Jörg Asmussen: The future of global economic governance

Speech by Mr Jörg Asmussen, Member of the Executive Board of the European Central Bank, at the Hertie School of Governance, Berlin, 22 February 2013.

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Dear Mr. Feldmann,[1]

Dear Dean Anheier,

Ladies and gentlemen,

- I am glad to be here in Berlin today at the Hertie School of Governance on the occasion of the launch of the Governance Report 2013 and to share with you some thoughts on the future of global economic governance.
- It has now become commonplace to say that we live in a "flat world", a world characterised by ever-growing interdependence and interconnectedness.[2] The integration of emerging market economies into the global economy, along with lower transportation costs and technological change has led to unprecedented increases in the circulation of goods, labour, capital and information around the world.
- Insofar as the world today has so profoundly changed, it is unsurprising that today's global challenges are also markedly different from those of barely one or two decades ago.

The globalisation of production chains is just one example of these profound evolutions. Products are no longer "made in Germany" or "made in France". They are "made in the world".[3]

The 2011 natural and nuclear disaster in Japan has shown how much countries are now connected in ways that are far stronger than previously thought. As we have learned, the impairment of a few factories in just one country can have a significant impact on policy choices in other countries, as we see here in Germany, on an entire industry worldwide and, ultimately, on the global economy. This new picture is so striking that the methodology to measure trade is being recast in terms of the value added each country brings to the production chain.

This may have important policy implications, for instance on the debate about global imbalances.

Formal and informal international institutions have been created since the aftermath of the Great Depression to manage the challenges arising from ever closer global economic integration. The IMF and the World Bank since 1944, the G7 since the 1970s, the WTO since the 1990s are all part and parcel of this global economic governance system. The outbreak of the global economic and financial crisis in 2008 has now brought the G20 at the centre of global economic governance.

The key question now is whether today's global economic governance is tuned to a world where challenges have become truly global in many aspects, an evolution which the global financial crisis has only accelerated. You are perhaps familiar with Zhou Enlai's answer to de Gaulle when he once asked him his opinion on the impact of the French Revolution of 1789.

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1 I would like to thank Arnaud Mehl and Isabel Vansteenkiste for their valuable input in preparing this speech.

2 See T. Friedman (2005), *The World is Flat, A Brief History of the Twenty First Century*, Farrar, Straus and Giroux.

3 See for instance WTO (http://www.wto.org/english/res_e/statis_e/miwi_e/miwi_e.h).

"Too early to say" was his reply. Barely four years after the outbreak of the global economic and financial crisis, you will not be surprised if my answer today remains tentative, too.

In my view, despite the important and significant progress already made, global economic governance still falls short of meeting the scale of today's challenges.

First and foremost this is because it is still largely driven by national considerations, but also because the evolutions that have occurred since the crisis still leave some key issues unresolved. These pertain to the leadership, coherence, efficiency and legitimacy of global economic governance. The discrepancy between the reality of today's interdependences, the challenges they create, and the capacity of sovereign governments to agree on how to deal with them remains significant.

In the remainder of my speech today, I would like to elaborate on these aspects by considering

- the challenges created by the onset of the crisis for the traditional foundations of global economic governance;
- the salient evolutions in the latter and their limitations; and
- how global economic governance could be strengthened going forward.

1. Challenges created by the onset of the global economic and financial crisis for the traditional foundations of global economic governance

The main reason why global economic governance today remains largely dependent on local considerations is that it is still founded on the principle of national sovereignty.

The Westphalian order of 1648, which sacralised the principle of sovereignty of Nation-States, remains at the core of international economic relations today.[4] More than three centuries after the peace of Westphalia, global economic governance still results for its largest part from decisions of sovereign states.

Any meaningful collective decision that helps address pressing global policy issues requires a consensus between sovereign nations, which still results from – often difficult – compromises.

Global economic relations hence remain mostly inter-national rather than transnational or supranational. In other words, global governance is still in essence the globalization of national governance[5]. It crucially depends on the ability of sovereign nations to find consensual solutions to the common challenges they face and on their willingness to stick to their agreements.

