PERSPECTIVES ON BETTER GLOBAL ECONOMIC GOVERNANCE

KEMAL DERVİŞ

A Personal Note prepared in the context of discussions on the April 2 meeting of the L-20+ in London** The views expressed in this Note are personal and should not be attributed to any organization. **And the broader debate on reform of global economic governance. An earlier version of this Note was presented to a workshop at Columbia University on the G-N processes on February 4th.

March 2009

SUMMARY

This Note focuses on the relationship between L-20 (L for Leaders) or G-20 type meetings and more formal reforms , particularly of the IMF. It should NOT be read as a proposed agenda for the April meeting of the L-20+, but as an input into the agenda of global reform that constitutes the context of the London and other international meetings. I do believe that given the massive and immediate threat posed by the unfolding worldwide economic crisis, the April meeting should focus on (i) the global size and coordination of the fiscal stimulus and macroeconomic policies worldwide (ii) immediate coordination as needed in the dramatic actions required with regard to the banking system in many major economies and, (iii) financial support to the developing countries experiencing a massive decline in export revenues, capital flows and remittances. The London meeting will be the first and very important start of a series of meetings in 2009, including the Spring and Fall meetings of the IMF/World Bank, which constitute an opportunity to build a global economic governance system that can manage the recovery from the current crisis, build globally coordinated financial sector regulation and reflect the realities of the 21st century.

Formal and Informal Governance

The current debate on how to reform global governance reflects a tension between two types of arrangements. On the one hand, there is a set of formal multilateral institutions established within an international legal framework, which includes the United Nations family, the Bretton Woods Institutions, and the WTO. On the other hand, there is a set of more ad-hoc, informal arrangements of the G7, G8, G8+5 or G20 type. Call them the G-N. These two forms of international cooperation are complementary. Both need to be improved to enhance global governance.

The informal arrangements have emerged to mobilize action, but face serious problems of legitimacy given that many countries are excluded not only from taking part but also from being represented. The fact that the G20 rather than the G8 is at the center of efforts to address the on-going financial and economic crisis is certainly a step in the right direction in terms of enhancing representation, inclusiveness and legitimacy. It was also significant that the meeting of the G20 that took place in Washington last November was convened at the level of heads of state or government, with a second "Leaders" meeting to take place again in London on April 2, 2009. The heads of international organizations (UN, IMF,WB as well as the Chair of the Financial Stability Forum) were also invited to attend in November. But despite the improvements, this still falls short.

An L-N

An enlarged G-20 at Leaders level, call it an L-N, should take place regularly once a year, and not only in a period of crisis. Given that we have had an L20 + meeting in Washington in November of 2008 and that we will have another one in April in London, institutionalizing the L-N could very well take as its starting point the 20 included in the original G-20 and those present at the two L-N meetings. Participation could be enlarged to include some rotating representatives of smaller and medium sized countries, in addition to the EU that is already present as the "20th" member, in a group that had 19 countries as members, thereby extending membership to an L-23 or L-24 and overcoming the total exclusion many countries deeply resent. Each of the additional countries could represent one of three or four regional groupings: for example Africa, Asia, and Latin America and the Caribbean. There are several possibilities when it comes to determining the countries representing larger groupings. They could be elected to represent the regional geographical groups at the United Nations. Alternatively they could be designated by regional organizations such as the African Union and ASEAN. Apart from allowing such regional representation, key leaders of multilateral organizations should be present in these meetings. The UN Secretary General, as the Senior Leader of the system of multilateral organizations, should always be invited, as he was to the Washington meeting, alongside the Managing Director of the IMF and the World Bank President. The Managing Director of the WTO should also be present given the absolutely central role trade has in international affairs. Perhaps the Director of the ILO should also be invited, at least in 2009 and 2010, as "decent jobs" is the single most important political and social challenge facing the world today. If the OECD becomes more global in the coming years, there would be a good case for inviting the Secretary-General of the OECD.

With key leaders of the international organizations present, there would be about 30 people around the table - a large number: in many ways too large for actual decision making. But an L-N meeting that truly brings together majors leaders from around the world and wants to be reasonably inclusive can no longer be much smaller. There are alternative proposals worth careful evaluation in the process of institutionalizing an annual L-N meeting- for example adding China, India, Brazil, Mexico and South Africa to the G-8 - but it will be very difficult to "dis-invite" major G-20 countries such as Korea, Turkey or Indonesia, particularly when one compares them in terms of population and GDP to some of the "old" G-8 members such as Canada or Italy. The Managing Global Insecurity (MGI) project sponsored by Brookings and NYU has proposed adding 3 more countries to the G-8 plus 5 formula (Indonesia, Turkey and Nigeria or Egypt), and the resulting L-16 would represent a huge improvement in inclusion and realism over the G-8. A good argument can be made that the MGI project's 16 is a very reasonable compromise between inclusiveness and manageability and it reflects very careful deliberations and consultations on this issue. The uncomfortable fact, however, is that any enlargement of the G-7 that is reasonably inclusive will end up with a number of participants that will make these meetings into high-level "forums" rather than meetings conducive to formal decisions. And yet it should be recognized that the original G-7 (or G-8) is now very far from reflecting the realities of the world of the 21st century and has outlived its usefulness.

