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IN THE WAKE OF CREATIVE DESTRUCTION: A NEW WORLD ORDER?

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The global economy has just come through a near-death experience. Although it is out of intensive care, it is still not out of danger, and the early rush of euphoria in the spring of 2009 is being replaced by sober recognition of just how massive was the destruction and how steep and how long is the road to recovery.

Creative destruction of this order of magnitude, argued Joseph Schumpeter in 1942 in his seminal Capitalism, Socialism, and Democracy, erodes the power, profits, and position of older, established firms. It shakes the foundations of economies, sweeps away the debris in a ruthless rush, uproots established orders, and makes space for innovation, for new forms of economic life.

This metaphor of creative destruction, which came to prominence after the Great Depression, is useful not only to explain the transformation of national economies. It also illuminates deep changes in the global economy, the repositioning of important global players, the rebalancing of global politics, and the consequential need for financial institutions and security instruments that reflect these fundamental changes in global dynamics.

Economic life and security are, of course, closely connected. As the forces of creative destruction rip through economies and societies, creating havoc as they push aside the less dynamic, they change the underlying structures of economic wealth. New economic innovators come to the foreground and reshape not only economic life, but political and social life as well.

In our interconnected economies, these processes of destructive innovation are at work, now on a global scale. Older established economies are struggling as dynamic "emerging" economies surge ahead, reverse-engineer products and technologies, capture larger global market share, and speak more confidently, with greater assurance, in global institutions. They speak not only about managing the economy, but also about constructing global security.

There is no important global issue where the United States today does not, for example, need the cooperation of China and, increasingly, of India. Whether it is the rebalancing of the global economy, or the reform of global financial institutions, or the crafting of a consensus on environmental issues, or managing the serious challenge of nuclear proliferation, or enhancing cyber security, on all these issues, Washington cannot close the deal unless Beijing is onside. And many other partners as well. On all the big global issues, the forces of creative destruction are elevating new voices and reshaping institutions. This should be no surprise to readers of global history.

Creative Destruction in the Global Economy

The last few days of June 2010 witnessed an unusual spectacle in Toronto. The leaders of the venerable G8, an institution now more than 30 years old, went up the mountain to discuss development and security. Ironically, these were the residual issues, those that the G20, the newcomer on the international institutional block, had not yet claimed as it focused heavily on the reform of the financial system in the wake of the global financial shocks. Down these same leaders came, after a dinner and a half-day meeting, to join the other 12 in the G20 at a meeting in downtown Toronto to push forward global financial reform on the way to their next meeting in Seoul.

This was the first time the old and the new met in tandem, within a day of one another: the old were familiar, comfortable, venerable, in familiar routine and with intimacy, already nostalgic for a world that is disappearing; the new were edgy, slightly unfamiliar, somewhat uncomfortable and at times uncertain, but pushing into a world that is fast becoming, if it is not already here.

Whether or not the G8 continues to meet — a meeting is scheduled for the spring of 2011 in France — or gently disappears is not of great moment. Old clubs continue to meet long after they have been overtaken by history, to preserve old friendships, and to bemoan the brashness of the newcomers. Visit almost any old boys' club in London or Toronto and listen to the conversation.

The transition in the global economy, predating the financial shocks but made more visible by them, is now obvious to the naked eye. When G20 leaders meet in Seoul, for the first time they will meet in the capital of a member who is not in the G8. That change must make itself felt in the architecture of global governance, in Bretton Woods institutions and, even more difficult, in global security institutions.

How deep is the transition in the global economy? The most recent IMF projections of annual growth rates of the BRIC countries in comparison to the "mature" economies show significant differences. China's economy is expected to grow at approximately 10 percent through 2011, India at 7.5 percent, Mexico at 5 percent, and Canada at just over 3 percent, while the growth rate of the U.S. economy is projected at only 2.5 percent. Of course, the United States remains the world's largest economy — at $14.26 trillion, just slightly less than three times the size of China's ($4.91 trillion). Growth rates can be misleading when the base is small, but nevertheless, it is clear that growth and dynamism will occur largely in the non-G8 members. China, India, Brazil, Turkey, and Mexico are likely to lead the world in that regard.

