POLICY BRIEFING NO 2
November 2008
South African Institute of International Affairs

CONTENTS

Towards a new 'Washington consensus'?

South Africa, the G20 leaders' summit, and the financial crisis

Peter Draper

Agriculture and relief were simple matters compared to international monetary arrangements. The period of gestation of the latter about doubled that of elephants.
– Dean Acheson, reflecting on his experience as the US State Departments' delegation head at the Bretton Woods conference.[1]

Peter Draper is a Research Fellow of the South African Institute of International Affairs, and heads its Development through Trade Programme.

BACKGROUND

To the apparent surprise of G20 Finance Ministers and Central Bank governors meeting in Washington during the annual October gathering this year, George Bush, outgoing President of the United States of America (US), proposed that a formal summit of G20 heads of state convene in Washington on November 15th. This will be the first time that the G20[2] has been convened at Heads of State level, an indication that something serious has animated the meeting.

Not much can be achieved beyond foreign policy symbolism and Heads of State are not the right people to be discussing complex issues of international finance

The immediate backdrop to this important initiative is well-known: the financial crisis emanating in the developed world and the USA in particular, which is now threatening to spread to emerging markets. Less clear, however, are USA intentions in convening the summit. Some observers[3] argue that it is motivated by the need to be seen to be doing something, in order to contribute to restoring market confidence. In this view not much can be achieved beyond foreign policy symbolism and, in any event, Heads of State are not the right people to be discussing complex issues of international finance and management of the global economy (a job best left to Finance Ministers and Central Bank governors). Some see it as an implicit recognition that G7/8 efforts are insufficient in the context of a changing global political economy. One variation on this theme regards the meeting as an attempt to sell G7 crisis management programmes to a broader group of 'systemically significant' countries – both developed and developing. Another, optimistic variation sees it as a golden opportunity to overhaul global financial governance, with the grandest proposal being that the summit be used to kick-start a 'Bretton Woods 2' process equivalent in ambition to its illustrious predecessor which established the broad outlines of the current set of governance arrangements.

As with most things in life the truth lies somewhere in-between. Accordingly, this briefing explores the likely contours of the meeting and its longer-term implications. This discussion is deliberately framed at a broad strategic level, at the risk of sacrificing detail. Reform options for global financial governance are also discussed. Throughout the political economy parameters within which the discussions will take place are emphasised, in order to establish what is feasible at the summit and what is not. The briefing concludes with concrete recommendations for how the South African government should position itself in the summit, in light of political economy realities.

THE AGENDA

According to the White House, the purpose of the November 15th meeting is to[4]:

> … review progress being made to address the current financial crisis, advance a common understanding of its causes, and, in order to avoid a

repetition, agree on a common set of principles for reform of the regulatory and institutional regimes for the world's financial sectors.

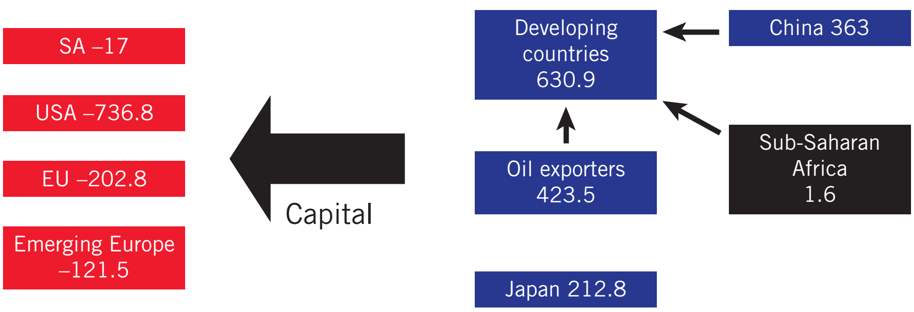
Accordingly, in order to understand how South Africa should position itself we need to take this broad agenda and unpack it.

