



Policy Brief

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The latest financial and economic crisis has highlighted the major structural imbalances in the global economy—imbalances which the G-20, even in its elevated status, fails to address. Yet these are precisely the problems that need to be resolved if we are to avoid another downturn, and shift to a truly equitable, just and sustainable development path.



## What is missing in the G-20 agenda? Redressing structural imbalances for equity, justice & sustainability

**Structural imbalances behind the global downturn still beg the G-20's attention, despite the Group's self-appointment as guardian of global economic growth and stability**

THE GROUP OF TWENTY'S (G-20) OFFICIAL MANDATE is to "promote open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. By contributing to the strengthening of the international financial architecture and providing opportunities for dialogue on national policies, international co-operation, and international financial institutions, the G-20 helps to support growth and development across the globe."<sup>1</sup>

The G-20 was set up in 1999 to prevent a repeat of the Asian Financial Crisis which struck in 1997 and spread to other regions of the world. After nearly a decade of G-20 meetings, an even bigger financial crisis erupted in 2008 at the heart of the global financial system and has since become the worst economic crisis to afflict the world since the Great Depression of the 1930s. Clearly the G-20 has failed spectacularly in its core mandate.

This latest financial and economic crisis has highlighted even more starkly than before the major structural imbalances in the global economy which the G-20, even in its elevated status, fails to address. Yet these are precisely the problems that need to be resolved if we are to avoid another downturn and shift to a truly equitable, just and sustainable development path.

**The structural imbalances in the global economy – inequality between capital-owners and wage-earners, between high finance and the real economy, between developed and developing countries, and the democratic deficit in institutions of global economic governance – constitute systemic failures of the neoliberal development model which the global crisis has exposed.**

## Structural Imbalances

First, there is the grave imbalance in the distribution of income between capital and labor. The shift to neoliberal economic policies in the 1980s – liberalization of investments and trade, the privatization of public assets, deregulation of markets and cutbacks in social services and welfare spending – has boosted productivity in many countries but worsened income inequalities. There has been a secular decline in labor's share in the national income across the globe ranging from developed countries to major emerging economies of Latin America, Asia, as well as Eastern Europe, who have all shared similar neoliberal policy templates promoted by the Bretton Woods institutions.<sup>2</sup>

The net result is that by 2000, the richest 1% in the world own 40% of global assets, the richest 2% own 51%, while the poorest half of world population own barely 1% of global wealth and experience falling living standards, greater insecurity and vulnerability.<sup>3</sup>

Given that wealthy households spend a smaller proportion of their income compared to low-income households, the decline in the purchasing power of working class families has had to be offset by encouraging debt and asset inflation in order to keep consumption rising along with productivity gains.

This condition has also created another major structural imbalance in the macroeconomy – that between the real economy and high finance.

With consumption ultimately limited by the decline in labor's share of income, further investment in new productive capacity (such as factories and employment) becomes increasingly less profitable on the margin. Thus a rapidly rising share of surplus capital is seeking profits not in the real economy but in financial speculation – a process sometimes referred to as the "financialization" of the economy. This was further encouraged by deregulation in the financial sector which allowed and encouraged the proliferation of trading in securities, derivatives and other "exotic" financial products that ultimately inflated asset bubbles.

This can be seen in the rapid increase in the value of the world's financial stock. From roughly equal to world GDP in 1980, this had doubled in size by 1993, and by the end of 2005, it had risen to 316% or more than three times the world GDP. Government and private debt securities account for more than half of the overall growth in the global financial assets from 2000 to 2004, indicating the role of leverage or debt in driving this process. In 2004, daily derivatives trading amounted to \$5.7 trillion while the daily turnover in the foreign exchange market was \$1.9 trillion. Together they add up to \$7.6 trillion in daily turnover of just two types of portfolio capital flows, exceeding the annual value of global merchandise exports by \$300 billion.<sup>4</sup>

The frenetic increase in speculative financial trading and the resulting asset inflation represents the increasing alienation of finance from production and explains much of the heightened volatility and instability in today's global economy.

One response of developing countries to heightened volatility in the globalized and deregulated financial markets is to build up reserves as a form of self-insurance against the possibility of sudden capital outflows. This self protection has resulted in a massive accumulation of U.S. dollar reserves – the U.S. dollar being the dominant world currency – amounting to \$3.7 trillion for all developing countries in 2007.<sup>5</sup> These reserves are in essence a transfer of resources, at very low interest rates, from developing countries to the developed economies, especially the U.S., which issue the reserve currencies.

