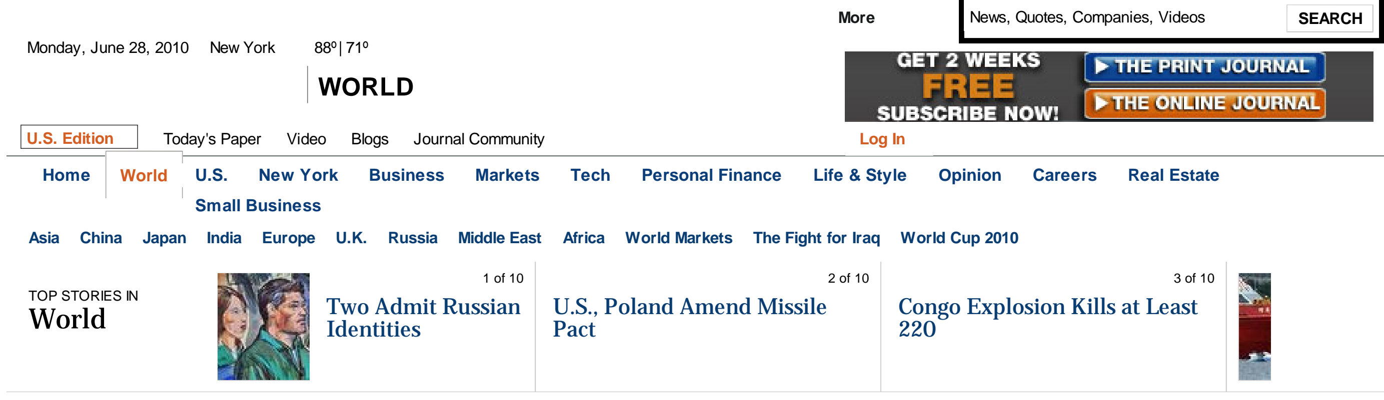


WORLD NEWS | JUNE 28, 2010

G-20 Agrees to Cut Debt

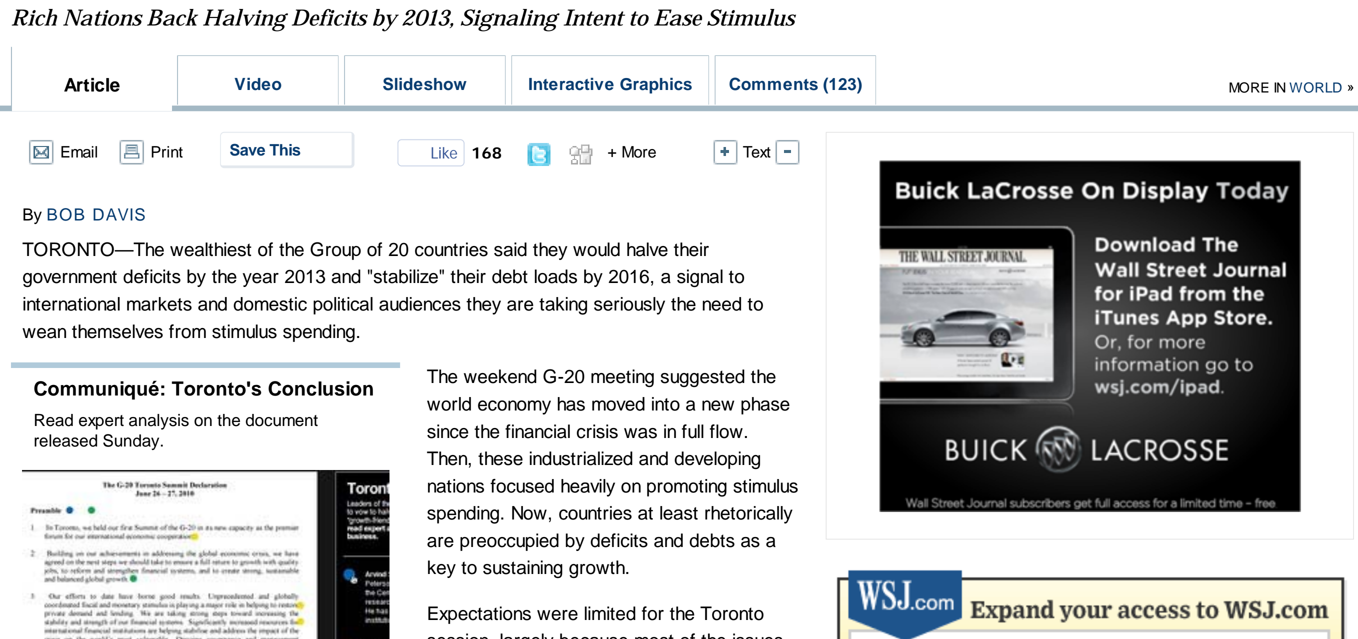
Rich Nations Back Halving Deficits by 2013, Signaling Intent to Ease Stimulus

By BOB DAVIS

TORONTO—The wealthiest of the Group of 20 countries said they would halve their government deficits by the year 2013 and "stabilize" their debt loads by 2016, a signal to international markets and domestic political audiences they are taking seriously the need to wean themselves from stimulus spending.

