FOREIGN POLICY

The Future of Global Economic Governance: From the G20 to a Global Economic Council

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To many, the Seoul summit was thus the real test of the G20: the outcome would show whether the G20 continued to have viability and relevance. The result was disappointing. In the words of the *Financial Times,* the G20 had shown "how not to run the world".[1] In the view of many, the self-declared steering committee for the global economy had failed.

Often, issues of legitimacy and effectiveness are thought of in terms of a trade-off: more legitimacy, less effectiveness – and vice versa. This paper is based on the reverse assumption: that in matters of global economic governance, legitimacy and effectiveness go hand in hand. The paper therefore sets out to identify the main legitimacy problems of the G20, and uses this analysis as the basis for proposing a mode of global economic governance that it considers more likely to be effective. The proposal should be pursued jointly by France, which holds the Presidency of the G20 in 2011 and the Trio Presidency (Poland, Denmark and Cyprus) of the European Union (EU).

The paper advocates a fundamental reform of the existing Bretton Woods system, reshaping its governance structures to reflect the geopolitical realities of the 21st century. Being firmly embedded in the Bretton Woods system, the creation of a Global Economic Council would establish a legitimate steering committee of the global economy, serving as the pinnacle of a new model for global economic governance.[2]

The origin of the G20

The G20 first emerged in the wake of the financial crisis in Asia in 1999, as an informal finance ministers and central bank governors' forum. On 25 September 1999, the G7 finance ministers and central bank governors announced their decision to "broaden the dialogue on key economic and financial policy issues".[3] The G7 countries hence invited their "counterparts from a number of systemically important countries from regions around the world" for the first G20 meeting held a few months later in Berlin. The Berlin *communiqué* reiterated the intention stated by the G7 in its September meeting:

> *The G20 was established to provide a new mechanism for informal dialogue in the framework of the Bretton Woods institutional system, to broaden the discussions on key economic and financial policy issues among systemically significant economies and promote co-operation to achieve stable and sustainable world economic growth that benefits all*[4].

It is striking that the G20 was conceived as a forum for informal dialogue within the framework of the Bretton Woods system. A decade later, many would see the relationship between the G20 summits and the Bretton Woods system as, at best, antagonistic and ambiguous. No less remarkable is the reference to "systemically significant economies" and the absence of a reference to the G20 as a "representative" forum. The question of legitimacy, in terms of "representing" a large share of the global economy, was not really an issue in 1999. It was a club of the "systemically significant".[5]

For the first decade, from 1999 to 2008, the G20 forum of finance ministers and central bank governors attracted little public attention. With the advent of the global financial crisis this changed completely. Now leaders of the largest powers of the world economy decided to use the G20 construction as the basis for creating a Heads of State forum in which to discuss and coordinate responses to the global financial crisis. In a short period of time, the G20 moved from relative obscurity to centre stage, in face of a financial crisis that threatened to cause a meltdown of the global economy.

The illegitimacy of the G20

The G20 claims that its "economic weight and broad membership gives it a high degree of legitimacy".[6] However, in a setting where the great majority of countries have no voice and influence, any claim to "representational" legitimacy is less than convincing. The permanent exclusion of 173 countries violates the principle of universality, a fundamental principle of liberal internationalism and indeed of international cooperation since the Second World

1. "G20 show how not to rule the world", *Financial Times,* 12 November 2010
2. This essay draws upon a recently published report: Jakob Vestergaard, "Beyond the G20. Towards effective global economic governance", DIIS report 2011:4, Danish Institute of International Studies (DIIS), 2011, available at: http://www.diis.dk/graphics/Publications/Reports2011/RP2011-04-G20-and-beyond_web.pdf
3. G20 Research Group, "The Group of Twenty: A History", November 2008, p. 8, available at: www.g20.utoronto.ca/docs/g20history.pdf
4. *Ibid.,* p. 63
5. The countries invited for the first G20 meeting in Berlin in December 1999 were Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the UK, and the USA. In addition to these 19 nation states, the twentieth member of the G20 was the EU, "represented by the rotating Council presidency and the European Central Bank" (G20 2010a). The G20 is really a "G19+1" then
6. French G20 Presidency/HM Treasury, United Kingdom, "What is the G20?", 2010, accessed on 22 April 2011, available at: http://www.g20.org/about_what_is_g20.aspx

