Conference on

Global Cooperation for Sustainable Growth and Development

Views from G20 Countries

A SUMMARY BASED ON CONFERENCE DELEBRATIONS

September 13-14, 2011

Gulmohar Hall
India Habitat Centre, New Delhi

A two-day international conference on, "Global Cooperation and Sustainable Growth and Development: Views from G20 countries," was organized on September 13-14, 2011 in New Delhi by the Indian Council for Research on International Economic Relations (ICRIER) with support from the ADBI Institute, Chatham House, the IMF, the Konrad-Adenauer Stiftung and the World Bank.

The conference was addressed by eminent academics and policy-makers, of whom 20 were international participants representing 12 countries and 20 were Indian participants. Special addresses were delivered at the conference by Pranab Mukherjee, Finance Minister of India, Montek Singh Ahluwalia, Deputy Chairman of the Indian Planning Commission, Kemal Dervis, Vice-President of the Brookings Institution and former Finance Minister of Turkey, and R. Gopalan, Secretary of the Department of Economic Affairs in the Indian Ministry of Finance. Their speeches are on ICRIER's website.

This was the third in a series of international conferences on G-20 issues organised by ICRIER and its partners, the earlier two conferences having being held prior to the Toronto and Seoul G-20 Summit Meetings in 2009 and 2010 respectively. Continuing with this practice, this year's conference was held with a view towards the next G-20 Summit Meeting which is to be held on 3-4 November in Cannes, France.

The deliberations at the conference recognized that this forthcoming Summit would be specially challenging since it would have to respond to the new and immediate threats to world economic stability in the form of continuing slow recovery in the advanced economies, political uncertainties in the US and the unfolding sovereign debt crises in Europe. At the same time it would have the responsibility of carrying forward the long-term tasks set by previous Summits of reforming global economic governance and advancing the development agenda. It was felt that these challenges could be addressed only by carrying forward the spirit of mutual cooperation and the ability for decisive action which enabled the G-20 to take the lead in the global economic policy response when the crisis originally emerged and grew out of all proportions.

The work of the conference was divided into six sessions on financial sector regulatory reforms, global imbalances, the international monetary system, capital flows and financial safety nets, the development agenda and commodity markets and food security. We report below some of the key issues discussed in these sessions.

Financial Sector Regulatory Reform

The endorsement of the Basel III norms at the Seoul G-20 Summit had marked a major step forward for global financial sector regulatory reforms. The greater capital-adequacy requirements and the liquidity norms specified in Basel III would make the banking sector more resilient to negative shocks in the time to come. However, the timetable of the implementation of Basel III is very long—implementation is required to begin only by 2013 and is required to be completed only by 2019—and therefore its impact would be felt only over the medium term.

While Basel III was a welcome step forward, it also suffers from a number of shortcomings. First, the Basel norms apply only to banks. Yet it was not in the banks but in the non-banking financial institutions, the so-called "shadow banking system", that the present financial crisis originated. Basel III does not address the problem of excessive risk-taking and moral hazard in this shadow banking system. The Financial Stability Board (FSB) has already started some exploratory work regarding non-banking institutions and the Cannes Summit should put the task of regulating them firmly on the agenda.

Second, even as far as banks are concerned, Basel III is a 'one-size fits all' solution—the same capital-adequacy and liquidity norms have been specified for all countries. This may not be appropriate given that banks play a much larger role in financial intermediation in developing countries than in developed countries. Therefore, developing countries would feel much more sharply the negative impact on output growth that would arise from the constraints on the growth of the banking sector due to the Basel III recommendations. A comparison of costs and benefits would thus suggest that the additional prudential requirements on developing country banks should be lower than those on developed country banks. Other forms of regulation such as sector-specific credit caps can be allowed to play a larger role in developing countries to ensure that financial stability is maintained despite scaled back prudential requirements.

