



Global Governance of Public Goods: Asian and European Perspectives

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Sessions summaries

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SESSION 5- IS THE MULTILATERAL SYSTEM COLLAPSING? – PUBLIC

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During the 2010 G20 summit in Korea, the Korean government created a research group to propose a global governance reform consistent with the new globalized economy. Global governance can be conceptualized in terms of two structures, the superstructure and the infrastructure.

- The superstructure is composed of major economic players. We defined these economic actors as those whose decisions independently affect the global stability and the global economic development. Europe, China and the US fell in this category, they constitute the core of global governance by determining its structure and its decision making process.
- The infrastructure is composed of numerous multilateral institutions. In this category fall institutions like the IMF, the WTO and the G7 and numerous multilateral agreements. They constitute global governance in a broad way.

It was beyond our ability to deal with the profusion of these types of institutions, we thus decided to focus on multilateral institutions as bureaucracy of the superstructure of global governance. The G20 appeared to be the premium institution of global governance. We focused our analysis on the bureaucracy of the G20. The quality and role of the institutions constituting the operating arms of the G20 must be improved and expanded along three axes:

- Independence
- Accountability
- Transparency

We also emphasized the necessity to democratize these institutions by including emerging countries in their decision making process.

Specifically, we recommended the creation of a secretary for coordination of monetary policies which would exist inside the G20. To monitor every international institutions' activities to achieve coordination, we proposed to split every institutions in terms of the field they are operating in to facilitate coordination. The secretary would engage in macroeconomic policy assessment and propose arrangement for financial stability. Korea was only able to recover after the 2008 crisis thanks to a 30 billion currency swap from the FED, the moment the swap arrangement was announced, the market was reassured and investors decided to stay in Korea thereby stabilizing domestic financial markets and the exchange rate. The secretary would be able to create this kind of safety arrangement.

Surprisingly, the FED rejected our proposition arguing there was no need for a safety net as long as national economic policies were properly managed; therefore it was decided not to create neither the safety net nor the secretariat. Nonetheless, since 2010, the fact that the G20 listened to our idea helped a great deal in stabilizing financial markets and increased the probability of central banks cooperation.

Eventually, the globalized economy will need global institutions: a global central bank, a global financial regulatory authority and many else institutions in other fields. The system we have does not work properly, we need to improve our institutions and I hope our proposition will eventually be taken into account.

Francesco Giavazzi, Professor of Economics, Bocconi University

The multilateral system calls for more international policy coordination. The current system creates many negative demand externalities which are at the core of macro issues and need to be taken care of. Some countries rely too much on net exports which is to say demand coming from abroad. US consumers were the engine of growth before the crisis. When they stopped consuming, it put an end to world growth.

We must try to do what has succeeded during the G20 summit of London. Countries then decided they needed an expansion of domestic demand. Worried that some of them would play the free rider game, they all committed to expand fiscal policy at once, and they almost all delivered. It was a unique situation in 2008, we no longer have the incentives to coordinate. It is worrying that the chairman of the US gave so much relevance to the exchange rate in her remarks when she explains why the lift off had been postponed, implying that even for the US net exports are important despite their strong domestic demand and their relatively closed economy.

China has been trying to rebalance its economy towards consumption but has not managed to do so yet. Germany still opposes the expansive fiscal policies Europe needs. How will we convince China and Germany to do more to spend on domestic demand? We have a unique opportunity to solve the current lack of global demand: the refugee crisis. China and Germany have the same problem: demography. Their population are both reaching an age in which the propensity to save is the highest, this phenomenon weighs strongly on domestic demand. Migrants are the obvious solutions: they are usually young people in their 20's with low propensity to save. By assimilating migrants in their population, Germany and China could rebalance their demography and structurally increase domestic demand.

Germany and China could also solve their lack of domestic demand via investment. Investment in infrastructure appears to have very low effect on potential output, by contrast investment in human capital gives high return to investment. Investing in human capital would be a good way to increase consumption in the short run and potential growth in the long run. Here again, the refugee crisis creates incentives to invest in human capital.

Global demand imbalances are mainly generated by demographic factors, fortunately, the migrant crisis will force us to address the problem, and the humanitarian aspect of this crisis might create the incentive we need for these governments to open up their borders.

Bernard Hoekman, Director of Global Economics, European University Institute (EUI)

There has been a lot of change lately, we've witnessed a substantial increase in the volume of trade partly due to the integration of Eastern Europe and China into the world economy and partly due to a huge policy shift towards liberalization. As a result of that and in conjunction to technological change we've witnessed the rise of global value chains. By providing a rule based system and a framework for trade and investment the GATT and then the WTO have

played an important role in supporting this process. China integrating the WTO was also a huge achievement for the system.

