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# The New Landscape of Global Economic Governance: Strengthening the Role of Emerging Economies

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# THE NEW LANDSCAPE OF GLOBAL ECONOMIC GOVERNANCE
***Strengthening the role of emerging economies***

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## Abbreviations

| | |
|---|---|
| ACP | African, Caribbean and Pacific group |
| ASEAN | Association of Southeast Asian Nations |
| BRICs | Brazil, Russia, India and China |
| BWIs | Bretton Woods Institutions |
| COP | United Nations Climate Change Conference |
| DDR | Doha Development Round |
| DFQF | Duty Free Quota Free |
| EXIM | China Development Bank and China Export-Import Bank |
| EU | European Union |
| FDI | Foreign Direct Investment |
| GATT | General Agreement on Trade and Tariffs |
| G7 | Group of finance ministers from seven industrialised nations |
| G20 | Group of finance ministers from twenty industrialised nations |
| G77 | Group of seventy seven developing countries |
| GDP | Gross Domestic Product |
| GFC | Global Financial Crisis |
| GHG | Green House Gas |
| GSTP | Global System of Trade Preferences among Developing Countries |
| IR | International Relations |
| LCA | Long-term Cooperative Action |
| LDCs | Least Developing Countries |
| LICs | Low income countries |
| IBRD | International Bank for Reconstruction and Development |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| ICBC | Industrial Commercial Bank of China |
| ICSID | International Center for the Settlement of Investment Disputes |
| IDA | International Development Association |
| MFN | Most Favored Nation |
| MIGA | Multilateral Investment Guarantee Agency |
| NICs | Newly Industrialised Countries |
| OECD | Organisation for Economic Cooperation and Development |
| PPP | Purchasing Power Parity |
| SDR | Special Drawing Rights |
| SDT | Special and Differential Treatment |
| SSA | Sub-Saharan Africa |
| TRIPs | Trade Related Aspects of Intellectual Property Rights |
| WB | World Bank |
| WBG | World Bank Group |
| WWII | Second World War |
| WRI | World Resources Institute |
| WTO | World Trade Organisation |
| UK | United Kingdom |
| UNFCCC | United Nations Framework Convention on Climate Change |
| US | United States |

## 1. Introduction

Institutional arrangements and international agreements consolidated and created since 1945 for global economic governance are facing new challenges and opportunities in the light of newly industrialised and emerging economies. This paper examines how the governance of global economic institutions might develop in the years to 2020 given the entrance of these new actors into a system that used to be dominated by Western European and North American interests. It also examines the new roles of the EU in this.

In some cases existing structures are being challenged as a direct result of the food, fuel and financial crises which erupted in 2008, the ramifications of which are still ongoing. In other cases, we draw attention to how new forms of global economic cooperation are arising, and existing governance structures being reinforced with new actors making full use of the rights provided to them. We discuss the evolution of the G20, the IMF, WTO, and the UNFCCC.

New forms of cooperative relationships towards global economic governance are unlikely to evolve unless the structures, objectives and norms of these institutions are better aligned with the preferences of emerging powers. This provides the EU, which also accommodates divergent economic interests across its member states, with a role to facilitate the progress towards a multi-polar world that seeks cooperation in order to advance its own interests.

We discuss the extent to which changes in the governance of global economic institutions are currently reflective of shifts in economic power, which are likely to accelerate in the years between now and 2020. We argue that the extent to which existing institutions are able to incorporate new actors and accommodate their interests effectively within them will determine how they might be retained, strengthened or weakened by 2020.

There are risks of continued perceptions of illegitimacy, if the new emerging actors and their interests are not effectively included within existing institutions. In addition, there are risks of potential redundancy if existing institutions are unable to adapt and deal with the challenges posed by both the level, pace and shifts in the drivers of globalisation expected up to 2020. Instability and insecurity would damage the weakest countries most. But the effective inclusion of the new emerging powers could also assist such countries better advance their own developmental interests.

The structure of this paper is as follows. Section two provides a brief overview of the growing wealth and distribution of power across the newly industrialised and emerging economies in the international political economy, emphasising China's status as a major new power alongside Europe and the

US. The possibility that other developing states will become major powers is also considered.

Section three proceeds to contrast these developments with the governance role of the new emerging powers within global economic decision making bodies such as the G20, IMF, WTO, UN and UNFCCC. Where appropriate it distinguishes between new emerging actors and their interests, so as to avoid making generalisations about objectives, and to assist in the sensible articulation of potential alignments of spheres of influence with the EU.

Section four explores the implications for the EU and its role within global economic governance and identifies potential synergies with and strategies for collaboration with the new emerging actors up to 2020. Distinct strategies are articulated for different types of interests with new emerging powers and related institutions so as to facilitate the transition towards a peaceful multi-polar order during the coming two decades. Section five concludes.

## 2. Shifting patterns in economic power

The last decade has been characterized by shifting patterns of production and trade as the purchasing power of newly industrialized countries and other large emerging economies has started to catch-up dramatically to traditional Northern markets. These changing patterns of demand, and supply, have been accelerated by the impacts of the global financial crisis, and are set to continue. If the 18$^{th}$ and 19$^{th}$ centuries represented a great divergence in per capita incomes and growth between the 'West and the Rest', and the 20$^{th}$ century was characterized by convergence between a few countries in East Asia and the 'rise of the rest' and a bimodal distribution of world income[1], the 21$^{st}$ century is likely to see the convergence of the many in terms of income, but divergence in relation to growth. This is because most growth up to 2020 will be driven not by the West, but by the rest which includes large emerging economies, such as India, and newly industrialized countries such as China.

In 2003, Jim O'Neil of the investment bank Goldman Sachs coined a new term, "BRICs," describing four fast-growing economies – Brazil, Russia, India and China – and their likely impact on the distribution of wealth in the international economy in the coming half-century.[2] Given current growth trajectories, and assuming political and institutional stability, it is considered likely that by 2050 Brazil, Russia, India and China would replace four Western European countries (Germany, Italy, France and the UK) and take their place alongside the US and Japan in the pantheon of the world's six largest economies. Despite its relatively simplistic forecasting and classification[3], the intuitive appeal of the piece - that the phenomenal growth

[1] See Quah (1996, 2002) who analysed cross-national convergence in incomes, but not within country inequality.
[2] See Wilson and Purushothaman (2003).
[3] The criteria are based around a country's size, demographics and its growth potential.

and large size of these economies meant that they were likely to change the distribution of power amongst states in the coming century - ensured that the term “BRICs” entered the modern lexicon.

Since then it has been recognized that the term excludes many other emerging markets that also contribute substantially to global GDP, but also that the term emerging markets is too broad to really distinguish between those countries becoming wealthier *and* likely to initiate changes in global economic governance structures. The number of countries that exhibit similar characteristics to the BRICs is growing and the list created in 2003 is being added to, most recently in 2011 through the inclusion of Mexico, South Korea, Turkey and Indonesia.[4] We use the term BRIC+ to refer to these countries (these countries are the emerging powers in the G20).

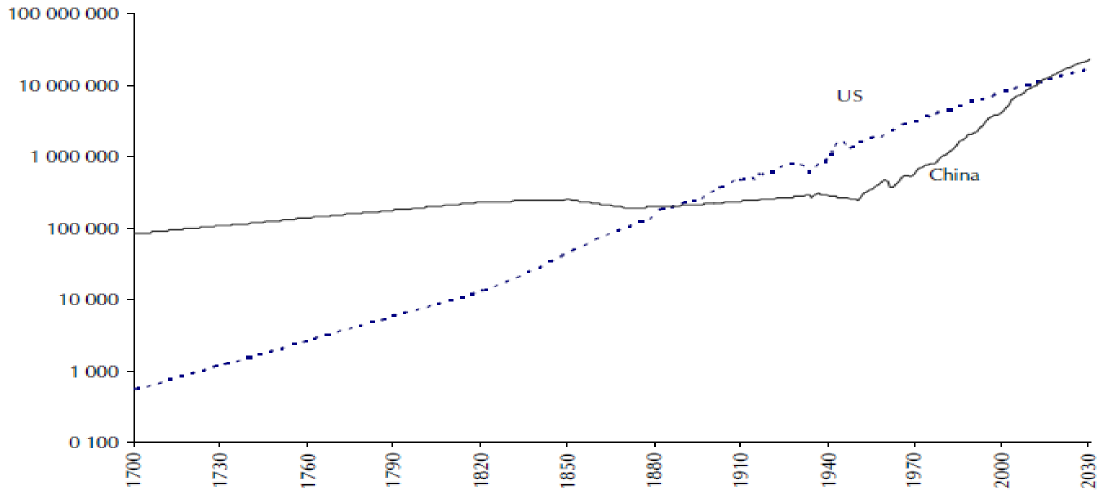
The BRIC + countries are identified based on their potential as emerging *markets*, “growth economies”, and not as emerging *economies*. The term emerging markets valorises countries as a source of demand for goods and services produced (or sold) in the West, rather than as economies developing their own financial services, own globalised production networks etc. Although the recognition of the future economic power of new emerging economies is increasingly being recognised, there are some shortcomings in the methodology used to classify countries which may either over or understate the potential role of these countries in the international political economy. Making this distinction is important in terms of drawing the implications for international political economy because these countries are not just going to be important markets, but economies, with their own trade and investment networks, as well as manufacturing and services firms that also seek markets (Amsden 2007).

This suggests that a simplistic focus on a limited number of countries may obscure the role of other important economies in redefining the global economic landscape, and the future trajectory of the globalisation process, more broadly. Further analysis of the trade, finance, investment and aid relationships between these countries and other low income countries is required in order to better understand the implications of these shifts in economic power between the West and the Rest. For example, South Africa is excluded from the most recent BRIC+ list developed by O’Neil because its contribution is 0.6%, below 1% the threshold for inclusion on the BRIC+ list. However, South Africa is a G20 member. Its economy drives regional markets in Southern Africa: the tentacles of the South African economy have penetrated deeply into regional markets on the continent. And it has been invited by the BRIC economies to become BRICS. Korea, which has a per capita GDP greater than Italy is a newly industrialised country, has only recently been added to the BRIC+ list.[5]

[4] See Hughes (2006).
[5] See Wagstyl (2011), who also makes reference to other organizations classification of emerging economies, such as Standard and Chartered who base their classification on countries with regular gross domestic product growth of 7% a year or more.

