The Global Governance Agenda and the Role of the G20 (WP)

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'International cooperation, like passionate love, is a good thing but difficult to sustain'. Benjamin Cohen (2000, p. 246).

Introduction[1]

The international financial crisis and the recession that followed it have made clear the need to rethink global economic governance. The devastating socio-economic impact of the crisis makes it essential that the international community launch a debate on what the limits of economic liberalisation should be (especially financial liberalisation), how to minimise the risks of openness through adequate regulation and what institutional mechanisms are necessary to improve international economic cooperation. This debate has been muffled over the past two decades because of excess confidence both in market liberalisation and the idea that markets regulate themselves. However, the crisis has shown the model's dangers and unsustainability. What is more, even before the crisis there were signs of a need to strengthen global economic rules so that the interaction of a highly internationalised economy with regulations that are particularly national, segmented and unconnected would not yield adverse results. In the wake of the crisis, improving international economic regulation has simply become critical.

Although there seems to be a consensus on the need for major progress, it is unrealistic to think it will be possible to create democratic and legitimate global economic governance in all relevant areas. What is more, history has taught us that harmonising the national legislations of all countries is not always a good idea, both because different governments disagree on what the best institutional and regulatory framework is and because the room for manoeuvre in institutional innovation is key to growth in developing countries (and can be hindered by global rules). But global economic governance does not necessarily have to mean common rules in all realms. In fact, in the areas in which there is no consensus on what kind of supranational common rules to adopt, it will be necessary to ensure that markets do not go beyond national regulatory frameworks. This decision to partially limit economic globalisation in some destabilising aspects (such as, for instance, regulating international capital flows differently depending on the needs of each country

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or even banning some financial instruments) should also be a product of consensus and therefore be part of what we call global economic governance.
When the crisis broke out, major efforts at international economic coordination were made through the convening of the G-20 summits in Washington and London, which can be considered to have been relatively successful in that they helped to avert an even greater collapse in world production and held back (to some extent) protectionist tensions. Also, the fact that it was the G-20 and not the G-7 that coordinated the international response to the crisis marked a step forward in boosting the legitimacy of global economic decision/making forums because the G-20 features ample representation from developing countries. However, since late 2009 international cooperation has been hindered by national economic interests, the reluctance of most countries to give up more sovereignty to supranational entities and different interpretations of what the best policies are for overcoming the recession or improving economic regulation. Certainly, one contributing factor is the speeding up of the relative decline (in both economic and ideological terms) of the US and Europe and the swift rise of emerging countries, which for the first time are handling the crisis better than the industrialised countries. Another factor is that, now the worse of the crisis is behind us, countries feel less of a sense of urgency to act in a coordinated fashion.

But even during the worst moments of the crisis, there has not been across-the-board, improved coordination. There are areas in which the recession has increased economic and geopolitical tensions, making cooperation more difficult. Good examples of this are the incipient 'currency war' that broke out in the second half of 2010, the failure of the Copenhagen Summit in December 2009 on climate change and the use of new non-tariff trade barriers on trade issues (not to mention the worthless efforts to conclude the Doha Round of WTO talks or the slow pace of internal reforms at the IMF).

So it is a paradox that, just when international economic cooperation seems most necessary, the international community is having the hardest time moving forward in this area. However, it would be a tragedy to fail to take advantage of the opportunity opened up by this crisis to make major headway both in the effectiveness and the legitimacy of new global economic rules. In the current situation, the priorities seem to be to make progress in the financial, monetary, exchange rate and trade areas. But it will also be necessary to address international cooperation on energy, climate change, food security, international migration and the fight against poverty. These issues have been placed on the back burner after the crisis broke out but they are crucial for international stability and long-term growth. It is also important to determine in which areas common regulations are feasible and in which others it will be necessary to settle for the coordination of national policies. To think that global, commonly-accepted rules can be adopted in all areas is somewhat unrealistic, and in certain respects is not desirable either.

At the same time, while moving ahead on reform proposals is important, so is debating which are the best institutions for achieving the right results. This requires defining and assessing the role of the G-20 –which, since the summit in Pittsburgh in September 2009 has become the directorate for global economic governance– and how this informal institution should coordinate with others such as the United Nations, the IMF, the World Bank and the WTO.

This paper addresses these issues. It focuses on how the international community should prioritise the global economic governance agenda and what role the G-20 should play in the process. The first section analyses the challenges that the international community faces, exploring which elements of this complex agenda have the best prospects for being addressed successfully. The second section discusses what kind of institutional structure is needed in order to carry out reforms and what the role of the G-20 is in that structure.