Diagnosing and addressing the financial crisis

There is broad consensus on the proximate causes of the financial crisis. This concerns the inadequate regulatory frameworks governing financial markets in the developed world, and the US in particular. Of most concern is the relatively recent rapid expansion in use of leveraged financial instruments which led over time to diffusion of debt across developed world financial systems. This fuelled a series of financial bubbles that ultimately burst - the most serious and notorious being the mortgage finance or 'sub-prime' crisis in the US. Within this a key problem has been tracing liability for debt to its various sources, since all financial institutions seem to have participated in the 'leveraging' process whereby debts were spliced, diced, parcelled out and are ultimately difficult to trace to their origin. This opacity has fuelled a collapse of confidence in credit markets, which in turn have frozen up as financial institutions find it difficult to know which of their peers is credit-worthy and which not. This 'credit crunch' is now feeding through into the real economy, as firms find it difficult to raise finance and consequently curtail spending plans or find their loans being called in notwithstanding often good financial situations. Hence the credit crisis is now fuelling recessionary conditions in the developed world and through a variety of channels in the developing world too.

Notwithstanding this broad consensus regarding the regulatory origins of the crisis, the picture is more complicated than that. At the systemic level it is clear that the massive expansion of leveraged debt was fuelled in the US, and elsewhere, by relatively lax ***monetary conditions***[5]. Partly this is owing to policies pursued by the US Federal Reserve, which has maintained rather low real interest rates for most of this millennium. Behind this, the Bush administration practised deficit spending whilst US consumers engaged in record consumption, with the result being that US savings levels have been very low for years now. These conditions resulted in the US running historically unprecedented trade deficits, funded by extraordinary capital account surpluses. In effect the US has been borrowing from Asia and oil

Figure 1: Global imbalances in 2007 – current account in bn$



exporting countries in order to finance domestic expenditure (see Figure 1)[6].

Thus US credit markets in recent years have been pumped up by massive infusions of emerging market capital, which kept US interest rates low. Substantially underlying this has been Asian governments' desire to run trade surpluses, which in turn require undervalued currencies effectively pegged to the US dollar with the US being the main export market too. Those currency pegs – China's in particular – inhibit market led unwinding of macroeconomic imbalances, whilst at the same time fuelling protectionist sentiment in those countries with substantial manufacturing bases and flexible currencies (such as South Africa).

From the above it is clear that addressing regulatory problems alone is necessary but not sufficient to addressing the problem. Global macroeconomic imbalances form a critical backdrop to the credit market crisis, and will have to be addressed in any discussion about reform. Furthermore, it should be apparent that the broader ***multilateral trade agenda*** has to be addressed as part of a broader package designed to alleviate the crisis, stave off protectionist pressures, and underpin the reformist thrust.

As for ameliorating the current crisis, the developed world has already taken major steps in the right direction: recapitalising banking systems; in the US case implementing a process to remove 'toxic assets' from financial institutions books; guaranteeing their debts; guaranteeing consumer deposits; and providing liquidity through interest rate cuts. These steps are designed to get banks to resume lending to each other thereby alleviating the credit crunch. However, it is important to appreciate that the course the crisis will take is likely to be substantially different in the US and United Kingdom (UK) compared to Europe. In the US case the amount of money likely to be spent in fixing the system will probably be in the order of 10-15 percent of gross domestic product (GDP) – well within historical parameters.[7] Given the pace with which the US government has moved[8] it is also likely that recovery will take place relatively early.

Global macroeconomic imbalances form a critical backdrop to the credit market crisis, and will have to be addressed in any discussion about reform

The UK government has also moved decisively to implement crisis response measures. And it is able to do so more flexibly than its European counterparts by virtue of the fact the latter are constrained by their common membership of the European Monetary Union (EMU).[9] Given that EMU countries have ceded monetary policy autonomy to the European Central Bank, whose sole mandate is to combat inflation, fiscal policy is the only instrument available for reflating their economies. However, prolonged use of deficit spending will strain the finance and stability pact which underpins the EMU.[10] Spain faces the most severe deflationary conditions since its housing and construction bubbles are the largest; consequently it is likely to find itself severely constrained by EMU strictures. Italy is already highly indebted, and its banks are very exposed to Eastern Europe[11] where the crisis is likely to hit hardest. It too will face major challenges in keeping its economy afloat. The travails of these two countries, possibly joined by Austria – whose banks are also highly exposed to Eastern Europe – could strain EMU unity to the breaking point if not handled correctly. In addition, the Eastern European countries that have been queuing to join the EMU will find their aspirations postponed for a considerable length of time as the crisis strains their economies and treasuries. Russia, notwithstanding its recent wobbles, is likely to be able to ride out the storm owing to its massive foreign exchange reserves which have already been deployed to recapitalise its banks.[12]

