

Creating a More Global Collaborative Asian Leadership for the G20 (Shanghai Conference)

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Executive Summary

On the eve of the first G20 summit to be hosted by a Asian country -the Centre for International Governance Innovation (CIGI), The Stanley Foundation (TSF), The Munk School of Global Affairs, University of Toronto, the Lowy Institute and The Shanghai Institute for International Studies (SIIS) invited leading experts to Shanghai to evaluate the prospects for collaboration and leadership by key Asian nations. The conference sessions focused on the Seoul agenda and the perspective of the summit's Korean hosts, the perspectives from the large emerging market powers, perspectives from the traditional advanced countries, other Asian countries including Singapore and Vietnam as well as the prospects for collaboration more broadly. The main observations and recommendations stemming from the -conference were:

- Notwithstanding the G-20 summits' legitimacy advantages over the traditional G8 leaders summits, the G20 has not yet solidified a permanent role;
- In the view of participants, the immediate challenge for the G20 is to follow through on the commitments and agenda from previous summits—particularly financial stability, governance reform for the Bretton Woods institutions, and strong, sustainable and balanced economic growth. The more ambitious vision of a G20 tackling the full sweep of the global multilateral agenda, while championed by some participants, was resisted by many.
- A few issue areas seemed somewhat logical directions for an expanded G20 agenda in the near- to medium-term. Korea has been pressing the topics of growth-led development and “green growth.” Other participants suggested the G20 leaders summit deal with the climate change financing issues in the Copenhagen Accord. And the G20 has already been discussing elimination of fossil fuel subsidies;
- All participants agreed that currency and exchange rates had become a major challenge for the G20 leadership. Although the Seoul summit might not fully resolve exchange rate friction, finding a framework for rebalancing between account surplus and account deficit countries would help multilateralize the currency issue and avoid a heated and possibly unhelpful bilateral US-China exchange over the

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dollar-renminbi exchange rate; competitive devaluation between the US and China others;

- While Korea's new approach to the development agenda drew praise for its comprehensiveness, rigor, and emphasis on local ownership, participants were concerned that the nine-pillar plan being prepared for Seoul may be seen as insufficiently concrete or connected to traditional donor-oriented development strategies promoted by the G8;
- Participants were impressed with Korea's outreach process to non-G20 nations, regional bodies and key international institutions, especially the UN Secretary General;
- Korean participants also described possible models for the establishment of a G20 secretariat to further support summit preparation, implementation and monitoring of national commitments, and the preservation of institutional memory;
- China's well known reluctance to embrace multilateral leadership clouds the picture for future global governance. While Chinese experts cite the many decades the United States took before embracing global leadership in the mid-20th Century, the challenges on today's international agenda could make it harder for China to resist pressures and expectations for its leadership. China's desire to protect its independence and freedom of action, especially over domestic economic matters, is understandable yet could erode the strength of the very global system that enabled China's rise. These tensions between sovereign prerogatives and the global economic commons are already emerging in the efforts of the G20. Conference participants from outside China noted sympathetically that expectations of Chinese leadership might be unfair and yet unavoidable.
- Despite the conference theme of collaboration among the Asian G20 states, participants resisted notions of special regional interests or a regional agenda in global forums. In part, this reflected concern that such collaboration could be a slippery slope to establishing an Asian caucus and afflicting the G20 with the same political bloc dynamics that have bedeviled the UN. But participants also offered their assessment that the nature of the 21st Century agenda promoted shifting coalitions on a variety of issues. It was also pointed out that the European countries caucus and largely avoid the label of a bloc. Such consultation in Asia may prove helpful in helping to fashion policies in global governance, though little appears to be occurring at present.

The emergence of the G20 summits as an important multilateral forum reflects a turning point in the changing global order in response to shifts in the distribution of economic power. The increase in Asian seats at this "High Table" of global diplomacy is likewise significant beyond mere symbolism, indicating the increased influence of key Asian states.

