Think Global – Act European

Think Global – Act European

The Contribution of 14 European Think Tanks to the Spanish, Belgian and Hungarian Trio Presidency of the European Union

Directed by:
Elvire Fabry and **Gaëtane Ricard-Nihoul,** Notre Europe

Think Global – Act European

GLOBAL GOVERNANCE

Crisis Calls for Greater EU Cohesion to Manage Globalisation

Adam Jasser Member of the Board, Director of Programmes, demosEUROPA

The need for economic and financial policy coordination in Europe and globally is going to be even greater in the post-crisis environment than during the French and Czech Presidencies, when the crisis hit with full strength and forced initially disorganised public authorities into an unprecedented global response to shore up the financial sector. The crisis provided the ultimate, painful evidence that globalisation has taken deep root in the world and that no market, no region or individual country can claim immunity to large-scale economic disruptions taking place anywhere on the globe. The myth of 'decoupling' between mature and developing economies, between old and emerging powers has been consigned to the garbage bin. Multilateral dependencies between saving and deficit nations, the transnational character of trade and financial flows have made the argument for strengthening global governance more compelling than ever. Hence the role of G20, the World Trade Oraganisation (WTO) and the International Monetary Fund (IMF) is likely to continue growing in the years ahead. The challenge for the EU is going to be how to translate the bloc's combined economic strength into political clout and maximise its influence on decisions and policies designed by the G20 and other international bodies. The broad representation of European powers at such bodies is just an illusion of influence because it is not backed by a vigorous common stance. The forging of such a common stance should become a prime task for the new President of the European Council, the High Representative and President of the euro group as well as the Commission and the ECB. The rotating Presidency should have an auxiliary role in the process.

Redesigning global finance: EU needs inward reform and external action

A major task around the world is how to redesign the financial sector, the malfunctioning of which was an important cause of the crisis. Following the G20 meeting in Pittsburgh in September 2009, there is a consensus among leading developed and emerging economies that financial sector regulation will need to increase substantially in the coming years.

The debate about specific measures focuses on closer and more coordinated supervision, limits on derivatives, and basic design of the financial system that could reduce opportunities for excessive risk-taking. The last part is particularly challenging. The basic moral and economic dilemma of policy-makers in Europe and elsewhere is between, on one hand, the need to prevent a financial system collapse and restore normal credit action for businesses and, on the other, allowing the financial sector to return to bad old ways on the back of the generous capital injections and liquidity provision by public institutions. The former could nip the recovery in the bud, while the latter creates a sense of impunity or moral hazard which could result in another asset bubble and another, more painful recession. The way out of this dilemma seems to be a gradual shift away from thinking which holds that there are financial institutions in Europe and the United States that are too big to fail. To quote Professor Robert Wade of the London School of Economics: “If a bank gets to be too big to fail – that is, where it has an assurance that the government will bail it out – then it is too big to exist”. One idea making the rounds in Europe and the United States is to return to a strict division of financial institutions into ‘plain vanilla’, or utility banking (based on deposit gathering) and investment banking (based on arbitrage and risk-taking for maximum profit). Critics argue that this may lead to over-regulation and arbitrary decisions on where classic banking ends and investment banking begins. As a way forward they point instead to higher capital and reserves requirements as a means of restricting the financial sector’s tendency to over-leverage. Another aspect worth taking into account is the attachment of policy-makers to maintaining interest rates close to zero. Central banks are gradually withdrawing the extra liquidity measures that sustained the financial system, but only a few have had the courage to actually hint at higher rates. But a higher cost of capital remains a key tool for preventing excessive borrowing. The trouble is that as governments in Europe and the United States struggle with growing fiscal deficits, they are interested in low borrowing rates for themselves. The three EU Presidencies – all in the hands of heavily indebted governments – may struggle to come clean on the trade-off inherent in this approach: lower rates may help finance the budget deficits but they also provide an incentive to investors to borrow cheaply and seek higher returns, which can easily re-inflate asset and commodity bubbles. There is some evidence of such bubbles building up already and unless this trend is moderated soon, there is a potential for another major market disruption and a double-dip recession. The 3rd November recommendation by the outgoing Commission that the fiscal and monetary stimuli be reeled in during 2011 is a point of departure for more detailed discussions, and these may require strong leadership from the current Trio Presidency.

