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GOOD TALK, LITTLE ACTION
The Limits of the G20

Immediately following the outbreak of the global financial crisis, there appeared to be a renewed willingness to engage in global cooperation to mitigate the crisis and prevent the next one. Rather than the United States and the IMF taking center stage as in previous crises, the G20 was elevated to a global leaders’ forum where world leaders from industrialized countries and emerging-market and developing countries (EMDs) came together and pledged to coordinate. Through the G20, a new institution was created, the Financial Stability Board (FSB), and the International Monetary Fund (IMF) was revitalized with new funding. Directly and indirectly, this newfound coordination also addressed issues related to cross-border finance. In some sense, the G20 became another forum for cooperative decentralization. Nation-states would independently regulate their financial systems and devise macroeconomic policies, but with a coordinated eye on the global implications of these policies. How did it fare?

The most significant success with respect to cross-border capital flows at the G20 was in terms of discourse and official communiqués. Particularly significant was the negotiation of a set of “Coherent Conclusions” on the regulation of capital flows that was agreed on and signed by G20 finance ministers, central bank governors, and then heads of state in 2011. The same BRICS coalition (Brazil, Russian, India, China, and South Africa) that resided in the IMF (often staffed by the same negotiators) organized at the G20 on these matters. As we have seen in chapter 6, the coalition also was able to include language in the highest-level official communiqués on the need to regulate capital flows and on the need for source countries
to be more cognizant of the spillover impacts of their monetary policies. Another
major success, not so related to short-term financial flows, was the absence of a
major move to put up tariff barriers across the world; the G20 repeatedly made
global pleas to that effect. Yet that major step forward was followed by two steps
backward. In the spirit of avoiding a rash of trade protectionism, the Organisation
for Economic Co-Operation and Development (OECD), under the auspices of
the G20, constructed the term investment protectionism and started issuing annual
monitoring reports seeking to identify such protectionism. In these reports the
G20 singled out many cross-border financial regulations as protectionist despite
the fact that the G20 “Coherent Conclusions” justified the same policies—and
despite there being no economic reason to call such measures protectionist.

All these communiqués and reports were not paralleled by coordinated policy
action on the regulation of global capital flows. The real promise for collaborat-
ing on both ends was the G20 coordination of financial regulatory reform. At the
2011 G20 Summit in Cannes, France, leaders pledged to regulate the global deriv-
ative markets by putting them in clearinghouses and placing harmonized margin
requirements on their use. This pioneering move had great promise of becom-
ing an avenue for cooperation on the regulation of cross-border finance at both
ends. But, deep into the negotiations over the rules of the US Dodd-Frank act,
the United States exempted important foreign exchange (FX) derivatives from
the bill. As we have seen in chapter 4, the FX derivatives market was one of the
key channels that allowed the crisis in 2008–2009 to become global and was the
source of turbulence and financial amplification effects in the 2009–2012 period.
The result was a “hypocrisy trap” (to use the term in Weaver 2008), whereby the
G20 made great strides in making new policies and outcomes in some situations
but completely contradicted them in others.

In this chapter, I first discuss the emergence of the G20 in the wake of the
financial crisis. I then analyze G20 policy with respect to capital flows. Last, I
evaluate the political economy of EMDs in the G20 and beyond.

**The Rise and Promise of the G20**

The Bretton Woods institutions and subsequent coordination among the indus-
trialized nations were intended to provide a number of public goods to the world
economy to prevent and mitigate financial crises. EMDs were initially shut out
of the principal global economic-coordination bodies in the post-Bretton Woods
period. At the turn of the twenty-first century, however, the G20 was formed
and then was elevated to prominence in the wake of the global financial crisis.
The G20 is the most inclusive of these groups formed thus far, and it held great
promise in the wake of the global financial crisis.
Following the collapse of Bretton Woods in the early 1970s, a group of finance ministers began to meet on a regular basis in an attempt to coordinate macroeconomic policies and pursue other objectives. That group became known as the G5 and consisted of the United States, United Kingdom, France, Germany, and Japan. Later, Italy, Canada, and Russia were invited in, and by the end of the 1990s, heads of state became regulars and the group became known as the G8. There had long been critiques of the lack of inclusiveness of these bodies, and in response to the Asian financial crisis and other crises in the late 1990s, the G20 was born as a ministerial-level grouping (Bradford and Linn 2011).

