The G-20 and International Economic Governance: Hegemony, Collectivism, or Both?

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Following the East Asian crisis of 1997–1998, much attention was paid to financial sector reform. While little of substance has changed in the intervening years, a number of potentially important new forums were established to facilitate international cooperation. By drawing on and modifying theories of hegemony, this article provides a theoretical context within which to explore one of these institutions: the Group of 20 (G-20). The key question examined is whether institutions like the G-20 are likely to provide genuine mechanisms for cooperation and inclusion or simply become instruments of "hegemonic incorporation." The argument here is that despite the continuing "structural" dominance of the international system by the United States and the Group of 7 (G7) nations, the G-20 provides some scope for other nations to influence outcomes. Keywords: G-20, hegemony, governance, institutions, international financial system.

The contemporary international financial system in recent decades has expanded greatly in size, reach, and liquidity. At the same time, however, it has become much more susceptible to crisis and instability, not only in emerging markets but more recently in the developed economies as well.1 The financial crisis that engulfed East Asia in the late 1990s was especially important in highlighting the potentially devastating effects of exposing immature domestic financial systems to highly volatile international capital flows. Debates about a "new financial architecture" and new coordinating institutions followed in the wake of these events.2 A report by the Bundesbank’s president, Hans Tietmeyer, was endorsed by the Group of 7 (G7) in 1999 and led to the creation of the Group of 20 (G-20) and the Financial Stability Forum (FSF). The focus of this article is the G-20, a forum designed to promote dialogue on financial and global economic governance issues in which nations of both the North and the South come together to discuss and attempt to manage common systemic problems. Its key participants are finance ministers and central bankers from the traditional G7/8 countries as well as from Australia, Argentina, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States, and the European Union (EU). These are countries
that together represent over 85 percent of world gross domestic product (GDP), 80 percent of world trade, and two-thirds of the world’s population. The G-20 also has representatives from the EU, the International Monetary Fund (IMF), and the World Bank.

To help frame our analysis of the political dynamics of the G-20, we utilize two conceptualizations of the politics of international coordination and inclusion: hegemonic incorporation and collectivist cooperation. Both are potential vehicles for coordination but on different terms and via different logics of interaction. Hegemonic incorporation implies US and G7 dominance, which Alison Bailin refers to as “group hegemony,” involving an “incorporationist” logic applied to the non-G7 members within the G-20.3 This logic encourages the adoption of a broadly neoliberal consensus and policy model by emerging market economies, not only in the interests of overall coordination and a safer world for the lead economies and their economic and financial interests, but also in terms of the conditions under which emerging market economies gain access to key trade and financial flows. However, collectivist cooperation involves an institutionalized voice and new role, especially for the non-G7 members of the G-20. The creation of the G-20 ostensibly suggests a collectivist and inclusive logic in international politics aimed at functional and normative goals: a more diverse and inclusive membership increases the prospects for consensus and effective policy coordination, while simultaneously enhancing credibility and legitimacy through a wider representation of interests.4 The collectivist logic also implies some degree of mutuality and shared influence in developing new understandings or policy frameworks. In this sense, the politics of collectivist cooperation may not simply be a fig leaf for continuing US or G7 dominance, but a genuine—if still incremental—shift toward wider participation in the governance of the international economic and financial system. Certainly, this was the way the G-20 was presented to the world by its sponsors back in 1999.

The central questions we address are whether the emergence of institutions like the G-20 mark a fundamental departure from US or group hegemony, or whether this apparent embrace of such a multilateral approach is simply hegemony by other means. Our broad answer to both questions is no or, perhaps better still, not quite. The G-20 does not mark a fundamental departure from US or group hegemony, but nor should it be understood as simple hegemony by other means. This is largely because the incremental shift toward wider participation apparent within the G-20 marks an interesting multilateral departure in international politics born of specific institutional dynamics within the G-20, underpinned by wider structural shifts in the international system. The specific institutional dynamics we refer to involve a form of relational hegemony involving trade-offs and resource exchanges between the members of the G-20. We thus locate the G-20 within
the shifting modalities of authority and the promulgation of new norms in international politics and argue that the G-20 network is helping to produce modified variants of hegemony and collectivism within the system. These institutional and structural dynamics caution against writing off the G-20 as part of what some scholars see as a wider current crisis of multilateralism. It may be true that institutions such as the IMF, World Bank, and World Trade Organization (WTO) are being marginalized, but we argue that the institutional dynamics emerging within the G-20 nevertheless deserve wider analysis and discussion. In this article we explore new perspectives on the G-20 gained in part by interviewing key Australian insiders.

In other words, we suggest that neither of the two models presented wholly captures the evolving politics of the G-20. Their either/or nature obscures the fact that the dynamics of both hegemony and collectivism are at work within the G-20, each being partly shaped by different structural logics in international political economy. Hence, the operation of the G-20 and, especially, its broadly neoliberal policy commitments reflect important elements of structural influence over the international economy by the major powers, notably the United States. Nevertheless, nested within this broader framework, the G-20 should also be seen as a case of dynamic institutional development in which new institutional effects and at least some collective capacities appear to be developing. The key to our analysis is to show how structural elements of hegemony (properly understood) relate to institutional and agent-centered relational dynamics within the G-20 itself. We also argue that the dynamics and exchanges within the G-20 relate to two different structural dynamics in the international system: the structural dominance of neoliberalism and the lead states, and structural shifts in the system whereby power balances as well as levels of economic integration are being altered by the rise of significant emerging market economies, such as, among others, India, Brazil, and China. The G-20 itself refers to this latter change as a “tectonic shift in the global economy.”

In the next section we unpack the models of hegemonic incorporation and collectivist cooperation before briefly outlining the origins of the G-20. Following an exploration of the internal dynamics of the G-20, we argue then that the evolving amalgam of hegemony and collectivism within the G-20 reflects deeper structural and institutional logics.

Modeling International Economic Governance
Both of the models outlined in the following discussion offer accounts of possible patterns of international coordination in the contemporary international system. To understand their development, significance, and possible attractions, however, we need to place them in context and say something about the evolution of US hegemony.
Hegemony in Historical Perspective

There is now a large literature that deals with the nature of hegemony from a variety of theoretical perspectives. What is significant about such debates in the present context is the way they help us to understand familiar, if not entirely resolved, problems of structure and agency. For our purposes, it is useful to make a general distinction between the structural and relational aspects of hegemonic power. Susan Strange famously argued that the structural aspects of hegemony are derived from a state's dominant position in production, finance, knowledge, and security. Most analyses from a political economy perspective understandably focus on the first three of these factors. However, we argue that if we are to understand how US hegemony has evolved, and why it may not have as much leverage over other states as it once did, then we need to take the overarching security context seriously too. One of the arguments we develop is that the United States has been forced to assume a more accommodating position vis-à-vis other states partly because other states are no longer as constrained by geopolitical or structural considerations as they once were.

While it is clear that the United States remains the most powerful country in the international system, it is also apparent that US hegemony currently operates in very different circumstances from those in the immediate aftermath of World War II. The geopolitical constraints that made the creation of the Bretton Woods institutions and the reconstruction of successful capitalist economies in Europe and East Asia such a critical ideological imperative, as well as a formidable "technical" challenge, have weakened. The principal consequence of this reconfigured strategic environment is that there is currently not a contest about the type of economic system that should prevail, but only about its management and precise form. One of the ironies of the postwar period from the narrowly conceived perspective of America's "national interest" is that the very success of the postwar international order has seen the emergence of formidable competitors in Europe and Asia—rivals that are not only gaining on the United States' relative economic position but also pushing for greater political and institutional representation as a consequence. In such circumstances, the relational aspects of hegemony, in which the application and distribution of power assume more contingent and negotiated forms, become increasingly important.

The contradictions that emerge from the interaction of structure and agency are thrown into sharp relief in a long-term historical context. At the level of what Michael Barnett and Raymond Duvall describe as "productive" (as opposed to structural) power, the United States has clearly been able to promote and institutionalize practices and relationships that are broadly congruent with neoliberal ideas and interests. But there has always been a tension between the role of the United States as hegemonic
stabilizer and systemic leader and its own interests as a country like any other. The potentially unsustainable nature of these competing imperatives was highlighted by the collapse of the postwar system of regulated international finance in the 1970s, which the United States abandoned because of domestic economic and political imperatives—leading directly to the much more liberalized financial order we see today.

Two further contradictions are worth briefly noting. First, it has been belatedly recognized that a “deregulated” financial system requires a good deal of regulation if it is to avoid periodic crises. This is why, absent the United States’ former leadership/stabilizing role, institutions like the G-20 are potentially significant, especially if they can help shape national and international financial regulation. Second, despite a clear decline in the United States’ relative economic position, it has been able to access—indeed, it has become increasingly dependent on—the sorts of large-scale capital flows that are so characteristic of the new order. Without continuing inflows of capital from Japan and, more recently, China, the United States would not be able to underwrite its debt-driven economic development and consumption patterns. Furthermore, even those aspects of US hegemony that are taken to be so unequivocal and unchallenged—especially its unrivaled military dominance—would be less assured and require greater domestic sacrifices without assured access to the savings of foreigners. Consequently, the United States in particular has powerful incentives to try to maintain the international system as it currently operates.

Hegemonic Incorporation Versus Collectivist Cooperation

There are, we suggest, two broad possible responses to this reconfigured environment. The hegemonic incorporation model suggests that the G-20 should be seen as an institutional development crafted by the core economies under US leadership, primarily as a discursive and deliberative forum designed to help inculcate the virtues of globalization and stabilize the international economy. In this view, the G-20 is an institution of international coordination via the incorporation of previously peripheral players that are now considered to be of “systemic importance” as the reach and potential vulnerabilities of the international financial and economic systems increase. The basic thrust of such coordination is a commitment to a broadly neoliberal consensus and the adoption of domestic liberalization and other reforms designed to make emerging markets more stable and easier to access for footloose investors. Consequently, we might expect that debates within this model would reject the notion that financial markets suffer from systemic instability or that they themselves should be the target of reform. According to this model, the G-20 thus helps the United States and the G7 dominate a wider order and legitimize a G7-generated view of the world.
Much of the scholarly writing on the G-20 from international political economy (IPE) scholars has been strongly influenced by this kind of hegemonic and incorporationist view. Tony Porter, for example, argues that the G-20 should be seen as a forum for selling and “legitimating G-7 policies.”\textsuperscript{17} Other scholars reach similar conclusions.\textsuperscript{18} The problem with this type of account, however, is that it reflects a kind of totalizing structuralist form of hegemony. An important critique of what might be called “crude” hegemonic concepts in IPE is provided by Randall Germain and Michael Kenny,\textsuperscript{19} who argue that such approaches fail to appreciate the subtlety of Gramsci’s original formulation of hegemony, one that stressed that the power equations at work are both structured and \textit{relational}. As David Levy and Peter Newell suggest, hegemony is not primarily about direct coercive control but about “coalitions and compromises that provide a measure of political and material accommodation with other groups and on ideologies that convey a mutuality of interests.”\textsuperscript{20}

In the postwar era, the implicit hegemonic bargain was predicated on a highly institutionalized order in which US power was constrained, with significant payoffs for other cooperating countries as a consequence. Crucially, “secondary states” were given access—albeit somewhat limited—to decisionmaking processes through multilateral institutions.\textsuperscript{21} Transposed to today’s international arena, this form of rule or incorporation still generates significant payoffs for cooperating countries. In other words, the international system (including the G-20) might have originally been crafted by the dominant players, but to effectively incorporate wider interests it must also inculcate support and offer benefits and compromises to other noncore actors. Hence, hegemonic incorporation is a subtle process. It is structured by the dominant patterns of economic and political power that make up the international system, but it involves a degree of cooperation and compliance based on a series of ideological and material exchanges between the stronger and weaker parties. It is on this basis that the G-20 is best understood as the institutionalization of both (relational) hegemony and a new form of emergent collectivism—essentially a form of relational hegemony played out inside the G-20. In this sense, the G-20 is not a neutral institutional venue but one that, because of its format and procedures, facilitates the kinds of collective engagements and exchanges we analyze in this article.\textsuperscript{22}

Two structural changes in the international economy have provided an impetus for this style of collectivist cooperation. First, there is the heightened perception of systemic vulnerabilities, which have increased the perceived need to work more closely with emerging market economies.\textsuperscript{23} Second, the structure of the world economy is changing. Not only are emerging markets now systemically important, but the older G7 club is increasingly expected to be less central in the world economy as players such as Brazil and (especially) India and China continue to expand in size, potentially altering the
balance of economic power. Extant policy coordination problems and the rapid rise of powerful new economies have led some to argue that there is little choice but to include such new actors and to seek genuinely collective solutions to international problems. As one senior financial official argued in 2003, the G-20 represents the “recognition by the international community that the solutions to global financial pressures had to reach well beyond the G7.” These views place an emphasis on the institutional and normative requirements for collectivism and inclusion within the international economic system and the G-20, with a focus on technical collaboration, consensus formation, information flows, regulatory cooperation, mutual influence, and perhaps a broader shared vision of how the system should be managed. All this involves, according to Germain, a “strong functional argument” for the politics of coordination. Mobilizing effective collective action across countries to provide the basis for joint action in a system that is more difficult to govern by a hegemon acting unilaterally or in alliance with a small group such as the G7 consequently necessitates the development of a politics of inclusion, in which a range of key stakeholder countries are brought into an institutionalized process of consensus forming, if not decisionmaking and power sharing.

But the authentic pursuit of a politics of inclusion creates a related normative argument: new collectivist forms of coordination are likely to be supported and seen as legitimate only if they incorporate genuine forms of engagement and inclusion. The key issue, especially for non-G7 countries, is the perceived legitimacy of coordinating institutions in the international economy. In this context, legitimacy refers to issues such as transparent procedures, fair and equitable treatment and rules, and, above all, a sense of inclusiveness and meaningful participation. This is especially germane because critics in the developing world and “global civil society” have drawn attention to the exclusive, inequitable nature and impact of decision-making within the established institutions and the “democratic deficit” within them.28

Paul Martin, a former Canadian prime minister and a major advocate of the G-20, has argued that new institutions and policies “will work only if the developing countries and emerging markets help shape them, because inclusiveness lies at the heart of legitimacy and effectiveness.” The G-20 was inaugurated partly as a result of the view that the most badly affected crisis countries were not represented in the existing intergovernmental bodies like the G7, which, despite the inclusion of Russia (to form the G8), remains dominated by the established industrial powers of Western Europe and North America. This unrepresentativeness, combined with the fact that the most crisis-prone countries had little capacity to influence the development and operation of the international financial system, has been one driver of ongoing support for the G-20 process. Moreover, a policy consensus that
emerges from this forum can be expected to enjoy substantial legitimacy—something that ought to facilitate ongoing policy implementation by other agencies.

We argue that this collectivist logic and the revised hegemonic model described are not alternatives but are linked in complementary ways. In this view, the G-20 is a specific institutionalization of certain elements of collectivism nested within and dialectically interacting with the form of *relational* hegemony as outlined. This is why neither of the models we have presented provides a comprehensive account of the politics of the G-20—largely because both hegemony and new forms of institutional collectivism are at work at different levels, each in turn reflecting differing logics in the international political economy.

The Evolution of the G-20

Significantly, the G-20 was originally promoted by the United States and Canada and by the G7.30 US efforts in establishing the G-20 reflected its role in promoting the earlier G-22 and subsequently the G-33 in early 1999, both moves demonstrating its unique capacity to bypass or create new organizations and operate unilaterally or multilaterally as it chooses.31 Efforts to morph the G-33 into the G-20 were pursued from early 1999 because of views that the G-33 was too ad hoc and unwieldy (with European views that it was too skewed toward Asian representation).32 This restructuring implied, as the G-20 puts it, that “some participants of the G-22 and G-33 would be disappointed.”33

The G-20’s modus operandi is to hold a series of preliminary meetings and an annual ministerial conference that discuss policy issues with the aim of establishing a consensus among the attending finance ministers and central bankers on the key issues and policy agendas pertaining to the management of the global economy and related problems. In the wake of the Asian crisis, issues such as market volatility, emerging market crises, domestic financial reform and operation of the international financial institutions, and exchange rate issues were the main focus of the initial G-20 meetings. Indeed, the creation of the G-20 was an explicit acknowledgment that such issues could not be tackled without including key emerging market economies. Over time, the G-20’s agenda has widened, and in recent years discussions have ranged more broadly across aid effectiveness, debt relief, energy security, demographic shifts, and the like. Thus far annual conferences have been held in Canada (2000, 2001), India (2002), Mexico (2003), Germany (2004), China (2005), Australia (2006), South Africa (2007), and Brazil (2008).

Our central argument, then, outlined more fully later, is that the G-20 constitutes an instantiation of relational hegemony, sustained by a series of evolving exchanges between stronger and currently weaker parties within
the G-20. In such a setting it is useful to ask how non-G7 countries have operated within the G-20 to forge exchanges with the dominant powers. First, however, we need to underline the fact that the ideas and positions endorsed within the G-20 are broadly neoliberal in character. The G-20 meeting in Berlin in 2004, for example, reflecting strong impetus from Germany, generated a key document, the *G-20 Accord for Sustained Growth*, which spells out its consensus position on central issues of economic management. This was accompanied by a *Reform Agenda* which lists (in a rather perfunctory fashion) the *Accord* initiatives that each G-20 member has undertaken to prioritize. The most striking feature of the two-and-a-half-page *Accord* document is its range of orthodox neoliberal formulations: price stability, fiscal discipline, labor market flexibility, competition, transparency and accountability, good governance, and trade and capital liberalization. In the financial arena, the reform agenda aims to promote the vision of relatively free and lightly regulated capital flows and deal with potential problems by strongly encouraging target countries to improve and modernize their economic and financial governance arrangements. The adoption of best-practice regulatory and prudential systems, capital opening, flexible exchange rates, monetary stability, and greater transparency are all part of the recommended toolkit. Despite being broadly neoliberal, however, such commitments also reflect a degree of disenchantment with any lockstep adoption of the so-called Washington Consensus. This emerged clearly in the G-20’s Montreal meeting in 2000, embodied in the so-called Montreal Consensus, which dealt with issues such as income distribution and social protection.

The G-20 does not promulgate rules, it does not make or implement policies or allocate resources, and—at least from the perspective of those involved from Australia—it does not browbeat members. According to the Australian Treasury’s Gordon de Brouwer, there is “no split between industrialised and emerging market countries within the G-20... it’s not a matter of the industrialised countries coming in and laying out a set of propositions for the emerging market countries.” It could be that the G-20’s neoliberalism is a product of groupthink. Perhaps even more plausible is the argument that it stems in large part from the way the international economy is structured. Crucially, policies of neoliberal openness are more or less the prerequisite for participation in the trade and especially the financial flows of the international economy, and such participation is something all G-20 members desire. Even former communist countries such as China are now bent on economic opening and neoliberal engagement and—in China’s case, at least—have made substantial alterations to their domestic constitutions to comply with the dominant international order as a consequence. In part, at least, neoliberal commitments reflect instrumental responses to the structural characteristics and requirements for greater participation in the international economy.
Yet as critics of neoliberal "convergence" point out, such structuralist arguments do not tell the whole story, and at the national and institutional level there are degrees of freedom for divergence and policy innovation. Hence, broad policies of openness can be seen as a structural requirement for engagement in the international economy, although even at this level, protectionist and closed trading arrangements are not uncommon (especially in the major powers). But despite structural or market confidence pressures on countries to comply with sound fiscal and monetary policy settings, there is still some room for maneuver, even in areas such as monetary policy. It is not clear then that the pressures of "disciplinary neoliberalism," as experienced within institutional settings such as the G-20, are necessarily overwhelming.

