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# Reforming Global Economic Governance: A Strategy for Middle Powers in the G20<sup>1</sup>

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Australia, Brazil, Indonesia, Korea and South Africa in International Affairs”  
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## I. Introduction

In this paper I argue that middle powers that are members of the G20 can extract substantial benefit from their participation in the G20 if they have both a clear long term vision of global economic governance and a plan of action that is based on obtainable short term objectives.

To establish this proposition, I will address four issues. The first is that the institutional arrangements for global economic governance will remain unstable until the current process of changes in the balance of global political and economic power plays itself out. The second is that, given the changing international power dynamics, the current “manager” of the global economy, the G20, is unlikely to be a stable entity. Consequently it can only be effective if it focuses on the relatively narrow range of economic issues of common interest to all G20 members. Third, middle-size countries need a long term vision of global financial governance to guide their conduct in the G20 and other forums of global governance. Fourth, the middle powers will only be able to capitalize on whatever short term opportunities may arise from their participation in the G20 if they identify a set of achievable short term objectives and devise a strategy for reaching them.

## II. State of Transition in Geo-Political Power

The recent financial crisis demonstrated that the G7<sup>4</sup> countries are no longer able to function as the pre-eminent forum for global economic governance. These countries have been forced to recognize that they need the other G20 countries to effectively manage the global economic and financial system. Consequently, they elevated the G20, which had previously been only a gathering of finance ministers and central bankers, to the level of a meeting of heads of state. This has two important consequences. First, it is resulting in pressure to expand the agenda of the G20 beyond its prior relatively narrow focus on financial and monetary affairs, which could undermine its effectiveness. Second, it is converting the G20 into potentially the most important

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<sup>1</sup> DO NOT QUOTE OR DISTRIBUTE WITHOUT PERMISSION OF THE AUTHOR However, the author welcomes receiving reader’s comments on the paper.

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<sup>3</sup> Will be included in a book to be published by the Australian International Affairs Institute and the Konrad Adenaur Foundation.

<sup>4</sup> While Russia’s participation in recent meetings of the G7 has converted the group into the G8, the G7 is still the meaningful grouping for economic purposes.

international forum for the management of the global economy, even though it lacks stable membership<sup>5</sup>, a permanent secretariat and a formal legal existence.

The shift in power away from the G7 countries should not be over-stated. While these countries have accepted the G20's pre-eminence in economic matters, they have not surrendered their control over the global economic agenda, which is dominated by the regulatory and governance issues of most interest to them. The shifting balance of power merely means that the rising powers in the G20 can participate in the discussions on these agenda items and can influence their prioritization. They do not appear able, however, to persuade the G20 to take decisions that the G7 oppose.<sup>6</sup>

The current situation, therefore, must be seen as being a time of transition, in which the leading states in the G7 seem to be losing power relative to some of the larger and more influential developing countries in the G20. This shift in the balance of relative power has only advanced far enough to deprive the G7 of their previous dominance. The rising powers however have not gained sufficient power to have either the will or the ability to take over leadership of the global economic system. The result is an unstable situation in which the institutional arrangements for global governance are likely to remain provisional until the process of rebalancing global power has played itself out and the relative positions of the new and old powers are clarified.

There are some inevitable consequences that follow from our current position in the rebalancing process. First, we can only be confident that the G20, as currently constituted, will remain the primary manager of global economic governance in the short-to-medium term. It is already possible to see pressure to change its composition, as evidenced by the facts that additional invitees, such as Spain and the Netherlands, have been included on an *ad hoc* basis in the G20 summits and that there is pressure to expand its agenda beyond financial and economic issues to include such issues as climate change and development.

Second, the efforts to reform the current institutional arrangements for global economic governance are likely to be partial, unsatisfactory and unsustainable. This suggests that, while limited reforms are possible, there can be no definitive resolution of the debates about the mandates and the governance of the existing international financial institutions. Similarly, there is unlikely to be a final determination about whether the Financial Stability Board should be merely a forum of discussion and coordination among regulators or, for example using its proposed peer review mechanism, should play a more active role in global economic governance. Also unlikely to be resolved is the appropriate role, procedures, and power of bodies like the Basel Committee of Banking Supervisors (BCBS), the International Organizations of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS).

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<sup>5</sup> In addition to the original G20, Spain and the Netherlands have participated in G20 summits and there is an expectation that additional participants (primarily the current chairs of such regional groupings as the AU, ASEAN and NEPAD) will be invited to the two summits to be held in 2010.

