The Mounting Challenge of Global Governance

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I am extremely pleased to be again at Geneva's Graduate Institute for International Studies. I was very happy to be here only a few months ago with my colleagues and friends from The Elders to attend an incredibly interesting session where students and faculty members interacted with Mary Robinson and Gro Harlem Brundtland.

Today I relate for the first time that my sort of sentimental relationship with the Institute goes way back, because I have always suspected that a timid aspiration of mine to apply for a post-doctoral fellowship to the Institute in 1985, which I vaguely commented to my majors at the Central Bank of Mexico, had to do with a promotion I received a few days after my comment. So I didn't apply to the Institute but became one of the deputy directors of the Bank and a member of its Governing Board. So, with more than 30 years' delay, I say tonight: thank you Graduate Institute.

I also reiterate my gratitude for giving me the opportunity to deliver the first TAIT lecture seven years ago thanks to an invitation from Professor Richard Baldwin. That was in February of 2009 when we were in the acute phase of economic collapse brought about by the Great Crisis.

What I want to do today is to stand by a claim I made in that lecture, and I quote:

> We could soon find ourselves regretting how little, or in fact nothing, states have done to improve the institutions created mostly in the second half of the 20th century to manage the process of global integration. For it is a fact that in the last ten years as globalization accelerated dramatically, the process of international reform stalled.

Somehow, the Graduate Institute also gave me the chance to expand on the fear I had expressed in my TAIT lecture, for Professor Charles Wyplosz commissioned Jeffry Frieden, Dani Rodrik, Michael Pettis and myself to produce the 14th Geneva Report on the World Economy of 2012, which we titled *After the Fall: The Future of Global Cooperation*.

That project was a fine opportunity for us, on the one hand, to once again state the case for the value -- and in fact the indispensability – of international cooperation. On the other hand, unfortunately, the four co-authors also converged on a rather pessimistic view on the prospects of such cooperation.

Our reasons for pessimism were manifold. First, we acknowledged the well-known difficulties inherent in the provision of any global public good.

Second, we observed that even in cases where the argument for collective action has been strong, the history of cooperative efforts was not terribly encouraging.

Third, we gave special weight to Jeff Frieden's domestic political economy consideration: that as a consequence of politicians' usual failure to communicate to their constituencies the benefits of international cooperation and interdependence while exaggerating -- even hysterically -- the latter's potential downsides, there will be limited public support for the measures necessary to expand cooperation. In other words, and ironically, that in a crisis caused partially by lack of international cooperation, domestic politics would turn against it rather than in favor of it.

Of course, by the time we drafted our Geneva Report, we had evidence to support our pessimism. It was not only the historical one but also what we were living in real time back then.

Consider the G20's performance. Undoubtedly, its formation at the leaders' level in the fall of 2008 was excellent news. It seemed that at last the leaders of the largest economies in the world would take up the challenge of filling the economic governance gap. It was encouraging to learn that at their first summit meeting in

November 2008, the G20 leaders themselves admitted that inconsistent and insufficiently coordinated policies had led to the crisis, and on that occasion and at two subsequent meetings, they committed to bring about that purported cooperation focused largely on reform of financial systems, preservation of open markets, reinforcement of the multilateral financial institutions and, of course, macroeconomic policy coordination.

Not surprisingly, given how the crisis erupted, from its first meeting the G20 was calling for a coordinated move towards sweeping reform in all the members' financial systems and even produced, in a noticeable display of granularity for a leaders' summit, a comprehensive work plan for reform, duly stressing in every part of it the importance of international cooperation. The elevation of the financial stability forum to board status – by virtue of expanded membership and additional responsibilities – and an agreement on the basic criteria for what eventually would become the Third Basel Accord, were early outcomes – and I am not saying terribly good ones -- of the promised cooperation for financial reform.

That impetus was short-lived. Rather soon the key players -- that certainly embarked on financial reforms -- failed to do it in the consistent, coherent and coordinated manner that they had offered at their frequent summits during the first year of the G20's existence. Contrary to what they said, the major players went ahead unilaterally with the respective reform undertakings, as shown by the way in which the U.S. Dodd-Frank, the Vickers-inspired U.K. reform, and the EU reforms have proceeded – not to speak, as we are in Geneva, of the then surprising and unilateral "Swiss Finish on Basel III." It is tempting to say that the G20 substantially gave up its early pledge of financial reform coordination around 2010.

