Global economic governance: What role for the European Union and Asia?

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Abstract

This paper analyses the change in global economic governance (economic policy coordination, financial regulation, competitiveness) after the financial and economic crisis in 2008. Specific focus will be devoted to the sovereign actors in the European Union, China, and India.

The research question covers key issues of collective action problems in the economic area:

- *On cooperation: Is there a demand for substantially enhancing economic governance?*
- *On legitimacy: Which institutional parameters are subject for adjustment, including on distributing decision-making power?*
- *On substance: Is the western liberal order to be challenged as a result of a greater role of Asian emerging economies, and is an alternative model emerging?*

The article assesses the current state of play and formulates the tendencies emerging for future development based on the analysis of the positions of the sovereign states and the developments of international organisations (IMF, World Bank) and informal groupings (G20).

Key words: economic governance, economic crisis, Asia, Europe, collective action

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Introduction

Globalisation is experiencing a paradox: the economy is getting progressively more interlinked but governance of economic activities is not following at the same pace. Additionally, the existing global economic order was shaped by the West and the question is what place should emerging powers play in it. These issues were addressed by the Asia-Europe Pilot Project (AEPP) at the Lee Kuan Yew School of Public Policy[2]. This paper[3] summarises key findings of the first stage of the Project.

The question of how to address global economic governance in the 21st century needs to be discussed in the context of the debate about the future of the Western liberal order. This U.S.-led order is becoming increasingly challenged by the gap between hugely increased geographical, functional, and normative ambitions of international society and the lack of means to deliver them. The political challenges have become particularly evident in the wake of the recent global financial crisis marking the end of the so-called Washington Consensus and raising questions about the underlying principles of future global governance.

The potential and limits of collective action to avert catastrophe, when either financial institutions or sovereign debtors fail, have been highlighted by the recent international financial and economic crisis. The IMF exists in part to perform this function, and is currently seeking to reinforce the idea that countries should use the institution to pool their reserves internationally. However, at the same time, many countries are seeking to use regional and sub-regional arrangements. These parallel arrangements have yet fully to be studied comparatively in a way which illuminates the strategic choices about cooperation being made by governments in different regions (including as between regional or international funds), and the implications for global cooperation.

It narrows the focus of the excessively broad global governance discourse by examining a specific collective action problem, that is, the European Sovereign Debt Crisis. While the debt crisis can be considered a regional problem of the European Union, the repercussions are global, given the complex interdependence of our international economy. There is a high risk that European problems will spillover into Asia. As the IMF recently stressed, China's economic growth will be cut almost in half if Europe's crisis worsens. The crisis epitomizes the paradox underlying 21st Century global governance: we increasingly rely on state government and regional and global institutions at a time when their authority to deliver is severely eroded. While regional integration in post-World War II Europe has demonstrated the potential of state sovereignty pooling in order to lower transaction costs and maximize Pareto-benefits, the European Sovereign Debt crisis in the early years of the 21st Century illustrates the limits of collective action problem-solving amongst like-minded democracies.

What is Asia's answer to the pressing demands for closer cooperation and deeper integration resulting from growing intra-regional trade and investment? With the problem-solving capacities of Asian regional *fora* still relatively underdeveloped, the need to engage in a major debate on how to strengthen collective action is particularly strong in this part of the world. For example, the recent establishment of the Chiang Mai Initiative Multilateralization (CMIM) aims at providing an effective regional mechanism for emergency liquidity to ASEAN+3 economies in case of currency crises through formal reserve pooling arrangements, a weighted voting system for disbursement of

[2] Asia-Europe Workshop Programme - 'Global economic governance in Asia : Through the looking glass of the European sovereign debt crisis', Lee Kuan Yew School of Public Policy, 19-20 November 2012

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funds, and enhanced surveillance capabilities. However, the regional CMIM is clearly nested within global institutions such as the IMF. By avoiding the perils and pitfalls of regional surveillance and enforcement mechanisms, is the global-regional nexus of international institutions a more promising way of achieving financial stability?

The objective of the article is to understand better the short-term and long-term repercussions of the European Sovereign Debt Crisis for regional economic integration in Asia. The fundamental questions concern the scope of global governance, which can only be tackled from a multidisciplinary perspective: e.g. whether there is a Post-Washington Consensus emerging on how to achieve better global and regional economic policy coordination; whether 'liberal democracy' is the best form of state government to provide global public goods such as financial stability; the interests and strategies of emerging powers in securing global financial stability; the question of leadership (or the lack thereof).

