GOVERNANCE, TRANSPARENCY AND ACCOUNTABILITY IN THE "Gs"

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April 20, 2009

Discussion Draft

In this paper I make two points. Its overall focus is on the role and impact of the "Gs" – groups of nation-states that act together to achieve common aims and objectives – on improving global financial governance. First, the Gs (most prominently, the G7, G8, G10, G13, G20, G24, G77) collectively represent a form of *asymmetric global governance*. The asymmetry is starkly reflected by the facts that there are two subsets of Gs, one representing developing countries (the G24 and G77), which play a passive or reactive role, while the other, representing industrial or emerging market countries (principally the G7/8 and G20), play a more active or agenda-setting role. Clearly, the latter are the "Gs that really count" in shaping global policies, institutions and events. Moreover, among the latter groups, agendas or rules are established for the world, and implemented through international organizations (such as the Bretton Woods institutions). While in principle such rules should have universal validity, in practice the rule makers are not typically subject to the writ of international organizations, and abide by a "best efforts" approach in applying their own rules to themselves. Accountability to the rules is therefore subject mainly to peer-pressure by the rest of the Group through its regular meetings, rather than through the conditionality or other mechanisms of the international institutions (for example, Article IV assessments by the IMF).

The second point addresses the question, "Is some form of G-X inevitable, for example the G-8 or G-20?"[2] In particular, do collective action problems render a universal body, the G-192 (embodied for example in the United Nations), dysfunctional? If so, it is imperative to recognize the problems of the status quo, and find remedies to the current asymmetric global governance. On the other hand, even if it is possible to refute the collective action arguments on which the dysfunctionality of the G-192 is based, that does not necessarily lead to more "effective" global governance although it would certainly be more representative, and likely enhance accountability and transparency.

1. Asymmetric Global Governance

Much has been achieved in the past six decades in many parts of the world by way of more representative, responsible, transparent and accountable governance at the level of the nation-state, although in all states better

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[2] Or even an architecture of "variable geometry" consisting of a G-X for some issues such as the global economy, a G-Y for others such as the global environment, and so on, where X and Y may overlap somewhat but are not fully congruent.

governance can be regarded as a work in progress. Since 1945 the world has been facing the challenge, or perhaps just the possibility, of applying the same aspirations to global governance, which is exercised through the international organizations and rules that have come into being in the postwar period.

Of course, each international agency has its own framework of accountability. The question posed here is whether the “Gs” that have sprung up parallel to the international organizations have aided or impeded the accountability and transparency of global governance.

It was during the Cold War that the first “Gs” emerged, with the G77 and the G10 during the 1960s, followed by the G24, G5 and the G7 in the 1970s, along with the institution of the annual economic summit among the major Western industrial powers (Culpeper 2001, 2003).

Developing country groups

Two of the above Gs represent groups of developing countries. The Group of 77 represented developing countries at the first United Nations Conference on Trade and Development convened in June 1964 in Geneva. Its aims were to provide “the means for the countries of the South to articulate and promote their collective economic interests and enhance their joint negotiating capacity on all major international economic issues within the United Nations system, and promote South-South cooperation for development.”

The other developing-country coalition was the Intergovernmental Group of 24, which was created in 1971 to “to concert the position of developing countries on monetary and development finance issues.” Whereas the G77 operates in the UN system, the G24 has acted within the Bretton Woods institutions.

Both the G77 and G24 were born in the heyday of the debates over the New International Economic Order. Those debates lingered into the 1970s and experienced a final flourish during the “North-South Dialogue” of the late 1970s and early 1980s, but expired with the Cancun North-South Summit in October 1981, which coincided with the advent of President Reagan and Prime Minister Thatcher.

Both the G77 and G24 had an important influence on the international policy dialogue during the debates over the NIEO and subsequently. But they cannot be said to have had a significant impact on global governance, apart from the establishment of UNCTAD, which is considered an important part of the global architecture by many low-income developing countries, and perhaps the Generalized System of Preferences (GSP) in the trade arena. But in general the G77 and G24, and to large extent UNCTAD itself, can be considered “reactive” to the policy discourse that is dominated by the G7 and its successor, the G20, rather than shaping outcomes and directing the course of international policies. This may reflect the fact that developing countries are far more heterogeneous than developed countries. Accordingly it is much more difficult to mobilize developing country groupings around common interests or objectives.

