

## **Who should govern the world economy: the challenges of globalization and governance**

(Final version published in *Renewal* Vol 9, No.2/3 (2001) pp. 73-82)

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### *Abstract*

*As protesters vent their fury at international meetings concerned globalization, they express a more widely held concern about who is governing the world economy, and at whose behest? This article describes the ways in which the new global economy is being managed. Using the international financial system as an example, I draw out four emerging models of governance and discuss the implications of each for democratic accountability. In conclusion I argue that policy-makers face a deep challenge in respect of global economic governance today, requiring clearer thinking as to where globalization is heading and by what processes its trajectory should be managed.*

## **Who should govern the world economy: the challenges of globalization and governance**

Trillions of dollars worth of investments, capital flows, goods and services now make their way around the world economy. With the new opportunities, come new risks and powerful reasons for policy-makers to worry about globalization and its impact. The new global economy is the product of three changes: internationalization, liberalization, and a technological revolution.

Internationalization has been occurring over a long period of time as states forge more links with one another as well as more international institutions to pursue mutual goals. Liberalization has accelerated since the 1980s with governments the world over adopting policies which integrate their economies more closely into the world economy. For some countries this is more of a genuine 'choice' than for others who have liberalized under intense pressure from bilateral donors, and international institutions such as the WTO, the IMF and the World Bank. A revolution in technology and communications has fuelled change, making it easier for market actors, companies, non-governmental organizations and the like - not to mention criminal gangs - to operate transnationally. The product is a world economy in which policy-makers and their constituencies are less sure of what can be managed in the world economy and how.

In the face of both new opportunities and threats, people across the world are beginning to focus more on governance in the world economy. Policy-makers worry that they are losing yet more control over their own economies and policy choices as key policy instruments seem to dangle just out of reach. They are turning increasingly to regional or international institutions in the hope that coordinated solutions will provide some respite. On the streets, however, critics argue that policy-makers are wrong to seek refuge in international institutions. They argue that in so doing, governments are removing key decisions from the people and deciding them in a secretive and

undemocratic way. At the popular level, we see this argument in the actions of protesters venting their fury on international organizations like the WTO, the IMF and the World Bank. Protesters accuse the international institutions of accelerating globalization primarily (if not purely) in the interests of big business. For this reason, globalization, injustice, and international fora have become synonymous and targets of an anti-globalization movement. The serious point here is that more issues are now being dealt with at the international level, posing a sharp question as to whether existing institutions of governance adequately represent the wide range of people and countries they now affect, and whether the agencies are adequately accountable to those they affect.

This article focuses on the political and normative questions as to how the new global economy should be managed. Below, I start by dissecting how the international economy is being governed, taking the international financial system as an example. From this starting point, I draw out four emerging models of governance in the world economy and the implications of each for democracy. In the concluding section I argue that policy-makers face a deep challenge in respect of global economic governance today, requiring clearer thinking as to where globalization is heading and by what processes its trajectory should be managed.

### **The new challenges of globalization**

Globalization has created quite specific policy challenges for governments the world over. The international financial system presents a compelling example. In the 1990s a wave of new financial crises caused world economic policy-makers to think about how to respond to new vulnerabilities in the world economy. At the end of 1994, the Mexican peso plummeted (depreciating by 50 percent within one week) causing reverberations in Washington DC and New York, as well as in other Central and South American countries worried about a 'Tequila' effect - a contagious loss of confidence in economies across the region which would cause the crisis to spread (French-Davis, 1997). In the case of Mexico, the US Treasury and the IMF were able rapidly to put together a large assistance package in order to shore up confidence in the Mexican economy - a reaction facilitated by the magnitude of US interests in Mexico. However, the Mexican case immediately raised concerns about how to deal with financial crises if they occurred in other parts of the world.

Policy-makers' concerns about financial instability proved well-founded. In 1997 a financial crisis sparked by the devaluation of the Thai baht spread across East Asia. This was soon followed by a crisis in the Russian rouble in the summer of 1998 and a financial disaster within the United States - the collapse of an investment group called 'Long Term Capital Management' (LTCM). Each of these events focussed attention on the need for more effective international cooperation and coordination, catalysing policy-makers to start discussing a 'new international financial architecture', and questions such as: Should the IMF be given a new role? Could and should the Fund intervene? Would the IMF have enough resources to intervene effectively?

