Don't Let Globalization Go into Reverse

KASHIWAGI SHIGEO

The Group of Twenty summit in London at the beginning of April did not put an end to the sense of uncertainty pervading the global economy. But that does not mean the 20-member gathering was a failure. The problems that the world faces are not ones that can be solved just by having government leaders assemble and reach a set of agreements. It will be necessary to continue talks among nations aimed at achieving global measures to deal with a global crisis.

The G20 leaders discussed topics including macroeconomic policy coordination to prevent a global recession, tightening of financial oversight and regulation, strengthening of the world's international financial institutions, and resistance to protectionism. A common theme that bears watching as we consider the global economy in the period ahead is the path of globalization. In their final communiqué the leaders declared, "We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions." The key question is whether they will be able to take action in line with this message.

In this article I will discuss the points on which we should focus when discussing the future of globalization and the role that Japan should play.

THE FUTURE OF GLOBALIZATION

Until the outbreak of the current crisis, the world economy was globalizing at a rapid pace. In addition to the dramatic advances in information and communications technology, a major factor promoting this trend was the adoption of policies by many countries encouraging the free movement of goods, capital, and labor across national borders.

Unfortunately the movement toward globalization currently seems to be going into reverse. The sharp worldwide economic slowdown has led to contraction in the cross-border movements of goods, capital, and labor, made people lose confidence, and caused them to start looking inward. Global trade has shrunk for the first time in 25 years, and the flow of capital has also decreased.

Though we can hope that economic conditions will eventually improve, causing resumption of the expansionary trends in the private sector, the current situation is truly a source of concern. But what is even more worrisome is the emergence of moves by some governments to reverse the trend toward liberalization that has prevailed until now. In response to the impact of the financial crisis on real economies, a number of countries have started to adopt protectionist measures, such as import and export controls and tariff hikes.

Last November leaders assembled in Washington for the G20 Summit on Financial Markets and the World Economy, where they agreed to avoid taking measures in pursuit of their own countries' advantage alone in order to cope with the difficult situation. Despite the lofty posture of fighting protectionism that the leaders set forth in the declaration they adopted in Washington, however, a string of protectionist moves subsequently emerged. One example is the "Buy American" provisions that the US Congress attached to the economic stimulus package introduced by President Barack Obama's administration. At the London summit, which was convened to follow up on the Washington gathering, the G20 leaders reaffirmed their intention of resisting protectionism and promised to promptly rectify any violations of this commitment. Even so, we see increasing use of "hidden" protectionism in such forms as measures nominally directed against global warming.

An additional source of concern is the recent emergence of moves that run counter to globalization in the financial sector. Up to now finance has been globalizing rapidly, following in the wake of the globalization of the real economy. The process was so rapid that it ended up setting off a global financial crisis. The instability in the financial sector has resulted in the adoption of policy measures that are causing the international flows of funds to contract—financial protectionism, so to speak. For example, countries that have provided funds to shore up financial institutions have taken steps requiring that the institutions give priority to increasing their domestic lending.

Properly speaking, the international flow of funds through financial markets from countries with a surplus of domestic saving to countries with a saving shortage is expected to contribute to the steady development of the global economy as a whole. If the idea of prioritizing domestic use of domestic saving spreads, the flow of excess saving to other countries will be impeded, dealing a serious blow to developing and emerging market economy countries with persistent saving shortages. This is why the discussions at the London summit were closely watched by developing countries and others around the world, and

KASHIWAGI Shigeo

Received his master's degree in public affairs from Princeton University. Has been executive director at the Asian Development Bank, executive vice-president of the Policy Research Institute in the Ministry of Finance, and executive director at the International Monetary Fund. Is now a professor at Keiō University.

why there have been calls for enhancing the financial resources of the International Monetary Fund.