Institutionalized Collectivism

It is here that certain institutional and even perhaps collectivist elements of the G-20 are worthy of attention because they are potentially reinforced by the structural developments already noted—namely, increased intervulnerability in the international economy as well as the slowly changing structure of international economic power. It is certainly true that the G-20 brings to the table a number of large emerging market economies and offers the opportunity to widen the debate beyond a narrow neoliberal agenda. As the Australian observers Gordon de Brouwer and L. Yeaman argue, the G-20 is potentially important because "the active engagement of the key mid-sized economies ensures the forum’s decisions are not just the big countries deciding things for the rest of the world . . . it also provides an opportunity to broker consensus between, and consensus by, the big countries that they are not able to make between themselves." As South Africa’s finance minister noted in 2000, “The G-20 provides us with the opportunity to make allies among the middle powers to engage with the G7; to push for structural change in a world where the inequalities are often reinforced.” Similarly, Vanessa Rubio Marques, formerly of the Mexican finance ministry, argues that the G-20 provides a "space" in international politics for the interaction between the advanced and emerging economies and that the strength of the G-20 lies in its "representativeness, its legitimacy and the systemic influence of its members." A recent G-20 survey of the attitudes of participant members also found support for the notion that the G-20 served non-G7 members’ interests: "All members expressed a high degree of satisfaction with how the Group operates and the procedures in place; those representing emerging countries particularly so.”

However, despite the expectations that surround the evolving institutional dynamics of the G-20 as a research, consensus-building, and discursive forum, its institutional capacities have potential limitations. The G-20’s lack of operational or implementation capabilities and the limited number
of ministerial meetings—only one a year—would seem to place constraints on the G-20’s effectiveness. The lack of a permanent secretariat similarly raises concerns. The modest character of the G-20 as an informal discussion forum for finance ministers and central bankers (not government leaders) highlights its lower profile compared to the G7/8 groupings. Even admirers of the G-20 have questioned its significance because there seems to be little current prospect of converting it into a more robust Leaders group, or L-20.48

And yet, the lack of a secretariat and the fact that the G-20 is not currently evolving into an L-20 or some similar configuration may actually be potential strengths, not weaknesses. To understand why, it is necessary to explain the G-20’s distinctive style of operation.

Porter’s work on some of the institutional dynamics of international financial governance points in the direction of such nuanced institutional accounts. Porter compares his “technical systems approach” with a “power politics” approach and argues that the legacy of cooperative technical collaboration, whereby problems are addressed through what he sees as research and reasoned debate, has influenced practices within the FSF and even the G-20. Porter’s argument regarding the G-20 experience is that its broad discussion agenda—including social issues related to globalization—has been a function of previous technical collaboration experiences.49 Such views are reinforced by insiders like Martin Parkinson from the Australian Treasury, who argues that the G-20 has institutional attributes that help foster debates through informality, consensus formation, and experience sharing. Indeed, according to Parkinson, the lack of a formal bureaucracy, the limited number of participants, and the open nature of discussion are key strengths: “In most other international meetings you will be sitting there with a script. And as a result you find it hard to get a dialogue going. The thing that’s really striking about the G20 is that it’s very frank and very open. This capacity to foster low key open discussion is actually one of the G20’s great strengths.”50 Moreover, continuity and coordination of the policy agenda has occurred through the development of a troika, composed of the most recent, current, and future annual conference chairs, which draw on expertise, ideas, and input from member countries in ongoing work and in the lead-up to the annual ministerial meetings.51

Equally counterintuitive, and at odds with other more established bodies like the G7, the G-20 has a multiyear time horizon. According to Australian participants, the fact that the G-20 does not have to satisfy short-term politicized aspirations at the leaders level or produce the sort of deliverables that have plagued the Asia-Pacific Economic Cooperation (APEC) forum52 means that the G-20 can deal with more contentious issues than can the G7. Accordingly, the governor of the Reserve Bank of Australia, Glenn Stevens, believes that converting the G-20 into an L20 would be a “mistake,” as this
could undermine or transform the underlying dynamics that revolve around longer-term consensus building: “If you’ve got a heads of state meeting . . . they’ve got to go home with some great triumph in their bag, and so the focus becomes on what is deliverable. . . . It is less likely that you can actually work hard over a number of years on quite important fundamental things.”

53 Indeed, the G-20 highlights the importance of policy learning and transfer, the role of epistemic communities, and the discursive and policy activism of increasingly autonomous organizations. According to insiders like Parkinson and de Brouwer, the G-20 offers a forum for widening existing mind-sets and policy paradigms. An intellectual soil-tilling exercise in this regard occurs in the run-up to annual ministerial meetings by way of several prior deputies meetings as well as workshops, study groups, commissioned research, and background discussions, which help set the agenda and frame issues.

Notwithstanding the underlying commitment to a broadly neoliberal agenda, Parkinson argues that the G-20 debates are relatively fluid and wide ranging. In the immediate wake of the Asian crisis, G-20 attention was mainly focused on orthodox positions such as maintaining openness and improving transparency in target countries. But the G-20’s ideational framework has subtly shifted over time, toward what Parkinson sees “as a sort of post-Washington or collective view of all of the membership.” This shift has been partly spurred by a widespread perception that the IMF mishandled the Asian crisis. The emerging “post-Washington consensus” recognizes the potential dangers that badly managed integration into the international system can entail, with the concomitant recognition that capital account opening contains potential dangers as well as benefits. The East Asian crisis drew widespread attention to the question of sequencing, and the need to develop sound financial institutions and mechanisms of regulatory oversight before wholesale capital liberalization occurred. As former Reserve Bank governor Ian Macfarlane commented,

I think there has now been an acceptance that it takes a long time to build good institutions and that you just can’t let markets free before the institutions have been built. I think everyone now accepts that. That was the big lesson out of the Asian crisis. . . . I think the IMF will never admit that it was wrong but it has stopped doing a lot of the things that it used to do under American pressure.

57 Discussions within the G-20 have also generated a broad, though not universal, consensus that soft currency pegs and other fixed-rate regimes, combined with an adverse policy mix, are likely to contribute to a financial crisis. There is also support for floating rates as a viable longer-term option. The G-20 discussions have also registered the view that globalization involves potential social costs, that different countries might need to
respond flexibly to crises, and that capital account liberalization should be gradual and supervised. G-20 discussions have also focused on energy security, ways to combat terrorist financing, the introduction of collective action clauses in international bond contracts, and codes of conduct between major sovereign borrowers and lenders. Issues of trade access and liberalization have also been raised at the G-20, but as with the failed Doha Round within the WTO, there has been little progress thus far. Other examples of policy discussion that are perhaps more aligned with non-G7 members' concerns have also included development and aid programs, employment and demographic issues, migration and remittances, fiscal policy and social safety nets, and reform of the Bretton Woods institutions.

These latter elements go beyond the original G-20 focus on financial stability and demonstrate the G-20's increasingly broad-ranging discussions. "This shift in emphasis," according to the G-20, reflects the "fact that discussions on crisis prevention and resolution, the key issue when the G-20 was established, had run their course ... most merging economies have increasingly pursued prudent domestic economic policies." Some member participants in a recent review of the history of the G-20, however, noted that the emphasis on longer-term issues of growth and development perhaps reflected more the interests of finance ministers than of central bankers.

G-20 participants also stress the G-20's capacity to overcome policy logjams that exist in higher-profile bodies like the G7. Parkinson argues that "a lot of the flow in recent times has been from the G-20 to the G7." He also commented that "the G7 has been fairly high handed at times ... causing significant resentment that can restrict their ability to be influential." Work on tax havens and transparency, for example, "came through the G-20 after a combined German/Australian initiative because the G7 and OECD were fundamentally incapable of breaking deadlocks." De Brouwer and Yeaman argue that "for a number of years, the growing role of the G-20 as a circuit breaker has become apparent." The G-20 itself argues that "the role of the G-20 has become increasingly independent from that of the G7." Influential former participants in the G-20 like Ian MacFarlane argue that its institutional dynamics and membership make it a potentially vital component of any regime of future crisis management. Similarly, the G-20 itself comments that "while difficult to measure, there is also considerable value in the personal contacts and trust that has developed among G-20 ministers, governors and senior officials, which can be drawn upon in the event of a crisis."

The G-20 as an Instrument of Wider Institutional Reform?

A big test, therefore, is whether the G-20 can help reconfigure the international institutional order that has previously attracted such criticism. An important measure of the G-20's influence and operational style has been its
push for reform of the IMF governance system, a move that gathered momentum at the G-20 ministerial meeting in China in 2005. \(^{66}\) A key issue of contention has been the dominant role of the United States and Europeans in the IMF, with the convention being that the executive director would be a European national. By contrast, other non-G7 countries have wanted more say in the IMF. In this context, Ian Macfarlane argues that the G-20 should actually have the authority “to sit in judgment of the IMF.” Macfarlane contends that the G-20’s broader constituency gives it the legitimacy to push for IMF reform. Indeed, progress on such institutionally fundamental issues of inclusiveness and legitimacy were seen by McFarlane as a measure of the G-20’s future relevance and viability.

Australia’s former treasurer Peter Costello made it clear in a speech at the 2005 China conference that Asia’s low representation at the IMF was a problem. Parkinson argues that a coalition including Australia, the UK, Canada, and Japan had been pushing for reform partly because the IMF/World Bank annual meetings scheduled for 2006 in Singapore were the first time these meetings had been held in Asia since the late 1990s crisis and were keen to exploit this “big symbolic moment.” According to Australian officials, G-20 pressure “helped break a long-standing deadlock within the IMF.” \(^{67}\) The G-20 also comments that G-20 measures “aimed at increasing the representation and voice of developing countries within the IMF contributed to the IMF’s Singapore resolution of 2006.” \(^{68}\) The 2006 Singapore meeting saw, in principle, agreement from the governors for a two-stage governance reform package. First, there are ad hoc quota increases for the most significantly underrepresented countries: China, Korea, Mexico, and Turkey. But the real reform, according to Parkinson during an interview, is a second stage where “we get a new formula that reflects the economic weight of the globe at the moment. And that will be updated on a regular basis. So you won’t get a situation where the quota structure ossifies.” This momentum for progress on IMF governance reforms coming out of the G-20 is probably its main concrete achievement thus far. The key linkage has operated through the finance ministers and senior financial officials in the G-20 who have then worked within the IMF to push the agenda.

Despite progress regarding IMF governance and on other issues such as promoting collective action clauses, the current limits of the G-20 (not to mention the G7) are also clearly apparent. For example, the G-20 has noted “disappointment” that the appointment of the World Bank president was not more open and transparent, as urged by the G-20 since 2005. It also comments that one of its limits has been in driving through some of its consensus views and converting “policy objectives into operation.” \(^{69}\) This has been especially so in relation to current “tough issues,” such as dealing with the US budget deficit as well as wider issues of exchange rate
management and global imbalances. The G-20 Reform Agenda includes a commitment to address the US public budget deficit, however, given that this continued to increase under the George W. Bush administration, especially as a consequence of its strategic commitments and reluctance to raise taxes; it will remain a major test of the G-20's willingness and capacity to tackle politically sensitive issues. Beyond this, the United States' increased dependence on China for continuing inflows of capital to fund its budget deficit, and growing tensions about China's exchange rate, mean that some mechanism must be found to manage US-China relations. And yet, despite the fact that influential commentators such as Fred Bergsten consider the G-20 as possibly uniquely qualified to address such issues, it is noteworthy that at the 2005 G-20 meeting in China there was limited discussion of the exchange rate issue, with no suggestions about how it might be managed. Even if the G-20 attempts to address such problems, it will need to confront a number of issues that are so central to perceived US interests that it is doubtful whether, absent a major systemic crisis, it could have much of an impact. As the G-20 itself admits, following a survey of member views, "G-20 support for global initiatives has had only a modest effect on members' behavior, and even less impact on the behavior of non-member countries."

Conclusion
The combination of hegemony and collectivism analyzed in this article at first appears contradictory, but it is not. The embryonic institutional collectivism operating within the G-20 is nested within a wider hegemonic system, in a relational mode. Large inequalities in power between countries, the manifest dominance of the lead states, and the impact of wider institutional and structural processes all strongly influence the dynamics of the G-20. This hegemonic perspective is reinforced by the general reluctance of sovereign states to share power or to confer significant authority on international organizations. Nevertheless, institutionally embedded in this wider structure are potentially important processes and exchanges between parties that help legitimate this wider system but that may also slowly alter it. This view of the G-20 highlights issues of legitimacy and cooperation, in part reflecting growing opposition to what is widely seen as unrepresentative groupings like the G7/8. This suggests that there may be an opportunity for other organizations to provide a venue for the management of international problems and relations. What is clearly needed is a more detailed understanding of the internal dynamics of organizations like the G-20 from a wider variety of national perspectives.

Despite the importance of broader power structures, then, the G-20 has become—at a more meso or institutional level—the site of interesting and
potentially useful institutional dynamics that have in recent years made some progress in broader consensus formation and fostered a modicum of collective action, especially around issues such as IMF reform. Most important in the longer term, the inclusion of systemically important emerging market economies into a new multilateral forum reflects important structural changes in the world economy. Such institutional and structural developments need to be taken seriously. As emerging market economies such as China, India, and Brazil increase in size and influence, they will inevitably play a greater role in international forums—something that potentially makes the G-20 a key institution. In this context, the G-20 may also be favored by the fact that two of its most significant members—India and China—may not prefer to run with alternatives like an expanded G8. In the medium term, the G-20 could reflect—and possibly even help manage—a major reorientation in the relative standing of the world’s major powers. If it can, it may yet reflect the hopes of some of its admirers and the underlying belief that it is an idea whose time has come.

Notes
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3. Alison Bailin, From Traditional to Group Hegemony: The G7, the Liberal Economic Order and the Core-periphery Gap (London: Ashgate, 2005).

6. Much of this article is based on extensive interviews with a number of Australian participants, including senior Treasury officials Martin Parkinson and Gordon de Brouwer, both of whom have worked closely with Australia's treasurer in G-20 meetings; the recently retired governor of the Reserve Bank of Australia (RBA), Ian Macfarlane; and the current governor of the RBA, Glenn Stevens. We note the potential for bias in such a sample and suggest further, more extensive, in-
terviews with a wider range of interviewees from a wider set of countries, especially developing countries; this would be an important next step to expand research on the G-20.

7. Leslie E. Armijo, “The BRICs Countries (Brazil, Russia, India, and China) as Analytical Category: Mirage or Insight?” Asian Perspective 31, no. 4 (2007): 7-42.


10. Susan Strange, States and Market (London: Pinter, 1994).


22. Another good example of such processes is the OECD “talk-fests,” which provide venues for the discussion and development of new regulatory norms. See J. Braithwaite and P. Drahos, Global Business Regulation (Cambridge: Cambridge University Press, 2000).

30. G-20, The G-20: A History. Australia’s former Reserve Bank governor, Ian Macfarlane, recalls: “The Americans pushed the G-20 [but] the Europeans were extremely unenthusiastic because they have much more representation in the G7. The Europeans didn’t like the G-22 very much because they were under-represented . . . and they lobbied heavily to make sure it didn’t continue in that form. And eventually a compromise was reached and it evolved into the G-20.”
31. Rosemary Foot, S. Neil MacFarlane, and Michael Mastanduno, “Introduction,” in Foot, MacFarlane, and Mastanduno, eds., US Hegemony and International Organization (Oxford: Oxford University Press, 2003), pp. 265–272. Glenn Stevens argues that the “Americans would use the G-20 where it suits them to do so, and they won’t be in the slightest bit averse to using any other forum or just unilateral action where they think that suits them. And most big countries will always be that way.”
32. It should be noted that there have also been a number of regionally-based responses to the crisis, such as the Chiang Mai Initiative, but they have yet to realize their potential. See C. R. Henning, East Asian Financial Cooperation (Washington, DC: Institute for International Economics, 2002).
34. This document, along with other G-20 statements, is available at www.g7.utoronto.ca/g20/g20-041121growth.html.
36. Interview with Gordon de Brouwer.
37. On the Montreal Consensus, see www.fin.gc.ca/news01/01.
42. On the other hand, the G-20’s neoliberalism should not be downplayed. Robert Wade reports that at a G-20 officials meeting he attended in Sydney in 2002, there was limited input from developing country representatives and the neoliberal agenda was Australian-Canadian led. Personal correspondence, 17 July 2008.
50. Author interview with Martin Parkinson.
51. Glenn Stevens, the current governor of the Reserve Bank of Australia, also highlighted the importance of this preparatory work.
52. For an explanation of this point, see John Ravenhill, *APEC and the Construction of Pacific Rim Regionalism* (Cambridge: Cambridge University Press, 2001).
53. Author interview with Glenn Stevens.
57. Author interview with Ian MacFarlane.
60. Ibid., p. 41.
61. Author interview with Martin Parkinson.
62. de Brouwer and Yeaman, "Australia’s G-20 Host Year."
64. Author interview. Much of the following discussion draws on this interview and those with Martin Parkinson in particular.
66. See the G-20 Statement on Reforming the Bretton Woods Institutions, released in November 2005 following the G-20 China ministerial meeting.
69. Ibid., pp. 50–51.
71. The urgency of this issue can be seen in China’s explicit criticism of the IMF and its apparent reluctance to deal evenhandedly with the United States and China. See *Financial Times*, 20 June 2007.

74. Parkinson argues that “the Indians do not have an appetite for going anywhere near the G7.” China similarly prefers to be part of larger groups in which it is a potentially powerful player and in which it is less likely to come under pressure on issues such as exchange rate policy. See Thomas G. Moore, “Racing to Integrate or Cooperating to Compete? China, Globalisation, and East Asian Regionalism,” paper presented to the conference “Regionalization and the Taming of Globalisation?” University of Warwick, 16–28 October 2005.
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From *Pax Americana to Pax Mosaica*? Bargaining over a New Economic Order

AMRITA NARLIKAR AND RAJIV KUMAR

The economic rise of new powers, frequently identified as the ‘BRICs’ (Brazil, Russia, India and China), has been dramatic, and most analysts agree that the ‘unipolar moment’ is over. The implications of this emerging multipolarity for global economic governance are not clear. In this article, we address the question: can the diffusion of power among a greater diversity of countries result in the creation of a new global economic order—a *Pax Mosaica*—to succeed the *Pax Americana* of the previous century? And if so, what are the multilateral bargains that would have to be struck to facilitate the benefits of such a system while reducing its costs? A major concern here is whether *Pax Mosaica* will be successful in evolving a set of universally accepted norms through a process of consultation and consensus-building, or if we will have to go through a period of significant confusion and multiple conflicting norms until a new hegemon emerges and stipulates its own rules of the game. We argue that given the changes in global economic and strategic balances, it is both desirable and feasible that the global community strives to put in place a rules-based system of global governance that is in sync with the multipolar reality.

Our argument proceeds in four steps. First, we provide a brief overview of the achievements and limitations of the system that was established at the end of the Second World War, and lasted for over half a century in the form of *Pax Americana*. In the second section, we investigate the emergence of multipolarity, and highlight the opportunities that this generates and also the costs. In the third section, we explore the routes whereby the changing balance of power might be harnessed towards the creation of a *Pax Mosaica*—that is, a global economic order that retains and deepens the benefits of increasing inclusiveness by establishing a rules-based multilateral global governance system, but also overcomes current and potential problems. The fourth section concludes with ideas for reform with reference to the World Trade Organisation (WTO), the Bretton Woods institutions and the G20.

**Pax Americana: achievements and limitations**

As the Second World War drew to a close, the links between economic prosperity and international peace were clear for international negotiators seeking to rebuild the foundations of global economic governance. While the goal of free trade was broadly agreed upon, there were other trade-offs to be made in the negotiations to establish institutional structures. The importance of these bargains was twofold. First, they illustrated that even at the peak of its absolute power, the United States did not and could not impose its blueprint for global economic governance on the international community. But in serving as the power that could and would ultimately act as the guarantor of public goods, American hegemony was vital. Second, under the constraints of what has been described as the ‘Unholy Trinity’, ‘Trilemma’ and the...
'Inconsistent Quartet', negotiators had to recognise that not all their policy goals were consistent with each other. Hence, for example, the postwar bargain was one that sacrificed the goal of capital mobility in favour of free trade, fixed (but variable) exchange rates and domestic monetary autonomy.5

The multilateral trading regime, as governed first by the General Agreement on Tariffs and Trade (GATT) and subsequently the WTO, provides us with more of a success story than the international financial and monetary regimes as governed by the Bretton Woods institutions. But as this section illustrates, both regimes suffered from limitations, especially for those concerned with questions of fairness and distributive justice, and these limitations derived at least partly from the balance of power that underlay them.

