Legitimacy and Effectiveness in Global Economic Governance

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Edited by

Biagio Bossone, Maria Chiara Malaguti, Susanna Cafaro and Saverio Di Benedetto

CAMBRIDGE SCHOLARS PUBLISHING

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This book first published 2013

Cambridge Scholars Publishing

12 Back Chapman Street, Newcastle upon Tyne, NE6 2XX, UK

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN (10): 1-4438-5301-1, ISBN (13): 978-1-4438-5301-9

TABLE OF CONTENTS

Introduction

Legitimacy and Effectiveness of Global Economic Governance: Rethinking Traditional Premises against the Complexity of the Present

Coping with the challenges of global economic governance is a topical issue of the current international agenda and the object of a vivid debate among scholars. The on-going international financial and economic crisis reveals the fallibility of the neoliberal paradigm that has dominated the world economic landscape over the last quarter of a century: regulatory and supervisory institutions have disclosed their weaknesses, and markets have shown their limits to the rational allocation of risks and resilience to shocks.

This book intends to offer a comprehensive view of this subject matter, taking on the dialectic and very fluid relations between State sovereignty, supranational rules and the role of markets, looking with the authors' eyes at finance, trade, economic development, social values and the rule of law in the many aspects relevant to governance.

The opportunity to deal with economic and regulatory challenges through the lens of legitimacy and effectiveness is the *fil rouge* of the co-authors' original contributions and the inner sense of the book. The global economy today needs a system of governance that is both effective and legitimate. Only bodies and institutions that are perceived to be legitimate can ultimately make choices that are accepted and effective. Legitimacy requires (direct or indirect) participation in decision-making, and participation in decision-making provides the only way to make choices that draw on the views and interests of all the parties involved, which are affected by those choices. Only those who see their rights recognised to participate in decision-making are then motivated to "own" the decisions taken and to respect them.

Effectiveness in governance requires a capacity to respond adequately and rapidly to emerging challenges, to prepare for foreseeable future developments, to strive for the best possible action results, and to act in ways that are appropriate to the given contexts. This is only possible if an adequate allocation of power is established, so that the best placed entities can take the most suitable measures for the circumstances. In a complex and articulated reality, both legitimacy and effectiveness are essential for sound governance.

Indeed, legitimacy and effectiveness may trade off each other in the short term: broad participation would secure legitimacy but might hinder rapid decision-making. A monocracy, instead, can lead to very rapid decisions but might totally lack legitimacy. Effectiveness and legitimacy, in fact, are mutually complementary in the long haul. In communities with multiplicities of growing voices and interests, effectiveness would be at risk if decisions were taken in contexts that were not recognised as legitimate by the members of the communities; that is, if decisions were taken outside of institutional frameworks that granted proper recognition to those multiplicities of voices and interests. Perception of illegitimacy would sooner or later raise forms of resistance or opposition to the governance system, eventually compromising the effectiveness of its action. Moreover, ignoring voices and interests would cause the decision-making process to lack relevant information, thereby putting effectiveness at risk. It would also weaken the incentives for the community members to co-operate for the success of the action taken. Effective governance requires efficient decision-making; yet efficiency may not be pursued at the expense of legitimate representation, and decisions must be the expression of a shared understanding of common objectives among community members.

On the other hand, decisions that persistently produced ineffective action would induce community members to challenge the legitimacy of the governance system in place. They would push for revising and reforming the institutional set-up underpinning the governance system and the mechanisms presiding over its decision-making processes. Legitimacy and effectiveness are dynamically and mutually linked: they constrain and condition each other and require achieving a balance between the demand for legitimate representation and the quest for effective results. But they also support one another, and no governance system would survive without one of them.

To place these considerations in a concrete perspective, it is necessary to reconsider a number of premises and to re-appraise the multifaceted dimension of the governance system of the current global economy. Indeed, both legitimacy and effectiveness have to come to terms with the multi-layered structure of the existing governance system, its highly articulated allocation of powers, and its inherent combination of old and new paradigms and actors. It is in this light that the co-authors of this book have approached different relevant topics in the context of global economic governance, highlighting inner tensions, and proposing new interpretations.

Section One draws on the theoretical key-concepts of the investigated subject, with a view to re-thinking critically the assumed premises underlying the functioning of global financial and economic markets. This exercise serves as a conceptual introduction to the following sections, by discussing the very essence of the neo-liberal paradigm and its shortcomings to understand the most recent events and to offer satisfactory solutions. Solutions that have been proposed at the highest levels to overcome the financial and economic crises of these years are criticised for attacking only the surface of the problems, while leaving the rules of the game substantially unchanged.