<sup>6</sup> See, Leonardo Martinez-Diaz, "The G20 After Eight Years: How Effective A Vehicle for Developing Country Influence?", Global Working Papers #11, Brookings Institution (2007)

Third, the institutional relationships between the G20, global institutions like the International Monetary Fund and the World Bank Group, and sub-global groupings of states, whether based on regional or other criteria, cannot be effectively resolved until the over-arching global power relations are clarified. However, it is important to note that the resulting uncertainty can create opportunities for these sub-global groups to help shape the future global order into one that is more open to effective participation by all participants.

### III. Short Term Agenda

During the current process of power rebalancing the range of issues on which meaningful and sustainable results are obtainable is likely to be narrow and limited to tinkering with the existing arrangements. This can be seen, for example, in the limited agreements reached on reforming the governance of the IMF and the World Bank, despite the general agreement on the need for change in their decision making procedures and their mandates. The changes that have been agreed and, in some cases actually implemented, have not substantially altered the real power arrangements in these institutions. For example, the recently announced change in World Bank voting, once implemented, will merely increase the vote for developing and transitional countries from about 44% of total to 47% of total and it will not affect either the US veto or the ability of the EU member states to block decisions that they strongly oppose. Similarly, the promised change in the procedures for selecting the leader of the World Bank and the IMF is unlikely to significantly change the functioning of these organizations. As the example of the United Nations shows, those states with vetoes are able to dominate an institution even if its head is not one of their nationals.

The current international efforts to reform global financial regulation are similarly constrained. The items at the top of the global regulatory reform agenda -- capital adequacy, liquidity, hedge funds, derivatives, executive bonuses, bank taxes to recoup the costs of earlier bank bailouts— are all items of most interest to G7 countries. There appears to be no space on the international agenda for such issues as expanding access to the financial system, an important issue for African countries and others in the developing world, reinvestment of capital flight back into the developing countries, using regulatory incentives to encourage greater attention to development issues or broadening participation in the decision making procedures of the BCBS, IOSCO and the IAIS.

### IV. A Long Term Vision of Global Governance

As discussed above, the middle powers can only effectively exploit the limited opportunities arising from their participation in the G20 if they base their actions in the G20 on a long term vision of global economic governance. This vision should be based on the following five factors.

#### A. *A Holistic Vision of Development*

All states are developing states in the sense that they are striving to create better lives for their citizens. While states may differ in defining their responsibilities in this regard and on which aspects of the development process they wish to prioritize, they all agree that the well-being of both individuals and societies can be positively or negatively affected by a range of economic

and non-economic factors. Thus they all see development as a comprehensive and holistic process in which the economic aspects cannot be separated from the social, political, environmental, and cultural aspects, all of which are integrated into one dynamically integrated process.<sup>7</sup>

The extent to which the global governance arrangements incorporate this holistic vision of development will influence how effectively they help all states achieve their developmental objectives.

### B. *Comprehensive coverage*

Comprehensive coverage means that the mechanisms and institutions of international economic governance should be applicable to all stakeholders in the international economy. For example, the mechanisms of international financial governance must be incorporate the activities and operations of financial intermediaries that engage in sophisticated national and cross border financial transactions and their clients, savers and investors who wish to base their financial transactions on religious principles, as well as small financial institutions that operate only in local markets, and micro-financial institutions.

There are three important corollaries that follow from the principle of comprehensive coverage. First, the mechanisms of international economic governance must be sufficiently flexible and dynamic that they can adapt to the changing needs and activities of their diverse stakeholders. Second, the totality of international economic governance arrangements must ensure that the international community receives all the services it requires from a well functioning global economic system. The third corollary, which is intended to ensure that the governance arrangements are flexible, efficient and not unduly centralized, is the principle of subsidiarity.<sup>8</sup> This principle holds that all decisions should be taken at the lowest level in the system compatible with effective decision making. It is a complicated principle to implement because it must apply both in standard operating conditions and in crisis situations, which may require that decisions are made at a different level than is the case during standard conditions. In addition, it needs to be linked to a conflict resolution mechanism that is capable of resolving disputes between regulators at different levels as to which level is the most appropriate for resolving a particular issue

### C. *Respect for applicable international law*

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<sup>7</sup> See, for example, UNDP, *Human Development Report 1990* (Oxford University Press 1990); Amartya Sen, *Development as Freedom*, (Oxford University Press 1999) (see also, Daniel D. Bradlow, *Differing Conceptions of Development and the Content of International Development Law*, 21, 1 S. Af. J. on Hum. R. 47 (2005)), Available at SSRN: <http://ssrn.com/abstract=788070>.