According to Colin Bradford and Johannes Linn (2011), it just so happened that a G20 meeting was scheduled for November 8–9 in São Paolo, Brazil, in 2008. On the advice of Gordon Brown, then UK prime minister, it was decided to elevate the G20 to a leaders’ forum and hold the meeting a week later in Washington, DC. The meeting was hastily assembled after the Lehman collapse and then the election of Barack Obama. The G20 leaders’ summit in Washington was a show of force by a large group of leaders in unison. The hope was to temporarily calm markets and put in place a larger process for reform. That larger process fell to the United Kingdom and Gordon Brown, who took over for the second leaders’ summit, which took place in London in April 2009.

The London summit was truly historic. G20 leaders came together to signal that global fiscal and monetary expansion was okay, and they led by example with over $5 trillion in fiscal stimulus packages. The IMF was also given new funds, and new special drawing rights were issued; $250 billion in trade finance was pledged to EMDs, and the Financial Stability Forum was elevated to a new global institution called the Financial Stability Board (FSB) (Woods 2010). Moreover, the G20 developed a core agenda to work on in years going forward that focused on macroeconomic coordination for recovery, strengthening national and global regulations on financial markets, and reforming the international financial institutions (Bradford and Linn 2011).

All three components of the core agenda of the G20 could be perceived to provide greater justification for world leaders to coordinate on the regulation of cross-border finance. Indeed, the actions of the G20 and the central banks of the industrialized members of the G20 immediately after the crisis all constitute attempts by the global community to allocate the five public goods outlined by Kindleberger (1986) as necessary for a stable international system (see chapter 2): maintaining relatively open markets during recessions, providing countercyclical lending, policing exchange rate stability, coordinating macroeconomic policy, and acting as a lender of last resort. Kindleberger saw these as public goods because every nation benefits from stability regardless of whether a country provides such goods. Indeed, this allows countries to free ride on the production of
public goods by others. Kindleberger thought these public goods needed to be provided by a hegemon, the United States. Others thought these goods could be provided through new institutional arrangements (Keohane 1984). Remarkably, the G20 and its members became a forum to coordinate and communicate on all five of these public goods.

**The G20 and the Regulation of Cross-Border Finance, 2008–2013**

To what extent did the G20 serve as a forum for the global coordination of the governance of global capital flows? There was an unprecedented elevation of issues impacting global financial flows, clearly initiated by the EMDs. Whereas capital flows, exchange rate volatility, and spillovers were sometimes not mentioned in the communiqués of G7/8 meetings, such issues became the cornerstone of G20 communiqués. What is more, Brazil and Germany brokered an explicit declaration on the management of capital flows that went well beyond the IMF institutional view on capital flow management. But these significant new policy statements were not matched by positive economic outcomes. On exchange rates, the period following the Lehman collapse became known for its “currency wars.” The United States defended its loose macroeconomic policy and took no measures to mitigate the negative spillovers associated with its policy.

When we compare EMD clout at the G20 and the IMF, it is clear that EMDs had more leverage at the G20; at the IMF, voting was and is skewed against them (at the G8, they are not present). An analysis comparing G20 and G8 communiqués and subsequent interviews with key G20 negotiators reveals that EMDs brought capital flow volatility to the forefront of global coordination discussions and were even able to shape policy language in terms of communiqués, statements, and declarations.

The G20 communiqué form the Seoul Summit broke ground first. As discussed in chapters 4 and 5, South Korea engaged in traditional and third-generation cross-border financial regulations throughout the post-crisis period. Indeed, in 2010 South Korea was in the midst of implementing some of its stiffest regulations. Although 2010 is characterized as a key year in the capital inflow surges to EMDs, the G8 communiqués did not mention the issue. In contrast, at the Seoul Summit, South Korea, Brazil, and other countries wanted to ensure they had the policy space to deploy their domestic regulations and moved to put the issue on the agenda. The final communiqué of the 2010 finance ministers meeting states, “we have agreed to prioritize the following issues on the agenda for the Seoul Summit: . . . Further work on macro-prudential policy frameworks, including
tools to help mitigate the impact of excessive capital flows” (G20 Information Centre 2010a). At the Seoul Summit, this was reiterated by the formulation of an action plan that in part resulted in the IMF institutional view; it stated, “In order to deal with systemic risks in the financial sector in a comprehensive manner and on an ongoing basis, we called on the FSB, IMF and BIS to do further work on macro-prudential policy frameworks, including tools to mitigate the impact of excessive capital flows” (G20 Information Centre 2010b).

