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What do Asian Countries Want the Seat at the High Table for? G20 as a New Global Economic Governance Forum and the Role of Asia

Yoon Je Cho

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Abstract

The recent global crisis has reminded everyone of the importance of reforming the international monetary and financial system. The current system is no longer adequate to meet the needs of a complex, integrated world economy. Various proposals, both on the demand and supply sides, have been put forward, and include building a stronger global financial safety net, diversifying the supply of international reserve currencies, and so on. However, these proposals face trade-offs between desirability and political feasibility.

In this situation, a practical proposal entails strengthening policy coordination among the major economies and reforming the International Monetary Fund. Success on both fronts depends heavily on reform of global economic governance and the effectiveness of the G20. Asia's representation in the G20, and its increased status, give both privileges and responsibilities. To meet these responsibilities, Asians should invest greater efforts in developing their intellectual leadership in global economic issues.

Keywords: Global Economic Governance Reform, Reform of International Monetary System, Reform of the International Monetary Fund, The role of Asia in global economic governance

JEL Classification: F42, F53, F55

1. Introduction

The recent global financial crisis has been the outcome of, among other things, the mismatch between institutions and the reality of the market in the current global financial system. The world we are living in now is drastically different from that of a half century ago. So is the global financial market. Yet the basic design and operations of the international financial institutions (IFIs) are not now that different from then. The Bretton Woods institutions and the postwar international monetary order were framed by design of and negotiation between, primarily, the United States (US) and the United Kingdom during World War II. In the immediate postwar years, the US was the preeminent power overseeing operations of the international monetary system (IMS) through the International Monetary Fund (IMF); postwar reconstruction and development through the World Bank and bilateral economic aid; and liberalization of trade through the General Agreement on Tariffs and Trade, which became the World Trade Organization (WTO) in 1995. With the recovery of Europe and rapid economic growth of Japan, these countries became more assertive in global economic governance. But it was essentially the US—and Western Europe to a smaller degree—that made the global economic rules, with Japan largely a follower, usually content to go with the US position under the latter's nuclear umbrella.

This scene started to change in the late 1980s and early 1990s. With the collapse of the former Soviet Union and consequent impact on Eastern Europe, over 400 million people were integrated into the free market economic system. With the opening and accelerated growth of the economy of the People's Republic of China (PRC) and India, nearly 2.5 billion people became fully integrated into the global economic system. That means, over the last 20 years, that we have seen economies with half the world's population integrate into the global economic system. In addition, globalization of national economies across the world, both advanced and developing, started to accelerate in the 1990s. Emerging economies accelerated their financial deregulation and opening, which led to rapid integration of their financial markets into the global market. This also led to massive—and volatile—capital inflows to these economies.

The IFIs that were designed more than 60 years ago can no longer effectively meet the challenges of the global economy. While the global financial market has become integrated like a single market, there is no global central bank or global regulatory body. And while global imbalances have intensified, there has been no international instrument or mechanism to drive orderly adjustments of those imbalances. Only the global crisis could stimulate the adjustment, imposing heavy costs on national economies and the global economy.

There also has been a rapid shift in the weight of economic power. In purchasing power parity (PPP) terms, the share of the Group of 7 (G7) countries in global gross domestic product (GDP) fell from nearly half to 40% in the last 10 years. During this time, the share of emerging market economies including the PRC (EMEs) increased rapidly. Virtually all projections predict that this trend will intensify. For example, the global GDP share of the "BRIC" countries—Brazil, Russian Federation, India, and the PRC—was 20% in 2000. It has increased to 30% in 2010 and is expected to increase to nearly 40%

by 2020. This means that we are facing not only inadequate international economic institutions to cope with global economic issues, but also an inadequate governance structure at those institutions.

Therefore, the tasks facing us today are to reform (i) the IFIs—mandate, resources, management, and governance structure; (ii) the IMS (which usually refers to the rules and institutions for international payments) and the regulatory framework of the global financial system; and (iii) global economic governance. This last concept is difficult to define. It is abstract in the sense that there are no such governance bodies or organizations as we see in the case of national government. Global economic governance may be a combination of, at this point, international organizations based on treaty or agreement, rules (accounting, capital standards, etc.), norms, practices, and decision making for which rules, guidelines, and codes have arisen to manage the global economy. For the purposes of this paper, however, the main focus will be on the role of the Group of Twenty (G20) summit meetings, largely because at the G20 meeting in Pittsburg in 2009, leaders declared that the G20 would be a “premier forum for our international economic cooperation”.

At the center of the rapid change in the distribution of global economic weight has been the rapid ascent of the Asian economies during the past half century. Japan took the lead in the 1950s–1960s, followed by Hong Kong, China; the Republic of Korea; Singapore; and Taipei,China in the 1960–1970s, with Indonesia, Malaysia, the Philippines, and Thailand in the 1980s. But the rapid growth of these economies did not pose a serious challenge to global economic governance issues, because they were relatively small economies (except Japan), and broadly under the influence of the US or Europe for various reasons, including security pacts. However, when the PRC and India woke up from their rather long hibernation and started to show staggering rates of economic growth, not only did the ascendency of Asia for this century become evident, but also did a change of international political and economic dynamics.

Reflecting these shifts, and with the global crisis, a new global economic governance forum, G20, emerged. In this forum, there are five Asian countries (six if we include Australia) with a seat. This is in great contrast to the “outgoing” forum, the G7, where only one Asian country was represented. Asians have now achieved greater participation in global economic governance. But will this achievement in the near future significantly change the nature of global economic governance, or the global economic order, or the way the IFIs will be run?

Asians may be happy and proud to have greater representation in such a forum. But we Asians also have to recognize that we remain ambivalent about our global roles. We want to sit at the high table. We want to alter the rules of the game and have a stronger voice in global governance. But perhaps we still lack vision for the future global economic system. We also do not want to take any greater responsibilities or burdens. Asian countries so far have been passive followers of the international economic order, which was shaped by the West after World War II. They have grown fast in this global environment. Most Asian countries, including the PRC and Japan, are preoccupied with domestic growth and political stability, and lack the vision of how to shape the future global economic system.

In this situation, can we expect any significant changes to the global economic institutions and system with the emergence of the G20? If, for instance, the role of international institutions such as the IMF is strengthened (as endorsed by G20 summit meetings) without much real change either to their operations or governance structure, what would that mean to Asia? Would that mean stronger governance over Asian economies by Western controlled and dominated institutions, or a more significant Asian role in global governance? What should Asia do to take the current opportunity of enhanced representation in order to enhance its de facto role in global economic governance?

The next section discusses the problems of the IMS. It reviews the present debate and discussions on how to reform the IMS along with developing countries' interest in the system. Section 3 discusses the future role of the G20, which is expected to remain a premier forum for global economic governance for a while, as it is important to have effective global governance not only for orchestrating the successful reforms of the IMS and the IFIs but for securing effective policy coordination for balanced, stable, and sustained growth of the global economy. Section 4 discusses how the IFIs (particularly the IMF) should be reformed. Section 5 discusses the role of Asia in global economic governance. Some conclusions are suggested at the end of the paper.