The same can also be said about the G20's key commitment on trade: the successful conclusion of the Doha Round. As a response to the crisis, they aimed for "an ambitious and balanced conclusion to the Doha Development Round in 2010," which evidently did not happen.

Under the impulse of the crisis, early on the G20 went back to the old, but repeatedly unfulfilled, objective of reforming comprehensively the multilateral financial institutions.

They explicitly committed to reform those institutions' mandates, scope and governance to reflect changes in the world economy and the new challenges of globalization and give emerging countries greater voice and representation.

They also agreed upon the allocation of larger resources to the IMF. As we know, no significant governance reform for those institutions has even been tried ever since, and it has taken an additional five years to conclude the quota review process of the IMF originally targeted to be concluded by early 2011.

As we expressed in our Geneva Report, working seriously on macroeconomic policy coordination should be the big thing for the G20. The G20's leaders themselves seemed to have had the same conviction early on. As I mentioned already, at their first summit, they rotundly declared that inconsistent and insufficiently coordinated policies had led to the crisis.

Unfortunately, almost seven years after they pledged to fix that deficiency, it is fair to say that their pledge has not been honored in any lasting way. True, there was some initial coordination of fiscal policies in 2009 and central banks have done their best – albeit with alarmingly increasing difficulty -- to continue providing some coherence to their respective policies, but there has not been a serious attempt to evolve towards an institutional framework that would deliver the necessary effective cooperation on macroeconomic policies.

The peer review process agreed at the Pittsburgh meeting of the G20 (known as MAP, Mutual Assessment Process) to deal with the prevention and correction of macroeconomic imbalances proved to be totally ineffectual and the subsequent offer to enhance the IMF's surveillance mandate and action has been left unfulfilled as well.

In our 2012 Geneva report, we argued emphatically that the MAP was not the way to go. We said that the procedures to engage, define basic monitoring criteria, characterize each party's policies, agree on each party's desirable policies and procure compliance of each party's responsibilities, as contemplated in the MAP, did not constitute a governance framework with any significant chance of success.

We observed that the MAP was built to provide the ones bearing the greatest responsibility for adjustment multiple escape hatches from either acknowledging or complying with that responsibility. We concluded that the MAP, rather than a system of peer review, looked more like a system of peer complicity.

At the Los Cabos G20 summit in 2012, the MAP's profile was further downgraded by making it just an input into something then baptized as the Accountability Assessment Report, an instrument innocuous, and therefore useless, for any significant purpose of macroeconomic policy coordination. It is now clear that the G20 has failed "to ensure that our fiscal, monetary, trade, and structural policies are collectively consistent with more sustainable and balanced trajectories of growth," as they solemnly committed at their Pittsburgh Summit of 2010.

The G20 failed to endow the system with effective tools for a globally coordinated adjustment. It is, thus, not surprising that the crisis and its sequel have proven to be such a protracted and hugely costly process. Nor is it surprising, but it is certainly regrettable, I insist, that despite the huge pain already endured, effective collective action continues to be missing.

The multilateral revival that the G20 seemed to be willing to stage back in 2009 has evaporated into thin air, as further proven by recent events. Just consider the brutal way in which the Doha Round was euthanized by the USTR alone in an inelegant FT op-ed of his published on the eve of the WTO Nairobi Ministerial. Don't forget that as recently as November 2014 at the Brisbane Summit, the G20 was committing (admittedly for the nth time and therefore with nil credibility) to get the Doha negotiations back on track in order to "restore trust and confidence in the multilateral trading system." Seemingly, restoring that confidence is no longer on the agenda.

It is almost pathetic that not even the financial trepidations and global slowdown of the last few months have stimulated at least some talk of re-entertaining the old quest for macroeconomic policy coordination. In the face of the scary developments in global financial markets and in the real economies of the key players, it is remarkable that policies are as uncoordinated and inconsistent as they can be in normal times. And this, if you will allow me to be stubbornly repetitive, is to be regretted.