Industrial country and emerging market groups
The G7[3] emerged in 1976 at a Summit convened by the United States in Puerto Rico. From the beginning there were indications of asymmetry creeping into global financial governance. Since its creation the G7 has had a leading role in reforming the global financial architecture. In 1976 it spearheaded the Second Amendment to the IMF's Articles of Agreement, which gave the IMF a mandate to promote a "stable system of exchange rates" to succeed the "system of stable exchange rates" that collapsed in 1973. In the 1980s the G7 played a lead role in addressing the developing country debt crisis (culminating in the Brady Plan of 1989), and the Mexican currency crisis in 1994-95.

The policy conditions accompanying the debt relief initiatives, articulated in the "Washington Consensus", generated controversy that continues today. Although conditionality was administered through the international financial institutions (including the regional development banks) they originated in the U.S. Treasury Department and were then validated by the G7.

In its first two decades the U.S. (the "G1") led the other members of the G7 in these global initiatives rather than seeking consensus. These intra-group dynamics began to change during the 1980s with the Plaza (1985) and Louvre (1987) Accords aimed at realigning exchange rates, particularly between the overvalued U.S. dollar, the Japanese yen and the German mark. The need for the U.S. to get buy-in from other members of the G7 and emerging market economies outside the G7 became increasingly evident—indeed to realign exchange rates with its major trading partners it was unavoidable.

While the Plaza and Louvre Accords may on the surface be considered as a successful G7 initiative, the fact is that it was undertaken outside the IMF, the agency responsible for promoting exchange-rate stability. Moreover, the impact of the currency realignments extended beyond the G7—in particular a depreciated dollar had consequences for developing countries' exports as well as for Japan and Germany. But countries outside the G7 had little or no role in the process.

The genesis of the G20, along with the establishment of the Financial Stability Forum (FSF) in the late 1990s, also demonstrated the same signs of asymmetry exhibited by the evolution of the G7 (see Culpeper 2001for a full account). As Kirton (1999) put it, the G20 represented the "G7-ization" of international financial

[3] Here the G7 refers both to the group of Finance Ministers and Central Bank Governors, and the leaders' group meeting at the annual economic summit. The G8, which also includes Russia, has only met at the heads of government level, and originally had a distinct and more political rather than economic focus. Over time the G8 has supplanted the G7 at the heads of government level while G7 Finance Ministers and Central Bank Governors continued to convene without Russia.

decision-making rather than a genuine broadening of participation. The Asian financial crisis demonstrated the need to involve the emerging markets in the decision-making process, or at least to invite them to the table. However, as with the earlier debt crises, the process was driven by the U.S. Treasury with others effectively co-opted into the eventual decisions that were taken. The invitation list was determined by Treasury. In the case of the FSF, the list was limited to the G7 countries with non-members invited on an ad hoc basis[4]. In addition to country representatives, the principal international financial institutions (World Bank, IMF, BIS) and international regulatory and supervisory institutions (e.g. the Basle Committee on Banking Supervision) participated. In this way the proceedings of the FSF were directly transmitted for implementation by the Bretton Woods institutions and the other IFIs[5].

As with the earlier debt crises, the policy conditionality that emerged from the Asian financial crisis generated controversy. But this time it also led to resistance in the form of "defection" particularly from the IMF. To protect themselves from future crises and IMF conditionality borrowers prepaid their loans and adopted strategies of self-insurance through rapid accumulation of foreign exchange reserves. The unintended consequence of this strategy was to feed the growing macroeconomic imbalances and the asset bubble that burst in the financial crisis of 2007-8.