Many of the earlier estimates of when the balance of economic power will shift from the West to newly emerged powers may also be out of date. Latest estimates by the Economist suggest that China will overtake the US economy by 2019 in terms of GDP measured at current prices.[6] According to Maddison (2007), in real PPP terms Chinese GDP is projected to surpass that of the US by 2015 (Figure 1). China has already overtaken Japan as the World's second largest economy, and is estimated to have surpassed the EU in terms of its share of global GDP in 2010, to be followed by the US by 2015; India is expected to surpass the EU by 2030 and the US by 2040 (Figure 2).

**Figure 1: Comparative levels of GDP, China and the US (1700-2030)**




Source: Maddison (2007)

The sum of Chinese and Indian GDP could be double that of US GDP by 2030 (Maddison 2008). The average annual growth rates of the industrialized countries were already surpassed by the rest of the world, taken as a group, which took off between 1973 and 1990 (*Ibid*). This period is generally considered to mark the beginning of the third phase of globalisation, which took off as the 'golden age' of capitalism between 1945 and 1973 ended.

*Global Rebalancing*

As economic historians have pointed out, the global rebalancing expected to take place during the 21st century will restore equilibrium since the great divergence which occurred in the 19th century: for eighteen of the past twenty centuries, Asia has produced over half of world output.[7] The industrial revolution which took place in the 19th century, first in the UK and subsequently on the European continent, resulted in economic divergence between countries and between regions. This is because at that time technological change was highly specialised and uneven in its occurrence

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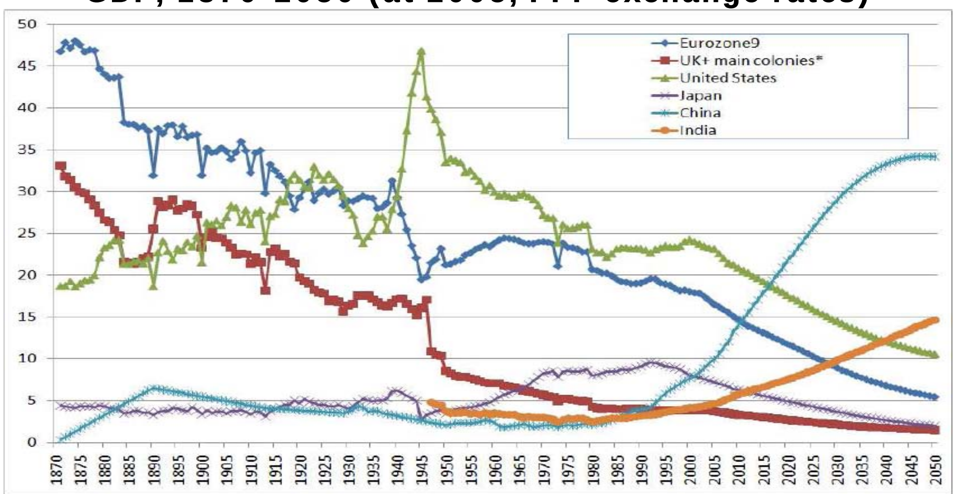
[6] See: http://www.economist.com/blogs/dailychart/2010/12/save_date
[7] See the Economist (2010).

within certain industries at a particular time and geographical location; this period has been called the 'great specialisation'.[8] In comparison, the latest phase of globalization - which began in the 1980s - has been driven by revolutions in information technology and characterised by the spitting up of production processes across countries, trading in tasks as opposed to final products, and increasing fragmentation of trade and investment links. This phase has been termed the 'great unbundling.'[9] This latest phase is expected to drive convergence of incomes across countries, accompanied by a divergence of growth rates, all other aspects considered *ceteris paribus.*[10]

**Figure 2: Percentage shares of selected countries and areas in World GDP, 1870-2050 (at 2005, PPP exchange rates)**




Source: Bénassy-Quéré and Pisani-Ferry (2011). Based on historical statistics calculated by Angus Maddison (http://www.ggdc.net/MADDISON/oriindex.htm) updated using CEPII projections.
Note: * includes Australia up to 1900, New Zealand until 1939. India until 1946. Canada is not included because of the significant autonomy it obtained in 1867.

The scale of global integration achieved through trade and financial channels in recent years is unmatched by previous phases of globalization: never in history has global integration involved so many countries and people, both in absolute numbers and as a percentage of the global population.[11] If the phenomenon of globalisation means the increasing integration of national economies through trade, investment, capital flows and migration, it is fair to say it shifted gears in the 1980s and accelerated throughout the '90s and '00s (with a blip at the end during the global financial crisis) further to regulatory changes and technological revolutions related to transportation and communications.

[8] See Findlay and O'Rourke (2010).
[9] See Grossman and Rossi-Hansberg (2006) and Blinder (2006).
[10] This includes for example the potential for new technological advancement in advanced economies or the outbreak of war, disease or any other natural catastrophe.
[11] As argued by Das (2010).

The global financial crisis which erupted in October 2008 does expose limitations with the theory, and policy, used to guide the process of globalisation to date. This realisation, coupled with the ramifications of the crisis more broadly, has implications for the likely changes in global economic decision making bodies that we expect to take shape between now and 2020. We discuss some of these shortcomings below.

*Evolution of Global Economic Governance*

The global economic governance architecture that evolved between 1945 and 1973 was that of the Bretton Woods system, in which the role of the US was central. Europe and Japan, whose capital had been destroyed by WWII constituted the emerging periphery (Dooley et al., 2003). The Bretton Woods Institutions (BWIs) created at that time included the International Monetary Fund (IMF) and World Bank (WB) whose mandates were (and remain) the facilitation of international trade, investment and finance. The periphery countries at that time, European countries and Japan, chose a development strategy of undervalued currencies, controls on capital flows and trade, reserve accumulation, and the use of the core region - the US - as a financial intermediary. This system lent credibility to their financial systems, and in turn, the US lent long-term to the periphery, generally through FDI.[12]

During this golden period, countries and regions were clearly demarcated globally in terms of policy, for example between those that had pursued export orientation, such as Japan and later the East Asian newly industrialized countries (NICs) (South Korea, Taiwan, Hong Kong and Singapore), and those that had pursued import substitution, as in Latin America and sub-Saharan Africa. However, the Bretton Woods system began to unravel during the 1970s as the US, for domestic reasons, moved towards a system of floating exchange rates untied to the gold standard. This meant that the system was no longer based on one central country, or gold, or indeed the IMF, although the US remained the dominant, or core country, as issuer of the dominant international currency, the US dollar.[13]

Stagflation in the 1970s resulted in the rejection of Keynesian as the dominant economic orthodoxy and rise of Monetarism. Fuelled by oil price rises, the recycling of petrol dollars in the Eurodollar market, and recession in the US and UK, the subsequent sovereign debt crisis in much of Latin America occurred at the same time as the rise of neo-liberalism in Anglo Saxon economies. The economic crises of the 1980s shifted the attention of the BWIs towards a new periphery – the developing world. As a result of the increased leverage of the Bretton Woods institutions because of the debt crisis in the developing world of the 1980s, those countries vulnerable to the crisis at that time were advised to undertake structural adjustment of their

[12] See Dooley et al. (2003)
[13] *Ibid.*

economies, which meant a radical overhaul of trade and investment and other market control measures.

By pursuing more open trade and investment policies - embodied by the Washington Consensus - developing countries could benefit from external economies of scale through trade.[14] The justification for such policies was based on the historical growth experience of the East Asian newly industrialized countries (NICs) which unlike other developing country regions *had* managed to convergence their living standards with the West during the post-war period.[15]

The period between the 1980s and 1990s resulted in new categories of borrowers and lenders to the BWIs, whose roles in global economic governance grew from simply the facilitation of trade, investment and finance, towards policy conditionality. The two institutions encouraged countries to integrate into the global economy. This vision was translated into a determination to ensure trade liberalisation and the opening up to foreign investment by borrowers; the greatest success of the BWIs has been in their role as globalisers (Woods 2006).

Strategic political and economic interests of the US at the time of their creation meant that the mandates of the BWIs were limited. Over time these mandates have not been updated even though the remit of the BWIs has increased in terms of scope towards policy conditionality, as well as in terms of membership. For example, Keynes had sought to embed within the international monetary system adjustment mechanisms to address distortive trade imbalances, but these proposals were rejected at the time by the US. However, as argued by Skidelsky and Joshi (2010) the Keynes proposal of 1941 for dealing with the trade imbalances of that period, between the US and Europe, are just as relevant to dealing with the challenges posed by US-Asia imbalances today.

The running of persistent current account deficits in the US (the country holding the world's reserve currency) of more than 5% of GDP, the level generally considered as sustainable, was the subject of much debate and controversy prior to the Global Financial Crisis (GFC). Despite this, prior to October 2008 there was an inability of both governments and markets to act on apparent warning signals. The shortcomings of the international monetary system in terms of avoiding global imbalances at the macro level, disciplining

[14] Sufficient conditions for gains from trade arise from economies of scale; those that are achieved from foreign sources via international trade are more conducive to gains from trade than national economies of scale; a country gains from trade if it brings about an expansion of its increasing returns industries and a contraction of decreasing returns industries (Krugman and Helpman 1989).

[15] As publicized in the trailblazing *East Asian Miracle* report (World Bank 1993), although the literal interpretation of the catch-up experience of the NICs as publicized at that time still remains highly disputed. The experience of the East Asian NICs has informed the new revolution in economies more broadly, for example in relation to new growth, new institutional and new trade theory.

exchange rate regimes, in addition to curbing irrational behaviour within financial markets - which does not conform to the efficient markets hypothesis, the guiding regulatory principle to date - are clear.

