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Global Economic Governance at a Crossroads: Replacing the G-7 with the G-20

Colin I. Bradford, Jr. and Johannes F. Linn

Finance ministers representing the Group of 7 (G-7) industrialized countries met in Boca Raton, Florida, in early February amid concerns about the weakening of the U.S. dollar. One factor in the dollar's decline is the U.S. trade deficit, which is partly due to the undervalued Chinese yuan.

World leaders meet at the 2003 G-8 in Evian, France. Organizers will need a bigger table if the G-20 replaces the annual G-7/G-8 summit.

The involvement of China, which is not a G-7 member, illustrates both the glaring gap in global governance and the increasing economic and policy interdependence between industrial countries and major emerging market economies (EMEs). As one observer, referring to the Boca Raton meeting, put it, "China is the 800-pound gorilla and it isn't even part of the negotiations."

But China is a member of the G-20—a larger, more representative group of finance ministers that has attracted worldwide attention as a useful forum for discussing and negotiating policies on global economic issues. Policymakers should upgrade the G-20 to head-of-state level and use it to replace the increasingly ineffective G-7 for several reasons: future demographic and economic changes will further shift the balance away from G-7 countries and toward the large EMEs; globalization presents new challenges that require more representative global governance approaches; and EMEs have played a key role in the origin, impact, and solutions of recent global economic crises.

The G-7 was founded in 1978 by French President Giscard d'Estaing and German Chancellor Helmut Schmidt. At the time, the major world economies consisted of six North Atlantic nations—Canada, France, Germany, Italy, the United Kingdom, and the United States—along with Japan. In the 1980s, regular meetings of heads of state and finance ministers were essential to addressing global economic issues. In the 1990s, the G-7 was expanded to the G-8 by including Russia in heads-of-state summits, but the finance ministers retained the G-7 framework for their regular meetings. Over the last few years, however, as EMEs have played an increasing role in the world economy, G-7/8 meetings have become an inadequate means to address global economic challenges.

The G-20, in contrast, is composed of ten industrial countries (the G-7 countries plus Australia, Russia, and the EU president) and ten emerging market economies (Argentina, Brazil, China, India, Indonesia, Korea, Mexico, Saudi Arabia, South Africa, and Turkey). The G-20 was founded in 1999 at the initiative of the German finance minister, Hans Eichel. Then-Canadian Minister of Finance Paul Martin was its first chair.

The G-20 has shown it can play an important role in international negotiations. Late last year, Supachai Panitchpakdi, the head of the World Trade Organization (WTO), and Pascal Lamy, the trade chief for the European Union, met with G-20 finance ministers to discuss how to break the trade deadlock after the Doha Round negotiations unravelled in Cancun, Mexico, months before. As a further sign of the G-20's growing importance, Paul Martin, now the Canadian Prime Minister, called a meeting at the end of February to promote the idea of elevating the G-20 to head-of-state meetings.

Global events and trends justify moving forward quickly to replace an obsolete G-7/8 with a strengthened G-20 so that global economic governance can bring to the table the large emerging market economies that are of growing importance, both in terms of population and economic weight.

THE GLOBAL MAJORITY AND GLOBAL GOVERNANCE

In the next fifty years, the world's population will increase by fifty percent, from 6 billion people to 9 billion. The 3-billion-person increase will occur solely in developing countries, while the number of people living in advanced industrial countries will be about the same in 2050 as it is today—roughly 1 billion people.

These trends mean that the industrial countries associated with "the West" (including Japan) will become an ever smaller minority of the world's population, with their share of the world's population falling from 17 percent to 11 percent. By contrast, the number of people in developing countries will increase in population by sixty percent, from 5 to 8 billion people. This means that the global majority from the developing countries today will total about 90 percent of humanity by 2050.

In a world where the G-7/8 economies still appear so dominant, it may be difficult to grasp the degree to which the global economy is today already multipolar. In the last twenty-five years, EMEs have generally had growth rates substantially higher than those of the G-7/8

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members. Five EMEs now rank among the ten largest economies in the world as measured by gross domestic product at current exchange rates (see box). China is the fourth largest economy in the world. Brazil, Mexico, India, and South Korea are already major economic forces. As higher economic growth continues in large, middle-income economies and demographic trends proceed as anticipated, the structure and dynamic of the global economy will become increasingly multipolar. Goldman Sachs projects that by 2050, the non-Western G-20 EMEs from the developing world may comprise as much as 70 percent of total GDP from all G-20 economies, compared to 17 percent of total GDP today.