The Global Governance Agenda

The global economic governance agenda has grown steadily in recent years. In addition to the usual challenges of maintaining an open and well-regulated multilateral trade order, designing an international financial architecture that provides stability and contributes to growth, and fighting together against poverty, new issues have emerged over the past few years: the battle against global warming, managing international economic migrations, the risks of new energy nationalism and preventing new food crises or global pandemics. What is more, the great recession of 2008-10 has incorporated new factors, which must be linked to the usual agenda of trade and monetary cooperation but addressed in a different way. Here, we are talking about resolving macroeconomic trade imbalances so as to restore equilibrium in world growth and avoid trade and currency wars, opening a debate on the future of the dollar, and moving forward in a determined way towards new international financial regulations in which 'market discipline' is replaced by new rules, which, if possible, would be coordinated at the international level. Finally, it is essential to begin to take measures in a coordinated fashion again greenhouse gas emissions so as to tackle the problem of climate change. All of this also requires reforms of obsolete institutions of economic governance so as to enhance both their legitimacy and effectiveness.

All of these challenges make for a very broad agenda. As it is difficult to make progress in all areas, it is essential to prioritise. These priorities should be: (1) re-balancing the world economy (in order to boost growth and avert currency wars and protectionism); (2) coordinating financial reforms (in order to avoid both a new crisis and regulatory arbitration); (3) deepening reforms of the IMF (to increase its legitimacy and effectiveness); (4) opening up a debate on the global reserve currency (to avert a dollar crisis); and (5) reaching an international agreement limiting greenhouse gas emissions (to address global warming and its effects on poverty).

(1) Re-balancing the world economy (in order to boost growth and avert currency wars and protectionism)

As the IMF's Chief Economist, Olivier Blanchard (2010), has argued, in order for the global recovery to be sustainable, countries have to make two changes in the way they grow. One is internal, and involves increasing investment and private consumption and reducing government spending; the other is external, and requires countries with current account surpluses to boost their domestic demand and those with current account deficits to reduce it. Both processes are vital and are progressing more slowly than would be desirable. However, while the internal changes must be done by each country, the externally oriented reforms must be coordinated at the international level.

Resolving these global macroeconomic imbalances (an excess of savings in China, Japan and Germany, oil-exporting countries and some other emerging powers in Asia, and an excess of spending in the US, the UK and the peripheral countries of the EU) was already a priority before this crisis. For authors such as Wolf (2006) and Rajan (2010) this model of lopsided growth, which has been called Bretton Woods II, was one of the triggers of the crisis. Low interest rates in the US and excess savings in emerging countries gave rise to a glut of liquidity that ended up generating a bubble in asset markets, which was also fed by financial deregulation and the creation of new investment products. But now that recovery is underway, these imbalances have reappeared and pose two kinds of threats for world growth.

The first is that the level of private debt in the US, Japan and most European countries is so high that the world needs new sources of growth in order to sustain the dynamism of the past decade. This new growth must come from the emerging countries, both because they have recovered from the crisis better than industrialised countries and because they have younger populations and a greater potential for growth (IMF, 2010). And for this to happen, measures involving international coordination must be taken so that domestic demand in this countries can in fact grow.

The second threat is that the persistence of these imbalances is causing political tension between China, the US and other emerging countries. China's refusal to revalue its currency, the prospect of the US Federal Reserve launching another wave of quantitative easing to guard against deflation, create jobs and lower the value of the dollar and the harmful impact of both policies on the emerging countries (which are receiving large influxes of capital that raises inflation) is fuelling a fledgling currency war. If this is not resolved in a multilateral way it could lead to a rise in protectionism such as that of the 1930s, which caused tension in international relations and deepened the Great Depression (Eichengreen & Irwin, 2010).

The ideal would be an agreement coordinated by the G-20 under which China revalues nominally its currency and un-links it from the dollar; the US, Japan and the euro zone and the UK coordinate monetary expansion through quantitative easing measures; and the remaining emerging economies specify clearly what kind of capital controls they plan to use in the event their currencies appreciate too much as a result of US monetary expansion policy. This cooperative solution would allow adjustments in real exchange rates to contribute to re-balancing the world economy, keep at bay the risk of deflation that hangs over wealthy countries and would justify the use of some capital controls in emerging countries such as Brazil and India, which are experiencing major capital inflows that are causing them inflation and bubbles in asset markets and risk becoming the seed of the next financial crisis. In fact, the 'Framework for Strong, Sustainable and Balanced Growth' which the G-20 approved at the Pittsburgh summit in September 2009 was designed precisely to facilitate this process of re-balancing world economic growth under the supervision of the IMF.

