world have together implemented 496 beggar-thy-neighbour policy measures; that is, more than one for every working day." Only 99 of these measures were the traditional restrictions such as anti-dumping and countervailing duties.

The problem with judging the true extent of protectionism is that these measures, though they have the potential to restrict flows of trade, appear not to have done so very much.

Unless growth in actual measured trade and services slows or goes into reverse, it is unlikely that the world's policymakers will agree with Prof Evenett that the global economy is suffering from an epidemic of protectionism.

Bonds are both shaken and stirred

Government bonds

Volatility and high yields stalk once staid markets, says **David Oakley**

The government bond markets of the developed world have changed forever – or at least for another generation.

These once staid and predictable markets are now some of the most volatile in the world, as debt levels have piled up and their economies have registered metrics that make them look more like their weakest emerging neighbours.

Before the financial crisis erupted in the summer of 2007, Greek 10-year bond yields traded close to those of Germany, Europe's biggest and strongest economy that is used as a benchmark for prices.

Today, Greek yields – which have an inverse relationship with prices – trade more than 5 percentage points above those of Germany. Last October, that difference was just over 1 percentage point. In July, 2007 it was under a quarter of a point.

In the case of Greece, investors simply refused to buy the country's debt, regardless of the extra premiums, as two-year yields rose above 20 per cent.

Portugal, Spain and Ireland, considered the weakest economies in the eurozone after Greece, are all having to pay investors much bigger yield premiums to coax them to buy.

Even the yields of France, the eurozone's second biggest economy, are trading at about half a percentage point higher than Germany. Three years ago, there was barely a basis point separating them.

Even Germany, however, could see its markets come under pressure because of the depth of the debt crisis, not just in Europe but in other developed world markets such as the US and Japan.

So will the government bond markets ever be boring and predictable again?

The consensus answer is no, or not for a long time, as it will take years for the world's developed markets to bring down debt levels and budget deficits that are likely to act as a curb on growth and reduce living standards.

Phillip Apel, head of interest-rate strategy at Henderson, says: "The world has changed in the developed bond markets, particularly in the eurozone.

"We are not going to go back to the days when German bond markets and those of the peripheral eurozone economies traded at similar levels for a long time. It may take years of fiscal pain and possibly more integration in the eurozone."

Graeme Caughey, head of government bonds at Scottish Widows Investment Partnership, agrees: "We are not going to see a return to the days when all eurozone debt was considered virtually risk-free.

"We will only see yields converge with more fiscal union, which seems likely as Europe is determined not to see the break-up of the euro."

A big step change for the eurozone bond markets is their reliance on the support of the €750bn international rescue package, which was announced in May and acts as a backstop for those countries that cannot raise money in the private debt markets.

The creation as part of the international support package of the European Financial Stability Facility (EFSF), which has €440bn at its disposal to help out eurozone members struggling to issue debt, is the key component of this package and vital for the stability of the markets.

The European Central Bank's buying of eurozone government bonds is also necessary to prevent the weakest markets from imploding.

For many, the EFSF could be a trigger for more fiscal union, as the chances of Portugal or Spain having to use the fund are considered high.

Certainly, these countries have had to pay higher and higher yields to attract investors. At some stage, these yields will be so high that the sensible course will be to use the EFSF – expected to charge about 5 per cent for loans – even if the political stigma makes it a last resort.

If this happens, the EFSF, which will issue bonds guaranteed by all eurozone members excluding Greece, could be a precursor to a common European bond that would also be a step towards fiscal union.

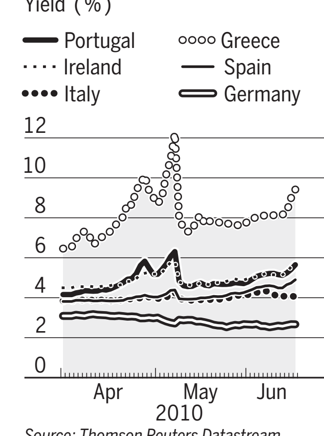
Mark Austen, managing director of the Association for Financial Markets in Europe, says: "Out of the ashes, the EFSF could lead to a stronger euro and more stability in the eurozone."

However, for the time being, the economies will have to go through the pain of fiscal retrenchment.

