International systemic issues: imbalances and reform

The rapid fall in value of housing, stock markets and assets around the world, along with a global credit crunch, has unleashed a torrent of proposals for reinforcing or re-structuring global economic governance.

Many of these proposals came up at the September opening of the UN General Assembly in New York and again at the October Bretton Woods meeting in Washington, DC, marked especially by concern that the crisis originating in the world’s richest countries would impact severely on the prospects of poor and developing nations, even including those that have carried out successful macro-economic and fiscal reforms.

One reflection of mounting pressure is a proposal in the Doha Financing for Development negotiating text. It states the need to convene a major international conference to review global economic governance – a so-called “Bretton Woods II” – and invites the International Monetary and Financial Committee to take up the matter. This plan is modelled on an earlier proposal, presented by the United Kingdom at a meeting of its Commonwealth countries.

Most recently, the United States invited leaders of the Group of 20 developed and developing countries and other world leaders, including the UN Secretary-General, to a November 2008 meeting in Washington, DC, billed as the first in a series of summit-level discussions on the international financial order.

Pillars of the international financial architecture

Governance of the global economy is in fact quite limited – mostly to standard setting, surveillance, advice and provision of capital. There is no formal grouping of the institutions that carry it out. But among those referred to as main players are the following (the year of their establishment indicated in parentheses):

- The Bretton Woods institutions (1944) were founded around the same time as the United Nations, and their links with the UN system were strengthened in the Monterrey Consensus under the Framework of Financing for Development. The World Bank provides long-term loans – and for the poorest countries, interest-free credits and grants – to public entities in developing countries for development projects. The International Monetary Fund lends to countries with balance of payments difficulties and monitors economic and financial developments worldwide.

- The World Trade Organization (1995) is a negotiating forum for trade agreements and an arbiter of trade disputes based on these agreements. Its predecessor is the General Agreement on Tariffs and Trade (1948), which oversaw the 1986-94 Uruguay Round of trade negotiations that led directly to the WTO’s formation.

- The International Group of 24 on International Monetary Affairs and Development (1971) was established to study and help identify the position of developing countries on monetary and development finance issues.

- The Group of 7 (1976) holds meetings of finance ministers and central bank governors from member countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States) and is generally considered a standing forum for global economic policy issues. The G7 also holds annual meetings at the Head of State level; in 1997, Russia was invited into this summit-level club, creating the G8.

- The Basel Committee on Banking Supervision (1974) provides a forum for central bank governors from 10 developed countries to cooperate on supervisory matters and develop guidelines and standards, including on adequate levels of capital. Like the Financial Stability Forum (FSF) (see below), it is serviced by a secretariat located in the Bank for International Settlements in Basel, Switzerland.
• The **Financial Stability Forum** (1999) was convened by the G7 in the wake of the Asian financial crisis. Its job is to assess vulnerabilities affecting the financial system, identify and oversee needed action and improve coordination among authorities responsible for financial stability. The Forum brings together senior representatives of central banks and treasury departments from selected developed countries, as well as of international financial institutions and international regulatory groupings.

• The **Group of 20** (1999) is comprised of the G7 members and emerging-market countries. It was created, in the wake of the Asian financial crisis, to examine major economic and financial global issues and to promote dialogue and consensus-building among systemically important economies, both developed and developing.

**Grounds for reform**

The fact that the international economic system – the Bank, the Fund and GATT – was established more than 60 years ago is referred to by those who say that it is time for new governance structures or guidelines. Not lost on developing country governments is that, of the five above-mentioned organizations with permanent headquarters, two are based in Washington and three in Switzerland; and also that, apart from the WTO, membership in these institutions is either limited to or by invitation from developed countries or voting procedures utilized are weighted in those countries’ favour.

Adaptations have been made, however, to reflect the growing economic weight of developing countries. G8 summits now invite leaders from major developing economies; the FSF has also brought in developing world representatives on a consultative basis, and the IMF revamped its voting rules at its April 2008 meeting to provide an incrementally larger allocation of voting rights to developing country members.

**Global imbalances**

The crisis of 2008 is rooted in the build-up over several years of global imbalances, whereby unrestrained spending in Western countries was funded mostly by Asian savings. An indication of the extent of the imbalance is the accumulation of more than $4 trillion in international reserve holdings by West Asian oil-exporting and East Asian countries (*UN World Economic Situation and Prospects 2008*). Among items on the other side of the ledger is $3 trillion in securities from the United States Treasury and US government agencies that were foreign-owned in 2007 (US Treasury).

The US ran a trade deficit of nearly $800 billion in 2007, and the European Union of almost $200 billion, while Japan amassed a trade surplus of almost $200 billion, China, more than $200 billion, and the rest of developing countries and transition countries together, a trade surplus of about $300 billion (*UN World Economic Situation and Prospects 2008*).

One corrective measure suggested by these imbalances was to stimulate expansion in surplus countries while reducing deficits and debt in the US, preferably without too rapid a downward jolt to its economic growth, upon which many other national economies depend. UN economists have been among those advocating such measures.

In mid-2006, the IMF initiated multilateral consultations to address global imbalances through concerted policy actions. The talks involved the US, Japan, the Euro-area countries, China and Saudi Arabia. While there was apparent agreement on addressing global imbalances without jeopardizing growth, commensurate follow-up policy actions were not taken.

In October 2008 there was a semblance of a coordinated response (interest rate cuts, injections of liquidity, loan and bank guarantees), as a great many countries took individual actions in rapid-fire succession. But by that time, policy measures were implemented in the crisis response, not prevention, mode.

In addition to finding mechanisms by which national economic policies can be coordinated to mutual advantage, other proposals for policy reforms have included:

• changes in global standards for regulation and banking, including the possibility of a supervisory body to oversee the world's 30 largest banks;

• a revamped world economy early warning system inside the IMF;

• a rules-based and impartial debt workout system for countries;

• a standing pool of resources available for liquidity provision, with the IMF as the world lender of last resort.