Svein Gjedrem: Multilateral approaches to global challenges

Speech by Mr Svein Gjedrem, Governor of Norges Bank (Central Bank of Norway), at the Peterson Institute for International Economics, Washington DC, 25 February 2010.

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Ladies and gentlemen,

I am honored to be a guest speaker today at the Peterson Institute.

The international order and Norway

The financial problems that originated in the US banking system spread quickly around the world. A severe international financial crisis followed, leading to a deep economic downturn and dramatic dislocations in global trade. Authorities worldwide have implemented unprecedented policy responses.

When the crisis unfolded, the G20[1] and the International Monetary Fund (IMF)[2] rose to the task. Nevertheless, I believe that the role of non-statutory bodies and the statutory institutions must be reconsidered to promote the necessary multilateral approach to global governance. This will be the theme of my talk today.

Norway is a small, open, advanced and essentially commodity-based economy. Norges Bank is an independent central bank with an inflation targeting framework. It also manages the Norwegian Pension Fund Global, the world's second largest sovereign wealth fund. The country is a founding member of NATO, but not a member of the European Union. However, based on the European Economic Area Agreement (EEA), Norway participates in the Single Market of the European Union. The country has been an active participant in multilateral cooperation and institutions. It is an original member of the IMF and the World Bank, and is represented on the Executive Boards of both institutions together with seven other countries in the Nordic-Baltic Constituency.

In line with its long-held policy of supporting multilateral institutions, Norway entered into a bilateral loan agreement with the IMF in the first half of 2009, when the IMF urgently needed to strengthen its lending capacity. Later in 2009, Norway agreed to raise its commitment under the New Arrangements to Borrow (NAB) and expanded its voluntary transactions in SDRs following the large allocations. It also committed to support IMF lending facilities for low-income countries. Thus, Norway has actively backed the multilateral responses to the global crisis, in large part stemming from decisions of the G20 at the London Summit in April 2009.

Norway has a strong external and fiscal position based on large petroleum revenues. The lion's share of the revenues is invested abroad through our sovereign wealth fund.

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[1] The membership of the G20 comprises Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Korea, Japan, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States and the European Union. The G20 was formed as a new forum for cooperation and consultation on matters pertaining to the international financial system. It studies, reviews, and promotes discussion among key industrial and emerging market countries of policy issues pertaining to the promotion of international financial stability, and seeks to address issues that go beyond the responsibilities of any one organization.

[2] The International Monetary Fund (IMF) is an organisation of 186 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

The accumulation of capital in the Fund reflects the depletion of a non-renewable resource. The assets of the Fund now amount to some USD 450 billion, the equivalent of 115% of Norway's GDP in 2009, or around USD 100 000 per capita.

About 40% of the Fund's investments are in fixed income instruments and 60% in listed stocks. The Fund invests globally according to market value weights. It roughly holds 1% of all listed equities. This would not be possible without open and accessible international capital markets. Norway has a strong and vested interest in the well-being of global financial markets. Norway participated actively in the formulation of the *Generally Accepted Principles and Practices* for Sovereign Wealth Funds, the "Santiago Principles", a process coordinated by the IMF. Our sovereign wealth fund respects these principles.

Norway has weathered the crisis better than most countries. We believe a strong fiscal position and well-anchored inflation expectations have contributed to our relative success. In addition, investment activity in the petroleum sector held up well, our exposure to the hardest hit sectors in the global downturn was fairly limited, and our banks are small and relatively solid. Norway is recovering sooner than most countries, and Norges Bank was among the first central banks to raise its key policy rate. It did so twice in late 2009, up to 1.75%.

As a global investor and an open market economy, my country shares the interests of most market participants, large and small. We have a common interest in a market-based international order, supporting a level playing field and sound economic governance. Like many other countries, we have benefitted greatly from economic and financial globalisation. It has delivered prosperity and growth without precedent. In the midst of the crisis, these gains must not be forgotten.

