Javier Guzmán Calafell: Global economic governance – recent progress and remaining challenges

Remarks by Mr Javier Guzmán Calafell, Deputy Governor of the Bank of Mexico, at the panel on "Shift in Global Financial Governance and China's Financial Reform", organized by the Shanghai Development Research Foundation (SDRF), the Reinventing Bretton Woods Committee (RBWC), the PBC School of Finance, Tsinghua University (PBCSF), the Shanghai Advanced Institute of Finance (SAIF), and the Triffin International Foundation, Shanghai, 31 October 2015.

* * *

The views expressed in this document are strictly personal.

Let me start by thanking the organizers for the kind invitation to participate in this important Conference.

A number of formal and informal organizations have been created over the course of more than eight decades, and particularly since the Great Depression, to provide strategic direction and a solid basis for collective action to face emerging challenges and achieve sustained economic growth at a global scale. The International Monetary Fund (IMF), the World Bank, the Bank for International Settlements (BIS), the General Agreement on Tariffs and Trade and its successor the World Trade Organization (WTO), as well as informal country groupings such as the G7 first and the G20 later on, have been at the center of this global economic governance framework.

Although this model has been fundamental to prevent a reemergence of hazards observed in some years – like those that erupted in the interwar period – and to foster economic development worldwide, the need for a major overhaul of the global economic governance framework has become increasingly evident.

Three fundamental changes to the world economic landscape are worth highlighting in this respect.

- The role of Emerging Market Economies (EMEs) in the global economic and financial system has become far more important. The share of these economies in world GDP has increased substantially over the course of the last decades, as it rose from slightly over 36 per cent in 1980 to an estimated figure of almost 60 per cent in 2015.[1] Emerging Asia and, in particular, China are prominent examples in this regard, not only because of the sheer size that their growth dynamics have allowed their economies to reach, but also because of the impact this has had on the economic well-being of their population. For instance, the ratio of GDP per capita (PPP-adjusted) in the United States to that in Emerging Asia and China, increased from around 22 and 41 in 1980, respectively, to levels around 5 currently.[2]
- Economic and financial globalization has been one of the main characteristics of the world economy in recent years. This has been the source of many benefits, but it has also been accompanied by new challenges. In particular, as the global financial crisis (GFC) has clearly shown, the growing interdependence that has resulted from globalization means the economic problems of one country can be rapidly transmitted to others. In this context, policy options that are apparently reasonable

---

[1] Shares based on PPP-adjusted figures for GDP.

[2] Figures provided by, or calculated with data from, International Monetary Fund (2015): World Economic Outlook Database, October. See also Mohan, Rakesh and Muneesh Kapur (2015): "Emerging Powers and Global Governance: Whither the IMF?", *IMF Working Paper* No. WP/15/219, October.

at the national level are not necessarily so when adopting a global vision. Therefore, a highly globalized world presents the typical prisoner's dilemma, where a non-cooperative approach leads to poorer results for all the parties involved as opposed to one based on cooperation. In other words, the nature of today's challenges underscores the need for a framework of global governance with a much higher level of cooperation and, consequently, a level playing field.

- The GFC brought to the forefront many of the limitations of the governance framework in place. To start with, it showed that contrary to the then prevailing views, advanced economies (AEs) are at least as vulnerable to crises as EMEs. It also made clear that no effective mechanisms were in place to ensure consistency between the economic policies in the main advanced countries and global economic and financial stability. Naturally, this gave rise to serious concerns about the legitimacy of the existing global economic governance arrangements. To put it in Jean-Claude Trichet's words, "…the industrialized countries have proven particularly clumsy in their handling of global finance before the crisis at a time when their responsibility in global governance was obviously overwhelming. There was therefore no reason to confirm their exclusive prime responsibility".[3]

The GFC sparked an effort of cooperation of the international community, unprecedented in terms of its complexity and reach, which allowed to prevent the collapse of the global financial system. In addition, as a result of the crisis, major steps were taken to adjust the global economic governance structure.

In particular, EMEs were given a more prominent role in the global decision- making process:

- Following the GFC the G-20, integrated by the main advanced and emerging market economies, became the prime forum for international economic cooperation. Similarly, the Financial Stability Board (FSB), whose membership includes that of the G-20, emerged as one of the key international settings for the discussion of global financial issues.
- The GFC accelerated efforts of IMF reform required to give EMEs a participation and representation within this institution that better reflects their importance in the global economy. In particular, in 2010 a 100 percent increase in total quota resources was agreed, with the full amount devoted to selective or ad hoc adjustments to increase the quota shares of a group of dynamic emerging market economies.
- Changes within the BIS in the aftermath of the GFC also allowed greater EME participation in global monetary and financial issues. For instance, in January 2010 the responsibility for providing guidance and setting work priorities to some of the BIS main bodies (the Committee on the Global Financial System, the Committee on Payment and Settlement Systems and the Markets Committee), which had been in the hands of G-10 central bank governors for decades, was transferred to the Global Economy Meeting (GEM), consisting of governors from 30 BIS shareholding central banks in major advanced and emerging market economies.[4]

These efforts towards greater EME participation in global governance, though historically important, are still subject to a number of question marks. On the one hand, they are still far from sufficient to be consistent with the enlarged relevance of this group in world economic

---

3 See Trichet, Jean-Claude (2010): "Global Governance Today", Keynote Address at the Council on Foreign Relations, New York, 26 April.