<sup>8</sup> “The principle of subsidiarity is defined in Article 5 of the Treaty establishing the European Community. It is intended to ensure that decisions are taken as closely as possible to the citizen and that constant checks are made as to whether action at Community level is justified in the light of the possibilities available at national, regional or local level. Specifically, it is the principle whereby the Union does not take action (except in the areas which fall within its exclusive competence) unless it is more effective than action taken at national, regional or local level. It is closely bound up with the principles of proportionality and necessity, which require that any action by the Union should not go beyond what is necessary to achieve the objectives of the Treaty.” Subsidiarity, [http://europa.eu/scadplus/glossary/subsidiarity\\_en.htm](http://europa.eu/scadplus/glossary/subsidiarity_en.htm) (Retrieved on July 7, 2009).

The institution arrangements for international economic governance, either because they are formal international organizations created by treaty or involve decision making by sovereign states, should comply with applicable international legal principles. In particular, this means that the decision-making bodies and institutions engaged in international economic governance should conform to universally applicable customary and treaty based international legal principles. There are four sets of principles that are applicable in this regard.

The first is the principle of respect for national sovereignty. It is clear that by participating in a global governance arrangement, states are agreeing to forego some level of sovereignty in order to reap the benefits of a well-functioning international system. Given the different power and wealth characteristics of the participating states, it follows that, *de facto*, the amount of independence they give up will be positively related to their power and wealth. However, the principle of national sovereignty should still provide them with the means for preserving as much independence and policy space as is practicable and consistent with the demands of effective global financial governance.

The second is the general principle of non-discrimination. This means that the institutions of international economic governance should treat all similarly situated states and individuals in the same way. This inevitably means that there will be disparate treatment for differently situated states and individuals. The key question thus becomes what standards can be used to ensure that all stakeholders receive treatment that is fair and reasonable.

In the case of sovereign states, this means that, while the institutions of global governance should base their treatment of all states on the same principles, they should apply these principles in a way that is responsive to the different situations of each member state. One way of implementing this approach could be to apply the general principle of special and differential treatment that is applicable in a number of international legal contexts -- for example international environmental and international trade law -- to international economic governance. This could result in special consideration being given to weak and poor states so that they are able to enjoy a meaningful level of participation in international economic decision making structures, even when they are based on principles like weighted voting. A consequence to this may be that the organization offers some mechanism of accountability to these states and their citizens to compensate for any participation deficit.

In the case of non-state stakeholders in global economic governance, the relevant principles should be derived from documents like the Universal Declaration of Human Rights, which many now consider to be part of customary international law<sup>9</sup>. Thus, one indicator of good economic governance could be the level of respect that the institutions of international financial governance show for human rights in their member countries.

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<sup>9</sup> United Nations, Universal Declaration of Human Rights, <http://www.un.org/en/documents/udhr/> (last visited July 7, 2009); The Special Representative of the Secretary-General, Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, ¶ 38, U.N. Doc. A/HRC/4/35.

The third set of international legal principles applicable to international economic governance deals with the responsibility of states for the functioning of the global economic system. Based on general principles of state responsibility<sup>10</sup>, they have an obligation to provide foreign legal persons, which are present in the state, either through an investment or an individual transaction, with fair and non-discriminatory treatment. This means that these foreign entities should receive comparable treatment to similarly situated domestic institutions.

A fourth set of applicable international legal principles are derived from international environmental law<sup>11</sup>. At a minimum these principles would impose on regulators an obligation to insist that all financial institutions and other economic actors fully understand the environmental and social impacts of their practices and of individual transactions.

#### D. *Coordinated specialization*

The principle of coordinated specialization acknowledges that, even though development is holistic and all aspects of international governance are inter-connected, international economic governance cannot function efficiently without a limited and specialized mandate. Thus, the principle of coordinated specialization has two requirements. First, the mandate of the mechanisms and institutions of international economic governance must be clearly defined and limited to international economic affairs. Second, these institutions cannot ignore the other important aspects of the development process. Consequently, there is a need to ensure some form of coordination between the institutions and mechanisms of international economic governance and other organizations and arrangements for global governance. The coordinating mechanism, if it is to effectively resolve tensions between the different aspects of international governance, needs to be transparent and predictable. It may also need some dispute settlement mechanism.

#### E. *Good Administrative Practice*

The basic principles of good administrative practice in global governance are the same as those applicable to any public institution. These principles are transparency, predictability, participation, reasoned decision making, and accountability. This means that all the institutions involved in international economic governance must conduct their operations in a manner that is sufficiently open that their procedures, decisions, and actions are predictable and understandable to all stakeholders. They must also offer these stakeholders some meaningful way of raising their concerns and having them addressed by the institutions. The institutions should also be required to explain their decisions and operations to all interested stakeholders. Finally, the stakeholders should be able to hold the institutions accountable for their decisions and actions.