The multilateralism of Bretton Woods

At the end of the Second World War, 45 countries agreed to establish a new international financial and economic order with the Bretton Woods Institutions, the IMF and the World Bank, at its center. In his inaugural speech to the Bretton Woods Conference in 1944, US Treasury Secretary Henry Morgenthau noted the following:

> *"We know that economic conflict must develop when nations endeavor separately to deal with economic ills which are international in scope. To deal with the problems of international exchange and of international investment is beyond the capacity of any one country, or of any two or three countries. These are multilateral problems, to be solved only by multilateral cooperation. They are fixed and permanent problems, not merely transitional considerations of the post-war reconstruction. They are problems not limited in importance to foreign exchange traders and bankers but are vital factors in the flow of raw materials and finished goods, in the maintenance of high levels of production and consumption, in the establishment of a satisfactory standard of living for all the people of all the countries on this earth."*[3]

These wisely spoken words are as relevant today as in 1944. When the IMF and the World Bank were established, it marked the beginning of a period of international economic and financial cooperation which over time embraced virtually all the countries of the world.

The Bretton Woods Institutions have served their membership well. When needed, their policies have adapted promptly and timely to changes in the world economy and the global financial system. The IMF, with its crucial competence, has been a key forum for policy collaboration. Its surveillance and lending activities are unique. I strongly believe that global

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[3] Cited inter alia in Harold James: International Monetary Cooperation since Bretton Woods, The International Monetary Fund, Washington D.C., 1996.

governance is best served by a statutory-based international economic order, with effective and legitimate multilateral institutions where all countries are represented.

In the recent decade, the rapid expansion of many large emerging economies has greatly altered the global economic landscape. Most dramatic is the re-entry of China as a major economic power. At the same time, the growing imbalances in the world economy became and continue to be a source of instability, in addition to spurring protectionist tendencies. It is perhaps time to honor some fundamental principles, such as the one noted in an IMF Pamphlet from 1992: *"The philosophy of the Articles of Agreement is based on the superiority of free trade as the organizing principle of international economic interaction."*[4]

Lessons from the crisis

The joint, massive, and unprecedented policy responses that were put in place as the crisis unfolded surely deserve due credit. As Mr. Subramanian here at the Peterson Institute noted in the Financial Times in late December 2009:[5]

> *"What is striking about the influence of economics is that similar policy responses in the fiscal and monetary areas, and non-responses in relation to competitive devaluations and protectionism, were crafted across the globe. They were evident in emerging-market economies and developing countries as much as in the industrial world; in red-blooded capitalist countries as well as in communist China and still-dirigiste India. If ever there was a Great Consensus, this was it."*

A key lesson from the crisis is the need for multilateral cooperation and collective action. It relates to the framework for polices on prevention, resolution, reform and implementation. It also relates to the institutional set-up. The international community turns to the IMF in times of crisis, in part because it is an effective institution that performs the vital functions that are called for, but also for the very simple reason that the world has no one else to turn to. The IMF has played a pivotal role in presenting the initial lessons from the crisis, in providing finance to countries with temporary balance of payments needs, and in preparing the overall framework for the international policy response. When the good times return, we must avoid *memory failure* and remember these facts of life.

The financial crisis has left a legacy. Large public and private debt, high unemployment and wide global imbalances continue to challenge the global framework for economic policy.

Shaping the global governance structure

In recent years, increasingly assertive non-statutory bodies have emerged in the area of international economic and financial collaboration, most notably the G20. The global crisis pushed the G20 into closer cooperation and at new levels. As an effective and powerful group, the G20 featured prominently in the broad international efforts to stabilise the global economy in late 2008 and early 2009. Without its prompt and comprehensive action, the consequences of the crisis would have been much worse. It is in the interest of all that the large and systemically important countries discuss issues of common interest. Their successful collaboration benefits not only themselves, but also the rest of the world.

Among the G20 measures of 2009 were the efforts to strengthen confidence in international financial institutions, the IMF in particular, to permit it to play an effective role in tackling the

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[4] The Unique Nature of the Responsibilities of the International Monetary Fund. IMF Pamphlet Series No. 46, 1992, footnote 54.

[5] How Economics Managed To Make Amends, by Arvind Subramanian, Peterson Institute for International Economics. Op-ed in the Financial Times December 28, 2009.

crisis. Indeed, the G20 increasingly uses the IMF as an instrument of its policy implementation.

The governance structures of the IMF have received considerable attention, as they are not deemed to adequately reflect recent important changes in the global economy. Misgivings about the legitimacy of these structures have played a role in prompting the G20 member countries to *"…designate[d] the G20 to be the premier forum for our international economic cooperation"* as agreed by the G20 leaders at their summit in Pittsburgh last September. With his presence at the World Economic Forum meeting in Davos last month, the Chair of the G20 aimed to *"drum up support for the idea of making the summit [in Korea later this year] a "premier forum" where all major discussions on worldwide economic cooperation will take place"*.[6]

Therefore, the current ambition of the G20 may not only be driven by the global crisis. It may also reflect the frustration of some key countries with what they see as a slow evolution of the decision-making bodies of the IMF in response to changes in the composition of the world economy and the rise of new economic powers.