Other assumptions made in earlier theoretical models used to guide the globalisation process have also been challenged. The increasing ability to fragment, offshore and outsource more knowledge and skill intensive activities means that these activities do not always have to be Northern based (Krugman 2007). The sheer size of new entrants, such as China, that have recently adopted and adapted export-orientated growth models has challenged some of the assumptions made within earlier models, such as Krugman and Venables (1995). The scale of production within China means that the inevitable upgrading of production which counteracts increases in inequality in destination markets may be delayed (Krugman 2007). As opposed to reinvesting the cost reductions that have resulted from the globalisation of production in domestic productive assets, such as R&D, they have supported the financialisation of the non-corporate sector (Milberg and Winkler 2009).

If the crisis of 2008 did indeed represent the turning point in relations between the West and the Rest – meaning emerging economies in general – then it should start to be reflected in changes in the associated governance structures of global economic decision making bodies. The current structure of the BWIs reflects the state of the world in 1945, which was unusually asymmetric, with Europe and its [colonial] offshoots accounting for a historically high share of world manufacturing activity, income and political influence.[16] The world has clearly moved on. But how are these changes being reflected in global economic institutions that govern? This question is discussed in the next section.

## 3. Shifts in Global Economic Governance

As Section two has highlighted, international political economy by 2020 may be the only time in recent history that there is such an even distribution of power. China, the US and Europe are likely to be the three primary powers, with other states such as India, Brazil, Iran and Russia serving as secondary powers. This distribution need not be characterised by conflict. In fact, the greater the number of areas marked by cooperation with new and rising powers, the greater probability that multi-polarity is peaceable. This serves to underscore the importance of seeking collaborative, strategic and new types of partnerships which effectively assimilate and advance common interests within existing institutions.[17]

[16] See O'Rourke and Findlay (2010).
[17] This conclusion is also reached by Humphrey (2010).

In this section we first discuss the central role of the G20 as advancing these interests and how its interventions have helped to accelerate and deepen changes in the governance structures in the global economic decision making bodies. This is followed by the Bretton Woods institutions of the IMF and WB; the role of the WTO; and finally, the UN and UNFCCC. We explore the roles of the newly industrialized and emerging economies in these fora, their interests, and how associated governance structures are conducive to the advancement of these, or not.

*The Group of 20*

The main emerging powers have assumed a larger role in global economic governance through the G20, which includes the G7 countries and their representative finance ministers (Canada, France Germany, Italy, Japan, UK and US)[18] as well as a number of developing countries: Argentina, Australia, Brazil, Canada, China, Indonesia, India, Mexico, Russia, South Africa, Saudi Arabia, South Korea, and Turkey.[19] Similar to the G7, the G20 was formed in response to the outbreak of financial crisis: the G7 was formed after the first oil price shock occurred in the 1973, and had its first meeting in 1975; the G20 was established in 1999 in the aftermath of the East Asian financial crisis (1997-1998). During the crises of the late 1990s it became clear that in order to design the appropriate responses, emerging economies needed to be assimilated into the core of global economic governance, and discussions.[20]

The G20 was a financial and technical grouping which emerged from the fallout of the East Asian financial crisis dominated by ministers of finance. The 2008 global financial crisis then led to unprecedented coordinated action by the G20, and added a new public element to the G20 by initiating a G20 leaders meeting (Draper et al. 2010).

In addition to including a number of newly industrialised and emerging economies - which were selected somewhat arbitrarily when the G20 was formed[21] - the G20 meetings also include the managing director of the IMF, the chairman of the IMF, the president of the World Bank, the International Monetary and Financial Committee, and Chairman of the Development

[18] Formed in 1976 when Canada joined the earlier G6 group of capitalist economies.

[19] The immediate precursor to the G20 Leaders' group was an informal forum for discussion among officials from the G7 countries and a select group of "systemically significant" developing countries in the wake of the 1997 East Asian financial crisis. The G20 Finance group emerged because it became clear (at least to some) that G7 discussions on dealing with the global crisis of 1997 needed to include countries who were not part of the informal G7 network which for a long-time had been driving policy in the IMF. See Woods (2010).

[20] See: http://www.g20.org/about_what_is_g20.aspx

[21] There are no formal criteria for G-20 membership and the composition of the group has remained unchanged since it was established. In view of the objectives of the G-20, it was considered important that countries and regions of systemic significance for the international financial system be included. Aspects such as geographical balance and population representation also played a major part. See: http://www.g20.org/about_faq.aspx#5_What_are_the_criteria_for_G-20_membership

Committee. The G20 has recently led on topics such as reform of the IMF and WB as well as global financial architecture, more broadly. However, as argued by Woods (2010a) although the G20 has a larger membership than the G7 it has not instantly produced different outcomes to those of the pre-existing G7 at least prior to the GFC. But its composition has sowed seeds of change for reform to global economic governance in the longer-term.

The inclusion of emerging economies within discussions related to stimulating demand and avoiding protectionism since October 2008 as well as working out plans for global financial regulation were crucial at that time. This is because their role within the global economy had grown rapidly since, for example, the formulation of the G7 after the East Asian financial crises in the 1990s. And uncoordinated actions could spark tensions between trading partners. In April 2009 at the London summit, G20 leaders agreed to a seemingly dramatic set of measures. These included:[22]

- IMF access to some $500 billion of new resources to be extended by existing credit lines, but with new creditors providing new resources to them.[23]
- Additional SDR allocations from the IMF which would inject $250bn into world economy.
- Agreement on extending regulation and oversight to all systemically important financial institutions, instruments and markets, including, for the first time, hedge funds.
- At least $100bn additional lending by the MDBs, and a promise of $250bn of support for trade finance.
- Additional resources from agreed IMF gold sales for concessional finance for poorest countries, together with surplus income, so as to provide $6bn in additional concessional and flexible finance for the poorest countries over 2-3 years.

In response to getting agreement, on for example, the extension of new credit lines to the IMF, the G20 took the issue of IMF quota reform further than what had already been agreed before the crisis in 2006. Members of the G20 were able to use their leverage in order to obtain further reforms in the IMF than would have occurred in the absence of the crisis and the need for their resources.

The G20 has also been successful in adding new issues on its agenda. For example. the 2009 London Summit announced fiscal stimulus packages which have indirectly helped developing countries, injected more liquidity into the financial system with explicit guarantees for low income countries (LICs), and agreed, with some success, not to increase protectionism.

[22] See Woods (2010a).
[23] This is further discussed in Woods (2010b).

Building on these developmental components, the Seoul summit included the Seoul consensus for shared growth.

However, despite some agreement being reached by the G20 on crisis resolution, as well as deeper reform of the IMF, the most recent G20 summits appear to be marked more by differences in opinion as the agenda has shifted since October 2008, from crisis resolution to addressing regulatory gaps, for example on disciplining undervalued exchange rates. Because of the different range of interests - offensive and defensive - among G20 members on this potentially explosive issue, the final communiqué issued from Seoul in November 2010 included references to global rebalancing and 'maintaining current account imbalances at sustainable levels', in addition to a detailed description of changes desired in the IMF. But no statement on exchange rate regimes in emerging economies and their management.[24]

There are growing concerns as to the potential risks of a global currency war because of continued quantitative easing in the US as well as in the UK in addition to China's resistance to allowing the Yuan to appreciate. This highlights the ongoing lack of an international cooperative mechanism to deal with exchange rate disputes, such as the return to an authoritative role for the IMF in exchange rates (Woods 2010a). But it also highlights how the G20, in order to maintain its legitimacy, ultimately has to avoid risking confrontation between its members.

For example, the US had been seeking to garner support from other G20 members on the damaging role played by the perceived undervalued Yuan, including Brazil. However, Brazil refused to support the US on this because of its perception that the quantitative easing being undertaken by the US was exacerbating capital inflows in Brazil, which has subsequently led Brazil to impose capital controls. A number of other emerging economies, not all of which are included within the G20, have subsequently imposed capital controls in order to deal with the post-crisis financial environment (Massa 2011). The G20 could play a central role in seeking to discipline such measures through mandating their use and instructing the IMF to this effect. However, there remain divisions across the G20 as to what the current priorities of global economic governance are. This means that any one priority risks being watered down, as others are put forward.

A number of issues related to global economic governance thus remain outstanding, such as disciplining exchange rates, the use of capital controls, enforcing agreements on avoiding excessive trade imbalances, curbing speculation in financial markets, and other issues relating to international

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[24] See: http://media.seoulsummit.kr/contents/dlobo/E1._Seoul_Summit_Leaders_Declaration.pdf. In comparison, the G20 communique released further to the summit in Toronto, June 2010, does include reference to undervalued exchange rates, see http://www.g20.utoronto.ca/2010/g20_declaration_en.pdf

development more broadly, including effectively managing sovereign wealth funds. Although some statements have been made and endorsed by the G20, they remain political statements that need to be acted upon. They also appear to be fragile, wrought by intense debate and divergent views and opinions.

These differences in opinions are shown most clearly through a simple comparison of the views of G20 central bankers on how to reduce global imbalances.[25] Whilst the US continues to blame the low saving rates in Asia for its historically low interest rates, other emerging economies such as Argentina acknowledge that the accumulation of foreign exchange reserves is a means of self-insurance from financial crises. Although exchange rate adjustment is seen as an important means through which to rebalance the global economy by some countries, such as France and Italy, the Chinese dismiss the link between its nominal exchange rate and savings behavior. Indonesia and Brazil, along with South Africa, focus on the challenges of capital inflows to emerging economies and volatility. Others such as Korea and Germany appear more preoccupied with the challenges of ensuring a resilient global economic system in general, and how to secure stability, and therefore growth. The governor of the UKs Central Bank argues that many policies in addition to changes in exchange rates will be needed to reduce global imbalances, but warns that unless agreement is reached on how to reduce them at best there will be a weak world recovery and at worst the seeds of the next financial crisis will be sown.

