SOVEREIGN RIGHTS AND DUTIES: THE FUTURE OF THE G20

Paul Martin

The former prime minister reflects on the future of the G20, of which he was an early proponent when he advocated the creation of the G20 finance ministers' forum and served as its first chair. As prime minister, he pushed strongly for the elevation of the G20 to the leaders' level, which occurred as a result of the 2008-09 financial crisis. He believes that the first responsibility of the G20 as the world's steering committee is to deal with the gridlocked issues that prevent globalization from working as it should. He gives three examples: food security, climate change and bank regulation following the financial crisis. For the G20 to succeed, Martin says, it will have to deliver on a recasting of sovereignty to include duties as well as rights.

L'ancien premier ministre Paul Martin anticipe l'avenir du G20, dont il avait très tôt proposé la création en préconisant un G20 des ministres des Finances puis en présidant sa première rencontre. Une fois au pouvoir, il a continué de plaider pour un G20 des chefs d'État, qui a finalement vu le jour pendant la crise financière de 2008-2009. En tant que « comité directeur » des affaires du monde, le G20 doit selon lui s'attaquer prioritairement aux enjeux non résolus qui empêchent présentement la mondialisation de donner sa pleine mesure, notamment la sécurité alimentaire, les changements climatiques et les problèmes de réglementation bancaire découlant de la crise. Pour réussir, dit-il, le G20 doit revoir la notion de souveraineté de façon à ce que celle-ci entraîne des obligations, pas seulement des droits.

As a result of the great recession of 2008-09, the G20, following three unprecedented summit meetings within a year, has succeeded the G8 as the world's new steering committee.

The question that must now be addressed as Canada and Korea prepare to host the next two summits is, "What is the measure by which the G20 should be judged?"

The answer for many of us who pushed for its creation is the degree to which it improves the way globalization works in the here and now and the way it prepares for the road ahead.

This is not an academic yardstick. Our goal was to relieve the gridlock that is paralyzing the international system, and that, on issue after issue, is the litmus test the G20 will be called upon to meet.

In this context, I would like to highlight three examples of the above. They are global poverty, climate change and the global banking crisis.

First, global poverty. Poverty has many faces. One of the most incomprehensible in the modern age is the lack of food security — malnutrition and famine.

In 2008, the price of the world's food staples tripled, and developing countries' budgets were decimated as they struggled to import food, and civil unrest spread throughout Africa and Asia.

Now the world's great agrifood companies say that new technologies will solve the problem. I hope so! However, at the present time, the growth rate in agricultural production is falling, not rising, and the UN predicts that within a generation the demand for food will increase massively as the globe's population soars by a third and growing affluent populations intensify the pressure on agricultural resources.

Nowhere is the threat of famine more serious than in Africa, where the shortages are due to drought and major imbalances in the food chain. Yet with the exception of a bow in its direction, the G20 has virtually ignored Africa and the issue of food security.

Now the member countries may plead the pressures of the financial crisis as their excuse, but the fact is the crisis was of too many of its members' making. Yet it is the developing world, beginning with Africa, that has suffered the most grievously as its significant economic gains over the last decade were wiped out through no fault of its own.

So, if the question is "How has the world's new steering committee done so far?" the answer is that it has a long way to go. Of course Africa's leaders have much to answer for, but the G20 must respond much more urgently than it has if it is to live up to the hopes so many have vested in it.

The next issue is climate change.

On most questions, what is important is the signals the G20 sends to the world's negotiating tables. In the case of climate change, this meant Copenhagen, where, suffice it to say, the signals sent were the wrong ones.

Of course, the prime responsibility for CO_2 emissions lies with North America and Europe. But this does not mean that all of the G20 members do not have a responsibility as their emissions increase to Bangladesh, the Philippines, Central America, and Africa, for instance, regions of the world that 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.

After Copenhagen, the world cannot afford another failure. The next climate change summit will be held in Mexico next November-December. Before then, there will be the two G20 summits. Rather than a last-minute ad hoc meeting between the US, China and a few others, as was held in Denmark, let the G20 prepare now to send the proper signals well ahead of time so that the Mexican meeting has a chance to succeed.

