Multilevel Economic Governance through Subsidiarity: Remodelling the Global Financial Architecture

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Introduction

We find ourselves, at the beginning of the twenty-first century, in a world beset with critical transnational problems which cannot be resolved without serious reflection, ingenuity, and political will on the part of individuals and institutions at all levels of governance – viz. local, national, regional, and global. The solution to many of these problems may well hinge on our ability to forge new or amended structures, mechanism, or institutions of global governance. Our specific task at this Vision 2020 workshop is to draw up the blueprints for the kind of global economic architecture we envision could be feasibly built by the year 2020. As such, this is a speculative and subjective exercise. However, we were instructed "to envision a desirable and practicable architecture."

Thus, it should not be all that surprising if the reader finds within my proposals a strong normative underpinning that pushes the envelop as far as possible. It should also not come as a surprise that the proposed "vision" is tempered by the realities of the ideational, institutional and material structures (as well as of the possible resistances from status quo forces), which could be expected to act as a constraint on the implementation of the proposed global economic architecture.

To envisage and design what might be considered appropriate institutional requirements (principles, norms, rules and decision-making procedures) for future global economic governance is a major challenge. But it is even more daunting to begin the process of crafting effective and legitimate processes—processes that are participatory and fair—to move the world toward what would be considered by others as a desirable new governance system. Therefore, I make no claims about "intersubjective consensus" over the proposals in this paper. The only claim I do make is that underlying my proposals is a normative concern that whatever global economic architecture is built, it should have as a focus poverty eradication, equity, sustainability, inclusiveness and justice.

If the global rules system is to be "harmonised" through deeper integration among national economies within an agreed overall framework, as many currently advocate, consideration must be given first and foremost to the development of discursive democratic mechanisms as the rules and framework are created and implemented. There can be no global harmonisation without representation. Accountability guarantees need to be at the centre of any vision for a new global economic governance system.[1] It is for this reason that at the centre of this

[1] See the argument made by August Reinisch, "Securing the Accountability of International Organizations", *Global Governance*, vol.7, no.2 (April-June 2001), pp.131-150.

blueprint for a global economic architecture lies a bottom-up model of subsidiarity. The bottom-up subsidiarity model is based on the notion that lower levels of governance should not be denied their competencies as long as they are capable of carrying out specific tasks assigned to them. This particular model of governance allows the more immediate levels (those most affected by a decision-making fall-out) to be responsible for carrying out tasks for which they have certain competence. [2]

This paper is divided into four parts. Part One provides the backdrop for the speculative exercise. It succinctly lays out the history and evolution of international financial architectures since roughly 1870 until the present period. It also pinpoints the flaws in the design and structure of the post-World War II international financial and economic system as it tried to weather the turbulence and transition of a rapidly globalizing world. Part Two then examines critically the intensification of globalisation, the impact of this phenomenon on the international financial architecture, and the calls for reform of this system of economic governance. Part Three deals with the emerging structure of what some have called a new international financial architecture (NIFA) and enumerate the problems with this emerging governance structure. Part Four offers a blueprint for a new Global Economic Architecture (GEA) that ought to be seen, not so much as a replacement of the extant international financial architecture as much, as an attempt at remodelling. Finally, I conclude by reiterating the need for an overhaul of existing international economic governance and demonstrating why proposals such as mine could be feasibly implemented by the year 2020.

The Backdrop: Formation and Evolution of International Financial Architectures

According to Leslie Armijo, there have been at least four major financial architectural structures present in the world over the past century and a half.[3] Between 1870 until the First World War, an embryonic international financial architecture was designed around the classical gold standard. It was embryonic in the sense that finance was still governed exclusively by national authorities (both public and private). [4] The inter-war period saw a re-configuration of the financial governance structure, even though attempts were made through international conferences to re-establish the gold standard. In practice, the financial architecture consisted of a combination of floating exchange rates, capital controls, limited intergovernmental co-operation and national macroeconomic policy aimed at meeting domestic needs.