The World's Ten Largest Economies in 2002

(Gross Domestic Product in billions of dollars, at current exchange rates)

1. United States*	10,417	
2. European Union*	8,563	
3. Japan*	3,979	
Germany*		1,976
United Kingdom*		1,552
France*		1,410
4. China	1,237	
Italy*		1,181
5. Canada*	716	
Spain		650
6. Mexico	637	
7. India	515	
8. South Korea	477	
9. Brazil	452	
Netherlands		414
10. Australia	411	

*=Member of G-7

Source: World Bank, *World Development Indicators*

The implications of these demographic and economic facts are that the structures, mechanisms, and processes of global economic governance must be realigned to better correspond to the current realities of the global economy and global society, not to mention the patterns that will change over the next half-century. The G-7/8 economic summits of heads of state, along with semi-annual meetings of G-7 finance ministers, are currently the preeminent forum of the global governance system for the world economy. Yet these meetings shut out the great majority of the world's population and a significant share of the world's economic power.

THE NEW GLOBAL AGENDA

But it is not just a matter of population and economic weight. It is also a matter of how globalization has changed the way countries interact economically. Globalization is not merely the internationalization of trade and financial flows between national economies interacting at arm's length. Globalization, in fact, has fundamentally transformed the nature of international economic interaction. The world's economies now penetrate each other's internal domains because large, modern firms are no longer merely factories but global networks that function seamlessly across borders. Intra-industry and intra-firm trade have increased as a proportion of total trade. The integration of world financial markets has created what is essentially a single global capital market. Migration and the outsourcing of activities have transformed and linked labor markets globally. And modern transportation and communication linkages in effect have shrunk geographic distance. As a result of these factors, porous borders have changed the meaning of the boundaries that define nations.

Not only have the channels for transmission of economic forces been transformed, but the relationship between different types of interactions has been changed. Trade, finance, economic growth, poverty reduction, environmental sustainability, social progress, and governance, which were once treated separately, are now inextricably linked to each other. For example, the social and environmental dimensions of trade are now major issues for WTO negotiations. Concern by the United States and Russia that meeting emissions targets would dampen the rate of economic growth and cost too much to implement have limited support for the Kyoto Protocol.

These transformations in the nature of international economic interactions put new demands on the mechanisms, institutions, and policies of global economic governance. In particular, political and policy attention must be focused on the inter-face issues between finance, trade, development, and poverty reduction as well as between economic, social, environmental, and governance issues. This translates into a need to focus on the inter-relationship between the principal international institutions dealing with each in these various "domains" and on the complementarities, synergies, and interactions among them.

Therefore, in today's globalized world, a simple call for a clearer division of labor between the global institutions is no longer sufficient, since each traditional domain of responsibility of a particular international organization now overlaps and is intertwined with the domains of many other international institutions. Nor are bureaucratic competition or interagency coordination among the international institutions the most effective ways to address these overlaps.

A high-level global political forum in which the leaders of a representative group of countries give serious attention to global strategic and systemic issues that cut across the traditional roles and mandates of international institutions and provide broad guidance to them is essential, and an enhanced G-20 is the right forum for this purpose. At the highest political level, there is no other representative forum mandated to address these inter-sectoral and inter-institutional issues, which are part of the G-20's founding principles.

According to the International Monetary Fund's (IMF) website, "the G-20 was founded as a new forum for cooperation and consultation on...policy issues pertaining to the promotion of international financial stability and seeks to address issues that go beyond the responsibilities of any one organization."

GLOBAL STABILITY

Emerging market economies have achieved above average economic growth rates and have integrated themselves into the world economy through both trade and finance in ways that have transformed them as well as the global economy. At the same time, EMEs have been the main source of international economic instability for a decade, as the world lurched from one financial disaster to the next: the 1994 Mexico tequila crisis, the 1997-1999 Asian financial crisis, the 1998 Russia crisis, the 1999 Brazil crisis, and the financial crises of Argentina and Turkey since 2000.

The international financial institutions, particularly the IMF and the World Bank, have played an important role in supporting long-term growth and economic stability, in helping address financial crises, and in giving EMEs an important and responsible voice in the international financial system.

The twice-yearly meetings of finance ministers in the IMF-World Bank ministerial committees (the International Monetary and Finance Committee and the Development Committee), which include ministers from EMEs, have brought leaders into global conversations on financial and economic development. However, the mandates of these committees remain relatively narrow, their agendas institutionally driven by the operational focus of the World Bank and IMF, and the governance structures of the international financial institutions remain dominated by what are widely seen as antiquated distributions of voting rights, since G-7 countries have an over-representation in the capital and voting structures of these institutions. The committees, then, do not solve the problem of creating a more broad-gauged and representative forum.

The G-20 Countries

Industrialized Economies	Developing Economies
Australia	Argentina
Canada	Brazil
France	China
Germany	India
Italy	Indonesia
Japan	Mexico
Russia	Saudi Arabia
United Kingdom	South Africa
United States	South Korea
EU Presidency (when not G-7/8)	Turkey

Source: www.g20.org

MULTIPOLAR ECONOMY, MULTICULTURAL WORLD

A final reason for a more broad-based global governance structure is that demographic and economic growth and globalization are associated with global cultural shifts. While many of the trappings of Western consumer culture have influenced the rest of the world, it would be parochial for the West to think that Western formulations of progress and modernity are universally held. There is in fact an increasing global presence of cultural expression from the non-Western world—Africa, Arab-Islam, Asia, and Latin America. The world is becoming increasingly and overtly multicultural, as it becomes increasingly multipolar, economically.