Furthermore, important as climate change is, that's not the only issue at stake here. If after five meetings of the G20, not to mention countless expanded meetings of the G8, the differences between the developed and emerging economies show as few signs of being bridged in Mexico as they did in Copenhagen, then we will have a problem on our hands that extends far 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 national interests. It must recognize the needs of others, including those who are not at the G20 table.

The point is quite straightforward. The G20 came into being because the world has changed. Its members are members because they have power and position, but they also have responsibilities — responsibilities they must live up to!

The last example I would cite arises, not surprisingly, from the current financial mess. 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, and we cannot afford another one. To put it starkly, the great recession of 2008-09 has done its damage, and too many countries that are already dealing with the costs of aging populations are now having to confront decimated balance sheets, and none of them can afford to engage in their own deficit fight only to have it all unravel because of another global banking upheaval.

In the never-ending cycle of financial downturns, bubbles and implosions, bank crises are undoubtedly the worst, because bank credit is to the economy what wind is to sail. It is that on which all else depends. When confidence in the banks fails, it drags everything else down with it.

The great strength of the free market is its ability to innovate; its great weakness is the tendency every so often to take that innovation a bridge too far. Nowhere is that weakness more damaging than when it appears in the banking system, a system that depends almost entirely on the trust we repose in it. That is why the moral hazard posed by institutions that feel they can violate that trust will eventually eat away at the foundations of the free market, and that is why I agree with the Governor of the Bank of England, who said, "If a bank is too big to fail, it is too big."

As both Lehman Brothers and AIG bear witness, 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 answer, however, is not to protect financial institutions from bankruptcy; it is to develop a protocol on how failing mega-institutions can be unwound without bringing down the whole global system. The broad proposal that major financial institutions should establish "living wills" to that end is interesting.

Fundamentally, what has to be done is to reduce the complexity and entanglements that prevent major elements of an existing institution from being separately regulated and hived off if necessary. Of course the devil is in the details, but these must be faced up to. The fact is that as a result of mergers and takeovers such as Lloyd's and HBOS in the UK, Wells Fargo and Wachovia in the USA, the problem of size has gotten worse, not better.

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Thus, the third test I would cite as we judge the success of the G20 is one the leaders themselves put upfront and centre, and that is the need for the international monitoring of crossborder financial institutions and the need for comprehensive international financial standards.

Let me be clear. A single global regulator is simply not workable. Such a body could never have the domestic insight and intuition required to provide adequate national regulation. That being said, if globalization is to work, we must recognize that national regulation alone cannot deal with the gaps in the global financial system.

Thus we must ensure that the effectiveness of national regulation itself is audited by an international coordinating body for both scope and competence. Furthermore we must ensure that this coordination is mandatory, not voluntary, and therein lies the rub, for it is in the quicksand of the debate around these issues that the G20 is currently bogged down.

After what the global economy has just been put through, this is more than passing strange. For given the difficulty major US and European bankers now appear to have remembering how remorseful they were but a short time ago, it is evident that a voluntary process of global coordination will lead nowhere.

Quite simply, over time, regulatory arbitrage (i.e., shopping for the weakest jurisdiction) will make it impossible in a permissive system for the G20 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 for many reasons, not the least of which was 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, Frankfurt, Singapore and Tokyo 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!

At the present time the G20 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 core equity, liquidity and leverage ratios for G20 banks themselves. As anyone who witnessed the taxpayer-induced resurrection of those American and European banks whose imprudence contributed to the pain and suffering of so many innocent people around the world would testify, it is difficult to watch the resistance of those same banks today to what for anyone else would be simple common sense.

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These core standards are essential. Regulation is important but it is no panacea. Unfortunately nothing is.

For this reason financial institutions require a solid foundation — an equity base and prudent ratios that will allow for human lapse — one that has a better chance of withstanding the ravages of greed or the unexpected. In short, bankers, their shareholders and creditors must understand that a system whereby institutions take excessive risks and earn excessive profits but taxpayers pay the bill for failure is no longer on.

