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**Research Report**

## The twenty-first century needs a better G20 and a new G7+

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# THE TWENTY-FIRST CENTURY NEEDS A BETTER G20 AND A NEW G7+

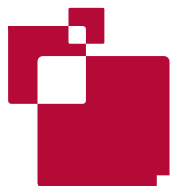
JIM O'NEILL AND ALESSIO TERZI

## Highlights

- During the 2008 financial crisis, the G20 was hastily elevated to 'global economic steering committee'. In the early stages of the crisis, the G20 was an effective forum for crisis containment. As the crisis has eased, however, the G20 has lost both direction and momentum. Governments and policymakers have felt less need to act in unison and have rather refocused on their national agendas, as is their duty and primary function. However, effective global governance is needed permanently, not just in crisis times. It is desirable to have more representative and effective global governance that, among other things, is equipped to prevent crises rather than just react to them.
- In an environment of rapid change in global patterns of trade and wealth creation, a new revamped (but highly representative) grouping should be created within the G20, to provide leadership on key economic policy matters. Euro-area members should give up their individual seats in this G7+, allowing room for China and other large emerging economies. Without euro-area countries taking such a step, it would be impossible to reconcile effectiveness and representation in this new G7+, which would take charge of decision making on global economic imbalances, financial and monetary issues. All existing G20 countries, including individual euro-area countries, would however remain in the G20, which could potentially expand and would remain the prime forum for discussion on all remaining matters at global level.

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## THE TWENTY-FIRST CENTURY NEEDS A BETTER G20 AND A NEW G7+

JIM O'NEILL AND ALESSIO TERZI, NOVEMBER 2014

**IN THE EARLY STAGES OF THE GLOBAL FINANCIAL CRISIS**, the G20 proved to be an effective forum for crisis containment, agreeing to (i) launch a coordinated fiscal stimulus at global level, (ii) strengthen the financial safety net by increasing the resources available to the International Monetary Fund, (iii) enhancing regulatory and supervisory regimes by establishing the Financial Stability Board and agreeing on Basel III. However, as recovery from the crisis has gradually progressed (with some notable exceptions, especially in the euro area), G20 progress on finding agreement in many areas, including shadow banking and regulation of over-the-counter (OTC) derivatives, has been very slow. In some areas, the momentum has come to a halt (Véron, 2014). For example, a viable way forward on resolving systemic financial institutions across borders has yet to be identified (Shafik, 2013). The stalling of the G20 has led to questions being raised about whether the G20 is still delivering (Bertoldi *et al*, 2013), whether it is the right forum for discussion on global macroeconomic issues (Pisani-Ferry, 2009), whether its agenda should be refocused (Bénassy-Quéré *et al*, 2009) and what its future should be (Asmussen, 2013).

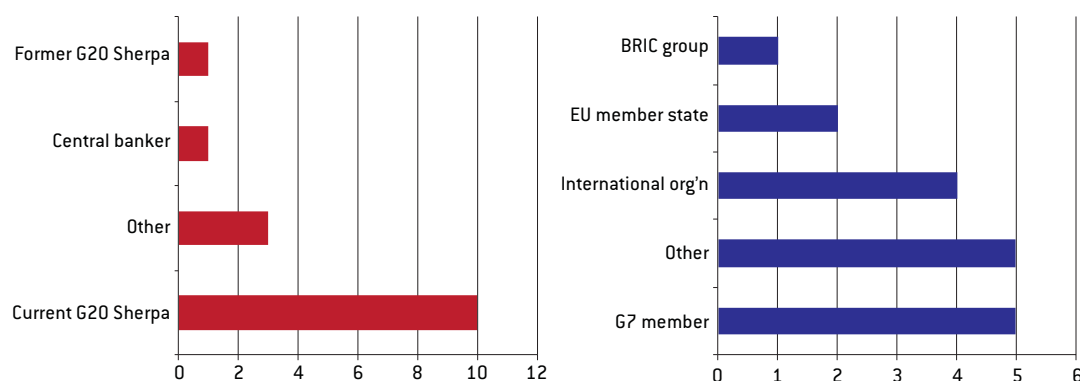
of G20 Sherpas – the high-level advisors of heads of state or government – found that the main factors hampering the forum's effectiveness are its excessively wide policy agenda and its overly heterogeneous composition. Figure 1 shows the composition of the group of Sherpas who responded to the survey.