The financial crises of the 1990s also demonstrated the capacity of private sector actors including banks, investment houses, security brokerages, hedge funds and asset managers to create turmoil. As these actors created profit centres out of currency, derivatives, and emerging market security trading departments, and take large positions in leveraged instruments on proprietary accounts, their

frenetic trading activities create what one analyst has described as a 'global whirlpool' (Mistry, 1998). Crucially, these actors also became powerful political lobbyist and participants in the debate about how to govern (or leave to the markets) the global financial system.

Hot on the heels of the need to reform the financial system came the question of who should participate in the debate, and in what forum? In the wake of the crises discussed above, the US Treasury moved swiftly to invite 22 countries to take part in a discussion of reform (the so-called G-22 which would later become the G-20). Other governments complained that the initiative was too US-dominated. The French Minister of Finance argued that discussions should be undertaken in the IMF's Interim Committee which at least represents all members of the IMF (Strauss-Kahn, 1997). In a separate proposal the British Chancellor of the Exchequer, Gordon Brown, argued for an over-arching 'Standing Committee for Global Financial Regulation' which would bring together the IMF, the World Bank, the G-10, and other national and international regulatory institutions (Brown, 1998). Alongside the G-20, the G-7 also created a 'Financial Stability Forum' (FSF) in February 1999, comprising themselves, representatives of the multilateral financial institutions, and market actors and regulators.

One question raised by these initiatives and responses is how do they all hold together and with what consequences for governance in the world economy?

### **The emerging governance in the global economy**

What has emerged from the debate and plethora of policies described above, are a number of different kinds of governance in the world economy. These range from a unilateralist approach by the most powerful economy in the world, to an idealized vision of global democracy. The models are worth examining in more detail in order to analyse their justifications and - for want of a better word - legitimacy.

#### *1. US unilateralism*

One strand of governance, currently dominating debate amongst analysts of world affairs, is the role, or better said the nature of US leadership. In the wake of the financial crises mentioned above, one strand of response was more US-unilateral than multilateral. Indeed, when the US Congress debated whether or not to allocate more resources to the IMF in 1997-1998, they made their approval conditional on the creation of an International Financial Institution Advisory Commission. The Commission considered the future roles and structures of the IMF, the World Bank and other institutions and reported back (the so-called 'Meltzer Commission Report') in 2000. Notable about this approach to the multilateral institutions was the fact that the Commission undertook no consultation with other countries nor in particular those most affected by the work of the international financial institutions. Rather, this statement of how the institutions should be reformed is framed in an overall presumption (comparable to US positions on other UN agencies) that if the US is not 'tough' with multilateral institutions, then foreigners will take US taxpayers for a ride. The instincts are not isolationist (as some would describe them), but rather solidly unilateralist. The goal is for the US to bring the institutions, single-handedly under control. The new administration in

Washington DC looks unlikely to take a different line.

The democratic rationale for the unilateralist approach is that the American people elect their government to look after their own interests. Rather underplayed in this rationale is the fact that as the most powerful country in the world, the US is the only country which can (at least attempt) unilaterally to define multilateralism and international cooperation so as to meet its own interests. Democracy, stability, and growth in other countries may well be impinged upon by US policies. From anywhere else in the world, and indeed in many of parts of the US which now depend upon a globalizing world economy, this democratic rationale is strictly limited.

More importantly, given the new challenges of globalization, unilateralism is unlikely to work to fulfil even US objectives. Put bluntly, having more power than other countries does not mean that you can always control outcomes, bending other countries to the US will. This was learnt at great cost by the US in Vietnam. Coercion is a costly and often ineffective tool to extract compliance from others. It may work on some issues and with countries most directly within the US sphere of influence. However when it comes to the world economy, the aspirations of US businesses, investors, and consumers go beyond this, extending to countries and markets the US has to win over by persuasion not force. For this reason, participation in the multilateral institutions is essential to the US. For other countries, international institutions are vital as a way of ensuring that their own interests are considered. The extent to which they are depends upon the structure and efficacy of such institutions.