Third, while Basel III had a macroprudential component in terms of countercyclical capital requirements, its focus was predominantly microprudential. However, the present financial crisis was not primarily due to the failure of microprudential regulation. The amplification of a crisis originating in the US sub-prime market into a global crisis can be understood only once we account for the role played by interlinkages among financial institutions and shared exposures among institutions. When many financial institutions hold similar portfolios, fire-sales of assets by one distressed firm, which causes the prices of those assets to fall, ends up impacting the balance sheets of other firms that hold the same range of assets, causing the spread of financial distress. There is a pressing need to make further progress on macroprudential regulation that would address this systemic risk that arises from such interactions among firms. At the Cannes Summit the FSB is expected to propose criteria for the identification of Globally Systemically Important Financial Institutions (G-SIFI), a set of additional capital requirements to be placed on such institutions, and methods of resolution when such institutions fail. There has been some pushback from financial institutions against these measures on the grounds that they would further slow down economic recovery. However, the Cannes Summit should go ahead with the measures since it is in stressful economic conditions like the present that financial failures are more likely and therefore safeguards against financial fragility are most needed. The reform of OTC derivatives markets and commodity markets is another area in which the Summit has the opportunity in making major progress.

Global Imbalances

While discussing global imbalances, it must be recognized at the outset that not all imbalances are bad. Current account deficits and surpluses, and the capital flows that finance them, are a form of trade across time. They allow some countries to consume and invest more than what is allowed by their domestic savings at present in return for allowing other countries to do the same in the future. In an ideal world this intertemporal trade should increase welfare in exactly the same manner that free trade in goods and services does. To this extent imbalances can be beneficial. Imbalances become bad in the presence of distortions in the functioning of markets. One such source of distortions is the inability of financial markets to correctly assess risks and the moral hazard created by explicit or implicit government guarantees to institutions that create risk. This distortion may lead to excessive international borrowing which finances consumption and asset-price bubbles, as seen in the East-Asian crisis as well as in the current crisis. It is these bad imbalances that need to be addressed by global policy.

The imbalance on which the greatest attention has been focussed is the large current account deficit of the US and the large current account surplus being run by China. Different explanations have been given for the existence of this imbalance. Some have attributed it to misguided policies: the low interest rate policies pursued by the US Federal Reserve since 2000, Chinese exchange rate policies of maintaining an artificially undervalued Renminbi and the decision by emerging economies to accumulate large, precautionary foreign exchange reserves following the East-Asian crisis. Others have attributed the imbalance to structural sources such as demographics, high Chinese savings propensities and the greater liquidity and credibility of the US financial system through its role in the global trade and payments system. Regardless of the source, the general consensus is that the high and sustained US current account deficit and the growing US external debt they have given rise to are not sustainable. If the imbalance is allowed to continue there is a risk of a market-driven readjustment taking place in the future that would overshoot its target and create additional economic disruption.

The pressing need for rebalancing, however, is to be tempered with a realization that the world also needs a satisfactory level of *absolute* economic growth. At least this is the prevailing global view though, by itself, this may not be a tenable position and the prevailing global experience may require belt-tightening across the board. In any event, this growth is at risk right now. The continuing deleveraging in the OECD countries has led to a very slow pace of economic recovery. The future prospects of recovery have been put in further danger by the still unfolding sovereign debt crisis in Europe. In the face of these risks to growth, too many countries are trying to ensure export-led growth, not realising the futility of all countries trying to export while cutting back on imports. As a result, the inter-temporary arrangement described above is liable to break down. Given this environment, it is essential that any policies undertaken for global rebalancing do not end up further endangering global economic recovery and growth.

Prior to the present crisis, expansionary fiscal and monetary policy in the US had made the US the leader of world economic growth, allowing other countries to run current account surpluses and follow an export-led growth strategy. A continuation of this arrangement does not seem to be either a likely or a desirable solution for the present global economic predicament. First, at present there seems to be limited domestic political support for expansionary policies in the US. Second, with US nominal interest rates at their zero lower bound and the US administration's fiscal stimulus plan having had only a limited impact, the economic effectiveness of US fiscal and monetary policy instruments is itself doubtful. Finally, and most importantly, a recovery driven solely by US demand would only aggravate the problem of global imbalances.