Although recognising that organisational changes can never be a substitute for substance and vision, some experts have suggested that the creation of a G20 steering committee or permanent secretariat could alleviate these problems<sup>1</sup>. Given the nature of the G20, composed of the heads of state and government of the largest countries, we doubt a bureaucratic entity could effectively streamline the agenda and decision-making within the forum. Putting it more bluntly, one G20 participant explained how, in his view, “[within the G20 setting] *nobody listens to the IMF itself, so it is not clear why they would listen to the secretariat*”<sup>2</sup>. We would certainly share the view that the IMF needs to raise its delivery standards, as we detail later in this Policy Contribution.

Meanwhile, as the G20's decision making falters, the forum is failing to fully achieve its own objectives as spelled out in the *Framework for Strong*,

A recent Bruegel (O'Neill and Terzi, 2014a) survey

Figure 1: G20 Sherpa Survey, respondents' current post (left panel) and geographical origin of employing institution (right panel)



Source: O'Neill and Terzi, 2014a.

1. See for example Angeloni and Pisani-Ferry (2012).

2. Authors' conversation with a G20 member, March 2014.

*Sustainable and Balanced Growth*, which are: maintaining sound public finances, promoting balanced current accounts, implementing structural reforms with the objective of raising global potential growth, preventing asset bubbles and undertaking monetary policy with a view to price stability and keeping exchange rates aligned with fundamentals<sup>3</sup>.

World growth has indeed recovered since the crisis, but it has been generally regarded as disappointing with the actual pace of recovery repeatedly falling shy of consensus forecasts, and those of the IMF. Moreover, the global debt-to-GDP ratio has continued soaring since the introduction of the sustainable growth framework in 2009 (Figure 2), raising the possibility that one of the perceived primary causes of the 2007-08 crisis has become an even bigger issue. While there remains considerable debate about whether the continued growth of debt reflects the sluggishness of some economic recoveries or a poor mix of spending and taxation policies, a number of emerging economies regard the continued rise of debt in so-called developed economies as a particular burden for them in a world in which the monetary system and its governance remains so dominated by the current G7 members, and is a key reason why many of them – justifiably in our view – desire significant change. In particular, several Chinese academics and policymakers have said that unsustainable public finances and soaring debt levels in advanced economies are undermining the stability of the currencies that dominate the current monetary system, with a detrimental

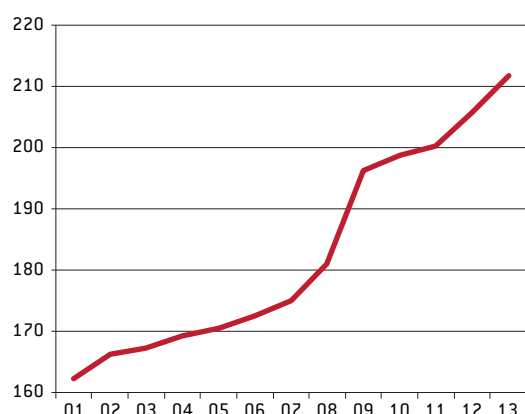
effect on their invested reserves. At times, implicit if not explicit criticism has featured in statements by the BRICs political leaders about the dominance of the G7 countries in global governance, especially as it relates to monetary matters<sup>4</sup>.

Meanwhile, investment on a global level is performing quite poorly, possibly resulting from the same fears about rising total debt levels, crowding out (although low levels of bond yields and interest rates more generally do not support this) and related heightened uncertainty about the future.