Will the present economic crisis reverse the trend toward globalization, as happened at the time of the Great Depression in the 1930s? It will be no easy matter to halt the current of globalization seen in the trend toward the integration of national economies. Also, countries are fully aware of the damage caused by protectionist measures, whether involving merchandise trade or financial transactions. At the same time, however, it is hard for countries to ignore the political voices calling for protection of sectors that are crying out in pain. Each country is struggling to maximize the benefits it receives from globalization while minimizing the resulting costs. In order to achieve a favorable outcome from these efforts, it is essential to keep up international talks among top leaders and at every other level so as to reconfirm the commitment not to reverse the current of globalization. In this respect the London summit was a highly meaningful event.

GLOBALIZATION AND FINANCIAL LIBERALIZATION

The global financial crisis has also led to reassessment of the trend toward liberalization and deregulation of the financial sector. In the communiqué adopted at the London summit, the leaders identified "major failures in the financial sector and in financial regulation and supervision" as fundamental causes of the crisis, and in keeping with the Action Plan adopted at the Washington summit, they affirmed their intention to strengthen transparency and accountability, to expand sound regulation, to enhance the fairness of financial markets, to strengthen international cooperation, and to reform international financial institutions. They also issued a "Declaration on Strengthening the Financial System" as an annex to the communiqué, expressing their intention to apply new regulatory and supervisory measures to products, markets, and players of importance to the system, extending the reach of these measures to areas that have not been adequately covered by existing systems of regulation and supervision, such as securitized products, hedge funds, and credit-rating agencies.

In order, however, to avoid reversing the current of globalization and contribute to sustained growth by achieving smooth international flows of funds on a medium- to long-term basis, it will be necessary not just to focus on extending the reach of regulation and supervision but to make sure that the systems applied are both comprehensive and mutually consistent. This is no easy matter, since financial globalization and the development of financial technology have given rise to "regulatory arbitrage," in which players pick the jurisdiction with the most lenient regulatory regime. There is also a problem with the classification of financial institutions by business category as banks, securities companies, and insurance companies, which are subject to different sets of rules as formulated by different international bodies—the Basel Committee on Banking Supervision for banks, the International Organization of Securities Commissions for securities firms, and the International Association of Insurance Supervisors for insurers. Advanced players are enthusiastically developing new financial technologies and methods regardless of their business category, and there is a danger that they will choose to operate in the category whose regulations best suit their own convenience.

In view of this, it will be necessary to standardize or at least harmonize the financial regulations applied by different countries and in different business categories. But it is doubtful whether it is possible or even desirable for every country to apply exactly the same regulations. The various national systems of financial market administration, particularly in developed countries, have been constructed over long periods on the basis of multiple factors, including each country's financial system, legal system, custom-

AFP/JIJI

The leaders of the Group of Twenty assembled in London at the beginning of April to discuss the global economic crisis.

ary practices, and culture. It may be difficult to make these all converge into a single global standard.

The issue for the future is what to make of the current situation in which, as globalization progresses, financial market participants and transactions are rapidly moving beyond national borders but the authorities regulating and supervising them continue to operate within the bounds of single countries. There is a need for common regulation based on internationally agreed rules, but the question is whether there is a consensus for this. Another issue is the scope of the countries to be covered by a common framework. Up to now the main focus has been on the Group of Seven, partly because these seven countries account for such a major part of the global economy, but also because their financial and legal systems are built on very similar foundations. It is possible for these developed countries to adopt common regulations, and they can be expected to implement such regulations effectively. As a result of financial globalization, however, transactions have spread more widely to other countries, and so it may be necessary to extend the scope of common regulations to include the emerging market economies in the future. A key question will be whether this can actually be achieved.

GLOBALIZATION AND REFORM OF THE IMF

The biggest concrete result of the London summit was the agreement it reached on reform of the IMF. Why was this a topic of discussion? And does the fact that it was relatively easy to reach an agreement on this issue mean that it will be easy to implement it and that we can hope for the IMF to contribute to preventing the reversal of globalization?