The multilateral trade regime

Despite some ups and downs, the story of free trade in the postwar system was largely one of success. The blame for the failed attempt to create the International Trade Organisation falls on the United States, but ironically, to the United States must also go a good measure of the credit for the negotiation of the GATT in 1948. First on the strength of the American leadership, and subsequently through American cooperation with other developed economies, the GATT provided the de facto basis of the multilateral trading system until 1995.

Starting out with tariff reductions, the GATT came to regulate behind-the-border measures and further expanded its mandate to cover the ‘new issues’ of services, Trade-Related Intellectual Property Rights (TRIPS), and Trade-Related Investment Measures (TRIMS) in the Uruguay Round. Proof of the system’s success lay in the significant and reliable market opening that it secured, plus the number of countries clamouring to sign on to it. The original signatories to the GATT numbered 23; 123 countries had signed the Marrakech Agreement in 1994 that concluded the Uruguay Round and created the WTO.

However, the multilateral trading system established under Pax Americana was not without its problems. While the contribution of freer trade to promoting economic growth remains largely undisputed, the regime came under criticism for several reasons particularly from the developing world. First, especially in the first few rounds, decisions were taken on the basis of the Principal Supplier Principle. This meant that the onus of tariff reduction was placed on the largest economies, and deals arrived at were extended to all contracting parties. But the flip side of this free ride for the majority of GATT players was that only principal suppliers enjoyed agenda-setting power.

Second, even after the Principal Supplier negotiating method was replaced by a formula approach, developing countries frequently found themselves marginalised. This was because though the GATT theoretically operated on a one-member-one-vote principle, in practice all decisions were arrived at through consensus. Consensus was built among the major players—the Quad (the European Union, the United States, Japan and Canada)—and in consultation with a few other countries that would get invited to Green Room meetings at the initiative of the Director General. The process of consensus-building was thus seen as lacking in transparency, and one where the developing country majority lacked voice.

Finally, developing countries took issue with the coverage of the GATT. They pointed out that the mandate of the GATT facilitated liberalisation on issues of direct interest to the developed countries, while issues where the comparative advantage of developing countries lay (for example, agriculture, textiles) were governed by exceptions. The GATT was branded as the ‘Rich From Pax Americana to Pax Mosaica?’ 385


Man’s Club’ and developing countries preferred to invest their energies elsewhere (for instance, the creation of the United Nations Conference on Trade and Development [UNCTAD] in 1964).

Thus even though the GATT provided a foundation stone for global economic growth and stability, it could not easily counter the charge of unfair process that contributed to the marginalisation of the developing world. Several of these problems persisted after the creation of the WTO. Not long after the conclusion of the Uruguay Round, the WTO attracted vehement criticism from developing countries for failing to deliver the promises of the round on agriculture and textiles and for further burdening them with the costs of implementation of other agreements. On procedural issues of fairness, and particularly the lack of transparency and inclusiveness in decision making, criticism of the WTO persisted and reached a crescendo at the Seattle Ministerial in 1999. Importantly, this criticism came from not just disgruntled non-state actors, but its own members from the developing world.

The critiques of the trade regime derived fundamentally from the balance of power that underlay it. Even though the institution had attempted to overcome power asymmetries by allocating one vote to each member, in practice consensus-based decision making took place through small group meetings that were dominated by the United States and its allies. The minimal voice of developing countries in this skewed negotiation process further skewed the substance of trade governance. And hence, even though Pax Americana delivered the goods of freer trade and aggregate economic prosperity, it lacked legitimacy.

International monetary and financial system

Even more than trade, the international monetary and exchange rate system, negotiated at the Bretton Woods conference of 1944, relied on American hegemony due to the role that the dollar played as the reserve ‘nth’ currency. But herein lay the Achilles heel of the postwar settlement on exchange rates, best captured in the Triffin Dilemma: while the world economy needed dollars to grow, it had to be financed progressively by a growing American deficit which undermined the credibility of the dollar. Further, the bargain that had been struck over the inconsistent trinity began to unravel with difficulties encountered in maintaining capital controls. President Nixon’s decision to abandon the convertibility of the dollar in August 1971 marked the collapse of the Bretton Woods exchange rate system. Attempts to salvage the bargain via the Smithsonian Agreement’s fixed but variable exchange rates were largely unsuccessful. By the 1990s, capital movements had reached an unprecedented high since the period before the First World War, producing considerable financial instability. A new bargain within the trilemma emerged: ‘Capital was highly mobile; exchange rates were free to vary in most countries; and monetary policy could be used for domestic reasons.’ Amidst these upheavals, the persistence of the dollar as the world’s reserve currency illustrated just how deeply rooted the system was in American hegemony.

The unmistakable influence of the United States was felt not only in the bargains of the trilemma, but also in the operation of the Bretton Woods institutions. In striking contrast to the GATT and the WTO, both the International Monetary Fund (IMF) and the World Bank use systems of weighted voting. Votes are allocated according to the quotas that countries hold, which in principle depend on their shares in the global economy; in practice, the system has been slow to adapt to changing economic balances. The United States enjoys de facto veto power as key decisions require 85
per cent majority, and the United States is the sole power to control over 15 per cent of the votes to this day. The imprint of the United States and its allies is further reflected in the Bretton Woods system if one examines its leadership: the chiefs of the World Bank and the IMF have historically been American and European, respectively.

Conditionality emerged as another contentious feature of the system, which was introduced in the 1950s when the United States became concerned that it was going to effectively have to act as guarantor for IMF loans as the holder of the nth currency. But the scope of conditionality increased dramatically in the 1980s. With the onset of the debt crisis, both the IMF and the World Bank became more involved in policy-based lending and conditionality. At first these conditions focused on macroeconomic indicators in the case of the Fund, and specific sectoral reforms in the case of the Bank. In the ensuing two decades, however, the conditionality coverage of both institutions had broadened and deepened, delving into areas such as good governance, the rule of law, judicial reform, corruption and corporate governance. And even after this expansion, the effectiveness of conditionality-based lending remained questionable.7 The application of conditionality was often undertaken within the policy paradigm of the ‘Washington Consensus’. The paradigm emphasised minimising the role of the state, strictly balanced budgets, greater openness and liberalisation and a belief that self-regulating private enterprise operating in a competitive environment usually maximises growth and welfare. The doctrinaire application of this policy paradigm for addressing the Asian Crisis of the late 1990s resulted in grievous welfare loss and human misery across a range of Asian economies.

Even though Pax Americana persisted after the collapse of the fixed exchange rate system, this was more because of the de facto persistence of the dollar as the reserve currency and the special place that the United States occupied in the governance structures of the relevant institutions. The ‘non-system’ that emerged with the end of the original Bretton Woods bargain was a product of changes at the ground level and flaws within the original concept, rather than a product of altered epistemic consensus or carefully negotiated strategy.8 The role of both institutions came under challenge because of the arguable effectiveness of conditionality, and also their questionable role in crisis prevention and alleviation (for example, in the East Asian financial crisis of 1998). The limitations of the Bretton Woods institutions were revealed even more graphically with the occurrence of the global economic crisis in 2008 and the sovereign debt crisis of 2011, raising serious questions on the ability of the IMF to perform even its most basic function of surveillance and monitoring directed towards crisis prevention.

**Power transition: opportunities and challenges**

The global economic crisis represented the final straw that may have broken the back of a system that had encountered several challenges for some time. The effective challenge to these governance structures today derives principally from the changes in the balance of power on the ground. The changes at the ground level can be explained in terms of both economic weight and norms. The former takes the shape of the rise of the BRICs. In 2010, the Economist reported that the BRICs had already come to constitute the biggest economies outside of the Organisation for Economic Cooperation and Development (OECD), and they were the only developing economies to have annual gross domestic products (GDPs) over US$1 trillion.9 Together,
they constitute over 40 per cent of the world’s foreign exchange reserves. With this rising power comes a greater willingness and ability of the BRICs to flex their muscle. This is evident in their use of the Dispute Settlement Mechanism in the WTO. And all three—Brazil, China and India (Russia became a member of the WTO only in December 2011, and its influence in the organisation remains to be seen)—have also proven themselves to be skilled users of the power of collective action via the coalitions they have led in the Doha negotiations. It is important to bear in mind, however, that the balance of power is shifting not just towards the BRICs but also towards other members of the Global South.

The power of the Global South derives partly from the large emerging economies with which the smaller developing economies are allied. Additionally, this power stems from normative considerations. The concerns of the smallest and weakest in the international economy are harder to side line today due to a change in international context that attaches more attention to alternative norms as those embodied in the Millennium Development Goals or the Doha Development Agenda (DDA). These structural and normative changes mean that different stakeholders that constitute the Global South have greater voice in global economic governance. Admittedly, this is not always a united voice. In certain areas, we do see a genuine alignment of interests and strategy. For instance, in the Doha negotiations, Brazil and India in particular frequently logroll the agenda of the less developed countries (LDCs) in the collective agenda of the coalitions that they lead. On other occasions, we see a clash of interests: rumblings of discontent, for example, from many of the developing countries that are not included in the core group decision-making processes of the WTO.

The evolving balance of power has generated different responses from different international institutions. The WTO has made the most far-reaching attempts to incorporate these new voices into the heart of its functioning. The old Quad has been replaced by several new permutations, ranging from the New Quad to the G7—all of which have consistently included Brazil and India (and more recently, China), along with the EU and the United States. These changes, moreover, are not restricted to the realm of process, but also translate into substance: hence, for example, the development focus of the current round.

Despite the WTO’s adaptability to the changing balance of power, we do not see greater buy-in from the BICs, while the disengagement of the United States and the EU is high. The result is the recurrence of deadlock in the organisation, which delays the benefits of concluding the DDA and also undermines the credibility of the WTO. Another symptom of the malaise that grips multilateral trade is the turn to regional and bilateral alternatives. It appears that advanced economies and their major domestic stakeholders, having lost the dominant position in the WTO, are unwilling or unprepared to use the institution to reach consensus that is not as structured in their favour as in the past and has a greater development component. On the other hand, the BICs do not yet have the negotiating experience—and arguably, the economic wherewithal—to strike a compromise that will yield some advantage to advanced economies while at the same time pushing forward the development agenda.

There are three reasons why the multilateral trading system is in such difficulty despite the WTO’s successful incorporation of a mosaic of major powers at its core. First, the inclusion of the BICs—countries at very different levels of development from the EU and the United States—introduces much more diversity even in small group meetings. Power in the WTO is more evenly distributed than...
it was under American hegemony in the GATT. And the more equal the power distribution, the harder it is to reach agreement. Second, multipolarity and cultural diversity could perhaps be dealt with if there were suitable institutional mechanisms in place, but the WTO, even after incorporating the new balance of power, still retains many of the institutional features of the GATT, and consensus-based decision making makes it harder to reach decisions even within the diverse group at the high table of negotiations today. Third, the focus on development has led interest groups, particularly in the developed world, to see the current round as one for charity rather than based on reciprocal gain. This in fact translates into a fundamental divergence of views on the purposes of the trading system: for some, its goals are and should be limited to freeing up of trade, while others see the WTO’s mandate as extending to issues such as development, labour standards and even climate change. The WTO presents us with a particularly interesting example of relatively unsuccessful reform in response to the changing balance of power.

In contrast, the Bretton Woods institutions showcase a different type of problem. Bar some revision of the quotas and voting shares in favour of the rising powers, change in the IMF and the World Bank has been slow despite the considerable and urgent need for it in light of their poor records on lending, crisis prevention and crisis alleviation, and also persistent problems such as currency imbalances and the emergence of alternative conditionality-free aid flows from bilateral donors. The global financial crisis in 2008 and the sovereign debt crises in Europe and problems within the United States in 2011 have reinforced the challenge to the Washington Consensus, especially when the decline in the OECD economies is compared against the relative success and stability of the rising powers (and towards whom the Old World now turns for rescue). Against this background, the success and legitimacy of Pax Americana stands severely dented.

Some attempt has been made towards a more integrated reform effort of both the financial and trade system via the leaders’ level G20. The G20 represents an example of the attempt to broaden global governance away from American hegemony, or indeed a European–American duopoly, towards a more inclusive mosaic of powers. Insofar the G20 is not restricted to any one of the major international organisations, it holds the promise of facilitating greater coherence in the system across institutions (and hence, for example, more effective regulation of issues that fall between the current institutional mandates such as the undervalued yuan). It played a useful role in preventing the escalation of the 2008 financial crisis into a global economic depression. Some progress has also been made in strengthening global financial regulation under the aegis of the expanded Global Financial Stability Forum. But the collective action required to accelerate recovery and bring global economic growth has so far eluded the G20, with several observers dismissing the forum as little more than a talk-shop. This is unsurprising for the following reasons.

Despite its members constituting over 80 per cent of the global economic output, the G20 enjoys even lesser legitimacy than the main international organisations. Its legitimacy deficit is especially high among the some 160 countries not included in its ranks. The G20 also does not enjoy high favour with some developing countries that are included in this elite group, but which have only recently learnt to use mainstream international organisations to their advantage and resent the attempted forum-shifting. The group also lacks the efficiency that derives from small group consultations on
account of its diversity and relatively large membership. Thus the G20 suffers on both counts of efficiency and legitimacy.

These different developments—major and unsuccessful reform in the WTO, limited and inadequate reform in the Bretton Woods institutions and the allocation of responsibilities to alternative forums like the G20—indicate the recognition, to varying degrees, of the emergence of new powers in global economic governance. In no instance thus far, however, has this resulted in the creation of a *Pax Mosaica*.

A new global order: routes to *Pax Mosaica*

The inclusion of rising powers in positions of responsibility in international organisations and parallel forums has contributed to greater inclusiveness, diversity and pluralism in the evolving architecture of global economic governance. These improvements, in turn, contribute towards fairer process in global economic governance. These are all valuable achievements. And yet, in no variation yet has this improved inclusiveness resulted in improved efficiencies or the emergence of a *Pax Mosaica*. In the WTO, where this inclusion has been the most systematic and far-reaching, we see an increase in deadlock; more limited reform attempts in the Bretton Woods institutions have generated even poorer results; parallel developments in the G20 have also proven inadequate. In this section, we explore ways in which the changing balance of power may be harnessed more effectively to deepen the newfound gains of inclusiveness and fairness, but also address the new problems that have emerged. We do so by posing four sets of questions, which must be answered if the mosaic distribution of power is to lead to greater economic stability, growth and peace.

The first question is the *what* question: What is meant by *Pax Mosaica*? In our understanding the two necessary features of *Pax Mosaica* are: greater inclusiveness that represents a predominant share of global population and economic output; and the rules are multilaterally negotiated and implemented. Under *Pax Mosaica*, multipolarity rules, rather than hegemony, duopoly or oligopoly.

The second is the *who* question: Who gets included in the ‘*Mosaica’ at the heart of global economic governance, and thereby bears the responsibility for the provision of global public goods? A system that lacks a hegemon also runs the risk of lacking the leadership to supply public goods such as free trade or currency stability. We have had instances of collective action in the past through other means, such as the Concert of Europe in the nineteenth century, but standards of international democracy today differ from those that were applied to the historic concerts of power, and the majority of developing countries are unlikely to follow the rules advanced by an exclusive group of Great Powers. A *Pax Mosaica* would thus need to be more inclusive and diverse than the historic concerts of Great Powers. The WTO and G20 tend towards this, in that both forums bring together old and new powers into the driving seat; note, however, that both need to secure more systematic buy-in from the smaller and multiple members of the international system not included in the core. Further, a global order founded on a *Pax Mosaica* would simultaneously need to be sufficiently small to facilitate efficient decision making and thereby also avoid some of the problems outlined earlier with reference to the WTO and G20. Clearer mechanisms to facilitate representativeness, effectiveness and accountability could hold the key to this problem.

The issues of representativeness and accountability automatically take us to the third question—the *how* question:
How is global governance to be conducted, even after a small group of major powers is identified, such that these powers represent the interests of different stakeholders and can be held to account? Take the example of the WTO where the inclusion of the BICs has improved representativeness, but high levels of dissatisfaction still persist among the majority of smaller players who do not regard the coalitional affiliations between the BICs and themselves as adequate grounds for representation. A peace sustained by a mosaic of established and rising powers, even if it could be negotiated within the core group, would need to be accountable to other stakeholders (at the very least, other states, which benefit from but do not lead the Pax Mosaica).

One reason why states are seldom satisfied with indirect representation in international forums is a divergence of interests. The issue of divergent interests takes us to the scope question under Pax Mosaica: What gets included and excluded from the mandates of particular institutions? We know from historical experience that mandate evolution is seldom uncontested. In trade, the conflict over including TRIPS, TRIMS and services versus agriculture and textiles in the Uruguay Round, or indeed the Singapore Issues and environment versus development considerations in the Doha negotiations, was deep-rooted and divisive. In the Bretton Woods institutions, ‘mission creep’ and conditionality expansion have proven controversial. At a minimal level, all the existing international organisations need to specify the criteria to be used for determining their mandates.

The scope question also translates into a fundamental question of which public goods are to be provided. This can sometimes be an issue of framing and integrative bargaining: for example, the battle lines between proponents of free versus fair trade could be overcome by illustrating that free trade—under equitable rules—is fair trade. In other instances, however, the negotiation over which public goods can be highly divisive. This is especially the case if the major powers are at differing levels of development, and attach conflicting values to different public goods. One of the reasons for the recurrence of deadlocks in the WTO today is the differing priorities that the developed versus developing countries attach to free trade and development (even though both constituencies recognise the positive correlation between the two).

Even in the 1940s, when American power enjoyed overwhelming supremacy, states found it difficult to agree upon the goals that emerging international institutions should pursue. Such a negotiation is rendered even more difficult under multipolarity. Particularly important is the danger of the undersupply of public goods due to the temptation of each major power to freeride, in contrast to the relatively higher willingness of the hegemon to bear these costs due to the higher stakes that it has in the system by virtue of its size. Pax Mosaica has been elusive so far despite the emergence of a mosaic of major powers in global economic governance. Bearing in mind the four questions just discussed, what concrete steps could be taken to facilitate the creation of greater multilateral stability, growth and peace amidst growing multipolarity?

**Directions for institutional reform**

As we have argued, the record of existing international institutions differs considerably, both in terms of their achievements in the second half of the twentieth century as well as responsiveness to the changing balance of power. Rather than rewrite the existing global economic order completely through a new Bretton Woods, what is needed is a careful assessment of the institutions and norms that...
have served us well thus far and should be retained and others that need to be re-negotiated.

Among the existing regimes, the WTO fares better than most. A broad level of consensus exists on the merits of free trade, and the resilience of the multilateral trading system stood the test of the financial crisis of 2008 when a global upsurge of protectionism was avoided. The organisation has done well in including the rising powers in key decision-making processes and adapting their concerns into the substance of the negotiations. Where the WTO falters, however, is in ensuring that these changes actually improve rather than decrease its workability. At least some of these challenges could be resolved by addressing the *how* question, and reforming decision-making processes (such as consensus) to bring them in line with the altered power realities. Thinking along such lines has already begun in the policy and academic worlds.\(^\text{11}\)

The IMF and the World Bank have a further way to go in terms of broadening representation for the rising powers. Not only do the Bretton Woods institutions represent a defunct distribution of power, but their ability to provide relevant public goods is also under question. Their limitations were revealed with the outbreak of regional financial crises in the 1990s and their mishandling of the attempted recovery. But their inadequacies became even more evident in the prelude and aftermath of the global economic crisis of 2008/9. On all four of the what, who, how and scope questions, the Bretton Woods institutions fare poorly. The old bargain over the trilemma has unravelled, but a new one is yet to be negotiated; their management is not inclusive and they under-represent the rising powers; their outmoded systems of weighted-voting continue; and the exchange rate system has so far been unable to adapt to the rise of possible alternatives to the dollar despite the *de facto* strength of the Chinese Renminbi.