The 2011 G7 summit also revealed little discussion of the issue, but it did note the following in the communiqué: “Excess volatility and disorderly movements in exchange rates have adverse implications for economic and financial stability” (G7/8 Finance Ministers Meetings 2011). At the G20 that year, capital flows were much more explicitly incorporated into finance ministers’ communiqué: “Today we agreed on a work program aimed at strengthening the functioning of the IMS [international monetary system], including through coherent approaches and measures to deal with potentially destabilizing capital flows, among which macroprudential measures, mindful of possible drawbacks” (G20 Information Centre 2011a).

As we have seen, at the 2011 G20 meetings EMDs proposed and, together with industrialized country leaders, presented the “G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experience” (G20 Information Centre 2011b; see chapter 6). The “Coherent Conclusions” was signed by finance ministers and central bank governors, and subsequently by the G20 heads of state. This document stands in contrast to the IMF institutional view and to any documents solely articulated by the G7/8:

Capital flow management measures may constitute part of a broader approach to protect economies from shocks. In circumstances of high and volatile capital flows, capital flow management measures can complement and be employed alongside, rather than substitute for, appropriate monetary, exchange rate, foreign reserve management and prudential policies.

Both push and pull factors, such as global liquidity conditions, long-term growth prospects, and global risk perception, play a role in determining size and composition of capital flows. Any country that has the potential to affect others through its national policy decisions (including, in this particular context, exchange rate management policies, monetary policy in reserve currency issuing countries and regions, regulatory and supervisory policies, and capital flow management measures) should take the potential impact of such spillovers into account when weighing different policy options consistent with national
This effort was initiated by Brazil at the G20 and co-authored with Germany. Germany had sought EMD financial assistance at the 2011 meetings for Greece and other eurozone countries in crisis. Brazil capitalized on this to leverage the “Coherent Conclusions.” During this period of cross-border financial turbulence, this is a milestone; an EMD had proposed and brokered a significant declaration justifying the use of cross-border financial regulations and significantly less restraining than the IMF institutional view. As noted earlier, this document was used to wedge open more maneuvering room at the IMF, where EMDs had less voting clout.

Finally, in 2013 the BRICS led an effort to have the industrialized nations acknowledge and pledge to monitor the spillover impacts of their monetary policies. In early 2013, the US Federal Reserve had begun to signal that it would taper off its loose monetary policy. This created jitters in many EMD markets, and capital began to flee, resulting in India, Brazil, Indonesia, Turkey, and South Africa seeing significant depreciations in their currencies. The 2013 G7 summit reaffirmed the commitments of the industrialized countries to their macroeconomic policies. In contrast, the G20 finance ministers’ statement was starkly different: “Monetary policy should be directed towards domestic . . . and continuing to support economic recovery. . . . We commit to monitor and minimize the negative spillovers on other countries of policies implemented for domestic purposes” (G20 Information Centre 2013). At the G20 meetings in Russia, BRICS had simultaneously negotiated the details of a reserve currency pool that would leverage $100–500 billion in reserves. This gave the coalition significant leverage at the meetings, with even the industrialized-country finance ministers wanting to go to the BRIC side meetings. The specter of this pool was used as intraforum leverage to get more concessions at the G20.

