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Summitry again proves its own irrelevance

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The Group of 20 leading nations comprises the most powerful people on the planet. There is a tremendous competition over which countries should, and should not, be represented. Yet last week's summit proved almost comically irrelevant to the future of the global economy.

It was a big mistake to try to push Italy into an International Monetary Fund programme without being able to deliver such an outcome. If you really want to force such a momentous decision, the minimum condition is for leaders to say so openly, and for the European Central Bank to announce that it will no longer support the Italian bond market. But they blinked, and let Silvio Berlusconi once again off the hook. The prime minister's assertion that Italy had no crisis because the restaurants are full is an appropriate reflection of the intellectual depth seen at such gatherings.

I would have preferred the summit to tell the eurozone that it needs to solve the crisis on its own, given that it has the financial capacity to do so. The actual outcome of the summit leaves us in a void, with no crisis resolution strategy in place. In the previous decade, the old Group of Seven failed to prevent various financial crises. This decade, the G20 is failing to solve them.

Just as the eurozone is a microcosm of the global economy, the dysfunctional G20 is a macrocosm of the European Council. Its members, European Union leaders, also gather for high-profile summits. Each time they promise comprehensive solutions and fail to deliver. The parallels are remarkable.

I know some would cite the 2008 London G20 summit as an example of successful co-ordination. But that, too, was mostly an exercise in public relations. The US had already decided on a discretionary stimulus, and the Europeans threw all their non-discretionary programmes into the mix to produce the semblance of a genuinely important agreement.

Listening to discussions on economic policy themes at the recent Global Economic Symposium in the German city of Kiel, I was struck by the ubiquity of co-ordination failures in a large number of policy areas. It is fashionable to pin today's problems on weak leadership. But this is missing the point. The present generation may not be particularly impressive – the eurozone is clearly unlucky to have leaders such as Mr Berlusconi at a time like this – but would Gerhard Schröder really have handled this any better than German chancellor Angela Merkel? And do we really think François Hollande as French president could solve the crisis?

My own interpretation is that the various global crises require solutions outside the standard political space. Bringing an end to the eurozone crisis would require a central bank that acts as a lender of last resort, a common European bond market and, ultimately, a fiscal union with a high degree of labour and product market integration. However, these measures are at present inconsistent with national constitutions, European treaties and political preferences. Paul Krugman, the economist, recently explained the problem in terms of what he called the "Euro Venn". The intersection between politically acceptable solutions and those that would solve the crisis is zero.

It is clear today that the eurozone's political leaders created a monetary union with an insufficient political set-up. When they woke up 10 years later, they realised they had created a political monster with loads of linkages that they could no longer control. They thought they had protected themselves against fiscal irresponsibility through fiscal rules – only to succumb to a crisis of private sector imbalances and weak banking systems. They had no plan to deal with such a crisis. Getting governments organised in eurozone summits or G20 meetings was the best they could do. But this is about as effective as running a country through a committee of local councillors with veto rights.

Just like the eurozone, the global economy suffers from internal imbalances and an inability to take collective action. Its institutional infrastructure is also unfit. The IMF, for example, is simply not equipped to deal with countries of the size of the Italy. Nor, in fact, is the European financial stability facility. It, too, was set up to deal with small countries such as Greece and Ireland. Simply extending it is not going to work. Both the eurozone and the global economy need a different approach.

Creating the G20 and extending the IMF seemed the pragmatic response to the global financial crisis – just as the EFSF seemed a pragmatic response to the eurozone debt crisis. But neither is working. Both the eurozone and the global economy need more fundamental reforms than the cosy political processes currently in place are able to deliver. Unless we are ready to reverse monetary integration and financial globalisation, and accept the economic and political consequences, there is no alternative but to create a new institutional framework, with new rules, both within the eurozone and at global level. Our policies have run out of control.