I grant that the theoretical and historical case for macroeconomic policy coordination is not crystal clear uncontroversial. Opting for or against this coordination, I believe, can only rely on good judgment, informed by theory, empirical evidence, history and an objective assessment of the existing policy predicaments.

It is still my judgment that the enormous policy predicaments confronting the governments of the countries with the most significant economies – even if ultimately solving them is their own and primary responsibility – have a better chance to be addressed with considerably less pain within a framework of coordination than in a scenario of mainly unilateral and inward-looking policies.

Not even the country with the biggest economy and the chief world reserve currency, the US, can be confident that unilateral policies are in its best medium- and long-term interest. However difficult, there is no alternative to essential agreement and cooperation, at least among the key players if the outlook of much slowed growth for all in the years to come is to be improved substantially.

Uncoordinated efforts by each of the key economies will give rise to the re-emergence of macroeconomic imbalances, mutually inconsistent exchange rate policies, and ultimately beggar-thy-neighbor kind of situations that will lead to contention and conflict, frustrating the participants' aspirations for stronger growth.

The best way to put in place a sensible coordination of macroeconomic policies consists of enabling a multilateral institution to carry out that endeavor. That institution, in principle, already exists. It is the IMF. But its members would need to sensibly reinforce its surveillance authority and empower it with a much stronger mandate and the tools necessary to entice countries to deliver the policies consistent with the commonly agreed objectives of economic growth and financial stability.

To be frank, such repowering of the IMF would be tantamount to a major overhaul of the global financial architecture. But the world – or more clearly its key powers – does not seem to be ready or willing for such an overhaul at this point.

Nevertheless, the G20 must find a way to get out of the self-constructed trap of inefficacy and irrelevance into which it has been sliding. It needs to show to the international community – and to its members' national constituencies – that it can take important decisions that make a positive difference for each G20 country and the world at large.

It should start by refocusing on the truly essential issues, in fact just a subset consisting of those indispensably requiring collective agreement and action and are of the highest urgency. I would like to think that the ongoing shakiness in financial markets and practically global economic weakening could provide a stimulus for the G20 to get serious and embark on an idiosyncratic agreement on macroeconomic policy coordination. I say idiosyncratic because, as I said, truly systemic reform doesn't seem to be in the cards anytime soon. It may be a few crises away.

The idea would be to achieve from each key player policy packages coherent among themselves and of enough aggregate strength to generate *a tide that would lift all boats.* I would like to think that the synchronized slowdown, that this time includes the second largest economy (China's), the collapse in some key commodity prices, and the volatile capital markets could materialize in an accord carrying some good policy teeth.

The G20 is meeting this year in China, and given that that country's GDP growth threatens to fall short of target, is suffering from significant financial volatility, capital flight and a marked drop in its foreign exchange reserves, it would seem that that power's own interest is becoming well aligned with the other chief players' interests for macroeconomic policy coordination. For its own sake, China should try to exercise a constructive assertiveness to encourage its key G20 partners to deliver on the promises made in years past. But I don't want to elaborate on this, because if recent experience is any guide, right now I'm just doing some wishful thinking.

Indeed, international cooperation is not having its finest hour. And this is true not only about economic governance but also in almost every aspect that pertains to the multilateral system. It is certainly the case on the vital questions on peace and security. Over and over again we have witnessed horrendous humanitarian crises stemming from inter-state or intra-state conflicts that could have been at least mitigated, if not outright prevented, had the major powers agreed and acted in a concerted manner.

Perhaps foolishly I sometimes fall into the temptation of running a mental exercise imagining what would have happened if the big powers had played more cooperative strategies in the key institutions. Just imagine if the United States of America and its too-willing allies had seriously abided by the 2002 United Nations Security Council Resolution 1441: there would have been no invasion of Iraq in 2003 and a huge humanitarian, economic and geopolitical cost – which is still accruing – would have been avoided.