Given the uncertainties over the extent of the bad debt problem, and the challenges Europe in particular faces in managing the fallout, it is questionable whether the steps taken by developed countries will suffice in ***keeping the global economy afloat***. Therefore, one of the items likely to feature on the G20 Leaders' agenda is what steps other substantial economies, especially Japan and China, can take to underpin global economic growth.[13] Both face major challenges. Japan is still recovering from its 'lost decade' in the 1990s and does not have the fiscal or monetary policy space for major reflationary policies.[14] Furthermore, the Yen faces continued appreciation pressure while the 'carry trade'[15] continues to unwind. This is pressuring Japan's export sector – the most dynamic part of its economy. China's leadership is concerned about the implications of slowing export growth combined with its own house price deflation. Nonetheless both have huge foreign reserves and should contribute to emerging market bailouts – via the International Monetary Fund (IMF) or otherwise. China also has substantial scope for domestic reflationary policies, and has just announced a major stimulus package in this regard amounting to some US$ 586 billion[16], which comes on top of three recent interest rate cuts. However, China should not stop there and should consider further measures concerning appreciating its exchange rate, although that issue may belong to the medium-term reform agenda.

China's leadership is concerned about the implications of slowing export growth combined with its own house price deflation

And there will be pressure on those 'in a position to do so' to implement reflationary measures.[17] From a South African perspective the question is what measures could be taken here, in the context of a looming election and uncertain macroeconomic prospects? We return to this question in section 3.

Whilst all of this is necessary in order to prevent the crisis from becoming much worse the developing world nonetheless faces starker economic prospects. The most immediate and broad problem is that developed country banks and other financial institutions are withdrawing capital from developing countries in order to shore up their own books; hence emerging economies with high current account deficits – such as South Africa – and/or dubious policy environments are now exposed. The second problem is that as the developed world recession deepens, so demand for developing country exports, especially commodities, slackens. For those countries that depend on such exports for their foreign currency earnings they are likely to be hit by a 'double-whammy'.

Therefore the ***IMF*** has moved back into the frame as the 'lender of last resort'. However, with the exception of a recently announced facility for loans to systemically significant developing countries exhibiting sound policies[18], the IMF still imposes stringent conditionality's on those countries forced to turn to it in difficult times. And there are some doubts about whether it has sufficient capital to assist emerging markets likely to be overwhelmed as the devastation caused by the financial crisis spreads.[19] Furthermore, it is not the only lender in town: the US Federal

Reserve has extended currency swap lines to several large developing countries[20]; China and Japan are sponsoring an East Asian initiative to establish a crisis fund which builds on the Chiang Mai initiative of currency swap-lines established in the aftermath of the Asian financial crisis[21]; and there is talk in Europe about setting up a stability fund to assist crisis-exposed East European countries[22]. Africa, parts of Latin America, and other small, poor countries are left out of these independent crisis response mechanisms meaning that should trouble strike they will probably be obliged to turn to the IMF – unless China opens its credit taps to them. Overall, though, it is clear that the IMF is back in business albeit the nature of its role will be under the microscope within the broader context of discussions over reforming it to match 21st century requirements.