In 1944, at Bretton Woods, New Hampshire, representatives from 44 nation-states met to design yet another international financial architecture. This multilateral post-war system was intended to regulate trade and monetary relations between states so as to avoid the economic depression and instability that resulted in World War II. "The policymakers at Bretton Woods believed that the length and severity of the Great Depression was exacerbated by the lack of

[2] W. Andy Knight, *A Changing United Nations: Multilateral Evolution and the Quest for Global Governance* (Houndmills: Palgrave/Macmillan Press, 2000), p.171.

[3] For a more detailed survey see Leslie Elliott Armijo, "The Geography of World Financial Reform: Who wants what and why?" *Global Governance*, vol.7, no.4 (2001), pp. …

[4] Randall Germain argues, that global financial governance "did not exist under the international gold standard of the 19th century," since finance was governed at the time exclusively by national authorities such as the Bank of England, the Banque de France and Germany's Reichsbank, along with the finance ministries and treasury boards of national governments like the US. See Randall D. Germain, "New Departures: The Emerging Structure of Global Financial Governance," *Global Governance*, vol.7, no.4 (2001), pp….

commitment by individual states to the maintenance of a stable world economic regime and the absence of formal international rules to guide state action.[5] In essence, the Bretton Woods system (BWS) was a financial and monetary regime whose main pillars included the twin international financial institutions (IFIs) of the World Bank (IBRD) and the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT).

The World Bank's primary role was conceived as one of a financial intermediary to assist in the post-war reconstruction of European states whose economies were devastated by World War II. The Bank also provided creditworthy countries with access to international capital markets. As colonies gained their independence during the 1960s, the Bank's role was modified somewhat. It provided many Third World states with major loans for large-scale infrastructural projects such as roads, dams, bridges and airfields. In the late 1950s the Bank created the International Finance Corporation (IFC) to help states obtain finance for major project from private lenders. In 1960, an International Development Association (IDA) was formed to finance projects in the poorer developing countries. By the 1970s, the World Bank turned its attention to fighting poverty and got into the business of providing aid to Third World countries willing to undertake specific economic and social reforms. One should note that during this period a number of regional multilateral development banks, modelled on the World Bank, sprung up in Asia, the Caribbean and Africa.[6] They also formed important components of the international financial architecture.

The IMF's role was conceived as one of overseeing exchange rate relationships in a fixed, but adjustable, exchange rate system and to prevent international financial instability by managing national liquidity and currency crises. The GATT's role was to prevent discriminatory trade practices and to facilitate freer trade through multilateral negotiations (known as 'rounds').

The architectural form of the BWS was designed to exclude a vast majority of states. The main architect was the United States whose structural power and liberal imprint became embedded in this international financial edifice.[7] Not only has the US remained at the centre of this international financial governance; the manner in which the BWS has operated also served US hegemonic purposes (Pax Americana) and neo-colonial expansionism.

The oil shocks of the 1970s, coupled with the emergence in importance of the Eurodollar markets rattled the very foundation of the BWS. The US unilaterally abandoned the fixed exchange rate regime of the BWS as it saw its political and economic scaffolding around the international financial architecture become undone. In the US itself, economic stagflation led to growing balance of payment problems which forced the US government, under President Nixon, to revert initially to protectionism and beggar-they-neighbour policies. The US also chose to suspend the dollar's gold convertibility, which meant that national currencies could be determined by forces of supply and demand in the world market. The immediate post-Bretton Woods regime was therefore distinguished by floating exchange rates, the easing of controls on private capital movements, and the end of embedded liberalism.

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[5] Susanne Soederberg, "International Financial Institutions," in Janine Brodie (ed.), *Critical Concepts: An Introduction to Politics*, 2nd edition (Toronto: Prentice Hall Canada, Inc., 2001), p.423.

[6] The Asian Development Bank, the Inter-American Development Bank, and the African Development Bank.

[7] John Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," Stephen Krasner (ed.), *International Regimes* (Ithaca, NY: Cornell University Press, …)

It is the post-Bretton Woods international financial architecture that is under scrutiny today by many economist and political analysts. What are the structural weaknesses and flaws of this edifice? One only has to look at the string of bank failures in the 1970s and 1980s, the debt crisis of the 1980s, the Mexican peso devaluation in 1994/95, the Asian financial crises of 1997/98, falling rates in profits in the productive sphere to realise the overall crisis in global capitalism.[8] These symptoms are indicative of a set of larger problems, i.e. the failure of international economic governance in a world gripped by the intensification of the globalisation phenomenon, and the need for a remodelling the extant international financial structural design into a truly global and multilevel economic architecture.

