

**THE IRONY OF GLOBAL ECONOMIC GOVERNANCE:
THE SYSTEM WORKED**

Daniel W. Drezner
The Fletcher School of Law and Diplomacy
Tufts University
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ABSTRACT

Prior to 2008, numerous foreign policy analysts had predicted a looming crisis in global economic governance. Analysts only reinforced this perception since the financial crisis, declaring that we live in a “G-Zero” world. This paper takes a closer look at the global response to the financial crisis, which reveals a more optimistic picture. Despite initial shocks that were actually more severe than the 1929 financial crisis, global economic governance structures responded quickly and robustly. Whether one measures results by economic outcomes, policy outputs, or institutional flexibility, global economic governance has displayed remarkable resiliency since 2008. Multilateral economic institutions performed well in crisis situations to reinforce open economic policies, especially in contrast to the 1930s. While there are areas where governance has either faltered or failed, on the whole, the system has worked. The system has worked better than expected because the distribution of power, institutions and ideas has changed less than is commonly understood. Misperceptions about global economic governance persist because the Great Recession has disproportionately affected the core economies – and because the efficiency of past periods of global economic governance has been badly overestimated.

Introduction

The 2008 financial crisis posed the biggest challenge to the global economy since the Great Depression. During the first ten months of the “Great Recession,” global stock market capitalization plummeted lower as a percentage of its pre-crisis level than during the first ten months of the 1930s depression.¹ Housing prices in the United States declined more than twice as much as they did during the Great Depression.² The International Monetary Fund estimated that banks and other financial institutions lost more than \$4 trillion in the value of their holdings as a result of the crisis.³ The McKinsey Global Institute estimates that the global decline in asset values led to aggregate losses of \$27 trillion in 2008 – a half-year’s worth of global economic output.⁴ The International Labour Organization estimated that global unemployment increased by 14 million people in 2008 alone.⁵ Nearly four years after the crisis, there continue to be elevated concerns about systemic risk.⁶

The demand for global economic governance structures to perform effectively is at its greatest during crises.⁷ I define global economic governance as a set of formal and informal rules of transnational scope, and the collection of authority relationships that coordinate, monitor or enforce said rules. As Menzie Chinn and Jeffrey Frieden note, “The 1929 recession became a depression largely because of the collapse of international cooperation; the current crisis may head in that direction if international collaboration fails.”⁸ One of the primary purposes of multilateral economic institutions is to provide global public goods – including keeping barriers

¹ Barry Eichengreen and Kevin O’Rourke, “A tale of two depressions,” VoxEU.org, March 2010. Accessed at <http://www.voxeu.org/index.php?q=node/3421>.

² Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009), p. 226.

³ International Monetary Fund, *Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risks*, April 2009.

⁴ Charles Roxburgh, Susan Lund and John Piotrowski, *Mapping Global Capital Markets 2011*, McKinsey Global Institute, August 2011. An Asian Development Bank report estimates the 2008 decline in asset values to have been twice as large. See Claudio Loser, “Global Financial Turmoil and Emerging Market Economies,” Asian Development Bank, March 2009, p. 7.

⁵ International Labour Organization, *The Financial and Economic Crisis: A Decent Work Response* (Geneva: ILO, 2009), p. v.

⁶ See, for example, the FT-*Economist* Business Barometer, August 2012. Accessed at <http://www.ft.com/intl/cms/s/0/2648032c-e78d-11e1-8686-00144feab49a.html#axzz23kj5DEaP>, August 2012.

⁷ I define *global economic governance* as the set of economic rules and regulations of transnational scope, and the collection of authority relationships that manage, monitor or enforce said rules.

⁸ Menzie Chinn and Jeffrey Frieden, *Lost Decades: The Making of America’s Debt Crisis and the Long Recovery* (New York: W.W. Norton, 2011), p. xvi. See also Harold James, *The End of Globalization: Lessons from the Great Depression* (Cambridge: Harvard University Press, 2001).

to cross-border exchange low. An open global economy lessens the stagnation that comes from a financial crisis, preventing a downturn from metastasizing into another Great Depression.⁹

Since the Great Recession began, there has been no shortage of scorn for the state of global economic governance. Nevertheless, a closer look at the global response to the financial crisis reveals a more optimistic picture. Despite initial shocks that were more severe than the 1929 financial crisis, national policy elites and multilateral economic institutions responded quickly and robustly. Whether one looks at economic outcomes, policy outputs, or institutional resilience, global economic governance structures have either reinforced or improved upon the status quo since the collapse of the subprime mortgage bubble. These regimes performed well during the acute phase of the crisis, ensuring the continuation of an open global economy. To be sure, there remain areas where governance has either faltered or failed. Even if the policy outcomes have been less than optimal, however, international institutions and frameworks performed contrary to expectations. Simply put, the system worked.

How and why did this happen? The system worked for multiple and reinforcing reasons. The relative power of the United States was underestimated. The pre-existing institutional commitment to an open economic order made it easier to reinforce the status quo. The relative efficiency of prior eras of global economic governance has been overestimated, exaggerating the contrast between the past and the present. Even as the global economy appears to be slowing down in 2012, the fault lies not with international institutions, but with the national policies of the governments themselves.

The perceived crisis in global economic governance.

Even if states are the primary actors in world politics, they rely on a bevy of acronym-laden institutions – the International Monetary Fund (IMF), World Trade Organization (WTO), Bank of International Settlements (BIS) and Group of Twenty nations (G-20) – to coordinate action on the global scale. International institutions can be the policymaker's pacifier. In an anarchic world, these structures reduce uncertainty for all participating actors. When they function well, they facilitate communication and foster shared understandings between policy principals.¹⁰ When they function poorly, a lack of trust and a surfeit of uncertainty stymies responsible authorities from cooperating.

⁹ Stijn Claessens, M. Ayhan Kose and Marco Terrones, "Financial Cycles: What? How? When?" IMF Working Paper WP/11/76, April 2011, p. 18

¹⁰ Alexander Wendt, *Social Theory of International Politics* (Cambridge: Cambridge University Press, 1999); A. Iain Johnston, "Treating International Institutions as Social Environments," *International Studies Quarterly* 45 (December 2001): 487-515.

Even prior to the 2008 financial crisis, there was growing worry about the ability of these institutions to handle severe challenges. Public confidence in multilateral institutions was trending downward before the subprime mortgage bubble popped.¹¹ Policy elites were also sounding warning alarms.¹² There appeared to be a growing mismatch between the global distribution of power and the institutional prerogatives within global governance structures. If those mismatches were allowed to fester, many feared a breakdown of the open economic order in favor of a more balkanized, mercantilist set of arrangements.

Some modest steps were taken to address these issues prior to the crisis, but pre-2008 global economic governance seemed to confirm the worst expectations of dysfunction. Despite rising macroeconomic imbalances, China vetoed any serious discussion of exchange rate issues at the IMF. Fund discussions of financial mismanagement in the eurozone area were suppressed prior to the crisis.¹³ The IMF was so dormant that in the spring of 2008 its leadership opted to sell off some gold reserves to shrink its operating deficit.¹⁴ The Basel Committee on Banking Supervision's core banking standards not only failed to prevent banking crises across Europe – in some ways the standards likely accelerated the banking crises. The Doha round of world trade talks was stalemated, and U.S. trade promotion authority expired. G-8 efforts to reach out and include the BRIC economies in their summitry bordered on the insulting. The “Outreach-5” process that started at the 2007 Heiligendamm G-8 summit amounted to the creation of a children's table at those summits, and was mercifully ended soon afterwards.