A sense of historical perspective is necessary in order to temper ambitions for the Washington summit

Clearly the agenda at the Washington summit could be crowded, if not properly handled. It is worth bearing in mind that the original Bretton Woods conference took years to conclude and was led by senior officials, not Heads of State. Furthermore, that conference was convened in the context of a global conflagration – World War Two – in the aftermath of the most serious economic meltdown in recent economic history – the Great Depression. The current crisis, whilst serious, does not currently appear to be in the same 'league' and occurs in the absence of worldwide conflict. Consequently, a sense of historical perspective is necessary in order to temper ambitions for the Washington summit, thereby focusing on what can realistically be achieved rather than lofty, unrealisable ambitions. And much depends on how US President-elect Barack Obama positions himself at the meeting since he will be in attendance. Consequently, the following discussion fleshes out plausible contours of the Washington agenda.[23]

STRUCTURING THE SUMMIT AGENDA: CONTOURS OF POTENTIAL COMPROMISE

From the foregoing analysis, it seems to me that five broad elements for the summit agenda present themselves:

- Next steps to reflate the global economy;
- Reforming regulatory frameworks governing financial markets;
- Reform of and repositioning the IMF in relation to regulatory reforms;
- The cluster of issues concerning macroeconomic imbalances;
- Reviving the multilateral trade agenda.

Needless to say, the key actors are not of one mind on these issues – and it is a big agenda. Next I take each issue in turn and briefly speculate on how the key actors may position themselves on it, in relation to other issues they wish to promote at the summit. In the next section I discuss how South Africa could position itself in relation to these issues, in light of political economy realities.

Reflating the global economy

On this issue there is broad consensus that more steps are required, particularly in the realm of fiscal policy in developed countries and major developing countries, especially China. There is also consensus that some developing countries – such as South Africa, may not be in a position to make a major contribution on this front. Hence this particular agenda item seems relatively uncontroversial, and could in principle be handled relatively quickly.

Reforming regulatory frameworks governing finance

Not surprisingly, this issue could prove contentious. It is beyond the scope of this briefing to delve into the technical details involved. At the geo-economic level whilst there is broad agreement that reforms need to be undertaken, there is less consensus, if not disagreement, on what exactly needs to be done. It would appear that the US and UK favour some reforms, but nothing too radical that would undermine their obvious competitive advantages in global finance, including subjecting their financial systems to supra-national control. Those advantages have brought enormous benefits to each economy, and will not be lightly conceded. In addition, both the US and UK seem to be relatively well-placed to manage the crisis and ensuing recession, compared to their EMU counterparts and possibly Japan. Consequently they are even less likely to make major concessions.[24] The EMU countries, on the other hand, are agitating for wholesale regulatory reform. It is likely that they will receive some support from developing countries most exposed to the crisis, such as Brazil, South Africa, and possibly India. However, it is not clear which way China will lean, since China's financial system is largely insulated from the crisis – albeit the economic impacts will be felt via a growth slowdown. And it is not clear which way smaller developed country G20 members such as Canada and Australia will lean. If they were to support the European position it is unlikely to tip the scales in favour of wholesale regulatory reform, given the likely opposition of the US and UK.

In my view while more coordinated and tighter regulations are clearly necessary and not in dispute, this should not be taken so far that the outcome is to strangle global capital flows. Many countries, especially in the developing world and including South Africa, have benefited from capital inflows albeit the association is difficult to prove. The trick is to manage such inflows well, and not to pursue precipitate liberalisation.[25] In short, whilst better and more coordinated regulation is necessary, the baby should not be thrown out with the bathwater.

The US and UK favour some reforms, but nothing too radical that would undermine their obvious competitive advantages in global finance

Beyond the geo-politics of regulatory reform, there are many technical and institutional challenges involved. Howard Davies, formerly Chairman of the UK's Financial Services Authority (FSA), notes[26] that when he assumed his post in 1997 the FSA was a member of 75 international bodies and committees; when he left that number had doubled. Furthermore, he notes that the global regulatory system is built in three 'silos' - banking, securities, and insurance - and that risks are transferred between all three. He argues that simpler structures are needed.

Nonetheless, there may be considerable room for crafting compromises on some of the technical issues in play, such as proposals for counter-cyclical capital adequacy requirements, but how to pursue such proposals is a vexed issue. Regarding the institutional questions Davies notes that both the key multilateral regulatory forums confront legitimacy problems: the Financial Stability Forum and the Basel Committee. To this we would add the IMF. In all three institutions European countries are over-represented, and Asia under-represented, relative to their current and potential weights in the global economy. This is the meat of the longer-term reform agenda, which I return to below in the context of the discussion on the IMF.