The Impact of Globalisation and the Emerging Structure of Global Financial Governance

The collapse of the BWS coincided with the advent of intensification in the processes of globalisation. Much has been written about the phenomenon of globalisation so it is not necessary to regurgitate the various positions on this subject. Suffice it to say, as Camdessus does, that globalisation brings with it both opportunities and risks.[9] Like a two edged sword, the impacts of 'hyper-liberal' globalisation has been both positive and negative. Since the 1980s, many countries have realised the benefits of globalisation.

Apart from the main industrialised countries, countries like Chile, India, Poland and Turkey joined the newly industrialising East Asian Tigers in efforts to integrate their domestic economies more firmly into the global economy. They were able to attract significant foreign investment and take advantage of the technological advances that accompanied the intensification of the globalisation phenomenon. Some of these countries had export growth rates in the vacinity of 5% per year and they began to diversify their domestic economies. On the other hand, there were many other countries that benefited little from globalisation, the expanding markets or advanced technologies. Among them were countries like Madagascar, Niger, the Russian Federation and the Commonwealth of Independent States (CIS). In sum, the global economic opportunities derived from globalisation "are unevenly distributed – between countries and people."[10]

One of the negative impacts has been the unequal global distribution in income. As Robert Wade correctly points out, "if the world's income distribution" was "more equal in the past few decades, this would be powerful evidence that globalisation works to the benefit of all. It would give developing countries good reason to integrate their economies closely into the world economy, as the IMF and the World Bank – and their mostly rich-country shareholders – urge them to do."[11] The reality, however, has been that global inequality is worsening at a rapid pace. The annual average income of the majority of the populations of Africa, India, Indonesia, and rural China is approximately $1,500 as compared with $11,500 in countries like the US, Japan,

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[8] See Robert Cox, *Production, Power, and World Order: Social Forces in the Making of History* (New York: Columbia University Press, 1987)..

[9] Michel Camdessus, "The IMF at the End of the 20th Century: Can we establish a humanized gobalization?" *Global Governance*, vol. 7, no.4 (2001), p…

[10] United Nations Development Programme, *Human Development Report 1999* (New York: Oxford University Press, 1999), p.2.

[11] Robert Wade, "Global Inequality: Winners and Losers," *The Economist* (28 April 2001), p.72.

Germany, France, Britain and Italy. As Wade puts it, "if incomes were measured using actual exchange rates, the range from poorest to richest would be much larger."[12]

The UNDP's Human Development Report of 1999 presents some startling facts about the impacts of globalisation. The income gap between the fifth of the world's people living in the richest countries and the fifth living in the poorest countries was 74 to 1 in 1997. This was an increase from 60 to 1 in 1990 and 30 to 1 in 1960. By the late 1990s the fifth of the world's population living in the highest-income countries had 86% of the world's GDP while the bottom fifth had only 1%. Similarly 74% of the world's telephone lines can be found among the top fifth of the world's people living in the highest income countries, while the bottom fifth had only 1.5%. OECD countries with 19% of the global population have 71% of global trade in goods and services, 58% of foreign direct investment, and 91% of all Internet users. The assets of the top three billionaires in the world are more than the combined GNP of all the least developed countries (with a population of approximately 600 million people).[13] What these alarming statistic show is that there is a problem with the way in which global economics and finance are governed.

The policy makers in the major industrialised countries began to realise the seriousness of the problem in the 1990s when a series of high profile financial crises threatened to dismantle the existing international financial architecture and to spread their effects globally. In 1992-93 the German government lost about $1 billion and the Swedish government about $26 billion due to problems associated with the Western European Exchange Rate Mechanism (ERM). In 1994-95, the Mexican peso crisis, dubbed "the tequila effect" created havoc particularly amongst the emerging market economies of Latin America. Finally, between 1997-99 the East Asian financial crisis not only brought down Suharto regime in Indonesia but also "rocked the economies" of the so-called Asian tigers. By 1988, for instance, Indonesia, Korea, Malaysia, and Thailand each saw a drop in their GDP of between 5.7 and 13.7 percent.[14]

