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The EU and the Governance of Globalisation

This paper is a contribution to the project *Globalisation Challenges for Europe and Finland* organised by the Secretariat of the Economic Council. The project is a part of Finland's EU Presidency programme and its objective is to add momentum to the discussion in the European Union on globalisation, Europe's competitiveness policy and the Lisbon strategy.

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rebuilding the world trade regime. Yet the global economic governance regime – the set of global rules that govern international economic relations, the network of institutions that support and enforce those relations and the processes that steer change in this system – has not undergone a parallel transformation.

The changes that have taken place should certainly not be dismissed. The core institutions have taken up new roles – the IMF, for instance, has moved from financing current account deficits in the fixed exchange rate world of the early post-World War IIwC g('MBKRWqCag(IBinxBwxxxRWCng'Ceg(RBMIRk'Crg(KBx'wC g(KRRBkWRChgahrhatanc

being the prime example of a global public good whose preservation must rest on international cooperation.

On the whole, considerable changes in the global economy have not been mirrored in the structure and missions of global institutions; and although institutions have adapted, there is a clear disconnect between economic and institutional developments.

It is, in a way, a remarkable tribute to the architects who were "present at the creation" of the post-war order – mostly US policymakers, and a few British ones – that the system they conceived sixty years ago has been able to serve a rapidly transforming world economy without major institutional reform. However, there are limits to the extent to which this flexibility allows the global governance system to adapt.

Against this background, two recent trends affecting the world economy are especially noteworthy. The first one is a threat of a nationalist resurgence. The second is the challenge of the rise of regional arrangements. We now turn to these, before exploring more fundamental causes of the malaise.

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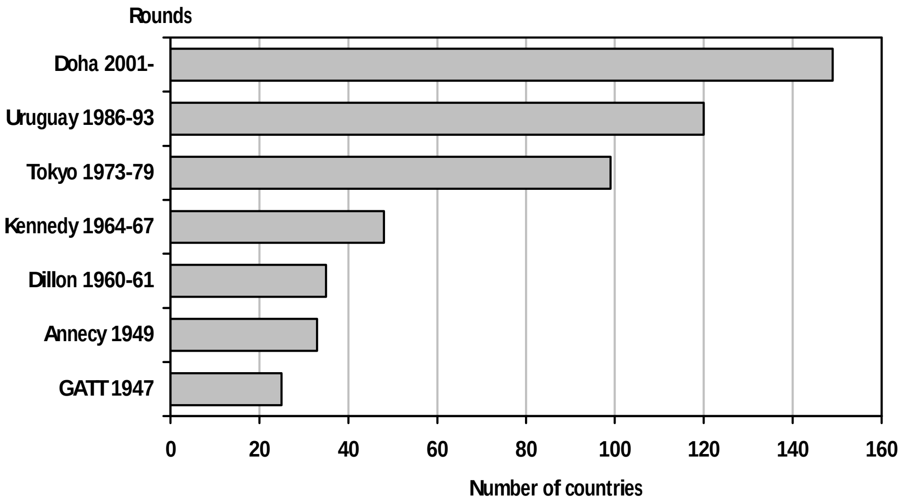
The most profound shift may however be the emergence of new powers which have a different attitude towards multilateralism. Key economic players in the first decades after World War II were Europe and Japan, which had been recently traumatized by nationalist hubris. China, India or Brazil do not share the same historical experience and can easily perceive multilateral commitments as excessive constraints on policies inspired by national interest. Furthermore, in East Asia the traumatic experience of the financial crises of 1997–1998 has fuelled sentiment that the multilateral system cannot be trusted – hence the reliance on self-insurance through the building up of foreign exchange reserves.

Energy is another illustration. Since the fear of resource scarcity has re-emerged, national governments in developed and developing countries have been busy securing access to oil fields through the strengthening of bilateral links with oil and gas producers. Despite emerging efforts to create an EU energy policy, the world has a long way to go before the need to ensure energy security can be taken up collectively rather than individually.

Number of countries taking part in multilateral trade negotiations.



Source: WTO.

Second, among countries of unequal development level, many global issues involve an international distributional dimension that compounds the difficulty of reaching agreement. This is obviously the case for debt relief, but is true also for trade liberalisation, since countries benefiting from the preferential trade agreements in existence are bound to lose from an alignment of trade tariffs. This also applies to policies designed to tackle global environmental challenges, for which equity issues are compounded by the intertemporal dimension: the prime objection of emerging countries to curbing greenhouse gas emissions is that developed countries had a free ride on the global environment in the previous stages of their development. In principle, those obstacles can be addressed – at least for a transition period – through international redistribution. In fact, some redistribution is already taking place through development assistance and the asymmetric allocation of greenhouse emission quotas. However, the distributional problem remains extremely difficult to tackle unless a benevolent hegemon stands ready to internalise the problem and buy off opposition.

