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Global Governance and Systemic Risk in the 21st Century: Lessons from the Financial Crisis

Ian Goldin and Tiffany Vogel
University of Oxford

Abstract

Recent decades of globalisation have created a more interconnected, interdependent and complex world than ever witnessed before. While global policy has focused on facilitating integration, the implications of growing interdependence have been largely ignored. The acceleration in global integration has brought many benefits, but it also has created fragility through the production of new kinds of systemic risks. This article provides a framework for understanding these new 21st-century systemic risks and examines the challenges they pose to global governance. The 2008–2009 financial crisis will be used to illustrate the failure of even sophisticated global institutions to manage the underlying forces of systemic risk. We show this is symptomatic of institutional failure to keep pace with globalisation. The failure of the most developed and best-equipped global governance system, finance, to recognise or manage the new vulnerabilities associated with globalisation in the 21st century highlights the scale and urgency of the global governance challenge.

Policy Implications

- The rise of systemic risk requires a systemic response. Effective global governance and policy development have never been so necessary and urgent.
- The financial crisis illustrated that current global financial institutions are inadequate in their policy response to systemic risk and cannot keep pace with innovation and increasing system complexity in global finance. Deeper structural changes are required, including regulatory reforms.
- The institutional rigidity and profound shortcomings of global institutions apply not only to global finance, but to other looming systemic risks in the future. Neither the current global governance system, nor the planned reforms, meet the test of addressing new global systemic risks.
- Global governance requires radical structural changes in existing institutions and the development of new global institutions that reflect the realities of new global power balances and address the forces of systemic risk in the 21st century.

1. Globalisation in the 21st Century

While the precise definition and various periods of globalisation have been widely studied and debated (see Held et al., 1999 for an overview), the latest wave of globalisation has been unique, with particularly widespread and intense integration of markets, trade and finance. This has been facilitated over the past 20 to 30 years by seismic policy shifts, such as the economic and political reform process in China, and much of Asia, Latin America and Africa, the fall of the Berlin Wall in 1989, European integration following the signature of the 1992 Maastricht Treaty, and the ideological convergence around market primacy ushered in during the Reagan, Thatcher and Kohl era in the 1980s. According to International Monetary Fund (IMF) and World Trade Organisation (WTO) reports, between 1980 and 2005, global foreign investment inflow increased 18 times, real world GDP growth had increased by approximately 32 per cent and world merchandise imports and exports increased more than sevenfold.

Technological innovation has also accelerated economic integration through both virtual and physical time–space compression (Harvey, 1989). While the development of fibre optics, the Internet and mobile telephony, as well as exponential growth in computing power all revolutionised the underlying architecture of systems by *virtually* increasing proximity, *physical* proximity has also increased through technological innovation in transport and infrastructure. Population growth and urbanisation, too, are driving physical proximity, integration and interdependence. The world population has nearly doubled since 1950, and the urban share has increased dramatically from 29 per cent in 1950 to over 50 per cent in 2009.[1]

Policy shifts, technological innovation and increased population density have also been paralleled by changes in managerial practice and accounting standards, which extended the 'Just-In-Time' management strategy to emphasise that inventories reflect tied-up working capital, and must be made to 'sweat' (Hutchins, 1999). This has shortened the time between the production and consumption of goods and services, while outsourcing and global

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