But growth is only part of the story. What about the structure of the world economy? In 1999, the United States was the world's largest exporter, with Germany second, and Japan third. A decade later the United States had fallen to third place behind Germany, which was still in second place, and China at the top. In 1999, China ranked ninth. China is now the largest car market in the world — it has overtaken the United States here too — and just recently passed Japan as the world's second largest economy. China is now the most important price maker of commodities in the global economy. It is the surge in inexpensive Chinese exports, fueled by an artificially low currency, that created the structural imbalances in the global economy that must now be corrected.

India's story is less widely known, but equally striking. It is the second-fastest-growing economy in the world, the fastest-growing free-market economy, and some forecasters put it in third place by 2040, ahead of Japan and Germany.

Are these changes an artifact of this last decade? Not if you listen to senior economists in Delhi and Beijing who assert, occasionally with some asperity, that India and China are merely resuming their rightful position in the global economy, a position they lost only in the 20th century and are now regaining. Colleagues in the two capitals are uncomfortable with the term "emerging economies" when it is applied to them. They emerged a long time ago, they insist, and are merely returning to positions of global and economic power that they once held.

As a distinguished economist in Delhi put it to me recently: "In less than 100 years of independence from nearly two centuries of colonial rule, India will have regained its position as one of the world's leading economies and emerged as a major global power." Historical data over the last 300 years are consistent with that claim.

A fundamental shift in economic power and dynamism — a rebalancing of the global economy — is now well underway. It will play itself out in bursts and spurts over the next several decades, hopefully without the cataclysmic violence that has given birth to changes in economic and political structures in the past. That shift cannot but affect the capacity to provide security as a global public good, to manage sustainable growth, and to engineer a new architecture of global governance. The progress thus far, however, has been remarkably timid and incremental. There is barely a whiff of the deeper structural changes that are coming.

Incremental Reform of Global Financial Institutions: From Toronto to Seoul

The G20 has had only limited success in its first four meetings in achieving its most important objective, the reform of international financial institutions. At its initial meetings in Washington and London, leaders were overwhelmingly preoccupied with stabilizing the global economy, with preventing a worldwide recession. By the third meeting, in Pittsburgh, the reform of financial architecture had moved to the top of the agenda. In Toronto, leaders managed only to give the issue a nudge rather than a push. They expect to move the reform agenda forward at their meeting in Seoul in November 2010.

In fact, Some progress has been made. The membership of the Financial Stability Board (FSB) has been expanded to reflect the shift in global economic power, and the International Monetary Fund (IMF) has been reinvigorated by the infusion of new resources to stabilize economies in trouble. Although no data are yet available, anecdotal evidence suggests nevertheless that the World Bank has been more successful then the Fund in moving money out the door to economies under stress.

The G20, the informally constituted newcomer, has asked the formally responsible institutions, the FSB and the IMF as well as the Basel Committee on Banking Supervision, to prepare reports and recommendations for the meeting in Seoul, to act for all intents and purposes as their technical arm. The IMF has been asked to identify inconsistencies among national assumptions and to determine the effects of national frameworks on the global economy.

The exercise represents the strongest attempt yet at coordinated multilateral surveillance on a global scale. These technical reports are expected to provide the impetus to concrete follow-on policy and implementation agreements in Seoul. This is a challenging agenda, for governments will have to give some weight to the negative consequences of their national policies for the global economy even when these policies produce benefits at home. Historically, this is a tall order, an order that grows taller as memories of the financial crisis recede. How seriously governments will commit themselves remains an open question. The most obvious issue, but far from the only example, is China's exchange rate.

Beneath the policy challenges are structural inconsistencies, inconsistencies that are likely to bedevil the reform agenda. The relationship between the informal G20 and the formal IMF and its Executive Board is unclear. Strictly speaking, the G20 has no authority to make requests and issue orders to the staff of the IMF. Far more important, no institutional reform of the IMF has yet been implemented. The G12 — those states other than the G8 in the G20 — do not have the voice or votes that reflect their share of the world economy. Particularly in Asia, suspicion of the IMF is rife in the wake of the Asian financial crisis, and leaders are unlikely to be receptive to advice, no matter how expert and technically competent it is, that comes from an unreformed Fund.