In Section Two, this critical approach results in investigating gaps and ambiguities of the institutional framework of the major international economic organisations (G20, WTO, IMF, EMU), by pointing out the unavoidable trade-offs between the claim for legitimacy and the need for effective decision-making. The crisis of the Bretton Woods institutions has been the main topic in the agenda of political leaders since 2008 but the solutions found have been largely insufficient and clearly oriented not to reinforce multilateralism, but rather to re-allocate powers upon limited groups of nation states, thus raising the question as to whether multilateralism is still a shared value across today's international community. It is then recognised that multilateralism today has to be reconsidered in the light of regionalism. The still on-going crisis within the European Union, which is commonly understood as being a crisis of governance in the first place, has re-opened the same kind of issues that occupied the debate at the global level, showing that common patterns can be detected within the trade-off between legitimacy and effectiveness. It has also shown that regional crises are strictly linked to global crises, and cannot be treated exclusively as local events that are only relevant to the parties directly involved. "Systemic" has become the new catchword for reading the present, since in a global world we are all connected and interdependent.

Section Three proposes a re-discussion of the regulatory role of the State to cope with the challenges of the global economy, by focusing on new legal paradigms for corporate activities, referred to as concrete experiences, such as regimes of insolvency, competition, and corporate social responsibility. The issue of the role of sovereign states in global economic governance is of course not new, and overlaps with the general discussion over the role of the State in economic matters, vis-à-vis that of the Market. In fact, the whole mainstream approach to international law and global governance in the past was based on the role of sovereign states, and has slowly evolved towards the acknowledgment of its gradual erosion. Many words have been spent regarding the new limits to state sovereignty, up to the prophecy of the death of the State. Yet, it is clear that nation states still play a relevant role in global economic governance, and that what has changed are in fact their tools or the forms of co-operation among nation states. Regulatory competition and regulatory harmonization, often by means of soft law, produce challenging trade-offs, which need to be considered within the general appraisal of global economic governance, and form part of the overall picture of the multifaceted dimension of governance today.

Finally, Section Four provides a test-bed to evaluate the possible contradictory interactions between financial paradigms and sustainability with regards to economic development policies. Indeed, too many efforts have been devoted to the analysis of financial crises, putting aside the inherent linkages between finance, trade and development. By focusing exclusively on financial markets, the analysis has suffered from too narrow a perspective and has shown an inherent inability to address issues from the roots. The authors in this section try, by the opposite, to combine finance, trade and economic development within the same conceptual frame, with a view to defining new paradigms that can better help address the real challenges of the present and the future.

In discussing global governance, we realise that the world evolves quickly. The debate on the global financial crisis of 2007-09 has left it to the sovereign debt crisis within the European Union, and its possible worldwide repercussions. The crisis of legitimacy of the institutions acting in support of the crisis countries - the IMF and the European Union in the first place – has become more and more evident: their decisions replace those of governments legitimised by the popular vote. The demand for effectiveness, too, has grown stronger in light of the role played by the time factor. It is impossible for the growing number of unemployed people to wait for solutions yet to be invented.

Some partial solutions have been explored at the global and European level, starting with the strengthening of surveillance. The dialectics between the supporters of fiscal discipline and the defenders of the welfare state, and the trade offs between rigor and growth, have put the spotlight on the failure of the capitalistic model itself – at least as we know it – to resolve those dialectics and trade offs, but there still aren't new paradigms in sight that could replace that model.

In short, while this volume is now completed, topics and ideas emerge for the next one. The Group of Lecce (GoL)[1] keeps organizing new meetings of scholars and experts, to continue a conversation that inevitably will never end.

The scope of the contributions to this book is not exhaustive, and the objective of the editors was not to strive for achieving an unrealistic completeness of the topics. The purpose was rather to tackle the issues of legitimacy and effectiveness of global governance from a variety of prospective angles, which, taken together, show the complexity of the

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[1] Established in early 2009 at the Scuola Superiore ISUFI (Euro-Mediterranean Law and Politics Section), under the auspices of the University of Salento, Lecce (Italy), and now become an autonomous think tank which collaborates with many domestic and international institutions, The Group of Lecce (GoL) consists of experts in law, finance and economics who share an interest in the development of democratic and effective institutions of global governance. In the course of its activities, GoL has elaborated a number of proposals to reform the governance system of the world economy, to be submitted to world leaders. Initially, the group has limited its contribution to proposals to strengthen economic and financial multilateralism with a view to reviving the original international co-operative spirit of Bretton Woods within the new global economic, political and social context of our times. This then led to considering the reform of the governance of the IMF and the World Bank as the first step of a broader analysis that the group has carried out. In light of this more ambitious plan, the group has then monitored and keeps monitoring policy developments following the G20 summit deliberations and other fora, and has contributed ideas and further proposals on specific aspects of global economic and financial governance (including at European Union level), with the purpose of soliciting governments' policy actions supportive of democratic and effective international institutions of global economic governance. GoL intends to expand its composition to include foreign scholars. It establishes international contacts to promote new ideas, and is open to participation of experts who share its basic principles – as enshrined in its proposals – and who wish to support its mission. All the activities and documents of GoL are available at www.the groupoflecce.org.

Within this context, GoL also organises events to discuss specific topics with scholars, civil society and members of think tanks and institutions, to open a wider debate on the future of global governance. In particular, an international workshop was held in Lecce in Spring 2011, where a large number of scholars from around the world joined together for an open discussion. This book comes from the results of that occasion for discussion and confrontation, and we are proud and would like to thank Cambridge Scholars Publishing for having offered us the chance, by publishing this book, to progress on our way towards an open dialogue on what we believe lies at the heart of our future.

matter and the inadequacy of the solutions that are only meant to dust the surface of existing paradigms.

