Research Article

The Limits of Global Economic Governance after the 2007–09 International Financial Crisis

James M. Boughton, Domenico Lombardi and Anton Malkin
CIGI

Abstract
The economic and financial crisis of 2007–09 uncovered serious deficiencies in the oversight of the global economy, some of which came to light quickly and induced a concerted response by national authorities and multilateral institutions. Foremost among them was the need for appropriate regulation of financial institutions and oversight of derivative financial instruments. In this area, the G20 led a response that is still underway. Meanwhile, new regional entities emerged to challenge the existing multilateral order built around the IMF, the World Bank and the WTO – a development that has prompted further attempts to reform the current framework, including the creation of new institutions. These responses, however, have left major gaps in global financial governance. We argue that these gaps include: the balkanisation of oversight over global capital flows and current account imbalances; inadequate international burden sharing and policy coordination in response to financial crises; and a persistent inability of global institutions and national governments to ensure that the gains and losses from financial globalisation are equitably distributed across and within countries. Looking forward, the G20 and relevant multilateral institutions need to broaden the agenda to ensure that economic growth can become more resilient to shocks, more generally shared across economies, and more inclusive within countries.

Policy Recommendations

- Establishing comprehensive systemic oversight: to preserve gains from globalisation, stronger cross-border regulatory cohesion and oversight of economic activity is essential, with a focus on a greater sharing of the costs of economic adjustment across as well as within countries.
- Broadening the Global Economic Governance Agenda: the achievement of sustained economic growth entails a broader strategy centred on growth-enhancing structural reforms supported by fiscal policy, as well as measures aimed at compensating those side-lined by global economic integration.
- Reforming Bretton Woods Institutions and expanding G20 governance: sustaining better global economic performance requires a strengthening of current multilateral financial institutions so as to improve the ownership and support of their global membership. In this vein, the G20 needs to improve its legitimacy and representation.

The global financial crisis of 2007–09[1] will likely be seen as a turning point in the history of the postwar globalisation experiment. While the origins of the crisis are complex, multifaceted and continue to be debated, the financial crash and subsequent economic fallout laid bare some of the more glaring deficiencies of the international approach to globalisation. This paper offers an overview of these deficiencies as well as the limitations of the responses that have been made thus far, and proposes a policy agenda for overcoming them.

The global crisis shattered confidence in light regulation of finance and globalised capital flows, which had already been weakened by a series of financial crises in emerging markets from 1994 to 2002. It suddenly became clear that financial deregulation and global financial integration did not reduce the risk of widespread financial insolvency, but amplified it. And as technical insolvency spread from the epicentre (US financial institutions) to European banking systems, the crisis forced European policy makers to confront the inadequate institutional design of the Eurozone common currency system.

As the contagion risks became much clearer, so too did the costs of ignoring rising income inequality within countries. Beyond fostering social unrest and undermining the existing narrative of the positive relationship between globalisation and widespread prosperity, the consequences for economic growth and social mobility of skewed income gains and wage stagnation grew louder.

As the crisis brought these deficiencies to the forefront of international policy debates, nowhere was their impact more palpable than in Europe. In the Eurozone, the costs of budget consolidation in the southern periphery forced officials in Brussels and in the stronger northern countries to confront the question of how member states would, and should share the burden. For the weaker economies, the common currency increasingly resembled the deflationary straightjacket that defined and prolonged the Great Depression for those that adhered to the gold standard in the 1930s (Eichengreen, 1992). In the United Kingdom – one of the most heavily financialised and financially open economies in the world – society became polarised between those who had gained from globalisation (and specifically from membership in the European Union) and those who had not (or who at least perceived that they had been left behind). The surprising results of the Brexit referendum in 2016 demonstrated that dissatisfaction with globalisation was broader and more deeply rooted in the political psyche of the country than most observers had previously imagined.[2]

Before the crisis, the era of economic globalisation was characterised by rapid financialisation (replacement of physical output by financial services) and by growth in private-sector indebtedness and leveraging, both of which were abetted by a laissez-faire approach to financial governance. Although the authorities in leading countries, acting through the Group of Twenty (G20), have made a sustained effort to reform the functioning of globalisation, the effort has been inadequate in three respects. It has done little to overcome the balkanisation of oversight over global capital flows and the assessment of current account imbalances; it has left insufficient international burden sharing and policy cooperation in response to future financial crises; and, most importantly, it has failed to address the need for the gains and losses from financial globalisation to be more equitably distributed across and within national boundaries.

1. Effects of the crisis

Although the threat to globalisation was rising for at least a decade prior to the 2008 crisis, the shock aggravated several of the negative forces that were already in play. It heightened concerns about the benefits of international trade; it dramatically illustrated the dangers of unfettered capital flows; and it worsened the tendency for income growth to be concentrated in the upper reaches of the distribution. While, a number of analyses have already surfaced both defending (Drezner 2014) and criticising (Helleiner 2014) the alleged successes of global economic governance following the 2007–09 crisis, this paper broadens the discussion beyond the post 2007–09 world and explains how long-standing deficiencies of postwar economic globalisation have been exacerbated by the financial crash. It suggests that in order to address the problems exposed by the crisis, global economic governance responses should be crafted to address longer-standing problems created by postwar economic globalisation. We therefore see 2007–09 as a culminating crisis of economic globalisation – not just a crisis of globalised finance.

