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A Sinking Feeling at the Group of 20 Summit

By Martin Gilman

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Even low expectations can be disappointed. President Dmitry Medvedev and the other Group of 20 leaders, who are in Seoul for their fifth summit in two years on Thursday, cannot relish the prospect of a wasted trip and, even worse, of a wasted opportunity. Since these much-hyped gatherings began amid high expectations in November 2008, their value-added has declined, and few can anticipate meaningful results.

For the Russian delegation, the best that can be expected will be a lack of public conflict and a photo appearance of harmony. If the preparatory meeting of finance ministers two weeks ago was any indication, even that outcome may be too much to hope for. Brazil's finance minister, warning of a "currency war," didn't even go, and China and India publicly underscored that their patience was running out.

The United States, relying on the only hope left in its economic arsenal, last week decided to print enough money to pay for the entire federal budget deficit next year. Ironically, this move contradicts the most fundamental advice that the International Monetary Fund gave to Russia throughout the 1990s — to never use the Central Bank to finance the government. The Chinese interpreted the announcement by the Federal Reserve to purchase $600 billion in U.S. Treasury bonds as a blatant attempt to provoke a depreciation of the dollar, which will give U.S. goods and services a competitive advantage. With this resort to quantitative easing by the Federal Reserve without regard to the global consequences, the United States has put the remaining players in this risky game of musical chairs into a quandary. Perhaps unintentionally, each member of the G20 is trying to solve its own problems at the expense of the others. The game will end presumably when emerging market economies, including China, become an unsustainable bubble — or, more likely, considering recent trends in bond prices, when the relentless appreciation of the euro forces a deflationary debt crisis in the European periphery. In the process, Russia will not be spared.

To be sure, the other global players are not passive. Japan and Britain have loosened monetary policy further, while the European Central Bank is perhaps more reluctantly being forced to buy more Greek, Portuguese and Irish bonds as markets have turned against some sovereign debtors. Despite such actions, if the euro were to appreciate further against the dollar, the political pressure within Europe to intervene would be hard to resist. Meanwhile, China continues to thwart both political and market pressures for more rapid nominal appreciation of the yuan, Russia has managed a small depreciation of the ruble in recent weeks, and Brazil, Indonesia, South Korea and Thailand have taken various steps to stem large short-term capital inflows, exchange-rate appreciation and inflationary risks.

At least by its timing, the G20 summit in Seoul may be the last, best hope to avoid a protectionist trade and currency war. It is hard to imagine that any of the major players will take the lead to forge a workable compromise.

In principle, Russia could play a pivotal role. It is the richest of the BRICs on a per capita basis and the only one with a completely convertible currency. It strategically straddles East and West, and it is the largest energy producer and the third-largest holder of currency reserves in the world. As a creditor with a keen interest in a well-functioning international financial system and even the ambition to become more central to global finance, Russia is well placed. Although Russia has a managed peg exchange rate — driving it much closer to China than, say, Brazil — it seems to be seen as neutral in the quarrel between the United States and China, which forms the basis of the "currency war."

But to be taken seriously, a country should be pursuing policies that are viewed as an example of success — or at least coping successfully — in the eyes of the world. Unfortunately, Russia, despite an enviable set of natural and economic endowments, does little to warrant such a reputation.

Ironically, earlier this year Russia seemed to have understood. From Medvedev on down, the analysis and policies set out in "Go Russia!" — published just over a year ago — were seen as the belated blueprint to transform the country. Most notably, inflation was finally brought down and presumed to be tamed with a three-year plan to control budget spending and a monetary policy aiming at inflation rather than the exchange rate.

Since then, the allure of high oil prices and competition for more spending in the face of flaccid intellectual firepower to defend the budget plan has resulted in a loss of nerve, a resurgence of inflation, lackluster economic performance and a worrying concern for the future direction of economic policy. These are hardly ideal conditions for Russia to stand tall among the G20, much less to pretend to assume a leading or at least mediating role. But if no country takes up the challenge to defuse a budding currency war, the road ahead is uncertain.

The global economy does not need to be a zero-sum game. In fact, all countries would be better off if cooperation could prevail. Therein lies the difficulty since each country, in the absence of leadership, focuses on how to export its unemployment through relative currency depreciation.

History does not necessarily repeat itself, yet current circumstances in a dysfunctional global economy are a disturbing reminder of an earlier futile attempt by the major world powers to avert exchange rate and trade wars, which then proved to be the precursor for a different, much more destructive war. Like this week’s G20 summit in Seoul, the London Economic Conference in July 1933 raised expectations of a global currency deal to resolve tensions between creditor and debtor countries. But any possibility of currency stabilization was debunked by U.S. President Franklin Roosevelt, who insisted on U.S. reflation and took the United States off the gold standard.

The current stance of China and other creditor countries is eerily reminiscent of Roosevelt’s position. French President Nicolas Sarkozy, who takes over as the head of the G20 at the end of the Seoul summit, is likely to find that his stated goal to make the G20 more effective will be sorely disappointed.

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