2. Global Financial Crisis and International Monetary System

There have been extensive discussions about the causes of the global financial crisis: a financial regulatory framework that encouraged excessive risk taking and high leverage in financial institutions; interconnectedness among large financial institutions in the global financial system through derivatives markets; and inadequate fiscal and monetary policies that fueled asset bubbles. And so on. From a fundamental standpoint, however, the issue starts with the institutional mismatch that failed to meet new challenges posed by the rapid globalization that progressed over the last several decades. The global financial market has been integrated like a single market—yet there has been no international lender of last resort or global regulatory body.

Financial institutions are competing with each other across national borders these days. Banks in the Republic of Korea, Japan, Malaysia, Thailand, US, and Europe compete for the same clients. Banks in the Republic of Korea, for example, have to compete with many other banks from the US, Europe, and Japan, to secure major companies in the Republic of Korea (which already have become global companies) as their main customers. They have to provide similar kinds of banking services to those of foreign banks so as to keep them as their customers. In the process, their balance sheets have become increasingly exposed to assets and liabilities denominated in foreign currencies (especially the dollar) (Park 2010).

When an external shock, such as the US subprime mortgage crisis, hits, liquidity evaporates in the global financial system and banks all over the world face a severe liquidity shortage. Banks can be helped over a local currency shortage by their national central banks. However, with a shortage of foreign liquidity, central banks in EMEs are helpless. Only central banks issuing international reserve currency can bail them out, but

these central banks' operations are confined to their national laws, even though the currency they issue is international. For example, the Federal Reserve issues international reserve currency but does not provide liquidity to international banks unless they are US-based. This has been one of the factors that pushed EMEs and developing countries that do not issue international currency to accumulate large foreign reserves. This in turn contributed to the global imbalances.

Other problems face the current IMS. It refers to the currency/monetary regimes of countries, the rules for interventions if an exchange rate is fixed or managed in some way, and the institutions that back those rules if there is a problem through official credits, controls, or parity changes (IMF 2010a). The IMS is deemed to be no longer adequate to meet the needs of a complex, integrated world economy. It may even exacerbate instability rather than contain it. In fact, the current IMS is something of a "non-system". After the collapse of the Bretton Woods system in 1971, the world has divided into two camps—one with major currencies that float freely and permit free flows of capital, and one with varying degrees of control over exchange rates and cross-border flows (Mateos et al. 2010). The current IMS does not have any established mechanism to facilitate the adjustment of global imbalances, and so they persist, becoming a source of increased uncertainty and instability.

Current IMS problems can be summarized as follows. First, the demand for foreign reserve accumulation has been increasing despite the movement from fixed exchange rate regimes to floating rate regimes some 40 years ago. While the collapse of the Bretton Woods system was expected to lead to smaller holdings of foreign reserves, we have in fact seen a rapid rise in them among EMEs, especially after the Asian financial crisis of 1997–98 (Figure 1). If this trend continues, it is expected that total foreign reserves in dollars held outside the US will rise to 700% of US GDP by 2035 from the current level of less than 50% (IMF 2010a).

Second, this increasing demand for foreign reserves has been concentrated in US dollar assets, especially public securities. This has made it difficult for the US to achieve internal and external equilibrium. This is not a new problem for the country, whose domestic currency is used as an international currency under the fiat money system (the "Triffin" dilemma). But this problem has become more acute as the US economy weakened with deepening internal and external imbalances.

Third, as the IMS relies too heavily on the supply of currency issued by a center country (the US), it gives an exorbitant privilege to this country, which can issue Treasury bills at the lowest possible interest rate in the international capital market (Mateos et al. 2010, Subacchi and Driffill 2010, IMF 2010a and b, UN 2009). As a result, the center country lacks any market pressure for macroeconomic policy discipline, facilitating the buildup of asset bubbles and the worsening of global imbalances. This, together with loose financial regulations, led to those in the market to seek higher yields and take greater risks in the financial system. For their part, the EMEs whose currency is not used as international currency have to bear a severe and painful adjustment when they face a currency crisis, or have to pay a steep cost in maintaining high foreign reserves for self-insurance against such a crisis. According to a recent IMF estimate, EMEs are paying

about 1.3% of national income for holding large amounts of foreign reserves (assuming a 3 percentage point premium above US Treasury securities) (IMF 2010b).

Fourth, as a related problem, the global financial system depends too heavily on the center country's ability to maintain the stability of the value of its currency and strength of its own financial system. This overdependence heightens the uncertainty and source of instability. As long as the US maintains a sound financial regulatory framework, solid macroeconomic policies, and a strong and stable financial system, the system can work reasonably well. However, once US economic and financial-system credibility is weakened, the global system can become very unstable. If there were an international institution (or instruments) that could effectively monitor and govern the soundness and stability of the macro-financial policies of the US and other major economies, we might see a more stable global financial system. However, there is not.

Fifth, international capital flows have been distorted in the current IMS. The capital flows from EMEs and developing countries where the productivity of capital investment is higher, to advanced economies, especially the US, where the return to capital investment is lower. This distortion reduces the investment opportunities for developing countries to construct their infrastructure and industrial base for higher economic growth.

Given these problems, there have been various proposals to reform the current IMS, which fall into two groups: demand-side and supply-side reform.

2.1 Demand-side Reform

The key here is how to reduce the widespread strong demand for foreign reserve holdings among EMEs. Self-insurance against currency crisis is not their sole motivation for large foreign reserves. The export-oriented growth strategy has also been a significant motivation to undervalue the currency and sterilize capital inflows, leading to a large accumulation of foreign reserves. However, according to one estimate, self-insurance—especially after the Asian currency crisis—accounts for one-half to two-thirds of total reserves and accounted for about half the increase of total foreign reserves in the decade to 2008 (Obstfeld et al. 2008).

In the current global financial market environment where capital flows are volatile, EMEs and developing economies run a high risk of currency crisis. They have to walk a very narrow line of policy discipline between openness of their financial system and sound economic management. Although the history of their financial market opening is short, many of these economies' capital markets are more open and integrated into the global system than the advanced economies (Figure 2). If their balance-of-payments position deteriorates for a sustained period, they have a high risk of, at some point, facing a massive sudden reversal of foreign capital flow, with a huge impact on the domestic financial system and the economy. Even though economic management may be sound in these countries, they are exposed to risk through contagion from a crisis that has begun elsewhere. To insure against such a possibility, they have to manage their external balance carefully, maintaining a competitive export environment and a stable macroeconomic situation, including currency stability and competitiveness. This

pushes them to intervene in the currency market when there are massive inflows of foreign capital and a buildup of foreign reserves.