Within the G20, for instance, advanced economies cannot be forced to implement the commitments they made at the Toronto Summit of 2010 to halve fiscal deficits by this year and stabilise debt ratios by 2016, if they are reluctant to do so. Nor can emerging market economies be forced to move more rapidly towards market-based exchange rates.

Even in global trade relations, which are policed by WTO rules, the preferred solution in case of disputes is not to resort to the WTO's system of dispute settlement, but for the countries concerned to discuss their problems and settle disputes by themselves.[6]

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[4] See H. Kissinger (1994), *Diplomacy*, Simon & Schuster.

[5] See the speech by P. Lamy entitled "Global governance requires localising global issues", Oxford, 8 March 2012.

[6] See H. Horn, L. Johannesson and P. Mavroidis (2011), "The WTO Dispute Settlement System 1995–2010: Some Descriptive Statistics", IFN Working Paper No. 891.

For many years, even centuries, the Westphalian principles seemed to provide a stable system as power – meaning the ability to get things done – and politics –meaning the ability to decide which things need to be done – were conjoined in the institutions of the Nation-State.

Global stability was guaranteed insofar as global policy making was steered by one global leader, or hegemon, such as the US for the largest part of the 20th century. Then, from the 1970s the world's leading industrialised economies became increasingly associated to the management of global economic and monetary affairs through the G7.

This gathering has been based on common interests and values, such as democracy, the market economy and floating exchange rates.

The 2008 global financial and economic crisis has sent a large shock wave through this traditional system, however, for two main reasons.

First, it has accelerated the rise of the "Rest" relative to the "West", to paraphrase Samuel Huttington. Its impact was felt most strongly in advanced economies, while emerging economies – barring Central and Eastern Europe – have remained less affected.

It has hastened the emergence of China, Brasil and India as leading engines of global economic growth. It has given them greater legitimacy to hold an important role in global policy making. There is no clear hegemon any more able to centrally steer the process.

Second, the 2008 global financial and economic crisis has made more visible the gap between power and politics created by globalisation.[7] As interdependences and international spillovers have steadily grown, power, i.e. the ability to address today's most pressing policy challenges, such as international macroeconomic cooperation, global imbalances, financial regulatory reform or protectionism has partly evaporated from the Nation-State to the global level. But politics, i.e. legitimacy in taking decisions, remains largely local and national, as it was before.

We have seen a similar gap between power and politics in the European debt crisis: Developments in single Member States where ultimately not controllable by the sovereign nation state anymore and they created spill-over effects on other Member States through a number of channels in the internal market.

Member states lacked the power to tackle the problems while at the same time, institutions at the European level to fill this gap were either missing or the working methods were inadequate for crisis management. We have made remarkable progress in enhancing the governance structures in Europe in 2012 and in closing the gap between power and politics. The ESM is fully functioning, we have improved the working methods of the Eurogroup and we are working on a banking union. Still much needs to be done in enhancing European governance in the next years following the four Presidents' report.

Most importantly from my perspective, we have to strengthen democratic legitimacy on the European level and thus the role of the European Parliament.

2. Salient evolutions in global economic governance since the onset of the crisis and their limitations

Global economic governance has not remained immobile since the onset of the crisis. Importantly, it has become more inclusive, notably through the ascent of the G20. It has been reformed to account for the growing importance of emerging market economies in the global economy. I was involved in G20 meetings of Finance Ministers and Central Bank Governors since this forum first met in Berlin in 1999 and I also served as the Chancellor's Sherpa in the

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[7] See Z. Baumann (1999), *In Search of Politics*, Stanford University Press.

Cannes Summit in 2011. Nobody participating in the first gathering, which took place less than 1 kilometre from where we meet today, would have anticipated the role this forum would gain in global governance within one decade.

The upgrade of the G20 from a Finance Ministers' to a Heads-of-State level in November 2008 strengthened its political profile even significantly further and we have seen a similar development on European level from a finance ministers' format – the Eurogroup – to leaders' level – the Euro Area Summits.

