

PROCEEDINGS OF CONFERENCE ON

# G20 and Global Governance Reform

THE ASAN INSTITUTE for POLICY STUDIES



*THIS IS AN ONLINE VERSION OF THE PRINTED VOLUME  
FORTHCOMING IN AIPS SERIES ON GOVERNANCE*

# **G20 and Global Governance Reform**

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THE ASAN INSTITUTE FOR POLICY STUDIES  
*Seoul*

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## FOREWORD

This book is the collection of the papers and comments that were presented at the International Conference on G20 and Global Governance Reform on October 11-12, 2010 at the Asan Institute for Policy Studies (AIPS), Seoul, Korea. The AIPS organized the conference jointly with the Hills Governance Center at Yonsei University (HGCY). Prominent intellectual leaders from diverse fields and officials from international organizations and the Korean government were invited to address issues ranging from the future of international economic cooperation to the reform of international financial institutions in search of G20's strategic leadership in the evolving global governance. They also discussed ways to reinforce Korea's role in the global areas. To complement the conference papers, the editors added four new papers after the conference that had been previously released as working papers by HGCY.

The organization of the conference and the publication of the book would not have been possible without the support of many friends and colleagues. The editors would like to acknowledge the support and encouragements of Lee Hongkoo, former Prime Minister of Korea and Chairman of the Seoul Forum for International Affairs, Chung Mongjoon, Honorary Chairman of AIPS, Han Sungjoo, Chairman of AIPS and former Foreign Minister of Korea, and Roderick Hills, the founder and Chairman of the Hills Program on Governance at the Center for Strategic and International Studies and former Chairman of the Securities and Exchange Commission.

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# **G20 and Global Governance Reform**

# INTRODUCTION

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The G20 is a group of 20 leading industrial and emerging countries. Leaders from the G20 nations met for the first time in Washington at the peak of the global financial crisis in November 2008 to coordinate their actions to prevent the further collapse of the international financial system. They reached an agreement to reinforce policy cooperation, improve the regulatory and supervisory framework of the world's financial markets, reform the existing international financial institutions and avoid trade protectionism. In the subsequent summits in London and Pittsburgh, the G20 pledged to combat the worst global economic recession in many decades with a \$5 trillion stimulus package. The Pittsburgh Summit officially designated the G20 to be the premium forum for international economic cooperation and expanded the G20 agenda into the reform of international financial institutions, global economic and trade growth, financing for climate change issues, and financial regulatory reform. G20 leaders in Pittsburgh also promised to support the "Framework for Strong, Sustainable and Balanced Growth," heralding a new era of global economic governance and laying the ground for institutionalizing the summits. In June 2010, leaders called for fiscal consolidation in Toronto after the European debt crisis threatened the still fragile global economic recovery. The Seoul Summit is expected to make further progress and draw a new map for the global economy beyond the crisis by addressing global imbalances and competitive currency undervaluation. Other issues ranging from IMF governance reform, bank capital rules, global financial safety net to development issues have also seen significant progress.

The rise of G20 reflects the changes in the distribution of power and the structure of the global economy since World War II. G20 represents a transition from the multilateral global governance system dominated by major powers to a more democratized global governance system where emerging states hold a stronger voice. By pushing for international policy cooperation, the G20 not only tries to prevent the repeat of a global financial crisis, but also supports sustainable global economic growth. It also spearheads the reform of the global governance system at international organizations. Yet the academic community is only beginning to recognize the growing significance of G20 in terms of global governance. Building on the previous work on the G20 (Bradford and Linn, 2007; Hajnal, 2007; Bradford and Lim, 2010; Alexandroff and Cooper, 2010), this volume attempts to present a systemic



study of the G20's evolution and future path. What distinguishes this volume from others is that the authors here couch their analysis more squarely into major theoretical debates of their disciplines.

The articles in the volume also seek to gain better understanding of East Asian perspectives on the G20. East Asia carries significant weight with its stake in the G20 as four East Asian countries, namely China, Indonesia, Japan, and Korea, have a seat at the G20 table and the G20 covers issues such as macroeconomic imbalances that are critical to the future of East Asian economies. It turns out that East Asian attitudes toward the G20 are not uniform across countries. East Asian authors explain the prevailing views of leaders of their country regarding G20 issues.

### **The Promise of the G20 as an International Regime**

The overarching issue from the point of international relations theory is the future of the G20 in the system of global governance. Even though the G20 is not a formal international organization, it is playing a pivotal role in forging international economic cooperation. In assessing the future of the G20, international relations scholars can draw on the rich literature on international regimes. An international regime is broadly defined as a set of international rules, norms and procedures in an issue around which actors' expectations converge, and therefore the G20, even as an informal organization, can qualify as an international regime. The emergence, evolution and persistence of an international regime are issues of central importance to scholars of international regimes.

Looking at the G20 as an international regime, Stephen Krasner in Chapter 1 argues that that the G20 will persist and could coordinate regulatory reform because the G20 conforms closely to contemporary power distributions. According to Krasner, the strength of a regime depends on three factors - the underlying distribution of power, the complementary nature of member interests, and the degree to which underlying beliefs are shared. And the G20 clearly satisfies the first condition but not the others.

Krasner sees many sources of instability ahead for the G20. He believes that the distribution of power will be fluid as it is not yet clear how far China will go in challenging the U.S. In addition, G20 also has to deal with ideological uncertainties as well as the divergence of interests. Member countries do not agree on the role of the state and market. There are many paradigms of economic management competing in the world now after the consensus based on neoliberal ideology broke down in the wake of the 2008 global economic crisis. The interests of member countries also diverge on banking reform, exchange rate realignment, fiscal stimulus, and macroeconomic imbalances. Other developments do not bode well for the future of the G20. The G20 agenda is becoming overly ambitious, encompassing all major issues of globalization from environmentally sustainable growth to

corporate governance. Powerful domestic interest groups such as labor unions and environmental groups are applying pressure on their leaders not to compromise their interests in G20 negotiations. Krasner, however, concedes that there is no feasible alternative to the G20. For this reason, he predicts that the G20 would “stumble, probably forward.”

Chapter 2 by Motoshi Suzuki concurs with Krasner on the overall prospect of the G20. He questions how G20 can govern itself with a heterogeneous membership at a difficult time when governments are increasingly adopting mercantilist beggar-thy-neighbor policy practices. To become a viable promoter of global governance, G20 needs a viable policy idea based on neoclassical liberalism to pursue a balance of growth, stability and environmental protection. Suzuki notes that it is difficult to make drastic change when every country tries to protect its interest with the existing systems.

Others are more optimistic about the future of the G20. Presenting a Chinese perspective in Chapter 3, Yanbing Zhang argues that while the U.S. sees East Asia becoming more important, East Asian countries see tensions over U.S. power building. Prior to 2008, the U.S. had been unwilling to accept the G20. But the crisis precipitated the formation and acceptance of the organization. U.S. hegemony has not been challenged as there are no other countries that can directly challenge its dominant position. China, the most plausible candidate, still has many domestic problems that it must tackle. G20 faces three obstacles on its way to becoming a genuine and effective mechanism of global governance - attitudes of major powers, the relationship between G20 and the existing international organizations, and its ability to showcase its effectiveness, namely agenda setting and timely decisions. They are all interrelated and are likely to converge at the Seoul summit. What is promising is that the US, EU, and China have adopted a fairly positive attitude toward G20, although they do have different ideas about how G20 should be run and different interests to express through G20. Some medium powers like Canada, Korea and Australia can also play positive roles in strengthening the G20. G20 should eventually return to the UN system for its legitimacy. And in order to become the genuine steering committee of global economic governance, G20 should become a mechanism placed above the IMF, World Bank, WTO and OECD and put all these organizations under its supervision. G20 should have its own agenda but the agenda setting should be inclusive. G20 must find consensus within its major powers which in his view is more important than expanding the number of member states. The G20 may not work if the world breaks into different regional blocs and G8 member states decide to return to the G8. But given the support for G20 by the U.S. and emerging powers, he predicts that the G20 will become more viable in two or three years.

Yul Sohn in Chapter 4 points out that the alternatives to the G20 may be equally or even more limited than the G20. The existing functionally-divided governance institutions such as the IMF have proven incapable of dealing with new complex and cross-jurisdictional issues such as the financial crisis. The G20 holds great promise if it can evolve into a networked, flexible, scalable, responsive and informal institution of global governance. As a network, the

G20 must be an architectural committee, not a crisis institution. Now each power at the G20 has its own theory and idea of how the global financial crisis occurred in addition to different national interests. Emerging institutions like the G20 should be more flexible and networked to become effective in addressing pressing and intertwined issues.

Chapter 5 by Jongryn Mo presents another approach to understanding the rise of the G20. Unlike Krasner who views the G20 as an international regime and Sohn as a network, Mo argues that the G20 is evolving into a legislative body for the world economy as it makes important economic policy decisions and at the same time, actively oversees the operations of international financial institutions. The functions of a legislature are legislation and oversight, and the G20 is clearly fulfilling both roles in the governance system of the global economy. As a de facto legislative body, Mo argues that the G20 cannot function as an informal caucus and must acquire sufficient legislative machinery, especially, an organization such as an accounting and audit office to support the oversight function of the G20. The acceptance of the G20 as a legislative branch of the global governance system has two major implications for G20's relations with other international institutions. First, the G7 may have to return to its roots as a caucus of like-minded leaders of industrial democracies. Second, the G20 needs to reshape its relations with international financial institutions in a way that the former focuses on a narrow set of strategic issues at the latter such as crisis management, governance reform and cross-jurisdictional issues while the internal boards of the latter take up more routine oversight duties.

## **The G20 and the International Monetary Fund**

As the G20 is solidifying its position as the premier forum for international economic cooperation, it confronts a number of challenges in establishing cooperative relations with existing international organizations. The G20's relationship with the International Monetary Fund (IMF) in particular is becoming the linchpin of the new G20-centered system of global governance as the G20 must rely on the IMF to implement important decisions made by G20 leaders on international macroeconomic coordination and the surveillance of member countries' exchange rate policies. The governance reform of the IMF is vital since there is a lack of accountability, transparency, general authority at the IMF. The reform is necessary to build legitimacy and to be effective. But institutionalizing the G20-IMF relationship has proven to be a difficult task. To improve their cooperation, the G20 and the IMF must overcome disagreements on the mission of the G20 among G20 member countries as well as structural barriers arising from the conflict between the G20's guidance of the IMF and IMF's own formal governance structure.

Kenneth Dam presents his analysis of the relationship between the G20 and the IMF in Chapter 6. Dam's central message is that the G20 cannot be a substitute for existing

international organizations such as the IMF as it is “merely a forum” that lacks not only specialist personnel but also financial resources. The G20 has been effective in coordinating national economic policies to tackle the global financial crisis but now it should delegate the tasks of reforming international economic institutions. As for the IMF governance reform initiatives, including its "shares" or member countries' relative voting power and "chairs" at the Executive Board, Dam thinks that the only way to break the current logjam is to persuade the Europeans to give away some of their seats and quotas to China and other emerging economies. Only after Europe gives up some of its seats and a proportion of its quotas can power be shared with emerging countries.

In Chapter 7, Masato Hatake agrees with Dam's view that the G20 is merely a forum that cannot implement effective measures. But such an institution might be able to create a favorable environment or an arena for constructive discussions. In game theory, “cheap talks” can play a key role in coordinating actors’ divergent expectations about game outcomes. To fulfill this role, G20 should not become too bureaucratic. G20 presents an opportunity for a player to send his or her views on the current global economic situation and also indispensable actions by the global community. A good example is Japan's pledge to finance up to \$199 billion to the IMF at the G20 in Washington in 2008. Given the complexity in changing cultures, G20 can contribute to solving the problem by setting clear targets that can be solved in a certain length of time. Therefore, delegating the task of reform to the very international organizations is possibly a wise move.

Chapter 8 by Ying Huang argues that the current IMF reform is an important step to move forward, but it is not enough to restore the IMF to the center of international finance. She hopes that the G20 will do more to modernize the management of the IMF. But she questions the G20’s ability to reform the IMF. In reforming the IMF, it is important for the twenty leaders to be a collective in shaping their relations with an international organization such as the IMF. But the reality is that G20 leaders have conflicting agendas and find it difficult to cooperate.

Joongi Kim calls for a more active role by the G20 in guiding and steering the IMF in Chapters 9 and 10. Even though the G20 cannot be a substitute for existing international financial institutes (IFIs), it has the potential to help untangle the gridlock that has hampered IFI reforms through judicious guidance and compromise. If the G20 becomes more institutionalized with its own specialized secretariat and staff, it can play a far more significant role on a continuing, sustained basis in guiding and leading the IFI reform efforts. Kim proposes that the G20 should have more of an oversight role as there is a tendency for organizations to develop inertia when they become larger, and find it difficult to undertake internal reforms. The only opportunity of change is in times of crisis, such as the current financial crisis. In addition, there are also many problems within the IMF, besides the issue of shares and chairs. For instance, there is a lot of skepticism, especially from developing countries, that the IMF is not an organization with good representation. The G20 can

potentially play a role, especially in IMF governance reform. The G20 can specialize on the governance part, instead of technicalities, including, for instance, nominating or perhaps electing the managing director to break the long-standing tradition that the US and Europe have alternated the post, a factor which has undermined its legitimacy in the eyes of developing countries. Kim acknowledges that there is a danger that the G20 might add another layer on top of the existing hierarchies, but certainly it can play a more constructive role as the G20 is representative, geographically diverse, largely democratically, and has a strong share of the global GDP, all of which bestows it with authority and legitimacy.

### **Domestic Politics and the Domestic Support for the G20**

Another area where political scientists can contribute to the future development of the G20 is the domestic political foundation of the G20. So far, domestic politics has been discussed largely as a constraint on decision-making at the G20. Important constituent groups such as opposition parties, labor unions, financial institutions and civil society groups have pressured G20 leaders to take their interests into consideration when discussing important economic issues at the G20. But G20 leaders must recognize that domestic politics is more than a constraint and in fact, a key success factor of the G20. To endure as an effective governance body, the G20 must build firm foundations in the domestic politics of great powers. The worst nightmare for the G20 would be to suffer the same lowly reputation among the public as many international organizations. The key domestic institution to watch as a barometer of the domestic support for the G20 is the United States Congress. The U.S. Congress has a history of playing spoiler to new international organizations such as the League of Nations and the International Trade Organization.

In Chapter 11, David Brady presents an analytical framework for understanding the likely responses of the U.S. Congress to the G20. He compares the U.S. politics in dealing with global security and free trade agreements, with a number of recent decision making examples. Foreign policy crisis such as a war usually prompts a quick and effective response as Congress tends to conclude that leaving the decision to the president is a safer choice amid the uncertainties. But trade policy is different as it affects real economic interests and the members of Congress try to better represent their constituencies. Since Democrats are more closely tied to labor interests, the current government of a Democratic president and a Democratic Congress is the worst combination for free trade advocates. And the economic downturns increase anti-trade and anti-globalization interests, which in turn constrain governments' ability to negotiate, finalize or approve trade treaties and leads to a long gridlock.

The G20 represents a combination of security and trade policy elements to congressmen. Congress understands the importance of the G20 in providing an open forum for leaders from

advanced industrial and emerging economies to coordinate currency and other economic policies to get the global economy out of the crisis and move it forward. Given the complexities of macroeconomic and financial cooperation, Congress has so far shown a willingness to defer to the president. But Congressional attitudes can turn negative if actions at the G20 are viewed as threatening the economic interests of their constituents. In this regard, Congress will carefully watch whether or not the G20 will successfully resolve the current realignment issue between China and the United States. If the G20 succeeds, President Obama may be able to use that momentum to fend off organized protectionism interests and promote free trade.

Keisuke Iida in Chapter 12 notes that Japan has had mixed feelings about the G20. Japan had been the only Asian country in the G8 and it had prided itself on that status. With the G20, Japan is only one of the five or six Asian countries. So, Japan has lost its scarcity value. As for the domestic constraints, Prime Minister Kan's recent unpopularity with a tax increase proposal presents some lessons. First, many items on the G20 agenda, especially fiscal policy, are closely connected with domestic politics in each country and therefore, agreements on these issues are very difficult if not impossible. Second, if there is a conflict between international cooperation and domestic politics, domestic politics invariably trumps international agreements. As in the United States, domestic constraints in Japan are very severe in trade policies, while less so in security policies. Fiscal policy in particular is considered as a part of domestic policy

The situation in Indonesia is similar as Natalia Soebagio gives her account in Chapter 13. Indonesia's parliament, mostly driven by short-term and personal interests, pays little attention to grand issues at G20, although the government offered several initiatives, namely greater financial access for developing economies, tackling climate change, governance reform of the IMF and World Bank and resuming the stalled WTO negotiations. Hence in trying to bring G20 into the people's minds, the challenge lies in generating enough public awareness of G20 to stimulate greater discourse in parliament. What is needed to generate domestic support for G20 is to "localize" the issues.

## **G20 and the International Cooperation for Climate Control**

Climate change presents a key challenge to the international community. Yet there is a growing recognition following the Copenhagen Conference in December 2009 that the current international framework for addressing the problem of climate change is inadequate and may benefit from the support of complementary mechanisms. Many experts have proposed the G20 as such an alternative mechanism. Adding climate change to the G20 agenda is not a simple issue. The G20 may already have a crowded agenda and adding another issue would undermine its effectiveness. The loss of legitimacy would be another

casualty if G20 leaders decide to discuss climate change issues at a small-group forum such as the G20 instead of the United Nations with its universal membership.

Soogil Young assesses in Chapter 14 whether G20 can be an effective body in tackling climate control issue. There are three main venues for climate control: United Nations Framework Convention on Climate Change (UNFCCC), Major Economies Forum on Energy and Climate Change (MEF), and G8/G20 summits. The UNFCCC is unlikely to yield a global contract that leads to control of greenhouse gases, and can only have a fairly limited impact. Therefore, the G20 Summit must be used as a supplement with which to enforce the UNFCCC process. The Kyoto Protocol is a binding agreement between signatories in reducing greenhouse gases. The Kyoto Protocol will remain in effect until 2012, and the negotiations to secure the second commitment period from 2013 to 2020, which was first discussed in the Bali Action Plan of 2007, failed in Copenhagen. Although the Copenhagen meeting produced no definite conclusion, it is important to note that the Copenhagen Accord was produced. In April 2009, the MEF was first launched by President Obama in Washington, April 2009. The G8 has been a continuing process since the 1970's, but it was not until the 2005 Gleneagles G8 Summit that the second commitment period was discussed. As a major forum where a small group of countries can come to a major climate-change initiative, the MEF is focused on technology. The G20 does not have to replace the UNFCCC; it can serve as a leading caucus group. It is too late for the G20 to tackle major climate change issues in Seoul; the best the G20 can do at the Summit is to agree to discuss climate change in future meetings. The G20 can play a role by reaching an agreement and showing an example to non-member countries.

Chapter 15 by Suh-Yong Chung goes further. He argues that the UNFCCC is not reliable as it has become too political to tackle climate change issues, with developed countries pitted against developing ones. The 2009 Copenhagen meeting produced only a non-legally binding and political soft law instrument, Copenhagen Accord, which does not include detailed standards in meeting the targets recommended by the IPCC to keep the GHG concentration level at 450ppm. The UNFCCC regime may not be able to make a significant step towards a more decisive and resolute agreement unless it finds a way of transforming the politicized negotiation process to one that can realize environmental integrity. In this context, Chung sees the G20 looks as a very attractive alternative as it is a soft forum consisting of major economies both from developed and developing country groups. The G20 is relatively free from being constrained by the formalized negotiation framework and can mobilize strong political momentum with summits. G20 leaders can persuade other UNFCCC members to support their decisions. In this way, the G20 shows great promise. In 2020, the global community must reduce 19-giga tons of greenhouse gases from the atmosphere, and 12 of these must be removed by developing countries. The G20 can be an important forum where urgent climate-related issues can be discussed. The UNFCCC has shifted from purely environmental issues to financing issues to make climate control requiring truly a global

commitment. The G20 can provide an effective framework for these talks, and Korea should place climate change on a higher priority on its agenda. Many of these climate-related forums and meetings can be placed under the G20 umbrella.

Thierry Soret offers alternative views in Chapter 16. Even though the G20 and other "mini-lateral" approaches can help address cross-border issues such as climate changes with their capability to take swift collective action, the United Nations should still take the initiative to better reflect the interests of developing countries and enforce big emitters' pledge to finance the adaptation process of small and vulnerable developing countries.

## **Opportunities and Challenges for Korea at the G20**

In Chapter 17, Mo and Eunkyung Seo explain the role of Korea in the evolution of the G20. Korea became the first non-G7 country to host and chair the G20 summit. Korea has made every effort for its success as the G20 is Korea's first official debut as an active and responsible player in the global decision-making processes. At the G20, Korea is determined from the very beginning to aggressively lead the global discussions on ways to fight the global financial crisis as it was one of the biggest victims in the 1990s. President Lee Myung-bak called for a standstill on trade protectionism at the first G20 Summit in Washington two years ago.

Korea's contributions have been particularly noteworthy in the areas of common interests both for the developing and developed countries as it defines its role as a bridging power between the two camps. Korean initiatives at the Seoul Summit include global financial safety net and development for the less developed countries. The idea of the financial safety net, a mechanism designed to help shield the emerging economies from external shocks, has attracted strong interest from those vulnerable to international capital flows. Korea has endorsed the IMF's efforts to ameliorate the stigma effect of an IMF bail-out which has severely undermined the credit-worthiness of borrowing countries. By managing the global financial safety net, the IMF can shift its mandate from a post-crisis bailout fund to a pre-crisis prevention insurer. The IMF recently enhanced its existing Flexible Credit Line (FCL) and introduced a Precautionary Credit Line (PCL), hoping the moves will help facilitate the efforts for global rebalancing by reducing the need for emerging countries to accumulate foreign reserves as self-insurance against volatile global capital flows. Korea is seeking ways for IMF lending facilities to link up with various regional arrangements such as the Chiang Mai Initiative in Asia. Korea's presidency of the G20 also presents an opportunity to bring development issues to the table. With its vivid memories of successes and failures, Korea has already pushed for a development agenda and multi-year action plan, including a pledge to duty-free, quota-free market access for low-income countries. The initiatives could make the



G20 Summit a much more inclusive and relevant event for the entire world as it can bring more than 170 non-member countries into the G20 arm.

Mo and Suh note that Korea still faces many challenges in establishing its leadership in the global community. The Korean government and private-sector experts should take more active roles in the global negotiation tables while research institutes and civil groups should make further contributions to the international market of knowledge. The task requires long-term investment. The government should take the initiative in building knowledge capacity within international organizations and nurturing experts and specialists. At the G20, Korea should provide more strategic guidance, showing the way where the G20 should be headed. The G20 offers a rare chance in making international organizations more accountable. Global governance can improve significantly if the G20 works as an effective steering committee for international financial organizations, assessing their managers and holding them accountable. The current loose system cannot bring about a breakthrough to the international bodies. The G20 should not rely excessively on the IMF for administrative assistance when it leads and oversees the reform. The G20 needs its own secretariat or investigative body. Korea should lead the G20 into becoming a global governance watchdog as part of its efforts to institutionalize G20.

Sohn's discussions at Chapter 4 are also relevant. He suggests that an increasingly interdependent world, middle powers like South Korea can increase their influence by developing soft power with a neutral, universalistic and principled approach. But Korea's approach to the G20 has not been as networked as needed. Sohn believes that the Korean government is not realistic in terms of power politics. Korea is also still very much reliant on the United States and its support. If it wants to play a bridging role, Korea should not just be on the U.S. bandwagon. Korea has to reconfigure its political status in the world and needs to have both regional and global vision as a successful mediator. If Korea wants to play an important role, not just as the chair, but also as an important agenda setter, Korea should be able to share constructive crisis-related stories with others, addressing questions such as the cause, process and the future of the crisis; it has recovered relatively quickly from the financial shock, but there seems to be no explanation about the actual cause. Serving as a moderator, and holding a successful Summit is simply not good enough.

In Chapter 18, Mo and Chiwook Kim broaden the debate by challenging East Asian countries at the G20 to step up their collective leadership. Even though four East Asian countries, Japan, China, South Korea, and Indonesia, participate in the G20, their collective record is mixed at best. As the largest surplus countries in the world, for instance, they can bring long-term stability to global financial markets by working together to reduce their reliance on exports. The four East Asian G20 members are far from becoming a distinctive group, let alone speaking with a united voice on the global stage. Even at the G20, East Asian leaders have not been viewed as leading the agenda.

Mo and Kim call on East Asian leaders to set aside their national ambitions and begin to

think about what they want to do collectively with their power. Unless the region offers a new alternative that the rest of the world will find attractive and appealing, the impact of East Asian participation in global governance will be minimal, even negligible—especially if the region's leaders simply endorse decisions made by others. East Asia must also strengthen its regional institutions as it needs strong regional coordination and implementation mechanisms to effectively participate in global governance.

## **Summary and Conclusions**

Most contributors to this volume agree that the G20 is the only platform that can exercise a decisive and effective leadership in the changing global governance system as the existing international organizations have lost much of credibility due to inertia and political gridlocks. The G20 can serve as a decision-making and complementary body for the international organizations while leading and overseeing their reforms. But there are a number of challenges that the G20 must address in the immediate future to solidify its position as the leading organization of international economic cooperation. The authors discuss the challenges and possible responses which are summarized as follows:

- The G20 faces several stumbling blocks in its way to becoming a strong international regime. G20 has fast developed into a major forum to discuss key pressing issues after being launched as a crisis-fighting committee two years ago. The G20 leaders must focus on achieving notable successes in some areas before expanding its agenda further. The overarching responsibility for the G20 is to prevent a repeat of the global financial crisis, for which it must resolve how to reduce global macroeconomic imbalances, including currency adjustments.
- The G20 should improve its effectiveness in the next one or two years. The ultimate yardstick in measuring the legitimacy of the G20 is effectiveness. Unless it proves its effectiveness, the G20 can face similar criticisms as the G7 and might be dismissed as a body that merely offers empty rhetoric. Despite its structural limitation due to its expanded membership, it is also important to enhance its outreach efforts to include non-member countries and encourage the heads of regional organizations to participate in talks.
- The G20 should lead reform of the governance structure at international organizations dominated by developed countries if it wants to effectively replace the G7 and reflect a more democratized world with the rise of emerging states. The G20 lacks resources and staffs needed to lead IMF reforms. Unless the G20 can overcome these shortfalls, it would be better to delegate the issue to the international financial institutions.
- Despite its structural constraint, the G20 can contribute to reforms of international

organizations. It can provide a breakthrough to the gridlock and it has already done so. G20 may need to create a Global Accounting Office to assess the performance of international organizations and set guidelines for reform.

- The G20's success largely depends on support of domestic constituencies. It must obtain the trust from the public and media in major countries, as in the case of the United Nations, or it will lose much of its authority to resolve global problems.
- As the U.S. plays a primary role in the evolution and management of the G20, the support by the U.S. Congress can be one determining factor in the G20's future direction. Congress has been in favor of the G20 so far but the currency disputes to be discussed at the Seoul Summit will likely present a test of whether the lawmakers will continue their support. Protectionism has gained more ground in Congress after the global financial crisis shattered the world's largest economy. Congress has increased pressure on China to raise the value of its currency and even passed a punitive bill imposing taxes on Chinese products, arguing that the weak yuan had adversely impacted domestic industries and jobs. Against this backdrop, if the Seoul Summit achieves some meaningful progress over the yuan-appreciation issue, the U.S. Congress will likely provide much stronger support for the G20.
- The international community expects the G20 to take the lead on the climate change issue. After the failed Copenhagen meeting, many experts perceive the G20 as the most effective alternative in complementing the existing UNFCCC.
- The G20 can contribute to the global climate change policy but G20 leaders must be cautious not to undermine the current UN process on climate control. It may not be desirable in the long run as the legitimacy of the United Nations can be hurt if the G20 replaces the UN process.
- The rise of the G20 and the changes in global governance present an opportunity to Korea. But it is unclear whether Korea can maintain its leadership at the G20 after the Seoul Summit. Korea needs a new vision and strategy to contribute to global governance through the G20.
- Korea should continue to serve as a conduit between developed and emerging countries. It needs a long-term strategy to enhance the soft power leadership that can mediate the differing views between advanced and developing countries and between government agencies and non-government organizations.
- Korea should start to consolidate its experience of G20 participation over the past years and share these lessons with other countries. It should also utilize the lessons to nurture global talent in Korea. A joint study by private and public experts to assess Korea's role in the G20 and its preparation for the Seoul Summit should be launched. Furthermore, based upon the knowledge and leadership of agenda-setting and mediation in global governance that Korea gains through the G20, a research center should be established to specialize in the G20 and global governance to enhance its stature and share its

achievements with the world.

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PART I

*The G20 and Global Governance*

## **CHAPTER ONE**

### **The G20 Stumbling, Probably Forward**

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#### **Introduction**

The creation of successful global regimes requires a convergence of power, interests, and ideas. Such a convergence is rare. At the global, as opposed to regional, level, it has virtually never happened. The contemporary international environment is characterized by uncertain hegemonic power, competing but not zero-sum interests, and differing ideas. Under these conditions it will be impossible to reach a consensus on new overarching global regimes, although an agreement can be reached in a few areas, most notably regarding financial sector regulation, where market failures are evident and distributional conflicts are not too severe. The policies of individual states, the more powerful ones in particular, will be driven by short and medium term interests derived primarily from domestic political pressures. Variable geometry will continue to characterize international institutions. The G20 will occupy a salient place in this space, but it is a space that will be crowded by many other organizations including the United Nations, the Bretton Woods institutions, regional organizations, and issue specific entities like the Proliferation Security Initiative, and the Financial Stability Board.

#### **The contested past**

The contrast between the present situation and the Cold War is striking. The distribution of power was bipolar and it appeared to be stable (The collapse of the Soviet Union was not anticipated by policy-makers or academics.) Although in retrospect the triumph of the west seems self evident, this was not what was expected for much of the post-war period. Soviet economic growth outstripped that of the west immediately after the Second World War. Sputnik appeared to demonstrate the superiority of Soviet technology. Only in the 1980s was there a clear sense that the Soviets were faltering.

During the Cold War core security interests were convergent for the major players within the western bloc. The United States was the undisputed leader. The Soviet Union was the

clear threat. The U.S. was able to create alliance systems with the two other industrialized centers of the world, Western Europe and Japan, even though its efforts in other areas such as the Middle East and south Asia faltered. Economic interests were also complementary in part because the United States wanted to support economic growth of its allies by, for instance, encouraging European unification. American leaders feared that economic stagnation would strengthen communist movements in Europe and elsewhere and undermine the security of the United States.

There was also a convergence of ideas within blocs but not across them, or at least there was a very great difference between the ideas that motivated political and economic organization in the east and the west. The United States and its allies were committed to democracy and market economies. The Soviet Union and Bolshevism advocated party rule and state direction of the economy.

During the Cold War there were no global regimes or at least no effective global regimes. The United Nations was created in 1945 when the American administration still hoped for cooperation with the Soviet Union, expected the UK to re-emerge from the war as a major power, and anticipated that China would be a stable democratic polity. In fact, the distribution of power within the UN Security Council was completely misaligned with the interests, power, and beliefs of its members. The Cold War hardened by the late 1940s. The veto system made it impossible for the United Nations to act. The biggest UN sanctioned operation, the Korean War, was a fluke that occurred since the Soviet delegation had walked out because the Communist regime in Beijing had not been given the Chinese seat. The IMF and the World Bank played significant roles, especially beginning in the 1950s, but the Soviet Union and its satellite states were not members.

Even during the Cold War, however, there were clear limits on the ability of the United States, and even the Soviet Union, to secure consistent support from bloc members and dictate the terms of international or regional regimes. The United States was not able to secure the support of the developing world for its vision of international order. The Non-Aligned Movement and G-77 were alternatives to the west and the east. During the 1970s and 1980s the G-77 pushed for a New International Economic Order that rejected market oriented policies and emphasized the desirability of legitimating high levels of state control over the transnational flow of capital, goods, technology, and information.

Nor was it the case that the United States was always able to line up its allies even on critical economic and political issues. The Nixon administration unilaterally abandoned the gold standard in 1971. Japan was pressured into accepting so-called voluntary export constraints in the 1980s. There was far from uniform support in the west for the Vietnam War. There continued to be a variety of capitalisms across the advanced industrialized world. The American model never went beyond the US, and perhaps the UK. In continental Europe, the state played a much bigger role than it did in the US, which is reflected in the significant differences in government spending as a share of GDP that persist to the present day.

In the end the United States enjoyed great, actually stunning, success. The Soviet Union collapsed. As Francis Fukuyama argued twenty years ago in his “End of History” there is now no legitimated alternative to democracy and market economies even if there continues to be great debate about the specifics of these models.

American power peaked in the 1990s. Japanese economic growth faltered. China had not yet taken off. Russia was in disarray. The Europeans were focused on deepening the EU. But, with the exception of the WTO, even the 1990s did not produce a new set of international regimes that could institutionalize American preferences over the long term. Even the much commented on and now widely dismissed Washington Consensus had limited impact.

In assessing the contemporary environment and the prospects for the G20, and especially the role of the United States, it is important to recognize that there was no idealized past in which global outcomes were identical, or nearly identical, with the ideal preference point of the United States.

## **Contemporary structures**

### *Power*

The United States remains by far the most powerful country in the world. Using current dollars, the U.S. accounts for 24 percent of world GDP followed by Japan and China with about 8 percent, and then Germany, 6 percent, France, 5 percent, and the UK, 4 percent. India’s share of world GDP is 2 percent. Historically these are very big gaps. No country achieved anything like this kind of resource dominance in the 19<sup>th</sup> century. During the Cold War, the Soviet Union was able to challenge the United States in at least the security arena. At present, the U.S. spends more than the next twenty countries combined, or by some measures more than everyone else, on defense.