The Great Recession provided a severe “stress test” for global economic governance – and there has been no shortage of scorn for the state of global economic governance. Richard Samans, Klaus Schwab and Mark Malloch-Brown concluded, “nearly every major initiative to solve the new century's most pressing problems has ground to a standstill amid political gridlock, summit pageantry, and perfunctory news conferences.”¹⁵ The World Economic Forum concluded, “As the financial crisis unfolded in 2008 and 2009, the world lacked an appropriate and effective crisis response mechanism.”¹⁶ Ian Bremmer and Nouriel Roubini blasted the G-20 as toothless,

¹¹ <http://www.worldpublicopinion.org/pipa/articles/btunitednationsra/163.php>

¹² National Intelligence Council, *Global Trends 2025: A Transformed World* (Washington: Government Printing Office, 2008); Rawi Abdelal and Adam Segal, “Has Globalization Passed Its Peak?” *Foreign Affairs* 86 (January/February 2007): 103-114; Daniel W. Drezner, “The New New World Order,” *Foreign Affairs* 86 (March/April 2007): 34-46; Fareed Zakaria, *The Post-American World* (New York: W.W. Norton, 2008); Alan Alexandroff, ed., *Can the World Be Governed? Possibilities for Effective Multilateralism*, (Waterloo, ON: Wilfred Laurier University Press/CIGI, 2008).

¹³ On China, see Alan Beattie and Christian Oliver, “Accord on IMF board masks lack of progress,” *Financial Times*, October 25, 2010. On Europe, see Peter Doyle's June 2012 resignation letter to the IMF Executive Board, accessed at <http://cnnbusiness.files.wordpress.com/2012/07/doyle.pdf>.

¹⁴ Harry Dunphy, “IMF Approves Eventual Gold Sale,” Associated Press, July 7, 2008.

¹⁵ Richard Samans, Klaus Schwab and Mark Malloch-Brown, “Running the World, After the Crash,” *Foreign Policy* 184 (January/February 2011): 80-83. See also Lee Howell, “The Failure of Governance in a Hyperconnected World,” *New York Times*, January 10, 2012.

¹⁶ World Economic Forum, “Global Agenda Council on Geopolitical Risk,” Davos-Klosters, Switzerland, January 29, 2012.

proclaiming instead that we live in a “G-Zero” world: “the divergence of economic interests in the wake of the financial crisis has undermined global economic cooperation, throwing a monkey wrench into the gears of globalization.” Bremmer is particularly emphatic on this point. In January 2012, he concluded in the *Financial Times* that, “the effectiveness of many global institutions is under severe strain, as they remain largely unchanged from their postwar forms.”¹⁷ Indeed, trashing global economic governance seems to be a prerequisite for writing in the *Financial Times*. Alan Beattie epitomizes the collective disdain in his e-book *Who’s In Charge Here?* He concludes, “The collective response of the world’s big economies since 2007 has been slow, disorganized, usually politically weak and frequently ideologically wrong-headed.”¹⁸

The current skepticism about global economic governance extends beyond pundits to include many international relations scholars. Many international relations theorists subscribe to the venerable theory of hegemonic stability: an economic superpower is a necessary and sufficient condition for the effective functioning of global governance and the adequate provision of global public goods. When a hegemon declines, the theory goes, so does the functioning of global governance. If this theory is correct, then today’s relative American decline is a bad omen. This shift in the global distribution of power evokes the disaster of the interwar period of 1919-1939. As Charles Kindleberger famously explained in *The World in Depression*: “In 1929 the British couldn’t and the United States wouldn’t [stabilize the world economic system]. When every country turned to protect its national private interest, the world public interest went down the drain, and with it the private interests of all.”¹⁹

To many economists, historians and international relations theorists, the current era echoes that one all too ominously.²⁰ Now it is the developed world that is willing but unable and the developing world that is able but unwilling. In the preface to a new edition of Kindleberger’s *The World in Depression*, J. Bradford DeLong and Barry Eichengreen note: “The parallels between Europe in the 1930s and Europe today are stark, striking, and increasingly frightening.” In *No One’s World*, Charles Kupchan warns that, “emerging powers will want to revise, not consolidate, the international order erected during the West’s watch.”²¹ Not surprisingly, the latest Geneva Report on the World Economy concludes that with the exception of monetary

¹⁷ Ian Bremmer and Nouriel Roubini, “A G-Zero World,” *Foreign Affairs* 90 (March/April 2011), p. 4; Bremmer, “Decline of global institutions means we must embrace regionalism,” <http://blogs.ft.com/the-a-list/2012/01/27/decline-of-global-institutions-means-we-best-embrace-regionalism/>, January 27, 2012. See, more generally Ian Bremmer, *Every Nation for Itself* (New York: Portfolio/Penguin, 2012).

¹⁸ Alan Beattie, *Who’s in Charge Here?* (New York: Penguin, 2012), p. 18. For other pessimistic *Financial Times* books, see Gideon Rachman, *Zero-Sum Future* (New York: Simon & Schuster, 2011) and Edward Luce, *Time To Start Thinking* (New York: Atlantic Monthly Press, 2012).

¹⁹ Charles Kindleberger, *The World In Depression, 1929-1939* (Berkeley: University of California Press, 1971), p. 292.

²⁰ See, for example, Michael Mastanduno, “System Maker and Privilege Taker: U.S. Power and the International Political Economy,” *World Politics* 61 (January 2009): 121-154; Stephen Cohen and J. Bradford DeLong, *The End of Influence: What Happens When Other Countries Have the Money* (New York: Basic Books, 2009); Chinn and Frieden, *Lost Decades*.

²¹ Charles Kupchan, *No One’s World* (New York: Oxford University Press, 2012), p. 7.

policy, “on virtually every other important global economic issue, international cooperation is stalled, flawed, or non-existent.”²²

How does global economic governance work?

Debates about whether global governance “works” or not usually do not suffer from an abundance of facts. More typically, critics of the current system tend to rely upon a few stylized facts that are meant to suggest general dysfunction. In recent years, the three events most commonly cited include:²³

- *The collapse of the Doha round.* Just before the financial crisis hit its acute phase, last-gasp efforts to Doha round of WTO negotiations stalled out. Subsequent G20 pledges to abstain from protectionism and complete the Doha round of world trade talks have been as common as they have been toothless. Within the first six months of the financial crisis seventeen of the twenty countries had violated that pledge, implementing a combined forty-seven measures to restrict trade at the expense of other countries.²⁴ The current status of the Doha round is so moribund that the Bush administration’s last U.S. trade representative advocated abandoning the effort.²⁵
- *The breakdown of macroeconomic policy consensus at the June 2010 Toronto G20 summit.* Prior to the Toronto summit, there was a rough consensus among the G-20 in favor of government stimulus to keep the global economy afloat. The United States went into that summit to argue for more expansionary monetary and fiscal policy, but came out of it with no consensus. Other countries embraced austerity policies instead. In the subsequent eighteen months, numerous G20 members accused each other of starting a currency war.
- *The escalation of Europe’s sovereign debt crisis.* As an increasing number of eurozone economies have found their fiscal fortunes collapsing, European institutions have appeared powerless to stop the spreading financial contagion. If the European Union, the single most powerful regional institution in existence, cannot cope with this crisis, why should we expect global governance structures to do better with bigger problems?