Finally, if we are seeking to protect the global economy against undue risk to the global banking system, if we want to inhibit contagion across borders of the kind we have just lived through, then not only must we have more prudent ratios, we cannot have widely different rules of general application for crossborder financial institutions.

For instance, the fact that so many banks even today are pockmarked with toxic assets that they refuse to value properly and that are a blockage to a desperately needed economic recovery, because they are impeding the flow of credit, is in itself reason enough to stop the game playing across borders.

In the same context, assuming acceptable global standards are eventually put in place, financial institutions are going to have to be monitored for transparency and credit rating agencies for conflict of interest, and that is going to require 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 Basel to check the temperature.

Furthermore this supervisory body must have an enforcement capability. The announcement by the Financial Stability Board that regulators around the world will submit to peer reviews and that consideration is being given to whether to publicly identify countries that refuse to cooperate is welcome, but only as a first step. Eventually, much stronger countermeasures will be necessary.

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

For instance, let's assume Canadian banking ratios and regulation became the order of the day. In

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Les compagnies de recherche pharmaceutique du Canada those circumstances how long does anyone think it will be before others, chafing at the bit, will seek ways around the rules — ways that will certainly increase systemic risk? Does anyone think that, when this happens, the voluntary subscription to global standards that are not continuously reviewed and enforced will be sufficient? Only if they believe in the tooth fairy!

The next question, of course, is, "By when must this be settled?" Well, there is one G8 meeting and two G20 meetings scheduled in 2010, two of them hosted by Canada in June, with the G8 at Muskoka and the G20 in Toronto.

Given the ongoing differences in approach within the United States and Europe and between them, and the delays that flow from this, it is clear that the most urgent need is to establish the essential foundation first, resolving the other arguments later.

Thus I don't believe it is too much to ask that the G20 confirm in June that the definition of tier 1 capital coupled with the ensuing ratios will be settled by the fall, and the remaining issues in the months (not years) that follow. Beyond that, memories of the crisis will begin to fade, and so will the urgency to act as well — until the next time, that is.

In short, the time for the G20 to draw the line in the sand is now. But while the right words are being spoken, it's evident from the ongoing delays and incessant debates that not all of the G20 members are prepared to carry through.

What the recalcitrant should remember is that they are there to speak not only for themselves but also for the 173 countries that are not at the G20 table. In short, the parochialism of rigid borders makes no sense, not if you want to make globalization work.

The G20 is a global steering committee, not a small club of the self-interested, and the question to ask is not how you keep New York, London or German bankers happy, it's how you keep the global economy healthy.

So where does all this leave us? I have suggested a litmus test for the G20, making reference to three examples. All three are part of the G20's inheritance from the G8. They are global poverty and food security, climate change and the financial crisis.

In each case, the jury remains out but the grounds for optimism are there. In each case, however, as well, there are two constants that have to be dealt with if the G20 is to fulfill the hopes so many have for it.

The first is the trade-off between generations. This of course is most evident when addressing climate change. However, it should be every bit as evident when dealing with global poverty, but apparently there are those who continue to believe the rich world can isolate itself from the misery of others.

Let them not kid themselves. In 2050 Africa will have a population of 2 billion, 500 million more than either China or India at that time. This will be the largest agglomeration of people and the highest proportion of young people anywhere on the planet.

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 G20 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 that no wall will be able to resist — then those young people will turn, as so many in their circumstances would, 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.

The choice is ours; the consequences of that choice, however, will be borne by our grandchildren.

The second constant that is crucial to the success of the G20 is whether the leaders of the member countries show a capacity to rise above the political comfort of narrow nationalism — this because coming to grips with what it takes to make globalization work requires a global consensus that cannot be squared with the traditional exercise of sovereignty.

In establishing the G20, there was no intention to create some kind of international superstructure overseeing the 193 countries that make up the United Nations. The purpose of the G20 can be no more than to be a deliberative body whose recommendations will not always be followed but which will certainly carry considerable weight because of the nations that make it up.