4 Governors from another 15 central banks attend the GEM as observers. See Bank for International Settlements (2010): "80th Annual Report", Basel, 28 June; and Bank for International Settlements (2015): "A Brief History of the Basel Committee", October.

and financial affairs. In addition, as risks for the world economy became less severe and a collapse of the global financial system was avoided, the momentum for an overhaul of global governance fostered by the outbreak of the GFC lost steam.

The 2010 agreement on IMF reform provides a clear example of existing constraints on the overhaul of global economic governance, even after the most recent efforts. The measures embraced included fundamentally a doubling of quota resources under the 14th IMF General Review, and an increase in quota shares of EMEs from 39.5 to 42.3 per cent, both measures to take effect by October 2012; completion of the 15th General Review of Quotas by January 2014; and a reduction of advanced European countries' representation at the Executive Board and the elimination of appointed Executive Directors, to be implemented in late 2012.

This agreement was considered by IMF management as "…the most fundamental governance overhaul in the Fund's history, and the biggest ever shift in influence in favor of emerging market and developing countries to recognize their growing role in the global economy".[5] And yet, the proposed increase in quota shares of EMEs is still well below the figure that would be consistent with their near 60 per cent stake in the world economy. Furthermore, the reform, approved by the IMF's Board of Governors in December 2010, is still to be implemented, since the required endorsement by U. S. Congress on the most important measures has not thus far been possible. As a result, the envisaged more prominent role for EMEs in Fund governance has not materialized and, notwithstanding the huge expansion of world economic and financial transactions over the last years, the Fund has not seen a general quota increase since 1999. In addition, work on the 15th quota review has been delayed, and is unlikely to be completed by the deadline set under the Fund´s Articles of Agreement (December 15, 2015). Thus, contrary to the quota-based nature of the Fund, its financing has relied disproportionally on borrowed resources. It is also important to note that the 2010 IMF reform disregarded a modification of the criteria for the designation of the Fund's Managing Director, a position that traditionally has been reserved for European nationals. The implications of this overall situation for the efficiency, credibility and legitimacy of the Fund are evident.

Growing frustration of a number of EMEs with the current framework for global economic governance, has coincided with a proliferation of alternative schemes for international cooperation under the form of bilateral arrangements, regional financial agreements and new multilateral financial institutions. It is difficult not to establish at least some degree of causality between both trends.

The emergence of new sources of international finance, be it at the bilateral, regional or multilateral level, is a welcome development. Global needs of financing for crisis prevention and resolution, and development, are huge and not covered by existing arrangements. However, it is also important to take into consideration that to the extent that those new alternative sources of financing respond to dissatisfaction with current global governance, they may end up implying a wider dispersion of global decision making or, to put it differently, the advent of a parallel governance framework. Should this be the case, the challenges for creating adequate channels for coordination and communication, and more generally for proper cooperation among the different institutions involved, would become much greater.

Will the recent economic difficulties in EMEs affect in any significant way the current situation? This is very unlikely. Notwithstanding the complexities of the problems they face, as a result of a combination of factors EMEs will most probably continue to show higher rates of growth than AEs. In fact, according to the latest IMF projections, the share of world GDP

---

5 "IMF Executive Board Approves Major Overhaul of Quotas and Governance", Press Release No. 10/418, November 5, 2010.

accounted for by EMEs will adhere to an upward trend in coming years, with the OECD reaching similar conclusions for a much longer forecast horizon.[6]

It is therefore evident that as the center of gravity of the world economy continues to move towards EMEs, a corresponding adjustment of global economic governance will inevitably take place. As a result, we are basically left with two alternatives. One, to promote and embrace an orderly, guided change towards a better, more inclusive and representative global governance framework, and the other, to keep stalling the much-needed reform process, with the risk that even higher levels of dissatisfaction of EMEs result in the emergence of additional alternative financing schemes, and a more complex framework for global economic governance.

Allow me to make a last reflection. The predominance of national considerations over the global interest has for long been an obstacle for effective global economic governance. As some have noted, global governance in essence depends on the ability of sovereigns to find consensual solutions to common challenges and on their willingness to stick to their agreements.[7] This problem is present even in cases where a political commitment with the common interest appears to be stronger, as illustrated by the difficulties that have emerged on the road to create the institutional infrastructure required for the adequate functioning of the European Monetary Union. In my view, the reluctance of individual nations to subject decisions to global rather than local needs, is closely linked to an inadequate understanding by the authorities, and the public in general, of the implications of interdependence among countries for national prosperity in a globalized world. Clearly, we also need a much better grasp of the global implications of domestic economic policy decisions, especially in the case of the largest economies.

Are there reasons for optimism looking forward? Even if limited in scope and depth, the recent reform of the global economic governance structure was simply unthinkable a few years ago. It took the worst global crisis since the Great Depression to create consensus for the approval, although not yet implementation, of this reform. I hope that this time around it will be a good dose of wisdom, leadership and political effort, rather than the eruption of a new crisis, that will allow us to move to the required track.

---

6 See International Monetary Fund (2015): *World Economic Outlook* Database, October; and Organisation for Economic Co-operation and Development (2014): Long-Term Baseline Projections of the *OECD Economic Outlook* No. 95, May.

7 See Asmussen, Jörg (2013): "The future if global economic governance", speech at the Hertie School of Governance, Berlin, 22 February.