²² Jeffrey Frieden, Michael Pettis, Dani Rodrik and Ernesto Zedillo, *After the Fall: The Future of Global Cooperation* (Geneva: International Center for Monetary and Banking Studies, 2012), p. 2.

²³ By no means are these the only facts that are mentioned when talking about the perceived failure of global economic governance. Another example would include the PBoC chairman’s March 2009 call for a “super-sovereign currency” to replace the dollar, the failure of the Copenhagen climate change summit in December 2009, or the continuation of the norm whereby a European heads the IMF and an American helms the World Bank. Very often, haplessness at the United Nations is also cited as evidence of the failure of global governance more generally.

²⁴ Elisa Gamberoni and Richard Newfarmer, “Trade Protection: Incipient but Worrisome Trends,” World Bank Trade Note #37, March 2, 2009.

²⁵ Susan Schwab, “After Doha,” *Foreign Affairs* 90 (May/June 2011): 104-117.

These facts are true, but are not the whole truth. To ascertain the effectiveness of global economic governance after the 2008 financial crisis, we will look at three different levels of analysis. First, what do the *policy outcomes* look like? How have global output, trade and other capital flows responded since the start of the Great Recession? Second, what do the *policy outputs* look like? Have key international institutions provided policies that experts would consider significant and useful in response to the global financial crisis? Finally, have these governance structures demonstrated *institutional resiliency and flexibility*? A common complaint prior to 2008 was that these institutions had not adapted to the shifting distribution of power. Have these structures maintained their relevance and authority? Have they ensure that rising actors continue to “buy into” existing arrangements?

Policy outcomes

In looking at *outcomes*, the obvious question is how well the global economy has recovered from the 2008 crisis. The current literature on economic downturns suggests two factors that impose significant barriers to a strong recovery from the Great Recession: it was triggered by a financial crisis and it was global in scope. Whether measuring output, per capita income, or employment, financial crashes trigger downturns that last longer and have far weaker recoveries than standard business cycle downturns.²⁶ Furthermore, the global nature of the crisis makes it extremely difficult for countries to “export their way” out of the problem. Countries that have experienced severe banking crises since World War II have usually done so when the global economy was largely unaffected. That was not the case for the Great Recession.

The global economy has rebounded much better than during the Great Depression. Economists Barry Eichengreen and Kevin O’Rourke have compiled data to compare global economic performance from the start of the crises (see Figures 1 and 2).²⁷ Two facts stand out in their comparisons. First, the percentage drop in global industrial output and world trade levels at the start of the 2008 financial crisis was more precipitous than the falloffs following the October 1929 stock market crash. The drop in industrial output was greater in 2008 nine months into the crisis than it was eighty years earlier after the same amount of time. The drop in trade flows was more than twice as large. Second, the post-2008 rebound has been far more robust. Four years after the onset of the Great Recession, global industrial output is 10 percent higher than when the recession began. In contrast, four years after the 1929 stock market crash, industrial output was at only two-thirds of precrisis levels.

²⁶ Reinhart and Rogoff, *This Time Is Different*, chapter 14; Claessens, Kose and Terrones, “Financial Cycles: What? How? When?”; Carmen Reinhart and Vincent Reinhart, “After the Fall,” NBER Working Paper No. 16334, September 2010; Barry Eichengreen, “Crisis and Growth in the Advanced Economies: What We Know, What We Don’t Know, and What We Can Learn from the 1930s,” *Comparative Economic Studies* 53 (March 2011): 383-406.

²⁷ Eichengreen O’Rourke, “A Tale of Two Depressions,”; Eichengreen and O’Rourke, “A Tale of Two Depressions Redux,” VoxEU.org, March 6, 2012. Accessed at <http://www.voxeu.org/article/tale-two-depressions-redux>, August 2012.

A similar story can be told with aggregate economic growth. According to World Bank figures, global economic output rebounded in 2009 with 2.3 percent growth, followed up in 2010 with 4.2 percent growth. The global growth rate in 2010 was 44% higher than the average of the previous decade. More intriguingly, the growth continued to be poverty-reducing.²⁸ The World Bank's latest figures suggest that despite the 2008 financial crisis, extreme poverty continued to decline across all the major regions of the globe. The developing world has already achieved its first Millennium Development goal of halving the 1990 levels of extreme poverty.²⁹

An important reason for the quick return to positive economic growth is that cross-border flows did not dry up after the 2008 crisis. Again, compared to the Great Depression, trade flows have rebounded extremely well. As Eichengreen and O'Rourke observe, four years after the 1929 stock market crash, trade flows were off by 25 percent compared to pre-crisis levels. Current trade flows, in contrast, are more than five percent higher than in 2008. Even compared to other postwar recessions, the current period has been seen robust cross-border exchange. Indeed, as the CFR's Maurice Greenberg Center for Goeconomic Studies concluded in May, "The growth in world trade since the start of the [current] recovery exceeds even the best of the prior postwar experiences."³⁰

Other cross-border flows have also rebounded from 2008/2009 lows. According to a joint OECD/UNCTAD report to the G-20, global foreign direct investment (FDI) has returned to robust levels. FDI inflows rose by 17% in 2011 alone. This put annual FDI levels at \$1.5 trillion, surpassing the three-year pre-crisis average, though still approximately 25 percent below the 2007 peak. More generally, the McKinsey Global Institute estimates that global foreign investment assets reached \$96 trillion, a five percent increase from pre-crisis highs. Remittances from migrant workers have become an increasingly important revenue stream to the developing world – and the 2008 financial crisis did not dampen that income stream. The World Bank estimates that cross-border remittances to developing countries quickly rebounded to precrisis levels and then rose to an estimated all-time high of \$372 billion in 2011, with growth rates in 2011 that exceeded those in 2010. Total cross-border remittances were more than \$501 billion last year, and are estimated to reach \$615 billion by 2014.³¹

²⁸ *World Bank Development Indicators 2012*.

²⁹ *Ibid.* See also Shaochua Chen and Martin Ravallion, "An update to the World Bank's Estimate of consumption poverty in the developing world," March 1, 2012; Annie Lowrey, "Dire Poverty Falls Despite Global Slump, Report Finds," *New York Times*, March 6, 2012.

³⁰ <http://www.cfr.org/geoeconomics/quarterly-update-economic-recovery-historical-context/p25774>, accessed July 2012.

³¹ For FDI data, see OECD/UNCTAD Report, "7th G20 report on investment measures," accessed at http://www.wto.org/english/news_e/news12_e/igo_31may12_e.htm, July 2012. For foreign investment assets, see Roxburgh, Lund and Piotrowski, *Mapping Global Capital Markets 2011*, p. 31. For remittance flows, see World Bank, *Migration and Development Brief 18*, April 23, 2012.

