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### Internet Resources

Center for Nonproliferation Studies: [www.cns.miis.edu](http://www.cns.miis.edu)  
 Cluster Munition Coalition: [www.stopclustermunitions.org](http://www.stopclustermunitions.org)  
 European Union external relations: [www.ec.europa.eu/politics/external\\_relations/-foreign\\_affairs](http://www.ec.europa.eu/politics/external_relations/-foreign_affairs)  
 Global Centre for the Responsibility to Protect: [www.globalr2p.org](http://www.globalr2p.org)  
 Human Security Report Project: [www.hsrgroup.org](http://www.hsrgroup.org)  
 International Atomic Energy Agency: [www.iaea.org](http://www.iaea.org)  
 International Campaign to Ban Landmines: [www.icbl.org](http://www.icbl.org)  
 International Crisis Group: [www.crisisgroup.org](http://www.crisisgroup.org)  
 Organization for the Prohibition of Chemical Weapons: [www.opcw.org](http://www.opcw.org)  
 Preparatory Commission for the Comprehensive Test Ban Treaty Organization: [www.ctbto.org](http://www.ctbto.org)  
 Stockholm International Peace Research Institute: [www.sipri.org](http://www.sipri.org)  
 UN Department of Peacekeeping Operations: [www.un.org/en/peacekeeping](http://www.un.org/en/peacekeeping)  
 UN Office of Disarmament Affairs: [www.un.org/disarmament](http://www.un.org/disarmament)  
 UN Peacebuilding Commission: [www.un.org/peace/peacebuilding](http://www.un.org/peace/peacebuilding)  
 UN Security Council Counter-Terrorism Committee: [www.un.org/sc/ctc](http://www.un.org/sc/ctc)  
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# 8

## Global Economic Governance

### Case Study:

#### The Global Financial Crisis of 2008

In the fall of 2008, the global financial system came close to collapse, resulting in the greatest challenge to the global economy since the Great Depression of the 1930s. Global stock markets plummeted; one of the world's largest banks collapsed; both industrial output and world trade levels dropped far more than they had in 1929; global foreign direct investment and flows of remittances from migrant workers plunged; and global unemployment increased by an estimated 14 million people just in 2008. In the United States, unemployment more than doubled. Consumer demand plummeted and credit became almost impossible to obtain. In 2014, the effects of the crisis continued to ripple through the global economy.

What can be learned about global economic governance from how various actors responded and the policies that have been put in place? Daniel Drezner (2012: 1) argues that “the system worked,” writing: “A review of economic outcomes, policy outputs, and institutional resilience reveals that these regimes performed well during the acute phase of the crisis, ensuring the continuation of an open global economy.” While others disagree with this assessment, the global economy has rebounded relatively well—far better than was the case in the aftermath of the Great Depression.

The way the 2008 crisis rippled around the world was indicative of global economic interdependence, although the effects of the crisis were not felt equally in all parts of the world. The United States and Europe were most severely affected; many developing countries much less so. States such as China, South Korea, and Japan, dependent on exports to the United States and Europe, saw their markets shrink and export earnings fall. Oil prices dropped by 69 percent between July and December 2008, severely affecting oil-exporting countries such as Saudi Arabia, Russia, Angola, and Venezuela. In emerging markets of Eastern Europe, the Baltic



states, and other former Soviet Union states, private foreign investment plummeted in 2008 to less than half that of a year earlier. In late 2008, Iceland became the first state victim when its banking system collapsed. The speed and depth of the collapse of global financial markets and international trade were breathtaking. Over \$10 trillion in wealth was lost to households worldwide.

The crisis had many causes: irresponsible lending in the United States and Europe; central bankers and other regulators who tolerated risky practices; a glut of savings in Asia that reduced global interest rates; years of low inflation and stable growth that made people overconfident. It "highlighted the fragility, volatility, and occasional catastrophe that come with globalized capital markets" (Drezner and McNamara 2013: 155). Initial responses to the financial crisis were mostly unilateral. Both the United States and various EU member governments took unprecedented steps to bail out banks and insurance companies to get credit markets functioning and stimulate investor confidence. Fairly quickly, however, central banks such as the US Federal Reserve, the Bank of England, and the European Central Bank, undertook coordinated action, cutting interest rates and expanding credit facilities to avert a currency crisis. Those actions were critical to preventing a deeper depression. In 2008 and 2009, all the major economies implemented major stimulus packages to address the unemployment, drop in investment, and tight credit effects of the crisis.

The IMF initially responded to the crisis by making available almost \$250 billion for credit lines, then tripled that to \$750 billion in 2009. Iceland became the first Western country to borrow from the IMF since 1976. Substantial emergency loans were also made to Ukraine, Hungary, and Pakistan. In addition, the IMF created the Short-Term Liquidity Facility for emerging-market countries. It reorganized the Exogenous Shocks Facility, designed to help low-income states, to provide more rapid assistance. Subsequently, the International Development Association (IDA) of the World Bank Group increased its resources for lending to some of the poorest developing countries, and ASEAN broadened its Chiang Mai Initiative to create an arrangement for currency liquidity.

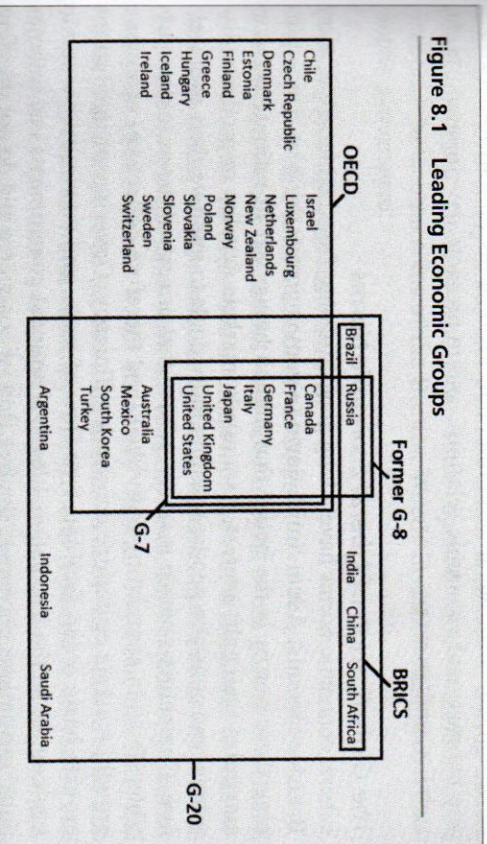
Yet none of the existing institutions were up to the task of coordinating responses. Both short-term emergency responses were needed as well as better long-term cross-border supervision of financial institutions, global standards for accounting and banking regulation, and an early warning system for the world economy (Cooper and Thakur 2013: 13). US president George W. Bush's decision to convene the G-20 at the leaders level for the first time in the Summit on Financial Stability and the World Economy in November 2008 marked a recognition of those shortcomings and the need for a new approach, one that recognized that any solution to the crisis

needed to include developing countries such as China, India, Brazil, and Mexico.

Thus the crisis also brought a major geopolitical shift, with the G-7, dominated by major developed countries, supplanted as the principal global economic forum by the G-20 (see Figure 8.1). Over the course of ten months, the G-20 leaders met an unprecedented three times, establishing the group's reputation as a crisis first-responder. They produced a number of major initiatives, including support for large domestic stimulus packages and new resources for the IMF, World Bank, and IDA; they took steps to prevent a rise in trade protectionism and reconfigured the Financial Stability Forum into the Financial Stability Board. Indeed, one of the G-20's accomplishments was an unexpected outcome of the crisis was the revitalization of the IMF, making it the site of an early warning system for future crises (Cooper and Thakur 2013: 78).

A key to the G-20's ability to orchestrate rapid responses to the crisis was the experience of members' finance ministers in meeting with one another regularly and engaging in frank, unscripted exchanges with all members. The difference in moving to the summit level was that leaders had the ability to make commitments, deals, and concessions to solve problems.

In this chapter, we address the global and regional governance structures for finance, trade, and macroeconomic policy coordination that long revolved around developed states, and then in Chapter 9 turn to governance for economic and human development in the developing world.





## An Evolving Global Economy

The visibility of economic issues today makes it hard to remember the international economic relations are now vastly different than they were at the end of World War II in 1945. Let alone in 1900. In 1945, there were roughly fifty sovereign states; economies were largely national; there was limited interdependence; policies were elite-led. There were also four competing sets of ideas and economic systems in the world. The Soviet Union had established a model of socialist, command economies, dominated by central planning and state ownership. There were a handful of liberal market systems, led by the United States. The imperial preference systems of the major European colonial powers maintained privileged relationships between their economies and colonies. Finally, a majority of countries pursued mercantilist, statist economic policies. Tariff and other barriers impeded the growth of trade, movement of capital, and convertibility of currencies. There were no precedents and no international institutions for providing assistance to countries experiencing economic difficulties, or for development.

Today, there are 193 sovereign states; almost all national economies are open to some degree and linked in patterns of complex interdependence that include globalized production in some industries, global financial markets, and vastly expanded world trade—elements of a single global economy. Multinational corporations, international banks, and markets are important actors alongside states, and NGOs have become increasingly vocal. Liberal (or neoliberal) market capitalism is the dominant economic approach, with various adaptations. Recognizing the need for expanded global economic governance, states and nonstate actors have established a large number of formal and informal international institutions to help manage international economic relations, and to promote development, trade, stability, and growth.

### *The Globalization of Liberal Economic Norms*

Liberal economic norms have a long genesis, dating from eighteenth-century British economist Adam Smith down to contemporary thinkers. Underpinning these norms is the belief that human beings act in rational ways to maximize their self-interest. As a result, markets develop to produce, distribute, and consume goods, enabling individuals to improve their own welfare. Competition within markets ensures that prices will be as low as possible. Thus, in stimulating individual (and therefore collective) economic growth, markets epitomize economic efficiency. Government institutions provide basic order, facilitate free flow of trade, and maximize economic intercourse. At the international level, if national governments and international institutions encourage the free flow of commerce and do not interfere in the efficient allocation of resources provided by markets, then increasing

interdependence among economies will lead to greater economic development for all states.

Yet not all states face the same problems, nor have all adopted liberal economic norms to the same degree and in the same way. Indeed, some states reject them. Some states have prospered; many, including a large number of developing countries, are still struggling. A group of emerging economies, including the BRICS, ASEAN states, and Mexico, have made significant economic gains, though not all people within each country have benefited from the gains. While Russia moved initially toward a more market-oriented system in the 1990s, the government's role in the economy has again been strengthened and the economy has become highly dependent on oil and gas exports. China, too, has shifted from a communist system to a more market-oriented one, but state-owned firms and banks still control a significant portion of its economy. The liberal economic system established at the end of World War II under US leadership looks quite different today.

One major challenge to economic liberalism came from statist mercantilism, which emphasizes the role of the state and the subordination of all economic activities to the goal of statebuilding. Where liberals see the mutual benefits of international trade, mercantilists see states as competing with each other to improve their own economic potential. Statist policies stress national self-sufficiency rather than interdependence, limited imports of foreign goods through substitution of domestic products and high tariffs, and restricted foreign direct investment. The "tigers" of East Asia, including South Korea, Singapore, and Taiwan, successfully used this approach to economic development during the 1980s and early 1990s, as discussed in Chapter 9. Yet many states that pursued statist approaches during earlier stages of their development have since opened their economies and accepted the central roles of the Bretton Woods institutions in global economic governance.

### *The Bretton Woods Institutions:*

#### *The Core of the Liberal Economic Order*

The Bretton Woods institutions have been integral to the growth of a liberal economic order. As discussed in Chapter 3, the World Bank was to rehabilitate war-damaged economies and provide needed development capital. The IMF was to provide short-term aid to compensate for balance-of-payments shortfalls and ensure a stable monetary system. Together, the IMF and World Bank were to be the lubricant needed to allow all states to slide into a more globalized world economy. The General Agreement on Tariffs and Trade was to facilitate economic growth through reduced barriers to international trade. Later, when GATT was transformed into the World Trade Organization, it provided a dispute settlement body for trade grievances to



that lowering barriers to foreign products did not mean they would be exploited.