War. There are several further reasons why the G20's claim to representational legitimacy is unconvincing:

- There is only one African member country (South Africa)
- No low-income countries are included
- Not one single "small, open economy" is present in the membership

This reflects, of course, that when the countries were originally selected, the intention was to create a forum for "systemically significant" economies. Today, however, after having been elevated to a Heads of State forum, which alludes to being the premier forum of global economic governance, under-representation of Africa and the absence of low-income countries have become highly problematic. The same applies for the absence of small, open economies. This type of economy is perhaps the most common in the world economy, but there is nevertheless no small economy included in the G20 to voice the perspectives and concerns of such economies.

As a leader's forum for responding to the global financial crisis, the G20 was outdated from the beginning. Had twenty countries been selected in 2008, on the basis of the then prevailing geopolitical world order, there is no doubt that a different set of countries would have been chosen. The problem was not only that member countries had been selected a decade earlier, however, but also that the process by which countries had been selected was of questionable legitimacy, a "reflex of the G7 world":

> *They were selected by Timothy Geithner at the US Treasury in a transatlantic telephone call with his counterpart at the German Finance Ministry, Caio Koch-Weser. Geithner and Koch-Weser went down the list of countries saying, Canada in, Spain out, South Africa in, Nigeria and Egypt out, and so on; they sent their list to the other G7 finance ministries; and the invitations to the first meeting went out.*[7]

The inclusion of countries such as Argentina, Australia and Saudi Arabia reflected not so much that these were considered more "systemically significant" than other countries, but that an effort was made to include in the forum good allies of the United States (US). This means that, contrary to received wisdom, the G20 cannot claim to be legitimate, not even in the limited sense of being the world's largest economies.[8]

Going forward, the absence of objective criteria for membership is a serious shortcoming of the G20. How is membership to be adjusted to the rapidly changing realities of the global economy in the coming years? One may say that the main strength of the G20, that it was already there, ready-made and "flexible", has turned out to also be its main weakness: its membership is outdated – and this problem will only increase in coming years.

7. Robert Wade, "From global imbalances to global reorganizations", *Cambridge Journal of Economics*, 33, 4, 2009, p. 553
8. If one was to reshape the G20 so as to be comprised of the worlds' twenty largest economies, Argentina, South Africa and South Korea would need to be replaced by the Netherlands, Poland and Spain (see Annex 1 for details)

Annex 1 | The world's largest countries, by GDP (billion USD) and population (millions)[9]

Ranking	GDP (nominal)	GDP (PPP)	GDP* (60/40)	By population
1	US (14256)	US (14256)	US (14256)	China (1331)
2	Japan (5068)	China (9104)	China (6633)	India (1155)
3	China (4985)	Japan (4138)	Japan (4696)	US (307)
4	Germany (3347)	India (3784)	Germany (3202)	Indonesia (230)
5	France (2649)	Germany (2984)	France (2458)	Brazil (194)
6	UK (2175)	Russia (2687)	India (2300)	Pakistan (170)
7	Italy (2113)	UK (2257)	UK (2207)	Bangladesh (162)
8	Brazil (1572)	France (2172)	Italy (2036)	Nigeria (155)
9	Spain (1460)	Brazil (2020)	Russia (1813)	Russia (142)
10	Canada (1336)	Italy (1922)	Brazil (1751)	Japan (128)
11	India (1310)	Mexico (1540)	Spain (1474)	Mexico (107)
12	Russia (1231)	Spain (1496)	Canada (1314)	Philippines (92)
13	Australia (925)	Korea, Rep. (1324)	Mexico (1141)	Vietnam (87)
14	Mexico (875)	Canada (1280)	Korea, Rep. (1029)	Egypt (83)
15	Korea, Rep. (833)	Turkey (1040)	Australia (898)	Ethiopia (83)
16	Netherlands (792)	Indonesia (967)	Turkey (786)	Germany (82)
17	Turkey (617)	Australia (858)	Netherlands (745)	Turkey (75)
18	Indonesia (540)	Iran (844)	Indonesia (711)	Iran (73)
19	Belgium (469)	Poland (727)	Poland (549)	Thailand (68)
20	Poland (430)	Netherlands (673)	Iran (536)	Congo, DRC (66)

Source: World Development Indicators (WDI). All data are for 2009 (latest available).