## *2. Cooperation among states*

A second strand of governance which has played a central role in managing the new strains of globalization involves strengthened and institutionalized cooperation among governments. We have seen a new emphasis being put on institutions such as the IMF, the BIS, the World Bank, and the WTO, in the hope that through multilateral negotiation and technical expertise, solutions can be found to new vulnerabilities and these can be implemented through these agencies. Enthusiasts of international technical cooperation have proposed the creation of new institutions, such as a global financial regulator, a global bankruptcy court, global money and a global central bank to deal with the challenge of globalization.

The democratic rationale for this approach to governance is that it forges a cooperation which is in everyone's interests. International institutions enhance the mutual benefits to be gained from globalization. Agencies such as the IMF, the World Bank and the WTO smooth over the gaps and failures in the operation of markets, ensuring a more robust and stable global economy from which all benefit. Furthermore, this kind of governance is democratic in the sense that each multilateral institution has a Board which represents member governments. Beneath this Board, experts get on with the business of fostering greater cooperation and growth in the world economy.

The problem with this rationale is that it skips too lightly and quickly over the issues of representation and accountability. Large sections of the public do not buy the idea that they are represented in institutions such as the IMF, the World Bank and the WTO. And they are not

altogether wrong. In reality, representation and accountability have always been weak in these institutions. Now, however, the weaknesses are glaring because the institutions are being called upon by their powerful members to intrude much more deeply into areas which were previously the preserve of national governments. The IMF and the World Bank now seek to ensure 'forceful, far-reaching structural reforms' in the economies of their members (IMF, 1998). Trade negotiations within the WTO already include many issues-related domestic policy matters and working groups in the WTO are now working on issues such as competition policy, government procurement, and the environment for possible inclusion.

In both G-7 and developing countries, people are beginning to ask: by what right are these international institutions stepping into domestic policy? And when they do so, to whom are they accountable? The structures of the IMF and World Bank reflect their origins as essentially technical agencies dealing with issues of international coordination. The institutions are supposedly accountable to their member governments through representatives on the Executive Boards. Yet there are deep flaws in this structure. Only 8 countries are directly represented. As argued elsewhere (Woods, 2001), if their accountability is to come closer to matching their functions, the institutions need at least to have properly representative executive boards which actively control and monitor and are accountable for the work of the institutions, as well as open and legitimate processes for the appointment for the heads and staffs of the institutions. Indeed the UK government has been active in recognizing this imperative (DFID, 2000).

Multilateral institutions ideally provide opportunities for genuinely international debate and cooperation. In this they are a vital aspect of governance in the world economy. The importance of their representative role is highlighted by contrasting them to the new 'networks of experts' which are emerging as a form of governance on some issues. Enthusiasts of these networks argue that they are a crucial remedy to the failure of international institutions to engage more directly with market-based actors such as investors and regulators as well as non-governmental organizations (NGOs). Let's explore this argument.

### *3. Networks of experts*

A new strand of governance in the world economy draws upon less institutionalized forms of regulation and rule-making - the emergence of so-called 'networks' of market actors and governments in different combinations who enjoy the flexibility, expertise and a shared mind-set so as to be able to forge the kinds of rules and institutions which are necessary in a modern, globalizing economy. One (albeit rather state-centred and institutionalized) example is the Financial Stability Forum which brings together representatives of the G-7, the IMF, the World Bank, the Basle Committee on Banking Supervision, the International Organizations of Securities Commissions, the International Association of Insurance Supervisors, the BIS, the OECD, the Committee on Payment and Settlement Systems, and the Committee on the Global Financial System (formerly the Euro-currency Standing Committee).

The membership of the Financial Stability Forum highlights the great variety of institutions which has emerged in the international financial system, including networks of regulators and supervisors. An

example of a more exclusively market-based network is the International Accounting Standards Committee (IASC), a London-based voluntary group of private-sector accountants primarily drawn from OECD countries. In a recent study, one scholar has detailed the way in which this market-based group edged out inter-governmental efforts to promulgate accountancy standards and subsequently became the key actor in standard setting in the global regulatory regime, with explicit recognition of this role being given to the group and its members by the G-7, the IMF and the World Bank in 1998 (Martinez, 2001).