There have been several proposals to reduce the self-insurance motivation and thereby demand for foreign reserves. They include third-party insurance and the expansion of the opportunity to borrow from a global and regional reserve pool, or access to a global lender of last resort (or something similar). However, the first option would be too costly. The private market to insure against such a risk has so far failed to be established. Public insurance through any international organization would be too costly and unfair in sharing the burden (IMF 2010a and b).

That leads us to the second option—building a stronger global financial safety net. The authorities of the Republic of Korea, which hosted the Seoul G20 Summit in November 2010, have taken an initiative with the IMF to push through this option by improving the current financing facilities of the IMF. The IMF has made some innovations in its lending program in consultation with the G20 countries' authorities and these were endorsed at Seoul. These innovations include refining the flexible credit line (FCL) by increasing the size and maturity of the loan with improved pre-qualification criteria for the loan to reduce the "stigma" effect; and creating new lending facilities, called the precautionary credit line (PCL), for the countries who are not fully qualified for FCL but with generally sound polices, that need some precautionary financing (IMF 2010). The G20 Summit in Seoul also agreed on efforts to increase the link between the IMF regional financing facilities.

2.2 Supply-side Reform

Discussions on supply-side reform of the IMS focus on how to diversify the supply of international reserve currency. The proposals include moving to a multiple currency system; increased allocation and wider use of special drawing rights (SDR); and creating a new global reserve currency. A more diversified allocation across available and new reserve assets would reduce the system's (and individual countries') exposure to risks stemming from economic outturns and policies in a single country, and may provide more stable stores of value by increasing reserve issuers' incentives to pursue sound policies and avoid losing associated benefits. While global reserves are already diversified to some degree and further diversification is likely to continue slowly over time, the pace and eventual degree may not be enough to bring about the desirable balance in supply, especially if reserve accumulation continues apace (IMF 2010a and b).

A key question is whether diversification should be encouraged among suitable existing currencies, or if it should be sought more with global reserve assets, acting as a complement or even substitute to existing ones (IMF 2010a). All proposals have their pros and cons; they also face trade-offs between desirability and political feasibility. As the world becomes more multipolar in terms of GDP, the drive for a multicurrency system that mimics global economic weights is likely to increase. A more diversified reserve system would be better in that it would help discipline policies of all reserve issuers, given enhanced substitutability of their assets. However, a disadvantage would be lower network externalities and possible costs for trade and investment due to volatility among major reserve currencies (McKinsey Global Institute 2009).

A more ambitious reform option would be to develop a global currency. Issued by a global central bank, it would be designed as a stable store of value that is not tied exclusively to the conditions of any particular economy. One option is for that global currency to be adopted by fiat as a common currency (like the euro was), an approach that would immediately result in widespread use and eliminate exchange rate volatility among adopters. A somewhat less ambitious option would be for the global currency to circulate alongside national currencies, though it would need to be adopted by fiat in at least some countries for an exchange market to develop. If the global currency were to circulate as a dominant currency in place of the US dollar, then current account imbalances that reflect today's situation—surplus countries pegging to the global currency with deficit countries floating against it—would adjust more systematically, and perhaps more automatically than in the current system since the deficit currencies would be expected to depreciate against the global currency (IMF 2010a). However, this option would suffer from the same problems that are faced by common currency areas such as the eurozone. Adoption of a common currency could limit scope for adjustment to shocks by individual countries. It would be essential to construct governance arrangements that ensure accountability of the global currency-issuing institution while ensuring its independence. It also requires a substantial concession of economic sovereignty by individual countries. Hence political feasibility is very low.

As another option, a greater role could be considered for SDR (for example, UN 2009, IMF 2010a and b, Zhou 2009). The SDR had been almost forgotten until the recent global crisis. The SDR is an international reserve asset created by the IMF in 1969 to supplement official reserves of member countries. For countries with a balance-of-payments need, it represents an unconditional right to obtain foreign exchange or other key reserve assets from other IMF members. The value of the SDR is based on a basket of currencies (currently the US dollar, euro, yen, and pound).[1] But it is not itself a currency.

There are many benefits to using the SDR broadly as a reserve asset. With a value defined in terms of a basket of major currencies, it has more stable store-of-value and unit-of-account attributes. As in the case of the putative global currency, if some surplus countries that currently peg to a national currency (such as the US dollar) were to peg instead to the SDR, some automaticity would be introduced in the global adjustment process as the currencies of deficit countries could depreciate relative to others in the basket. However, one disadvantage is that its use so far has been essentially restricted to the official sector and only about SDR200 billion (about 4% of total global reserves) has been allocated to member countries (IMF 2010a). Additional hurdles to developing an SDR-based system include potential resistance from reserve issuers who have no direct use for SDRs; restrictive allocation rules and complicated usage rules; lack of deep and liquid markets; and the need to convert SDRs into a freely usable currency for most payment transactions.

In 2009, Mr Zhou Xiaochuan, governor of the People's Bank of China, suggested wider use of the SDR as a reserve asset (Zhou 2009). As the confidence in the future value of the US dollar has weakened, countries with large amounts of US-dollar foreign reserve

[1] In the future, the PRC yuan and the Brazilian Real, for instance, could be included.

assets are concerned about losing value. If, for instance, the PRC moves to rebalance its foreign reserve composition from the dollar to other currencies, it risks causing an immediate fall in the dollar, with no beneficial consequences for the PRC, the US, or the global economy. If the PRC could hold more SDR instead, its foreign reserves would be immediately better diversified into that currency basket, becoming more stable in value. This would be possible when there is an international agreement to expand the allocation and use of the SDR, extending its use from the official to the private sector.

2.3 Historical Experience and Prospects

As discussed above, although there have been widely shared views on the problems of the current IMS, there are different views on how to reform it, or even if it needs to be reformed. Some economists argue that we need fundamental reform while others believe that we cannot find any better alternative to the current system in the near future. The latter group also argues that what we need is reform of the regulatory aspects of the global financial—not monetary—system. They argue that the current system is the outcome of an evolution that complemented the weakness of the previous systems, including the gold standard, Bretton Woods, and the interwar free-floating system, and has worked reasonably well over the last 40 years (Truman 2009).

The evolution of the IMS has been shaped not only by the experiences of previous systems but also by the dominant economic thoughts, balance of economic weights, and political economy of the time. The dominant reserve currency changed with the shift of economic power, but only after a substantial time lag. In the initial stages, the dominant country was always reluctant to accept changes and push reforms, while the emerging power was hesitant to accept greater responsibility as a reserve issuer. As a result, there was no big impact, but only gradual and incremental change.