In their original incarnations, the institutions adopted a type of Keynesian approach that saw a strong role for governments in promoting liberal trade and investment policies as well as stimulating growth during periods of economic contraction. This mix of policies was intended to result in an ever-expanding global market while reassuring those who might be overwhelmed by international forces that the state would help them transition to the new environment (Ruggie 1982). Full employment, equalization of incomes, and a strong social safety net were key parts of this social contract.

During the 1990s, however, there emerged a version of liberal economic ideology called the Washington Consensus. This held that only by following the "correct" economic policies, as espoused by the Bretton Woods institutions and the US government, could states achieve economic development. Ingredients of the consensus included fiscal discipline; privatization of industry; liberalization of trade and foreign direct investment; government deregulation in favor of open competition; and tax reform. The Washington Consensus became the dominant approach undergirding almost all international development lending and IMF aid to countries experiencing financial and debt crises.

In particular, the IMF (along with the World Bank) used its resources as leverage to persuade states to adopt these liberal measures—often in the face of strong local opposition. This "conditionality" stipulated that funds would only be available to states that committed to these measures, even if the result was a reduction in social spending, increased income inequality, and even increased poverty. This was applied to developing countries during the debt crises of the 1980s and 1990s as well as the Asian financial crisis of 1998, with mixed results. Today, "austerity" is a familiar term around the world. In Europe, the European Commission and European Central Bank have teamed with the IMF to impose harsh medicine like that of the Washington Consensus on such countries as Greece and Spain to resolve what they view as profligate spending and economic mismanagement.

The Washington Consensus (and its particulars) unraveled as the Bretton Woods institutions and major donor states recognized the limits of such a cookie-cutter approach to countries' debt and financial crises and the need for local solutions to closing the finance gap and finding the appropriate mix of economic and governance policies. As discussed earlier, the 2008 global crisis led to some reforms in the Bretton Woods institutions. Since 2010, the G-20 have consistently advocated a pro-growth strategy supporting state investment to stimulate economic activity.

### *The Role of Multinational Corporations*

MNCs are the vanguard of the liberal order. They are "the embodiment par excellence of the liberal ideal of an independent world economy. [They have] taken the integration of national economies beyond trade and money in the internationalization of production. For the first time in history, production, marketing, and investment are being organized on a global scale rather than in terms of isolated national economies" (Gilpin 1975: 39). For liberals, MNCs represent the most efficient mechanism for economic development and improved well-being. They invest capital worldwide, open new markets, introduce new technologies, provide jobs, and finance projects that industrialize and improve agricultural output. They are the transmitters of capital, ideas, and economic growth, and are important parts of global economic governance.

Early forerunners of today's MNCs included the Greek, Phoenician, and Mesopotamian traders, and the British East India, Hudson Bay, Levant, and Dutch East India companies in the seventeenth and eighteenth centuries. The prominence of MNCs has increased dramatically, however, since the 1960s, facilitated in part by the formation of the European Common Market and by liberalization of trade generally.

The significance of multinational corporations cannot be overstated. In 2007, before the global financial crisis, more than \$2 trillion was invested overseas by private firms seeking long-term control of foreign operations. Although the pace slipped in subsequent years, in 2011 it was up to \$1.5 trillion and rising. While roughly 80 percent of foreign direct investment comes from developed countries, more and more comes from firms based in developing countries. Chinese companies, many of them private, are a significant source of new investment, with almost half of that investment going to developing countries.

### *Private International Finance*

It is also difficult to overstate the importance of private international finance in the contemporary world economy. It includes pure banking transactions such as deposits and loans involving private individuals, firms, governments, brokerage houses, and hedge funds, as well as the gamut of transactions involved in the stock market. One could add the roles of insurance companies, mortgage companies, bond-rating agencies, financial advisers, and currency-exchange companies in moving funds around the world.

The scale of activity in international private finance is massive. Each day roughly \$4.5 trillion crosses international borders, including \$110 billion in the form of loans and \$150 billion in the form of portfolio investment (stocks and bonds) and between \$50 and \$100 billion in purely spec-



and goods, constituting an annual global product of roughly \$45 trillion (2012), change hands many times over each year. Tens of thousands of financial institutions are involved in these transactions. When the United States negotiated for access to information about bank accounts held by Americans overseas, it secured agreement from a staggering 77,000 different financial institutions! And this covered only seventy countries. The number of institutions that engage in international transactions could be several times that figure.

Among the new financial actors are sovereign wealth funds. While these are state-owned, the managers use market financial instruments including stocks, bonds, precious metals, and property. Formed in surplus countries such as China and in the major petroleum exporters such as Kuwait, the United Arab Emirates, Norway, Russia, and Canada, these wealth funds move capital quickly across national boundaries, taking advantage of currency differentials and trading in new financial instruments to maximize their long-term economic returns, while serving as a source of capital for other states.

Although most of these entities operate in the developed world, an ever-increasing proportion of transactions take place in the global South—particularly among the BRICS. The world's three largest corporations are now Chinese banks, with combined assets of \$7 trillion in mid-2014.

### *Shifting Global Economic and Political Power*

The rise of China as a global economic power, the rise of the BRICS, and the relative decline of the United States are changing how rules are shaped and enforced. China's gross domestic product in 2004 ranked fifth in the world, but by 2010 was the second largest, and by late 2014 the IMF ranked it number one, although others project it will be 2018 or later before China surpasses the United States. China's growth still far outpaces the much slower rates of leading developed countries, although its per capita income lags far behind. China's economic strategy, with its emphasis on state-guided exports, presents a direct challenge to Bretton Woods models. China has developed a massive trade surplus, exporting roughly \$30 billion more than it imports. With large financial surpluses, it can provide credit to the rest of the world—including the United States, where China owns \$1.3 trillion in federal bonds (funds without which the United States would be forced to dramatically increase taxes and reduce spending). Since 2013, China has also pursued a much more assertive foreign policy under President Xi Jinping, raising tensions over political and security issues. As discussed earlier, this could portend future clashes and even system change. These developments have resulted in pressures to change voting structures of the Bretton Woods institutions, or, failing that, replacing them with organizations that reflect changing power relations. In fact, the BRICS cre-

ated two new financial institutions in 2014: the New Development Bank, to finance infrastructure and sustainable development projects, and a foreign currency reserve pool that will be rivals to the World Bank and IMF. While China is the main contributor in both cases, the membership is broad and each state has a vote, with no veto power. Yet although the BRICS countries differ with the West over many issues such as market access, investment regulation, and intellectual property rules, they share little in common, making it unclear how soon and how well the new institutions begin functioning.

Because international finance and trade have been dominated by developed countries since World War II, governance too has primarily involved the major Western economic powers. Only now, with China's rise and that of other emerging economies, are the politics of global economic governance shifting significantly.

### **Governance of Global Finance**

#### *Global Currency Governance:*

*from the Gold Standard to the Float, BIS, and IMF*

States, markets, firms, banks, and international institutions are all actors in the governance of international finance today. They have generally preferred stable currencies and readily available credit with sufficient capital for long-term investment and trade. They have also often sought to control the movement of capital, but it is not possible to do all at the same time. Currency values generally respond to market forces. Traders are willing to pay more for the currency of a country with a large, well-managed economy rather than its opposite, and as a country's economy moves in one direction or the other, the value of its currency will generally rise or fall. If states seek to control the value of their currencies, they must also take steps to control how attractive their overall economies will be relative to the economies of other states. Countries may resist allowing their currencies to rise, since this makes exports more expensive for foreign customers. Conversely, states may resist acknowledging that their currency has lost its value, since this makes imports more expensive, which can lead to rising prices overall. More prestige is attached to a strong currency as well, but artificially high or low currencies usually produce profound imbalances around the world.

At different times throughout history, gold was the linchpin of the world currency system. Most recently this occurred during the 1920s, when the value of the US dollar was linked to gold. A few other currencies were also linked to gold, but the Great Depression made this arrangement unsustainable. After World War II, the US dollar returned to the gold standard,



although since it was the only currency to do so, and other currencies attempted to "peg" (or establish their value in relation) to that of the dollar. This "dollar-gold" standard helped consolidate the role of the United States as the world's creditor and manager of the international financial system. For twenty-five years, the world went through a period of relatively stable exchange rates and high confidence in the dollar, which in turn stimulated long-term international investment and the postwar recovery of Europe and Japan.

The US dollar was taken off the gold standard in 1971 due to pressure on the US economy from increasing trade deficits. Instead, to restore the balance and address other cash-flow issues, the United States allowed the free market to establish the exchange rate for the dollar. This produced a crisis in international finance, as some feared a return to the financial instability of the 1920s. Instead, currency values stabilized with the help of periodic coordinated actions by the world's central bankers and the IMF. The floating currency system has actually provided more flexibility than the system of fixed exchange rates and the gold standard, as it allows currencies to rise and fall with fluctuations in the major economies. Two international institutions have been important: the Bank for International Settlements (BIS) and the IMF.

**The Bank for International Settlements.** The BIS was the first public international financial institution, established in 1930 by the central bankers of the United States, Japan, and several European states as a means of coordination. It was soon asked to intervene to bail out an increasing number of collapsing currencies. Although it was unable to prevent the unfolding Great Depression, it has remained in existence and was put to work after World War II to facilitate exchanges between various European central banks until the IMF was able to begin making loans in the early 1950s. While it played a secondary role thereafter, the BIS is still an important source of banking advice, particularly regarding banking reserves designed to ensure solvency.

The Basel Committee on Banking Supervision was created within the BIS in 1974 to facilitate cooperation between government agencies that supervise and regulate banks. It has established standards by which banks are to be regulated and, in that role, is central to how global financial governance works. Despite its global reach, however, the committee has a small secretariat and is made up of representatives from the central banks and bank regulatory agencies in only twenty-two countries. Because of the importance of these countries and their central banks, there are "strong incentives" for other states to follow the same standards. The IMF, other financial institutions, and international capital markets also use the standards to evaluate the soundness of banks (Young 2011: 39).

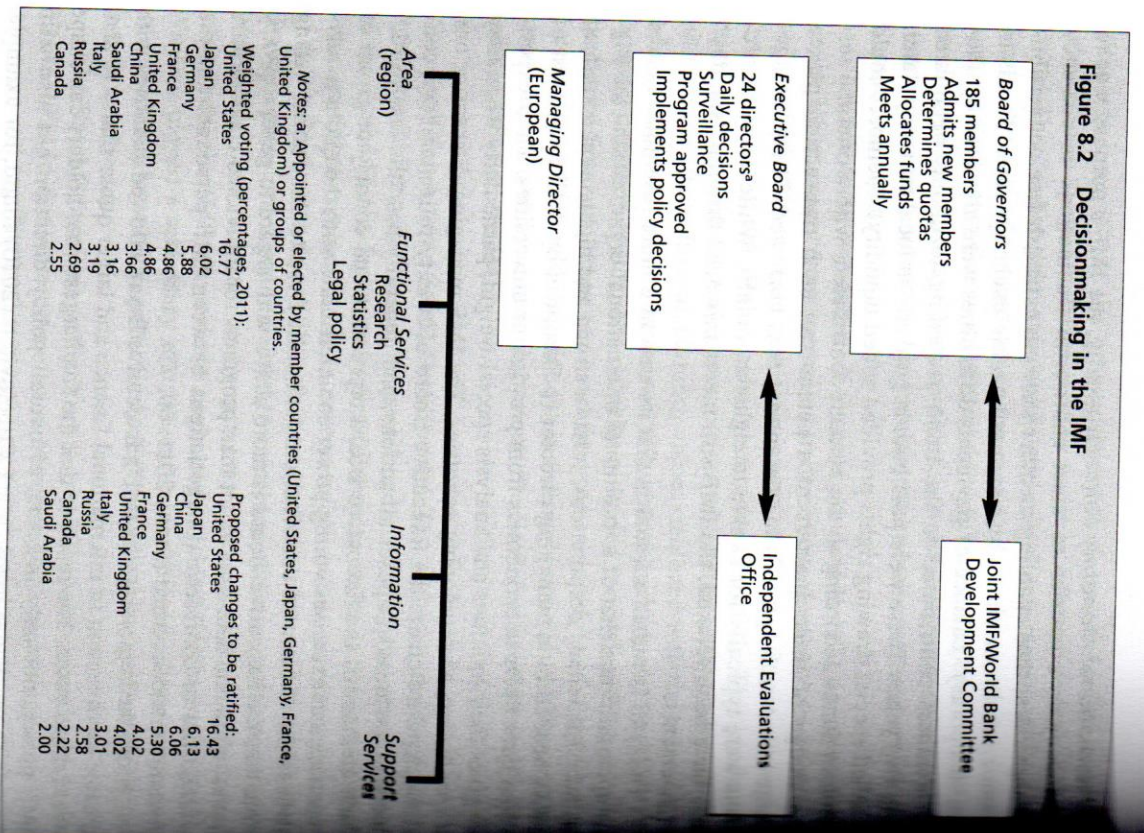
**International Monetary Fund.** Originally, the IMF's purpose was to provide money to countries to meet short-term fluctuations in currency exchange rates, thus enabling member states to establish free convertibility among their currencies and maintain stable exchange rates. Funds to meet a "temporary" balance-of-payments difficulties were allocated by quotas. Members contributed to the Fund according to quotas negotiated every five years. These were paid both in gold and in local currency (later, in called special drawing rights provided added liquidity). Members could withdraw funds according to the amount contributed, with a onetime service charge of three-quarters of a percent on each transaction plus a charge based on length of time the money was borrowed. These arrangements were typically for twelve to eighteen months. While quota restrictions have been relaxed, the IMF still meets this need through "standby" arrangements.