This purpose is in line with the objectives of the GoL – of which the editors are all members – as well as with the GoLs efforts to facilitate an open debate among scholars and practitioners from many different places and backgrounds.

It is the GoL's firm belief that the crisis the world is currently experiencing cannot find unilateral solutions. A genuine multilateral approach to governance is needed for the world, not only to recover from the current crisis but, even more importantly, to mitigate the risks of instability inherent in global capitalism and to build institutions to achieve sustainable growth. A creative effort is needed in the spirit of multiculturalism and inclusiveness.

Biagio Bossone, Maria Chiara Malaguti,
Susanna Cafaro & Saverio Di Benedetto,
Editors and among the founding members of the GoL

The editors thank Liboria Maggio for her precious help in the last revision of this volume.

SECTION I –

UNDERSTANDING A MULTIFACETED DIMENSION

CHAPTER ONE

THE IMPACT OF FINANCIAL CRISIS ON THE TRANSFORMATION OF GLOBAL ECONOMIC GOVERNANCE

LUCA EINAUDI*

Abstract

Since the first signs of a long economic and financial crisis of the West appeared in 2007, important changes have taken place in global economic governance, but within an incomplete and unstable new framework. The newly created G20 leaders' process has largely superseded the G8 in its first year of life, achieving a successful start beyond expectations. In September/October 2008, the G8 followed the events, and only later managed to co-ordinate with difficulty and delays, the reaction of Europe and the US to the fallout of the Lehman Brothers collapse. Shortly after, in November 2008, the G20 leaders' process was created and took over for the following year the leading role in co-ordinating, in a much more substantial manner, a response at the global level to the threat of a depression, involving for the first time emerging countries on a truly equal footing. Against the expectations of many, the G8 has survived the emergence of the G20 and the growth of Chinese, Indian, Brazilian and Russian influences (the so-called BRIC countries). The G20's effectiveness stalled in 2010-2012, when the common interests of G20 members weakened with the end of the perception of a symmetric global threat to economic growth. Since 2010, global economic problems have focused on European debt and European institutions have been called to

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engineer solutions to a new set of problems. The EU’s difficult governance has become the focus of attention among additional signs of an accelerated relative decline of old industrialized countries and threats to the single European currency.

The largest international shift of economic and political influence since the WWII is taking place at an accelerated pace and contributes to maintaining an open-ended process of global governance reform. Historical precedents offer some insights about how unstable the evolution of international economic governance can be, especially when new potential leaders are not ready or willing to assume their new role.

1. Massive crises accelerate shifts of relative economic weight and political influence, the birth of new institutions and episodes of co-operation

The transformation of global governance has always followed in a non-linear manner and, with a certain delay, the transformation of relative economic weight of countries. Since 2000, a great convergence has accelerated between a rising China (and to a lesser extent India), returning to a more reasonable weight in the world economy, and a stagnant EU and USA (in relative terms). This is a return towards a pre-industrial relative importance of Europe and Asia, but today’s grandiose convergence is happening much faster than the divergence of the previous 150 years. According to Angus Maddison’s figures, in 1820 China represented approximately a third of the world GDP, India more than 15% and Europe 27%. In the following century and a half, industrialization, colonialism, opium and then Communism in Asia produced a concentration of production and wealth in Europe and the US that had reduced the two Asian giants combined to a mere 4.7% of the world GDP in Purchasing Power Parity by 1980, despite representing around 40% of the world population. By 2000, reforms, trade liberalization and globalization had increased *Chindia*’s share of the world GDP to 10.8%, and by 2011 to 20.1%, through a virtuous cycle of growth (see *graph 1*). So far, the lack of adequate real exchange rate readjustment of the Chinese currency has reduced the impact on the world GDP at market prices of China’s economic importance (14.4% at PPP and 10% at market price in 2011), but a re-evaluation of the Renminbi, called for by the USA and Europe, would suddenly reveal its real extent.

The readjustment of global economic and political Governance to the rapid rise of Asia (and on a much smaller scale of Latin America and Africa) had been very limited. It accelerated only as a consequence of the shock of the 2008-2009 crises. During the past decade, European countries have tried to slow down as much as they could the growth of emerging countries' role in international institutions, from the G8 to the International Monetary Fund (IMF) or the World bank (WB), accepting only a limited redistribution of influence and voting powers. In 2008 reinforced international co-operation meant an acceleration of change and the birth of new institutions. The economic emergence of China, facilitated by its accession to the World Trade Organisation (WTO) in 2001, received real political recognition in terms of influence throughout the crisis and thereafter.