And this does not just apply in continental Europe. The US and UK, which have been out of the spotlight, have budget deficits and debt levels that are worse than the aggregate of the eurozone.

Jamie Stuttard, head of European and UK fixed income at Schroders, says: "It may take years before we see the European peripheral markets stabilise.

"Until the problem of Greece is resolved – and still the threat of the country defaulting hangs over the markets – then we are likely to be stuck with more volatile markets."



Source: Thomson Reuters Datastream

Labouring to make progress on job creation

US employment

James Politi on fears that companies remain wary of hiring new workers in big numbers

Hard work: job hunting is a long process for many, after US companies cut over 8m jobs — Ronda Churchill/Bloomberg

Economists shuddered early this month when the US labour department reported that private US employers created only 41,000 new jobs in May.

The figure was a big disappointment compared with expectations of private sector payroll gains closer to 200,000, marking a much slower pace of job creation by US businesses compared with March and April.

It damaged hopes that the US recovery could gather momentum even in the face of the market turmoil caused by the European sovereign debt crisis, and validated the belief that the labour market will be one of the weakest spots for the US economy for months to come.

"Getting back to full employment is going to be slow, it's going to be a slog, it's going to be long and gradual," says Neil Dutta, an economist at Bank of America Merrill Lynch in New York.

During the recession, US employers slashed more than 8m jobs, reacting aggressively to falling demand for their goods and services. The pace of job cuts hit a peak at the beginning of 2009, moderating over the course of the year until companies started hiring again at the beginning of this year.

Economists including Mr Dutta caution against drawing conclusions from one month's dip in the data, and note that there were some positive aspects of the latest jobs report, including an increase in hours worked and hourly earnings.

But the figures did reignite fears that companies remain wary of hiring new workers in a big way, despite the fact that the US economy grew at an annualised rate of 3 per cent in the first quarter.

"The economy has been in a state of recovery for the last couple of quarters, and I think still is, and within that the biggest risk from my perspective here in the US is job creation," said Dick Parsons, the chairman of Citigroup and former chief executive of Time Warner, at a Bloomberg conference in Washington on June 15. "We just gotta create jobs."

The unemployment rate – which is calculated by the government using a different survey than the payrolls data – is 9.7 per cent, an exceptionally high figure for the US economy and only slightly below this recession's peak above 10 per cent.

At the Federal Reserve, expectations are that high unemployment will not go away any time soon, with US central bank officials forecasting that it will dip only to 9.3 per cent by the end of the year.

Indeed, while Ben Bernanke, Fed chairman, this month acknowledged what he described as "some modest improvement in employment, hours of work, and labour income", he also added: "In all likelihood, however, a significant amount of time will be required to restore the nearly 8.5m jobs that were lost over 2008 and 2009."

The lacklustre unemployment picture has also become a big problem for the Obama administration and its economic team, led by Tim Geithner, treasury secretary, Lawrence Summers, head of the National Economic Council, and Christina Romer, chair of the White House Council of Economic Advisers.

At the beginning of this year, President Barack Obama promised to make job creation his top domestic priority in 2010 ahead of midterm congressional elections scheduled for November. But since that pledge during the

> 'Getting back to full employment is going to be slow, it's going to be a slog, it's going to be long and gradual'

"state of the union" address, Mr Obama has been focused on a myriad of other issues, including the passage of healthcare and financial reform, and more recently, the oil spill in the Gulf of Mexico.

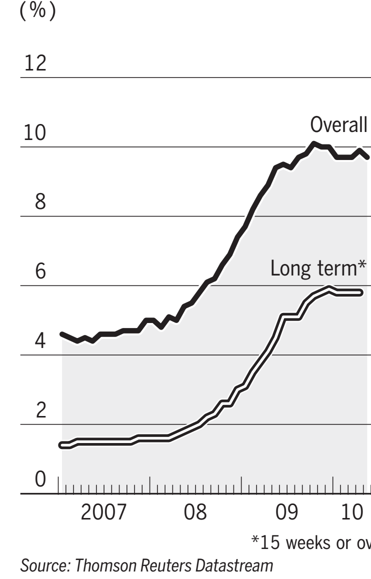
In addition, the administration's options on promoting job creation seem limited at this point, as US lawmakers, including members of the Democratic majority, are growing increasingly concerned about the soaring budget deficit and wary of any additional spending on top of the $862bn stimulus that was passed last year and whose effect will begin to fade later this year.