The future course of American power is, however, highly uncertain. Extrapolating current trends, China will pass the United States in GDP in the coming decades, although its per capita income would obviously remain much lower. Current trends might, however, change. The financial crises may or may not mark a permanent decline in American growth rates. China might or might not be able to successfully manage the social and political pressures that accompany its rapid transformation. It might, or might not, be able to make the jump from middle to high income, an achievement that only a very few countries, among which Korea is an outstanding example, have been able to make. India, because of its democratic system, might be better able to manage these stresses or might continue to be hampered by inefficient bureaucracy, ideological divisions, and patronage politics.

It is uncertain how power transitions will play themselves out, especially in Asia. Rivalry between India and China could become more acute. Korea might choose to continue its alliance with the United States in order to balance against a rising China, or opt for



bandwagoning with its ever more formidable neighbor. Japan will not want to abandon its ties with the United States, but will at the same time seek wider influence in Asia. China will try to create regional organizations that it could more easily dominate, but this might only lead to greater anxiety, and more forceful appeals to the United States, Japan, and even India, from its neighbors.

The rise of China is not, however, likely to lead to war. Sometimes power transitions have been handled gracefully as in the shift that took place between the United Kingdom and the United States at the end of the 20<sup>th</sup> century; Britain essentially ceded suzerainty in the western hemisphere to the U.S. Sometimes power transitions have gone very badly as in the case of Germany's rise in the late 19<sup>th</sup> and 20<sup>th</sup> centuries, a development that led to two catastrophic wars. When scholars of international relations have focused on power transitions, they have pointed to three areas of conflict: territory, spheres of influences, and international regimes.

Territorial conquest will not happen in Asia in the 21<sup>st</sup> century. Since 1945, only one widely recognized state has permanently disappeared as a result of war- South Vietnam. There has been no war among the major powers since 1945, the longest period on record. The factors that have led to this absence of major power war – nuclear weapons, the advantages of trade as opposed to conflict, changing values at least in the advanced industrialized states, the illegitimacy of conquest – will persist.

The dangers of armed conflict are not, however, absent, even if conquest is off the table. There are unsettled territorial claims in the South China Sea. The Chinese regime has legitimated itself through economic growth and nationalism and the latter may make compromise difficult in a crisis. As Chinese military strength continues to increase, the balance of naval and air power in the region will become more uncertain; uncertainty would make a clash between China and the United States more likely.

There will be tensions over spheres of influence in Asia. This is inevitable. The most likely outcome is balancing against China. For Korea and Japan, the United States should continue to be an attractive ally. China will, however, become more influential in central Asia. Russian power is waning. China needs the energy resources of central Asian states. The Shanghai Cooperation Organization, even though it includes Russia, is the clearest manifestation to date of China's inevitably increasing influence in central Asia.

Many countries in the developing world have prospered over the last several decades, some spectacularly, but others have continued to falter. Failed and failing states have become part of the international landscape. Many of these failed or failing states, 9 out of the 15 lowest ranked, on a recent *Foreign Policy* list are Moslem. Until 9/11, these states were mainly a matter of humanitarian concern. Foreign aid became a highly legitimated international activity, even though it failed to demonstrate consistent success. The attack on the World Trade Center made it clear that at least some states with miserable domestic governance and limited resources could pose security threats, not just humanitarian

challenges, to the advanced industrialized world. There is, however, no consensus on how these security challenges should be most effectively addressed.

In sum, the distribution of power is uncertain. Power resources might or might not shift quickly from Europe and the United States to Asia. Poorly governed and weak states will continue to be an important feature of the international landscape. They cannot be ignored. The spread of WMD, nuclear and biological, has broken the relationship between basic power capabilities and the ability to do harm. But how poorly governed and weak states might be changed remains a question whose answer is elusive.

### *Interests*

During the Cold War there were clashes of interest not just between the Soviet and American dominated blocs, but also between these blocs and the developing world, and within the blocs. There has not and will never be pure harmony in the international system. Even if states have the same objectives, they will have disagreements over how these goals should be paid for.

The differences of interests are, however, more problematic in the contemporary world than they were during the Cold War, the last great period of regime creation, because of the growing importance of emerging market economies including China, India, Brazil, Indonesia and others. It is belaboring the obvious to say that China is a major player in the world economy. What is, though, so different about China, is that it is a major player whose per capita income is less than 10 percent that of the major industrial powers (\$3500 as opposed to \$47,000 for the US, 42,000 for Germany, and 37,000 for Japan). India's per capita income is only a little more than a thousand dollars.

Large differences in per capita income inescapably mean greater differences in interests. The domestic political organization and configurations of interests groups, which influence the policy preferences of states, are different in poor countries and rich ones, even poor countries that are becoming richer very quickly. There is a relatively smaller middle class. Labor may be less well organized. Producers will not be as concerned with the protection of intellectual property rights. Leaders may be more anxious about underlying political stability, and therefore less willing to make compromises at the international level.

### *Values, norms, and causal understandings*

There is also more variation now than during the Cold War with regard to values, norms, and ideas about causal relationships. During the Cold War there was hardly consensus on how domestic political economies should be organized. The variation is, however, greater in the contemporary world. The United States remains the standard bearer of Anglo-Saxon capitalism, which is more dismissive of the role of the state than social democratic Europe. The 2008 financial crisis is not going to lead to a change in the basic organization of the American political economy. The role of the state will still be limited. Fiscal and monetary

policy will continue to be seen as legitimate, if contested, roles for the state; industrial policy will not be accepted; skepticism about state intervention in the market will continue. The American social safety net will remain flimsy compared with that of its continental European counterparts.

Political leaders in the major emerging market economies share some ideas with their western counterparts but not others. China continues to be run by the Communist Party even if the party's rule is legitimated by nationalism and economic growth, not Marxism. Differences over human rights and democracy will persist.

Brazil has benefitted from adopting market oriented reforms initiated by Cardoso and followed by Lula, but Lula has not abandoned the legacy of the Workers' Party with its suspicions of the United States and greater reliance on the state. The Turkish Brazilian initiative to Iran in 2010 was a reflection not only of Brazil's international ambitions, but also of the sentiments of the domestic supporters of the President's party.

India does not have a vision for global leadership or direction, or better put, it has many competing visions. At least some members of India's foreign policy establishment are strong believers in *realpolitik* with its emphasis on international threats, and the need for a balance of power, a perspective reinforced by Indian anxiety about Pakistan. Others still see India as a leader of the developing world, and are suspicious of the advanced industrialized countries. Still others emphasize India's unique past and its commitment to non-violence. The Prime Minister of India, Manmohan Singh, and some of his closest advisers, are Ph.D. economists with an understanding of the world economy that would mirror that of their counterparts in Europe and North America.

Dynamic power configurations, differing interests, and disagreements about values, norms, and causal understandings have not precluded impressive levels of global cooperation. Despite the pressures of the financial crisis, the international monetary and trading system has not fallen apart. There has been no replay of the 1930s. While interests are not identical, they are in many instances, complementary. Existing regimes, notably the WTO, have constrained behavior. Initiating new regimes, however, is more difficult than sustaining new ones. The G20 has an ambitious agenda, but its success will be limited.

## **Challenges for the G20**

### *Mission Creep*

Although focused on international financial and regulatory issues, the G20 has taken on an ambitious agenda. Given the organization's prominence, agenda creep is inescapable. Each country, but especially the host nation, aspires to identify some issue and possibly a set of accomplishments that can be associated with its chairmanship. The host country may be driven by normative aspirations, by hopes for international advantage, or by domestic

political incentives. Regardless of the motivation, different countries will push different agenda items.

Since it came into existence, G20 communiqués have addressed a wide range of issues (Table 1-1). This table is a long list and it will grow longer. Managing issue agenda creep will be difficult because of the differences in values, causal understandings and interests within the G20.

Table 1-1: Key Policy Issues of the G20 communiqués

Financial sector reform
Macroeconomic coordination
Terrorist financing
IFI reform
Great foreign aid
Debt relief for Haiti
Trade access and trade reform
Migration and remittances
Social safety nets
Corporate governance
Infrastructure spending
Exchange rate flexibility
Environmentally sustainable growth
Combating corruption

### *Legitimacy*

From the point of view of any individual country, with the possible exception of the United States and China, the ideal number of countries in an international group allows them to be the last one admitted. The smaller the group, the more exclusive; the more exclusive, the more attractive. Every foreign minister wants to be a player on the world stage, or at least not to be pushed off the stage entirely.

The G20 has brought the right players into the same room. The member states account for 85 percent of world GDP, 80 percent of world trade, and about two-thirds of the world population. This has not, however, made those countries that are not members of the organization more comfortable. In an interview in the major German weekly *Der Spiegel* published on June 22, 2010 the Norwegian Foreign Minister Jonas Gar Støre called the G20 “One of the greatest setbacks since World War II.” He argued that the G20 had no legitimacy, that its mandate was unclear, that it was unacceptable for the great powers to act on their own, that the European Union and its member states were over-represented while other European countries (Norway being one) were excluded, and that the world already had international

institutions, like the World Bank and the IMF, that were designed to deal with international economic crises. While Støre accepted the need for the Group of 20, or some such group to meet in the immediate wake of the crisis, he questioned its continued existence. He argued that given the roles that Norway and other Scandinavian countries play in fighting global poverty, it was unacceptable to exclude them from aid discussions. Additionally,, given Norway's importance in European energy provision and combating global warming through support for re-forestation, it ought to have a seat when those issues were to be discussed as well.

The Norwegian foreign minister was particularly forceful, but he is hardly alone. There are more than 150 countries not a part of the G20, among which some are arguably as important as countries in it. For the developing world, the United Nations still provides the most attractive venue. In the General Assembly, each country has one vote, and many countries have a chance of being chosen for the non-permanent seats on the Security Council. Even in the international financial institutions, all countries have some representation even if their percentage of total votes is small. In the case of the G20, countries are either out or in.

### *Institutional stickiness*

Underlying resource capabilities constantly change in the international system. Economic wealth, technological prowess, and military capacity constantly shift. International institutions, in contrast, are sticky; they are viscous. They do not change easily.

As the steering committee for global reform, the G20 must rely on other institutions, for the most part, to carry out any policy changes that it agrees to. It cannot implement changes on its own. Policies agreed to in the G20 are not legally binding on its members. Their implementation relies on policy changes taken in individual countries, and by other international organizations. Some of these organizations are now structured to carry out reforms, others could be changed, still others are stuck. For some issues, there is no appropriate institutional regime; that is no set of principles, rules, norms, and decision-making procedures around which actor expectations could converge.

The most evident example of institutional viscosity is the United Nations. Security Council reform has been at the center of the agenda for UN reform. Nothing has happened. Japan, the third largest economy in the world, and the second largest contributor to the United Nations, would be a permanent member of the Security Council under any set of objective criteria that could be imagined; but it is not. Two of the five permanent members, the UK and France, are no longer fully sovereign states. As member states of the European Union, they have voluntarily undermined their own Westphalian/Vattelien sovereignty by creating supra-national organizations and qualified majority voting. The Lisbon Treaty creates a foreign minister for the EU. Nevertheless, neither country has volunteered to leave the Security Council or create an EU seat that would represent all members of the Union.

In the area of exchange rate policy and macro-economic coordination, there is no legitimated venue or a set of ideas agreed up on that could facilitate the resolution of differences, especially between China and the United States. The IMF was originally created to police a moving peg exchange rate regime. One lesson of the inter-war period was that competitive devaluation could contribute to the destruction of an open international economy. IMF member-states could only change their exchange rates if there was a fundamental imbalance. Temporary deficits could be financed by borrowing from the Fund. This system collapsed after the United States abandoned the gold standard in 1971. Now countries follow a variety of exchange rate regimes including fully flexible, fixed to a single currency, fixed to a bundle of currencies, and dollarization. There is no agreement on rules and decision-making procedures.

There are also disagreements about the basic causes of the crisis. There are two fundamentally different interpretations. The micro-interpretation points to poor bank regulation, mistaken Fed policies, and consumer self-indulgence in the United States leading to low interest rates, a housing bubble, and the subsequent collapse. The macro-explanation points to high savings rates in China resulting from, among other things, China's weak social safety nets, and undervalued currency leading to high capital outflows, low interest rates in the United States, the housing bubble, and the subsequent crisis. The micro-economic perspective points to policy failures in the United States. The macro-economic perspective points to global imbalances that involve China and the United States. There is no consensus about which interpretation is correct.

Climate change is characterized by even more acute problems with regard to venue and conflicting ideas. Copenhagen demonstrated that universal meetings are highly problematic. A small number of countries can block consensus. One hundred and ninety six countries participated at Copenhagen, but only thirty account for 90 percent of global emissions. Six objected to the final document: Bolivia, Cuba, Nicaragua, Sudan, Tuvalu, and Venezuela. Because of their objections, the Copenhagen document was "noted" but not "agreed to." Developing countries used the Copenhagen Conference to demand more foreign assistance, and substantial pledges were made, but this assistance, even if it does materialize, will have very little impact on greenhouse gas emissions even if it did facilitate adjustment in some poorer countries. Efforts to change the venue for discussions on climate change will, however, be resisted by poorer countries with minimal levels of emissions because they want a seat at the table. The Major Economies Forum does bring together the right players, but it will experience the same legitimacy challenges as the G20.

There also are major differences about climate change that should be addressed especially with regard to mitigation as opposed to adaptation. Vanuatu was one of the six countries that blocked a consensus at Copenhagen. The country, or parts of it, could disappear if climate change leads to a rise in sea level. The population of the country is about 250,000. How much in the way of resources should be committed to preserving this archipelago of 83 islands?

Some would argue that the Vanuatans have an absolute right to have their country preserved, given that they bear no responsibility for climate change. Others would argue that resources would be more appropriately committed to helping the population resettle elsewhere. Even if there is agreement on the science of global warming, there will remain deep disagreements about how the problem should be addressed.

Other institutions are, however, more functional than the United Nations and more able to make changes that could increase their effectiveness. The G20 has supported reform of the Bretton Woods institutions. The capitalization of the IMF has been increased. Weighted voting determined by formula makes change easier. Even here, however, there has been tension. The US, which is in no danger of losing its own single seat, has been more willing to accommodate emerging market economies than has Europe.

Financial sector reform is one area where the G20 has made substantial contributions. The Financial Stability Board (FSB), discussed at greater length in the Asan-HGCY conference by Dr. Jong-Goo Yi, has made significant contributions. There has been an acceptance of the need for greater bank capitalization. There has been recognition of the need for special treatment for systemically important financial institutions (SIFIs). The FSB has played some role in coordinating national regulations.

The need for greater bank capitalization is one area where the market failure problems are obvious and the costs of policy coordination are limited. For any one country, a policy of low regulation may be attractive provided that other countries provide stability to the system by insisting on high capitalization for their banks. If, however, no one regulates, the chances for an international capital crisis rise. Moreover, the costs of securing international cooperation may not be that high. Bank regulation may be closer to a case of harmony than it is to a problem of market failure related to the provision of a collective good (international financial stability). Individual countries, and even banks, might prefer higher capital requirements than lower ones. While this would limit their ability to lend, it would also signal that they were safer for depositors. As Dr. Yi notes, Switzerland has unilaterally adopted higher capital requirements than other countries.

## **Conclusion**

Creating new institutions is often easier than reforming old ones. In the contemporary international system, the establishment of coalitions of the willing is inevitable. The G20 is one, but hardly the only, example. The G20 does bring the right players into the room, but its ability to act decisively across a wide range of issues will be hampered by uncertain power configurations, competing interests, and clashing ideas. The legitimacy of the G20 will continue to be questioned. Some of the international organizations on which the G20 must rely to implement its decisions are poorly structured: those that have the capacity to act may

not have influence within the organization. In universal organizations, consensus decision making procedures can empower states whose material resources are extremely limited. Relatively poor countries, such as China and India, are now major players on the world stage; the diversity of interests across major countries is greater than it has been in the past. All of these challenges to the G20 do not mean that international cooperation is doomed. There are areas, notably financial sector reform, where the G20 can play an important coordinating role because there is some consensus on what needs to be done, and interests may be more complementary than divergent.



## CHAPTER TWO

### **Is the G20 a Promoter of Global Governance or Anarchy?**

Motoshi Suzuki, Kyoto University

#### **The pre-G20 system of global governance: success and failure of neoclassical liberalism**

The pre-G20 system of global governance was built largely on the economic idea of neoclassical liberalism, alternatively known as neoliberalism or the “Washington Consensus” (Williamson, 2008). The idea originated in the Reagan-Thatcher revolution in the 1980s and expanded across the industrial world in the wake of subsequent politico-economic changes, including the demise of communism as a counterweight to capitalism, economic reforms in many other developed states, and the adoption of the idea by the Bretton Woods institutions, including the International Monetary Fund (IMF) and the World Bank. Neoclassical liberalism progressively transformed the post-World War II order based on embedded liberalism that was created in the 1944 Bretton Woods conference under the leadership of the same Anglo-American coalition (Ruggie, 1998). Embedded liberalism was a variant of liberalism that permitted states to aim at balanced pursuits of economic efficiency and social stability through discretionary government interventions in markets.

Neoclassical liberalism that has replaced embedded liberalism rejects the effectiveness of Keynesian stabilization policy, and even stresses a destabilizing impact of governmental discretion on business conditions (Lucas, 1981). Instead, neoclassical liberalism calls for a diminishment in governmental roles in economic life and revitalization of the markets’ self-correcting mechanisms, thereby enhancing individual competition and human creativity. Other G7 states more or less coordinated their policies in line with the neoliberal project pioneered by the Anglo-American coalition. This epitomizes an asymmetric coordination game as outlined by Professor Krasner (1991) in his influential *World Politics* article in which he argues that there are multiple international policy equilibria from which powerful states choose one equilibrium to their liking and provide a focal-point effect to the game: for lesser states, coordination on the chosen equilibrium is individually rational and unilateral deviation, is irrational. In consequence, the idea of neoclassical liberalism was encapsulated

within state power, providing political authority and stability to the pre-G20 system of global governance.

The neoliberal project has produced a strong tide of economic globalization in which enormous amounts of goods, services, capital, technologies, and information move across lowered national boundaries. State-of-arts financial techniques have reduced the prohibitively high risks associated with investment in potentially lucrative, but uncertain markets. The concealed risks in financial products are arguably a major cause of the financial crisis that hit the global economy severely in 2008 (Rajan and Diamond, 2009).

In contrast, the emerging states including Korea, China, Singapore, India, and Brazil, have successfully exploited mobile capital and technologies along with their own richly endowed productive factors for growth, and acquired a quarter of the world GDP. The law of international power politics dictates that these emerging states should be incorporated into the coordinating body of global economic governance, transforming the G7 into the G20. Hence, the G20 reflects the new reality of economic power distribution and is seemingly ready to alter the vote weights for the Bretton Woods institutions. It is ironic that economic growth in not so liberal states has been facilitated by the neoliberal international economic order. What this means is that the state can provide a major engine of economic growth by creating appropriate institutional arrangements (Gilpin, 2001; Rodrik, 2007).

### **Strong statism as a nuisance to G20 leadership**

The rise of the G20 could contribute to reinforcing the state-centric international system. A strong state is a common denominator for the emerging states that vary enormously with respect to culture, politics and economics. Most of them have experienced state-led economic growth and are not promoters of liberal values. Even among the older members of the G20, or the G7, the state has arisen as a victor out of the financial crisis, which is expected to pull the economy out of the risk of deflation through the once discredited Keynesian governmental instruments (Skidelsky, 2009). It was only two decades ago that many observers claimed the retreat of the state to be in conjunction with ongoing economic globalization (Strange, 1996). According to their theses, there is no meaningful economic role for the state to play in deregulated and privatized social life. However, the financial crisis has led G7 policymakers to reconsider the market-centric beliefs. They have increasingly come to understand that a sustainable approach to the world economy calls for improved state roles in markets, including tight prudential regulation, countercyclical liquidity provision, and even a lender of last resort function.

In addition to these expanded roles, the G7 states are expected to improve macroeconomic performances, under adverse circumstances as well. On the one hand, the states are expected to stimulate their recessionary economies and reduce unemployment that has risen to and stayed at unprecedentedly high levels. On the other hand, the states are

required to keep their fiscal houses in order. In a deep dilemma, they are taking an easy way out by exploiting macroeconomic stimulation and currency depreciation for export promotion. Likewise, the emerging states are expected to continue the expansion of their booming economies, dilute the deflationary pressure created by the G7, and bring the world economy back to a path toward steady growth. At the same, the emerging states are expected to reduce governmental influence in their economies by adopting liberal market practices and diminishing the magnitude of industrial policy that has the effect of transferring profits from foreign to domestic firms. Under these paradoxical expectations, the states, both old and new members of the G20, are engaging in diverting economic problems at home to foreign countries through various policy channels (Goldstein, 2010).

### **The G20's role and relationship with the G7**

The natural role for the G20 is therefore to check such beggar-thy-neighbor policy practices. The question is whether G20 can govern itself, given strong domestic political pressures for easing economic problems and promoting the peoples' economic aspirations. The G20 is composed of states with greatly different political, economic, and social institutions. In contrast, the G7 with some success in economic governance for last three and half decades is relatively a homogeneous body based on shared liberal democratic values and common security interests that enabled them to come up with policy cooperation agreements, such the 1985 Plaza Accord, as well as the multilateral institutional arrangements that have produced some favorable effects in constraining beggar-thy-neighbor policies in the aftermath of oil crises in the 1970s.

Such political homogeneity is nonexistent in the G20. The G20 represents the heterogeneous international system and presents a forum in which the members struggle to negotiate and form coalitions in order to pursue international agreements to their own advantage. But, as WTO experiences have shown, the process of coalition building among heterogeneous members is painstakingly slow and often acrimonious. Whatever agreement they can come up with might merely add an incremental change to the current form of global governance<sup>1</sup>.

In spite of the odds, to be a viable promoter of global governance rather than anarchy, the G20 needs to begin discussing technical policy issues with limited distributive implications in which they can find some common grounds for reaching agreements. For instance, the Capital Adequacy Accord, known as Basel III, has gathered widespread approval from G20 as well as G7 states because the accord is highly technical and promotes the contracting states' joint interest in improving confidence in their banking systems and preventing future financial crises. Only after building confidence in the G20 as a useful governing institution,

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<sup>1</sup> See Helleiner (2010) for various other reasons.

will the G20 states be able to enlarge the zone of agreement progressively on more substantive issues with greater distributive implications, including currency misalignments, trade imbalances, global warming, and poverty, whose solutions they owe to the rest of the world.

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## **CHAPTER THREE**

### **The Post-crisis World Order, the Dilemmas of U.S. Hegemony and the G20**

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The global financial crisis of 2008 has continually changed the world order, and furthermore the global governance system. It has so far continued ramifications, and we are still within this great historical process. It is still hard to predict when a post-crisis world order will come into being, and what the new global governance system will look like in the future. Thus, this short chapter aims to analyze what has changed until this moment with a particular focus on the fate of the G20 as a potential new global governance body. I will mainly focus on key factors that shape the world order and the G20.

#### **The post-crisis world order**

The pre-crisis world order was established after the Second World War, and was strengthened after the Cold War. The basic characteristic of that regime was the U.S. hegemony. The U.S. hegemony used to have several key pillars, namely the geopolitical, the military, the technological, the economic, the financial and the ideological. Besides these absolute superiorities compared to other great powers, the United States also had a kind of structural power, based upon its unique position in the world and could often influence other great powers and countries with its smart power.

The U.S. hegemony has faced some challenges since it came into being. In the Cold War period, it faced military, technological and ideological rivalries from the Soviet Union. Since the 1960s, it has continually been engaged in economic competition with Western Europe and Japan. In the 1970s, a unified Arabic world tried to monopolize the supply of oil of the world. Within the liberal camp, the social market model of continental Europe and the developmental state model of Japan have always been alternatives of the Anglo-American free market model. But all of these have not fundamentally shaken the U.S. hegemony. The

Soviet Union finally collapsed. The rapid economic growth of Western Europe, Japan, and emerging economies in the recent years has led to a decline in the share of the U.S. economy in the world, but the U.S. economy still remains the biggest in the world, and nearly three times bigger than the Japanese and the Chinese. Oil has been priced in U.S. currency, and the Middle East has largely been under the control of the U.S. after two Iraq Wars. Finally, the dominant, worldwide ideology since the late 1970s has been neoliberalism, or the Washington Consensus, which has been promoted by international organizations dominated by the U.S.

Has the global financial crisis shaken the U.S. hegemony? Yes. Has the American hegemony and the existing world order been fundamentally changed by the crisis? No. We still live in a world order that is called ‘yichao duoqiang’ in Chinese, literally meaning “there is one super power and several great powers.” This is the basic power structure of the world. In the Chinese context, the current world order is still described as ‘going to be a multi-polar world’. But of course ‘going to be’ is vastly different from; it has been.’

### **The dilemmas of American Hegemony**

To say that the American hegemony has been shaken by the global crisis but has not been challenged by it has two implications.

The first is that the global crisis was basically caused by the U.S. domestic political economy rather than anything else. Essentially, this crisis is a U.S. crisis, which first caused troubles in the United States, and then the whole world. Although there are competitive explanations about the origins of the crisis, there were at least two things the U.S. could only blame on itself. The first was the massive debts the U.S. government, financial institutions, and citizens had accumulated. All financial crises are essentially debt crises. Nobody had, or could have forced the United States to borrow, to buy, and then trap itself in crisis. The second was the financial derivatives designed by the U.S. financial institutions, which hugely enlarged the debt crisis. No entity in the world besides the U.S. government could regulate these financial institutions, but it obviously failed to do so.

Because of these two factors, three key pillars of the U.S. hegemony have been shaken, namely the economic, the financial and the ideological. The decline of the economic power, or the production power, of the United States, was the fundamental reason of the debt crisis. In the last several decades, the United States has consumed much more than it can produce. That is why it needs to borrow and is also highly dependent on its financial sector. In other words, the crisis clearly shows the problem of the U.S. productive and consuming structure. There is not enough space to discuss why the United States has met with this problem, but two issues may be briefly stated. The first is that the United States has been trapped in the Anglo-Saxon financial capitalism model, which was originally developed in the United

Kingdom. In fact, because of its plentiful domestic resources, it is not necessary for the United States to copy the UK model. It also means the United States certainly has the potential to be re-industrialized in the future. The second is a general problem faced by all post-industrial societies, i.e. how a society's economic development should be promoted, once it has finished industrialization and urbanization. The United States is certainly not the first country to have suffered from this problem, nor will it be the last one. In fact, the real theoretical challenge faced by academia lies here.

What has been directly damaged by the global crisis are *the U.S. financial sector* and its *ideological hegemony*. There is no need to repeat how much the U.S. investment banks, its whole banking sectors, and its insurance companies have suffered in the crisis, but obviously, they deserved their failures. Here, I want to highlight a little bit more on the decline of the U.S. ideological hegemony, or the U.S.'s soft power, from a global perspective. The U.S. development model used to be admired by a lot of countries, and some key modern values promoted by the United States were also widely accepted by the world in the post Cold War period. Yet the crisis clearly shows to the whole world that the U.S. development model not only has serious problems in nature, but also cannot be copied by others. The key problem is that the U.S. model relies on global borrowing and the U.S. dollar hegemony in the global monetary system. These two phenomena are two sides of one coin. Although the capitalist system has a culture of borrowing in nature, no debtor, particular failed debtor, can be respected by all cultures around the world. In other words, the crisis makes the United States become politically incorrect or morally unjustified. If it decides to depreciate its currency, it will worsen its portfolio, but it seems to be on this road. Further, the U.S.'s global borrowing is basically supported by its dollar hegemony. Obviously, there is no other country that can copy this model. In the future, more and more people may view the United States as an exception rather than a model.

The decline of the U.S. economic, financial and ideological power has begun to shake the U.S. hegemony to some extent. However, there is no other country able to fill the power vacuum left by its decline. This is the second implication that the U.S. hegemony has been shaken by the global crisis but not been fatally challenged by it.

Some people proposed the idea of the G2 in the turbulent days of financial crisis. This idea reflects the economic development of China. But this idea has been formally rejected by both the U.S. and the Chinese governments. From the Chinese perspective, the reason of the impossibility of the G2 is that China has no capacity and willingness to share global leadership with the United States. High speed economic growth and huge foreign exchange reserve are only parts of the so-called 'Chinese miracle', if there is one. In fact, currently, China faces serious domestic social and economic problems, including widespread heavy corruption, economic inequality and regional disparity, social injustice, and environmental degradation etc. The group of leaders who are responsible for China's foreign policy is exactly the same group who must also deal with these domestic problems. Consequently, the



leaders' ambition and capacity to do more on the global front is largely limited. But this does not mean that China has no willingness to take on its global responsibilities. The key point is that the world needs a proper form of global governance. That is why China takes a positive view toward the G20 and wants to work with others within this new framework.

## **The potential of the G20**

It is widely believed that the G20 Summits since 2008 in Washington have played a quite positive role in managing global financial crisis, preventing great global recession, and reforming international financial institutions. In the Pittsburg Summit in September 2009, the G20 was officially defined as the premier forum of international economic cooperation and was also given a role to promote strong, sustainable and balanced growth globally. More and more people began to recognize that the G20 summits may become the new mechanism of global economic governance, and even the key mechanism of global governance in general if the non-economic agendas is gradually brought in.

However, in the post-crisis era, in order to become a genuine and effective mechanism of global governance, the G20 summits still have a long way to go. At least, we can identify three key obstacles to the formation of this new mechanism. The first is the attitudes of the major powers toward the mechanism in the long term. The second is how to deal with the relationship between the G20 and the existing international organizations in the medium term. The third is whether or not the coming G20 summits can keep achieving something to show its effectiveness in the short term, namely the issues of agenda setting and timing. Obviously, these three obstacles are interlocked, but all of them may appear in the dawning Seoul Summit this November. The key points here are:

1. The US, the EU and China still maintain quite positive attitudes toward the G20, although they have different ideas about how the G20 should be run, as well as different interests to express through the G20.

2. There are some countries that do not like the G20 and want to keep the G7/8, but the G7/8 and the G20 can coexist for a certain period. Although there might be a kind of division of labor between the G7/8 and the G20, gradually, the G20 may become the new mechanism of global governance.

3. Some medium powers like Canada, Korea and Australia can play positive roles in the process of building up the G20 if they are willing. This will not only serve their national interests but also global interests.

4. The G20 should deal with its relationship with existing global governance bodies like the United Nations, IMF, World Bank, WTO and OECD properly. Eventually, the G20 should go back to the UN system for legitimacy. In order to become the genuine steering committee of global economic governance, G20 should become a mechanism above IMF, World Bank, WTO and OECD and put these organizations under its supervision.

5. The G20 should have its own agendas, but the agenda setting should be inclusive rather than exclusive.

## CHAPTER FOUR

### **The G20, a Neorealist- or Network-based Institution?**

Yul Sohn, Yonsei University

What has altered in international institutions after the coming of the financial crisis? The primary change appears to be the place of the United States in the global system; it is no longer the hegemonic leader. Rather than imposing its will on others, it needs to accommodate rising states. China is such a case as it has clearly become one of veto points in any current international institution. Now the G20 is a rising institution that compensates for America's declining capabilities and legitimacy as a principal rule maker. As Krasner correctly points out in this volume, the G20 is adjusting and conforming to contemporary power distributions or an implicit hierarchy of powers. But he is pessimistic of its future as an important global governance institution because as a premier realist scholar he believes that the global distribution of capabilities that sustains the G20 is unstable and altering. Regimes are less effective when power changes, distributional conflict is more intense, and existing organizations are sticky.

While the G20 points to the capacity of accommodating rising states, it also relates to the specific form of institutions that govern the 21<sup>st</sup> century global issues. In the context of globalization, two points need be mentioned. First, new non-state actors have emerged and linked to each other, playing significant roles in global governance in certain issue areas. Financial institutions, corporations, professional organizations, and global advocacy groups affect outcomes in global financial governance (Milner and Moravcsik, 2009). Together, trans-governmental networks perform important functions in areas that deal with highly technical issues such as finance that necessitate technocratic responses by technocratic bureaucrats (Slaughter, 2004).

Second, there emerged new issue areas. So many areas of policymaking now require international coordination that is hardly handled by traditional international institutions. Together, globalization is producing increased connections and linkages among issue areas, which necessitate novel forms of governance. Amidst the current financial crisis, it became apparent that financial issues were linked to trade, development, environment, gender, and even security issues (Alexandroff and Cooper, 2010). The existing, functionally divided

governance institutions such as IMF and World Bank find it difficult to handle the expanded, complex scope and depth of contemporary interdependence.

What is emerging is networked institutions. The hallmark of networks is flexibility, scalability, responsiveness, and informality, all of which are useful for including new members (reduced transaction costs in joining). Networks are also effective in serving as forums for experimentation, or a context for learning when confronted with new complex problems (Castells, 1996). The G20 is an informal institution that is functional in nature. By adding new members it lacks like-mindedness, but it concerns a wide range of issues being linked.

The 21<sup>st</sup> century global governance reflects both traditional (power-political) and new (networked) characteristics of international institutions. It can be seen as a mixture of the two. The United States, not wanting to give up its global leadership, appears to take a more ad hoc approach to global governance by not sticking with a fixed G20, but being in favor of a more networked one that varies in membership. The European Union, already a networked institution, tries to impose its own practices on the G20.

In a networked institution, participants do not have direct influence over one another. Influence comes not only from one's hard power, but from the ability to earn trust and attractiveness, a process that can lead to the advantage of knowledge power. Also, in a networked structure, power relates to network position, to persistent relationship among states, rather than the individual attributes of states. Power tends to come from connectedness or centrality.