But it is less clear whether this broader Asian inclusion is accompanied by practical collaboration on their substantive concerns—or whether these states are embracing greater leadership responsibilities.

The Shanghai conference benefited from participants from all the Asian G20 countries except Japan (our Japanese colleague reluctantly had to cancel), as well as from Vietnam, Singapore, Canada, and the United States. Participants discussed the challenge for the G20 to its momentum; its potential for managing other transnational problems; and the role of US and China in forging a new multilateral world. A number of key questions remained open after thorough deliberation. Should the G20 mandate expand beyond global financial and economic matters? Should Asian G20 countries consult with each other more—not to create a regional caucus, but to develop through consultation ideas that could be taken to the whole G20?

Perspectives of the Korean Hosts

The hosts of the upcoming summit are pressing the so-called 'Korean initiatives', which would add growth-oriented development, new financial safety nets, and regularizing G20 outreach to its agenda. Korean participants in Shanghai noted that their country's experience from the 1997 financial crisis (not to mention the ROK's transformation from post-war devastation to OECD membership) gives it special credibility. As one participant noted, Korea's middle power status makes it well situated to serve as a harmonizer between the status quo G7 countries and status-challenging BRICS+ countries. More immediately, the challenge for Korea is to both preserve momentum on legacy issues from past summits and build consensus on issues that would extend G20's mandate into the future.

On the financial agenda, Korean participants noted recent progress 'legacy' items on financial regulation via the approval of Basel III. Looking towards a stronger safety net system Korean officials have worked with the IMF to improve flexible credit lines and introduce precautionary credit lines and globalization stabilization mechanisms. These reforms provide a buffer for reserve-poor states and also contribute to a broader effort to reduce self-insuring accumulation of foreign reserves and help lessen the imbalance between capital account surplus and capital account deficit states.

On the growth-oriented component of Korea's development initiative, delegates praised it as a substantive break from previous G8 approaches to global poverty. In the past, host countries simply sliced out a specific aid issue, usually related to the Millennium Development Goals, and sought funding pledges from others at the summit. A Korean delegate argued that these summit pledges were ineffective in tackling development challenges as well as out of touch with the needs of low-income countries. Korea has worked closely with South Africa in the G20's new Development Working Group and consulted with low-income countries to develop the nine-pillar development plan for the Seoul summit. The initiative was praised as being more comprehensive and effective, presumably, by its long-term multi-year action strategy, which includes mechanisms to

evaluate developmental needs and a transition plan for France and Mexico to monitor commitments to development initiatives.

Korean participants also highlighted their country's extensive process of outreach to non-G20 nations. Summit conveners have consulted with regional bodies, international institutions and have met with non-members on a regular basis to report back to G20 members. "Korea's decision to extend invitations to the United Nations Secretary General as well as to five non-members, Singapore as Chair of the 3G (Global Governance Group), Vietnam as the Chair of ASEAN, Spain and Ethiopia and Malawi as the Chair of NEPAD and the African Union respectively", would, Korean officials hope, "go a long way to address the representation deficit problem." It was also proposed that leaders at the Seoul summit should establish general operating principles for the invitation of non-G20 members and devise a scheme for the rotation of chairmanship.

The potential establishment of a secretariat structure is aimed at systematizing summit preparations, implementation and monitoring of commitments and the preservation of institutional memory. Alternatives to the traditional notion of a secretariat were raised, including a 'secretariat-non-secretariat' model and a two-tiered approach. The former suggests a revolving secretariat based on a "management troika" with Sherpas of the preceding, present and next summit hosts at the center. The two-tiered approach would add a permanent technical staff responsible for monitoring, archiving, record keeping and evaluating. Given sensitivities that a permanent secretariat would feed concerns about G20 usurpation of the UN, this could start with the experiment of a cyber or virtual secretariat.