A key line of defence for the G20 is that because it is so obviously an improvement *vis-à-vis* the G7, it cannot sensibly be criticised. It is a positive development that the G7 countries now feel inclined to consult in a systematic manner with dynamic emerging market economies. Indeed, some form of multipolar deliberation and dialogue has become a *sine qua non* for global economic governance, given the geopolitical realities of the world economy. There are several reasons, however, why the G20 was the *wrong* form of multipolar deliberation:

- First, the G20 continues and reinforces a troubling trend towards "plurilateralism-of-the-big", by which the vast majority of nations lose voice and influence on matters that affect them crucially.

9. There is no agreement among governments about which Gross Domestic Product (GDP) indicator to use. Generally, most developed countries are proponents of using GDP at market values (nominal), while many emerging market economies prefer GDP at purchasing power parity (PPP). In the recent voting power realignment in the IMF and the World Bank, the compromise reached was to use a composite GDP indicator, given 60% weight to GDP at market values and 40% weight to GDP at purchasing power parity

- Second, the G20 effectively undermines the existing system of multilateral cooperation in institutions such as the International Monetary Fund (IMF), the World Bank and the United Nations, causing resentment towards the G20 in those institutions in general and among non-G20 countries in particular.
- Thirdly, what is needed to address today's key problems – such as global imbalances, climate change and rising poverty – is not an informal leaders' forum, but binding deliberations in a truly multilateral framework.

Institutional Framework for a Bretton Woods II

From the perspective of effective global economic governance for the 21st century, the two main deficiencies of the Bretton Woods system that need to be addressed are the following:

- There is no Heads-of-State forum, and hence Bretton Woods suffers from a lack of "political weight"
- Its systems of voting power do not adequately recognise the increased economic and political weight of dynamic emerging market economies

The way forward is to reform the Bretton Woods institutions so as to allow them to operate effectively as key pillars in a multilateral system of global economic governance, under the stewardship of a Global Economic Council. Three key reforms should be undertaken: (i) creation of a Heads-of-State forum, the Global Economic Council; (ii) reform of the voting power systems of the Bretton Woods institutions; and (iii) reconfiguration of their systems of country constituencies.

Establishing a Global Economic Council

The cornerstone of a revised Bretton Woods system should be a Global Economic Council. Its key task would be to act as steering committee of the global economy.[10] The Council should consist of 25 country constituencies, in an arrangement similar to that of the Boards of the IMF and the World Bank, with procedures for consultation and rotation to ensure that all member countries have a voice in the process in proportion to their Gross Domestic Product (GDP). A Global Economic Council based on country constituencies – with the relevant 25 Heads of State meeting twice a year on the basis of prior consultation with their country constituencies – would have the benefits of multilateral legitimacy and the advantages of being embedded in the existing institutional framework of the IMF and the World Bank.

10. The Council should deliberate on key issues with regard to the further reform of the governance arrangements of the existing Bretton Woods institutions. But it would be natural for the Council to have also informal discussions on global economic governance issues beyond the two Bretton Woods institution such as, for instance, the matter of how new momentum may be brought to the WTO's Doha Round

Reforming the existing voting power systems

The current systems of voting power of the Bretton Woods institutions do not adequately reflect the geopolitical realities of the world economy. The oft-cited principle that voting power in the Bretton Woods institutions should reflect countries economic weight in the global economy is theory more than practice. In both the Bank and the Fund, a range of other criteria than weight in the global economy – such as degree of "openness" and "economic variability" and amount of international reserves in the case of the IMF – has been used in calculating the voting power of member countries. As a result, relative voting power no longer has a strong, consistent link with economic weight in the global economy.[11] It is of paramount importance to the legitimacy of the Bretton Woods institutions that their voting power systems are revised in a manner that restores a fundamental balance between voting power and GDP. The proposal here is to simply allocate to countries a share of voting power equal to their share of world GDP. This is the best way to ensure that relative voting power continuously reflect the realities of the global economy.