The IMF is an international institution established at the lead of the United States and Britain with the aim of promoting economic stability after World War II. Its basic functions are to monitor member countries' economic conditions and policies, offer appropriate advice from an international perspective, and provide funds to assist members when they experience temporary problems in their international payments balances. The member countries contribute equity funds ("subscriptions") according to quotas based on their economic strength, and their voting rights are set in line with these subscriptions. So, unlike the one-country, one-vote system adopted by the United Nations, the voting system in the IMF reflects the size of member countries' economies, with the United States holding a 17% quota share, for example, and Japan a 6% share.

The first reason for the calls to reform the IMF is the need to secure additional resources for it so that it can play an appropriate role in supporting countries hit by crises. What is particularly essential is to provide financial support for the emerging market economies that have been powering global growth in recent years. In order to restore global confidence it is essential to secure a proper flow of capital.

The second reason is the need to make the IMF's lending system easier to use in addition to increasing the volume of its funds; this is in response to the fact that recent years have brought a decline in the use of IMF resources. People have noted that the loan application procedures are time-consuming, that the amounts of loans fall short of borrowers' requirements, and that the policy conditions imposed on borrowers are too strict. In line with such observations, the IMF moved in advance of the London summit to expand its lending limits and to create a new system of "flexible credit lines," allowing countries with strong economic fundamentals and sound policies to set up provisional credit lines that they can draw on immediately. It also decided to overhaul its lending system. Mexico promptly took advantage of the new flexible credit line facility, a move that the London summit participants noted with approval. The IMF needs to undertake bold reform so that it can offer appropriate support for globalization among its member countries.

The third reason for IMF reform is to monitor the implementation of macroeconomic policy pledges that countries have made in the face of the current global crisis and construct an early warning system that will be effective in predicting and forestalling future crises. Leaders have pledged various measures in order to overcome the current crisis, but inasmuch as each of their countries is sovereign, the surveillance of implementation is a task that can only be handled by an international institution like the IMF. In this respect it is hoped that the IMF will play a major role in overcoming the crisis and preventing a reversal of globalization. The existence of this sort of international institutional framework is a major difference between now and the 1930s, and this is the basis for assertions that it will be possible to avoid the worst-case scenario in the face of the current crisis.

The fourth reason is the desire to reform the weighting of quotas within the IMF as a part of the reform of global governance so as to reflect countries' voices more appropriately in discussions concerning global issues. It is thought that countries' voices within the IMF should basically reflect their shares of the world economy. But quotas are not necessarily reviewed in a timely manner, and so there is a strong tendency for countries with fast-growing economies not to have their shares reflected accurately. People have been noting the need for reform of the IMF's governance to correct the imbalances that have arisen and keep questions about the institution's legitimacy from interfering with its effective functioning.

KEY POINTS FOR IMF REFORM

The London summit participants expressed high hopes for the fruits of IMF reform, but implementation of the reform measures may not be easy, and we can expect to see various twists and turns in the road ahead. What are the key points to watch in connection with this process of IMF reform?

First of all, we should note that agreement has yet to be reached concerning the details of the enlargement of the

IMF's resources. The orthodox approach would be an ordinary capital increase in the form of hikes in the member countries' subscriptions, but the task of sorting out the countries' conflicting interests in this connection is likely to take considerable time. So the London summit participants agreed on a $500 billion increase in the IMF's resources in the form not of a capital increase but of loans from specific countries, with market borrowing to be considered if necessary as a supplement. Of the $500 billion, just half has already been found in the form of concrete commitments from Japan ($100 billion), the European Union, Canada, and Switzerland. It is expected that other countries, such as the United States and China, will also make concrete offers, but the amounts and timing remain uncertain.

Japan has won high marks in the international community for its commitment, which was made last autumn, before any other country came out with such an offer. But partly because such a loan does not lead directly to an increased voice within the IMF, few others have followed suit. One hopes that other Asian countries with ample foreign reserves will do their share in promoting global economic stability by actively extending similar loans.