However, and this is probably an under-discussed improvement at world level, current account imbalances have alleviated since the crisis (O'Neill and Terzi, 2014b). Both the United States and China have seen their balance-of-payments imbalances improve by more than 50 percent since the crisis, with the US deficit below 3 percent of GDP and China's surplus similarly low. This has occurred despite the inability of the G20 to agree a common framework and targets for current account imbalances at the Seoul 2010 G20 meeting. It might be argued that this suggests not only the limitations of the current G20 but also that the G20 is not so important anyway. For the US and China to have made this progress while maintaining growth is an important positive development. This said, of course, the current account surplus of the euro area has continued to rise, and is now slightly larger than that of China. In contrast, this appears to be purely due to the very subdued domestic demand in most euro-area economies, and a refusal by key euro-area countries, especially Germany, to recognise any adverse consequences of such surpluses. It is also possibly the case that despite the improvements in the US and China's external positions, there is less evidence of a major rebalancing of consumption, with China's private consumption probably still too low and that of the US too high, each relative to the rest of their economies.

All in all, since the G20 took over responsibility for the global economy in late 2008, it has played an important role in limiting the likelihood of a bigger global recession, but in terms of a more balanced world economy, and one with better and more

Figure 2. Global total debt, % of GDP, 2001-13



Source: Buttiglione et al (2014).

3. Leaders' Statement following the G20 Pittsburgh Summit (2009).

4. See, for example, BRICs Sanya Declaration (2011).

equitable global governance, it is unclear that the G20 has been particularly effective.

### OUR PROPOSAL

Based on the findings of our survey of G20 Sherpas, we believe that the G20 is unlikely to succeed in meeting its objectives outside crisis times, greatly due to the sheer size of its composition and the breadth of its agenda. There are too many members and rotating agenda setters in order for timely albeit important wide-reaching decisions to be taken. What the world needs, possibly together with the current G20, is a smaller group with just as much legitimacy but an ability to act fast and make more meaningful decisions, especially when it comes to global economic matters, notably imbalances and monetary issues. The G5 group in 1985 came together (US, Japan, France, Germany and the United Kingdom) to play a key role in averting a shift towards protectionist economic policies and presiding over an orderly rebalancing of the US dollar, and then the G7 came into existence in 1987 (with the addition of Canada and Italy), and for many years, was an effective forum for dealing with major pending issues. By contrast, the G20 is an unwieldy group that, at its own Sherpas' admission, is only likely to take decisive action when there is another crisis.

We specifically propose the formation of a new grouping, which we call G7+ (Table 1)<sup>5</sup>, in which China and India would be added, and the three euro-area countries (Germany, France and Italy) would give up their seat. The euro area itself would then become a member. China, the euro area, India, Japan and the US would be at the core of the reframed grouping. There might be a rationale to limit the membership of the new more focused, yet representative group to these five. But the other two BRIC heavyweights, Brazil and Russia, each currently have economies larger than India's (estimated at market exchange rates, Table 2). Another option would be that Canada and the UK should remain, with the group either expanded to a G9 or kept as a refined G7 excluding Brazil and India.

Though it is admired by many current G7 participants, it is difficult to justify Canada's continued inclusion on any basis other than history (why

Canada rather than Australia for example). The UK position is a little more nuanced given the UK role in global financial services, but if financial regulatory matters were to remain primarily with the G20, then the UK would have less powerful arguments in its favour. On balance, we are in favour of recommending that all four BRIC countries should join Japan, the euro area, the UK and the US as being at the core of this new revamped G7+ group.