Our paper is structured as follows. This section offers our review of the effects of the crisis on international trade, finance, and international as well as intra-national income distributions. The following section situates these effects in the broader historical context of economic globalisation of the postwar period, focusing on the long-standing threats to sustaining global economic openness. Underlying these two related analyses is the suggestion that the backlash against globalisation in Europe and around the world, including events like Brexit and the election of Donald Trump, are results of longer-term mutually-reinforcing global economic trends, such as the balkanisation of oversight over global capital flows; the proliferation of current account imbalances; insufficient international burden sharing and policy coordination in response to financial crises; and, most importantly, the need for the gains and losses from financial globalisation to be more equitably distributed across and within countries. The last section suggests a more ambitious agenda for global economic reform.

Effects on international trade

The most pervasive effect of the global crisis has been disillusionment with, and consequently a general decline in, the growth of international trade. This is not entirely surprising, given the linkages between postwar globalisation in trade and the persistent current account imbalances in cross regional, global, and bilateral trade regimes.

Throughout the second half of the 20th century and into the early years of the 21st, trade grew rapidly and was the engine of global economic growth. After the crisis, however, growth in the volume of trade slowed markedly and continued to decline despite a brief recovery in 2012–13 (Constantinescu et al., 2015). The shift has been particularly acute in the Eurozone, where import volume fell by 1.4 per cent in 2012 and rebounded only slightly (0.9 per cent) in 2013 (Constantinescu et al., 2015.), with recent data suggesting continued tepid growth or even decline in recent months (Donnan, 2016). While the slowdown no doubt has been partly cyclical, driven by the overall deceleration of growth following the crisis, the likelihood is that the world economy is indeed actually shifting to a secular and structural decline in the role of trade in driving economic growth (Hoekman, 2015).

Part of the explanation for a post crisis secular trade deglobalisation is political and driven by a rise in income inequality. According to Krugman (2008), Haskel et al (2012) and Helpman et al. (2012), while the erosion of trade barriers between 1970 and 2000 was not accompanied by lower wage growth for the majority of the middle class, the subsequent period ushered in a negative relationship between tradeable goods competition from developing countries and middle-income wages in advanced economies. The accompanying rise in popularity of anti-trade rhetoric, especially in England and the United States, caught most observers by surprise. This apparently negative relationship between economic globalisation and the prosperity of the middle class in advanced economies goes a long way toward explaining the shock.

Thomas Piketty (2014) may have brought the issue of rising inequality in advanced economies to the academic mainstream, but the role played by the absence of effective global governance in the interconnected area of trade and global finance in facilitating the precipitous rise in inequality since the 1980s has remained under the radar of most non-specialists. As Schwartz (2009, 2012) has shown, such distributional issues were indeed at the heart of a housing boom in advanced economies. The boom was predicated on the existence of high levels of savings in countries such as Germany, China, Japan and many resource-exporting economies, wherein surplus capital from exports and household savings was recycled into the financial markets of deficit countries like Spain, the United Kingdom, the United States and others. Simply put, while the causal linkages between increased trade and income inequality within countries is difficult to establish, the observation that uncoordinated trade, that is, global imbalances, helps to skew the income gains from globalisation toward some sectors, countries, and income brackets, is not an especially controversial one.

A deeper economic explanation for the shift away from trade arises from the imbalances that have been inherent in globalised trade over the past few decades. The emergence of a persistently large trade surplus in China is the most obvious case. Another example is the Eurozone, which was founded on the principle that currency union would lead to fiscal coordination and ultimately to political union. Instead, the single currency led investors into a false sense of security about the risks of lending to the relatively weak economies in the system. Risk premia effectively vanished, and savings naturally moved south and contributed to a debt build up that finally proved to be unsustainable.

Globally, the recycling of savings has arguably been done to maintain trade surpluses that would sustain employment and economic growth (Bernanke, 2005; Wolf, 2010). The magnitude of the imbalances, however, became a flashpoint for anti-trade political pressures. Although some progress was made post crisis to reduce those imbalances – China's shrinking surplus being the most notable example – it was insufficient to stem the backlash (see Eichengreen, 2010; Borio and Disyatat, 2011; Chinn et al., 2014).