However, this coordinated solution, which is already being compared to the Plaza agreement of 1985, which at the time served to drive down the dollar, will be difficult to hammer out in an agreement –authors such as Rodrik (2009a) do not consider it to be the ideal solution–. This is the case for various reasons. First, there is China's resistance to revaluing its exchange rate for domestic political reasons. Secondly, there is US mistrust of China and other emerging economies that intervene in currency markets and accumulate reserves in dollars. Thirdly, there is uncertainty over what the impact will be of a new wave of quantitative easing by the Federal Reserve, the Central Bank of Japan and the UK, which may or may not contribute to the fight against deflation but could affect exchange rates. In the fourth place, one must note the indifference with which the European Central Bank (ECB), following Germany's game plan faithfully, is dealing with the problem of exchange-rate volatility and the strength of the euro. Finally, there is the dangerous, general sensation that each country will seek solutions to its own problems without tending to the needs of the world economy. This is particularly applicable to relatively small countries which are not able to keep unilateral policies adopted by major powers from affecting them adversely. The latter involves countries as diverse as South Korea, Switzerland, Brazil, Thailand and Indonesia, which are seeing their currencies rise and can do nothing to avoid it. But it also involves countries on the periphery of the euro zone, which see how the constraints of sharing a common currency and the ECB's conservative attitude make export-based growth harder due to the strength of the euro. Put briefly, internal political factors are thwarting a cooperative solution at the international level.

Coordinating financial reforms (in order to avoid both a new crisis and regulatory arbitration)

While global macroeconomic imbalances were one cause of the crisis, the other (and possibly the most important one) was the financial deregulation carried out in the late

1980s (Roubini & Mihm, 2010). This liberalisation, based on trust in market discipline and the financial markets' ability to regulate themselves, allowed for a quiet rise in the banking system, the growth of leveraging and an inadequate assessment of risk, which led to a crisis when real estate prices started to fall. What is more, financial globalisation acted as a conduit for transmitting the crisis, which caused it to spread much more quickly than other crises did in the past.

For all of these reasons there is a consensus on the need for deep reforms of financial regulation and supervision, especially in markets and segments which turned out to be what Warren Buffet has called 'weapons of mass destruction' for the rest of the economy. Although there are nuances as to how to address reforms, there seems to be agreement that it is essential to limit levels of leveraging and risk, provide more information and transparency in markets, change the system of bonuses and salaries paid to executives in the financial sector, redefine and harmonise rules governing accounting assessment, regulate tax havens, boost capital requirements for financial institutions, extend regulation to some markets that until now were opaque, make it so that credit is not so pro-cyclical, oversee derivatives markets better, ensure that asset prices are incorporated better into monetary policy to prevent the emergence of bubbles and revise how credit-rating agencies work.

In fact, some progress has already been made, such as approval of the Basel III criteria forcing banks to boost their core capital reserves and the steps the US and the EU have taken in their respective financial reforms.

Still, two debates are raging. The first involves the clash between those who advocate more regulation and those who feel that better rules are all that is needed. The former, who argue that the crisis was a huge failure of the market, want to revert to the model that was in place between World War II and the 1980s (Roubini & Mihm, 2010; Stiglitz, 2010). This model, introduced in the US under the Glass-Steagall Act of 1933, was characterised by a separation between retail and investment banks, the division of institutions that were 'too big to fail', the banning of some sophisticated financial products, strict limits on levels of leveraging and controls on free international movement of capital. Those who back this more interventionist model also advocate taxes on banks and on international transactions.

Those who differ from this point of view say the crisis mainly involved a failure in regulation, not in the market. They accept that it is necessary to improve financial rules, but not necessarily increase them, and warn against an excess of rules that might squeeze credit and, with it, levels of economic growth. This is the position defended by Wall Street and most of the international financial sector. Some neo-liberal economists also defend it. Right now, the balance seems to be tipping in favour of those who advocate more regulation. However, both the reforms approved in Europe and the US and the recommendations made by the Bank for International Settlements and the Financial Stability Board can be considered moderate.

In the debate on new financial regulations, there is a second scenario with a clash of ideas, that which refers to the level at which new rules should be established: international, regional or national. While some advocate international rules that would be applied in all countries, others feel that the peculiarities of different countries' financial systems make a single, common system of regulation impossible (or undesirable). This is the position of the emerging countries. They argue, and rightly so, that the crisis stems from deficiencies in the financial systems of wealthy countries and that they have adequate regulatory systems and have simply suffered contagion from industrialised countries to the north. They argue that the top priority is to toughen rules in the US, the UK and the euro zone (the world's main financial centres). Even so, everyone agrees on the need to coordinate reforms so that all national regulatory frameworks have some common principles, thus avoiding regulatory arbitration, in other words, money flowing to jurisdictions where regulations are less strict. This process of coordination, which is already under way, should be carried out under the leadership of the G-20 and the Financial Stability Board, which, since it was expanded to include emerging countries at the London summit of the G-20 in 2009, has become the organ that carries out decisions made by this informal forum.

