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ECIPE Press release, March 9, 2011

New Paper:

The Crisis and the Global Economy: A Shifting World Order?

The global economic crisis has sparked short-term divergence of economic performance between the West and emerging markets, and thereby accelerated the longer-run convergence of the latter on the former, argues Razeen Sally in a new study. That is particularly evident in globalising Asia. This shift to the East is also even more evident in international trade and FDI than it is in other channels of globalisation. And it creates very different economic and geopolitical conditions to those that prevailed under US leadership and a transatlantic-centred world economy in the second half of the last century. Western and emerging-market elites are only just beginning to recognise this shift, but they still have little clue how to deal with it.

Yet emerging markets' political and economic institutions, and intra-regional divisions, continue to hold back their rise. That means the Shift to the East will not translate into Chinese or other emerging-market leadership for a long time to come – if ever. The USA is still the fulcrum of international relations, and the world is far from being "post-American". But the USA is diminished; it is less capable and willing to exercise global leadership – clearly evident under the Obama administration. Europe is also no substitute for US leadership. The EU has the world's biggest unified market. But that is the extent of the EU's global power. Its hybrid nature, internal divisions and absence of hard power (a unified military capacity) will always prevent it from having a serious, coherent foreign policy. Its soft power, outside the greater European neighbourhood, is mostly postmodern hot air.

Thus the economic shift to emerging markets, accelerated by the crisis, does not translate into a paradigmatic shift in global political-economic order. But it does insert more multipolarity and uncertainty into that order, and leaves more of a leadership vacuum.

These are very general global political-economic observations, but Razeen Sally argues in the new paper that they also capture the present global trade-policy context. As for trade policy, governments' responses to the biggest deglobalisation since the Depression did not precipitate a descent into 1930s-style protectionism. Domestic crisis interventions – a combination of bank bailouts and expansive macroeconomic policies – took priority. Traditional protectionism hardly increased; borders remained open. But crisis interventions and the return to Big Government leave the West with crippled public finances and more restrictions on competitive markets. Also, they threaten to spill over into creeping protectionism of the subtle, non-tariff, regulatory variety. New patterns of protectionism are similar to developments in the 1970s and 1980s rather than the 1930s. They are barely contained by WTO rules. The danger is that they will slow down recovery and reglobalisation in the next decade.

The short-term challenge is to arrest the slide to Big Government at home and creeping protectionism abroad. The medium-term challenge is to get back on track with trade and FDI liberalisation combined with domestic structural reforms – substantial unfinished business left before the crisis struck. The BRICS and many other emerging markets still have big pockets of up-front trade and FDI protection. They have even higher domestic (though still trade-related) barriers embedded in services regulation, intellectual property rules, public procurement, customs administration, food-safety and assorted product standards, and competition rules. They do badly on business-climate indicators compiled by the World Bank and other organisations. But "second-generation" reforms to tackle these barriers are much more complex and politically sensitive than the "first-generation" reforms of the Washington Consensus heyday. Compared with border barriers to trade and FDI, domestic regulatory barriers are defended by more powerful, entrenched interest groups, uniting insider elites in government, business and unions, usually with the public sector and the organs of the state at their core.

Notwithstanding these great obstacles, these reforms are primarily a matter for *unilateral* action by governments and *competitive emulation* among them. They can be reinforced by international policy cooperation in the WTO, G20 and other fora, but not too much can be expected of cumbersome global-governance, let alone regional-governance, mechanisms.

Publication details:

The Crisis and the Global Economy: A Shifting World Order?, by Razeen Sally

ECIPE Occasional Paper No. 03/2011

The paper can be downloaded here

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