Not only is there difficulty in getting agreement on the agenda, but it is also unclear how the G20 can embed the decisions it takes, within implementation bodies at the National level, by constituent states, as well as with multilateral organizations such as the IMF and WB. In the case of the latter, the mandates agreed by the G20 and subsequently passed to the multilateral institutions to act upon, essentially override their own internal decision-making processes, however flawed the associated governance structures of these institutions are perceived to be. Although representatives of the IMF and WB are present at the meetings of the G20, the mandate is set by a limited number of wealthy countries. This is a frequent complaint made by the G77 countries. Despite some concerns on its future, it is often said that the G20 stands for speed and action, whilst the UN systems stand for legitimacy (by representing countries globally).

### *The Bretton Woods Institutions: IMF and World Bank*

The IMF and World Bank (WB) were created in 1944 as the Allies sought to leverage the international system for post war reconstruction and

[25] The full list of submissions by Central Bankers to the Banque de France, as part of the G20 Financial Stability pact, are listed here: http://www.banque-france.fr/gb/publications/rsf/rsf_022011.htm. See the Economist (2011) for discussion.

development.[26] The indelible memories of the Great Depression of the 1930s were undoubtedly strong influences on the form and roles of the two institutions. The Bretton Woods system was fully operational by 1946, the division of labour between the IMF and the World Bank, at that time called the International Bank for Reconstruction and Development (IBRD) was in simple terms for the IMF to facilitate finance and international payments and for the World Bank, or IBRD, at that time to perform the role of providing loans to governments so as to facilitate the post-war construction of Europe.

As mentioned above, the international monetary system established had the US at its core and was based on the gold standard – a system of exchange rates essentially pegged to gold. Each member of the IMF was obliged to adopt a monetary policy that maintained the exchange rate of its currency within a fixed value, related to the value of gold. Because the US was at that time the world's largest holder of gold reserves, this meant it played a central role within the system in terms of anchoring exchange rates. The British economist John Maynard Keynes who represented Great Britain at Bretton Woods favoured the creation of an international central bank and possibly even a world currency rather than the gold-pegged system.[27] However, what he did regard as the most beneficial outcome of the Bretton Woods system was that it regulated exchange rates and restricted capital flows, thus reducing the risks of capital flight, attacks on currencies and other devices offered by financial liberalisation.[28]

As previously mentioned, the Bretton Woods system broke down in the early 1970s when in order to avoid inflation and other macroeconomic difficulties the US severed the ties between its currency and gold and suspended convertibility from US dollars to gold. This resulted in a global system of credit based on faith in countries abilities to service their debts rather than their stock of gold. The role of the IMF evolved into *de facto* lender of last resort as its mission crept to that of providing loans to crisis affected countries mostly in the developing country periphery since the 1980s and 1990s.

The World Bank was essentially re-orientated to the needs of the developing world much earlier than the IMF, when the Marshall Plan was implemented in the early 1940s, and particularly under the vigor and energy of Robert McNamara the 5$^{th}$ president of the WB (1968-1981). Although since their establishment the division of labour between the two Bretton Woods institutions has remained unchanged, there are different pressures currently bearing down on both for change in how they are governed. We discuss these in the following sections.

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[26] The Bretton Woods system of global financial management was created by 730 delegates from all 44 Allied second World War nations who attended a UN-hosted Monetary and Financial Conference at the Mount Washington Hotel in Bretton Woods in New Hampshire in 1944.
[27] Keynes ideas were not accepted. See Skidelsky and Joshi (2010).
[28] See Chomsky (2008).

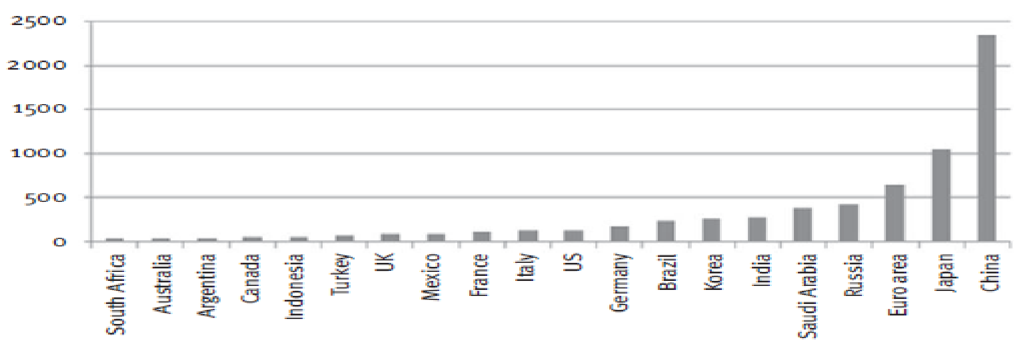
*The International Monetary Fund (IMF)*

The governance structure of the IMF started becoming problematic as soon as the first wave of crises hit the developing country periphery during the 1980s and 1990s. There is a large body of literature that critically analyses the response of the IMF to these crises and the associated conditionality of its lending. The IMF was heavily criticised in Asia during the 1990s. Its intervention in the financial crises which erupted there between 1997 and 1998, with its loan conditions, made the recession worse.[29]

The role of the IMF as de facto lender of last resort during the 1990s was perceived to have simply compounded moral hazard problems; instead of taming financial instability, it was accused of stoking it. This led to the bizarre situation in the 00's when IMF members, particularly in Asia, but also elsewhere, preferred self-insurance through the accumulation of foreign exchange reserves, rather than rely on any assurances that the fund gave (Figure 3 shows how Asian countries in particular have built up large reserves). Pertinent questions were raised as to how the IMF functions, its remit and, more importantly, its governance.

Prior to the global financial crisis of 2008, the IMF was having a real crisis of legitimacy: without any financial fires to fight, what was its role in global economic governance? The current crisis has given it a new lease of life, but it has also raised new issues to do with resources and, by implication, governance. The fund has been avidly lending again to crisis-affected economies, but this time its clients range from developed to developing economies because there is no longer a clear distinction between 'periphery' countries. And its policy has changed on such issues as the use of capital controls to curb hot money[30], which it had staunchly ruled out when the Asian financial crisis was raging.[31]

**Figure 3 - International reserves (US$ billion), October 2009**




Source: IMF, reported in te Velde (2010)

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[29] See Sachs (1997); Feldstein (1998); and Stigliz (2002).

[30] There is no formal definition of 'hot money' but it is generally used to refer to the flow of funds (or capital) from one country to another to earn a short-term profit on interest rate differences and/or anticipated exchange rate shifts.

[31] See Blanchard et al. (2010), Ostry et al. (2010) also Cozzi and Nissanke (2009).

As part of a recent deal made at the G20, China, along with other emerging economies, including Brazil, pushed for further reform in voting rights in return for their support. This means that while the IMF will continue, for now at least, to be dominated by the US, the European Union and other developed countries as majority shareholders, emerging economies including Brazil, China, Korea, India, Mexico, Singapore, and Turkey, will have a larger say relative to the pre-crisis governance reforms already agreed in 2006 (see Box 1). Some smaller European countries such as Belgium and the Netherlands are amongst the losers.

**Box 1: Changes in IMF Governance**

In March 2006 at the annual meeting of the IMF and World Bank it was agreed to give an immediate ad hoc increase in quotas to the most underrepresented countries: China, Korea, Mexico and Turkey. The second round of reforms endorsed in March 2008 included: a new quota formula (the formula determines a country's economic size and openness and therefore its voting power and access to resources in the IMF); ad hoc quota increases based on the new formula; and a trebling of basic votes. The reforms taken together mean an overall shift of 5.4 per cent of voting power in the IMF from traditional donors towards the following countries: Korea, Singapore, Turkey, China, India, Brazil and Mexico. After the GFC erupted, the G20 in November 2008 delegated specific tasks to different international institutions. In April 2009 G20 leaders announced $750 billion of additional funding for the IMF for this purpose: China would contribute $40 billion while Brazil and India were promised 'contributions'. On 24 November 2009, after heated political wrangling between the new emerging economy members and traditional economic powers, agreement was finally reached on a new $600 billion, some of which would come from the new donors. At first, China, Brazil and India refused to participate in the initiative until more substantial reforms were undertaken in the IMF's governance and arrangements. The end result is a slightly larger-than-expected shift of more than 6 percentage points towards emerging market countries in the "quotas" that determine voting power in the 24-member executive board, and Europe agreeing to give up two of its board seats.

Adapted from Woods (2010b), Beattie and Oliver (2010), Phillips (2007).

Despite the agreed changes, which have been hard won, Beattie and Oliver (2010) argue that they will make almost no formal difference to the governance of the IMF, where most decisions are taken by consensus. The US (and Europe, if acting collectively) in effect wield a veto over important decisions, which still require an 85 per cent "super-majority". Therefore European governments appear to have failed in their effort to deprive the US of that blocking power. Woods (2010b) argues that the changes will do little to offset the perception of emerging economies that the IMF is mostly a US organisation – a perception fed by the fact that the United States has a veto power in the IMF; the senior management are all appointed only with the approval of the United States and Europe; the institution is situated amid US government agencies in Washington DC; and finally, it works in English, with a large proportion of its staff being US-trained.

However, even if not immediate, then over time, the IMF's enhanced membership will mean further adjustment in terms of how it does business in the future. If the 1980s represented a silent revolution for the IMF towards a common set of norms (the Washington Consensus), this decade seems to have brought global convergence on the need for alternatives to these. This provides a role for the EU in supporting the transition from a 'hegemonic' system centred on the US dollar towards a 'multi-polar' system, with the dollar, the Chinese currency and the euro as its key pillars, which corresponds to the long-term evolution of the balance of economic weight in the world economy.[32] Box 2 briefly explains the role of Special Drawing Rights (SDRs) in the IMF and how increasing the range of currencies included within the SDR basket, and promoting their use, could reduce the need for countries to run current account surpluses to accumulate dollar reserves.

