4. A Way Forward: Formal and Informal Aspects of Economic Governance

By Kemal Derviş

The economic crisis that started to unfold in 2008 has made it even clearer that we are now living in a strongly interdependent world, where factors such as trade, capital flows, financial products, but also carbon emissions or threats from nuclear proliferation or infectious disease tie us together, more than ever before. Interdependence is also reinforced by more "intangible" factors, such as the rapid "contagion" in expectations as well as the transmission of tastes and social trends. The crisis may lead to a temporary retreat from some of the policies that have accompanied globalization, but the technological and socio-economic factors that have led to increased interdependence are not going to disappear.

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It is possible, for example, that there will be some retreat from trade liberalization, as countries try to protect domestic employment. In the aggregate this would be self-defeating, since one country's imports are another country's production and jobs. The world witnessed the destructive effects of "beggar thy neighbour" trade policies in the 1930s. There may be a somewhat more justified retreat from cross-border financial liberalization. Massive cross-border speculative capital has more cost associated with it than benefit. Long-term productive foreign investment is a positive force for development, however, as it helps the diffusion of technology and accelerates overall productivity in the world economy.

Looking forward, it will be desirable to have the right incentives and regulations in place to promote productive investment and the spread of knowledge, and at the same time discourage and control destabilizing behaviour. Another critical area of global interdependence is of course due to carbon emissions and climate change. The interesting fact in this context is that even if countries decided to cut all contact with each other, carbon emitted in one country would still affect all other countries: global interdependence could not be avoided even by autarchy!

Interdependence and technology-driven globalization is here to stay. There is huge potential for both ill and good in globalization. The key challenge for the 21st century, therefore, is how to build a global system of governance that allows the management of global issues, the adequate provision of global public goods and the most effective forms of collective action. The arrangements and mechanisms of cooperation we should try to build in this first part of the 21st century will still have to rely on nation-states as the legitimate "building blocks" of the global system. The nation-state is constrained by global forces and cross-border externalities. It is still, however, the key decision maker. In most domains, it alone can enforce the law, national or international. The nation-state is still the basic carrier of legitimacy, both through electoral processes and through the sentiments of allegiance it is able to mobilize. Global governance cannot be global government. It is instead a system involving many types of international cooperation that facilitate collective action.

The economic crisis and the summit meetings it has triggered have placed economic governance at the heart of the international debate in 2008 and 2009. Below I will focus on the economic aspects of global governance, and some of the institutions that are most important for economic governance. Global governance relating to other areas, such as security (and the UN Security Council), or global health and other non-economic areas of global collective action are beyond the scope of this paper.

Informal and Formal Mechanisms of Global Economic Governance

The convening of the two "leaders level" G-20 meetings, first in Washington on 15 November 2008 and then in London on 2 April 2009, has been a major step forward in enlarging the table that was for decades reserved for a group of rich countries' meeting as the G-7, and then, with the addition of Russia, a single middle income country, as the G-8. These two very visible G-20 meetings have added momentum to the debate on global economic governance, at a time of great crisis in the world economy.

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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 system, the Bretton Woods Institutions, and the WTO. The United Nations system itself includes a great variety of treaty- or formal international agreement-based organizations with special mandates, such as the ILO dealing with employment issues, the UNDP dealing with development or UNESCO dealing with science, technology and education, to give just three examples.

The G-20 meetings reflect another, informal approach. These gatherings are not treaty based. They are simply meetings of nation-states trying to discuss global or regional issues in an informal setting, with the aim of either making some decisions together or of preparing decisions to bring them to the formal governing organs of the treaty based international organizations. I will call the various groups that are being talked about the G-N, where N ranges from 7 to 20 or more. It is important to distinguish between the two different forms of international cooperation, formal and informal. Both need to be improved to enhance global economic governance.

Starting with the first G-7 meetings in the 1970s, initiated by then French President Valery Giscard d'Estaing, the informal arrangements have endured and have become institutionalized, but they 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 G-20 rather than the G-8 has now moved to center stage in the 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 meetings of the G-20 were convened at the level of heads of state or government, with the second "Leaders" meeting having taken place in London on 2 April 2009.