As with the dollar today, the demise of the pound was widely anticipated but the process was more gradual than expected and a widely predicted abrupt collapse was avoided. Even though the emergence of the US as the dominant economic power became evident after World War I, the pound played the role of major international reserve currency for a while. The IMF estimated that official sterling reserves, excluding those held by colonies, were four times the value of official dollar reserves and that in 1947 sterling still accounted for about 87% of global foreign exchange reserves (Schenk 2010). It took 10 years from the end of World War II (and a 30% devaluation of the pound) before the share of dollar reserves exceeded that of sterling. The shift from sterling to the dollar and the elimination of sterling as a major international currency resulted in periodic crises, international tensions, and conflict over the United Kingdom's domestic economic policy. In short, although it was not a painless transformation, it was still tempered by international commitment to avoid a damaging tipping point for sterling that would have undermined confidence in the IMS as a whole (Schenk 2010).

The transition this century would likewise require close collaboration among the major players—incumbent and emerging powers—to avoid turbulence and severe instability in the international financial system. The shape of the IMS in the 21st century will be significantly influenced by the views, interests, and requirements of the emerging powers. However, it is important to ensure the sustainability of the current system and avoid its

collapse. This should include efforts at the least to strengthen policy coordination and collaboration among the major economies, and to reform the IMF to make it a more effective institution for bilateral and multilateral surveillance and as an international lender of last resort. The success on both fronts depends heavily on global economic governance reform and the role of the G20.

3. Global Economic Governance Reform and the G20

The global financial crisis provided momentum for the emergence of the G20 Summit as a premier forum for international economic cooperation. It is now clear that the problems of global imbalances, economic recession and recovery, and financial system reform cannot be discussed without involving EMEs. The G7 can no longer be the right forum. For example, the G7 summit meeting started in 1974, and it took 13 years for G7 leaders to agree to meet annually. But it took only one year for G20 leaders to expect to meet annually. This shows how much such a forum was needed.

Any governance body is subject to a test of legitimacy, representativeness, and effectiveness—and the G20 is no exception. The G20, like the G7, is a self-proclaimed global economic governance forum. It is not formed on the basis of any international treaty or agreement. The G20 represents about 85% of the world's GDP, 80% of its trade, and 67% of its population (Heinbecker 2010). Countries from all continents are included in the G20. In contrast to the G7 membership, the G20 includes all the systemically important countries such as the large emerging economies of the PRC, Brazil, and India. Therefore, legitimacy and representativeness may not be an important hurdle for the G20 to function as a global governance forum. There is no clear reason why those 20 particular leaders should sit around the same table, but any other selection would invite similar questions and criticism. The G20 seems to be a reasonable grouping as it is balanced between advanced and emerging economies, and regionally. Effectiveness, however, could be a serious challenge.

As the world may be unable to find an alternative to the G20, the G20 may well stay as the premier forum for global economic governance—for at least some time. Still, although it showed its usefulness as a forum for policy cooperation during the crisis, it is unclear whether it can continue to be an effective global economic governance body. The experience of the G7 suggests that G20 could become no more than an annual diplomatic event of leaders meeting without any significant outcome to address or resolve global economic issues. A meeting with 20 leaders will find it harder to be effective than one with seven or eight.

As discussed, however, the global economy desperately needs an effective forum to coordinate economic policies among advanced and developing countries. It has been fortunate that the G20 emerged as a premier forum, and this could be the most profound evolution in global economic governance over the last couple decades. It represents the first adaptation of the global governance structure to reflect dramatic changes in the distribution of power since the end of the Cold War. It is also the only forum in which major established and emerging players meet in a setting of formal equality, unlike the two-tiered Security Council of the UN or the weighted voting in the IFIs.

The G20 acknowledges that global governance cannot be done by the West alone. It can provide a framework in which established and emerging powers can work out an agreement and negotiate breakthroughs on pressing global economic issues. As Patrick (2010) says "G20 has the potential to shake up the geopolitical order, introducing greater flexibility into global diplomacy and transcending the stultifying bloc politics that have too often hamstrung cooperation on global governance in formal, treaty-based institutions, including the United Nations."

The US proposed a mutual assessment of economic policies on the basis of a "Framework for Strong, Sustainable, and Balanced Growth" at the G20 Summit in Pittsburg in September 2009. The US has subjected itself to peer reviews of the Organisation for Economic Co-operation and Development and the IMF. However, ''this is the first time the US has agreed, even proposed, to submit itself to a structured, full peer review process" (Lombardi 2010) in a forum such as the G20 where, at least formally, the peers participate on an equal footing, globally.

Through this framework, leaders pledged to devise a method for setting objectives, to develop policies to support such objectives, and to assess outcomes through mutual evaluation. The IMF's involvement has been sought in providing analysis on various national and regional policy frameworks and how they fit together. On the basis of country submissions, the IMF has been asked to point out inconsistencies and/or incoherence in national assumptions, to evaluate the mutual compatibility of different country frameworks and policies, and to determine the aggregate effects of various national frameworks and policies in the global economy. Once the entire framework process has been completed (the aim was by the Seoul G20 meeting), it could then be fully implemented annually. This mutual assessment of macroeconomic policies represents the first instance of multilateral surveillance on a global scale in recent history. Previously, such surveillance was, at best, handled within the closed circle of the G7.

3.1 The G20 Role in Global Governance System—A Kind of Legislature?

There are three types of institutions in the global governance system: international organizations, government networks, and non-state actors (Mo 2010). The last includes transnational civil society groups and business associations. International organizations and government networks are both intergovernment organizations (IGOs). The main difference is the degree of formality. An international organization is the more structured of the two, that is, it has a constitutive intergovernment agreement and a secretariat. In contrast, government networks are often created without a formal intergovernment agreement and managed without a secretariat. According to this classification, the G20 is a government network in that it has neither a charter nor a secretariat. However, the G7/G8 and G20 are government networks whose jurisdictions overlap with those of existing international organizations that affect their decisions—they are supervisory government networks. Since such networks make decisions that existing international organizations are expected to implement, they should be viewed as a kind of legislative body with international organizations playing the role of executive agency. The fact that the G7/G8 and the G20 exist and have become more influential over time suggests that there is a demand in the global governance system for an effective supervisory and legislative body that is independent of international organizations (Mo 2010).

The G7 began as a kind of caucus, an informal group of legislators, with leaders reluctant to involve ministers and refusing to create a permanent secretariat. The global governance system demands a new organization that can work as a legislature and the G20, at this moment, is the available alternative. Some observers say that the G20 is already acting as a sort of legislature as it directs new rules for the global financial system and assigns tasks to the IFIs.[2]

The role of the IFIs has been limited to their own jurisdiction and, to a large extent, they have not been able to be effective even in their given jurisdictions. They have been marginalized in global economic governance and have failed to address cross-jurisdictional issues such as financial stability (Stewart 1996, Varma 2002, Bryant 2010). Of course, the G20 faces difficulties in meeting this role. It is a group of "systemically important" economies. Unfortunately, except for their economic impact, G20 members have little in common with respect to their ideologies and levels of development. This strengthens the need for the G20 to become more institutionalized in its process of making agreements, decisions, and overall implementation.

A legislature has two core functions: legislation, and oversight of executive agencies. The G20 should provide the mandate and oversight of the operations of international economic organizations. It should also be a place where effective policy coordination among member countries happens. But for the G20 to meet these two functions, there should be innovative institutional design for the G20.