However, nothing has happened in the WTO since 2001, in part due to the fear inspired by the success of the Chinese economy. There has been a change in how governments view globalization and this has reflected in the WTO's functioning. It is now very hard to pass an agreement in the framework of the WTO. Countries have thus turned towards mega regional agreements like the TPP, the TTIP and the RCEP. Much uncertainty surrounds these agreements: How are they going to relate to each other? Are there going to be building blocks? Given the sclerosis of the WTO, can these agreements fill the gap and be multilateralized? There are no guarantees that these agreements are going to be successful: in these framework, rules are often non-consistent like in Korea where rules signed with the US overlapped rules signed with the EU.

There is a revealed preference from governments to act in smaller clubs. However, there is significant scope to act within the frame of the WTO, so why are these treaties not under the umbrella of the WTO? Multilateralization in the WTO can go through two types of agreements:

- Critical mass agreements, a number of countries come together, agree on a subject and then apply whatever they have negotiated to the rest of the world who can just free ride. This type of agreements can work well but it's limited to market access measure. This has not been used for rules that apply on a most favorite nation basis. Lawyers have written these kind of agreements in a way that make those difficult to use in practice however.
- Plurilateral agreements. This allows signatories to discriminate against non-signatories. A group of countries can sign an agreement within the framework of the WTO without having to open to non-signatories countries. As they are signed under the umbrella of the WTO, these agreements have significant advantages, they are more transparent and negotiated in a way that keep the non-signatories informed. The mega agreements currently being negotiated do not display these advantages. They could be negotiated within the WTO framework to gain positive spillovers and to create the opportunity for other countries to gradually join.

Why do countries then prefer to negotiate outside of the WTO? There is a consensus constraint in the WTO, all members must agree to an agreement even if not concerned by it. Plurilateral agreements are heavily constrained by this requirement. To promote multilateralization this particular constraint has to be overcome. This constraint was created because countries were worried they could be affected by negative externalities from agreements between other countries. Creating a code of conduct that actually deals explicitly with these types of concerns could help unlock this constraint.

Another necessary condition to do more within the WTO is to facilitate the scheduling of these type of agreements. The WTO inherited the GATT legal text which does not allow for this type of cooperation to occur. The services agreement that was negotiated in the Uruguay round when the WTO was created actually does that, this need to be implemented in the WTO.

The lack of leadership in the WTO is the last difficulty that needs to be addressed. One country has to take the lead and try to move away or complement what is happening through the mega agreements. It's certainly not going to come from the US, Brazil or India. Asia and the EU should do more in the WTO along these lines and focus on these issues. Countries that have acceded to the WTO after 1995 also have interest in doing this. Newcomers in the WTO have made huge institutional investments in order to be accepted. It is a mystery that these countries do not take a more pro-active role in the WTO, the attitude of China in particular is puzzling.

There is also a big gap in the actual trading system on polylateral agreements. We have seen one example of this in the WTO: the trade facilitating agreement, a number of important innovations have been made creating common rules on trade facilitation. But governments had a lot of flexibility in implementation, being able to decide when to do what. Again, leadership is needed to push these kinds of agreements. Most of these polylateral agreements are not taken at a global level although the WTO creates the incentive for this kind of cooperation. Allowing the private sector and the regulators to opt-in in these negotiations could increase incentives to negotiate these agreements within the WTO.

The shift we observe to mega agreements is dangerous, the WTO should be the institution in which plurilateral and polylateral agreements are signed. Ultimately, the WTO will need leadership and I fail to understand why we don't see more efforts being made by the excluded states and the states that have the most interests in this.

Jean Pisani-Ferry, General Commissioner, France Stratégie

Is the coordination problem we have based on the obsolescence of models underlying negotiations? The backbone of negotiations are procedures and institutions which date back to the 40's. The transformation of global interdependence raises the question of the ability of the existing framework to adapt.

The underlying model for the trade system is the HOS model. Countries negotiate on a multilateral basis to lower tariffs in order to increase trade. Here negotiations are very adequately done at a multilateral basis because this is a very simple framework which only has a few objectives like the level of tariff.

The way we see world trade today is very different because of the rise of global value chains. It has become increasingly hard to identify offensive and defensive interests of each country. The subject of negotiations is no longer tariffs but standards and other dimensions which are hard to deal with in a multilateral framework. Bilateral negotiations have filled the gap, they enable to discuss a wider scope of integration measures but at the price of a narrower geographical scope. Can these bilateral agreements be multilateralized? We do not yet have a structure for holding such discussion at a multilateral level.

If we turn to macro financial interdependence, the basic model underlines the importance of the exchange rate: interdependence occurs through trade and net capital flows, this is very much the model the IMF has been relying on. This model failed to see the risk to stability arising from stock interdependence between the EU and the US which triggered the crisis. It also failed to see that despite the absence of an exchange rate, there was a risk to financial stability created by capital flows inside the EU area.