As Figure 3 shows, in terms of global legitimacy, in population terms the G7+ would be smaller than the G20, but much bigger than the current G7, which represents just over 10 percent of the world's population. In terms of share of global GDP, the G7+ performs even better: with just eight key players, it would cover more than 80 percent of global output (in current US\$ terms, 60 percent in

**Table 1. Current G7 composition, G7+ proposal and G5 option (see also footnote 5)**

Current G7	G7+	G5
Canada	Brazil	China
France	China	Euro area
Germany	Euro area	India
Italy	India	Japan
Japan	Japan	United States
United Kingdom	Russia	
United States	United Kingdom	
	United States	

**Table 2: GDP and gross financial assets, selected countries**

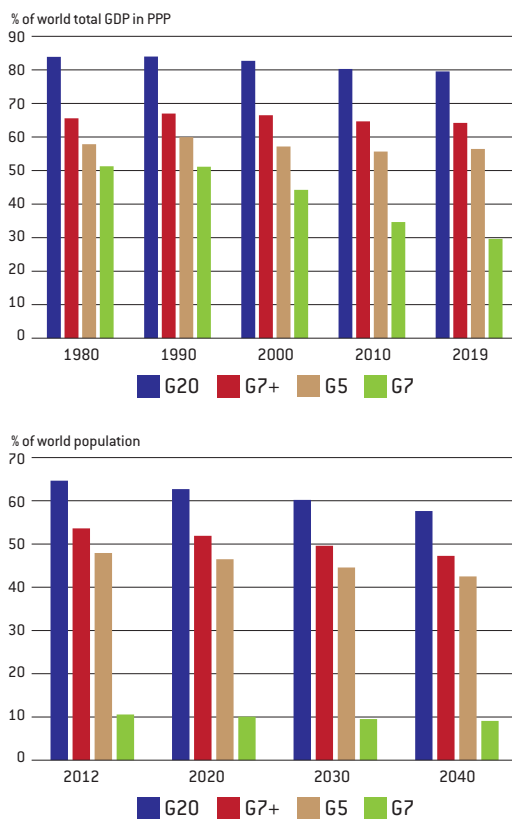
	GDP at market exchange rates [% of world]	GDP in PPP [% of world]	Gross financial assets [% of world total]
US	22.4	16.4	40.8
Euro area	17.1	12.3	17.3
China	12.7	15.8	8.9
Japan	6.6	4.6	9.9
Germany	4.9	3.4	4.4
France	3.8	2.5	3.7
UK	3.4	2.3	5.0
Brazil	3.0	3.0	1.0
Russia	2.8	3.4	0.4
Italy	2.8	2.0	3.3
India	2.5	6.6	0.9
Canada	2.4	1.5	3.0

Source: IMF WEO, October 2014, Allianz Global Wealth Report 2014. Note: 2013 data based on IMF estimates; euro-area financial assets are based on Bruegel estimates.

5. We prefer the term G7+ to G8, because to us the '+' incorporates both a component of novelty and augmented composition.

PPP terms) at least until the end of the decade. It would also bring China directly into a smaller, more responsible group for key global monetary matters. As for the euro-area countries, the move to our proposed format would be a massive signal of their intent to ensure permanent monetary union, and maybe even a sign of genuine structural change.

Figure 3: Shares of world GDP (upper panel) and population (lower panel)



Source: Bruegel based on Eurostat, UN, IMF.

Figure 4: Shares of world trade



Source: Bruegel based on O'Neill and Terzi (2014b).

In terms of trade in goods and services, the aggregate G7+ would command a world share above 50 percent, increasing in the years to come (thanks to the rising role of China) (Figure 4). By contrast, the current G7 has been below the 50 percent mark since the early 2000s, and is fast plunging. With such numbers, we can easily imagine important trade agreements being struck in such a small setting, in which leaders can meet to exchange views openly, helping revamp trade multilateralism in the post-WTO era, and with potential significant effects on global growth.

