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Brazil, India and China (BICs) in the G-20

CINDES

June, 2010

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1. Background: the "Great Recession" as a Turning Point

Before the "Great Recession", global macroeconomic policy was coordinated by a small group of industrialized countries (G-5, G-7, G-8). The decision to establish the G-20 as the leading forum for international economic coordination during the Pittsburgh Summit in September 2009 marks an important change in the international decision-making process, with growing importance of emerging economies.

The BICs responded vigorously to the global financial and economic crisis by adopting effective monetary/fiscal stimulus programs. These helped to stabilize global output, enhancing their credibility and economic power. China's massive economic stimulus was one of the largest in the G-20, avoiding a disastrous collapse in employment and contributing to a marked reduction in the current account surplus/GDP ratio between 2007 and 2009. In the meantime, China became the world's largest exporter. In Brazil and India, good economic management and the belief that—this time around—emerging markets were not the cause of the crisis, consolidated the popularity of the democratic governments.

G-20 Summits

- Washington (November 2008)
- London (April 2009)
- Pittsburgh (September 2009)
- Toronto (June 2010)
- Seoul (November 2010)
- France (2011)

The BIC's robust macroeconomic performance during the recession has translated into increasing geo-political influence and a growing willingness to step up their participation in global affairs. With a view to increasing the degree of "multipolarity" in the world, the BICs have pushed strongly to establish the G-20 as the leading forum for global economic discussions. At the same time, they have enhanced their mutual cooperation, increasing the frequency of meetings and coordination efforts.

The relationship between the US and China is key to the resolution of several G-20 issues, notably the unwinding of global imbalances. Negotiations within the G-20 group are complicated by the different growth patterns of key members, particularly the recession-stricken US and Europe on one side of the scale, and the fast-growing China and India on the other. While G-20 commitments have become more specific (see Box 1), it is unclear whether they can yield any tangible results, since the G-20 lacks a formal enforcement mechanism, working by consensus.

Box 1. Key Commitments from London and Pittsburg Summits

- Establish the G-20 as the premier forum for global economic issues.
- Create a framework to check the consistency, coherence, and compatibility of national policies with G-20 objectives (monitored by the IMF).
- Establish the Financial Stability Board (FSB) as a successor to the Financial Stability Forum, with expanded membership and stronger mandate (coordinate and monitor progress on regulatory reforms).
- Expand the funding base of international financial institutions and reform their governance, with increasing representation of emerging countries.
- Refrain from protectionist measures (to be monitored by the WTO).
- Complete the Doha Round of *multilateral* trade negotiations.
- Eliminate fossil fuel subsidies over the medium term.
- Reach agreement on reduction of greenhouse gas emissions.

Brazil, India, and China (BICs) have emerged as more assertive leaders after the Great Recession. Their common platform is their desire for increased participation in international decision-making, and in the construction of a new international architecture, with more democratic, representative, and legitimate structures of global governance. They try to minimize their differences in order to offer a united front in their attempts to defend their strategic interests (and safeguard those of smaller developing countries) and to obtain growing visibility as emerging global powers in a changing international order. This note focuses on the convergences and divergences of the BIC's positioning in the main themes of the G-20 agenda.

2. Agenda for Toronto Summit (June 26-27)

The theme for the Toronto summit will be "Recovery and New Beginnings". Discussions will focus on the necessary measures to consolidate the recovery from the global economic and financial crisis, and on the implementation of commitments from previous G20 summits. However, the rising sovereign debt of developed countries, in particular the recent eurozone debt crisis, is likely to take the center stage.

Key Themes

Recovery and Global Imbalances

With the global recovery still fragile, G-20 leaders will seek to develop coordinated and orderly exit strategies, promoting a careful move from stimulus to fiscal consolidation. To this end, they will take stock of progress in implementing the peer review process agreed in Pittsburg. The draft IMF report suggests that there has been little rebalancing of global demand so far, as the improvement observed in 2009 was only temporary, related to the weak growth in the US and the EU, the increase in the US savings rate, and the massive fiscal/monetary stimulus adopted by China. With the crisis easing, China's policy of competitive undervaluation, which has resulted in the accumulation of large trade surpluses (especially vis-à-vis the US) and vast international reserves, will be a key topic in the agenda.