The democratic legitimacy of 'network governance' relies on a new way of conceiving of democracy which some describe as 'deliberative democracy' which shifts the focus from the 'inputs' of the decision-making system (i.e. elections and representative government) to the quality of the 'outputs' of the system. In this vision, networks of experts provide the opportunity for high-quality deliberation which improves outputs and governance. This is because the process of deliberation is (ideally) one in which the best ideas can be aired, genuinely expert participants can partake (without the limitations of a representative system), and in deliberating participants can learn and come to understand alternatives and modify their own starting positions. For these reasons, scholars are using this framework to justify the inclusion of non-governmental organizations (NGOs) as well as private sector actors in multilateral negotiations. For example, in trade delegations we have seen private sector actors such as American Express taking part under the US auspices in negotiations over financial services. The argument is now being used to push for the inclusion in trade negotiations of environmentalists and other transnational NGOs seeking influence on specific issues.

The weakness of this rationale lies in its lack of concern about who defines the rules and outcomes of deliberation. Those who focus on 'outputs' pay too little attention to inputs and who sets the rules, such as: who determines who can participate in the exercise?; who sets the agenda?; and who sets the parameters within which acceptable outcomes must fall? In so doing, the network governance enthusiasts overlook deep problems of legitimacy and accountability which arise from these processes.

Let us take, for example, the FSF mentioned above. Although clearly an expert group, politically it is controlled by the G-7. In June 1999, the G7 broadened representation in the forum by inviting senior representatives from Hong Kong, Singapore, Australia and the Netherlands to participate. However, there is no question that the G-7 remains in control of the membership and the agenda of the group. Likewise the IASC remains heavily OECD dominated. Does this matter?

The significance of who controls networks lies in the content and impact of their work. The FSF has been working on three issues: capital flows, off-shore financial centres, and highly-leveraged institutions (see [www.fsforum.org](http://www.fsforum.org)). All three have a direct impact on developing countries who are vulnerable to the systemic risks and issues involved, and some of whom will be directly affected by regulation in this area, such as that which would reduce offshore financial activities upon which some small developing countries rely. Likewise, the work of the IASC feeds into the assessments of investors, multilateral institutions, and bilateral donors upon whom developing countries rely. Doubtless all these issues needs investigation. Some could benefit from standards, others from

regulation. However, the participation and commitment of 'recipient' states will be required to implement the findings of the FSF or the standards of the IASC and here there is a question of whether this is to be achieved through coercion or cooperation. Some would argue that participation in deliberations from an earlier stage make cooperation more possible, and a satisfactory and sustainable solution more likely.

Network governance has an important contribution to offer in managing the world economy, bringing as it does, considerable and varied expertise on increasingly complex issues. However, even in seemingly technical areas such as accounting standards, the nature and choice of outcomes are affected by the interests of those who control the process. In essence, network governance proposes substituting expertise for democratic accountability. The problems with this argument have been aired in popular concerns about the lack of accountability of the European Central Bank. These problems magnify when network governance is expanded to encompass wider policies which have the potential to create yet larger groups of winners and losers.

#### *4. Global democracy*

Perhaps the most radical proposal for governance in the global economy is made by those who argue that globalization presents us with the opportunity - if not the need - to establish a more global democracy, or at the very least to enshrine human rights as the corner-stone of governance. From the bottom-up this means expanding the ways people can participate in decisions which affect them, and how they can shape and hold international institutions accountable. In recent debates we see this expressed in arguments for 'mainstreaming human rights', for improving the participation of NGOs, for ensuring that development strategies are empowering (see WDR 2000), and in a new questioning about how to enhance voice and accountability in economic decision-making (see framework of HDR 2002).