The successes and problems encountered by the WTO and the international financial institutions also offer useful lessons for other institutional initiatives, including the G20. The G20 enjoys the advantage of broad coverage, and thereby opportunity to address the problem of coherence across institutions. More controversial is whether it can or should be a substitute for the more formal organisations. There are two diverging views on the role of the G20, which also presented a useful point of difference for the authors of this article. Kumar accords greater potential legitimacy to the G20 as a forum in its own right; Narlikar sees the G20’s role as more limited, providing no more and no less than a focal point for addressing some of the challenges we have outlined and a complementary forum to reinforce existing international organisations.

**A prominent role for the G20**

The emergence of G20, the relative decline of the G7 and the continued ineffectiveness in large parts of global governance of the formal United Nations system perhaps point towards the need for a new architecture of global governance. It is true that the larger number of players and the diversity in their worldviews and growth models would make convergence within the G20 unlikely (in contrast to what was achievable in the G7). A smaller but representative informal group would be necessary to deliver global public goods.

The diverse G20 membership could formalise a set of multilateral rules or norms that would be binding on all members of the smaller informal group. This would be achieved through negotiation that is premised on the understanding that multipolarity requires that all variety of views are taken on board and a convergence achieved. In the absence of such a core group similar to the G20 adhering
to a commonly agreed set of rules, there will be a tendency for regional and sub-regional formations to emerge. This could create a confused and unmanageable global disorder as memberships would overlap and in some cases regional norms conflict with each other. This is best avoided. The alternative therefore is to identify a core group of existing and emerging players that could evolve a set of rules, which would, quite like the written constitutions in nation-states, embody and represent *Pax Mosaica*.

**The G20 as a focal point**

While the G20 could potentially serve as a vital signaling device and focal point for political leadership, it cannot and should not become a substitute for the existing international organisations. Attempts to build even a preliminary consensus through a G20 ministerial process are unlikely to enjoy ownership from the rest of the stakeholders. Drawing on the example of the WTO, one of the problems that the organisation faces today is that the mosaic of powers at its helm is diverse and numerous, which renders consensus-building difficult; the G20 multiplies this problem by having an even bigger number and diversity of members. Smaller countries have greater opportunity to exercise their voice via trade coalitions and also improved internal transparency mechanisms in the WTO, in comparison to their non-existent voice in the G20. A smaller core group within the G20 is unlikely to provide a satisfactory answer to their concerns. Forum-shifting towards the G20 would not only exacerbate the efficiency problem, but would also worsen the legitimacy problem.

**A convergence?**

Formal and informal mechanisms that work in parallel with dedicated international organisations do have an important role to play, especially in conditions of systemic power transition. While we have focused here on some of the technical deterrents to the emergence of a full *Pax Mosaica* in specific institutions, a major reason for why even more representation to the BRICs (for example, in the WTO) has generated poor results is the leadership vacuum in global economic governance. Technocratic solutions can only work if major stakeholders are willing to bear the political and economic costs of the provision of public goods. Here, forums like the G20 can play a major role in galvanising leadership. For example, were the G20 leaders to go beyond cheap talk and actually bind themselves into completing a Doha deal by a specified deadline, this would be just the boost that the multilateral trading system needs. Smaller meetings may not be able to formalise solutions, but they may be able to provide just the focal points necessary to catalyse our mosaic of established and new powers into building a *Pax Mosaica*.

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**Notes**


6 Daunton, ‘The inconsistent quartet’.


8 Daunton, ‘The inconsistent quartet’.


A BRICS DEVELOPMENT BANK: A DREAM COMING TRUE?

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A BRICS DEVELOPMENT BANK: A DREAM COMING TRUE?
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Abstract

BRICS leaders have approved creating a new development bank which would fund long-term investment in infrastructure and more sustainable development. This paper documents the scale of unmet needs in these areas in developing and emerging economies. It then estimates the likely level of loans that this new development bank could make, under different assumptions. It highlights the complementary role that such a bank would play with existing development banks and shows its importance for enhancing the influence of BRICS and other developing countries in the international development architecture.

I. INTRODUCTION

There has been a fundamental change in the international economy, especially so in the last decade. Emerging and developing countries have significantly increased their weight in global GDP and especially in global economic growth; in particular, they have been responsible for most of the growth in the world economy since the 2007–2008 crisis. Perhaps most important in the context of this paper, some emerging and developing economies have accumulated very large long-term foreign exchange assets, which they have typically placed in Sovereign Wealth Funds. The share in the world total, as well as the absolute level of foreign exchange reserves that emerging and developing countries have accumulated, has also grown remarkably in the last decade. A large part of these resources are invested in developed countries, with relatively low yields (see, for example, Griffith-Jones, 2011).

At the same time, there are very large unmet needs in the emerging and developing countries, most clearly in the field of infrastructure and more environmentally sustainable forms of development where a deficit of investment of up to around US$1 trillion annually has been identified beyond what is currently likely to be financed (Bhattacharya, Romani and Stern, 2012; Bhattacharya and Romani, 2013). The persistence of such a major deficit would constrain future growth of developing and emerging economies, as well as imply that a large proportion of the world’s population would continue not to have access to electricity and clean water.

The fact that emerging and developing countries have the necessary savings and foreign exchange reserves to finance a new development bank that could contribute to finance such investment makes a clear case for such an institution to be created. This institution would be a complement, not a substitute, for existing financial institutions both in the public and the private sector. Its existence would clearly strengthen the voice of developing and emerging economies in the development finance architecture, as well as provide much needed additional finance.
In this context, it is very welcome that the leaders of the BRICS countries (i.e. Brazil, the Russian Federation, India, China, and South Africa) approved in March 2013, during their meeting in Durban, the creation of a new Development Bank to finance investment in infrastructure and more sustainable development in BRICS and other emerging and developing countries. This is reflected in the March 2013 Durban Summit Declaration and Action Plan:

In March 2012 we directed our Finance Ministers to examine the feasibility and viability of setting up a New Development Bank for mobilising resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries, to supplement the existing efforts of multilateral and regional financial institutions for global growth and development. We have agreed to establish the New Development Bank. The initial contribution to the Bank should be substantial and sufficient for the Bank to be effective in financing infrastructure (BRICS, 2013: paragraph 9).

The paper is structured as follows: section II places the BRICS Development Bank in the context of the broader needs of a South-South financial architecture and outlines some of the other existing gaps in the financial architecture of Southern countries. Brief reference will be made to other Southern initiatives that are taking place or are desirable in this context. In relation to the BRICS development bank, section III addresses the needs in infrastructure and more sustainable development that should be met in developing and emerging economies, including the BRICS themselves, thus defining the level of finance required for infrastructure investment and more sustainable development. Section IV addresses features that a BRICS development bank could have to achieve its envisaged mandate, including possible trade-offs, where these exist. Naturally, the ultimate decisions on the size and other features of the BRICS development bank will be taken by the BRICS Governments themselves, but discussions of the technical options, and of related relevant experiences, may provide helpful inputs for those decisions. The type of issues to be discussed will include the capital level, as well as its structure, the scope of its lending, as well as its governance structure. Section IV also examines the way in which the BRICS development bank would cooperate with other development finance institutions, both public and private ones. Section V concludes.

II. EXISTING GAPS IN THE SOUTHERN FINANCIAL ARCHITECTURE

As we will discuss in more detail in the next section of this paper, there is a massive gap in development finance relating to the unmet needs for long-term financing to fund infrastructure and more sustainable development. Yet, this is clearly not the only need for the financial architecture of the South.

An equally important need is the provision of short-term liquidity by Southern institutions. The significance of such financing has again been shown by the very large capital outflows from emerging economies, leading to falling exchange rates, as a result of the announcement that the United States Federal Reserve may start “tapering” Quantitative Easing (QE), and later as a result of the beginning of actual tapering. This impact has happened, even though at the time of writing fundamentals (such as levels of foreign exchange reserves, debt to GDP ratios, inflation and growth) have in most emerging economies been sound. The uncertainty caused by the conflict between parts of the United States Congress and the United States President leading to fears of a default on short-term Treasuries, as well as the partial closing down of the United States Government due to disagreements on the United States Budget, have further shown the potential vulnerability of the emerging and developing economies to external shocks coming from the developed economies.

Though the International Monetary Fund (IMF) exists to provide short-term balance of payments financing, such funding is often insufficient, and is often tied to inappropriate conditionality. There is therefore a clear gap for a broad-based Southern-led monetary fund, that can be led by the BRICS, and that builds on the experience of, and complements existing regional Southern institutions. Examples of the latter include the original Chang Mai Initiative – which has evolved into the 10+3 foreign-exchange reserves pool established by the Association of South-East Asian Nations (ASEAN) plus China, Japan
and the Republic of Korea, with a size of 240 billion US dollars, called CMIM, or Chang Mai Initiative Multilateralization – and the smaller-scale Fondo Latinoamericano de Reserva (FLAR).

The aim of CMIM is to strengthen the capacity of its member states to protect themselves against increased risks and challenges in the global economy. The core objectives are to address balance-of-payments and short-term liquidity difficulties in the region, as well as to supplement existing international financial arrangements. CMIM is limited to a regional grouping and to a currency swap. Moreover, it remains linked to the IMF, as only 30 per cent of a member’s quota is accessible without the prior agreement of an IMF programme, though the share that is available without an IMF programme has been increasing, and reportedly the goal is for it to go up to 40 per cent by 2014. It is encouraging that at the Durban Summit the heads of state of the BRICS agreed to establish the BRICS Contingent Reserve Arrangement (CRA) – a stabilization fund of US$100 billion in reserves. Indeed, the CRA is a coordinated central bank fund which is set up to provide mutual liquidity in the event of a crisis, probably without the involvement of the IMF.

Thus, one likely key difference from the CMIM is that the BRICS CRA will not include a link to the IMF, which brings about policy conditionality in the event of crisis (Younis, Watson and Spratt, 2013). In this sense the BRICS CRA would be similar to the FLAR, which has no link with IMF conditionality. The initiative to establish a BRICS CRA was reflected in the Durban Summit Declaration and Action Plan:

In June 2012, in our meeting in Los Cabos, we tasked our Finance Ministers and Central Bank Governors to explore the construction of a financial safety net through the creation of a Contingent Reserve Arrangement (CRA) amongst BRICS countries. They have concluded that the establishment of a self-managed contingent reserve arrangement would have a positive precautionary effect, help BRICS countries forestall short-term liquidity pressures, provide mutual support and further strengthen financial stability. It would also contribute to strengthening the global financial safety net and complement existing international arrangements as an additional line of defence. We are of the view that the establishment of the CRA with an initial size of US$100 billion is feasible and desirable subject to internal legal frameworks and appropriate safeguards. We direct our Finance Ministers and Central Bank Governors to continue working towards its establishment (BRICS, 2013: paragraph 10).

Furthermore, as emerging economies began to be affected quite strongly by the announcement by Federal Reserve Chairman Bernanke that “tapering” of QE could start soon, informal coordination between BRICS leaders has been reported. Widely reported in the press was the fact that Brazilian President Rousseff and Chinese President Xi Jinping spoke late in June 2013 on “ways to strengthen policy coordination” in the context of the recent depreciation of their currencies, especially against the dollar (Younis, 2013). Thus possible BRICS institutional developments, such as the creation of a CRA, are being preceded by informal coordination, the urgent need for which is being catalysed by events. The CRA would be the first attempt to broaden such agreements to a global level amongst emerging economies.

At the time of writing, it is encouraging that the Deputy Governor of the People’s Bank of China, Yi Gang, was reported as saying to the Chinese press that the BRICS countries were close to consensus on the establishment of a CRA. He specified that consensus had been reached between the BRICS countries on the ratio of contributions, operation mechanisms, governance structure and loan to value ratio. He reported that “the working group of the CRA was actively pushing the process forward”. As market volatility and uncertainty swell, according to Mr. Yi, the CRA will be conducive to enhancing confidence among BRICS countries. Mr. Yi also told a media briefing that China will contribute the “biggest share” to the fund, but not exceeding 50 per cent of the total contributions. He did not give out any more details (Economic Times, 28 August 2013).

At the same time, it was reported in Reuters that members of the Indian Government had informally said it was seeking support from other emerging economies for coordinated intervention in offshore foreign exchange (Kumar, 2013). India’s currency had shed a fifth of its value against the dollar in three months. It was disappointing that such support was not forthcoming, and India received support instead from a
developed economy, Japan. In some ways, a race against time has emerged, as the need for the CRA has come with some urgency, at a moment when the CRA was clearly approved in principle but whose details had not yet been agreed, and therefore was not quite ready for use. Indeed, this urgency could hopefully provide an impulse for the CRA to be quickly finalized, implemented and used. This could show the effectiveness of BRICS mechanisms at a difficult time for some BRICS countries.

III. INFRASTRUCTURE AND MORE SUSTAINABLE DEVELOPMENT NEEDS IN THE EMERGING AND DEVELOPING COUNTRIES

It is interesting that most regional and multilateral development banks have started their existence with a major or exclusive focus on infrastructure. For example, the European Investment Bank (EIB) started its operations with the aim of building key infrastructure that helped integrate infrastructure between European countries, as a complement to trade integration of a more classical kind (such as lowering tariff barriers) and of building infrastructure in the poorer areas of the European Union (such as the Southern parts of Italy) to help encourage convergence between poorer and richer regions, especially because it was feared that, otherwise, trade liberalization would risk increasing the divergence between richer and poorer regions. Similarly, the World Bank was originally established to support the reconstruction of European infrastructure after World War II. Over the course of time, most of these regional and multilateral banks diversified and expanded their activities to lend to other sectors (e.g. social sectors, indirect lending via global loans channelled through commercial or other banks to SMEs), and in recent years, have increasingly focussed on more sustainable development.

The rationale for the BRICS development bank has been built focussing on the major needs in infrastructure and more sustainable development. Thus, Bhattacharya, Romani and Stern (2012) as well as Bhattacharya and Romani (2013) – both of which have been very influential with the BRICS Governments – make the case for a major step increase in investment in infrastructure and more sustainable development, based on the need for growth, structural change, inclusion as well as sustainability and resilience. Firstly, developing countries need a step-increase in infrastructure investment to accelerate economic growth and development. There is extensive empirical evidence that infrastructure development can increase economic growth and reduce levels of inequality (Mwase and Yang, 2012; Agénor and Moreno-Dodson, 2006; Straub, 2008). As countries move from primary to secondary and tertiary sector-based economies, infrastructure needs expanding. Furthermore, there is strong evidence that a lack of infrastructure is a barrier to growth. As regards structural change, with around two billion people projected to be moving into urban centres in emerging and developing countries in the next three decades, there is a great need for major investments in urban infrastructure.

As regards inclusion, infrastructure is crucial for increasing access to basic services by poor people. Deficits are very large, as 1.4 billion people have no access to electricity, 0.9 billion people do not have access to clean drinking water and 2.6 billion lack access to sanitation. Helping provide these basic needs is a pre-condition for a more inclusive pattern of growth (Bhattacharya, Romani and Stern, 2012).

Last but certainly not least, it is crucial for development that environmental sustainability and climate resilience is guaranteed, and this requires new infrastructure. This implies reducing the environmental impacts of existing infrastructure, adapting it to a changing climate, and designing new infrastructure creatively to promote environmentally sustainable lifestyles, as well as a broader model of development. Investment in infrastructure, which enables the use of renewable energy, is an important initiative to promote development that is environmentally sustainable (Spratt, Griffith-Jones and Ocampo, 2013).

To meet these objectives, Bhattacharya, Romani and Stern (2012) have estimated the annual need for infrastructure investment. They project broadly that investment spending in infrastructure (excluding operation and maintenance) in emerging and developing countries will need to increase from approximately US$0.8–0.9 trillion per year currently, to approximately US$1.8–2.3 trillion per year by 2020, or from
around three per cent of GDP to 6–8 per cent of emerging and developing countries’ GDP. This includes about US$200–300 billion to ensure that infrastructure results in lower emissions and is more resilient to climate change.

The calculations suggest that, in absolute terms, East Asia and the Pacific has the largest need for infrastructure investment, while as a share of GDP, sub-Saharan Africa has the largest needs (figure 1). As regards categories of countries, low- and lower-middle income countries account for 85 per cent of total needs. Regarding economic sectors, the largest needs, i.e. 45–60 per cent of the total, are estimated to be in the electricity sector, including generation capacity, transmission and distribution networks, with the remainder roughly equally distributed between the transport, telecommunications and water sectors (figure 1). Though most of the investment will be needed in the construction phase, it is important to stress that between 5–10 per cent will need to be invested in project preparation and arranging funding. The high proportion of the latter is an important feature of the planned BRICS bank, as it is sometimes considered that existing development banks do not devote sufficient resources to this purpose.

An additional important function of a BRICS bank would be to collect the experience of many projects in a centre of expertise. A useful extension of such a centre of expertise could be to provide technical assistance for project implementation and for project preparation. Recent analysis and experience (for example of the EIB) have stressed the importance of providing technical assistance for project preparation and implementation, especially in the case of low-income countries.¹

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¹ I am grateful to Matthias Kollatz, but also others, for making this point.
As already mentioned, current annual spending on infrastructure is estimated to reach around US$0.8–0.9 trillion (figure 2), leaving an estimated gap of unmet needs of between US$1.0–1.4 trillion (figure 3). As shown in figures 2 and 3, the main source of financing investment in infrastructure at present are national government budgets, which fund well over 50 per cent of the total; this national public share rises further if investment by national development banks is added, with the total of both categories summing up to US$570–650 billion annually. Domestic budgets will continue to play an important role in the future. However an increase in financing investment in infrastructure from national budgets will inevitably be constrained by macroeconomic considerations regarding sustainable levels of debt and budget deficits.

The next main source is private finance, which is estimated to provide US$150–250 billion annually (figure 2). One problem of this type of funding is that it is very pro-cyclical, and tends to fall during and after crises. Such a sharp decline of private finance for infrastructure investment in developing and emerging economies happened after the 1997–1998 East Asian crisis, and has also occurred since 2008, especially in relation to private bank finance. The capital outflows from emerging economies in the second half of 2013 – prompted by the fear of tapering of QE2 – would make attracting long-term private finance even more difficult. Private finance is also heavily concentrated in certain sectors, such as telecommunications, and in middle-income countries.
Overseas Development Aid and existing Multilateral Development Banks (MDBs) finance provide only an estimated US$40–60 billion annually, and South-South flows are estimated to finance only around US$20 billion or less annually.

The resulting financing gap amounts to US$1.0–1.4 trillion annually, depending on how the estimations are done (figure 3). The main, though not the only, reason for creating a BRICS development bank is that it can contribute to bridge that crucial gap. The fact that the estimated financing gap is so large is an important reason for providing the BRICS bank with a large capital endowment. Another reason to create a BRICS bank is to give emerging and developing countries greater voice in the development finance architecture, at a time when they clearly have the financial resources to do so. From the perspective of the BRICS themselves, as well as other potential contributors of capital to the new bank, there are clear advantages in putting a small part of their existing reserves into long-term investment in developing countries, as this offers them clear benefits of diversification, as well as improving facilities for infrastructure in countries with which they increasingly trade and invest in.

IV. KEY FEATURES OF A BRICS BANK

As pointed out in the Introduction, this section will address features that a BRICS development bank could need to achieve its envisaged mandate, including possible trade-offs, where these exist. Naturally, the ultimate decisions on the BRICS development bank will be made by the BRICS Governments themselves, but discussions of the technical options, and of related relevant experiences (for example of the Development Bank of Latin America (CAF) and the EIB) may provide helpful insights for those decisions. We will discuss here the scope of a BRICS bank lending activities, the level and structure of its capital endowment, and its governance structure. How the BRICS development bank would cooperate with other development finance institutions, both public and private, will also be examined.

