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GLOBAL ECONOMIC GOVERNANCE: BEYOND MANAGEMENT BY THE UNITED STATES AND THE EUROPEAN UNION?

The Decline of Global Economic Governance and the Role of the Transatlantic Powers

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Abstract

Although the global economy has flourished in the current global economic governance regime, the foundations of this order are starting to crumble. Both in trade and in finance, the existing institutions are under severe stress. In trade, more and more countries undermine the WTO by implementing preferential trade agreements. In finance, the IMF has been weak for most of this decade, although it experienced a revival in the current crisis. First and foremost, this weakness of the institutions of global economic governance is the result of policies implemented by the transatlantic powers. Both the European Union and the United States are actively pursuing policies that weaken the existing institutions. In trade, there is a large gap between the official rhetoric, which highlights the importance of the multilateral regime, and the trade policy practice, which is weakening the WTO. In finance, the transatlantic powers have until very recently blocked any progress in the IMF with regard to lending policies. In addition, the EU continues to defend its unjustified overrepresentation in the IMF's governance structures.

The article suggests that one of the key explanations for this development is the weak support for globalization in most OECD-countries. Confronted with no enthusiasm for globalization in their domestic constituencies, policy makers in Europe and the United States are increasingly opting for policies that will, over time, erode the existing regimes of global economic governance.

KEYWORDS: trade, finance, WTO, IMF, globalization

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1. Introduction

Since the emergence of the current global economic governance regime, largely constructed after World War II, the global economy has developed remarkably well. Year after year, global trade has been growing significantly faster than world GDP.[1] In the last two decades, cross-border transactions in finance have also grown dramatically, fueled by the dismantling of restrictions on capital flows. In the 21st century, the global economy appeared to be on track for further internationalization of the production processes and a continued increase of cross-border capital flows.

However, the current economic crisis has called the stability of the previous regime into question. Policy makers, managers, and citizens are asking whether today's regime of global economic governance is appropriate. Not surprisingly, the business community is also very concerned. Well-run and soundly managed companies are confronted with a sudden, far-reaching, and unexpected collapse of global demand. One of the most dramatic examples of the collapse of demand is that of Volvo, the Swedish automotive manufacturer. While Volvo secured 42,000 orders in the third quarter of 2007, one year later new orders for Volvo trucks totaled a mere 115.[2] Many other companies in the global economy have been hit similarly hard.

Thus, the financial crisis has created unprecedented interest in matters of financial regulation and, to a certain degree, global economic governance. While business managers did not consider the potential negative effects of financial turbulence on their business models prior to 2007, problems in the financial sector and financial governance are now seriously accounted for as potential threats to the stability of their companies. The phase of benign neglect and irrational exuberance in the financial sector has come to an abrupt end.

The weakness of global economic governance has existed for a long time, but it had hitherto not been accounted for by most companies. Now, these weaknesses in both the prevention and the management of financial crises are being identified as a major and ubiquitous challenge. Added to this is a rising concern about the stability of the global trade regime. The bailout-packages implemented for the American and European car industries call into question whether the global trade regime is adequately equipped to secure a level playing field in trade. While direct protectionism has been largely avoided so far, many states have implemented policies that are indirectly protectionist. Obvious examples include subsidies for certain industries, which not only result in enormous costs for taxpayers, but which also distort competition. Asian

[1] The share of merchandise exports in World GDP grew from 5.5 percent in 1950 to 17.2 percent in 1998 see Maddison (2001), p. 127.
[2] Handelsblatt, 27 October 2008, p. 14.

carmakers, for example, would be justified in questioning whether the subsidies for General Motors and Chrysler constitute as illegal subsidies.

In essence, we are recognizing the ease with which globalization—narrowly defined as the deepening of economic ties—has proceeded for decades has come to a (temporary?) halt (Altmann 2009). In the golden days of globalization, the regimes that govern trade and finance were not pressured to develop further, and now it seems almost certain that they are ill-equipped to handle the current crisis. In trade, we are witnessing the decline of the multilateral order, which is gradually being substituted by bilateral and regional types of regulation. In particular, the rapid increase of bilateral trade agreements is undermining the central position of the World Trade Organization (WTO) in global economic governance.[3]

There are almost 400 free trade agreements and a few customs unions already recognized by the WTO. More are currently being negotiated and all regions of the global economy are participating. This could not be said a few years ago, as the entire Asia-Pacific region, for example, largely avoided these agreements. Countries like Japan and South Korea, and even Australia, were staunch supporters of the multilateral regime. Only ASEAN countries were advancing preferential trade within their ASEAN Free Trade Area (AFTA), which started in 1992. However, this pattern has changed dramatically. In recent years, no major economy has been willing to abstain from the current trend of bilateral trade agreements.

In finance, the main institution in charge of international financial markets had, until the outbreak of the crisis, become almost obsolete. Ten years ago the International Monetary Fund (IMF) was the most important international organization in the economic arena, but in the current crisis has lost much of its former importance. Moreover, both Asian and Latin American countries have attempted to disassociate themselves from the IMF. However, the Fund is still an important institution, and has even been strengthened recently with the decisions made at the G-20 Summit in London in April 2009. But the IMF continues to be an organization shaped and governed by the transatlantic powers, and their inability to redefine the role of the IMF beyond the expansion of its resources poses one of the main challenges for global economic governance in the coming decade.

In this article, I will analyze the role of the transatlantic powers in the decline of global economic governance. Though the weak constitution of economic governance is considered to be the consequence of the rise of new economic powers, in particular the emerging economies of Brazil, India, China and Russia, this line of thinking does not withstand scrutiny. It is in fact the

[3] See, for example Aggarwal/Urata (2006), Dent (2003), Dieter (2009), Ravenhill (2003), Whalley (2008).