Recognizing that the best way to pressure China to revalue its currency is to reframe the Yuan undervaluation as a *multilateral* concern, the US current strategy is to address this issue through the G-20, seeking support from large developing countries, such as Brazil and India, which are affected by China's exchange rate policy. A March 2010 letter (http://www.whitehouse.gov/the-press-office/joint-letter-g20-leaders) from the five countries hosting past and planned summits included an explicit reference to the link between members' exchange rates and trade imbalances— a topic avoided in past summits and in the April 2010 G-20 communiqué —thus indirectly putting pressure on China. More recently, the US shifted the debate to industrial policy, calling attention to the mounting restrictions US companies face to do business in China.

Financial Sector Reform

G-20 members will also review progress on their commitment to strengthen financial regulatory systems. There is widespread agreement on the need for new international regulatory standards, including higher liquidity and capital requirements, but major efforts are needed to harmonize countries' positions on the necessary rules to curb risk-taking. Given the lack of consensus, it is unclear whether the regulatory reforms agreed in Pittsburg will be finalized this year and implemented by late 2012 as envisaged.

3. From Economic Prosperity to Political Confidence

a. To BRIC or to BIC?

Brazil, India, and China are part of the BRICs, a group that has gained traction in the wake of the Great Recession.[1] BRIC countries are key regional players, increasingly competing for industrial and agricultural markets (with the undervalued Yuan hurting the exports of Brazil and India) and for geopolitical influence (China, India, and Russia in Asia; Brazil and China in Africa). China has a comparative advantage in manufacturing exports; Brazil in commodities; and India in IT services. Given its dependency on oil and gas, poor performance during the crisis, declining population, and lack of WTO membership, Russia fits poorly in

[1] The first BRIC summit was held in June 2009 in Yekaterinburg (Russia), with a relatively broad agenda. Since then, the drive for cooperation among the BRICs has been increasing. The second summit took place in Brasilia in April 2010.

this group.[2] Notwithstanding the catchy acronym, several analysts have questioned the rationale for the BRICs, suggesting that their differences overshadow their common interests and hinder their ability to agree on a common strategy.

The BICs are big countries, with large domestic markets, but marked economic differences. In terms of economic weight, China is the dominant member of the group. They have adopted different approaches to economic management, with China following a development model based on heavy investment and exports, while Brazil and India are more focused on domestic markets. The three countries are trying to innovate and diversify their economies in an increasingly globalized world. Despite recent strong growth, poverty and income distribution are still major concerns.

Economic Indicators (US$ million)

	Country/ indicator	GDP	GDP *per capita*	Exports	Imports	FDI stock	Direct Investment Abroad (stock)
1990	Brazil	478.575	3.200	31.414	24.977	37.143	41.044
	China	404.494	361	62.760	53.810	20.691	4.455
	India	326.795	379	17.813	23.991	1.657	124
2000	Brazil	644.729	3.702	59.644	61.875	122.250	51.946
	China	1.192.836	958	249.223	225.175	193.348	27.768
	India	467.802	449	42.627	50.336	17.517	1.859
2008[1]	Brazil	1.552.656	8.088	197.067	229.877	287.697	162.218
	China	4.348.303	3.308	1.469.280	1.196.750	378.083	147.949
	India	1.252.903	1.061	191.926	304.166	123.288	61.765

Notes: [1] Estimated data.

Source: Unctad

[2] For arguments against including Russia in the BRICS, see for example "What's in a BRIC?" by Joseph Nye (http://www.project-syndicate.org/commentary/nye82/English).

Brazil and India are full-fledged democracies, enjoying high degrees of legitimacy domestically, regionally, and internationally, while China follows a more autocratic approach. Both Brazil and India are campaigning for reform of the UN Security Council, where permanent seats are reserved for nuclear powers. As a non-nuclear power, Brazil resents not having a permanent seat in the UN Security Council, a sentiment shared by nuclear India.

China's position on key G-20 issues is typically based on pragmatism, and on the attempt to integrate its complex relationship with the US with its desire to speak and be seen as a developing country. Despite its growing economic power, China prefers to exercise its leadership indirectly, through coordination with other large emerging countries such as Brazil and India.