In effect, the debt-led growth and the resulting current account deficits in the U.S. is being financed by the surpluses of developing countries like China and South Korea, and the oil rich Middle Eastern countries who are purchasing U.S. government bonds.

This exacerbates the third major structural imbalance in the global economy whereby precious resources which could be used for eradicating hunger and poverty, mitigating climate change and financing sustainable development in the South is being used instead to fuel unsustainable consumption and capital accumulation in the North.

According to UN estimates, Southern countries are transferring resources to the North at an average of nearly \$500 billion per year since 2000, reaching a peak of \$891 billion in 2008. This means debt interest payments, profit remittances, and investments in capital markets in developed economies, more than offset financial inflows to developing countries.<sup>6</sup>

Finally, there is the structural imbalance in terms of democratic participation in global governance. The G-20 – the self-designated "premier forum for international economic co-operation" – excludes the rest of the G-192 countries. Not a single least developed country is represented in the G-20, not to mention the voice of civil society. The International Financial Institutions (IFIs), which the G-20 has directed to assume the central role of dealing with the crisis at the international level, remain as unrepresentative of the interests of poor countries as before. The G-20 has issued token proposals for reforming voting shares in the International Monetary Fund (IMF). But these principally benefit middle-income and emerging market economies whose vote will rise by 5% at the IMF and by 3% at the World Bank – in order to entice these surplus economies to take a greater stake in these institutions. But low-income countries (LIC) have nothing to gain in terms of voting rights, especially Sub-Saharan Africa.

These four structural imbalances are interrelated and constitute systemic failures of the neoliberal development model which have been foregrounded by the current global financial and economic crisis.

## The G-20's Response

The official response to the crisis, however, virtually ignores these structural imbalances and instead focuses solely on issues of liquidity and regulatory failure.

The wealthy economies have responded with massive bailouts for their financial institutions that are considered too big to fail. This has succeeded in stabilizing the financial markets and preventing a deeper recession in the developed countries. But developing countries who have little responsibility for causing the crisis have scarce resources and limited policy space for dealing with its impacts.

The G-20 leaders committed an additional \$1.1 trillion in emergency financing to counter the global downturn – with \$750 billion to be channelled through the International Monetary Fund (IMF). Of the \$1.1 trillion committed, only \$240 billion is expected to go to developing countries and \$50 billion to low income countries which are most in need of additional resources. This is a paltry amount compared to \$20 trillion (or some 30% of world GDP) committed by the wealthy economies to recapitalize banks, take partial or full government ownership of ailing financial institutions and provide guarantees on bank deposits and other financial assets.<sup>7</sup>

The G-20 also directed the IMF to issue \$250 billion to member countries in the form of Special Drawing Rights (SDRs), the IMF's reserve asset, to boost global liquidity. But shares are allocated according to IMF contributions. Hence the largest share of the \$250 billion allocation went to the U.S. (\$42.6 billion) while developing countries expected to get around \$90 billion. Low-income countries (LICs) are to get \$18 billion and Sub-Saharan Africa can only claim \$10 billion.

Despite commitments made by donors to increase their aid at the Gleneagles G-8 and the London G-20 Summit in 2009, a number of donor countries have cut their aid from previously announced levels. France and some other EU countries have either reverted back to the minimum EU target, or extended the timeline for achieving their minimum targets. Also, since most donors link their aid levels to their gross national income, reduced growth prospects will also diminish the real value of their targeted commitments.<sup>8</sup>

On the other hand, the international financial institutions (IFIs) have increased their lending activity to provide additional liquidity to poor countries. But this creates potential debt crises in the near future. The debt-to-GDP ratio of 28 countries is already above what the IMF considers a sustainable threshold at more than 60%.<sup>9</sup> Moreover, the IFIs (especially the IMF) remain as committed to imposing the same neoliberal policy prescriptions on developing countries that require their assistance. These include pro-cyclical monetary and fiscal policies that have long formed part of the

staple of IMF conditionalities that worsen the adverse impacts of the downturn on developing countries. The G-20 has not only reinvigorated the IFIs' role in the global economy with a new infusion of capital, it has assigned to the unreformed IMF the role of de facto technical secretariat. This shows that the G-20 remains as committed to the neoliberal economic paradigm that has brought on this crisis.

As for improving financial regulation, the G-20 appears to lack political will in curbing financial speculation and making financial institutions publicly accountable. It merely promises to come out with rules on bank capital requirements by end of 2010 for implementation by end of 2012; calls on firms to reform compensation policies to discourage excessive risk taking; calls for improved transparency in the derivatives markets and promises to come out with prudential standards for "systematically important financial institutions" by end of 2010.