Third, globalisation is divisive within developed and developing societies. The extent of its contribution to the rise of within-countries inequality and job insecurity is disputed, but the most basic models of integration through trade, capital flows and migration point to distributional effects that create winners and losers. Furthermore, in many instances, global institutions are regarded as the source of globalisation itself and of its deleterious consequences, thereby weakening their political legitimacy.

Fourth, and not least, the end of the Cold War has removed an powerful incentive to collective action. The change in the 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[2], has probably less to do with economic factors than with political factors. Being now the world's biggest debtor, the US is wCig(xBw [illegible]

Financial Reporting Standards (IFRS) as an alternative to US GAAP accounting rules, and by the growing unease in the US about EU-originated product regulation.

Another substitute for governance by global public institutions is a similar function, but exercised by private-sector organisations. Markets have an ability to self-organize without the direct involvement of international institutions and are generally faster in designing and reforming arrangements. This is especially true of financial markets, which have always been the spearhead of international integration and have developed spectacularly in the past 25 years.

It is worth recalling that the widespread financial liberalisation of the last two decades has taken place without countries entering multilateral negotiations and taking on formal commitments, at least at a global level. While public institutions participate in the monitoring of financial fragilities, private rating agencies such as Standard & Poor's and Moody's have established *de facto* global standards in the assessment of sovereign as well as private debts.

Private-sector global governance regimes are emerging as a significant component of global rule-making. The International Organisation for Standardisation (ISO, founded 1947), International Accounting Standards Board (IASB, founded 1973) or Internet Corporation for Assigned Names and Numbers (ICANN, founded 1998) are well-known examples. In addition, private initiative in development assistance is making inroads into the traditional domain of public institutions.

As expressed by Francis Fukuyama (2006), *"The old realist model of international relations that sees the world exclusively organised around sovereign nation-states simply does not correspond to the world that is emerging, and it will not be sufficient to meet the needs of legitimacy and effectiveness in international action in the future. [...] Formal organisations acting on the basis of instructions that come up the accountability channels of sovereign states are too inefficient to suit the economic needs of the global economy. We have accepted a trade-off of legitimacy, transparency, and accountability for the sake of efficient decision making in the economic realm"*.

This does not need to be regarded as a threat to the multilateral system. Governance through multilateral institutions and rules can coexist with market self-organisation and can even find positive synergies with it. Yet this does represent a challenge as governments and institutions need to adapt to the emergence of new forms of governance.

the case of the WTO do the treaties foresee the possibility that member countries form regional groupings and insist that they respect certain rules in doing so. However, the rules have been so weak that only one of the 130 or so regional trade agreements (RTAs) notified to the WTO has actually been formally nxxRWKr%r%r q rWBRRRRRTxTxTne

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Summing up, the main challenge for the years ahead is to adapt the global governance system to the new global reality: a larger and more diverse set of countries; new priority such as migrations, climate change and energy security; geopolitical conditions that deeply differ from those of the previous decades; the rise of new powers with strong national sentiments; the irreversible development of regionalism; and changing borders between the realms of public regulations and market self-organisation. This will require initiative and leadership. We now turn to the question of what role Europe can play in such a process.

4 THE EU AND GLOBAL GOVERNANCE

If anything characterises Europeans' attitude towards global governance, it is ambiguity.

On the one hand, there is a natural synergy between an effective EU and an effective global governance regime. In international economics as elsewhere, European public opinion is also very sensitive to the issue of globalisation and Europeans expect the EU to help "manage" globalisation. In a 2003 survey[4], 56% of EU15 respondents said that globalisation needed more regulation and 61% trusted the EU to ensure that globalisation went in the right direction. Europeans also consistently assign to the EU, rather than to the member states, responsibility for participating in global governance. For example, a recent survey indicates that 77% of respondents in the EU25 would like more decisions regarding the promotion of peace and democracy in the world to be taken at the EU level. The corresponding proportion is 72% for the protection of the environment and 70% for the prevention of major health problems[5]. The notion that there are global issues which can better be tackled by the EU than its member states seems to receive strong support among Europeans.