In the past century every major economic or financial crisis has led to the creation of new institutions (*see table 1*). The Federal Reserve System was created as the US response to the panic of 1907, solved by the private banker J.P. Morgan, because of the lack of a lender of last resort and adequate public institutions. Out of the Great Depression and WWII came the Bank of International Settlements (BIS) and the Bretton Woods Institutions (IMF and WB) to manage, in a co-operative manner, exchange rates, and financial imbalances, to manage current account disequilibria, facilitate adjustments, prevent crises and foster joint development. The crises of the 1970's produced the G's summitry, starting in 1974 with US, Germany, France, UK and Japan (G5), and then adding Italy and Canada in 1975-76 to form the G7. The addition of Russia in 1997 into the G8 did not include the involvement of the latter country in the financial operations of the G7, except for occasional invitations. The main economic success of the G5-G7 was a concerted effort to contain excessive fluctuations of the dollar exchange rate in the 1980's. In response to the Asian crisis in 1997-98 the Financial Stability Forum (FSF) was formed, as well as the G20 Finance Ministers' process. Given that it appeared only after the end of that crisis, the G20 became, in its early years, mainly a forum for discussions, without many practical effects. Only the 2008-9 crisis produced the G20 leaders' process and caused the transformation of the FSF into the Financial Stability Board (FSB) with a larger membership and wider mandate, followed by a cascade of new EU and national financial institutions, from the European Banking Authority to those created by the Dodd-Frank Act in the USA in 2010.

The creation of institutions after crises, however, does not guarantee that attempted co-ordination at the transnational level actually works. The initial success of the G20 in 2008-2009 in averting a global depression is even more notable for that. Most economic, financial and military crises in the last 150 years have led to episodes of attempted international co-operation, but the majority failed, either straight away or at the implementation stage of decisions initially agreed upon. Successful co-operation is not the norm but rather the exception, as a rapid review of co-operative attempts in *table 3* shows.

Four major inter-governmental conferences between 1867 and 1892 attempted to regulate the international monetary system during the first globalization, when the emerging gold standard worked much less smoothly than is remembered today. After initial agreement on the gold standard and on the demise of silver as a monetary instrument, all attempts failed to achieve a more expansive monetary policy during repeated cyclical downturns through the partial remonetisation of silver, despite the efforts of several countries. After WWI monetary reconstruction worked up to a point and the financial system emerging out of it collapsed between 1929 and 1933. The 1933 London World Economic Conference call to agree a common response against the Great Depression in terms of exchange rates, foreign debts and reparations was an utter failure. Only Bretton Woods in 1944 was a significant success, rebuilding a monetary system based on a dollar standard with fixed but re-adjustable exchange rates, new International Financial Institutions (IFI), assistance for countries in need of readjustment and a process to re-start international trade and capital movements. As Harold James put it "only at the end of a war that had required an all-out mobilization of resources, and only in the context of a fundamental consensus about overall economic objectives, could such an international project of supranational co-operation be accomplished"[1]. As already mentioned, Bretton Woods was the outcome of three years of negotiations, with a limited number of participants, all belonging to the same Anglo-American wartime alliance and under a strong US hegemony. The Bretton Woods arrangement collapsed in 1971 and none of the following attempts of international co-operation managed to bridge the diverging interests and reconstruct a full system regulating exchange rates, readjustment mechanisms, and cross-border financial regulation.

2. The G8 and the G20 during the post Lehman crisis

In 2008, some European leaders initially thought they had a "good" crisis in terms of influence on the transformation of global governance, because they sensed an opportunity to show their financial expertise in hard times (Brown), or their skills in crisis management (Sarkozy), or the

[1] Harold James, *International Monetary Co-operation Since Bretton Woods*, Washington, IMF, 1996, p. 57.

limits of the US deregulated model of financial capitalism (the German social-democratic leadership). By the beginning of 2009 it emerged that Europe was actually hit by the economic crisis far worse than any other area of the world, including the US. Furthermore, global governance reform, called to make room in favour of emerging powers, took a turn which weakened primarily large European countries and Japan, while the US still kept its leadership and suffered smaller losses of GDP, despite the fact that the crisis had originated there.

3. The ballet of the G's: G8, G13, G14, G16 or G20?

The need for co-ordination at the international level against a spreading crisis forced, in October 2008, the discussion on which new format would best address the situation. It was necessary to find an optimal equilibrium between a larger representation of emerging and developing countries and the highest level of effectiveness in decision-making. The G8 was widely considered to be insufficiently representative because emerging and developing countries were excluded. The G8 itself was aware of this and in 2007 the German Chancellor Angela Merkel initiated a process of involvement in part of the activities of the G8 of the five main emerging economies (China, Brazil, Mexico, India and South Africa) through the Heiligendamm Dialogue. Most G8 countries, however did not want a full enlargement of the G8, particularly continental Europe, Canada and Japan. In the key weeks leading to the definition of a new format for world governance the Japanese G8 presidency was paralysed by a domestic governmental crisis and its slow reaction left the way open for all sorts of proposals by G8 members (G8, G10, G13, G14, G18, G20, etc…). Candidates wishing to join an enlarged G8 multiplied, including Spain, the Netherlands, Switzerland and the African Union on behalf of the clearly under-represented Africa continent.