Brazil's impact on the international agenda is growing, despite its small share in international trade, anchored on an active diplomatic effort to assert its leadership. Brazil played a crucial role in transforming the G-20 into the main forum for global decision-making during the Washington summit in late 2008, when it held the rotating presidency of the G-20. Brazil's relations with the US have become more confrontational and ideological over time, while the dialogue between the US and the other two BICs is more intense and pragmatic.

India views the support for developing countries as a test of the leadership capacity of large emerging countries. To this end, it consistently defends the interest of developing countries, pressing for attention to their needs, notably regarding infrastructure and export credit financing.

b. Status of Bilateral Relations

Brazil-China: Chinese commodity demand was crucial in helping Brazil ride out the downturn. Resource-hungry China became Brazil's main trade partner in 2009, with much of Brazil's exports based on commodities. Behind the growing economic ties (recently enshrined in a five-year action plan to boost trade and energy cooperation), there is serious competition, with the undervalued Yuan hurting Brazilian exports of manufacturing goods.

Brazil-India: While bilateral trade has been growing dramatically, it is still modest compared to trade between Brazil and China. Brazil and India typically come together in *multilateral* forums, championing the cause of the developing world, with increasingly similar positions and votes. One important exception is their different trade policy strategy. They are both major players in the Doha Round negotiations, but Brazil is far more liberal than India, especially in the agriculture sector.

China-India: The agendas of the two countries are informed by tensions on trade and territorial issues. Bilateral trade and investments are below potential, as India sees China's expansionist ambitions as a threat.[3] The two countries are now looking for ways to redress current imbalances and to align their interests more closely in *multilateral* discussions. However, there seems to be an internal split in India on whether to consider China as a partner or as an enemy.

[3] The bulk of India's exports to China are raw materials, while India's imports from China are higher valued-added finished goods.

4. BIC's Positions on Key G-20 Issues

a. Recovery and Global Imbalances

China rejects the argument that a stronger Yuan would resolve the US trade imbalance. Rather, it points to the lax financial supervision in advanced countries as the main cause of the crisis, and to their fiscal weakness as the main threat to economic recovery —a position shared by Brazil and India, and likely to be bolstered by the sovereign debt crisis in the eurozone. At the same time, China is facing growing pressure from some of its peers to begin appreciating its currency. Although so far India and Brazil have avoided putting pressure on China overtly, recently they joined US calls for Yuan appreciation. This raises their own bargaining power with the US: while China seems to be immune to US pressure, it is more sensitive to opposition by other large developing countries.[4]

The rift with the US obscures the internal debate taking place in China ahead of a leadership change in 2012. There seems to be agreement on the need to change its export-dependent development model, but disagreement on the timing and the method of transition to a model more reliant on consumer demand. A stronger Yuan would help reduce capital inflows, contain inflationary pressures, and promote domestic demand, reducing dependence on exports. On the other hand, some policymakers see the Yuan as a tool to create jobs, which they don't want to give up because employment has not recovered as much as output after the crisis. In addition, Chinese politicians are generally determined to resist foreign pressure. Against this background, any change in China's exchange rate policy is likely to be consistent with the three principles China has always followed: it must be gradual, controlled, and adopted at Beijing's initiative.

[4] The BICs are likely to call attention also to the need to close the gap in development, not only in current account imbalances.

With interest rates in the overleveraged developed world at record lows, all three countries are facing increasing capital inflows. As a result, they have had to cope with significant appreciating pressures on their currencies and the threat of overheating. In China, the massive stimulus spending on fixed investment has raised the danger of overcapacity. Moreover, expectations of Yuan appreciation have encouraged inflows of hot money. But the recent decline of the euro in the wake of the eurozone debt crisis is likely to delay any currency appreciation.

Despite China's strong growth performance, there are doubts about the BIC's capacity to act as engines of world growth in the near future. In the meantime, the BICs will continue to press developed countries to implement countercyclical monetary and fiscal policies to ensure a lasting recovery, while pointing out the risks in their unsustainable fiscal positions. The dilemma between promoting fiscal consolidation and extending the fiscal stimulus illustrates the challenges facing G-20 leaders during the Toronto Summit.

b. Financial Sector Reform

The BICs are united in calling for reform of the international financial system. At the same time, they are committed to improving their own financial sectors and to strengthening international cooperation. However, when it comes to detail, their position is not uniform, reflecting significant differences in their own financial systems. In all three countries banks are well-capitalized and well-funded, and state banks have a big presence, helping to implement the stimulus programs during the crisis. Brazil has the most sophisticated financial sector of the three countries, but banks in China and India are rapidly catching up.