One element of criticism for the G7/G8 summits was the lack of continuity and implementation monitoring. The G20 will have to demonstrate that it can do better. However, with the increased number of participants relative to the G7/G8 and the likely more comprehensive agenda of the G20, the preparation and follow-up process for the G20 summit will be more complex and demanding as it involves many more players and less continuity in the leadership. Furthermore, unlike the G7, which is a like-minded group, the G20 is extremely diverse in terms of political organization and ideology. Divergences among the G20 were masked during the first year of the crisis, as countries focused on the short-term, urgent goals of preventing global economic depression. As the world has started to come out of the crisis, the underlying diversity of opinions, interests, and perspectives in the G20 could reemerge. Diversity in the composition of the membership has the risk of hindering consensus building within the G20 as was evidenced in the Toronto and Seoul summits, and, therefore, hurting the G20's effectiveness as a global decision-making body.

To build consensus and ensure effectiveness, the G20 requires creative intuitional innovations. One of them would be to set up a G20 secretariat or something similar (Linn

[2] Mo (2010) says for example, "In thinking about the meaning and significance of the G20 in the history of global governance, it is constructive to take a step back from current issues and ask ourselves what the founding fathers of the new global governance system would make of the G20. Seen from this constitutional perspective, it is clear that the G20 belongs to the legislative branch side of the global governance system. The G20 is already acting like a legislature as it legislate new rules for the world economy and tasks and evaluates international financial institutions."

2010, Carin 2010). At the finance minister level, the G20 chair is part of a revolving three-member management troika of “sherpas,” consisting of the current chair, as well as the immediately preceding and succeeding chairs. The management picture at the leader level is less clear. The chair country now sets up a temporary secretariat for the duration of its term. The temporary secretariat coordinates the group work with technical support from the IFIs. But the G20 reliance on temporary and rotating arrangements is unlikely to last long as they already create the problem of work discontinuity and conflicts of interests. A rotating secretariat makes it hard for the G20 to maintain organizational coherence. The IMF can play a type of secretariat role for the G20; however, the agenda for the G20 could be broadened beyond macro-financial issues, such as energy and trade. Also, it may not be a good idea for the G20 to depend too much on the IMF for secretariat functions as this may compromise its ability to reform and monitor the IMF.

However, concerns have been expressed that leaders would not want to see a bureaucratic structure take over the G20 summit or that the existence of a heavy secretarial structure could undermine the commitment by the national executive agencies to their engagement in the G20 summit processes. The aim is to manage and organize the summit to ensure continuity, institutional memory, and the implementation of plans and promises that are yet to be driven by member governments. The challenge will therefore be to keep any secretariat structure small, non-bureaucratic, and driven by member governments.

Alternative options could be considered to ensure effective logistical and technical support for the G20, such as cross-posting of high-level staff from countries that have had the G20 presidency in the past to countries taking on this role. Stronger liaison contact points and implementation-reporting requirements could be established in the key international institutions that are tasked with follow-up on the G20 summits (Linn 2010).

The G20 currently works as a “committee as the whole” without select or standing committees. As the number of issues that the G20 takes up increases, the G20 may consider the use of standing committees to divide work among member countries.

4. Reform of the International Monetary Fund

The IMF, as a key institution of the IMS, has not played an effective role in the surveillance of the global economy and financial market. The recent upgrading of the IMF by the G20 as the main institution for the surveillance of the global financial market and economy, and the willingness of some G20 countries to include the reform of the IMS in future agenda (Taylor 2010) suggest that the IMF should be substantially reformed to meet the challenges of this upgraded role. The areas to reform are resources, lending facilities, surveillance, and governance/management. Some of them have already been endorsed by the G20 and agreed to by member countries, but in some areas more innovative ideas must be sought.

4.1 Resources

The resources available to the IMF are far smaller than current global capital flows, and are a small fraction of total foreign reserves held by EMEs. The G20 summit meeting in London endorsed the move to increase IMF resources, including quota and borrowing capacity. The expansion and modification of the New Arrangement for Borrowing (NAB) by roughly $500 billion will approximately triple the total resources available for lending, from the current level of $250 billion. This will help the IMF to be more effective in meeting the financing gap to member countries when they face foreign-currency liquidity problems. Still, its total available resources may not be enough to support all the new lending facilities under discussion to strengthen the global financial safety net. They will still be less than half the foreign reserves of the PRC alone. Thus, a further increase in resources will be required to support the new lending facilities. To meet this need, perhaps, the current total quota size should also be doubled at the least.[3]

4.2 Lending Facilities

The IMF introduced the FCL in 2009, in response to criticism that its lending facilities to address unexpected foreign liquidity crises faced by EMEs are too rigid and have costly policy conditionality. However, only three countries—Colombia, Mexico, and Poland—used FCL as they faced severe liquidity problems in the global financial crisis. Other EMEs, including the Republic of Korea, refused to use the FCL—though they also faced severe liquidity problems—since they were afraid of the stigma effect.

The crisis highlighted three potential gaps in the global financial safety net. First, many countries and observers feel that the FCL is not as predictable and effective an instrument as it was initially planned to be. Second, there is a sense that the FCL caters to only a narrow group of countries and it offers too little to those well-performing countries that are ineligible for FCL. Third, the IMF does not have adequate instruments to act proactively and contain risks in a systemic crisis where several major EMEs, with varying degrees of concern about the stigma effect, may benefit from an early and clear signal by having access to financial resources to calm the market fears that stoke contagion.

The IMF is not the only institution with a mandate to provide a global financial safety net. Central banks of reserve currency-issuing countries and regional financing arrangements, such as the Chiang Mai Initiative (CMI), also have a role to play. In the case of the Republic of Korea, the swap arrangement between the Federal Reserve and the Bank of Korea in 2009 was the most effective way to calm foreign exchange market instability. Furthermore, careful consideration will need to be practiced in balancing the goal of a more effective global financial safety net against potential moral hazard and the need for adequate safeguards. However, the above observations still call for a reform of the IMF's financing facilities.

The IMF has recently introduced some innovations to its lending facilities, including the modification of the existing lending program as well as the introduction of new lending

[3] Doubling of the IMF quota was endorsed by the leaders in the G20 Summit Meeting in Seoul.

facilities (FCL and PCL, as discussed above). The IMF has also been discussing with G20 governments on how it might, in well-defined circumstances, use a multicountry swap line mechanism to offer liquidity unilaterally to a limited set of systemically important countries with strong policy records. This has not yet materialized.

Moral hazards and resource constraints could be obstacles to the expansion of the global safety net through the reform of the IMF's financing facilities. However, given the strong and increasing demand for foreign reserves for self-insurance by EMEs, which threatens the stability of the IMS, these reforms are badly needed. The new facilities would be useful additions to the IMF lending armory and would enhance its capacity to act as international lender of last resort.

