

NOTES FOR REMARKS

to

The Centre for International Governance
Innovation
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by

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It is always a pleasure for me to come to CIGI, but perhaps never before as much as today – the weekend following the summit in Pittsburgh, for gathered here in this room are so many of those who led the movement that culminated in one of the most significant breakthroughs in the architecture underpinning global governance in recent times.

That being said, before we congratulate ourselves too much, we must recognize as well that there remain many questions about its own architecture that must be answered if the G-20 is to succeed – questions that few can debate and answer as profoundly as the people in this room.

Therefore as context for that debate, what I'd like to do in these opening remarks, is to set out what I believe is the measure by which the G-20 ought to be judged over time; that is to say judged against the expectation that led to its creation, and that quite simply, is the degree to which the G-20 as the world's new steering committee improves the way globalization works in the here and now and also in the way it prepares for the road ahead.

This is not an academic yardstick. Our goal was to relieve the gridlock that was paralyzing the international system, and that on issue after issue will be the litmus test the G-20 will have to meet in the future.

What I'd like to do now is to highlight three of these issues in order to gauge how we are doing in the wake of Pittsburgh and even more importantly as Canada and Korea prepare for Huntsville next June.

The first issue is that of global poverty and in particular the poverty of African nations. Twenty-four of the world's twenty-eight poorest countries are in Africa, and so are the majority of the world's fragile states.

That being said, reaching out to the poor on the continent is not only a question of morality or history, it is very much in our own self-interest and even more to the point, that of our children.

In 2030, Africa will have a population equal to China or India. In 2050 it will have a population of 2 billion; 500 million more than either one at that time. This will be the largest agglomeration of people and the highest proportion of young people anywhere in the world.

Now, hopefully that massive percentage of young by mid-century will provide the world with an engine of growth when the global economy needs it, comparable to the shot of adrenalin China is providing today.

Indeed if the transportation and energy infrastructure that would lead to the African Common Market is built, if Africa's governments build the schools and health care

systems that are needed and if the G-20 lives up to the commitments that are so essential to all this happening, then that bright future can be within Africa's grasp.

However if in 2050, Africa's young are unemployed and rootless, millions, desperate, with no hope but plenty of anger, migrating in a wave of discontent which no wall will be able to resist, then those young people will turn, through no fault of their own, what could be the success story of the 21st century, into an unstoppable source of global instability with all the misery and terror that entails.

Of course, Africa's leaders must act, but the G-20 must respond much more than it has, if it is to live up to the hopes so many have vested in it.

So far it has not, and clearly, therefore, as the economic recovery gains ground, the vision of the world's new steering committee will have to broaden.

The next issue is climate change. In the circumstances, the decision to push the debate to Copenhagen in December was understandable. Not every G-20 meeting has to result in a lengthy grocery list of announceables.

On most issues, what is important are the signals the G-20 sends to the world's negotiating tables, the WTO and the Doha Round, the WHO and pandemic threat, and in the case of climate change – Copenhagen.

That being said however, if after three meetings of the G-20 not to mention countless expanded meetings of the G-8, the differences between the developed and emerging economies show no signs of being bridged at Copenhagen, then we will have a problem on our hands that extends beyond climate change to the very heart of the effort to revive true multilateralism after its lengthy siesta.

Multilateralism must mean more than a camouflaged concern only for one's own interests. It must recognize the needs of others including those who are not at the G-20 table.

For instance, we all agree that it is the developed industrial world that must take the lead in setting firm targets for the reduction of CO₂ emissions. That being said however, this does not let the emerging economies off the hook. Firm targets are only a necessary first step. The real action lies in setting out the plans and the ensuing accountability that will enable a country to meet those targets.

Of course, China, India and Brazil are much less guilty of the causes of climate change than either North America or Europe, but this does not mean as their emissions increase they will not have a responsibility to Bangladesh, the Philippines, Central America and Africa for instance, all of whom are virtually innocent of the causes of climate change and yet whose poor will bear the greatest cost in terms of creeping deserts, flooding and famine.

The G-20 came into being because the world has changed. Its members are members because they have power and position, but they also have responsibilities. The emerging economies may have their differences with the per capita richer members of the G-20, but they cannot avoid their responsibility to the world's poor wherever they may be anymore than can their G8 counterparts.