In a traditional power politics arena, middle powers like South Korea have a limited influence. Because of its limited "resource power," Korea has taken the position of what's given. In a networked world, however, power comes from "network power" as well as soft power (Nye, 2004; Kahler, 2009). It rests on the ability to connect with others, to find links to network partners that are otherwise weakly linked, and to design the structure of networks. Korea can find opportunities to do more. It must act in a way that exploits the opportunities provided by a new institutional setting.

Four points are in order.

(1) Korea has put enormous effort into shaping the agenda for the Seoul Summit. Aside from prior summit commitments, it added two issues as Seoul initiatives (development and global financial safety net). All this depends on the status of the G20 as a global governance institution. The fate of G20 can be explored in ways that address two mixed dimensions of contemporary global governance. First, G20's position depends on contemporary power distributions. The key is the United States. Given the fluid global power distributions, its commitment to the G20 as a premier forum is unclear. It appears to grasp at multiple institutions. Equally important is the extent to which the G20 is equipped with networked characteristics of institution. Just like what is called the "G-x process," membership criteria are flexible in networks. A networked institution can vary from the G20 to the G7/8 to the G2,

depending on the issue areas or international circumstances. If the G20 remains flexible and inclusive in membership, agenda-setting, and consultation, it will most likely survive a premier forum.

(2) So far, Korea's success as a member of the G20 as well as the host country for the Summit, attributes largely to the United States. To the extent that Korea sticks with the alliance externality, its policy course will most likely follow that of the United States. But a proactive role, if it wishes, requires more – seeking a positional power that takes a role as a bridge or broker between the advanced industrial countries and developing countries, between the East and the West, and among the Asian members (Mo in this volume). In doing so, Korea must be equipped with an appropriate soft power that includes neutral, universalistic and principled approach as the basis of action. Power derived from resources (or from its ally) does not work for a broker.

(3) The G20 concerns the issue of building a post-crisis financial architecture. By far, the *raison d'être* of G20 has been derived from the effects of the rescue efforts as a crisis committee. Now it must be derived from effective performance as an architectural committee. This is a knowledge game in which participants try to convince others to accept a new global/regional architecture through argumentation and persuasion, one that addresses the cause of the current crisis and the future of capitalism. Korea must have its own attractive 'story telling' that moves beyond the discursive divide of the crisis of neoliberal capitalism vs. global imbalance.

(4) Korea can contribute to the stability of the G20 in several ways. It must work to eschew an exclusive club. It can make a collective appeal through shared interests with a global like-minded group in and out of the G20, one that shares institutional characteristics (i.e., construct an identity of states that are medium-sized, open, internationally-oriented economy, yet vulnerable to external shocks). It can also work to find ways that effectively incorporate non-state actors into the forum so that the G20 makes a networked form of governance.

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## CHAPTER FIVE

### Placing the G20 in an Emerging System of Global Governance<sup>1</sup>

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The purpose of this chapter is to make recommendations for the directions of G20 reform from the perspective of overall global governance. There is no doubt that the G20 can play a positive role in improving the system of global governance. But that will happen only if the G20 finds a proper place within the system of global governance and derives proper relations with other international institutions on the basis of democratic principles.

#### The status of the G20 as of April 2010

Section 50 of Leaders' Statement of the Pittsburg Summit in September 2010 was unequivocal where the G20 stood as an international institution:

*Today, we designated the G-20 as the premier forum for our international economic cooperation. We have asked our representatives to report back at the next meeting with recommendations on how to maximize the effectiveness of our cooperation. We agreed to have a G-20 Summit in Canada in June 2010, and in Korea in November 2010. We expect to meet annually thereafter, and will meet in France in 2011.*

First, the G20 became the premier forum for international economic cooperation. Although G20 leaders did not specify what other forums existed in addition to the G20, most observers took the statement to mean that the leaders would consider the G20 as more important than the G7/8.

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<sup>1</sup> A previous version of this chapter was released as a working paper (10-02) by Hills Governance Center at Yonsei University.

Second, the G20 was formally designated as an annually held event in Pittsburgh. Leaders said that they expected to meet annually after 2010 in their statement. True, they did not promise to meet annually. But leaders rarely make a formal commitment to the regular holding of an informal forum. It took 13 years for G7 leaders to formalize the G7 as an annual event. It was in the 1988 Toronto G7 Summit that G7 leaders acknowledged their commitment to the G7 by agreeing “to institute a further cycle of Summits.” Before 1988, G7 leaders made only a one-year commitment by saying that they “have agreed to meet again next year.”

### **Where is the place of the G20 in the system of global governance?**

It is important to place the G20 in the system of global governance because it can reveal what role it plays and should play in the overall system. Clearly, the G20 has a role to play but that role should not be too expansive.

The system of global governance currently in place consists of three constituent parts, the structure, behavioral patterns and institutions. The basic structure of the world system is still characterized as the system of unitary states where states interact with one another through diplomacy, public international law and international organizations (Keohane, 2001). Under the unitary state system, we are advised to aim not at creating world government, but devising “a set of practices for governance that improve coordination and create safety valves for political and social pressures, consistent with the maintenance of nation-states as the fundamental form of political organizations” (Keohane and Nye, 2000).

But there are other elements of the system that significantly affect governance outcomes, behavioral norms and institutions. The basic pattern of ruling-making in the world system is the club model (Keohane and Nye, 2000); a relatively small number of relatively rich countries get together to make rules at important international organizations such as IMF and WTO. Even though clubs of rich countries have expanded their memberships over time, the number of countries that participate significantly in global governance remains small.

There are three types of institutions in the global governance system, international organizations, government networks (Slaughter, 2005), and non-state actors. Non-state actors such as transnational civil society groups and business associations are straightforward to define. But the differences between international organizations and government networks need further explanation. International organizations and government networks are both inter-government organizations (IGOs), i.e., only official representatives of governments participate formally. The main difference between them is the degree of formality. An international organization is the more structured of the two; that is, it has a constitutive inter-government agreement and a secretariat. In contrast, government networks are often created without a formal inter-government agreement and managed without a secretariat. According



to this classification, the G20 is a governmental network in that it has neither a charter nor a secretariat.

The functions of government networks, however, are not the same. Most of them are clearly informational or consultative organizations and operate like professional associations. Many do more, and make rules in their issue areas. Another important dimension in the typology of government networks is the level of representation of government offices. Some such as the G7/8 and the G20 are head-of-state summits, while others have lower-level officials participating.

The boundary between international organizations and governmental networks is not as clear-cut as one may expect. Some rule-making government networks make rules in areas not covered by existing international organizations, so they should be viewed as *de facto* international organizations or international organizations in waiting. But informational government networks do not make rules, so their relationships with international organizations are not an issue.

There are also governmental networks whose jurisdictions overlap with those of existing international organizations, and significantly affect their decisions. The G7/8 and the G20 belong to this group of supervisory (*vis-à-vis* international organizations) government networks. Since supervisory government networks make decisions that existing international organizations expect to implement, they should be viewed as a legislative body with international organizations playing the role of an executive agency.<sup>2</sup>

In thinking about the meaning and significance of the G20 in the history of global governance, it would be 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. Like the United Nations General Assembly or Economic and Social Council, the G20 is an organization with a substantial quasi-parliamentary component in which government representatives meet regularly to make decisions under established procedures. Since 2008, the G20 has been more active as a legislature as it has legislated new rules for the world economy and tasked and evaluated international financial institutions.

The fact that the G20 does not have its own executive agencies bolsters its credentials as a legislative organization. By design, most formal international organizations perform both legislative and executive functions. The fact that the G7/8 and the G20 exist and have become more influential over time suggests that there is a need in the global government system for an effective supervisory and legislative body independent of international organizations.

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<sup>2</sup> According to Grant and Keohane (2005), the executive boards at the World Bank and IMF are examples of a *supervisory* mechanism of accountability through which states guide and constrain the management of international organizations directly. The legislative G20 would add another layer of supervisory accountability.

But does the G20 qualify as a legislative body? Most G20 leaders would not view the G20 as a legislature. To them, the G20 is more of a caucus, an informal group of legislators; a caucus forms when its members find it necessary to meet and discuss among themselves but do not want to make binding decisions. In fact, the G7 began as such a caucus with leaders reluctant to involve ministers and refusing to create a permanent secretariat. Even though the G7/8 has developed an elaborate system of sub-processes over time, it has tried hard to remain faithful to its original design of a leaders-only informal forum (Hajnal, 2007).

### **What can the G20 do to improve the global governance system as a whole?**

Regardless of leaders' intentions, the G20 may as well develop into a legislature for three reasons. First, a caucus is not an alternative for the G20. A caucus is a group of like-minded leaders. The G7 clearly satisfied this condition in the beginning because it brought together leaders from leading industrial democracies. But the G7 began to lose its caucus identity when it admitted Russia as a full member when she was not yet a liberal democracy.

The G20 bills itself as 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. So the G20 cannot work effectively as a group of like-minded leaders.

Second, the global governance system demands a new organization that can work as a legislature. The current arrangements that divide international organizations into specific issue areas are inadequate as they fail to address cross-jurisdictional issues such as financial stability.

Third, the G20 is the only alternative available, i.e., the default option, among possible legislature candidates. G20 leaders have already accepted the G20 over the G7/8 as the premier forum for international economic cooperation, so the G7/8 is not a feasible option. The expansion of the G7/8 to a G13/14 is possible but would entail significant labor pains before it can come into being. In theory at least, an existing or new assembly or council in the United Nations can play a role expected of the G20. But political realities of the United Nations make this a highly unlikely outcome.

If G20 leaders accept the idea of a legislature as their proper role, the direction for G20 reform becomes straightforward. The G20 should institutionalize in a way to make it an effective legislative body.

The history of legislatures in national governments shows that a legislature learns, adapts and organizes itself over time to improve its performance in its two core functions, legislation and oversight of executive agencies. The U.S. House of Representatives is a typical example; it had taken over one hundred years for the House to develop into the present system of a highly institutionalized body.

A major study of the institutionalization of the U.S. House of Representatives defines an institutionalized legislature as having the following three characteristics (Polsby, 1968):

*1) It is relatively well-bounded, that is to say, differentiated from its environment. Its members are easily identifiable, it is relatively difficult to become a member, and its leaders are recruited principally from within the organization. 2) The organization is relatively complex, that is, its functions are internally separated on some regular and explicit basis, its parts are not wholly interchangeable, and for at least some important purposes, its parts are interdependent. There is a division of labor in which roles are specified, and there are widely shared expectations about the performance of roles. There are regularized patterns of recruitment to roles, and of movement from role to role. 3) Finally, the organization tends to use universalistic rather than particularistic criteria, and automatic rather than discretionary methods for conducting its internal business. Precedents and rules are followed; merit systems replace favoritism and nepotism; and impersonal codes supplant personal preferences as prescriptions for behavior.*

Polsby's first and third criteria are specific to a national legislature like the U.S. House of Representatives and are not relevant for the G20.<sup>3</sup> The first criterion of the establishment of boundaries refers mostly to a channeling of legislators' career opportunities such as membership turnover and internal leadership development. The third criterion of universalistic and automated decision making applies to rules deciding the committee ranks of individual legislators, and the outcomes of contested elections.

Polsby's second criterion, the growth of internal complexity, is more universal and should be relevant for the G20. According to Polsby, the internal organization of the U.S. House of Representatives grew more complex and specialized with the growth in the autonomy and importance of committees, the growth of specialized agencies of party leadership, and the internal increase in the provision of staff and budgetary support to members. These three patterns of institutionalization point to likely directions of the G20.

First, the G20 will introduce a committee system. The G20 currently works as a committee of 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.<sup>4</sup> The G20 already feels the pressure for internal differentiation as it is debating whether or not to redeploy working groups to acquire issue-specific expertise.

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<sup>3</sup> Keohane (1969) also applies Polsby's criteria to the institutionalization of an international organization.

<sup>4</sup> It should be noted that all six committees of the United Nations General Assembly are committees of the whole, showing the reluctance of member states to defer to other states on legislative deliberations.

Second, the G20 will provide more institutional support for the G20 leadership. According to Polsby, the institutional support for party leadership, such as the office of the Speaker and the whip system, helped to institutionalize the U.S. House of Representatives. At the moment, the G20 supports its chair through two institutions, the troika system and the steering committee. The troika is a revolving three-member management group of past, present and future chairs to ensure continuity in the G20's work and management across host years. The Chair can also count on the steering committee of past and future host countries to forge consensus on summit agendas and organization.

Although the troika and the steering committee have served the G20 well so far, further divisions of labor between the troika and the steering committee and among member countries will be necessary to deal with the chair country's increasing administrative responsibilities. One possible division of labor among troika members is to have the respective past and future chairs to handle follow-up and outreach issues, while the present chair focuses on agenda development and logistics for the summit at hand.

Third, the G20 will create a permanent secretariat. The U.S. House of Representatives maintains a big bureaucracy to support the legislative activities of its members, consisting of personal staff, committee staff and the staff for Congressional agencies such as the Congressional Budget Office and the General Accounting Office. The G20 as an informal leaders' forum does not have a permanent staff. The chair country now sets up a temporary secretariat for the duration of its term. The temporary secretariat coordinates the group's work with the technical support from international financial institutions. But the G20's reliance on temporary and rotating arrangements is not likely to last long as they already create the problems of work discontinuity and conflicts of interest. A rotating secretariat makes it hard for the G20 to maintain organizational coherence. It also creates a conflict of interest situation with the IMF; the G20 should not depend too much on the IMF for policy advice as it does now because it compromises its ability to monitor the IMF.

The secretariat for the G20 will serve three functions - logistics coordination, provision of policy advice, and support for oversight activities. Since national governments and international organizations are alternative sources of administrative support and policy advice, the most important function of the G20 secretariat in the long run may become its watchdog role with respect to international financial institutions. Many have called for an independent agency to evaluate the performance of international financial institutions, assess the impacts of their programs and investigate the transparency of their activities. A watchdog organization as part of the G20 secretariat that reports directly to the G20 may be the best institutional arrangement for such an agency.

**How should the G20 as the supervisory legislative body reshape its relations with other international organizations?**

The legislature metaphor also helps clarifying relations between G20 and other international institutions. With regard to the G7/8, it is the G7/8 that should adapt to the new political realities and think about redefining its role. One option for the G7/8 is to return to its original roots as a group of industrial democracies and participate in the G20 process as an informal caucus of industrial democracies.

Even as a group of advanced industrial democracies, the G7 needs to consider member expansion beyond the original seven countries. Even before the rise of the G20, some scholars urged the G7 to add new emerging democracies (Sachs, 1998) to their membership. If the G7 expands too much, however, its membership may overlap with that of the OECD.

With the G20 as the senior legislative body, the relationship between the G20 and international organizations becomes clearer. The management of international organizations would now be held accountable to two boards, the internal board(s) and the G20. To make this double-board system work, G20 leaders should clearly delineate the division of labor between the G20 and the internal boards of an international organization. One option is to divide labor according to priorities. G20 focuses on a narrow set of strategic or high-priority issues in its dealings with international organizations such as crisis management, governance reform and multi-jurisdictional issues, while the internal boards take up more routine oversight and policy-making duties

## **Conclusion**

This chapter uses the legislature analogy to explain the current role and future development of the G20. Clearly, the G20 at the moment is a club. Keeping this in mind, I make two points in this chapter. First, we can get a clear sense of the G20's place in the system of global governance only if we think of the G20 as a legislature or legislative club. Second, the legislative analogy provides a useful framework for understanding the future role and institutionalization of the G20.

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PART II

*G20-IMF Relations*

## CHAPTER SIX

### The G20 and IMF Governance Reform

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Every informed person accepts the premise of this conference that the G20 is an important international institution. Certainly it has emerged as a successor to the G7 for economic issues, and it has a far broader membership than the G7 by including, in particular, developing and emerging economies. The issue to discuss, therefore, is not whether the G20 is important, but whether it is an effective institution as presently constituted. That question breaks down into a further set of questions under the heading of “Effective at What?”

To begin a discussion of the “effective at what” question, it is helpful to make a rather oversimplified dichotomy between two kinds of roles for the G20: (1) coordination of national economic policies and (2) reform of international economic institutions. Without going into detail, I would offer the broad judgment that the G20 has had an on-the-whole positive record in improving coordination among national economic policies during the past few years of financial downturn and slow, difficult recovery. But the G20’s effectiveness in reforming other international economic institutions remains to be fully tested. We do know that declaratory statements at G20 Summits that are not properly prepared in pre-Summit meetings are demonstrably doomed to failure. To take one example, the 2008 Washington Summit declaration that nations should refrain from protectionist measures was a failure, if indeed it was intended as more than a pious declaration of hope.<sup>1</sup> Still, the fact that the G20 process culminates in Summits makes the Summit an action-forcing event for heads of government who attend.<sup>2</sup>

The essentially positive record on coordination has been achieved through parallel national policies of expansionary fiscal and monetary policies in nearly every country important to the world economy. The initial financial freefall and follow-on recession has been arrested and economic expansion has begun haltingly throughout the world -- with some

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<sup>1</sup> Declaration, Summit on Financial Markets and the World, para. 13 (Nov. 15, 2008).

<sup>2</sup> Let us recall that the G20 dates back, at the Finance Minister/Central Bank Governor level to 1999. See the G20 website (<http://www.g20.org/index.aspx>). The G20 has evolved rapidly in quite recent years. Beginning in 2008 the G20 began to meet at the Summit level. And at the G20 Summit in Pittsburgh the G20 Leaders designated the G20 as the premier forum for international economic coordination, thereby giving rise to what are likely to be overly ambitious expectations.



hopefully isolated exceptions in individual countries such as, say, Greece and Ireland where earlier imprudent domestic policies combined with Euro membership (which removed the traditional policy lever of devaluation) have made adjustment exceptionally difficult.

Although the record on coordination of economic policies of member states is on the whole positive, the G20's success in the reform of international economic institutions cannot yet be judged as positive. Granting that it may be far too soon to reach a negative judgment, we should reserve judgment because of the implicit strategy that the G20 Leaders have been forced to follow on the reform issue. The fact is that the necessary preparation for true and ambitious reforms could not be reached in a timely fashion, at least as the G20 is presently organized (a topic I shall return to). To take an example, the fruitless declaration at the Washington Summit about avoiding protectionism was not accompanied by any attempt to reform the World Trade Organization (WTO) or even the WTO's Doha Round of trade negotiations. Indeed, a successful round would be the best way of combating protectionism but the Doha Round is widely regarded as *de facto* dead; certainly the Round has shown few signs of vitality since the Leaders began meeting at the Summit level.

Before turning to the question of why the G20's record has been better in economic coordination than in the reform of international economic institutions, it is useful to note how the G20 differs from the kinds of international economic institutions it is supposedly expected to reform. The G20 is a forum, not an international organization such as, for example, the International Monetary Fund, or the World Bank, or the multilateral development banks (such as the Asian and the Inter-American Development Banks). Those organizations, unlike the G20, have staffs of their own. And they have their own financial resources to deploy. To be sure, those organizations are bound by agreed processes that require member state participation (through agreed processes, such as the IMF Executive Board) in the decisions to expend funds; and indeed the funds these organizations hold and disburse necessarily come (apart from any investment income and from interest on loans) from contributions by member countries pursuant to treaty arrangements.<sup>3</sup> So even these institutions are dependent on member states since they have no power of taxation of economic actors or of the public.

It is fair to say that the G20 can best reform these other economic organizations by delegating the reform task to those very organizations. So, for example, reform of the financial transfers made by the IMF to member countries to stabilize exchange rates, and more generally the financial sector, have been *de facto* delegated to the IMF, the international institution involved. So too thus far has the question of how the IMF makes its decisions (which, after preliminary IMF staff recommendations, depends on the action of the Executive Board). Certainly there is a general understanding in the international community that the developing world needs an increased voice and vote in the Executive Board. However, the operational decisions as to how to achieve that result in all of its complicated details (having

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<sup>3</sup> Some institutions can earn interest on investments. The World Bank can borrow in the bond markets.

to do with country quotas, which countries have seats on the Executive Board, etc.) is not one than can be taken at the G20, which after all is just a forum for the reasons I have already indicated, and is in no position to take such complicated decisions at its occasional Summits.

Finally, the IMF has in fact been addressing the reform of the IMF itself, and in a moment I shall turn to those IMF efforts. Before doing so, it is worth noting that the G20's own governance arrangements compel a de facto delegation to the IMF. Not only does the G20 have no funds at its disposal to substitute for the IMF's financing role, but it also has no staff of its own to carry out the preparatory work necessary for the G20 (either at the ministerial level or at the Summit level) to address the many complex issues involved. Essentially all preparations for a G20 Summit are left to the host government, mediated to be sure by a "troika" arrangement in which the outgoing host government and the forthcoming host government work with the immediate host government to provide as much continuity as possible, at least with respect to agenda. To be sure, extensive diplomacy of one kind or another occurs leading up to the meetings, but no formal process governs these interactions.

Let me also emphasize, before coming to the IMF's reform efforts, that a failure to delegate to the IMF would have serious implications for the structure of the G20 itself. A G20 Summit and even preparatory G20 ministerial meetings are bound to have crowded agendas in today's complex world.<sup>4</sup> To have the necessary work done, in the absence of delegation, would require the G20 to recruit and finance a highly specialized staff of its own (and indeed to have similar staffs for reform of the World Bank and multilateral development banks). And as reforms are contemplated in other fields, such as WTO and trade round reform, still additional staff members with different qualifications would have to be recruited. Even with seconding of staff from national governments to the G20, these diverse tasks would be difficult for the G20 as presently organized. So after deciding on objectives, the G20 Summit has no practical choice but to delegate reform to the institutions to be reformed (or perhaps alternatively or additionally, to member governments). And in any case, if the G20 tried to do the work itself, the result would be considerable duplication with the work of the staff and decisional organs of the institution to be reformed.<sup>5</sup>

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<sup>4</sup> The first G20 Summit's "final declaration contained an action plan with a list of 47 action items, 39 of them relating to financial regulation and the others of broadly related issues such as tax, controls on capital flows, actions to fight terrorism financing and money laundering, and general reform of the Bretton Woods institutions." Stephane Rottier and Nicolas Veron, *An Assessment of the G20s Initial Action Items*, Bruegel Policy Contribution, Issue 2010/08 (September 2010).

<sup>5</sup> A quite recent study by Bruegel, the Belgian think tank, concludes that "a strong correlation is observed between the effectiveness of implementation and the nature of the main public institution[s] in charge: the more the implementation of the action item depends on action by an international body with independence of administration and resources, the more effective the implementation." Rottier and Veron, *supra*, summary page. The implication is that the G20 as an institution is unlikely to be effective in implementing decisions it takes. Moreover, in grading the implementation of the G20's initial action items, the same study concluded that the IMF and World Bank deserved a higher than average score with regard to action item (#45) concerning the reform of the governance of Bretton Woods institutions.

## The Work of the IMF on IMF Reform

At a high level of abstraction one can say that IMF reform turns on “shares” and “chairs.” “Shares” refers to a country’s relative voting power. That is, each country’s voting power turns on its quota as a proportion of the quota of all members in total. (The quota determines as well how much a country must contribute to the capital of the IMF and has an important bearing on how much a country can borrow from the Fund, at least in the absence of unusual circumstances or the creation of special funding vehicles.) So the first issue in IMF reform in giving developing countries a greater voice in IMF governance is whether and how to increase developing countries’ quotas as a proportion of total quotas. In the past, efforts to redistribute quota proportions have involved long, difficult and no doubt tedious negotiations.

Quotas are important. They determine how much every member, however poor, is required to pay into the IMF coffers. They determine, albeit leavened by basic votes that every member has in equal number, the relative voting power of each member. And they determine in the first instance (through so-called “access limits”) the maximum amount each member is entitled to borrow from the IMF.

Since quotas are important, they are formally reviewed regularly, normally every five years, sometimes with however no increase in quota, as was the case in 2003 and 2008. The last actual increase that took place in 2010 was not agreed on in a general review, but was rather an ad hoc increase. In April 2010, the IMFC (a ministerial level committee of the IMF) agreed to complete a new (the 14<sup>th</sup>) General Review of Quotas before January 2011, some two years ahead of schedule.<sup>6</sup> The underlying policy reason for moving the review forward was to benefit developing countries, particularly those that have shown greater rates of economic growth than developed countries, by increasing those developing countries’ relative voting power and hence their voices in IMF decision-making.

However, in April 2008, the IMF did agree that the next general increase (later agreed, as stated above, to be completed by January 2011) would reform the process by including an ad hoc increase “to all of the 54 countries that were underrepresented,” by “tripling the number of basic votes to increase the voice of low-income countries,” and agreeing that quotas and voting shares would henceforth be realigned every five years (in contrast to the two prior general review decisions to leave quotas unchanged).<sup>7</sup>

The second issue (beyond “shares”) is that of “chairs”; that is, what countries actually sit at the table – in this case, the table of the Executive Board. The total number of directors specified by the Articles of Agreement of the IMF is 20, but under the Articles the number

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<sup>6</sup> International Monetary Fund, IMF Quotas (Factsheet, Sept. 29, 2010).

<sup>7</sup> The G20 Leaders at the Pittsburgh Summit declared: “We are committed to a shift in International Monetary Fund (IMF) quota share to dynamic emerging markets and developing countries of at least 5% from over-represented countries to under-represented countries using the current quota formula as the basis to work from.” How the G20 statement relates to the prior IMF decision is not entirely clear.

can be increased by vote of the membership. But any member or group of members with more than 15% of the total voting power can veto such an increase. The United States, with a quota determined under the general formula for quotas, which is based on several factors with the size of its economy being the principal factor, has more than 15 percent of the total of national quotas, and therefore can veto any increase. So, too, any ad hoc group of other countries, for example developing countries with a collective voting power of more than 15 percent. So the political difficulty of increasing the percentage of voting power required for a veto, in order to eliminate any perceived unilateral advantage of the United States, may turn out to be that the 15 percent rule (or, inversely, the 85 percent rule) is often perceived, and rightly so, as a protection for minorities.<sup>8</sup>

In any case, the United States has in the past supported a present temporary increase in the number of Executive Directors from 20 to 24. But the temporary increase period runs out on November 1 of this year. So a new arrangement for the future would have to be worked out to keep the number above 20. In fact, some kind of compromise was worked out a few months ago to increase the number. But the United States took the unusual step of vetoing the compromise in an Executive Board meeting in August.

Why did the United States take this unusual step? The answer to that question reveals why the process of reassigning “chairs” is so difficult. The U.S. view has been that European countries are overly represented, and that any effort to give the developing countries more of a voice at the table would necessarily require some contraction of the number of Executive Directors.

It had been hoped, at least by those who care about shifting greater power and voice to the developing world, that a compromise would have been worked out before the IMF annual Autumn meeting on October 8-10, But, unfortunately, no such compromise has been worked out. Nonetheless, some resolution may be worked out before the G20 Summit meeting in Seoul in early November. Certainly it seems unlikely that the G20 Leaders would themselves be able to work out a compromise in their very short meeting. It is unlikely, or at least in my view, undesirable, that any compromise will be to increase the number of Executive Board members above 24; that would be, of course, an easy way out of a difficult problem, but it is generally understood that the Executive Board has so many issues to consider and so many existing Executive Directors to speak on each issue that this solution would be one of the worst possible solutions if the objective is a more effective and efficient IMF.

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<sup>8</sup> See IMF, IMF Governance—Summary of Issues and Reform Options 17-18 (July 1, 2009). Of course, the United States could unilaterally declare that it would not alone exercise a veto, but of course the United States could presumably often find other countries that, for one reason or another, chose to come to the U.S. side on the issue of the moment, thereby to that extent vitiating the force of any such declaration. It should be noted that the veto applies only to major changes, such as in quotas. Lesser matters are decided by majority of the voting power, a rule that has led to proposals for a double majority, under which decisions in the Executive Board would require both a majority of voting power and a majority of member countries, thereby giving more voting influence to smaller and to lesser developed countries than at present.

Let me state a few basic considerations in considering any compromise. The IMF is an organization based on a treaty (a legally binding treaty) – the Articles of Agreement (hereafter the “Articles”). That treaty provides in binding detail how decisions shall be taken. Those governance provisions can be decisively changed only by treaty amendment, a difficult and time-consuming process. The heart of IMF decision-making lies in its Executive Board. The Articles of Agreement provide for an Executive Board (hereafter the “Board”). The Board has, under the Articles, 20 members. It has a life of two years. If it is not reconstituted at the end of any such two-year period, the IMF will be in crisis and cannot take basic decisions. The present two-year period expires on November 1, 2010. A failure to take the prescribed measures to reconstitute the board by this coming November 1 would leave the IMF in deep crisis, to say the least.

The Articles provide that the number of directors can be increased beyond 20 under prescribed voting procedures. The number has been increased to 24, a level where it has been for a number of years, but if there is no vote by November 1, the number will automatically revert to 20. There are two kinds of members. There are five members who are appointed by the member countries with the largest economies. Those five countries must appoint their board members. Other board members are elected. Most or all of the remaining board members represent constituencies of countries. These five appointing members are currently the United States, Japan, Germany, France and the United Kingdom. However, the new board will surely have different members since China has moved up the economic ladder with its economy already considerably larger than Germany, France, or the United Kingdom. Indeed, China’s economy may well be larger than Japan’s (as measured under IMF criteria), in which case China will end up with the second largest voting power.

At present, Europe has three members entitled, and required, to name their own board members. But there are other European countries that have nationals sitting as board members. Those are the countries that are chosen by constituencies, of which they are part, to represent those constituencies on the Board. Among the European countries in that position are Belgium, the Netherlands and Switzerland. Interestingly enough, those three European countries represent constituencies made up largely of non-European countries – such as African countries, central Asian countries and the like. Of course, those non-European developing countries are willing to vote for these developed countries’ European directors because those developing countries can influence their votes and speeches at the Board meetings, and because the European individuals representing these non-Europeans are usually highly able and effective people, supported by first-rate civil servants.

Of the six European constituency heads, three of them are a bit special in that unlike Belgium, Netherlands and Spain, they are not chosen by African, Asian or South American developing countries to bring experience and IMF know-how to the table. The Italian chairmanship is indeed made up of small and, in some cases developing countries, but they are European countries (except for Timor-Leste), namely, Albania, Greece, Malta, Portugal

and San Marino. Denmark heads a constituency composed entirely of countries that are either in Scandinavia or are close by: Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden; in that sense, Denmark heads a regional constituency within Europe and not a constituency that is essentially one of developing countries. In any case, the idea often expressed that the EU should have one, and only one EU chair, runs into the reality that the UK is part of the EU but not of the Eurozone (an important factor in discussion of exchange rates), as well as the fact that such a “one EU chair” solution would potentially infringe on the notion that constituencies should be freely chosen by members. Finally, Switzerland is in some sense not a typical European country, but it is situated in Europe.

The result is that nationals of nine European countries sit on the Executive Board, more than is the case for any other region. That is why it has become conventional to say, particularly in the United States and much of the developing world, that Europe is overrepresented on the Executive Board. By the way, complaints are heard about the United States’ position, and for two quite different reasons. First, by tradition, Europe and the United States have normally had their own nationals sitting as Managing Directors of the IMF and the World Bank, respectively. However, that is arguably a separate issue that could be dealt with by a change of procedures for the selection of Managing Directors. It is likely that any compromise involving the reduction of European seats would be accompanied by a new provision calling for the Managing Director to be chosen through a more open and merit-based process.

Second, the United States has, with just over 15 percent of the voting power through its quota, an effective veto power under the special majority requirements of the Articles for certain kinds of major decisions. In fact, under the GDP-related method of calculating quotas, the United States would be entitled to more than 15 percent of the total voting power because of its large economy.<sup>9</sup> Any overall compromise is likely to involve some change in this veto rule and perhaps in how voting power is calculated.

The problem this very month, just before the November 1 “drop dead” date, is that Europe, as a continent, has no way of acting as a unit to reduce its disproportionate number of seats. That is why it is often said that the IMF governance problem is not just one of shares (of total European voting power) but of chairs (that is, the number of Europeans sitting on the Executive Board). Certainly the European Union not only does not represent all European countries, but it also has no substantive right to take any decision in this matter under the European Union treaty or, for that matter, under the IMF Articles.

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<sup>9</sup> Voting power is based on quotas, but quotas are based – aside from the basic vote -- on a complex formula that includes “a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). For this purpose, GDP is measured as a blend of GDP based on market exchange weights (weight of 60 percent) and on PPP exchange weights (40 percent). The formula also includes a ‘compression factor’ that reduces the dispersion in calculated quota shares across members.” IMF Quotas, *supra*.

Consider some of the dilemmas faced by European politicians. As for the five so-called permanent members (those appointing their own executive director), if China moves up, as it should and surely will, into the top five member appointive category in view of its rapid economic growth, what country will have to drop out and lose its membership? It almost surely would have to be France or the United Kingdom. Let us pity the European politicians who have to make that decision, whether the decision be taken by “the numbers,” or by “backroom” negotiations, or by direct agreement between France and the United Kingdom!

Then there is the inevitability of the board dropping from 24 to 20 members if there is no agreement within the IMF by November 1. The result will be a scramble to reconstitute the constituencies, with all of the questions about chairs, perhaps multiplied in complexity. Putting aside the question of what European chairmanships of constituencies might be involved, what about the non-European chairs? The other possible candidates for losing their chairmanships due to the reduction in chairs to 20 would almost certainly be developing countries – a rather disturbing development for anyone seeking greater representation for developing countries.

I have left out one fact of great importance. That fact is that there was a proposed compromise about how to proceed to avoid the drop-dead date of November 1. But it has become publicly known only relatively recently that the United States vetoed that compromise in August.<sup>10</sup> And why did the United States veto it? Because the United States government believed that the compromise did not achieve the governance objective of giving greater influence in shares and chairs to developing countries. What an irony, at least if the U.S. veto does not lead to a new solution, for the developing world could end up worse off, not better off!