Bilateral swap arrangements between central banks are only on an ad hoc and temporary basis, while they could be a very effective tool to stabilize the foreign exchange market in time of global financial crisis. Multilateralization and institutionalization of the swap arrangements through the IMF could be an effective way of building a global financial safety net, providing a global public good in the current global financial market environment where national economies are closely integrated and there is little distinction between national and global financial systems. To some extent, it may be the responsibility of the central banks that issue international reserve currency (especially the Federal Reserve) to provide the global financial system with some role of "lender of last resort" themselves. If this is difficult to institutionalize due to these banks' national laws, it may be done indirectly through the IMF. These central banks could commit some resources under certain conditions to the IMF, with the IMF in turn providing a modality to use these resources for EMEs according to certain prespecified rules and conditions.

4.3 Surveillance

Increased access to and expansion of the IMF's emergency lending facilities should be accompanied by greater and more effective surveillance of member country economies by the IMF. The IMF failed to establish itself as a credible monitor of the IMS or as a provider of credible surveillance over macroeconomic and financial sector policies of individual economies. Most severe criticism centered on the asymmetry of its surveillance—too harsh on small developing countries with a deficit while almost mute on advanced economies and surplus countries.

The IMF surveillance should be strengthened in both the bilateral and multilateral arenas. The IMF should be able to clearly point out the problems in member countries, including advanced economies, which they can take seriously so as to make the necessary policy adjustments. For that, IMF leverage should be strengthened. This can be done only in a multilateral context such as the G20. The G20 should strengthen its function of mutual assessment of macroeconomic policies with the objective of "strong, sustainable, and balanced growth." Global economic surveillance should, indeed, be one of the G20's important roles. If the G20 mandates some significant role for the IMF in this process, strengthened peer pressure could give the IMF's bilateral surveillance more bite. Its multilateral surveillance, too, needs to be strengthened, both on macroeconomic policies

and financial market issues. The surveillance role of the IMF should be reinforced to more effectively address problems of exchange rates and payment disequilibria.

In order to produce objective and neutral reports on the economic policies of individual countries, it would be necessary to insulate IMF staff from political pressures from their own board. The IMF needs to issue its own reports on exchange rate policies of major member countries, assessing a wider range of policies (including monetary, fiscal, and exchange rate) and financial sectors more frequently and independently. It should perhaps be the IMF management rather than the board that has the authority to approve such surveillance reports, to help keep staff from political pressure.

The G20 countries have so far committed to a peer-review process for their economic policies and to a broadly defined policy objective. This does not mean that they have committed to specifically defined policy targets for which they can be held accountable in a multilateral forum. This is reminiscent of early IMF attempts, in the 1970s, to get systemically important countries to commit to a multilateral surveillance framework (Lombardi 2010). Ultimately, these countries distanced themselves from specific commitments and the IMF multilateral surveillance became simply a forum for exchanging views and information on each other's economic policies. With the G7, the IMF played an advisory role; but with the G20, its advisory role is more clearly spelled out, and, given the greater number of economies, needs to be much more strategic. Nevertheless, its role of surveillance is not clearly mandated yet.

The G20 itself should implement effective mutual assessment on the macroeconomic and financial policies of member countries in the context of well-defined objectives set for the whole group. The IMF should be asked to provide the framework and technical support of this assessment, which should be based on some rigorous quantitative analysis.[4] It may be asked to strengthen the "score-keeping" capacity by allowing it to issue its own quarterly reports on exchange rate and other relevant policies (Subacchi and Driffill 2010). The IMF would thereby become more vigorously engaged in the mutual assessment process. This would help to increase its leverage in its bilateral surveillance of its major member countries.

The success of mutual assessment or peer-review surveillance depends critically on two essential ingredients: competent staff to support the process, and a strong analytical foundation for studying macroeconomic interactions. It would, in fact, be difficult to find a better alternative to the IMF for this role. What, then, should the IMF do to fulfill this task? In essence, it should perform sharply defined multilateral surveillance, generate greater value and traction from bilateral surveillance, and integrate the two better. For that, it should do more analysis of outward spillovers, and generate new reports covering such spillovers from countries whose policies or circumstances affect the overall system.

In order to increase the effectiveness of bilateral surveillance, especially with advanced economies and surplus countries, the IMF should try to reach broader audiences than it

[4] At the Seoul Summit Meeting, the leaders agreed to enhance the mutual assessment process to promote external sustainability. Persistently large imbalances, assessed against indicative guidelines to be agreed by finance ministers and central bank governors, would warrant an assessment of their nature and the root causes of impediments to adjustment as part of the process.

does now by producing more timely and topical reports, and increase engagement with stakeholders. By increasing the peer pressure of the global community through its timely and credible reports, it can improve the effectiveness of its bilateral as well as multilateral surveillance. Setting up an independent outside panel of experts, which can regularly evaluate and monitor the IMF's performance in such surveillance, could also be a helpful measure.

4.4 Governance/Management

Enhanced surveillance by the IMF would mean increased IMF interventions in member countries' economic policies. However, unless changed from previous practice—one dominated by the traditional powers—it would be regarded by most EMEs as a worse outcome. Hence the most important element of IMF reform is radical change to its governance structure.

There was wide criticism in the past that the IMF has been used as an instrument for industrial nations to achieve their policy objectives. It bailed out creditors of industrial countries and imposed very costly adjustment programs on debtor countries. Mistrust in the IMF is in part due to the perception that its surveillance has been asymmetric, with greatest attention paid to the weaker developing states or those in deficit, while the major deficit and surplus countries, including the US and the PRC, are given too much leeway. Mistrust is also in part due to its policy conditionality based on too much (or sometimes axiomatic) "belief in the market." This is not to say that the IMF has made no attempt to overcome this criticism. In recent years, it has in fact become more flexible in its approach to individual country situations and has somewhat shifted its position from emphasizing quick adjustment to expanded financing as a possible alternative to rapid adjustments (Adam, Collier, and Vines 2010). Nevertheless, further efforts are needed to establish trust among all its member countries, and this can be done most effectively through rebalancing of the governance/management structure of the institution.

There are two major problems with present governance arrangements: the composition and voting structure of the board, and the appointment of management and those at senior positions. The board is too heavily weighted toward industrial countries, especially in Europe, and it fails to give sufficient weight to EMEs and developing countries, which are of course seriously affected by its decisions. Currently, the quota share of advanced economies is more than 60% (US 17.6%, Europe 31%). EMEs and developing countries' share is about 39%. However, Europe's voice can be potentially much bigger than this figure suggests, due to the current composition of the executive board.

At the G20 Seoul Summit it was agreed that 6% of the quota share would be transferred from Europe to EMEs, though the formula to achieve this has not been fully sorted out. It was also agreed that two seats of the executive board currently occupied by Europe would be transferred to EMEs. However, these two measures would not change the governance structure significantly—the US and Western Europe would still dominate decision making through various rules (including the "85% rule" and the veto power of the US) and through the composition of the executive board. Would EMEs, say Asian EMEs, welcome strengthened IMF surveillance with this unchanged governance structure? Unlikely.