These significant changes in new policies on capital flows gained by EMDs at the G20 were not matched by positive economic outcomes, however. Macroeconomic policy across the industrialized nations and EMDs remained uncoordinated despite G20 pledges. In the absence of currency coordination, 2009–2011 became a period of “currency war”—with the United States, Japan, and China debasing their currencies to some extent and many EMDs following. In the absence of macroeconomic policy coordination, many EMDs were shocked when the Fed announced that it would taper off its loose monetary policy in May 2013 and were equally surprised when the Fed did not taper off those policies
in September 2013. These moves by the United States caused, in part, significant exchange rate volatility and subsequent financial amplification effects across EMDs. During the G20 meetings from 2008 to 2013, there was a full sudden stop in 2009, a massive surge from 2009 to 2011, and significant capital flight in 2013, all causing economic disruption. But this time the United States did not shun EMD efforts to mitigate the harmful impacts through the use of cross-border financial regulations, as it had during past crises.

The Rise of Investment Protectionism?

The G20 can partially take pride in preventing the adoption of a rash of trade barriers in the wake of the crisis. At every G20 summit since the global financial crisis, the final communiqué committed to restraining member nations from taking protectionist measures. It is a remarkable achievement that no country had a “Smoot-Hawley” moment, putting major protections in place that would have distorted world trade and growth. The US Smoot-Hawley tariffs had been imposed on US imports during the Great Depression to great detriment to the world economy. Recall that, according to Kindleberger (1986), one of the key public goods is keeping markets open during recessions. As proposed at the 1944 Bretton Woods meetings, the establishment of the General Agreement on Tariffs and Trade (GATT; which later became the World Trade Organization, WTO) in 1947 as an attempt to provide this collective good. Indeed, institutional arrangements at the WTO provided EMDs a mechanism to push back the United States when it attempted to put “Buy America” provisions into the fiscal stimulus package. From 2008 to 2011, the WTO and numerous independent assessments saw no significant moves toward protectionism. The WTO considered this its greatest victory in what otherwise was a difficult period (during which it was in the midst of a gridlock in its longest running negotiation in its history). After 2011, however, both the WTO and independent analysts started to see protectionist measures adopted. But, although these studies show that there was an increase in trade measures, there was little significant impact on actual trade flows in the world economy (World Trade Organization [WTO] 2011; Evenett 2013; Montpetit et al. 2011; Drezner, 2014).

As we will see, however, the G20 then overgeneralized this observation by mis-diagnosing the regulation of cross-border finance as “investment protectionism” in its further efforts to monitor trade policy in the wake of the crisis. Following the G20 call against the rise of “protectionism,” the OECD and UN Conference on Trade and Development (UNCTAD) constructed the concept of investment protectionism and extended their monitoring of protectionist measures
to investment policy. These efforts specifically targeted cross-border financial regulations, among many other policies. The term *investment protectionism* dates back to a 2008 article by the right-of-center US think tank, American Enterprise Institute (AEI). In an article published shortly after the crisis, Claude Barfield made a case that measures blocking foreign investment were just as significant as trade measures and called on US President Barack Obama to lead an effort to prevent such protectionism (Barfield 2008). This language was adopted by the G20 when the OECD (a longtime supporter of the deregulation of investment markets) and UNCTAD produced a joint 2009 report on investment measures in response to the G20 communiqué calling for restraints on protectionism (OECD-UNCTAD 2013). Between 2009 and 2012, the OECD and UNCTAD issued nine reports to the G20, and they continue to do so. In addition to restrictions on FDI, the OECD-UNCTAD reports singled out cross-border financial regulations as protectionist—including measures used in Brazil, South Africa, and many of the countries discussed in this book.

This move was largely missed or ignored by outside observers, but it made EMD governments very uneasy. Two independent groups monitoring trade policy in the wake of the crisis, Global Trade Alert and the G20 Information Centre, continued to use the traditional definition of *protectionism* as trade measures in their analyses.

The G20 redefinition of investment regulation as protectionist goes far beyond economic theory. As we have seen in chapter 3, the economic case for deregulating cross-border financial markets is far weaker than for trade; this has repeatedly been echoed by Jagdish Bhagwati (1997), an eminent trade theorist. Alan Beattie, *Financial Times* columnist, was one of the few outside observers who picked up on this redefinition early. Writing in the *International Economy*, Beattie (2008) rightly argues that calling investment regulation “protectionism” is conceptually and theoretically weak and urges that the term *investment protectionism* not be used for sake of clarity. What is most inconsistent about this G20 approach is that G20 leaders at the highest level endorsed a set of ”Coherent Conclusions” justifying the very policies that G20 reports are currently singling out as protectionist.