International policy cooperation has thus moved out of statutory bodies and into groups of a select few, bypassing established channels and fora. Other countries do not participate, directly or indirectly, but are called upon to contribute to efforts that others have agreed. The G20 discusses and aims to agree on changes in IMF governance. The vast majority of the membership of the IMF has no voice or representation in these discussions, including all low-income countries and most emerging economies.

If they are not addressed effectively, the large and growing global imbalances that contributed to the current crisis are likely to widen anew. This would again put at risk the stability of the global economy. Linked to these prospects are the continued rigidity of important exchange rates and excessive reserve accumulation leading to the build-up of unsustainable debt. I agree with those who have said that in recent years, the international monetary system failed to promote timely and orderly economic adjustment.[7] Global capital markets failed to channel surplus savings in emerging market economies into profitable long-term investment in wealthier countries. It would seem that we still risk repeating recent failures.

Let me also mention another concern. Mercantilist attitudes may also gain ground in surplus countries. Investment behavior in these countries may be motivated by broader strategic considerations, which may prompt retaliatory measures and result in restrictions on cross-border capital flows.

Global and prompt policy action is warranted yet again. To this end, the G20 has embarked upon an unprecedented exercise in policy collaboration with the adoption of the Framework for Strong, Sustainable and Balanced Growth. IMF surveillance will acquire a new dimension by assisting G20 Finance Ministers and Central Bank Governors in the process of mutual assessment of their economic and financial policies. It is crucial that the G20 framework lives up to expectations. The decisions and policies adopted by its members will affect the environment for the formulation of economic policies in all countries, large and small, rich and poor. The Governor of the Bank of England, Mervyn King, remarked last month that *"…so far the only specific agreement [among the G20] is to talk to each other. Concrete steps to reduce the scale of global imbalances have, to date, been notable by their absence."*

6 Press release (27 January 2010) on the G20 website: President Lee to Attend Davos Forum.

7 Mark Carney: The Evolution of the International Monetary System, Remarks at the Foreign Policy Association in New York City, November 19, 2009.

And I agree that the G20 has laid its reputation on the line. It will be damaged if the framework comes to nought.[8]

And yet, the G20 lacks the legitimacy that historically has been associated with a truly multilateral framework. Its ambitious economic cooperation should be anchored in a multilateral institution. The IMF is the logical choice.

The G20 includes only the countries that established it. Membership seems to have been somewhat arbitrarily determined and not solely on the basis of relative size or importance in the global economy. The G20 formally founded the Financial Stability Board (FSB)[9] and sets its agenda. Membership is at the discretion of the G20. The G20 agrees on the activities of and changes in the IMF and more or less dictates decisions to the rest of the membership. The FSB agrees on standards for financial sector activity, which the rest of the world is expected to adopt, without having been consulted or given the opportunity to voice an opinion in the preparatory phase.

A strong institution like the IMF must be at the center of multilateral economic and financial cooperation. Virtually all the countries of the world participate and are represented in the IMF. To be able to continue to play an effective role, the IMF needs to enjoy confidence and trust, and to be seen as having a legitimate structure of governance. Last but not least, the IMF needs to be financially strong, to have at its disposal financial resources commensurate with its tasks, including the ability to provide prompt and significant financial support when needed.

The Bretton Woods Institutions are adapting to new world economic conditions, including greater relative weight of some emerging market economies. The members of the IMF aim to agree on changes in the governance of the Fund by January next year as confirmed in the latest IMFC[10] Communiqué. A review of quotas is central to these deliberations. Quotas determine the voting weight of individual member countries in the institution. Some expect the review to lead to changes in the Executive Board of the IMF. Its current size ensures broad and fair representation of the member countries and avoids an undesirable concentration of power.

An important part of the governance reforms should be to enhance the role and status of the IMFC. The composition of the IMFC ensures fair representation of the membership through the constituency structure. Although without formal decision-making powers, it has political power and stature which it can bring to bear. A reinvigorated IMFC requires a firm *policy commitment* from the membership that strategic discussions for the institution and global economic cooperation take place in the IMFC. Adequately dedicated and effectively managed, it can provide strategic leadership and guidance to the Executive Board.