Another salient outcome is mass public attitudes about the global economy. A general assumption in public opinion research is that during a downturn, demand for greater economic closure should spike, as individuals scapegoat foreigners for domestic woes. The global nature of the 2008 crisis, combined with anxiety about the shifting distribution of power, should have triggered a fall in support for an open global economy. Somewhat surprisingly, however, the reverse is true. Pew's Global Attitudes Project has surveyed a wide spectrum of countries since 2002, asking people about their opinions on both international trade and the free market more generally.³² The results show resilient support for expanding trade and business ties with other countries. 24 countries were surveyed in both 2007 and in at least one year after 2008, including a majority of the G-20 economies. Overall, 18 of those 24 countries showed equal or greater support for trade in 2009 than two years earlier. By 2011, 20 of 24 countries showed greater or equal support for trade compared to 2007. Indeed, between 2007 and 2012, the unweighted average support for more trade in these countries increased from 78.5% to 83.6%. Contrary to expectation, there has been no mass public rejection of the open global economy. Indeed, public support for the open trading system has strengthened, despite softening public support for free-market economics more generally.³³

The final outcome addresses a dog that hasn't barked: the effect of the Great Recession on cross-border conflict and violence. During the initial stages of the crisis, multiple analysts asserted that the financial crisis would lead states to increase their use of force as a tool for staying in power.³⁴ Whether through greater internal repression, diversionary wars, arms races, or a ratcheting up of great power conflict, there were genuine concerns that the global economic downturn would lead to an increase in conflict. Violence in the Middle East, border disputes in the South China Sea, and even the disruptions of the Occupy movement fuel impressions of surge in global public disorder.

The aggregate data suggests otherwise, however. The Institute for Economics and Peace has constructed a "Global Peace Index" annually since 2007. A key conclusion they draw from the 2012 report is that "The average level of peacefulness in 2012 is approximately the same as it was in 2007."³⁵ Interstate violence in particular has declined since the start of the financial crisis – as have military expenditures in most sampled countries. Other studies confirm that the Great Recession has not triggered any increase in violent conflict; the secular decline in violence that

³² Data accessed from <http://www.pewglobal.org/database/?indicator=16&survey=13&response=Good%20thing&mode=table>, July 2012.

³³ On the latter, see <http://www.pewglobal.org/database/?indicator=18&survey=12&response=Agree&mode=table>, accessed July 2012.

³⁴ See, for example, Paul Rogers, "The Tipping Point?" Oxford Research Group, November 2008; Joshua Kurlantzick, "The World is Bumpy," *The New Republic*, July 15, 2009; Rogers Brubaker, "Economic Crisis, Nationalism, and Politicized Ethnicity," in *The Deepening Crisis: Governance Challenges After Neoliberalism*, Craig Calhoun and Georgi Derlugian, eds. (New York: New York University Press, 2011), p. 93.

³⁵ Institute for Economics and Peace, *Global Peace Index 2012*, June 2012, p. 37. Accessed at <http://www.visionofhumanity.org/wp-content/uploads/2012/06/2012-Global-Peace-Index-Report.pdf>.

started with the end of the Cold War has not been reversed.³⁶ Rogers Brubaker concludes, “the crisis has not to date generated the surge in protectionist nationalism or ethnic exclusion that might have been expected.”³⁷

None of these data suggest that the global economy is operating swimmingly. Growth remains unbalanced and fragile, and has clearly slowed in 2012. Transnational capital flows remain depressed compared to pre-crisis levels – primarily due to a drying up of cross-border interbank lending in Europe. Currency volatility remains an ongoing concern. Compared to the aftermath of other postwar recessions, growth in output, investment, and employment in the developed world have all lagged behind. But the Great Recession is not like other postwar recessions in either scope or kind; expecting a standard “V”-shaped recovery was unreasonable. One financial analyst characterizes the current global economy as in a state of “contained depression.”³⁸ The key word is “contained,” however. Given the severity, reach and depth of the 2008 financial crisis, the proper comparison is with Great Depression. And by that standard, the outcome variables look impressive. As Carmen Reinhart and Kenneth Rogoff conclude in *This Time is Different*: “that its macroeconomic outcome has been only the most severe global recession since World War II – and not even worse – must be regarded as fortunate.”³⁹

Policy outputs

It could be that the global economy has experienced a moderate bounceback in spite rather than because of the global policy response. Economists like Paul Krugman and Joseph Stiglitz have been particularly scornful of policymakers and central bankers.⁴⁰ In assessing *policy outputs*, Charles Kindleberger provided the classic definition of what should be done to stabilize the global economy during a severe financial crisis: “(a) maintaining a relatively open market for distress goods; (b) providing countercyclical long-term lending; and (c) discounting in crisis.”⁴¹ Serious concerns were voiced in late 2008 and early 2009 about the inability of anyone to provide these kinds of public goods, threatening a repeat of the trade protectionism and beggar-thy-neighbor policies of the 1930s.⁴²

By Kindleberger’s criteria, however, public goods provision has been quite robust since 2008. On the surface, the open market for distressed goods seemed under threat. The death of the

³⁶ See, for example, the Human Security Report Project, *Human Security Report 2009/2010: The Causes of Peace and the Shrinking Costs of War* (New York: Oxford University Press, 2010); Lotta Themnér and Peter Wallensteen, “Armed Conflicts, 1946-2011.” *Journal of Peace Research* 49 (July 2012): 565-575. .

³⁷ Brubaker, “Economic Crisis, Nationalism, and Politicized Ethnicity,” p. 94.

³⁸ David Levy, “The Contained Depression,” Jerome Levy Forecasting Center, April 2012.

³⁹ Reinhart and Rogoff, *This Time Is Different*, p. 273.

⁴⁰ Paul Krugman, *End This Depression Now!* (New York: W.W. Norton, 2012); Joseph Stiglitz, *The Price of Inequality* (New York: W.W. Norton, 2012).

⁴¹ Kindleberger, *The World In Depression*, p. 292.

⁴² *Economist*, “The Return of Economic Nationalism,” February 5, 2009; Kurlantzick, “The World is Bumpy”; Michael Sesit, “Smoot-Hawley’s Ghost Appears as Economy Tanks,” *Bloomberg News*, February 19, 2009; Rawi Abdelal and Adam Segal, “Yes, Globalization has Passed Its Peak,” *ForeignAffairs.com*, March 17, 2009.

Doha round, the rise of G-20 protectionism after the fall 2008 summit, and the explosion of anti-dumping cases that occurred at the onset of the financial crisis suggested that markets were drifting towards closure. According to the WTO's data, anti-dumping initiations surged by 30% in 2008 alone. This surge quickly receded, however. Figure 3 shows that by 2011, anti-dumping initiations had declined dramatically to pre-crisis levels. Indeed, these cases have fallen to their lowest levels since the WTO's founding in 1995. Both countervailing duty complaints and safeguards initiations have also fallen to pre-crisis levels.

Some post-2008 measures aren't captured in these traditional metrics of non-tariff barrier, but similar results hold. Most of those implemented measures were concentrated in countries that already possessed higher barriers to global economic integration, such as Russia and Argentina. Even including these additional measures, the combined effect of protectionist actions for the first year after the peak of the financial crisis affected less than 0.8% of global trade.⁴³ Furthermore, the use of these protectionist measures declined further in 2010 to cover only 0.2% of global trade. Protectionist actions rose again in 2012, but again, the effect of these measures remains modest, affecting less than 5% of global trade flows. The quick turnaround and growth in trade levels show that these measures have not seriously impeded market access.⁴⁴ In part, accelerated steps towards trade liberalization at the bilateral and regional level have blunted the effect of these protectionist actions (see next section).