Legitimacy: Outreach, Representation & Membership Structure

There was a general agreement among participants that the G8 is an exclusive club that no longer reflects current global power distribution. The elevation of the G20 in global governance is a significant step in bringing emerging market and developing states into the global decision making process. Nevertheless the fact that the G20 is a self-appointed body—without clear mechanisms to represent non-members, international institutions and regional bodies—inevitably raises questions of legitimacy.

There were differences among participants regarding whether the G20 should expand membership, to whom and how it should institutionalize a membership selection process. Chinese participants were quite cautious about expanding membership. In the view of several Chinese scholars, it is too early to talk about expansion and representation at this stage in G20's development. Increasing membership now could decrease the effectiveness of the body, overwhelm or draw the agenda away from global economic challenges. Expansion can only exacerbate the collective action problem. In contrast, other participants portrayed the membership issue as essential to the longevity of the G20. One American participant noted if it fails to address structural questions like membership, the "G20 can over time follow the way of the G8 and UN Security Council where membership is out of step with the real world". One possible scheme would recalibrate G20 membership every five years, automatically choosing the top two economies from five or more regions and ten economies after that. Although extending invitations to regional groups such as ASEAN is a

positive step, one participant noted that these organizations cannot represent all small and medium-sized countries. Moreover, summit leaders have not invited all regional bodies from all regions, noting the absence of Gulf Cooperation Council and Latin American bodies. To ensure fuller representation of non-members, the 3G representative from Singapore echoed support for a variable geometry mechanism to allow non-members to participate in ministerial and working groups.

Several scholars agreed that the G20 should develop closer institutional ties with the United Nations, with its highly developed structures for consultation and implementation. Given that the G20 is informal and can only deal with issues via the crude political will of world leaders—owing to its lack of a treaty mandate or implementation capacity—the G20 inevitably has to work with the UN as well as with other international bodies to consult and coordinate on policy measures. A scholar from Vietnam also echoed that without a membership structure, it would be difficult for small and medium countries to see the G20 as a legitimate body. He proposed that the G20 develop a mechanism to formalize the participation of regional institutions.

Creating A More Global and Collaborative Asian Leadership for the G20

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In a global economic debate dominated with the immediacy of currency wars, it would be easy to forget that the long term rebalancing of the global economy depends on more than one factor, however crucial. We need internal rebalancing from public stimulus to private demand and external rebalancing from surplus countries to deficit countries. We need to find new sources of aggregate demand and new areas to invest for growth.

One of the areas that we have neglected in this rebalancing act is the growth of Low Income Countries. They are under-invested in basic infrastructure, human capital and the capacity essential to grow and yet we know they could be a part of the solution to global rebalancing and growth instead of being seen as a problem. They can be the subjects, not objects of development.

And in many parts of the world we are seeing the dawning of an opportunity for the first time in decades. Sub-Saharan African growth rates averaged over 7% between 2002 and 2008. And since 1995 there has been a substantial reduction in the frequency and severity of shocks that reduce and reverse the gains from this growth. If these growth rates can persist and overcome bottlenecks and shocks, we have the real prospect of sustained improvements in health, education and living standards.

Economic growth is overwhelmingly the single largest contributor to reducing extreme poverty – up to 97% of long run poverty reduction is due to growth of average incomes. The Republic of Korea is living proof of the fact that it can be done. In one generation it went from a low to a high income country, from recipient of aid to a donor and achieved all the human development indicators that we are fighting to achieve in the Millennium Development Goals. The single biggest factor separating success from failure in achieving the MDGs is strong, resilient and inclusive growth.

This is not to underplay the need for aid, which in most Low Income Countries is essential if not sufficient to meet vital social needs as well as for economic growth. Promises of aid **must** be kept regardless of the pressures of fiscal consolidation. But long-term aid dependency is not a measure of our generosity but a sign of our failure. Our ultimate objective must be aid to end aid – help partner countries to go beyond meeting basic human needs and generate self-sustaining growth to reduce poverty and achieve human development.