What the world needs is a cooperative solution in which there is a sufficient increase in spending in surplus countries, a sufficient decrease in spending in deficit countries and an adequate change in relative prices to bring about expenditure switching. This in turn would require a global rule-based institutional framework for supporting good national policies and coordinating them for the sake of systemic goals. The G-20 Mutual Assessment Process (MAP) has the potential to play this institutional role. With the G-20 agreeing this year, as a part of the MAP, on a set of indicators for assessing internal and external imbalances and indicative guidelines against which the imbalances are to be judged, it is expected that an Action Plan to address these imbalances will be adopted at the Cannes Summit. During the negotiations on the MAP indicators China had opposed the explicit inclusion of the current account deficit as one of the indicators and, given its aggressive posture, it is unlikely that the Cannes Summit would bring about any immediate change in policy direction. While, the continuing discussion of the global imbalance problem in a multilateral setting and the willingness at least in principle of countries to address this problem in a rule- and data-based framework may be an achievement in itself, slow actual progress carries the seed of a free-falling global depression in the making.

The International Monetary System

International monetary and financial arrangements since the breakdown of the Bretton Woods system in the early 1970s have been characterised as a 'non-system': countries are free to choose their exchange rate and capital control policies as they see fit without any international obligations. In practice, the US dollar plays a central role. A large proportion of official foreign-exchange reserves are held in dollar-denominated assets; a large proportion of international trade and financial transactions are denominated in terms of the dollar; and many countries manage the exchange rate of their currencies to keep them stable against the dollar.

Since the outbreak of the economic crisis this 'non-system' has come under increasing criticism on a number of grounds. First, the lack of an international framework governing exchange rate and capital controls creates the possibility of international disputes. Indeed, they have increased in the post-crisis economic environment more fraught with disputes. Examples are the ongoing exchange rate dispute between the US and China and the opposition of emerging countries to the spillover effects of expansionary monetary policy in the US. Second, the outbreak of the crisis has brought to focus the fact that the present arrangements do not have any systematic mechanisms to meet global liquidity shortages. Excessive holdings of foreign exchange reserves by emerging countries to self-insure themselves against international liquidity shortages have imposed unnecessary costs on these countries and have also contributed to the problem of global imbalances. Third, to the extent that countries peg or manage their exchange rates against the dollar, they lose their monetary policy autonomy while the US remains free to set its monetary policy to meet its domestic objectives.

These shortcomings have led to growing demands for a reform in international monetary arrangements. Many commentators believe that a multi-polar international monetary system (IMS) is a natural counterpart to a world economy which is itself becoming increasing multi-polar. A delay in the transition to such a multi-polar system is likely to lead to an intensification of conflicts and uncertainties discussed above as the US becomes increasingly unable and unwilling to play its role of global monetary anchor. There is also the risk of the decreasing economic predominance of the US leading to an abrupt market-driven shift away from dollar assets, which could be disruptive for the global economy.

The Renminbi and the Euro are the natural candidates for joining the dollar in a multiple-currency based IMS. There would be an increase in transactions costs arising from the use of multiple currencies in international trade and financial transactions but these costs are likely to be more than offset by the benefits of diversification and increased discipline imposed on reserve currency issuers.

Despite these benefits, a multiple-currency-based IMS can only be a long-term solution since neither the Euro nor the Renminbi is in a position to challenge the domination of the dollar at present. The position of the Euro as an international currency suffers from the fact that, while Europe has the most developed financial markets after the US, these markets are still fragmented along national lines—there is no unified Eurobond market. Also, the European Union lacks the political cohesion and authority of a national government. These shortcomings have become painfully evident in the course of the recent sovereign debt crises in Europe. In the case of the Renminbi, China has so far taken only the first steps in internationalising its currency. It will have to further develop its capital markets and allow its exchange-rate to be determined more freely in order for the Renminbi to become acceptable as a reserve currency to other countries. Given its dependence on an export-led growth strategy which benefits from an undervalued Renminbi, China is unlikely to move towards these goals rapidly.

