Multilateralism on the Wane: Can the World Economy Become One Again

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The overarching theme of the conference is whether the global economy can become one again.

The reference to 'again', suggests that the global economy was once 'at one'.

We do know that over the last few decades, the international economic and financial systems have become much more interconnected and interdependent due to economic development, liberalisation and technological progress.

But we also know that the global economy is under great strain.

It is unbalanced, with activity in many advanced economies faltering while other economies, particularly emerging markets and developing economies have been expanding rapidly.

As the BIS noted in its recent annual report, five years on from the outbreak of the financial crisis, the global economy is seemingly becoming more unbalanced as interacting weaknesses amplify themselves.

The BIS concludes that the situation is unlikely to be sustainable.

The growing integration of the global economy in recent years has been a source of great growth and development. Yet it is also a source of vulnerability, as we saw with the financial crisis that commenced in 2008. The crisis demonstrated that the policies of one country may create spillovers that undermine the stability of the global economy.

That is the situation we face now, with the spectre that the crisis in Europe could intensify and unfold in such a way that it sends shock waves throughout the global community.

And there are certainly forces working against an interconnected global economy.

We have already had a session on the reorientation of the financial system along national lines.

The Eurozone crisis is increasingly leading to the balkanisation of Europe's financial system and has undone much of the efforts over the past decade to promote financial integration. Banks are increasingly retrenching to their domestic markets and trying to match assets and liabilities by country.

Bond investors are also increasingly staying in their domestic markets.

And trade protectionist pressures are rising. In a report released in April this year, the WTO said that since mid-October 2011, G 20 countries had added 124 new restrictive measures affecting about 1 per cent of world imports.

The European Union also recently reported that there was a 'staggering increase in protectionism in recent months'.

Will there be an unravelling of the global economy and what wouldl be the implications?

Dani Rodrik from Harvard University's Kennedy School of Government recently wrote a piece entitled '*The end of the world as we know it".* It basically outlined a scenario where:

- Greece leaves the Eurozone
- Spain enters into a bailout program involving additional fiscal cuts and structural reforms which keeps Spain financially afloat for several months, but the Spanish economy continues to deteriorate, unemployment heads towards 30 per cent, the Government calls for a referendum about its future but Europe cuts off further support, there is a bank run, a financial collapse, it leaves the euro with the resulting consequences.

- Rodrik's scenario continues with the dislocation and economic collapse continuing in Europe, with growing repercussions on the US and Asia in particular.
- Chinese factories are faced with the prospect of massive layoffs, China announces a package of measures to boost growth, including direct financial support for exports and intervention in the currency to weaken the remimbi.
- The US responds, announcing across-the-board import duties on Chinese exports.
- His scenario goes on to describe a world economy that slips into what he says will be known as the 'Second Great Depression', countries sinking into economic autarky, a major realignment of politics and ultimately military conflict.

Rodrick concludes by asking the question whether this is a remote scenario, and answers by saying; '*Perhaps, but not remote enough'*

So how do we reduce this risk and help ensure that the world does become one?

Many would say that it requires more effective multilateral institutions

The World Economic Forum's recent study on *Global Redesign; Strengthening International Cooperation* concluded that;

> *'A new era of international relations characterized by more complex interdependence has dawned. The challenge for this generation of leaders is to muster the imagination and will necessary to update international cooperative structures and arrangements accordingly'.*

It is easy to say, doing so is more challenging.

Going back to Rodrick's scenario involving *'The end of the world as we know it',* as the world economy unravels, he refers to *'repeated global economic summits yielding few results beyond empty promises of cooperation'*

Some may say that is the world of 'summitry' that we currently know.

For example, David Rothkopf recently commented in an article in the Foreign Policy magazine that:

' we have gone in a matter of not too many months from a moment of optimism about multilateralism to grappling with the dark frustrations of aimless muddelateralism…our entire global ecosystem is shuddering from the after-effects of a world that seems to be lacking effective global institutions'.