This "upgrade" of the G20 to the leaders' level led to its elevation to the status of premier forum for international economic cooperation at the Pittsburgh Summit of 2009. The membership of other key international fora has been extended to overlap with that of the G20, such as that of the Financial Stability Board, which plays an active part in strengthening the international financial architecture and global financial stability. IMF quotas and governance have been adjusted in 2010 to raise the voting shares and representation of large dynamic and emerging market economies.

And the largest of these economies (Brazil, Russia, India, China and South Africa) now meet regularly at the level of Leaders to discuss issues of common interest since the Yekaterinburg Summit of 2009.

The G20's promising start has unfortunately been followed by more mixed results. The first three G20 Leaders' Summits of 2008–09 (Washington, London and Pittsburgh) led to important achievements. Concerns that the global economy was on the verge of the most severe downturn since the Great Depression helped forge agreements on a joint macro-policy response, on increasing IMF resources and on a financial repair and reform agenda.

The Seoul Summit of 2010 proved less ambitious, although the IMF quota and governance reform was then widely regarded as a welcome step.

Since then, the G20 has lost further momentum with the Cannes and Los Cabos Summits delivering more modest results, putting in questions the G20's effectiveness and by this its credibility.

This loss of momentum is to an important extent due to a waning sense of urgency. At the height of the global economic and financial crisis in 2008–2009, G20 Leaders collectively agreed on the root causes of the problems and on the urgency and course of action needed to overcome the crisis. Since the global economy stepped back from the brink, progress has slowed down as world Leaders feel less pressured to strike deals. As a result, some have noted that "active involvement" has moved into "passive avoidance".[8]

Hence global economic governance as we know it today seems to be well equipped to manage a global crisis. But it is less effective during normal times, which also lessens its ability to prevent future crises.

Four interconnected dimensions of global economic governance account its lack of effectiveness outside crisis periods:

Its leadership: The G20 lacks clear leadership. Uncertainty as to which country or countries could emerge stronger from the crisis is blurring global leadership, insofar as a new global governance regime is the product of a "consensus of the winners", as once argued by former Brazil President Cardoso, pointing to the case of the US and its allies after World War II.[9]

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8 See IFANS brief 2011–32.

9 See the quotes from former Brazil President Cardoso in N. Berggruen, *Intelligent Governance for the 21st Century*, p. 157.

Its coherence: the shift from the G7 to the G20 has increased the representativeness of the leading forum for international economic cooperation at the cost of increasing the diversity of values and interest expressed at the negotiation table. Differences in views on issues like the Doha trade talks or climate change are such that they are rarely tabled for discussion in G20 meetings anymore, because chances for progress are thin.

Some go as far as claiming that the crisis would have created a "zero-sum" world, one in which one country's gains are increasingly considered as another's losses.[10] They point to tensions on global imbalances between external surplus and deficit economies, on international financial spillovers arising from the effect of monetary policy easing in advanced economies and reserve accumulation in emerging economies, on trade and financial protectionism, as substantiating their view.

Its efficiency: the legitimacy gained by the G20, relative to the G7, has come at the cost of an efficiency loss. Consensus is easier to find in small, informal gatherings rather than in heterogeneous, large ones. Given the prevalence of the Westphalian principle of sovereignty, a premium remains on "naysayers" which can block decisions. Agreement on the smallest common denominator remains prevalent.

Its legitimacy: the G20 suffers from a lack of legitimacy in two respects. From a global perspective, it still excludes over 80% of the countries in the world which some see as weakening its legitimacy as the global economic rule setter.

From a domestic perspective, the fact that the G20 might appear distant to citizens is not helpful to strengthen its legitimacy given, as it has been observed, that it is intrinsically linked to local proximity.[11] Given the current set up, G20 decisions are often difficult to convey and explain at the domestic level.

As a result, some pessimists have argued that we would now live in a "G-zero" world.[12]

I do not share such a pessimistic view. Despite its limitations, the G20 remains an essential instrument for global economic cooperation. There is no viable or obvious alternative to the G20. In many policy fields a return to the G7 is not an option. Moreover, there is no shortage of global challenges in need of a global response, just think of trade and protectionism, the still not completed financial reform agenda or climate change.