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transatlantic powers that bear substantial responsibility for the apparent weakening of the multilateral order. Both the EU and the US have contributed massively to the trend for preferential trade agreements, the most dangerous systemic competition for the multilateral regime. In finance, the transatlantic powers have not used their strong positions in the International Monetary Fund—together accounting for approximately 50 percent of the voting rights of the Fund—to modernize the institution and make the IMF an important pillar of global economic governance.

Instead, the transatlantic powers have at times abused their might and have used the IMF as an instrument of their foreign economic policy, most notably in the Asian financial crisis. In subsequent years, the United States and Europe repeatedly argued with each other, but not on substantial matters. Rather, Washington and Europe fought bitterly over internal political issues, such as the succession of the Managing Director of the IMF. While lending policies of the IMF have been modified in the current crisis and conditionality has been reduced, the fund continues to be ill-equipped for the challenges of the 21st century. In particular, Asian powers are underrepresented and may, over time and without significant change, be induced to create their own, competing structures of financial governance.

Of course, it would be myopic to characterize the reluctance of the transatlantic powers to take the initiative and contribute to the reform of the existing regime of global economic governance as their interest in retaining established power structures. While this dimension cannot and should not be neglected, there is another important factor at play. In many OECD-countries, a noteworthy development has been the widespread unease about the utility of globalization. Until a few years ago, citizens and policy makers alike perceived globalization to be a development that by and large benefited industrialized countries and exploited the developing world. Although a stark generalization, this perception contained some truth. Financial crises in the developing world—and all crises of the last two decades, bar the most recent occurrence in the US—as well as anecdotal reports about exploitation fed that perception. Around the turn of the century, however, OECD-countries appear to have lost their once dominant position. This is obvious in finance; just consider China's unprecedented foreign reserves. It is also apparent in production, where China and other countries have established themselves as competitive producers. Thus, globalization has also lost one of its most vital supporters: the business community. The reluctant support for pursuing further liberalization in trade becomes apparent when analyzing the debate on the Doha Round. There is no big push for a conclusion of the round either in Europe or North America.

Because the specific political context matters and shapes policies toward economic governance, I will first discuss the context of the economic policies of the transatlantic powers. Why are policy makers in OECD-countries in general and in the transatlantic economies in particular so reluctant to modernize the institutions of economic governance? How do voters in OECD-countries perceive their countries' position in globalization? Subsequently, I will look at the multilateral trade regime and its future, additionally considering the failure to conclude the Doha Round in July 2008. Then, I will discuss financial governance after the subprime crisis and in the era of rising financial power in emerging markets. In the last section, I will discuss the consequences for global economic governance and suggest some policy remedies. In particular, I will analyze whether there is scope for joint policy initiatives of the transatlantic powers and how global economic governance could be modernized in order to accommodate the interests not only of the old, but also of the new rising powers.

2. Declining Support for Globalization in OECD-Societies

The departure from an agenda of economic liberalization in general and the multilateral trading regime in particular is primarily fueled by four developments. First, in OECD-countries we can observe a declining support for deeper international division of labor, one of the core dimensions of globalization. Traditional supporters of trade liberalization, and business in particular, have recently been lukewarm in their support for the WTO. A second and related trend is the recent academic debate, particularly in the US, where prominent and respected American economists have been questioning the utility of trade liberalization and called into question America's ability to compete on global markets. Inevitably, this academic debate has been picked up by politicians, who support calls for protectionist policies with references from mainstream economists.[4] Third, we can observe an increasing rivalry between major players. America, Europe and, in recent years, China are competing with each other for influence rather than engaging in a cooperative effort to advance the multilateral system. Fourth, and as a consequence of the first three trends, we are witnessing the already mentioned mushrooming of bilateral agreements in trade and a tendency for unilateral and regional measures in finance, e.g. the built-up of large foreign reserves as well as regional cooperation such as the Chiang Mai initiative in Asia.[5] While these four factors are not exclusively responsible for the current weakness of global economic governance, simultaneously they are the primary drivers of the decline in support for multilateral trade institutions.

[4] One example is Barney Frank, a leading Democrat in US Congress, who suggested in 2007 that "a full embrace of globalization … has now come to an end", Political Transcript Wire (2007).
[5] For a more detailed discussion of monetary regionalism in Asia see, for example, Dieter and Higgott (2003), Dieter (2008) and Kawai (2007).

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Despite severe problems, globalization has been a positive force for millions of people. In many Asian developing countries, particularly in China, empirical evidence supports the view that globalization shows a strong correlation with success in the fight against poverty. In China, more than 400 million people have been lifted out of absolute poverty since 1990. At the same time, global welfare gains from the increasingly deeper division of labor have not been evenly distributed. Both in developed and in developing countries, substantial parts of the populations have been affected negatively. In this context, one should not underestimate the important role that politics can play. It is, therefore, no wonder that globalization is associated with negative consequences such as the off-shoring of employment and job losses at home.