At this point it is critical to stress that an L-N group, even if kept smaller, would not - could not - be a formal governance body. Decision and resource use oriented global economic governance has never been and can never be anchored in an informal group, but has to use formal treaty based mechanisms and institutions such as the IMF, the UN or the WTO. How else can countries worldwide commit themselves in a binding way to certain policies, dispute resolution mechanisms, or to sharing resource burdens in certain ways? These inherent limitations on any L-N do not at all make such gatherings useless. On the contrary, an L-N that evolves with the times would have a wholistic perspective on world affairs, provide a valuable forum to deal with a broad agenda, allow key leaders to meet and to get to know each other better, and project an informal and yet reasonably business like approach to discussing pressing issues that require global approaches. The L-N could inspire and influence the formal and specialized international institutions, but cannot replace them or their governance. Moreover a new institutionalized annual L-N would obviously not preclude other regional or other desirable and smaller "Leaders-level" meetings. The coming meeting in London in early April will be an extraordinary opportunity to send a powerful message of cooperation, inclusiveness and resolve to the whole world, at a time of grave crisis. Institutionalizing an L-N would be a breakthrough in the architecture of international cooperation - but it would have to be complemented by decisive reform of the more formal parts of economic governance.

A new and reformed IMF- perhaps renamed World Economic Organization - for better Global Economic Governance

The major multilateral institutions - the UN, the Bretton Woods Institutions, the WTO represent constituencies with universal or near universal memberships and have legal mandates that are critical to addressing a range of global issues in a way that allows resource use and burden sharing. Each one of these organizations needs far reaching reform. The governance and activities of these institutions have to better reflect today's realities and challenges. The remainder of this note on *economic* governance focuses on the IMF, given the size and critical importance of this institution in the context of the response to the current financial and economic crisis. Very important roles can and should also be played by the World Bank and the Regional Development Banks as well as the UN Funds, Programmes and Specialized Agencies but that discussion is beyond the scope of this Note.

A renewed and reformed IMF should and could be the key international institution in providing the critical "global public good" of *financial and macro-economic stability.* National policies will always be central, and other international and regional organizations also matter a great deal - but the current crisis has shown how desirable international *macroeconomic* policy coordination is in today's world economy. The need to manage a worldwide recovery provides a unique opportunity to reform the IMF and make into an effective and legitimate *World Economic Organization* that facilitates macroeconomic policy coordination and that has sufficient resources to play a lead role in cooperation with national treasuries and central banks in the provision of cross-border precautionary and emergency finance.

Part of the reform has to do with substantive policy issues, in which the role and the nature of the IMF's policy advice needs to be strengthened and improved to ensure that it is effective. This includes a stronger role in macroeconomic policy reviews and policy coordination with an enhanced commitment by all member states, including rich countries, to this process. The times when the IMF's role was to advice and exercise surveillance with respect to developing countries only should be gone. The current crisis has demonstrated that all countries need advice and formal policy reviews by a body that is at arms-length from immediate domestic political interests and pressures. The reform should also include a more rapid and less constraining process for providing liquidity to countries facing balance-of-payments problems due to external shocks. This will involve both a review of existing lending facilities and a very substantial expansion of resources available. An expansion in the allocation of SDRs and an enhanced role for the SDR or, better, for a new SDR in the global reserve system, should be part of this reform. A detailed discussion of these matters is beyond the scope of this Note focusing on governance issues only.

Reforming the governance of, and decision-making at the IMF, to enhance both legitimacy and effectiveness, is critical to making the IMF into a 21 century world economic organization. The key to such governance reform could be the transformation of the IMFC into a governing Council of Ministers that would act as a real new governance mechanism. This proposal is currently debated actively and reflects the need for stronger multilateralism which in the interests of all, but particularly also in the interests of the developing countries, provided of course the new stronger governance arrangements take into account the role and weight the developing countries have gained in the world economy. The seats on the Council and the weighting should be adjusted - not once and for all, but in a continuous and dynamic way -to reflect the new economic realities. This *World Economic Council* would have universal representation through the system of constituencies - with some 20+ constituencies each electing a Governing Council Member.