What, in the end, will determine the G20's success or failure will be the ability of its greatest powers to recognize that the protection of national sovereignty in today's world depends no longer on territorial isolation but on territorial cooperation.

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To illustrate this point, let me return to the issue of the financial crisis and the resistance to enforceable global standards of financial regulation.

At the core of this resistance is a counterproductive definition of sovereignty — of "who is boss" — a definition that is increasingly outdated.

PMO Photo

Finance Minister Jim Flaherty and Prime Minister Stephen Harper at the big table of the G20 Summit in Pittsburgh last September. Former PM Paul Martin, who as finance minister played a leading role in creating the G20, calls it the world's steering committee.

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, my point quite simply is that the definition of sovereignty today must now include sovereign duties.

For instance: 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 the 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 is the key to making globalization work.

Now this is all too theoretical, some may say, but the fact is that arguments over sovereignty continue to provide the underpinning of virtually every debate at the G20 table.

Well, 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" (R2P) 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 Westphalian definition.

However, as his purpose is 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 when he writes: "States can no longer refuse to act by hiding behind 17^{th}-century concepts of sovereignty in a world of 21^{st}-century dangers. International law should not be powerless to prevent deadly non-state threats from spreading from one state to others."

The future of globalization is the great issue of our time, and the issues of global poverty, climate change and the financial crises are all manifestations of the need to make it work better.

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 true in the case of the R2P. It is true in the case of the responsibility to contain. And it is true in the case of the responsibility of great powers not to decimate the global economy because of failures in their own bank regulatory processes, which is what the G20, the Financial Stability Board and the Basel Committee 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 — these are the $64 billion questions!

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

A similar argument can be inferred from a recent newspaper article where Dennis Blair, the US Director of National Intelligence, was cited as suggesting that the primary US security concern is now the destabilizing global political fallout from the economic crisis.

If this is so, can the G20 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 financial crisis are fresh and the window of opportunity is open.

The point is that as the G20 seeks to do its job, it is here in the definition of sovereignty that the battle lines will be drawn, for with the designation of the G20 as the world's new steering committee, the debate is no longer over what will replace the G8, it is over whether any steering committee can succeed under the old rule of sovereign rights without sovereign duties.

Indeed, the argument goes well beyond the G20. Contrary to many, I believe the redefinition of sovereignty to include duties as well as rights is not a threat to the integrity of the nation-state; I believe it is now a necessary protection of nationhood.

What European and North American legislators must come to grips with is the reality that 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, there will be no stimulus package big enough to rescue us if we in the West hide behind the traditional interpretation of sovereignty to frustrate the effective resolution of global issues now — now when we have the opportunity to improve the rules of the game, an opportunity we 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 and standards with teeth infringe on national sovereignty. Quite the opposite. In fact, they are the reaffirmation of national sovereignty in that they allow sovereign governments to deal with problems that affect the common good, problems that transcend their borders that otherwise they could never solve. That is the argument the G20 not only must make, it is one it must deliver on.

The future of globalization is the great issue of our time, and the issues of global poverty, climate change and the financial crises are all manifestations of the need to make it work better.

In that vein, how the G20 deals with them will provide an indication of how it will deal across the board with the interdependence of states in the future.

The question the G20 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 at the table, what is it we must do to ensure that this works to everyone's benefit?" The answer to that question does not require genius, but what it does require is a level of international cooperation that improved in Pittsburgh but that unfortunately failed the test in Copenhagen.

If the G20 is to succeed, what it must do is 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 could be the most important role the G-20 has to play.

Paul Martin, Prime Minister of Canada from 2003 to 2006, was minister of Finance from 1993 to 2002, in which capacity he played a leading role in creating the G20 finance ministers' forum, forerunner of the G20 leaders' forum. Adapted from a presentation to a conference hosted by the Centre for International Governance Innovation in Waterloo, Ontario, on October 4, 2009.

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