The governance structure should be more radically changed, for without it, the IMF risks becoming marginalized as an agent solely for a group of industrial countries. (As noted, there is a large asymmetry between the governance structures of G20 and the IMF.) Ideally, the formula for IMF quota reallocation should give emerging economic powers more representation than their current economic weight (which is based on nominal GDP) justifies. However, as this would be difficult to implement in reality, other measures would have to be sought. One way would be a reconfiguration of the composition of the board of directors, cutting the number of European seats—a single eurozone seat could be an option.

Another way would be to have the G20 finance ministers meeting as a steering committee for IMF governance, determining the direction of major policy issues. If the G20 became a decision-making ministerial body within the IMF itself, it would reduce the asymmetry both between global economic governance forums and the governance structure of the IMF. This would also help reassert the centrality of the IMF's role as a key institution in the IMS. This proposal has been featured in a recent advisory report to the IMF Managing Director (the "Fourth Pillar" report) and has been put forward by a number people, including Mervyn King, governor of the Bank of England (Lombardi 2010, King 2010).[5] The progress of reform of the IMS, including increased allocation and wider use of SDR as international reserve assets, could be facilitated when this kind of significant change in the IMF governance structure occurs.

On the second problem, that of appointments, the selection process for managing director should become more transparent and be open to qualified non-Europeans, including those from EMEs. Appointments to senior positions should be more merit-based, and better balanced between staff from advanced economies and EMEs. (Similar changes will be required for the World Bank.)

5. Global Economic Governance and the Role of Asia

Although the global financial crisis prompted the G20 Summit, it was, more fundamentally, a decision to integrate rising powers, mainly from Asia, into the multilateral system. In the G7/G8, only one Asian country, Japan, was represented; in G20, five (six with Australia). So the question now is: If Asia secured proper representation for itself in the global governance system, what would it do with it? Does it have a clear vision—or any vision—for the future global economic system?

Under the current global economic order, indeed, Asian economies developed quickly and prospered, and to a large extent have been the main beneficiaries of the postwar settlement, taking full advantage of it. Successive trade rounds of the General Agreement on Tariffs and Trade (which significantly reduced trade barriers of industrial nations while allowing developing countries some preferential treatment), as well as the export-oriented growth strategy of most Asian nations, made their rapid growth and industrialization possible. Increased capital flows and investment (direct and portfolio) by the West accelerated their growth potential. Further back over the last four centuries, the world has been dominated by Western ideas, knowledge, ideology, philosophy,

[5] Mervyn King, speech at the University of Exeter, 19 January 2010.

technology, and vision. Many Asian countries were colonized by the West. Even now, Asians have been passive followers of the West's global economic order.

So, would the global order that Asians want be different from the current one? If so, how? We Asians have long wanted to sit at the high table, but do we have the ideas, vision, skills, or knowledge to lead the global economy? The answer to these questions is not yet clear—at least to me.

Asians might have wanted to increase their economic weight and participation in global governance, but *we may not want more global governance:* we want to be recognized as an important power, to have a greater share and a bigger voice in international organizations, but not necessarily either to be more governed by global rules, regulations, and institutions, or to take a leadership role and accept greater responsibility for addressing global issues. But increased representation at the G20 by Asian nations not only gives a greater privilege, but also presents a great responsibility.

How should Asia respond?

5.1 Take the Leadership of the Open Multilateral System

Asian countries should lead the efforts to maintain and contribute to further strengthening the open multilateral system. This system has been a lynchpin of Asian success since World War II. Most Asian economies are very open, depending heavily on international trade and investment. Maintaining an open system will be a key to their future success. The West's leadership of the multilateral system has been dwindling recently, and Asia should now assume this mantle. Asia will suffer more than any other region if the world allows the system to fail.

5.2 Take Greater Responsibility for Global Economic Issues

Asian countries should take greater responsibility for global economic issues, concomitant with their economic status. Increased economic power and status should come with increased responsibility. Asian countries are still preoccupied with their own domestic issues. (The PRC, for example, is reluctant to assume a leading role as its priority is still heavily skewed toward domestic political stability and economic growth.) Asian countries should play a more active role in economic policy coordination and collaboration even though this may temporarily slow down their export growth. Asian economies have already grown too big to continue relying on exports for growth. Their growth strategy should rely more on expanding domestic demand through macroeconomic policy adjustments (including exchange rate policies) and structural reforms.

5.3 Contribute to the Developing World

Asian countries should more actively contribute to the developing world's economic performance. They have emerged as industrial powers from poor, developing countries and this experience is still embedded in the current generation. They should share this experience not only within the region but also across the world. Wealthier Asian

countries should increase their aid and grants to developing countries. But more important, they should share the knowledge, experience, and know-how of managing institutions and development with developing countries, not by lecturing them but by trying to find more effective development paths with them, fitting to their own economic and social circumstances. Asian countries have not been entirely happy with the Washington Consensus, but they have not come up with an alternative development model. Asian economists and scholars need to commit to a range of goals, including doing more research to synthesize and crystallize the essence of their own development experiences; exchanging views more actively among themselves to find best practices and modules that can be applied to other developing countries; collaborating more effectively with their policy makers; and articulating their views in multilateral institutions. The Asian Development Bank may be able to play a central role in this endeavor.

5.4 Increase Voice in International Financial Institutions

Asia should demand a greater voting share and voice in the IFIs. As the roles of these institutions are expected to be strengthened in global economic governance, they should be rebalanced toward greater Asian weights. Otherwise, the strengthened roles of these institutions could be in Asia’s disfavor. Asia should not only demand greater share, but more seats on their boards, and senior positions.

Most Asian country currencies are not international currency. As a consequence, they are exposed to high risks of foreign exchange instability and currency crisis in the current global financial market environment. They also pay high costs in self-insurance. Asian countries should therefore take the lead in strengthening the global financial safety net, reforming the IMS. They should push for reform of IMF lending facilities and the link between the IMF lending program and regional financing arrangements. The case for an increased role for Asia would be even stronger for the World Bank, where more diverse ideas and development experience should be reflected in its policy recommendations and technical assistance programs to developing countries.

5.5 Create New Institutions and Forums

Finally, Asian leaders should try to get themselves better prepared to provide their own vision and leadership for the future. The premier economic governance forum has shifted from the G7 to the G20. In the G7, only Japan represented Asia. Now it is time for change. At the same time, however, Asians have to admit that we lack the vision, intellectual wealth, and accumulation of knowledge on global issues relative to the West and should try hard to start to build them. For instance, Asia has only about 10–12 universities among the top 100 in the world. It has produced only one Nobel Prize winner in economics out of 67 so far.[6] To this end, Asia needs to promote higher-quality education by upgrading academic institutions and think-tanks, and to facilitate more active exchange of views among its intellectuals. The existing Asian institutions should provide more occasions for this, and perhaps many new regional forums will have to be created to facilitate such exchanges and to consistently articulate Asia’s vision and interests in global economic issues.