Why does the G20 not do something? Because it cannot! It is merely a forum. It has no legal jurisdiction to act. And – here is the crucial point for me – until the G20 develops a first-rate staff of its own, capable of producing studies and draft resolutions and the like, the G20, to the extent it pretends to be an organization in any sense at all, is merely an onlooker. In any event, as argued above, when it comes to reforming institutions like the IMF, it is in my opinion far better that the reform issue be de facto delegated to the legal processes of the IMF than that the G20 forum attempt to decide the matter. The G20 is an important and broad economic forum, but it could find itself becoming just another international economic organization, perhaps with more representation of developing and emerging countries, but turning out to duplicate the function of existing institutions that have accumulated years of specialized experience. The G20, through its worldwide prominence, can push reform of other institutions, but it cannot realistically substitute for those other institutions – at least in the foreseeable future.

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<sup>10</sup> The exact nature of the proposed compromise is not publicly known.

## CHAPTER SEVEN

### **The G20: A Driver for the IMF Reform?**

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Since the outbreak of the 2008 international financial crisis, the G20 has emerged as the premier forum for addressing world economic issues. Although the legitimacy, representation and effectiveness of this group is still widely questioned, no one can deny the positive role it played in combating the crisis. However, as the crisis subsides, it seems that the G20 is increasingly plagued by a lack of consensus on almost every issue. Amid this trend, can we expect the G20, a newly created forum, to be successful in promoting the reform of the IMF, a well-established international financial institution (IFI)? To solve this puzzle, we should first find answers to the following three questions.

#### **The first question: is the IMF reform on the top agenda of the G20 summits?**

The issues that the leaders have discussed most at the summits can be divided into five categories. First is the co-ordination of macro-economic policies. Second is financial issues, including enhancing the financial supervision, reforming the IFIs and overhauling the international monetary and financial system. Third is curbing the trade protectionism. Fourth is promoting development. The last one is the institutionalization of the G20. However, these five issues did not receive equal attention from the world leaders.

From the Washington Summit in November 2008 to the Toronto Summit in June 2010, macro-economic policy coordination remained in the center of the debate. In the Pittsburgh Summit, the twenty leaders agreed on building the framework for strong, sustained and balanced growth. This perhaps is the most perceivable fruit harvested by the G20 summits besides the collective adoption of the expansive fiscal and monetary policies. However, as the leaders failed to identify the ways and means to achieve this goal, this will sow the seeds for disputes in the future. In the Toronto summit, the advanced world was split on the exit strategy. Before the Seoul Summit, the exchange rate issue again triggers a heated debate among the major economies. It is almost inevitable that the macro-economic issues will continue to dominate the agenda of the Seoul Summit.



The G20 summits have also committed the twenty countries to promoting development and fighting trade protectionism, but up until now, only lip service has been paid to these two issues. In fact, the developing members are reluctant to cooperate with the advanced countries on the development issue, feeling they do not share the same ideas in how to help other countries achieve economic success. As for the fight against the trade protectionism, the twenty countries are often criticized for adopting protectionist measures despite their solemn vows to maintain free and open markets in the summits.

Compared with the above two issues, a certain degree of breakthrough has been made in reforming the IFIs and institutionalizing the G20. Now the G20 is at the crossroads to decide the future role of the IFIs and of itself. While every member agrees that the summit should be regularly held after the financial crisis has subsided, most of them are quite satisfied with the low level of institutionalization, which means the G20 remains as a loose forum, without a secretariat or an ability to enforce its decisions. As for the IFIs reform, the leaders singled out the quota and voice reform as the first important step to modernize the IMF. Without this external pressure, the IMF would continue to be trapped in the deadlock of ceaseless talk and zero action. However, it seems that the developed world is unable to work out a plan of how to transfer 5 percent of quotas to the developing world. We are not sure whether they can solve this problem before the deadline of the Seoul Summit, so the IMF can move on to other crucial reforms.

Given the above analysis, it is clear that the G20 has mainly functioned as a platform for macro-economic policy coordination. Given the complex economic relations and problems among the major countries, most of the energy of the world leaders will continue to be consumed by the problem of how to direct the world economy toward a “strong, sustained and balanced growth”. Other issues will remain on the agenda, but will be put on the back burner.

### **The second question: what kind of role do we expect a reformed IMF to play in the post-crisis era?**

The IMF was one of the three main pillars in the Bretton Woods System. Before 1971, it was a well-esteemed international organization. It helped to promote the world economic growth by providing a stable international financial environment. However, after the collapse of the Bretton Woods System in 1971, the world economy has steered into the unknown waters. For the last 30 years, financial crises and global imbalances have become the two persistent phenomena. They have created disputes, disrupted the involved economies, and demolished the widely accepted rules that once governed the world economy. In this changing environment, the IMF has been increasingly marginalized. It used to be a confident judge and respected guardian for the international financial system, now it acts more as an incompetent

consultant and an often belated firefighter. In fact, the IMF faced an identity crisis long before the 2008 crisis.

Should the IMF be restored to the center of the international financial governance? If we do not expect the reformed IMF to play a center role in stabilizing the international financial system in the future, then what's the point in taking the trouble to reform it? If we truly believe the IMF should be transformed to play a crucial role, then we should prepare ourselves for the comprehensive and arduous work.

First is to realign its quota shares and voting rights, and to reform its governance structure. This is already under discussion. According to the leaders' declaration of the Toronto Summit, the plan to transfer the 5 percent of the quotas should be completed before the Seoul Summit. One method to eliminate the differences is to discuss the weighted factors of the quota formula in a more open and transparent way. Other issues that have been brought to the spotlight are how to elect more representatives from the developing world to the Executive Board, and whether it is desirable to terminate the 85 percent rule which puts America in a de facto privileged position.

Second is to clarify the core mandate of the IMF. For the past forty years, the effectiveness of the IMF has been plagued by its inflating mandates. Meanwhile, it was ineffective in its effort to prevent the financial crises of the same nature from reoccurring in the different parts of the world, and to help reduce the global imbalances before it became a disaster. The IMF should refocus its attention and energy to its core mandate: maintaining a stable and healthy financial environment.

Third is to improve its surveillance capability. The IMF should play a more proactive role, for example, to detect signs of a crisis, and to prevent it from erupting. The fact that the IMF failed to warn against the advent of the 2008 financial crisis reflects the fundamental defects in its risk-warning system. The IMF should improve its surveillance work by spending more efforts monitoring the systemic risks, the systemically important institutions, and economies.

Fourth is to enhance its crisis-managing capacity. This problem was partly addressed by the London Summit, which decided to treble the resources available to the IMF to \$750 billion. However, the IMF still needs to renovate its liquidity-providing tools and re-examine its lending conditionalities, or the small economies would rather turn to their wealthy neighbors for help than accept the harsh conditions prescribed by the IMF.

Indeed, to adapt an old organization like the IMF to the 21st century reality is a formidable task. This kind of discussion was started years ago, but only a mega-crisis like the 2008 financial crisis can trigger and catalyze such a comprehensive reform. At the same time, we should bear in mind that the greatest difficulty in modernizing the IMF is to persuade the major countries to confer more power to this organization. The proper function of the IMF requires both the cooperation and the voluntary self-discipline of the major powers.

### **The third question: can the G20 act as an effective driver for the comprehensive IMF reform?**

This question is, in fact, more about the relation between the G20 and other international organizations, or where the G20 stands in the global governance structure. The G20 is still searching for its identity. Where should the G20 go from here? Should it concentrate on economic affairs and refrain from political, environment and other important issues? Should it remain a loose forum instead of an international organization whose decisions are binding, and are respected and followed by its members? Should it not have a permanent secretariat, a governance body and a group of professional staff? People who ask these questions, in their mind, doubt the ability of the G20 to outperform the G7 in producing positive and effective results. Given the fact that the G7 did not have a very good record in coordinating the economic policies of the seven members, how can we expect a less like-minded forum with a more extensive membership to function better than its predecessor?

As a self-appointed group, it is difficult for the G20 to define its relations with other international organizations. Since even its own members do not have to follow the recommended policies contained in the leader's declaration of the summits, why should other well-established IFIs heed its decision? Although all the important players in the IMF are included in the G20, it is still difficult to turn the decisions made at the G20 summits into IMF's concrete actions. While some of the problems are technical in nature (as fully explained by Kenneth W. Dam in Chapter 6), others originate from the ambiguity of its niche in the global governance structure. For the G20 to influence other IFIs, merely maintaining a good working relation with the latter can not guarantee anything. What should be achieved is a division of labor among the Financial Stability Council, the IMF and other IFIs. In fact, whether the quota reform plan can be produced before the deadline becomes a touchstone of the effectiveness of the G20. But even if the disputes between America and the Europe are successfully resolved, the fate of its future decision about the IFIs is still uncertain. There is an old saying in China, which goes: "If you are not entitled to do something, then you can't explain why you do it. If you can't explain the reason, you can't be successful in doing it." This old wisdom also applies here.

In short, the G20 acts as the most important external pressure for the IMF reform, but the reform has never been the most important issue to discuss at the summits. To restore the IMF to the center of the international financial system, a comprehensive reform should be adopted and more power should be endowed to this organization. If the G20 has an ambition to act not only as a policy-coordinating forum but also as a driver for the IFIs reform, it needs to forge an identity that empowers it to do so.

## CHAPTER EIGHT

### **Significant Roles that ‘Merely a Forum’ Can Play: Cheap talk and Signaling at the G20**

Masato Hisatake, Ministry of Economy, Trade and Industry, Japan  
and Cambridge University

Professor Dam studies in Chapter 6 the issue whether the G20 is an effective institution as presently constituted. He investigates present mechanisms articulately and gives us most plausible recognitions and forecasts on related specific issues, such as: how the G20 differs from the kinds of international economic institutions, the fact or assertion that the G20 cannot realistically substitute and can best reform these other economic organizations by delegating the reform task to those very organizations, and IMF reform on “shares” and “chairs.”

He also notes as follows: *“Why does the G20 not do something? Because it cannot! It is merely a forum. It has no legal jurisdiction to act. And – here is the crucial point for me – until the G20 develops a first-rate staff of its own, capable of producing studies and draft resolutions and the like, the G20, to the extent it pretends to be an organization in any sense at all, is merely an onlooker.”*

I agree with his opinions, because all the facts he gives us depict the reality precisely. Thus, based on those facts, first of all, we should be realistic. Then, I would like to discuss what can be attainable and what are to be met.

#### **The possible function of “merely a forum”**

It is true that merely a forum cannot implement effective measures. This kind of institution, however, might be able to provide a favorable environment or an arena where constructive discussions can be realized. In this context, we can think of “cheap talks” and “signaling” investigated in the game theory. Both can affect the result of the game played.

Firstly, “cheap talk” means communications among actors. The point is that those communications do not affect their payoffs directly. Though it is quite often misleading by its name, it can play a crucial role when we are thinking about our future in the situation as having plural possible outcomes (equilibria), just as existing in front of us. Simply speaking,

we can avoid undesirable outcomes. To fulfill this role, the G20 should not lean too heavily towards bureaucracy, though this is not an easy task judging from our experiences with the G7. It should be noted that changing the culture is very important in several occasions to achieve favorable results through communication.

Secondly, “signaling” means sending of messages by a player, which may be costly for him or her (the message sender). The G20 can be an opportunity where a player sends his or her views on the reality of the current global economic situation, and also indispensable actions by the global community. A typical example is Japan expression of its readiness to finance up to US\$100 billion to the IMF at the Washington Summit in November 2008. To change shares would take a long time. What was needed was not the capital or money which could be counted as a share in, but the amount of money which could be utilized.

There exists what merely a forum can or in certain occasions only that may achieve. For example, if there were to be a kind of consensus that a new type of leader is indispensable for those other economic organizations to pursue meaningful reform, or at least to change the culture, it would be very difficult to realize this only from their internal decision making process. Though a leader of different background who is qualified to this important role is awaited, it would take many years. In such a situation, the G20 can announce their views on this issue. Probably it will affect the outcome of following events. This conduct is not to solve the problem but to clearly outline the problem so that it may be solved in a certain length of time. Borrowing the phrase from Professor Dam’s chapter, the way of “delegating the reform task to those very organizations” has crucial significance.

### **In addition to governance**

Governance is important. Though this is true, it cannot explain everything and there are a few complementary issues. When people are talking about how to improve the performance of a company, they tend to consider the attractiveness and quality of products and services the company provides. In addition to governance system, technology or know-how which is embodied in goods and services actually matters.

In this regard, views of Professor Stieglitz must be paid due attention in order to avoid repetitions of similar failures. At the same time, an excessive usage of the term “systemic risk” will lead to a situation in which soft budgets appear almost everywhere. “Too big to fail” may not be applicable now, but we observed “too influential to fail” situations in the cases of relatively small countries. The method of surveillance to prevent those ex ante in an era when containment of financial risks is almost impossible is yet to be explored. IMF may be merely a lender for a certain set of countries.

To improve the content of the service, human resource management also plays an important role, including recurrent training programs and system of performance evaluation.

Any kind of discipline may change drastically in a few decades. Economics is not an exception.

These are also areas where the momentum from the external force can contribute to organizations without “market competition.” The realization of this process is achievable in a certain setting but will be facilitated with an appropriate change in the system of governance.

## **Sharing the heavy burden**

Burden sharing is important and will be much more so in this coming decades. Its degree and speed may affect the future course of the global economy. Looking back in history, especially from late 19<sup>th</sup> century to the World Wars, it might not be unproductive to seriously think about this point.

The development of globalization traces back over roughly two centuries. This may be classified into three phases. The first phase occurred over the century between 1820 and the outbreak of World War I in 1914. The point I would like to note is that the United Kingdom led the way in instituting and maintaining a free trade system, a stance which it maintained despite protectionist trends emerging in the 1870s in continental Europe and the United States, the latter a rising nation at the time. This trend was followed by the second phase of globalization retreat. Over the 30-odd years spanning the two world wars, a variety of barriers were erected and the world broke up into economic blocs.

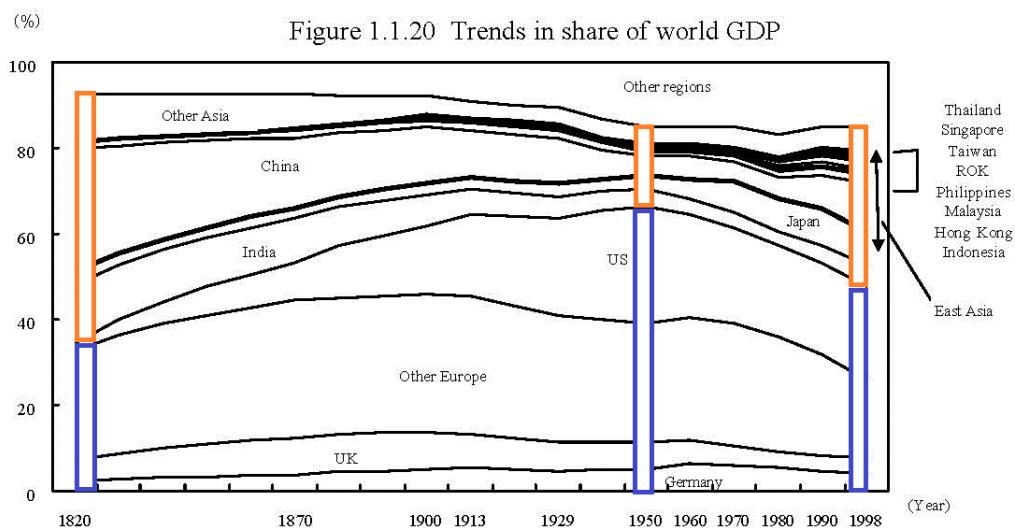
The third phase comprises the post-war years to the present day, though its future is discussed now. The second age of globalization was powered by further advances in transportation and communications technology and efforts toward the construction of an international trading and financial system under the leadership of the United States. There have been a series of discussions on the issue of global imbalances. On the other hand, the U.S. economy may be sustainable as the pattern of its international account shows that U.S. can be classified as a young country of “immature debtor nation” according to the theory of international balance of payments development stage. Regardless of whether this classification is correct or not, an excessive burden on a single economy may not be sustainable.

One example of practical ways to share burdens may be observed in the contributions made by the Japanese and Korean governments to international development assistance (IDA). They are merely examples and it is expected that each country take its own initiative, not in a passive manner. Rights are usually accompanied with duties.

## Before concluding comments

I think it is worthwhile to share a historic view. It is hardly deniable that we are in the midst of changes. Then, the question is, once in how many years? There seems to be two answers.

- Once in decades: We know that Bretton Woods institutions (BWIs) were established around six or seven decades ago.
- Once in centuries: Look at the trend shown in the next figure.



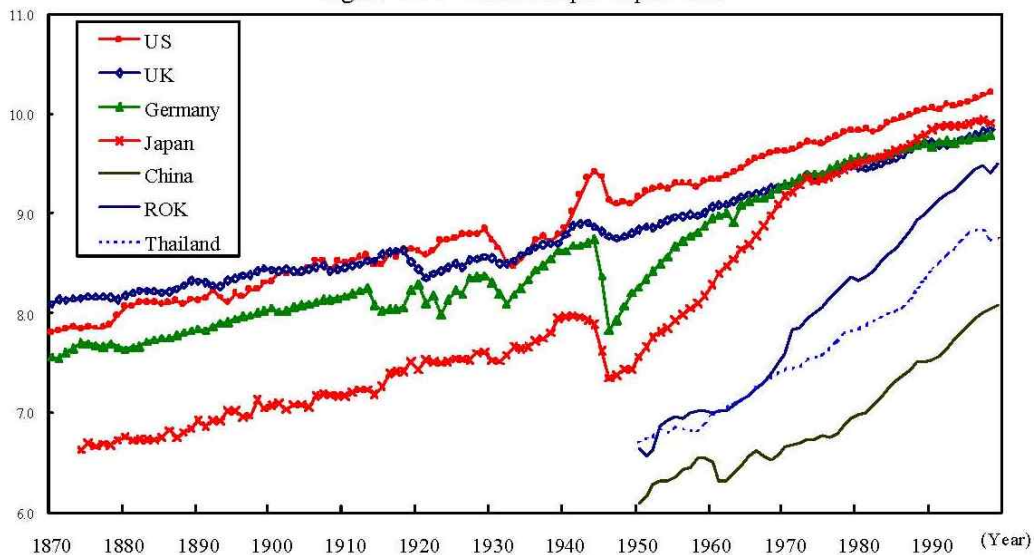
Note: "GDP" here is expressed in 1990 Gary Keamis dollars. Because the statistics for the various countries and regions refer to different years, for the sake of convenience, those years for which data was universally available (1820, 1870, 1900, 1913, 1929, 1950, 1960, 1970, 1980, 1990, 1998) were plotted on the graph and straight lines drawn between the points.

Sources: Data up to 1949: *Monitoring the World Economy 1820-1992* (Angus Maddison, OECD, 1995); Data from 1950: *The World Economy—A Millennial Perspective* (Angus Maddison, OECD, 2001).

Source: White paper on International Trade 2002, METI, GOJ

How long this trend continues? Very hard to answer, but, as long as we manage to deal with global issues such as environmental problems, the most likely answer is that this will continue to the year when per capita GDP of developing countries which have taken off (China, India...) catches up with that of developed countries.

Figure 1.1.4 Trends in per capita GDP



Note: Natural logarithm value of per capita GDP (Gary Keamis, 1990; expressed in dollars).

Sources: Data up to 1949: Monitoring the World Economy 1820-1992 (Angus Maddison, OECD, 1995); Data from 1950: The World Economy—A Millennial Perspective (Angus Maddison, OECD, 2001).

Source: *ibid.*

How much shares will they have? Simple math tells us, those will be proportional to (almost the same percentage of ) the population shares of those countries in that year. Whichever answer you might like, it seems true that we need a change sooner or later and have “muddle through” by taking advantage of everything that can be utilized. It seems almost impossible to have a flawless plan and make a breakthrough at once. To be realistic, however, does not mean at all to abandon an idealistic view. I would like to recall the meaning of the old maxim, “Festina lente.”



## CHAPTER NINE

### Unrealized Potential?: The G20's Role in IMF Reform

Joongi Kim, Yonsei University

This chapter presents my comments on Professor Kenneth Dam's chapter on the G20-IMF relationship. As a foremost expert on the governance of international financial institutions (IFIs), Professor Dam provides unique and keen insight into the problems that face IFIs such as the IMF. Most importantly, he elaborates on the possible role the G20 can play in this reform and concludes that the G20 should delegate the reforms to the IMF itself. Most of my comments largely derive from my own working paper concerning IMF reform.<sup>1</sup>

Professor Dam first comments on the prospects of the G20. He believes that the G20 will serve as a worthy successor to the previous G7 summits, particularly because it includes prominent developing and emerging countries. He then continues to probe whether the G20 will be effective, and if so, in what areas. He assesses the G20 role in coordinating national economic policies more favorably, but considers the G20 efforts in reforming IFIs less optimistically. He cites the coordinated response to the recent Global Financial Crisis where countries from around the world jointly engaged in expansionary fiscal and monetary policy to stem the downturn. In contrast, he is particularly critical of the G20's poorly prepared "declaratory statements" such as the recent statement to refrain from protectionist measures. Most of his criticism in this regard centers on the inability to reform the WTO and to help jumpstart the conclusion of the Doha round. He also notes that the G20 faces natural limitation because it is a "forum" and not an institution that has professional staff and resources. He stresses the G20 owns organizational, governance and resource limitations.

Professor Dam believes that the reform of the IFIs should be delegated to the organizations themselves. In the case of the IMF, for instance, he believes the most important organ to lead this internal reform from within would be the Executive Board. The G20 cannot serve such a role because in his view it already must oversee a broad range of agenda items and does not have the expert staff needed to conduct the preparatory work and implement reform of a major IFI. He asserts that the G20 is not in a position to tackle the thorniest issue

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<sup>1</sup> Joongi Kim, "IMF Reform from a Corporate Governance Perspective: A Test Bed for a New Paradigm for Global Governance," Hills Governance Center Working Paper (July 2010).

of the IMF which concerns the rebalancing of the country quotas so that they more properly represent the voices of developing countries. He warns that the G20 can push reform of other institutions but it cannot “substitute” other institutions.

While I agree with the limitations that G20 currently faces, I do not see why they have to be permanent and why the G20 has to remain a “forum” and cannot become a more institutionalized organization with its own specialized secretariat and staff, instead of being operating in an ad hoc manner. Hence, if the G20 was to attain this type of stature, it could play a far more significant role on a continuing, sustained basis in guiding and leading the IFI reform efforts. I agree that the G20 cannot substitute the IFIs, but I believe that the G20 has the potential to help break the gridlock that has hampered IFI reforms through judicious guidance and compromise.

Professor Dam also describes then the “shares” and “chairs” problems as critical to reforming the IMF. He proceeds to discuss the U.S.’s recent vetoing of the compromise that was reached to increase the number of Executive Board members, largely because they believed that with 9 members out of 20, the number of European board members need be reduced. He adds in his background discussion that who China will replace among the so-called permanent members, either France or the UK, will remain an important political challenge that must be resolved.

I concur with Professor Dam that the Executive Board is the most important subject for reform, particularly due to its dual “legislative and executive” role. Most timely, on October 5, 2010, in the ASEM “Brussels Declaration on more Effective Global Economic Governance,” it was announced that European countries have reportedly agreed to significant shares and chairs adjustments that augur well for the prospects of IMF governance reform. The ASEM leaders agreed with the conclusions made at the October 2009 meeting of the International Monetary and Financial Committee in Istanbul, and reaffirmed that IMF quota shares should be shifted by 5% to underrepresented dynamic emerging markets and developing countries. Asia remains the most underrepresented following by Africa (Table 9-1).<sup>2</sup> Europe has reportedly agreed to relinquish two of their nine seats on the Executive Board, which will hopefully be enough to convince the U.S. They agreed that the current quota formula should be the basis to work from, while stressing the need to protect the voting power of the poorest countries. The ASEM leaders also agreed to address “an open, transparent and merit-based process for the appointment of heads and senior leadership of international institutions,” “Fund Governor’s involvement in the strategic oversight of the IMF,” staff diversity at senior and midlevel positions, voting modalities, and a representative and inclusive size of the IMF’s Executive Board.

In the end, I agree that the key issue remaining is how to enhance the authority of the highest executive body, whether it is the Executive Board or the Board of Governors, or

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<sup>2</sup> The IMF when first founded in 1944 had one director for every 5 member countries, but now, one director represents 11 member countries.

establishing a Council. An independent supreme governing board must effectively oversee the management's purpose of providing global financial stability. The top executive body must not only be held accountable and transparent, but also be granted the political heft and legitimacy needed to carry out its responsibilities. One novel option would be to establish a nominating committee that proposes candidates who are later elected by the members. The appointment of the Managing Director could particularly be considered in this fashion. Of course, the key consideration would then be how to appoint the nominating committee and who would be considered. Board members thus appointed would then serve guaranteed fixed tenures, and would be accountable solely to the member countries as a whole in a far more representative manner.

Ultimately, the five large block countries that make the most substantial contributions must eventually yield their status for the benefit of the institution. The fundamental tension between the large voting countries that remain in control based upon economic size and demographics that existed more than 60 years ago, and newer or developing countries whose composition and stature has rapidly changed, must be addressed for the IMF to regain its vital influence. The dramatic governance changes that the EU has been able to adopt serve as a reminder of these possibilities, where they have skillfully reached an equilibrium that combines both the representation of smaller and emerging countries while granting sufficient influence to the larger more traditional states.

Table 9-1: Regional Breakdown of Quota and Votes

Out of 100%	North/Central America†	Europe/Russia*	Asia/Middle East	South America	Africa
Votes	20.37	38.47	27.74	8.81	4.35
Number of Executive of Directors	2(8.3%)	9(37.5%)	8(33%)	3(12.5%)	2(8.3%)
GDP	25.16%	28.21%	38.75%	5.20%	3.77%
Population	7.68%	13.10%	60.43%	5.56%	14.42%

† Includes Ireland

\*Includes Azerbaijan, Kyrgyz Republic, Serbia, Tajikistan, Turkmenistan, Uzbekistan, Timor-Leste, Israel

## CHAPTER TEN

# IMF Reform from a Corporate Governance Perspective: A Test Bed for a New Paradigm for Global Governance<sup>1</sup>

Joongi Kim, Yonsei University

### Introduction

Following the meltdown that brought global financial markets to the brink of collapse, much attention has shifted to the inability of leading international economic institutions to prevent such crises and curtail its repercussions. Organizations such as the IMF and World Bank have faced a barrage of criticism with frustration focusing on the existing international economic order that largely contributed to the formation of the G20. Members of the G20, in particular, have been pushing for a new system of global governance that would lead to serious reforms to the existing order of international economic organizations.

This chapter will seek to outline the primary reforms that need be undertaken to modernize the IMF so that it will be able to effectively monitor and prevent further financial catastrophes from recurring in the future and fulfill its mandate as a “guardian of systemic stability.” It will first describe the pressing needs that need to be addressed in our global economy, review the current problems of the IMF, evaluate the various proposals for reform and then seek to propose the best solution. It will focus on the governance reforms that are currently being proposed, and where feasible, evaluate them from a corporate governance perspective to try to shed new light on the long-standing and massive debate on IMF reform.

In the end, the key issues remaining are how to enhance the authority of the highest executive body, which body should carry out this function, and how that body should be organized relative to other internal organs. This chapter takes the view that establishing an independent governing board that can effectively oversee the management’s implementation of the IMF’s mandate of providing global financial stability is needed. The byzantine, overlapping division of responsibilities must be clarified. Ultimately, whether in the form of a revamped council or executive board, top executive body and management must be

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<sup>1</sup> Hills Governance Center at Yonsei University released a previous version of this chapter as a working paper (10-01).

accountable and transparent for the organization to be bestowed with the legitimacy and authority it needs to operate. Finally, quota and voice reform should refer to the reforms that have been adopted by the European Union.

## **The Need for Reform**

A vast array of reasons has been propounded for the need to reform the IMF. First, the divide between advanced countries and emerging economies and less developed ones has widened. Increasingly advanced countries prefer to resolve monetary and financial issues in other smaller international fora. Meanwhile, emerging markets and developing countries remain frustrated with their lack of voice, the unfair quota treatment and the insufficient attention to their special needs. To them, the IMF is both non-representative and non-participatory. Second, the IMF's financial resources failed to keep pace with private capital flows. Only after the crisis has its lending capacity more than trebled to \$750 billion. Many economies are even too large to benefit from the IMF's financial support. Third, the IMF lacks a mandate to oversee global financial stability such as financial sector, domestic macroeconomic policies, currency arrangements, prudential issues, financial spillovers. Fourthly, the lack of transparency, accountability, predictability has plagued the organization and hampered its legitimacy. Finally, poorly defined relations with other international organizations such as the World Bank, ILO, WTO, G7, OECD, BASEL, IOSCO, Financial Stability Forum, and even the G20 must be clarified for it to carry out its mandate properly.

## **IMF Governance and Corporate Governance**

Although far from an ideal correlation, much insight can be gleaned from corporate governance theory and practice since many critical and systematic similarities exist. Structurally, the IMF consists of an Executive Board that has 24 members of which five are from members with large quotas, ten from Europe, eight of whom are from the European Union with the Managing Director (MD) serving as the Chair of the Board. In addition, the organization has a Board of Governors, International Monetary and Financial Committee (IMFC), its management, and "shareholders" who are the member countries. Much akin to this, a board of directors oversees the general corporation and operations as conducted by a group of officers, and in many countries led by a Chair who may also function as Chief Executive Officer. Management and employees execute the functions of the company whereas shareholders technically provide checks and balances through the power of appointment.

In terms of ownership and decision making, both entities enable shareholders to exercise the ultimate approval rights for major decisions. This includes the selection of board members, senior officers and major decisions that affect the organizations. For the IMF, for example, major decisions require an 85% supermajority. Shares, however, have been allocated under a fixed quota system that is based upon the financial contribution. In corporations, ownership patterns differ widely across regions with dispersed ownership found in many Anglo-American common law countries, whereas concentrated ownership with a large block shareholder who has a controlling position is the norm for most other countries.<sup>2</sup>

To maintain effectiveness, transparency and accountability, regulation and oversight are established through both the board and shareholders as a fundamental matter but important variances can be found. First, in the case of the IMF, no market or competition really exists, nor are there public sector gatekeepers such as financial regulators or prosecutors. Private corporations operate in an environment where they must compete for products, services, capital, managers, employees, and even corporate control. This provides a powerful stimulus to operate efficiently and responsively. Reputation risks are coupled with legal obligations such as fiduciary duty that are enforced not only publicly through regulators, prosecutors and the judiciary, but also through private enforcement such as shareholder litigation. External auditors help provide decision-making transparency and financial accountability, and gatekeepers such as credit agencies and analysts also support the governance framework by benchmarking their reputation to provide analyses. In both instances, the media plays an important role as guardians of the public interest.

In terms of purpose, the parallels between the two organizations differ more widely. International economic organizations such as the IMF have a general obligation to collaborate to assure orderly exchange arrangements and promote a stable exchange rate system. It provides a rules-based monetary system that supports states that experience serious balance of payments difficulties. This broad international mandate contrasts with the general corporation that seeks to maximize corporate value through profits, and instead draws more similarities with state-owned enterprises. For private sector corporations, a spectrum of differences exists as to how much the interest of shareholders should be given priority, relative to stakeholders such as employees, communities, society and other interest groups.

Ultimately, the problems and concerns they face still hold similarities. The IMF faces problems of efficiency, monitoring costs, conflicts between management and shareholder, member countries and concerns over addressing the interest of stakeholders. In particular, tensions between large, block shareholders who are developed supplier states who exercise most control and smaller, non-controlling shareholders who are developing countries

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<sup>2</sup> La Porta R, Lopez-de-Silanes F, Shleifer A, Vishny R. Legal determinants of external finance. *Journal of Finance* (1997) vol. 52(no. 3): 1131–50. La Porta R, Lopez-de-Silanes F, Shleifer A, Vishny R. Law and Finance. *Journal of Political Economy* (1998) vol. 106(no. 6): 1113–55.

consumer states have escalated and created serious conflicts. For corporations, agency costs and monitoring costs are constant challenges in addition to conflicts between managers and investors, creditors and shareholders, and also controlling and non-controlling shareholders and shareholders and stakeholders.

## **Internal and External Governance**

The focal point for governance reform begins at the top echelon such as the Board of Governors, Executive Board, Council and senior Management. Much debate revolves around how to modernize the Executive Board. Proposals revolve around repositioning the Board into an advisory function for a newly revived Council or upgrading it with even stronger authority. Whether it is through the form of a Board or the Council, the top echelon body needs to be reconfigured into a more influential and representative manner.

### ***Board of Governors***

The Board of Governors (BOG) reigns as the supreme decision-making body of the organization.<sup>3</sup> It determines changes in the quota and votes and consists of one governor and one alternate governor from each country. Each governor is usually the minister of finance or the governor of the central bank of their respective countries, acting as an alternate. The BOG may delegate certain powers to the Executive Board, unless otherwise provided. For meetings, a quorum shall require a majority of the Governors having not less than two-thirds of the total voting power. Each Governor shall be entitled to cast the number of votes allotted under Section 5 of the controversial Articles of Agreement. The Board of Governors normally meets once a year and appoints a Chairman. In essence, the BOG serves as the shareholder meeting of a corporation with each shareholder holding a different range of voting power depending on their financial contribution as determined by their special drawing rights (SDRs).