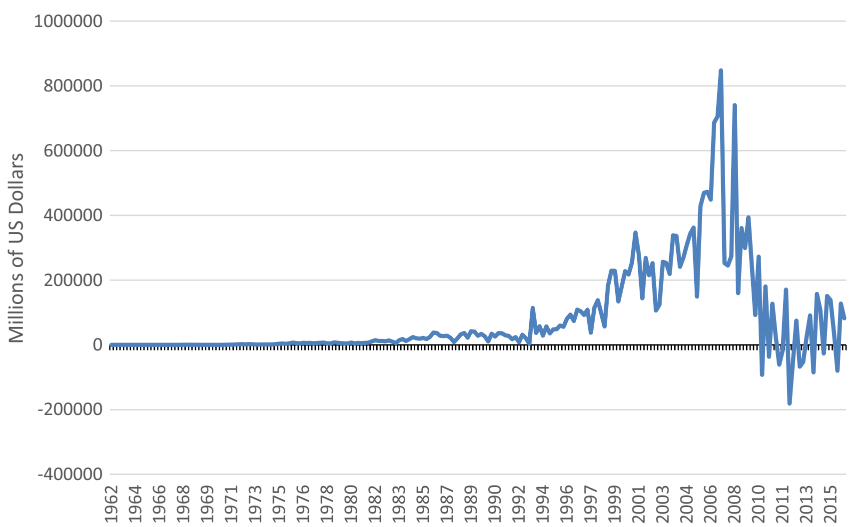
Effects on international finance

The effects of the global financial crisis on cross-border capital flows have similarly demonstrated the pronounced, long-term distributive dilemmas created by some instances of poorly-governed globalisation. The foundation of this process was the liberalisation of capital flows beginning in the 1970s. Cross-border transactions soared, with capital flows rising from 4 per cent of world GDP in 1980 to 5 per cent in 1990, 13 per cent in 2000, and 20 per cent by 2007. Throughout the era of rising financialisation, cross-border flows too often channelled capital into unsustainable asset price inflation, aided greatly by lax oversight (nationally and multilaterally) of the soundness of financial systems (Knight, 2016). When the financial crisis hit, flows plunged abruptly and then rebounded somewhat, driven in part by a surge in currency carry trades. Despite the rebound, however, flows were still only 6 per cent of GDP in 2012 (Lund et al., 2013).

The 2007 collapse in the US real estate market and the 2008 bankruptcy of Lehman Brothers induced a major break in financial globalisation. The two events starkly highlighted the risks associated with high levels of leveraging and extensive contagion across tightly linked national financial systems. The years following the crisis have consequently been characterised by a global scaling back of liquid financing (within as well as across borders) and by what might be called the 're-nationalisation' of finance. These developments have posed challenges for the effective governance of financial flows, but they are (at least in retrospect) not entirely surprising. Globalised finance is, and remains, the most contentious part of globalisation, with more clear causal linkages to inequality, economic instability, and lacking the strong empirical basis of positive aggregate welfare effects (see, for example, Epstein and Montecino, 2016).

International debt issuance collapsed in 2007, became highly volatile, and still has not recovered to pre-crisis levels (Figure 1). Much of the downturn can be explained by bank deleveraging in the Euro area and the subsequent scaling back of cross-border lending in Europe (Lund et al., 2013; Forbes, 2014). European policy makers responded to the challenge of European banking fragmentation by establishing a European Banking Union, but the extent to which this

Figure 1. Net issues of international debt securities for all issuers, all maturities



Source: Bank for International Settlements, retrieved from FRED, Federal Reserve Bank of St. Louis.

move can reduce the fragmentation is still very much an open question (Xafa, 2015).

That said, the post crisis decline in cross-border capital flows is not necessarily a negative development. After all, oversized growth in cross-border leverage and unstable capital flows were always a problematic feature of financial globalisation (see, for example, Wolf, 2010). Since 2008, global imbalances have levelled off, and global financial leverage has tapered (see Ekholm, 2013), with generally positive effects on economic stability and policy sustainability. The challenge however is to regulate the movement of capital so as to achieve the public goal of global financial stability, retain the benefits of cross-border financial flows, and avoid the costs associated with volatility and excessive leveraging.

Financial regulation has always been primarily a national enterprise, with international discussions aimed principally at identifying best practices (Brummer, 2010; Coley, 2015) and promoting common standards, albeit with mixed success (Walter, 2008). Decisions by national policy makers in large advanced economies to ease regulations and facilitate cross-border transactions were indeed a significant promoter of financial globalisation from the 1970s to the late 20th century (Helleiner, 1996), yet the global crisis of 2007–09 induced a rethinking of that strategy, with two related effects. First, national policies shifted back toward regulation. And second, although regulatory policies have both remained decentralised and have been implemented by national authorities focused on national interests (Helleiner, 1996, 2014), greater efforts have been made to develop internationally consistent policies.[3]

The shift toward scepticism surrounding unregulated cross-border financial flows began in earnest after the East Asian crisis of 1997–98, but the focus was on emerging markets with weak financial systems. In advanced economies, deregulation was still the dominant theme, as evidenced most clearly by the repeal of key provisions of the Glass-Steagall Act in the United States in 1999. The global crisis reinforced the view that flows should be regulated. Many emerging market countries (Gallagher, 2014) and some advanced economies subsequently took action toward greater regulation of domestic financial activity (for example, the Dodd-Frank Act in the United States and the establishment of a nascent Banking Union in Europe). In support of these efforts, the IMF famously retreated from its endorsement of open capital by adding a capital account regulation to its 'tool kit' of recommended policy measures (Ostry et al., 2016). Nonetheless, national policy makers in many advanced economies have remained committed to keeping global capital flows free and unrestricted (see, for example, Swedish monetary policy as explained in Ekholm, 2013).

The crisis also highlighted anew the problems arising from the dominant role of a single national currency, the US dollar.[4] Nonetheless, investors responded to the subsequent rise in global risks by buying US currency and driving up its value. One consequence of which, has been a renewal of efforts to strengthen the role of other currencies and to stabilise exchange rates.

While a multi-polar currency system may be more sustainable than one based on a single dominant currency, achieving long-term stability poses other challenges for global financial governance and requires additional action. In 2009, the IMF approved a large allocation of Special Drawing Rights (SDRs): the first general allocation since the early 1980s. And in 2016, the Fund agreed to add the Chinese renminbi to the SDR basket (which since the millennium had been limited to the dollar, euro, yen and pound sterling).[5] More generally, China has been promoting a more balanced international monetary system (see Zhou, 2009) and an enhanced role for itself and other emerging market countries therein. In addition to its recent shift towards internationalisation of the renminbi, China has spearheaded the creation of regional international financial institutions to parallel the existing global institutions of the IMF and the World Bank (He, 2016). Recent developments have included notably the Asian Infrastructure Investment Bank (AIIB), the New Development Bank and Contingent Reserve Arrangements linking the so-called BRICS countries,[6] as well as the multilateralisation of swap lines through the Chiang Mai Initiative.