Deepening reforms of the IMF (to increase its legitimacy and effectiveness)
Even before the financial crisis erupted there was some degree of consensus on the need to reform the IMF –as well as the World Bank– to make it more representative and legitimate in the eyes of emerging countries and thus allow it to gain effectiveness.

However, the debate on the governance, legitimacy and representativeness of the IMF, even though it remained present and even gave rise to reform of the quota and voting share systems in 2006-08, has been placed on the back burner for at least two reasons. The first is that developing countries chose to protect themselves by accumulating reserves to avoid having to turn again to the IMF, whose conditionality they mistrust. The second reason is that in the wake of the Asian crisis of 1997 the international economy entered in a phase of robust growth, macroeconomic stability and absence of systemic crises, all of which created the sensation that reforming the IMF was not a priority for world economic governance.

But all of this changed with the big meltdown of 2008. Although the IMF failed to anticipate and avert the crisis –in part because its richest member countries were not willing to follow some of its recommendations– its role has been quickly re-dimensioned. After carrying out major activity at the outbreak of the crisis by coming to the rescue of countries in need of liquidity, with new tools such as the flexible credit line and supporting coordinated fiscal stimulus, at the G-20 summit in April 2009 in London it was decided to quadruple the IMF's financing to US$1 trillion through various special instruments (an increase in Special Drawing Rights, a rise in quotas and the ability to issue debt on international financial markets). At the same time, with the IMF, Financial Stability Board and the BIS as the core, efforts are being made to build a new, more solid international financial architecture that can prevent future financial debacles. The IMF has also been assigned the difficult task of trying to promote more balance in world growth through implementation of the 'Framework for Strong, Sustainable and Balanced Growth' which the G-20 approved at the Pittsburgh summit in September 2009. Finally, its renewed (and for many people, heterodox) recommendations on the use of capital controls in emerging economies are allowing it to recover some degree of intellectual leadership in the eyes of countries that lost faith in it after the Asian crisis (Rodrik, 2009b).

In this context, debate on the need to reform the internal governance of the IMF to give it greater legitimacy has once again taken on a critical role. The crisis has provided a new opportunity for the IMF, but over the long term it will be able to enhance its now growing position of leadership only if it manages to undertake broad and ambitious reforms in an efficient and definitive fashion. The key test for reforming the institution was (and continues to be) modifying its quota system, which determines the number of votes each county has.

The need to move ahead with this reform to boost the legitimacy and representativeness of the IMF can be illustrated with a simple comparison. The sum of the GDPs of Italy, the Netherlands, Belgium, Sweden and Switzerland as a percentage of the world's total is less than the sum of those of China, India, Brazil, South Korea and Mexico (8.1% vs 11.9% measured at market exchange rates, and 5.8% vs 20.1% when measured in Purchasing Power Parity). However, before the reform enacted in 2006 these five European countries held 10.4% of the votes at the IMF while the five big emerging countries had 8.2% (Bryant, 2008). As the growth of the emerging economies was greater than that of the Europeans (and after the crisis the difference is even bigger) this divide, which is already hard to justify, is growing.

Every time the idea of reforming the quota system is raised, two issues have to be debated: (1) a possible increase in the quotas themselves, which is approved if it is deemed that the IMF needs more resources; and (2) the distribution of the enlargement, which can cause changes in the balance of power, since this is a zero-sum game in which one country's gain in votes is another country's loss. In any case, any change that produces winners and losers involves a modification in the formula that is used to determine quotas and which must be approved with 85% of the votes. That means the US, that has 17% of them, is the only country with veto power.
After the timid reforms of 2006-08, the G-20 took a major step in Seoul in November 2010. It agreed to transfer 6% of the quotas (and therefore a similar percentage of votes) from advanced countries to developing ones. This change lifted China from sixth to third place,

behind only the US and Japan in number of votes. What is more, in a historic decision, the countries of Europe agreed to cede definitively two of their eight seats on the IMF Executive Board (out of a total of 24) to developing countries. Although the details of this agreement will be not be finalised until 2012 it is possible there might be another gesture from the advanced countries, this one allowing the next Managing Director of the IMF to be Chinese, thus doing away with the unwritten rule that a the job always goes to a European.