As elaborated upon by Skidelsky and Joshi (2010), such an approach could make the IMF a more genuine lender of last resort, reduce the risk of instability caused by switches between reserve currencies and promote central bank use of SDRs, which would bring about a marked improvement in the functioning of the world monetary system. Moreover, such an approach could open the road to a bargain with China: if the first Bretton Woods system rested on a "grand bargain" between the US and Britain, so a new Bretton Woods would require an agreement between the leading surplus and the leading deficit country.[33]

As argued by Woods (2010c), the EU like other G20 members needs to push for more drastic reforms of the IMF in order to avoid the institutions being marginalized by emerging powers. This includes both in relation to authority and location (so as to avoid being Washington centric), as well as such aspects as the range of currencies included in the SDR basket. Regions such as Asia, and the newly industrialised countries within it, have already started developing alternatives to the IMF, such as the Chiang Mai Initiative.[34]

Without effectively incorporating the newly emerged and emerging economies and adapting governance structures - defined as decision-making majority, location, management and staffing - so as to facilitate the deepening of their integration with the global economy, there are risks of future redundancy, as well as instability in the global economy as new alternative regimes take shape.

The G77 and China have recently announced their support for the promotion of the use of SDRs for development purposes; they have called for a new and significant SDR allocation to meet liquidity needs and promote development.

[32] See Bénassy-Quéré and Pisani-Ferry (2011).
[33] This presents a challenge for the statesmanship of the US and China is to strike such a bargain (Skidelsky and Joshi 2010).
[34] This initiative consists of a number of bilateral financial agreements, as well as surveillance mechanisms designed to assist members within the region prevent a financial crisis. This includes the countries of the Association of Southeast Asian Nations (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam), China, Japan, and the Republic of Korea. These countries are collectively known as ASEAN+3. See Rana (2002) and Henning (2009) for further discussion.

### Box 2: The Role of Special Drawing Rights in the IMF

The Special Drawing Right (SDR) was created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system. A country participating in this system needed official reserves—government or central bank holdings of gold and widely accepted foreign currencies—that could be used to purchase the domestic currency in foreign exchange markets, as required to maintain its exchange rate. But the international supply of two key reserve assets at that time - gold and the U.S. dollar - proved inadequate for supporting the expansion of world trade and financial development that was taking place. The Bretton Woods system collapsed and the major currencies shifted to a floating exchange rate regime. In addition, the growth in international capital markets facilitated borrowing by creditworthy governments. Both of these developments reduced the need for SDRs.

The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions. In addition to its role as a supplementary reserve asset, the SDR, serves as the unit of account of the IMF and some other international organizations. The value of the SDR was initially defined as equivalent to 0.888671 grams of fine gold, which at the time, was also equivalent to one U.S. dollar. After the collapse of the Bretton Woods system, however, the SDR was redefined as a basket of currencies, today consisting of four currencies: the euro, Japanese yen, pound sterling, and U.S. dollar.

It is calculated as the sum of specific amounts of the four basket currencies valued in U.S. dollars, on the basis of exchange rates quoted at noon each day in the London market. The basket composition is reviewed every five years by the Executive Board to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. The next review will take place by 2015. Under its Articles of Agreement, the IMF may allocate SDRs to members in proportion to their IMF quotas. Such an allocation provides each member with an asset (SDR holdings) and an equivalent liability (SDR allocation). If a member's SDR holdings rise above its allocation, it earns interest on the excess; conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall. IMF members often need to buy SDRs to discharge obligations to the IMF, or they may wish to sell SDRs in order to adjust the composition of their reserves. The IMF acts as an intermediary between members and prescribed holders to ensure that SDRs can be exchanged for freely usable currencies.

The current global imbalances are driven by a number of factors that point to several key roles the IMF might play in addressing them:

- to provide a multilateral alternative to national reserves;
- enhanced surveillance with a view to enforcing multilateral rules on exchange rates;
- work to improve emerging economies' financial systems so as to lower their incentives to accumulate reserves.

The IMF could provide a multilateral alternative to the accumulation of national reserves as a form of 'self-insurance', but it would have to update its currency basket, for example by including the Chinese Yuan or Brazilian Real, in order to do so.

Source: Adapted from IMF (http://www.imf.org/external/np/exr/facts/sdr.htm) and Woods (2010b).

Moreover, this group has made it clear their view that the present quota voting system should be kept under review. This is because of perceptions that the present governance structure indirectly impairs the funds capacity to undertake objective and even handed surveillance, and that the institute itself is tilted towards the interests of a particular group of countries, which needs to change.[35]

*The World Bank (WB)*

When the WB was created in 1944, similar to the IMF, each member of the institution - at that time the Allies - were allocated 250 basic votes to which were added weighted votes apportioned, essentially on the basis of credit provided to the institutions. Over time, the proportion of 'basic votes' in total votes has diminished from a high point of 14 per cent to around 3 per cent in 2009, despite the increased membership of both institutions as their attention has shifted from Western Europe to the developing world.[36] Box 3 provides a brief overview of voting rights in the WB group, which includes the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

Since the 1980s, similar to the IMF, the WB has become heavily involved in conditionality and policy-based lending. This has resulted in a differentiation across the stakeholders of the institution in terms of those who contributed most to the founding capital of the institution compared to those contributing to its upkeep, in terms of providing returns from non-concessional borrowing.[37] However, these changes have not been reflected in the make-up of the Executive board of the Bank. As summarized by Woods (2001), the problem of accountability in the bank is exacerbated by the fact its operations have expanded dramatically in recent decades, but its representativeness towards its stakeholders has not.

Although this is a fair assessment and problematic in terms of the legitimacy of the institution, there appears to be less pressure on the World Bank to change than the IMF because, to some extent, its business model is sounder: it has a role to provide concessional and non-concessional lending to its clients as and when they need it. And when clients decide that they do not need resources from the WB, involving specific terms, they are increasingly able to go elsewhere, including to new bilateral donors.

China's supply of no-strings-attached loans for some sub-Saharan African countries, even though in direct competition with the bank, as well as other donors, has not yet proved overly problematic. This is even though there have been some instances where resources previously committed to clients by the WB were withheld because of concerns of new deals with China on

[35] See position paper of the Group of 77 and China on Reform of the International and Financial Economic System: http://www.un.org/esa/ffd/events/2010GAWGFC/6/Stmt_G77.pdf
[36] See Woods (2001) who also notes how neither the Bank nor the Fund were given an explicit mandate to enter into policy conditionality and to attempt to alter in a far-reaching way the economic structure of a members economy.
[37] See Woods (2010b) for further discussion.

trade in natural resources, for example, in the Democratic Republic of Congo.[38]

**Box 3: Voting rights in the WBG and similarities with the IMF**

WBG (World Bank Group) is a development services organization with a staff of more than 10,000 and a net administrative budget of about US$1.6 billion a year. The institution has five arms. Two of these—the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA)—focus their lending on public-sector entities. The IBRD provides non-concessional finance with government guarantees primarily to middle-income countries, while IDA provides concessional loans and grants to the world's poorest countries. Two other arms—the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA)—provide financing and services to private-sector entities.

The IFC provides loans, equity investments, and financial services to private-sector companies in developing countries, while MIGA provides political risk insurance to those seeking to invest in developing countries. Finally, the International Center for the Settlement of Investment Disputes (ICSID) provides facilities for conciliation and arbitration of international investment disputes. Voting power allocation is based on different principles in each of the Group's financing arms.

For this reason, the voting structure of each arm is different, but the voting power of the US is the highest across each institution. Voting power at the IBRD is conferred by two kinds of votes: basic votes and share votes. When the IBRD was founded, all members were allocated 250 basic votes. Share votes, by contrast, reflect the relative shareholdings of the IBRD's members. The IBRD does not have its own formula for calculating shareholdings but has historically used IMF quota shares as a base. In turn, IMF quotas (under the 2008 formula) are calculated using several variables, including measures of the member's GDP, economic openness, variability of the current account and capital flows, and the amount of international reserves held.

Source: Zedillo et al. (2009).

According to most recent estimates, new emerging donors such as China have lent more money to other developing countries over the past two years than the World Bank. China Development Bank and China Export-Import Bank (EXIM) signed loans of at least $110bn (£70bn) to other developing country governments and companies in 2009 and 2010, according to Financial Times research; the equivalent arms of the World Bank made loan commitments of $100.3bn from mid-2008 to mid-2010, itself a record amount of lending in response to the financial crisis (see Dyer et al. 2011).

In some cases loans to low income countries provided by China are closely linked to deals agreed on natural resources, and may often be provided in renimbi. It is therefore generally difficult to distinguish between aid flows, as traditionally understood, and foreign direct investment. For example, the "commercial corridor" for China-Africa commerce that has been created by the Industrial Commercial Bank of China (ICBC) channels investment by China to the those players (often these are Chinese) that invest in the African

[38] See Wallis (2010).

continent and operates alongside the China EXIM Bank and China Development Bank. The ICBC is a newly launched source of funding which has been created with the China-Africa development fund and the China Construction Bank.[39] There is no official definition of aid within Chinese government circles at present and where the term 'aid' is used the resources are indistinguishable from large financial loan packages, in general. And these packages are still increasing.

Box 4 summarises some of the key distinguishing features of Chinese aid and official financing from that provided by other traditional donors. According to Christensen (2010) the WB knows where the largest gaps are in relation to its financial assistance to SSA, namely the power sector, and realizes that these shortcomings are increasingly being made up by China: the largest recipient sectors for Chinese investments are power (hydropower) and transport (railroads).