**Regulating Derivatives at Both Ends?**

The G20 had implicitly promised to regulate capital flows at both ends, as Keynes and White had articulated in the run-up to the Bretton Woods conference (see chapter 2). To date, the G20 has failed in this effort by standing quiet as the United States violated the G20 agreement to harmonize margin requirements on derivatives across the countries in the group.
As early as 2009, the G20 committed to regulate over-the-counter (OTC) derivatives by forging rules that would require derivatives to be traded on an exchange or be subject to higher capital requirements. At the Cannes summit in 2011, the G20 agreed to harmonize margin requirements on derivatives products as well. The US Dodd-Frank Act was among the first reforms in the industrialized countries to regulate derivatives in this manner. Under Dodd-Frank, the United States will subject derivatives to a central clearing requirement that will require all derivatives dealers to register with a clearinghouse and be subject to margin requirements. Posting margins would increase the cost of leverage and effectively reduce the amount of capital available when engaging in the carry trade. Central clearing has the potential to regulate the carry trade on both ends as well.

As noted in chapter 4, FX derivatives instruments have been an important part of the carry trade, and exceptions create the incentive for investors to restructure their carry trade positions toward the exempted parts of the market. According to the Bank for International Settlements (BIS), the daily turnover rate for FX transactions is now US$5.3 trillion, up from US$1.2 trillion in 2001. Figure 7.1 shows that the largest and fastest growing area of the FX market is FX derivatives in the form of foreign exchange swaps. As we have seen, FX derivative markets played the decisive role in creating financial fragility.

Requiring that US financial entities place margin requirements on FX derivatives would implicitly be a form of regulating capital flows on both ends, as discussed by White and Keynes. The third-generation capital account regulations put in place by EMDs are a form of regulating the harmful aspects of the FX derivatives trade on the EMD end. Because of the sheer magnitude and sophistication of those markets, however, they have proved difficult for EMDs to regulate on a sustained basis. We have seen that such regulations have some positive impact (see chapter 4) but not enough to fully stem financial instability. The Brazilian FX derivatives regulations had only a partial impact given that the Brazilian market is nondeliverable and largely conducted offshore. Thus, the Brazilian regulations had jurisdiction only over financial entities based in Brazil that had one side of a particular position in the FX derivatives market. The regulations created an incentive for investors to engage not with counterparties located in Brazil but, rather, with large investment firms in the United States and Europe. If the United States and Europe instituted higher margin requirements for FX derivatives and derivatives had to be traded openly, this would raise the cost of the carry trade and implicitly be a form of regulating the market on both ends.

But a blow was struck to these possibilities in November 2012 when the US Treasury Department exempted FX swaps and forwards from the Dodd-Frank Act. Nondeliverable forwards, FX options, and currency swaps are still subject to regulation, however (Brush 2012). Timothy Geithner, then treasury secretary, argued that FX swaps and forwards were not a key part of the crisis in the United States and were already traded in a transparent market. To the contrary, in-depth investigative reports have shown that these exemptions were the result of an intense lobbying effort by financial interests in the United States and abroad. Deutsche Banke, the Bank of New York Mellon Corp, UBS, Goldman Sachs, and other financial lobbyists entered into over 1,000 contacts with US regulators on these issues and attended more than one-third of the 2,100 sessions held by regulators. The Securities Industry and Financial Markets Association paid upward of $3 million to lobbyists for these efforts (Brush and Schmidt 2013).

Political Economy of Global Cooperation on Capital Flows

Despite some remarkable strides in constructing new policies in goals, communiqués, and declarations, in the wake of the crisis the economic outcomes in terms of the provision of public goods were not well provided by the United States or the G20. As we have seen, including EMDs as part of coordinating bodies yielded some significant new policy language that, indeed, allowed a loose
regime of cooperative decentralization. Nation-states pledged to recover from the crisis and put in place financial regulatory reforms to prevent future crises, not through strong international standards but in ways pertaining to their own national circumstances. They also pledged to coordinate these efforts to ensure they were consistent enough so as to restore financial stability to the global system. Moreover, EMDs broadened the conversation about the global economy compared to the discussion and subsequent statements made in the G7/8. They used the G20 as an opportunity to negotiate an official declaration on the governance of capital flows. The “Coherent Conclusions” on the management of capital flows sent a significant signal that EMD efforts to regulate capital flows were sanctioned. It also provided fodder for EMD efforts at the IMF.