Despite this progress, as Pissani Ferry says (2009, p. 6): 'Keynes used to say that the job of the IMF is "ruthless truth-telling". But the Fund today lacks effectiveness in dealing with global problems because it does not have the legitimacy that would allow it to tell the truth to China (about its exchange rate) and the independence that would allow it to tell the truth to the US (about its external imbalance). In fact, it has done neither'. One of the challenges of global governance is making the IMF capable of doing this. Only in this way will it serve, among other things, to prevent future macroeconomic imbalances, which are one of the main causes of the crisis in which we are now mired. The problem is that the main countries involved are still reluctant to yield more sovereignty to this institution, which makes it harder for changes to proceed more quickly.

Opening up a debate on the global reserve currency (to avert a dollar crisis)

For decades, the dollar has been the only global reserve currency. However, since even before the outbreak of the international financial crisis, the creation of the euro, the rise of the emerging powers and the accumulation of dollar-denominated assets outside the US has raised doubts about the future of the greenback. As the crisis broke out in 2008, the dollar once again showed itself to be the currency of refuge to turn to, but both the rise in levels of US debt and its reduced geopolitical influence in the future could accelerate its decline. In this context, many hypotheses have emerged (Helleiner & Kirshner, 2009). Some authors argue that the euro will replace the dollar (Frankel & Menzie, 2008), while others say that the system of reserve currencies will turn into an oligopoly in which the dollar, the euro and a convertible yuan will coexist as regional currencies (Cohen, 2009). Still others maintain that the dollar will retain its hegemony as a currency (Posen, 2008).

It is impossible to foresee what will happen over the long term. However, it seems clear that it is increasingly risky (because of its potential instability) for the monetary system to continue to be so dependent on the greenback as a source of liquidity. But so long as the dollar maintains its current status, we will find ourselves, as was the case in the late 1960s, in what is known as Triffin's Dilemma (1960): the growing accumulation of dollar-denominated assets outside the US will lead sooner or later to a loss of confidence in the US currency which will force an abrupt departure from the system via a sharp fall in the dollar (Crespo & Steinberg, 2005). Alternatively, if the US wishes to preserve the credibility of its currency, it will reduce its global liquidity and thus slow down growth in peripheral countries, which would also destroy the system.

However, as the current international monetary system works in a fiduciary mode, it is impossible to anticipate when the countries of the periphery will lose confidence in the dollar. For example, McKinnon (2009) argues that so long as the Federal Reserve maintains the value of the dollar by keeping inflation relatively low, the countries of Asia –especially China– will remain willing to continue acquiring dollar-denominated assets and financing the current account deficit in order to ensure their own growth. McKinnon says that, therefore, the system is stable and the dollar's hegemony is not in doubt. However, Bergsten (2009) is much more pessimistic. He argues that the dynamic of dramatic growth in US debt will force a loss of confidence in the dollar, as a result of which the US should quickly carry out fiscal changes to preserve its economic strength over the long term. He also says that the US should realise that encouraging the maintenance of the dollar as the sole global reserve currency is no longer in its national interest because it hinders the internal discipline that the economy needs to chip away at the country's enormous debt.

In any case, there are more and more calls for a multilateral solution to this potential risk. And they coincide with criticism from some emerging powers that that have never been comfortable with American hegemony. The price of gold is also rising significantly, which shows there are increasing doubts about the will of US institutions to maintain the purchasing power of the dollar.

The Chinese authorities have made public statements urging the US to follow a responsible fiscal policy to protect the value of the dollar –and thus China's reserves– over the long term. The Governor of China's central bank has even proposed replacing the dollar with the IMF's Special Drawing Rights as a global reserve currency as the only way to keep the stability of the international payments system from depending on US fiscal and monetary policies, which he considers less and less reliable (Zhou Xiaochuan, 2009). France has also said it is necessary to take up this debate, and said that that will be the main focus of its turn as G-20 President, in the first half of 2011.

Both France and China, which enjoy the support of other emerging and European countries, would welcome an international monetary system reform based on establishing exchange rates that are 'managed' within certain fluctuation bands. They would also support the issuance of SDR by the IMF as a source of liquidity in addition to the dollar, and would also want to see the euro (and the yuan when it becomes convertible) gain ground on the greenback both in terms of international reserves and the issuance of debt and trade invoicing.