French President Sarkozy invited the US to call for a G8+ summit with restricted additional participation. Ultimately Bush announced a leaders' summit in November, under the G20 format chosen by the host for several reasons. Formally the G20 had existed since 1999 as a meeting of finance ministers and central bankers, therefore it had the diplomatic advantage that there was no need to choose who was in it and who wasn't, avoiding more discontent. The UK was already scheduled to hold the chair in 2009 and Brown was recognised as competent and reliable. Furthermore, China had repeatedly proved reluctant to join an enlarged G8 as a guest and not on a truly equal footing. The US policy community had a long-standing preference for the G20 (which represented two thirds of the world population and four fifths of the world GDP) over the G8, where Europeans were considered to be over-represented and quarrelsome.

The G20 was particularly well equipped to represent Asia, with China, Japan, Korea, Indonesia and India being part of it. Some European states which were not members managed to “gate-crash” the G20, with the support of Sarkozy. He had several hats available: as rotating president of the European Council as well as French President, and used them to “smuggle” Spain and the Netherlands inside. When international arrangements evolve, countries and institutions excluded by any new format tend to fight to get into the club. Those, which are already in it, resist being excluded from it, even if they are not full members. Therefore formats keep expanding, with more and more people in the room: for the G7 in 1976 there were 14 leaders and Sherpas in the meeting room; in the 1999 G20 of Finance Ministers and central bankers such numbers had grown to 88 and in the leaders’ G20 in 2011 it reached a record 116, representing governments and international organisations. The consequence of this process of bureaucratization is a tendency to decline in effectiveness, an evolution which damaged the G20 as well as its predecessors (see *graph 2*). The expansive tendencies of such bodies reduces confidentiality, informality and openness, in favour of more rigid and official exchanges based on written speeches, with less speaking time available for each participant and less capacity to reach decisions rapidly. The tendency to over-expand the agenda is also detrimental. Big states are therefore tempted to move real decision making elsewhere, towards smaller caucuses, even if less democratically accountable. In 2008-2009 the weakest members of the G8 and G20 feared smaller directorates, such as a US-Chinese G2 or a slightly larger group. The apparent US-Chinese harmony of 2009 somehow deteriorated afterwards, allaying such fears. In reaction to the proliferation of meetings and excessively large formats, Obama simplified and focused the 2012 G8 summit at Camp David to the core members, without inviting any other country. The Russian President Putin was invited but did not attend for the first time, showing how his priorities were shifting. The G20 leaders also reduced their meetings from two to one per year from 2011.

In this context, the concerns of the non profit sector for democratic legitimacy are often difficult to insert in official policy, also because the political representatives of large parts of the world excluded from the table are themselves often far from being democratically presentable: for example in 2009 Col. Gaddafi was the rotating head of the African Union.

Overall in 2010-13, the G20 has normalised its effectiveness; in other words it was reduced to the limited progress that is normally achieved on an ordinary basis in most international organisations or fora.

In the first year of the G20's life, the fear of a major crisis facilitated co-operation and increased short-term effectiveness. There were clearly perceived symmetrical advantages for all participants in stopping the financial crash, stimulating the economy, preventing a return to protectionism, re-assuring financial markets and public opinion. The images of the disaster in the 1930s was very present in the minds of participants, together with the lessons commonly drawn from it in terms of Keynesian deficit spending, the importance of free trade and of effective co-operation. Even the Republican President Bush said to his aides in late September 2008: "If we are really looking at a Great Depression, you can be damn sure I'm going to be Roosevelt, not Hoover."[2] Upon entering the White House, his successor Obama had research done on the consequences of the failure of international co-operation in 1933[3]. His chair of the Council of Economic Advisers, Christina Romer and the President of the FED, Ben Bernanke, both were scholars of the Great Depression and placed what they had learned from it at the centre of their policy making. Ultimately the recession brutally hit the G8, but most emerging countries did not enter into a recession, despite a strong decline in the rate of growth. After the G20 summit in London on 1st April 2009, confidence improved and the recovery started.

Monetary policy played an important role in addressing the crisis, through massive co-ordinated reductions of interest rates and an abundant supply of liquidity to the private financial and non-financial sector by central banks. That type of action, however, had been displayed already from mid-2007 after the Bear Stearns crisis in the US. It was clearly insufficient to address financial contagion and a massive recession in the West, spreading to the whole world through the collapse of world exports. The latter was more intense at the beginning of 2009 than during the early phases of the Great Depression and a cause of great concern for policy makers, also because of the fear of a protectionist backlash as in the 30s[4].

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[2] George W. Bush, *Decision points*, Crown Publishers, New York, 2010.

[3] Author's conversation with White House Staff.

[4] Barry Eichengreen and Kevin H. O'Rourke, '*A tale of two depressions: what do the data tell us*? February 2010 update,' *Voxeu.org*. http://www.voxeu.org/index.php?q=node/3421. The column was originally published on 6th April 2009 and then periodically updated. It showed that in the first months of 2009 industrial production, world trade and equity markets were declining faster than in the early phase of the Great Depression.

