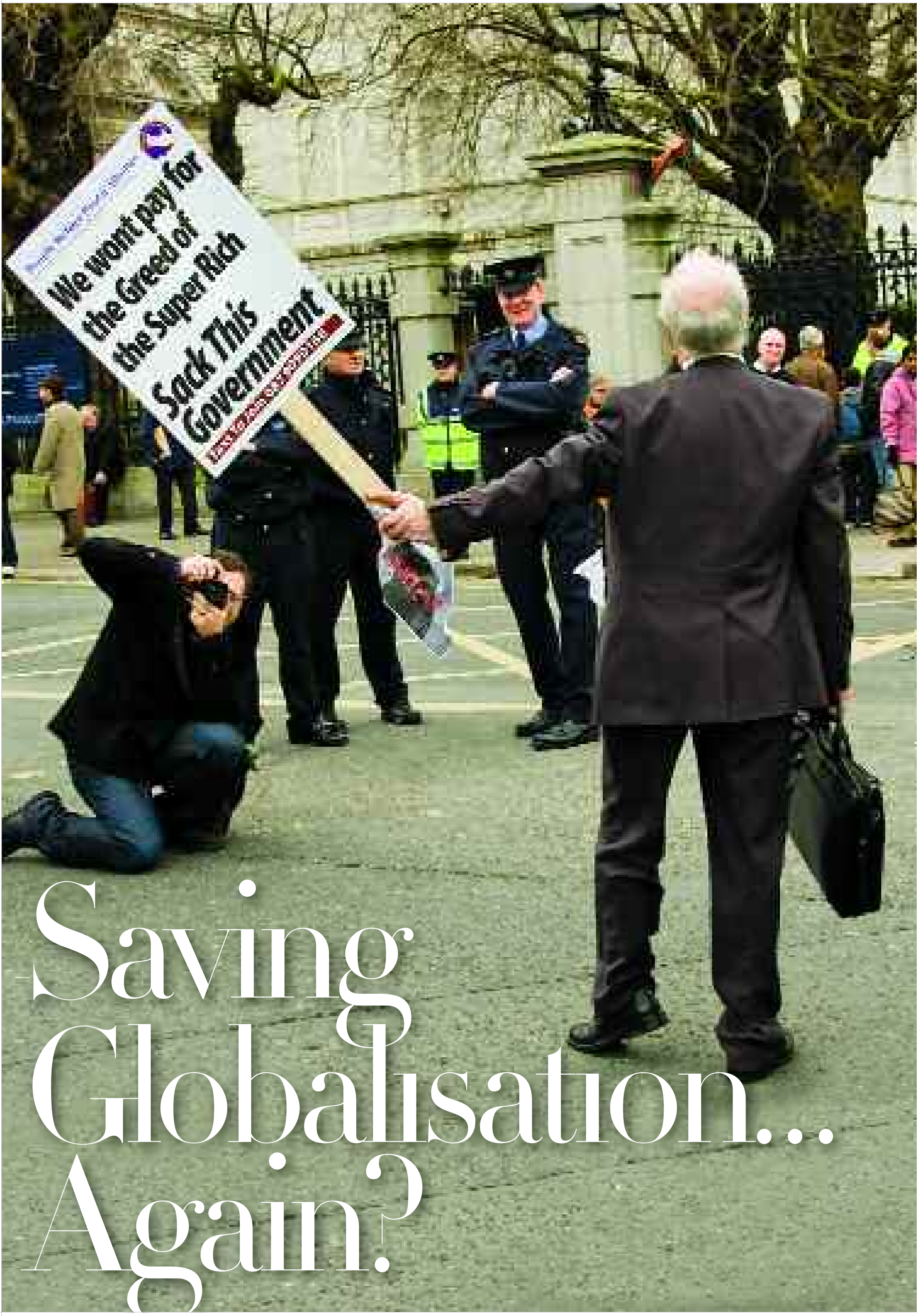
G20 ECONOMIC SUMMIT

Ngaire Woods, DIRECTOR OF THE GLOBAL ECONOMIC GOVERNANCE PROGRAMME, OXFORD UNIVERSITY



Saving Globalisation... Again?

The world will be watching when global leaders meet in London on April 2. A decade ago, massive anti-globalisation protests spurred finance ministers, from the same twenty countries as those meeting in London, to declare that they would make globalisation more inclusive. Ten years later, what looks inclusive are the harsh costs of the financial crisis with unemployment, foreclosures and a sharp economic slowdown spreading across the world. The public is angry and afraid. Angry that governments let global finance veer hopelessly out of control. Afraid that governments are now impotent to deal with the consequences.

Global leaders will have to show that they are willing and able to take measures to mitigate the harshest effects of this financial crisis at home as well as abroad. Longer-term they will need to prove that collectively they can regulate global finance, ensuring that the possibilities of globalisation do not necessarily entail a drunken dash towards casino capitalism. This is a tough agenda and the stakes are higher than ever before. The lessons from previous crises are sobering.

TOUGH LOVE

In the 1980s, a financial crisis exploded when the unregulated offshore lending activities of major banks proved unsustainable. Excessive loans to Poland, Mexico, Argentina, Venezuela and a dozen or so other countries suddenly looked unrepayable when interest rates rose after 1979. Public money, the International Monetary Fund (IMF) and World Bank were wheeled in to make emergency loans to ensure commercial banks were repaid and saved from collapse. The public in the United States and Europe were assured that international banking would henceforth be regulated to avoid any such future bail-outs.

The wider global political effects of the 1980s financial crisis were yet more dramatic. For some, the tight constraints on governments were exulted as a form of tough-love, rectifying the 'excesses' of the 1970s.