In principle, neither the US nor the UK (and probably not Japan, either) will support this proposal. However, it would be important for the debate to open up in the G-20 in order to explore the pros and cons of the different options. The idea is to avert a crisis involving the dollar or international monetary chaos due to a lack of leadership and geopolitical rivalry among the major powers. Although this scenario is unlikely for now, it could become a reality in the future if measures are not taken over the next decade.

Reaching an international agreement limiting greenhouse gas emissions (to address global warming and its effects on poverty)

The last of the top-priority issues, although not at all the least important one, is to achieve multilateral agreements in the battle against global warming. In this context of slow economic growth in wealthy countries, the issue has vanished from the list of priorities. But over the medium and long term it is perhaps the main challenge facing the international community. As shown by the reports issued by the IPCC (the Intergovernmental Panel on Climate Change of the United Nations) and shown very clearly by Stern (2009), there is a cause-and-effect relationship between human activity and climate change and this requires some kind of change in attitude by the world's main emitters of CO_2. But as these studies also show, the international community still has time to stabilise emissions of CO_2 and other greenhouse gases at levels that would prevent the planet's temperature rising too much, so that the pernicious effects of global warming would be manageable. Otherwise, unpredictable events will occur, ones with probably tragic consequences, such as drought and starvation and uncontrolled migration. What is more, the impact will be greater on developing countries. So whatever progress is made in the next few decades in the fight against climate change could be erased.

Confronting climate change mainly requires efforts at the national level, but international accords can be a huge help. Although it is individual countries (especially the ones that pollute the most) which must change their policies and production methods, international accords serve to achieve agreement on the best tools, set common rules, share costs, provide incentives and negotiate compensation or technology transfers from rich countries to poor ones. Finally, as increased efficiency, energy-saving and changes in the global energy model to one free of fossil fuels, are shared long-term goals, international accords to cooperate in research can also be useful. Although all countries are competing to develop new energy technologies and to benefit from exporting them, there are projects of such a grand scale that they can be carried out only if the financial and technical resources of several countries are harnessed together.

So there seems to be agreement on the diagnosis. But the limited progress made at the Copenhagen summit in December 2009 shows that the obstacles to achieving an international accord to replace the Kyoto protocol as of 2012 are enormous (within the G-20 there is an agreement to reduce subsidies for use of fossil fuels, but its impact is limited). The fundamental problem lies in the emerging countries' reluctance to assume, in an equitable fashion along with wealthy countries, the burden of enacting change (in the form of emissions reductions). They argue that the planet's accumulated pollution is the product of the advanced countries' industrialisation and that they have the right to behave like free riders or receive compensation for changing their policies, as reforms would lead to less growth and hinder their development. But since China is already the world's largest emitter of CO_2 (in absolute terms, not per inhabitant), and other emerging countries, especially India, have increased their emissions in recent years as the result of economic growth, if these nations do not cut their emissions there will not be much point to advanced countries carrying out big reductions of their own.

Nor is there agreement on what the best tools are for fighting climate change. Ideas have been mooted such as environmental taxes, generalising the European mechanism of transferable permits to create a global carbon emissions market and various alternatives involving voluntary action that could be appealing to some companies because it would help them boost their image in terms of corporate social and environmental responsibility (Lázaro Touza, 2008). What is more, the EU has already moved forward unilaterally by toughening its environmental legislation and committing to accept greater emissions reductions if other countries sweeten their offers. For now, however, progress has been slow. The new legislation approved in the US is weak and both China and India, which are increasingly showing themselves to be worried about environmental problems, are still not willing to accept the commitments that the rest of the international community is pressing them for.

In order to achieve concrete results, greater international leadership will be needed at the Cancún summit in late 2010. The G-20 can be a catalyst for an agreement, as all the key players belong to that group.

The Role of the G-20 in the Workings of Global Economic Governance

The global economic crisis has prompted a change in which the G-20 has taken over from the G-7/8 as the directorate of the world economy. There is general agreement that this shift will be useful as it will significantly enhance the legitimacy of the anachronistic G-7/8 and the potential for providing the leadership needed to move ahead in reforming international economic institutions. What is more, it comes at a time when it is more important to strengthen global economic governance (both because of the crisis and the very process of economic globalisation) and modernise the obsolete institutions created after World War II. But the rise of the G-20 also raises a series of questions. On the one hand, doubts persist about its legitimacy and representativeness, and about how it fits into the complex workings of existing international institutions. At the same time, doubts have emerged about its ability to truly bring about a change in paradigm in the way international economic decisions are made, bringing together points of view that are now considered heterodox and go beyond the ideological consensus that has ruled in western democracies over the past few decades. In this section we will address those issues, and the discussion will centre on institutional elements and decision-making processes. The agenda which the G-20 must undertake is the one described above.