In reference to painful events of current concern, we can also speculate on what might have happened had the UN Security Council sent a precise message in October of 2011 or February of 2012 to both the Syrian government and its armed opposition that the international community was united to prevent mass atrocity crimes and seriously supported their own envoy at the time, my fellow Elder, Kofi Annan, to broker a ceasefire and negotiate an end to the conflict. As we know Annan went as far as producing the six-point plan that he had already consulted with a number of he key players and achieving the Geneva Communiqué of June 30, 2012.

But I have fallen too soon again into a subjunctive mood, which is not terribly useful to deal with the harsh realities confronted by the international system.

Absent of great redesigns anchored in shrewd grand bargains, the challenge is what to make of the existing system to advance solutions to the other pressing problems faced by the international community.

In other words, we would want to explore the extent and the ways in which the existing instruments can be applied in the pursuit of those solutions.

In some cases, it would be about existing understandings and covenants that, being aimed at highly desirable objectives, actually lack the means to be effective. In these instances, the objective would consist of enhancing their effectiveness by means of a suitable permutation and repowering within the general framework they allow. My earlier description of the G20 is a case in point. But there are many others. I will expand on a crucial one in a minute.

In other cases, it would be found that the internationally agreed rules not only fail to help solve a problem but also flagrantly impede its solution, at times making it much worse. In those instances, a permutation of the system would do no good. Mutilation is what is needed.

To illustrate the difference between the paths of permutation and mutilation of international regimes, allow me to make reference to two topics that are very much on the multilateral agenda these days.

Reaching an agreement on the successor to the Kyoto Protocol was the motive for the recent 21st Conference of the Parties (COP21) of the United Nations Framework Convention on Climate Change whereas the problem of illicit drugs will be the subject of a UN General Assembly Special Session this April.

The Agreement achieved at the COP21 has been hailed as a significant success for the multilateral system. It is argued that it is the first-ever universal, legally binding, climate deal among 195 countries; that its goals to limit the increase in global average temperature and the submission by countries of their national climate action plans along with other provisions in the Paris Agreement, will put the world on track to avoid dangerous climate change.

Although we all should be pleased that the Paris meeting reached an agreement –and thus avoided the failure that was encountered at the Copenhagen COP of 2009, we should curb our enthusiasm about the capacity that the Paris Agreement may have to deliver its ultimate objective of sufficient climate change mitigation. A possible first step to temper expectations about the December Agreement could be to check whether it has overcome the problems that made the Kyoto Protocol so ineffective.

Early skeptical observers of the Kyoto Protocol warned that it would be ineffective because it contained obligations for only a limited number of signatories, not all of them; because it lacked the means to deter countries from not complying; and because it lacked stipulations for substantial action to mitigate climate change. Those skeptics were proven right sooner rather than later and definitely by the end of the 2008-2012 Kyoto budget period.

Even a quick read of the Paris Agreement suggests that the new instrument may suffer essentially of the same shortcomings that plagued its Kyoto predecessor. Although all countries in principle accept obligations (unlike Kyoto), the text is full of nuances about flexibilities, voluntarism and non-punitive mechanisms to promote compliance. Furthermore, each country's respective contribution to limit emissions would be nationally -- and therefore unilaterally -- determined. The Paris document itself "notes with concern" that the intended nationally determined contributions (INDCs) fall short of what is needed to put global emissions on track to meet the goals.

The Paris Agreement is not even constructed to insure effective (not just nominal) participation, adequate compliance and sufficient aggregate emissions reductions, all of which are necessary to achieve the purported climate change mitigation. In a nutshell, the Agreement will not prevent free riding.

Nevertheless, relative to the Kyoto Protocol the Paris Agreement conceivably could represent a significant advancement towards the necessary effective mitigation regime. For one thing, it has given up the explicit global cap and trade approach that was instilled into Kyoto, a feature that would make room to entertain alternative ways to pursue the necessary emissions trajectories. Admittedly, an international cap and trade is still in the spirit of the Paris Agreement but fortunately not rigorously spelled out. And its reporting and transparency provisions could also prove of enormous value down the road.