A. Scope of lending and other instruments

The scope of sectorial and country-specific lending of a BRICS bank has been clearly defined by the BRICS leaders in the Durban 2013 Summit Declaration as “mobilising resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries” (BRICS, 2013: paragraph 9).

The fact that the unmet needs in the area of infrastructure and sustainable development are extremely large and that such investment is crucial for inclusive and more sustainable growth – with only half of it currently being met by existing financial sources – justifies the BRICS leaders’ decision to focus the operations of a BRICS bank on this area. It is important for the move towards a greener economy that investment in infrastructure is broadly defined, so it also includes infrastructure investment such as for renewable energy, like solar, wind and others. A case could also be made for a BRICS bank to finance innovation regarding both the adaptation of technologies already developed to the conditions of emerging and developing economies and, even more ambitiously, the development of such innovation in the borrowing countries themselves. In this regard, the EIB’s experience in allocating an increasingly large share of its financing to innovation could provide useful lessons.

Furthermore, given that there are unmet needs in other sectors in developing and emerging economies (like lending to SMEs, which is crucial for growth and employment, as well as financing innovation and innovative firms which is key for increasing productivity) and the risk-reducing effects of having a diversified portfolio, this may in future justify that the BRICS bank expands its scope into other sectors, like lending via commercial or development banks to SMEs.

As regards the infrastructure and sustainable development sector, the overall un-met needs are massive, as discussed above. Firstly, this means that the scale of lending of the BRICS bank needs to be large
enough to make a meaningful impact. Below we discuss estimates for how much lending can be generated by a particular level of capital of a BRICS bank. Furthermore, the impact of a BRICS bank must be measured in terms of its capacity to leverage, through its co-financing of projects with the private and public sectors. National and regional development banks – as well as the World Bank – will be natural partners. It is interesting to note that regional or multilateral development banks are often most successful in those countries that have efficient and well-established national development banks. This is because of the valuable synergies between them with, for example, national development banks having greater local knowledge of national projects and local regulations as well as risks, and international or regional institutions having greater comparative experience of best international or regional practice, regarding engineering, design and financial packaging. An example was given in interviews with EIB senior management, who argued that outside Europe, the EIB found it particularly productive to work with countries like Turkey, because Turkey has a well-functioning national development bank.²

An important issue is the quality of the loans made. There is a potential trade-off here between the speed of growth of a portfolio of loans and the quality of loans. Though the scale of operations is clearly important, a high quality of loans is an important priority as it maximizes the likely development impact of the projects and minimizes the risk of default on loans; the latter is important for improving the credit rating of the BRICS bank. It is also important for ensuring that a BRICS bank makes profits on its loans, as those profits can be reinvested in the BRICS bank, allowing an expansion of capital, which will facilitate increased lending in the future (see below).

Initial speed in building up a portfolio of loans should not be at the expense of the quality of projects. Devoting resources to project preparation, including with financial resources provided by a BRICS bank, is a key component for improving the quality of projects. Rigorous evaluation of projects by the BRICS bank, as well as a strong professional approach to such evaluations, is extremely important. Autonomy of management of a BRICS bank for approving only technically well-designed projects is important. Indeed, the EIB and CAF pride themselves that their decision-making process is reportedly autonomous in that sense.³

A second important issue is the degree of financial “sophistication” of the instruments used. Firstly, the more complex the products, the longer they take to be designed and implemented. So-called “plain vanilla” loans can be made much faster than more complicated loan structures. Transactions involving equity take even longer (though they have desirable features, such as capturing part of the “upside” if projects are very profitable). Therefore beginning with simple products can help quickly build up a portfolio of assets. Secondly, the experience of the North Atlantic crisis (as the so-called global financial crisis can more precisely be labelled) that started in 2007–2008 indicates that complexity often breeds opaqueness and leads to greater risk and future losses, linked to the financial engineering and hidden excessive leverage. Indeed, though a BRICS bank may wish to assume greater project risks (e.g. investing in projects with less tested technologies, or investing in very poor countries, with weak existing infrastructure) when these projects have potential large developmental or other benefits, it should avoid taking purely financial risks that could lead to substantial losses. We refer to purely financial losses, in the sense of those instruments, like those that have higher embedded leverage, that can create higher returns, but also potentially very high losses. Public development banks should not be in the business of taking on such excessive financial risk, which has had such disastrous effects on private banks.

For the above reasons, simplicity of instruments seems desirable, especially in the initial phases of a BRICS bank, which is probably the opposite advice to what investment bankers will give a BRICS bank. Simplicity and transparency should also characterize the investments that a BRICS bank makes with any surplus liquid funds. The search for high short-term profits made some development banks (both

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² I am grateful to Matthias Kollatz, but also others, for making this point.
³ Interviews with senior management of both EIB and CAF.
national, such as some of the German Landesbanken, as well as regional ones) invest in assets that later led to major losses, during the North Atlantic financial crisis. This should be avoided by a BRICS bank.

**B. Capital level**

As reported in the press, officials from Brazil, the Russian Federation, India, China and South Africa have agreed to set up the BRICS bank with a total capital of US$50 billion, shared equally among them (for example, Wall Street Journal, 28 August 2013). It has also been reported that 20 per cent of this capital, or US$10 billion, would be paid-in. One proviso which should be mentioned here is that, once the BRICS bank is established, BRICS countries could consider making additional contributions to already paid-in capital, i.e. beyond the initial US$10 billion; this would have the advantage of generating future lending capacity in addition to that estimated below.

One option that has been discussed in this context is that non-BRICS countries (emerging and developing, as well as developed ones) could also contribute capital – either right at the beginning or only after the bank has been established. Assuming a total capital endowment of US$100 billion, of which 20 per cent would have been paid in, the level of annual lending could reach, after 20 years, a stock of loans of up to US$350 billion, equivalent to about US$34 billion annually. The latter amount could be used for investment projects worth at least US$68 billion annually, given that there would be co-financing by private and public lenders and investors. In what follows, we outline in detail levels of lending of a BRICS bank under different scenarios and assumptions.

To estimate the level of loans that such a capital endowment would generate, it is useful to look at similar development banks. One valuable precedent is provided by the CAF, though the credit rating of BRICS countries, especially China, is somewhat higher than that of CAF member countries. Nevertheless, the CAF has the advantage of being an institution with a long and very positive track record, including the fact that none of its borrowers has ever defaulted on any of its loans. In the period between 2007 and 2012, the average ratio of the total portfolio of CAF loans divided by its total available capital was 2.4. Here total available capital is defined as paid-in capital plus reserves and retained profits plus surplus capital.

In the case of the BRICS bank, we can assume that in the first year there would be no retained profits, but these could start building up. Assuming paid-in capital to amount to US$10 billion, which is 20 per cent of the US$50 billion of total capital in principle agreed by BRICS leaders, and applying the same leverage ratio as that of the CAF, the initial stock of loans that could be achieved would be US$24 billion. Further assuming the average loan maturity to be ten years, the average annual loan level could be US$2.4 billion. In this context we are assuming that lending would be based only on actually available capital, i.e. paid-in capital, given the priority to achieve a high rating (and the fact that rating agencies tend not to consider callable capital as a base for lending, though an effort should be made to persuade rating agencies that callable capital should also be given some weight, especially as several of the BRICS countries are highly rated). The high rating would allow a low cost of borrowing on international capital markets.

However, if we assume that the BRICS bank could make a return on its lending of, for example, five per cent, the accumulated profits could reach US$0.12 billion the first year; if the profits were immediately retained and thus added to available capital, lending the next year could be five per cent higher. Therefore, profits in the second year would also be five per cent higher, which would further increase capital. By the power of compound interest, after a period of ten years, the total stock of accumulated lending would reach US$34 billion, and total available capital would reach US$14 billion. Therefore, annual lending could reach US$3.4 billion. After a period of 20 years, the total stock of lending could reach US$86 billion and total available capital would have increased to US$36 billion. By that time, therefore, annual lending

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4 I thank German Rios, CAF representative in Europe, for providing this information.
could have gone up to almost US$9 billion. It may be desirable to discuss in detail these options with rating agencies to explore what the impact would be for different levels of capital, and whether some additional weighting could be given to callable capital being allowed as a base for additional lending, as would seem logical, given the fairly high ratings of BRICS member Governments; all of them have investment grade, according to Moody’s, as can be seen in table 1.

However, the BRICS bank could lend more if it was less concerned about its initial rating, and therefore about the cost of its funds in the market and the cost of its loans. Assuming its leverage ratio to be double that of CAF, its initial lending capacity would be US$48 billion; when profits were accrued and reinvested on an annual basis (following the same logic and formula as in the previous paragraph), the BRICS bank could, after a period of ten years, reach a total stock of lending amounting to US$68 billion and its total available capital would reach US$28 billion; this would imply a level of US$7 billion of annual lending capacity, if still assuming ten year average maturity of loans. After a period of 20 years, the total stock of lending could reach US$172 billion and the total available capital would have reached US$72 billion. This would mean a level of net lending of nearly US$18 billion annually. Furthermore, part of the financing of the loans by the BRICS banks could possibly be funded by sources other than the international capital markets, such as Sovereign Wealth Funds, that may be less dependent on the rating of credit rating agencies, which could further increase its lending capacity.

The levels of loans could be even higher once a payment record was established by the BRICS bank that would increase its ratings above that of its member countries, as has occurred in the case of the CAF, which has traditionally had higher ratings than its member countries. More recently the EIB has maintained its AAA rating whilst several of its member governments have lost their AAA rating as a result of the European sovereign debt crisis. Another reason why development banks have higher ratings for the bonds they issue than their member governments is that their bonds are issued against their asset book, such as infrastructure projects, which have concrete value.

Furthermore, if as discussed below, developed economies with higher ratings were also to contribute some (minority) capital, the rating of the BRICS bank would increase further. Care would be needed to ensure that these were developed countries with a rating higher than that of the BRICS countries, and likely to remain high. This warning emerges from the fact that the CAF has developed country members, such as Spain and Portugal (initially invited partly to provide higher rating to the CAF), that now have a lower rating than the CAF itself!

An alternative route to raise the rating of the BRICS bank could be to increase the proportion of capital contributed by the Government of China, which Moody’s has given a very high rating – Aa3 in April 2013, which is equivalent to investment grade, high quality and very low credit risk (see again table 1).

<table>
<thead>
<tr>
<th>Country</th>
<th>Rating</th>
<th>Date</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>Baa2</td>
<td>June 2011</td>
<td>Investment grade. Medium, moderate credit risk</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>Baa1</td>
<td>March 2013</td>
<td>Investment grade. Medium, moderate credit risk</td>
</tr>
<tr>
<td>India*</td>
<td>Baa3</td>
<td>December 2011</td>
<td>Investment grade. Medium, moderate credit risk</td>
</tr>
<tr>
<td>China</td>
<td>Aa3</td>
<td>April 2013</td>
<td>Investment grade. High quality and very low credit risk</td>
</tr>
<tr>
<td>South Africa</td>
<td>Baa1</td>
<td>July 2013</td>
<td>Investment grade. Medium, moderate credit risk</td>
</tr>
</tbody>
</table>

Source: Moody’s (2013).

For India, the rating is for domestic long-term issuer.
If China were to account for a higher share of paid-in capital, additional advantages would emerge (such as a higher level of total paid-in capital, given that China commands such high levels of reserves, which could then lead to higher levels of lending by the BRICS bank), but also the potential disadvantage of creating excessive dominance by China in the governance and decision-making of the BRICS bank. However, if capped – as was the case for the initial phases of the EIB with the share of German and French paid-in capital – a somewhat higher share of Chinese paid-in capital in the total of the BRICS bank could have two advantages. It would expand total paid-in capital and thus directly increase potential level of loans from the start, for a given leverage. This is highly desirable, given the large scale of unmet needs in infrastructure described above. Secondly, it could improve the rating of the BRICS bank, and thus expand the leverage allowed for a given level of capital, without increasing the cost of raising funds in the market. This higher share and level of China’s contribution to paid-in capital would thus increase the potential level of loans through two channels.

Last but not least, other emerging and developing countries could be allowed to participate as members of the BRICS bank. This would broaden the Bank’s membership base, and give voice also to all or most potential borrowers, thus improving significantly the governance of the BRICS bank, which should be an important consideration. As we discuss below, a BRICS bank would increase the weight of BRICS countries in global governance of development finance institutions, which will be very positive, but it should also give sufficient weight in its own governance to other developing and emerging economies. Furthermore, including other emerging and developing economies in the governance of the bank could also increase fairly significantly the level of paid-in capital. It could be objected that this expansion of membership could lower the rating of the Bank. However, if only paid-in capital is considered for calculating the leverage and the maximum of stock of loans, the value of the cash contribution of lower rated countries is the same as the cash contribution of that of higher rated governments (Griffith-Jones, Steinherr and Fuzzo de Lima, 2006). As the Romans said, “pecunia non olet” (money does not smell). Furthermore, it is worth remembering in this context that all countries (including low-income ones) are members of the World Bank, and this institution has AAA rating.

Thus, once the capital of both non-BRICS emerging and developing economies, as well as the minority share for developed economies were added, initial total capital could go up to US$100 billion and paid-in capital could increase to US$20 billion. This would mean an initial level of total lending of almost US$50 billion – that is US$5 billion annually initially – with accumulated profits reinvested in contributed capital. After a period of ten years, the bank could be lending US$7 billion annually. Assiming leverage to be double that of the CAF, annual lending capacity could, by that year, reach an annual amount of US$14 billion. In that case, after a period of 20 years, it could be lending up to US$34 billion annually, and the stock of total loans would reach almost US$350 billion.

This would imply that after a period of 20 years the level of lending of the BRICS bank would become comparable to the current total level of annual EIB lending, which in 2012 reached US$60 billion, with its lending for infrastructure reaching US$32 billion (figure 4). The EIB is the largest regional development bank (the CAF lent US$9.3 billion in total in 2012, see figure 4) and is far larger than the World Bank in its level of lending, as total World Bank lending in 2012 reached US$35 billion, with US$22 billion reportedly going to infrastructure (figure 4). Therefore, under this scenario, in year 20 the BRICS bank would lend as much as the World Bank does now, and almost four times the lending of the CAF.

An objection to the above reasoning could be that such a level of BRICS bank lending would build up only slowly. However, it is interesting to note in this context that the level of EIB lending started at a low level in the first decade of its existence (1959–1968), only to increase exponentially thereafter. Thus, in the first decade, average annual lending – expressed in constant 2003-Euros – reached only around €0.8 billion per year; this was in sharp contrast with 2003, when EIB lending had reached €42.3 billion just in that year. This development of the level of annual lending is related to the expansion of lending to original members, increased lending due to augmented membership in the EU, and lending to new sectors (Griffith-Jones, Steinherr and Fuzzo de Lima, 2006). Whilst initial EIB lending levels and the
initial growth of this lending may have been too low, it may partly be explained by the need to build up operations relatively gradually, gain experience in the field and focus on economically viable projects, as well as by restrictions linked to capital. The BRICS bank will be able to grow faster than the EIB did originally, also because it can build on the experience of so many successful national and regional banks (including those owned mainly by developing countries, such as the CAF), as well as that of the World Bank.

It should be emphasized that the total investment financed by BRICS bank lending would be significantly higher than the level of loans described above. Like other development banks, a BRICS Bank would finance no more than half of the total project cost, with the remainder being co-financed by other sources, such as private and/or national development bank lending, as well as private investors. For example, the EIB provides approximately one-third of financing for a given project, serving as a catalyst for banks, financial institutions and private sector entities to participate in the investment. Indeed, EIB loans and those of other multilateral and regional development banks, often have a positive signalling effect to both private banks and to other financing partners (such as equity investors) that a project has been carefully evaluated and is likely to be successful. A similar catalytic effect would be created by a BRICS bank. So if, after a period of 20 years, a BRICS bank was funding US$34 billion by year, as in the more ambitious scenario above, it could help funding projects of at least US$68 billion annually, which is a significant amount.

The option of including developed countries as minority shareholders in BRICS capital has reportedly begun to be discussed within the BRICS group. Having developed economies as shareholders would have the positive effect of helping the bank get a higher credit rating and enabling it to raise cheaper funds from the market. However, it would defeat the purpose of having a purely South-South institution, though having a minority stake for developed economies would imply a BRICS bank would still be different from existing development banks that have a majority or equal share of developed countries in their capital structure.

A final problem could be that developed countries may in the future be more reluctant than BRICS countries to expand the capital of a BRICS bank than BRICS nations themselves, as has been the case for the expansion of international financial and development institutions in recent years. In those situations,
special capital increases only by developing and emerging countries could be implemented, but it may be important to include such a provision in the BRICS bank’s initial Articles of Agreement. Doing so would be easier than in existing development banks, given that developing countries would have the majority of votes. From the perspective of developed countries, it may be desirable to participate in a BRICS bank, even in a minority position, as it would allow them some involvement and influence in this bank, which may be important for them.

As pointed out, another issue which has been reportedly discussed is whether other emerging economies, such as for example Turkey, Mexico or Indonesia, could join the membership of the BRICS bank (see, for example, Conway-Smith, 2013). This would be beneficial, not just because total capital would be larger, but the range of expertise available would be broader and governance would be more inclusive.

It may be desirable for the BRICS to create the bank on their own as negotiations may be less complex and therefore quicker. However, there should clearly be an option for broadening the membership left open for the future, and provisions could be easily made for such broadening when the BRICS bank is created. Indeed, the EIB was created by only six countries, i.e. the six original members of the then European Community, later to become the European Union (see below). Similarly, the CAF was created by the few countries integrating the Andean Community. Both regional banks have seen their membership expand significantly, automatically as EU membership was expanded in the case of the EIB, and a more ad-hoc increase of membership in the case of the CAF, due largely to its excellent performance.

We will detail the EIB experience, which as mentioned is to some extent particular, as the EIB’s membership is directly linked to membership of the EU. However, lessons can be extracted for the BRICS bank, but adapted to their circumstances. At the time of its establishment under the Treaty of Rome in 1957, the EIB had six founding members – Belgium, France, Germany, Italy, Luxembourg and the Netherlands. The subsequent growth in EIB membership has reflected EU enlargement, with countries becoming EIB members when joining the European Community. The United Kingdom, Ireland and Denmark joined in the early 1970s, followed by Greece, Spain and Portugal in the 1980s. Austria, Sweden and Finland acceded in the 1990s, as did another thirteen countries in the 2000s, mainly from Central and Eastern Europe. Today, the 28 Member States of the EU constitute the EIB’s shareholders. Each member’s share in the Bank’s capital is based on that country’s economic weight within the EU at the time of its accession. As mentioned above, a single shareholder cap of 16.2 per cent was instituted so that the four largest economies (France, Germany, Italy and then the United Kingdom) would all have equal shareholding. This idea of capping the voting share of a particular country could have some relevance for the BRICS bank, though the differences in size between the BRICS countries are far bigger than those between France, Germany, Italy and the United Kingdom.

Finally, there is the issue of whether developing countries (including low-income ones), which would also be important borrowers of a BRICS bank, should be allowed to contribute capital, and therefore participate in the governance of a BRICS bank. This would have the clear advantage of a more balanced approach between lenders and borrowers, as well as give voice to the borrowing countries, making for both a more democratic and more effective institution. As pointed out, it would also increase the paid-in capital of the bank.

BRICS countries may wish to limit the number of participating countries, especially in an initial period of, say, ten years. For example, they could say that the share of all non-BRICS countries should always be less than 50 per cent, so the BRICS would maintain a majority of votes. They could also decide that the President of the bank should always be from a BRICS country. Especially if there is a somewhat larger proportion of capital contributed by China, there could be a strong case for the President of the BRICS bank to be Chinese; this could be just the first President, and then there could be rotation amongst BRICS countries, or it could be a permanent Chinese position.