From the G-7/8 to the G-20: greater legitimacy and more efficiency

For years now, the emerging economies have been criticising the G-7/8 as a forum that does not really represent the current structure of the world economy. But for years, wealthy countries have ignored these complaints and simply invited some emerging countries to their meetings. The crisis has changed everything. As Wolf (2009) says: 'Crises overturn established orders. The financial and economic crises of 2007-2009 are no exception. The rise of the G-20 is a watershed in history, as for the first time since the industrial revolution economic power is not concentrated exclusively in western hands'. It took a devastating financial debacle and a long recession for the international community to realise that the group formed by the US, Japan, Germany, France, the UK, Italy and Canada –joined by Russia in the 1990s– is not sufficiently representative to respond to the challenges of globalisation. According to Moises Naim, the former Editor of the journal Foreign Policy and one of the top analysts of globalisation, this crisis has at least served to bury the G-7 once and for all. The need to incorporate emerging powers in order to confront a global recession and the rise of economic nationalism has made it necessary to give a larger group of countries, like the enlarged G-20, the leadership in designing new rules that ensure that globalisation does not self-destruct.

The G-20 is an informal grouping created after the Asian financial crisis of 1997. Since the collapse of Lehman Brothers in September 2008 it has met five times in less than two years (in Washington in November 2008, London in April 2009, Pittsburgh in September 2009, Toronto in June 2010 and Seoul in November 2010). The forum is broad enough (and therefore legitimate enough) to become the embryo of global economic reforms and small enough to be effective. Therefore, its replacement of the G-7/8 is excellent news. Even so, there are sceptics, such as Roubini & Mihm (2010, p. 261), who say 'It is unlikely that the G-20 can make substantial changes in the world economy and international monetary system'.

This scepticism stems from the enormous difficulty in reaching agreements between so many countries and the fact that, as the G-20 is not a formal international institution it cannot force anyone to abide by its accords. It cannot establish sanctions or incentives in a unilateral way, nor can it forge 'cognitive consensuses', which, as experience has shown, are key to achieving agreed and lasting responses when it comes to international economic cooperation. It can only act as a focal point for designing new rules that coordinate both reforms of countries' domestic economic legislation and the charters of international economic organisations. But even though that may seem not very much, providing such shared leadership and acting as a catalyst for reform is exactly what the international community needs right now. As the rise of the emerging powers is creating a world that is increasingly multi-polar, (Zakaria, 2008) there is no longer a single dominant power capable of taking over and providing leadership on its own as the US did after WWII. But at the same time, the demand for international economic cooperation regimes that facilitate agreements, reduce transaction costs and improve information (Kehoane, 1982) has only just begun.

This greater demand for international economic governance stems from the fact that over the past two decades markets have become global while the policies designed to regulate them continue to work fundamentally at the national level. However, the supply of economic cooperation is not able to meet demand. The mosaic of rules and international economic institutions is proving unable to respond to people's concerns, mainly that of the States' reduced room for manoeuvre that comes with economic internationalisation. In actual practice this means less sovereignty in economic policy and that democracy is undermined (Dervis, 2005; Stiglitz, 2006). Even before the crisis, all of this was leading to a growing conflict in international economic relations, a clash fuelled by unilateral action by many countries unwilling to adapt their national policies to global needs.

But as hard as it may be, in a world that is increasingly more economically integrated and interdependent, countries are fatedto cooperate, despite their opposing interests. Maintaining an economic system that is open, orderly and clearly regulated is a global public asset because it benefits all the world's citizens. But, as happens with all international public goods, providing them –in the absence of a dominant power– requires international cooperation (Keohane, 1984). What is more, in the case of governance of globalisation, understood not as government but as a decision-making procedure based on permanent negotiation and respect for the law (Lamy, 2008), issues of international legitimacy and even distributive justice come into play (Kapstein, 2007; Ocampo, 2010). Only if the rules of the global economy are perceived as legitimate, inclusive and reasonably democratic by the citizens of the main countries will they be effective and lasting because they will let people regain, at the supranational level, some of the economic sovereignty they lost at the national level because of globalisation. This element of legitimacy has become especially important in the wake of the financial crisis, whose devastating effects have generated a growing wave of anti-globalisation sentiment.

In this context, the international community needs to build shared international leadership that facilitates and enhances multilateral cooperation through improved dialogue between advanced countries and emerging ones. In order to achieve this, flexible and legitimate forums of dialogue such as the G-20 are absolutely essential. The plurality of points of view and the fact that the main players in the problems on the world economic agenda are represented at the G-20 make this group the most appropriate embryo for forging international agreements, which can later gain legal status through existing international organisations such as the IMF, the WTO or the various agencies of the United Nations.