From a corporate governance perspective, fundamental tension persists between the largest shareholders who remain in control based upon economic size and demographics that existed more than 60 years ago, and minority shareholders whose composition and stature has rapidly changed. Minority shareholders with the ability and aspiration for increasing their presence have to undergo a painstakingly slow process of amendments. The controlling shareholders on the other hand have had little incentive to alter to the ownership structure. A primary challenge for the Fund has been how to realign this configuration in an expedient fashion. The misalignment has not necessarily led to serious agency problems such as excessive executive compensation, corruption scandals or misappropriation but has undermined the authority and legitimacy of the Fund. Other challenges such as monitoring

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<sup>3</sup> Art. XII Organization and Management, Section 2, Board of Governors.

costs and incentive costs naturally have persisted. As Table 10-1 shows, in terms of population and economic size, Asia and Middle East remain under-represented, and African faces a similar position with regard to its per capita representation. Both regions are not adequately represented in their votes or the chairs such as the Executive Directors.

In April 28, 2008, the Board of Governors approved, the Resolution on Quota and Voice Reform in an effort to reconfigure the antiquated, power-sharing matrix (“chairs and shares”) that has been in place since 1946 when the IMF was first established. In 1946, for example, basic votes accounted for 11.3% of the total vote whereas in 2009: basic vote account for only 2.1%. As of March 2010, the April 2008 Resolution still needs ratification from three fifths of the member countries holding 85% of the total voting power. So far, only 64 member countries representing about 70 percent of the voting power have passed the necessary legislation. The Resolution calls or a new quota formula for 54 member countries plus one-off additional elements, increase in basic votes for 135 countries and the capacity of the two African constituencies.

Table 10-1: Regional Breakdown of Quota and Votes

Out of 100%	North/Central America†	Europe/Russia*	Asia/Middle East	South America	Africa
Votes	20.37	38.47	27.74	8.81	4.35
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Population	7.68%	13.10%	60.43%	5.56%	14.42%

† Includes Ireland

\*Includes Azerbaijan, Kyrgyz Republic, Serbia, Tajikistan, Turkmenistan, Uzbekistan, Timor-Leste, Israel

In particular, the process of adjusting the voting structure has proved to be excruciatingly slow, particularly when compared to global realities. A second round of quota increase had been scheduled for 2013, but through the efforts of the G20 and BRIC countries among others, pressure has amounted to accelerate the next quota change to January 2011. Most recently, at the G20 Summit held in September 2009, for instance, leaders agreed on transferring at least 5% of the quotas from over-represented countries to under-represented countries. Lowering of voting threshold on critical decisions from 85 percent to 70~75 percent has been another important objective. Furthermore, extending double majorities to a wider range of decisions has been proposed.<sup>4</sup> By counting individual countries on a separate basis, double majorities can further enhance the presence of under-represented member countries, a shortcoming under the current system that operates under a skewed voting power

<sup>4</sup> An example of the double majority exists under Article XXVIII, Section A that stipulates that amendments of the Articles requires approval from three-fifths of the members with 85 percent of the total voting power.



structure. The qualified majority voting used by European Union organs such as the Council of Ministers can also serve as another reference guide in terms of determining the appropriate distribution.

The ability to improve BOG or “shareholder” oversight and monitoring has to be reexamined. From an internal perspective, the BOG needs to have better ability to conduct internal audits or to verify compliance. The establishment of an ombudsman or independent review panel that receives and investigates complaints from any person, organization, or member state about the Fund’s non-conformity with its mandate should be considered. Further enhancement of the Independent Evaluation Office can be considered in this regard (IMF Independent Evaluation Office, 2006).

### *The Executive Board*

On a functional level, the Executive Board serves as the most important organ, performing a “legislative and executive role.”<sup>5</sup> It has thus been the leading subject of reform. From a corporate governance perspective, it has acted like the board of directors of a corporation bestowed with the power and duty to represent all member countries. At the top, the most important position remains the MD, much like the chair of the board. In 1944, when the Executive Board was first established it consisted of 39 members who were represented by 12 directors, five directors from the countries with the largest quotas in addition to seven directors from the remaining countries.<sup>6</sup> This appeared to provide adequate representation that amounted to roughly five countries per director.

With rapid expansion of nation states, however, membership has more than quadrupled. As of 2010, the IMF now serves 186 members but the number of executive directors has only increased to 24, which corresponds to 11 countries per director. Five executive directors are appointed from among the largest financial contributors, and because their composition has never changed, they have enjoyed de facto permanent standing much like the permanent members of the U.N. Security Council albeit Japan and Germany replacing Russia and China. The remaining 19 Executive Directors are elected every two years within a regional group of member countries. Most significantly, when an elected Executive Director casts his or her votes, he or she must do so as a block on behalf of his or her constituency. In total, the composition remains dominated European countries to an inordinate degree with a total of 7 Executive Directors.

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<sup>5</sup> Manuel Report, p. 8.

<sup>6</sup> Art. XII Organization and Management, Section 2, Board of Governors, Section 3(a)(b)(i).

Table 10-2: Five Appointed Executive Directors and their Votes

Director <i>Alternate</i>	Casting Votes of	Votes by Country	Total Votes	Percent of Fund Total
Meg Lundsager <i>Daniel Heath</i>	United States	371,743	371,743	16.74
Daisuke Kotegawa <i>Hiromi Yamaoka</i>	Japan	133,378	133,378	6.01
Klaus D. Stein <i>Stephan von Stenglin</i>	Germany	130,332	130,332	5.87
Ambroise Fayolle <i>Aymeric Ducrocq</i>	France	107,635	107,635	4.85
Alex Gibbs <i>James Talbot</i>	United Kingdom	107,635	107,635	4.85

This anomalous state of affairs has led to stringent criticism that the IMF remains antiquated and non-representative. The problem is the composition of the members since emerging market economies and under-developed countries continue to remain under represented. Hence, since expanding the number of board members would make it unwieldy, a general proposal would be to diversify its membership to better reflect the wide-range of participants and stakeholders. A weaker alternative compromise proposal advocates participation for affected or interested states to serve on the board on an ad hoc basis much like at the UNSC. Yet, it remains vital for the future of the IMF that the composition of the most important decision-making body become more representative. A March 2009 G20 report called for “deepening the participation of low-income countries, lifting the burden on constituencies that have a large number of members, and the consideration of a third chair for Sub-Saharan Africa” (G20 Working Group 3, 2009, p.7). Another key question arises as to whether a single person should be both the Chair of Board and MD, or whether the positions should be bifurcated. In terms of corporate governance, countries such as the UK the chair and CEO are rarely split, whereas in the U.S., more companies have separate individuals in these positions. Despite the sizeable, political roadblocks that must be overcome to reconfigure the Board; its legitimacy will remain questionable until these issues are resolved.

The Board also lacks the political heft and legitimacy needed to carry out its responsibilities and duties. Presently, board members consist of middle-career officials with short mandates and undefined terms of reference who basically serve as country representatives following instructions from their respective countries similar to an ambassador. From a different perspective, it is critical for the executive board to become more independent both from their own governments and also from management. Hence, they do not have enough incentive to act independently on behalf of the interests of the global economy. One option would be to promote the position by requiring countries to send minister-level officials. Borrowing from the example of corporations, another novel option would be to establish a nominating committee that proposes candidates who are later elected by the shareholder members. Such members would then serve guaranteed fixed tenures and

would be accountable solely to the member countries as a whole. Board members would then be subject to review for their performance. The danger or risk would be that Board members would become too independent, yet this could be controlled by active member country participation since ultimately they must approve all decisions. The large block countries that make the most substantial contributions must yield their status for the benefit of the institution. The dramatic governance changes that the EU has been able to adopt serve as a reminder of these possibilities.

The Board must provide more timely and effective decision-making. The Board needs to more precisely delineate responsibilities, and to narrow down excessively broad governance objectives such as focusing on lending and financial decisions. It should also focus on decisions regarding the use of Fund resources. It also needs to delegate more day-to-day operational decisions to the management.

Board had tended to play “a reactive role in strategy formulation.” The Manuel Report suggests that the Board should be “elevated” from day-to-day issues to become an advisory on strategic issues to a revamped Council and deliver critical supervisory function, including oversight and review of surveillance. Another evaluation described the Board’s involvement in day-to-day operations as distracting its attention from “needed oversight functions” and limited its ability to perform “in an independent manner” (IMF Independent Evaluation Office, 2008). Should advise Council on strategic decisions and prepare its work But many remain concerned that under such a structure the status of the Board would even further decline such that its relevance would be further questioned. The Manuel Report further contends that the Board’s governance objectives that include political voice, day-to-day operational decisions, oversight, and strategic vision are too broad and should be narrowed.

The Board should also focus on overseeing the MD and staff. Some suggest that the Board should no longer “appoint” MD which it only did theoretically. The MD enjoys far greater prestige and wields greater status than executive board members and undermines their authority by “going over their head” through direct relations with the minister-level representatives. Executive Board members have been unable to effectively oversee management. They instead have often held captive especially in the case of Board members from recipient countries.

Another important issue is whether the Board’s mandate should be expanded or contracted. If broadened it could include decisions on internal matters with major financial implications, including setting the medium-term budget and the staff compensation framework. If narrowed, it should delegate more of this type of authority to the Council or management. The more it delegates the more it should exercise ex post oversight as opposed to ex ante checks and balances that are more relevant with organs with wider powers.

If enhanced in stature, Board members should be not necessarily resident at IMF headquarters. Resident boards add considerable expense without per se increasing efficiency or performance. If non-resident, however, board members still must be there a sufficient

amount of time to ensure that members concerns are addressed in a timely manner. Executive Directors should be evaluated by their peers anonymously and confidentially and also by external, third parties who can provide more independent judgment. Board member independence can be guaranteed if they have longer terms. This can also be achieved through longer and staggered terms. Few explicit systems exist for measuring the performance of Executive Board members and holding them accountable

### *Council*

One of the most controversial proposals has been whether and to what extent to strengthen the Council. The Council at present remains a hypothetical and deactivated organ that was first proposed in 1978 when the Fund's articles were amended. The Council was supposed to consist of governors, ministers, or "persons of comparable rank" that would be appointed on the same basis as Executive Directors are appointed or elected. Several of the most vocal proponents for reform have advocated that the Council members needs to be empowered with minister-level authority and for the Board to act in a more advisory capacity (IMF Independent Evaluation Office, 2008). These advocates propose that members should convene at least twice a year and rotate on a regular basis. To provide them with a stronger voice, they should operate through direct voting that enables splitting of constituency votes into separate votes instead of block voting as is used by the Executive Board. The Articles of Agreement already allow direct voting that enhances independence and authority. Under this proposal, the Council must not be a renamed version of the IMFC, but must encompass fundamental changes.<sup>7</sup>

Under a new council-focused structure, the Council would be in charge of strategic decisions that would constitute the general "legislative" decisions. It would be surveillance decisions and establish new financial facilities, engage in policy coordination and react to emerging risks. Furthermore, it would supervise the management and adaptation of the international monetary system and the continuing operation of the adjustment process and developments in global liquidity.

From a governance perspective, to enhance its stature, the Council would appoint the MD through an open, transparent and merit-based selection process. Another interesting proposal from the Manuel Report is that the Chair, Former Chair and Future Chair should form a troika or triumvirate to lead the Council.

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<sup>7</sup> Composed of the most senior political authorities in the areas of finance and monetary policy, the IMFC advises and reports to the Board of Governors. It manages and shapes the international monetary and financial system, monitors developments in global liquidity and the transfer of resources to developing countries, considers Executive Board proposal to amend the Articles of Agreement; and deals with disruptions in the global financial system. It operates through consensus without any formal voting. The IMFC has 24 members who are governors of the Fund, ministers, or others of comparable rank and who are drawn from the pool of 184 governors. Membership reflects the composition of the Executive Board. The IMFC however lacks the ability to conduct strategic decisions.

Organizationally, to be a manageable size, the Council should be around 20 members. Of course, it needs wide representative from emerging countries and fixed chairs for the five largest quota countries that exist for the Board should be eliminated. Appointed chairs should be terminated in favor of elected chairs and the number of chair positions should be consolidated. Furthermore, the voting threshold on important issues needs to be lowered from 85% to 70~75% to enhance operability.

The primary concern concerning the establishment of such a Council-based model revolves around whether it will weaken the Executive Board. In essence it might become duplicative by acting as a dual-tier board system and worse yet it will usurp the role of the Board and render it irrelevant (Bossone, 2009). Bradlow (2006) and other remain skeptical as to whether a revamped Council would be any different from the previous Executive Board unless a fundamental realignment of the quota and voting structure is also implemented.

### *Management and Staff*

Reforms regarding management largely focus on the selection of its most senior members, the MD and the Deputy MDs. Until now, the selection process of the MD has been not only uniformly allocated to a European, but also viewed as shrouded in secrecy among the EU Ministers that compromise among each other to select a nominee. Then, technically, the Executive Board elects the MD. The First Deputy MD has traditionally been an American. This must change for the IMF to become a bona fide international economic organization that represents the interests of all member countries. The MD and DMDs must be chosen based upon their institutional competence and technical merit through an open, transparent selection process rather based on national or geographic allocation (G20 Working Group 3, 2009, p.8).

In terms of the MDs role and function, the MD should apply surveillance “legislation” in country-specific cases. As Chief Executive Officer and Chair of the Executive Board, the MD has dual responsibilities that are often conflicting. As CEO, she must be responsible for the execution and performance of management, whereas Board must oversee management and hold them accountable. Despite adverse effects and conflicts that exist due to this concentration of power, it would not be advisable to consider separating the MD’s dual function. The MD still needs to retain the authority and stature to serve as a bridge between the Board, Council and Management. However, due to the immense concentration of authority, it is critical that the MD be open to all candidates and be chosen based upon merit and competence and not regional allocation for the MD to have the institutional legitimacy required.

It has been proposed that chair positions should be eliminated. MDs also must conduct and complete member-specific surveillance. The IMFC, the IMF's highest-level policy steering committee, serves in an advisory position. The MD should continue to retain autonomy in the appointment, organization, and dismissal of staff. Only through this type of decision-making ability can they lead the organization. They further need the authority to

develop and implement annual budgets, within the medium-term budgetary and general compensation framework set by the Executive Board. Management needs to become more accountable and more guidance. Need a publicly available operational manual that contains the operational policies and procedures that its staff should follow in the conduct of their duties like WB.

For the staff, the whistle blowing process needs to be strengthened. All organizations face challenges related to corruption, embezzlement and improper and unethical behavior that undermine the organization's legitimacy. Staff working on the inside is often times privy to these types of problems but have little incentive to volunteer it unless given the adequate protections from adverse consequences such as retaliation. A comprehensive system must be in place to receive such complaints, to protect the staff that provides such information, to evaluate and correct the problems in an effective and discrete manner. Furthermore, staff should be educated about the institutional importance of preventing such improper behavior, and should be required to report it. Proper incentives should be provided for staff members that muster the courage to do so.

### ***External Governance***

The importance of external governance has remained outside the orbit of most reform discussions but should not be disregarded. NGO and civil society as well as the press play a critical role in providing desperately lacking check and balances and public oversight of the Fund. Unlike corporations, the IMF does not have these types of interest groups or watchdogs nor do they have regulators, law enforcement, courts that can provide public accountability. Independent, external review and audit must be provided.

### **Conclusions**

The IMF must promote economic stability and collaboration and serve as a “guardian of systematic stability.” It must also be at the forefront of coordinated policy stimulus formulating a global policy response with effective monitoring and analysis. To achieve lasting governance reform, the Fund needs the active support of its entire membership. In addition to the issue of quota and voice, the diversity of staff and management must also be addressed. Whenever necessary, voting must become the means of operation instead of relying on unanimity or consensus. How to balance effective decision-making with legitimacy and how to protect the sovereignty of the biggest countries remains a challenge. While cooperation has had successes in limiting protectionism, coordinating fiscal and monetary action and preventing destabilizing currency devaluations, global economic management is now reverting back to the pre-crisis mode of every country for itself. A

minister-level Council could foster strong political engagement in strategic and critical decisions.

Recently, the G20 has provided much needed political momentum to the IMF's governance reform efforts. The UK even proposed G20 become the governing council of the IMF. Under the UK proposal, the membership and structures of the G20 would be altered to coincide with that of the IMFC. While some support can be found, no consensus exists. The IMF has already taken on a number of tasks for the G20 as G20 pushes ahead with its peer review program to ensure national economic policies are consistent with sustainable global growth. G20 members represent some 85% of global economic output. A powerful tandem would emerge through the merger of the IMF's analytical skills and resources with the G20's political heft.

Even proponents acknowledge a myriad of obstacles that exist. Although this would be a dramatic change, the composition would still be fixed among the G20 countries. Excluded countries will be locked out and will be forced to rely upon the G20 member countries to act on their behalf. This not only raises serious fairness questions but also representation issues. Another fundamental problem remains how to establish a new institution with sufficient gravitas at the center of the Fund that has legitimacy but effectiveness. According to Barbara Ridpath, by forcing nations to represent and vote on behalf of a group of countries, the G20 grouping could lose the advantage of the largest economies sitting down behind confidentially and responding to pressing issues. It could bureaucratize the G20. Many states will also oppose granting the G20 enforcement powers. Respecting the sovereignty of the most powerful nations while tackling threats to global stability will remain a challenge.

Appendix 10-1: Position of Reports on Key Governance Reforms

Issue	CIMFGR (Trevor Manuel)	IEO	CSOs/Think tanks	Boutros-Ghali Committee	UN Commission (Stiglitz)	G20 Working Group #3
Importance of quota and voice reform	Yes	Yes, though outside scope of paper	Yes	Yes	Yes	Yes
Greater ministerial involvement in the Fund	Yes	Yes	Yes	Merits “careful consideration”	Yes, with reference to UN-based Council	Yes
Activate decision-making ministerial-level Council	Yes	Yes	Mixed	Merits “careful consideration”	Yes, with reference to UN-based Council	Mixed
Reform IMFC	No	Yes			No	
Review composition of Board and Management	Yes	Yes	Yes	Yes	Yes	Yes
Clarify roles and responsibilities of Board and Management	Yes	Yes	Yes			Mixed
More supervisory and advisory role for Board; delegate surveillance to management	Yes	Yes	Yes			
Enhance accountability	Yes	Yes	Yes		Yes	Mixed
Resident Executive Board	Yes	Yes	Mixed			
MD selection process – open, transparent	Yes	Yes	Yes		Yes	Yes
Review decision-making rules	Yes	Yes	Yes		Yes	Yes
Review and possibly expand Fund’s mandate	Yes		Mixed	Yes	Yes	Mixed
Increase staff diversity (skill sets, training, geographic background)	Yes		Yes		Yes	Yes

Source: IMF, IMF Governance—Summary of Issues and Reform Options, Strategy, Policy, and Review Department and the Legal Department, July 1, 2009



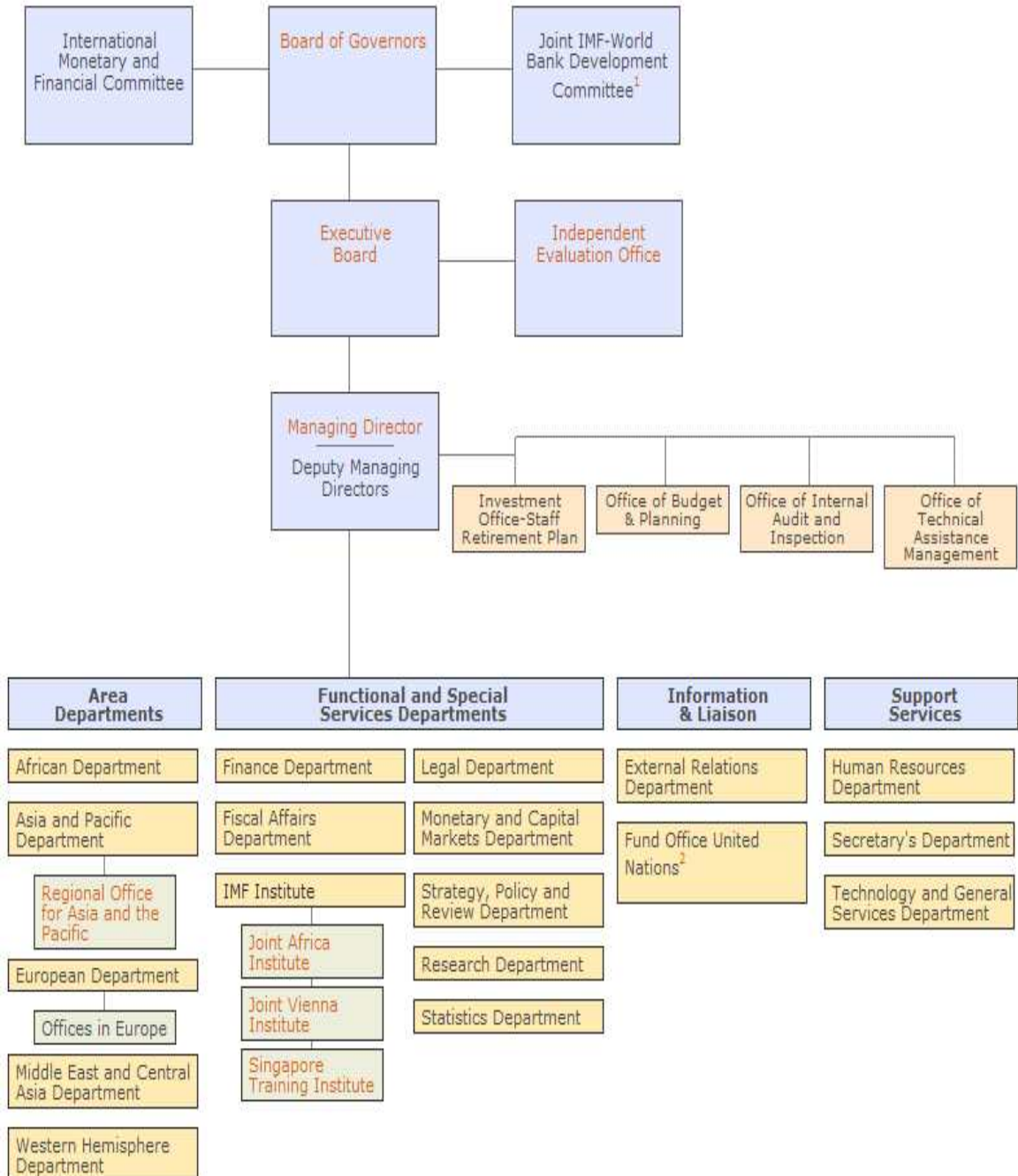
Appendix 10-2: Manuel Report Blended Proposal

Council	Board	Management
<p><i>Legislative functions in “critical” areas</i> (which are defined responsively over time)                      - e.g. surveillance mandate, establishment of financing instruments and facilities</p>	<p><i>Legislative functions in “non-critical” areas</i>, such as:                      - Routine reviews of and non-critical amendments to existing Fund policies and lending instruments                      - e.g. review of data provision to the Fund</p>	<p>Exercises initiative (status quo)</p>
	<p><i>Advisory role to Council:</i>                      - provides input on preliminary policy papers on the critical legislative issues</p>	<p>Exercises initiative (status quo)</p>
<p><i>Regulatory function—surveillance:</i>                      -early warnings and policy responses                      -concludes multilateral consultations</p>	<p><i>Regulatory Function –Surveillance</i>                      - quarterly review of themes from Articles IVs</p>	<p><i>Surveillance:</i>                      - concludes all Article IVs                      - however, the concerned ED/ group of EDs (at least 5) could ask for discussion                      -WEO/GFSR/early warnings</p>
<p><i>Financing decisions</i>                      Legislative function for key financial policies and instruments</p>	<p><i>Financing Function #1 Arrangements</i>                      - approval of arrangements                      - completion of reviews                      - waivers of PCs                      Advisory role in recommending new policies and instruments to the Council</p>	<p>Exercises initiative (status quo)</p>
<p><i>Strategic Priorities :</i>                      - defines medium-term priorities</p>	<p><i>Financing function #2: Budget</i>                      Sets medium-term budget and general compensation framework</p>	<p><i>Operational autonomy on allocating resources to achieve priorities:</i>                      - develops and implements annual budget consistent with medium-term priorities and framework                      - appoints, organizes, and dismisses staff (status quo)</p>
<p><i>Selection of MD:</i> Sets out criteria for MD selection and conducts open, transparent, and merit-based selection process.                      MD remains Chair of the Board.</p>		<p>- MD appoints DMDs on approval of the Board (status quo)</p>
	<p><i>Supervision over management:</i>                      - Review of management’s performance including ex post assessment (on Article IVs and meeting medium term goals)</p>	<p>- For oversight over the MD, the dean (or another Board member) chairs the Board (status quo)</p>
<p><i>Supervision/accountability of Board</i>                      - reviews report on Board, prepared by the Council or by a subset of Councilors</p>		

Appendix 10-3: IMF Organization Chart

# International Monetary Fund Organization Chart

as of April 30, 2007



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PART III

*Domestic Political Influences on the G20*

## **CHAPTER ELEVEN**

### **Congress and the Future of U.S. Engagement in the World**

David Brady, Stanford University

Assessing the United States Congresses' ability at this point in time to make public policy relevant to a global 21<sup>st</sup> century seems appropriate given the U.S. military involvement around the world and the fact that trade treaties with Korea and Colombia lie stagnant in the Congress. In this essay, I put forward a general theory of congressional policy making and then apply the theory to Congress in regard to global security and international trade agreements. After assessing the general performance of the Congress in these areas, I turn to the question of Congressional reaction to the UN and the G20.

#### **Gridlock theory**

In this section, I describe how voters' preferences and congressional institutions put constraints on policy formation, even if policymakers have complete information about the consequences of the proposed policy. Then, I expand the model to include the possibility of three forms of uncertainty: uncertainty about the economic effects of policy changes, uncertainty about their constituents' reaction to a given economic effect, and uncertainty about the location of other legislators' preferences.

The model makes three important assumptions. First, it assumes that each legislator takes account of the preferences of the voters she represents. For example, neither Democrats from conservative districts, nor Republicans from liberal districts, can (or need to) blindly follow the party line. Second, it assumes that, on any particular issue (global security included) the status quo and the preferences of each legislator and the President can be characterized in a single dimension, ranging from most liberal to most conservative. Third, it assumes that all legislators know the preferences of their electorate and of other legislators with perfect certainty. We discuss the significance of these assumptions below.

Based on the position of the status quo relative to the position of members of Congress, the model predicts whether legislation will pass successfully through the institutional structure of lawmaking. If a bill is to become law, it must gain a majority in both houses and

must not be killed by a filibuster or a veto.<sup>1</sup> In the context of global governance and trade policy, the filibuster is likely to be the most important binding constraint, so we focus on it in the discussion below. The filibuster is an institution that allows a Senator, once given the floor, to continue to speak for extended periods of time. When a Senator's right to hold the floor indefinitely is utilized to slow or stop the advancement of a bill, the action is commonly referred to as a filibuster. Obviously, filibusters could keep the Senate from acting on important legislation. As a result, the Senate has, over time, adopted rules limiting the use of the filibuster. Of great significance is Senate Rule XXII, allowing for a cloture vote to end debate. To invoke cloture, sixty Senators must agree that the issue has been sufficiently discussed and that the Senate should continue on with its business, often leading to a vote on the bill being filibustered. The cloture rule thus limits the power of any small group of Senators who wish to talk an issue to death. But it still allows a minority to have significant power over an issue. If forty-one Senators wish to kill a bill through a filibuster, they can do so by voting against cloture.

### *Basic model*

Figure 1 illustrates how the filibuster creates gridlock. The Figure arrays each of the 100 Senators on a line from the most liberal to the most conservative. Three Senators are labeled: the 41st most liberal (that is, the Senator who has 40 colleagues who are more liberal), the median Senator, and the 60th most liberal (that is, the senator who has 40 colleagues who are more conservative). Senator 'A' and the forty Senators to her left could successfully filibuster a bill. Likewise, 'C' and the forty Senators to the right could successfully filibuster.

Thus, if the status quo is between the preferences of 'A' and 'C,' no policy movement can occur. Consider a status quo just to the right of 'A.' A majority would prefer a more conservative policy, but 'A' would have no reason to go along. If the majority to the right of the status quo attempts to enact legislation moving policy to the right, 'A' and the 40 Senators to the left will filibuster to prevent any legislative movement. This does not mean that the minority on the left can dictate policy, however.

Indeed, if they attempt to move policy any further to the left, 'C' and the forty Senators to the *right* will filibuster to prevent *that* movement. Thus the status quo cannot be changed by the Senate, and "gridlock" occurs.

This "gridlock region" within which no policy change can occur is actually even larger than described above. The reason for this is found in a second institutional feature: the presidential veto. If the President adopts a position on an issue that is more conservative than 'C', the region of inaction is extended further to the right. The logic here is much the same as with the filibuster. If the status quo policy is fairly conservative and Congress acts to make

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<sup>1</sup> There are rules in the Senate that make certain legislation majority only --- appropriations and war powers are examples. In addition, when the Congress exercises tariff authority under fast track, the executive majority rule applies.

the policy more moderate, the President can veto that legislation. Instead of needing the forty-one conservative Senators required to maintain a filibuster, the President only needs thirty-four conservatives to sustain a veto. Because a cloture vote requires three-fifths of the Senate and a veto override requires two-thirds, the veto provides a greater constraint on policy action. When the President is conservative and the Senators are ranked along the main policy dimension, this region of inaction, or gridlock, stretches from the forty-first Senator to the sixty-seventh. With a liberal President holding veto power, this region stretches more to the left, from the thirty-fourth Senator to the sixtieth. If previous policy has positioned the status quo in this region, then Congress can successfully undertake no further policy action. Movement to the left or the right will be halted by successful filibusters or vetoes.

The gridlock region described above is important with regard to policy *action* as well as policy inaction. Figure 2 shows how the filibuster constrains policy outcomes, even when the status quo lies outside the range of preferences between 'A' and 'C'. In this case, the status quo policy is to the left, so the pivotal Senator 'C' allows a shift to the right just so far as is in that Senator's interest. The pivotal Senator will join the forty colleagues to her right to filibuster bills that go too far. We refer to this Senator as the *filibuster pivot*, as this lawmaker plays a pivotal role in deciding which bills are satisfactory and which should be filibustered. The policy will end up between P\* and the status quo; the exact position of the bill in this region is subject to agenda setting and political bargaining. In this range, the model is indeterminate.

The above discussion has concentrated mainly on the Senate. There similarly exists a gridlock region for the House. As filibusters are not allowed in the House, this region only stretches from the House median to the House *veto pivot*; that is, the legislator nearest the President who has one-third (145) of her colleagues to her right (or left). With a liberal President, status quo policies in this region cannot be shifted to the left because a majority would not vote for such a shift, and policies cannot be moved to the right because such a shift would be vetoed and the veto sustained. Because this region is smaller than in the Senate, it is often less of a constraint on policy. However, the need for a supermajority to override a veto is a serious constraint in both the House and the Senate.

### *Incomplete information*

The model above assumes that legislators can perfectly predict the economic effects of a policy change, their constituents' responses to these effects, and the preferences of other legislators and their constituents. In practice, of course, this is rarely the case. Members of Congress take many steps to collect as much information as possible. They listen carefully to constituents, paying attention to surveys and polls. They take advice from experts, whether committee members who have specialized in a policy area or authorities who give testimony in hearings. Still, the fact that the consequences of a change in policy are never fully known *ex ante* tends to increase gridlock for three reasons.

First, there is uncertainty over the actual policy results of passing a bill. In the above section, we assumed that the status quo policy and the alternative proposed were known and were easily placed on a one-dimensional line. Legislators then simply pick whichever policy is closer to their preferred outcome. In reality, policymaking is an uncertain activity. Budget estimates made over a five-year period will undoubtedly become less accurate over time. Members of Congress cannot perfectly predict which interpretations and actions other governments agencies will take. Policymakers and policy analysts are unsure of just how many jobs will be affected by passing trade legislation, or be indirectly affected by a policy change.

In addition to being uncertain about where the policy outcome of a bill will lie, members of Congress face a second uncertainty: how their constituents will react to how they vote. In the above section, we argued that members of Congress are aligned from liberal to conservative. Their positions on various issues can be determined by observing how they vote over time. When they vote, members of Congress seeking reelection must be aware of how their constituencies view their votes on the issues at hand. And yet these members are uncertain as to what the reaction will be back home, either in the short run or over time. Many policy votes will simply be ignored by constituents; others will be observed but play little or no role in swaying voters; and still others will become major campaign issues. Because legislators are risk-averse, increases in the scope of possible outcomes leads them to be less willing to support change.

Imperfect information on voters' preferences for change increases gridlock for a third reason: legislators may not know precisely where their colleagues' preferences lie, which makes bargaining over policy alternatives more difficult. This is simply a special case of the more general classic result from game-theoretic bargaining models. Given two parties with private valuations of a policy change, agreement is possible only if it is common knowledge that "gains from trade" exist -- that is, if each party knows *ex ante* that it is in the other party's interest to compromise (Ausubel, Cramton, and Deneckere, 2002). As the range of possible outcomes of a policy reform increases, voters' potential for dissatisfaction with change increases, which makes it increasingly difficult for legislators on one side of an issue to know how far off of the status quo their colleagues will be willing to move. It is this form of imperfect information that leads to the gridlock that Pauly (2004) describes as Altman's Conundrum. As they put it, conservatives in the trade relations policy favor free trade with Korea but are uncertain about how moderates and liberals will value trade reform. Thus, conservatives' uncertainty about how much they will need to compromise from their ideal policy lead them to be unable to reach a compromise with liberals, who view the status quo with Korea more favorably.



## **Global security Issues**

The best place to discover the heart and soul of the congressional response to global security issues is to look at the reaction and policy during a crisis situation. Before moving to an analysis of 9/11, a word on congressional preferences is in order. In regard to national security issues, Republican preferences are normally more hawkish and interventionist than are Democratic preferences. Thus on security issues, Republican Presidents with Republican Congresses have an easier time getting their way. Democratic Presidents with Democratic Congresses have more problems because the President sees and is held responsible for the overall security picture while the liberal wing of his party is not responsible for and their constituents in general oppose military actions. Democratic Presidents with Republican Congresses are somewhat better off because the President can move militarily and have Republican support. The hardest case is when there is a Republican president with a Democratic Congress because the normal set of Democratic preferences is unhindered by having a President of the same party. That is, Democrats serving with George W. Bush did not want him reelected.

