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From Crisis Management to Institutional Reform

As the financial crisis deepens, policymakers are focused on responding to the immediate impact of the crisis. However, there is also a strong interest in prevention, so that future crises can be better contained and managed. Here, economic considerations about tools and mechanisms are inevitably tied to political institutions, and the shifting nature of global interdependence and power-effective reform is not a merely technical exercise. This brief outlines the importance of understanding the diverging understandings of the crisis and their likely influence on options for reshaping global economic governance.

The crisis has triggered a shift in power from the G8 to the G20

The current situation is unique in its magnitude and origins: caused in developed countries, its rapid spread demonstrated a qualitatively new level of global interdependence. Politically, it resulted in the high profile institutional outreach to emerging powers through the G20 forum rather than reliance on the G7/8 forum. The G20 consists of the G7 + the European Union, the World Bank and the International Monetary Fund, Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, and Turkey. This expansion promises adaptation to fundamental changes in the importance and interests of some developing countries in the last 50 years.

Is the shift from G8 to G20 grand gesture or real change? The organisational principles of the G8 are based on its role as an informal club regime with self-selected membership (concerted power and constricted participation) and largely informal structures, including a focus on leadership. Previously, the combined economic strength of its members could sometimes have a decisive influence on markets or worldwide practice. But on the many other issues it tackled, its power rested in its capacity to exercise leadership within multilateral fora.

Shifting global realities have undermined this role. Today China is a key contributor to world growth and has overtaken the US as the top importer of emerging market exports. China and India may well have contributed more to reducing world poverty than the G8. Other actors (i.e. vertical funds, private foundations) play an ever increasing role in North-South relations

The G20's institutional authority is weak

The G20 was constituted after the Asian crisis of 1997–98. Its constitution is rather loosely based on the notion of 'systemic importance' i.e. countries who have the potential to affect the system as a whole. Its role so far has been small. Its members perceive it as a forum for informal dialogue. However, they also believe that G20 support for global initiatives has had 'only a modest effect on members' behaviour, and even less impact on the behaviour of non-member countries' (G20, 2008). If the G20 is to assume a major role in global economic governance, its authority will have to increase.

Institutional authority has many potential sources: it can be based on output and the ability to propel change, as well as the recognition of representativeness and adherence to the principles of the constitution. Both also depend on the ability to forge a shared diagnosis of the problems at hand.

There are various competing understandings of the crisis (Weber, 2008). For example,

- The crisis is due to regulatory failure in the main capitalist economies
- The crisis is a manifestation of an enduring 'stability-instability' paradox inherent in capitalist markets that includes cyclical panics
- The crisis results from 'exploitative hegemony' in which the US acted as an irresponsible great power (see Arrighi, 2005)
- The crisis represents a deep and fundamental catastrophe of Western financial capitalism, which originates in a fatal flaw in the US system.

A team of IDS researches tracked such frames in national debates in selected G20 countries (India, Japan, Indonesia, Mexico, Brazil, South Africa, and South Korea as well as Europe and the United States). This served to identify elite-level debates and the positions of some key domestic actors between October 2008 and February 2009. The box below illustrates how elements of the above narratives were expressed in national media.

Narratives from national media in G20 countries

- An 'unhealthy relationship' between Asia and the West, sometimes framed in terms of a culture clash (India, Korea, and Indonesia)
- Notions of Western 'greed' and arrogance and US/Western arrogance (India and South Korea)
- A general irresponsibility of western capitalist economies (Brazil)
- Chinese currency manipulation (US)
- 'Immoral capitalism' (France)
- Foreseeable regulatory failure (Canada)

Alongside geopolitical weight, these competing narratives influence views on participation and positioning in global fora. Developing country experts seem to prefer a global rather than a national approach to the crisis (Coupe, 2009). Yet, in national debates distrust in current processes appears widespread, as illustrated in the following box.

National narratives about institutional solutions to the crisis

- Resentment of western institutions for treatment received during the Asian crisis of 1997–99 (Indonesia)
- Open and latent distrust of the role of the IMF in any solution and concerns that its 'ideology' has not changed (India, Indonesia, Japan, Mexico and South Africa)
- There can be no return to the pre-crisis status quo (India and Japan)
- Wariness of G20 symbolism as well as potential mechanisms to make others share the responsibility for the 'mess' created by the G8 (South Korea)
- Value of G20 for information-gathering or diplomatic reasons (India, South Africa)
- Willingness to engage with new US leadership via the G20 and to reinforce multilateralism (Brazil, Indonesia and South Korea)

Key messages

The review of competing narratives reinforces that just expanding representation is not a solution. Policymakers' understanding of the different framings of the crisis may be as important to create institutional authority. For example, trust in current or future supervisory institutions will be essential given the difficulty to conclusively assess 'systemic risk' in financial markets. Any pre-designed approach, in which those who are to blame for the crisis are seen as devising its solution for others to implement, is unlikely to be successful.

Further reading

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Credits

This *In Focus Policy Briefing* was written by **Anna Schmidt**, a research fellow of the Governance Team at the Institute of Development Studies, and edited by **Louise Stoddard**. The series editor is **Clare Gorman**. For other briefs on the crisis see: **www.ids.ac.uk/go/infocus7**

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