G20 members did take the first step to reform the governance of the IMF: they agreed to transfer 5 percent of the quota to the rising economic powers by 2011. However, European countries, now significantly over-represented, have not yet agreed to reduce their share to make room for India, China, and Brazil. Here, the tension is evident between the G8 and the G12 in a world that is transforming; even incremental reform is painstakingly slow, blocked by the unwillingness of Europe to relinquish outdated positions of power. The G12 will not wait forever for international financial institutions to adjust. Progress on this issue is an important indicator of the flexibility of existing global financial institutions. If these institutions prove themselves to be insufficiently supple, incapable of making even incremental changes, newly powerful countries will turn away in frustration and commit their attention and resources to regional institutions.

Managing Global Security

Reform of the international financial architecture is important on its own merits. It may be helpful in mitigating the worst consequences of the next global financial crisis, which contrary to the optimistic rhetoric of public officials, cannot in all likelihood be prevented. Reform is also important because it will give voice and vote to the countries that have emerged as significant to the workings of the global economy. It is important that these countries be engaged in institution building, rather than standing on the outside looking in, often with considerable resentment.

How the effort to reform the international financial system develops will also be important to the effective management of the global security agenda. At the most basic level, there is a correlation between economic strength and the capacity to project military power. Of course, it is no coincidence that the United States, the strongest economy throughout the 20th century, is also the strongest military power, a military power that spends as much on defense as the next 15 largest spenders combined.

Throughout the last century, the United States provided security as a public good to its allies, and it continues to do so today. Historically, there is generally a lag between a decline in relative economic power and a reduction in military spending, but the constraints imposed by reduced economic power do eventually catch up. Great Britain comes readily to mind. The newly strong economies of India and China are already spending relatively more on their militaries than they were a decade ago.

Military spending is only one indicator, and an increasingly less useful one, of the capacity to contribute to global security. The use of military force is a last resort to deal with the menu of contemporary threats to global security and, indeed, it is an increasingly ineffective instrument. The likelihood of a major interstate war is low. More to the point, the use of military force in asymmetrical warfare against nonstate actors, the kind of war that is likely, has a poor record of success.

The United States military and its allies have been on the ground for a decade in Afghanistan and yet the government in Kabul remains insecure and, if Transparency International is correct, among the most corrupt anywhere. Although al-Qa'eda no longer operates with impunity in Afghanistan, the security challenge continues to be serious and, in neighboring Pakistan, it is much worse today than it was a decade ago.

The list of threats to security is daunting. Pirates threaten international sea lanes, criminal networks operate with a global footprint, space is increasingly being militarized, human and drug trafficking continue, and the miniaturization and privatization of dangerous technologies make defense against lethal attacks very difficult. From this menu, it is worth looking at two threats in particular: cyber warfare and nuclear proliferation. Both fall squarely within the security envelope, but neither can be addressed without the full engagement of many non-G8 countries that are currently in the G20.

Cyber Warfare

The global economy runs on highly sophisticated electronic networks. These electronic networks are the central operating system of the world, a system that is vulnerable to espionage, disruption, and cyber attacks. A diverse community of potential attackers has an interest in penetrating these systems: militants who seek to demonstrate their capacity to inflict damage in highly visible ways; those who seek to commit acts of terror; and those who are interested in military secrets or economic espionage. Cyber warfare has now been identified as the pre-eminent threat to national security in the United States and in Canada, and Washington is now spending billions of dollars to develop effective countermeasures.