There were significant economic outcomes as well. For the first time, some EMDs were able to obtain liquidity from outside the controversial and stigmatized IMF. By providing bilateral swap agreements to EMDs, the United States and China were able to mitigate the sudden stop that occurred immediately after the financial crisis. Another positive policy outcome was that EMDs were able to use the WTO to (partly) stem some of the protectionist measures in the US stimulus bill. In hindsight, however, the most significant economic outcomes remained elusive. Currency swings were rife throughout the period, finance was pro-cyclical, and financial fragility became accentuated.

Moreover, there were also significant setbacks in terms of a lack of new policies. The redefinition of investment regulations as investment protectionism was, until recently, largely missed by EMDs. As we have seen, reports issued to the G20 were initiated by the OECD and UNCTAD based on a broad interpretation of G20 communiqué language about the need to resist protectionist acts in the wake of the crisis. The OECD and UNCTAD have long been advocates of investment liberalization in general and of capital account liberalization in particular. In fact, there is no economic theory that equates investment liberalization to trade liberalization. And, of course, branding capital account regulations as protectionism is inconsistent with numerous G20 communiqués and the “Coherent Conclusions.”

A second and potentially more damaging setback was the exemption of certain FX derivatives from the Dodd-Frank Act. As we have seen, the FX derivatives market was one of the primary channels that allowed the crisis to become global and that caused a surge in capital inflows in the wake of the crisis. The regulation of FX derivatives in developed countries, especially the United States, would significantly to regulate capital flows at the source countries, and, with EMD regulation, regulate them at both ends. The G20 still says that those sectors that are exempted will have to post higher capital requirements. Yet most FX derivatives transactions occur off balance sheet and sometimes even in offshore nondeliverable forward markets—areas very hard to target.
Why did the major steps forward in inclusiveness and discourse not lead to subsequent gains in economic outcomes? Different combinations of power, institutions, and ideas explain both the gains and setbacks with respect to the political economy of global coordination on cross-border financial flows. Perhaps the best way to summarize the state of the G20 on the issue of providing public goods related to cross-border financial flows is that it is caught in what Catherine Weaver (2008) refers to as a hypocrisy trap. Weaver, in an in-depth analysis of the World Bank, defines a hypocrisy trap as the “persistent failure [of an institution] to act in accordance with its own ideals” (2008, 2) that results in “distinct and observable gaps or inconsistencies between the theories, goals and ‘best practices’ organizations claim to uphold and the actual policy agendas and instruments they employ” (2008, 176–77).

Power and connectedness go a long way in explaining both the inconsistent gains and setbacks for EMDs with respect to the coordination of capital flows. The relative gains in market power, financial interconnectedness, and reserve accumulation gave EMDs more bargaining power with the Fed, the People’s Bank of China (PBOC), and at the G20. Key EMDs were able to secure liquidity lines outside the IMF, through the Fed and PBOC, because they were key trading or investment partners with the United States—their fates had become tied, and it was now in the interests of the United States and China to provide help. If those countries had also had major financial crises, it would further hurt the United States and China. There is also some evidence that the United States used this to its advantage by making EMD alignment with US positions at the G20 a condition of EMD participation in the swap lines.