We are determined to create a long-term G20 agenda to help the strong, resilient and inclusive growth of Low Income Countries. This reflects the G20's comparative advantage as a leadership forum for international economic cooperation. It is also crucial to the G20's legitimacy. The G20 might represent 85% of global GDP but it must also address the concerns of 150 countries and 2 billion people not represented.

In our consultation with African leaders, Korea was sharply reminded of the skepticism it met from donors and multilateral development banks in the 1960s when it proposed to build the Seoul-Busan express way or to create POSCO or

the Korea Development Institute. We were told Africans also wanted to be empowered to choose their priorities for the future - infrastructure, skill accumulation, private investment – and not just the basic needs of their present. Having chosen the hard path itself, Korea could not choose the easy road for the Seoul Summit – picking one silo issue, creating a donor fund, moving on after the photo opportunity. The path we have chosen accepts the complexity, the choices and hard grind that development entails.

We have worked with the UN, World Bank, regional development banks and other agencies to build a new consensus around a framework for strong, resilient and inclusive growth. It complements the successful initiatives of many players so that our collective efforts add up to greater than the sum of their parts.

It will focus on nine areas or “pillars” that evidence has shown us are central to sustaining and accelerating broad-based growth: infrastructure; employable skills for job creation; the capacity and access to trade; private investment and jobs; access to finance for small and growing companies; food security; social protection in a down turn; mobilizing domestic tax revenue; and sharing knowledge for development.

Unlike some development initiatives in the past the new consensus will be based on a multi-year action plan. It recognizes that doing is more important than pronouncing and the right initiatives take time to implement. It will have inbuilt accountability for delivery of each action in each pillar within a specified deadline – what we promise we will deliver. It will be built on a genuine partnership with low income countries as well as other actors. And it will recognize, as represented within the G20, that there are common ingredients but more than one recipe for growth and development.

While it is right for the G20 to concentrate on short-run pressures, it cannot forget that there is no bigger long-run challenge than achieving growth in the world's poorest countries. If we fail on that, we will ultimately fail on everything that really matters.

The G-20 Calls a Truce in the Currency War

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KOREA

A specter of a lost decade is haunting the United States and China. With its core inflation rate eerily tracking the path of Japan's in the 1990s, the U.S. faces the risk of falling into sustained disinflation, if not deflation.¹ Persistently high unemployment, combined with the ongoing financial crisis, makes the situation in the U.S. potentially worse than it was in Japan, which managed to maintain employment and social cohesion during what was often called "a happy recession." China fears that a rapid appreciation of its currency would precipitate mass unemployment and bankruptcies, as Premier Wen Jiabao warned on October 6 at the EU-China Business Summit in Belgium. China is also determined not to fall for "Plaza Accord II" and repeat Japan's mistake—namely, agreeing to a drastic revaluation of its currency, adopting loose monetary policy to buffer the exchange rate shock, turning a blind eye to rapidly rising asset prices, and waiting for firms and financial institutions to grow out of their problems in the wake of the asset price collapse. These fears and anxieties provide the backdrop of the debate on quantitative easing and the undervaluation of the Chinese yuan, two key issues that have framed "the currency war" of the past several weeks.

A two-speed recovery in the increasingly integrated global economy further complicates the picture. While leading emerging economies are currently faced with the risk of overheating, advanced industrial nations, including those with reserve currencies, are concerned about falling back into recession. If leading emerging economies

put on the brakes, global aggregate demand would be reduced, with an adverse effect on external demand for advanced industrial nations. On the other hand, if the United States and other reserve-currency countries resort to quantitative easing to fight deflationary pressures, a substantial part of the increased money supply is likely to "leak out" overseas in search of higher yields. As IMF Managing Director Dominique Strauss-Kahn noted in Shanghai on October 18, massive capital flowing into emerging economies could lead to "exchange-rate overshooting, credit booms, asset-price bubbles and financial instability." And emerging economies may have to adopt capital controls to help moderate the vast flows. To manage the two-speed recovery and promote "strong, sustainable and balanced growth" around the globe, macroeconomic policy coordination is more needed than ever before.