Another point of some concern is the question of whether the IMF's newly established lending facility will actually lead to increased lending. The financial crisis has led to an increase in the number of countries applying for IMF loans, but in most cases the applications are being made after fund shortages have emerged, meaning that the countries' domestic economies have already started to feel adverse effects. In today's world, where global flows of funds have expanded greatly, even countries whose domestic economies are performing well can find themselves suddenly facing a shortage of funds if some external factor causes a large outflow of capital. In order to ward off such occurrences, the IMF should set up a precautionary system allowing countries meeting certain conditions to receive loans immediately on the basis of agreements reached in advance.

As noted above, it has set up the "flexible credit line" facility, which would seem to meet this description, but countries in poor economic condition cannot use it, and even countries that are eligible may be reluctant to apply for credit lines lest outsiders take their submission of an application as a sign that their economies are fragile. Mexico has applied for and been granted a credit line under this facility, but it remains to be seen how many other countries will step forward to use it. Of particular interest is whether such applications will be forthcoming from the emerging market economy countries in Asia, which have been keeping their distance from the IMF. Following the 1997–98 Asian currency crisis, countries in this region lost confidence in the IMF as an institution to turn to for help, and they instead moved to build up their own foreign currency reserves so as to be able to cope with any future such crises. Their response will be instrumental in determining the future effectiveness of the IMF in Asia.

An additional area in which problems exist is the IMF's responsibility for monitoring the economic policies of its members. The track record so far shows that even if the IMF offers fine advice to member countries about their policies, inasmuch as the recommendations are not binding, they have no effect unless the country receiving the advice can summon the political will and decisiveness required for implementation. In order for the IMF truly to serve as a major force in blocking the reversal of globalization, it is necessary to assure that countries accept its advice regardless of whether they are developing or developed or whether they are recipients of IMF lending or not. This point presents a difficult challenge for the major advanced countries, including Japan, and it also represents a crucial test for the IMF, whose effectiveness has been called into question.

The final problem I would note is in the area of the IMF's governance. Though the need for governance reform is accepted and there is agreement on the general principles involved, it will be difficult to achieve prompt concrete implementation. The IMF has been considering this matter since before the current crisis struck, and it has reached a certain degree of agreement. In the spring of 2008 it conducted an ad hoc adjustment of quota shares, and it has been agreed that future capital increases should be conducted in such a way as to make countries' quotas reflect their economic strength. In this respect the IMF deserves high marks by comparison with other international institutions set up under the leadership of the victorious Allies after World War II, such as the United Nations Security Council, where the original governance structure has remained fundamentally unchanged.

At the London summit it was agreed to seek further reform of the IMF's governance, including the adjustment of quota shares, in order to strengthen its relevance, effectiveness, and legitimacy. Achieving this will require cooperation and political commitment by the countries involved. It will be important in this connection for countries whose relative economic weight has declined to be willing to accept decreased shares, and for countries seeking larger shares to be ready to accept greater responsibility and burdens accompanying their increased voices within the IMF. Japan, which rose from the position of a defeated country receiving assistance to the status of an advanced country, and whose quota share within the IMF has risen accordingly, has a duty to tell other countries about its experience. It is to be hoped that Japan will show leadership in encouraging other Asian countries to play a more forward-looking and constructive role.

The road to reform of the IMF is unlikely to be a smooth one. There is a constant tendency for participants in international gatherings like the London summit to shunt off all the difficult problems to international institutions and minimize their own countries' burdens. The successful implementation of the agreements reached in London will depend on whether the national governments of the countries involved can refrain from dismissing these issues as somebody else's concern and take action in a responsible manner as the IMF's shareholders. The responses shown by Japan and other Asian countries will be of especially great importance in this connection.

GLOBAL GOVERNANCE

Ever since the G20 Washington summit last November, the issue of "global governance"—how the countries of the world should handle their discussions concerning global issues—has also been drawing attention. Over the past 30 years the emphasis has been on the annual summits of the major developed countries—originally the Group of Seven and now, with the addition of Russia, the Group of Eight—and the more frequent gatherings of the G7 finance ministers and central bank governors. But since last November interest has also focused on the Group of Twenty, which consists of the G7 countries plus 12 emerging market economy countries, such as China, India, Russia, and Brazil, along with the EU. The G20 framework was born out of the experience of the 1997–98 Asian financial crisis, which led to the establishment of the Group of Twenty Finance Ministers and Central Bank Governors in 1999. Will the G20 meetings henceforth take the place of the G7 gatherings and the G8 summits?