The G20 managed to change the perception of the relative impotence of international economic co-operation through its first three summits by addressing macroeconomic stimulus, stopping the risk of a protectionist reaction, refinancing international financial institutions to address local crises, beginning re-regulation and starting a new process of institutional reform. The key period in designing the responses to the crisis was between September 2008 and September 2009 (see *table 3*).

The first G20 leaders' summit (Washington, 15th November 2008) launched the new process, endorsing measures to stabilise financial markets and agreeing to reject protectionist measures and conclude positively the Doha round of trade liberalisation managed by the WTO. The Keynesian principle of a co-ordinated international macroeconomic stimulus was adopted by governments even though most were politically on the centre right. Such a cumulated stimulus was later estimated at five trillion dollars, the first operation of that kind agreed on such a global scale. The summit also decided to support developing countries and established principles for the reform of global financial regulations drawing on the work of the FSF and promised a larger role to emerging countries.

While the second G20 summit was being prepared, the concrete fear of a major economic calamity focused the energies of all governments[5], leading to forms of compromise usually absent. The US for example, promoted an increase in IMF lending resources by 500 billion dollars and the issue of Special Drawing Rights (SDR) for 250 billion dollars as a form of additional liquidity for member states, exactly the type of action that the US Congress had opposed for more than a decade.

A new informal institutional architecture developed temporarily in early 2009. The G20 Sherpas (personal representatives of heads of state and governments delegated to negotiate) and finance deputies (representatives of finance ministers) of member countries co-ordinated the work and interacted with all the relevant international economic institutions as well as being tasked with producing reports and proposals, from the IFI's to the WTO, the UN system, the OECD, the FSB and regulators and standard setting bodies, represented in *graph 3*. At the time a visible process of "Gtwentification" of institutions was taking place, with **c**hanges in governance, voting rights or membership in IMF, WB, OECD and FSF to adapt each institution to the G20's characteristics. The intensity of all that

[5] Group of Twenty, Meeting of the Ministers and Central Bank Governors, March 13–14th, 2009, London, U.K., *Global Economic Policies and Prospects, Note by the Staff of the International Monetary Fund.*

work was extreme and worked during the crisis, but of course it could not be sustained in the long term and through ordinary times.

The G20 summit of London (1st April 2009) was focused on providing more than a trillion dollars of resources to International Financial Institutions in order to provide the necessary firepower to support any country in difficulty. It was also necessary to provide credit to re-start international commerce which had collapsed under the joint pressure of the credit crunch and a freeze of private consumption produced by fear. The leaders agreed to the principle of redistribution of influence in favour of emerging countries in the IMF, World Bank and FSB, and defined principles for financial re-regulation, deciding also on an increase in capital requirements in the banking system, while keeping the pressure and monitoring against protectionist moves. Actions against fiscal paradises was also decided, putting pressure on them by publishing black and grey lists, associated to possible future sanctions against persistent refusal to co-operate on international tax evasion.

The sceptics viewed the London G20 summit as a simple photo opportunity, devoid of substance and unable to stop the recession from becoming a depression. This view proved to be wrong. The London Summit was a successful effort and did rebuild confidence, defeating the ghost of the failure of the 1933 London summit. World leaders patched up some high profile public differences about stimulus (Germany resisted it), regulation (France wanted more, the US and UK were less enthusiastic) and moves against non-cooperative jurisdiction on international tax evasion (France promoted it while China was concerned about its dependencies of Honk Kong and Macao). Although not perfect and despite some visible disagreements, the G20 worked in a cohesive way and made all the necessary compromises under the threat of disaster and the fear of financial collapse and economic depression. The huge amount of work done at the technical level and not visible to the outside world also meant that the process had more depth than most had realised. To deliver more than expected by observers was part of the strategy. To protect part of the negotiations from outside view was necessary to help governments compromise and achieve a deal, preventing the excessive rigidity typical of positions adopted publicly.

The Europeans, however, realised in 2009 that they were losing influence, between the persistent US resilience to the crisis and the emerging powers. Obama seemed less interested in the G8 and in Europe than in the G20, the Middle East or emerging Asia.

The third G20 summit took place in Pittsburgh in September 2009, when the first signs of economic improvement were clearly there and the collapse of the GDP had already stopped in most countries. The G20 focused on finding a new path for growth, more stable and without the imbalances which had shattered the previous cycle of globalization. It produced the “Pittsburgh framework for strong, sustainable and balanced growth”. It was the attempted response to the build-up of global imbalances from 2000 to 2007 (China, Germany, Japan and oil exporters had large current account surpluses, while USA, Spain, UK and Italy had large deficits). Obama declared immediately after being elected that the USA could no longer be the “consumer of last resort” to support world growth. The Pittsburgh agreement provided a framework to reduce global imbalances in consumption, trade balance and public finances. The IMF was asked to monitor and assist in a mutual assessment process, subordinated to national governments. It was not intended to be an IMF-led peer review, refused by emerging countries which still resented heavy-handed IMF austerity packages of the past.