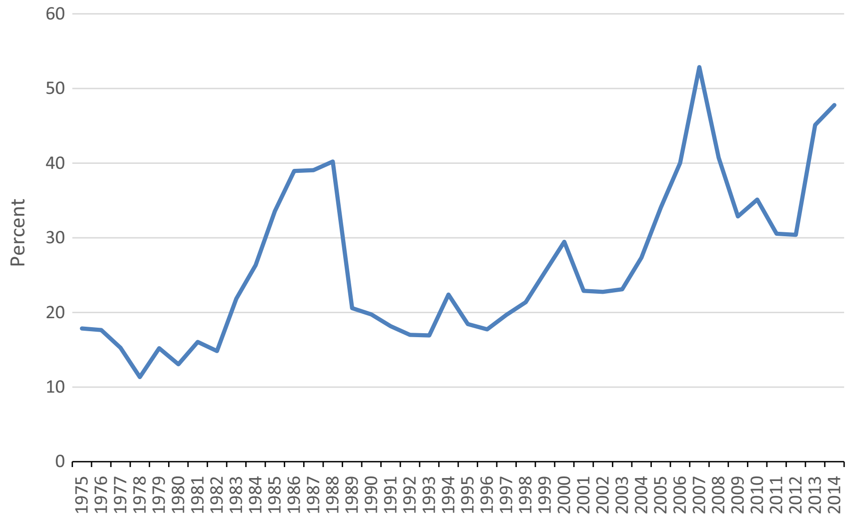
Effects on income distribution

The political backlash against globalisation arose in large part in reaction to the rising inequality in income and wealth. In fact, the overall weakness in income growth across countries since the 2008 crisis has exacerbated both the inequality and the malaise associated with it. Still, the linkages between globalisation, the crisis, and inequality are not so straightforward.

Economic globalisation has had both positive and negative impacts on income and wealth inequality. The growth of global trade and the outsourcing of jobs from advanced economies to emerging markets – particularly to Asian net exporting economies – has done much to reduce global poverty and inequality among countries (Milanovic, 2016a). But inequality within countries (emerging and advanced economies alike) has clearly risen since the 1970s (Piketty, 2014). And because most sources of within country inequality are context and case-specific and evidently linked to national social spending and taxation policies, rather than to trade or globalisation per se (Corlett, 2016), global action to address them has mostly been limited to defining and monitoring best practices (for example, Group of 20, 2016). Despite this trend, some research (for example, Assa, 2012; Goldstein, 2013) does suggest that at least one factor facilitating the rise of within country inequality has important global roots and consequences. According to these studies, over the past 40 years the growth of the scale and importance of financial transactions as a proportion of output, coupled with the growing importance of finance for revenues and employment in the non-financial sectors of national economies, has affected the internal economic structures of some countries to the extent that income and wealth inequality within their borders has risen.

During this time, financialisation expanded opportunities for a wide range of corporations, which derived an

Figure 2. Stock market capitalisation to GDP for world



Source: World Bank, retrieved from FRED, Federal Reserve Bank of St. Louis.

increasing portion of revenues from activities such as derivatives trading and mergers and acquisitions. It similarly affected households, as they were increasingly investing in equities and other financial instruments. Figure 2 shows, as an example, how the ratio of global stock market capitalisation to GDP rose gradually from 20 per cent in the late 1980s to more than 30 per cent by 2000. In the years leading up to the global crisis, this phenomenon accelerated, and the capitalisation ratio rose to 55 per cent before dropping precipitously back to 30 per cent and then rebounding up to 48 per cent.

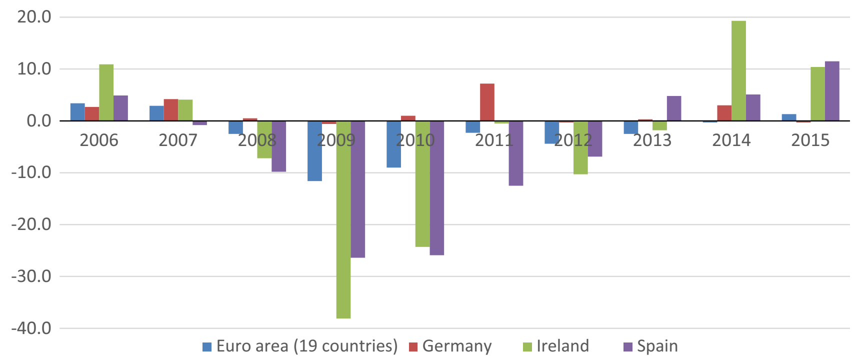
Financialisation also appears to have provided some stimulus to employment in advanced economies by creating jobs in construction and services to offset the loss of jobs in manufacturing. The negative effects, however, eventually outweighed the benefits. Financialisation contributed to rising inequality of income and wealth and to excessive housing construction. Financialisation in economies such as Ireland and Spain facilitated housing booms in which a large amount of labour was drawn into building and real estate activities that were unsustainable in the long run. Figure 3 shows the pre and post-2008 build-up, crash, and recovery rates in working hours devoted to construction in these countries (compared with Germany and the Eurozone average). In Ireland, for instance, the outsized and speculative growth therein was followed by a deep depression and a weak recovery at least through 2013 (also see Boland, 2016). A similar pattern can be observed in Spain (see Agnese and Hromcová, 2015).