It is very difficult to see European states agreeing to diminished influence at a time when they are strongly pushing the regulatory reform agenda

How could this representational problem be resolved? It is very difficult to see European states agreeing to diminished influence at a time when they are strongly pushing the regulatory reform agenda. One possible bargain could be for the US and UK to agree to substantial regulatory reform in exchange for expansion of Asian influence in these three multilateral institutions. However, three obstacles are immediately apparent. First, it is not clear what such a negotiating approach would deliver to the US and UK, beyond fulfilling a longstanding desire to integrate China more closely into Western designed institutions of global economic governance.[27] Second, the US regulatory system is fiendishly complex, and tied up with the balance of power between the federal government and states. Whilst President-elect Obama may have a unique window of opportunity to centralise regulation at the federal level, it is by no means obvious that Congress will acquiesce in this. It is also not obvious that Mr Obama will decide to deploy his political capital in this manner. Third, does China really want more multilateral finance responsibilities? Its financial system is relatively insulated; assuming more responsibilities may bring obligations to reform; it has many domestic challenges to deal with; and it is fully capable of deploying its financial muscle bilaterally and on its own terms. So what concessions would China extract should the Europeans agree to an expansion of its role?

IMF reform in relation to regulatory reform

There is a longstanding agenda on IMF reform, and the G20 has been particularly active in pursuing it. This is not the place to review that agenda, since it is long and rather technical; nonetheless I offer a few thoughts. First, it is likely that there will be some discussion around increasing Asian representation in the IMF, albeit this is likely to run into longstanding European opposition. Indeed South Africa is ambivalent to this agenda since any quota increase is almost certain to diminish Africa's 'voice'. Nevertheless, as mentioned above if the US and UK support regulatory reform there may be some scope for compromise here – assuming China wants in. In this light it may also be possible to obtain agreement to open up the process whereby the heads of the IMF and World Bank are appointed; in other words to abolish the 'ancien regime' arrangement whereby the US appoints the latter and the Europeans the former. Furthermore, and in light of the emergence of competitors to the IMF in the 'bailout game', it may be possible to secure less intrusive conditionalities attached to those bailouts – at least for those countries that are reasonably well-governed. And as Davies argues[28] it may also be possible to secure a greater role for the IMF in linking its current macroeconomic surveillance mandate to regulation, although the US in particular will not acquiesce to this being too intrusive. In this light and assuming China is willing it may also be possible to accord the IMF more oversight of currency regimes.

However, this is a complex and medium term agenda. Agreement on these issues is not likely to be forged in the Washington meeting.

Global macroeconomic imbalances

This agenda item is extremely complex, and not amenable to solutions in Washington. At its core is the rise of Asia and the region's associated currency management practices, and its flipside in US and European trade deficits with China. This problem is intricately tied up in the actions of multinational corporations, not least US and European, in operating East Asian production networks. And as Asian trade surpluses generate ever larger foreign exchange pools, so their deployment into sovereign wealth funds is attracting increasingly negative attention in Western capitals. Hence investment protectionism is on the rise. At the same time, the Chinese government has made it abundantly clear that it will not float its currency in the near future. Consequently pressure in Washington and Brussels for retaliatory trade measures is steadily building. Add to this associated protectionist pressures linked to climate change mitigation, and the multilateral trading system moves inexorably into the frame.