Revision of system of country constituencies

Since the existing configuration of country constituencies in the World Bank and the IMF is in need of serious repair, fundamental revision of country constituencies must be undertaken. New principles are needed both for the allocation of chairs among regions and for the allocation of chairs within regions.

The first principle of allocation of chairs among regions should be to achieve reasonable representation of all the world's main regions. This paper proposes basing future global economic governance arrangements on four main regions: Africa, Asia, Americas and Australasia, and Europe.[12] In the council, 16 seats should be distributed evenly among each of these four main regions; 4 seats for each region.

The second principle should be that 9 additional seats are assigned to the four regions in proportion to their weight in the world economy. At current, this would mean that all four regions except Africa would get 3 additional seats. Together, the application of these two principles would give Africa 4 seats and the three other regions 7 seats each:

11. Voting power to GDP ratios – which should ideally vary within a 0.85 to 1.15 bank – in fact varies from less than 0.5 to almost 4. This means, in brief, that the value of one dollar of GDP – in terms of voting power – varies dramatically from country to country, which it shouldn't
12. This categorisation of countries is based on UN statistics, which divides the world in five regions: Africa, Asia, the America, Europe and Oceania. The latter of these regions, Oceania, is integrated in two of the other regions, namely the Americas and Asia. Oceania consists of Australia, New Zealand, Norfolk Islands and three groups of island states: Melanesia, Polynesia, and Micronesia. Taken together, Australia, New Zealand, Norfolk Island and the Melanesian islands are known as Australasia. This part of Oceania is combined with the Americas, whereas Polynesia and Micronesia is considered part of the Asian region

Table 1 | GDP* and the allocation of seats in revised Bretton Woods system

	GDP* (% of total)	GDP seat indicator	Allocation of GDP seats	Regional seats	Total number of seats
Africa	3.23	0.30	0	4	4
Americas & Australasia	34.55	3.11	3	4	7
Asia	33.69	3.03	3	4	7
Europe	28.53	2.57	3	4	7
Total	**—**	**9**	**3**	**16**	**25**

The allocation of chairs *within* the four different regions should be based on two main principles. First, country constituencies should be *elected* chairs, with a minimum size of three countries per constituency. This would break with the current "mixed-system" of five appointed chairs and nineteen elected chairs. Second, all chairs should involve a mechanism of rotation to ensure consultation and dialogue within constituencies. Each constituency could have one Director and two Alternates, and decide internally whether there should be rotation on both levels or only at the level of Alternates. This flexibility in rotation modalities would allow large economic powers – such as the US and China – to maintain Directorship of a chair, while ensuring consultation with countries in their constituency through the system of Alternates.

Concluding remarks

The way forward in global economic governance is to revise the existing Bretton Woods system in a manner that addresses its weaknesses and makes it responsive to the geopolitical realities of a rapidly changing global economy. It is of paramount importance that the Trio Presidency of the EU (Poland, Denmark and Cyprus) joins forces with France, which holds the Presidency of the G20 in 2011, to gather global support and momentum for reforms towards this end.

Three reforms are essential. First, a Heads-of-State forum needs to be created, which is predicated upon the voting power and country constituency systems of the Bretton Woods institutions. Second, so that voting power better represents the economic weight of its member countries, the voting power systems of the Bretton Woods institutions must be revised. Third, to ensure a more balanced representation of the world's main regions, the country constituencies of the Bretton Woods institutions must also be revised.

The three major advantages of such a reconfiguration of global economic governance would be that:

- It would embed a leaders' forum within the institutional framework of the existing Bretton Woods institutions while at the same time bringing the latter up to date.

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- It would reconfigure the current country constituencies so that all chairs represents at least 3 and no more than 16 member countries.
- It would give long-term durability to global economic governance by being responsive to the rise and fall of nations – in and through a transparent, automatically updated system of weighted voting (based on GDP) – while at the same time ensuring interregional legitimacy by means of the proposed balanced allocation of chairs to the world's main regions.

A Bretton Woods system revised along these lines would allow for a better balance between established and rising powers, and provide a more durable way of adjusting the governing balance as the economic balance changes. Last but not least, a Global Economic Council firmly embedded in a revised Bretton Woods system would likely be significantly more effective in addressing the key challenges of global economic governance than the G20 leaders' forum could ever hope to.