Another proposal for IMS reform which has been discussed in G-20 forums is to give a greater role to the IMF's Special Drawing Rights (SDRs) as a reserve asset. This would create wider opportunities for diversification in countries' reserve assets as well as providing a neutral venue for international monetary coordination. At present the total allocation of the SDRs is a very small proportion of global reserves. This is due to creditor nations' opposition to SDR allocation on the grounds of monetary conservatism. The demand for SDRs is limited also because they can only be used through official channels. For the SDRs to play a greater role, the IMF has to agree on increasing the stock of SDRs, perhaps through regular annual allocations, and on redistributing the stock to countries actually in need of international liquidity. Also, given the large stock of existing dollar reserves, countries must be given ways to exchange dollar reserves for SDRs through a 'substitution account'. These are challenging issues that should be taken up by the international community, perhaps beginning at the Cannes Summit.

Simultaneously, there are proposals to expand the SDR basket to include emerging market currencies, particularly the Renminbi. The latter proposal is presently stuck on the IMF's insistence that currencies included in the SDR basket be "freely usable". It would be a positive move for the democratization of global economic governance if a criteria-based path could be found for expanding the SDR basket that respects the need for flexibility but does not amount to imposing particular exchange rate policies on countries whose currencies would be part of the basket.

Financial Safety Nets

The experience of financial and balance of payments crises in the last few decades, including the current financial crisis, shows that a crisis arising from a single country can very easily turn into a systemic crisis. This happens through a number of channels: direct trade and financial linkages, reassessment of the riskiness of a class of countries after one of them faces a crisis, and distress sales of assets by financial institutions in creditor countries exposed to the crisis-struck country. Contagion through these channels not only affects vulnerable countries but also countries with sound policies and economic fundamentals—the 'innocent bystanders'.

Given this contagious nature of financial crises, international financial safety nets have a number of important roles to play. First, financial safety nets act so as to mitigate a crisis in progress, helping countries struck by the crisis as well as the 'innocent bystanders'. Second, financial safety nets help to prevent speculative crises by increasing the confidence of asset holders. Third, financial safety nets provide an alternative to inefficient and potentially destabilising attempts by countries to protect themselves from crises through reserve accumulation and the imposition of capital controls.

At the outbreak of the present crisis the only form of formal financial safety net available was the traditional channel of IMF lending. Emerging countries did not utilise this channel to a great extent due to the stigma attached with borrowing from the IMF and the distrust of IMF conditionalities, Instead, they relied more on their own reserves as well as on ad hoc arrangements such as bilateral swap agreements with the US Federal Reserve. The London G-20 Summit in 2009 substantially increased the IMF's resources. The IMF has also introduced two new forms of financing—the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL)—that were designed as crisis-mitigation and crisis-prevention instruments to supplement IMF's traditional lending to support balance-of-payments requirements. IMF disbursements have accordingly played a role in crisis prevention.

Despite these advances, the global financial safety nets still suffers from deficiencies of both size and speed. Resources available to financial safety net arrangements are still a small fraction of world GDP and a shrinking fraction of world financial flows. Further, the need for prequalification for access to financing arrangements such as the FCL and the need to obtain domestic support in creditor countries for additional resources while a crisis is in progress reduce the flexibility of these forms of financial safety net.

One way to increase the resources available to the financial safety nets would be to allow the IMF to raise resources through novel methods including SDR allocations, borrowings from markets and borrowing from countries. However, allowing the IMF to borrow from the market carries with it the danger that the IMF would become captive to precisely the same speculative market sentiments that it would need to fight in the midst of crises. An increase in resources can also come through more formal links between the IMF and regional financial arrangements (RFAs) as well as through ex ante swap agreements among central banks. The flexibility of the financial safety nets can be improved by making access to funds more automatic. The limited demand for the IMF's FCL facilities in this crisis shows that the fears that a more automatic access to funds would lead to excessive borrowing and moral hazard are misplaced at the present level of maturity of the global financial safety nets.