The recent controversy between Research in Motion (RIM), the Canadian manufacturer of the Blackberry, and governments in the United Arab Emirates, Saudi Arabia, and India is emblematic of the new frontiers of security. RIM encrypts its messages for its business customers and sends them through secure servers that it controls. The security it provides to its business customers makes it more difficult for governments to monitor and read messages sent through the network. India claims that the militants who attacked Mumbai communicated through secure message systems that they could not read in a timely way. Research by the Citizen Lab at the Munk School of Global Affairs demonstrated as well that important elements of India's communication infrastructure were vulnerable to penetration from servers located in remote parts of China.

For the government of India, it was imperative that it simultaneously improve the security of its own systems and increase its capacity to monitor messages in real time. In the struggle between RIM and India, the government was determined to assert its authority over communication systems that had consequences for its security as well as its economy, and threatened RIM that it would close its markets to Blackberry unless RIM complied. That is an expensive action for India to take: it would damage its attractiveness in the global market place to firms that operate seamlessly across borders. Negotiations are still ongoing as RIM tries to protect its core competitive advantage in a global market while India is determined to assert the primacy of its security. Today, that means the capacity to monitor private messages that travel on global networks.

The controversy tells us that governments in the newly powerful economies are building national boundaries in what many think of as borderless cyberspace, vigorously asserting their sovereignty and enforcing their writ. The dream of cyberspace as a floating platform, as a mobilizing agent against authoritarian governments, remains just that. States will play a prominent role in securing cyberspace and using electronic systems to monitor threats to their security as well as to seek competitive advantage in the global economy. India, China, and other G20 members will need to be actively engaged in the regulation of cyberspace as a global public good if we are to avoid a scramble for spoils.

Proliferating the Bomb

Nuclear proliferation is the other issue that is at the top of the global security agenda. Limited progress has been made on the safeguarding of nuclear materials, a particularly urgent issue after a private network in Pakistan shared nuclear secrets with Libya and possibly with Iran. Even that limited progress was only possible in a high-profile forum of 47 states convened by Washington in April 2010.

Thirty-seven leaders came and some made voluntary commitments. In a significant change in its focus, India declared that it will build a center to promote nuclear security, and Ukraine, Mexico, Chile, Kazakhstan, Vietnam, and Canada agreed to dispose of hundreds of pounds of highly enriched uranium used in civilian facilities.

The agreement has no enforceability, however, and the capacity of the institutional architecture, led by the International Atomic Energy Agency (IAEA), to inspect and enforce agreements is woefully under-resourced. In the absence of strong global security institutions, the United States continues to have unparalleled convening power, but even Washington cannot operate without the newly powerful.

At the center of the global security agenda are the nuclear weapons of North Korea and the nuclear program of Iran. China is central to progress on both issues. As the strongest economic partner of North Korea, it plays an essential role in the Six-Party talks with the country, as does Japan. China and Russia are both critical partners in any sanctions against Iran as it proceeds with its nuclear program. Neither China nor India can be excluded from the executive committee of global leaders if they are expected to be partners in the active containment of nuclear proliferation.

The global security architecture is much weaker than the nascent governance system of formal and informal institutions in the global economy. The United Nations has been unable to reform the Security Council, the institution charged with the maintenance of peace and security, despite more than two decades of trying. Its current composition, which gives veto power to the United States, Russia, China, Britain, and France, is wildly unrepresentative. It excludes some of the G8 and, more to the point, virtually all of the G20. The Security Council is discredited in practice, and illegitimate in its restricted representation. As for the General Assembly, with just short of 200 members, it is wholly unequipped to manage, much less lead, on global security issues.

Given the vacuum in the global system, regional organizations have stepped in to fill the breach. NATO successfully managed the conflict within its own backyard. The dismemberment of the former Yugoslavia was a decade-long responsibility and NATO was able to mobilize support and resources from its members. The story is, of course, dramatically different in Afghanistan, NATO's first out-of-area mission in its 60-year history. NATO has failed to mobilize the resources, to deal effectively with differences among its members, and to execute effectively on the ground. The strongest, best institutionalized, and best resourced regional security organization was unable to perform effectively outside its region.

The G20: A Petri Dish of Global Governance

Unlike the global security architecture, there has been institutional innovation in the governance of the global economy. The G20 is self-appointed, not especially legitimate, and poorly connected to the United Nations, but far more representative than the G8, which excludes the essential countries that will have to underwrite new arrangements on financial reform, the environment, development, and on global security.