The IMF is rather unusual in that its structure more resembles that of a corporation than that of a traditional international organization (see Figure 8.2). Like many corporations, it has a strong and highly expert staff, of whom have PhDs in economics from prestigious universities. Their expertise gives their opinions and analysis special weight, particularly when they advise leaders of developing countries. The IMF managing director or one of the deputies chairs the Executive Board of twenty-four members, conducts its business, proposes all actions, and generally has "the last word." Each member of the Executive Board represents one country or group of countries and exercises voting power commensurate with the quota (equivalent to the amount of contributions) it holds. Despite this formal voting structure, the Executive Board is more active with regard to general policy issues, while the decisions about loan programs for individual countries are worked out in confidential negotiations between IMF personnel and the governments concerned (Stone 2011: 60, 77).

From the beginning, the IMF's Executive Board allowed countries with greater involvement in international finance and larger quota shares to also wield more votes. The result is that the five largest vote-holders can shape IMF policy, not only in terms of overall policy direction but also with respect to particular loans. Mark Copelovich (2010) found, for example, that where a country's financial troubles are likely to cause harm to one of the top five Executive Board members, funds are dispersed more quickly, in larger amounts, and with fewer conditions or stipulations. The United States, as the dominant economic power, has the most influence, and the formal weighted voting arrangements give it a veto over certain key decisions. Informally, and especially in a crisis, US influence is even more pronounced due in part to the IMF's location in Washington, DC, and its close relationships with US Department of Treasury officials (Stone 2011).



Figure 8.2 Decisionmaking in the IMF



*The IMF as global financial crisis responder.* Beginning with the 1982 Mexican debt crisis, the IMF took on the role of intermediary in negotiations between creditor and debtor countries, then became involved in bailouts and structural adjustment lending. It took the 1998 Asian financial crisis to demonstrate that all crises are not alike and that the IMF's prescriptions were not always correct. Still, through the 1980s and 1990s, the

IMF requirements for structural adjustment lending required recipients to institute economic policy reforms or achieve certain conditions (referred to as conditionality) in return for financial assistance. The conditions are aimed at overcoming structural bottlenecks in countries' domestic economies and governmental policies, as well as stimulating trade liberalization and private sector involvement. Figure 8.3 shows the diverse range of suggested policies, all of which are compatible with liberal economic norms. The IMF's role in dealing with developing countries' debt is discussed further in Chapter 9.

The IMF's response to the 1997–1998 Asian financial crisis had mixed results. Beginning in Thailand in 1997, the crisis spread to other countries in Asia, including Indonesia and South Korea in early 1998; exchange rates plummeted, stock markets fell, and real GDP dropped. Millions of people were forced back into poverty. The huge inflows of private investment capital that had fueled rapid development stopped, creating a crisis of confidence in the Asian economies. The crisis revealed the weakness of many Asian countries' banking systems, their heavy levels of short-term debt and current-account deficits, along with the corruption of “crony capitalism” that closely tied business and government.

The IMF responded to the 1998 crisis with large, controversial bailout packages to three of the affected countries (Thailand, \$17 billion; Indonesia, \$36 billion; and South Korea, \$58 billion), in addition to lengthy sets of conditions that each country was supposed to follow and monitoring devices to ensure compliance. Governments had to agree to carry out extensive structural reforms that would transform their economies from semi-mercantilist to more market-oriented. In South Korea, the government lifted restrictions on capital movements and foreign ownership and permitted companies to lay off workers, for example. The reforms were largely successful from an economic perspective, but they also led to a public backlash, a boycott of foreign products, and exposés of how foreigners benefited at the expense of Koreans (Moon and Mo 2000).

The IMF approach was similar to that in previous crises in Latin America in the 1990s (particularly in Argentina), calling for higher interest rates and taxes, reduced public spending, breaking up of monopolies, restructuring of banking systems, and greater financial transparency. Yet the IMF misdiagnosed the problem and its prescription proved inappropriate, especially in the Indonesian case. The Asian crisis was not the same as Latin American crises. High interest rates pushed more indebted companies into bankruptcy; budget cuts eliminated social services and pushed more families below the poverty line, leading to backlash against governments and the IMF.

The IMF also played a key role in the transitions of Russia and other former communist countries to market economies during the 1990s. It pro-



Figure 8.3 IMF Structural Adjustment Programs

*Profile of a Country in Need of Structural Adjustment*

- Large balance-of-payments deficit
- Large external debt
- Overvalued currency
- Large public spending and fiscal deficit

*Typical Goals of Structural Adjustment Programs*

- Restructure and diversify productive base of economy
- Achieve balance-of-payments and fiscal equilibrium
- Create a basis for noninflationary growth
- Improve public sector efficiency
- Stimulate growth potential of the private sector

*Typical Structural Adjustment Policies*

- Economic Reforms
  - Limit money and credit growth
  - Devalue the currency
  - Reform the financial sector
  - Introduce revenue-generating measures
  - Introduce user fees
  - Introduce tax code reforms
  - Eliminate subsidies, especially for food
  - Introduce compensatory employment programs
  - Create affordable services for the poor
- Trade Liberalization Reforms
  - Remove high tariffs and import quotas
  - Rehabilitate export infrastructure
  - Increase producers' prices
- Government Reforms
  - Cut bloated government payroll
  - Eliminate redundant and inefficient agencies
  - Privatize public enterprises
  - Reform public administration and institutions
- Private Sector Policies
  - Liberalize price controls
  - End government monopolies

vided financial resources to make external adjustment more orderly, including credits of \$27 billion to enable states to avoid external arrears and ease debt servicing. Russia alone received \$11.2 billion during its 1998 financial crisis. The most advanced economies in Central Europe and the Baltic states achieved rapid success, using the funds to liberalize foreign trade and reduce inflation. Although economic liberalization supported by the IMF paved the way to a resumption of growth in Russia after its 1998 crisis, Russia's subsequent economic boom owed much to the skyrocketing price of petroleum and new governmental controls. Yet those same petroleum

markets are also highly volatile, and declines in oil prices in late 2014, combined with the effects of Western sanctions following Russia's takeover of Crimea, have had a negative effect on the Russian economy, which now rises and falls with the globalized economic system.

The negative outcomes to some of these crises shook faith in the IMF and liberal economic solutions, and help explain why the Fund's response to the 2008–2009 global financial crisis was initially muted. Yet not only was the IMF revitalized as a result of that crisis, but it also took an active role in the euro crisis that followed (discussed later). In 2014 the IMF intervened with \$17 billion in funding to help the embattled pro-Western regime in Ukraine following the ouster of pro-Russian president Viktor Yanukovich, albeit with a package of stringent austerity measures similar to those imposed in earlier crises. The Fund was criticized by some for taking sides in the country's political crisis, but its Western supporters viewed the measures as essential to keeping Ukraine's sovereignty and economy intact.

Critics of IMF responses have focused on the so-called moral hazard problem of IMF rescue packages that encouraged international investors and states to engage in still more reckless behavior because they counted on the Fund's safety net. Whose interests was the Fund serving? Others think that more money and fewer conditions would help pull countries out of crisis faster. Still others advocated limiting the Fund's attention to balance-of-payments issues and crisis management, not development or economies in transition. And some critics focused on the secrecy of negotiations between the Fund and member countries, arguing for greater transparency in IMF decisionmaking. Even the IMF itself has been retreating from its earlier commitment to fiscal discipline and free markets. Not only has it encouraged governments to continue spending to stimulate growth, but in 2014 the IMF's managing director, Christine Lagarde, endorsed internal IMF studies that showed the need to reduce income inequality to achieve sustainable growth and social stability.

*IMF surveillance.* In addition to the structural adjustment requirements, the IMF introduced a surveillance process in the late 1970s, involving annual consultations with member governments to appraise exchange-rate policies within the framework of general economic and policy strategies. The purpose is to anticipate risks to stability and advise on policy adjustments before crises break out. The IMF offers technical assistance to members whereby state officials are trained at the IMF Institute and in regional training centers in data collection, bank management, and fiscal and monetary policy. Three regular publications are an important part of the surveillance process: *World Economic Outlook*, the *Global Financial Stability Report*, and the *Fiscal Monitor*.



Since 2000, the IMF's surveillance functions have grown in importance and expanded, even as structural adjustment lending has declined. In 2011 the IMF added regular "spillover reports" on the impact of the five large economies (China, the eurozone, Japan, the United States, and the United Kingdom) on their partner countries. Thus, while it may appear that the IMF often targets developing more than developed countries, it has, in fact, issued critical reports on US and European policies.

*IMF reform.* In the wake of the 1997 crisis, the IMF set up systems to improve monitoring of the international financial system, so-called fire alarms, to better anticipate financial meltdowns. It also set up a credit line to provide another account from which countries in trouble could draw, despite some opposition by Germany and other "tight money" European countries (de Beaufort Wijnholds 2011: 125). As part of the negotiation of the credit line, the IMF put in place a system whereby governments would be expected to divulge details of their national accounts that had previously been confidential. For those more eager to trade on global capital markets, even more information was expected. However, the IMF has resisted providing specific credit scores on countries, although enough information is now available to draw fairly specific inferences.

Following the 2008 financial crisis and the elevation of the G-20 as a key part of global economic governance, proposals were put forward to significantly increase the quotas, and hence the votes, of G-20 members that were considered underrepresented on the IMF Executive Board. Specifically, reforms agreed to in 2010 will double the quotas, while shifting about 6 percent of quota shares from overrepresented to underrepresented member countries and still another 6 percent to dynamic emerging-market and developing countries. With that realignment, China would become the third largest member country in the IMF, and Brazil, China, India, and Russia would be among the ten largest shareholders in the Fund. At the same time, the quotas and voting share of the poorest member countries would be preserved. Despite acceptance in March 2015 by 147 IMF member states, representing 77 percent of voting shares, however, the reforms had yet to be approved by the US Congress, leaving in doubt whether the quotas will be realigned in the near future.

*The Financial Action Task Force.* As discussed in Chapter 7 with regard to cutting off terrorist financing, the FATF, established in 1989, plays a major role in global efforts to address the problems of money laundering and terrorist financing. It operates as an independent entity based at the Organization for Economic Cooperation and Development in Paris. The 2009 G-20 summit in Pittsburgh added corruption to the agenda of the FATF, whose primary outputs are sets of recommendations for actions by states and mon-

itoring compliance. The FATF currently has thirty-six members, including ten regional IGOs (the EU Commission and GCC) and Hong Kong as a separate jurisdiction. As Ian Roberge (2011) notes, the FATF has placed the issue of illicit financial activities on the international agenda, and provided a forum for discussion that facilitates policy innovation and diffusion, and is small enough and flexible enough to act quickly. The standards are well known in the financial sector, although compliance is lowest, surprisingly, with firms in industrialized countries. That said, firms are less likely to break the rules if terrorist financing is involved (Findley, Nielson, and Sherman 2014).