In retrospect, it is clear that the decisions taken by the G20 and the FSF in the wake of the Asian crisis demonstrated a preference for risk management than "behaviour management". Reaffirmation of hedge funds, offshore financial centres, unrestricted capital flows and continued financial liberalization won the day over proposals seeking greater financial regulation (e.g. over hedge funds), selective capital controls, and reforms of IFI conditionality[6]. It is worth noting that the latter, more comprehensive and activist agenda was one endorsed by the United Nations taskforce summoned to consider policy options to address the financial crisis (United Nations, 1999). Such an agenda was much closer to the one that subsequently emerged when G20 leaders met in November 2008 to address the global financial crisis that erupted in the U.S. and Europe. For example, the UN taskforce recommended:-

- More universal surveillance of macroeconomic and exchange-rate policies, including those of the G-3. The next crisis may be generated by current account imbalances and asset bubbles in this group, and the potential for a

[4] For example, at its meeting in 2000, the non-G7 members invited comprised Australia, Hong Kong, Netherlands and Singapore.
[5] In parallel to the formation of the G20 Finance Ministers, with the 2000 summit the G8 leaders began to reach out to selected emerging market and developing countries. By 2005 the G8 had established an informal dialogue with the "O5" (the Outreach five, comprising Brazil, China, India, Mexico and South Africa). When the O5 met together with the G8, some observers began to refer to the "G13".
[6] With some notable exceptions in Asia, e.g. Malaysia's imposition of capital controls. However, these were seen as outliers and in Malaysia's case widely condemned as ill-advised.

global crisis arising from sudden shifts in exchange rates and asset prices is large; so it is in the interest of the world community to try to engineer a "soft landing".

- Transforming the IMF into a genuine lender of last resort, able to issue its own liquidity.
- More concerted approaches to debt restructuring, including the use of concerted payment standstills mandated by the IMF.
- A more stable exchange-rate regime; in particular, exploring options other than pure floating and hard pegs (for example, regional arrangements; see below).
- A more flexible approach to capital account liberalization, including the development of policies regarding capital controls, not as instruments inexorably to be abolished, but as permanent safeguards that can be invoked, when necessary, by countries vulnerable to capital surges.
- Greater regulation of bank and non-bank flows (including portfolio equity and hedge funds).
- Greater country "ownership" of adjustment policies adopted in crisis conditions.
- A thorough review and reform of IMF conditionality, particularly of the pervasive and intrusive sort evident in the Asian crisis.

The scope and comprehensiveness of the G20's deliberations were reaffirmed when its leaders reconvened in London on April 2, 2009[7]. The declaration they issued addressed not only the immediate crisis through the restoration of growth and strengthening financial regulation, but also the need to strengthen financial institutions and ensure that developing countries participate fully and equitably in the recovery. The announcement included a $1.1 trillion initiative[8] to restore credit, growth and jobs in the world economy. It is clear that G20 leaders principally had the emerging market and developing countries in mind.

Perhaps the most surprising part of this initiative was a decision to treble the resources available to the IMF to $750 billion, including a new SDR allocation of $250 billion. The latter represents a dramatic increase from the current cumulative allocation equal to about $32 billion[9]. Another surprising part of the declaration[10] referred to the "desirability of a new global consensus on the key values and principles that will promote sustainable economic activity. We support discussion on such a charter for sustainable economic activity with a view to further discussion at our next meeting."

[7] http://www.g20.org/Documents/final-communique.pdf, accessed 20 April 2009
[8] The extent to which the $1.1 trillion is "additional" is subject to dispute.
[9] This does not take into account the allocation of SDRs that would result when (and if) the Fourth Amendment to the IMF Articles comes into effect. The latter would double the cumulative allocation to about $64 billion. In their London communiqué the G20 endorsed urgent ratification of the Fourth Amendment, which was approved in principle in 1997 but requires an 85 percent voting majority. Note that the share of low-income countries in the new allocation of SDRs would amount only to $19 billion, less than 8 percent of the total.
[10] Paragraph 21. It is not clear what exactly is meant by "sustainable economic activity."