Pressure in Washington and Brussels for retaliatory trade measures is steadily building

Multilateral trade

The immediate focus should be on what each G20 participant country can do to contribute to seeing out the Doha round of multilateral trade negotiations. One option, put forward by Jeffrey Schott of the Petersen Institute for International Economics, is to pursue an 'early harvest'[29] in the negotiations combined with a 'standstill clause'[30], rather than wait for the entire package to be wrapped up.[31] If this proposal is accepted it would have substantial implications for the way in which multilateral trade negotiations are conducted in future since the 'single undertaking principle'[32] would have been breached. Indeed longer term reform of the WTO and the multilateral trading system is very much on the agenda so this would not be out of kilter with current discussions. However, given that the Doha round is so fraught and that Heads of State have committed to concluding negotiations before without visible impact, it is difficult to see what difference G20 leaders could make beyond rhetorical commitments to these objectives. And it is obvious that concluding the round is primarily the responsibility of Trade ministers, not Heads of State. That said, President-elect Obama could make a major contribution by affirming his commitment to seeking extension of trade promotion authority – a prerequisite to concluding the Doha Round.

Likely Outcomes?

One of the most significant achievements is merely to convene the G20 Heads of State. This grouping, whilst not perfectly representative by any means, nonetheless would mark a substantial improvement over the G8 – at least in terms of legitimacy. Its effectiveness, should the momentum be maintained, remains to be seen. Furthermore, developing countries are concerned that the G20 could become the conduit for policies cooked up in the G7/8, in other words a rubber stamp. Hence there are dangers associated with participating in the meeting, albeit it is arguably better to have a seat at the table than not. And the agenda – as outlined above – is complex. How then should South Africa position itself?

HOW SHOULD SOUTH AFRICA POSITION ITSELF?

First of all South Africa should support the institutionalisation of the G20 leaders summit, or at least a more representative north-south grouping. Whilst Heads of State are not best equipped to negotiate the items on this agenda (Finance and Trade ministers are better placed) a regular summit at their level could provide the necessary pressure to advance discussions and broker key political compromises. Concerning those compromises, South Africa is involved in establishing developing country groupings that offer the potential for countervailing the G7/8 on issues of broad developing country interest, and should start from a position of confidence that these formations will gain in strength as economic power shifts eastward. The countries in the G20 may not be the most representative grouping, but it is a good basis from which to proceed and more importantly the group has a track record.

South Africa is involved in establishing developing country groupings that offer the potential for countervailing the G7/8 on issues of broad developing country interest

Regarding the specific agenda items I take those discussed above, and tease out South African negotiating propositions. One caveat is important here: I do not expect progress on all of these items at the Washington summit; therefore the propositions outlined below should be regarded as a medium-term agenda.

Reflating the global economy

Clearly South Africa should support this goal. And we may have some flexibility to pursue reflationary policies. On the fiscal front the Jacob Zuma-led African National Congress has agitated for fiscal expansion to address the country's dire social challenges. Also financial markets are concerned about the possible growth impacts of the spreading international recession on South Africa. On the flip side inflation has most likely peaked as commodity prices, particularly oil, decline. Therefore, provided funds are spent for investment purposes there may be scope for escalating expenditures. However, if such expenditures are deployed to import capital goods to support infrastructure expenditures – as a substantial portion surely will be – this will place further pressure on our current account and thereby on the Rand. The latter is particularly vulnerable as capital continues to flow out of emerging markets. Hence inflation is likely to remain relatively high whilst the currency remains weak. That combination places a floor under the prospects for monetary easing via interest rates. A preferable fiscal expansion option might therefore be to cut taxes, although this may also lead to increased imports it is unlikely to be on the same scale as increased infrastructure expenditures. In sum therefore, South Africa may be able to offer some contribution on the fiscal side, but there is precious little room for manoeuvre on the monetary front. But a gesture on the fiscal front at the summit would serve both domestic political goals and afford some negotiating traction on other agenda items.

Reforming regulatory frameworks governing global finance, and the IMF

The South African financial system has emerged relatively unscathed from the crisis to date, largely owing to sound financial regulation. Accordingly South Africa should support the Europeans in pursuing this objective. In doing so, however, the delegation should be mindful that the Europeans are the principle obstacle in the way of reforming the IMF and other multilateral institutions concerned with regulating global finance, and that ambitious reform proposals are unlikely to succeed. Furthermore, such reforms are unlikely to benefit South Africa and Africa directly, albeit supporting greater Asian representation is 'the right thing to do'. Therefore, South Africa should hold the line on maintaining a minimum African representation in those institutions, or a 'floor' below which their representation should not subside. Furthermore, South Africa should continue to push for reform to the IMF's Board in order to increase African representation. In the absence of favourable movement on these issues South Africa should withhold support for proposals to increase the oversight powers of the IMF in domestic financial regulation, but for reasons explained below not on currency management.