China does not oppose stricter international regulatory standards because Chinese banks are less deregulated than banks in other countries and therefore, stricter regulation would not apply to them. Brazil favors a tightening of international regulatory standards for different reasons. Stricter international regulation would mean that developed countries would need to adopt measures already in place in

Brazil's well-regulated financial sector, following privatization and bank reform in the 1990s. India has acknowledged that the direction of the proposed reforms in the international financial system is in line with its own thinking. However, it has cautioned against stifling innovations and risk-taking, insisting that any regulatory changes should take the particular context into account.

Bank Levies

The IMF proposal for two bank taxes to reduce global financial instability will be discussed in the Toronto summit. The interim report, presented during the April meetings in Washington, rejected the idea of a global financial transactions tax, but suggested two other taxes on banks: (i) *a financial stability contribution* to be accumulated into a bail-out fund, and (ii) *a financial activities tax,* to be levied on bank profits and executive compensation, including bonuses.

So far, there is no consensus on this topic. Some countries (led by Canada) that do not have the type of institutions that pose systemic risk are against imposing taxes on banks, pressing instead for appropriate regulation. Although officially undeclared, China's position is likely to be along these lines. India also seems to be cool on the idea, concerned about the impact of new taxes on its efforts to boost financial inclusion and on banks' development role. Brazil is against the imposition of bank taxes on the grounds that Brazilian banks are already taxed at higher rates than other sectors of the economy. After intense debate during the early June meeting in South Korea, the Canadian-led opposition seems to have won, since the idea of a worldwide bank levy was dropped. Bank taxes are still likely to be introduced in some countries where taxpayers bailed out highly indebted banking systems.

Executive Compensation

Following the G-20 pledge to force banks to link pay to risk, a FSB report has shown a split between regulators in Europe and the US, who are pushing for fast action, and a number of countries, including emerging countries, that argue that their banking sector have not caused the crisis and are thus against excessive regulation. The report has found that significant progress has been achieved in incorporating FSB Principles for Sound Compensation Practices and their Implementation Standards into domestic regulatory and supervisory frameworks, but full implementation is far from complete.

Brazil and China have chosen different approaches to implement these regulatory reforms, while in India there are only ideas under consideration.

- Brazil has opted for a *regulatory approach*. It is currently drafting new legislation to regulate bank executives' bonuses to prevent destabilizing actions by banks. It is actively supporting the technical discussions of this and other topics at the FSB.

- China has opted for a *supervisory approach,* complying with G-20 pledges through the supervisory process. While it has placed some limits on executive compensation, this is not a high-priority issue.

c. Reform of International Financial Institutions (IFIs)

All BICs are currently under-represented in the international financial institutions and are thus strong advocates of quota, voice, and governance reforms. Since the global financial crisis erupted in 2008, they have been pressing for a comprehensive review of IMF and World Bank procedures and governance to reflect economic realities and enhance their legitimacy and credibility. There is no major difference in their positions on this topic.

Rather, the BICs are united in their disappointment with the slow pace of IFIs reforms and the lost sense of urgency once the crisis eased. The most pressing reform is the change in what they consider an unfair quota distribution, in order to secure a representation more in line with emerging countries' share in global GDP. During the G-20 meetings in April, the BICs called for an acceleration of the process of shifting quotas to emerging countries, and for governance reform at the IFIs, including changes in the appointment process for senior leadership. While the IMF communiqué included a commitment to accelerate IMF reform and complete the quota review before the January 2011 deadline agreed in Pittsburg, negotiations on specifics are expected to be difficult, especially with European countries, which stand to lose.

IMF Reform

BICs proposed a shift of 7-8 percentage points in the quota distribution from developed to emerging/developing countries at the IMF, compared to the 5 percent committed at Pittsburg. They also called for at least a doubling of IMF quotas in order to alleviate financing shortfalls and create sufficient space for the quota shift.

