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The Global Governance Reform, the G-20 and the Restructuring of the International Financial Architecture

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Abstract. The global financial crisis revealed that the international financial and monetary architecture has structural flaws. It was clearly seen that because of global economic integration, international cooperation is essential to restructure the international financial system and to constitute an effective global regulatory framework. In this conjuncture, significance of the global governance system and the G-20 increased. The aim of this paper is to evaluate the role of the G-20 in the restructuring of the international financial and monetary system within the context of global governance reform.

To this end, effectiveness and legitimacy of the G-20 are analyzed by utilizing the global governance concept. The discussions and negotiations among the developed and developing countries about the restructuring of the global financial architecture are evaluated. International and domestic political obstacles to global governance reforms and representativeness, coherence and compliance deficits of the G-20 are investigated.

It was concluded that the financial crisis enhanced the importance of global governance and the G-20 came out as the organization that could abate the representativeness, coherence and compliance deficits of the global governance system. Nonetheless, because of diverging interests of the U.S., the E.U. and the developing countries, it is expected that global governance reforms and the restructuring of the international financial system will proceed slowly.

Keywords: Global crisis, international financial system, global governance, the G-20, international politics

1. Introduction

The global financial crisis, which started in 2008 in the United States, spread quickly to other countries and dragged many countries into recession. The crisis demonstrated that because of global economic integration and interdependence, global collaboration is needed to create an effective global regulatory framework and a stable international financial system. In this conjuncture, the global governance concept gained importance. The restructuring of the global financial architecture, the reform of the global governance system and the role of the G-20 in these processes were investigated in many studies and discussed in various international platforms.

The main objective of this paper is to analyze the role of the G-20 in the restructuring of the international financial and monetary system. Representativeness, effectiveness and legitimacy of the G-20 are evaluated within the context of the global governance reform. Debates and negotiations among the developed and developing countries at different platforms such as the G-20 summits were analyzed. International and domestic political obstacles to global governance reforms are investigated.

The article proceeds in the following manner. In the second section, the reform of the global governance system and the role of the G-20 in this process are analyzed in connection with efforts to restructure the international financial and monetary system. In the third section, obstacles to the reform of the global governance system and the legitimacy and effectiveness deficits of the G-20 are evaluated.

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2. The Global Governance System, the G-20 and the Reshaping of the International Financial Architecture

The global crisis enhanced the significance of global governance, particularly with regards to the governance structures of the international financial institutions since it is expected that the international conflicts over international monetary system and currency policy will intensify [1]. Global governance and multilateralism also gained importance as states started to deal with economic, political and security issues in and around multilateral forums [2]. Effective cooperation among major economies and collective action are seen essential since if mercantilist strategies are followed by all major countries, it may lead deflationary pressure on the world economy [3].

Even before the global crisis, it was argued that credibility of the G-8 and the global governance system declined significantly in terms of who sets the rules of the game and why these rules are in place [4] The systemic shift in the global balance of power from advanced countries to developing countries and the gradual fall of US leadership led countries to demand global governance reforms [5]. After the crisis, it is argued that as the US declined in relative terms as a hegemon, it is unable to railroad through decisions in international summits without caring to win the argument in advance [6].

The global crisis necessitated the restructuring of the decision-making mechanisms of international institutions in a way that gives more voice to the developing countries. In this conjuncture, the G-20 came out as the institution, which could help alleviate the legitimacy and effectiveness issues of the G-7/8. The ascendancy of the G-20 is assigned to a number of factors. Its recognition as a leading forum for managing processes during the global crisis, its legitimacy stemming from representing almost 90 percent of world's gross domestic product, 80 percent of the global trade and 65 percent of the world population and its structure that encourages participation of developing countries such as the BRIC countries are among these factors [7].

Making the G-20 the main platform for international economic cooperation by including the developing countries has deepened the democratic legitimacy of global economic governance [8] since a necessary (though not sufficient) condition for any properly functioning government or governance system is that the major players buy into it, by giving them a bigger say in the decision-making [9]. Scharpf argues that global governance must rest on input as well as output legitimacy [10]. The traditional source of legitimacy for international institutions, problem-solving effectiveness is no longer sufficient according to many critics [11]. In this regard, participation of the developing countries in the decision-making processes of international financial institutions is seen essential.

Ikenberry and Wright argues that as a result of changing balance of power in world politics, the shift in style, agendas, and institutional forms of global governance are likely to emerge [12]. Two forms of global governance are likely to grow in importance; informal steering committees such as the G-20 and regional governance institutions.

The global financial crisis demonstrated that the international monetary system with the dollar as the global reserve currency is increasingly insufficient with regards to fundamental principles such as confidence, stability and adjustment. In this connection, the G-20's role to facilitate policy cooperation among countries to restore confidence and to reform the existing international monetary system arrangements is seen essential [13].

2.1. Criticisms against the G-20

The G-20 has alleviated the legitimacy issue of the G7/8 at some extent. Nonetheless, it is still criticized on the grounds of lack of representativeness. It is argued that the G-20 should be replaced by a more representative institution. The Commission of Experts of the President of the United Nations General Assembly headed by Joseph Stiglitz called for the replacement of the G-20 with the Global Economic Coordination Council [14].

All 192 countries in the world have different agendas and concerns with regards to the global governance system and are trying to participate in the restructuring of the international monetary and financial system in a number of different diplomatic and institutional arenas. In this context, it is argued that exclusion of the vast majority of countries from the G-20 limits the legitimacy of the G-20 [15].

To become more inclusive and legitimate, the G-20 invited five non-member countries to the Seoul Summit. Malawi was invited in its capacity as chair of the African Union; Ethiopia as chair of the New Partnership for Africa's Development (NEPAD); Vietnam as chair of the Association of Southeast Asian Nations (ASEAN); Singapore as chair of the Global Governance Group (3G); and Spain as one of the 10 largest economies in the world.