The Europeans are the principle obstacle in the way of reforming the IMF and other multilateral institutions concerned with regulating global finance

Macroeconomic imbalances: Chinese currency reform

As noted above this agenda is unlikely to succeed at the summit, but remains a critical component of overall reform. South Africa, with its floating currency and strong desire in the tripartite alliance to boost industrial growth through exports, has a strong stake in Asian currency appreciation. Therefore South Africa could broadly support the US and EU position on this issue, accepting that we will run up against China in doing so. But given that this issue is unlikely to gain much traction at the summit, and that there are some sensitivities around supporting a 'northern agenda', South Africa could simply signal its position without holding too strongly to it. But in the medium term it remains, in my view, in our core interest to push for Chinese currency reform.

Multilateral trade

South Africa needs to reaffirm its willingness to see the Doha round through.

Clearly, and as articulated by the South African authorities, this cannot be offered at any price. Therefore, South Africa should join the UK in pushing for further concessions on agriculture from France, Germany, and the US, in return for which some flexibility on industrial tariffs and services could be proffered. Such conditional signals should be made in the full knowledge that the Doha round has its own political dynamic which to date seems to have been impervious to the assurances of various Heads of State.

ENDNOTES

1 Acheson, D (1969) *Present at the Creation – My Years in the State Department*. London: Hamish Hamilton, P81.

2 Established in the aftermath of the Asian financial crisis of 1997-9, the G20 consists of: the G8 (the US; Canada; the United Kingdom; France; Italy; Germany; Russia; Japan); the G5 outreach partners (Mexico; Brazil; South Africa; India; China); South Korea; Indonesia; Australia; Saudi Arabia; Turkey; Argentina; and the heads of the IMF, World Bank, and European Union. Until the forthcoming leaders meeting it was constituted by Finance Ministers and Heads of Central Banks (besides the multilateral instutions).

3 This analysis is based on an extensive review of opinions concerning the meeting from the following sources: *The Financial Times*; *The Economist*; The Petersen Institute for International Economics; The Brookings Institute; The American Enterprise Institute; The Council on Foreign Relations; The *Guardian Newspaper*; Stratfor Consulting. Many articles were consulted and only a few are referenced below; interested readers are referred to the relevant websites via the hyperlinks provided with the caveat that some require subscriptions.

4 Cited in The *Financial Times*, October 23rd, 2008, 'US to host G20 summit over crisis'.

5 *The Economist*, 9th October, 2008, 'A Survey of the World Economy: A Monetary Malaise'.

6 I am indebted to Andreas Freytag who constructed this figure as part of a SAIIA project on South Africa's current account deficit, the final paper of which can be obtained on the SAIIA website.

7 Laeven, L 'The cost of resolving financial crises', *Voxeu.org*, 31st October, 2008.

8 In stark contrast to Japan in the 1990s; see Kobayashi, K 'Financial crisis management: Lessons from Japan's failure', *Voxeu.org*, 27th October, 2008.

9 For more on this see *Stratfor's* special coverage; Boone, P, Johnson, S and Kwak, J 'Start by saving the Eurozone', *The Guardian*, October 24th; and Lachman, D 'Europe Catches Pneumonia', International Economic Outlook, *American Enterprise Institute*, November 3rd, 2008.

10 Germany insisted on this pact prior to the formation of the EMU and adoption of the Euro. It contains a set of convergence criteria member states must meet in order to participate in the EMU, notably not running fiscal deficits in excess of 3 percent of GDP. Apparently the pact has been 'temporarily suspended' for the duration of the crisis, but this does not change the fact that loosening the purse strings will strain the EMU project. See *Financial Times*, November 9th, 2008, 'Europe to press US on reforms'.