There is an increasing assumption that further division of labor brought about by the growth in the economies of major developing countries such as China and India will have negative consequences for the major economies, especially the US and Europe. This attitude was not always so, as following World War II, trade liberalization enjoyed wide political support in most industrialized countries. In the decades after 1945, most workers enjoyed both improved employment opportunities, because of the rise of exports out of their economy, and an increase of their standard of living due to the lower cost of goods vis-à-vis less expensive imports. However, a substantial change in attitude can now be perceived. Workers still enjoy the benefits of inexpensive developing country imports, but their wages are no longer rising. In the United States, for example, more than 96 percent of all workers saw stagnant or falling real earnings between 2000 and 2006. Even college graduates have had to absorb a real reduction of earnings. At the same time, incomes have risen only for very small elite of highly qualified people and corporate executives, many of them in finance.[6]

In previous decades, workers in industrialized countries were partly protected from these negative effects of globalization by social policies that mitigated the relocation of production processes to countries with lower labor costs. This arrangement, encapsulated in John Ruggie's (1982) conception of "embedded liberalism," began to erode in the late 20th century. Workers in developed countries are increasingly exposed to the forces of globalization while comprehensive social protection is being dismantled. Ironically, the business communities in OECD-countries lobbied hard for a reduction of existing social safety nets, and thus contributed to the weakening of political support for liberal economic policies.

The situation in the United States suggests that public support for globalization grows when workers achieve higher wage levels and deteriorates

[6] Scheve/Slaughter (2007), p. 37.

when the labor market performs poorly. The picture is similar in other OECD-countries. In Germany, for example, trade liberalization enjoyed overwhelming support while real wages were rising during the immediate post Cold War decade. But as real wages stalled in the last decade, globalization gradually lost support.

There is ample empirical evidence that supports this trend. In a Gallup Poll of October 2006, support for globalization was weak in OECD-countries while strong in developing nations. In response to the question as to whether globalization was a good thing or a bad thing *for one's country*, only 26 percent of North Americans considered it 'a good thing', while almost as many, 24 percent, deemed globalization a 'bad thing.' Figures for Western Europe (28% positive, 22% negative) were similar. In sharp contrast, support for globalization in the developing world at the same time was considerably higher. 71 percent of Africans thought that globalization was good for their country. In the Asia Pacific, 52 percent of those surveyed had a positive perception of globalization, with only 5 percent viewing it as negative.[7] More recent polls confirm this dichotomy. In many developed countries, including Canada, France, Italy, Spain, the UK, and the United States, citizens considered the pace of economic globalization to be either much too quick or a bit too quick.[8]

Looking at polls on a country-by-country basis, the emergence of a globalization backlash in OECD-countries becomes even more obvious. A July 2007 poll saw only a minority of respondents in the five largest European countries and the US believing that globalization had 'a positive effect in their country.' This figure was lowest in the United Kingdom, Spain, and the United States (15 to 17%), and was, not surprisingly, highest in Germany, the world's largest exporter (36%). However, the fraction that perceived the negative effects of globalization was much higher in all six countries. Even in Germany, which has taken advantage of the trade opportunities created by globalization for decades, 42 percent of respondents thought that globalization negatively affected the country.[9]

Both the weakening political backing for globalization in OECD countries and the rising support in developing countries are explainable. The fear in the North has little to do with unreasonable demands of workers, and least of all does it express ill-founded xenophobic fears. Workers are simultaneously confronted with greater risks due to the rise of the international division of labor, cutbacks in social security systems, a rise in inequality due to rising incomes of the richest five percent of the population, and reduced efforts of policy makers to counter inequality by redistributing income. The bottom line is that, without political

[7] Gallup International (2006).
[8] BBC World Service (2008).
[9] Financial Times/Harris (2007), p. 4.

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efforts to change this scenario, declining support for globalization in OECD countries can be expected to continue.

In the US, for decades the world's strongest force in favor of globalization, the golden age of strong economic growth and ample opportunity for all Americans is widely thought to have ended. Although globalization is not the cause of the problems in the American economy, it has revealed underlying weaknesses and structural faults, including unprecedented governmental and international debt, a deteriorating public education network, and the ever weaker social security provision for health care and unemployment. All this is accompanied by a growing concentration of wealth and power at the same time as top earners contribute a shrinking percentage of their incomes to the common wealth. For example, between 1960 and 2005, the top marginal tax rate in the US declined from 91 percent to 35 percent.[10]

Although income distribution and support for trade liberalization are only weakly correlated, a substantial part of the legitimacy problems of the multilateral trade regime results from an increasingly unfair distribution of income, or at least an increasing perception of unfair distribution. While this argument has been illustrated with evidence from the US, the general argument pertains to other countries as well. When the middle classes in OECD-countries see their fortunes wane, they become inward looking. This trend does not bode well for globalization in general and trade liberalization in particular. In effect, the benefits from globalization have to be distributed more equally within societies if we are to prevent a rise of protectionism in OECD-countries, which can have potentially very harmful consequences for the stability of the global economy.

Citizens in some key OECD-countries have already come to the conclusion that there is a need to raise taxes in the top income bracket. In five European countries, majorities (between 52 and 66%) believe that taxes ought to be raised for the highest income earners. Even in the United States, recent data shows 61 percent support higher taxes for the highest incomes. and a recent report from the Financial Services Forum recommended that in order to minimize the backlash against globalization, it was necessary to raise taxes on 'winners' and share benefits of globalization more widely.[11]

Of course, these assessments may be considered alarmist by some observers. One could argue that enhanced global processes have always had

[10] Polaski (2007), p. 5. However, states add their own income taxes to the federal taxes, which results in top marginal tax rates well over 50 percent in many states in America.

[11] The Wall Street Journal, 26 July 2007, p. 9. The Financial Services Forum is an association of the chief executives of 20 major financial companies; including American International Group (one of the world's leading insurance companies, now government-owned), the world's biggest bank Citigroup and the Swiss-based bank UBS. Needless to say, these are not the classic critics of either globalization or unjust income distribution.

unwarranted side-effects. The deepening of the international division of labor has never been a pain-free process. But evidence is mounting that globalization is starting to hurt exactly those groups in societies that have to-date been the main political supporters of globalization, namely skilled workers in OECD countries. Ironically, many citizens in developing countries, particularly in Asia, are increasingly realizing that globalization is, on the whole, positive both for them individually and for their countries. At the time of this writing, the repercussions of the global economic crisis for the future perception of globalization remain unclear. At least so far, protectionist tendencies have been restrained during the current financial crisis.