The moment of optimism that Rothkopf refers to was the role of the G 20 in 2008 and 2009 in responding to the global financial crisis. But as for the G 20 today, he says the G 20 Leaders' Summit that was held in Los Cabos just last month had an official agenda that was 'laughably remote from the big issues of the day'. He goes on to note that:

'*In the past year, the group has played a much smaller role than was envisaged at the height of the financial crisis – reality that will be underscored as the reactive, last-minute agenda to address Europe's continuing crisis dominates the meeting, mostly through a flurry of bilateral leader conversations on the perimeter of the official event. There will be strong language…and a few essentially meaningless gestures that will do little to resolve anything.'*

This characterisation of the G 20 is misplaced.

For the world to become one again, effective multilateral organisations and forums are essential. These include forums such as the G 20 and international institutions such as the IMF.

The original intent of the IMF remains as valid today as it did 68 years ago. The 44 governments who gathered in Bretton Woods in July 1944 were seeking to build a framework for economic cooperation that would avoid a repetition of the vicious circle of competitive devaluations that had contributed to the Great Depression of the 1930s.

And this has remained the ongoing thrust of the IMF's work through surveillance and providing financial assistance, namely to promote economic policies that foster economic stability and reduce vulnerability to economic and financial crises.

Certainly since 2008 the IMF has done much soul searching to identify its failures and how it can be more effective in promoting global economic stability and growth

The IMF's Independent Evaluation Office examined the Fund's performance in the run-up to the global financial crisis and concluded that the IMF:

- failed to call attention to the build-up in vulnerabilities and risks in the global financial system;
- needed to do more work on identifying interconnections and spillovers between countries policies along with identifying risks, and
- needed to deliver clearer and more consistent messaging to its members.

The IMF has initiated a range of initiatives to enhance the effectiveness of its surveillance along with introducing new and more flexible lending instruments to provide the breathing room they need to make the necessary adjustments to overcome imbalances and vulnerabilities.

The G 20 Leaders process was, and remains, an important forum for facilitating and promoting international economic cooperation – and 'helping the world economy become one again'.

The underlying motivation behind the first of the G 20 summits in November 2008, at the height of the crisis, was that the world had to pull together in dealing with the crisis or alternatively it could disintegrate. And that motivation remains.

The fact that the G 20 was the body to take the lead in responding to the global crisis was also recognition of the rising importance of the emerging markets and developing countries – the integrated global economy that had developed over the past few decades had major players beyond the advanced economies and this needed to be recognised.

The G 20 has achieved much.

The London Summit in 2009 is often portrayed as being pivotal to the G 20s response to the global economic crisis – with a major fiscal expansion by G 20 members and commitments to increase the resources of the IMF and lending by the Multilateral Development Banks by over $1 trillion. At the height of the crisis there was a collective sense of danger and the policy action seemed relatively straight forward- intervention to support financial systems and fiscal and monetary stimulus to support activity.

But the consequences of the crisis have been complicated and protracted, country circumstances and policy flexibility is more differentiated.

There may not be the same forces supporting collective action that existed at the London summit in April 2009, but the significance of the G 20s response has extended well beyond the London Summit.

The G 20 has been instrumental in driving the strengthening of international financial regulation through the Financial Stability Board as well as reforming the governance arrangements in the IMF and World Bank.

Importantly, fearful that trade protectionism would rise significantly, G 20 Leaders at the height of the global financial crisis in November 2008 first pledged to refrain from erecting new trade barriers.

At the G 20 Summit in Los Cabos, Leaders agreed to extend the period when they will refrain from new protectionist pressures.

Admittedly, this deal was hard won and as noted, notwithstanding the pledge, there have been a number of new protectionist measures introduced by G 20 members. But while we will never know the counter factual, I believe that the rise in protectionism in the wake of the economic crisis would have been significantly larger in the absence of those G 20 commitments.

There is a vast literature on the potential gains from international policy coordination, and some have questioned the magnitude of the gains from policy coordination.

But there can be no question that if countries responded to the crisis by resorting to increasingly protectionist measures, both trade and financial protection, the world would clearly be worse off.

Moreover the *G 20 Framework for Strong Sustainable and Balanced Growth,* which was launched at the G 20 Leaders' Summit in Pittsburgh in 2009 is very important and has great potential.

It is continuing to be developed through the Cannes Action Plan in 2011 and more recently through the 2012 Los Cabos Action Plan.