Capital controls

A contentious issue that is likely to feature at the Cannes Summit is that of capital controls. Countries such as Brazil have imposed capital controls as a result of a surge in capital inflows which they blame on the easy monetary policy in the US. These countries have reacted negatively to the IMF's proposals that countries should impose capital controls only as a measure of last resort and not as a substitute for sound macroeconomic policies. Unfortunately, this negative response seems more of a knee-jerk reaction to a perceived encroachment of national sovereignty rather than being based on solid facts. In fact there seems to be a broad agreement in the research literature that capital controls cannot compensate for fundamental macroeconomic imbalances. At best they can improve the quality of capital inflows by increasing the proportion of longer-maturity flows. For example, despite India's complex system of capital controls, it has not been able to achieve its objective of defending a managed exchange rate regime. The obverse side of the limited effectiveness of capital controls is that there is a greater need for international coordination on monetary policy than the advanced countries have been willing to accept so far. Quantitative easing in the US is no longer a purely domestic matter if other countries cannot successfully isolate themselves from its macroeconomic ramifications.

Development Agenda

Labour Markets

As globalization progresses, international trade and labour markets across economies are becoming more integrated. Demographic changes such as shrinking and ageing populations and gender imbalances, climate change, and growing ethnic diversity, all pose challenges for appropriate functioning of the labour market. Both developed and developing countries face problems of skill matches in their labour markets. There exists an excess supply of unskilled labour and an excess demand for skilled labour. Eight focus areas to meet these challenges emerged out of the deliberations of the conference, namely, infrastructure, institutions and investment climate, migration and labour mobility, macroeconomic environment, urbanization and rural-to-urban migration, labour market regulation and job creation, social protection and safety nets, education skills and human capital, environment, climate change and natural disasters. All these eight areas must be addressed with an employment generation strategy. While macroeconomic issues have dominated the discussion in the G-20, achieving the development goals requires not just growth but also job creation. Moreover, it is not just the number of jobs but their quality which is important from the development perspective.

For example, recent ADB data reveals that, while developing Asia has low rates of unemployment, a large fraction of the jobs are in the informal sector. Informal employment is associated with lower income, underemployment, less security and absence of social security nets. Workers in the informal sector have much less access to benefits such as pensions, sick leave and maternity leave. The large proportion of informal jobs is in part due to the dependence of these countries on low-wage manufacturing for stimulating growth and to restrictive labour policies and uncompetitive market structures in the formal sector.

There needs to be a concrete and practical jobs strategy which will be executed through policies on education and training, labour market, diaspora and migration. Vocational training could be provided through apprenticeship programs that are directly related to jobs. Combining public employment programmes and job creation schemes with on-the-job training should reduce qualification mismatches in the labour markets. It is also important to establish active labour market programmes promoting self-employment. Workfare programmes prove to be better methods rather than unconditional cash benefits to effectively fight poverty and India's The National Rural Employment Guarantee Act (NREGA) can serve as a role model in this regard. The wide nature of the Development Agenda that the G-20 has conceived, it is obvious that the challenges are many, and that it is not at all clear whether such a comprehensive agenda will turn out to be too formidable a challenge in an environment of a deep global financial crisis, the redressal of which has to be remain the prime objective of the G-20.

Resource Mobilisation

Domestic resource mobilization is necessary to recover from the current global economic slump. Domestic resource mobilization, along with foreign direct investment, will help countries build their productive capacity and increase labour productivity. Poor budget policies, existence of hard-to-tax informal sectors and weak tax administration have made domestic resource mobilization difficult. In the current circumstances, developing nations should allocate more resources to review the tax gaps in their systems. There is no one-size-fits-all way to do this. Different countries have adopted different measures successfully. For example, the UK uses macroeconomic data to estimate the aggregate value of transactions in the informal economy that has evaded taxation while the US uses mainly microeconomic data from different taxed sectors to estimate potential tax liabilities.