Reform of Fund governance would include redistribution of the chairs and reorganization of constituencies to ensure a more adequate representation of emerging markets and developing countries. BICs also called for more diversity in IMF management and staff, with the next IMF Managing Director selected in an open, transparent, and merit-based way, irrespective of nationality (the same principles should apply to the World Bank Group). To avoid weakening the role of the Executive Board, the BICs are against the replacement of the current decision-making body of the IMF (the IMFC) with a less representative ministerial-level council.

On issues of substance, China and India have argued that the focus of IMF surveillance in recent years has been inappropriate. They urged the IMF to strengthen its surveillance of important financial centers and systemically important countries (especially their fiscal policies). India has argued for a redefinition of the Fund's mandate to include the promotion of international financial stability.

World Bank Reform

A shift of voting power of 3.13 percent in the World Bank Group was agreed during the Spring Meetings in Washington, increasing the votes of the developing world to 47.19 percent. While welcomed as a first step toward a more appropriate governance structure, the shift fell short of the 6 percent advocated by the BICs so as to reach an equitable distribution of voting power between advanced and developing countries.

As part of the overall call for general capital increases for *multilateral* development banks, the BICs argued for a capital increase for the World Bank Group, as well as improvements in its corporate governance. A capital increase would allow the World Bank Group to step up funding for infrastructure to replace lost export demand and boost growth in developing countries. In the event, during the Spring Meetings, the World Bank Group capital was increased by more than $86 billion. This increase was accompanied by a comprehensive reform package to make the World Bank Group more efficient, effective, and accountable.

d. Climate Change

While Brazil, India, and China are committed to addressing the global challenge of climate change, their interests do not always converge. Their position on climate change is coordinated with South Africa in the context of the BASIC group.[5]

India and China are among the countries most likely to be impacted by climate change: China is the world's largest emitter of carbon dioxide, and India is the 4th. Both countries are boosting energy efficiency and alternative sources of energy, but insist that any agreement on climate change should respect the need for development and growth in developing countries.

[5] The third meeting on climate change of ministers from BASIC countries (Brazil, South Africa, India, and China) was held in Cape Town during April 25-26, 2010. For their joint statement, see http://www.environment.gov.za/NewsMedia/MedStat/2010Apr26/BASIC%20Ministers.doc.

Brazil is a low-carbon economy country, with a diversified energy matrix. Given its high production of hydroelectric power and biofuels, it is less dependent on fossil fuels than the other two countries. Since deforestation is responsible for more than half of Brazil's emissions, a reduction in forest degradation is the principal component of Brazil's mitigating strategy. This turns out to be less restrictive to economic growth than the energy consumption reductions required of other emerging countries.

Reaching an Agreement to Reduce Greenhouse Gas Emissions

The climate change conference in Copenhagen (December 2009) failed to deliver a legally binding global agreement to cut emissions. Under a last-minute deal among all the world's largest emitters, developed countries agreed to provide financing to poorer countries, and to reduce their emissions substantially by 2020, while developing countries agreed to curb the future growth of their emissions. Without unanimity, the Copenhagen accord was not adopted under UN rules, and did not impose binding obligations on any of its signatories. In their recent joint statement, BASIC ministers called for the conclusion of a legally binding agreement during the climate change meeting in Cancun this year, or at the latest, in South Africa by 2011. But given the varied and conflicting interests involved, negotiations could drag on for years, as in the Doha Round.

Generally, the BICs prefer to hold negotiations on climate finance at the UN forum (the United Nations Framework Convention on Climate Change), following the principle of equity and common but differentiated responsibilities. Behind the scenes, however, there seems to be more flexibility in adopting a mixed approach, moving some of the agenda to the G-20. In an important shift of gears, in Copenhagen Brazil accepted that advanced developing countries could contribute to mitigation and adaptation funds, saving developed world funding for the small developing countries only. China and India have been vague on this, but seem to be open to provide more funding.