*From interstate to private governance in finance.* Since the mid-1980s, when many countries in the West began to privatize and deregulate various industries, including insurance and securities, private governance in the field of finance and self-regulating mechanisms has become more common. Associations of different businesses have taken the initiative to establish industry-wide standards or norms of appropriate behavior and to cooperate in order to manage markets. The International Organization of Securities Commissioners, established in 1983; the International Accounting Standards Board, created in 2001; and the International Association of Insurance Supervisors, founded in 1994, for example, have all developed rules and standards for their members to make their markets more secure and orderly. In many cases, these rules and guidelines are subsequently adopted by states themselves.

Bond-rating agencies such as Moody's Investors Service and Standard & Poor's illustrate a type of private governance developed by interfirm cooperation. They operate by selling their expertise at assessing the credit-worthiness of various institutions to private firms and investors. One scholarly label for such institutions "embedded knowledge networks" and characterizes them as often acting as "disinterested experts in assessing high-value transactions and in validating institutional norms and practices" (Sinclair 2001: 441). Such networks ensure investors' transparency, provide information to the markets, and establish rules for reporting, all of which are essential governance functions. Their ratings (AAA, AA, A) constitute a transnational surveillance system for private market investors as well as state authorities.

The ratings cannot always be trusted, however. Many of the large financial institutions that were given triple-A ratings in 2007 went bankrupt in 2008, leading states to more tightly regulate bond-rating agencies. For example, in the United States, the Dodd-Frank Act of 2010 requires more transparency with respect to rating methodology and accuracy over time as well as to limit conflicts of interest such as when ratings agencies must rate their own customers. European regulators have been concerned about the



opposite problem, namely ratings agencies that are too quick to deem a country as being in trouble. The EU has threatened legal action against major bond-rating agencies for violating EU regulations in downgrading various countries' sovereign debt.

### Governance of Trade: From GATT to the WTO

In liberal economic theory, trade is the engine of economic growth. Although trade protection grew in the two decades after World War I, international trade has since grown dramatically. Where \$62 billion in manufactured goods (in 2014 dollars) was exported worldwide in 1950, that figure was \$18.8 trillion in 2013—more than 300 times larger. Even comparing today's trade levels to those of 1970, merchandise trade is sixty times greater, easily outpacing overall economic growth.

The third part of the Bretton Woods system was the stillborn International Trade Organization. The General Agreement on Tariffs and Trade took its place in 1948; its members (called contracting parties) were initially the largest developed countries, excluding the Eastern bloc and the Soviet Union, as well as most less developed countries. Only gradually in the 1980s and 1990s did developing countries join GATT, and only in 1995 did a true global trade organization, the World Trade Organization, finally come into being. With the accession of China and Russia and others in this century, WTO membership has reached 160. Twenty-four states have observer status and are working toward membership. GATT had a loose link to the UN, but the WTO has none, although its director-general participates on the Chief Executives Board of UN agencies, chaired by the UNSG.

### GATT and WTO Principles and Operations

GATT and its successor, the WTO, are based on a number of important principles integral to the international trade regime, starting with support for trade liberalization, as outlined in Figure 8.4. At the heart of the GATT-based trading system were eight rounds of multilateral negotiations, between 1948 and 1994, that gradually reduced various types of trade barriers. Because GATT was not a formal organization, voting and formal decisions were not normal features of the rounds. Most decisions were taken bilaterally, then multilateralized. While it did have dispute settlement procedures, there were few ways to enforce decisions. The small bureaucracy (a staff of 200) was insulated and did not consult with businesses or NGOs, or review members' trade policies.

GATT negotiations in the 1960s were concerned with adapting the system to the European Community's creation and providing preferential access to Northern markets for the less developed countries to stimulate economic development. Average tariff cuts amounted to 10 percent and

Figure 8.4 The World Trade Organization: Central Principles

1. Nondiscrimination:
  - a. Most-favored-nation treatment—products made in one member must be treated as favorably as like-products originating in another state
  - b. National treatment—foreign-made products must be treated as favorably as like-products made domestically
2. Reciprocity: members try to make equivalent changes in policies; protection through tariffs only; members cannot use quotas
3. Transparency: members must publish their trade regulations and have procedures for review of administrative regulations
4. Safety valves for states to attain noneconomic objectives:
  - a. Protect public health and national security
  - b. Protect domestic industries from serious injury
5. Enforcement of obligations: mechanism for member states to bring cases before the WTO for dispute settlement

Source: Hoekman and Mavroidis 2007: 15–20.

then 35 percent on a volume of \$40 billion in trade. The Tokyo Round, which concluded in 1979, resulted in still better treatment for LDCs and agreements on the elimination of subsidies and rules governing such non-tariff trade barriers as government procurement and technical barriers and standards. Average tariff cuts were 35 percent on \$100 billion of trade. Although these enhanced the GATT-based trade system and made it fairer from the perspective of the LDCs, they did not significantly reduce growing protectionism.

The eighth round, or Uruguay Round, was concluded in 1993 after seven years of negotiations. It resulted in a 400-page trade agreement, the most comprehensive ever, covering everything from paperclips to computer chips. The 128 participants found the process difficult, as negotiations were affected by slower economic growth in the 1980s and 1990s, the complexity of many issues, and increased support for protectionism, especially in the United States. The Uruguay Round covered new items such as services (insurance, tourism, banking), intellectual property rights (copyrights, patents, trade marks), and, for the first time, agriculture and textiles. Previously, agriculture was seen as too contentious an issue, complicated by both US agricultural subsidies and the EU's protectionist Common Agricultural Policy. Average tariff cuts of 39 percent were negotiated on \$3.7 trillion of trade. GATT established rules for the international trade regime, and trade among participating states expanded significantly, although GATT itself could not claim all the credit. Perhaps the most important outcome of the Uruguay Round, though, was the agreement to create the World Trade Organization.



In 1995, the WTO replaced GATT as the arbiter of trade rules, providing a formal organization for trade for the first time. It incorporated the general areas of GATT's jurisdiction, as well as expanded jurisdiction in intellectual property and services through the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the General Agreement on Trade in Services (GATS). In all, WTO trade rules include over 1100 agreements and decisions.

#### *WTO Governance Innovations and Dispute Settlement Procedures*

The WTO has introduced several changes in governing procedures. Its top decisionmaking body, the Ministerial Council, meets at least every two years. The General Council, open to all members, meets several times a year. There is nothing in the WTO comparable to the IMF's or World Bank's executive boards. Council meetings, along with ministerial meetings, give the WTO a political prominence that GATT lacked. The WTO is a one-state, one-vote organization, unlike the World Bank or IMF, but decisionmaking is generally by consensus: each member has the right to make a motion, introduce and withdraw proposals, or block consensus. The (tiny) Republic of Georgia, for example, was able to block Russia's WTO membership for several months in 2013. Relative market size is the primary source of bargaining power, and weaker states are coerced by the powerful into agreeing with the consensus. Should the powerful not get their way, they can threaten to move the issue to another forum or create a new organization, and the proposals by the weak are often ignored (Steinberg 2002). The emergence since 2003 of the G-20 and of the Group of 90 (G-90), an umbrella alliance of the poorest and smallest states, makes it far more difficult to get agreement. Yet the presence of these groups has given greater representativeness to the decisionmaking process.

Based in Geneva, the WTO Secretariat has increased in size from the GATT days, but is still small (more than 600 individuals) compared to other major international economic institutions. It also has quite limited powers; the director-general cannot set the agenda for WTO meetings and cannot initiate a dispute settlement case. The secretariat cannot interpret GATT rules and is generally not permitted to chair committees. Thus the director-general is more a broker who tries to build a consensus for free trade through personal and political skills. Since trade policy is highly politicized at the national level, there is fear of giving more power to the WTO Secretariat. Despite these limitations, the secretariat does have influence through its analysis of world trade, technical assistance to developing countries, and interactions with members in developing approaches on particular issues. As a concession to shifts in global economic power, the first director-

general from a developing nation, Roberto Azevedo of Brazil, was appointed in 2013.

The WTO's most important organizational innovations are the Trade Policy Review Mechanism and the Dispute Settlement Unit. The former conducts periodic surveillance of members' trade practices based on states' periodic reports. In this forum states can question each other about trade practices and learn how to draft trade regulations.

The Dispute Settlement Unit has two distinct bodies. The first is the Dispute Settlement Body, composed of representatives from all WTO members. This body tries to find diplomatic options to resolving disputes; when those options are exhausted, an ad hoc panel composed of three experts chosen by the parties is convened. Its report is due after six months. The second component is the Appellate Body, a standing organ composed of seven persons (appeals normally take sixty to ninety days). Its decisions are only binding when adopted by consensus in the Dispute Settlement Body. After this two-step procedure, the parties are obligated to implement the recommendations. Compliance panels evaluate whether compliance actually occurs and whether equivalent countermeasures (i.e., equivalent to the damages suffered) have been taken.

The Dispute Settlement Unit has become one of the busiest international adjudicatory bodies. As of 2014, 479 requests had been made, about one-third leading to a panel report and a quarter leading to "out of court" settlement or withdrawal, with about seventy Appellate Body decisions. The EU and United States are either the complainants or the respondents or third party in an overwhelming number of cases, but China's share, especially as a third party, has rapidly grown. Other developing countries are virtually absent (Hoekman and Mavroidis 2007: 82). The barriers for developing countries are both economic and political. Gathering the information for a case and actually bringing a case are costly, typically around \$500,000. Politically, weaker states may fear jeopardizing relationships with more powerful states, especially if they find it impossible to coerce a settlement (Woods 2008: 5–6). The International Trade Centre—a joint undertaking by the WTO and UNCTAD—provides technical assistance to developing countries and emerging economies in trade policy.

China is now a regular party to disputes, having acted as a complainant in 12 cases, a respondent in 33, and a third party in 116 as of early 2015. It has "lost" a majority of the cases. The United States has brought more than 15 cases against China since the latter's accession in 2001—more than any other WTO member. US concerns center on China's adherence to WTO rules, the continuing heavy state role in its economy, and the incomplete adoption of rule of law (US Trade Representative 2013). Of cases involving the United States and China, for example, WTO panels have ruled against



China on cases involving Chinese tire imports to the United States and exports of auto parts to China, as well as on Chinese export restraints on rare earths. China's compliance with WTO decisions is still regarded as weak, although it has expressed a willingness to comply.

WTO cases have generated a number of ongoing controversies. A major issue concerns the distinction between product and process. GATT/WTO rules prohibit countries from banning a product and the process by which it is produced. Thus, in 1989, when the EU banned the sale of hormone-treated beef for health reasons, the United States objected. A WTO panel in 1996 ruled in favor of the United States, holding that the sale was not enough scientific evidence about the connection between hormones and human health. When the EU refused to lift the ban, the WTO authorized the United States to retaliate, and it did so in 1999, increasing tariffs on imports from the EU in the amount of \$116.8 million per year. Four years later, the EU amended its ban on hormone-treated beef, but a 2008 WTO panel upheld the US position that the revised ban was not justified scientifically and therefore was not consistent with WTO rules.

The WTO dispute settlement system has been hailed as a major advance in trade governance, as its legalization "decreases uncertainty and increases convergence of actors' expectations about international procedures" (Kim 2008: 678-679). Still, given the complex and costly procedures, there may be adverse consequences for future trade cooperation and a rise in more limited and streamlined regional trade agreements.

### Trade Policy Areas

There are a number of key trade policy areas that have posed particular challenges since the WTO's creation. Among them are intellectual property trade in services, government procurement, and agricultural subsidies. We look here at the first two. Neither are new issues, but negotiations over both have been particularly contentious.