Another major long-term challenge is the reform of the international monetary system. The world’s over-reliance on the dollar as a reserve currency means the corrective mechanisms that normally affect a currency’s performance and adjust it to economic fundamentals are distorted. This is aggravated by the over-representation of Western nations in the International Monetary Fund. Although in theory the IMF could operate a new global currency that could reduce the world’s dependence on the dollar, it will not be able to perform this function without additional funds provided by rising economic powers such as China, India or

Brazil. But these countries are reluctant to engage in what they see as an institution serving the interests of Western powers. The current Trio Presidency, working closely with the now normalised Eurogroup and the Commission, should take the lead in working towards a major rebalancing of the IMF's voting power (as recommended by the G20 meeting in September) in favour of emerging economies, even if this is at the expense of individual EU member states. The fact that the current Trio Presidency is held by small and medium-sized EU players should be encouraging in this respect, provided that they take a sufficiently broad view and engage closely with at least one of the big EU players which stand to lose out. France, Germany and Britain together have over 15% of IMF votes compared to China's 3.7%. Another way to a more diversified monetary system is to maintain pressure on China to liberalise its currency regime, something the Commission but also the Council will need to keep in mind as global imbalances refuse to correct themselves. The limited international exchangeability of the yuan as well as its tightly controlled exchange rate are major hurdles for the Chinese currency's ability to serve as another reserve currency. This paradoxically reinforces China's dependence on investing its huge savings in loans to the US government. The EU will need to engage the Chinese more vigorously alongside the United States in talks on the global currency regime, to ensure a fairer and more balanced pattern of trade and to help secure a new trade liberalisation deal. This is a diplomatic task for all key players, including the Chairman of the Eurogroup (institutionally formalised under the Lisbon Treaty), and the Presidents of the European Council, European Commission and European Central Bank.

The Eurogroup, hopefully with the support of the Presidencies, faces another challenge – the euro's difficulty in becoming an alternative to the dollar as a reserve currency. There are two main reasons for this: the fragmentation and lack of adequate liquidity in the EU's sovereign bond market (aggravated by Britain's self-banishment from the eurozone), and insufficient political and fiscal coordination in the eurozone. The fluctuations and disparity in bond spreads between Germany, other eurozone members, the UK and new member states which remain outside the euro area is a constant drag on the euro's credibility. However, the EU has the potential to gradually enhance the currency's appeal. A crucial element in this should be to shore-up internal coordination and the EU's ability to react to internal shocks. It was disconcerting in late 2008 and early 2009 to see the EU almost dormant in addressing the sudden capital stop experienced by poorer EU nations. The eurozone laggards were offered tentative support, which helped them weather the storm, but the non-euro nations of Central Europe found themselves confronted with a monetary form of the old Iron Curtain. Although the worst-hit economies received balance-of-payment support from the EU, for many observers it seemed like a throwback to the early days of post-communist reforms when the IMF rather than the Commission, the ECB or the European Council took the driving seat. Protectionist impulses of some leading eurozone politicians who sought to attach national strings to government bailouts of banks and other forms of support for companies did nothing to boost confidence in the European project. The Czech Presidency bravely sought to resist both the protectionism and the over-simplistic perception of the risks in Central Europe. Aided by other newcomers, notably the recession-resistant Poland, the Czechs managed to put together enough critical mass to get the message across to EU partners and markets, but their ability to follow through was limited due to domestic political instability culminating in the collapse of the government in the middle of the Presidency. The subsequent Swedish Presidency saw the situation calm down thanks to modest signs of recovery but the topic of eurozone's internal cohesion is set to come back as the EU designs its post-crisis strategy. The opening of the EU's new political cycle, crowned by the coming into force of the Lisbon Treaty, is providing policy-makers with an opportunity to consolidate the eurozone. The new German government's plan to ease taxes and not to rush with fiscal consolidation aligns the eurozone's largest economy closer with France, boosting chances of a more coordinated exit strategy. If this is coupled with a credible plan of reviving the Growth and Stability Pact as well as credibly extending the eurozone further east, the euro is bound to consolidate its position. One factor which could take the euro closer to a reserve currency status would be to return to discussions about the EU becoming an independent issuer of bonds, thus creating a pool of liquidity directly linked to the currency. So far the idea has received a very cool reception from Germany, which fears that such bonds would amount to an easy way out for recalcitrant budgetary offenders such as Greece, Italy, Spain and Portugal, at the expense of more disciplined eurozone members. Eurozone outsiders in Central Europe are also loath to the idea, fearing they would be left out in the cold in the crowded sovereign credit market. Yet, the idea seems worth revisiting in the context of the next EU budget. One possibility is that the budget contains a reserve fund for dealing with internal shocks, financed through EU borrowing in the market. The fund could also be used for financing clearly pan-European projects such as on energy security and climate change, and could be offset by a mechanism under which eurozone members would limit their domestic borrowing in proportion to EU level borrowing. A stronger mechanism for monitoring compliance with the Growth and Stability Pact is provided for in the Lisbon Treaty, but work should begin on enforcement. A determined Presidency could begin such discussions during 2010 in the run-up to the likely coordinated push for exit from stimulus and discussions on the next financial perspective, both set to take place in 2011.