The global crisis exacerbated these negative effects, at least for a number of advanced economies. The earlier democratisation of home ownership and participation in equity and other securities markets meant that a broad range of households suffered large wealth shocks while job stability was most at risk. Countries with high rates of financialisation – the United States, the United Kingdom, Ireland, and Spain among others – were particularly hard hit (Dolphin, 2013; Epstein and Montecino, 2016). As a result, the narrowing of the income gap between advanced and developing countries (especially with the rise of the middle and upper classes in China and other Asian countries) was juxtaposed against a rising income gap within some advanced economies. With most of the early post crisis income gains accruing to the very top of the income distribution, the dangers of excessive inequality became a staple of public debate, even in business-oriented publications, such as the *Wall Street Journal* (e.g. Cassel, 2013; Cronin, 2013).

Rising income inequality resulted in part from the shift from manufacturing to financial and other services (which hollowed out the job market for workers without advanced skills) and the secular policy drift toward deregulation of industries with substantial economies of scale (which enabled concentrations of power and wealth). The importance of these and other causes has been the subject of much debate, and the role of financial globalisation has arguably been more of an enabler than a cause. Nonetheless, the globalisation of both trade and finance became the focus of much of the popular backlash against the resulting stagnation that lay ahead for many households (see Burgoon, 2012, 2013). The need for expensive public rescues of large private financial companies such as AIG in the United States and Commerzbank in Germany further fuelled the backlash.

If the glories of economic globalisation were indeed oversold on the upswing (Summers, 2016), then the costs were similarly oversold on the downslope. The reversal thus fuelled a variety of democratic setbacks, including the rise of extreme nationalist parties in Europe, the British referendum to leave the European Union, and a Presidential campaign in the United States that relied heavily on nativist and mercantilist slogans.

Figure 3. Construction industry, selected countries, volume of work done (hours worked): percentage change compared to same period in previous year



Source: Own compilation, based on Eurostat, Industry, Trade, and Services database.

2. The threat to globalisation

The continuation of economic globalisation is not inevitable. While economic interdependence brings the world closer together, the negative effects it carries force policy makers to prioritise national, as opposed to global, governance responses, which lead to trade protectionism and the balkanisation of financial regulation.

For several decades after the Second World War, economic globalisation seemed to be an unstoppable and an irreversible characteristic of economic progress. From the 1970s and onward, with the spectacular growth in international capital flows, financial globalisation became an added and even more dominant feature of the landscape. Recent developments, however, have served to remind us that globalisation does have inherent costs and negativities. As the preceding section showed, a backlash against it began in the final years of the 20th century, and the crisis of 2007–09 has done much to reinforce a reversal.

As the economic historian Harold James has documented, the recent episode of globalisation had two major predecessors: one in the 16th century, fostered by the Age of Discovery; and one in the decades around the end of the 19th century, when the gold standard (along with advances in transportation and communication) helped stimulate international trade and finance. Both episodes were ultimately reversed, partly for idiosyncratic reasons unique to the period but more fundamentally because of the excesses and internal contradictions of uncontrolled expansion (James, 2001).

The abandonment of the international gold standard, an era which lasted only from the 1870s until the outbreak of the Great War in 1914, is a particularly relevant cautionary tale for the present day. While the outbreak of war was indeed the catalyst for the end of globalisation, the seeds of demise were already present due to the lack of an international regulating effort. Competition within a sovereign state can (and must) be regulated by the state so as to limit the concentration of power and wealth that would otherwise naturally occur, but competition among sovereign states lacked this natural braking system in the absence of a joint and sustained multilateral regulatory effort.

In the era of gold-standard globalisation, self-correcting gold flows and price-level shifts were systemic features that were supposed to limit the persistence of surpluses and deficits. These 'rules of the game,' as became apparent, lacked the 'invisible hand' of economic competition, were only rarely and accidentally consistent with full employment and price stability, and were capable of being overruled by national economic policy changes. With no institutional oversight or regulation, any open economy system would inevitably collapse of its own weight sooner or later.[7]

After the Great War, and partly because the only available self-sustaining global system (the international gold standard) was no longer feasible in an age of competing sovereign states as well as the failure of major countries to establish effective multilateral institutions to oversee said competition, international trade was no longer the engine of economic growth that it had once been. Countries that tried to go back onto the gold standard had difficulty competing with those that adopted more flexible exchange rate systems, and autarky gradually overtook market-based competition. The Great Depression ensued, and by the time war erupted again in 1939, both trade and financial investment had imploded into small blocs (most notably the sterling area). To a careful observer, it was evident that a resumption of growth – or even the restoration of stability – would require a new and better form of globalisation.

During the Second World War, economic planning turned forcefully toward restoring international trade and finance. Although the effort to create an institutional framework for trade did not immediately succeed, financial cooperation fared better. Wartime economic diplomacy, culminating in the 1944 monetary conference in Bretton Woods, New Hampshire, created both an institutional framework for the restoration of multilateral finance and a spirit of interdependence that largely reversed the depressive forces of the interwar period. Overcoming national interests in preserving trade preferences proved much more difficult, however. Nonetheless, postwar negotiation led to the establishment of the General Agreement on Tariffs and Trade (GATT) in 1947 and ultimately to its more institutionalised successor, the World Trade Organization (WTO), in 1995.