### Box 4: How Chinese Aid to SSA is Different

- **History**: The lack of a colonial past and similar experience as developing countries has resulted in a more trusting relationship between Chinese and African governments, who negotiate bilaterally.
- **Nature of relationships**: The relationship between government, state enterprises and financial institutions is close in China and this is reflected in how resources are delivered to recipient countries.
- **Type of assistance and delivery**: Often part of export credits and other financing for infrastructure investments is linked to the extraction of natural resources through "infrastructure for natural resources" deals.
- **Conditionality**: Aid is extended without economic policy conditions; typically the only condition is that recipients support the "One-China" policy.
- **Objectives**: China's White Paper on its Africa Policy based the relationship on five principles of mutual coexistence which targets economic "win-win" cooperation;
- **Scale**: Economic assistance was pledged to double between 2006 and 2009 and there are indications that this objective was achieved.

Source: Adapted from Christensen (2010).

Other emerging economies are also developing their own 'aid' programs for low income and lesser developed countries and regions. For example, South Africa – a member of the G20 – has recently announced its plans to create a development agency.[40] In South America, countries such as Brazil and Venezuela have been involved in the provision of aid for a number of years. In the case of Venezuela the approach of 'petrol-diplomacy' is arguably just as controversial as that of China, though on a much lower scale. However, similar to the approach of China and contrary to the stated objectives of the WB, the resources loaned to other developing countries are tied more to

[39] See Davies (2010) and Christensen (2010) for further information.
[40] See Bosco (2011).

strategic political objectives rather than the reduction of poverty as an explicit objective.

Because not all of the new emerging donors are members of the OECD, they do not follow established norms and protocols. For example, neither China, nor Brazil or India are members of the OECD and therefore do not report to the OECD/DAC system, and in the case of China do not publish comprehensive data on their foreign aid. In order to obtain such information, the new emerging economies would have to be accepted as members of the OECD and as a consequence adhere to its norms and objectives. It is not clear whether this is actually desirable in all cases, both for the new emerging donors and the recipient countries of cash flows that in many cases welcome the less bureaucratic, restricted and faster disbursement of funds that come from new donors. These new flows, unlike those from the WB and other traditional donors, do not have the same policy conditionality.

Reform of the WB could be accelerated so that new donors may begin to use their leverage of the multilateral system to better achieve their objectives, as well as those of recipient countries. The G20 has called for greater reform within the WB in order to achieve just that. Countries that provide any additional capital get increased voting power at the Bank, so it is unsurprising that the biggest supporters of capital increases have so far been middle-income countries including Argentina, Brazil, India, Russia and China, who all want a bigger say at the Bank.[41] The incorporation of new donors could be to the benefit of recipients if it means changes in the decision making process of the institution, whose interventions in developing countries have been criticised for lacking country ownership, ignoring concepts such as policy space, and for applying conditionalities that are not justifiable by technical considerations.[42]

In 2009 WB shareholders agreed to an increase in IBRD voting power for developing countries of at least 3 percent, building on 1.46 percent which was already agreed, taking their share up to 47 percent in total. Over time the share of 50 percent is expected to be reached as “emerging economies…share the responsibilities of assisting poorer countries with their development” (Zoeillick 2009). However, such a shift in voting rights will not necessarily be sufficient. As pointed out by Zedillo (2009:20-21): “The key concern is that there are no mechanisms by which the shareholders can engage meaningfully in strategy formulation at the appropriate level of seniority. The Development Committee and the Executive Board, as currently structured, lack the capacity to play this role effectively.” This suggests that an increase in shareholdings will not automatically translate into decision making processes and that further, possibly more fundamental organisational

[41] See http://www.brettonwoodsproject.org/art.shtml?x=565630
[42] See position paper of the Group of 77 and China on Reform of the International and Financial Economic System: http://www.un.org/esa/ffd/events/2010GAWGFC/6/Stmt_G77.pdf

changes (such as decentralisation) may be required in order to better align voting rights with power.

The Zedillo report, which included a high level commission comprised of members from India, Brazil, Jordan, Ghana, Japan, China and Mexico in addition to representatives from the WTO, and World Bank, on "*Repowering the World Bank for the 21st Century*" recommends a package of reforms to the WBG which includes parity of votes between developed and developing countries; an end to appointed chairs on the WBGs Executive Board, a reduction in European chairs by at least four, down from eight; a reduction in the majority needed to amend the Bank's articles of association to 80 per cent, down from 85 per cent, which would effectively put an end to the US veto over major changes at the Bank.

It argues that at the current time, the large number of European chairs on the Executive board reflects a 'historical legacy' that no longer is appropriate for a global institution in a transformed global economy: the number of chairs allocated to European countries is not in line with their population or economic weight in the global economy. Moreover, that current allocation reflects the absence of transparent and fair principles at the most senior level, since if the allocation of chairs at the executive level is really based on IDA contributions then this should be explicit rather than implicit.

The report argues forcefully that unless these structures are modernised the institution will become increasingly irrelevant as it is essentially embodies the characteristics of a world that simply no longer exists. This view is echoed by the G77 and China which has reiterated its view that the reform process should keep on moving in successive steps towards, at least, parity, and towards the objective of providing developing countries full and fair representation.[43] Others put the need for change in stronger terms: over sixty years since the establishment of the Bretton Woods, the world faces a new set of global challenges, greater, arguably than any since then.[44]

### *The World Trade Organisation (WTO)*

The global trade regime has evolved since the 1947 General Agreement on Trade and Tariffs (GATT) was created and formed as a mechanism through which its founding members could agree to reduce customs tariffs and facilitate trade amongst them, further to increases since the Great Depression and WWII. Between 1948 and 1994, the GATT provided the rules to govern world trade. During the 1980s and 1990s it became clear that a framework was needed to better guide the trade and investment driven globalization process. The Marrakesh Declaration established the World Trade Organization in 1994 which has a much broader scope and remit than GATT,

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[43] *Ibid*.
[44] See Alexander (2010).

namely to regulate trade in goods, services, and other issues such as intellectual property, organize trade negotiations between its members and settle any disputes that arise.

The creation of the WTO on the 1 January 1995 marked the biggest reform of international trade since after WW II and sought to rectify the failed attempt in 1948 to create the International Trade Organisation, as part of the Bretton Woods system.[45] Its members agree to uphold principles such as Most Favoured Nation (MFN) meaning non-discrimination among nations; national treatment (NT) with non-discriminatory treatment (NDT) between imported goods and domestic goods; transparency - all trade legislation must be notified to the WTO; and Special and Differential Treatment (SDT) to developing counties.

The WTO currently has 153 members which includes all newly industrialized and emerging economies as defined in Section Two, with the exception of Russia which unlike other transition economies such as China, is still in the process of negotiating the terms of its accession. Members join the organisation through a single process undertaking established during the Uruguay round (1986-1994). The rules-based system of governance adhered to by WTO members is based on a system of one vote per member and all members must agree on all new agreements. The system is therefore highly democratic in principle, although in practice negotiations may often boil down to the role of a limited number of countries – increasingly the US and EU versus newly emerging economies.

Developing countries have also become increasingly active in WTO trade negotiations. Countries like Brazil have worked together in fora such as the G22, to negotiate a more beneficial set of policies on agricultural products with the US and Europe, while resisting the West's attempts to introduce new issues into the trading round such as the liberalisation of trade in services. In fact, since 1995 developing countries have become increasingly organised and formed a number of special interest groups to defend their interests in trade negotiations.

A number of negotiating sub-groups now exist which have been constructed specifically to advance economic interests in the latest round. This includes the African, Caribbean and Pacific (ACP) group, which has concerns in the round related to preference erosion, as well as the G33 which seeks the use of a new safeguard mechanism by developing countries to counter market volatility and sudden import surges; an overview of negotiating groups and interests as identified in the most recent round for conclusion of the Doha Development Round (DDR) are presented in Page et al., (2008). Brazil and India in particular have continued to play an important role in these trade negotiations, a dispute with the latter and the US has been pin-pointed as leading to the breakdown in the DDR discussions in 2008.

[45] See http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm

As discussed by Page (2003), in multilateral negotiations, the bargaining power of the strongest nations is limited by the need for agreement. If a powerful country considers market access beneficial, it must secure its agreement. The converse situation also applies. In 1986, at the beginning of the last trade multilateral negotiations - the Uruguay Round - developing countries did not realise that the open-ended or vague commitments in the agenda could become significant agreements. Services and TRIPs (patents and copyright) were all in the negotiating mandate, but their implications were not clear. At the Seattle ministerial (1999), detailed rejection of points in the agenda led to failure; at Doha (2001) developing countries across negotiating groups were active in setting the agenda, realising that they could not remain outside any negotiation, however irrelevant or unimportant it might seem initially (*Ibid*).

The failure of the last round of DDR negotiations in 2008 is generally recognised as being due to the inability of the developed countries to abide by principles of differentiation. As discussed by Ismail (2009), in the Doha round developing countries were expected to make a major contribution by reducing their agricultural subsidies and opening their agricultural markets. In return, developing countries were expected to reciprocate by reducing their relatively higher tariffs in non-agricultural market access areas (namely, industrial goods). However, openings in agricultural market access were considered insignificant. Moreover, countries such as India and China were unable to agree to restrictions on their use of the special safeguard mechanism for the agricultural sector.[46]

Since the failure of the Doha round negotiations in 2008, the deepening of the financial crisis and the acceleration of the food price crisis into 2009, the role of the WTO has been increasingly to regulate rather than to advance liberalisation. The regulatory reform agenda which has gathered pace since the food, fuel and financial crises includes disciplining the use of export restrictions, in addition to the increasing monitoring of non-tariff barriers, and other protectionist measures.[47]

Although efforts to advance further liberalisation at the multilateral level are to some extent fighting an uphill struggle, this has not prevented the newly industrialised and emerging economies from stepping up their efforts in opening their markets to the Least Developing Countries (LDCs). A number of emerging economies have started offering duty free quota free (DFQF) market access to LDCs, in line with the WTO Ministerial decision taken in Hong Kong in 2005 that emerging economies ‘in a position to do so’ should do this. Many also participate in the Global System of Trade Preferences among Developing Countries (GSTP). Figure 4 summarises the schemes currently offered by Brazil, India, Russian Federation and China (the BRICs).