However, the growing unease of populations in OECD-countries is both accompanied and fueled further by a debate of mainstream economists and policy makers who express increasingly skeptical views on globalization. Most notably in the United States, influential, and impeccably credentialed, academic economists and policy makers have begun to question the utility of globalization for the American economy. These are not the usual anti-globalization suspects that have criticized the dark side of globalization for many years. In 2004, the Nobel Laureate Paul Samuelson questioned whether globalization would continue to be beneficial for all economies. Productivity gains in one country could, under certain circumstances, benefit just one country and hurt others. Mainstream trade economists, Samuelson argued, have for too long ignored the negative effects of globalization on income distribution in the United States.[12] The expectation of trade liberalization supporters had been that developed societies overall benefit from liberalization, even if the short term effects, because of the transfer of production facilities to cheaper locations, are negative.

Alan Blinder, another respected American economist, in 2007 added to this debate. Although Blinder continues to see the benefits of free trade, he also sees the adverse consequences, including a potential wave of job losses. Between 22 and 29 percent of jobs in the United States are, or will be, potentially off-shoreable, resulting in dramatic job losses in the American economy.[13] Blinder states that off-shoring is no longer restricted to low-skill jobs, but increasingly affects high-skill services such as radiology, architecture, and engineering.[14] These insights should alert the US to the fact that while the principles that underlie trade liberalization remain largely unchallenged, we must note that even in circles traditionally supportive of globalization, a process of qualification is underway.

The financial crisis, the severe recession and the prevailing uncertainty about America's position in globalization may result in a dangerous cocktail that

[12] Samuelson (2004), p. 142-144.
[13] Blinder (2007), p. 34.
[14] Washington Post, 6 May 2007, p. B 04.

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contributes to the destruction of the multilateral regime. Certainly the case for multilateralism was not helped during the presidential campaign, when Barack Obama argued that ordinary Americans were losing in trade liberalization.[15] In the first months in office, President Obama has avoided direct confrontation over trade policy, and has neither turned into a staunch free trader nor has he become an unrepentant protectionist. Proposals for "Buy American" clauses in the US stimulus packages were watered down by President Obama, who removed the most provocative sections from the proposed Bill.[16] Nevertheless, the bailout-packages for both US banks and US car manufacturers represent market distortions. Competitors of American car manufacturers in Asia and Europe have raised concern about the financial support for General Motors and Chrysler, although there has yet to be a coordinated and substantiated action taken by either foreign governments or business leaders. Still, government ownership of mature industries raises concern.

Of course, one of the core questions regarding global economic governance is whether the US will continue to support an open trade regime or whether it will pursue protectionist policies. Despite recent promotions of free trade by the US government, there is no guarantee the government will continue these policies. In fact, historical precedent and present day opinions on Capitol Hill invite skepticism with regards to the future of US trade policy. This skepticism is further fueled when the current economic climate in America is considered. The deep financial crisis combined with the lasting recession may well lead to another dramatic rise of protectionism in America.

There is widespread consensus that a repeat of 1930's beggar-thy-neighbor policies should be avoided at all cost. After World War I, America had cautiously liberalized its economy and gradually lowered tariffs. Following Woodrow Wilson's famous speech of 1918, policy makers realized that it was vital for American interest to open up its economy. In that speech, Wilson had called for trade liberalization not just for efficiency and welfare gains, but also to stabilize peaceful relations between countries. In point three of his Fourteen Points he suggested: "The removal, so far as possible, of all economic barriers and the establishment of equality of trade conditions among all the nations consenting to the peace and associating themselves for its maintenance."[17]

This policy represented a significant shift from the previously extreme protectionist trade policy of the US. However, even after initial implementations of economic liberalizations, the average applied tariff in the US in 1925 was as

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[15] New York Times. 2008. "Barack Obama's Feb. 12 Speech." Available online at: http://www.nytimes.com/2008/02/12/us/politics/12text-obama.html.

[16] Times Online, 4 February 2009, Available online at: http://www.timesonline.co.uk/tol/news/world/europe/article5655115.ece

[17] Woodrow Wilson, address to a joint session of the United States Congress, 8 January 1918.

high as 37 percent, significantly above the level applied by European countries such as the United Kingdom (5%), Germany (20%) or the Netherlands (6%).[18] More significant than the high level of tariffs was its continued increase in 1930. The infamous Smoot-Hawley Tariff, signed into law in June 1930, increased tariffs on over 20,000 items, deepening the global downturn. Smoot-Hawley raised average applied tariff levels—relative to the value of goods—in the US from about 40 percent to about 60 percent in 1933, and made a significant contribution to the decline of international trade.[19]

Thus, America shut its doors at the very moment open markets were needed to help stabilize the global economy. Many economic historians continue to posit that the Smoot-Hawley Tariff exacerbated the Great Depression, and rank it among the worst policy blunders in American economic policy. It should be noted that at the time, over 1,000 economists unsuccessfully protested against this legislation. It should also be noted that subsequently, trade volumes declined dramatically. World merchandise exports grew from 10,100 million dollars in 1900 to 33,000 million dollars in 1929, but shrank to 12,700 million in 1932. In 1938, export volumes had only modestly recovered to 22,700 million dollars.[20] (WTO 2007: 47).