The G20 has assumed a dominant role in matters of international economics and finance. Success in their ambitious tasks can only be welcomed by the rest of us. However, it is a weakness that the members of the G20 represent only themselves. Virtually entire groups of countries and regions are left out. They have no voice and no representation in the work of the G20 or in the institutions which it chooses to set up to further its agenda. This is at variance with the principles of multilateralism and international cooperation that have prevailed since the end of the Second World War. Over time, this could easily weaken not

[8] Mervyn King: Speech at the University of Exeter, January 19, 2010.

[9] The Financial Stability Board has been established to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. It comprises the G20, five other countries and international institutions and standard-setting bodies.

[10] International Monetary and Financial Committee – the policy steering committee of the International Monetary Fund.

only the G20 process, but also the IMF as it will be perceived as increasingly guided and controlled by the G20.

I referred earlier to a recent speech by the Governor of the Bank of England and I wish to do so again where he states: *"Looking further ahead, the legitimacy and leadership of the G20 would be enhanced if it were seen as representing views of other countries too. That could be achieved if the G20 were to metamorphose into a Governing Council for the IMF, and at the same time acquire a procedure for voting on decisions."* Needless to say, I agree with him, as did the Managing Director of the IMF in a recent interview.[11] In an article in the Financial Times late last year, Anders Åslund, a Senior Fellow at your Institute, argued in a refreshingly blunt manner for a change in the G20.[12]

The ongoing efforts to change global governance should not be limited to the IMF alone. In saying this, I repeat that I fully recognise the important role played by the G20 in the time of crisis. However, while the G20 continues to exist and even expands into policy areas as varied as food security, energy and climate change, its legitimacy and democratic foundations must be reinforced. This can be achieved by, for example, representation and participation on a rotating basis. Everyone does not have to be present all the time. The constituency model of the IMF and the World Bank could be adopted, providing for the participation of other countries, even if only indirectly. In that vein, the G20 might be expanded by, say, four members in conjunction with the adoption of a structure which embraces the rest of the world.

On the matters of economics and finance, I view the G20 as a complement, not an alternative, to the IMF. An appropriate solution would be the recognition of the IMF and the IMFC as the statutory-based principal forum. G20 collaboration on these matters would be recast in the IMFC or in an enhanced version in the Council if the membership decides to activate the provisions on its establishment. The IMFC is an institution of the IMF and thus has a statutory basis. It engages the membership of the IMF directly and indirectly. It would lend legitimacy and integrity to the process of international economic and financial cooperation. The Articles of Agreement of the IMF confer upon it to *"oversee the international monetary system in order to ensure its effective operation."*[13] During the crisis, the IMF proved its ability to respond promptly and effectively to very challenging developments.

I therefore submit that a statutory-based and representative global order should be one of the main objectives of the discussions on changes in the international financial architecture.

Conclusion

To conclude, I have presented my view on the prevailing international economic order which I find deficient in important respects. The G20 played a vital role in the response to the global crisis and the rest of the world depends on its successful cooperation. With the world recovering from crisis, the G20 should merge its activities with those of the IMF. That will give them both wider acceptance and legitimacy.

At the outset, I described some characteristics of Norway and emphasised our history of active support of multilateral institutions and collaboration. Currently, we do not participate where decisive discussions take place on international economic and financial issues and cooperation, including changes in the governance of the IMF. Yet we are called upon to make relatively large contributions to efforts agreed by a non-statutory body.

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[11] IMF chief warns of reliance on exports; interview with the Financial Times January 30–31, 2010, p. 5.

[12] Anders Åslund: The Group of 20 must be stopped, Financial Times November 27, 2009.

[13] Article IV, Section 3 (a) of the IMF Articles of Agreement.

I would emphasize certain key principles:

- ***First, systemically important countries need to collaborate effectively on consistent economic policies.*** Their success is vital not only for their own good, but also for that of others, including small open economies.
- ***Second, this collaboration should be anchored in a multilateral and statutory-based system of representation***, for example through constituencies, where smaller countries would participate, even if indirectly.
- ***Third, the constituencies should have rotating representation***, where small countries, at least periodically, could participate directly.

Without such a global order, the interest in contributing to international efforts is certain to diminish. There can be no taxation without representation.

Thank you.