Moreover, both in Washington and in London, the group that met was actually larger than the original G-20. In London, it included Spain and the Netherlands, as well as Ethiopia and Thailand, representing Africa and ASEAN (the Association of South East Asian Nations). But despite this enlargement, and to some degree because of it, it is unclear what the future of these meetings will be. On the one hand, even enlarged as they have become, there is a problem of legitimacy, with many of the excluded very unhappy at not having a seat at the table. On the other hand, with the group expanding, some argue that it is already too cumbersome, and that further expansion would defeat the purpose of having a relatively small number of leaders interact in an informal way that is conducive to real debate and also to actual decisionmaking. So what would be a best way forward?

A Leader's Group?

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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. We have had an L-20 + meeting in Washington in November of 2008 and another one in April in London. A third Leaders level meeting has been announced for the Fall of 2009, to be hosted by President Obama. Institutionalizing the L-N would naturally take as its starting point the 20 included in the original G-20. But in addition to countries representing only themselves, it would be good to enlarge participation to include more formally some rotating representatives of smaller and medium sized countries, in addition to the EU that is already present as the "20th" member, in the original group.

Three additional members could represent three 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. Alternatively, the "representative" participants could be elected to represent the regional geographical groups at the United Nations—in that case Eastern Europe would constitute a fourth grouping. Alternatively they could be designated by regional organizations such as the African Union and ASEAN, as was done for the London meeting.

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 and London meetings, alongside the Managing Director of the IMF and the World Bank President. The Managing Director of the WTO should also be present as he was in London, 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. As the OECD becomes more global in the coming years, there would be a good case for inviting the Secretary General of the OECD. In any case, Angel Gurría was a "non-resident" star of the London meeting, given the OECD's leadership role on the "tax-havens" issue.

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 major 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 the G-8 + 5 formula, 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.

The Managing Global Insecurity (MGI) project sponsored by the Brookings Institution and New York University has proposed adding three more countries to the G-8 + 5 formula (Indonesia, Turkey and Nigeria or Egypt). 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. 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 more into high-level "forums" rather than meetings conducive to formal decisions. The London meeting may have been exceptional as the worldwide crisis spurred the leadership of the G-20 nto actual decision making mode. 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.

On balance, and given where the world has arrived at with the London meeting in April of 2009, the annual "Leaders Table" should probably take the G-20 as its starting point and include some formal and rotating regional representation. The participation of the executive heads of the major international organizations already has brought a more truly global and inclusive dimension to the meetings and can constitute a link between the informal L-N setting and the discussions taking place within the framework of the treaty based organizations themselves. A form of regional representation linked to regional groups at the UN, or possibly to elections of the three of four regional representatives by ECOSOC, the UN's overarching economic and social governance body specified in the UN charter, would have the advantage of building an even stronger "bridge" between that inclusive world body and the new L-N group, increasing the wider appeal of the meetings to the community of nations, while still keeping the size of the L-N to manageable proportions.

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.

It is very important to stress, however, 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 World Bank, the UN itself, 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? 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 Washington and London meetings have been very useful in that way.

The L-N can 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. 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.

Reforming the Formal System of 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. The governance of each one of these organizations has become outdated and needs far reaching reform. Both the governance and activities of these institutions have to better reflect today's realities and challenges. In the London meeting the largest economies in the world have expressed their desire to see the IMF play a very central role in the world economy, in the fight against the current economic crisis and beyond. The final G-20 communiqué calls for a threefold increase in the resources of the IMF. The future of the IMF is going to be a central part of the future of global economic governance. The remainder of this note on economic governance focuses, therefore, on the IMF, given the size and critical importance of this institution. The London summit also gave support to Financial Stability Forum, renamed Financial Stability Board, and called on it to work closely with the IMF.

A renewed and reformed IMF could be the key international institution providing the critical "global public good" of precautionary finance and macroeconomic 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 it into an effective and legitimate organization that facilitates macroeconomic policy coordination and 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.