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[46] See The Economist (2008).
[47] See Keane et al. (2011).

**Figure 4: Summary of preferential access to BRICs markets**

| BRIC | Preferences for SSA countries (or for groups including SSA countries) | Approximate coverage (% of non zero-MFN tariff lines) |
|---|---|---|
| Brazil | Has announced that it will offer preferences | No details available |
| Russian Federation | **In 2009**:<br>GSP available to some 144 countries (incl. all SSA *except* Eritrea and South Africa)<br>Preferential rate for LDCs available to 47 countries (all SSA *except* Eritrea) | 27.3% (in 2009) – reduced rate for GSP, zero duty for LDCs |
| India | **In 2009:**<br>GSTP countries (includes *Angola, Benin, Cameroon, Democratic Republic of the Congo (DRC), Ghana, Guinea, Mozambique, Nigeria, Sudan, Tanzania, Zimbabwe*)<br>GSTP LDC countries (includes *Angola, Benin, DRC, Guinea, Mozambique, Sudan, Tanzania*) | 1.6% (none duty-free)<br><br>1.6% (same products as GSTP pref., but *some* lower rates – none duty-free) |
| China [a] | **In 2009:**<br>31 SSA countries (*Angola, Benin, Burundi, Cape Verde, CAR, Chad, Comoros, Congo Rep., Djibouti, Eq. Guinea, Eritrea, Ethiopia, Guinea, Guinea Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Senegal, Sierra Leone, Somalia, Sudan, Togo, Tanzania, Uganda, Zambia*) | 6.4% (all duty-free)<br><br>According to the WTO (2010) there was unilateral duty-free entry for 41 LDCs (including the SSA countries listed in Column 2 – although Cape Verde and Congo Rep. are not LDCs) for some 60% of 8-digit tariff lines – to be increased to 95% by 2015 |

*Note:*
(a) China applies a 'general' rate (higher than or equal to MFN) to countries not subject to MFN or not WTO members – including the following SSA countries: Liberia, Sao Tome and Principe, Seychelles.
*Sources:* UNCTAD's TRAINS database; WTO (2010).

Despite these advancements, the achievement of DFQF in all developed country markets remains a priority for LDCs at the WTO. Their efforts should be supported, as future growth in trade opportunities will be driven by new markets and actors, such as China, Brazil and India and other emerging economies. As the WTO (2010) makes clear, there is widespread recognition of China's constructive role in resisting protectionist pressures and boosting global demand during the recent economic downturn, as well as appreciation for China's stepped-up involvement in South-South trade and its duty-free scheme for imports from least-developed countries.

### *The United Nations (UN) and United Nations Framework Convention on Climate Change (UNFCCC)*

It is fair to say that the role of the new emerging powers in driving future global trade flows, and related responsibilities in terms of facilitating the integration of LDCs and other low income countries into the global economic system is being acted upon and welcomed by developed economies. However, similar to the reasons for the stalling of the Doha round, the prospects for obtaining a new deal on climate change are far less sanguine and remain held up by strong differences in opinion concerning principles of differentiation. Working with the emerging economies for developmental outcomes, for example, addressing the concerns of India in the DDR on food security and import surges, in addition to others, would give the EU a new role in these negotiations, as well as others such as negotiations for a new deal on climate change.

The UNFCCC was created at the UN conference on Environment and Development (UNCED) held in Rio in 1992.[48] Its objective was to seek a global agreement on stabilising green house gas (GHGs) emissions so as to avoid anthropogenic climate change. However, the agreement obtained at that time was not legally binding.[49] Since 1992 protocols have been attached to the agreements which are mandatory, such as the Kyoto Protocol which was agreed in 1997 and established targets for emissions reductions for developed countries (Annex 1), in recognition of their historical share of total global GHG emissions and provided for mechanisms, such as the clean development mechanism, to meet these objectives.[50]

The major feature of the Kyoto Protocol is that it sets binding targets for 37 industrialized countries and the European community for reducing GHG emissions; these amount to an average of five per cent against 1990 levels over the five-year period 2008-2012.[51] However, despite being embedded within the UN system the Kyoto protocol has not been ratified by all members, which includes the US – the largest GHG emitter.[52]

The commitment period of the Kyoto protocol will expire in 2012, having begun in 2008. Recognizing that developed countries are principally responsible for the current high levels of GHG emissions in the atmosphere as a result of more than 150 years of industrial activity, the Protocol places a heavier burden on developed nations under the principle of "common but differentiated responsibilities." However, because the GHG emission of the newly industrialized and emerging economies countries, based on current patterns of growth, are estimated to already exceed those of Annex 1 countries, including the US, the maintenance of this principle is highly disputed in negotiations for the next commitment period of global GHG emissions reductions (See Figure 5). Per capita emissions are presented in Figure 6.

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[48] The UN was created in 1945, as an outcome of the Bretton Woods agreement and as a replacement to the League of Nations, a covenant created after World War I at the Treaty of Versailles in 1919, designed to promote a liberal world order, international cooperation, peace and security. It included the creation of the UN Security Council, a key distinguishing feature between it and the former League of Nations. Since its establishment the UN's remit has expanded to cover a variety of programmes and funds, commissions and specialised agencies. See http://www.un.org/aboutun/unhistory/

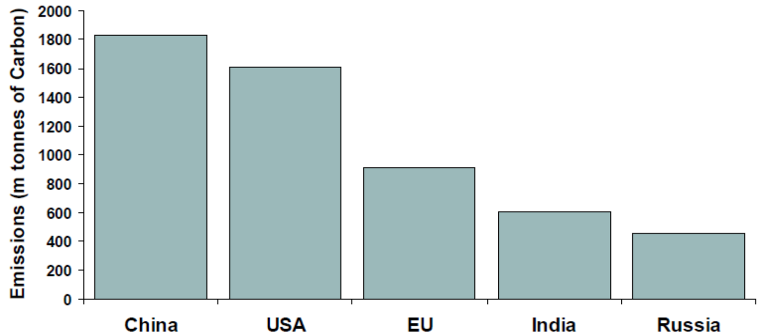
[49] See: http://unfccc.int/resource/docs/convkp/conveng.pdf

[50] See Keane and Potts (2008).

[51] See: http://unfccc.int/kyoto_protocol/items/2830.php

[52] See http://www.un.org/ga/search/view_doc.asp?symbol=ST/ADM/SER.B/755

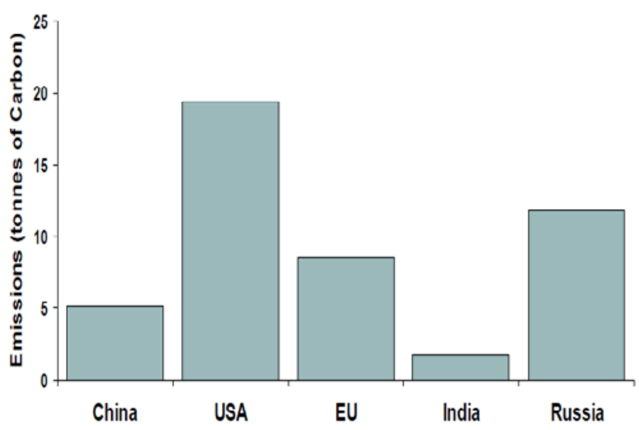
**Figure 5: National Carbon Emissions**




Source: Watson and Wang (2008)

The breakdown in negotiations for the second commitment period of the Kyoto protocol (2008-2012) in Copenhagen 2009 at the Fifteenth Session of the Conference of the Parties to the UNFCCC (COP 15) meeting was due to the desire by developed countries to create a new global agreement on climate change, the Copenhagen accord. This was as opposed to remaining within the framework already established by the UNFCCC, under the Kyoto protocol. The reason for the creation of a new accord by the developed countries in these negotiations was because of their difficulties in reconciling the principles of differentiation within the Kyoto protocol with the current and future emissions trajectories of the developing nations. This Copenhagen accord was rejected by members of the UNFCCC and by developing countries in particular: developing countries were unwilling to abandon the principles of differential obligations enshrined in the Kyoto protocol; the intention of some developed countries to move away from Kyoto seemed to contravene the principles of the UNFCCC framework.

**Figure 6: Per capita GHG emissions**




Source: Watson and Wang (2009)

The Copenhagen Accord was perceived to have been drafted hastily amongst a core group of developed countries, with the Danish presidency playing a leading role in seeking to coerce negotiators to accept it even though reference to legally binding outcomes had been dropped.[53] As discussed in Keane et al. (2010), COP 15 in Copenhagen coincided almost exactly with the tenth anniversary of the disastrous WTO Ministerial Conference in Seattle. In both Seattle and Copenhagen, the developing countries were criticised for obstructing agreement, but the two most important lessons that the WTO learned were, on process, that for a small, arbitrarily chosen group of countries to try to reach an agreement and then present it as a fait accompli to the rest would not be accepted (and bringing in ministers or heads of government may make compromise less likely) and, on substance, that if the major countries, now including developing countries, do not agree no procedure will produce an agreement.

The reasons identified for the failure at Copenhagen relate to both the procedural and the substantive reasons for failure at Seattle: on process, that there was no procedure to combine the negotiations of the formal UNFCCC process with the presence of heads of government, who held meetings set up according to their own or the host government's preferences; on substance, that the differences between the solutions acceptable to the US and to China had not been resolved (*Ibid*).

The meeting at COP16 proceeded in stark contrast to COP 15 which was marked by bitter divisions across the lead emitters. This includes in terms of the approach to negotiations, as well as substance, for the new agreement. The pressure to deliver was higher; the Mexican president allowed for divergent views (WRI 2010). The United States and China avoided any open sparring, and India emerged as a key broker between the two (Pew Centre 2010). All countries seek a global deal on climate change. But the sticking points remain compensation, or the provision of finance, for adaptation as well as the level of commitments and distribution globally of GHG reductions, which must be undertaken in order to avoid anthropogenic climate change.