Accordingly, we need no new institutions or bodies for global governance. Instead, the G20 should develop further into what it was meant to be from the outset: the premier forum for international economic cooperation.

3. How the G20's role in global economic governance can be strengthened

How could this be done? Let me give you some pragmatic suggestions that have been made as to how the G20 could be taken forward.

In the long run, stronger global economic governance might require to partly adapt the traditional Westphalian principles whereby global governance is still in essence the globalization of local governance.

This is, as I understand, in the spirit of one of the proposals made in the Hertie School's Governance Report 2013, with the notion of "responsible sovereignty", i.e. "an exercise of

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10 See G. Rachman, "Zero-Sum World", Financial Times, 22 October 2010.

11 See the speech by P. Lamy entitled "Global governance requires localising global issues", Oxford, 8 March 2012.

12 See I. Bremmer and N. Roubin (2011), "A G-Zero World", *Foreign Affairs*, Vol. 90, Issue 2.

sovereignty respectful of the sovereignty of other nations… that anticipates the limitations of "going it alone" while foreseeing the benefits of joint action".[13]

The debt crisis in Europe has painfully shown the limits of national sovereignty. I am convinced that sharing sovereignty on the European level means ultimately regaining sovereignty for the Member States and that this may also hold true in a global context in a longer term perspective.

For responsible governance, the G20 might need first and foremost to develop a set of common values at the international level in the name of which action could be taken.

Second, some have argued that the G20 could establish a permanent secretariat.[14] This would ensure continuity in agenda setting. There have been recent examples since the crisis of informal structures that have been usefully formalised, such as the shift from the Financial Stability Forum to the Financial Stability Board.

These ideas might give a sense of direction towards which to steer the G20 in the long run, but they are not easily implementable in the near term. In the near term, the ability to deliver results, the credibility, and therefore the legitimacy, of the G20 could be strengthened by improving existing processes. I see here three important avenues.

First, it is important for the G20 to increase the accountability and transparency of its decision-making process. Vague goals and non-measurable objectives leave too much scope for interpretation and reduce credibility.

Recently some progress has been made on agreeing on more concrete objectives. More recently, no later than last week in Moscow, G20 Finance Ministers and Central Bank Governors agreed to adopt an assessment process on the implementation of the structural reform commitments. However more efforts need to be undertaken in this regard.

Second, a more focused and concise and operational agenda might also be helpful. Since its inception, G20 meetings' agendas have gradually expanded. They now encompass a wide range of global policy themes which go beyond macro policy coordination. While in some cases, this has been helpful in engaging e.g. developing countries, in a structure with an annual rotating Presidency and without a permanent secretariat, it is difficult to make progress on an ever increasing number of issues in a meaningful way.

Finally, it has been also suggested that the G20 could enhance its legitimacy by relying more on international financial institutions and engaging current non-members on an issue-by-issue basis, rather than by expanding its membership overly, which could dilute its effectiveness.[15] Greater involvement of international organisations, whose membership is universal, could significantly increase the legitimacy of decisions taken at the G20. Involving countries which are currently not a member of the G20 on an issue-by-issue basis could equally improve its legitimacy. Currently, the G20 presidency can invite some non-members. However, the selection process remains ad-hoc. Using more objective criteria to involve certain non-member on issues for which they are of systemic relevance could be useful in this respect.

To conclude, the 2008 global and financial crisis has shown the need for more global solutions. Global leaders have shown their ability to respond to this need.

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[13] See Hertie School of Governance, *Governance Report* 2013, Overview, p. 3.

[14] See for instance C. Bradford, J. Linn, P. Martin (2008), *Global Governance Breakthrough the G20 Summit and the Future Agenda*, Brookings policy brief series, No. 168.

[15] See P. Subacchi and S. Pickford (2011), *Legitimacy versus Effectiveness for the G20: A Dynamic Approach to Global Economic Governance*, Chatham briefing paper.

Looking ahead, the work is not completed. It is now entirely up to all of us to keep the momentum going and to ensure global economic governance lives up to prospects laid down already by late Henry Ford

Coming together is a beginning

Staying together is progress

Working together is a success

Thank you for your attention.