Most likely, the headquarters of the bank could also be in a BRICS country. The World Bank had its headquarters established in the capital of the country that provided the largest share of the capital. Though
There is an assumption that the BRICS bank paid-in capital would be funded equally by the five BRICS countries, in practice, as pointed out above, it seems likely that China would contribute more resources. If the World Bank model was followed, then the headquarters of the new bank could be in China, possibly in a city like Shanghai or Hong Kong, with deep capital markets. This would have the advantage for the bank of have easy access to those capital markets and of access to financial expertise widely available in those centres. It would have the advantage for that financial centre, and for China – as well as for emerging economies more generally – of contributing to the further deepening of that financial market. It would also facilitate lending to Asian countries. However, there may be an advantage of having the headquarters of the new bank in a borrowing country, and one that could serve as a hub for other borrowers. This would point to the advantage of having the headquarters in South Africa, which would also facilitate close access to neighbouring sub-Saharan African countries, with large infrastructure needs. Furthermore, if China were to have the Presidency of the BRICS bank, it may be desirable for it to be headquartered in another country, to have a more balanced influence by different countries.

However, if the choice of the country where the bank should be headquartered became a bone of contention, a non-BRICS developing or emerging economy could possibly become headquarters of the bank. It would seem clearly important that the headquarters of this bank should not be in a developed economy, though of course important representative offices would be valuable in those countries, especially those where major financial markets are based and where there is significant expertise in the engineering and technical aspects of infrastructure.

C. Geographical coverage of lending

It seems clear that a BRICS bank would lend to both BRICS countries themselves and to other developing countries. Furthermore, it would seem desirable for the BRICS bank to have a balanced portfolio of loans that includes both middle-income and low-income countries from different regions, as this would be seen to make the bank more creditworthy, both because middle-income countries may be – or perceived to be – more creditworthy than low-income ones, and because it would ensure the benefits of geographical diversification that lowers risk, as problems in countries across regions are less correlated.

Clearly, however, sub-Saharan African countries have particularly large unmet infrastructure needs, and therefore there seems to be a case for greater priority to be given to lending to projects in that region. For lending to low-income countries, there could be a case for providing some subsidy element to make the loans concessional. One possibility for funding such a subsidy in the case of loans linked to more sustainable development would be to use international funds allocated for this purpose to finance the subsidy part of the loans, with the BRICS bank providing the loan itself. The rest could be financed by trust funds, funded by developed countries, in the context of existing international agreements.

D. Links with other multilateral, regional and national development banks

It seems important to think in terms of a system where synergies and complementarities exist between international, regional and national development banks. A BRICS bank would provide a valuable addition to that network of banks. It is evident that multilateral and regional development banks seem to perform far better their functions, including support for productive development through infrastructure investment, if they work closely with national development banks, which have far greater local knowledge. Moreover, such close collaboration also reduces asymmetries of information at the national level. Similarly, national development banks can operate better, if they have the financial and technical support of multilateral banks, such as the BRICS bank will be. There has been a lot of emphasis on public-private financial partnerships, but equally or even more important are the links between multilateral, regional and national development banks. An important advantage of the BRICS bank will be that this modus operandi – of close collaboration with national development banks – can be established right at its inception. Of course close collaboration with existing regional development banks and with the World Bank would also be an important feature of the BRICS bank.
A BRICS bank can initially benefit from the experience and expertise of existing development banks, like the CAF and EIB at a regional level, and for example, the Brazilian Banco Nacional de Desenvolvimento Econômico e Social, the German Development Bank (KfW), the South African Industrial Development Corporation, the Chinese Development Bank as well as others at the national level. Clearly the development banks of the BRICS countries themselves, especially in aspects where they have been successful, will also play a particularly large role in providing a model of best practice for the BRICS bank. At a later stage, the BRICS bank can play an important role in strengthening, as well as co-operating with national and regional development banks, especially in sub-Saharan Africa. Modalities of co-operation can, in the case of regional and national development banks, include co-financing with these institutions on bigger projects; in the case of national development banks, on-lending operations (especially where small and medium enterprise financing was involved, but also more broadly) would be desirable. There may be a case for some technical cooperation, once the BRICS bank is well established, to regional or national development banks in poorer regions.

It is interesting that the mere proposal of a BRICS bank has reportedly encouraged a new proposal by the World Bank Group to launch a separate large Fund for Infrastructure financing in sub-Saharan Africa, which would have a separate governance structure than that of the World Bank, with greater participation for developing and emerging economies, and would provide additional funding for much needed infrastructure. The fact that the BRICS bank, even before formally created, is already catalysing an expansion and improvement of World Bank initiatives is to be welcomed. It illustrates how the creation of a BRICS bank will generate, both through competition as well as complementarities, valuable externalities in the rest of the development finance institutions, as well as of course by making a major direct significant contribution through its own lending. More broadly, the development of large and effective BRICS institutions, like the Contingent Reserve Arrangement and the BRICS bank, can be a valuable platform for the BRICS advancing reforms in the international financial and development architecture that favour developing and emerging countries in general. Scale of the new institutions, as well as speed in establishing them, and making them effective, will significantly enhance such potential bargaining power for encouraging meaningful reform.

V. CONCLUSIONS

Emerging and developing countries have significantly increased their weight in global GDP and in global economic growth. Perhaps most importantly, some emerging and developing economies have accumulated very large long-term foreign exchange assets, which they have typically placed in Sovereign Wealth Funds. A large part of these resources are invested in developed countries, with relatively low yields.

At the same time, there are very large unmet needs in the emerging and developing countries in the field of infrastructure and more environmentally sustainable forms of development. A shortfall of investment of approximately US$1 trillion annually has been identified by Bhattacharya, Romani and Stern (2012), beyond what is likely to be financed with current institutions.

Emerging and developing countries have the necessary savings and foreign exchange reserves to finance a new development bank that could contribute to finance such investment. The fact that the leaders of the BRICS nations have committed to the creation of a new Development Bank for infrastructure and sustainable development is very welcome. This institution would be a complement, not a substitute, for existing financial institutions both in the public and the private sector. Its existence would also strengthen the voice of developing and emerging economies in the development finance architecture.

It is encouraging that BRICS leaders have also proposed the creation of other institutions, such as the Contingency Reserve Arrangements (CRA), amongst BRICS countries, which would provide official liquidity in times of need.
There are important similarities with other development banks in their initial phases, such as the World Bank, which also started life focusing on infrastructure. There is a strong case for a major step increase in investment in infrastructure and more sustainable development, based on the need for growth, structural change, inclusion as well as sustainability and resilience.

The scale of lending of the BRICS bank needs to be large enough to make a meaningful impact given the very large scale of needs identified. Furthermore, the impact of a BRICS bank must be measured in terms of its capacity to leverage, through its co-financing of projects with the private and public sectors. National and regional development banks, as well as the World Bank, will be natural partners.

An important issue is the quality of the loans made. There is a potential trade-off between the pace of growth of a portfolio of loans and the quality of loans. Though scale of operations is clearly important, a high quality of loans is a priority as it maximizes the likely development impact of the projects and minimizes risk of default; the latter is key for improving the credit rating of the BRICS bank. It is also important that a BRICS bank make profits on its loans, as those can be reinvested, allowing an expansion of capital, which will facilitate increased lending.

A second issue is the degree of financial “sophistication” of the instruments used. Firstly, the more complex the products, the longer they take to be designed and implemented. So-called “plain vanilla” loans can be made much faster than more complicated loan structures. Transactions involving equity take even longer (though they have desirable features, such as capturing part of the “upside” if projects are very profitable). Secondly, the experience of the North Atlantic crisis indicates that complexity often breeds opaqueness and leads to greater risk and future losses. Indeed, though a BRICS bank may wish to assume greater project risks (e.g. investing in very poor countries) when these projects have potential large developmental or other benefits, it should avoid taking purely financial risks that could lead to substantial losses.

It has been reported that officials from Brazil, the Russian Federation, India, China and South Africa have agreed to set up the BRICS bank with a total capital of US$50 billion of which 20 per cent or US$10 billion would be paid-in.

One possible option discussed is that non-BRICS countries (emerging and developing, as well as developed ones) could also contribute capital – either right at the beginning or after the bank has been established. Assuming a total capital endowment of US$100 billion, of which 20 per cent would have been paid in, the level of annual lending could – according to preliminary estimates made above – reach, after 20 years, a stock of loans of up to US$350 billion, equivalent to about US$34 billion annually. The latter amount could be used for investment projects worth at least US$68 billion annually, given that there would be co-financing by private and public lenders and investors.

It may be desirable for the BRICS to create the bank on their own as negotiations may be less complex and therefore quicker. However, there could be an option for broadening the membership left open for the future, and provisions could be easily made for such broadening when the BRICS bank would be created.

A BRICS development bank would lend to both the BRICS countries themselves and to other developing countries. Furthermore, it would be desirable for it to have a balanced portfolio of loans that includes middle- and low-income countries from different regions, as this would make the bank more creditworthy, both because middle-income countries may be more creditworthy than low-income ones, and because it would ensure the benefits of geographical diversification.

A BRICS bank would provide a valuable addition to the existing network of multilateral, regional and national development banks. Multilateral and regional development banks seem to perform far better their functions, including support for productive development through infrastructure investment, if they work closely with national development banks, which have far greater local knowledge. Similarly, national
development banks can operate better, if they have the financial and technical support of banks, such as the BRICS bank will give.

A BRICS bank can initially benefit from the experience and expertise of existing development banks, like the CAF and EIB at a regional level, and for example, the Brazilian BNDES, the German Development Bank (KfW), the South African Industrial Development Corporation, the Chinese Development Bank as well as others at the national level.

The development of large and effective BRICS institutions, like the BRICS bank and the Contingent Reserve Arrangement, can provide a valuable platform for the BRICS advancing reforms in the international financial and development architecture that favour developing and emerging countries in general. Scale of the new institutions, as well as speed in establishing them, will significantly enhance such potential bargaining power for encouraging meaningful reform.

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<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>Author(s)</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>214</td>
<td>December 2013</td>
<td>Jörg Mayer</td>
<td>Towards more balanced growth strategies in developing countries: Issues related to market size, trade balances and purchasing power</td>
</tr>
<tr>
<td>213</td>
<td>November 2013</td>
<td>Shigehisa Kasahara</td>
<td>The Asian developmental State and the Flying Geese paradigm</td>
</tr>
<tr>
<td>212</td>
<td>November 2013</td>
<td>Vladimir Filimonov, David Bicchetti, Nicolas Maystre and Didier Sornette</td>
<td>Quantification of the high level of endogeneity and of structural regime shifts in commodity markets</td>
</tr>
<tr>
<td>211</td>
<td>October 2013</td>
<td>André Nassif, Carmem Feijó and Eliane Araújo</td>
<td>Structural change and economic development: Is Brazil catching up or falling behind?</td>
</tr>
<tr>
<td>210</td>
<td>December 2012</td>
<td>Giovanni Andrea Cornia and Bruno Martorano</td>
<td>Development policies and income inequality in selected developing regions, 1980–2010</td>
</tr>
<tr>
<td>209</td>
<td>November 2012</td>
<td>Alessandro Missale and Emanuele Bacchiocchi</td>
<td>Multilateral indexed loans and debt sustainability</td>
</tr>
<tr>
<td>208</td>
<td>October 2012</td>
<td>David Bicchetti and Nicolas Maystre</td>
<td>The synchronized and long-lasting structural change on commodity markets: Evidence from high frequency data</td>
</tr>
<tr>
<td>207</td>
<td>July 2012</td>
<td>Amelia U. Santos-Paulino</td>
<td>Trade, income distribution and poverty in developing countries: A survey</td>
</tr>
<tr>
<td>206</td>
<td>December 2011</td>
<td>André Nassif, Carmem Feijó and Eliane Araújo</td>
<td>The long-term “optimal” real exchange rate and the currency overvaluation trend in open emerging economies: The case of Brazil</td>
</tr>
<tr>
<td>205</td>
<td>December 2011</td>
<td>Ulrich Hoffmann</td>
<td>Some reflections on climate change, green growth illusions and development space</td>
</tr>
<tr>
<td>204</td>
<td>October 2011</td>
<td>Peter Bofinger</td>
<td>The scope for foreign exchange market interventions</td>
</tr>
<tr>
<td>203</td>
<td>September 2011</td>
<td>Javier Lindenboim, Damián Kennedy and Juan M. Graña</td>
<td>Share of labour compensation and aggregate demand discussions towards a growth strategy</td>
</tr>
<tr>
<td>202</td>
<td>June 2011</td>
<td>Pilar Fajarnes</td>
<td>An overview of major sources of data and analyses relating to physical fundamentals in international commodity markets</td>
</tr>
<tr>
<td>201</td>
<td>February 2011</td>
<td>Ulrich Hoffmann</td>
<td>Assuring food security in developing countries under the challenges of climate change: Key trade and development issues of a fundamental transformation of agriculture</td>
</tr>
<tr>
<td>200</td>
<td>September 2010</td>
<td>Jörg Mayer</td>
<td>Global rebalancing: Effects on trade flows and employment</td>
</tr>
<tr>
<td>199</td>
<td>June 2010</td>
<td>Ugo Panizza, Federico Sturzenegger and Jeromin Zeettelmeyer</td>
<td>International government debt</td>
</tr>
<tr>
<td>198</td>
<td>April 2010</td>
<td>Lee C. Buchheit and G. Mitu Gulati</td>
<td>Responsible sovereign lending and borrowing</td>
</tr>
<tr>
<td>197</td>
<td>March 2010</td>
<td>Christopher L. Gilbert</td>
<td>Speculative influences on commodity futures prices 2006–2008</td>
</tr>
<tr>
<td>196</td>
<td>November 2009</td>
<td>Michael Herrmann</td>
<td>Food security and agricultural development in times of high commodity prices</td>
</tr>
<tr>
<td>195</td>
<td>October 2009</td>
<td>Jörg Mayer</td>
<td>The growing interdependence between financial and commodity markets</td>
</tr>
<tr>
<td>194</td>
<td>June 2009</td>
<td>Andrew Cornford</td>
<td>Statistics for international trade in banking services: Requirements, availability and prospects</td>
</tr>
<tr>
<td>No.</td>
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<tr>
<td>193</td>
<td>January 2009</td>
<td>Sebastian Dullien</td>
<td>Central banking, financial institutions and credit creation in</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>developing countries</td>
</tr>
<tr>
<td>192</td>
<td>November 2008</td>
<td>Enrique Cosio-Pascal</td>
<td>The emerging of a multilateral forum for debt restructuring: The Paris</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Club</td>
</tr>
<tr>
<td>191</td>
<td>October 2008</td>
<td>Jörg Mayer</td>
<td>Policy space: What, for what, and where?</td>
</tr>
<tr>
<td>190</td>
<td>October 2008</td>
<td>Martin Knoll</td>
<td>Budget support: A reformed approach or old wine in new skins?</td>
</tr>
<tr>
<td>189</td>
<td>September 2008</td>
<td>Martina Metzger</td>
<td>Regional cooperation and integration in sub-Saharan Africa</td>
</tr>
<tr>
<td>188</td>
<td>March 2008</td>
<td>Ugo Panizza</td>
<td>Domestic and external public debt in developing countries</td>
</tr>
<tr>
<td>187</td>
<td>February 2008</td>
<td>Michael Geiger</td>
<td>Instruments of monetary policy in China and their effectiveness:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1994–2006</td>
</tr>
<tr>
<td>186</td>
<td>January 2008</td>
<td>Marwan Elkhoury</td>
<td>Credit rating agencies and their potential impact on developing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>countries</td>
</tr>
<tr>
<td>185</td>
<td>July 2007</td>
<td>Robert Howse</td>
<td>The concept of odious debt in public international law</td>
</tr>
<tr>
<td>184</td>
<td>May 2007</td>
<td>André Nassif</td>
<td>National innovation system and macroeconomic policies: Brazil and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>India in comparative perspective</td>
</tr>
<tr>
<td>183</td>
<td>April 2007</td>
<td>Irfan ul Haque</td>
<td>Rethinking industrial policy</td>
</tr>
<tr>
<td>182</td>
<td>October 2006</td>
<td>Robert Rowthorn</td>
<td>The renaissance of China and India: implications for the advanced</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>economies</td>
</tr>
<tr>
<td>181</td>
<td>October 2005</td>
<td>Michael Sakbani</td>
<td>A re-examination of the architecture of the international economic</td>
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<td></td>
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<td>system in a global setting: Issues and proposals</td>
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<tr>
<td>179</td>
<td>April 2005</td>
<td>S.M. Shafaeddin</td>
<td>Trade liberalization and economic reform in developing countries:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>structural change or de-industrialization?</td>
</tr>
<tr>
<td>178</td>
<td>April 2005</td>
<td>Andrew Cornford</td>
<td>Basel II: The revised framework of June 2004</td>
</tr>
<tr>
<td>177</td>
<td>April 2005</td>
<td>Benu Schneider</td>
<td>Do global standards and codes prevent financial crises? Some</td>
</tr>
<tr>
<td></td>
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<td>proposals on modifying the standards-based approach</td>
</tr>
<tr>
<td>176</td>
<td>December 2004</td>
<td>Jörg Mayer</td>
<td>Not totally naked: Textiles and clothing trade in a quota free</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>environment</td>
</tr>
<tr>
<td>175</td>
<td>August 2004</td>
<td>S.M. Shafaeddin</td>
<td>Who is the master? Who is the servant? Market or Government?</td>
</tr>
<tr>
<td>174</td>
<td>August 2004</td>
<td>Jörg Mayer</td>
<td>Industrialization in developing countries: Some evidence</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>from a new economic geography perspective</td>
</tr>
<tr>
<td>173</td>
<td>June 2004</td>
<td>Irfan ul Haque</td>
<td>Globalization, neoliberalism and labour</td>
</tr>
<tr>
<td>172</td>
<td>June 2004</td>
<td>Andrew J. Cornford</td>
<td>The WTO negotiations on financial services: Current issues and future</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>directions</td>
</tr>
<tr>
<td>171</td>
<td>May 2004</td>
<td>Andrew J. Cornford</td>
<td>Variable geometry for the WTO: Concepts and precedents</td>
</tr>
<tr>
<td>170</td>
<td>May 2004</td>
<td>Robert Rowthorn and Ken</td>
<td>De-industrialization and the balance of payments in advanced</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Coutts</td>
<td>economies</td>
</tr>
<tr>
<td>169</td>
<td>April 2004</td>
<td>Shigehisa Kasahara</td>
<td>The flying geese paradigm: A critical study of its application to</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>East Asian regional development</td>
</tr>
<tr>
<td>168</td>
<td>February 2004</td>
<td>Alberto Gabriele</td>
<td>Policy alternatives in reforming power utilities in developing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>countries: A critical survey</td>
</tr>
<tr>
<td>167</td>
<td>January 2004</td>
<td>Richard Kozul-Wright and</td>
<td>Globalization reloaded: An UNCTAD Perspective</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Paul Rayment</td>
<td></td>
</tr>
<tr>
<td>166</td>
<td>February 2003</td>
<td>Jörg Mayer</td>
<td>The fallacy of composition: A review of the literature</td>
</tr>
<tr>
<td>165</td>
<td>November 2002</td>
<td>Yuefen Li</td>
<td>China’s accession to WTO: Exaggerated fears?</td>
</tr>
<tr>
<td>No.</td>
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<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>164</td>
<td>November 2002</td>
<td>Lucas Assuncao and Zhong Xiang Zhang</td>
<td>Domestic climate change policies and the WTO</td>
</tr>
<tr>
<td>163</td>
<td>November 2002</td>
<td>A.S. Bhalla and S. Qiu</td>
<td>China’s WTO accession. Its impact on Chinese employment</td>
</tr>
<tr>
<td>162</td>
<td>July 2002</td>
<td>Peter Nolan and Jin Zhang</td>
<td>The challenge of globalization for large Chinese firms</td>
</tr>
<tr>
<td>161</td>
<td>June 2002</td>
<td>Zheng Zhihai and Zhao Yumin</td>
<td>China’s terms of trade in manufactures, 1993–2000</td>
</tr>
<tr>
<td>160</td>
<td>June 2002</td>
<td>S.M. Shafaeddin</td>
<td>The impact of China’s accession to WTO on exports of developing countries</td>
</tr>
<tr>
<td>159</td>
<td>May 2002</td>
<td>Jörg Mayer, Arunas Butkevicius and Ali Kadri</td>
<td>Dynamic products in world exports</td>
</tr>
<tr>
<td>158</td>
<td>April 2002</td>
<td>Yılmaz Akyüz and Korkut Boratav</td>
<td>The making of the Turkish financial crisis</td>
</tr>
<tr>
<td>157</td>
<td>September 2001</td>
<td>Heiner Flassbeck</td>
<td>The exchange rate: Economic policy tool or market price?</td>
</tr>
<tr>
<td>156</td>
<td>August 2001</td>
<td>Andrew J. Cornford</td>
<td>The Basel Committee’s proposals for revised capital standards: Mark 2 and the state of play</td>
</tr>
<tr>
<td>155</td>
<td>August 2001</td>
<td>Alberto Gabriele</td>
<td>Science and technology policies, industrial reform and technical progress in China: Can socialist property rights be compatible with technological catching up?</td>
</tr>
<tr>
<td>154</td>
<td>June 2001</td>
<td>Jörg Mayer</td>
<td>Technology diffusion, human capital and economic growth in developing countries</td>
</tr>
<tr>
<td>153</td>
<td>December 2000</td>
<td>Mehdi Shafaeddin</td>
<td>Free trade or fair trade? Fallacies surrounding the theories of trade liberalization and protection and contradictions in international trade rules</td>
</tr>
<tr>
<td>152</td>
<td>December 2000</td>
<td>Dilip K. Das</td>
<td>Asian crisis: Distilling critical lessons</td>
</tr>
<tr>
<td>151</td>
<td>October 2000</td>
<td>Bernard Shull</td>
<td>Financial modernization legislation in the United States – Background and implications</td>
</tr>
<tr>
<td>150</td>
<td>August 2000</td>
<td>Jörg Mayer</td>
<td>Globalization, technology transfer and skill accumulation in low-income countries</td>
</tr>
<tr>
<td>149</td>
<td>July 2000</td>
<td>Mehdi Shafaeddin</td>
<td>What did Frederick List actually say? Some clarifications on the infant industry argument</td>
</tr>
<tr>
<td>148</td>
<td>April 2000</td>
<td>Yılmaz Akyüz</td>
<td>The debate on the international financial architecture: Reforming the reformers</td>
</tr>
<tr>
<td>147</td>
<td>April 2000</td>
<td>Martin Khor</td>
<td>Globalization and the South: Some critical issues</td>
</tr>
<tr>
<td>146</td>
<td>February 2000</td>
<td>Manuel R. Agosin and Ricardo Mayer</td>
<td>Foreign investment in developing countries: Does it crowd in domestic investment?</td>
</tr>
<tr>
<td>145</td>
<td>January 2000</td>
<td>B. Andersen, Z. Kozul-Wright and R. Kozul-Wright</td>
<td>Copyrights, competition and development: The case of the music industry</td>
</tr>
</tbody>
</table>