A new incremental approach to negotiations was adopted because it was recognised that agreement in Cancún hinged on finding a way to finesse the more difficult questions of if, when, and in what form countries will take binding commitments.[54] However, the final outcome from that meeting - known as the Cancun agreement - leaves all options on the table and sets no

[53] The Danish Presidency of COP15 had, in the early hours of 19 December 2009, brought forward the text of the Copenhagen Accord and asked the COP to consider its contents for adoption as a COP decision. However, many Parties that were not part of the group that negotiated the Copenhagen Accord objected with respect to both the procedural aspects and the substantive content of the Copenhagen Accord, eventually resulting in the "takes note" decision by the COP. This means that, in accordance with the practice of the United Nations, the COP was neutral and neither approved nor disapproved the Copenhagen Accord (South Centre 2010).
[54] See Pew Centre (2010).

clear path towards a binding agreement, instead it summarises a set of decisions taken to move international action forward.[55]

The Cancun agreement comprises decisions undertaken under two tracks: the Kyoto protocol track and the ad hoc working group on long-term cooperative action, or the long term cooperative action (LCA) track LCA track. These include decisions on finance, the use of land use related measures to reduce emissions and extension of negotiations for the successor to the Kyoto accord by one year. More than 130 countries have since associated themselves with the nonbinding accord agreed at Copenhagen which continues to be negotiated under the LCA track, and more than 80 have entered specific mitigation pledges under the Kyoto track.[56]

However, the legal form of the Cancun agreement remains uncertain since parties still need to agree whether to adopt a legally binding agreement that complements the Kyoto protocol, or another option where parties agree to cooperate through COP decisions, rather than a new treaty.[57] The COP 17 will be held in Durban, South Africa in November – December 2011, however, agreement on COP 18 has not yet been reached, which suggests unless substantial progress can be made towards the end of 2011, the appetite for negotiating the successor to the Kyoto protocol, and UNFCCC process in general, may diminish.

As with other initiatives to drive through changes in global economic governance, such as the G20, the potential legitimacy of decisions made in the LCA - which are non-binding - may be difficult to embed within implementation agencies such as the UN. In comparison, if a successor to the Kyoto protocol is agreed, this could provide legal certainty: while imperfect, the protocol represents the only legally binding international commitment to reduce GHGs.[58]

## 4. Recent Shifts in Global Economic Governance and the Implications for the EU

A question for the future of international relations is whether the continued ascendency of the newly industrialised and emerging economies will be characterised by their smooth incorporation into global economic governance structures, or whether it may be disruptive. This disruption could occur if the new actors and their interests are not effectively assimilated into existing institutions. As discussed in Section 3, there remain a number of contentious areas.

[55] See WRI (2010) and Pew Centre (2010).
[56] See Pew Centre (2010).
[57] See WRI (2010).
[58] See Robinson (2011) for more discussion on how climate change negotiations have proceeded.

However, because of the deep economic ties that exist between the new powers and existing powers, there is no reason to believe that the transition from a uni-polar to a multi-polar world order must be characterised by conflict.[59] For example, visions formulated by scholars on International Relations (IR) suggest that China's rise need not provoke conflict either with Western powers or within Asia.[60] This is despite the fact that mainstream IR theory predicts first, that as a hegemon loses power to new powers, the period is likely to be beset with uncertainty and even conflict, and second, that multi-polar systems are inherently more conflict prone than hegemonic ones.

As argued in section 2, the years to 2020 are most likely to be characterised by a continued shift in economic, and therefore political, power from the US and Europe to China, Brazil, India and several other large developing countries. A well-rounded vision of this shift does not necessarily suggest that it will be a conflictual one. As pointed out, this period may in fact be the only time in recent history that there is such an even distribution of power. This provides the EU with a unique opportunity to reform existing governance structures so as to assimilate the new actors, and their economic interests, within them. The challenge now is related to whether or not Europe can assist and influence this process, and its outcomes.

A quick review of the recent global governance debates suggest that the EU has ceased to be at the forefront of global negotiations. This is because its position is never at the extreme end of the negotiations.

For example:

- *Global economy*. In the G20, the real debate has been between the US and China: e.g. on exchange rates, and on deficit versus surplus countries. By contrast, the EU's role in the G20 is in decline, as e.g. the Netherlands was not invited in Seoul. Some of the EU's proposals for reform of financial regulation and bonuses were not taken on board by the rest of the G20. The EU itself already includes surplus and deficit countries, finds it difficult to have a view on this, and has maintained mainly domestic rules on the banking sector.

- *Development*. The EU is losing votes in the Bretton Woods Institutions with a reallocation towards emerging powers. That said, emerging markets would contribute increasingly to the WB and IMF. Thus, whilst Europe is losing some seats, there may also be more resources available.

- *Trade*. The WTO Doha round broke down in 2008, mainly because the US and India could not agree a settlement. Whilst the main trade

[59] Phillips (2007).
[60] See Phillips (2007: 18-19).

discussions used to be between the US and the EU, this is no longer the case. For the US, ambitious trade liberalization is crucial, but emerging markets such as India could not agree with the US.

- *Climate change*. An oft cited example of the irrelevance of the role of EU was that the final climate negotiations at Copenhagen were done by the US with Brazil, China and India. The US demanded more concessions on emission reductions from large emerging countries.

The EU speaks with one voice only in the WTO, but even there it is not at the forefront of negotiations. All the major global fora now seem to be held up by a confrontation between the US and the new economic powers. Not only does this lead to questions over the role of the EU in this new global governance system, but also the extent to which it may be able to better shape the future of global economic governance. We suggest that the EU could regain its influence and ability to assist in the transition of global economic governance institutions by taking a more active part in negotiations and seeking alliances with the newly emerged and emerging economies. For example:

- The EU could become an advocate of global economic rebalancing between debtor and surplus nations, by showing how this can be done internally. With Germany, as an example of a surplus country, and the UK as an example of a deficit country, if the EU itself cannot show how rebalancing can be done, it is understandable why it has lost credibility at the G20 level to argue how this could be done.

- The monetary and fiscal easing in the US does not help global rebalancing so the EU could speak out more against the US on this issue. This would mean that the EU aligns itself with other emerging economies concerned about the impact on their economies of the US policy of quantitative easing. The EU would also benefit from a more competitive and globalised renminbi policy, and an appreciation of China's exchange rate, so it could side with the US on that issue, as well as other developing countries concerned about their own trade deficits.

- The EU is losing votes in the Bretton Woods Institutions but that is of little concern if there are more development finance resources from emerging markets. So instead of holding on to certain BWI votes, the EU could be more vocal in arguing for more emerging power reserves to be channeled through the BWI system.

- The EU would have benefited from the July 2008 Doha package. It could have helped broker a deal between the US and India, e.g. offering (non-aid) finance to compensate for Indian farmers because that was holding up getting a global agreement, at that time.

- In climate change, the EU has a special position. The EU is an important emitter but is also more ambitious in emission reduction targets than either the US or emerging powers. Here the EU could lead the way and provide climate finance (especially private finance). Unlike in trade negotiations, emissions *per capita* are likely to play a role in future climate negotiations, so there will be automatic credit for emissions being taken now.

This review suggests that the EU could regain the initiative in global negotiations, not by taking extreme positions and seeking conflict, but rather by oiling the wheels and seeking intelligent co-operation with key alliances depending on the issues in which it has an interest (e.g. more free trade, more emissions reduction, global rebalancing, more resources for development). In some cases this means co-operation with emerging powers, in other cases with traditional powers such as the US.

## 5. Conclusions

This paper has examined the new landscape of global governance which is undergoing major changes due to the rise of emerging powers. We provided a brief overview of the growing wealth and distribution of power across the newly industrialised and emerging economies in the international political economy, and noted that a new distribution of power amongst states is emerging with China as a major new power, alongside Europe and the US. The power of other major developing states is also likely to increase.

We then examined developments in the governance roles being played by the new emerging powers within global economic decision making bodies such as the G20, IMF, World Bank, WTO, and UNFCCC. As has been shown, the key issues and current sticking points within each of these institutions can be seen to be boiling down to stand-offs between the declining hegemonic power - the US - with the new emerging powers. The EU plays less of a confrontational role, but it is not central.

New forms of cooperative relationships towards global economic governance are unlikely to evolve unless the structures, objectives and norms of these institutions are better aligned with the preferences of emerging powers. This provides the EU, which also accommodates divergent economic interests across its member states, with a new and unique role to facilitate the progress towards a multi-polar world that avoids confrontation but which seeks cooperation in order to advance its own interests.

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## EUROPEAN DEVELOPMENT CO-OPERATION TO 2020

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Over the next decade, Europe's development policies will have to act on a combination of old and new domestic issues and substantial changes in the global landscape. Change in Europe's internal architecture – with implications for development policy – takes place in times of wide-ranging global shifts, and at a time when questions of European identity loom large in national debates. A key questions is: How will the EU, how will "Brussels" and the member states be working together on common problems? Global challenges include three issues increasingly facing EU's development policy agenda:

- The emergence of new substantial actors in international development,
- The linkage between energy security, democracy and development and
- The impact of climate change on development.

Public and policy-making debates need to be informed about future options and their likely effects; and decisions need to be based on good research and sound evidence. EDC2020 seeks "to improve EU policy-makers' and other societal actors' shared understanding of the above named emerging challenges facing EU development policy and external action." EDC2020 will contribute to this shared understanding by promoting interaction across research and policy-making, aiming at establishing links to share perspectives across different arenas, and mutual learning. To this aim, EDC2020 will provide policy-oriented publications, a shared project website and high-level European policy forums.

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SEVENTH FRAMEWORK PROGRAMME

Project funded under the Socio-economic Sciences and Humanities theme

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FUNDACIÓN PARA LAS RELACIONES INTERNACIONALES Y EL DIÁLOGO EXTERIOR

IDS Institute of Development Studies

SID
Society for International Development

odi
Overseas Development Institute