The terrorist attacks of 9/11 brought about a period of bipartisanship in Congress that lasted less than a year. It is not surprising that an act of war that kills nearly 3,000 people in America's major city would bring about a period of national unity. The decision by the government to go after the Taliban in Afghanistan was a popular and essentially noncontroversial choice. But the decision to go to war with Iraq was another matter: A significant minority of Americans and a majority of America's European allies were opposed to military action in Iraq without a U.N. resolution authorizing the use of force. So why did President Bush get his way in Congress relatively easily? Why, despite the fact that a majority of Americans presently feel that the wars in Afghanistan and Iraq are going badly, does the Democratic President get the appropriations he asks for? Why does he not face votes in Congress forcefully expressing displeasure with the situation in Iraq or Afghanistan? In domestic politics President Obama was thwarted on cap and trade environmental legislation, making the 2001 and 2003 tax cuts for the rich disappear, and immigration policy, yet on Iraq and Afghanistan he faces only verbal criticism, not legislative defeat. Why this difference between foreign and domestic policy?

### *Preserving the status quo*

Put simply, with few exceptions, there is not much uncertainty in domestic policy relative to foreign policy. In domestic policy, members of Congress can accurately calibrate how shifts in policy will affect their district or state. Washington, D.C. is a city of information, set up to let members know how thousands of interest groups and millions of citizens feel across almost all areas of domestic legislation. In the 109th Congress, within a few months of

President Bush's State of the Union Address, every member of Congress had a good idea how hundreds of interest groups felt about the President's plan to privatize some Social Security funds. In the present Congress, members knew within weeks how Obama's cap and trade environmental legislation would affect industry and jobs in their state.

In addition to all of the interest-group information that members receive on domestic legislation, there are literally hundreds of polls taken by and for members showing how Americans, including those in their state or district, feel about any given domestic issue. Thus members can compare interest-group information against public opinion polls, focus groups, and district meetings to determine how legislation will affect their long- and short-term career ambitions.

In foreign policy there is much more uncertainty surrounding policy alternatives. There are many fewer interest groups in this arena, and public opinion is less predetermined, which allows the President, as commander in chief and head of state, to take the lead on policy formulation. The President's goal is clear - keep America and Americans safe - but the means are often controversial. Some view international institutions as the proper means for ensuring peace; others believe that we should have a strong military to protect our interests; still others believe that a combination of international institutions and force works best.

Additionally, in foreign policy much of the key information on a given issue is of a highly secure nature and is thus attached to the executive office. Consider the complicated nature of U.S. policy in the Middle East. Is the presence of U.S. troops in Iraq, Kuwait, Saudi Arabia, and Afghanistan increasing the number of terrorists ready to attack us, or are the terrorists all in Iraq and Afghanistan? Do the recent elections in Iraq and Palestine mean that democracy has a future in the region? Should the United States try to strengthen the United Nations, leave it as it is, or weaken it further? These are difficult questions when real information is often not present or in very small supply.

By and large, most Americans expect the President to resolve foreign policy crises such as the Iraq situation or the Israeli-Palestinian conflict. Because their constituents do not expect them to solve foreign policy problems, members of Congress can reasonably decide that not acting is a safer electoral choice than acting. Legislative inaction due to high uncertainty surely makes electoral sense, especially when the status quo does not seem too problematic.

### *Uncertainty prevails*

A clear example of this phenomenon is to look at a Democratic congressional reaction to President Bush. After 9/11, because of the immense uncertainty about the world, members of Congress generally preferred that the President act first, act quickly, and act decisively. Indeed, much of the country looked to President Bush for leadership and offered him their support. The President experienced the well-known rally-around-the-flag effect. In late

August 2001, CNN, Gallup, and Pew Research identified the President's job approval rating at a little more than 50 percent; on September 11 and 12, the *New York Times* had his approval rating at 76 percent. During the action in Afghanistan, the President's approval rating never dropped below 83 percent and was often as high as 90 percent.

The initial reaction of Congress toward U.S. policy in Afghanistan reflected the public's positive views of the President. There were several votes on Afghanistan. The most significant one, occurring on September 14, authorized the use of armed force against those responsible for the 9/11 attacks. In the Senate the vote was 98–0, and in the House it was 420–1 (Representative Barbara Lee of California was the sole no vote). Supplemental appropriations for the Afghanistan action also passed with bipartisan ease. The victory over the Taliban put the President's approval rating at 89 percent by the time of his 2002 State of the Union Address.

The steady march toward war with Iraq began to put some members under pressure to speak up about the role of Congress in the foreign policy process. By mid-July 2002, some members of the President's own party were pushing for a greater decision-making role. Republican Senators Arlen Specter (Penn) and Chuck Hagel (Neb) warned that there had to be a national dialogue on the issue to avoid some of the mistakes of Vietnam. Some House and Senate Democrats tried to use the appropriations committees as a way of affecting Iraq policy. Although some congressional noise about Iraq policy was present, it was evident to most members that they should vote with the President because that vote was easy to defend. There was a great deal of uncertainty over Iraq's intentions and weapons, and neither Congress nor the President controlled the status quo. That is, irrespective of what Congress might (or might not) do, the U.N. Security Council, the Arab world, and Al Qaeda were all going to take actions that would change the status quo.

Because members of Congress faced great uncertainty over the status quo, voting to support the President seemed the safest strategy for members of Congress who feared electoral retribution. Members from safe liberal seats could afford to object to the war in Iraq without affecting their electoral careers, but most members could not afford such a vote. Their strategy seemed to be to wait and see how things go: If the war went well, then they could tell voters that they'd voted with the President; if things didn't go well, they could object to the direction the President had taken and still be reelected. Given this risk-averse strategy of many members of Congress, it is clear why the President would go to Congress for a resolution authorizing force against Iraq, knowing victory was certain.

The House voted on October 10, 2002, on a resolution authorizing the use of force against Iraq. The final floor vote was 296–133, with 81 Democrats joining 215 Republicans to vote in favor—a significant show of bipartisan support. The next day, the Senate voted 77–23 to authorize the use of force. Of the 34 Senators up for reelection, 31 voted for the resolution. In the end, liberals from safe districts or states were less uncertain about how a no vote would affect them and thus felt more comfortable voting against the resolution. Yet those Democrats

up for reelection voted with the President much more frequently than those not up for reelection because it was an immediately safer bet.

### *Conclusion*

Understanding why Congress has supported the President in the past makes predicting the future much easier. The present Congress will continue to vote in support of appropriations for the military and for the Iraq effort. There is still a great deal of uncertainty about U.S. policy and what the future will bring in Iraq and the Middle East. Will the present Israel- Palestine talks bring peace between Israelis and Palestinians? Will the newly elected Iraqi government bring stability and, if so, how soon? As long as answers to these questions and others like them are not clear, uncertainty prevails, which helps the President continue to win votes for his foreign policy. In short, in regard to national and global security questions around the globe, the Congress of the United States will continue to defer to the President.

### **Trade Policy**

Trade policy unlike global security policy is not an area where Congress essentially delegates decision making to the President and then congratulates success and criticizes failure. Instead trade policy features real economic interests which can be calculated by interest groups in districts and states. Thus in this arena Congress plays a more substantive role in policy making. Before turning to the congressional policy making process let me first turn to congressional preferences. When there is a Republican majority and a Republican President the pro trade agreements - pro business preferences are greater than when there is a Democratic President and a Democratic Congress. This is largely because the labor union movement in the United States is aligned with the Democratic party and when Democrats are in power they have more sway. Combinations of presidents from one part and congresses of the other fall in between these two extremes. It is worth noting that the President, regardless of party, will always be more free trade than his congressional party. This is because as a representative of all the people only the President can see the trade off between voluntary export restrictions on Japanese auto imports and jobs for the domestic auto industry. The member from Michigan wants to keep auto jobs, the representative from California knows that her constituents prefer Japanese and German cars, so their preferences are given but neither faces a trade off as the President does.

Members' preferences will be determined by the interests in their respective districts and states; thus some Democrats will favor international trade agreements and some Republicans will oppose. The important point is that members' preferences here have a direct electoral connection and thus party will be tempered by constituency interests and coalitions can be bi-

partisan. Moreover, the bigger the trade agreement the greater the bi-partisan possibilities. Thus, trade agreements and business relations with China will be more important than trade agreements with Colombia. Trade and business dealings with Canada and Mexico will be more important than with Korea.

Policy outcomes in the U.S. are the result of the interaction between the two principal actors, the President and Congress, who have, as noted, different preferences.. The way these interactions are shaped is largely historical. According to the United States Constitution, the authority to regulate foreign trade is vested in Congress, and Congress had been dominant in setting trade policy until 1934.

The earliest U.S. tariff laws were characterized by bargaining between congressmen representing constituency interests. In the post-Civil War period (1865) parties played an important role. Republicans who represented the industrial East and Midwest favored high tariff schedules which would protect U.S. industries. Democrats who largely represented Southern and Midwestern agricultural interests favored lower tariff schedules which would allow their constituents to buy cheap European machinery and sell their products to Europe. When party became less important during the Progressive era (1906 – 1924) some Republicans sided with Democrats in favor of open trade. However, even during this period members attempted to protect industries located in their states and districts. By the late 1920s party was relatively unimportant and Congress began to have difficulty in putting together trade legislation due to the declining world economy. With the passage of the 1934 Reciprocal Trade Agreement Act, Congress realized that it could not escape the problem of over-representing local interests.

The four major reasons why Congress tends to favor protective tariffs are as follows. First, the cost of importing foreign goods tends to be geographically concentrated; those members of Congress whose constituencies are affected cannot find comfort in the fact that someone outside of their districts is gaining from open trade. Second, trade policy is a good area to raise voices without hurting or alienating anyone. The benefits of protection are concentrated, while costs are widely distributed among consumers. Third, unlike other countries the parties in the U.S. play a small role. Due to the U.S. system of federalism, checks and balances and electoral laws, the members of Congress are relatively less constrained by their party leaders. Fourth, Congress tends to develop norms of behavior and institutions that facilitate some cross party log-rolling.

As noted, the President is better able to take a national view. His constituency is national, and thus he can play one industry off against others. His reelection depends upon the state of the economy. Thus, when the economy is good and free trade is important for the economy, the President will favor free trade. Over the post-World War II period U.S. Presidents, especially Republicans, have favored free trade. In short, we can generally expect the President to be less protectionist than the U.S. Congress, and we can expect the House of Representatives to be the most protectionist since it represents the smallest constituencies

The Reciprocal Trade Agreement Act (RTTA) of 1934 should be viewed in the context of these inherent differences between the two main actors in trade policy, Congress and the President. The RTTA was a reaction to the failure of the Smoot-Hawley Act of 1930 and shifted the institutional focus of trade policy making in the United States toward the President. The Smoot-Hawley Act was a classic case of log-rolling in Congress; its members were so entangled with special interest groups that they ended up raising the tariffs to their highest level in U.S. history; many people blame this tariff measure for the deepening of the Great Depression.

The RTTA of 1934 also represented a bargain that gave the executive branch added powers in exchange for an implicit promise that it would protect members of Congress from the inevitable pressures of special interests seeking trade barriers (Yoffie, 1989). The act gave the executive the authority to negotiate reciprocal trade agreements within the bounds set by Congress. From the beginning, Congress never intended to forfeit much power. It retained its oversight powers and limited the duration of the President's authority. Its goal was to create a system that would allow industries in distress to appeal individually for help without the extensive log-rolling engendered by the Smoot-Hawley Act, but at the same time allow the executive to define the national interest in trade more broadly.

This arrangement led to a well-established post-war pattern: pressure for trade restrictions led not to statutory protection but to a growing number of special deals for special cases, arranged by the executive branch. Congress had sought alternatives to product-specific legislation by rewriting the trade-remedy laws. In other words, the President played the role of a trade broker. Under this system, the President only had to give protection to selective industries to help diffuse protectionist pressures. A number of Presidents did exactly this --- Eisenhower in 1955, Kennedy in 1962, Nixon in 1974 and Clinton in 1993; in order to pass comprehensive trade liberalizing bills in Congress. Presidents assured some industries such as textiles and steel that they would be protected. To other industries clamoring for protections the President could say no. Obviously resisting protectionist pressures was not easy. It took political leadership to succeed. The President was able to mobilize the anti-protection forces to deflect protectionist pressures and at the same time he was able to protect Congress by taking actions that helped some industries in distress. Some blame President Reagan's free trade policy for the emergence of new congressional activism in trade policy in the mid-80s. I now turn to some post-Reagan contemporary examples of trade policy to show how bi-partisan coalitions can affect trade results.

Given that Democrats are more tightly tied to labor interests, one would expect that the preferences of a Democratic Congress combined with a Democratic President would be the hardest combination for free trade advocates to crack. Thus, we turn to an analysis of the North American Free Trade Agreement. The central question is how was it that a unified Democratic administration could pass GATT, give China most favored nation trade status and bring China into the World Trade Organization while over the post-2000 period Congress

and the President cannot seem to get much done. The Bush administration in line with normal Republican preferences negotiated free trade agreements with Korea and Colombia, though after 2007 could not get a Democratic Congress to pass them into law. The present Democratic administration has not and will not move on trade legislation. Is there in principle something different about the present situation from that present in the Clinton era when even with a Democratic government NAFTA could be passed?

The answer is that the trade legislation passed during the Clinton era occurred in an era of unprecedented prosperity where the President could campaign against NAFTA and China but once in office be moved to sign pro trade agreements. I begin by using a relatively lengthy analysis of how NAFTA passed as an example of Congress and trade policy and then turn to a brief analysis of why no such progress has occurred since 2000.

### **NAFTA**

The North American Free Trade Agreement was negotiated by Ambassador Carla Hills during the Bush administration; thus the framework of the treat had already been established when President Clinton took office. During his presidential election campaign, Clinton had said that he would support NAFTA if side agreements on labor and the environment could be reached. Clinton's original idea was to create North American labor and environmental commissions with the power to levy fines and sanctions. However, Clinton walked a tightrope on NAFTA; in order to pass the treaty he had to have Republican support, and such support would disappear if the side agreements on labor and environment were too tough. Even with the trade agreement being placed under the 1991 fast-track rules, thus eliminating the threat of a filibuster, the President was not guaranteed a simple majority. Yet without the tough side agreements, labor unions and environmental groups would oppose the treaty. The negotiations for side agreements began on March 17, 1993, and on August 12, after five months of wrangling over the nature of the side agreements by the Mexican and Canadian governments, as well as the AFL-CIO and environmental groups, Ambassador Mickey Kantor and the Mexican and Canadian negotiators worked out a deal. The three countries agreed to create trilateral commissions to deal with environmental and labor disputes. Disputes not resolved by the commissions would be forwarded to an arbitration panel with the power to recommend trade sanctions against Mexico and the United States. In the case of complaints against Canada, Canadian Courts would impose penalties.

Opponents led by Representative Richard Gephardt (D, MO) said that the side agreements (1) failed to name a funding source for pollution cleanup along the U.S. – Mexican border; (2) did not go far enough to protect U.S. producers; and (3) did not include the possibility of trade sanctions against Mexico for failing to pay their workers a fair wage. The AFL-CIO president said that the agreements relegated workers' rights and the environment to commissions with no real power of enforcement (1993 *Congressional*

*Quarterly Weekly Report*, 2212). It was clear from the reaction of Representative Gephardt and the AFL-CIO that the President had chosen a strategy to keep Republican votes and pick up moderate Democrats, rather than appeal to the Democratic Party median.

In the weeks that followed, questions of funding border cleanups were answered and the amount and source of monies for worker retraining were debated. At one point President Clinton proposed a tax to provide the billions necessary for worker retraining. Minority whip Newt Gingrich (R, GA) immediately sent the President a note saying that House Republicans would not support NAFTA with such a provision in the enabling legislation, and the plan was dropped. In the crucial House vote, 132 Republicans voted for NAFTA along with 102 Democrats. The point is quite clear --- Clinton's early support hinged on the creation of the trilateral commissions with subpoena powers and sanctions, and such a policy was not acceptable to the Republicans. At every stage of the game, from renegotiating the NAFTA treaty to the side agreements to funding pollution cleanup and worker retraining, Clinton and Kantor took positions that diverged from the center of their party in an attempt to keep the support of the Republicans and the moderate-to-conservative Democrats. The final treaty and the final vote clearly reflect this appeal to the floor median member's preferences.

In the case of NAFTA as well as granting China most favored nation trade --- the President's original policy inclination was to the left of the floor median. In both cases, the final policy output was close to the median floor position, with the President calling for support of these centrist policies. In both the House and Senate the crucial votes came from Democratic Senators and Representatives at or about the median --- Breaux(LA), Boren(OK), Johnston(LA), and DeConcini (AZ) in the Senate; and Stenholm (D, TX), Wilson (D, TX), and other conservative Democrats in the House. When the Senate version of the budget act passed, it was Democratic liberals such as Pelosi (CA) and Boxer (CA) who objected to enhancing free trade and certifying China. In short, the left in the President's party could not be brought along.

It is relatively easy to predict the outcome of legislation for which there exists a majority in the House favoring the policy but not a supermajority sufficient to override a presidential veto. For House members, the election of a Democratic President eliminates the Republican presidential veto threat for bills like family leave and motor voter registration; thus these bills will most likely easily pass. The Senate presents a more interesting case because there is still a filibuster pivot (that is, a three-fifths supermajority is necessary), thus keeping the policy from drifting too far left. Here we would predict that if the President's policy is too liberal, there will either be a filibuster of the credible threat of one, and the policy will have to be modified to break the filibuster.

### *POST-2000 Developments*



The fact that the U.S. has not signed a major trade treaty since the Clinton administration is partially a result of that no major world trade initiatives have been agreed to and the partisan attitudes in Washington, plus the recent economic downturn. The NAFTA, GATT and admission of China to the WTO were achieved under President Clinton in prosperous times. The Bush presidency was consumed by 9-11, Afghanistan and Iraq. Thus, there were no major trade initiatives, though progress on U.S.-India relations was made. The global economic downturn affects globalization efforts negatively in that during bad times, governments concentrate on solving their own problems. During downtimes, anti-trade, anti-globalization interests arise in importance and constrain governments' ability to negotiate, finalize or approve trade agreements.

This deadly combination does not mean that the forces which enacted GATT, NAFTA and brought China to the WTO are gone; rather, they are dormant. Improvement in the global economy will bring the pro-trade forces to the fore as the anti-trade forces recede.

Politicians in the U.S. and elsewhere are hard-pressed to propose free trade agreements when unemployment is at about 10 percent. Even though, in my opinion, signing the Korean and Colombian free trade agreements is the right thing to do, no President, Republican or Democrat, could sign these without facing serious opposition from opponents portraying the President as anti-U.S. jobs. Thus, while the economy is bad, we should not expect progress on the trade front. When the world economy improves, the forces favoring free trade and globalization will come to the fore and progress will result. In short, the congressional policies described above, dominant in the Bush I and Clinton years, are still present and will reassert themselves as the economy improves.

## **Implications for Congressional attitudes toward the G20**

We have seen that congressional attitudes toward international issues from security to trade policy are governed by members' desire to stay in office. On national security issues where reliable information is hard to come by and uncertainty over policy outcomes enhanced, members delegate to the President and react to the actual policy results. In economic trade policy, members can reasonably calculate how policy alternatives will affect them. Thus, their collective delegation is more nuanced. As in the case of military base closings, members know that bases have to be closed --- and they don't want "their" base closed. In these circumstances, members create institutions like Base Closing Commissions which do the dirty work while allowing affected members (those losing bases) to show their concern and how hard they fight for their district. In trade policy, the Congress uses fast track legislation to maintain a role in the process without allowing local interests to create another Smoot-Hawley.

The twenty-first century will see major changes in international organizations if only because the United Nations and other organizations like the OECD no longer represent the world as it is. The United Nations will be the hardest to reform because of the strange relationship between the Security Council and the General Assembly. The Security Council, dominated by the U.S., Russia and Europe, no longer represents the world's major players as it did when created after World War II. Increasing the size of the Security Council's permanent members will not be easily attained. Every country will want in and some of the permanent members will not want to give up permanent status. The General Assembly will want more power, and bureaucrats in Paris, New York and Geneva will not want change. Besides changes in power arrangements, there will have to be new funding arrangements put into place, reflecting the new world reality. None of this will change easily or quickly so the world will either bypass the United Nations or it will create new institutions. The case of the Iraq war is an interesting case in point.

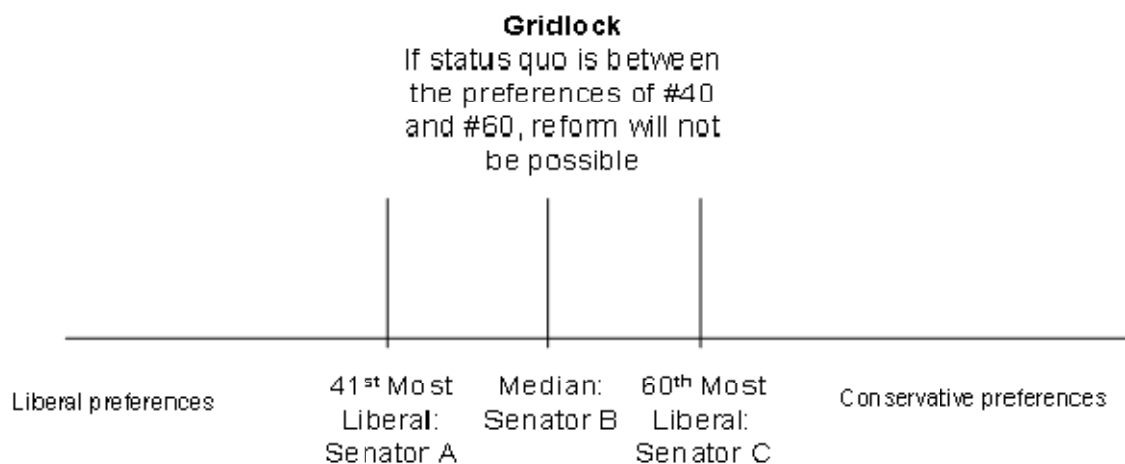
The United States sought a UN resolution but could not get the resolution passed. The normal game had been for American allies like France and Germany to use the United Nations' resolution process to wring concessions out of the United States and then go along ultimately with the United States. This scenario did not play out, as the U.S. went to war anyway. The present situation with regard to Iran looks eerily like a drawn-out Iraq situation, albeit with an American president ostensibly committed to negotiations and existing institutional arrangements. Congressional attitudes in either the Iraq or Iran situation are never, with the possible exception of Barbara Lee (D, Berkeley), concerned about the UN as an institution. It is always a secondary (if on the agenda at all) concern. If you were, as a member, opposed to going into Iraq, you might use the UN in a speech but it would never be placed before a member's concern for his or her district and how their actions would affect reelection changes. Thus, Congress (in its individual members) might praise the UN or use it as a whipping boy, but it will not vote it new funds to reorganize itself.

Change in congressional attitudes toward the G20 will be much easier to come by since the G20 better represents the relevant world economy than does the G7 or the OECD. The average member of Congress knows full well that China, India and the Asian tigers are the future drivers of world economic growth and thus have a say in how economic policy is discussed and financial policy coordinated --- to the extent that it can be coordinated. The purpose of G20 meetings is for the real economic leaders of the world to get together, discuss and disseminate the results of their negotiations. The G20 has no enforcement mechanism other than that in the 21<sup>st</sup> century, the economy will grow only in so far as these 20 nations see and coordinate their common interests. Does this mean that congresswomen and men will now praise the G20? No, they will continue to berate it and world trade (there go American jobs) when it suits their purposes. It will not get much praise because, unlike UN resolutions, the G20 does not deal with war and peace and feeding children, like UNICEF. However, because the G20 is the best international vehicle for coordinating and discussing economic

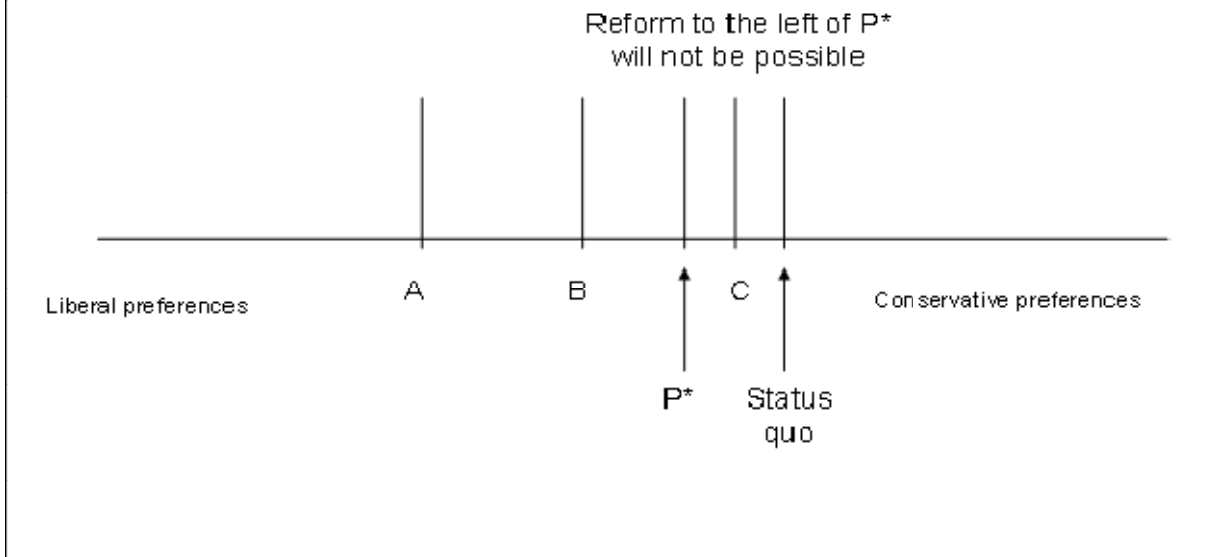
policy, Congress will not oppose it or use it in general as a whipping boy. Members of Congress know that the world is changing around them and that China, India, Korea and other countries are and will continue to be major players. The G20 represents the new world economic reality better than any other such organizations and since it does not make decisions in re trade or economic policy, members will leave it alone. Moreover, they will let the President and his economic team deal with the global economy. They will distance themselves from the President when the economy is bad and praise him when it is good.

In sum, congressional attitudes toward the G20 are a combination of their attitudes toward national security and trade. They are more attuned to the state of the economy than to security issues because they have more information and less uncertainty, due to G20 meetings. That is, the joint statements out of G20 provide useful information about how other important actors -- China, India, Europe --- are going to deal with, say, banking and currency issues. This information reduces uncertainty in a policy sense and, at the reelection level, lets members sound off about specific policies if they so need. Contrast this with the uncertainty about Iran's nuclear policy. Here the information is bad, the consequences great, and Iran's leaders are not making any joint statements about their intentions or coordination with other nation states. Precisely because the G20 represents economic reality and the leaders' stated intentions are roughly accurate, the organization does not represent any serious dilemma for Congress and its members.

## Figure 1: How the Filibuster Creates Gridlock



**Figure 2: How the Filibuster Constrains Policy, Even When Change is Possible**



## CHAPTER TWELVE

### The G20 and Domestic Politics: The Case of Japan

Keisuke Iida, University of Tokyo

The G20 has been an important institutional innovation in the wake of the global financial crisis after the Lehman shock. It is a forum where the G8 countries and emerging economies can discuss urgent economic matters on an equal footing.

I have to admit that Japan has an ambivalent attitude towards the G20. Japan had been the only Asian country in the G8, and had prided itself on that status. Now, with the emergence of the G20, Japan is only one among the five or six Asian countries in the forum.<sup>1</sup> So, our status has lost its value.

The organizers of this conference have provided a set of very challenging questions for this late afternoon panel.<sup>2</sup> They have to do with domestic foundations of the G20. They are all important questions, and if we could provide satisfactory answers we will be in a good position to fathom the future of the G20.

Unfortunately, the history of the G20 has been too short, and as far as Japan is concerned, there is no good basis upon which to answer these questions in a satisfactory manner. Therefore, what I will do in the following ten minutes is to tell you an anecdote, and then try to tease out some implications that pertain to the questions at hand.

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<sup>1</sup> Aside from Japan, the other Asian participants are: Australia, China, India, Indonesia, and the Republic of Korea.

<sup>2</sup> The questions are (and my brief responses in parentheses): 1) How involved is the national legislature of your country with G20 policies? (It varies from issue to issue; on fiscal policy, very much, and on regulatory issues, very little, except for tax-havens issues); 2) What role does your legislature play in formulating and supporting G20 policies? (Again, it varies from issue to issue; on fiscal policy, see the rest of the memo); 3) How strong are the public interest in and support for G20 and other international institutions? (G20 is too new to be well-known among the general public; the interest is limited to policy makers and policy-related academicians); 4) What impact will lack of domestic support have on the future of G20? (Again, this will depend on specific issues, but on sensitive issues such as those addressed in this memo, it could have a substantial impact); 5) How do you evaluate the domestic outreach efforts of your government? (Not much has been done in contrast to G8 outreach.); 6) What should your government and the G20 do to increase the domestic support for G20? (Hosting G20 in Japan. APEC is getting a lot of attention this year precisely because of this reason.)

As you know, one of the most important items on the agenda of the Toronto G20 Summit meeting last June was fiscal discipline in the wake of the Greek crisis of 2009-2010. After the Lehman shock, all industrial countries provided fiscal stimulus to prevent their economies from slipping into a deep recession. Thus, many countries, including the United States and UK, ran budget deficits exceeding 10 percent of GDP. Nearly all of EU countries also ran deficits exceeding the budget-deficit limit that is provided for in the Stability and Growth Pact. Greece was particularly a problem because the new government that came into office found out that the predecessor government had run deficits of more than 13 percent of GDP, but that had been hidden from the public through accounting manipulations. Therefore, speculators sold out in the Greek bond market, and the EU and IMF together had to bail out Greece. That much is well known.

Other European countries, which are dubbed PIIGS (Portugal, Ireland, Italy, Greece, Spain), all share the same problem. The US and UK have huge budget deficits as well. Thus, the conservative government in Canada, which had already embarked on fiscal tightening itself back home, decided to make this an important issue at the Toronto summit. In particular, Prime Minister Stephen Harper proposed that all industrial countries in G20 halve their budget deficits in three years (in other words, by 2013). But this posed a big problem for Japan. Japan also has big budget deficits (40 trillion yen this year or about 8 percent of GDP). Also public debt, which is an accumulated amount of budget deficits over the years, is 190 percent of GDP, which is by far the highest among the OECD countries. The economy is still very fragile, and any talk of cutting raising taxes is political suicide in Japan.

However, Prime Minister Naoto Kan had another idea. Before becoming prime minister after his predecessor Yukio Hatoyama resigned, he had been financial minister and listened to the Ministry of Finance officials who were determined to put Japanese fiscal policy on a sounder footing. The Finance Ministry had prepared a fiscal consolidation plan, which would halve the Japanese primary balance deficits by 2015 and to bring the primary balance into the positive domain by 2020. But it was not clear how this could be achieved. With obligatory social-welfare spending rising with the ageing of society, spending cuts are very hard to achieve, and the only realistic option is to gradually raise the consumption tax, which stands at 5 percent. The opposition party, the LDP, had suggested raising the consumption tax rate to 10 percent.

So what happened is as follows. On the morning of June 16, Prime Minister Harper talked to Prime Minister Kan on the phone and talked to him about the Canadian proposal about a fiscal consolidation pledge at the Toronto G20. Kan agreed. On the following day, Prime Minister Kan had a press conference and mentioned that the consumption tax could be raised to 10 percent. Granted, he did not say that he would raise the tax to 10 percent; here, he merely suggested that that might be a possibility. But the damage had been done. His popularity began to slide. This was particularly a bad timing because the elections for the upper house of the parliament (the Diet) had been scheduled for July 11.

Before going into G20, Finance Minister Yoshihiko Noda showed a cautious attitude about the deficit-halving pledge, and the Japanese government managed to be treated as an exception to that G20 pledge. During the election campaign, Prime Minister Kan was very apologetic about his early comment on the consumption tax, emphasizing that he merely wanted to start the policy debate about it and suggesting possible tax rebates for destitute families and so on. However, that was not enough to assuage the fear of voters about the future tax hike, and the DPJ, Kan's party lost a majority in the upper house of the Diet. Because of the superiority of the lower house where he still have a majority, Kan can still keep his job, but it is already known that passing bills from now on will be enormously difficult.

That is the end of my story, which contains certain lessons. First of all, many items on the G20 agenda, especially those pertaining to fiscal policy, are intimately connected with domestic politics in each of the participating countries. Thus, these entanglements that I have just described will continue to happen, not just in Japan but in many other countries. That suggests that agreements on these issues are very difficult if not impossible.

Second, if there is a conflict between international cooperation and domestic politics, as in Japan's case, domestic politics trumps international agreements. Governments, especially democratic governments, have to be supported by their legislatures, which are elected by voters. Thus, governments with no support from legislatures and voters will fail. No international pledge made by such weak governments is credible.

Third, it is curious in my episode that Kan did not mention the G20 in his discussion of consumption taxes. It had been customary in Japanese politics to use *gaiatsu* (foreign pressure) as an excuse to carry out painful reform at home. I do not know if this is the legacy of the LDP, which the DPJ wants to walk away from, or if the G20 still lacks the same degree of effectiveness as Uncle Sam to serve as *gaiatsu*.

My story does not imply that other issues, such as the tightening of financial regulation which is supposed to be agreed to at the Seoul G20, will face the same fate. Governments tend to have more leeway in more arcane matters of prudential regulation as well as monetary policy, the exclusive domain of the central bank. In these cases, domestic politics may not bite as much as my case shows.