The protectionist policies of the Smoot-Hawley tariff were not just an aberration. After Roosevelt was elected, he made it very clear where his priorities lay:

> *Our international trade relations, though vastly important, are in point of time and necessity secondary to the establishment of a sound national economy. I favor as a practical policy the putting of first things first. I shall spare no effort to restore world trade by international economic readjustment, but the emergency at home cannot wait on that accomplishment*.[21]

Roosevelt continued the inward looking policy when he took the US off the gold standard in 1933. The London Economic Conference of summer 1933 had aimed at re-establishing the gold standard, which had been providing exchange rate stability for decades, although not without turbulence. America was represented by its Foreign Secretary, Cordell Hull, who had been instructed to accept no proposals without personal approval from Roosevelt. On June 21, 1933, Roosevelt issued a radio message, criticizing the conference for trying to stabilize exchange rates, and referring to a previous statement he indirectly declared that

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[18] WTO (2007), p. 41.
[19] O'Brien (2001).
[20] WTO (2007), 47.
[21] Roosevelt's inaugural address, quoted in Dallek (1979), p. 23

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the US would not participate in the negotiations. Newspapers commented that "America has definitely chosen the path of economic isolation".[22]

In essence, the United States was unwilling to become the successor to the United Kingdom as the world economic hegemon. Global economic governance collapsed, primarily because there was no orderly transition from the old regime, underwritten by Great Britain, to the new order, shaped and secured by the United States. We can identify at least a few parallels. The rise of Asian economies and the integration of the European economies, manifested in the successful introduction of the euro, have undermined American hegemony without establishing a new regime of global financial governance. In 2009, however, Beijing has advocated the introduction of a new reserve currency. Despite the fact that the proposal by Zhou Xiaochuan, governor of the People's Bank of China, has been vague, it nevertheless represents a potentially important step towards the replacement of the dollar as the world's key currency.[23]

The current situation is complicated further by a rivalry for leadership. However, at the moment, no other country is capable of replacing the US as the global economic leader. The rivalry, however, has contributed to destructive policies of major players at the multilateral level, particularly by the transatlantic powers.

3. The Weakening of the Multilateral Trade Regime: Who Bears Responsibility?

Both the US and the European Union have actively contributed to the weakening of the WTO's position in economic governance. While both continue to rhetorically support the WTO, in practice neither is providing the leadership in trade governance that characterized earlier periods, in particular the 1970's, 1980's and 1990's.

Immediately after 1945, the newly established American hegemon created the global economic order. In the aftermath of World War II, the US used it's then unchallenged material and ideological power to set in place an international institutional infrastructure for global economic governance. Although underwritten by US hegemony, the Bretton Woods System and the GATT were multilateral in both tone and practice. Though many countries were excluded or excluded themselves from the Bretton Woods regime, such as most countries of the Warsaw Pact, the regime was open and inclusive by definition. The GATT in particular was a tremendous success. Starting with 23 countries in 1948, the list of contracting parties grew quickly longer, reaching 128 in 1994. The GATT quickly became a central pillar of global economic governance.

[22] London Times, 21 June 1933, quoted in Morrison (1993): p. 312.
[23] For a discussion of an SDR-based reserve currency see Williamson (2009).

As such, the US saw the GATT as beneficial to its national interest and its view of world order. But in the first decades after 1945, the US defined its interests broadly and in a sufficiently inclusive manner. Other countries felt able to sign onto a vision that stressed the importance of due process and the rule of law. Europe, an important player in trade policy after the completion of the customs union of the European Economic Community in 1968, by and large was a constructive force in supporting the further development of the multilateral trading regime. Asian players, in particular Japan and later the rapidly emerging economies of Southeast and East Asia, were loyal supporters of the GATT and later the WTO. This is best exemplified by the fact that there were hardly any preferential trade agreements in Asia prior to the year 2000.

Towards the end of the first decade of the 21st century, the situation has changed significantly. Under the Bush Administration, the US has definite its national interest much more narrowly, primarily in security terms.[24] Moreover, many Bush administration officials were outright hostile towards any multilateral, rules-based regime.[25] Even more importantly, in recent years Asian economies have firmly embraced preferential trade agreements,[26] although this process causes some friction in the transnational production networks in the region.[27] Nevertheless, the changing policy choices of Asian governments have resulted in a further weakening of support for the trade regime.

Of course, the multilateral trading system has always depended on the support of major players. The US had been the single most important supporter of the GATT in the first two decades after its implementation, nurturing a rules-based world trading system.[28] When the European Economic Community completed the creation of a customs union in 1968, Europe became the second major player in the multilateral trading regime. Some of today’s important trading nations, China in particular, were not yet members, while the countries under the influence of the USSR primarily traded with each other.

As such, the US and the EC continued to shape and further the multilateral trading regime in the three decades following 1968. While the evolution of the trading regime was neither linear nor without contradictions, it is clear that the GATT can be considered a success, both with regard to the liberalization of trade and the continuously expanding membership, which by 1994 reached 128 member countries. Furthermore, during the bipolar era, all GATT negotiation rounds eventually managed to be completed, though admittedly often after long negotiations. Most importantly, however, has been the creation of the World

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[24] Dieter and Higgott (2007), pp. 151-174.
[25] Ikenberry (2008), p. 33.
[26] Pempel (2006), pp. 239-254.
[27] Baldwin (2006).
[28] Irwin (2002), p. 225.

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Trade Organization in 1995, which provides member countries with a substantially improved dispute settlement mechanism. Prior to the creation of the WTO in 1995, dispute settlement could be blocked by the party accused of an illegitimate policy. This has changed with the WTO; it is one of the few multilateral organizations where any country can take the EU or the US to court and have a legitimate chance of rectifying the situation, though it may take some time. The implementation of the dispute settlement mechanism was not only a milestone for the creation of a rules-based system of international trade, but can also be interpreted as one of the few building blocks of global governance.