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Different cultures—with their distinctive perspectives on nature and the environment, community and individualism, and cooperation and competition—can have sharply different views on policy issues and on such basic questions as the role of the state. The broad goals and instruments of international economic, social, and environmental policies are determined in part by the perceptions of what represents progress and modernization. Distinctive visions of modernism and progress can help shape the future. Global governance mechanisms need to be vehicles for voicing and hearing those perspectives rather than excluding them.

AN OPPORTUNITY FOR THE G-20

For all the reasons we have outlined here, there is a fundamental asymmetry between today's global reality and the existing mechanisms of global governance, with the G-7/8—an exclusive club of industrialized countries that primarily represents Western culture—the prime expression of this anachronism.

As Fred Bergsten and Caio Koch-Weser pointed out in the fall of 2003 in a *Financial Times* op-ed, one response might be to strengthen the Atlantic alliance because it is a crucial relationship for the world economy. Bergsten and Koch-Weser argued for the "G-2" (the United States and European Union) as a forum for enhanced global management. But as Bergsten and Koch-Weser would recognize, better global governance is a game of inclusion, not exclusion, and a strong U.S.-E.U. economic policy dialogue makes the most sense within the context of a more effective, broader global forum.

In contrast to the G-7/8, the G-20 is a diverse group of nations, with four Asian countries (China, India, Indonesia, and Korea), three Islamic countries (Indonesia, Saudi Arabia, and Turkey), three Latin American countries (Argentina, Brazil, and Mexico), and a leading country from Africa (South Africa). It includes those economies which are sufficiently large to influence global outcomes. Elevating the G-20 meeting to annual heads-of-state summits to replace the G-7/8 annual summits would be the logical next step in the evolution of global economic governance. In fact, this would formalize recent efforts to make the G-8 meetings more inclusive by having invited the heads of the principal international institutions and the heads of state of certain developing countries to some of the meetings.

The focus of the new G-20 forum would be on global economic governance broadly construed to include trade, finance, health, environment, education, human security, poverty reduction, and conflict resolution, thereby extending beyond the realm of ministers of finance. The summits would also allow for face-to-face interactions among the heads of state, but would be geared toward decision-making, rather than mere exchanges of views and pleasantries as is now often the case in the G-7/8. The G-20 would provide guidance to the panoply of international organizations working on these issues, creating linkages between issues and institutions, facilitating coordination and a division of labor, creating more vision and strategic direction, and helping to settle conflicts (such as those on trade, which led to the recent breakdown in the WTO's Cancun meeting). G-20 meetings at the ministerial level could continue to meet twice a year, and ministers with different portfolios could rotate in, depending on the pressing issues of the moment. These semi-annual ministerial level meetings could prepare the agenda for the annual G-20 heads of state meeting. This sequence would build on the experience and the success of the G-20 since it was founded in 1999 and would provide new energy, a more representative structure, and greater legitimacy to global governance at the highest political level.

Many specific questions on organizing the new G-20 will have to be resolved, including how to rotate the presidency and whether to set up a permanent secretariat. There may also be difficulties and downsides associated with shifting from the G-7/8 annual summits to G-20 head-of-state meetings. The most obvious of these is that the size of the G-20 might hamper discussion and decision-making. However, wide consultation and strong substantive preparation can go a long way toward mitigating the problems associated with larger size. G-20 working groups on specific issues at sub-ministerial levels have already been effective forums for working through policy options and teeing up issues for G-20 finance ministers. The EU has demonstrated how fifteen (and soon to be more) governments and heads of state can make progress on policy actions when there is a strong agenda and good preparation.

AN OPPORTUNITY FOR ALL

With a strengthened G-20, developing country members, and with them the developing world at large, would gain a real voice and a sense of inclusion in global decision-making rather than the current token representation that many resent. For the G-7/8 countries, the apparent loss in exclusivity should be more than offset by the increased relevance and effectiveness of their efforts to address issues of great global and national significance. For the world at large, the new G-20 will mean a real and positive change from the increasingly stale and ineffective G-7/8 summits.

For the United States, elevating the G-20 to the heads-of-state level is both an opportunity and a challenge. It gives the United States a chance to reach out to the non-Western world, to recognize and respect the input of other nations, to strengthen multilateral cooperation, and to commit to finding common ground for international action. But it presents a challenge for the United States because it will require a shift in leadership style. Even more so than in the G-7/8 meetings, rather than presuming to lead by virtue of its relative weight and power, the United States would need to lead using an interactive exchange of views and consensus building, incorporating the ideas of others, compromising to be inclusive,

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and responding positively to differences of views rather than presuming the American way is best.

Without the support of the United States, the proposal to replace the G-7/8 with a strengthened G-20 will not fly. With U.S. support, it has a real chance of succeeding.

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