In the rest of the chapter, let me give specific comments on David Brady's chapter. Professor Brady has given us a very useful primer on the Congressional constraints on the President in conducting foreign policy. He notes that due to its peculiar institutional rules (filibuster, cloture, etc.), the Senate is a greater constraint on Presidential leadership than the House. There is also a contrast between domestic and foreign policy: due to a greater degree of uncertainty involved, the Congress tends to defer more to the President in foreign policy than in domestic policy. In foreign policy, however, trade policy is somewhat special, partly due to the more partisan nature of the policy and also the direct impact that trade policy has on the constituencies of the Senators and the members of Congress.

These domestic constraints on foreign policy are the bread-and-butter aspect of democracy, and to understand the feasibility of international agreements in the G20 and other forums, these issues are very important. That is why the organizers of this conference have set up a separate panel on the domestic dimensions of the G20 and global governance.

The questions still unanswered by his chapter are as follows:

- What about the domestic constraints imposed by the public opinion, interest groups, and other domestic actors? I suppose that the public opinion has the same rally-around-the-flag pattern as Congress as far as security crises are concerned, but how about the economic crises like the one we have witnessed since 2008?

- What is the nature of domestic constraints on other policy areas that are dealt with in the G8, G20, and other international forums? In the area of monetary policy, the central bank (i.e., the Fed) has an enormous amount of independence from the government. Does that pose a particularly significant problem for the United States or not?

- Global governance is closely tied to globalization, and anti-globalization forces are still strong in many advanced industrial countries, including the United States. The Seattle protest in 1999 readily comes to mind. Are the anti-globalization (and indirectly anti-global governance) forces getting stronger or weaker?



## CHAPTER THIRTEEN

### **The Challenge of Parliamentary and Public support: The Indonesia Case**

Natalia Soebagjo, Universitas Indonesia

Unlike the United States, Indonesia is a nascent democracy, just a little over a decade old with its institutions still in flux. Since the fall of Soeharto and the rebirth of democracy in Indonesia, Parliament is clearly no longer the rubber stamp parliament of pre-1998 Indonesia. It has been strengthened to balance and keep in check the role of the executive branch, so much so that the Indonesian presidential system seems to have been weakened by the virulent legislative branch. Public perception, however, of the Indonesian legislature is very negative, particularly during the era of current President Susilo Bambang Yudhoyono.

Members of the House of Representatives (DPR) during SBY's first term of office were tainted by sexual scandals, corruption and a bad working attitude reflected in the low attendance levels of meetings. The current batch has not proven itself to be much better, although in fairness, the members have only been in office one year with their term ending only in 2014.

It is doubtful, however, that they will be able to carry out their legislative, supervisory and budgetary duties effectively. As many as 70% of the 560 representatives are newcomers who need time to learn the political ropes and to fully appreciate the weight of their responsibilities. Thus far, there are already indications that they will most likely fall short.

During this term, the Parliament has targeted the completion of 70 bills but only 7 have been discussed and one actually passed concerning the revision of the law on clemency. Too much attention has been on Parliament's supervisory function. Unfortunately, the perception is that this function is being used as a tool for negotiations with the executive branch to extract political concessions. This was evident in the protracted Bank Century case questioning the government's decision to inject US\$716 million to bail out the bank during the global financial crisis. The hearings ultimately led to the removal of pro-reform Finance Minister, Sri Mulyani Indrawati, whilst the case itself remains pending.

Regarding its budgetary duties, the Parliament has shown itself to be insensitive to the economic hardships faced by their constituents. Recently, the public was shocked by the announcement that a new building will be constructed for House members, complete with a

swimming pool, fitness center, and spa facilities at the cost of US\$178.6 million. They had also submitted a proposal for state funds amounting to US\$1.7 million to be allocated for each house member, ostensibly for the benefit of their constituents. The public quickly dubbed it as a pork barrel scheme aimed at vote buying.

When politicians are too pre-occupied with short-term political gains, foreign affairs are not high on their list of priorities. Moreover, the national legislature is not directly involved in the formulation of the country's foreign policy. Hence it is not surprising that there has been very little discussion about the G20 in the Parliament. Within the government, Deputy Trade Minister, Mahendra Siregar, has been appointed Indonesia's sherpa for G20 to lay the groundwork for the meetings, working in cooperation with the Ministry of Foreign Affairs' Director-General of Multilateral Affairs.

As the third-fastest growing economy in the G20, after China and India; a major energy and commodity exporter; Southeast Asia's largest economy and the only ASEAN member to be in the grouping; as well as being a major security force in the region due to its strategic importance; and the world's third largest democracy, Indonesia has earned the credibility to become a strong voice for the developing world. As such, the Parliament supports Indonesia's more assertive role in G20, although they question whether the government has a clear concept of what Indonesia's role should be.

At the G20 Summit in June 2010, the Indonesian government offered several initiatives, namely greater financial access for developing economies, tackling climate change, governance reform of the World Bank and the IMF, and resuming the stalled WTO negotiations. Indonesia also emphasized the need to pay special attention to the needs of the developing countries. Coordinating Economic Minister, Hatta Radjasa, considers the G20 as a forum for leveraging Indonesia's clout to push new agendas.

These are, however, grand issues which have not caught the attention or the imagination of current House members who are more concerned with domestic issues and international issues from which they can gain greater political mileage. About Commission I, for example, overseas foreign affairs, defense and information was very vocal in its criticism of the government's recent handling of maritime border tensions with Malaysia, but this was spurred by strong public reaction against the detention of three inspectors from the Indonesian Maritime Affairs and Fisheries Ministry by the Malaysian Marine Police. Earlier, Indonesian officers had arrested seven Malaysian fishermen for trespassing and illegally fishing in Indonesian waters. Disputes with Malaysia frequently occur, whether it is caused by border tensions, abusive treatment of Indonesian workers, or claims over cultural heritage. House members quickly react to such "popular" disputes because the public is particularly keen to express its outrage against what they perceive as Malaysia's arrogance.

Hence, in trying to bring the G20 into the minds of the people, the challenge lies in generating enough public awareness of the G20 to stimulate greater discourse in the Parliament. The issues of the G20, the need for strengthening global governance, and even of

globalization, are, for want of a better word, too abstract to grasp. Very few understand these issues, including among House members themselves. Even so, according to Roy Morgan, a market research company, 60% of Indonesian still think that “globalization creates more problems than it solves” (Jakarta Post, July 6, 2010).

Such thinking is strong amongst anti-globalization NGOs which issued a joint statement in July 2010, rejecting Indonesia’s perceived “unreserved” involvement in the G20 and entrapment by the neo-liberal international economic system, calling instead for the Indonesian government to return to an economic system which is more people-oriented as mandated in the State Constitution. Signatories to this declaration are the Institute of Global Justice, International NGO Forum on Indonesian Development (INFID), Koalisi Anti Utang (Anti-Debt Coalition), KruHA (People’s Coalition on Rights to Water), Migrant CARE, Serikat Petani Indonesia (Farmers’ Union) and WALHI (Friends of the Earth Indonesia). Their views, however, rarely appear in the mainstream media.

The business community, however, welcomes the G20 which some view as a good mechanism for greater global coordination to steer the world economy out of its recession. Wariness of the G20 stems from the grouping’s plan to phase out subsidies for fossil fuels, an issue which is politically sensitive and directly impacts the poverty-stricken population. Should this plan be implemented, no doubt the G20 will be very much debated by the public, albeit in most likely negative terms.

What is needed, therefore, to generate domestic support for the G20 is to “localize” the issues. The government should bring the issues down to the level of how the grouping’s decisions impact on the lives of the people, such as farmers, SMEs, manufacturers and the like.

One area which can generate the support of the Indonesian people is the G20’s commitment to fighting corruption, an issue which Indonesia is seriously attempting to overcome. The Working Group meeting, which Indonesia co-chairs together with France, convened in late September 2010 to discuss the G20 Agenda for Action on Combating Corruption, Promoting Market Integrity, and Supporting a Clean Business Environment to formulate a common approach towards effective global anti-corruption regime and promote the UNCAC, to which Indonesia is a signatory. Indonesia’s leadership in this Working Group reflects Indonesia’s political commitment to the global effort and, for anti-corruption activists in Indonesia, will ensure that the Indonesian government will not back down from the challenging task of combating corruption in a country renowned for its systemic corruption.

What is also needed, according to Kemal Stamboel, former Chair of Commission I and now a member of Commission XI overseeing Economics, Finance, National Development Planning Board, Banking and Non-Bank Financial Institutions Affairs, are more Indonesian figures to play bigger roles on the global stage and in global institutions, with whom Indonesians can identify. Talk of Indonesians heading the FAO – or even the UN – reflects

this ambition. Former Finance Minister Sri Mulyani being appointed as the Managing Director of the World Bank was seen by many as a positive step.

The G20 is clearly keen to involve national constituents in its processes. Last month, Dr. M. Hidayat Nur Wahid MA, Head of the Inter-Parliamentary Working Group, together with Ir H. Azam Azman Natawijana of the Democrat Party, participated in the G20 Speakers' Consultation in Ottawa, Canada on the invitation of Noel Kinsella. This was the first of such consultations organized in the G20. The purpose is to allow the Parliament to give input to their governments regarding the follow-up to the recommendations made in Toronto in June 2009. Items on the agenda included food security, the economic model and global finance. With his constituents at home in mind, Nur Wahid suggested that developed countries allow developing countries to protect their key agricultural products from market liberalization, and to allow greater participation of farmers in policy making. How this can be achieved, however, depends on how Nur Wahid and fellow members of the Parliament engage with the public in raising these issues in the public's minds.

President Susilo Bambang Yudhoyono correctly pointed out in Toronto, "the concrete result of the G20 Summit would decide the public's trust in G20's role in the face of the global financial crisis." In order to gain public trust, however, the Indonesian government must first present a clear plan of what it hopes to achieve from being an assertive voice in the G20, how such a role would benefit the Indonesian people and most importantly how to convey its message effectively to the people if it expects greater participation from the public.

PART IV

*The G20 and International Cooperation for Climate control*

## **CHAPTER FOURTEEN**

### **The G20 and International Cooperation on Climate Change**

Soogil Young, Presidential Committee on Green Growth

There are three main venues for climate control: United Nations Framework Convention for Climate Control (UNFCCC), Major Economies Forum on Energy and Climate Change, and the G8/G20 Summits. The UNFCCC is the main venue where global response to the climate change is discussed and negotiated. The UNFCCC can only deliver so much; it is unlikely to yield a global compact that leads to control of greenhouse gas emissions. Therefore, the G20 Summit must be used as a supplementary instrument with which to enforce the UNFCCC process. The two venues can support each other, and with luck, we may bring climate change under control. The UNFCCC was launched in 1992, and under this convention, the parties get together each year for discussion, studies, and negotiation. This meeting is called the Conference of the Parties (COP). The COP 15 was held last year in Copenhagen, Denmark, and the number of signatories numbered 192 as of December 2009. The Kyoto Protocol constitutes a legal agreement which opens the avenue for the signatory countries to make a binding commitment for mitigation of global warming. The Kyoto Protocol is in effect until 2012, and it provided the launching of a so-called “post-Kyoto agreement,” which will cover the period from 2013 to 2020, the second commitment period. The second commitment period was first discussed in the Bali Action Plan at the COP 13 in 2007, and was supposed to be concluded at Copenhagen in 2009, but has failed to do so. The draft political document produced, the Copenhagen Accord, will hopefully become a legal document in the COP 16 in Cancun next year, or in subsequent COP meetings if needed. Korea and Dubai are competing to host the COP 18 in 2012, and the outcome will not be known until early next year.

Under the initiative of President Obama, the Major Economies Forum on Energy and Climate Change was first launched in April 2009. Eight meetings have been held thus far, with only one attended by leaders, and the others by ministerial representatives. The G8 has been a continuing process since the early 1970’s, but it was not until the 2005 Gleneagles G8 Summit that the post-2012 regime was first discussed. In the 2007 Heiligendamm G8 Summit, the G8 nations agreed to aim to at least halve global CO<sub>2</sub> emissions by 2050. In 2008, in addition to the Toyako G8 Summit, the Washington G20 Summit took up the issue of climate change. Since then, there has been continuous discussion of climate changes at the G20 and

G8 summits. Climate changes will probably not on the formal agenda of the Seoul G20 Summit in November, but given that the COP 16 will be held in Cancun immediately after, the Mexican president will probably bring up the issue of climate changes and how to conclude the UNFCCC negotiation process.

In the UN Process, one major goal which was agreed to under the Framework Convention was to stabilize greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system, and for advanced countries to reduce emissions to the 1990 level by 2020. And three principles of emissions reductions were agreed upon: advanced countries should take the lead, developing countries would share common and differentiated development, and developing countries would reserve the right to sustainable development. In the Kyoto Protocol, Annex I Parties – developed countries – agreed to reduce emissions during the first commitment period by at least 5% relative to the 1990 levels. The Bali Action Plan sets up the rules for negotiation of greenhouse gas emission reductions for the second commitment period. There was a distinction between Annex I and non-Annex I parties; the Annex I Parties agreed to national appropriate commitments that are legally binding, whereas non-Annex I parties agreed to undertake nationally appropriate mitigation actions, which are voluntary pledges and not legally binding. These actions would be conditional upon the provision of technology, financing and capacity building assistance by developed countries. Identified key issues include shared vision, mitigation, adaptation, and providing technology and financial support.

What has been the progress under the Bali Action Plan? There has been a series of very painful negotiation meetings. According to Trevor Houser, a senior fellow at the Peterson Institute of International Economics, there are two problems with the Bali Action Plan but is actually inherent in the Kyoto Protocol itself. Legally binding initial reduction apply only to developed countries, which accounted for 60% of total emissions in 1992, but this share will decrease while developing countries' emissions increase over time. By 2050, the developed countries will account for only a small share, while developing countries – especially China and India – will make up most of global greenhouse gas emissions. Non-inclusion of developing countries in the legally binding emission reductions is one problem, while the other problem is that the United States, the largest emitter, is not a party. The complication is that the Bali Action Plan outlines a vision of a comprehensive and environmentally effective approach by requiring mitigation commitments from both developed and developing countries, subject to meaningful financial assistance to help poor countries reduce emissions and adapt to climate change.

Two major disagreements have emerged among the negotiating parties that cause stalemate under the UN process. First, there is disagreement over the legal form of a Copenhagen outcome: the Bali Action Plan calls for “an agreed outcome,” but does this mean “a legally binding international agreement”? The Kyoto Protocol will not legally expire; it calls for Annex I countries to agree to further emission reductions from 2013 and beyond.

The EU wanted a single post-2012 agreement that would merge the architecture of the Kyoto Protocol and the goals of the Bali Action Plan, and also for the U.S. to accept a legally binding target. The Obama administration expressed an interest to accept a legally binding agreement, provided it was legally binding for developed and major developing countries alike, especially China. On the other hand, the so-called “BASIC” group – China, India, Brazil, etc. – had announced more ambitious domestic climate policies leading up to Copenhagen, but were reluctant to have an internationally binding agreement, although they would try. This is understandable, because there are technical uncertainties to realizing a pre-declared target. The BASIC countries wanted two Copenhagen agreements; a second commitment period for Annex I countries under the Kyoto Protocol, and a new agreement consisting of emission reduction commitments from the U.S. and non-binding mitigation actions from developing countries. The second major disagreement that causes stalemate negotiation under UNFCCC requires consensus among all 192 parties to reach a legally binding decision. Disagreement persisted on all core elements of the Bali Action Plan, and the length of legal documents continued to grow as key leading countries tried to narrow gaps among the members. One day before the end of the Copenhagen conference, 30 countries drafted a ‘Copenhagen Accord’ and presented it to all parties and asked for acceptance as a binding decision. In the end, because of the opposition of only six countries – Sudan, Venezuela, Cuba, Bolivia, Nicaragua, and Tuvalu – the decision could not be made. The conference was concluded, “taking note of the document.” The United Nations asked countries wishing to be associated with the accord to notify the secretariat of their intention to do so by the end of the subsequent month.

What are the key elements of the Copenhagen Accord? Mitigation calls for “deep cuts in deep cuts in global emissions, so as to limit the increase in global temperatures below 2 degrees Celsius.” There is no telling how temperatures increases of over 2 degrees Celsius will affect Earth’s climate system, but it will likely spell major disaster for humanity. Annex I parties committed to take on quantified economy-wide targets for 2020 to be listed in Appendix I of the accord, and non-Annex I parties agreed to implement domestic mitigation actions to be listed in Appendix II of the accord by the end of January, 2010. By early March this year, 106 countries have signed up, accounting for about 80% of global emissions and 76% of global population. Trevor Houser ran an economic model to see the environmental impact of the listed national actions against the business-as-usual (BAU) scenario. The atmospheric concentrations would reach over 1,000 ppm by the end of the century, which would equate to a global temperature rise exceeding 4 degrees Celsius. On the other hand, if all countries follow through on their pledges, he concluded that there was still hope and it would be possible to keep global temperature increases below 2 degrees Celsius. On transparency, another key issue, full transparency will be provided on the mitigation actions by developing countries, as well as for the non-Annex I countries that agreed to provide greenhouse gas inventories and report on the effectiveness of their actions in reducing emissions to the



UNFCCC secretariat. This will not be a binding document, but they would try their best to implement what they have pledged by way of mitigating climate changes. This, called the NAMA registry approach, was proposed by the Korean delegation to Copenhagen as a means of bridging the gap between developed and developing countries. There were also provisions on financing, and a ‘Copenhagen Green Climate Fund’ would be established to support mitigation, adaptation, and technology cooperation. Developed countries pledged a combined \$30 billion for the next three years, and \$100 billion per year by 2020. Much of this funding would come through the Copenhagen Green Climate Fund. The United Nations followed up by establishing an ‘Advisory Group of Climate Change Financing.’

What are the prospects, the potential for international action? If countries associated with the accord carry out their commitments, the worst consequences can be avoided. Transparent reporting that has been provided for will increase confidence in this potential. If the promised financing is realized, global emissions will be reduced further and the most vulnerable countries will be better protected from the consequences of climate change. But the COP did not formally adopt the Copenhagen Accord, so the prospects for its effective implementation are not clear. There is a call for the Cancun COP to turn the accord into a treaty, but the underlying issues should be resolved first. These issues are whether there will be one document or not, or in other words, whether to have developing countries legally bound or not, and how to cope with requirements for consensus for the UN process to reach a decision.

There are three options for coping with these two problems. One is the UN Treaty Approach, but as discussed previously, there are problems with this approach. The second is the small-group political approach, which is a politically binding approach that would open up a range of possible negotiating forums other than the UNFCCC. An example is the thirty countries that have drafted and agreed to the Copenhagen Accord; this group, although small, includes all the major emitters and important countries, and could come to a political agreement. Once they undertake actions to implement the agreement among themselves, they could be leading the other groups by example. The G20 and the Major Economies Forum on Energy and Climate Change are another such small political groups. We all know that leaders have heavy agendas and limited time, so one way of having the G20 address this problem is to create an environmental equivalent of the G20 finance ministers’ process. The MEF has a mandate which is focused on climate change, but does not have as much international credibility as the G20. In either case, the G20 or the MEF consists of major emitters, but the most vulnerable to climate countries are small island countries, like Tuvalu. We would have to create extra room for participation by those vulnerable countries. For example, we can set up a “Climate 30” group, consisting of countries that drafted the Copenhagen Accord, and let this group work to produce a political united action on climate change and lead by their own undertaking.

But in the real world, we do not have a choice between the two options; we must take the third option, the hybrid approach that combines the two, in which the small group will

provide political leadership, and their action will be translated into broader action by all participants of the UN process. I think that the Seoul G20 Summit is very unlikely to play this role, given its heavy agenda and its focus on the ongoing financial crisis as well as development agenda. Therefore, this is an approach that may be implemented beginning next year in France.

## **CHAPTER FIFTEEN**

### **The G20 as an Important Forum for Climate Control**

Suh-Yong Chung, Korea University

The 2009 Copenhagen meeting did not turn out to be as successful as it should have. Due to inherent limitations of the framework of the negotiation, being divided by developed and developing countries, negotiation processes had become too political to reach an effective agreement due to serious conflicts between the two groups. Obsessed with the concept of sovereignty as well as historical responsibility, developing countries were not ready to take more action to join global efforts of reducing greenhouse gas (GHG) emissions. As a result, the Copenhagen meeting produced only a non-legally binding and political soft law instrument, Copenhagen Accord, which does not include detailed standards to meet the target recommended by the Intergovernmental Panel on Climate Control (IPCC) to keep the GHG concentration level at 450ppm. It seems true that it might not be possible for the United Nations Framework Convention on Climate Change (UNFCCC) regime to make a significant step towards a more decisive and resolute agreement, unless it finds a way of transforming the politicized negotiation process to one that involves environmental integrity.

It is noteworthy to realize that more than 80 percent of total GHG emissions are made not only by Annex I countries but also by a few major developing countries: China, India, Brazil, Mexico, South Africa and Korea. More importantly, studies indicate that approximately two thirds of the required amount of GHG emission reduction needs to be made by developing countries in order to meet the maintenance target 450 ppm. And only about one third of required amount of GHG emissions needs to be reduced by developed countries. The immediate implication to design a climate change regime is the necessity of developing such a scheme which would allow advanced developing and developed countries to together participate in responding to climate changes without being affected by sovereignty and historical responsibility.

In this context, the G20 looks very attractive. It is a soft forum consisting of major economies both from developed and developing country groups. The G20 is also relatively free from being constrained by the formalized negotiation framework of Annex I vs. Non Annex I. As the summits of the G20 can mobilize strong political momentum to address climate change issues, agreements in the G20 will certainly increase the probability that the

UNFCCC regime to tackle difficult challenges among the members. The importance of the G20 also derives from the fact that a draft of Copenhagen Accord was prepared at the last minute by 25 summits of major economies—most of whom are also members of the G20.

As a matter of fact, the G20 has already been engaged in dealing with climate change issues, particularly since the Pittsburgh Summit meeting in 2009. Issues on climate change that have been considered within the G20 framework include climate financing, energy subsidies, green technologies and industries, low carbon economy and so on. Despite the importance of climate financing to mobilize necessary resources to address climate change, it seems as though there have been divided views on this issue. However, the energy subsidy issue has continuously been discussed within the G20 framework. Issues on green technology and market instruments used to be discussed within the framework of Major Economies Forum (MEF), which has developed in close relationship with the G20.

Emission trading and trade aspects of climate changes have not been actively considered by the G20. While carbon pricing, which includes the issue of emission trading, needs to be addressed in a broader context of climate change control, many G20 members may not be ready to incorporate this specific issue within its framework of consideration. Developing countries may not be ready to introduce the emission trading scheme, which presumes the existence of binding commitment in reducing GHG emissions. Trade aspect of climate change may also not be an appropriate issue for G20. It is mainly because this issue is politically too sensitive to both developing and developed countries and may not be easily addressed by the G20, considering neither of the international forums, WTO and the UNFCCC, can adequately deal with this difficult issue within their scopes of work. In other words, while there are many potential conflicts between addressing climate changes and free trade “in theory,” practical consideration may require either not advancing further into the discussion to avoid the complexity of the issues, or developing a new framework which may facilitate efforts to search for how to harmonize two conflicting issues into one framework.

In fact, many of G20 member countries have introduced their domestic policy measures on low carbon economy (or green growth) as a way of reducing GHG emissions while achieving economic growth. Furthermore, major international organizations such as the World Bank, OECD, UNEP, Asian Development Bank and Global Green Growth Institute (which was launched in 2010 in Korea) have also developed various policies on low carbon economy (or green growth) within their scopes of work.

The G20 should continue to discuss climate change issues by coordinating individual initiatives of states and international organizations. One way of coordinating those initiatives is for the G20 to consider a three step approach of institutionalizing current efforts. The first step may be to initiate the Climate Change (or Green Growth) Dialogue Initiative. Based on this, ministerial level meetings may be further developed among the ministers who deal with climate change and/or low carbon economy (or green growth). At this state, efforts also need to be made to closely utilize already existing mechanisms such as Major Economies Forum

and Clean Energy Ministerial Meeting. Finally, Climate Change Forum with a permanent secretariat may be established.

In this context, Korea, which plays an important role in addressing climate change and promoting green growth policy, should draw much more attention to the issues of climate change. While it is true that it may not be appropriate to have many agendas to be dealt with in Seoul Summit meeting, it need be kept in mind that addressing climate change is an urgent matter, and can be effectively controlled by major economies of the G20. There are still many G20 members who believe it should regard climate change as one of the important agendas within the G20. For example, it is apparent that Mexico (who will host the next UNFCCC COP16 meeting in 2010 as well as next year's G20 meeting) strongly wants G20 members to discuss issues of climate change in the upcoming Seoul G20 Summit meeting. The Seoul G20 Summit should continue discussions on climate changes among the summits so that it can provide a good platform for climate change issues to be considered in the upcoming G20 meetings.

## **CHAPTER SIXTEEN**

### **What Form of Global Governance for Climate Change?**

Thierry Soret, United Nations Development Programme

Since the Conference of the United Nations Framework Convention on Climate Change (UNFCCC) in December 2009, most of the critics of its outcome tended to blame the framework in which the Copenhagen Accord was noted. Because of its universal membership, its negotiation procedures and rules, where each of the 192 member states has a voice, and its decision-making processes requiring consensus-building, the United Nations has been blamed for failing to reach the agreement responding to the pressing challenges of climate change. The rationale behind this argument is that taking into account too many divergent interests in such a diplomatic process hinders the swift collective action.

If the Conference of Parties in Cancun (COP 16) in December does not advance enough on climate change mitigation and adaptation, attacks against the United Nations might be even harsher, by criticizing its inability as a Forum to enable a comprehensive agreement.

This presentation provides the counter-argument: Even though governance reforms are needed, the United Nations should stay at the center of the international process aiming at providing the global public good of climate stability, and delivering inclusive, effective and coherent global policies in the face of climate change challenges.

#### **Issues at stake in climate change global governance**

Climate change is one of the defining development challenges of our time. It is more than a global environmental issue; it threatens to reverse recent progress in poverty reduction and economic growth and poses grave risks to the attainment of the Millennium Development Goals (MDGs). Both in our current time and over the long run, climate change puts human development at risk by restricting the fulfillment of human potential and by disempowering people and communities in reducing their livelihoods options. As such it also might threaten international security and peace. Consequently, a global governance system is required to address climate change challenges.

The following features underpin global governance of climate change:

- A collective action challenge. Given the state of international relations (states remaining basic units and key decision-makers, heightened tendencies toward multipolarity heading to a new global balance of economic powers, lack of common approaches to the issue), the Copenhagen Conference and the negotiation process faced a “traditional” collective action challenge, that is enforcing an international set of rules or incentives that would foreclose free-riding and ensure international cooperation in preserving the climate stability.

- A set of common but differentiated responsibilities. The consensus rule in the UNFCCC implies to take into account “*common but differentiated responsibilities and respective capabilities*” to address this challenge. Short term interests are not necessary converging. On the contrary. Broadly speaking, developed countries are responsible for the most part of carbon stocks already accumulated in the atmosphere and wish to implement green economy strategies; large emerging economies are mainly responsible for carbon flux and want first to consolidate their economic development; and remaining developing countries, that carry the least responsibility for this phenomena and need to adapt (and thus require developed countries financing to do so), might bear the brunt of its damaging impacts.

- A scope of analysis beyond realism. Climate change cannot be tackled unless the major greenhouse gas emitters buy into an international framework. From a pure realist viewpoint, there is no climate change exception in international relations: the Copenhagen Accord is a result of negotiations between countries’ positions determined by their demographic trends, macro-economic interests, and strategic interests linked to energy policies. However, the realist approach cannot fully embrace the essence of the climate change challenge: Each government has no choice but to seek international cooperation and collective action, in order to protect its citizens against the cross-border ravages of it. It is a problem that is greater than national interest.

- Addressing the burden-sharing issue. Climate change is a cross-cutting and cross-border issue that has repercussions in terms of economic development, environment protection, migration, and international security. With climate change each country’s welfare and security tends to become partly dependant and sensitive on development policies led by other countries, and the most vulnerable are often the least accountable for climate change damages. Therefore, the burden-sharing issue can be put this way: how to allocate an effort both in terms of greenhouse gas emissions reduction and financing for adaptation, taking into account different situations in terms of historical responsibility, level of development, affordability?

## **What kind of arrangements to tackle climate change?**

Governments can select between two types of arrangements to pursue their international cooperation: either using the international setting of treaty-based institutions in order to

deliver global public goods (*i.e.* the UNFCCC is aimed at achieving the global public good of climate stability); or setting up informal arrangements and building *ad hoc* cooperation groupings in order to deal with issues of common interest. Such groupings, which bring together countries sharing certain characteristics, common interests or willingness to address cross-border issues, are generally perceived by their promoters to be more capable of taking swift collective action than the full-fledged machinery of more inclusive international bodies. This underlying logic has underpinned the establishment of such groupings, including the G7, the G20, and the Major Economies Forum on Energy and Climate (MEF). Recently, by convening an increasing number of leaders'-level meetings, these informal groupings have sought to provide political leadership for collective action even though they have no decision-making power and have to rely on treaty-based institutions to implement some of their decisions.

Could a way forward come up with combining formal and informal arrangements? A clear division of labor between informal and formal arrangements combining the inclusiveness of the UN's negotiating forums with a powerful engagement of the world's major emitters could be helpful. This way forward would be based on:

- The formal set of institutions which use their expertise to incorporate scientific findings into the negotiation process, compile national efforts at monitoring, verifying and reporting (MRV) emission reduction targets, and promote low-carbon climate-resilient strategies, policies and measures in developing countries (UNFCCC, IPCC, UNEP, UNDP, World Bank, regional development banks, etc.);
- Informal arrangements between major economic powers (G20, MEF) in order to give impetus and reach agreements on GHG emission targets. This “group of responsibility” or “coalition of willing” would provide leadership on mitigation, and could have a spillover effect to the formal negotiation process.

However, splitting up these two kinds of arrangements would be ineffective. There is strong evidence that an agreement on GHG emission targets within the G20 or the MEF could not suffice on its own to designing a global strategy. On the contrary it would give incentive to free ride in many other countries rather concerned by their short-term industrial and economic development than by the long-term climate stability. This kind of ‘prisoner dilemma’ stalemates progress in informal groupings, and climate stability forms part of these global public goods (Barrett, 2007) that require both an aggregate collective effort (*i.e.* global carbon emission reduction) and the involvement of the “weakest link” in collective action (*i.e.* adaptation financing in developing countries).

Therefore, coordination of mitigation and adaptation policy agendas, including technology, capacity building, and finance, is critical for reaching consensus on climate issues.



## A new 'mini-lateralism' on climate change?

Let us remind ourselves of the need to build on the Copenhagen Accord. For the first time in 18 years of negotiations, all the major GHG emitters, both developed countries and emerging economies alike have acknowledged that they have specific individual responsibilities to reduce their emissions. The Accord also makes some progress in establishing the responsibility of all major emitters to transparently report and be monitored on their efforts, and to cooperate with international analysis of them, in order to demonstrate that their claimed reductions and efforts are real (Para. 4). According to the terms of this accord, a registry in which mitigation, technology and capacity building measures seeking international support should be set up. These supported actions would be subject to international measuring, reporting, and verification. Furthermore, parties agreed to continue their negotiation process in all thematic areas (mitigation, adaptation, technology, capacity building, forestry mechanism, and finance) with a view to adopting firm decisions at the next Conference of Parties (COP 16). However, it is fair to recognize that preparation process of COP 16 in Cancun is not paving the way for such an outcome.

Is it necessary to encourage "mini-lateralist" initiatives? The current process has led some decision-makers to consider only "mini-lateralist initiatives" (Naim, 2009) as building blocks of an agreement, that is, within the universal UNFCCC framework, adopting various practical and flexible approaches, and making the group of major emitters the focal point for efforts to actually reduce emissions, and then reporting their results to a larger UN wide body and ask for broader support. Other small groupings bringing together countries sharing common approaches and/or interests could usefully contribute to the negotiation process and the consensus-building (ex: The African Union is representing the interests of its members in the current process).

Mini-lateralism may be necessary but not sufficient. Even though these 'mini-lateralists' initiatives could succeed in giving impetus to overcoming mutual mistrust and uncertainty among states regarding their respective intention in terms of mitigation (e.g. prisoner dilemma), their ability to reach global consensus depends on their financing for adaptation response. A big emitters' agreement has to take developing countries' financing needs for adaptation into account to get traction. As recently stated by Ghanaian Foreign Minister Muhammad Mumuni, before the UN General Assembly, poorer nations may soon experience a "*promise fatigue*" if developed countries do not carry through pledged funds, including the \$30 billion of fast-track funding for developing countries through 2012 committed at the Copenhagen Conference: "*For developing countries, the early delivery and transparent allocation of this money will boost our confidence in the dialogue and also show that industrialized countries are truly committed to progress in the broader negotiations*".

For the most vulnerable developing countries in the face of climate change, especially small islands whose existence is threatened, the only place where their voices can be heard and their interests fully taken into consideration is the UN system framework. The UN Framework, in particular the Copenhagen Green Climate Fund planned as operating entity of the UNFCCC in all major areas, would enable the necessary funding to flow appropriately.

Therefore, the international community should not build on new institutional schemes to address climate change challenges, but rather seek to make these two tracks of climate change mitigation and adaptation converging. Leading these two processes in parallel would be quite ineffective. Big emitters need to agree on carbon emission reduction targets but have to move concretely forward at the same time on financing for adaptation, especially in the most vulnerable countries. Any small grouping could be helpful in consensus building, but at the end of the day a global framework aiming at achieving the Climate stability global public good is needed. It is a matter of urgency because many people are already suffering from the damaging impacts of Climate change.