The 1994 TRIPS agreement introduced intellectual property rules into the trade system for the first time—an important concern for the developed countries and MNCs. It is designed to protect intellectual property such as patents, trademarks, creative materials (books, CDs, videos), and software. TRIPS requires members to take provisional measures, award damages, and prevent entry of counterfeit goods. While the developed countries had one year to implement the new rules, less developed countries had one and until 2016 for pharmaceuticals. To protect profits and market shares, MNCs have fought not only for harmonization of international intellectual property standards, but also for raising those protections. The World Intellectual Property Organization (WIPO), a UN specialized agency, exists for this purpose. It administers twenty-one international treaties covering the field of industrial property and copyright and related rights, providing pro-

tection for the international business community. Three registration systems for patents, trademarks, and industrial design—are of particular importance as they are the focus of 85 percent of the WIPO's budget. The TRIPS agreement, however, lacks binding and effective dispute resolution procedures. Many national judicial bodies, where enforcement actually occurs, also lack the capacity to enforce the rules. It is for this reason that MNCs and the United States have strongly supported using TRIPS and the WTO framework to force noncompliant countries to pass laws strengthening protection of intellectual property and to enforce them.

The intellectual property issue that has triggered particular controversy is generic drugs for treating HIV/AIDS and the provision of these drugs, primarily by developed-country pharmaceutical MNCs, to the poor in developing countries. Beginning in the 1990s, AIDS activists and developing-country generic companies pushed to make low-cost generic drugs available to HIV-infected poor people. In 2003, a compromise was reached that permitted an import waiver under TRIPS, allowing states to export generic pharmaceuticals made under license to developing countries in cases of national emergency. Despite the compromise, developed countries and their pharmaceutical companies worry that generics produced under compulsory licensing for poor-country markets will end up in the markets of developed countries, thus undercutting intellectual property protections. The WTO and TRIPS are the locus for addressing this problem.

Trade in services has been a key trade issue since the 1970s. With the 1994 General Agreement on Trade in Services, the WTO was charged with extending the multilateral trading system to the services sector, which includes public services often considered as government responsibilities, such as provision of education and water, as well as private services such as maritime transport, banking, tourism, and the legal profession. Negotiations are complex and laborious, as members send proposals directly to each other requesting greater access to markets for services and negotiate these requests bilaterally and multilaterally. The GATS agreement has so far not resulted in much added liberalization, as negotiations since 2000 have focused on locking in previous agreements.

*Expanding the global trade system: Complex WTO negotiations.* The Doha Round of WTO negotiations—labeled the "development" round—illustrates the challenges of contemporary trade negotiations that aim to expand the current global trade system. Begun in 2001 as the first round under the WTO, the talks aimed to produce major reform of the system by lowering various trade barriers and revising trade rules. The talks were supposed to serve the interests of developing countries in areas where prior GATT negotiations were thought to have disregarded them. The talks reached an impasse, however, in 2008 between the United States, Japan,



and the EU on the one hand, and the G-20 emerging countries on the other. One of the main sticking points was the opening up of developed agricultural markets. Instead of meeting the demand to eliminate, or at least significantly reduce, farm subsidies, the United States proposed capping the number of temporary work visas for professional workers, India and China in particular, sought, if not an end to farm subsidies, then special safeguards mechanisms for their own poor farmers, essentially on the grounds of ensuring food security. Despite the dogged efforts of Pascal Lamy, the WTO director-general of the WTO, no compromise was achieved and the Doha Round collapsed. More generally, the Doha Round appeared to have failed on the perception of fairness in trade. The developing countries sought more advantages in the politically sensitive areas of agriculture and other labor-intensive sectors than the United States and EU were ready to negotiate. They were already dissatisfied with new rules that opened competition in investment and government procurement. Many placed blame on the WTO's director-general, Roberto Azevedo, for not exercising more leadership to iron out disagreements as his GATT predecessors had sometimes done.

At talks in Bali in 2003, negotiators thought they had broken the impasse. To pave the way for an expansive trade facilitation agreement, the streamlined customs procedures and upgrade border and port infrastructure, negotiators devised a temporary solution to the issue of food subsidies and stockpiles, which was of major concern to India and other developing countries. The latter would not be penalized for imposing subsidies greater than 10 percent—the WTO cap—on grain produced for food in a country, nor for stockpiling grain to ensure food security for millions of impoverished citizens. In mid-2014, however, India said it would veto any global deal that did not protect its food security program—potentially jeopardizing the Bali agreement. Then, in late 2014, India and the United States reached an agreement on a timeline for negotiations on stockpiling, assuring India that the issue would not be sidelined. Director-General Azevedo reported, “This breakthrough represents a significant step in efforts to get the Bali package result, WTO members agreed to move forward with the Bali agreement, including adoption of the Trade Facilitation Agreement—the first trade reform pact since the creation of the WTO itself in 1995.”

In short, reaching agreement among 161 countries is a challenge. The complexities of new trade issues in a world of globalized production networks for automobiles and a host of other products remain. Meanwhile, the United States and European Union (and others) are pursuing regional and bilateral trade agreements, often with mutually incompatible rules, that will make future global agreements even harder to conclude. This trend rouses

debate among trade experts about the future of the trading system.

Another way to understand the challenges of the negotiation process involved examining the negotiation process in the WTO. China and Russia offer excellent examples that membership in GATT and now the WTO has not changed the basic principles and all existing trade rules. This is not to say that changes in their own trade regulations to make changes in their own trade regulations. The complex negotiations concern how to make changes in their own trade regulations. The complex negotiations concern how to make changes in their own trade regulations. The complex negotiations concern how to make changes in their own trade regulations.

China's formal accession to the WTO in 2001 was complicated by the large size of its population and its need to open up its economy to a more open market economy. A 900-page agreement on the terms of China's membership. The Chinese government had to revise laws to permit foreign investment and banking. The agreement called for a series of reforms to open up the insurance market to foreign competition, and to open up the insurance market to foreign competition. The difficulties, however, have been enormous. The difficulties, however, have been enormous.

The difficulties, however, have been enormous. The difficulties, however, have been enormous. The difficulties, however, have been enormous. The difficulties, however, have been enormous. The difficulties, however, have been enormous.

With the Doha Round in doubt and regional trading, clearly the future of WTO-based global trading, clearly the future of WTO-based global trading, clearly the future of WTO-based global trading, clearly the future of WTO-based global trading, clearly the future of WTO-based global trading.



### Macroeconomic Policy Coordination: The Roles of the OECD, G-7, and G-20

As international economic interdependence has grown, the need for coordinating the economic policies, especially of major economic powers, has increased. Coordination takes place in many settings, from the WTO, IMF, World Bank, and BIS to summits, the OECD, and various "Gs." It can also take a number of forms, including information-sharing regarding current and future policies, consultations about decisions being considered, establishing rules for acceptable policies, creating norms and expectations, and regular interactions among national policymakers. Coordination works best when countries enjoy good relations, and when problems are technical and can be delegated to specialists who have similar outlooks and are insulated from politics (Eichengreen 2011). Here we look briefly at the roles the OECD, G-7, and G-20 play in this process.

#### *The Organization of Economic Cooperation and Development*

The OECD was the successor to the Organization for European Economic Cooperation, which was established to help funnel US Marshall Plan aid to European countries after World War II. In 1960, with Europe's recovery complete, it was enlarged to include the United States, Canada, Turkey, and Japan and retooled as an economic policy forum for the world's major industrial countries. Much of the impetus came from the United States, which was concerned about sharing the burden of aid to newly independent countries in Asia and Africa. The OECD's agenda over time has included promoting economic growth and financial stability based on reviews of members' economic policies, employment problems, education, energy policy, East-West trade, restrictive business practices, and aid to less developed regions. In short, almost everything but military matters has been on the OECD's agenda at some point. Its institutional procedures include small working groups of experts that are tasked with devising solutions to problems; consensus decisionmaking; annual closed sessions to review and critique the economic policies; and the involvement of high-level officials from member countries. The objective is collaboration and coordination based on information and exchange.

The OECD's staff has grown both in numbers and in expertise, and as a result the organization is seen as a reliable source of information on various economic issues. The organization's membership has also grown, from twenty to thirty-four, including South Korea, Mexico, Israel, and Chile among other graduates to the "rich countries' club."

Although not well known, the OECD has proved of considerable value over time as a venue for coordinating the policies of developed countries, even issuing guidelines to be adopted by non-OECD states in such areas as

taxation policy and money laundering. And, since 1960, its Development Assistance Committee (DAC) has provided a forum for aid-giving countries to coordinate their spending levels and strategies (see Chapter 9).

The OECD has played an especially important role with respect to regulation of MNCs in the developed world. Its members have agreed to voluntary guidelines giving MNCs the same treatment as domestic corporations. Thus, host-country policies on employment and labor practices, environment, and combating bribery apply to both domestic and foreign corporations. Although the text of the guidelines never defines what a multinational corporation is, the principles and standards for conduct of business are designed to encourage MNC activity. Should disputes arise between host countries and MNCs, they are encouraged to utilize international dispute settlement mechanisms such as the World Bank's International Centre for the Settlement of Investment Disputes.

#### *The G-7*

The power and dominance of the North and liberalism in the governance of global economic relations are evident in the G-7. This is truly the "club of the rich," an informal institution with no charter, a limited bureaucratic structure, and no permanent secretariat. Its members (see Figure 8.1) function as the self-appointed leaders of global economic governance.

The practice of convening annual summit meetings of heads of state and government of these seven leading industrial countries began in 1975 with an invitation from then-French president Valéry Giscard d'Estaing at a time of financial crisis. The United States had delinked the dollar from gold; OPEC had dramatically raised oil prices; and developing countries sought to create a new international economic order. The initial sessions were informal meetings of the leaders alone and there was no vision of permanence. Gradually, the leaders appointed representatives, known as "sherpas," (named after the Himalayan guides) to handle summit preparations and took steps toward the gradual institutionalization of the G-7. Among them were the 1977 decision to make the summits annual, having representatives lay the necessary groundwork for discussions, and expanding summits to include regular meetings of foreign, finance, and trade ministers. The result is "a complex network of close relationships" in a process that runs 365 days a year, twenty-four hours a day (Gstöhl 2007: 2).

What roles does the G-7 play in international economic governance? Those who follow it closely emphasize the value of high-level consultations to manage crises, to address new issues at an early stage, to prod other institutions such as the IMF and World Bank to take action, and to create new institutions when needed. It has also proven valuable for establishing personal relationships among leaders and learning from each other's experiences.



Like the OECD, the G-7 has addressed a wide range of issues, including the consequences of globalization, job loss, cross-border crimes, financial panic, debt relief, world poverty, terrorism, and drug smuggling. Beginning with Russia and its economic transition was also a major topic in early 1990s. Debt and financial instability were prominent issues after 1997–1998 Asian financial crisis. In 2002, leaders of several African nations were invited to discuss the New Partnership for Africa's Development, an African-developed initiative for sustainable economic growth. Discussed in Chapter 9. This set a pattern for regularly inviting leaders from other countries to participate in some part of the annual G-7 summit. The 2005 G-7 summit, in Gleneagles, Scotland, resulted in agreement to cut all debt for the poorest countries. In 2007 and 2008, global climate change and the Doha Round were major topics of discussion.

During the period from 1998 to 2014, when Russia joined the group for noneconomic discussions, some analysts referred to the G-8 as the center of global governance more generally, as the G-7/8 created groups to deal with issues like terrorism and drugs that had no IGO "homes."

The G-7 was also responsible for creating the Financial Stability Forum in the aftermath of the 1997–1998 Asian financial crisis, with the BIS providing secretariat services. The forum's task was to promote financial stability through information exchanges and cooperation in financial market supervisions and surveillance. This included strengthening international financial codes and standards, generally reflecting the "best practices" in advanced countries. The twelve financial codes that the forum unveiled in 2000 include corporate governance practices of the OECD, accounting standards of the International Accounting Standards Board, banking supervision of the Basel Committee on Banking Supervision, and money laundering activities of the FATF. Virtually all these standards were designed for the developing world, even though those states either were not included or were underrepresented when the codes were conceived. Nevertheless, the IMF and G-7 expected compliance and were prepared to use resource allocations and economic sanctions to enforce the standards (Drezner 2007: 136–145).