So far, the administration has been successful only at enacting a modest $13bn measure that would give a tax credit to companies that hire unemployed workers. A much larger, near-$200bn package of measures to boost employment was scaled back by nearly $80bn before it passed the House recently amid deficit worries, and its fate in the Senate remained unclear in mid-June.

Mr Obama has also made repeated appeals for Congress to pass a $30bn plan to aid lending to small businesses, which account for a large chunk of job creation in the US and have lagged behind large companies in hiring new workers, partly because of lack of access to credit.

"Government can't create private-sector jobs," Mr Obama said on June 11. "But it can create the conditions for small business like these to grow and hire more people."

US unemployment rates
(%)



Source: Thomson Reuters Datastream

A big, unwieldy and diverse body moves upstage

The new era

Alan Beattie looks at the effectiveness of the G20

It was in the leaders' statement after the Pittsburgh summit in September 2009 that the solemn pronouncement came. The old era would receive a ceremonial cremation and a new, stronger one would arise out of its ashes.

"We designated the G20 to be the premier forum for our international economic co-operation," it said. "After this crisis, critical players need to be at the table and fully vested in our institutions to allow us to co-operate to lay the foundation for strong, sustainable and balanced growth."

In truth, the critical shift was made almost a year earlier at the Washington summit in 2008. The administration of President George W Bush had been casting around for a credible grouping to convene in support of the world economy. It lit upon the extant but under-used G20. The grouping had in fact been created after the Asian financial crisis in 1997-98, but had largely languished since, its meetings attended by ministers and officials of decreasing seniority as time went on.

But while the G20 is undoubtedly more representative of the world economy than its main predecessor, the Group of Eight (G8), it has many of the same problems in motivating its members actually to do anything.

The G20's first problem is that the G8, rather than being given a decent funeral with its corpse floated off to sea in a burning ship, is still alive, if not well, and fighting for influence.

Canada, the host of this month's G20 meeting, is particularly keen on keeping the G8 alive, as its influence in the larger grouping is considerably diluted.

France, which will chair the G8 and the G20 next year, has made noises about the obsolescence of the former, but has also suggested it could itself be enlarged into a G13 or G14 by the addition of selected emerging market countries.

Consequently, rather than neatly arranging the furniture of global governance, the advent of the G20 has merely created a bigger jumble of groupings than before.

The second problem is that, with a grouping so big and diverse, agreeing a common programme is close to impossible.

The proposals on banking regulation and the bank levy, for example, in reality are only strongly relevant for those G20 members with advanced financial centres.

That includes most G8 countries but hardly any of the non-G8 members of the G20, and a couple of economies such as Singapore that are, unhelpfully, members of neither grouping.

And perhaps the biggest problem is one that also bedevilled the G8. For such a grouping to be anything more than just a talking shop, it needs to make a material difference to the political debate in its member countries. To do this it has either to show that it

> There is precious little evidence that the G20 has made any member do anything it did not initially want to

can co-ordinate governments into a mutually desired outcome, or that it can compel them to undertake unpalatable but necessary policies by providing an external constraint.

It is much easier, for example, for a crisis-wracked government to blame public spending cuts on the International Monetary Fund than to say that the cuts are all its own idea.

But so far, sceptics say, there is precious little evidence the G20 has made any member do anything it did not initially want to.

True, China's decision this month to allow the renminbi to resume appreciating did appear designed to deflect criticism at this weekend's G20 gathering, but that appeared more to do with timing than substance.

The pledge to eschew protectionist trade actions that it took at the Washington summit in 2008 was broken within days. And while all members undertook to keep government spending going in order to boost global demand, no new big discretionary spending programmes were announced after the summit that had not already been prefigured.

Unlike, say, the World Trade Organisation, the G20 has no permanent secretariat, no treaty and no means of enforcing its decisions.