Proponents of trade liberalization embrace the "bicycle theory" – the belief that unless multilateral trade liberalization moves forward, the entire global trade regime will collapse because of a lack of forward momentum. The last four years suggest that there are limits to that rule of thumb. The *Financial Times*/EIU surveys of global business leaders reveal that concerns about protectionism have stayed at a low level.⁴⁵ Reviewing the state of world trade, Uri Dadush and his colleagues conclude, "The limited resort to protectionism was a remarkable aspect of the Great Recession."⁴⁶ Former U.S. Trade Representative Susan Schwab concurs, noting, "Although countries took protectionist measures in the wake of the crisis, the international

⁴³ Uri Dadush, Shimelse Ali, and Rachel Esplin Odell, "Is Protectionism Dying?" Carnegie Papers in International Economics, May 2011. Furthermore, while these measures are undeniably restrictive in nature, a case can be made that they represent a form of "efficient protectionism": small and symbolic measures that mollify protectionist constituencies in exchange for preserving and strengthening the overall level of economic openness. See C. Fred Bergsten, "A Renaissance for U.S. Trade Policy?" *Foreign Affairs* (November/December 2002): 86-98.

⁴⁴ Uri Dadush, Shimelse Ali, and Rachel Esplin Odell, "Is Protectionism Dying?" Carnegie Papers in International Economics, May 2011; Matthieu Bussière, Emilia Pérez-Barreiro, Roland Straub, and Daria Taglioni, "Protectionist Responses to the Crisis: Global Trends and Implications," *The World Economy* 34 (May 2011): 826-852.

⁴⁵ Between May 2011 and August 2012, a maximum of 13 percent of business executives cited trade protectionism as a serious concern.

⁴⁶ Uri Dadush, Shimelse Ali, and Rachel Esplin Odell, "Is Protectionism Dying?" Carnegie Papers in International Economics, May 2011, p. 3. See also Chad Bown, "Antidumping, safeguards, and protectionism during the crisis: Two new insights from 4th quarter 2009," February 18, 2010, at <http://www.voxeu.org/index.php?q=node/4635>.

community avoided a quick deterioration into a spiral of beggar-thy-neighbor actions to block imports.”⁴⁷ At a minimum, the bicycle of world trade is still coasting forward at high speed.

From the earliest stages of the financial crisis, there was also concerted and coordinated action among central banks to ensure both discounting and countercyclical lending. The central banks of the major economies began cutting interest rates slowly after the fall of 2007. By the fall of 2008 they were cutting rates ruthlessly and in a coordinated fashion, as Figure 4 indicates. According to BIS estimates, global real interest rates fell from an average of three percent prior to the crisis to zero in 2012 – in the advanced industrialized economies, the real interest rate was effectively negative.⁴⁸ At present, the highest interest rate among the major advanced economies is 0.75%, offered by the European Central Bank. Not content with lowering interest rates, most of the major central banks also expanded other credit facilities and engaged in more creative forms of quantitative easing. Between 2007 and 2012, the balance sheets of the central banks in the advanced industrialized economies more than doubled. The Bank for International Settlements acknowledged in its 2012 annual report that “decisive action by central banks during the global financial crisis was probably crucial in preventing a repeat of the experiences of the Great Depression.”⁴⁹

Central banks and finance ministries also took coordinated action during the fall of 2008 to try to ensure cross-border lending as to avert currency and solvency crises. In October of that year, the G-7 economies plus Switzerland agreed to unlimited currency swaps in order to ensure liquidity would be maintained in the system. The United States then extended its currency-swap facility to Brazil, Singapore, Mexico and South Korea. The European Central Bank expanded its swap arrangements for euros with Hungary, Denmark and Poland. China, Japan, South Korea and the ASEAN economies broadened the Chang Mai Initiative into an \$80 billion swap arrangement to ensure liquidity. The International Monetary Fund created a Short-Term Liquidity Facility designed to “establish quick-disbursing financing for countries with strong economic policies that are facing temporary liquidity problems.”⁵⁰ The Fund also negotiated emergency financing for Hungary, Pakistan, Iceland, and Ukraine.

Over the longer term, the great powers bulked up the resources of the international financial institutions to provide for further countercyclical lending. In 2009 the G-20 agreed to triple the IMF’s reserves to \$750 billion. In 2012, in response to the worsening European sovereign debt crisis, G-20 countries combined to pledge more than \$430 billion in additional resources. The World Bank’s International Development Association (IDA), which offers up the most

⁴⁷ Schwab, “After Doha,” p. 112.

⁴⁸ Bank of International Settlements, *82nd Annual Report*, June 24, 2012, <http://www.bis.org/publ/arpdf/ar2012e.pdf>, p. 39

⁴⁹ *Ibid.*, p. 41.

⁵⁰ “IMF Creates Short-Term Liquidity Facility for Market-Access Countries,” IMF Press Release No. 08/262, October 29, 2008.

concessionary form of lending, also increased its resources. The 16th IDA replenishment was a record \$49.3 billion, an 18% increase of IDA resources from three years earlier. By Kindleberger's criteria, global economic governance worked reasonably well in response to the 2008 financial crisis.

To be sure, there exist global public goods that go beyond Kindleberger's criteria. Macroeconomic policy coordination would be an additional area of possible cooperation, as would coordinating and clarifying cross-border financial regulations. Again, however, the international system acted in these areas after 2008. Between late 2007 and the June 2010 G-20 Toronto summit, the major economies agreed on the need for aggressive and expansionary fiscal and monetary policies in the wake of the financial crisis. Even reluctant contributors like Germany – whose finance minister blasted the “crass Keynesianism” of these policies in December 2008 – eventually bowed to pressure from economists and G-20 peers. Indeed, in 2009, Germany enacted the third largest fiscal stimulus in the world.⁵¹

Progress has also been made on regulatory coordination in finance and investment rules. There were developments in two areas in particular: banking regulation and investor protectionism. In the former area, international regulators have significantly revised the Basel core banking principles. At the November 2010 Seoul summit, the G-20 approved the Basel III banking standards. Basel III took only two years to negotiate – an extraordinarily brief period given that the Basel II standards took more than six years to hammer out. The new rules, scheduled to be phased in over the rest of this decade, increase the amount of reserve capital banks need to keep on hand, and add additional countercyclical capital buffers to prevent financial institutions from engaging in pro-cyclical lending.

Financial sector scholars have debated whether Basel III is a sufficient upgrade in regulatory stringency, and whether it will be implemented too slowly or not at all. There is consensus, however, on two points. First, Basel III clearly represents an upgrade over the Basel II standards in preventing bank failures.⁵² Second, the dampening effects of the new standards on economic growth are negligible. Furthermore, these standards were approved despite fierce resistance from the global banking industry. In November 2011 the Financial Stability Board designated globally systemic important banks that will be required to keep additional capital on hand, and plans to identify global systemically important non-financial institutions by the end of 2012.⁵³

⁵¹ Eswar Prasad and Isaac Sorkin, “Assessing the G-20 Stimulus Plans: A Deeper Look,” Brookings Institution, March 2009.