It would be natural to continue with the step by step reweighing of the existing constituencies, a process started in a very modest way at the occasion of the Singapore annual meetings in 2006. The next steps should be bolder, however, and include both, quota increases, changes in country weights and a major re-organization of the existing constituencies. A major step should be taken at the Istanbul annual meetings in the fall of 2009. Other steps should follow, perhaps every three years. The key advantage of a constituency based system is that it can be both universal (every country can participate) and have at the top a reasonably small and compact group of 20+ actual decision makers, with weighted voting reflecting objective criteria rather than historical accident or the "de facto" persistence of the past. If a country gains weight in the world, this should over time be reflected automatically in the voting weights in the Council. There is and will continue to be a debate on exactly what these weights should be - but this can be resolved given the overall framework of universal participation and representation through constituencies. There may be a need for other types of changes, including a cautious extension of the double majority system for the most important class of decisions (a double majority of 85% of the weighted votes and 60% of member countries already is needed for a change in the Articles of Agreement or for the exclusion of a member). An appropriate balance must be kept between the requirements of inclusion and legitimacy, on the one hand, and the need for IMF governance to function decisively, on the other. Double majority voting as well as the possible direct inclusion of population weights into a system of weighted voting has precedents in the EU Treaties, for example.

With the transformation of the IMFC into a governing Council of Ministers, the role of the IMF Board would change. It would no longer be a "policy maker"; it would rather advise and supervise. The Board would continue to approve individual programmes, but do so reflecting a systemic rather than case by case approach. The Council would make policy and decide on the types of programmes and facilities, with the Board checking whether individual programmes meet the broad parameters of the policies set. The Managing Director would continue to chair the Board, while the Council would be chaired by an elected and rotating President.

In addition to these formal governance mechanisms, the IMF's legitimacy and effectiveness would benefit from more institutionalized peer review and opening to *broad expert advice*. It would be desirable to establish a "Policy Advisory Group" made up of 15 to 20 eminent outside experts, geographically diverse and drawn from academia, civil society and people with proven track record in the private sector - and NOT all from the financial sector. This group would have to work closely with the Evaluation Department, but it would focus on the future and make recommendations on specific policies and programmes. The recommendations would not replace the normal functioning of governance arrangements, but the work of the group would provide a forum for vigorous debate, the possibility of thinking about unorthodox approaches and the inclusion of different perspectives in the policy debate. Too often in the past the debates in the IMF have had too much of a purely financial sector perspective, narrowing their scope in a manner that has made it more difficult to fully appreciate the weaknesses in the financial sector itself, and making it harder for the IMF to communicate more broadly with civil society and all kinds of stakeholders.

Global Financial Regulation

Finally, the communiqué of the G20 Washington Summit held in November called on the IMF to work with an expanded Financial Stability Forum and other regulatory and standard setting bodies on advancing the financing regulation agenda. The extent to which the IMF itself should be involved in financial regulation is an on-going debate, not dissimilar from the debate taking place inside nation states: should financial regulation be entrusted to national central banks or should it be with a separate financial regulatory authority? What is not in doubt is that while financial regulation needs to be anchored nationally, much stronger international cooperation will be needed in the future. This calls for making regulatory and standard setting bodies such as the Basel Committee and the Financial Stability Forum, working in cooperation with a reformed and more effective IMF, much more inclusive and participatory.

Conclusion

There is a vast agenda of reform ahead of us which should be debated, designed and implemented carefully. The L-20+ London meeting at a time of threatening crisis can give a strong impetus to reform of the actual global economic governance, without which decisions taken at various summits remain symbolic, and lack follow up and resources devoted to their implementation. The L-N or G-N type meetings - and an annual L-N meeting should be institutionalized - can complement and reinforce the reform dynamic in the international institutions and their more binding and more formal decision making processes. Global issues management requires *both* types of governance and networking mechanisms. The "best", even as a target, will evolve with time. The challenges the world faces are huge, but being ambitious should not make us forget that action will have to be based on compromise and, to paraphrase a well known saying, that "the best can be an obstacle to achieving the good".

About GPoT
Global Political Trends Center (GPoT) was established as a research unit under the auspices of İstanbul Kültür University in 2008.
GPoT Center aims to produce innovative and distinctive policy recommendations by analyzing the contemporary trends in regional and international politics.

GPoT Hakkında
Küresel Siyasal Eğilimler Merkezi (GPoT), 2008 yılında İstanbul Kültür Üniversitesi çatısı altında bağımsız bir araştırma birimi olarak kurulmuştur.
GPoT bünyesinde yapılan çalışmalar ile bölgesel ve uluslararası güncel siyasal eğilimler analiz edilmekte ve bu konularda öneriler sunulmaktadır.