My “former politician intuition” and knowledge of the theory of global public goods always made me skeptical of the global cap and trade concept upon which Kyoto was anchored. Recently my skepticism has been intellectually reinforced by the lucid work of scholars such as Martin Weitzman of Harvard and William Nordhaus of my own university.

In brief -and of course at the risk of vulgarizing their rigorous argument- Weitzman and Nordhaus conclude that negotiating a climate mitigation agreement of N emission quotas, if anything will yield not only a sub-optimal emission trajectory, but also that the coalition sustaining that agreement will tend to be unstable and prone to collapse –precisely as happened with the Kyoto Protocol.

Nordhaus and Weitzman (and now many others, including some who used to be firmly in the global-cap-and-trade camp) suggest that the way to have a better chance of achieving a “good” international regime, meaning one that could deliver in a sustained fashion the necessary global emissions trajectory, would be to have one in which the negotiating parties have the price of carbon emissions as the sole “focal point”.

This proposition has been further elaborated by Nordhaus –inspired in Buchanan’s Theory of Clubs- arguing that what is needed is a coalition of countries coming together to negotiate the required carbon price. This coalition would be considerably smaller than the so-called universal participation of the Framework Convention or the Paris Agreement. Based on theoretical arguments and numerical simulations of his model, Nordhaus believes that a coalition coming together out of self-interest (and perhaps a modicum of internationalist enlightenment) would be robust enough to derive into a good regime as I characterized before.

Frankly I adhere to the Weitzman-Nordhaus persuasion. Accordingly, my aspiration is to entice people like you to start thinking about a Post-Paris arrangement that would commit the key players to a harmonized-carbon-pricing regime. A set of countries that would seem fit to form the initial carbon club would be those that are large emitters, their INDCs are consistent with a substantial domestic carbon price, and/or the domestic externality is not hugely different from the global externality caused by their respective emissions.

It seems to me that sooner rather than later it will become evident that a significant enhancement of the regime agreed at Paris is indispensable if mitigation is to be undertaken seriously. Such an enhancement would not be a defection from the Paris Agreement but an Additional Agreement, or even better an Additional Protocol, to it. In the jargon that I used before it would be a **permutation** of the regime that painstakingly has been in the process of being built since the Rio Conference of 1992.

Admittedly the notion of Clubs to address global issues departs from the ideal of universal multilateralism that many, including myself, would prefer. But a Club operating effectively within a multilateral framework is better than a mechanism with universal participation devoid of any efficacy. I am afraid that multilaterally principled pluralism –like the Club notion a la Nordhaus for climate change, or a la Robert Lawrence for trade issues- would prove the way to go if the system is to be empowered to deliver the goals collectively agreed.

Unfortunately not all of the existing multilateral arrangements, if left unreformed, would accommodate such principled pluralism. A case in point is the multilateral framework to deal with the problem of so-called illicit drugs. As we all know, policies regarding these drugs have relied fundamentally on legal prohibition and its enforcement. It is safe to say that this approach is wholly inconsistent with best knowledge from the life sciences, sound public health research and economic analysis.

From what science knows about why people begin taking drugs and why some people become addicted to drugs, it can be postulated safely that even if the best possible prevention strategies were applied –which unfortunately has never been the case—there would still be a residual demand for drugs, irrespective of whether they are prohibited or even highly priced in whatever market they are available.

For its part, economic analysis demonstrates that prohibiting the production and consumption of any merchandise for which demand exists leads invariably to the creation of a black market by individuals and organizations willing to violate the law.

And yet for over a century, prohibition -and its intended enforcement- has prevailed as the preferred policy approach for dealing with the consumption of drugs. What is remarkable about the origin, spread and prevalence of the prohibition and enforcement approach is how inconsistent it has proven to be, not only with best knowledge but also with the results that such a policy has actually delivered in practice.

The faulty model has been enshrined in three United Nations Conventions[1] that frame national illicit drug regimes across the globe. Additionally the U.S. has made a big point in its foreign policy to agree to special enforcement mechanisms with countries considered key in the illicit traffic of drugs towards its own domestic market.