Nowhere in the official policy agenda are measures to deal with the long-running decline in the income shares and living standards of the working poor who constitute the majority of the population both in the developed and underdeveloped countries. Support for social protection measures such as conditional cash transfers and expanded social insurance may provide some relief or cushion to the poorest households but cannot compensate for the widespread destruction of livelihoods resulting from the crisis and policies that deter jobs-led recovery or further depress the living standards of the majority population.

Indeed, the the G-20's cautious pronouncements that the crisis is over and shift from economic stimulus to "fiscal consolidation" in the world's major economies has raised fears of a double-dip recession.<sup>10</sup>

The standard neoliberal policy response to deal with fiscal deficits – which the G-20 and the IMF are promoting – means more cuts in public services, social security and public pensions, as well as regressive tax reforms. The upshot to this is that working families are made to pay for the costs of the global crisis several times over, through falling incomes and rising unemployment, then through reduced access to social services in order to pay for the handouts given to financial giants responsible for the crisis. The worsening of inequalities and the same structural imbalances will surely lead to new financial convulsions and deeper economic crises in the future.

The Korean government, the first non-G-8 country to host the G-20 Summit, has made clear that the upcoming Seoul meeting will not be confined to finance and economic issues but shall encompass a broader development agenda. Unfortunately, the "development issues paper" released by the Korean government contains basically the same growth- and market-oriented development strategy that has dominated policy over the last three decades with devastating results for people and the planet as manifested in the current convergence of economic, financial and ecological crises.

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# Policy Alternatives to the G-20 Agenda

In the absence of more far-reaching reforms in the agenda of the G-20 and the IFIs, it is imperative to examine policy alternatives that are being put forward by heterodox economists and civil society, particularly those that deal with the different dimensions of the structural imbalances noted above.

These include domestic policies that redirect the economy towards creating decent jobs for all, ensuring universal access to essential services and reducing inequalities along gender, ethnic, and geographic lines. This means greater reliance on public employment and public expenditures on labor-intensive services like education, health, water, housing, public infrastructure and green investments. This also entails expansion of public ownership or public control over critical sectors that cannot be left to the market such as finance, (alternative) energy, mass transportation, etc., along with redistributive measures such as agrarian reform. These measures require greater domestic resource mobilization through progressive tax reforms, controls on capital flows, plugging tax leakages and illicit financial flows, reallocating military budgets and introducing new sources of finance such as a financial transactions tax (FTT).<sup>11</sup>

At the international level, the proposal for a FTT, by some estimates, can raise from under \$10 billion to \$1 trillion annually, depending on the rates and coverage of the tax.<sup>12</sup> This can then be used for financing domestic social investments, development in the South as well as global public goods including the MDGs and climate change mitigation and adaptation measures. At the same time, the FTT is intended to discourage speculative financial trading and reduce financial volatility. This is related to calls for the establishment of an International Tax Organization (ITO) to coordinate efforts to fight tax evasion and tax havens, and to study a global formula to levy taxes on multinational enterprises.

There is also a proposal to expand the scope and use of SDRs as a global reserve currency.<sup>13</sup> The intention is to eliminate the distortions imposed by the reliance on the U.S. dollar as a global reserve currency, minimize imbalances between surplus and deficit countries, meet urgent liquidity needs of developing countries in times of crises and provide additional resources to low-income countries for financing development.

There are also calls for a two-year moratorium on all external debt service payments of developing countries which would easily free up additional resources in the amount of \$30.5 billion annually for 64 of the world's most indebted countries and would represent an effective way to release extra funds for critical social investment, while ensuring that no additional debt would be incurred. This is accompanied by renewed calls for debt cancellation and the establishment of a fair and transparent mechanism for sovereign debt arbitration. This mechanism shall facilitate the orderly, predictable and rapid restructuring of unsustainable sovereign debt, balancing the interests of creditor and debtor nations; and linking repayment conditions to economic, social and cultural rights, as well as environmental conditions.<sup>14</sup>

These proposed reforms go hand-in-hand with calls for changes in multilateral institutions including the international financial institutions – both in terms of orientation and governance. These institutions must pursue policies that promote broader public interests of people and the planet instead of profits. At the same time, global governance structures must become more inclusive and more representative of, and accountable to, the needs, interests and views of all countries, not just the wealthy and powerful states.

All these can serve as various components of a comprehensive agenda that addresses the immediate impacts of the global crisis, responds to the urgent needs of the people and serve as first steps towards more far-reaching changes that fundamentally reshape the global economy, its governance and its institutions.

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## Notes

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