Three questions on global economic governance

a) Intensity of cooperation

The first question relates to the globalisation paradox of governance: while the global economy has increased the interconnectedness, vulnerability, and sensitivity of market economies, economic governance is lacking behind. A paradoxical evolution can be observed, where one can witness the erosion of the role of global institutions in times of globalisation in progress. The economic crisis in South-East Asia and in the West limited in a way the role of global institutions both in finance and trade (Takashi, T., 2009). Regions under pressure tended to develop regional responses rather than seeking closer cooperation with global institutions.

According to Chumakov, A. N. (2012), the world is facing new challenges and does not have an adequate system of governance. At the core is the question of the willingness of states to share or to pool part of their sovereignty. This is a sensitive issue for all countries. The history of the construction of the European Union demonstrates that the intensity of inter-state cooperation is critically dependent on the acceptance of sovereignty sharing. In this respect, Wang, J. (2013) and Zhang, Y. (2013) note that China holds firmly the principle of state sovereignty, while Mohan, R. C., (2013) stresses that India recognizes the importance of states shedding some sovereignty to promote international cooperation.

b) Substance of cooperation

The second question is whether the liberal economic model based on the Washington consensus is the way forward or rather whether there is a need for an 'Asian system' with more involvement of the public sector. There was no emerging consensus on this. While Asia is neither able nor willing to redraw the Bretton Woods architecture of global economic governance, three matters arise from there. First, the Western liberal model is deeply contested in the absence of any alternative. There is no Beijing consensus emerging on how to steer the global economy; there is also no consensus on the do's and don'ts of Asian financial and economic integration. Second, it is high time to start a discussion on global economic governance that can engage Asia and Europe on a more equal footing. And third, Asia needs to develop a better understanding of the *political* dimension of European economic integration.

At the same time, one issue is at the heart of the discussion for both sides, namely the definition of the public good. Any further development in global economic governance should probably start with this issue. This can be interpreted in the economic sense, as it is often done in the West, or in a broader political sense, as some of the Asian scholars suggested.

c) Legitimacy of cooperation

Third, there are several issues related to the legitimacy of economic cooperation (Lesourne, J., 2012-2013). The key issue here is the division of power in global institutions. Emerging economies are calling for greater share in voting and representation. This is a recurrent point where many observers are calling for an adjustment of the votes and power within the global institutions in favour of the emerging economies. Emerging economies such as China and India call for greater role and representation in the institutions of global economic governance. Another issue involves the role and mission of existing global institutions such as the IMF, World Bank, WTO and others.

Furthermore, there are concerns about a ‘silo’ architecture of global economic institutions. There is one institution dealing with economic assistance, another with development aid, yet another with trade etc. However, to have coherent economic governance one should probably think about a more horizontal approach which would also allow a trade-off between the specific policy areas.

Stakeholder involvement is part and parcel of legitimacy. The key issue here was the role of the state in the globalized world. What is the role of the state in the West and in the East? Can the state govern and regulate all entities in the West? The answer is ‘no’ and the example of the accounting standards rules and Basel committees showed that the state is ready to delegate its power to non-public stakeholders, and it works. Another example is the rules governing the Internet. What is the role of the state in the Asian economies such as China? What division of labour should there be between private, semi-public and public stakeholders?

The West designed the global economic institutional architecture in place today. Asian conference participants emphasised a lack of ownership in the US-led Bretton Woods global economic order. However, we are, once again, confronting a paradox here. With economic power shifting from the West to the East, we would expect a strong interest by Asian stakeholders to design new governance structures and processes, according to their own interests, or to seek amendments to the existing architecture. In fact, Asian stakeholders expressed disdain at Western demands of an ‘Asian wish list’ for global economic governance reforms. One could express this in the form of a very unfortunate psychology at play here, one barely recognised by Western governments: Parents (‘the West’) are telling their adolescent children (‘the East’) to make up their minds. This explains at least some of the deep reluctance of key Asian stakeholders to shoulder responsibilities for a crisis that, first and foremost, originated in the West. Behind all this might also be semantic and cultural issues, which can often lead to misunderstanding. In addition, a distinction should be made between governance and government/normative regulation, given that the conflation of these has clouded the debate thus far.

Finally, to enhance legitimacy of global governance, innovation and leadership is needed (Reninicke, W., 2012). With the understanding that there is a need for more adjusted economic governance structures in the globalised world, the practical way forward might be to innovate the existing ones. In the context of transition management in Asia, which aims at keeping peace in the region and maintaining political stability, there are three key principles that come up: ensuring the public good, legitimacy and trust. Innovation would need a technical and measurable approach close to the theory of cybernetics with elements of measurable parameters and feedback. However, to make it happen, leadership is needed. In today’s multi-polar world, there are however not many candidates for it: the West is continuing to provide it but the East is not very interested. This evokes the problem of ‘free riders’.