These are the kinds of problems that have forced a rethinking of the global financial governance system. At the centre of that system today is the Group of 7 (G-7). Germain calls the G-7, "the engine room of the global economy."[15] The policy-makers within the G-7 have recognised that the health of their economies may be directly linked to the financial systems on the periphery of the global economy. Under the leadership of Bill Clinton, a new element of the international financial architecture was added in 1998 with the creation of the G-22 – a group with significant representation from emerging markets, although most of its recommendations clearly reflect US preferences. The unhappiness of the Europeans with continued American dominance over these international financial institutions (IFIs) led in 1999 to the creation of yet another cog in the wheel of international economic governance, viz. the Financial Stability Forum (FSF). Initially, there was no developing country representation in this body. Later Hong Kong, Singapore, the Netherlands, Australia and SAR were added. While not adhering to the principle of inclusion, the FSF was envisaged as a response of the international community to global financial contagion after the Asian crisis.

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[12] Robert Wade, "Global Inequality: Winners and Losers," p.72.

[13] see UNDP, *Human Development Report 1999*, pp.2-3.

[14] Leslie Elliott Armijo, "The Geography of World Financial Reform: Who wants what and why?", p…

[15] Randall Germain, "New Departures: The Emerging Structure of Global Financial Governance," *Global Governance*, vol.7, no.4 (2001), p….

Emerging market economies (EMEs), naturally outraged by the obvious exclusivity exhibited in the FSF, pushed for a G-20 (with representation from the EMEs). This latter body, created by the G-7 grouped together finance ministers and central bank governors from the G-7 countries, from Australia and eleven of the large emerging market economies, as well as representatives from the European Union and the Bretton Woods institutions. As Porter notes, the G-20 "is envisioned as a place for developed and developing countries to develop genuine dialogue about long-range international financial architecture questions in a relatively informal process modelled on the G7."[16] Some observers are optimistic that the G-20 "provides a forum for bringing the emerging market economies into the decision-making structure of the global financial system."[17] However, others are not as sanguine. Armijo, for instance, prefers to withhold judgement for the time being on the G-20 arguing that "rich countries hold significant control over the G20's agenda."[18] Clearly, these new additions to the architecture of international finance have been made possible because of the so-called "Washington consensus".

The IMF, the World Bank, and now the WTO, are viewed by the US as still necessary component parts of the international financial architecture. The IMF utilises its structural adjustment policy (SAP) programmes to discipline countries in the South into accepting the hyper-liberal position of that is at the heart of the Washington Consensus. As a result, the Fund is now the main organiser of international debt agreements with countries in the developing world. And, the track record has not been all that good. After almost two decades of IMF's SAPs there has been increased poverty in the developing world.

The former Managing Director of the IMF, Michael Camdessus, has called for corrections to the "financial architecture" as a means of dealing with the issue of poverty reduction. He notes that more than 1.2 billion people live on less than US$1 per day, more than 1.4 billion people have no access to clean drinking water, 0.9 billion people are functionally illiterate and 0.8 billion suffer from hunger or are malnourished. In his words, "the widening gaps between the rich and the poor within nations, and the gulf between the most affluent and most impoverished nations, are morally outrageous, economically wasteful, and socially explosive. It is not enough to increase the size of the cake; the way it is shared is deeply relevant to the dynamism of development."[19] It is to this latter point that I now turn in my effort to sketch out a rough blueprint for the kind of global economic architecture which, in my opinion, is desirable at this point in our history.

Blueprint for a Multilevel Economic Governance Arrangement

Despite all of the "add-ons" to the existing international financial architecture, the problems that beset the international community's system of economic governance still remain. Helleiner asserts that "serious efforts to prepare appropriate governance arrangements (international financial architecture, not plumbing) for the global monetary and financial system have scarcely begun." He continues that the main multilateral institutions concerned with the overall functioning of the global economy and the global monetary and financial system continue to be

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[16] Tony Porter, "The Democratic Deficit in the Institutional Arrangements for Regulating Global Finance," *Global Governance*, vol.7, no.4 (2001), p…

[17] Randall Germain, "New Departures: The Emerging Structure of Global Financial Governance," p…

[18] Leslie Elliott Armijo, "The Geography of World Financial Reform: Who wants what and why?", p….