11 The region is characterized by high current account deficits and debt to GDP ratios. This explains why two countries – Ukraine and Hungary – have already turned to the IMF whilst more wait in the wings.

12 The geopolitics of Ukraine's IMF loan, in light of the contest for influence there between the West and Russia and the recent Russia-Georgia war, will be particularly interesting to watch.

13 For further insight into these constraints see *Stratfor*, October 23rd, 2008, 'The Financial Crisis in Japan and China'.

14 *Stratfor*, 'The Financial Crisis, the Carry Trade and the Global System', October 27th, 2008.

15 As Japan's interest rates have been very low for more than a decade, investors borrow money in yen and invest it offshore in higher interest-bearing accounts. Many countries in which those funds were invested now face financial problems and associated currency weakening, making these bets potentially unprofitable. Consequently investors are repatriating their funds back to Japan in large amounts, hence the upward pressure on the Japanese currency.

16 *Financial Times*, November 10th, 2008, 'China authorizes 'massive' stimulus package'.

17 Goldstein, M 'Making the G20 Summit Work: The 'Ten-Plus-Ten-Plan'', *Petersen Institute for International Economics*, October 27th, 2008.

18 *Financial Times*, October 28th, 2008, 'Reforms do not mean cash without strings'. Interestingly this report argues that South Africa is not eligible for this package – a view contested by one South African official interviewed in the course of compiling this briefing.

19 *Financial Times*, November 6th, 2008, 'IMF reassures on its liquidity levels'.

20 Brazil, Mexico, Singapore, and South Korea. See Brad Setser's blog of October 29th, 2008 on the Council for Foreign Relations website.

21 *Stratfor*, October 27th, 2008, 'ASEAN+3: A Rainy Day Fund for the Region'. However, one proposal apparently sponsored by Japan, is that China and Japan should earmark a percentage of their foreign exchange reserves for use by the IMF as emergency liquidity funds. See Financial Times, November 9th, 2008, 'Asia looks to rework IMF relationship'.

22 Gros, D and Micossi, S 'A call for a European Financial Stability Fund', *VoxEU.org*, 30th October, 2008.

23 This discussion is based on the following illuminating analyses: Eichengreen, B 'New World Pragmatism', *Guardian Newspaper*, October 24th, 2008; Rieffel, L 'The G-20 Summit: What's It All About?', *Brookings Institution*, November 4th, 2008; Kettle, M 'In times like these', *Guardian Newspaper*, October 23rd, 2008; Mallaby, S 'A 21st Century Bretton Woods', *Council on Foreign Relations*, October 25th, 2008; Wolf, M 'Why agreeing a new Bretton Woods is vital', Financial Times, November 4th, 2008; Williamson, J 'On the Agenda for Bretton Woods II', *Peterson Institute for International Economics*, October 28th, 2008; Williamson, op.cit;

24 We would do well to remember that financial crises are an integral feature of capitalism. See the authoritative account by Kingleberger, C (1996) (3rd edition) *Manias, Panics, and Crashes: A History of Financial Crises*, New York: Wiley.

25 See the perceptive analysis by Prasad, E and Rajan, R 'Capital account liberalization: New thoughts on an old topic', *Voxeu.org*, 11th August, 2008.

26 Davies, H 'Five Ways to Fix Our Financial Architecture', *Washington Post*, October 23rd, 2008.

27 For a penetrating analysis along these lines see G. John Ikenberry. GJ 'The Rise of China and the Future of the West', *Foreign Affairs*, 87(1), January/February 2008.

28 Op.cit.

29 In other words to implement agreements already reached in relatively uncontroversial areas before the entire package is agreed.

30 This would commit members not to introduce any new protectionist measures whilst the negotiations are still being conducted. In light of the looming recession and likely surge in protectionist pressures, this is a particularly important proposal.

31 Schott, J 'Trade and the November 15 Summit: First, Do No Harm', *Petersen Institute for International Economics*, November 3rd, 2008.

32 In terms of which nothing is agreed until everything is agreed. As Schott points out there is precedence for this.