Communiqué: Toronto's Conclusion

Read expert analysis on the document released Sunday.



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The weekend G-20 meeting suggested the world economy has moved into a new phase since the financial crisis was in full flow. Then, these industrialized and developing nations focused heavily on promoting stimulus spending. Now, countries at least rhetorically are preoccupied by deficits and debts as a key to sustaining growth.

Expectations were limited for the Toronto session, largely because most of the issues of financial regulation weren't scheduled for completion until the end of the year at the Seoul summit. But the conference became a way for major nations to try to address fears in the market that government spending was spinning out of control.

G-20 Toronto Summit

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The meeting's concluding statement, a compromise between two competing visions of the international economy, masked divisions between the U.S. and Europe evident in the run-up to the summit. The U.S. has warned that moving too fast to cut deficits and reduce stimulus spending could risk another global recession. European nations, especially Germany, have cautioned that moving too slowly could produce unsustainable debt loads, higher interest rates and even defaults.

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With each side pushing, the U.S., and Europe cut what a U.S. official called a "combo deal." The U.S. agreed to make the goal of halving deficits a G-20 initiative, in exchange for G-20 support for language making growth the top priority, said a European official. President Barack Obama has already made similar deficit commitments back at home.

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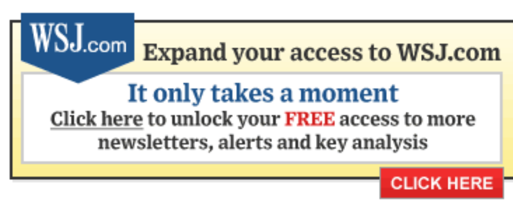

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The statement characterized the recommended pace of deficit cutting as "growth friendly" — meaning it was supposed to demonstrate a will to reduce deficits, but didn't envision stepping too quickly off the accelerator. India, Brazil, China and other emerging countries were wary of undermining global growth especially in the U.S., the world's largest economy.

Chinese President Hu Jintao said, "We must act in a cautious and appropriate way concerning the timing, pace and intensity of an exit from the economic stimulus packages and consolidate the momentum of recovery of the world economy."

A G-20 statement called the global recovery "uneven and fragile" and said that to sustain growth, "we need to follow through on delivering existing stimulus plans, while working to create the conditions for robust private demand."

"The conversations were by and large pretty nuanced," said a senior U.S. official. "A variety of countries were saying, 'Let's be careful about the impact of synchronized withdrawal [of stimulus] but also be on the path of announcing to restoring strong public finances.'"

Germany, which has held itself out as the champion of austerity, took some potshots. German Finance Minister Wolfgang Schäuble used an interview in the French newspaper Le Monde to throw a jab at the U.S., saying Mr. Obama's giant stimulus spending has had little impact on the country's jobless rate, which remains well above 9%.

By Sunday, German Chancellor Angela Merkel was declaring solidarity with the U.S. and other nations.

French President Nicolas Sarkozy, meanwhile, seemed less than committed to the deficit-reduction goal, calling "a compromise, a point of equilibrium" rather than an "instruction from the G-20."

According to documents passed among G-20 countries, the U.S. and Germany, as well as France, Britain and Canada, are on similar paths of halving their deficits; the G-20 summit gave them a way of making those commitments more clear.

The U.S. estimates it will reduce its deficit to 4.2% of gross domestic product by 2013 from 10.1% currently, while Germany is looking at a 3% deficit in 2013, down from 5.5% in 2010. But the U.S. depends more on economic growth to reach its goal than does Germany, which is expected to grow at a slower pace.

They might have to make deeper cuts in deficits to comply with its pledge. A White House statement said that government debt in the fiscal year ending Sept. 30, 2015, would be at an "acceptable level." President Obama said that next year he would present "very difficult choices" to the country in an effort to meet deficit goals.

The president cited his disappointment with the U.S. tax code. "Next year, when I start presenting some very difficult choices to the country, I hope some of these folks who are hollering about deficits and debt step up, 'cause I'm calling their bluff," Mr. Obama said.

"Historically, summit commitments have helped countries to do what they wanted to do anyhow," said Ted Truman, a former Obama administration official who is now an economist at the Peterson Institute of International Economics. In the 1990s, he said, U.S. commitments in international forums to reduce its budget deficit "was widely viewed as maintaining the focus of deficit hawks on the issue," he said—although similar pressure didn't work in the 1980s.

