

**SUMMARY** The system of multilateral rules and institutions that is currently responsible for global economic governance is in a sorry state. In the coming months, Europe will be faced with important decisions about the future of this system. *The EU should not wait before proposing and initiating reforms. Europe has a large stake in the multilateral system and has considerable experience in designing effective institutions, making it well*



GOVERNANCE of the global economy used to be an issue for the future. It has become a pressing matter and signs of this tectonic shift are everywhere:

● In July 2006 global trade negotiations under the aegis of the World Trade Organisation were suspended. This development highlights the added complexity implied by the increase in the number of key players in the negotiations, and indicates the difficulty of delivering on the multilateral front. What could in the past be solved bilaterally between the US and the EU requires more demanding compromises involving developed, emerging and developing countries.

● The two global institutions long seen as most effective, the International Monetary Fund and the World Bank, are struggling to adapt to new realities. They have both lost relevance. The IMF's core business of conditional financial assistance is threatened by Asian disaffection and Latin American detachment, and its attempted resurrection as a venue for managing global current account imbalances is a high-risk gamble. The World Bank has been largely crowded out from project lending to emerging countries by the development of financial markets. Furthermore, conditional debt relief to poor countries is being undermined by a new wave of unconditional bilateral credits from China and elsewhere. Both institutions are also sorely in need of further governance reform to enhance the participation and voice of emerging economies.

● Almost ten years after it was signed, the Kyoto Protocol on global warming is still rejected by the US and major emerging economies and even those countries that support it make insufficient efforts to enforce it at home.

● The shifting supply and demand patterns for fossil fuels, water and other natural resources create scope for new tensions, but no meaningful international response has emerged to establish proper-functioning mar-

kets and avert the risk of tension. On the contrary, national governments in developed and emerging countries have recently been busy securing access to oil fields through the strengthening of bilateral links with producing countries.

This situation raises major, perhaps unprecedented policy challenges. Yet the balance of economic and political power makes addressing these challenges more difficult than at any time in recent decades. Under US leadership, global economic governance was a stable and relatively simple game with few players. It is made much more unstable and complex by

the rise in the number and diversity of players, the growing weight of new economic powers, and increasing US scepticism about 'foreign entanglements'.

Given its economic size and experience, the EU has an important potential role to play in the reform of global governance. Europeans, however, have mixed feelings about it.

On the one hand, they see themselves as supporters of strong global rules

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Finally, the end of the Cold War has removed a powerful incentive to collective action. The change in attitude of the United States, which is now more inclined to adopt a multi-track strategy that includes regional agreements and unilateral initiatives as alternatives to the multilateral route, has probably less to do with economic factors than with political factors. The US position in the world economy is less dominant today than at the end of World War II when it spearheaded the multilateral system. But it is on the political side that the most important shift has taken place. In the eyes of many US policymakers, US national security no longer calls for cementing an economic coalition of states in the way it did in the Cold War period. As scholars of international relations often say, the Cold War glue has gone.<sup>4</sup> Interestingly, the so-called war on terror has not, so far, rested on a system of economic alliances that bind countries together.

#### National leadership

Countries holding a dominant position may set de facto rules for the global economy. This is typically the case for standards, where the United States and the European Union play a dominant role largely because of their size. The US has generally taken the lead in financial matters, whereas the EU has been a dominant player in certain pca,tat



### 3. GLOBAL GOVERNANCE MATTERS

Global governance should not be considered as the only possible way to manage globalisation. Nor can it be dismissed, however, because there are issues that call for global collective action. This is obviously the case where there are important global externalities, such as for the global environment, global epidemics and global financial crises. In this re



Box 1: European representation in the Bretton Woods institutions

Governance reform is on the official agenda of the Bretton Woods institutions. In Singapore in September 2006, it was agreed in a first

<sup>5</sup>More precisely, it was agreed to revise both the member countries' quota (their participation in the Fund's capital, which also determines their access to credit) and their voting rights (which closely follow their quota).

<sup>6</sup>Report of the Managing Director of the IMF to the International Monetary and Financial Committee, 14 September 2006.

<sup>7</sup>Quota and votes are decided upon by the 184 "governors" of the Fund (country representatives). They are traditionally adopted by the World Bank also.



Third, the legitimacy of the EU in the eyes of its own citizens largely hinges on its ability to tackle global issues. An EU that has regained legitimacy by setting itself an ambitious agenda on trade, energy, global finance and climate change will be better placed to find a solution to the constitutional conundrum than one that gets lost in introspection.

#### C. Reforms are needed

This applies especially to trade, finance and the environment. The EU should stand ready to take initiatives to unlock the global trade negotiations. It cannot anymore give precedence to sectoral interests nor render its external stance hostage to internal compromises, especially on agriculture.

The Bretton Woods institutions are another immediate area for reform. EU member states should be proactive in specifying a mandate for the EU as a catalyst for reform of the IMF's and World Bank's governance. This is a necessary, if not sufficient, condition to ensure the legitimacy of these institutions, which have played a helpful and important role in the past and could do so again in the future. Against this background, the case for a single European or, more realistically, a euro-area seat at the IMF Board is strong. Within the framework of a significant realignment of quota and votes, a unified representation would actually solve two problems. It would allow a better representation of emerging and developing countries and strengthen Europe's influence (see Box 1).

First, procrastination is a losing strategy. The longer the EU waits to recognise that the world has changed, the smaller its weight in this world will be. The time for action is now.

Second, the EU can no longer hide behind the US. For economic and political reasons, the US is now less ready than at any time since World War II to move global economic governance forward. It would be imprudent to assume that this situation will soon be reversed. Rather, European policymakers should indicate willingness to take their share of global responsibilities and build on this commitment to initiate a renewed dialogue with the US.

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Regionalism is both a fact and a natural response to the diversity of preferences in the world economy. It is therefore bound to develop further not only in trade but also in other areas. But for regionalism to support rather than undermine multilateralism, safeguards need to be defined. Being itself the archetype of a strong and successful regional grouping, as well as a traditional supporter of the multilateral system, the EU is ideally placed to contribute constructively to this conversation. It should seize the initiative and exercise leadership in the definition of guiding principles for making regional agreements built-