⁵² Adrian Blundell-Wignall and Paul Atkinson, “Thinking Beyond Basel III: Necessary Solutions for Capital and Liquidity,” *OECD Journal: Financial Market Trends* 1 (2010); Chinn and Frieden, *Lost Decades*, p. 214; Nicolas Véron, “Financial Reform after the Crisis: An Early Assessment.” Peterson Institute for International Economics Working Paper 12-2, January 2012.

⁵³ It should be noted that some scholars have questioned whether the FSB has the capability and flexibility to impose more rigorous standards on the global financial system. See Stephany Griffith-Jones, Eric Helleiner, and Ngaire

Progress was also made in investor protectionism against state-owned enterprises and funds. The rise of sovereign wealth funds prior to 2008 had precipitated a ratcheting up of restrictions to cross-border investment by state-owned enterprises and funds. The OECD articulated its own guidelines for recipient countries, but warned that unless these funds demonstrated greater transparency, barriers to investment would likely rise even further. In September 2008 an IMF-brokered process approved a set of “Generally Accepted Principles and Practices” for sovereign wealth funds. These voluntary guidelines – also called the Santiago Principles -- consisted of 24 guidelines addressing the legal and institutional frameworks, governance issues, and risk management of these funds. Contemporaneous press reports characterized the new rules as “a rare triumph for IMF financial diplomacy.”⁵⁴ The expert consensus among financial analysts, regulators and academics was that these principles – if fully implemented – address most recipient country concerns.⁵⁵ Since the IMF approved the Santiago Principles, furthermore, investor protectionism has declined.⁵⁶

Institutional resilience and flexibility

The degree of institutional resiliency and flexibility at the global level has been rather remarkable. Once the acute phase of the 2008 financial crisis began, the G-20 quickly supplanted the G-7/G-8 as the focal point for global economic governance. At the September 2009 G-20 summit in Pittsburgh, the member countries explicitly avowed that they had “designated the G-20 to be the premier forum for our international economic cooperation.”⁵⁷ This move addressed the worsening problem of the G-8’s waning power and relevancy – a problem of which G-8 members were painfully aware.⁵⁸ The G-20 grouping comprises 85 percent of global economic output, 80 percent of global trade, and 66 percent of global population. The G-20 is not perfectly inclusive, and it has a somewhat idiosyncratic membership at the margins, but is far more legitimate and representative body than the G-8.⁵⁹ As Geoffrey Garrett puts it, “the G20 is globally representative yet small enough to make consensual

Woods, eds., *The Financial Stability Board: An Effective Fourth Pillar of Global Economic Governance?* (Waterloo: Centre for International Governance Innovation, June 2010).

⁵⁴ Bob Davis, “Foreign Funds Agree to Set of Guiding Principles,” *Wall Street Journal*, September 3, 2008.

⁵⁵ Deloitte Touche Tohmatsu. 2008. *Minding the GAPP: Sovereign wealth, transparency, and the “Santiago Principles.”* October 2008; Edward Truman, “Making the World Safe for Sovereign Wealth Funds,” October 14, 2008, accessed at <http://www.piie.com/blogs/realtime/?p=105>; Cohen and DeLong, *The End of Influence*, p. 89.

⁵⁶ OECD/UNCTAD, “7th G20 report on investment measures,”

⁵⁷ Accessed at <http://www.pittsburghsummit.gov/mediacenter/129639.htm>.

⁵⁸ Mark Sobel and Louellen Stedman, “The Evolution of the G-7 and Economic Policy Coordination,” U.S. Treasury Department Occasional Paper No. 3, July 2006; Drezner, “The New New World Order.”

⁵⁹ The G-20 also has no treaty status or permanent secretariat, but there are theoretical arguments in favor of this informal status. See, for example, Charles Lipson, “Why are some international agreements informal?” *International Organization* 45 (September 1991): 495-538.

decision-making feasible.”⁶⁰ As a club of great powers, consensus within the G-20 should lead to effective policy coordination across a wide range of issues.⁶¹

To be sure, having the capacity to be an effective body and actually *being* effective are two different things. The perception is that G-20’s political momentum stalled out years ago after countries disagreed on macroeconomic imbalances and the virtues of austerity. The reality is a bit more complex. According to the University of Toronto’s G-20 Information Centre, compliance with G-20 commitments actually increased over time. They measured G-20 adherence to “chosen priority commitments.” Measured on a per country average, G-20 members have steadily improved since the 61.5 percent compliance rate for the April 2009 London Summit commitments, rising all the way to 77 percent for the November 2011 Cannes Summit.⁶²

An obvious rejoinder is that this kind of assessment inflates compliance because the pledges made at these summits are increasingly modest.⁶³ It could be that the G-20 has simply scaled back its ambitions – even in its “priority commitments” – making compliance easier. There are examples, however, of great powers using the G-20 as a means of blunting domestic pressures for greater protectionism – at precisely the moment when the group was thought to be losing its momentum. For example, the G-20 has served as a useful mechanism to defuse tensions concerning China’s undervalued currency. In response to congressional pressure for more robust action, in April 2010 Treasury Secretary Timothy Geithner cited the G-20 meetings as “the best avenue for advancing U.S. interests” on China’s manipulation of its exchange rate.⁶⁴ In June of that year, President Obama sent a letter to his G-20 colleagues stressing the importance of “market-determined exchange rates.” Three days after Obama’s letter was sent, the People’s Bank of China announced that it would “enhance the RMB exchange rate flexibility.” For the next two years, the renminbi nominally appreciated at a rate of five percent a year – more so if one factors in the differences in national inflation rates.⁶⁵

Other key financial bodies also strengthened their membership and authority as a response to the 2008 crisis. In March 2009, the Basel Committee on Banking Supervision expanded its membership from 13 advanced industrialized states to 27 countries by adding the developing country members of the G-20. The Financial Stability Forum was renamed the Financial Stability Board in April 2009, given greater responsibilities for regulatory coordination, and also

⁶⁰ Geoffrey Garrett, “G2 in G20: China, the United States, and the World after the Global Financial Crisis,” *Global Policy* 1 (January 2010), p. 29.

⁶¹ Daniel W. Drezner, *All Politics is Global: Explaining International Regulatory Regimes* (Princeton: Princeton University Press, 2007).

⁶² G20 Information Centre, *2011 Cannes G20 Summit Final Compliance Report*, p. 12.

⁶³ George Downs, David Locke and Peter Barsoom, “Is the Good News About Compliance Good News About Cooperation?” *International Organization* 50 (June 1996): 379-406.

⁶⁴ Statement of Treasury Secretary Geithner on the Report to Congress on International Economic and Exchange Rate Policies, April 3, 2010. Accessed at <http://www.ustreas.gov/press/releases/tg627.htm/>.

⁶⁵ David Leonhardt, “As U.S. Currency Rises, U.S. Keeps Up the Pressure,” *New York Times*, February 15, 2012. It should be noted, however, that the yuan has depreciated against the dollar for much of 2012.

expanded its membership to include the developing country members of the G-20. During this period the Committee of the Global Financial System also grew in size from 13 countries to 22 members, adding Brazil, China and India among others. The Financial Action Task Force on Money Laundering added China, India and South Korea to its grouping over the past five years. Prior to 2008, the G-7 countries dominated most of these financial standard-setting agencies.⁶⁶ In terms of membership, that is no longer the case.