The choice of solutions will vary according to the cause of the tax gap. If procedural incoherence or excessive complexity of the tax rules accounts for part of the gap, simplification of the tax system will help, as has been the case in the US, UK, South Africa and Singapore. If the gap is due to a lack of information sources and disclosure, withholding taxes (or tax deduction at source) can be helpful. Enhancing accounting disclosure standards is also necessary. In case of weak enforcement of tax laws contributing to the tax gap, revenue authorities need to expand information reporting obligations, improve early detection and provide speedy resolution of non-compliance. Tax administrations also need to be careful regarding the cost-benefit tradeoffs in the allocation of their internal resources.

The absence of data is a principal impediment to controlling tax evasion. To enhance the accounting disclosing standards, the US Financial Accounting Standards Board (FASB) released FIN 48 which clarified how Uncertain Tax Positions (UTPs) are to be treated in the financial statements that adhere to the US Generally Accepted Accounting Principles (US GAAP). This UTP disclosure regime is highly desirable from the standpoint of tax administration. It promotes and fosters disclosures that are arguably vital in a system of self-assessment.

With globalization the impact of tax evasion has assumed a greater and international dimension. The scope for tax evasion has increased with the mobility of capital and identification and monitoring has become increasingly difficult with cross border transactions. To remedy this, in 2008, the G20 and the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") set out to secure the widespread global adoption of the OECD's Exchange of Information (EOI) standards. The primary aim of EOI is to prevent the frustration of domestic tax laws of one state with safeguards for privacy needs and the domestic interests of the assisting state.

Countries are also entering into bilateral withholding tax agreements. In August 2011, Switzerland signed agreements with Germany and the UK to withhold taxes on future investment income and capital gains of German and UK residents. Since such a withholding tax is considered as having a long-term impact equivalent to the automatic exchange of information, these agreements are likely to influence debate within the EU, and also provide guidance for emerging economies regarding methods to combat tax evasion through utilisation of tax havens.

Tax amnesty programmes have also been used by tax authorities to target taxpayers who under-declare their taxable income. These programmes tend to be useful in the short run in cases involving foreign income where the enforcement powers of the tax authority is limited. However, tax amnesty programmes do not have the potential to increase long term compliance rates. Some countries have also started shaming offenders by publishing the identities and details of tax evaders.

Infrastructure in the Asia-Pacific Region

Closing infrastructure gaps holds the key to sustaining Asia-Pacific countries' dynamism and inclusive and balanced development in a post-crisis scenario. Currently there are huge infrastructure investment gaps in Asia-Pacific. An ADB-ADBI study has estimated in the period 2010-20, Asia needs to invest US$8.3 trillion (about US$750 billion per year) in both national and regional infrastructure for energy, telecommunications, transport, water and sanitation.

While the Asia-Pacific region presently generates a large volume of savings, these are held as foreign exchange reserves or invested in Western securities in the absence of a well developed regional financial architecture. Infrastructure projects in developed countries attract far greater global private sector funding than developing economies in the region. The private sector's share in East Asia's infrastructure investment is as low as 5% (prior to the 1997 crisis it was 20%).

Though there are a number of initiatives, apart from ADB, to mobilize savings for financing infrastructure investment in Asia such as the Asian Clearing Union, ASEAN+3 Chiang-Mai initiative, Asian Cooperation Dialogue, SAARC Development Fund, SAARC Finance, and ASEAN Infrastructure Fund, most initiatives are at early stages and generally have limited scope and coverage. Clearly, there is room for expansion and speed in this area.

Efficient institutional intermediation between Asian savings and unmet investment needs a more developed regional financial architecture commensurate with Asia's stature as a growth pole of the world economy. To fully exploit the potential of financial cooperation, this architecture needs to cover different financing needs of the diverse and growing region. Crisis prevention and management, mobilizing regional savings, regional capital markets integration, higher cooperation among the trade financing agencies, exchange rate cooperation and evolution of a regional reform perspective, are some of the important elements of this regional architecture. As per the mandate given by the 66th session of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) held in Incheon, Korea, in May 2010, the ESCAP secretariat is elaborating the form and structure of such architecture needed for the Asia-Pacific region to facilitate infrastructure investments.

