

International Financial Governance: Toward the London G20 Summit

Meeting of UK Officials with Brookings, CFGS and CIGI Experts

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On February 9, a team from Brookings Institution, Centre for Global Studies and Centre for International Governance Innovation convened a Chatham House rule conference in London with senior British government officials. The conference reviewed ideas and possible initiatives for the April 2 London Summit. Prime Minister Gordon Brown kicked off the day with an address and Q & A session, which was open to the press and invitees from U.K. business and civil society.

Prime Minister Brown highlighted the need for international coordinated action on three fronts: recapitalization of banks, monetary policy and fiscal stimulus. He noted that poor countries have been severely affected (net flows cut from \$1 trillion per year to \$160 billion). He cited the risk of new protectionism in the financial arena. He declared that the international financial institutions need to be fundamentally reformed. The International Monetary Fund (IMF) needs to strengthen its role in surveillance, akin to an independent central bank, and needs new resources (loan facilities, trust funds, new types of bonds and increased Special Drawing Rights). The World Bank and regional development banks have to “sweat” their resources to support the emerging economies and poor countries.

The Prime Minister repeatedly referred to the April 2 Summit as the “G-20 summit.” He emphasized the extensive consultation process to hear the views of non-participants.

In response to a question on the road forward for the various G summits (G7, G8, G8+5, MEM), Prime Minister Brown noted the need for an effective global executive, a continuing presence able to take on functions that are continuous and regular. Aside from the financial crisis, he noted that there is no international organization to provide a funding mechanism for supporting energy efficiency and environmental change in developing countries and even in emerging markets. He concluded:

“...institutions that were shaped in the 1940s are no longer adequate for the tasks of 2009. It will need a bold leap forward to reshape them in such a way that they actually perform functions that you need to have performed...You are going to need some permanent presence of a world

body dealing with these economic problems if we are going to make greater progress in the future.”¹

In the first session on IMF Resources and Governance Reforms, characterized as “a problem like a Rubik’s Cube with 30 sides”, there was consensus that the IMF required substantially increased resources but lacked credibility for surveillance,² early warning and “bite without teeth marks”; and that emerging economies shun the IMF and would rather self insure by persistent trade surpluses. We need more ambitious governance reform, more resources and less conditionality.

Proposals for G20 Leaders’ decision and commitment on April 2 included:

- Cooperation on national fiscal stimulus packages and market access;
- A “Grand Bargain”: greater role for emerging economies and poor countries in the governance and decision making in IMF in exchange for less self-insurance: “Grand Bargain” may be a more effective refrain than the current London Summit’s “Stability, Growth, Jobs”;
- An immediate general Special Drawing Rights allocation of up to \$275 billion to provide a signal and incremental resources to poor countries (US Congressional approval not required);
- Leadership selection reform (merit-based selection) with the US and EU yielding their traditional right of appointment to heads of the World Bank and IMF: this would be a down payment on governance reform, setting the stage for a reduction in European Executive Board seats, revisiting quotas and perhaps double majority voting (European acceptance of reduced votes would probably be contingent on the US giving up its veto);
- Reopening last year’s insignificant outcome on IMF reform;
- Agreement that the IMF monitor fiscal stimulus in all countries.

We should avoid an “Edifice Complex” – building new institutions takes time; focus April 2 should be on short term deliverables. There was unanimous concern that new forms of protectionism are appearing and the summit should categorically come out against these.

Other ideas presented included:

- Care should be taken grafting new instruments on weak institutions, lest fragmentation weakens them further;
- The IMF should look beyond the balance of payment business – the test should be whether a country can usefully apply the support;
- To improve accountability, the Executive Board should be chaired by one of its own members;
- To reform quotas, G20 Leaders should make a political statement about the desired reform, instructing their Ministers to work out an appropriate formula;
- Options for “directing” the SDR increase to poor countries and for global public goods should be explored;

¹ <http://www.londonsummit.gov.uk/en/media-centre/latest-news/?view=Speech&id=13475210>

² We must abrogate the developed countries informal “mutual non aggression pact”.