The age when the G7 or G8 countries could reach agreements just among themselves and, thanks to their overwhelming strength, turn them into global agreements is now clearly over. In recent years the participants in both the G8 summits and the G7 meetings have been conducting "outreach" programs, giving some emerging market economy countries the opportunity to make their opinions heard. And henceforth the need to listen to such other countries' opinions will become even greater. In this respect the G20 can be expected to play a major role. But it is simplistic to think that the G20 can solve every problem; we must keep its limitations in mind. Like the G7, the G20 is a forum in which countries exchange opinions unofficially. Global decision making needs to take place in officially recognized international forums like the UN General Assembly and annual meetings of the IMF and the World Bank. The role of both the G7 and the G20 is to give countries the opportunity to conduct unofficial exchanges preliminary to the formal decision-making process.

Also, it is rash to think that the G20 can completely replace the G7 and G8. The G7 will probably continue to play a major role as a forum for discussing and reaching decisions among developed nations sharing the same sorts of economic systems and conditions. A group with as many participants as the G20 may not necessarily be able to discuss matters efficiently and effectively. In the period to come, we are likely to see the G7, G8, and G20 all continuing to play their respective roles, coexisting and overlapping as forums for international exchanges of opinions. An emphasis on multilateralism is bound to mean increased importance for unofficial bilateral and group discussions among countries. What is crucial in this connection, as in the case of countries' voices within the IMF, is that the new participants recognize that the right to take part in such gatherings is accompanied by the need to accept certain responsibilities with respect to the world economy.

Henceforth we need to reform global governance from a broader perspective, not just with reference to the numbers of countries participating in particular meetings. The world has international institutions and forums of various sorts, and they have become highly specialized in terms of the types of problems that they deal with. In order to prevent a reversal of globalization and achieve stability for the world, we may need to create an institution that can take a comprehensive approach.

The existing IMF–World Bank system was created at the Bretton Woods conference hosted by the United States in 1944. Some are now calling for a "new Bretton Woods" gathering to redesign the system. This may be desirable, but we cannot be too sanguine about the prospects of its realization in the near future. The marked decline in the relative leadership strength of the United States has made it difficult to achieve the sort of US-led solution to global problems that was seen previously, as in the case of the original Bretton Woods conference, where America, along with Britain, exerted overwhelming leadership.

JAPAN'S ROLE

Even if the world economy gets over the current crisis, there will remain a number of difficult problems needing to be addressed from a medium- to long-term perspective. Given the obvious decline in the relative position of the United States, which previously exercised strong leadership, multilateral discussions have become all the more important. And these difficult problems all concern Japan; our country cannot turn its back on them. As the world's number-two economic power, Japan needs to feel a sense of responsibility and play a leading part in addressing these matters. Since it will be difficult or impossible to resolve global issues without the United States —however its leadership strength may have decreased—Japan should approach the issues on the basis of a firm relationship of US-Japan cooperation. Instead of just being buffeted by each positive or negative comment from Washington, our country should recognize that it needs to contribute proactively in dealing with these global concerns.

Also, in the period ahead Asia's presence in the world economy is certain to grow, and it will become impossible to ignore the opinions of Asian countries. Japan, while playing its own leadership role, should encourage its Asian neighbors to speak up from positions of responsibility concerning global issues and should play a major part in conveying Asian opinions to the rest of the world.

Translated from "Gurōbaru-ka no gyakumodori de sekai keizai no suitai o manekanai tame ni," Chūō Kōron, *June 2009, pp. 182–93; abridged by about one-fourth. (Courtesy of Chūō Kōron Shinsha)*