When taken together, these two parts of the London declaration warrant some caveats. First, until quite recently the very future of the IMF was in question, not only by erstwhile borrowers “defecting”, but also by the G7 countries themselves who were increasingly critical of the ineffectiveness of the IMF for a number of reasons. Second, judging from its support to countries seeking its support because of the current crisis, there were signs that the IMF’s policy conditionality had not changed substantially in its lending to a number of transition and developing countries. Fiscal compression and credit restrictions were features of loan conditionality in Romania, Armenia, Mongolia and the Democratic Republic of the Congo. This has led some critics to demand that reform of the IMF’s policy conditionality must precede investing it with the $500 billion in additional resources promised by the G20.

Furthermore, the reference in the communiqué to “a new global consensus on the key values and principles that will promote sustainable economic activity” may be welcome, and could indeed address (among a number of things) the need to reform the policy conditionality of the IMF, but it seems odd that the G20 would try to forge a “global consensus” through its own discussions. If it did so the legitimacy of whatever emerges, no matter how enlightened, would be highly questionable. This is clearly a subject which warrants far more inclusive and participatory discussions involving the entire world community, both the “G192” and non-state actors as well.

To conclude, the lack of transparency and accountability of the G7 and the G20 has resulted in decision-making more focused on short-term crisis management than on long-term financial reform, and in decisions that have not stood the test of time very well. Indeed, neither the G7 nor the G20 can be held directly accountable since their power and influence is exercised informally through the IFIs. The latter are formally accountable to their governing boards, which are dominated by the G7 and G20, so in a superficial sense formal accountability is being observed through the IFIs.

It is worth noting that the compliance of the G8 to its own decisions has been mediocre at best. Monitoring by the University of Toronto’s G8 Research Group[11] indicates that between 1996 and 2002 compliance to commitments (economic and political) as expressed in annual summit communiqués varied between a low of 12.8 percent to a high of 81.4 percent. (The fact that it has fallen to this scholarly group to track the G8’s compliance, rather than through more public channels, is itself noteworthy.) The accountability of an organization that does not comply with its own decisions is a legitimate question. However even 100 percent compliance would not necessarily imply better outcomes, if in fact the underlying decisions are sub-optimal. The same points on compliance and accountability can be made about the G20’s decision-making.

[11] http://www.g8.utoronto.ca/evaluations/allissues.html, accessed 19 April 2009

A word of *realpolitik* is in order. At the time of writing it seems clear that the dynamics among the G20 leaders will be different than that prevailing among G20 finance Ministers and Central Bank Governors, where a hierarchy of sorts emerged with the United States at its pinnacle, the other G7 countries just below, and the remaining developed and emerging market countries at its base. Among the emerging market countries, China seems intent on playing a more active role. In the run-up to the London G20 meeting, for example, the Chinese authorities expressed misgivings about the stability of the US dollar and the international currency system as a whole. In addition, the Governor of China's Central Bank expressed support for the creation of a new international currency. These public pronouncements, it can be surmised, had a direct impact on the London discussions and likely played a role in the G20's decision to support a new emission of $250 billion SDRs through the IMF, representing a tenfold increase in SDRs.

Whether China and some other "BRICs" (Brazil, India, and South Africa) decide to collectively exert greater voice through the G20 remains to be seen. To date there is little sign that they have chosen to coordinate their positions on international financial issues. However, if they do so, given the impact China has had acting alone, they would surely have a pronounced impact on decisions and reshape the rules (Nayyar 2008).

2. <u>Collective action problems: are the Gs inevitable or suboptimal?</u>

Mancur Olson (1971) theorized about the rationality of collective action and concluded that smaller groups are far more likely to succeed in mobilizing to advance their interests than larger groups, since the benefits of co-operation are higher, coordination is easier and it is less easy for members to be free riders among small groups. Olson's conceptualization is often understood to mean that collective interests are highly unlikely to be served through collective action by the public as a whole. However, it can equally be understood as a critique of small-group mobilization, which typically serves the members of the small group ("special interests" or lobby groups) as against the wider public interest (McLean 2000).