The last example I would cite arises not surprisingly from the current financial crisis. The fact is, despite all of our talk about globalization over the last 25 years, today's crisis shows just how unprepared the world's governments were and still are when faced with a global economy whose problems lie beyond the scope of purely national solutions.

This was not simply another economic downturn. It was one that mutated into a perfect storm because at its core was a banking crisis of unprecedented global reach.

Thus, the third test I would raise with you as we judge the success of the G-20, is one the leaders themselves put up front and center and that is the need for the international monitoring of major financial institutions and the need for comprehensive financial regulation.

Let me be clear.

No one seriously suggests installing a single "global" regulator anymore, it's simply not workable.

That being said however, if globalization is to work, we must recognize that national regulation cannot deal with the gaps in the global financial system, and furthermore we must recognize that the effectiveness of national regulation must be ensured by an international coordinating body, both for scope and competence.

Finally, and most importantly, we must recognize that the enforcement of this coordination must be mandatory, not voluntary - and therein lies the rub, for despite all the history supporting this view, it is far from universally held.

Following the Asian crisis, 10 years ago the G-7 agreed that each member country would submit its bank regulation to a new IMF peer review process called the Financial Sector Assessment Program. It was a Canadian initiative, but unfortunately we did not make it mandatory. As a result, although Canada went first and we were followed by other G-7 countries, there was one exception - the United States, which said that a peer review of its regulatory processes would be a waste of time - better we were told to focus on those countries where there was a potential for problems. Needless to say that argument is now a bit harder to make.

Looking ahead, given the differences that are evident between the European and US administrations on a wide range of regulatory issues and given the difficulty major US and European bankers now appear to have remembering how remorseful they were but

a couple of months ago, it seems pretty clear that a voluntary process of global coordination will lead nowhere.

Quite simply, over time, regulatory arbitrage (ie: shopping for the weakest regulatory jurisdiction), will make it impossible in a permissive system for the G-20 to deal with escalating breaches in the dike.

The fact is that history does repeat itself. The push for the deregulation of financial institutions occurred primarily because of the competition between London and New York for market dominance, and while the animal spirits that gave birth to that competition may be in abeyance, they will not be for long!

Furthermore, as today's crisis memories fade, London and New York will not be alone in seeking to gut regulatory constraints to attract the world's financiers. Already Paris and Frankfurt are gearing up for the next round. And of course, this is but the tip of the iceberg. Wait until Hong Kong and Shanghai combine to challenge the incumbents. Then the battle will really be on!

In short, the time for the G-20 to draw the line in the sand is now, and while the right words were said in Pittsburgh, it's far from clear that all of the G-20 members are prepared to carry through.

What the recalcitrants should remember however, is that they are there to speak not only for themselves but also for the 173 countries who are NOT at the G-20 table. The G-20 is a global steering committee not a small club of the self-interested, and the question to ask, is not how do you keep New York, London or German bankers happy, it's how do you keep the global economy healthy.

(As an aside, the issue of whether G-20 countries represent themselves only or their regions or their status as part as the G77 for instance, is something CIGI may want to debate. It's certainly going to come up in the future.)

Returning to the issue of mandatory versus voluntary coordination, the question is not only limited to the debate over regulation.

When Mervyn King, the Governor of the Bank of England said "if a Bank is too big to fail, it is too big", he was speaking for many of us, and not just about banks.

The fact is, the global economy must never again be put at risk by the failure of any country to understand how far the global tentacles of its institutions reach.

The consequences of the Lehman Bros. bankruptcy will be felt for years. What would have happened to global markets had the US let AIG go as well?

At a minimum, a protocol on how failing mega institutions can be unwound without bringing down the whole global system must become part of the arsenal of the Financial Stability Board or the IMF.

And that protocol cannot be voluntary, or catch as catch can. It too must be part of a predetermined work out process established well in advance.

That being said, given the progress being made on “Living Wills” for banks, I believe the G-20 is meeting expectations – so far!

So where does all this leave us?

We have touched on the litmus test for the G-20 with reference to three examples: Africa, climate change and the financial crisis. In each case, the jury remains out, but the grounds for optimism are there. In each case however, there is one common constant that has to be dealt with if the G-20 is to fulfill the hopes so many have for it.

To cut to the chase, it is evident that the G-20 will succeed only if its leaders demonstrate a capacity to rise above the political comfort of narrow nationalism, for only then will they make the trade-offs required to make globalization work.