The International Monetary Fund and World Bank have also changed after the financial crisis, though on the surface that might not appear to be the case. The implicit compact in which a European is given the IMF managing director slot and an American the World Bank presidency has continued over the past two years. Despite the scandals that engulfed Dominique Strauss-Kahn in 2011 and Paul Wolfowitz five years earlier, former French finance minister Christine Lagarde replaced Strauss-Kahn in 2011 and American Jim Yong Kim became the new World Bank president in 2012.

Beneath the surface, however, the Bank and the Fund have witnessed significant evolution. Power within the IMF is based on quota size, calculated using a complex formula of economic variables. Prior to 2007, the allotment of quotas in the IMF bore little resemblance to the distribution of economic power. This has changed. The most significant step has been two rounds of quota reform in the IMF, the first enacted in 2008 and the second to be completed by the end of this year. The explicit goal of the quota reform was to expand the voting power of advanced developing economies to better reflect the distribution of economic power. Once completed, China will possess the third largest voting share in the Fund, and all four of the BRIC economies will be among the ten largest shareholders in the IMF.⁶⁷ The World Bank Group underwent a parallel set of reforms. Between 2008 and 2010, the voting power of developing and transition economies within the main World Bank institution (the International Bank for Reconstruction and Development) had been increased by 4.59 percentage points, and China became the third largest voting member. The International Finance Corporation (IFC) approved an even larger shift of 6.09 percentage points. More importantly, the Bank's Development Committee agreed that Bank and IFC shareholding would be reviewed every five years beginning in 2015, routinizing the process.⁶⁸

While the appointments of Lagarde and Kim might seem retrograde, they came with political bargaining that reflected the greater influence of the advanced developing countries. In both cases, the nominee had to woo developing countries to secure political support in advance of voting. The appointment of Chinese national Min Zhu to be a Deputy Managing Director of the

⁶⁶ Drezner, *All Politics Is Global*, chapter five.

⁶⁷ See <http://www.imf.org/external/np/exr/facts/quotas.htm> on IMF quota reform.

⁶⁸ [http://siteresources.worldbank.org/DEVCOMMINT/Documentation/22723851/DC2010-0014\(E\)Reform.pdf](http://siteresources.worldbank.org/DEVCOMMINT/Documentation/22723851/DC2010-0014(E)Reform.pdf).

IMF at the same time that Lagarde took over shows a shift in the distribution of senior-level appointments towards the advanced developing economies.

The content of Bank and Fund policies have also shifted to better reflect developing country concerns. In a staff paper, the IMF acknowledged that “capital controls may be useful in addressing both macroeconomic and financial stability concerns in the face of inflow surges,” a shift from the Washington Consensus. As for the Bank, Kim’s appointment to the presidency in 2012 highlights the shift in priorities. Trained as a doctor and an anthropologist, Kim’s entire career has focused entirely on health policy until now. This suggests that the Bank will use a more capacious notion of development going forward.

The trade and investment regimes have displayed somewhat less resiliency than global financial governance – but these regimes have not withered on the vine either. The multilateral trade regime in particular would appear to have suffered the most from the Great Recession. The collapse of the Doha round was a severe blow to the World Trade Organization. Nevertheless, the WTO as an institution has endured. Indeed, it has expanded its reach in several ways. Geographically, the WTO finally secured the accession of the Russian Federation, the last G-20 non-member, after a slow-motion 15-year negotiation process. The WTO’s Dispute Settlement Mechanism helped to contain the spread of protectionist measures that the Great Recession triggered; there is no evidence that compliance with these rulings has waned since 2008. As Alan Beattie recently concludes, “The ‘Doha Round’ of trade talks may be dead, but the WTO’s dispute settlement arm is still playing a valuable role.”⁶⁹ The WTO’s Government Procurement Agreement (GPA) helped to blunt the most blatant parts of the “Buy American” provisions of the 2009 fiscal stimulus, thereby preventing a cascade of “fiscal protectionism.” Although the GPA is only plurilateral, China is now negotiating to join the agreement. The United States, European Union and 18 other countries are also accelerating talks on a services liberalization agreement that would encompass most of the OECD economies as well as advanced developing countries.⁷⁰

In truth, the Doha round had lost its momentum long before the 2007/8 financial crisis, and was effectively moribund before the Great Recession started. What is interesting to note is that the enthusiasm for greater trade liberalization has not lost its momentum, but rather found a new outlet: the explosion of regional and bilateral free trade agreements (FTAs). The traditional expectation that an economic downturn would dampen enthusiasm for greater openness has not been borne out by the data on FTAs. In the four years prior to the collapse of Lehman Brothers, 51 FTAs were reported to the World Trade Organization. In the four years since Lehman, 58 free trade agreements have been registered.⁷¹ A trans-pacific partnership and a transatlantic free trade zone are at preliminary stages of negotiation as well. To be sure, not all of these FTAs

⁶⁹ Alan Beattie, “Decommission the weapons of trade warfare,” *Financial Times*, August 8, 2012.

⁷⁰ Doug Palmer, “US, trade allies push for international services talks,” Reuters, September 19, 2012.

⁷¹ Data from <http://rtais.wto.org/UI/PublicPreDefRepByEIF.aspx>, accessed July 2012.

were created equal. Some of them have greater coverage of goods than others. Some of them might promote more trade diversion than trade creation. Nevertheless, the patterned growth of these FTAs mirrors how they spread in the late 19th century.⁷² Although these FTAs do not possess the “most-favored nation” provision that accelerated trade liberalization in the 19th century, the political economy of trade diversion still generates competitive incentives for a growth in FTAs, thereby leading to a similar outcome.⁷³ Through their own shared understandings and dispute settlement mechanisms, they act as an additional brake on protectionist policies.⁷⁴

There is no multilateral investment regime to display resiliency. Instead, investment is governed by a network of bilateral investment treaties (BITs). Compared to the data on free trade agreements, it would appear that the pace of BITs has slowed since 2008. According to UNCTAD data, an annual average of 78 BITs were completed in the three years prior to 2008; only an average of 61 per annum were negotiated in the three years after 2008. That indicates a slowdown. A look at the longer time series, however, reveals that this slowdown is not surprising. As Figure 5 shows, the peak of BIT negotiations took place in the decade after the end of the Cold War. From 1992 to 2001, an annual average of 160 BITs were negotiated. After 2001, however, the number of negotiated BITs declined, following a standard diffusion pattern. Based on that kind of pattern of diffusion, the last three years have seen expected levels of BIT growth. Furthermore, in 2012 the United States introduced a new “model BIT” and started negotiations with China and India on bilateral investment treaties.⁷⁵

Why has the system worked?

Global economic governance did what was necessary during the Great Recession – but *why* did the system work? The pre-crisis observations about sclerotic international institutions and waning American power did not seem too far off the mark. How did these actors manage to produce the necessary policy outputs and reforms to stave off systemic collapse? The most commonly-provided answer is that the shared sense of crisis spurred the major economies into joint action. The same crisis mentality did not lead to sustained cooperation during the Great Depression, however. Significant postwar economic downturns – such as the end of the Bretton Woods regime, the oil shocks of the 1970s, and the failure of the European Exchange Rate Mechanism in the early 1990s – also failed to spur meaningful great power cooperation. What caused powerful actors to think of the 2008 crisis as a “shared” one?