### V. Tactical Issues

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<sup>10</sup> G.A. Res. 62/61, U.N. Doc. A/RES/62/61 (Jan. 8, 2008); Responsibility of States for Internationally Wrongful Acts, Report of the ILC on the Work of its Fifty-Third Session, UN GAOR, 56th ses, Supp No 10, p. 43 UN Doc A/56/10 (2001).

<sup>11</sup> See generally, David Hunter, James Salzman, and Durwood Zaelke, *International Environmental Law and Policy* (Foundation Press 2006).

It is clear that there is neither general consensus on this long term vision nor on how to implement it. Moreover, it is clear that in the current phase of the transitions in global power, it is not possible to implement this vision. This suggests that during the current phase, middle powers should have adopted a pragmatic, approach to global economic governance reform. In brief they should concentrate on developing short term tactics that both result in real benefits for their countries and their citizens and that open up further opportunities for achieving global economic governance reforms that are consistent with their long term objectives.

Implementing this strategy requires both setting priorities for the short term and developing a plan of action for achieving these objectives. For example, given that South Africa's and Africa's concerns in the global financial arena are focused on questions of poverty and inequality, the sorts of issues that South Africa should prioritize in the G20 are those that can enhance the ability of Africa to address these issues. Given this general orientation, there are two issues in the financial area, that offer suitable short term objectives. The first relates to financial regulation. South Africa can call for broadening the scope of the banking regulatory reform agenda. In particular, South Africa can point out that for many African countries a key issue is the fact that many of their citizens and small companies do not have effective access to financial services. They can add that regulation can help address this issue by encouraging banks to develop new products that are specifically targeted at this problem. In this regard, it can also remind the rich countries of Paul Volcker's contention that the most important financial innovation of recent years is the ATM because of its impact on enhancing convenience and access to financial services. Africa could also remind the world that the next innovation of this sort might be cell phone banking, in which Africa is a leader. Another regulatory issue that should be addressed is the problem of how to get international banks to recycle at least a small proportion of the capital flight that they attract from African and other developing countries back into these countries. A third regulatory issue is incentivising the banks to extend some of their more impressive social responsibility initiatives to other aspects of their business. A good example of such an initiative is the Equator Principles<sup>12</sup>, which deal with the management of the social and environmental risks in large project financings.

The second issue that South Africa and other that middle powers can prioritize is reform of the governance arrangements of the IMF. It is becoming increasingly clear that, regardless of the rhetoric about the need for substantial reform of the IMF's governance, substantial reform is unlikely to take place in the short term. Consequently, the most realistic reforms are those that are possible within the existing legal framework. One reform that can easily be achieved within this constraint is increasing the IMF's public accountability. Unlike the World Bank and all the other multilateral development banks, it does not have an independent accountability mechanism. These mechanisms allow non-state actors, who claim that they have been harmed by the failure of these organizations to comply with their own policies and procedures, to have their claims investigated and reported to the Boards of these organizations. Their benefit to the organization is that they increase the efficacy of the operations of these entities by both enhancing compliance with their policies and procedures and by enabling the institution to gain more detailed empirical knowledge about the actual impact of their operations. This improves their ability to learn from their operations and to improve them. Another action that would improve global financial governance and is relatively easy to implement is increased

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<sup>12</sup> For more information on the Equator Principles: <http://www.equator-principles.com>

participation by developing countries in the appropriate decision making bodies of the international regulatory authorities like the BCBS, IOSCO and the IAIS. This increased participation should result in these bodies developing principles and policies that are more sensitive to the needs of these countries and to impact of financial regulation on poverty and inequality.

Finally, South Africa should combine this short term substantive vision with a plan of action that seeks allies from both other middle powers, like Australia, Brazil, Indonesia and the Korea, as well as other G20 members including, if appropriate, the G7 countries.

## VI. Conclusion

In this paper, I have argued that participation in the G20 offers middle powers like South Africa an opportunity to influence the global economic agenda and the institutional arrangements for global governance. However, given the current configuration of geo-political forces and the process of change they are undergoing this opportunity is limited both in terms of the scope of issues that can be addressed and in terms of the benefits that can be obtained on each issue. Moreover, in order to maximize the benefits that the middle powers can gain from this opportunity, they need to have a long term vision of the forms of international economic governance that they are seeking and to derive their short term objectives and implementation strategy from this vision.