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The G-20 said it remained committed to the so-called rebalancing effort, started at the Pittsburgh G-20 summit in September 2009. In that exercise, countries with trade surpluses—especially China—were expected to commit to policy changes to reduce exports and boost domestic consumption, while trade-deficit countries—especially the U.S.—were expected to do the opposite in the so-called rebalancing initiative. The overall goal is to reduce dependence on recession-scarred U.S. consumers who are likely to spend less on imports than they did before the financial crisis.

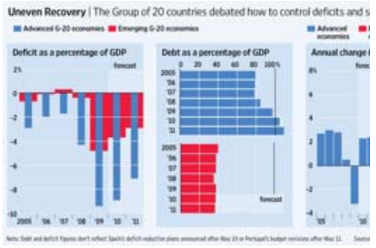
In a economic simulation prepared for the G-20, the IMF estimated that if the U.S. and other wealthy countries slash budget deficits somewhat deeper than they are planning and China and other large emerging boost domestic consumption more strongly, global growth would expand 2.5% faster than it otherwise would in five years.

IMF Managing Director Dominique Strauss-Kahn praised the meeting's progress on Sunday, noting "I am encouraged by the conclusions of the G-20 Summit, including the active engagement of the leaders in developing the G-20 framework for strong, sustainable and balanced growth."

The Toronto summit was dogged by some of the largest demonstrations targeting an international economic meeting since the Seattle World Trade Organization riots of 1999. About 600 people were arrested in protests that started off peacefully but disintegrated into roving bands of violent youths. Some news briefings were interrupted by the violence, but the fights were far from where the leaders were meeting and didn't disrupt negotiations, as occurred in Seattle.

Uneven Recovery

The G-20 debated how to control deficits and stimulate growth. Click to enlarge graphic.



Twenty Economies, One Communiqué

Among the pledges G-20 nations made at the Toronto summit:

Advanced economies that make up the group committed to slashing their government deficits by at least half by 2013 and cap debt ratios within the following three years.

Member nations said banks should be required to keep a level of capital sufficient to deal with "stresses of a magnitude associated with the recent financial crisis."

Absent consensus on a bank tax, leaders agreed that financial institutions should help pay for any interventions to help the financial sector, but noted a range of options.

Following the recent oil spill in the Gulf of Mexico, leaders recognized the need to "share best practices to protect the marine environment, prevent accidents related to offshore exploration and development, as well as transportation, and deal with their consequences."

The G-20 session had remarkably little focus on problems or requirements of big developing countries. For China and India, the most significant part of the summit may have been that it was on the international calendar, allowing them to use it as a deadline to press for changes.

Both Washington and central bank officials in Beijing used the specter of the session to win Chinese government approval to let the its currency, the yuan, appreciate. In April, U.S. Treasury Secretary Timothy Geithner made clear that the U.S. expected a currency move by the G-20 summit when he delayed issuing Treasury's twice-yearly report on international currency practices. That could have used to accuse Beijing of manipulating the yuan to gain an edge in international trade.

In Beijing, says Eswar Prasad, a Cornell University economist who was the International Monetary Fund's chief China hand, the G-20 deadline helped officials in the central bank, who favored currency flexibility, in their fights with trade officials who wanted to keep the currency undervalued.

Indeed, there wasn't a specific mention in the G-20 statement pressing China to follow through on its commitment to let the currency appreciate. Rather it referred to the need for "greater exchange rate flexibility in some emerging markets."

The Indian government said Friday, just ahead of the summit, it would sharply reduce consumer subsidies for gasoline and kerosene. That would lower government spending and boost energy efficiency, complying with a longtime G-20 goal of reducing energy subsidies.

Much of the agenda, especially efforts to tighten capital and liquidity standards and other financial regulations won't be decided until the next G-20 leaders session in Seoul in November.

"What's left over for Seoul?" asked Hyun Song Shin, an adviser to South Korea's president. "Everything."

The G-20 toughened its ambitions, noting it wanted a level of capital that would enable banks to handle ""without extraordinary government support – stresses of a magnitude associated with the recent financial crisis." Previously, the G-20 hadn't set a qualitative goal.

But there remains hard bargaining ahead, particularly on setting a specific number as to how much capital is sufficient. A meeting in Basel, Switzerland, in July is aiming to make progress on that issue. Mario Draghi, chairman of the Financial Stability Board, which is working on the regulations, in a letter to G-20 leaders, noted that "good progress has been made in recent weeks towards new global standards to strengthen bank capital and liquidity, and limit leverage."

U.S. and European countries remain divided on an international leverage ratio and on whether to recommend taxes on banks. The U.S., Germany, U.K. and France back a levy to pay for the costs of bailouts while countries including Canada, Brazil and India, which didn't have to lay out public funds to recapitalize banks, oppose the idea.

President Obama added to the Seoul agenda when he said he wanted to rework parts of the Korean Free Trade Agreement during negotiations with South Korea and have a deal in hand by the Seoul summit.

—Nirmala Menon, Monica Gutschi and Ian Talley contributed to this article.

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