- Rather than relying on one means of increasing resources, a menu should be explored, including bilateral loans and the Fund borrowing from the market.

In the second session the discussion focused on the challenges of increasing global regulatory capacity:³

- How to get the U.S. to accept that being part of a global supervisory system is in its own long-term interest;⁴
- How to expand the representation of the Financial Stability Forum (FSF) and fix its relationship with the IMF, and how to proceed with the idea of “colleges of supervisors”;
- How to define the perimeter of regulation (i.e., which financial institutions and/or functions to monitor);
- How to supervise/reform management incentives;
- How to stem tendencies of financial protectionism.

The third session focused on reform of the World Bank. Given the dimensions of the global economic crisis, there was a consensus that:

- The World Bank and the regional development banks should mobilize (“sweat”) their capital base and front-load concessional resources flows. In particular, the Asian Development Bank needs an early capital increase;
- A temporary relaxation of cumbersome safeguard procedures should be devised, with wider use of ex-post audits.

We reiterated that the G20 should announce that the US and EU have decided leadership should henceforth be based on merit rather than nationality.

More substantive proposals for governance reform were tabled and had considerable support among the experts, including a high-level non-resident Executive Board, and double-majority decision making.

In the concluding sessions, while most agreed that the G7/G8 could no longer function as a global steering group, there was no consensus among key governments on the successor. There is no prospect of emerging economy countries empowering international institutions unless they have effective voice and vote. Effective voice must also be given to poorer countries. The European overrepresentation is a particularly debilitating factor. The Washington summit was not restricted to only G20 members; nor may the April 2 event be limited to the countries in the G20 Finance Ministers group. There were 46 seats around the table in Washington, and there may be more on April 2. The large number around the table is worrisome, since the larger the group, while enhancing representativeness and legitimacy, the less likely it will be an effective executive steering group. The position of the US administration will be critical but is currently unknown. Points made were:

- A G20 at Leaders’ level is a pragmatic interim step in summit reform;

³ See the background paper by Morris Goldstein at http://www.l20.org/publications/42_FT_Dig-into-the-IMF's-Tool-Kit-to-Lessen-Impact-of-Crisis-on-EMs.pdf.

⁴ The Chinese will not be persuaded to support reform, if they believe the US will not be scrutinized and that reform is an exercise to add tools to attack China. But if they are persuaded, a larger Fund would reduce the need for large Reserves, and they may relax their position on their exchange rate.

- Restoration of global confidence will be helped by a clear commitment of leaders to the G20 summit as the key forum where the global crisis will be addressed and monitored;
- The G7/G8 could continue, perhaps best as a caucus within the G20;
- The Leaders G20 remit should eventually be expanded to include trade, climate change and other pressing global issues;
- To provide a blend of continuity and follow up with flexibility, a G20 secretariat could provide technical and logistical support, but should be kept lean and nimble. It could be led by the Sherpa Troika (in 2009, it would be led by the UK Sherpa, with Brazilian and Korean vice-chairs);
- The G20 will have to reach out to those countries not included; eventually, an IMF type of constituency approach may have to be explored;
- 2010 will represent a key challenge to Korea as chair of the G20, and opportunity for Canada as the chair of the G8, in determining the future of the G8 in its relationship with the G20;
- Having built a world based on private capital flows, the need is for a fallback at the centre that can stand in when private flows dry up; we have to protect innocent bystanders;
- We may need new institutions to handle collective action problems like climate change, where in this zero sum game, it is necessary to have the appropriate set of monitoring and sanction capacities to ensure “the other guy doesn’t cheat”;
- One way forward would be an agreement for G20 Leaders to meet again in the fall, with a remit to Sherpas to prepare for Leaders’ consideration options for updated mandates, new institutional machinery and arrangements, and reformed governance structures.