In conclusion of this first part, the issue of global economic governance is a non-consensual issue between the academics of the East and West. Progress here would require developing patterns and understandings of governance that can be applied across regions. A good starting point would be the development of a shared terminology and a common understanding on three key issues: a) what is the public good at stake?; what means of cooperation need to be deployed to secure the public good?; and c) what are the mutually agreed rules and principles underlying collective action to achieve the public good?

Where Asia stands in this discussion

Three important issues need to be raised in this discussion from an Asian perspective:

a) The perception of inefficient EU decision-making

Especially China is concerned about the perils and pitfalls of EU decision-making, which has been considered inefficient. At the same time, as one prominent Chinese participant of the Asia-Europe Workshop put it, “EU leaders appear more nationalistic than ever,” which stands in stark contrast to “the vision of European integration … European leaders of the older generation were devoted to.” This is compounded by the mixed messages Beijing receives in individual bilateral talks with representatives from respective European capitals – e.g. Berlin, London, and Paris, with detrimental effect. The perception of a disunited Europe fosters a tendency amongst Chinese policymakers to exploit the differences amongst EU member states.

b) Limited burden-sharing

Despite the potential negative repercussions of the European sovereign debt crisis for the region, (East) Asian countries may not necessarily wish to assume greater collective responsibility for some of the key problems in the global financial system. While East Asian countries may want more global governance to stabilize the global economy and to address the risks in the Eurozone, at the same time, “these countries also want less global governance if that comes in the form of stricter or more intrusive regulation in areas like rebalancing and Sovereign Wealth Funds that go to the heart of domestic political economies,” as one South-East Asian participant at the Asia-Europe Workshop succinctly put it.

c) The stark juxtaposition of East Asian regionalism against globalism is not helpful

Economic regionalisation in East Asia “has been remarkably open and externally-oriented,” as another South-east Asian Asia-Europe Workshop contributor put it. “This functional characteristic fundamentally limits the prospect for the ‘closed’ regionalism project.” Consequently, any changes at the regional level will be deeply interwoven with governance reforms at the global level.

Where Europe stands in this discussion

Looking at this discussion from a European perspective, three comments can be made:

a) Europe should clean up its house

The European Union is at a crossroads in many respects. The real economy needs a continuation in structural changes. Public finances should be put under control in some countries. Better governance needs to be implemented in the banking, fiscal and economic areas. The European Union is currently making progress in all these areas, so the crisis can be seen as a healthy element.

b) Outward looking approach

The economic crisis and the organisation of sharing sovereignty in Member States are consuming probably too much of the European Union's energy. Thus, one of the effects of the crisis is that the European Union looks predominantly at its internal business. In contrast to this, the reaction of some other regional groupings in the world while going through the crisis was different. An example would be ASEAN which, after its economic crisis in the late '90s opened its doors to larger cooperation in the Pacific rim. The European Union has a unique opportunity to be a catalyst of the democratic model for larger regions such as the countries which recently came through the 'Arab Spring', the Balkans or Western countries of the ex-Soviet Union. In the sphere of economic governance, there is space for 'more European Union and less Europeans in fora'.

c) Contribution to global economic governance

The European Union is a unique project in history. With its normative approach based on clear rules of the game and sharing sovereignty, the EU can serve as a laboratory at the global scale. Laboratory does not mean model. The European Union can offer its experience on how to overcome the narrow, national and sectoral interests and being able to progress. The European Union can also establish its 'do' and 'don't do' lists and offer it for a fair discussion at global fora.

Conclusion

Global economic governance is in the spotlights of politicians and scholars because of two developments. In a long-term perspective, due to globalization and a major redrawing of the global economic map. In the short-term, the interest is driven by the shared objective to put in place mechanisms to minimise future crises.

It appears there is no clear willingness from key global players to move global economic governance to a qualitatively new level. Recent economic difficulties in the Euro Area countries demonstrate to what extent it is difficult for states to agree on mutually agreed principles to govern sensitive areas such as economic reforms or financial regulation.

Similarly, it seems that Asian emerging powers do not challenge the fundamentals of the existing economic order. In the end, they are the clear beneficiaries of it. China and India appear not interested in leadership ambitions for a dramatic overhaul of the current model.

The area where there is a call for change is the legitimacy and legitimation of global economic order. The paper indicated some of the salient issues in this respect: distribution of power in the global institutions, adjustments of their mission of the, role of stakeholders, namely states, and innovations of governance models.

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