In essence the *G 20 Framework* is an exercise where the G 20 members identify the policies required to achieve strong, sustainable and balanced global growth, make commitments as to the policies they will adopt, and then hold themselves accountable to their peers for their progress in implementing those commitments. All this is done with the assistance of the international organisations, particularly the IMF and World Bank.

It is work in progress, but it does offer great potential. In many respects it is a bold experiment in advancing economic policy cooperation.

But realism is required.

It is easy to be a critic of efforts towards better international economic cooperation such as the G 20.

It is all too easy to say that Leaders summits are nothing but costly talk shops that produce few tangible results.

On the other hand, there is also a tendency for the official side to get carried away with its own rhetoric and attempt to present the outcome of every Leader's summits as a path breaking step towards global prosperity.

To repeat, for the world to become one again, we need better multilateral organisations, but realism is required as to what these organisations and forums can and cannot achieve.

For example, two risks confronting the global economy are the escalation of financial stress in the euro area and the 'fiscal cliff' in the US.

But the crisis in Europe will not be solved by the G 20, the IMF or any other international institution.

These forums and international institutions can help, but the crisis can only be solved by Europe. And the solution to sustain the euro will require Europe 'becoming one', through a speedy move to true integration, not only a monetary union, but also banking, fiscal and ultimately a political union.

Similarly, the 'fiscal cliff' that threatens the US economy will not be solved by the G 20.

It will be solved by a political agreement between the Democratic and the Republican parties that sees the fiscal adjustment in the US in 2013 tailored to the circumstances confronting the US economy in the short-term but also paired with stronger and tangible adjustment over the longer term.

The IMF provides analysis and advice. It does not have the power to compel nation states to act in accordance with IMF Board conclusions.

Similarly the G 20 cannot compel countries to act.

Some have said this is a weak link in an exercise that strives to coordinate policy across a diverse group of countries.

But there will never be a mechanism to compel countries to act in the G 20. The enforcement mechanism will remain based on accountability, transparency and peer pressure.

The strength of the G 20 comes from the commitments that each member makes in terms of its own actions and policies. Its effectiveness will depend on whether members deliver on their commitments.

And this is why it is important that the G 20 Framework and Mutual Assessment Process is owned by G 20 members.

It is not an exercise in surveillance where an international institution tells countries what policies they should adopt – and the countries either take that advice or ignore it.

It is an exercise where G 20 members set out their objectives and the policies they will follow to meet those objectives and hold themselves accountable for their actions.

However whether the world economy will become one again will ultimately depend on political leadership.

It will depend on governments and political parties showing the leadership necessary to win the domestic political battles necessary to implement the policies which will contribute to the recovery in their own economies and the global economy.

Multilateral forums and institutions can help. It is easy to criticise summits as nothing but talk shops, but in an integrated global economy, an effective economic dialogue between the leaders and finance ministers of the major global players is essential – the more dialogue the better.

As we have seen from the efforts by the IMF in improving its surveillance, it is important that countries focus more on the spillovers that come from their policy action, not only negative but also positive spillovers.

It is important to identify and reinforce commonality of interests.

One focus of the IMF's work in assisting the G 20 Framework discussions is to identify upside scenarios, and these upside scenarios are primarily focused on recognising the mutually reinforcing impact of individual country policy actions.

And this is the challenge that political leaders have. To be able to convince their electorates that the policy steps that they are advocating are ultimately for the benefit of their citizens, even if it is not immediately apparent.

For example the domestic political pressure may be for increased protection of local industry in order to protect jobs. But political leaders will need to explain that rising protectionism will cost jobs and in fact the best way to promote growth is through further liberalisation.

Participation in international summits can help Leaders with their own domestic political battles. To be able to say that the measures that are being implemented are part of a broad international effort can be beneficial. And summits can help stiffen political resolve, Leaders will want to report positive progress to their peers.

In this regard the G 20 has served a role in putting pressure on Europe to effectively respond to its crisis. And in Los Cabos the Euro Area members of the G 20 committed '*to take all necessary measures to safeguard the integrity and stability of the area'*.

Whether these turn out to be empty words or not will ultimately rest on the actions taken by European Leaders.

So to come back to the basic question that has been asked at this conference, 'will the global economy become one again'?

It had better, because the cost of the global economy unravelling is enormous.

As to becoming one again, it is in essence a political issue, and will ultimately require strong political leadership.