At the G-20 summit in 2009, the forum was reestablished as the Financial Stability Board; G-20 countries that were not already members were invited to join, and Spain and the European Commission were added. With the expanded membership has come a broader mandate and a more institutionalized structure.

Although the G-7 has been supplanted on several issues, the G-7 finance ministers continue to meet. In the spring of 2014, two leaders' summits were convened hastily to condemn Russia's annexation of Crimea and its violation of Ukraine's sovereignty, and to expel it from the G-8.

#### The G-20

In the 2008–2009 global financial crisis made it clear, as discussed in the opening case of this chapter, that many of the standards in banking, accounting, insurance, and securities were either inadequate or not being enforced. The crisis also made it evident that the G-7 members no longer dominated the world economy and therefore could not continue to make the rules without more consultation with all the new actors.

Recognition of the limitations of the G-7 actually became apparent much earlier, during the 1998 Asian financial crisis. At that time, US treasury secretary Lawrence Summers and Canadian finance minister Paul Martin convened a group of nineteen finance ministers from leading industrial and developing economies plus the EU. The G-20 was born. The finance ministers have met annually since 1999, but not until the 2008 financial crisis was a leaders' summit convened. The G-20 replicates much of the G-7 structure in that the association is informal, consisting of multiple working groups and periodic summits of heads of state, as well as meetings of senior ministers or their representatives. Like the G-7, the G-20 functions without a headquarters or permanent staff. The leadership rotates among the various member states, and the rotating chair is responsible for providing secretariat functions.

Since 2008, the G-20 has met at least annually to address financial crises, economic growth, trade, and employment. It has also adopted rules on tax havens and money laundering that parallel those of the OECD.

While it may be too soon to assess the G-20, it has greater diversity of membership and hence legitimacy. There is no veto power, weighted voting, or presumption that leadership will be monopolized by major powers. As Andrew Cooper and Ramesh Thakur (2013: 16) note, its size makes it difficult to manage. Therefore, much will depend on "whether or not leaders and their advisors could work together and make the commitments, big deals and concessions required not only to solve problems on an issue-specific basis but to maintain the momentum for the G20 as a pivotal and innovative forum of global governance."

Given the larger voice for developing countries, it is not surprising that the G-20 has consistently advocated national prerogatives to promote growth rather than submit to the rigors of market discipline. Yet some important economic players are not members of the G-20. Switzerland, for example, famous for its bankers' discretion, is not part of the G-20 discussion on banking secrecy. The absence of Israel and Iran, both major economic actors, also suggests the group's desire to avoid ugly political debates. And Pakistan, Nigeria, and Bangladesh, despite having a combined population of more than half a billion people, were not invited to join.

The G-20, like the OECD and G-7, has an ambitious agenda of coordinating the macroeconomic policies of a large number of major actors.



Another approach is to bring economic governance to the functional level or even the region.

### The Key Roles of Functional Institutions and Regimes

Functional organizations have been around longer than any other type of IGO, as discussed in Chapter 3. They are known for adopting a problem-solving, apolitical approach aimed at working with stakeholders such as states, citizens, corporations, professional associations, and social movements. While the list of functional organizations is long and many are addressed elsewhere in the book, two types are directly related to international trade and commerce: intergovernmental regimes in transportation (aviation and maritime transport) and the nongovernmental institution governing product standards, the International Organization for Standardization (ISO).

#### *Functional Regimes in Transportation*

International trade and development and the international monetary system are lubricated by a network of international functional regimes. Trade can not occur without a physical means to transport goods. Hence there are strong international rules and norms in ocean shipping and air transport, negotiated among relevant parties.

Ocean shipping and air transport are two areas that have had a direct impact on expanding economic relations. Thanks to technological improvements, both means of transport have become faster, more efficient, and cheaper. About 95 percent of international trade by weight, or about two thirds of all international trade by value, occurs through ocean shipping.

The most important norms concerning shipping date back to the nineteenth century—namely freedom of the high seas and innocent passage through territorial waters, the right of the state to control entry of foreign ships, and flag-state jurisdiction over ships operating on the high seas. The myriad other norms, rules, and regulations have been the product of both public and private international organizations.

The International Maritime Organization (IMO) is the UN specialized agency designed to facilitate technical cooperation in shipping, through various committees that approve technical standards and regulations on such issues as accidents, pollution, and compensation. Until the 1960s, enforcement was centered on flag states (a few developing countries with little interest in regulation) and insurers or bankers with economic interests. As ocean shipping grew and safety standards came under attack, traditional maritime nations like Great Britain and the United States expanded their powers as coastal states under the 1972 International Convention for the Prevention of Pollution from Ships, and the IMO developed procedures that

solidified it as the center for maritime regulations. That trend accelerated during the 1990s when IMO member states both helped flag states develop capacity to follow regulations and privately pressured them to follow international standards. Initiatives by both the United States after 9/11 and the EU's European Maritime Safety Agency to rank specific ships and flag states on the extent that they followed the rules and conducted container inspections enhanced the IMO's involvement (Arianova 2006).

Private initiatives are also important. The International Maritime Bureau collects data on pirate attacks and provides these updates to shipping firms, insurance companies, and the IMO. It is the responsibility of states, not the IMO, however, to police their own waters. Data compiled by the bureau suggest that states have actively responded to piracy attacks only 16 percent of the time, a figure that has not varied with the rise in piracy. Thus, with the rash of attacks off the coast of Somalia in 2007–2009, it fell to the UN Security Council to authorize enforcement under Chapter VII of the UN Charter, as discussed in Chapter 7 (Stiles 2009). But piracy has now shifted to Southeast Asia and the West African coast, motivated by petroleum cargo transported in small ships. Attacks in the Gulf of Guinea (West Africa) accounted for 19 percent of all maritime attacks in 2013.

During the latter half of the twentieth century, comparable norms evolved for air transport, as states recognized freedom of air transport above the oceans, while requiring state consent for passage over sovereign territory. For both air transport and ocean shipping, states have accepted norms governing damage control, accident prevention, and crimes such as piracy and hijacking, as well as norms to prevent pollution and environmental harm. Most of the airline and air transport norms were established through the International Civil Aviation Organization (ICAO), a specialized agency of the UN created in 1944, and the International Association of Transport Airlines (IATA), created by the airlines in 1945. At the outset, it was intended that the IATA would provide technical information to the ICAO and that the two would work closely together. The dominance of the US airline industry as supplier of aircraft, however, has meant that the United States plays a more hegemonic role in setting safety standards and norms. The IATA is most concerned with facilitating the flow of travelers and luggage, exchange of tickets, and fare-setting. The ICAO and IATA have made positive contributions to standardizing transport regulations and enhancing airline safety and efficiency.

In particular, the ICAO's inspection of its members' aviation administration systems—complete with a public “scorecard”—went far to push members toward improved safety and training. These efforts are ongoing. And after Malaysian Air Flight MH370 disappeared in 2014, there was renewed pressure on the ICAO to improve communication blind spots over the world's oceans.



*The International Organization for Standardization*

The ISO is a unique, nongovernmental umbrella organization composed of 165 national standards-setting bodies that since 1946 has created technical specifications for products and services for most industries, spanning technology and manufacturing to food safety, agriculture, and health care. Experts from around the world develop the standards for different sectors based on their knowledge and experience. Some 19,500 international standards as of 2014 specify the chemical content of batteries, software found in credit card-reading machines, manufacturing of smokestack scrubbers, and the like. The ISO and its partner institution, the International Electrotechnical Commission, together promulgate 85 percent of the world's product standards. More than 1,500 new international industrial standards are set each year, some of which are later incorporated into domestic law (Bühne and Mattli 2011: 7).

Setting these standards allows consumers to trust the reliability of "ISO certified" goods and services and increases the chances that companies that comply will be able to market their goods and services worldwide. Yet standard-setting is inherently a political process. Firms that are unable to satisfy the requirements are by and large excluded from the marketplace. In some cases, the technology and capital investment required to meet the standards is beyond the capacity of many firms. Likewise, standards calling for certain levels of training of workers and staff may only be available abroad, making the meeting of the standard unrealistic. Even attending meetings may be too costly.

Since noncompliance is most likely to affect firms in developing countries, the ISO has developed outreach and training programs to help them achieve the standards. Despite questions about the legitimacy of the process, more and more firms have adopted ISO standards for their sector. And there can be a spillover effect. For example, when the ISO adopted a standard on environmental protection, firms that act as suppliers to companies that have embraced the standard have significantly reduced their own pollution, despite weak state laws on the subject (Prakash and Potoski 2014).

**Private Governance**

For many years, but especially since the 1980s, governments, international organizations, and a variety of private entities (including for-profit and not-for-profit actors) have formed associative arrangements. But sometimes, private actors act independently in what is referred to as private governance.

Private economic governance takes a number of different forms. Production alliances or producer cartels are one form of private governance.

One example is the diamond cartel, which purports to control about 80 percent of the world's diamond trade. Largely controlled by the De Beers company along with Russia, it makes a conscious effort to sustain the illusion that diamonds are scarce, therefore justifying high prices. The cartel works principally through a central selling organization to control the volume of diamonds on the international market, their classification, and advertising. Since 2003, the Kimberley Process Certification Scheme, a multistakeholder process, has sought to curb the flow of "conflict" or "blood" diamonds—diamonds whose sale fuels civil conflicts particularly in Africa. Organized through the World Diamond Council and monitored by independent groups, including Global Witness and Partnership Africa Canada, the Kimberley Process was successful for several years. In 2011, Global Witness pulled out, citing the ineffectiveness of the certification process.

Businesses or trade associations sometimes unite, sometimes cross-nationally, to develop industry-wide standards or enforce particular practices. The OECD has analyzed over 230 such corporate codes of conduct. Some are applicable only to a specific firm; others are in force among firms, committing competitors to certain standards of conduct, such as the Code of Conduct for the Tea Sector or the Common Code for the Coffee Community.

Self-regulation is largely a response to informal and formal pressures from shareholders (under the rubric of socially responsible investing), from NGOs, and even from governments threatening stronger regulatory action. Such pressures have led corporations to impose self-restrictions governing purchasing agreements, labor conditions, and environmental standards. Since 2005, Walmart has demanded that its suppliers follow increasingly stringent environmental standards or have their contracts suspended. In most cases this means firms exceed the requirements of their own domestic law. Dozens of Chinese firms have, in fact, adopted Walmart's high standards, despite Beijing's weak environmental rules. The Rugmark Foundation and the Clean Clothes Campaign involve two NGO-inspired codes of conduct to improve labor conditions in respective industries. For firms to adopt such standards and still be competitive, however, it behooves them to cooperate with others for a joint industry standard. Many of these have developed partnerships among companies, labor groups, and NGOs, and are discussed in Chapters 10 and 11. The UN Global Compact on Corporate Responsibility represents such an approach and is discussed in Chapter 9.

There are advantages and disadvantages to private governance over state and IGO governance. On the positive side, firms develop relationships with each other over time and are often able to respond to changing conditions faster than could a government or international bureaucracy. Even though the decisions are not what could be considered democratic, it may not matter if the result better fits the demands and needs of ordinary peo-



pe in places where their governments are unconcerned about their being. Perhaps Walmart and ISO environmental standards may be more for the health of Chinese people than the government. Yet there is possibility that private actors are only accountable to themselves and too much power is concentrated in their hands, while the interests of the and ordinary individuals are neglected (Papadopoulos 2013).

There are critics of all these approaches and no direct evidence that self-regulation works. Nevertheless, certification and monitoring programs have proliferated, with NGOs putting pressure on companies through sophisticated mass-marketing techniques. Sometimes private and governmental actors decide that an international arrangement may be too difficult to arrange and inefficient, and hence turn to regional arrangements and organizations.

### **The Regionalization of Economic Governance**

Regional governance has proliferated with the expansion of the EU and the creation of AFTA, NAFTA, the Asia-Pacific Economic Cooperation, Mercosur, ECOWAS, and other regional and subregional economic groups, discussed in Chapter 5. Indeed, since the Doha Round of WTO negotiations stalled in 2008, a hundred new regional trade agreements have come into force, for a total of nearly 380 as of mid-2014.