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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 and truly global role in macroeconomic policy reviews and policy coordination, with an enhanced commitment by all member states, including rich countries, to this process. The fact that the richest countries did not really engage with the IMF on their domestic policy issues in the past was a key source of weakness and lack of legitimacy. The times when the IMF's role was to advise 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 review. This has been recognized in the London meeting. 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. The IMF has developed a new facility to address the current crisis and future precautionary needs. There is also an ongoing review of existing lending facilities in the context of the substantial expansion of resources that is under consideration. An expansion in the allocation of Special Drawing Rights (SDRs) and an enhanced role for the SDR or, better, a new SDR with compositional weights that reflect today's realities in the global economy, should be part of this reform.

The discussion about the resources of the IMF, its role and its governance are all interlinked. Reforming the governance of, and decision-making at the IMF, to enhance both legitimacy and effectiveness, is critical to the use of its resources. At the end of 2008 and the beginning of 2009, we witnessed the strange situation of mounting resource needs in many emerging market economies hit by the crisis and the presence of a new short-term liquidity facility at the IMF, without any demand for that facility materializing! Part of the reason for this lack of demand, despite pressing needs, has been the continued stigma attached to IMF programs and the internal political problems IMF programs create for national governments. One new facility developed in time for the London meeting already has Mexico as its first user. But it is too early to say whether the political and stigma issues have been resolved.

Some are proposing that the key to governance reform at the IMF should be the transformation of the International Monetary and Financial Committee (IMFC) into a governing Council of Ministers that would elevate the level of governance, reflecting the vastly enlarged financial role that the institution is called on to play. The proponents of this proposal view it as a way to strengthen multilateral economic governance, in the interests of all, but particularly also in the interests of the developing countries. And yet most developing countries have resisted the call for a Ministerial governing "Council", because they perceive it as a vehicle that would further strengthen the *de facto* influence of the rich countries, with Treasuries able to draw on much more staffing and resources than their developing country counterparts. Moreover, a governing Council of Ministers mirroring the existing distribution of seats and voting weights of the IMF board, with European countries being strongly overrepresented, would make things worse, rather than better in the eyes of the developing countries.

A Ministerial Governing Council for an organization of the importance of the IMF would be an important step forward, provided 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. Without a real reform in the voting weights, there can be no governance reform at the IMF. And without governance reform, the institution will have difficulties in playing the critical role it is being called on to play.

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 but also a major re-organization of the existing constituencies. A major next step should be taken at the Istanbul annual meetings in the fall of 2009. Other steps should follow, every two or three years. The key advantage of the 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 senior leaders, 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 top governing body. 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 percent of the weighted votes and 60 percent 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, and should be discussed in the context of improving the legitimacy of the IMF's governance.

If eventually agreement can be reached on 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 Ministerial 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.

Some argue that even with major governance reforms, the IMF will always be too constrained by national policy makers and their immediate political interests to be able to come out with the tough and totally impartial policy analysis and early warning messages that are required. In addition to these formal governance mechanisms, the IMF's legitimacy and effectiveness no doubt 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 12 to 15 eminent outside experts, geographically diverse and drawn from personalities with proven track record policy making, academia, civil society or the private sector. They should NOT all come from the financial sector. This group should be appointed for several years, and once appointed, should enjoy total independence. The group would work closely with the Evaluation Department of the IMF, 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 reflected 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 a much broader set of stakeholders.

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The communiqués of the summit meetings have also called on the IMF to work with an expanded Financial Stability Forum and other regulatory and standard setting bodies on advancing the financial sector regulation agenda. The extent to which the IMF itself should be involved in actual 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 "Board", working in cooperation with a reformed and more effective IMF, much more inclusive and participatory. paper.

Conclusion

The enlarged L-20 meeting in London at a time of threatening worldwide crisis has given visibility and impetus to the debate about global economic governance. The institutionalization of such a meeting would overcome the outdated nature of the G-7 and constitute a big step forward in bringing the new dynamic developing countries into the evolving system of global economic governance. This should not lead one to forget, however, that the informal G-N processes should reinforce the reform dynamic in the international institutions and their more binding and more formal decision making processes. Global issues management and collective action require both types of governance and networking mechanisms. Hopefully the current crisis will be an opportunity for a real breakthrough, not only in the reform of the IMF, but in the reform and the strengthening of the multilateral institutions as a whole.

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