The ADB has also been playing an important role in financing and sustaining development in Asia. 'Strategy 2020' is ADB's long-term strategic framework, which has three pillars: inclusive economic growth, environmentally sustainable growth, and regional integration. The infrastructure core focuses both on building physical assets and related institutional/policy reforms, and aims at promoting investments in improving transport, communication, and energy connectivity within and among developing member countries. ADB recommends that leaders of G-20 economies need to ensure more efficient spending and facilitate unlocking infrastructure development projects in the pipeline. It also recommends developing bankable projects and minimizing associated risks. The ADB also suggests mobilizing private financing by deepening and linking the financial markets, especially local currency and regional bond markets, as well as through public provide partnerships such as special purpose vehicles (SPV's).

Commodity Markets and Food Security

While trends in production and consumption demand remain the main long-run drivers of commodity prices, recent commodity price spikes have drawn attention to new factors such as the developing linkages between commodity markets on one hand and energy and financial markets on the other, as well as the role of speculation in commodity markets themselves.. Among commodity markets, volatility in the market for food is particularly worrying since food crises have a large human cost and can contribute significantly to macroeconomic and social instability. Unilateral restrictions on trade by food-producing countries in times of crisis can make global food price volatility worse. Instead it is desirable to keep food trade open while taking collective international action to manage food price volatility. But this has become a difficult objective to achieve.

While earlier discussions on food security tended to pit market based solutions against government intervention, what is required today is both freer trade in food commodities and public buffer stock programmes to deal with large common shocks and to provide relief to the most vulnerable sections of society. Public stock holding is most necessary for commodities such as rice, which have thin global markets and in countries, such as India, which are so large that purchases by them in a bad year can significantly raise world prices. However, great care is needed in designing a public intervention programme. Price stabilization schemes with pre-announced price bands are open to speculative attacks. It is also possible that once an intervention programme is in place, excessive stocks can be accumulated for political reasons, which should be avoided.

The role of speculation in driving commodity price volatility has been much debated. Theoretically, speculation can both stabilize and destabilize commodity markets. Speculation is stabilizing when the speculators are confident about the fundamental forces driving the market, and sell when prices are high and buy when they are low. Speculation becomes destabilizing when sudden changes in market fundamentals makes speculators nervous, or when they act in a herd, buying when prices are rising, and selling when prices are falling, with these destabilizing trades being increasingly triggered by pre-set algorithms. While it is hard to conclusively prove the role of speculation in particular episodes of price volatility, many observers have agreed that the sharp spike in commodity prices between 2006 and 2008 is hard to understand on the basis of fundamentals alone. In order to curb speculation, commodity markets, including markets in food commodities, should be kept within the ambit of the stricter regulation of financial markets that is being put into place following the present crisis.

Rather than focus on volatility alone, international policy must, however, focus on the long-term tasks of promoting agricultural growth through investment and technological progress and of developing financial safety nets that should be able to shield the poor from the adverse effects of food price volatility.

Conclusion

The G-20 Leaders' Summit at Cannes would perhaps be the most important G-20 Summit after the London Summit of 2009 which had put the G-20 in a leadership position in global economic governance. Then, as now, the world economy seemed to be in the grip of a crisis the solution to which was beyond the reach of solely national and regional policies. The Leaders at Cannes will have to take decisive action to ensure that the goals of global growth and stability to which they have committed themselves are not jeopardized by the extremely slow recovery in the advanced countries and the unfolding sovereign debt crisis in Europe. But compared to 2009, they now have the advantage of having a proven track record of coordinated action and a set of reform initiatives which are already in motion. Cannes must build on these already existing successes of the G-20 to address present problems rather than letting itself be sidetracked by need for immediate firefighting.