Regional or preferential trade agreements have come into force that members will experience economic benefits by taking advantage of economies of scale, spreading costs over larger regional markets, and increasing political cooperation. Two debates regarding regional trade agreements have emerged. First is the question of whether they improve the economic welfare of their members through trade creation or whether they is actually diverted and thus reduces economic welfare. With regional trade agreements, some trade is created in goods produced efficiently relative to the rest of the world. Trade is also diverted from efficient nonmembers because of the preferences states grant to each other, and hence state welfare is reduced.

Second is the question of whether regional trade agreements are a steppingstone or a stumbling block to global trade arrangements. On the one hand, they clearly involve fewer parties in negotiations and enhance the competitiveness of some domestic industries, making it easier to argue for liberalization. Some see them as a steppingstone toward integration on a larger scale, since they allow states to gradually improve their competitiveness. On the other hand, under regional trade agreements, larger economies can impose their will more easily and interest groups may find it easier to lobby for their interests, inhibiting freer global trade. Jagdish Bhagwati (2008), a prominent opponent of regional trade agreements, calls this col-

tion of agreements "terminates in the trading system." Regional agreements make states less likely to agree to global tariff cuts; freer trade may not be the narrow gains already won. Both of these issues are prominent in the debate over the oldest and most extensive regional trade group, the European Union.

### **The European Union's Single Market**

The EU's evolution into a single regional market occurred in three distinct phases. In the first phase, from 1958 to 1968, members worked to eliminate internal tariffs, dismantle quantitative import restrictions among the six original members, and establish a common external tariff and the Common Agricultural Policy. Thereafter, members negotiated as a single entity in international trade negotiations. In the second phase, during the 1970s and early 1980s, membership was enlarged in two waves and key institutional changes were undertaken, as discussed in Chapter 5, but deeper integration stalled. In the third stage, members implemented the Single European Act to stimulate new economic growth by completing their single market and introducing the common currency (euro) to achieve monetary union.

**Breaking down the trade barriers.** The Single European Act (SEA) of 1987 provided the foundation for major economic changes and a deepening of the integration process. European economic growth had been sluggish since the mid-1970s and Japan and the United States were becoming increasingly competitive. Completing the single market would provide the needed boost. So in 1985 the European Commission issued a white paper on completing the internal market. When approved, the Single European Act amended the Treaty of Rome and gave new impetus to European integration.

The SEA's goal was to achieve a single market by December 1992 and to strengthen community institutions. This would ensure the free movement of goods, persons, and capital throughout the EU. The process was complicated, involving removal of all physical, fiscal, and technical barriers to trade, and harmonization of national standards through over 300 community directives. To eliminate restrictions on movement of goods and persons, it was necessary to eliminate customs duties, quantitative restrictions, and measures having equivalent effect. Customs barriers were abolished at the end of 1992, but the movement of persons proved more difficult. Since 1993, residents of EU member states have had the right to live and work in any other EU member state, although some restrictions were placed on citizens of Eastern European countries that joined the EU in 2004 and 2006. Most countries eliminated passport controls and adopted common visa regulations, but Britain, Ireland, and Denmark refused. States have gradually begun to recognize each other's educational and professional qualifications, a requirement for the free movement of labor.



Abolishing technical barriers to trade has proven more difficult. Although the European Court of Justice ruled in 1979, in the *Cassis de Dijon* case, that products meeting the standards of one member state could be legally sold in another (see ECJ 1979), states continue to assert health and safety standards as legitimate restrictions on trade. Since harmonizing technical standards had proven difficult, the SEA adopted the less rigid approach of mutual recognition, acknowledging that states could have different standards and requirements as long as those standards approximated each other.

Competition policy has also proved to be a significant technical barrier to trade. The Maastricht Treaty prohibits EU member states from giving preferences to home companies in government contracts, even though certain areas of economic activity, such as road transport, water, and financial services, are often under the control or management of state enterprises. Breaking long-standing state monopolies and prohibiting state aid to specific sectors are politically difficult, although most recognize that such practices do distort trade. The European Commission is now more actively examining malfeasance and initiating actions against states that provide uncompetitive (and therefore unfair) state aid. In addition, the Council of Ministers more carefully examines mergers for anticompetitive implications. Antitrust regulations have been expanded to eliminate monopolistic sales agreements, discrimination by nationality, and predatory pricing. In one controversial case that began in 2004 and dragged on until 2012, the EU found Microsoft guilty of anticompetitive behavior and fined it \$794 million for failing to respect the settlement. This marked the first time a company had been fined for that reason, but, in fact, the fine had been significantly reduced from the original judgment of \$2.7 billion.

A de facto single market exists today among the EU's twenty-eight members, with most restrictions eliminated. This has resulted in increased wealth and productivity as trade and foreign investment have grown. European corporations have become more competitive, and integration of transportation and energy networks has proceeded, although unemployment remains comparatively high, especially since the global financial crisis and the eurozone crisis that followed.

*The special problem of agriculture.* Of the EU's economic policies, none is more complicated than those that fall under the Common Agricultural and Rural Development Commission. Agriculture is the most integrated of the EU's economic sectors, receiving just over 42 percent of the EU's total budget. Foodstuffs are vital for national security, and no country wants to be dependent on other states for essentials.

A complicated and expensive system of subsidies to farmers was established under the CAP, whereby the EU purchases the surplus from farms at

a guaranteed price and either stores it, donates it to food aid programs, or absorbs the loss. Significant reforms in effect since 2013 have simplified the regulations. The reforms eliminate intervention price supports for certain crops, provide added benefits to smaller active farmers, support sustainable farming practices, and boost rural employment opportunities.

Not only are EU members deeply attached to retaining the CAP, but the EU has also adopted very strict regulations on food imports, including a ban on many genetically modified foods, which particularly affects US-EU trade. These regulations and the remaining price supports have been and will continue to be an impediment in WTO negotiations.

*Monetary integration.* In the 1960s, members of the European Economic Community declared their interest not only in an economic union, but also in a monetary union, though not much progress was made for many years. The formation of the European Monetary System in 1979 created some structure for coordinating financial policy; the European Currency Unit served as a means of settling accounts; and the Exchange-Rate Mechanism provided fixed, though adjustable, bands of currency exchange. But these were weak instruments. In the late 1980s, during the discussions of the single market, provisions were made for greater cooperation in monetary policy.

The Maastricht Treaty of 1992 delineated the features and timetable for movement toward forming the European Monetary Union, which included establishing a single currency, the euro, and common monetary policies. The euro was realized for businesses in 1998 and for consumers in 2002. Not only does the single monetary unit serve as a powerful symbol of community unity (and loss of state sovereignty over currency), but member states have also agreed to relinquish their right to use exchange rates and interest rates as instruments of national economic policy.

The euro quickly established itself as a safe and stable currency worthy of use around the world. By reducing "transaction costs"—the costs of entering into a deal—it helped facilitate cross-border trade and investment. Many EU members, including Greece, Ireland, and Spain, experienced high growth rates during the 1990s and early 2000s. In Greece, public sector borrowing was fueled by high public sector wages. In Ireland and Spain, private sector borrowing was fueled by the construction and housing sector, all facilitated by low interest rates set by the European Central Bank (ECB).

When the global financial crisis hit, governments dependent on borrowing in international markets were unable to meet debt obligations, weak and loosely regulated banks were unable to cover liabilities, and individuals whose net worth had declined were confronted with declining wages and unemployment. Meanwhile, Germany, the strongest eurozone member, continued to enjoy trade surpluses because of high productivity and wage



restraint. With German exports even more competitive, other eurozone countries had worsening balance-of-payments positions. But Germany, French, and Scandinavian banks had made substantial loans to states in trouble and were therefore vulnerable.

As problems worsened, critics questioned how the euro could work with no fiscal union and with each state having different tax and pension rules. How could the eurozone work with no strong central bank with bank regulatory oversight?

The response to the crisis was found in coordinated actions. Ireland took the first step at restoring fiscal stability with an austerity plan, then in 2010 turned to the EU and IMF for a financial bailout package of 85 billion euros, to be combined with tax increases and spending cuts. Greece required multiple bailouts from the EU, ECB, and IMF, as the government took multiple steps to slash public spending, improve tax collection, and renegotiate labor contracts, all of which were highly unpopular. By 2011, there had been more than twenty summits to address the eurozone crisis, involving the major leaders, and representatives from the European Central Bank, EU, IMF, as well as the private banks.

Questions remain, however, about the wisdom of imposing such severe austerity measures. For example, Germany became the target of considerable criticism by 2014 for its strict adherence to austerity. Even the ECJ and IMF called for stimulus measures to invest in growth and reverse the high unemployment levels in many EU countries. With anti-austerity sentiments strong in many countries, alongside the growing strength of Euroskeptic parties, European leaders have become divided on the appropriate measures to address their economic problems. Indeed, Greece elected a leftist government in 2015 espousing an anti-austerity policy, widening the divide among EU members.

As a result of the eurozone crisis, major reforms have been instituted and others proposed. The Stability and Growth Pact, controlling national budgetary policies, has been strengthened, and fines have been levied for deviant policies. The European Financial Stability Forum, an IMF-like institution established in 2010, provides funding to facilitate structural adjustment among its members. The Macroeconomic Imbalance Procedure identifies risks, which then facilitates policy coordination. In 2012 the European Central Bank was reorganized to be a bank regulator, with deposit insurance programs to augment national programs and authority to examine bank balance sheets. In 2014 after the first review, it identified twenty-five failing banks and thirteen others that needed strengthening. Calls for some form of common governance, including a possible fiscal union, persist. Yet there also remains the possibility that Greece and other eurozone members may be forced to leave the zone, with unknown consequences for the EU.

### *The ASEAN Free Trade Area*

The ASEAN countries have been working toward their own free trade area since concluding AFTA in 1992. The four newer members were required to sign the agreement as a condition of joining ASEAN, but given longer time periods to meet the tariff reduction obligations. The AFTA agreement is relatively brief and contains no binding commitments, ironic given the fact that ASEAN members' prosperity depends heavily on trade. It is designed to eliminate all tariffs among members, but unlike in the EU, members do not aim to create a common external tariff. The exception to these reductions is rice, the regional food staple, along with certain other "highly sensitive products." By the end of 2014, 70 percent of ASEAN intraregional trade incurred no tariffs, and the average tariff rate was less than 5 percent. AFTA has primarily focused on tariff reductions, but has begun to work also on nontariff barriers, which are now the primary protective measures, as well on quantitative restrictions and harmonization of customs rules. As of 2010, one study showed "positive and significant" trade creation effects on a wide range of products, particularly for the original six ASEAN members. Overall, the study showed an expansion of intra-ASEAN trade, especially imports of parts, components, and capital goods, which pointed to the formation of regional production networks. Exports to China had expanded more than intra-ASEAN exports, likewise indicating the formation of ASEAN-China production networks (Okabe and Urata 2013).

As discussed in Chapter 5, AFTA members signed agreements in 2009 to form an integrated ASEAN Economic Community by 2015 (minus a common currency) to boost growth. Whether ASEAN members can bridge their large differences in levels of development and national standards, however, remains to be seen. Most analysts say achieving the single market envisioned in the AEC is still a long way off. China has voiced its interest in joining AFTA—a step that would further complicate regional economic integration.

With the ASEAN Charter adopted in 2007 giving the organization legal personality, ASEAN had a basis for concluding trade agreements with countries, regional, subregional, and international organizations. As of 2014, it had six such agreements, with India, Australia and New Zealand, Japan, China, South Korea, and the EU. Like other preferential agreements, these violate the most-favored-nation principle by favoring only those that are parties, and illustrate the further splintering of the WTO-based global trade system.