Pending issues for the G-20: beyond the 'founding euphoria'

The high level of international economic cooperation brought about by the G-20 summits in Washington and London were certainly a collective success and an exercise in responsible global economic governance in the face of a crisis. But after this initial phase, the G-20 has been losing cohesion and drive, both because the possible collapse of the global economy no longer seemed a likely risk and because the domestic political agendas of the main countries made international cooperation difficult. Therefore, the main challenge that the G-20 will face is to continue being relevant. In order to do this, it needs to demonstrate that it is useful in a context in which the harshness of the economic recession, persistent high levels of unemployment and the uneven regional nature of the global recovery are causing many countries to place international cooperation on the back burner so they can concentrate on domestic political priorities (Frieden, 2010).

A second problem facing the G-20 is that it is still subject to criticism for not being representative or democratic enough (Wade & Vestergaard, 2010). The idea of these complaints is that some countries should be in the G-20 and are not, while others that are present should not be, since the selection process was arbitrary and did not follow objective criteria, such as GDP or share of world trade. Nor did it attempt to achieve any regional balance. For this reason, the group is lopsided in geographical terms (just like the G-7, which has a clear European and Western slant and very little African representation), poor countries are not represented at all, and at the institutional level the group is not linked to the United Nations, which is the only undisputedly legitimate forum in the international political system.

However, from a practical perspective, and acknowledging that there is always a trade-off between representativeness and efficiency, in its current makeup the G-20 is small enough to make decisions that are representative of more than 80% of the world's population and GDP. This does not mean there is no room for improvement, nor that there should not be a debate to try to fill in the gaps in representation. However, given the difficulty of current member states accepting substantial changes in the group's make-up, it will be necessary to make the best of its current line-up.

Furthermore, authors such as Keohane, Macedo & Moravcsik (2009) have argued that the existence of multilateral institutions in a highly globalised world eases the problem of the democratic deficit. To the extent that the G-20 promotes reforms of institutions such as the IMF and the World Bank to make them more representative and legitimate, it will be contributing (although in an imperfect way) to reducing the problem of the democratic deficit (which, by the way, also affects more representative institutions such as the EU and the United Nations because people perceive them as being too distant).

The last issue that the G-20 will have to define is how it will fit into the current system of international institutions. It could continue to be an informal gathering of heads of state and government focused on economic issues, as was the G-7, which only answered to the peoples of its member states. However, given the importance of the undertaking at hand, it would be advisable that the G-20 take on more of an institutional status, which would also help resolve some of the legitimacy problems discussed earlier. Specifically, it would be good for the G-20 to join the system of the United Nations, as well as the IMF and the World Bank (the WTO, which for now is an independent international organisation, should also do so). In this way it would no longer be perceived as a forum that is neither inclusive nor transparent, and one that has simply incorporated as new members the club that already held international economic power, a process which Beeson & Bell (2009) have called 'hegemonic incorporation'. Consider, for instance, that the UN Security Council, which also needs to be reformed, was always considered more legitimate than the G-7 because it was part of the United Nations system. Furthermore, if the G-20 gets more involved in climate change issues it will have to coordinate with the United Nations (in particular with the United Nations Framework Convention on Climate Change), so it would be useful to clear up the G-20's relationship with the UN system.

The main obstacle to its integration in the United Nations is that, in order for this to happen, there would have to be a debate on which countries really should or should not be in the G-20. And the countries that belong to the group without having a level of influence in the world economy that justifies their presence would try to block such a debate.

Conclusion

Throughout, this paper has stressed the need for the international community to move towards creating an institutional framework for global economic governance that is capable of responding to the growing economic and climatic challenges facing the world. The financial crisis has served as a wake-up call of the risk of maintaining a highly globalised economy with national rules, and of the risk that lax financial regulation poses for everyday people.

It has explained why the priorities of global economic governance should be re-balancing the world economy, coordinating financial reform, deepening the internal reform of the IMF, opening up a debate on the global reserve currency and establishing a multilateral framework for fighting global warming. These measures would allow the growth model on which the world economy is now based to be more stable, sustainable and inclusive. What is more, these are reforms that can be undertaken if a shared and a sufficiently legitimate leadership is created, such as that which the G-20 was able to provide at the outset of the crisis.

In this respect, it has also said that the G-20 faces a series of difficulties that it will be able to overcome only if it proves itself capable of being useful and representative in a context in which countries' domestic problems are making it increasingly difficult for them to engage in international economic cooperation.

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