Indeed, in this respect it may not differ very much from the G8, which had a habit of making grandiloquent commitments and not following up. One of the most high-profile G8 meetings of all, the gathering at Gleneagles, Scotland, in 2005, announced a set of ambitious promises on development aid that began to be broken almost as soon as they were made.

In reality, the G8 (and its smaller sibling the G7, a primarily economic and financial grouping that excludes Russia) has acted mainly as a kind of steering group for those institutions such as the IMF whose own governance structures are large and unwieldy.

For the moment, it seems likely that the G20 will be restricted to playing that kind of guidance role rather than evolving into a fully formed international institution.

There is inevitably a trade-off with international organisations between speed and legitimacy.

The G20 has certainly acquired a lot more of the latter than did the G8, but whether it can translate that into action is a question that it still has to answer.

Sarkozy to press for common framework

France

Ben Hall finds little chance of a breakthrough

President Nicolas Sarkozy of France will push for a more ambitious agenda of financial regulation at the G20 in Toronto. With Chancellor Angela Merkel of Germany, he will promote plans for taxes on financial transactions and banks.

"Germany and France want to make things move rapidly at Toronto," Mr Sarkozy said at a meeting with Mr Merkel in Berlin this month, as the two leaders sought to unite on financial regulation after months of tension over the eurozone debt crisis.

The French president wants the G20 to agree a common framework to deter excessive risk-taking by banks through a system of levies, for which there is broad consensus inside the European Union.

However, the chances of a French-led breakthrough on these two objectives are slim, with Canada and Japan firmly set against an internationally co-ordinated bank levy and the US sceptical of a transaction tax.

Mr Sarkozy attributes high importance to the G20, seeing it as the best instrument for taking his campaign to "moralise capitalism" to an international level.

The French president pushed hard for an ambitious agenda of financial regulation at the meetings in London and Pittsburgh last year and intends to do the same in Toronto.

As well as transaction taxes and bank levies, Mr Sarkozy is likely to step up pressure for rapid regulation of derivatives markets and the adoption by all G20 members of new capital requirements for banks as agreed by the Basel committee of regulators.

The French government believes progress on these issues, and others, such as convergence of accounting standards, has been disappointing.

"It is too early to call the G20 financial regulatory agenda a failure," notes Nicolas Véron, an analyst at Bruegel, a Brussels-based think-tank. "But there is an inescapable sense that the vision of global financial harmonisation, while certainly appealing, is incompatible with realities. Regulation is politics, and all politics is local."

Mr Sarkozy has no intention of abandoning his global regulation drive, not least because, in November, France takes over the year-long rotating presidency of the G20, giving him a platform to re-energise a grouping he thinks has begun to flag.

"The president thinks the G20 must remain a decision-making forum and a motor for the process of financial market regulation," says an Elysée palace official.

After an overhaul of the pension system this year, Mr Sarkozy intends to wind down his domestic reform and focus on the international stage as a way of rebuilding popular support ahead of the 2012 presidential election.

> 'The vision of global financial harmonisation is incompatible with realities'

France's G20 presidency is a vitally important platform, not least because an active role in taming international financial capitalism would help to blunt the appeal of Dominique Strauss-Kahn, managing director of the International Monetary Fund, who is mulling a return to French politics to run for the presidency.

Mr Sarkozy has already set his sights high by saying France will seek to reshape the international monetary system.

France has consistently called for action on currencies before international meetings. Usually its calls have fallen on deaf ears. Sometimes it has even failed to raise the issue at the meetings in question.

This time, French officials say, will be different. However, they admit the concrete proposals they are working on may not live up to the president's rhetoric.

"I would see it rather as a series of smaller steps than a complete overhaul of the monetary system," says an official.

French officials are working on ideas for hedging and insurance instruments to give emerging economies protection against sudden changes in capital flows without having to accumulate large capital reserves.

They acknowledge, however, that such instruments could help sizeable emerging economies such as Mexico and Indonesia, but would not be applicable to China.

The French government is also examining ways of expanding the use of Special Drawing Rights, a virtual international reserve currency created by the IMF whose value is based on a basket of currencies.

One proposal would be to get international development banks to issue debt in SDRs. Expanding the use of SDRs could ease some pressure on the US dollar and euro as reserve currencies.

However, the euro's slide against the dollar in recent months may have made the issue of reform of the monetary system less of a pressing priority for Mr Sarkozy.