Seen in this light, the formation and leadership of the G7/8 and G20 are not simply the reflection of the profound difficulties of mobilizing the global community (the "G192", if expressed in terms of the member-states of the United Nations). However, *any* subgroups of the G192 (the G7/8, G20, G24 or G77) are more likely to pursue their own, narrower interests than act in the global interest. Certainly, many of the decisions and initiatives undertaken by the G7 in its 33-year history reflect the power and influence of their industrial and financial sectors. For example, the policies pursued in response to the Asian financial crisis served the financial sector in the U.S., as well as unconstrained fiscal and credit expansion, for another decade before the crash in 2007-8.

At the very least, the G7/8 and G20 can be regarded as suboptimal, if not downright harmful in the promotion of global welfare. That does not, however, imply that organizing the G192 is easy or straightforward. All the constraints facing large group mobilization mentioned by Olson are no less binding. Others, such as Garrett Hardin (1968) have invoked the “tragedy of the commons” to argue that managing common property resources in the global public interest is exceedingly challenging and requires intervention ranging from privatization at one end of the spectrum to draconian government intervention and regulation at the other.

However, Olson also has a growing list of critics who refute his claims that larger groups are less able to engage in collective action (Marwell and Oliver, 1993). These critics do not claim that group size is unimportant, but instead that collective action cannot be ruled out simply because group size is large. A more pragmatic, and less pessimistic, literature on the prospects for collective action has emerged, thanks largely to political scientists, sociologists and anthropologists, grounded in field research, rather than economists (such as Olson). For example, Ostrom (1990) finds many examples where humans and ecosystems have interacted in a practical and sustainable manner rather than leading to natural resource collapse, as Hardin would have it.

Another literature has sprung up around the subject of Global Public Goods (GPGs, e.g. Kaul et al, 1999), which focuses both on the reduction of “bads” such as climate change and international financial instability, as well as the production of GPGs such as peace, equity and justice, environmental sustainability, global health, knowledge and information. An important facet of Kaul et al (1999) is that non-state actors, both in civil society and the private sector, are as important as states in the provision of GPGs. In a recent contribution to this literature, Barrett (2007) provides an analytical framework for examining international cooperation on global public goods. Barrett’s framework examines the costs and benefits of supplying GPGs, which allows the possibility that some GPGs may be provided by one or two large and powerful nations in their own self interest, while others require universal cooperation, including that of the most fragile states.

3. A Brief Conclusion

When it comes to international financial governance, the track record of the G7/8 and the G20 provides evidence of asymmetric global governance. However, the challenges posed by China, with respect to a global public goods issue such as the need for an international currency, suggest that it will not be business as usual in the G20, with the United States effectively calling the shots and the remainder of the G7 following suit. Differences between the continental Europeans and the Americans about the relative priority of fiscal stimulus vs. increased regulation have also served to undermine the old hierarchy with the United States securely at the top.

However, whether a G20 that is less hierarchical and in which China, India and Brazil challenge the industrial old guard remains to be seen. And even in this scenario, it is quite possible that the G20 will continue to represent a form of asymmetric global governance, except that it will now reflect the interests of the emerging market countries instead of, or as well as, those of the U.S. and the other G7 countries. On the other hand, China and the other emerging market countries may well represent the concerns and interests of other non-G20 developing countries much better than the G7 could ever do so.

In the meantime, the track record of the G192, when it comes to addressing international financial governance, seems much more prescient and comprehensive when the efforts of the taskforce established after the Asian financial crisis are reviewed. The current work of the Commission of Experts convened by the President of the UN General Assembly on Reforms of the International Monetary and Financial System (UN 2009) reinforces this view.

Finally, the most likely scenario—which is supported by the evolving literature on collective action and global public goods—may involve a more variable geometry of Gs. In addition to the G7/8, G20, and G192, there are likely to be other coalitions of Gs, involving non-state actors as well, to ensure that global public goods are supplied more commensurately with global needs. This perhaps makes for a somewhat messy and confusing global architecture. That being the case, the United Nations could play a crucial role to ensure that the various Gs are acting as much as possible in concert.

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