[19] Michael Camdessus, "The IMF at the End of the 20th Century: Can we Establish a Humanized Globalization?", p…

the IMF and the World Bank Group. In these institutions, "formal voting power is determined by a formula assigning primary weight to economic strength with the result that their governance is, by far, the least democratic of the major multilateral bodies."[20] The US also retains its "blocking" voting power in the principal decisions of the Bretton Woods institutions.

This democratic deficit is even greater in most of the newer institutions and regimes of international financial governance such as the G-7, the G-10, the BIS, the OECD, and the G-20. Germain argues that there is a new principle of inclusion at work in some of these newer institutions. However, if one examines them carefully, one notes that the inclusive efforts are extended only to a few countries, and these are mostly the emerging market economies. This is nothing more than a symbolic gesture on the part of the major industrial states in an attempt to have these institutions retain some element of legitimacy. Despite these attempts, it has been noted that the G-20 is severely flawed in that it has no representation from the poorest of the developing countries. In any case, most of the decisions on the issue of democratisation of international financial institutions are being made by the G-7 – a body that itself lacks legitimacy.

The G-20 also lacks any mechanism for reporting or for accountability to the broader international community; its origins in the G-7 reduce its legitimacy; its membership is not fully representative; its mandate is narrow; its procedures are not inclusive enough to allow for participation by non-governmental organisations; and, its operations are not all that transparent either.

The first step in crafting a new global economic architecture by 2020 is to sketch out multilevel governance scaffolding that would allow one to introduce the component part of the architecture. Those component parts can be viewed as the principles, norms, rules and decision-making procedures around which the actors involved in the economic and financial issue area cohere. I see that scaffolding as comprising a subsidiarity form of global economic governance. As noted in the introduction, a subsidiarity framework is based on the notion of multiple levels of governance. In the case of economic governance, one can envision micro, meso and macro governance levels at the local, the state, the region, and the globe.

As this is a speculative exercise, it is useful for a moment to think outside the box, especially since the past international financial architecture has proven to be flawed in a number of ways. A scaffolding of subsidiarity could allow one to remodel the existing architectural form into something that is more relevant and more desirable. What seems most desirable at this point is the reduction of poverty. Even the World Bank and the IMF have listed the fight against poverty as a priority item on their agendas. In 1999, the IMF and the World Bank agreed to replace the Enhanced Structural Adjustment Facility with the Poverty Reduction and Growth Facility (PRGF). This development was based on the recognition of a link between debt and poverty. It would be desirable if, by the year 2020, this PRGF could become a mechanism that would respond adequately to the needs of the poor. To do so, some attention should be paid to creating consultative and discursive forums (CDFs) at the local, national, regional and trans-regional levels that would channel the needs of the impoverished to the global Facility. Doing so would strengthen the subsidiarity element of global economic governance and adhere to the principle of inclusiveness and democracy that is so lacking in the current international financial architecture.

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[20] Gerald Helleiner, "Markets, Politics and Globalization: Can the Global Economy be Civilized?" *Global Governance*, vol.7, no. 3 (2001), p.…

One of the main concerns of the Highly Indebted Poor Countries (HIPCs) has been the heavy burden that they have had to bear as a result of heavy debt and an absence of relieve from that debt. The HIPC initiative, established back in 1996 and modified recently, has the potential of offering debt relief to these countries. Today, about 22 countries have negotiated a debt write-off of $14 billion. There is no reason why this possibility of a debt forgiveness mechanism should not be extended to other countries that are heavily riddled with debt. The blueprint for a new global economic architecture by the year 2020 should take this point into consideration and allow for the development of a global Debt Relief Fund (DRF) that can be provided on a case by case basis through local, government, and regional banks.