The G7+ would encompass more than 84 percent of world total financial assets, compared to just over 70 percent for the current G7<sup>6</sup>. Although less than the current G20 (94.5 percent), we note this is still a quite remarkable share after a 60 percent reduction in the seats (and therefore parties with a veto). Looking at individual country estimates, we note how members like Argentina (with total financial assets estimated at around €40 billion, or 0.1 percent of the world total) add very little in terms of coverage of measures agreed on, although Argentina has a binding say on the issues at stake, therefore weighing on the achievement of consensus. This is an issue also pointed out by one of the G20 Sherpas in our survey<sup>7</sup>.

Another issue which was raised indirectly by respondents to our survey was that some countries that are currently not present should be. We note that, for example, Nigeria is now officially a larger economy than South Africa, and together with a population nearly four times larger, its claim to G20 membership would seem quite strong. Of course, the current G20 members were quite arbitrarily picked in 1997-98. Although not a priority at the current juncture, we could easily imagine the G20's composition being expanded to accommodate Nigeria and potentially other emerging countries, once the forum is relieved of the pressure to decide on the crucial global economic challenges of the moment.

As emphasised, we believe that the G7+ would exist within the current G20/1. Its agenda would concentrate on truly globally sensitive economic and financial matters, as it is usually economic issues and related imbalances within the coun-

6. Authors' estimations for 2013 based on the "Allianz Global Wealth Report 2014".

7. "There are several difficulties with membership: too many Europeans, Argentina not relevant, Saudi Arabia a one-issue member; Africa under-represented."

tries we have recommended for G7+ participation that would have global consequences. Consistent with the general answers from our Sherpa survey, we believe that the G7+'s focus should be narrow but crucial global matters, including shared regulatory matters. The interaction between the G7+ and the G20/1 would be similar to the current structure of the United Nations, with the reframed G7 providing leadership and fast-paced effective decision-making at world level, coupled with a more encompassing and legitimate forum for discussion. When it came to formal agreements that required acceptance from a broader group of important countries, the existing G20/1 would still play an important role and its support would be required. Other global matters that are currently discussed by the G20 could remain with this group.

### FEASIBILITY

With respect to a single euro-area representation, we were warned by a G20 Sherpa from an international organisation that "[it] *would make sense indeed but provided it reflects a genuine unity of view*". If the euro-area countries are serious about their own commitment to keep the single currency in place, we would expect this to be the case regarding imbalances, monetary and financial regulation matters, at a time when a banking union is in the process of being established and an internal European macroeconomic imbalance monitoring framework is in place. Our survey also shows how this move would be welcomed by a majority of non-euro area G20 partners<sup>8</sup>.

More practically, we could envisage Euro Summits to be scheduled in such a way as to discuss ex ante and give a mandate for discussion to the EU Council and/or Commission president heading to a G7+ or G20/1 meeting.

Finally, our survey illustrated a political deadlock regarding the reform of global international fora, with emerging economies wanting the advanced economies to take the lead, and current G7 members stating how (yet) another crisis will be needed for the G20 to be reformed. To avert this admittedly dismal scenario, we would urge the IMF, as the only organisation with the necessary credibility, to take a lead on this G20 reform. As implied by the blunt comment of a G20 participant, the Fund needs to raise its delivery standards, and here is a prime example of how and why.

### CONCLUSIONS

The time has come for more concrete steps to improve the functioning of global economic governance while safeguarding its legitimacy. Our G7+ proposal would considerably improve the functionality of the current global economic governance framework, while maintaining its representativeness and therefore legitimacy. It also offers a way for euro-area members to send a stronger message to the world about the permanence of monetary union.

Our proposal might be regarded as too conceptual and impractical in a world in which having a seat at the highest diplomatic tables is regarded with such prestige. Moreover, in this regard, who would have the authority and power to push through such changes? As world leaders seem to be convinced that only another major crisis will kick-start a much-needed thorough review of the current global governance framework, the IMF would need to demonstrate that it is the only organisation that has the credibility to push for such reforms in non-crisis times and make up for the lack of leadership on these topics by many, especially advanced countries. Waiting for another crisis as a catalyst for reform is not an option: this time must be different.

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