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[6] Amartya Sen was a Cambridge economist who is an Indian.

6. Concluding Remarks

One of the fundamental causes for the recent global financial crisis was the "institutional mismatch"—the mismatch between the institutions and the market in the global financial system. The development of institutions fell far behind that of financial markets over the last two or three decades. The integration and tight interconnections among financial markets and the global economy now require a new regulatory framework, which entails the reform of the IFIs and the IMS. At the same time, more effective economic policy coordination among major players of the global economy is needed, and this cannot be achieved without establishing an effective global economic governance system.

This paper has discussed the necessary reforms of the IMF and the IMS, and how to make the G20 an effective governance forum. History shows us that the world suffers when incumbent powers fail to give rising powers their proper place. Inclusion of major EMEs, including the PRC, Brazil, India, and others in the G20, has been the right move. The challenge now is how to make the G20 effective. Without institutional innovations within the G20, there is a high risk that its summits will follow the path of previous summit meetings.

Asia's rising powers have now been given seats at the high table of global economic governance. Yet they do not seem to be well prepared to provide the new vision and leadership required to shape the future global economic system. Increased status and representation of Asian countries in the G20 give both privileges and responsibilities to Asians. To meet these responsibilities, Asians should put forth greater efforts to develop their intellectual leadership in global economic issues, including creating regional forums and upgrading academic institutions.

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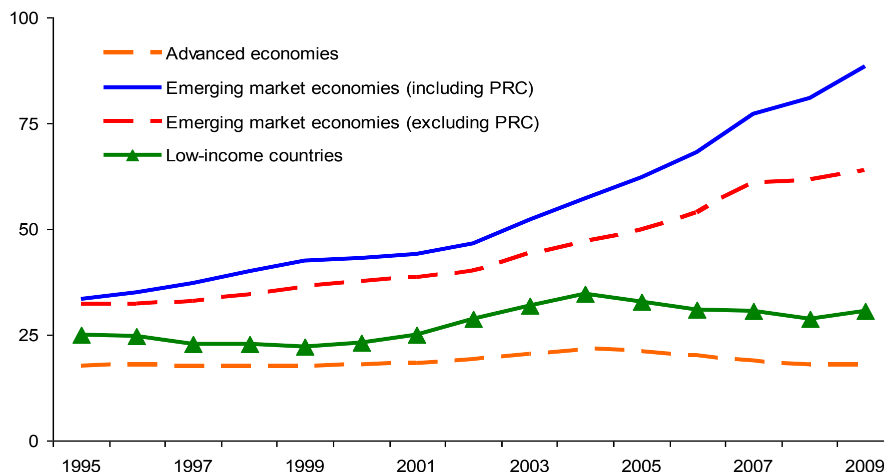
Figure 1: Reserve Accumulation, 1995–2009

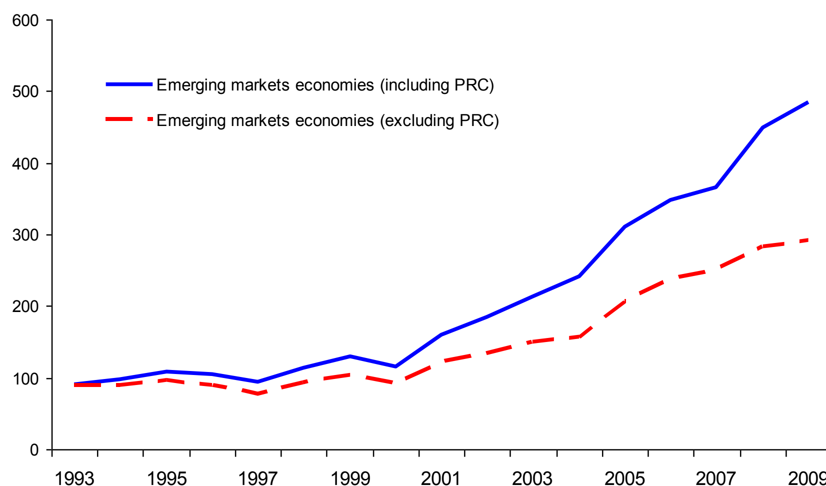
a) Reserves as a percentage of imports of goods and services (three-year averages)



PRC = People's Republic of China.
Note: Advanced economies comprise Hong Kong, China; the Republic of Korea; and Singapore. Data for PRC exclude Hong Kong, China and Taipei,China.

Source: Author's calculations using data from International Financial Statistics, International Monetary Fund. http://www.imf.org/external/data.htm (accessed December 2010).

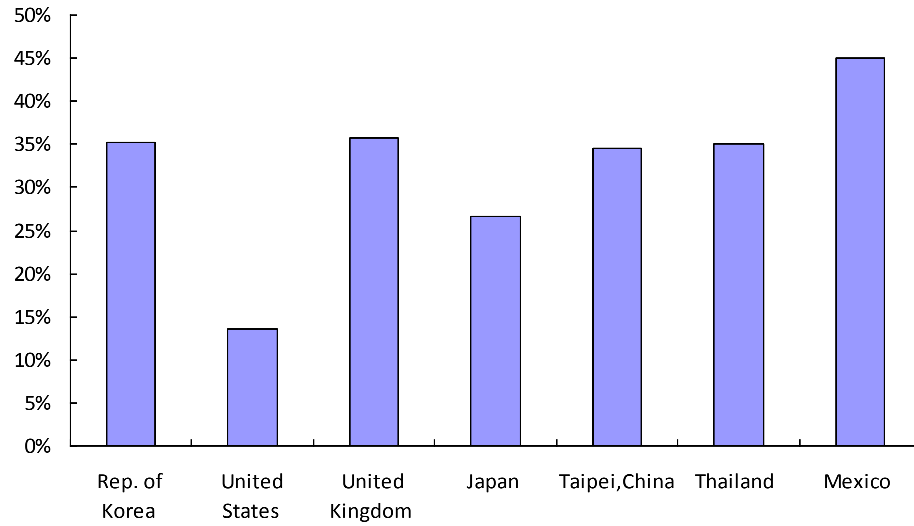
b) Reserves as a percentage of short-term external debt



PRC = People's Republic of China.
Note: Short-term external debt includes liabilities to Bank for International Settlements banks; official bilateral loans; multilateral loans; official nonbanks trade credits; international debt securities; and international nonbanks debt securities due within a year.

Source: Author's calculations using data from International Financial Statistics, International Monetary Fund. http://www.imf.org/external/data.htm; and Joint External Debt Hub. http://www.jedh.org/ (accessed December 2010).

Figure 2: Foreign Investor Share in Stock Markets, 2006



Source: Data compiled from Korea Exchange database.

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