However, the decisive support both the GATT and the WTO enjoyed in 1995 is no longer visible. In the second term of Bill Clinton's presidency, the decline of multilateral was palpable. Unilateral solutions were preferred, and this approach was only been intensified when George Bush took up office.

Since the aborted Seattle WTO Ministerial Meeting of 1999, there has been a growing hostility to the WTO in US policy circles. Historically, US commitments to multilateralism have always been stronger in the economic domain than any other area of policy. But in what has been a continual tension between unilateralism and multilateralism the unilateralist urge has been gaining the upper hand once again. The US' rhetorical commitment to a successful Doha Round must be contrasted with its increasing recourse to bilateral free trade, or more accurately preferential trade agreements. President Obama has not improved the US position in this regard. While there is remarkable change in other areas of foreign policy, the Obama administration continues to implement a cautious trade policy. Despite continued rhetorical support for the Doha Round, e.g. at the G-20 Summits in Washington and London, the US has yet to push for a conclusion of the Doha Round.[29]

However, it would be unfair to single out American economic policies for the current malaise of the multilateral regime. The European Union has favored preferential agreements for many years, weakening the WTO. In fact, the European Union, in its rhetoric one of the strongest supporters of the WTO, is further expanding its portfolio of preferential trade agreements to the vast majority of WTO member countries. In effect, the EU organizes its international trade with just a few countries on a most-favored-nation basis. Preferences for individual countries, i.e. free trade agreements, the Generalized System of Preferences, and the "Everything but Arms Initiative" have lead to a situation in which the WTO is of declining importance for the EU. In 2004, the EU traded with just eight, out of 149 WTO member countries, under the most-favored nation clause. These were the United States, Canada, Australia, Japan, New Zealand,

[29] The US may well be the last opponent of a conclusion of the Round, given that there has been a change of government in India in 2009. The former Minister for Trade and Industry, Kamal Nath, was a major opponent of the Doha Round, but he no longer holds the trade portfolio.

Hong Kong, Singapore, and South Korea.[30] Considering the advanced negotiations with South Korea (the EU and South Korea reached a principal agreement in July 2009), this number will shrink further.[31] The expansion of preferential agreements is continuing relentlessly.

The use of free trade agreements has spread beyond just the EU and US, as Asian nations, which have hitherto avoided such agreements, have rapidly implemented numerous FTAs. Of course, this in part reflects the unresolved rivalry between China and Japan for leadership in Asia. China has become one of the most active players pushing bilateral agreements. It is pursuing 27 bilateral and regional free trade initiatives in the Asia-Pacific region, although most of them are still under negotiation. Furthermore, the negotiations with the ASEAN group are already well advanced. China and the ASEAN countries have agreed to create a free trade zone by 2010, and they have already implemented important steps in some areas, such as the so-called early harvest programs.

What we are witnessing in the early twentyfirst century is increasing rivalry between a handful of major players who are competing for both political and economic influence. The new battlefields are preferential trade agreements. Leading powers such as the US, the EU, and China are no longer emphasizing multilateralism first, but are instead pushing for preferential agreements. This reflects both the inability to cooperatively advance the multilateral regime and the damaged position of the previous hegemon, the US. Since the start of the global war on terror, America has lost popularity in many countries that have traditionally supported the US. The unilateral moment of US hegemony may have lasted shorter than some had predicted by the late 1990s.[32] The American-made financial crisis has only contributed further to at least a temporary weakening of the popularity US.[33]

It is becoming obvious that the current wave of bilateral and other preferential trade agreements has severe repercussions for the multilateral regime. In 2005, for the first time ever, more trade has been carried out in preferential agreements than under the most-favored-nation clause.[34] According to Jagdish

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[30] World Trade Organization (2004), p. 21.

[31] The Wall Street Journal, 20 July 2009, p. A 12.

[32] See, for example, Mortimer Zuckerman's upbeat assessment of the American position (1999).

[33] Altmann (2009), p. 6. However, some observers have suggested that the US will emerge less damaged than others form the crisis. Michael Lind observes: "Relying on the import of money, workers and brains for more than three centuries, North America has been a Ponzi scheme that works. The present crisis notwithstanding, it still will" Lind (2009).

[34] Whether the actual trade in the preferential agreements takes place utilizing the preferences or whether companies prefer paying the tariffs due to the complexity of rules of origin requires further analysis.

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Bhagwati, Article 1 of the General Agreement on Tariffs and Trade, the most-favored-nation clause, has degenerated into the least-favored-nation clause.[35]

Bilateral free trade agreements are mushrooming all over the world. The lasting standstill in multilateral trade negotiations has contributed further to this trend. Therefore, the engagement in bilateral trade agreements is not simply a US phenomenon. The Europeans are largely credited with its initial implementations, and numerous other smaller and weaker states have explored the benefits of bilateral trade agreements. However, the enthusiasm with which bilateral activities has been picked up by the US is of primary interest. The role of the US, as the strongest partner in any bilateral relationship is bound to be disproportionately influential. The US is in a position to use its hegemonic power and the prospect of preferential access to the US market.[36] Of course, neither the US nor the EU is alone in pursuing bilateral free trade agreements. They have been popular with the policy elites of the small states that are offered them. Australia and Singapore, two examples among many, have been keen partners in this process.[37]

The proliferation of bilateral PTAs represents the greatest divide between entrenched economic theory and short-term political practice in the global economy that can be seen since the introduction of protectionist measures in the 1930's. Both economists and political scientists agree that bilateral trade deals are sub-optimal and pose major threats to the multilateral trading system. When looking closely at some of the details, the disadvantages of bilateral deals become even more evident. One major drawback is that the important and useful dispute settlement mechanism of the WTO might be diluted because of the mushrooming of preferential agreements.