As much as international coordination is critical to recovery, however, it is far more important to get domestic policy right by crafting political consensus. Even in this age of globalization, large economies—whether advanced or emerging—still derive most of their aggregate demand domestically, and a country like the U.S. finds it difficult to narrow its output gap (estimated by the Congressional Budget Office to be 6.3 percent of potential GDP in the second quarter) unless its domestic demand recovers. At the same time, due to the liquidity-trap conditions, loose monetary policy is likely to be largely ineffective in generating additional demand. Under these circumstances,

¹ See Mary Daly, "Fed Views," Economic Research Department, Federal Reserve Bank of San Francisco, October 14, 2010, last figure in the article, available at: <http://www.frbsf.org/publications/economics/fedviews/fv20101014.pdf>.

advanced industrialized nations with high unemployment and underutilized capacity should adopt a greater fiscal stimulus designed to create jobs and improve infrastructure at home, to crowd in private-sector investment after households and firms repair their balance sheets and recover their business confidence.² The widely publicized second underwater tunnel connecting New York City and New Jersey may be an example of a productivity-enhancing infrastructure project that would support employment and aggregate demand. Unfortunately, the U.S. and other advanced industrialized nations instituted a rather insufficient fiscal stimulus even though the bond market has been signaling with extremely low interest rates that the U.S. and other advanced economies should undertake much more aggressive fiscal expansion.³ In particular, advanced industrialized nations should do more to reduce high unemployment, which has such a corrosive effect on consumer confidence and business sentiment. If prolonged, “structural” unemployment will become a self-fulfilling prophecy as workers’ skills depreciate.

China and other leading emerging economies must deal with exactly the opposite kinds of problems faced by the U.S. and other advanced industrialized nations. When the global financial crisis of 2008 broke out, many emerging economies saw their currency values plummet as investors took flight to the so-called safe-haven currencies—with some selling their assets in emerging markets to make up for the losses they suffered in advanced industrialized nations. Maintaining capital controls, China put a halt to the appreciation of the yuan, which had risen by 21 percent over a three-year period since the

adoption of a currency basket system in July 2005. With the stabilization of global financial markets and faster recovery in emerging economies than in advanced industrialized nations, currency values now have to readjust. Exporters in emerging economies, who have become used to making easy money, may not welcome the prospect of currency revaluation, but emerging economies facing inflationary pressures should take steps to avoid overheating. They should not be afraid of making this adjustment. China suffered no economic catastrophes when the yuan gradually appreciated by 21 percent from 2005 to 2008. If anything, it became an economic powerhouse over this period. Going back further, Korea used the currency revaluation and wage increase in the late 1980s as an opportunity to upgrade its industrial structure. Similar adjustments, in coordination with major economies, could be mutually beneficial.

The G-20 finance ministers and central bank governors met in Korea’s ancient capital of Gyeongju in late October to address these policy challenges. They agreed to “move toward more market determined exchange rate systems that reflect underlying economic fundamentals” and “pursue the full range of policies conducive to reducing excessive imbalances and maintaining current account imbalances at sustainable levels.” They also agreed that persistently large imbalances would warrant “an assessment of their nature and the root causes of impediments to adjustment as part of the Mutual Assessment Process,” in cooperation with the IMF. Although the idea of placing symmetric numerical caps on current account imbalances was floated, the ministers and governors failed to produce specific targets just yet.

² Japan offers useful lessons on quantitative easing and fiscal expansion after the collapse of asset prices. Richard C. Koo, chief economist at the Nomura Securities and author of *Balance Sheet Recession*, notes that since the asset prices collapsed in 1990, Japanese households and firms have been deleveraging, despite near-zero nominal interest rates, to repair their balance sheets. Today, the corporate leverage ratio of debt to capital has fallen to 1.78, from 4.05 during the height of the bubble, but “just like the millions of Americans who never borrowed money after the Great Depression, there is tremendous aversion toward debt in Japan, even with zero interest rates.” He argues that in the face of deflationary pressures, “Japan has managed to maintain its GDP above the peak of the bubble for the past 20 years because the government stepped in to borrow and spend the surplus savings in the private sector.” See Richard C. Koo, “Now Isn’t the Time to Privatize Japan Post: Far from crowding out private lending, the bank is crowding in by financing stimulus spending,” *The Wall Street Journal*, April 19, 2010.