The real tension for the global democracy advocates lies in how they justify tradeoffs between means and ends. The global democracy case typically includes both a strong case for the implementation of a universal set of moral values - a 'law of peoples' - and a clear set of principles regarding the nature and composition of implementing institutions (Held, 2001). However, in implementing the human rights agenda, some advocates heavily privilege the ends over the means. In other words, they propose that existing institutions such as the IMF, the World Bank, and the WTO, however unfairly or unaccountably constituted, should be used to push a further agenda of conditionality in the area of human rights. Their critics argue that this smacks of imperialism, pointing out that international institutions already have too much power vis-a-vis their developing country (borrowing) members and are too unaccountable and too unrepresentative to impose further conditionality. The implication is that advocates of global democracy through a human rights approach need carefully to distinguish their argument from, say the unilateralist assertions of the US Congress. Using effective power and leverage to achieve 'good' ends casts profound questions not just about whether the ends are appropriate but equally as to whether there will be unintended consequences (which may cancel out the 'good' ends). This is not to say that might and right are always at odds, but rather that advocates of this position have carefully to pick their way into this argument.

One solution proposed by advocates of global democracy is to reform from the bottom-up as well as from the top-down by creating a new over-arching political institution - such as an Economic and Social Security Council - which would oversee and monitor the work of the IMF, the World Bank, the WTO and all other institutions of global economic governance, holding them accountable to particular human rights goals (Stewart and Daws, 2000). Such an ESSC would be more representative and accountable than the existing institutions, hence mitigating some of the means/ends problems discussed above. However, an ESSC would not necessarily mitigate the more powerful sense of political alienation and powerlessness currently being expressed in the anti-globalization movement. Below, I shall conclude by considering the challenge for policy-makers in that regard.

## **Conclusions**

Anarchists and vandals aside, the anti-globalization movement poses two serious challenges about governing the global economy which many other commentators have expressed in less newsworthy ways. The first challenge is for politicians and policy-makers to spell out their endgame, or at least their assumptions, about globalization. The second is to turn their minds to the processes by which globalization is governed.

Already G-7 countries (and many others) are actively pushing measures which accelerate globalization, through increased capital flows, freer transnational investment and production, increasing liberalization, incentives for the wider dispersion of new technologies, and a broadening of trade access into services, trade-related investment and so forth. It is not unfair of their electorates to ask, what are they aiming for? What are their assumptions about the impact of these changes?

Nobody is persuaded by a first-year economics textbook answer that the goal is a free market in which an invisible hand will produce benefits for all. Yet this kind of assumption still underpins a lot of policy-making. Policy-makers often seem to be opting to muddle along towards a more global economy, managing whatever unfortunate side-effects they can along the way. But experience demonstrates that markets become freer not as a matter of inevitability but as a matter of political choice and priorities. Witness the failure to open agricultural markets in the EU and USA after fifty years of trade liberalization, or the reluctance to free up immigration and permit the free movement of people. On the flip-side, we might note the considerable energy being expended by some G-7 members to open up trade in financial services. There is a vision, or at least a scenario in respect of the world economy underpinning these choices which politicians have not spent much time expressing or justifying to their constituencies.

Although setting out the end-goal or vision runs up against a longtime civil service traditions of pragmatism and muddling-through, nevertheless, the UK's Department for International Development has recently attempted at least to begin such an exercise. In 2001, it produced a second white paper on globalization, responding in particular to the question of how globalization might be managed so as to mitigate the costs to the poor in poor countries (DFID, 2000). Building on this, the government could go much further, spelling out the scenario or scenarios envisaged (or

even the endgame of globalization) for the UK.

The DFID report also recognizes the second challenge facing policy-makers about governance and globalization: the need to update and reform the processes by which decisions about globalization are made. A first step in this regard would be to make institutions such as the IMF, the World Bank and the WTO more accountable, and to demonstrate that people most affected by these agencies do have some voice in them. The problem is not unduly complex. In the IMF and the World Bank developing countries are not directly represented. Lumped together in groups of countries, each group elects an Executive-Director who no one country can subsequently call to account. Compare this to the UK representative who can be recalled or replaced at a moment's notice by the government. Unsurprisingly the result for developing countries is an enormous gap between the needs and views expressed by governments and those expressed on the Boards of the Fund and Bank. An equivalent lack of representation and accountability, albeit in a different structure, exists in the WTO (Woods and Narlikar, 2001). The UK has long led the field in attempting to improve these international institutions, a continuation and sharpening of these efforts is now urgent.

Policy-makers have much further to go in spelling out their assumptions or competing scenarios about globalization and governance. They will doubtless be reminded of this by the rowdy protests which now seem to accompany every inter-governmental negotiation or meeting on globalization.

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