There is controversy about the optimum number G-X members. Carin and Mehlenbacher argues that it is theoretically possible for a group of twenty leaders to reach a consensus agreement provided that they are farsighted about the impact of their decisions, seek opportunities for issue linkage, and fully disclose their values and interests [16].

3. Obstacles to a Coherent and Effective G-20

During the initial phases of the global crisis, there was consensus among the countries on the need for structural reforms in the existing global governance system. In these circumstances, the G-20 gained importance and became the main platform for international economic cooperation. But as soon as the emergency receded, the appetite for fundamental reforms also receded and many promises made by the G-20 leaders remained unfulfilled [17]. It is argued that after cooperation of developed and developing countries in the initial emergency period, the international arena is becoming a conflict zone as competing interests complicate efforts to build international consensus on many issues such as trade and currency policies [18]. Even if the G-20 was successful in coordinating national and international stimulus packages at the initial phases of the global crisis, it took a little more than a year to see the signs of summit fatigue and some degree of backtracking on the G-20 promises [19].

Helleiner argues that innovations in global financial governance and a new international financial system are likely to come into being through a slower and more incremental process of development than they did in 1940s when the Bretton Woods System was born [20]. He divides the process into four phases: a legitimacy crisis, an interregnum, a constitutive phase and an implementation phase. He states that even if the global crisis created a legitimacy crisis, the process did not pass into a constitutive phase from the interregnum phase.

Even if the G-20 took important steps to coordinate fiscal policies and stimulus efforts, to reform the financial regulatory framework and to increase IMF's financial resources; since reforms in decision-making process of the IMF came to a halt, it is estimated that the emerging countries will still depend on their reserves to protect their financial stability [21]. The G-7 countries (minus France) were reluctant to publicly discuss fundamental reforms of the international monetary system within the G-20 process or to evaluate the expansion of the use of the SDRs in spite of the demands from the developing countries, particularly the BRIC countries [22]. The BRIC countries called for the reform the international monetary system by replacing the dollar as the global reserve currency

Even if the G-20 increased the participation of the emerging countries, there are substantive and philosophical differences among the Anglo-Saxons, the European countries and the developing countries. It is argued that there are three challenges to make the G-20 framework operational, namely establishment of quantitative criteria, definition of goals, and enforcement mechanism [23].

Apart from differences among the Anglo-Saxons, the Europeans and the developing countries; there are differences between both sides of the Atlantic, among the European countries and among the developing countries. For example, the European Union was unable to intervene in the sovereign debt crisis in Greece effectively for months, which deepened the crisis and caused contagion to other European countries. The G-20 was also ineffective and transferred the problem to the IMF [24]. It is argued that governments should concentrate on what the G-20 can actually do rather than talking about the potential of the G-20 to revolutionise the global governance system.

Sheng uses network analysis to find the right steps to improve financial and global governance. He states that the network analysis views the global financial architecture as a "complex evolutionary network of local networks, highly concentrated with power law distribution of transactions by value, highly interactive, and currently prone to financial instability due to volatile capital flows arising from structural imbalances and policy errors" [25]. He argues that even if the balance of power is changing from developed countries to emerging countries such as China and India; basic rules of game have not changed and there is strong will to protect the status quo.

Even if the need to regulate the financial sector globally is generally accepted, some argue that the action in financial regulation is local, which limits the effectiveness of the G-20 [26]. The financial crisis has clearly shown that there is a national as well as international dimension to all of these problems and their solutions [27]. It is argued that convergence and divergence of the positions of governments regarding the global governance reform, specifically the reform of the IMF and the banking sector cannot be explained only by analyzing the international system framework. National institutions and domestic ideas and interests also affect positions [28]. Because of this, the governance of global finance should be reformed by taking account important changes in the organization of global financial relations between financial intermediaries, their home governments and sovereign wealth funds (SWFs).

One of the obstacles to the regulatory reform of the financial sector is the "revolving doors" issue, according to which regulators are put under pressure to become compliant with industry demands through promises of future careers in the regulated industry. In the U.S., a "Wall Street-Washington corridor", according to which many Goldman Sachs employees took up key posts at the Treasury and the Federal Reserve and then returned to the industry, is seen as one of the obstacles in front of the financial sector regulation [29].

4. Conclusion

The financial crisis enhanced the significance of the global governance system since it was clearly seen that the restructuring of the international financial and monetary system required the collaboration of developing and developed countries. In this conjuncture, the G-20 came out as the organization that could abate the representativeness, coherence and compliance deficits of the global governance system. At the initial phases of the global crisis, the G-20 countries reached consensus at least on some issues. Nonetheless, as emergency receded, monetary and fiscal policy preferences of the Anglo-Saxons, the European countries and the developing countries started to diverge because of asymmetry of interests.

As the policy preferences diverged, the global governance reforms came to a halt and bigger problems left unresolved while states attempted to stave off the crisis by short-term policies. Domestic political and economic obstacles complicated the process furthermore. The G-20 lost its effectiveness at some extent and cleavages among the Anglo-Saxons, the Europeans and the developing countries (particularly the BRIC countries) with regards to issues such as the reform of the governance structures of the international financial institutions widened.

It is expected that the global governance reforms will proceed slowly. It is anticipated that if the interests of the Anglo-Saxons, the Europeans and the developing countries diverge furthermore, the reform of the global governance system and the restructuring of the international financial system may become a conflict zone of international politics. A clear vision, strong leadership and more cooperative action by governments are needed to make the G-20 an effective coordinating mechanism for global economic governance.

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