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The postwar liberal international order (LIO) has been a largely US creation. Washington’s consensus, geopolitically bound to the western ‘core’ during the Cold War, went global with the dissolution of the Soviet Union and the advent of systemic unipolarity. Many criticisms can be levelled at US leadership of the LIO, not least in respect of its claim to moral superiority, albeit based on laudable norms such as human rights and democracy. For often cynical reasons the US backed authoritarian regimes throughout the Cold War, pursued disastrous forms of regime change after its end, and has been deeply hostile to alternative (and often non-western) civilizational orders that reject its dogmas. Its successes, however, are manifold. Its ‘empire by invitation’ has helped secure a durable European peace, soften east Asian security dilemmas, and underwrite the strategic preconditions for complex and pacifying forms of global interdependence.

Despite tactical differences between global political elites, a postwar commitment to maintain the LIO, even in the context of deep structural shifts in international relations, has remained resolute—until today. The British vote to leave the EU (arguably as much a creation of the United States as of its European members), has weakened one of the most important institutions of the broader US-led LIO. More destabilizing to the foundations of the LIO has been the election of President Trump. His administration has actively encouraged the breakup of the EU, questioned enduring US global security alliances such as NATO, and seen the advocacy of an economic nationalism that threatens to reverse globalization.1

If the dominant cultural paradigm of the early post-Cold War period was the end of history as a triumphant liberal internationalism flattened global geopolitical space, Trump’s victory represents the end of this interregnum: a rearticulation of the primacy of the nation-state, a fracture in the postwar liberal internationalist consensus and a hardening of geopolitical revisionism. Even if we dismiss President Trump’s statements as mere rhetoric, his capacity to motivate millions to vote for him, as well as broader centrifugal movements including Brexit, signal a

* For comments on earlier versions of this article, the author wants to thank Michael Cox, Kit Waterman, the participants of the roundtable on the liberal international order at the International Studies Association Annual Convention 2017 and the anonymous reviewers.

weakening of the postwar liberal consensus. In rejecting the Trans Pacific Partnership (TPP), seeking to reverse the longstanding North American Free Trade Agreement (NAFTA), and placing security partners on notice, the United States is now clearly asking why it should remain the world’s hegemonic stabilizer if the costs of maintaining that order far outweigh the benefits to itself. ‘It’s possible that we’re going to have to let NATO go,’ Trump argued; when ‘we’re paying and nobody else is really paying … you feel like the jerk.’ While it is undeniable that the United States has had to underwrite a number of costly global regimes, is Trump’s portrait accurate? The question is an important one, sitting at the heart of the administration’s cost–benefit analysis as it surveys the myriad American commitments across the globe, the reversal of which will have profound and lasting implications for world politics. In addressing that question, this article develops a number of arguments.

First, I sketch a nascent foreign policy world-view that we see developing under Trump: an ‘America First’ bilateralism founded on cost–benefit calculations. I then contrast this bilateralism with the longstanding US postwar globalism that, I argue, saw the hard-wiring of the American national interest into a systems-maintaining role. Given the order maintenance costs of performing this role, why would the United States choose to do so (Trump’s ‘jerk test’)? Drawing from hegemonic stability theory, the article identifies three types of explanation, each focusing on a particular type of hegemon: the benign hegemon, which is happy to lead and absorb costs; the coercive hegemon, which seeks to recover its costs from other states; and the structurally advantaged hegemon, which recovers more than its costs without resort to coercion through its positional advantages.

Second, the article argues that while system maintenance costs are rising, and the United States is in the throes of a slow relative decline, the US remains a structurally advantaged hegemon in a number of very important areas. These include the continued use of the dollar as a global reserve currency; the global security regimes in which it predominates, which provide it with leverage over other states’ geopolitical and economic choices; and the still overwhelming command capacity of the American economy, most notably in its continued preponderance in global foreign direct investment (FDI). As such, its postwar globalist grand strategy of deep engagement continues to make rational sense, not least as it gives the US leverage over the international regimes it underwrites. A reversal of this grand strategy would undermine not only this leverage but also, I argue, the world economic order, which remains centred on America. It is thus highly unlikely that the agency of Trump will overcome the deep structures and path dependencies that incline towards systemic maintenance. Although it is hard to predict how far Trump will seek to deviate from the postwar norm, or how much damage his learning curve will inflict on US leadership, it is likely that once his term is over, American elites will seek to ‘snap back’ to the status quo ante, given the goods the United States still derives from its hegemony.

2 Trump quote from Dan Goure, ‘Will President Trump renegotiate the NATO treaty?’, The National Interest, The Center for the National Interest, nationalinterest.org/blog/the-buzz/will-president-trump-renegotiate-the-nato-treaty-18647. (Unless otherwise noted at point of citation, all URLs cited in this article were accessible on 1 Oct. 2017.)
Third, I argue that American geopolitical primacy has allowed US elites to reshape the world in ways favourable to American interests, while other centres have also flourished under this system. This has presented problems. Paul Nitze expressed the dilemma clearly in the late 1950s: ‘The most difficult problem facing the formulators of United States foreign policy is that of relating and bringing into some measure of convergence policies appropriate to the coalition of free nations, the alliance system, and the United States as an individual nation.’

While it is highly unlikely that we will see deep structural changes in US objectives, the ‘liberal’ component of the LIO has, especially over the last three decades, often meant the promotion of a specific kind of neo-liberal global economy: free markets, deregulated forms of capitalism and the rolling back of state interference in the domestic economy. These changes have created new global winners and losers, with rising income inequality in the West weakening commitment to America’s hegemonic role. Rather than a rising China, a revisionist Russia or Islamic insurgency, it is this dual crisis of weakness in western strategic agency and in the social contract that poses the biggest threat to the LIO, not least as America still does so well out of the order it helped create. US elites may well wish to go back to the status quo ante; but, given the often negative effects of globalization for American living standards, the West, tied as it is to American leadership, will continue to suffer (often self-inflicted) systemic shocks.

The Trump world-view: transactional bilateralism

While it is still early days for the Trump administration, it is possible to sketch the development of an ‘America First’ world-view and foreign policy. In terms of security strategy, there is an interesting cleavage emerging between the President’s rhetoric and foreign policy reality. Rhetorically, he has clearly drawn from the American grand strategic tradition of retrenchment that seeks to rebalance the US’s sprawling global defence commitments or pass the buck to regional states. Posen captures the logic well: ‘The United States has grown incapable of moderating its ambitions’, choosing to pursue a globally expansive grand strategy ‘which is unnecessary, counterproductive, costly, and wasteful’. He argues that America should, instead, forgo any ambitions that are not directly related to immediate national interests. In explaining why the United States has become the underwriter for global regimes, Posen traces US ambitions back to a domestic ideology of liberal internationalist globalism that seeks to fashion a world order in America’s own image and spread free-market democracy around the globe using its overwhelming military primacy. From this perspective, US intervention and global engagement is a choice driven not by national security need but by a (mistaken) globalist ideology that has seen it militarily overcommit, make itself a target of global ire and neglect pressing domestic concerns. The United States now has the luxury of choice: it can decide to reverse its course and abandon

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its ideologically driven mission to craft the world in its own liberal democratic image.

Drawing from this scepticism, while he has back-pedalled on his campaign rhetoric that NATO is obsolete, Trump has nonetheless questioned the utility of America’s longstanding security alliances. In his inaugural speech, for example, he argued that these alliances have been a zero-sum equation for America:

For many decades, we’ve enriched foreign industry at the expense of American industry; subsidized the armies of other countries, while allowing for the very sad depletion of our military. We’ve defended other nations’ borders while refusing to defend our own. And spent trillions and trillions of dollars overseas while America’s infrastructure has fallen into disrepair and decay. We’ve made other countries rich, while the wealth, strength and confidence of our country has dissipated over the horizon.5

Continuing in this vein, he remained ambiguous about the US commitment to NATO’s Article 5 collective defence commitment at the alliance’s May 2017 summit. In response, and following Trump’s castigation of Germany as ‘very bad’ because of its trade surplus with the United States,6 German Chancellor Angela Merkel concluded that the ‘times in which we can fully count on others are somewhat over’. She continued by asserting that ‘Europeans must really take our destiny in our own hands … we have to fight for our own future ourselves’.7 However, notwithstanding his often bombastic statements, Trump’s nascent foreign security policy is characterized by a greater deal of continuity than is commonly assumed. In this sense, his foreign policy alters Roosevelt’s famous dictum and Trump ‘speaks loudly whilst carrying a big stick’. Specifically, he has in fact increased the US military commitment to Afghanistan by abandoning a ‘timeline-based strategy’ in favour of a ‘conditions-based’ strategy (effectively, an increased and open-ended US military presence). He has also raised funding for the European Reassurance Initiative by US$1.4 billion to US$4.7 billion for 2018, while tightening sanctions on Russia and bombing Syria, ostensibly on humanitarian grounds.8 Moreover, Trump has maintained US security commitments in east Asia in dealing with an increasingly bellicose North Korea. While his still developing national security strategy is thus characterized by often brash and abrupt rhetoric, his foreign security policies are broadly in line with those of previous administrations, exhibiting continuities deeper than popularly perceived.9

In contrast, foreign economic relations under Trump have seen a remarkable discontinuity. He explicitly campaigned on a platform of hostility to the central tenets of the postwar LIO, including globalization and free trade. Since taking office, he has wasted no time in acting accordingly. At the time of writing he has already abandoned the Asian TPP, a ‘disaster done and pushed by special interests’, \(^{10}\) sought to renegotiate NAFTA, the ‘worst trade deal in the history of the world’, \(^{11}\) and pulled the United States out of the Paris Climate Accords, placing the US totally at odds with the G7 on an agreement which 195 nations have signed and 147 have formally ratified. Moving against the postwar economic consensus on free trade, he has sought to erect tariff barriers against other states engaged in what he argues is unfair trade and to impose penalties on American companies that move jobs overseas.

In this repudiation of a globalized multilateralism, Trump embodies instead what we might term a cost–benefit bilateralism. This bilateralism rejects a transformational foreign policy driven by ideals such as human rights or democracy in favour of transactional relationships, and is deeply sceptical about regimes perceived as encumbering or restricting American freedom of action. Rather, it prefers to deal with other powers individually on the basis of cost–benefit calculations as to how each relationship works in America’s perceived economic or political interests. In the words of H. R. McMaster, the White House National Security Advisor, and Gary Cohn, Trump’s senior economic adviser, the ‘world is not a “global community” but an arena where nations, nongovernmental actors and businesses engage and compete for advantage. And, they assert: ‘Rather than deny this elemental nature of international affairs, we embrace it.’ \(^{12}\) On this basis, US leverage of its preponderance plays to US strengths. Why underwrite economic regimes that may be costly and tie the United States down when one-on-one deals will almost always favour America, given its sheer preponderance?

At the core of Trump’s ‘America First’ world-view, then, is an abiding scepticism towards existing global regimes that subsidize others at US taxpayers’ expense, or that have perceived negative externalities for US economic interests. ‘Trump believes that America gets a raw deal from the liberal international order it helped to create and has led since World War II,’ and accordingly seeks to recalibrate American ambition. \(^{13}\) In the next section of this article I relate this nascent foreign policy world-view to International Relations (IR) theory and ask whether this world-view is accurate and, perhaps more importantly, what some of the

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implications are of Trump’s administration for American hegemony within the liberal international order.

**Globalizing the US national interest**

At the end of the Second World War, the United States possessed almost half the world’s manufacturing capacity, the majority of its food supplies, nearly all of its capital reserves and a military power unparalleled in human history. In this context, the US national interest became globalized as America set about using its hegemonic leadership to fashion a new world order. Whereas closed economic blocs had exacerbated the rise of nationalist extremism after the First World War, after 1945 American foreign policy elites sought to use the new US hegemony to create an international order based on economic interdependence, a conditional and institutionally bound multilateralism and strategic alliance networks under US leadership. These networks existed in part to contain Soviet expansionism militarily, but also to dampen geopolitical competition from other centres of world power such as Japan or western Europe.¹⁴ The promotion of the LIO thus represented the institutional instantiation of the kind of world order that would allow the United States to thrive while also remaining first among equals in a Pax Americana.¹⁵ This order, while allowing the United States to flourish, also carried substantial costs, with the emergence of economic challenges from other states. Both Germany and Japan, formerly locked into an existential struggle for world mastery, emerged as economic challengers to the United States a little over three decades after the cessation of hostilities. This was, then, a remarkably benign form of hegemony, giving rise to the question: why would the United States choose this form of hegemonic leadership, and the often steep concomitant costs in blood and treasure, to maintain a system that, in economic terms at least, allowed other centres of power to emerge?

At this point we can usefully turn to IR theory, and in particular hegemonic stability theory (HST), which can help us to understand the structural logic underpinning hegemonic leadership. Broadly speaking, HST argues that the international system is more likely to be stable when a single state is the dominant power within that system. The existence of a hegemon helps eliminate collective action problems associated with the generation of often costly global public goods necessary to world commerce and to the underwriting of the political and strategic contexts of global economic interdependence—problems that have long bedevilled international politics. Aside from the alleged efficacy of world hegemonic leadership, what does HST tell us about why a preponderant power would seek this often costly role of global leadership?

The first explanation is most closely associated with Kindleberger, and argues that a hegemon provides leadership as a form of benevolent service to the


international community.\footnote{Charles P. Kindleberger, \textit{The world in depression: 1929–1939} (Berkeley: University of California Press, 2013), p. 304.} In this sense, the hegemon seeks to promote not only its own interests but also the collective interests of the states that it leads: a form of \textit{noblesse oblige}. In so far as hegemonic leadership is ‘thought of as the provision of the public good of responsibility, rather than exploitation of followers or the private good of prestige, it remains a positive idea’. Importantly, hegemonic leadership can help to pacify forms of economic rivalry inherent within the global economy. That is, leadership can help ‘pool sovereignties to limit the capacity of separate countries to work against the general interest; such pooling is virtually attained today in some of the functions needed to stabilize the world economic system’ and is ‘necessary in the absence of delegated authority’.\footnote{Kindleberger, \textit{The world in depression}, p. 304.} The hegemon is benign as its net resource transfers to the rest of the international community through the costs of the public goods it supplies, including security public goods in the form of alliance networks such as NATO, are extremely costly. This implies that the United States is not predominantly seeking either its own immediate advantage or its own one-sided long-term strength \textit{vis-à-vis} other economic centres. Instead, it is promoting change in the collective interests of world prosperity through the exercise of a benign hegemony.

Proponents of this explanation of US global leadership would tend to view the various deviations from multilateralism as being both secondary and generated by domestic protectionist and mercantilist lobbies using their domestic political power to undercut a multilateral mainstream to some extent on some issues at various times. The image of American external economic policy as being predominantly multilateral since 1945 rests above all on two indicators: levels of protectionism in the field of goods and services, and levels of America’s international economic integration, in particular the growth of the share of imports as a percentage of GDP. On both these indicators, American policy since 1945 would seem to have broadly favoured economic multilateralism: both tariff and non-tariff barriers, historically high in the United States throughout the nineteenth century and the first half of the twentieth in the industrial field, were dramatically reduced after 1945, since when the American economy has become progressively more integrated into the world economy, its trade rising rapidly as a percentage of GDP. The case for this multilateral image is especially strong for the quarter of a century after 1945, paradoxically because Washington did not, at that time, use its enormous power resources to force open the markets of the rest of the world as a strategy of economic nationalism would have suggested, given the economic ascendancy of American business at that time.\footnote{G. John Ikenberry, \textit{Liberal Leviathan: the origins, crisis, and transformation of the American world order} (Princeton: Princeton University Press, 2012).} Instead, Washington scaled back its earlier plans for a radically open postwar world economy and gave priority to the economic revival of both western Europe and Japan: a necessary step in helping to support the ‘rump’ of the LIO in the Cold War context of bipolarity, while encouraging a gradual winding down of European colonialism lest too rapid a withdrawal create
geopolitical vacuums. It is this form of relatively benign leadership that informs the historical narrative of liberal internationalists.19

A second image is that of the coercive hegemon. In contrast to Kindleberger’s benign hegemon, Gilpin’s hegemon provides public goods but is far less tolerant of states attempting to free-ride.20 This hegemon helps to sustain the international order not out of benevolence but out of self-interest, and is quite willing to coerce free-riders into paying to help fund its hegemony. In this version there is no Kindleberger-style transfer of resources from the hegemon to the international community as a whole, and provision of public goods is resource-neutral for the hegemon as long as other states are either willing to pay for them or can be coerced into doing so. All other things being equal, this ought to be good for hegemonic longevity. However, using coercion to cover the costs of supplying public goods may create problems for the hegemon in another area, namely that of legitimacy: according to both liberal internationalist and constructivist theorists, consensual regimes help prolong the longevity of the order itself, as other states have ‘voice opportunities’ to help shape the order.21 That is, there is a trade-off between coercion and legitimacy. As amply demonstrated in the US-led ‘war on terror’ after 2001, coercive hegemony, even in the context of military unipolarity, can only get you so far, as allied states need to reconcile the demands of the hegemon with their own domestic publics. Push too hard, and it is very likely that both soft and hard balancing dynamics begin to develop, or that one’s democratic allies are punished by their respective hostile publics.22

From this perspective, an American commitment to multilateralism, rather than being benign, is in fact a ruse for promoting free trade in fields where American businesses lead; what we might term an ‘informal empire’, where free trade makes sense because of the sheer economic preponderance of the hegemon’s domestic businesses.23 Leading structural realists have revived the ideas of William Appleman Williams, who in the mid-twentieth century outlined an economically expansionist dynamic in American foreign policy and the drive for what he called an ‘Open Door world’.24 On this reading, the language of liberal free trade has supplied a legitimizing discourse for a strategy devoted to opening the markets

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of others to American business interests. Proponents of this coercive mercantilist image also argue that the liberal characteristics of the international trade regime which emerged in the 1950s and 1960s were a reflection not of a strategic commitment to multilateralism on the part of American leaders but instead of their confidence in the competitive ascendancy of American industry. Accordingly, when that ascendancy faced challenges in the 1970s, American economic strategy turned against liberal internationalist principles. The most obvious example of this was the abandonment of the gold-linked international monetary regime after August 1972, when the Nixon administration closed the ‘gold window’. Within the Bretton Woods system the dollar was the key unit of account, at a fixed, though in principle adjustable, exchange rate to gold. This system required the American Treasury to adjust American macroeconomic policy to ensure the stability of the dollar against gold. By breaking the link with gold, Washington signalled its refusal to allow American national economic policy to be constrained in this way, thus subordinating the stability of international monetary relations to purely American national interests (this point is examined in more detail below).