In many wealthy countries, while the economy contracted, governments sought to reduce their obligations to the unemployed, the sick and the poor: unemployment, crime and inequality all rose rapidly. In developing countries, the effects were even more severe. While the tough new economics was hailed as a solution to profligate, corrupt, high-spending governments, the longer term results were less salutary.

As poor countries' access to aid and international finance dried up, governments were urged to privatise, liberalise, and reduce expenditure, including on health, education, food subsidies and the like. These cutbacks soon produced still tougher politics.

As governments retrenched, a new, costly, violent politics appeared. Where governments failed to provide, aggressive new leaders played on tribal, communal, or religious bonds, to seize power and opportunities. Populist religious extremism soon emerged in India and Pakistan. Bitter ethnic conflicts exploded in the former Yugoslavia. Islamic extremism rose in central Asia and across the southern Mediterranean. We still live with the results today.

UNCHARTED TERRITORY

Can this crisis be managed differently? Global leaders certainly seem to be trying and, at least this time round, a fear of inflation is not lurking behind them. At their first meeting in Washington in November, the G20 leaders made numerous pledges. Among them, four core elements stand out: direct government involvement in economic growth, the regulation of global finance, financing for poor countries, and reforming international institutions.

Taken together, these measures signal a very different response to that of the 1980s. Put simply, governments are saying that this time they will try to step-up rather than step-back from managing their national economies and the global economy. Can they do this?

A first element of this G20 package is a 1930s-style New Deal response. Governments have pledged to use monetary policy to stabilise financial systems and fiscal policy to stimulate demand in each economy. Politically this is crucial.

As mentioned above, an angry and scared public wants to know that their governments can do more than push on the ends of pieces of string. But this is uncharted territory for countries who have not planned and implemented major government-led investment programmes for decades. They will have to learn fast.

Equally challenging is how governments will invest in British jobs for British workers or in America's Main Street without introducing protectionism by the back-door. The New Deal took place amidst powerful beggar-thy-neighbour

FLICKR.COM/PHOTOS/DECSRAMBLE/

protectionism. Today no country wants to find the door slammed on its export markets – indeed in November global leaders pledged to avoid protectionism. But at the same time, as they invest in their flagging economies, governments are invariably subsidising their own companies and disadvantaging those of other countries.

Beggar-thy-neighbour protectionism is not so easy to distinguish from much-needed social protection. And in global finance, capital controls look increasingly attractive to countries swept into a crisis which originated in regulatory systems far beyond their control or influence.

ROBUST RULES

A second part of the solution involves new, more robust global regulation of finance. Already, experts are hard at work drafting new rules for global banking, investment, and financial services. The challenges here are significant. Previous crises have generated promises to regulate global finance. But the spectre of robust rules has evaporated as soon as public attention has turned away.

Agreement from the US and Britain will be crucial, but their large financial sectors have typically made them averse to regulation. And once the new rules are agreed they will need to be robustly monitored, and enforced at the global level, perhaps by a new international tribunal created for the purpose. In short, more substantial architecture is required if the rules are to have any force.

A third part of the G20 package concerns international action to ensure that developing countries are not left bereft. Here leaders are talking about pushing the IMF, the World Bank and multilateral development banks to use their full capacity. Sweating these institutions is crucial.

In previous recessions the poorest countries have suffered a drastic reversal of aid and finance – and they have the least capacity to adapt to such shifts. Progress made in the last decade, such as towards the Millennium Development Goals, will be all too quickly extinguished.

The counter-argument to stretching the World Bank and other institutions is that they must be protected from any over-extension. But it bears noting that the risks of over-extension fall mainly on wealthy countries whose quotas and guarantees underpin the finances of each institution.

The leaders have also pledged to seek to provide more resources for the institutions. This is crucial. The IMF has fewer reserves than some medium-sized emerging economies. Here G20 leaders should be much more ambitious.

CREATING MONEY

One measure global leaders could agree on is jointly to create more money for the world's governments to use in fighting the crisis. Provision for this already exists in the IMF. By agreeing to a large new Special Drawing Rights allocation, the G20 leaders could both prove they are prepared to act collectively, and make more resources available to governments.

They could, by fiat, create say a trillion dollars worth of reserves which would be allocated across the membership of the IMF. The only obstacle to this is political – the US requires that an allocation of more than approximately $270 billion needs Congressional approval. Key then is for Americans to lead in this part of the solution.

CREDITOR TURNS DEBTOR

Finally, the leaders have pledged to reform the international institutions to equip them better to address twenty-first century problems. In particular, this would give more voice and representation to emerging and developing economies, including the poorest countries. This is long overdue.

The IMF and World Bank are still configured to reflect a world in which the US was the world's largest creditor – it is now the world's largest debtor – and in which Europe and the US could jointly run the global economy as engines of growth for the rest. They are now finding it difficult to engage the new engines of growth – China and other emerging powers – in global cooperation in the absence of genuinely global institutions.

For emerging and developing countries, neither the IMF nor the World Bank look like honest brokers, neutral arbiters, or impartial rule-enforcers. The Washington-based institutions are perceived as every bit as American and European as the President of the World Bank and the Managing Director of the IMF always have been. Power in these institutions will need to be redistributed – fast – to make it possible for them to coordinate global actions.

In London, the G20 could start by agreeing:

- a new process for reallocating voting power in each organisation;
- ensuring the head of each organisation is internationally selected and agreed;
- that the staff of each institution should reflect the countries in which they work; and
- to move to establish a strategic decision-making directorate – like a new G7 – for each organisation which represents the seven or eight major world regions.

The G20 leaders summit – or London summit – will stretch leaders every bit as much as the crisis is stretching their populations. Yet there is much they can do if they combine coordinated national actions with global collective action.