Transferring dispute settlement to the bilateral level signals a potential deterioration in trade practices, in particular for the weaker players. In many bilateral schemes, there is an option: either a bilateral dispute settlement or a multilateral dispute settlement, i.e. in Geneva. It is obvious that the bilateral route offers many possibilities for the more powerful partners to promote their case. Hierarchy and power—never fully absent in international trade—have a more prominent role in bilateral trade agreements than in the multilateral regime. The existence of an alternative to the WTO dispute settlement mechanism provides the more powerful countries with an additional choice, but for weaker countries this is a drawback.[38] In the WTO, countries can form coalitions in dispute settlement,

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[35] Bhagwati (2005), p. 7.
[36] The Financial Times, 14 July 2003, p. 3.
[37] Dieter (2006), pp. 85-111.
[38] In the European Union disputes are conferred exclusively to the European Court of justice and other EC bodies. By contrast, in NAFTA's chapter 20 there is a choice of forum for dispute settlement, Pauwelyn (2003), p. 1012.

which both reduces costs and increases the bargaining influence.[39] None of these options exist in bilateral agreements.

Considering the negative effects of preferential agreements, their utility appears to be limited while their disadvantages are quite substantial. Rather than advancing the rules-based multilateral trading system, these preferential agreements result in a return of hierarchy and power in trade relations. If the decline of the multilateral order shall be stopped, there is urgent need to stem the tide of preferential trade agreements. The transatlantic powers would be ideally poised to engineer a return to multilateralism in trade. Given the elections in India in 2009, which returned a market-friendly coalition, there seems to be an opportunity for the US and Europe to push for a conclusion of the Doha Round. Of course, the governance of international trade is not the only area with severe problems. In finance, the situation is even more problematic with the emergence of an international regime of financial governance a distant prospect.

4. The Failure of the Transatlantic Powers to Modernize International Financial Governance

In the entire postwar period, the regime of international financial governance and its institutions were shaped by the United States and, to a much lesser degree, the countries of the European Union. In contrast to trade, where Europe has been speaking with one voice ever since the completion of the customs union in 1968, individual countries have contributed to the debate on the policies regarding international finance. Despite the fragmentation of political unity, the US and European countries have been the main drivers of the liberalization of finance, both at the national level as well as at the international level. With regard to national financial systems, the US in particular has urged other countries to follow its example, suggesting that the financial sectors in other countries should be freed of the regulations that restrict market participants.[40] Regarding the international level, the United States government has continued to put pressure on countries that continued to apply restrictions on capital flows. Two well documented examples are the Free Trade Agreements of the US with Chile and Singapore, both of which prohibit the use of restrictions on capital flows.[41]

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[39] Davis (2006), p. 7.

[40] A recent example is the persistent American criticism of China's exchange rate regime which permits only limited appreciation of the yuan.

[41] Chile applied restricted on capital inflows – the so-called encaje – in the 1990s. In theory, Chile could still implement that measure, but doing that will require the consent of the US government. Singapore used a measure to curb speculation against the Singapore dollar, in effect limiting the amount of domestic currency that foreigners could borrow. That instrument – a restriction of capital flows – is also (implicitly) banned.

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With regards to institutions, the transatlantic powers bear responsibility for the decline of the International Monetary Fund. Firstly, the IMF was used previously as a foreign policy instrument. The United States was the main culprit in this case. In particular, the Asian crisis of 1997/98 was used to force countries to change their economic policies in areas relevant to specific American interests. South Korea, for example, had to accept a long list of conditions that had very little, if anything, to do with the immediate solution of the financial crisis. Furthermore, in December 1997 the provision of liquidity—a prime function of the International Monetary Fund—was deliberately delayed for weeks in order to force the Korean government to accept these commands. Not surprisingly, this coercive policy has resulted in lasting resentment in the affected Asian societies.[42]

Secondly, the EU and the US, which continue to be the major forces in the IMF, delayed modernizing the Fund's lending policies for too long. Although the Fund introduced a new facility, the so-called flexible credit line, in March 2009, this change came about belatedly and only after the Federal Reserve, the European Central Banks, and the Bank of England had been flooding financial markets with liquidity for more than 18 months.[43]

The Fund has been offering a lending facility that fits the requirements of modern finance only under severe pressure. The reason for the flexible credit line is obvious: countries participating in international financial markets, that is, economies that have dismantled restrictions on capital flows, are exposed to liquidity risk. While liquidity is easily obtainable in normal times, it regularly dries up in times of crisis. Economies active in international financial markets have two options to prepare for a potential liquidity crunch. They can either create their own homegrown lender-of-last-resort, i.e. they can accumulate foreign reserves in order to be able to support banks or companies in the event of a liquidity crunch, or, alternatively, they can entrust an international lender-of-last-resort to provide liquidity in the event of a crisis. Since the transatlantic powers failed to implement a credible emergency lending facility until 2009, countries have chosen the former option, with economies in Asia and Latin America amassing large foreign reserves. In Asia alone, foreign reserves have risen fivefold between 1999 and 2008.[44]

Of course, countries should also take heed of the argument that governments and central banks should exercise caution and avoid providing generous liquidity to the financial sector to sidestep the problem of moral hazard.

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[42] In Korea, the financial crisis is referred to as the "second national disgrace", the first being the colonization by the Japanese in 1907, Milner (2003).

[43] For details of the new facility see the IMF's press release at http://www.imf.org/external/np/sec/pr/2009/pr0985.htm.

[44] Reserves in China, Japan, South Korea, Taiwan and the ASEAN countries rose from 900 billion dollars in 1999 to 4,511 billion in 2008.