Finally, the Europeans have a major stake in the global governance regime. With the exceptions of the United Nations and the WTO, which are based on the one-country-one-vote principle, most international institutions have an internal allocation of power that reflects the world of yesterday rather than today, and Europe is, nominally at least, the biggest beneficiary in this (Table 1). This is particularly true in the Bretton Woods institutions, where the EU controls about one-third of the seats and the voting rights, not an oversized share in reference to current GDP, but a clear overrepresentation by most other measures. As observed by Vijay Kelkar et al (2005), the combined votes of Brazil, China and India in the Bretton Woods institutions are about 20% below those of Italy, Belgium and the Netherlands, while their combined GDP at market exchange rates is 23% larger, their combined GDP at PPP exchange rates is four times larger, and their total population is 29 times larger. These are astonishing figures, which may explain why Asian countries feel so little ownership in the Bretton Woods institutions. The quota revision proposed by the IMF for adoption at its 2006 Singapore annual meeting does not change this overrepresentation in a significant way: it would reduce the EU share from 31.9% to 31.3%.

[4] Special Eurobarometer survey on globalisation, November 2003.

[5] Eurobarometer survey on the future of Europe, May 2006. The survey did not include specific questions on the economic governance of globalisation.

Weight of the EU in international economic and financial institutions.

Institution	Votes*	Current-dollar GDP 2005	PPP-based GDP 2005	Population
	EU Share	EU Share	EU Share	EU Share
G7**	**57.1 (4 of 7)**	**32.8**	**31.0**	**36.4**
G8**	**50.0**	**31.9**	**29.2**	**30.3**

That said, Europe's behaviour more than occasionally contradicts its stated goals and apparent interest in global governance. Although claiming to be a champion of multilateralism, the EU has in fact contributed toward challenging it by taking the initiative to negotiate a whole array of regional trade agreements. While all major players nowadays have developed a regional strategy alongside their participation in multilateral institutions, it is the EU which launched the trend (Sapir, 1998).

Moreover, the EU does not really play in global governance a role commensurate to its representation. The EU is undoubtedly a major player in international trade negotiations where it has clearly stated priorities and the ability to push for them. Whatever the negotiation setting, it is part in the game. The EU has also played a key role in the negotiation of the Kyoto protocol; after the US withdrawal, Europe has taken the leadership in pushing for ratification and implementation. However, the EU has kept a strikingly low profile on global macroeconomic issues. In stark contrast to the US, Europeans have not expressed any strong views so far on issues such as the unwinding of current account imbalances or the Chinese exchange rate. On the euro-dollar exchange rate, several mutually inconsistent opinions have been expressed by Europe's ministers of finance and central bank governors. On the nature and speed of the US current account adjustment, Europeans have more than once given the impression that their best hope is for a exchange rate stability, while routinely exhorting the US to fiscal discipline and a correction of the external deficit. On the Chinese exchange rate, Europe has tended to follow the US lead, although Europe's interest may differ substantially from that of the US. Euro area policymakers thus seem to have refrained from drawing conclusions from the new *de facto* world status of their currency.

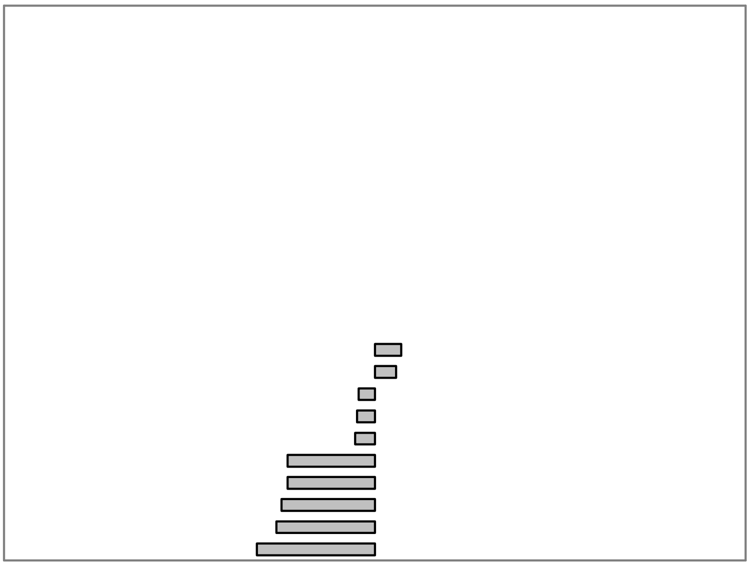
On international finance, Europeans have certainly been part of the conversation within the G7, the G20, the Bretton Woods institutions and other public forums. They may even claim some successes, such as the par behave as a world monetary and financial power[6]. Here again, the EU's effective role does not seem to be commensurate with its members' representation in the Bretton Woods organisations.