In fact the effects of the Pittsburgh framework have been quite limited, because in 2010 economic growth re-started spectacularly and regardless of the framework (5% as a worldwide average, with Europe trailing behind), fears of disaster receded and co-operation declined rapidly. While reports and recommendations for growth were produced at the international level, Europe focused too much on fiscal austerity in response to the Greek debt crisis, transformed in the spring of 2010 into a European debt crisis, hitting Ireland, Portugal and later on the whole of southern Europe. Spreading synchronized austerity policies have reduced growth prospects in Europe and worldwide. A certain degree of austerity was necessary and unavoidable in some countries affected by very high debt or deficit, but it has to be at least partially compensated by an expansion of demand in surplus countries with sound public finances. Such policies of localised stimulus are necessary to reduce their imbalances; otherwise the principles of Pittsburgh are ignored. Too much attention was focused on exchange rates (the hoped for re-evaluation of the renmimbi, fears of “currency wars”, private expectations of a Euro break-up). Despite the efforts for co-operation the world is back to the concerns raised by Keynes during the preparatory work for Bretton Woods: the burden of adjustment of current account imbalances cannot be left exclusively to deficit countries but must be shared by surplus countries as well, to prevent a fall in aggregate demand and a vicious cycle leading to recession.

Under pressure from the US, the UK and emerging countries, the G20 proclaimed itself at Pittsburgh the “premier forum for international economic co-operation”. The question of a future G8 survival was left open, but at the time the US appeared to prefer its abolition, or at least a drastic reduction in its scope.

The IMF benefited from a new life through the G20, becoming its main instrument of action and reversing its worst decline in relevance since it was founded. In 2007, its outstanding loans had reached a minimum since the 1970's (graph no.4) and it was trying to reinvent its role and mission, amid an internal funding crisis. Globalization and booming financial markets were providing governments with alternative sources of private funding, more attractive because of being devoid of traditional IMF conditionality. The IMF returned to the centre of the scene with the crisis in 2008-09, reducing conditionality in its programmes, redefining its policies, becoming one of the main advisers of the G20 and promising a larger role to emerging economies. It also received many more financial resources in 2009, so that it could help stabilise several countries in Eastern Europe, Latin America and Africa. That rebirth had limits nevertheless, because when called to negotiate a programme of readjustment with a government in need, the IMF still requires austerity (although often milder than what is demanded by the EU under German leadership). It is therefore still unpopular when it intervenes, the Strauss Kahn resignation has weakened it and the institution, like the FSB, still depends on the full co-operation of member states to be really effective.

4. G20 and G8 at the periphery of the European crisis in 2010-2012

In 2010-2012 the crisis morphed into a European debt crisis. The action moved from the G20 and G8 to the European council, Eurozone meetings and bilateral European meetings, with occasional warnings and interventions by the US. In facing the European crisis the G20 has proved unable to provide meaningful help, apart from some pressure on Italy during the Cannes summit in November 2011. An attempt failed to obtain financial support from the USA, the UK and emerging countries to reinforce the European Financial Stability Facility (EFSF), providing it with capital needed to be able to tackle the possible extension of support to larger Eurozone countries such as Spain or Italy. BRICs appeared to offer some support against contagion in the European debt crisis but then stepped back. They argued that they would channel their intervention only through the IMF, in exchange for a larger voice and representation in its decisions. China was asked bilaterally to buy bonds issued by the EFSF but declined. In the end, the June 2012 G20 summit committed to reinforce further IMF resources for possible support to Eurozone countries, with commitments of contributions for 456 billion dollars. However, none of the funds were coming from the US or Canada and only 75 billion came from BRICs, while it was Europeans themselves who put most of the financing on the table (259 billion dollars).

The great ambition of the French G20 presidency in 2011 to achieve a new international monetary agreement failed, as did most previous attempts on this matter. Sarkozy discovered in 2011 what Gordon Brown had realised in 2009: a highly visible and successful chairmanship of the G20 does not help win a re-election in the domestic arena.

5. The future role of the G8 and the G20

After 2009 the G20 expanded its agenda from economic and financial issues to development, energy and other fields, while the G8 concentrated on political issues, security, development aid, energy and climate change. But, given that leaders cannot be prevented from addressing any issue when they decide to meet, in fact the G8 has kept some space for energy and monitoring of economic policies, especially after the enthusiasm for the G20 has started to decline. On a more political level it was not the G20 that seized the initiative during the Arab revolutions of 2011 but rather some G8 countries, especially in Libya, together with other European and Arab allies. Obama decided to hold back-to-back G8 and NATO summits in 2012, indicating that the two are coming closer together. On the other hand the financial arm of the G8, the G7 Finance Ministers' process, which does not include Russia, managed to mount a successful co-ordinated operation to support the yen after the earthquake and tsunami which hit Japan in 2011, showing that it was still relevant and capable of action. The G8 discussed widely the European crisis in 2012, placing again economic issues at the centre of its agenda, despite G20's claim of pre-eminence on the subject.

6. What's left of the efforts of 2008-2009 and the reform process?

It is always easy to watch from the outside the complex and confidential work and negotiations of international institutions such as the G8 and G20, and judge it in a negative manner on the basis of scarce information. In fact the very nature of its complex operations, divided into a very large stream of activities, which are very difficult to monitor from the outside, can lend itself to hyper-simplified assessments by external observers, missing some real progress.