Risk of bankruptcy is the ultimate sanction in a capitalist economy. If the financial sector was assured that no matter how reckless the lending policy of the individual player, they would be rescued by safety net of liquidity, discipline in financial markets would be impaired. As such the IMF was instructed by the transatlantic powers to be cautious and refrain from encouraging irresponsible behavior of market participants.

However, observers in developing countries and emerging markets have noticed that the rigor they were exposed to whenever hit by a financial crisis previously has not been applied in the current financial crisis. Irresponsible behavior was thus implicitly sanctioned with liquidity. Both the Federal Reserve and the European Central Bank not only provided liquidity against bad collateral, but also bailed out individual firms. For example, the Fed supported the takeover of Bear Stearns by accepting dubious collateral, a textbook mistake.[45] Subsequent bailouts, such as AIG, Commerzbank, General Motors, and Chrysler hardly adhered to the recipes the transatlantic powers imposed on developing countries.

The effects of the American financial crisis for global economic governance are substantial. The West has not only failed to modernize the IMF, it has also lost credibility. Policy makers in developing countries and emerging markets question the willingness of the Western powers to modernize the existing institutions of economic governance, and understandably so in the wake of such blatant double standards. The subprime crisis has not just been the biggest financial crisis since 1929, it has been a Waterloo for America's and Europe's credibility and integrity. Henceforth, America and Europe will not be in a position to lecture policy makers in other parts of the world on the benefits of lightly regulated financial markets.

The International Monetary Fund, a symbol of the American dominated regime of financial governance, is thus by association weakened further by the subprime fiasco. Although the Fund's coffers have been replenished following the G-20 Summit in London in April 2009, the credibility and legitimacy of the Fund remain weak.

The IMF had advised time and again the American financial regime as the most advanced and the model to follow. Of course, its goals now will not only be to re-regulate the US financial sector, but to also develop a new blueprint for the regulation of financial markets elsewhere, including a innovative approach towards the regulation of international capital flows. While the transatlantic

[45] The bailout of Bear Stearns, in which the Federal Reserve accepted dodgy collateral in return for a 29 billion loan, constitutes the violation of a long established principle of finance. Lending against bad collateral is rewarding the financial sector for unsustainable behaviour and creates the expectation that similar bailouts can be expected in the future. In other words: The Federal Reserve has created moral hazard. Interview with Alan Meltzer in: Frankfurter Allgemeine Zeitung, 5 June 2008, p. 15.

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powers continue to self-reflect, observers elsewhere have noticed that China's much more regulated financial sector—which includes restrictions on cross-border capital flows—has fared better than virtually all others. The US and the European economies will find restoring their credibility a formidable task.

5. Conclusion: Can Global Economic Governance be Revived?

In this short, discussion of global economic governance in the first decade of the 21st century, the weakness of the existing regimes and the contributions of the transatlantic powers to its current state are apparent. Either intentionally or by accident, the US and the EU have been weakening the existing regimes and have been unable to maintain the attractiveness of the institutions that have been created by these very countries after 1945.

One of the key foreign policy questions in the coming two decades will be the modernization of the current regime of global economic governance. John Ikenberry has pointed out while the rise of China is a challenge, so far the Chinese have operated within the existing order and refrained from staging a full-fledged confrontation.[46] However, continuing on the present trajectory will not be sufficient for the emerging powers, particularly China, India, and Brazil. The transatlantic powers and influential interest groups in these states have to address the challenge of modernizing economic governance.

The business community in particular might have to rethink its previous approach. Taking a liberal economic order, especially one dominated by the transatlantic powers, for granted may not be tenable in the 21st century. The business community not only has to give up its previous policy of benign neglect vis-à-vis the excesses of the financial sectors. In addition, it must develop a much more explicit strategy towards the institutions of global economic governance, including financial affairs.

Considering the recent trends in the multilateral trading system, the prognosis is uncertain with regard to the possibility of a quick revival of the regime. The trend toward bilateral preferential agreements has been identified as the single biggest problem for the WTO. Needless to say, this will not change even with the conclusion of the Doha Round, since the Doha Round negotiations hardly mention free trade agreements. Even if the Round were concluded in 2009 or 2010, most of the forces driving preferential agreements would not disappear. In particular, the rivalry between major powers would continue.

The fundamental issue is that the importance of a rules-based, open multilateral trading regime has to be mainstreamed in the policy making circles in OECD-countries. All too often the utility of the WTO is ignored, and it should be

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[46] Ikenberry (2008), p. 37.

clear that pushing preferentialism is also re-introducing discrimination. Considering the experience of previous collapses of multilateral regimes, the transatlantic powers in particular should consider a joint initiative that underlines the centrality of multilateral regimes.

In finance, rebuilding confidence both in the institution of financial governance and in the model that has dominated thinking in the last decades will be extremely difficult. The mess we are witnessing in the United States will not be easily solved, and it will be even more difficult to come up with a blueprint for the organization of financial markets that convinces policy makers in the OECD and beyond. The entire catalogue of so-called financial innovation has to be reconsidered.

What would be necessary is nothing less than a new Bretton Woods. The global economy would need a world economic conference where the existing regime in trade would be modernized while in finance a new blueprint would be developed. A new reserve currency, perhaps based on SDR, would be an integral part of such a new regime.

Of course, the realization of a fundamental revision of the existing monetary order is not likely in the short term. In the absence of a new hegemon, there will be very little willingness of both developed and developing countries to subscribe to a collectively created new multilateral regime in finance. Global economic governance will probably remain chaotic, and both policy makers and the business community will probably favor regional governance in both trade and finance.

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