The G20 is a back-of-the-envelope experiment, an ad hoc adjustment to a new world: untested, unproven, clunky, and cumbersome. It is more difficult to organize than the G8 and less intimate, but it brings most of the right governments to the table. It is the first incremental change in a global architecture that must evolve to reflect global rebalancing.

The G20 is already expanding its mandate. South Korea has put development on the G20 agenda for the meeting in Seoul, in an effort to achieve a more balanced outcome from globalization, one that is more equitable across and within countries. It is artificial to separate development from the broader management of the global economy: the two are inextricably interlinked.

As its remit expands, it is unclear how the G20 can avoid duplicating the mandates of other institutions in the formal architecture of development, led by the World Bank, the regional development banks, and the family of UN agencies. The G20 will need astute and forceful leadership if it is to demonstrate its worth as the steward of the global economy.

What the G20 has not shown — and wisely so — is any appetite to take a leadership role on global security. That now becomes the exclusive province of the G8, indeed its sole responsibility as leadership of the global economy and development gradually migrates to the G20, with the insistent pushing of some of the G12.

The G8 has experience, familiarity, and a capacity to work informally in an unexpected emergency. These are valuable assets, but they do not compensate for the poor representation of the newly powerful in Asia, Latin America, and Africa, who are growing, innovating, and finding their voices again. The G8, if it survives, will be less and less able to go it alone in a world where power is diffusing, and will need the help of strong, effective regional organizations that are legitimate among their members.

Even if the G20 succeeds in its ambitions, it will not fully reflect the rebalancing that is taking place not only across regions but also across players. Already, meetings on global health now routinely include the Gates Foundation and Doctors without Borders as well as contributing and receiving states. Almost all emergency assistance is now delivered by nongovernmental organizations and most bypasses governments and is given to churches, mosques, and organizations working on the ground.

Governments around the world are partnering with private security companies as they struggle to find the human and financial resources to secure operations abroad and vital infrastructure at home. The design of counter-measures to threats to cyber security is being led largely by the private sector. G20 leaders are increasingly steering rather than rowing the boat and, on many issues, the rowers are not principally other states. The bigger challenge they face — beyond oiling the clunky machinery of the G20 — is to build the scaffolding of a far more diverse architecture of global governance than we have known in the past.

It is important, finally, to underline the intimate connections between the management of the global economy and global security. Strong, prosperous economies that generate employment and reduce inequality are the foundation of global security. That relationship between opportunity and security becomes even more important in a world where the demographic divide is sharpening. Europe, Japan, and China are aging rapidly; Canada and the United States are doing so at a significantly slower rate, but they are getting old. At its core, the G8 is a club of aging societies. Not so the G20, which includes Brazil and Mexico, India and South Africa, all young societies.

Bridging that divide is a fundamental challenge to the effective management of the global economy and global security. And most African countries, now growing rapidly but far from stable, are excluded completely from the G20, as are wealthy countries in the Middle East that are nevertheless poorly integrated into global governance. If Africa is to become more stable, it will need to provide opportunities for its young people as China and India are doing for theirs. Providing that kind of opportunity is a global as well as a regional challenge, and an issue on the global security agenda as well as at the global economic table.

Whether the G20 meets the challenge of international financial reform will have a significant impact on the management of global security. These two spheres of global policy are not hermetically sealed off from one another; rather, they are intimately connected.

Is there a demonstrable capacity to innovate, to build new institutions that reflect the changing balances of wealth and power? Can these new institutions succeed? Can they be legitimate and effective? Can the older powerful welcome the newly powerful, smoothly, with grace? Can they give voice and representation to the new old-timers? Can they broaden the club and welcome the new members?

If the newly powerful states do not sense that they have an important stake in global order, they will have little incentive to come to the table on global security issues unless they are directly affected. If that proves to be the case, the long transition ahead will be much bumpier, more uneven, and more dangerous than anyone expects or would like.

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