Eliminating Fossil Fuel Subsidies

The elimination of fossil fuel subsidies is also part of G-20 commitments on climate change. So far, a firm deadline for this has not been established, with elimination supposed to take place 'over the medium term'. A recent study by the International Energy Agency will be discussed in Toronto. All G-20 countries are required to present an action plan during the Toronto summit to deal with their subsidies. This is clearly a difficult task for developing countries, as evidenced by street protests in India following subsidies cuts in 2008. India claims that subsidies are needed in developing countries to help poor people and control inflation.

e. Global Trade

Given other pressing topics, trade is unlikely to be top priority in the Toronto summit. The G-20 has been largely successful at one of the specific actions in its trade agenda: avoiding the escalation of protectionist measures following the global financial crisis. However, despite their pledges to get negotiations back on track, the current stalemate over the WTO Doha Round of *multilateral* trade is likely to continue this year.

The BICs have embraced the G-20 trade agenda, vowing to resist protectionism and to step up efforts to conclude the Doha Round as part of the exit policy from the global financial crisis. They have also committed to increasing trade with each other in their own currencies, in an attempt to bypass the US dollar. The idea of setting up an alternative reserve currency, aired during the first BRIC meeting, has been quietly shelved, however, given the large amount of BRICs' foreign reserves held in dollar-denominated assets.

Crisis-related Protectionism

World trade was one of the worst casualties of the Great Recession, almost collapsing at the end of 2008. Sluggish trade followed, given the slump in global demand, along with increased protectionist sentiment among G-20 countries.

At the request of the G-20, a bi-annual report on the protectionist practices of its members has been prepared by the WTO, with collaboration of the World Bank and the UNCTAD. Heightened awareness of the risks of protectionism, together with enhanced monitoring have limited the protectionist response by G-20 countries. The most recent report suggests that, after an initial wave of violations following the onset of the crisis, widespread protectionism has been avoided.[6]

Brazil and India have been part of a core negotiating group to complete the Doha Round, trying to stitch together a comprehensive negotiating position. However, Brazil's interests as a highly competitive exporter clash against India's wish to protect its small farmers.

Brazil tries to put pressure for trade liberalization on the other two countries privately, while accommodating them in public. Despite their own protectionist policies, India and China insist that protectionism from developed countries remains a real threat to the global economy, including the 'indirect protectionism' represented by discriminatory policies against foreign commercial interests in domestic stimulus programs. China is less interested in new negotiations under Doha, since it is still busy fulfilling the protocols agreed when it joined the WTO.

India and Brazil are more 'classical protectionists', resorting to tariffs and quotas. While Chinese tariffs are low, China uses industrial policy, an undervalued currency, and artificially low interest rates as a protectionist tools.

[6] For details see Trade and Crisis—Protect or Recover; IMF Staff Position Note 10/07 (http://www.imf.org/external/pubs/ft/spn/2010/spn1007.pdf).

5. Conclusions

The BICs emerged from the global financial and economic crisis with strengthened credentials to influence global affairs. Their robust macroeconomic performance during recession leveraged the legitimacy of their demands of an increased participation in the relevant international economic fora. The three countries have strongly pushed to establish the G-20 as the leading forum for international economic coordination, enlarging the small G's that used to coordinate the global macroeconomic policy before the "Great Recession".

While striving to enhance their participation in international affairs, the BICs reinforced their mutual cooperation, increasing the frequency of the meetings and coordination efforts. Their common platform is their desire for increased influence in international decision-making and in the construction of a new global economic architecture. Despite their efforts to build common positions in the relevant negotiation fronts, they have marked differences in their economic and strategic interests.

The chart bellow represents an attempt of summarizing the three countries' positions in the main issues of the G-20 agenda:

BICs' Positions on Key G-20 Issues

Issue	Summarized Positions
Recovery and Global Imbalances	**Divergent interests:** Brazil and India have been negatively affected by the Yuan appreciation, but they have avoided putting pressure on China overtly.
Reform of the International Financial Sector	**Moderately convergent:** the BICs are united in calling for reform of the international financial system, but there are important differences in the details, reflecting differences in their national financial systems.
Reform of International Financial Institutions	**Convergent:** they are united in demanding quota, voice and governance reforms.
Climate change	**Divergent interests, but convergent positions in the G-20:** they have very different energy matrix, divergent interests, but the three have been trying to present common positions. Brazil has recently moved to a more "progressive" approach. They prefer to hold climate change negotiations at the UN forum, instead of moving this agenda to the G-20.
Global Trade	**Divergent interests, attempts to coordinate positions:** they have been trying to coordinate at the G-20 for trade, but they blew the coalition when they faced the Lamy Package (July, 2008).