Leaders of G-20 Vow to Reshape Global Economy

By Edmund L. Andrews
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PITTSBURGH — One year after a financial crisis that began in the United States tipped the world into a severe recession, leaders from both rich countries and fast-growing powerhouses like China agreed on Friday to a far-reaching effort to revamp the economic system.

The agreements, if carried out by national governments, would lead to much tighter regulation over financial institutions, complex financial instruments and executive pay. They could also lead to big changes and more outside scrutiny over the economic strategies of individual countries, including the United States.

"We have achieved a level of tangible, global economic cooperation that we've never seen before," President Obama said shortly after the summit meeting of 20 leading economies concluded here. "Our financial system will be far different and more secure than the one that failed so dramatically last year."

The leaders pledged to rethink their economic policies in a coordinated effort to reduce the immense imbalances between export-dominated countries like China and Japan and debt-laden countries like the United States, which has long been the world's most willing consumer.

The United States will be expected to increase its savings rate, reduce its trade deficit and address its huge budget deficit. Countries like China, Japan and Germany will be expected to reduce their dependence on exports by promoting more consumer spending and investment at home.

The ideas are not new, and there is no enforcement mechanism to penalize countries if they stick to their old habits. But for the first time ever, each country agreed to submit its policies to a "peer review" from the other governments as well as to monitoring by the International Monetary Fund.

That in itself would be a big change, given how prickly national leaders have often been toward outside criticism of their policies. American officials, who pushed for the plan during weeks of negotiations before the summit meeting, argued that governments were so shocked by the economic crisis that they were willing to rethink what was in their self-interest.

"I'm quite impressed," said Eswar S. Prasad, an economist at Cornell University who had initially been skeptical about the proposed "framework" for stable growth. "A commitment by the U.S. to take the process seriously is a potential game-changer that would give the framework some credibility."

The outcome was revealed the same day the leaders formally announced that discussions about global economic issues would shift permanently from the Group of 7 big industrial nations — the United States, Britain, France, Canada, Italy, Germany and Japan — to the Group of 20, which includes China, India, Brazil, South Korea and South Africa, reflecting the increased clout of fast-growing developing nations in the global economy.

The decision reflected both symbolic and practical needs. Poorer but fast-growing nations have long complained that their influence on global policy has lagged behind their economic role. As a practical matter, China and other developing countries played a central role in fighting the global downturn by undertaking aggressive stimulus programs in concert with the United States and Europe.

American officials had been negotiating with their foreign counterparts for months before the summit meeting, and the agreements endorsed on Friday were mostly pledges rather than binding commitments.

One of the most important elements of the agreement calls on the Group of 20 countries to require higher levels of capital at banks and other financial institutions. The goal is to reduce risk-taking by forcing institutions to keep bigger reserves as a buffer against unexpected losses or disruptions in credit markets.

The Group of 20 communiqué outlines a long set of principles for tougher rules, and governments pledged to develop “internationally agreed” regulations by the end of 2010.

But the communiqué includes no specific numbers on how high capital reserves should be, and there are big disagreements over that issue.

French and German banks generally have lower capital reserves than their American rivals, and European officials have complained that their banks could be at a disadvantage because they would have to set aside more money to meet new requirements. Japanese officials have warned that they need to pursue their own approach, contending that Japanese banks are inherently more conservative than American banks.

Similarly, American and French officials disagreed before the summit meeting on how to clamp down on executive pay. Officials on both sides agreed that executive bonuses contributed to the financial crisis by rewarding short-term performance without regard to longer-term risks. But French officials wanted to impose specific caps on bonuses, perhaps based on a percentage of a bank’s profits.

American and British officials thought specific caps were too rigid, and pushed for rules that would defer the payout of bonuses for several years and reduce the incentive for people to take short-term gambles. The American view prevailed, but that does not preclude governments from imposing tighter restrictions.

For all the unanswered questions, the final communiqué covered an extraordinary number of complex financial issues. The leaders agreed, for example, to devise policies by the end of 2010 for closing troubled financial institutions that were considered “too big to fail.” They also agreed on the need to regulate financial derivatives, endorsing the approach proposed by the Obama administration in its bill to overhaul the regulatory system.

They also renewed their vow to give China and other Asian nations a bigger share of the vote at the International Monetary Fund and the World Bank. Asian countries have long complained that their stakes no longer reflect their financial contributions.

In another nod to developing countries, the leaders agreed to revive talks to reach a new global trade agreement by the end of 2010 that would, among other things, reduce barriers to agricultural exports. The goal may be optimistic: the Obama administration has shown no enthusiasm for new trade deals, and many Democrats want to see more protections rather than fewer.

The big question is whether the Group of 20 will be more effective because it includes important new players like India and Brazil, or whether it will simply be more unwieldy.

American officials acknowledged that the economic crisis crystallized priorities of countries with normally conflicting agendas in ways that occur only rarely in normal times. But they said they were betting that individual governments would see their self-interest as more tied than before to the stability of the rest of the world.

“The announcement today is more than symbolic,” said Robert M. Kimmitt, who served as deputy Treasury secretary under President George W. Bush. “The fact that leaders are turning to the strategic challenge and doing it in a coordinated way at the level of the Group of 20 is significant.”