Our vision of the world strongly depends on the model we use: the Mundell-Rogoff model sees the world in term of flow independence and emphasizes the role of the exchange rate while the Rey-Shin model focuses on gross flows and stock interdependence. The two models provide quite different views about what matter and on the policy actions that would have to be followed. In 2002, Obstfeld and Rogoff wrote that interdependence was quite limited, coordination was desirable but not seen as necessary as countries could address all problems within the scope of domestic policy. In contrast, the last IMF spillover report put the emphasis on the massive importance of coordination because of the strong externalities of countries domestic policies on their partners. The structure of international discussions will be determined by the model we will choose much more than by doctrinal considerations.

On world climate, the problem is different because we did not have any model on the subject of global public goods in the past. Climate is a true global public good, it needs to be completely global. We lack models to address the problems of the sort, the Kyoto protocol and then Copenhagen made an attempt to create a binding framework based on quantity, but the geographical scope did not correspond to the contribution of each country to climate change and it eventually was a failure. The Kyoto protocol also failed to address equity problems.

COP21 is the return of the open method of coordination, method which has failed miserably at the European level. It is good that we see several countries declaring their intention to reduce their emission and partially coordinated commitments which summed up might come close to what is needed. Hard issues are equity, the intertemporal dimension and the means to monitor and enforce implementation. The 1st best solution would be a mandatory global tax and a global capping system, but this is very much a multilateral utopia. Climate clubs in which there would be some degrees of trade protection against non-participants like in the trade field seem more likely to be built.

There is a mismatch between agreements based response and the true model of the problem. A system of institutions is easier to modernize than a system based on agreements. The IMF for example has been remarkably adaptable to what has happened in the world. If institutions are to be preferred, we must settle the questions of governance of these institutions and how to make room for newcomers. Open door clubs are another response, they combine flexibility and a universal potential. We could also create a two layer system, on that provide a basis for everyone and another which plugs in new forms of coordination.

Question of Sebastien Jean: One particular feature of present time is the fact that the 1st economy is a poor economy on a per capita basis. In this framework, clauses of non-reciprocity are not adapted. Isn't the problem about inventing a degree of reciprocity between non and full reciprocity with gradual obligations depending on income level?

Response of Bernard Hoekman: This is clearly a challenge, China has been growing fast but is still a poor per capita country. The software in the trading system was outdated since its creation. It was created hypocritically by OECD countries with the idea that LDCs needed not to be included as their spillover effect did not have any effect on richer countries. But there has been a lot of learning since then which the trade facilitation agreement illustrates. However, so far only 18 countries have ratified the agreement.

Question from the floor: Bernard Hoekman, if you were to become the head of the WTO, what would you do to make it effective?

I thought the Dornbusch model could be introduced into the Mundell-Rogoff model where asset to market could play an important role. In the Mundell-Rogoff spillovers are limited because of exchange rate flexibility, but that would be the case for nominal shocks, for real shocks the exchange rate flexibility cannot absorb so that in a multi country model there would be significant spillover.

Response of Jean Pisany-Ferry: What I wanted to emphasize was the fact that this generation of model does not pay attention to stocks and gross flows. Focusing on net flows makes us underestimate the channel transmission of shocks. For emerging countries net flows are not so much different from gross flows, but for developed countries this is a problem we need to address.

Response of Bernard Hoekman: Killing the no-round would definitely help a lot although it might not be possible to do. What can be done however is the creation of an infrastructure for these open clubs, it is puzzling that it has not already been done.

Question from the floor: Institutions are undoubtedly more adaptable but pose problems of legitimacy. How can governance of international institutions evolve as to be more legitimate?

Response of Pisany-Ferry: Legitimacy of international institutions lies in the mandate that was given to them. Because they are trusted with specialized mandate these institutions are still accountable for what they do, to ensure legitimacy we must not broaden the mandate of these institutions.

Response of Francesco Giavazzi: On the flexibility institutions I will take the two examples of the IMF and the ECB. The IMF has a very weak board dominated by the US, if the US agrees, the IMF has the flexibility it needs to act. The ECB is composed of a strong board and a constraining mandate. If we want to add more discretion to the ECB policy, we need more political accountability. It could be introduced by creating a sub-chamber inside the European Parliament that would deal with the Eurozone.

He Fan – Chair: In China, influx of migrants are not much of an issue as migrants can easily be absorbed in the immensity of the territory. In Europe however, the heterogeneity of new immigrants create risks with public opinion. How can European countries address potential costs and risks?

Response of Jean Pisany-Ferry: The ability of the EU as an entity to respond is indeed worrying. The refugee highlights differences in attractiveness of labor markets and differences in the attitudes of various countries. The European Union is facing a huge challenge.