Beyond AFTA, ASEAN has taken steps since the 1997–1998 Asian financial crisis to create mechanisms to prevent and address any future financial crisis. In 2000, the ASEAN Plus Three established the ASEAN Surveillance Process to monitor capital flows, the Chiang Mai Initiative to provide a currency-swap arrangement supplementing the IMF, and a net-



work of training institutions to strengthen banking capacity. These clearly reactions to the harsh and inappropriate measures imposed by the IMF during the 1997–1998 crisis and subsequent scuttling by the United States of a proposed Asian monetary fund. In 2010, the Chiang Mai Initiative was “multilateralized” to create a reserve of pooled funds, then doubled in size in 2012 when a stability fund was created—all in response to adverse effects of the 2008 global financial crisis. In addition, ASEAN+3 Three finance ministerial meetings now include central bank governors. Although there is considerable debate about how effective AFTA and the Chiang Mai Initiative are, ASEAN has clearly broadened the scope of regional economic governance beyond trade alone.

### The Proliferation of Regional Trade Agreements

To say that regional trade agreements (RTAs) have become popular since the end of the Cold War would be an understatement. As Figure 8.5 shows, the number of these agreements rose from roughly 50 in 1990 to nearly 400 less than twenty-five years later, with an average of over a dozen new agreements a year. If all the RTAs that have been agreed to enter into force there will soon be nearly 600 of them.

With many governments skeptical about concluding a new WTO agreement and of the capacity of the WTO to meet all their needs, regional trade

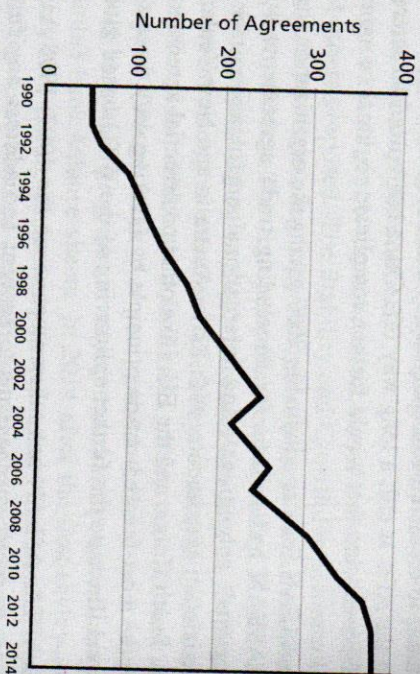


Figure 8.5 Cumulative Active Regional Trade Agreements, 1990–2014

Source: WTO Secretariat, [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm).

agreements are seen as a practical alternative, involving less risk, variable commitments, more familiar partners, and rapid enactment. But they may be easier to create than to put into practice. Actual implementation depends mostly on whether the signatories are closely intertwined economically and have the resources to enforce new rules. Further, once multilateral trade agreements are in place, they are likely to expand to include more partners—something that is rare with respect to bilateral deals (Mansfield and Favelhouse 2013).

Although RTAs have proliferated, in most cases they link a variety of countries with each other but they are not exclusive. In Africa, Latin America, as well as Europe, states belong to multiple bilateral, subregional, and regional agreements, leading many pundits to refer to a “spaghetti bowl” of state commitments. These crisscrossing commitments may limit the capacity of states to resort to protectionism when times get tough and should therefore help sustain international liberalism, but regional trade agreements may also work at cross-purposes and undermine overall effectiveness.

We look briefly at two major RTAs that have been under negotiation for a number of years: the Transatlantic Trade and Investment Partnership, between the United States and the European Union, and the Trans-Pacific Partnership.

**The proposed Transatlantic Trade and Investment Partnership (TTIP).** The United States and the European Union are negotiating a series of trade and investment agreements that would knit together their economies even more closely. In 2013, one-fifth of US exports went to the EU, while the EU exported one-eighth of its goods to the United States. The proposed TTIP is intended to reduce obstacles to trade and investment, such as EU barriers to genetically modified foods, and empower US firms to sue in local European courts. Some Europeans are concerned about granting more rights to US firms, which could lead to weakened worker protections, but some economists predict the deal could result in economic gains equivalent to an extra \$700 per year for each European family of four (Francois et al. 2013). The negotiations are scheduled to conclude in 2015.

**The proposed Trans-Pacific Partnership (TPP).** Since 2011 the United States has also been involved in talks on a partnership that would more closely link twelve Pacific Rim nations, including both developed and developing states such as Canada, Chile, Mexico, Vietnam, Japan, and Australia. China, however, is not included in the negotiations, leading some analysts to see the TPP as part of US efforts to contain China’s rise. One goal is regulatory harmonization, meaning that governments would adopt increasingly similar rules governing production and trade. This may lead to



stricter rules for many countries, such as much stronger protection of rights and patents. In other cases it could lead to weakening of regulations especially where foreign companies are able to sue local governments. More than for the TTIP, however, secrecy surrounding the talks for the agreement has prompted skepticism in the US Congress about negotiators' intentions. Senator Ron Wyden, for example, complained in 2012: "The major negotiations, while representatives of U.S. corporations are being consulted, made privy to details of the agreement" (Edsall 2014).

### **Critics of Governance Institutions in Finance and Trade**

Developing countries have long been critics of the international liberal economic system and expressed this dissatisfaction through the UN, African Union, and other international organizations. In the context of economic governance, sought to regulate MNCs, and offered reform proposals (rich) and in economic theory (particularly Marxist and dependency theory). Still other criticisms have been rooted in concerns for equity, fairness, and social justice. Many critics of the liberal economic model have focused on the MNCs, believing that they occupy a position of preeminence within the global economy, being subject to adequate international or state controls, as explored in depth in Chapter 9. Yet determining what is to be regulated, even defining what MNCs are, as well as the scope of regulations, has always been problematic. IGOs are easier to identify, making the IMF and WTO subject to criticisms from every ideological position. We look at critics of the IMF and WTO therefore, along with antiglobalization critics.

#### **The IMF and Its Critics**

Developed-country critics of economic liberalism generally have targeted a number of specific deficiencies at the IMF, many of which were introduced earlier in this chapter. Interestingly, those critiques come from different ideological directions. Conservative critics say that the IMF is too interventionist in economies; they see the free market economy working efficiently without interference. Rescuing countries that have followed profligate economic policies—whether Thailand, Russia, Ukraine, Argentina, or Greece—poses a moral hazard.

Most liberal critics generally want reforms within the established frameworks. The 2008 global financial crisis resulted in calls for a new "architecture" of institutions and rules to govern, reinforcing banking regulations, modifying voting within the IMF, and enhancing surveillance mechanisms. Liberal feminists call for more women in policymaking posi-

tion, since only a quarter of the Fund's staff are women. When IMF managing director Dominique Strauss-Kahn resigned in 2011 amid a sex scandal, the Fund's female staff issued an open letter calling for a woman to run the organization. The appointment of Christine Lagarde as managing director was designed to improve the Fund's working environment and reputation. In 2011, only one woman sat on the IMF Executive Board in 2014, and in 2015, more than 10 percent of the European Central Bank's leadership and senior staff are women.

A few radical critics from developed countries would join the critics from the developing countries of the IMF as an outmoded, Western-dominated institution failing to reflect changes in world affairs. Many of these positions are similar in their approach to the critiques of the WTO.

#### **The WTO and Its Critics**

With a wide range of goods and services under its jurisdiction and strengthened dispute settlement mechanisms, the WTO has become a lightning rod for groups from both developed and developing countries who see the organization as the culprit in the negative consequences of economic globalization, usurping state sovereignty and domestic interests and favoring the interests of major developed countries over poor countries. Even though each WTO member has a voice through the consensus procedure, decisions often involve "unequally matched states against one another in chaotic bouts of negotiating which has seen developed countries secure more of the economic opportunities they already have while offering developing countries very little of what they actually need" (Wilkinson 2014: 2). Still others point out that although some developing states participate in the WTO's dispute settlement system, the vast majority do not, because of the considerable cost of proving injury from the trade policies of another country and the reluctance to retaliate against a major power should a decision be rendered in their favor.

At a more general level, many are critical of the effects of reducing barriers to trade and making the world more "globalized." Scholars sometimes question whether the world is globalizing and even more so whether it should be (Veseh 2010).

Among activists, antiglobalization NGOs are major opponents of WTO activity, charging that the WTO's power to make regulations that have consequences and settle disputes with authoritative measures is an intrusion on national sovereignty. They are also critical of the lack of transparency in WTO procedures. In addition, there is a widely held perception that the organization is captive to the demands of rich governments and big MNCs.

To other NGOs, the WTO's adherence to the interests of free trade undermines the application of labor and environmental standards, discussed



in Chapters 10 and 11. Thus, labor movements and environmentalists have joined the opposition, believing that the WTO privileges economic liberalization over social values. The environmental groups argue that trade rules need to be more environmentally friendly and urge the establishment of environmental implications before WTO accords are passed. In 1996, the WTO rejected negotiations with labor groups, referring the motion of labor standards to the ILO instead, where compliance procedures are generally loosely enforced. In contrast, labor groups from the developed world have lobbied for the WTO to take up the labor-friendly agenda, and the WTO has the power to institute trade sanctions for labor violating Labor groups joined with other opponents of the WTO in the 1990s in the protests against the organization.

### *Antiglobalization Critics*

In the late 1990s, opponents of economic globalization formed a broad movement of workers, environmentalists, farmers, religious activists, women, and human rights advocates seeking greater economic justice. Many of these groups have found common cause in the streets of Seattle, Prague, Washington, DC, and Calgary by staging mass protests in conjunction with meetings of the international financial institutions and G-7/8 since the late 1990s. Although groups have had their own agendas, they have been united in denouncing globalization and seeking a return to governance at the local (or national) level. To many, goals of economic efficiency and being able to buy the cheapest goods need to be replaced by support for local economies through providing local employment rather than exporting jobs, and by fair and environmentally friendly conditions for workers.

While demonstrators continue to march in the streets of Europe, antiglobalization protests have moved to the marketplace—supporting local agriculture, buying fair trade products, pressuring the giant multinational Walmart to reform its purchasing, labor, and other practices—in an effort to roll back economic globalization at the local level. The question, however, is no longer “Are you for or against globalization?” Now the question is “What should the rules of globalization be?” (Rodrik 2008: xx).

Decisions about free trade, stable currencies, and macroeconomic coordination, despite efforts by some to paint them as apolitical, are quintessential political decisions, since they shape who gets what. Many of those involved in global economic governance want us to believe that they are operating on the basis of technical, apolitical principles. Yet evidence from the IMF, WTO, MNCs, international banks, and large investment firms does not bear that out. The links between ideas, politics, and economics are even more clear when we examine global governance relating to human development.

### **Suggested Further Reading**

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### **Internet Resources:**

- ASEAN Free Trade Area: [www.asean.org](http://www.asean.org)
- Bank for International Settlements: [www.bis.org](http://www.bis.org)
- Basel Committee on Banking Supervision: [www.bis.org/bcbs](http://www.bis.org/bcbs)
- Corporate Accountability International: [www.stopcorporateabuse.org](http://www.stopcorporateabuse.org)
- European Union: <http://europa.eu>
- Financial Action Task Force: [www.fatf-gafi.org](http://www.fatf-gafi.org)
- Financial Stability Board: [www.financialstabilityboard.org](http://www.financialstabilityboard.org)
- Group of Seven: [www.g7.utoronto.ca](http://www.g7.utoronto.ca)
- Group of 20: [www.g20.utoronto.ca](http://www.g20.utoronto.ca)
- International Association of Transport Airlines: [www.iata.org](http://www.iata.org)
- International Centre for the Settlement of Investment Disputes: <http://icsid.worldbank.org>
- International Civil Aviation Organization: [www.icao.org](http://www.icao.org)
- International Maritime Organization: [www.imo.org](http://www.imo.org)
- International Monetary Fund: [www.imf.org](http://www.imf.org)
- International Organization for Standardization: [www.iso.org](http://www.iso.org)
- North American Free Trade Agreement: [www.nafta-sec-alena.org](http://www.nafta-sec-alena.org)
- Organization for Economic Cooperation and Development: [www.oecd.org](http://www.oecd.org)
- World Bank: [www.worldbank.org](http://www.worldbank.org)
- World Intellectual Property Organization: [www.wipo.int/portal/en/index](http://www.wipo.int/portal/en/index)
- World Trade Organization: [www.wto.org](http://www.wto.org)