To illustrate this, let me return to the third example, and to the efforts to prevent the next global banking crisis.

Given the seamless nature of global capital markets and their capacity for contagion, I don't see how anyone can argue that an international sanctioning mechanism is not necessary. But there are many who argue just that. For instance, both the US Congress and others such as the German Financial Authority have made it abundantly clear that they would never accept such supervision on a mandatory basis.

Well that - the parochialism of rigid borders - makes no sense, not if you want to make globalization work.

At the core of this resistance is a counterproductive definition of sovereignty – of “Who is Boss” – a definition which is increasingly outdated.

The Treaty of Westphalia established the definition of national sovereignty in 1648. That was a long time ago and it was all about sovereign rights. However, such is the seamlessness of global capital markets in 2009, that the definition of sovereignty today must now include sovereign duties.

The questions I would put to you are the following: when the US and European financial players created toxic assets and sold them around the world to everyone's detriment, was that not an infringement on the rest of the world's sovereignty?

Is today's global recession itself not partially the result of the infringement on the sovereignty of every country that has been affected by the failure of the European and American banking systems to exercise minimum standards of prudence?

In short, I believe recasting sovereignty by stressing its duties as well as its rights, thus bringing it into the reality of today's interdependent world, is the key to making globalization work.

Now this is too theoretical some may say, but the fact is arguments over sovereignty already provide the unconscious underpinning of virtually every debate at the G-20 table.

And not only at the G-20! For instance – only this week, the President of France's largest insurance company challenged the right of the International Accounting Standards Board to set binding international accounting rules, by saying that the setting of accounting norms was and I quote "an instrument of political sovereignty".

Well, I believe the time has come to move on.

What is required now is a new approach to an old concept.

Such an approach was broached by the UN when the reform commission recommended "the Responsibility to Protect" as a restraint upon a country's ability to oppress its own people. Ultimately it was one of the few reforms that passed, but the difficulty that any reference to sovereignty entails is highlighted by the fact that attached to the R2P is a Security Council override.

Another suggestion can be seen in a recent article in *Foreign Affairs* by former US Homeland Security Secretary Michael Chertoff, which deals with the "Responsibility to Contain" the threat of terrorism.

At the very beginning of the article, Chertoff defends the traditional definition when he writes, and I quote:

"Imposing international legal mandates on a nation without its consent undermines the traditional concept of sovereignty" and he then goes on to say – "conflicts with the democratic will." End of quote.

However as Chertoff's purpose was to focus on the need for the United States to deal with terrorist threats emanating from other countries, he is finally drawn to a different conclusion at the end of his article and I quote once again:

"States can no longer refuse to act by hiding behind seventeenth-century concepts of sovereignty in a world of twenty-first-century dangers. International law should not be powerless to prevent deadly non-state threats from spreading from one state to others." End of quote.

I have the greatest respect for Michael Chertoff. I just wish others would travel the road to Damascus as honestly as he has.

This is so in the case of the R₂P albeit where acceptance is far from unanimous. It is so in the case of the responsibility to contain which is part of a much larger debate; and it is so in the case of the responsibility of great powers not to decimate the global economy because of failures in their own regulatory processes, which is what the G-20 and the Financial Stability Board are wrestling with now.

That global banking standards will eventually be negotiated I have no doubt. What they will be however and how they will be enforced if too much time is allowed to lapse and memories of today's crisis fade away, these are the 64 thousand dollar questions!

At the present time, while enforcement measures have been discussed such as peer review, capacity building and what is called counter-measures, the G-20 finance ministers have recommended their use so far only in cases of tax havens or money laundering by what is called non-cooperative jurisdictions.

In other words, at the present time the G-20 is going after corruption which it should and some smaller jurisdictions where it has to, but so far it has not decided what should be the standards in G-20 countries in the crucial areas of inadequate Bank equity and imprudent borrowing levels. As we know both of these issues were at the root of the financial crisis. Furthermore the G-20 refuses to address how it would enforce new standards if they were put in place.

Wherein lies the problem? It lies with all those legislatures from Berlin to Washington and including a number of the emerging economies where 17th century notions of sovereignty continue to abound.

For instance - US Treasury Secretary Geithner has proposed that all major financial Institutions world wide should increase their equity bases, and adjust their lending ratios to a more responsible standard.

Germany disagrees and maintains its right to keep the much weaker standards that are currently enjoyed by its financial institutions.