The situation of poverty and inequity is so dire in some of the least developed countries that, from time to time, there may be a need for a pool of contingency funds to help such countries when they find themselves in economic crisis or require assistance with the clean up of an environmental disaster, and so on. Already there are already a number of suggestions as to how such a pool of funds can be attained. One of the more popular suggestions is the crafting of some form of neo-Marshall Plan for the globe.[21] Other funding proposals which ought to be considered include: extracting a global carbon tax on the users of fossil fuels which is projected to yield as much as US$28 billion annually in the US alone; imposing a tax on the trillion dollars a day volume of foreign exchange transactions which could raise an enormous sum of money annually; and, payment of 'rent' by the developed industrialised countries to developing countries as a means of compensating the latter for the former's disproportionate use of the global commons. [22]

While tax proposals are generally a hard sell, it is quite possible that by the year 2020 there could be sufficient political will in the industrial North to implement some of them. In any event, if such taxes are to be collected, there should be a Global Structural Adjustment Facility (GSAF) to secure and allocate these funds.

The key principle which ought to be central to the operations of the above additions to a remodelled global economic architecture is democracy. By democracy, I am not referring simply to a formal procedure of elections and voting. Instead, I take the position of Tony Porter who argues that "contemporary problems, actors, and institutions have outgrown traditional formal democratic procedures" and that there has been a noticeable shift in the location of authority "away from elected officials."[23] Porter explains that there are for types of authority in this era of intensified globalisation: 1) private authority that is "generated through collaborative institutions of market actors"; 2) technical authority that is "generated through bodies of scientific and technical knowledge (a point also made in several places by Tim Sinclair); 3) supranational authority that is "generated by the creation of global institutions with a degree of autonomy from nation-states; and, 4) popular authority that is generated when "citizens support or comply with a set of political prescriptions that are generated by non-governmental organisations and social movements rather than by legislatures."[24]

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[21] See for instance, Philip Shabecoff, "A 'Marshall Plan' for the environment", *The New York Times*, 3 May 1990.
[22] For more of these schemes see Morris Miller, "Where is Globalization taking us? Why we need a new 'Bretton Woods'", p.136.
[23] Tony Porter, "Democratic Deficit in the Institutional Arrangements for Regulating Global Finance," *Global Governance*, vol.7, no.4 (2001), p…

[24] Tony Porter, "Democratic Deficit in the Institutional Arrangements for Regulating Global Finance," p..

It would be useful if by the year 2020 all of the institutions within the global economic architecture could adhere to the principle of democracy in their policy-making process. There ought to be a number of Consultative Councils (CCs) created at every level of governance in which serious discussions and discourses can be held regarding changes to the global economic architecture. The input must come from all levels if the add-ons to this architecture are considered legitimate.

Conclusion

Essentially, the above blueprint for a new global economic architecture is not all that radical. It does not call for a dismantling of the existing international financial structure. Instead, it opts for remodelling, albeit paying specific attention to principles of democracy, inclusion, transparency, and accountability. After all, no attempt at creating such an architecture would be considered legitimate today if all of the players involved in global governance, in one capacity or another, did not have some say in how this architecture was crafted. In offering my proposals, I was cognisant of the fact that the year 2020 is not too far away from the present moment. Thus, one should not expect a major overhaul of the global economic architecture.

One can assume that with the US still at the core of the existing global financial arrangements, the main pillars of that structure will endure for sometime. Thus, the G-7/8, the IMF, the World Bank, and the WTO will continue to be central to this architecture by the year 2020. In addition, newer elements of the architecture which include the FSF and the G-20, while not as inclusive as they should be at the moment, will remain in place. I expect to see changes to these bodies as increasing pressure is applied by anti-globalisation protesters for a more transparent and democratic/representative process of decision-making in these bodies.

The new features which I have added to this architecture are designed to address the main problems still facing the existing international financial structure, i.e. the instability that could be caused if nothing is done about poverty in the HIPC countries, excessive debt, global economic inequities, and the democratic deficit in most IFIs. Central to these new institutions is the notion of discursive and consultative mechanism that will ensure proper input from below. Finally, a scaffolding of bottom-up subsidiarity is offered as a means of ensuring that whatever feature is added to the future global economic architecture will be supported by those who are most likely to be affected by the economic decision-making fallout.

Poverty alleviation must be the centrepiece of any strategy for creating a new global economic architecture. But suggestions for such strategies must come from the poor and marginalized people themselves. The approach must be local/national specific not top-down (i.e. not coming from IMF and World Bank officials. Whatever global economic architecture is designed for the future must be aimed at reducing the heightened insecurity which a large segment of the global population is experiencing as a result of unemployment, job insecurity, poverty, inequality, marginalization and exclusion.