# G8 ignores mounting problems in world economy

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In its early years, the heads of government meeting now known as the G8 was regarded as a means of co-ordinating the policies of the major capitalist powers to try to overcome major problems in the world economy.

Those days have long gone. At the conclusion of this year's summit the state of the global economy was listed under "Other Issues" in the official summing up. The statement noted merely that "global growth remains strong and has become more broadly based" while there was also discussion on "high and volatile energy prices, global imbalances and growing protectionism". "We re-iterated our commitment to address global imbalances, working together to remove distortions to the global adjustment process, promote liberalization of trade and investment, and modernize the international financial institutions."

The scant attention to the global economy, let alone any discussion of co-ordinated economic policies, is remarkable given the fact that, despite continued economic growth, the world economy is facing a series of problems as serious as any since the so-called Asian economic crisis of 1997-98.

Oil prices are hitting new records, with predictions that they could reach as much as $100 per barrel, the risk of a slowdown in the US economy is increasing, there is a simultaneous tightening of interest rates in the three major economic regions for the first time since the early 1980s, growth remains sluggish in Europe and agreement has yet to be reached on the Doha Round of trade negotiations, with the prospect that failure to do so will bring increased protectionism.

The stalled Doha Round was the subject of intense discussions on the final day of the summit following an intervention by World Trade Organisation director-general Pascal Lamy.

Lamy, who was mandated by WTO negotiators to try to bridge the gap in the trade talks after they broke down on July 1, indicated that progress towards narrowing differences over the past two weeks had only been "marginal".

"The deadlock in which we are caught will lead us to failure very soon if you do not give your ministers further room for negotiation," he told the meeting.

"A failure would send out a strong negative signal for the future of the world economy and the danger of a resurgence of protectionism at a time when the pace of globalisation is weighing heavily on the social and economic fabric of many countries and when geopolitical instability is on the rise."

The main sticking points are the demands by the US and the EU for further concessions from the so-called developing countries, led by Brazil and India, on tariff reductions on industrial products, and demands that the EU offer bigger cuts in farm tariffs and the US reduce agricultural subsidies.

It appears that there are sharp differences within the EU. According to a report in the *Financial Times*, while the European Commission president José Manuel Barroso, British prime minister Tony Blair, German chancellor Angela Merkel and Italian prime minister Roman Prodi all struck an optimistic note, the French president Jacques Chirac said the EU had reached the outer limit of its negotiating mandate.

"We have made enough concessions, unless there is a very important counter offer by our American friends," he told reporters at the conclusion of the summit.

There is little sign of movement on the US side. American negotiators have insisted that the US needs new markets for its agricultural exports but India and other poorer countries have so far rejected US demands on the grounds that they have to protect small farmers.

Before leaving St Petersburg, Sean Spicer, the spokesman for US trade representative Susan Schwab, repeated American claims that others had to move more than the US. On the other hand, an EU official commented: "If the US is calling for ambition in market access, it needs to show similar ambition in terms of reducing farm subsidies."

The conflicts over trade indicate that the reason there is so little discussion on the imbalances in the global economy—the ever-increasing US deficits financed by the central banks of East Asia—is because no common approach can be agreed to on their resolution.

During the late 1990s in the wake of the Asian economic crisis, there was considerable discussion on the need for international co-operation and a new global financial architecture. But at the St Petersburg summit one of the most significant economic events of the recent period passed without comment.

The decision by the Bank of Japan (BoJ) last Saturday to lift its overnight call rate from zero to 0.25 percent ended the six-year long zero interest rate regime. The BoJ said the decision was necessary because leaving rates at zero could lead to "large swings in economic activity and prices in the future". The move has far-reaching implications both for currency relationships as well as the financial flows which have sustained the $800 billion US balance of payments deficit.

It means that for the first time since the early 1980s, the Bank of Japan, the US Federal Reserve and the European Central Bank are all tightening interest rates and draining away funds that have been used to finance the assets boom of the past period.

Japanese rate tightening has particular significance because funds raised in Tokyo have played a key role in financing so-called carry trades in which funds raised at a cheap rate in one market are used to finance risky trades in others.

The question now being asked is whether the BoJ decision will be followed by further increases which would immediately impact on the world economy. As the *Financial Times* noted yesterday: "Future rises in Japan's interest rates could encourage Japanese investors to invest their money at home rather than abroad. The danger is that this could lead to a higher yen and a fall in the value of foreign assets as a result of lower demand. Less investment in US assets could bring a bursting of the US housing bubble and a brake on consumer-led growth, spreading economic pain across the world."

The economics correspondent of the British *Daily Telegraph*, Ambrose Evans-Pritchard, described the policy shift as an "epochal turning point", noting that Japanese pension funds, insurers and individuals hold funds abroad of $2,500 billion, almost equivalent to the overseas holdings of the rest of the world. "If they repatriate part of this money to exploit rising returns at home, the world will feel the tremors."

As with all the summits of the recent period, the St Petersburg gathering prompted comment on the relevance of the G8.

An editorial in the *Australian Financial Review* on Monday took up the issue of the Doha Round insisting that it would be "unacceptable if the St Petersburg G8 only manages to produce the sort of glib, motherhood communiqué which is almost invariably the production of these summit meetings."

To have met and failed to make a contribution to dealing with the challenges confronting the global economy "would not only be a lost opportunity but would also leave the value of G8 summits in greater doubt," it said.

Similar sentiments were voiced on the other side of the world. According to *Financial Times* columnist Wolfgang Munchau: "The multiple failures of the St Petersburg summit raise the question of whether the Group of Eight leading industrial nations still serves a useful purpose. The reason is not a lack of important issues that require global co-ordination. On the contrary, rarely has there been a greater need for joint action. But no matter whether you want to rescue a failing trade round, improve energy security or influence the global financial markets, the G8 is the wrong group."

Munchau wrote that the problem of global imbalances, which had become more acute in recent years, had to be addressed by a Group of Four consisting of the US, the eurozone, Japan and China.

But a G4 would no more be able to address the issue of global imbalances because the problem is not the numbers involved or the diffuse agenda but the conflicting interests of the major powers.