The international financial system established at Bretton Woods lasted for less than a quarter-century, ending only when so many countries were competing successfully in global trade that an even more open and flexible system was required to replace it.[8] From 1950 to 1972, the volume of world exports grew at an annual rate of close to 9 per cent, enabling world output to grow at a rate of just under 5 per cent.[9] But that system of export-led growth was based on fixed exchange rates around the world; a central and dominant role for a single currency, the US dollar; cheap energy extracted from less developed fuel-exporting countries; and the suppression through national regulations of the free movement of financial capital across borders. By the early 1970s, none of those factors could be sustained in an increasingly complex world economy. What emerged from the ashes was a more flexible system in which each country could choose almost any exchange regime ranging from fully fixed to fully floating (except for pegging to gold, which was now prohibited) as long as it implemented monetary and fiscal policies consistent with that regime.

The demise of the Bretton Woods system ushered in the modern age of financial globalisation. Cross-border private-sector financial flows rose sharply in the 1970s and then even more rapidly in the 1980s and 1990s. Official encouragement came from institutions such as the IMF and the Organisation for Economic Cooperation and Development (OECD) as well as from the major self-appointed steering committees including the G7 and later the G20. International trade, the argument went, required cross-border finance in order to flourish. Regulatory suppression of financial flows, even if necessary to foster stability, would suppress investment and economic growth and limit the ability of developing countries to 'emerge' into the global trading system.

Although international trade continued to grow, concerns about financial globalisation arose in the early 1990s. The worry was mainly that many emerging market countries had financial systems that were neither adequately developed nor regulated to ensure that capital inflows would not be destabilising. Fears of instability were realised in numerous instances from 1994 (crisis in Mexico) to 1997–98 (crises in several East Asian countries, Russia, and Brazil) and to 2001 (crisis in Argentina). By then, the realisation had set in that achieving the financial-sector strength that was a precondition for successful absorption of foreign capital was a much more daunting task than had been previously assumed.

Throughout the second half of the 20th century, trade expansion was also facilitated by gradual reductions in tariffs and non-tariff trade barriers (NTBs) under GATT rounds and regional agreements, culminating in the creation of the WTO. By the end of the century, however, a backlash was taking hold, much as it had in earlier episodes of globalisation. This millennial reaction was motivated by a widespread recognition that globalisation had failed to deliver on the promises of its supporters. In advanced countries, that failure had two primary dimensions: disappointing aggregate economic growth and a calamitous lack of inclusiveness in the distribution of the gains.

The first disappointment was that global economic growth had been lower in the post-Bretton Woods era (1973– present) than in 1946–72, the logic being that the whole motivation behind accepting capital inflows is to finance investment and enable growth. On balance, and for several reasons, this relationship has been much weaker than anticipated. Abuse of financial gains by hedge funds and international bankers for short-term benefits in many emerging markets has combined with the inherent volatility and instability of international capital markets to more than offset the advantages. Major financial crises have routinely cut into and overwhelmed the economic growth that initially followed from surges in capital inflows (Boughton, 2014). Disillusionment with short-term capital flows into nascent financial markets rose to the fore after the East Asian and subsequent crises in the late 1990s. The global crisis of 2008 solidified and amplified those concerns.

The second and larger disappointment, as noted in the preceding section, is that the gains from international trade and from economic growth more generally have been distributed unevenly. Most people in advanced economies as well as in emerging markets and less developed countries have experienced only limited benefits. As Branko Milanovic (2016a, 2016b) documents, the gains are very heavily concentrated in the top 1 per cent of the income distribution in advanced economies and in the middle and upper classes in Asian countries. Economists have always noted that globalisation (or more specifically, international trade) has winners and losers, that the gains exceed the losses, and that the key is to compensate the losers so that most people benefit or at least do not end up worse off. The system has failed to deliver on the last step. Indeed, the biggest concentration of relative losers from recent globalisation has been in middle-income families of relatively rich countries, particularly of Europe and North America. On average, that group has seen little gain in real income since the late 1980s.[10]

In addition to these two primary problems, globalisation came to be seen as a source of environmental degradation and a contributor to the decline of labour rights. Developing countries typically have more lenient environmental standards and less labour protection than wealthy countries, and if those differences enable developing countries to produce goods at lower cost, then international trade may not be taking place on a level field of competition. This view led to an expanded agenda for new trade agreements, in which environmental and labour regulations were important subjects for negotiation. That agenda, however, was susceptible to abuse and offered a cover for protectionism. Not surprisingly, the past twenty years have witnessed intensive debates over these concerns so that efforts to make such new agreements have been difficult to bring to fruition.

The 2007–09 crisis solidified and magnified the backlash because of the perceived link between trade and income distributions. A decline of 12 per cent in global trade in 2009, unprecedented in its scope since the Second World War, contributed importantly to a decline of nearly 3 per cent of world output per capita. Instead of triggering a concerted effort to restore trade and economic growth, the downturn intensified efforts to protect domestic jobs and incomes by further suppressing imports. The already troubled Doha Development Agenda, through which the WTO attempted for eight years to reduce trade barriers (especially in agriculture and services) and strengthen rules governing intellectual property, finally ground to a halt. To date, no further progress has been made and negotiations have been suspended.

More recently, the ongoing European crisis, including notably the continuing threat to Greece's membership in the Euro area and the United Kingdom's decision to exit the EU, has further leaned against continued globalisation. As the most integrated economic region in the world, the EU serves as a model both for the advantages of openness to trade and finance as well as for the challenges facing economic integration. Even before the global crisis, the Euro area was struggling to cope with its internal contradictions. Its Stability and Growth Pact, which set arbitrary ceilings on the size of public deficits and debts, lost a measure of credibility after Germany and France asked for and received exceptional latitude in the 1990s. The absence of a commitment to share the burden of fiscal adjustment made the system prone to recurring crises, as vulnerable countries sought alternative ways to avoid bearing the full cost by themselves. The possibility that one or more countries would exit the currency zone or abandon EU membership altogether gradually eroded confidence in the sustainability of the system itself.