Rather than being a consistent pillar of world economic governance, the EU can thus be characterised as an accidental player (Pisani-Ferry, 2005) – one which, depending on the issue, is sometimes at the table and sometimes absent, sometimes voca , e

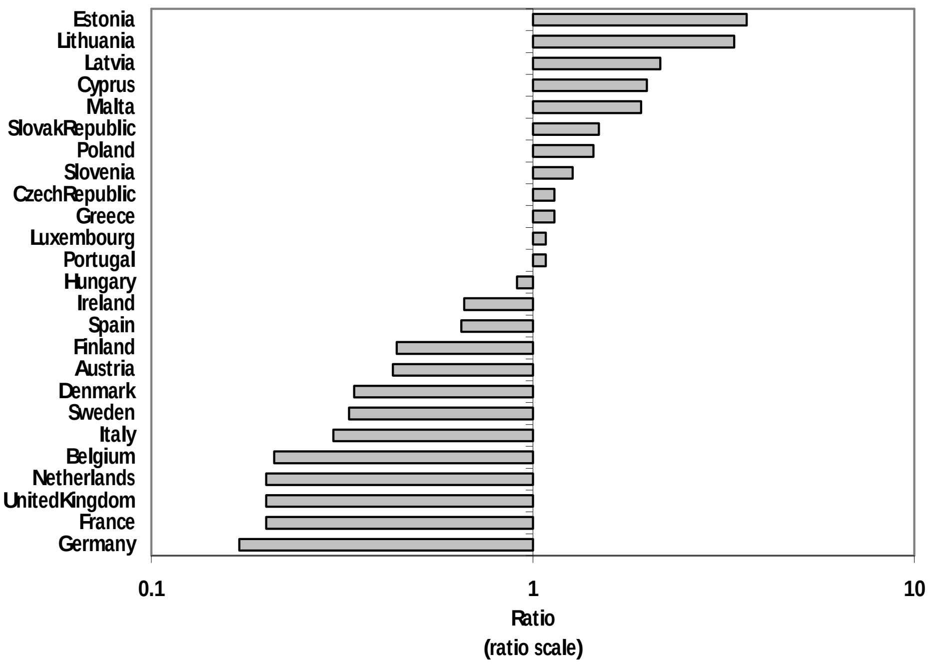
financial relations with the rest of the world. In some fields, policy responsibility is fully delegated to an EU institution – in most cases, the Commission or the ECB – which has been given a clear mandate to act. In others, responsibility is divided between member states which may endeavour to coordinate their views. It could be the inefficiency of some of its governance mechanisms that prevents the EU from playing the role it could play.

Apart from being important in itself, the IMF provides an interesting testing ground. It is an institution where the EU is at the same time overrepresented in numbers and underrepresented in voice. According to Lorenzo Bini Smaghi, who prior to his appointment to the board of the European Central Bank was involved in the coordination of European positions in international monetary and financial affairs, *"if EU countries wish to improve their collective influence in international issues and the IMF, some institutional changes in the way European interests are represented and promulgated may be necessary"* (Bini Smaghi, 2004).

Moreover, for reasons already given a reform of the global economic and financial institutions that would rebalance power within them is not simply a matter of fairness; it is also a necessary (though not self-evidently sufficient) means to ensure a sufficient degree of ownership in the multilateral system by emerging countries. The EU has every interest in encouraging all countries to



However, there would actually be more losers in this move since internal EU decision would need to be determined by the notoriously inefficient system of qualified majority voting established by the Nice Treaty (Figure 5). This is because the large supermajorities required to make a decision under the Nice system would in fact prevent the EU from benefiting from its power within the Fund. The largest countries would logically be the biggest losers.



natural resources (including fossil fuel and water) is also increasingly likely

a definition of the ways in which various national views are mediated and the external representatives are monitored. There would be no point in aiming at more external influence while at the same time preventing it from existing because of an internal inability to reach decision.

4. For the economic and political reasons that have been developed in this paper, the US is less ready than at any time since World War II to exercise constructive leadership in global economic governance, and this trend is unlikely to be reversed any time soon. European policymakers should be ready to assume the responsibilities that shifting patterns of leadership may imply for them.

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