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PART V

*Going Forward and East Asia's G20 Leadership*

## CHAPTER SEVENTEEN

### **The Korean G20 Presidency and Evolving Global Governance<sup>1</sup>**

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The Group of 20 nations (G20) has effectively replaced G7/8 as the world's premier forum on economic cooperation after the global financial crisis revealed how much the world is interconnected from trade and finance to environment and democratized with the surge of middle powers. The G20 proved its capability to respond to a crisis as the member countries harmonized their stimulus packages and the IMF tripled its lending resources to stave off currency shocks. The world is now witnessing the evolution of the G20-centered hierarchical multilateral system, with the G20 providing a flexible problem-solving framework for global governance.

But skeptics predict the eventual dissolution of the G20 in doubt of its political will and leadership to enforce any agreements under the current structure. The coming years will test the sustainability of the G20 as it moves towards the transition from an emergency crisis committee to a standing global steering committee to reshaping the global economic order and leading the reforms of international financial institutions. Global public goods are quickly expanding beyond traditional issues such as security, financial stability and market opening to terrorism, climate change, environment, epidemics, poverty and organized crime, and they all require higher level of international cooperation and governing rules. Many experts agree that the G20 can succeed if it offers comprehensive agenda and leadership reflecting broader interests with some institutional consolidation, effective decision-making and legitimacy.

The G20 reflects the dramatic changes in the distribution of power since the end of the Cold War, and represents a more democratized world on international economic issues. It provides an open stage where major emerging and advanced nations discuss pressing global issues on an equal footing, unlike international organizations either with a two-tiered arrangement or weighted voting system. At the same time, however, the G20 is vulnerable to gridlock stemming from the polarization of interests between advanced and developing countries. Therefore, the success of the G20 largely depends on the foresight and leadership

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<sup>1</sup> A previous version of this chapter was released as a working paper (10-03) by Hills Governance Center at Yonsei University.

of leading developed and developing countries. It also helps if there are honest brokers or neutral arbiters between the two groups. There are only a few countries who can take the role as a middle power belonging to neither of the two camps of large developed and developing countries. Possible candidates are Spain, the Netherlands, and the Scandinavian countries in Europe, Korea and Australia in the Asia Pacific, Turkey in the Middle East, Mexico and Argentina in Latin America. But the European countries have little incentives to drive the global governance reforms as they have to give up some of their influence at the international institutions to rising states. The Latin American countries have always championed the interests of developing countries while Turkey is beginning to find its global role. The circumstances present more opportunities and challenges to Korea and Australia as a middle power. Korea, in particular, is well-positioned to mediate between the two camps as it has risen from one of the poorest countries in the world to a wealthy member of the OECD. Furthermore, only a few countries - Korea, Australia, the U.K., namely- see the G20 as the ideal platform for global cooperation. Many other members are less optimistic or even apathetic.

Against the backdrop, Korea became the first non-G7 country to host and chair the G20 summit. Korea is making every effort for its success, as this is the first official debut as an active and responsible player in the global decision-making stages. Many participants in the G20 meetings have lauded Korea's leadership in terms of agenda-setting, coordination and mediation, global communication, and organizational capacity.

Korea has contributed significantly to the G20's establishment and evolution. It determined from the very first beginning to aggressively lead the global discussions on ways to fight the global financial crisis as it was one of the biggest victims in the 1990s. President Lee Myung-bak called for a standstill on trade protectionism at the first G20 Summit in Washington two years ago. Korea's contributions have been particularly noteworthy in the areas of common interests both for the developing and developed countries, as it defines its role as a bridging power between the two camps. Korean initiatives at the Seoul Summit include global financial safety net and development for the poor countries. The idea of the financial safety net designed to help shield the emerging economies from external shocks has attracted strong interest from those vulnerable to international capital flows. Korea has propelled the IMF's efforts to get rid of the stigma effect destroying the credibility of borrowers and shift its mandate from a post-crisis bailout fund to a pre-crisis prevention insurer. The IMF recently enhanced its existing Flexible Credit Line (FCL) and introduced a Precautionary Credit Line (PCL), hoping the moves will help facilitate the efforts for global rebalancing by reducing the need for emerging countries to accumulate foreign reserves as self-insurance against volatile global capital flows. Korea is seeking the ways for the IMF lending facilities to link up with various regional arrangements such as the Chiang Mai Initiative in Asia.

Korea's presidency of the G20 also presents an opportunity to bring development issues to the table. With its vivid memories of successes and failures, Korea has already pushed for development agenda and multi-year action plan, including a pledge to duty-free, quota-free market access for low-income countries. The initiatives could make the G20 Summit a much more inclusive and relevant event for the entire world as it can bring more than 170 non-member countries into the G20 arm.

In addition to agenda-setting and coordination, the Korea government has demonstrated its commitment to effective consensus-building and global communication in the run-up to the G20 Seoul Summit. It hosted the World Bank and IMF conferences alongside the meetings of finance ministers and central bank governors in Korea and invited most top government officials from Africa to hear their opinions about the G20 agenda and build up a consensus on the development issue. It also plans a gathering of more than 100 chief executive officers from Fortune 250 companies during the Seoul Summit in a bid to reflect the private-sector views when political leaders discuss the global issues and concerns. The "business summit" may become a regular sideline event of the annual G20 Summit as France, the next chair, is to host a similar meeting.

The Seoul Summit also aims to achieve macroeconomic coordination with detailed policy recommendations for each individual member country to develop the Framework for Strong, Sustainable and Balanced Growth. The uneven and slowing global economic recovery sparked a currency war, with the U.S., China and Japan beefing up the battle to grow through exports. Another key agenda is to overhaul the IMF, especially the shift of 5 percent in quota to underrepresented members from the over-represented countries. Korea as the chair works hard to hammer out agreements on most of the controversial issues by November.

Despite the impressive efforts, Korea still faces many challenges in establishing its leadership in the global community. Its vision and strategy on the G20 and global governance is not yet clearly articulated and communicated. Korea supports the need of and an international agreement on the reforms but its vision about global governance is ambiguous. It needs to pursue global public goods more than its own national interest in order to effectively show its leadership as a middle power, and secure international reputation as a fair player in everybody's interest. Korea also has to provide soft-power leadership with knowledge and services for others. The government and private-sector experts should take more active roles in the global negotiation tables, while research institutes and civil groups contribute to the global knowledge market. The task requires long-term investment. The government should take the initiative in building knowledge capacity on international organizations and nurturing experts and specialists.

As a mediator, Korea should best not take any side, but instead approach to every issue in a balanced and flexible manner. But balance and rationality become useless in the absence of principles and vision. A leadership without principles and vision cannot obtain trust from others. Korea should provide strategic guidance, showing the way where the G20 should be

headed for. The G20 lends a rare chance to make international organizations more accountable. Global governance can improve significantly if the G20 works as an effective steering committee for international financial organizations, assessing their managers and holding them accountable. The current loose system cannot bring about a breakthrough to the international bodies. The G20 should not rely excessively on the IMF for administrative works when it leads and oversees the reform. The G20 needs its own secretariat or investigative body. Korea should lead the G20 into becoming a global governance watchdog as part of its efforts to institutionalize G20.

## CHAPTER EIGHTEEN

### **Power and Responsibility: Can East Asian Leadership Rise to the Challenge?<sup>1</sup>**

Jongryn Mo, Yonsei University  
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#### **East Asia before and after 2008**

A recurrent complaint of East Asians is their under-representation in the system of global economic governance (Mahbubani, 2008). They question the continued dominance of the United States and Europe in the International Monetary Fund and World Bank when East Asia's economic power already matches and is likely to soon surpass that of Europe and the United States.

The exclusion of East Asia is more than just a fairness issue. Some East Asians maintain that global governance would benefit from East Asian participation, as the West has shown itself incapable of handling critical global problems in finance, trade, security and the environment.

But do East Asians have valid grounds for complaint? Not if we look at East Asia's position at the G20, a group of twenty large economies.<sup>3</sup> As the G20 took center stage in the international effort to manage the 2008 economic crisis, it is clear that the representation of

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<sup>1</sup> This chapter, which was previously released as a Hills Governance Center at Yonsei Working Paper (09-01), covers developments as of September 2009.

<sup>2</sup> This chapter is based on interviews on the future of G20 conducted in New York, Washington, and Seoul in the last week of August 2009. The authors would like to thank IL Sakong, Jongoo Yi, Heenam Choi, Christian Oliver, Evan Ramstad, Joongi Kim, Scott Snyder, Yul Sohn, Youngnam Cho, George Downs, Yotam Margalit, Wonsoo Kim, Enna Park, Ellen Kang, Roderick Hills, Jerry Hyman, Reza Moghadam, Jeff Lewis, John Hamre, Domenico Lombardi, Raymond Gilpin, Kent Hughes, Dick Thornburg, Uri Dadusch, Nancy Birdsall, Steven Schrage, Laurence Krause, Barry Eichengreen, Kenneth Dam and Edwin Truman for their insights and comments.

<sup>3</sup> G20 countries include G7 members of advanced industrial economies (United States, United Kingdom, Japan, France, Germany, Canada, and Italy), G5 members of large emerging markets (China, India, Mexico, Brazil and South Africa), O5 members of middle powers (South Korea, Australia, Indonesia, Turkey and Argentina) and Russia, Saudi Arabia and the European Union.



East Asia in the system of global economic governance had increased significantly, suggesting that the East Asian grievance has finally been addressed.

At the G7/8, only one East Asian country, Japan, represented East Asia. But at the G20, the number had risen to six (Japan, China, India, South Korea, Australia and Indonesia). Simple arithmetic would put East Asia at 30 percent (6 out of 20) of global economic power under the G20, a doubling of its 14 percent (1 out of 7) share at the G7. The East Asian share would be even greater if the world economy were to be managed between the United States and China as many supporters of the G2 would predict.

The world is now watching how East Asia will exercise its new-found power and responsibilities. It is one thing to demand for more rights but quite another to shoulder the responsibilities that come with them.

But the East Asian record so far is mixed at best. While East Asian leaders customarily express support for the G20 process and agreements whenever they meet on the sidelines of G20 meetings or in regional forums,<sup>4</sup> they are far from becoming a distinctive group, let alone speaking with a united voice within the G20. The only clear case of East Asian unity at the G20 finance ministers' meeting happened in 2006 when East Asian countries demanded greater representation in the governance of international financial institutions.

This tardiness in the emergence of an East Asian leadership and vision has many causes. Regional identity is historically weak in East Asia. Many East Asian countries such as China are still in the midst of ensuring balanced and sustainable economic growth, so domestic considerations and stability is their top-most priority. Mutual suspicions among East Asian countries, rooted in historic rivalries and failed reconciliations, pose yet another barrier. With weak regional identity, it is not surprising that regional institution-building is embryonic with many recent projects initiatives such as APEC stalled.

East Asian loyalties are also divided. Some East Asian countries such as China may identify more strongly with developing countries than with other Asian countries. Japan may also consider itself as a developed country rather than an Asian country. The United States too is partially responsible for the state of divided East Asian allegiances. While American military allies in East Asia such as Japan, South Korea and Australia tend to coordinate their policies with the United States, non-American allies like China and India pursue a more independent policy line.

But the most important reason for the lack of East Asian leadership and initiative at the G20 is the inability of East Asian leaders to come to terms with their new responsibilities. Long accustomed to the practice of demanding a greater voice or relying on American

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<sup>4</sup> Joint Press Statement of the East Asia Summit on the Global Economic and Financial Crisis. Bangkok, June 3, 2009; Japan-China-ROK Trilateral Summit Joint Statement on the International Finance and Economy. Fukuoka, December 13, 2008; Joint Message, Trilateral Finance Minister's Meeting among China, Japan and Korea. Washington, DC, November 14, 2008.

leadership, East Asian leaders do not appear comfortable, and are generally ill-equipped with the idea of exercising independent East Asian leadership.

East Asian nations will realize that global governance is incomplete, even ineffectual, without regional coordination. Just as geographic representation is an important basis of representation in any country's governance system, it is arguably even more so within the global governance system. Almost all major international organizations employ a constituency system to select member countries for their governing bodies which is based in part on geographical representation.

The G20 will be no exception. As the G20 makes its presence felt, regional representation will become more salient as member countries turn to regional coordination out of practical necessity. Through their regional representatives, nonmembers will also demand representation at the G20, as they increasingly question the legitimacy of G20 membership.

To improve the role of East Asia in global economic governance, East Asian leaders, first and foremost, should step up to the challenge of independent leadership and begin to think deeply about what they want to do with their new power. Given that global imbalances are the structural main source of global financial instability, East Asia must work together with other regions to make East Asia's growth less export-dependent and help reduce East Asian trade surpluses. East Asia can also help make global economic governance more representative and legitimate. China and India have long represented the interests and concerns of developing countries. Korea as a middle power is also well positioned to play a mediating role between advanced and developing countries.

Second, East Asian leaders should strengthen their regional institutions in line with the restructuring of global economic institutions. Even though various regional arrangements such as East Asian Summit, ASEAN+3/6, China-Japan-ROK Tripartite Summit and Ministerial Meetings exist in East Asia, they are not yet strong enough to support East Asian coordination at the global level or implement G20 agreements at the regional level. As the dual process of globalization and regionalization continues in the world economy, an isomorphism between global and regional institutions is likely to emerge, and it is unlikely that East Asian can participate effectively in global decision-making with the machinery provided by regional institutions.

### **The structure of global economic governance transformed**

Let us first explain how East Asia was able to claim a larger share of global decision-making power after the onslaught of the economic crisis which erupted in 2008. As we will see from our account, the way East Asia garnered more power and representation, which remains informal and needs to be further consolidated, reflects a variety of forces at play in the international system.

First, it is important to understand the current structure of global economic governance. There are two parallel structures, one formal and the other informal. Formal institutions are international organizations which can be further divided into governing bodies and executive bodies. One such formal governing body in the area of global economic governance is the United Nations Economic and Social Council. Executive bodies whose mission is to carry out the mandates granted by governing bodies include specialized agencies under the UN system such as the International Monetary Fund and World Bank.

Apart from formal institutions, there are also informal governing and executive bodies. Various groups of countries form informal forums such as the G7/8 and the G20 to discuss international economic issues and when they are influential, they act as de facto governing bodies that give directions and guidance even to formal international organizations such as the IMF. International standard-setting bodies (ISSBs) such as Financial Stability Forum and Basel Committee are also informal organizations as their decisions are not legally binding. They should also be considered as executive bodies to the extent that they draft rules and regulations according to the governing bodies' guidelines.

Given the existence of formal institutions, why is there a need for informal governing bodies within the global economy? According to Laurence Krause, an informal group is one of three institutions necessary for an effective governance system: an umbrella institution in which all major players are represented and deliver prepared speeches, an informal institution in which confidentiality is critical, hard questions asked, and confrontations can take place, and a respected IMF that does an annual bilateral examination of countries that scrutinize the appropriateness of financial policies. Under Krause's framework, the United Nations clearly plays the role of an umbrella institution for the global economy, while the G20 has emerged as an important informal institution that functions as what Eichengreen (2009) calls the "steering committee" for the world economy.

When the crisis called for new global institutional arrangements in 2008, world leaders chose to work with informal arrangements. There have been no changes in the governance of the United Nations and the Bretton Woods Institutions (BWIs). What has changed instead was the composition of influential informal organizations. The G20 has replaced the G7/8 as the primary informal governing body in dealing with the crisis. The Financial Stability Forum has also been expanded and reconfigured to become the Financial Stability Board. Membership in other international standard-setting bodies such as Basel Committee on Banking Commission expanded to include the G20 members who were previously excluded.

Why the preference for informal governance over formal governance? One obvious reason is the lack of confidence in formal institutions. Despite many decades of reform efforts at the United Nations and the IMF, the governance structures of formal organizations had remained largely unchanged. The problem with formal institutions is that they tend to freeze the political relationships that existed at the time of their founding. The distribution of power at the United Nations still represents that of the period immediately after World War II.

IMF reform is no different; the position of the managing director is still reserved for a European candidate even though Europe is not the only economic powerhouse in the world worthy of candidacy. The perception that international organizations are unwieldy was compounded when countries practically gave up the completion of the Doha Development Agenda in 2007.

There are also advantages to informality. A crisis demands a speedy response, and a formal international organization is not a place for swift decision-making. Leaders also needed a framework under which they could discuss ideas informally and build a consensus before taking it to the next step. Quick decisions made at an informal forum have the added advantage of building confidence among investors and giving assurances to anxious publics.

The most significant decision made in response to the 2008 crisis was to use the G20 as the primary vehicle for consensus-building rather than alternative arrangements like the G7/8. Economic realities precluded the use of the G7/8 which was a club of rich developed countries. Any resolution of the crisis required the cooperation of large emerging economies, especially China, who held large foreign currency reserves and whose growth was critical to world-wide economic recovery. So world leaders had to find a grouping that would include key emerging economies.

But which emerging economies to invite and which to exclude became a thorny issue. One option was to add the G5 (Brazil, India, China, South Africa and Mexico) to the G7/8 to form a G14. Europeans were generally sympathetic to this idea, and French President Nicholas Sarkozy explicitly endorsed it in 2008. But the United States preferred a different set of emerging economies as G5 countries tended to oppose the United States on important economic issues.

As the host of the first emergency conference of leaders, United States could not just decide arbitrarily. At this point, the existence of the G20 became handy. The G20 had met since 1999 as a meeting of finance ministers of 20 major economies. It was launched that year by G7 finance ministers in a bid to involve emerging economies in discussing financial market stability in the aftermath of the 1997 Asian financial crisis. Until 2003, the G20 had focused on crisis prevention and management, but since 2003 long-term issues had been added to its agenda.

Given the difficult choice of country selection, the United States decided for the sake of expediency in November 2008 to invite the leaders of the G20 countries to a summit meeting. The five additional countries (South Korea, Australia, Turkey, Argentina and Indonesia) other than G8 and G5 members were countries generally friendly towards the United States.

## **G20, East Asian Participation, and International Relations theories**

From an international relations theory perspective, the choice of the G20 as the primary decision-making body should be viewed as an attempt on the part of the international community to accommodate rising powers into a rules-based multilateral system. The fact that rising powers have agreed to join the G20 is an indication that they are also interested in negotiating a new system of governance with established powers. An open clash between rising and status quo powers for global hegemony, which the power transition theory predicts (Organski, 1958), is not yet a serious possibility.

The elevation of the G20 also means that the club model of multilateral cooperation is still a preferred mode of global governance. According to Keohane and Nye (2000), government representatives from a relatively small number of relatively rich countries have formulated rules in each issue area of global governance. The G7, the Quad at GATT (the United States, the European Union, Japan and Canada), and the five countries with “appointed seats” at the IMF Executive Board (United States, United Kingdom, Japan, France and Germany) are examples of clubs who dominated the decision-making at multilateral organizations of their respective domain.

These old clubs are being replaced not by formal multilateral institutions but by the newer and larger clubs such as the G20. The realities of the anarchic international system still seem to dictate the reliance on what Keohane and Nye described as “network minimalism” which refers to “a set of practices for governance that improve coordination and create safety valves for political and social pressures, consistent with the maintenance of nation-states as the fundamental form of political organization.” The G20, for example, is networked because it is a horizontal network of nation-states rather than a set of hierarchies, and minimal because state autonomy is strongly guarded. To be effective in today’s global environment, however, an organization based on network minimalism must expand participation by non-governmental actors such as civil society groups, give more independence to government agents in increasing multilateral cooperation, and develop international norms.

International relations theories are silent on whether or not revamped or expanded clubs will succeed, and if they do, what substantial differences they will make to global policy outcomes. The durability of a consensus-based group such as the G20 will depend on its capacity to deliver legitimacy, effectiveness and the requisite changes. The kind of policies the G20 uses to achieve its goals are also important. Will they fundamentally depart from the policy prescriptions of neoliberalism or the Washington consensus or represent a relatively marginal remodeling of the neoliberal model?

To a large extent, the preferences and strategies of two new groups to global decision-making, emerging economies and East Asian countries, will shape the future evolution of G20 and the global governance system as a whole.

## East Asia's performance at the G20

We can get a glimpse of the impact of East Asia on global governance by examining the record of its collective G20 performance. The G20 was not created anew in 2008; it has a longer history dating back to 1999 when it began as a finance minister's meeting.

The overall impact of East Asia on the G20 in the pre-crisis period is fairly unclear, even ambiguous. But in at least two instances, the chair rotation decision in 2002 and China's chairmanship in 2005, East Asia was recognized or acted as one group.

When the G20 finance ministers' meetings institutionalized the selection of future chairs in 2002, it decided to rotate the chairmanship annually among five notional groups of countries. Groups for G20 chair rotation were divided largely geographically. Under this scheme, four East Asian countries, China, Indonesia, Japan and Korea, were grouped together as one cluster. Australia belonged to another group with Canada, Saudi Arabia and United States while India was grouped with Russia, South Africa, and Turkey. At the pre-crisis G20, geographical representation was as important as level-of-development representation; the G20 members agreed that "there should be an equitable annual rotation among all regions and between countries at different levels of development" (G20, 2007, p. 23).

The fact that East Asia was institutionally recognized as one region by the G20 had important consequences. When an East Asian country was selected as the chair for a particular year, it was to consult closely with other East Asian members as the representative of the East Asian group. Apart from proposing agenda issues for the G20, a chair also plays host and provide logistical support to the G20 ministerial meeting.

The chairmanship of China in 2006 was another instance where East Asian impact could be observed. As the G20 chair, China focused on two issues, development and growth, and the reform of the Bretton Woods institutions (BWIs). The Chinese emphasis on development was consistent with China's long-standing policy of supporting developing countries. Moreover, Asian representation at the IMF and the World Bank had been a major issue for many rapidly growing emerging economies, especially those in Asia. Under Chinese chairmanship, the G20 finance ministers' meetings began to address the BWI reform in earnest and issued a statement in which it reaffirmed "the principle that the governance structure of the BWIs – both quotas and representation-should reflect (such) changes in economic weight" (G20, 2007, p.36). Under G20 pressure, IMF governors agreed in 2006 to increase quotas for countries considered most under-represented at the IMF – China, Korea, Mexico and Turkey.

Although the pre-crisis record of East Asia at the G20 is illustrative, it should not be over-emphasized. The G20 before and after 2008 are two fundamentally different organizations. Although the post-crisis G20 kept most of the practices of the pre-crisis G20, most notably, membership and the troika system, it had to formulate new rules and processes in accordance with its new status as a leaders' meeting. In 2009, for example, G20 leaders met twice, so

ministers meetings were held more often than before to prepare for the summit meetings. Calendars also had to change; the annual ministerial could no longer meet in November of each year as it had done before 2008.

The elevation of the G20 to the summit level raised the stakes for all member countries. Issues and decisions of greater consequence were discussed at G20, forcing G20 leaders to guard their national interests more carefully. As a result, the post-crisis G20 is far more likely to reveal the shape of the emerging system of global governance system than the pre-crisis G20.

Unfortunately, East Asia has not shown much leadership so far. As Seward (2009) puts it mildly, East Asian countries at the G20 summits were “not viewed as leading the agenda.” In some issues such as financial regulations, East Asian G20 members expressed little interest or have no strong positions. There were also few indications that East Asian countries had coordinated their positions at the post-crisis G20.

Some complain that East Asian countries seem content with having won a seat at the G20 without thinking about what they intend to do with their power (Subramanian, 2009; Glosserman, 2009). Parell-Plesner (2009) also observed that East Asian countries are more interested in individual branding than in regional branding. Worse, when East Asian countries unite, they seem to do so only when their direct interests are at stake, e.g., the redistribution of power at international financial institutions.

Without East Asia acting together, the main antagonists at the G20 have been United States and Europe on financial reforms and the developed countries and the emerging economies on governance reforms and development support. The United States and Europe disagree mainly on the strength of financial regulations. While Europe favors strict regulations on financial institutions and new financial instruments, the United States supports more market-compatible regulations.

The primary agenda of emerging economies at the G20 has been to increase finance for development and reform the governance of international financial institutions such as the IMF and the World Bank. They would like to transform the IMF and the World Bank into an organization that represents or promotes the interests of poorer countries and people. The practice of imposing conditionalities on developing countries seeking financial support, in particular, is their main source of grievance with the IMF and the World Bank.

East Asia has two sub-groups. China and India tend to represent the interests of developing countries and appear neutral in areas where the United States and Europe have conflicts. Being nationalistic, both China and India are wary about the expanding reach of international regulatory bodies that may infringe upon their policy independence. America’s East Asian allies, Japan, South Korea, Australia and Indonesia, have supported the positions of the United States, especially, with respect to issues of contention between the United States and Europe.

The leadership capacity of each East Asian country is not to be doubted even at the G20. Individual East Asian countries did contribute to the success of the post-crisis G20 and Soesastro (2009) describes their contributions as follows:

“China stepped forward on all fronts, with the promise of a significant elevation of its role in the funding and governance of the IMF. Japan made a substantial contribution to the expansion of IMF liquidity. Indonesia pursued an effective agenda on easing the bottleneck in trade credit. Korea was a staunch advocate of the standstill on trade barriers. India pursued the expansion of credit to the developing world. And Australia played a key in framing the entire strategy and in the diplomacy that won support for it.”

What is lacking is collective initiative and close coordination on the part of East Asian leaders at the G20.

### **East Asia and the future of the G20**

Another source of uncertainty is East Asian commitment to the G20. Officially, all East Asian G20 members support the G20 as an alternative governing body for the global economy. But on the question of giving priority to G20 over other arrangements, they seem to have different views, depending on the availability of alternative arrangements.

The O5 countries (South Korea, Australia, Turkey, Argentina, and Indonesia), which are now in the G20 but not in G7/8, have the greatest interest in the maintenance of the G20 and are likely to support the primacy of the G20 over other groupings. If the G7/8 expands to a G13 or G14, the largest emerging economies, BRICs or G5, will surely be invited, but not O5. Unsurprisingly, two G5 countries, India and China, are not as committed to the G20 as O5 countries. Although China supports the G20 as “a useful institution,” it may actually favor a G14 over the G20 if it is asked to choose one over the other. China has been very open to the idea of G14 and has been supportive of the G8+G5 meetings in Japan and Italy. China’s support for the G14 is consistent with its emphasis on the expanded role of BRICs in global economic governance.

As long as the G20 remains the status quo, however, China will prefer it to the G7/8 or G2. China has been critical of the G7/8 and would not join it as a matter of principle. China has traditionally advocated the interests of developing countries and does not consider it appropriate to join an exclusive club of developed countries. Neither is the G2 (the United States and China) viewed positively by China. Chinese officials do not think that China is ready for such a role or that the United States is sincere in treating China as an equal partner. More importantly, China fears the economic burden that will be accompanied by its elevation to a G2 status, e.g., the forced revaluation of the Yuan.

The attitude of the lone Asian G7 member, Japan, toward G20 is also ambivalent. Even though Japan is generally supportive of the G20, many Japanese intellectuals are quick to



point out the limitations of the G20 and the advantages of the G7 process (Ogoura, 2009). The Japanese reaction is not unexpected, since Japan's status under the G20 is relatively diminished than under the G7. But if Japan is asked to choose between the G20 and the G14, however, it will, like the United States, favor the G20 because it has better relations with the O5 than the G5. Again, the current status quo of coexistence of the G7/8 and the G20 is likely to remain unchanged for the foreseeable future. Given this, it is hard to imagine any East Asian country actively promoting an alternative grouping to the G20. Thus, as long as the G20 is in place, East Asian countries will use the G20 framework to achieve their global economic objectives.

East Asian positions on the legitimacy of the G20 are also likely to vary across individual countries. Although all of them will be unenthusiastic about tinkering with the status quo arrangement, especially, when there is no consensus on alternatives, the degree of openness to proposals to expand membership or introduce a constituency system will depend again on the attractiveness of alternative groupings. China, India and Japan would feel secure enough to support the constituency system while the others, the O5, would be less receptive to such a proposal.

Institutionalizing the G20 (e.g., the creation of a permanent staff and secretariat and the regularization of the G20 Summit) would face the same configuration of supporters and opponents. O5 countries are likely to support the formalization of the G20 process while G5 and G7 countries would not be as supportive. So whether or not the G20 will firmly establish itself as the primary governing organization for the world economy will depend on the leadership of the United States, who sees itself as the founder of the G20, and O5 countries, who are likely to lose their privileged positions in an alternative grouping. Bretton Woods institutions would also prefer to work with the G20 because of the overlapping nature between G20 membership and their executive boards. The International Monetary and Financial Committee (IMFC) of the IMF consist of 24 members.

While the G20 is not a perfect solution to the problem of global economic governance (Eichengreen, 2009), it is also true that there is no clear alternative to the G20. This lack of alternatives is the most compelling reason for our optimism about the future of the G20. If the G20 takes roots as the de facto governing body for the world economy, what will the future of the global economic governance system look like? Although it is still too early to predict, the performance of the G20 had so far indicated that the United States is likely to maintain its leading position in the global economic governance system. Other G7 members have a common interest in preserving the U.S.-led status quo system. G5 countries are also reluctant to undertake radical changes either because they are averse to such changes or because they do not feel ready to assume the costs of leadership, such as further contributions to international organizations or currency realignments.

The basic liberal nature of the international economic system will also continue. Even East Asian critics of Western leadership in global economic governance concede that East

Asia does not have to invent new principles to improve global governance; the Western principles of democracy, the rule of law, social justice and openness should continue to guide the world economy (Mahbubani, 2008).

In maintaining the liberal international economic order, the role of O5 countries will be crucial. As relatively small and open economies, it is in the interests of O5 countries to keep the international economic system open and rules-based. As the “swing voters” at G20 between two G20 voting blocs, advanced and large emerging economies, the O5 is likely to enjoy a disproportionate amount of influence at G20. Among O5 countries, three, Korea, Indonesia, and Australia are East Asian countries. Recognizing their strategic positions, they are planning to cooperate (Parello-Plesner, 2009). President Lee Myung-Bak and Prime Minister Kevin Rudd, for example, contributed an op-ed piece together to the *Financial Times* (September 2, 2009), calling for G20 leadership in macroeconomic policy coordination.

### **The Impact of East Asian participation on regional governance**

The G20 is also expected to make a positive contribution to East Asian regionalism. One reason is that the demand for A6-centered regional coordination will increase under the G20 framework. Already, East Asian leaders hold bilateral or trilateral talks on the sidelines of the G20 summit. China, Japan, and Korea, for example, used informal meetings during the November 2008 Washington Summit to boost their bilateral currency swap agreements.

East Asian G20 members will have to coordinate their positions at least in three areas. First, they will be induced to cooperate on issues of common interest. Public statements by East Asian leaders indicate that there are at least three objectives that they can agree on at the G20 (Rieffel, 2009). First, they are unanimous on the need for greater representation of East Asia at the IMF executive board and the subsequent reduction of European representation. Second, all East Asian countries have an interest in maintaining the value of the United States dollar as they are the largest buyers and holders of U.S. government securities. Third, East Asian countries consider themselves as beneficiaries of the open trade system and have vested interests in the continuation of the open trading system.

Second, regional forums and mechanisms can help implement G20 statements and action plans. At a minimum, East Asian leaders can support and reaffirm G20 agreements in their regional meetings like the APEC Summit. They can also discuss regional measures necessary for effective enforcement of G20 agreements such as stronger regional financial surveillance and regulations.

Third, non-G20 members will put pressure on G20 members to represent their interests at the G20, or take joint action to hold them accountable if they find the G20 outcomes unsatisfactory. So consultations between G20 members and nonmembers will occur more

frequently. Six Asian G20 members (A6) are likely to use both G20 meetings and existing regional mechanisms (ASEAN + 3, ASEAN + 6) for regional cooperation.

If regional cooperation at the G20 accelerates, the A6 is well-poised to become a governing body for regional economic governance. Some already have already called for the creation of an “East Asia Caucus” as an informal regional forum, consisting of the A6 or A6 plus a few other countries (Young, 2009; Shiraishi, 2009; Sukma, 2009; Parello-Plesner, 2009). The A6 can begin as an informal discussion group but gradually transform itself into the steering committee for regional financial institutions such as the Asia Development Bank and the Chiang Mai Initiative (CMI). If East Asia creates an Asian Financial Stability Dialogue (AFSD) (Drysdale, 2009) as a regional financial regulatory body, akin to the Financial Stability Board (FSB) for the world economy, and turns the CMI into the Asia Monetary Fund (AMF), the basic structure of East Asian regional governance will parallel that of global economic governance. As the G20 oversees IMF, FSB, and the World Bank, the A6 may do the same for AMF, AFSD, and the ADB.<sup>5</sup>

### **Will East Asia rise up to the challenge?**

For the time being, the dual structure of informal inter-governmental coordination (G20) and formal executive bodies (the IMF and the World Bank) is expected to govern the world economy. It is not an exaggeration to say that East Asia holds a decisive vote in this new global governance system. But whether or not East Asia will exercise its power effectively is still a moot possibility at this juncture. To meet this historic challenge, East Asian countries should first set aside their national ambitions and embrace the emerging system of global economic governance. No global system of governance is perfect, and East Asia must help the emerging dual system to succeed, especially since there is no clear alternative in sight.

Second, East Asia must offer independent leadership. Even though it is important to move cautiously and support the liberal system led by the United States, East Asia must have its own liberal vision that sets itself apart from the US model. Otherwise, East Asia cannot play undertake a constructive role in a consensus-based governance system.

Third, East Asia must strengthen its regional institutions. G20 coordination increases the demand for regional coordination, and vice versa. East Asia cannot be effective at G20 without the support of East Asia as a whole and with the regional policy implementation machinery provided by regional institutions.

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<sup>5</sup> It is important to acknowledge the existence of significant barriers to East Asian economic regionalism such as the place of the United States in East Asia and China-Japan rivalry for regional leadership (Grimes, 2009).

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