Clearly the immediate priority must be to encourage a higher level of economic growth to get us out of the current downturn but in the longer term, the question remains: who is right?

The answer is clearly Geithner, as anyone who has witnessed the rise of the living dead that now pose as banks in the USA, Germany and the UK would have to testify, and who understands how much their imprudence has contributed to the pain and suffering of so many innocent people around the world.

If we are seeking to protect the global economy against risk to the global system, if we want to inhibit contagion across borders of the kind we have just lived through, then we must have more prudent ratios and we cannot have different rules for different countries. That is just inviting a repeat of the current mess.

For this reason as well, assuming acceptable global standards are eventually put in place, they are going to have to be enforced by the G-20 against G-20 members, and that is going to require enforcement by a supervisory body with an experienced staff of professionals whose only responsibility is the integrity of the global system. In short, no more one-day monthly trips to Geneva or Basle to check the temperature.

Finally, that supervisory body must have enforcement tools that are every bit as effective as those a national regulator would have at home.

Why? Because in a world of seamless capital markets, there are no borders, and if those are the rules of the game the bankers or players play by, then those must be the rules the referees play by as well.

For instance let's assume Geithner's suggestion is adopted. The immediate effect will be to reduce the return on equity of the major financial institutions and "guess what", the compensation paid their senior executives.

How long do we think it will be before the bankers find ways around these rules - ways which will certainly increase systemic risk?

Do we think under those circumstances that the voluntary subscription to global standards that are not continuously reviewed and enforced will be sufficient? Only if you believe in the tooth fairy!

Nor are the reasons to redefine sovereignty arising out of the financial crisis limited to the gripping domain of bank regulation!

In a recent newspaper article, the US Director of National Intelligence was cited as suggesting the primary US security concern is now the destabilizing global political fallout from the economic crisis.

If this is so, can the G-20 allow an archaic definition of sovereignty to forestall global action? I for one do not believe so, and furthermore I believe the time to act is now, while memories of the crisis are fresh and the window of opportunity is open.

Clearly, if the G-20 seeks to do its job, it is here in the definition of sovereignty (whether its expressed that way or not) that the battle lines will be drawn, and where those like CIGI who led the fight for the G-20 must engage once again.

For the debate is no longer does the world need a new steering committee. It is can any steering committee succeed under the old rule of sovereign rights without sovereign duties.

The argument to be made is quite straightforward. It is, in the light of 21st century realities, that the redefinition of sovereignty should no longer be viewed as a threat to the integrity of the nation-state but as a necessary protection of nationhood.

For instance, in the years to come, when the Chinese and Indian economies become as large as the American, and a Chinese hedge fund fails, or a mortgage meltdown occurs in India - who will bear the disproportionate share of the fallout, if not the US and European economies if they hide behind their sovereignty to frustrate the effective resolution of global issues now - now by the way when they have the opportunity to do so, an opportunity they may not have in a decade when the emerging economies are feeling their oats even more than today.

The fact is effective global coordination does not mean the slow road to global government as some seem to fear. Nor do global institutions with teeth infringe on national sovereignty! Quite the opposite.

In fact, global solutions to global problems are the reaffirmation of national sovereignty in that they allow national governments to deal with problems that transcend their borders which otherwise they never could solve.

In conclusion then, let me simply remind us that the future of globalization is the great issue of our time, and the current financial crisis is only one manifestation of the need to make it work better.

In that vein, how the G-20 deals with the crisis may well provide an indication of how the world will deal with the interdependence of states in the future.

The question the G-20 has to answer, is now that there will be not one or two, but for the first time in our lives, five or six giant economies, what is it we must do to ensure that this works to everyone's benefit.

The answer to that question does not require a Nobel prize in economics, but what it does require is a level of international cooperation that improved significantly in Pittsburgh but which has still not passed the test.

If the G-20 is to succeed, what it must do is to ensure that its dialogue takes place not just on the basis of the sovereign rights of its members but on the basis of their sovereign duties as well. Indeed, this may become the most important role the G-20 has to play as the world's steering committee.

Mr. Justice Oliver Wendell Holmes, phrased it well when he said "My right to extend my hand, stops at the other man's nose".

Well, the reality the G-20 must deal with is that in today's world - that distance between "my" hand and the other man's nose, has just gotten a lot shorter.

Thank You!