Combine carbon tax debate with Doha round

International trade has been one of the biggest casualties of the crisis. The Doha round of WTO talks aiming to further liberalise trade has been largely marooned, with an increasing number of diplomats expecting that the 2011 deadline for a deal may need to be pushed back. Despite a body of evidence suggesting trade liberalisation would aid the global recovery, many governments are treading water, fearing the impact on their domestic industries. The shifting global economic landscape and the uncertain future of the post-Kyoto deal on combating climate change are additional impediments in the trade talks. The growing debate on the global carbon tax, which the European Commission sees as one way to finance the climate change adaptation of developing nations, should be dealt with in the WTO context even if this could cause further delay in the talks. Here the role of the EU Presidency could be complementary to the Commission's WTO negotiating mandate. The lack of a binding agreement at Copenhagen in December 2009 reinforces the case for such an approach going forward. The reasons to include the carbon tax in the Doha negotiations are good even though there are a number of respectable voices arguing the opposite. Angel Gurria, head of the Organisation for Economic Cooperation and Development (OECD), said recently that "the danger is that arguments over border (carbon) taxes could make an agreement (in the Doha round) even more difficult to negotiate. There is no need for this distraction, as fears about the potential impact of leakage and loss of competitiveness are exaggerated". He has a point. The developing nations are generally expecting the EU and the United States to lower barriers on agricultural products and reduce subsidies to their farm sectors. In return they are prepared to open up to non-farm goods exports from the developed nations. The exact formula and scale of liberalisation on both sides remain sticking points and would be further complicated by the carbon tax, which – unlike the emission trading schemes – would apply to transport and farming goods. Yet, in reality, it is misleading to separate international trade from the push to make global industry (producing tradable goods) more environment-friendly and energy efficient. In the same way as global currency imbalances distort trade by giving a *de facto* unfair competitive advantage to some countries, carbon-intensive industries enjoy a similar advantage over industries which are switching over to low-carbon technologies. If the EU genuinely wants to play a leading role in combating climate change, it should design a formula linking farm trade liberalisation with making the carbon tax universally accepted.

Fewer Europeans, more Europe in international bodies

The Lisbon Treaty bears a promise of making Europe's voice on the global scene more coherent. Both the President of the European Council and the High Representative will have the capacity to represent the Union in external relations. The Presidency will from now on have a more auxiliary role in presenting the EU's views to the outside world. However, it has a significant role to play in creating the internal EU unity that is necessary to give the new posts a strong influence. The logical next step is for the EU to rethink its representation in key world governance bodies. The issue of EU over-representation at the IMF and the need to rebalance the voting power at the Fund has already been discussed and it seems some progress there is possible. One way to move things forward would be to break with the tradition that the top IMF job always goes to a European. If Europe wants to see greater engagement of emerging powers in global monetary governance, backing an Asian, possibly Indian, candidate to succeed Dominique Strauss-Kahn would be a gamble worth taking. It would bear witness to Europe's seriousness in seeking a more balanced, multi-polar global order, and would display Europe's trademark model of consensus-building on the world stage.

Whereas the outside pressures for IMF reform create an incentive for Europeans to act, the European representation at the G20 and on the UN Security Council is a much trickier issue. Yet the establishment of the President of the European Council and High Representative could offer a much-needed stimulus to revisit the issue. Regarding the G20, the EU should seriously consider a much leaner representation. At the moment, six EU nations sit in the G20 meetings – France, Germany, Britain, Italy, Spain and the Netherlands. The last two have sneaked into the group on dubious grounds. The benefits of such wide representation of Europeans are hard to find, apart from creating a feel-good factor in some capitals. The argument that it is better to have more people voicing the European point of view is misguided – who wants the same message repeated six times in one meeting? Negative effects are more tangible. It creates yet another division line in Europe, with new member states in particular feeling that they have been short-changed and deprived of influence on the G20 agenda. To the outsiders, the plethora of Europeans at the table is symbolic of Europe's inconsistency. On the one hand, it shows that European nations still harbour an ambition to dominate the global agenda despite their shrinking individual power, and on the other it shows the inability of Europeans to pool resources, reach internal consensus and speak with a single voice. This state of affairs reinforces the perception that Europe is satisfied with appearances of influence rather than real power. To illustrate the point: even if Europeans actually reach a consensus on an issue discussed by the G20, as they did before Pittsburgh, will all the six EU representatives deliver the same speech or will each try to be original, muddling the message as a result? How quickly will some of the partners at the table stop listening to yet another European, or will they all listen attentively to spot rifts in the allegedly unified EU stance? And what if the EU is indeed divided on an issue – does it benefit the bloc to paper over the divisions in the run-up to the G20 only to put them on display during the meeting? One way or the other, this is no way to do serious business, avoid irrelevance and win the respect of partners. The institutional changes provided by the Lisbon Treaty should therefore be used as an opportunity to radically overhaul the system. The G20 should be purged of all national European representation and replaced by the Trio of the President of the European Council, the Commission President and the ECB. This would force the EU to seek genuine internal consensus around consistent policies. The paradox is that such a smaller European representation, speaking with a single voice, would enhance rather than reduce European influence. It would certainly be welcomed by the United States and could boost Washington's appetite for a closer coordination with the EU on global governance issues. The prospect of a world increasingly run by a G2 comprising the United States and China (with Europe, India, Brazil and Russia in the back seat) could thus materialise as a G3, in which Europe would wield political influence consistent with its economic clout.