As for the idea of scrapping the G8 grouping or merging it with the G20, the idea has made little headway, at least in Paris.

"After all, we hold the presidency of the G8 next year too," says an official.

In step: Nicholas Sarkozy and Angela Merkel are united on regulation Photoshot

The UK What contribution will David Cameron make?

Gordon Brown loved the G20. The group of industrialised nations embodies the former British prime minister's vision of global economic governance, a subject that fascinated him even before the financial crisis. He regards the London G20 summit in April 2009 as the highlight of his three-year premiership, a turning point in the global recession.

With only a week before the general election, the FT interviewed him at his Manchester hotel: Mr Brown talked eagerly about global reforms, bank capital ratios and the Toronto G20 summit, even though the polls told him he would not be attending. His aides dearly wished he would focus on issues closer to home.

On May 6, the opinion polls were borne out and Mr Brown was ousted by David Cameron, the 43-year-old Conservative party leader. Still relatively unknown outside Britain, what contribution will he make to his first G20 summit?

Mr Cameron is a British politician of his time. Like George Osborne, the UK finance minister, and the four leading candidates to succeed Mr Brown as leader of the Labour party, he is a career politician who worked his way up through his party from researcher to ministerial adviser.

During that apprenticeship, Mr Cameron worked at the Treasury during the early 1990s and witnessed the humiliating ejection of sterling from the European exchange rate mechanism; the prime minister remains sceptical about the EU and opposed to British membership of the euro.

Although not a policy wonk on the level of Mr Brown, the British leader is not an economic slouch. He likes to point out that he gave an interview to the FT focusing on bank capital levels months before Northern Rock presaged the near-collapse of a large part of the British banking sector.

While G20 veterans may miss some of Mr Brown's acumen, they may find the new British prime minister to be a more congenial member of the club. Mr Cameron is generally optimistic, open and upbeat – a mood which prevails in his team, at least in this honeymoon period.

His ability to work as part of a team has been proven – so far – by the fact that he stitched together a coalition government with the Liberal Democrats from scratch after little more than a week of post-election negotiations, and formed a close working relationship with Nick Clegg, the Lib Dem leader and deputy prime minister.

Mr Cameron is at the early stage of forming international relationships, and has yet to form a particularly warm bond with US President Barack Obama. The prime minister has vowed to avoid any "slavish" relationship between Britain and the US, and American attacks on "British Petroleum" over the Gulf oil spill have strained relations.

He has also had to overcome a considerable degree of suspicion from fellow European leaders, who feared his election would mark a return of confrontation between London and the rest of the EU.

He made a point of visiting Paris and Berlin early in his premiership to assure Nicolas Sarkozy and Angela Merkel that he wanted a constructive partnership. As with Mr Brown, this three-way relationship is at the heart of Britain's European engagement.

Agreement between London, Paris and Berlin has been essential in forming a joint EU negotiating position, whether in the Copenhagen climate change meeting or in framing global financial regulations at the G20.

Here, Mr Cameron fits neatly into an emerging European view that deficit reduction is the top priority. Unlike Mr Brown, he does not think the UK can afford to wait until strong growth is restored before acting – a view which could put him at odds with President Obama in Toronto.

In spite of coming from the self-styled "party of business", Mr Cameron is also an advocate of a global bank levy – Britain will press ahead regardless of any G20 deal – and he will also press the case for the dismantling of big banks, splitting off investment arms from retail banks.

He said on his visit to Paris last month he agreed with President Obama that "retail banks should not be involved in the most risky activities – the so-called 'casino' banking activities".

With both the bank levy and the proposed dismemberment of the banks, Mr Cameron would rather be part of an international consensus. However, he has signalled his willingness to stand up to the City of London if necessary, and his desire to "rebalance" the British economy in favour of other service sectors and manufacturing.

Some have suggested that Mr Brown might return one day to the G20 fray, possibly as head of the International Monetary Fund. But Mr Cameron may not be so keen, given that he blames Mr Brown for "making a mess" of the British economy.

As one senior aide put it with a smile: "Wouldn't we have to nominate him?"

George Parker

David Cameron: generally optimistic, open and upbeat

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