As expected, since the prohibition and punitive model has failed to achieve its objectives in the US and other highly developed countries, it is not the least surprising that the model's effects on countries with weaker institutions and fewer

[1] The three are the "Single Convention on Narcotic Drugs, 1961," United Nations (http://www.unodc.org/pdf/convention_1961_en.pdf), the "Convention on Psychotropic Substances, 1971," United Nations (http://www.unodc.org/pdf/convention_1971_en.pdf), and "United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988," United Nations (http://www.unodc.org/pdf/convention_1988_en.pdf)

economic resources available to enforce the rule of law has proven to be not only ineffective but actually disastrous.

The human, institutional and economic disaster caused by organized crime stemming from the illegal-drugs traffic will remain as long as there is not a fundamental revision of the international approach to drug policy. Tragically this change is not yet clearly on the horizon despite the opportunity to undertake such a revision that conceivably could be given this April with the convening of a Special Session of the General Assembly of the United Nations on the world drug problem known as UNGASS 2016.

The Global Commission on Drug Policy – that other than myself is formed by highly distinguished individuals including the Former President of the Swiss Confederation, Ruth Dreifuss and Michel Kazatchkine, both graciously attending this session- in its 2014 Report expressed the aspiration that the upcoming UNGASS 2016 be taken as "an unprecedented opportunity to review and re-direct national drug control policies and the future of the global drug control regime." Unfortunately that aspiration will be totally thwarted, or so it seems as the preparatory process to the Special Session stands now. I regret to report to you that the latest draft of the document that would constitute the outcome of the UNGASS 2016 essentially reaffirms the permanence of the prohibition and punitive approach.

It is tempting to say –paraphrasing the great García-Márquez -- that the preparatory process of UNGASS 2016 has been *a chronicle of a failure to reform foretold*, if for none other than the simple reason that the countries opposed to serious reform have used their influence to practically predetermine their desired outcome.

Defenders of the status quo claim that sufficient flexibility can be found within the Conventions to pursue significant reforms in drug policies. They point out, and rightly so, that the Conventions can be interpreted as allowing the decriminalization of drug consumption.

The problem is that the Conventions essentially provide nil flexibility for any regulated supply of the same drugs whose consumption could in principle be decriminalized. Obviously it would be inconsistent to decriminalize demand without taking supply out of the hands of criminal organizations. All other aspects being equal, demand liberalization alone would boost the illegal traffickers' revenues and thus their criminal power.

It is for this reason that our Global Commission, while calling for an altogether end to criminalization of drug use also proposes to reform the global drug policy regime so that governments can intelligently regulate drug markets. As we frankly expressed: "Ultimately this is a choice between control in the hands of governments or gangsters."

If my worst fears about the UNGASS 2016 are confirmed, I would then suggest that mutilation of the existing international regime by defection from the Conventions should be seriously considered by those countries willing and in need of pursuing policies seriously informed by scientific knowledge.

Dear friends of the Graduate Institute:

There are more reasons today than there were just a few years ago to regret the patent inaction, or even obstruction, to reform some critical aspects of the international system. This is worrisome because the opportunity cost of such inaction, human and economic, is mounting.

Conflicts taking hundreds of thousands of human lives and resulting in millions of refugees; quasi-stagnant developed and emerging economies regressing to the mean in their growth trajectory; globalization contained or retreating because its downsides are not addressed and its upsides are not tapped more decisively; the global community's failure to adequately provide significant global public goods like climate change mitigation; and stubborn attachment to expensive approaches to deal with some problems despite overwhelming evidence against their efficacy; are all challenges being hugely enlarged, although of course not solely caused, by lack of serious commitment to enlightened international collective action.

Ultimately it will be up to political leaders to steer away from this dangerous course of action but academic communities have much to contribute to the needed rectification. Those who think seriously about international relations must contribute to deepen our understanding of the political economy of international cooperation and also explore formulas that would make it easier to circumvent the obstacles that so far have made the warranted collective action so elusive. Educating the future scholars and practitioners of these disciplines is equally critical for this endeavor.

Mindful of its admirable research and educational history, I trust that the Geneva Graduate Institute will continue to excel in the pursuit of such a crucial mission.