At the G20, the market power of BRICS was accentuated by the nature of the G20 as an institution. Unlike in the IMF or in the asymmetric bilateral bargaining forums at the G20, members of the BRICS coalition have an equal say. Key EMDs, especially BRICS, were able to consolidate this power by working in a coalition at the G20 and by exerting both intraforum and extra-forum leverage to achieve some of their objectives. As we have seen, EMDs at the G20 exerted intraforum leverage by forging the “Coherent Conclusions” on capital flows. In this case, EMDs had the upper hand because the Western members of the G20 were actively seeking funds from EMDs to help save certain eurozone countries from collapse. They made the negotiation of the “Coherent Conclusions” a condition of discussing EMD finance for the crisis in Europe. Exerting extra-forum leverage, BRICS negotiated a reserve currency pool agreement and a BRICS development bank on the sidelines of the G20. This gave EMDs the clout to insert language about capital flows and the negative spillovers of Western monetary policies into G20 communiqués.
Market power, the interconnectedness of financial and trade systems, and the broad institutional mandate of the G20 allowed for a more balanced North-South give and take there than in the IMF or in FTAs and BITs. For the first time, the industrialized countries needed the EMDs for trade, to prevent internal collapse, and for external finance for Europe. Because of the nature of power and institutional arrangements, EMDs and industrialized nations were able to agree on certain new policies despite the fact that they had different ideas about the nature of their individual policies. On swaps and the sudden stop, EMDs, the PBOC, and the Fed were all on the same page—they agreed that the costs of not extending swap lines outweighed the benefits to all parties—thus, there was a strong policy outcome. The spillover effects of US monetary policy and the right to regulate capital flows were another matter. The United States had a different idea bout the costs and benefits than did EMDs. The industrialized countries, particularly the United States, thought that the global benefits of a loose US monetary policy outweighed the costs (Bernanke 2013). Some EMDs thought those costs were too high to bear, but EMD leverage was able to extract concessions only in terms of forging new policy. US power prevailed in the economic outcomes.

The EMD gains in new policy language did not fully translate into gains in economic outcomes because the United States still maintains primary economic power in the world economy. The fact that the US dollar is still the core reserve currency and that the US economy is still the major source of foreign trade and finance puts EMDs at a structurally weaker bargaining position despite the seemingly even institutional distribution of power at the G20. This is accentuated by the power of the financial sector in the West. As we have seen with the FX derivatives exemption in the Dodd-Frank Act, the US financial lobby has an enormous amount of resources and clout.

Moreover, the institutional structure of the central banks further solidifies the current power dynamics. The US Fed acted in what it saw as in its interests and in its mandate of maintaining stable prices and full employment in the United States. If the United States instituted a more rigorous and targeted fiscal stimulus, the Fed believed that it could achieve both objectives—and perhaps help the world economy because the subsequent economic growth would trigger the demand for global goods. The Fed has no explicit institutional mandate to think about world policy. And even if the Fed did agree with EMDs on the need to cooperate on financial flows, it would have had a hard time explicitly doing so.

Ideas about the coordination of capital flows were not aligned either. As already mentioned, the Fed thought that if the US government had a stronger fiscal position, the benefits of a US recovery would outweigh the costs of the negative spillovers from US monetary policy. Moreover, there was a lack of constructive
ideas in terms of policy alternatives on the part of the EMDs. Brazil and others at G20 meetings criticized US monetary policy in particular, implying that the United States should raise interest rates or stop quantitative easing. Such talk was unacceptable to the United States, and for good reason. Some independent experts did suggest some measures that would have allowed the United States to cooperate more actively. Robert Pollin (2012) suggested a maximum reserve ratio on US commercial banks that would require them to lend. If coupled with tax credits to small and medium-size enterprises in the United States, US banks would have had a better incentive to lend for employment-based growth activities in the United States rather than to hoard cash or send it to EMDs. Others emphasized that margin requirements on FX and other derivatives would implicitly help steer investment away from areas of greatest turbulence (Griffith-Jones and Gallagher 2011a, 2011b). The maximum reserve ratios were proposed to the Fed but were not carried further. The margin requirements on FX derivatives could have been a cornerstone of G20 financial cooperation but fell prey to the US financial lobby and the lack of attention to the matter by EMD G20 members. There are no public comments from EMDs to the rulemaking bodies of the Dodd-Frank Act on this matter.

What was left, then, was indeed a very different policy output than in crises past. The United States and other Western powers officially acknowledged through G20 communiqués and the “Coherent Conclusions” that there were negative spillovers from industrialized country monetary policies and that EMDs had the policy space to regulate cross-border finance to mitigate the harmful aspects of those spillovers. This is a major step forward from past crises but not enough to provide the key public goods necessary to prevent and mitigate financial fragility in the world economy.