³ The target indicator for fiscal consolidation, the debt-GDP ratio, has both a numerator and a denominator, and it does little good for the ratio if GDP rises more slowly than debt in the process.

This agreement represents a major accomplishment in policy coordination as it enables the G-20 to move beyond the narrow focus on the yuan-dollar nominal exchange rate and adopt a fair, gradual and multilateral approach to global imbalances. First, the agreement recognizes that both excessive surpluses and deficits should be fixed, subject to country-specific factors such as natural resource endowment and the asymmetry between reserve-currency and non-reserve-currency countries. In fact, it calls on advanced economies, including those with reserve currencies, to be “vigilant against excess volatility and disorderly movements in exchange rates.” Also, the agreement implicitly acknowledges that while the exchange rate is an important variable, it is not the only variable that affects the savings-investment balance. It explicitly recommends “fiscal, monetary, financial sector, structural, exchange rate and other policies” to deal with imbalances. Second, instead of calling for a big-bang adjustment, the agreement has a medium-term framework to deal with persistently large imbalances, “assessed against indicative guidelines to be agreed.” Third, the agreement recognizes the danger of politicizing global imbalances as a bilateral problem between the U.S. and China and instead defines it as a multilateral issue to be resolved through the Mutual Assessment Process.

Some critics, however, have argued that the agreement lacks teeth and needs specific numerical targets to be effective. Although the behind-the-scene bargaining over numerical targets is likely to be intense,⁴ there is a good chance that the G-20 will agree to indicative guidelines by the time of the Seoul Summit on November 11-12. As for “teeth,” the fundamental problem is that you

cannot name and shame great powers because they are shameless and powerful. The effectiveness of the IMF surveillance work and the Mutual Assessment Process will be limited to that extent. However, it will be still useful to have a multilateral mechanism that considers both excessive deficits and surpluses as problems, and provides the basis for gradual (not glacial) adjustment. In fact, it is worth noting that one of the major factors that triggered the currency war was the slow adjustment of the yuan in the months following China’s announcement to increase its flexibility on June 19, just before the Toronto G-20 Summit. When the yuan appreciated by only 1 percent over the next three months, the economic issue of exchange rate adjustment turned into a much larger problem of *trust* and China had to face increasing pressure from other countries to keep its word as another G-20 Summit approached. Although great powers always have the option of ignoring other countries, the holding of summits and ministerial meetings at regular intervals ensures that the G-20 is far more likely than stand-alone international organizations to follow through on the members’ commitments.

The recent G-20 agreement does not force its members to adopt all the necessary macroeconomic policies or resolve their domestic political problems, but at least it helps to shift the policy focus away from the yuan-dollar nominal exchange rate and to larger and more fundamental issues. As such, the agreement qualifies as a step forward. With international coordination taking shape, it is now up to individual nations to craft domestic political consensus to get their policy right.

⁴ In its initial discussions with the U.S., China and others, Korea used the standard 5 percent of GDP threshold for current account imbalances. At Gyeongju, U.S. Treasury Secretary Timothy Geithner was reported to be interested in setting the cap at 4 percent. As Gavyn Davies, among others, has noted, a cap of 5 percent catches only Germany among the top 10 economies at the moment, but 4 percent gets China as well as Germany; whereas 3 percent catches the U.S. and Japan as well. Interestingly, it was not China, but rather Germany, Brazil and Japan who led the opposition to numerical targets at Gyeongju. In fact, Yi Gang, deputy governor of China’s central bank, stated on October 9 that the Chinese government aimed to reduce the current account surplus to 4 percent of GDP or below over the next three to five years.