Because of the leading role that the EU and its monetary union have played in the postwar trend toward globalisation of trade and finance, any threat to European unity could also become a threat to globalisation. The decision by voters in the United Kingdom to renounce EU membership, notwithstanding its multiple motivations, could become the leading edge of a mercantilist retrenchment.

3. The remaining policy agenda: comprehensive oversight

These threats lie at the core of the looming reality of economic and financial de-globalisation, and are manifest in such events as the rise of the nationalistic political right, threats to EU cohesion, and the spread of anti-immigration sentiments across and beyond Europe. However, the reversal of globalisation is not a foregone conclusion. If G20 leaders seek to preserve the gains from globalisation, they must choose greater cross-border regulatory cohesion and oversight of cross-border economic activity; even more importantly, they must agree to greater sharing of the costs of economic adjustment. Otherwise, we are likely to see a restoration of barriers to global trade and finance, as national policy makers in the developed world take it upon themselves to compensate the increasingly politically vocal constituencies that have been left behind by globalisation.

So, if globalisation is to be preserved as a positive force in the coming decades, a number of policy and institutional reforms will be needed. Since the crisis hit, in an effort to preserve the potential gains of globalisation, a global reform agenda led by the G20 has focused primarily on the regulation of financial institutions and activities, including the conversion of the Financial Stability Forum into the Financial Stability Board (FSB) with a stronger mandate and larger membership, recapitalisation of banks, enhanced supervision of 'too big to fail' financial institutions, Dodd-Frank legislation in the United States, establishment of Banking Union in the EU, and so forth. Further, to reduce global imbalances and restart economic growth, the G20 set out a framework in 2009 for national action and a Mutual Assessment Process to track progress (Faruqee and Srinivasan, 2012). Implementation, however, has been piecemeal and too heavily reliant on monetary rather than fiscal measures.[11] Regional institutions such as the AIIB and plurilateral agreements have supplanted multilateral institutions and programmes in the effort to retain some of the benefits of international cooperation. Efforts to redress the worsening of income and wealth inequality that has driven much of the political reaction to globalisation have been even more limited, the net effect being to avert the very real risk of an implosion of the world economy into a 1930s-style depression (Drezner, 2014) but not the risk of persistently slow growth. Yet, the silo structure of economic and financial governance, with excessive reliance on national actions and without any comprehensive oversight of the system, still remains in place (Boughton and Bradford, 2007; Helleiner, 2014).

Agreeing on a broadened Global Economic Governance Agenda

In the short term, a resumption of economic growth at the rates enjoyed in the last third of the 20th century will require supplementing and then replacing monetary stimulus with commensurate structural and fiscal actions. The communiqué issued by G20 leaders after their meeting in Hangzhou, China, in September 2016 acknowledged that 'monetary policy alone cannot lead to balanced growth' and underscored the importance of structural and fiscal policy in achieving that objective. It fell short, however, in presenting an actionable strategy for correcting the over-reliance on monetary policies or for limiting the severity of income and wealth inequality. Instead, the communiqué merely noted that leaders 'will continue to explore policy options, tailored to country circumstances, that the G20 countries may undertake as necessary' (Ministry of Finance of the People's Republic of China, 2016). Coordinating such 'exploration' will not be easy, but it would have the potential to make national policy actions more effective on a global scale.

The reluctance to formulate a consistent strategy centred on structural reforms and supported by fiscal policy reflects a deeper problem at the national level in many advanced economies. The failure of national authorities to devise appropriate policies to cope with 'stagflation' in the 1970s induced a generalised distrust of Keynesian demand management. With encouragement from mainstream economists, including those in the IMF, most advanced economies eschewed not only the 'fine-tuning' approach to macroeconomic policy that had failed in the 1970s, but also the more general commitment to use fiscal and monetary policies to try to maintain high levels of employment and growth over the medium term.[12] The central macroeconomic policy goals became the maintenance of price stability and fiscal probity. The first goal at least has been admirably achieved, but arguably at a greater expense in terms of lost output than was necessary. If growth is to be restored and sustained, a renewed commitment to the objective on the part of national governments will be required (Boughton, 2014).

In Europe, such a policy shift would involve relaxing the post-2008 emphasis on fiscal austerity, particularly in countries with severely depressed economies. That shift, in turn, can be achieved only through an increased commitment to burden sharing on the part of surplus countries with strong economies (Setser, 2016) along with an increased commitment to structural economic reforms and sound macroeconomic policies on the part of deficit countries. Otherwise, countries such as Greece cannot be expected to attract enough financing on their own to generate the economic growth that would be needed to reverse the losses recorded since 2009. The urgency of this task is heightened by the fact that the costs of European austerity have been borne disproportionately by poor and vulnerable groups (Ginn, 2013).