A lot of work has been done indeed, but many of its results are disappointing (see *graph 5*). The Doha round of international trade liberalization has stalled and made no progress since the G20 took up the issue. The 2010 reform of voting rights at the IMF will produce a shift of 6% of quota shares in favour of the dynamic emerging markets and developing countries (Brazil, China, India, and Russia will move up among the top 10 shareholders of the IMF). It has not yet, however, been ratified by a sufficient number of member states to take effect, like the previous agreement of 2008.

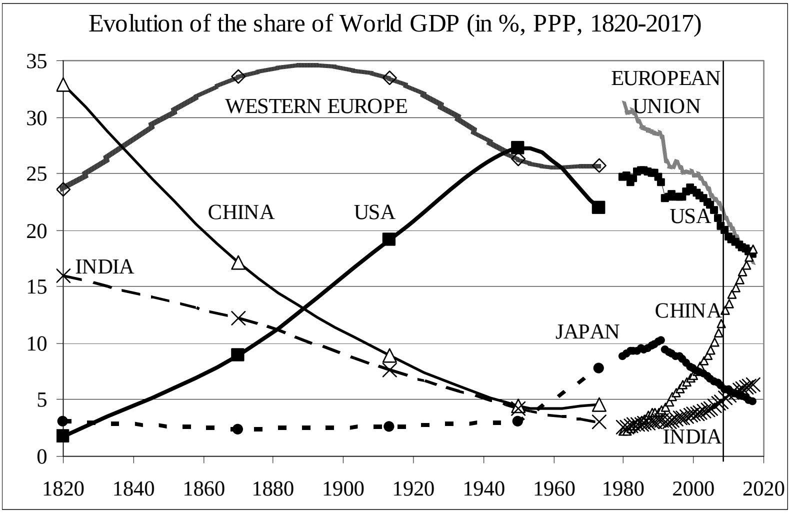
Financial regulation reform is proceeding, mainly through the FSB, but so far with limited and sometimes controversial effects on the financial system. Private financial firms lobby against more severe rules, as always after any new attempt to regulate, interlinking their claims with repeated acute phases of tension in European markets. As a consequence, policymakers hesitate and repeatedly reverse course of action. For example, capital requirements for the banking system were supposed to be raised rapidly to give banks the stability needed to prevent excessive risk taking and future bailouts at the expense of taxpayers. Then in 2010 the Basel Committee on Banking Regulation decided to implement the new rules only very progressively, until 2018, so as not to force banks to raise capital during periods of financial tensions and to prevent them from shrinking their loan portfolios to meet the new requirements. Instead at the end of 2011, the European Banking Authority (EBA) responded to the fears of a new debt fuelled financial crisis in Europe by anticipating higher capital requirements in 2012, contributing to further tensions on the banking system and prompting a new round of calls to slow down the process, leading in early 2013 to new decisions of the Basel Committee to ease and slow the process. Rating agencies, despite endless discussions on how to reduce conflicts of interest and de-stabilising decisions, still work as pro-cyclical amplifiers of instability through continuous downgrading of sovereign debt. The regulation of Over the Counter Derivatives is taking different directions in different countries. Compensation and bonus schemes in the financial sector still defy principles of prudence, reason and the need to reinforce capitalization through more retained profits[6].

[6] Eric Helleiner, "*Unfinished Business: Priorities for the International Financial Regulatory Agenda*," 27 September 2011, CIGIOnline. http://www.cigionline.org/publications/2011/9/unfinished-business-priorities-international-financial-regulatory-agenda.

7. Conclusions

A real and enduring change has taken place in global governance, but its effect has been weakened by a combination of inertia and political and financial counter-reactions. In 2009 the G20 succeeded on a number of points beyond what many acknowledged, thanks to the sense of absolute and symmetrical emergency. The G20 has not been fully successful on long-term structural changes and the hardest topics to solve are left on the agenda, undermined by a declining willingness to compromise (global imbalances, exchange rates, re-regulation). The G20 will remain, less effective, but still useful in a more "normal" way. In light of historical precedents it is not reasonable to expect transformational decisions to take place on a routine basis. The G8 has been weakened in a permanent manner, but will not disappear and is showing signs of persistent relevance as a caucus of more homogeneous, likeminded countries, while the BRICS do not yet show much strength and coherence as an alternative forum for decisions. After the "great moderation" of the early 2000's, we are now in an "age of turbulence" characterized by a relative western decline, but so far without an alternative centre of power for international economic and financial co-operation.

Graph 1



Source: until 1973 data is from Angus Maddison, *The World Economy, vol. 1: A Millennial Perspective, Vol. 2: Historical Statistics,* Development Centre Studies, OECD, Paris, 2006, p.641. For data and forecasts from 1980 to 2016, see IMF, *World Economic Outlook*, October 2012. IMF data on the European Union includes all 27 current members for the whole period, even before their actual membership of the Union.