The third image, that of the structurally advantaged hegemon, is the one that I argue best captures the nature of US hegemony. Here, leadership gives the hegemon the capacity to shape world order in ways that confer upon it advantages that will enable it not only to recover the costs of supplying public goods, but to accrue other positional advantages. That is, the hegemon acquires the benefits of cooperation without having to resort to coercion, while reinforcing its position by extracting resources from the rest of the international community and reinvesting them in ways that help prolong its hegemony. Moreover, the hegemon can do this as other states accept the hegemon’s overall international order as legitimate, at least for as long as the opportunity costs of major systemic revision outweigh the costs of staying with the status quo. The hegemon is therefore in the position of enjoying resource inflows from the rest of the international community. In this sense, the United States is thus both a ‘system maker’ and a ‘privilege taker’, and accrues advantages through structuring world order in ways that benefit its interests while delivering enough benefits to other states to discourage them from seeking to revise the US-led order. What, then, are some of the key positional advantages that the US enjoys?

Structuring advantages within the liberal order

As the protector of an open, integrated international market, the American state can claim special privileges to enable it to preserve the zone effectively, and there are a number of areas where being the system maker gives the US huge positional advantages. The first such area we should note here is its ‘dollar hegemony’, whereby the greenback acts as the world’s default global currency: this, most notably, allows it to run progressively larger current account deficits without having to worry about foreign exchange reserves. This makes the US Federal Reserve the world’s de facto central bank, giving it the luxury of unilaterally setting borrowing costs for the rest of the global economy. It is this form of dollar hegemony, and the ‘exorbitant privilege’ it affords the American state, that has helped inform a range of scholarship on American economic decline, especially in relation to a rising China and the potential internationalization of the renminbi and the associated challenge to US monetary regimes. According to this ‘declinist’ narrative, if the dollar loses its international reserve currency status other aspects of US hegemony, most notably its global military primacy, will begin to crumble as other currencies vie for international monetary leadership. In short, the ‘dollar’s reserve currency role is central to America’s geopolitical preeminence and if it loses that status US hegemony will be literally unaffordable’. However, not only does this ‘renminbi revisionism’ ignore the ways in which US military primacy in east Asia helps bolster its monetary power (see below); it is not borne out by the hard data. According to the most recently available data from the Bank of International Settlements in its 2016 triennial survey, the dollar accounted for 88 per cent of all over-the-counter trades in foreign exchange markets in 2016. The renminbi accounted for just 4 per cent. This is a huge disparity and hardly supports the idea of an imminent end to dollar hegemony.

Dollar hegemony also has profound geopolitical implications. Specifically, the United States can fund its overseas military operations with freshly printed dollars largely at will. Between 2003 and 2008, for example, the ‘largest airborne transfer of currency in the history of the world’ saw the Federal Reserve print and ship US$40 billion in cash to Iraq to help finance the war. In just ‘the first two years, the shipments included more than 281 million individual bills weighing a total of 363 tons’. Dollar dominance has thus ensured that imports, debts

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and overseas military–political operations could all be paid for with greenbacks produced by the American state, which at the same time could gear its domestic macroeconomic management exclusively to conditions within the United States without any significant external constraint. More interestingly, dollar liquidity means that investors continue to use US monetary regimes even in the context of major global economic instability. For example, during the global financial crisis of 2008, not only did we not see a flight from US financial and monetary regimes, we actually saw the reverse: a global flight of capital into US debt markets, to the extent that in some instances US Treasury bonds had negative interest rates. In short, dollar hegemony and its privileges allow the US to externalize major crises through its unilateral capacity to alter its interest rates, to force other states to adjust accordingly, and to fund geopolitical hegemony on the cheap.

Second, American global security regimes have allowed the United States to structure regional international relations and other states’ international economic preferences in ways it considers conducive to its interests. In the 1980s Keohane rightly identified that ‘it is difficult for a hegemon to use military power directly to attain its economic policy objectives with its military partners and allies’, as these ‘cannot be threatened with force without beginning to question the alliance; nor are threats to cease defending them unless they conform to the hegemon’s economic rules very credible except in extraordinary circumstances’. He continued, however, that this does not mean that military force has no utility: it ‘has certainly played an indirect role even in U.S. relations with its closest allies, since Germany and Japan could hardly ignore the fact that American military power shielded them from Soviet pressure’. This form of leverage has continued in the post-Cold War period. For example, in the face of fears over North Korea’s capacity to hit the continental United States with a nuclear missile, President Trump directly linked US trade negotiations with regional security dynamics in east Asia. Trump argued that he had ‘explained to the President of China that a trade deal with the U.S. will be far better for them if they solve the North Korean problem’. While enjoying strong economic interdependence with the United States, China is of course emerging as a geopolitical rival to America and a regional hegemon in east Asia. This developing security dynamic helps reinforce east Asian states’ reliance on American military power as a hedge against an increasingly assertive China. This, among other factors, has played a major role in encouraging states that can claim political equality but are subordinate in security terms to buy into broader US-centric


monetary and financial regimes. In the case of Japan and the United States, for example—which together account for 30 per cent of the world economy—a recent post-TPP statement affirmed the close relationship between US security guarantees and bilateral economic relations: ‘The US commitment to defend Japan through the full range of US military capabilities, both nuclear and conventional, is unwavering’, while the two countries remain firmly wedded to ‘deepening … trade and investment relations and … their continued efforts in promoting trade, economic growth, and high standards throughout the Asia–Pacific region’.

Third, US leadership of the LIO and its attendant grand strategy of deep engagement have also given the United States the capacity to promote the kinds of global economy most conducive to its highly internationalized multinational corporations. To take just one area, FDI shows how the US retains both overwhelming economic preponderance and very strong structural incentives to maintain an active shaping role as global hegemon. According to the most recent report by the UN Conference on Trade and Development (UNCTAD), FDI flows into the United States were just under US$380 billion in 2015, while its outward flows were almost US$300 billion. The next highest figures for a single country were for China, with just over US$135 billion of inward flows and outward flows of just over US$127 billion.

These FDI flows are important for two main reasons. First, inward flows signal global investor confidence—and, more importantly, the sheer preponderance of the American economy, with global elites and businesses heavily invested in US economic health. A relative decline of the American economy would also signal an arguably greater decline of others, given its centrality to the global economy. Second, and especially in relation to outward flows, US-based FDI gives what Strange termed ‘command capacity’ in relation to global business decision-making and thus future sources of innovation and revenue streams. As such, US-sourced outward FDI means that flows of capital and innovation are under the control of US executives. As such, the decision to grant a licence to produce is taken within the United States itself. In other words, the directive capacity for what is made, licensed and sold on world markets, and future revenue streams from these processes, continues to be mainly US-centred. Furthermore, as we drill down into the data, it is clear that FDI as indicative of economic interdependence mainly flows between countries that are also directly tied into US-centric security regimes. Outward flows of FDI stood at 33.2 per cent of GDP for the United States in 2015, 29.7 per cent for Japan and 57.6 per cent for the EU, and

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were also primarily concentrated among these advanced economies. In terms of individual nations, then, the United States is thus still hugely preponderant in terms of FDI measured as a percentage of GDP; it also—reaffirming the close synergy between the US political/economic and security regimes—remains the linchpin of the security alliances of the other centres of world economic power (for example the US–Japan security treaty and NATO). This security dependency is a huge boon to American leverage within world politics. Who would rationally seek to alienate their primary security guarantor? China’s outward FDI, by contrast, stood in 2015 at just over 11 per cent of GDP, and the country’s security alliances are of limited import.41

What can we conclude from the above? First, on a broad array of capabilities, the United States continues to enjoy a huge lead over other states within the international system. Second, while there have been tactical differences among American foreign policy elites, its status as primus inter pares has afforded the American state the capacity to shape global order in ways that have suited its geopolitical and economic interests. Until the Trump administration, these same elites agreed that the LIO acted as the pre-eminent institutional instantiation of America’s global preferences. I have argued that the United States enjoys a range of positional advantages that it would make little rational sense to relinquish, and that the regimes it underpins, while costly, have been a huge boon to American hegemony. Will President Trump, in abrogating the very foundations of the LIO, thus squander America’s unique positional advantages as global hegemon? And—arguably more importantly—what were the underlying social conditions that helped propel Trump to power? In the section below I seek to examine these important questions. I argue that globalization has restructured the constellation of winners and losers within the global economy, and that, to the extent that globalization is equated with the LIO, the ‘success’ of globalization has weakened US domestic support for the postwar international consensus.

Globalization and the (neo-)liberal order under Trump

At this point I would like to argue that we can trace a developing post-liberalism to changes that have occurred as a result of neo-liberal globalization and its reconfiguration of the global economy, specifically the way in which it has deepened income inequality. In respect of rising income inequality, the data show that there have been two primary beneficiaries from globalization. On the one hand, there has been huge growth in the rapidly industrializing economies of Asia. For example, between 1988 and 2008 incomes multiplied by three in urban China and doubled in Vietnam, Thailand and Indonesia, with rural incomes rising by 80 per cent.42 The other winners have been the global top 1 per cent, and are

overwhelmingly to be found in the world’s richest countries. The United States dominates. Half of the people in the global top 1 per cent are American. (This means that approximately 12 per cent of Americans are part of that global top 1 per cent.) The rest are almost entirely from western Europe, Japan and Oceania. Of the remainder, Brazil, Russia and South Africa each contribute 1 per cent of their populations. On the other hand, income inequality in the United States has grown considerably and wage stagnation is widespread. The data show that in real terms the average wage peaked more than 40 years ago, with the top 1 per cent of wages growing by 138 per cent since 1979, while wages for the bottom 90 per cent grew by just 15 per cent. Globalization has been central to this trend, and while it has been remarkably successful in helping address inequality between nations, inequality within nations has grown, often with damaging domestic effects.

Trump’s election victory can be seen in relation to these trends. Among the non-college-educated white working class (the so-called ‘precariat’) Trump won 67 per cent of the popular vote (to Hillary Clinton’s 28 per cent), with one in four of President Obama’s 2012 white working-class supporters shifting from the Democrats in 2016 to either supporting Trump or voting for a third-party candidate. Trump also received support from those manufacturing states that were most at risk from outsourcing and increased global manufacturing competition: ‘America is a nation of many economies, but those that produce real, tangible things—food, fiber, energy and manufactured goods—went overwhelmingly for Trump.’ Trump’s discourse explicitly tapped into these voters’ sense of economic insecurity and their desire to reverse globalization. Americans, he explained, ‘must protect our borders from the ravages of other countries making our products, stealing our companies and destroying our jobs’: protection, he asserted, ‘will lead to great prosperity and strength’. In so doing, he appealed to the rational self-interest of those who have often been left behind by processes of globalization.

US elites thus find themselves facing the same problem that Nitze identified in the early postwar world: how to conjugate America’s active global role with the

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contradictions and domestic costs this role often generates. Given the structure of American capitalism sketched above, with its dominant multinational corporations, financial hegemony, high-tech sectors and huge preponderance in FDI, an open global economy under US leadership, both to pacify geopolitical rivalry and (minimally) partially to structure other states’ international preferences, continues to make sense. Equally, however, globalization has contributed to hollowing out the earning capacity of ordinary Americans and undermining traditional ‘blue-collar’ jobs in the American economy. In the long economic boom following the Second World War, Nitze’s dilemma was easier to manage; now, as the contradictions within the American domestic economy grow, with a greater reliance on credit and debt to shore up the earning capacity of American workers, the benefits of American elites’ preferred global model, suited as it is to powerful sectors both within the country and also globally, becomes a much harder sell to those who feel acutely the economic costs to themselves and their families.

Compounding this domestic problem has been a weakening of consent for American leadership internationally. During the Cold War, bipolarity offered an agreed-upon Soviet ‘other’, which fostered the coherence of the LIO around American leadership. Moreover, the existential threat was real, with American hegemony solving collective action problems while also offering ‘club goods’ for those in the US sphere of influence. As Aron presciently pointed out, ‘the strength of a great power is diminished if it ceases to serve an idea’.

In the post–Cold War world, what is the ‘idea’ that provides the moral impetus for US leadership? We have seen the fracturing of consensus occur in a number of ways. First, America’s allies have frequently differed over their respective interpretations of what constitute existential threats to their national security interests; this in turn has made it difficult for the United States to build coalitions to serve its priorities and to fight the kinds of wars it has embarked on since the end of the Cold War. It remains to be seen how key institutions like NATO will respond to greater American reluctance to engage, or even total indifference.

Adding to this mix is the fact that the UK, Europe’s pre-eminent military power, is seeking to revise its relationship to the EU. This complicates US geopolitical interests in Europe, and while it is highly unlikely that London will seek major revision of security arrangements, the prospect of British exit from the EU places longstanding and crucial relationships in a state of flux and uncertainty.

Second, the rise of other powers, most notably China but also Russia, may obstruct US action and raise both the costs of supporting US international preferences and the costs of US action (or indeed inaction). Moreover, these hegemonic challenges often look different from different geopolitical positions, and rising powers have the capacity to generate incentives to pull other powers into their own institutional orbits.

The major hope of advocates of the LIO is


that other states will seek to work within it, rather than taking on the immense burden of seeking to revise it. However, while China is not seeking major global systemic revision, its regional intentions are clear. Trump’s abandonment of the TPP has added both to China’s growing self-confidence and to its capacity to build Sino-centric institutions such as the ‘one belt, one road’ initiative. Its aspirations also extend beyond its immediate east Asian neighbours, with major non-Asian US allies joining its Asian Infrastructure Investment Bank (AIIB). Britain gave the United States twenty-four hours’ notice of its intention to join in 2015, and opened the door to other major powers such as Australia and South Korea. This represented a ‘major affront’ to the United States, which saw the AIIB as a rival to the World Bank. Indeed, in the face of Trump’s seeming abandonment of globalization, Chinese President Xi Jinping stated that while some ‘people blame economic globalization for the chaos in our world’, we ‘should not retreat into the harbor whenever we encounter a storm or we will never reach the other shore … No one will emerge as a winner from a trade war.’ In essence, Xi was staking a claim for potential Chinese leadership of economic globalization (an extraordinary development, but perhaps understandable given the data on some of the key winners from globalization).

In sum, the crisis in US leadership predates Trump, but his rise and the social forces he managed to capture to win the presidency are rooted in the very successes of the globalized model that US foreign policy elites have promoted in the postwar world. This model has recalibrated the global economy and created new winners, especially in Asia and among the top 1 per cent of earners in the West, while creating a body of losers in the US domestic political economy that poses a challenge to US foreign policy elites seeking to generate a domestic consensus on American leadership. As Mandelbaum argued, ‘for the foreign-policy elite, the need for American leadership in the world is a matter of settled conviction’. He continued, however, that in the ‘general public the commitment to global leadership is weaker … The politics of American foreign policy thus resembles a firm in which the management—the foreign-policy elite—has to persuade the shareholders—the public—to authorize expenditures.’

Domestically, what of Trump’s commitment to ‘drain the swamp’ of special interests and put ordinary Americans first? At the time of writing he has in fact done the opposite. Nearly half—47 per cent—of his proposed US$6.2 trillion in tax cuts will be enjoyed by the top 1 per cent of earners, amounting to additional

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income of almost US$3 trillion over a ten-year period.\textsuperscript{55} His financial reform package seeks to undo the minimal Dodd–Frank reforms put in place by the Obama administration to guard against the kinds of casino capitalism that led to the Great Depression of 2008, while his repeal of Obama’s Affordable Care Act would, according to the Congressional Budget Office, see 23 million Americans lose access to health care by 2026.\textsuperscript{56} If we accept that there is a relationship between greater income inequality in the United States, strongly linked to the promotion of globalization by its elites, and a weakening of support for key tenets of the LIO and America’s hegemonic role, then Trump’s presidency does not augur well for the kinds of domestic stability necessary for resolute American international leadership.

**Conclusion**

What can we conclude from the above analysis? This article has outlined a nascent foreign policy worldview on the part of the Trump administration that combines elements of isolationism with cost–benefit bilateralism and, most strongly of all, a deep ambivalence towards the liberal international regimes that America has helped bring to birth and sustain since the end of the Second World War. Drawing on IR theory, I have argued that this process of order creation was undertaken to reinforce American leadership, and that its positional advantages remain considerable. Given that the benefits far outweigh the costs, the logic driving the abrogation of these regimes is hard to discern. Globalization, while helping to lift millions out of poverty, especially in Asia, has had a demonstrably negative impact on workers in the West, particularly in the United States where social protections are much weaker than in other areas. The so-called ‘American Dream’ worked because it had at its heart a simple equation: work hard, do the right thing and your children will enjoy a better life than you. It is clear that the social forces that helped propel Trump into power feel that this dream has become more of a nightmare in a country where huge wealth disparities are now seeing the richest Americans living almost a generation longer than the poorest.\textsuperscript{57} This presents US elites with a grave dilemma. How are they to reconcile the huge structural pressures from leading sectors of the American economy to produce the kinds of international order necessary to allow them to continue to profit with the demands of a public increasingly hostile to the effects that this order helps produce? Trump’s anti-globalization rhetoric has captured a popular and, from the standpoint of

\textsuperscript{55} Tony Nitti, “Trump’s “massive” middle-class tax cuts are tiny compared to those promised to the rich”, *Forbes Magazine*, 3 March 2017, https://www.forbes.com/sites/anthonymitti/2017/03/01/president-trump-promises-massive-middle-class-tax-cuts-but-will-he-deliver/#40012f9f1f9e.


ordinary Americans, entirely rational mood, and in many ways the Trump administration is a strong case-study for the perennial social science problem of structure and agency, a theme that I have developed throughout this article. Will the agency of Trump, in seeking to reverse aspects of the LIO, overcome the deep structures and well-trodden path dependencies of powerful sectors of American business and elite opinion? It may be the case that Trump does so much damage to US prestige that the United States loses the luxury of grand strategic choice and, as other powers rise, sees its freedom of action becoming more tightly constrained. To date, rival and contending ‘models’ for organizing interstate relations range from the statist to the illiberal or highly sectarian. Imperfect as it is, the LIO is still the ‘best of a bad bunch’; but, to the extent that America remains its keystone state, it needs to address long overdue and pressing problems that are undermining the domestic order upon which its international leadership rests.