Moving the centre of gravity within Bretton Woods institutions

Over the longer term, sustaining better global performance will require a strengthening of the multilateral institutional structure, which will inevitably cause some stakeholders to cede decision-making power to others – namely, from the developed world to emerging economies. Part of the problem is that the most important institutions have not always received the political support that they would need to perform effectively in a rapidly changed world economy. A major package of reforms for the IMF (including a shift in voting power towards emerging market economies), which was approved at the ministerial level in 2010, was not ratified until 2016: a gap of six years since the institution was called upon to play a central role in devising and implanting solutions to the global crisis. Even then, the reluctance of the traditional institutional powers – the United States and western Europe – to cede more control to the more rapidly growing emerging markets such as China has left the governance structure of the IMF in a politically weak position. Distrust of the Bretton Woods institutions remains widespread and continues to spur the regional balkanisation of the international financial system. The redistribution of voting rights at the IMF and World Bank needs to happen more effectively than it has in the past.

Expanding G20 governance

Even more fundamentally, the system suffers from the absence of an effective and legitimate institution at the apex, with comprehensive oversight capability. Each multilateral economic institution – the IMF, the World Bank, the WTO – functions independently and acts in its own sphere of influence (finance, development, and trade, respectively). In principle, the Economic and Social Council of the UN (ECOSOC) was intended to serve as a coordinating body to provide overall consistency to the work of a host of UN-related agencies.[13] In practice, however, it lacks the broad membership, the treaty authority, and the political support that would be needed for it to serve such a function effectively. A number of proposals have been made in recent years to establish a true comprehensive overseer for economic governance (Dervis, 2005; Boughton and Bradford, 2007; Bradford and Linn, 2007), but no additional action has been taken (or is foreseen) in that direction.

Until more fundamental reform of the global architecture gains political support, oversight will remain largely in the hands of relatively narrow, self-appointed steering committees rather than the established treaty-based institutions. The current self-appointed overseer, the G20, across its member economies accounts for the great majority of world trade and output, but although it constitutes a major advance over its predecessor (G7), it represents only a small portion of the world's countries, and practically omits and largely ignores one major region; sub-Saharan Africa.[14] Further, it is not treaty-based and it lacks the constituency structure that would give it a measure of democratic legitimacy. In contrast, the IMF's governing body, the International Monetary and Financial Committee (IMFC), *is* treaty-based and employs a constituency structure; on the other hand, it is dominated by the G20, deals only with the work of the IMF, and its formal structure makes it difficult to act flexibly in a timely manner (Kharas and Lombardi, 2012; Knight, 2014). The systemic gaps persist, and the challenge of creating an effective governance system for a globalised economy remains very much a work in early progress.

Notes

1. The crisis began in 2007 with the subprime mortgage collapse in the United States, but it became global in 2008 after the bankruptcy of the Lehman Brothers investment banking firm.
2. See Arnorsson and Zoega (2016) and Zoega (2016) for evidence that a backlash against globalisation (which they call 'fear of EU') was a major factor in the Brexit referendum.
3. As a counterpoint, Kirton (2013) and Drezner (2014) suggest that global economic governance after the crisis was quite effective and even transformative.
4. Recent analyses include Andrews (2006), Helleiner and Kirshner (2012) and Helleiner (2014).
5. The SDR is, in effect, a line of credit with its value denominated by a currency basket and sufficiently liquid to serve as a component of official reserves. In general, allocations are made to all IMF member countries, proportionally to their economic size.
6. The BRICS (Brazil, Russia, India, China, and South Africa) are frequently cited as the most significant emerging economies in terms of economic weight and global political influence.
7. For analyses of the intrinsic weaknesses in late-nineteenth century globalisation, see O'Rourke and Williamson (1999) and James (2001).
8. As one of the authors has argued elsewhere (Boughton, 2014, 2016), the excessively lax fiscal policies pursued by the United States in the late 1960s and early 1970s – often cited as the reason

for the collapse of the Bretton Woods system of fixed exchange rates – were merely a catalyst and not the root cause.

9. Trade data are taken from the World Trade Organization's time series on international trade, and GDP data from Maddison (1995).
10. See Milanovic (2016a, figure 1.1). The data reported cover 1988 to 2008. Corlett (2016), however, warns that many advanced economies have, in fact, seen their middle and lower income citizens benefit from globalisation. These countries' policy makers were found to be those that more actively manage their integration into the global economies, using social transfers and redistributive taxation to cushion citizens from the destructive aspects of globalisation.
11. National monetary policies have included deep cuts in interest rates and innovative measures known as quantitative easing. At the international level, central bank swap lines have increased in size and scope (Henning, 2015).
12. Ostry and others (2016) highlight the trade-off faced between desired economic growth and accompanying wealth distribution effects, including unemployment, and advocate for a flexible, nuanced approach to managing the trade-off across countries. Also, see Ball and others (2013). For a similar discussion as it pertains to capital account liberalisation, see Furceri and Loungani (2015) and IMF (2012).
13. The IMF and the World Bank are specialised agencies of the UN. They are not governed by UN decisions, but they participate in ECOSOC. The WTO is outside the system and does not participate.
14. South Africa is a member of the G20, but it is not seen as representative by the region as a whole.

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Author Information

James M. Boughton is a Centre for International Governance Innovation (CIGI) senior fellow. He is a former historian of the International Monetary Fund (IMF), a role he held from 1992 to 2012. From 2001 to 2010, he also served as assistant director in the Strategy, Policy, and Review Department at the IMF.

Domenico Lombardi is director of the Global Economy Program and a member of the Executive Management Committee at CIGI in Canada. He also serves on the advisory boards of the Peterson Institute for International Economics and the Bretton Woods Committee in Washington, and is a member of the Steering Committee of the Asian Economic Panel.

Anton Malkin is a Research Fellow at CIGI. He holds a PhD in global governance from the Balsillie School of International Affairs.