⁷² David Lazer, “The Free Trade Epidemic of the 1860s and Other Outbreaks of Economic Discrimination.” *World Politics* 51 (July 1999): 447–83.

⁷³ See Daniel W. Drezner, *U.S. Trade Strategy: Free Versus Fair?* (New York: Council on Foreign Relations Press, 2006), pp. 71-92 for more on this dynamic.

⁷⁴ Dadush *et al*, *Is Protectionism Dying?*, p. 8-9.

⁷⁵ James Politi, “US revises investment treaty approach,” *Financial Times*, April 20, 2012.

A fuller answer will require additional research, but some tentative answers can be proffered here. Power, institutions, and ideas are among the primary building blocks of international relations theory – and each of these factors offer a partial explanation for the performance of global economic governance. Comparing the current situation with the analogous moment during the Great Depression along these three dimensions, we can discern why events have unfolded differently this time around. Looking at the distribution of power, for example, the interwar period was truly a moment of great power transition. At the start of the Great Depression, the United Kingdom’s lack of financial muscle badly hampered its leadership efforts. Even as it was trying to maintain the gold standard, Great Britain possessed only four percent of the world’s gold reserves.⁷⁶

In contrast, American power and leadership during the recent crisis turned out to be more robust than expected. This was particularly true in the financial realm. Despite occasional grumblings among the BRICs, the U.S. dollar’s hegemony as the world’s reserve currency remains unchallenged, giving the United States the financial power that the United Kingdom lacked eight decades ago. Capital surplus countries – such as China – exaggerated the leverage they could obtain from holding large amounts of dollar-denominated reserves.⁷⁷ They rapidly discovered that U.S. dollar hegemony bound their interests to the United States on financial issues. While domestic politics might have prevented a more robust U.S. policy response, partisan gridlock did not prevent the United States from pursuing emergency rescue packages (via the 2008 Troubled Assets Relief Program), expansionary fiscal policy (via the 2009 American Recovery and Reinvestment Act), expansionary monetary policy (via interest rate cuts, three rounds of quantitative easing and Operation Twist), and financial regulatory reform (via Dodd-Frank). These acts of U.S. leadership helped to secure multilateral cooperation on macroeconomic policy coordination for two years, as well as Basel III.

Another way to demonstrate the significance of U.S. leadership is to compare and contrast the finance and trade dimensions. As just noted, U.S. power in the financial realm remained significant even after the crisis; according to the IMF, in 2010 the United States was responsible for 25 percent of global capital markets. American policy outputs were significant enough to display leadership on these issues. The picture looks very different on trade. U.S. relative power on this issue had faded: According to WTO figures, U.S. imports as a share of total world imports declined from 18.1% of total imports in 2001 to 12.3% a decade later. U.S. policy on this issue was more inert. The executive branch’s trade promotion authority expired, and

⁷⁶ Jeffrey Frieden, *Global Capitalism* (New York: W.W. Norton, 2006), chapter eight; Liqat Ahamed, *Lords of Finance: The Bankers Who Broke The World* (New York: Penguin, 2009).

⁷⁷ The arguments in this paragraph draw from Daniel W. Drezner, “Bad Debts: Assessing China’s Financial Influence in Great Power Politics.” *International Security* 34 (Fall 2009): 7-45; and “Will Currency Follow the Flag?” *International Relations of the Asia-Pacific* 10 (September 2010): 389-414.

legislative demands for protectionism spiked. Not surprisingly, the global policy response on trade has been somewhat more muted than on finance.

Despite weaker U.S. power and leadership, the global trade regime has remained resilient – particularly when compared to the 1930s. This highlights another significant factor – the thicker institutional environment. There were very few multilateral economic institutions of relevance during the Great Depression.⁷⁸ No multilateral trade regime existed, and international financial structures remained nascent. The last major effort to rewrite the global rules – the 1933 London Monetary and Economic Conference – ended in acrimony.⁷⁹ Newly-inaugurated president Franklin D. Roosevelt unilaterally took the United States off the gold standard, signaling an end to any attempt at multilateral cooperation.

In contrast, the current institutional environment is much thicker, with status quo policies focused on promoting greater economic openness. A panoply of pre-existing informal and formal regimes were able to supply needed services during a time of global economic crisis. At a minimum, institutions like the G-20 functioned as useful focal points for the major economies to coordinate policy responses. These structures also served to blunt domestic pressures to act in a more unilateral manner. International institutions like the Bank of International Settlements further provided crucial expertise to rewrite the global rules of the game. Even if the Doha round petered out, the WTO's Dispute Settlement mechanism remained in place to coordinate and adjudicate monitoring and enforcement. Furthermore, the status quo preference for each element of these regimes was to promote greater cross-border exchange within the rule of law. It is easier for international institutions to reinforce existing global economic norms than to devise new ones. Even if these structures were operating on "autopilot," they had already been pointed in the right direction.

The final difference between the interwar era and the current day is the state of economic ideas. As the Great Depression worsened during the decade of the 1930s, there was no expert consensus about the best way to resuscitate the economy. Prominent economists like John Maynard Keynes, who had been staunch advocates of free trade a decade earlier, reversed themselves as the depression worsened. There was no agreement on the proper macroeconomic policy response to the downturn, nor was there any agreement about how to fix the broken gold standard.

There has also been a rethinking of causal beliefs after the 2008 financial crisis – but this rethink has been much less radical. Former Federal Reserve chairman Alan Greenspan made headlines when he admitted that his faith in the intellectual edifice of self-correcting markets had "collapsed." As previously noted, the IMF has reversed course on the utility of temporary

⁷⁸ James, *The End of Globalization*.

⁷⁹ Herbert Feis, *1933: Characters in Crisis* (Boston: Little Brown and Company, 1966).

capital controls. While the Washington Consensus might be fraying, however, it has not been dissolved or replaced by a “Beijing Consensus” – indeed, it is far from clear that a Beijing Consensus actually exists even within China.⁸⁰ Post-crisis surveys of leading economists suggest that a powerful consensus remains on several key international policy dimensions. For example, the University of Chicago has run an Economic Experts Panel for the past few years. The survey results show a strong consensus on the virtues of freer trade, and a rejection of returning to the gold standard to regulate international exchange rates. On the other hand, there is much less consensus on monetary policy and the benefits of further quantitative easing.⁸¹ This absence of agreement reflects a much greater policy debate on this area. This helps to explain why macroeconomic policy coordination has been less robust.

Why the misperception?

Why is there such a profound gap between perceptions and reality in evaluating the performance of multilateral economic institutions? The simplest explanation is that the core economies – the advanced industrialized democracies – have not rebounded as vigorously as expected. Two trends have marked most postwar global business cycles: economies rebound as vigorously as they drop, and the advanced industrialized states suffer less than the economic periphery. Neither of these trends has held during the Great Recession. As previously noted, the recovery from a financial crisis tends to be longer and slower than standard business-cycle recessions. After the 2008 financial crisis, the recovery has been particularly weak in the advanced industrialized economies. According to the Economist Intelligence Unit, the OECD economies have averaged GDP growth of 0.5 percent between 2008 and 2012. The non-OECD economies have averaged 5.2 percent during the same period. A weak economy feeds perceptions of institutional breakdown. The 2012 Edelman Trust Barometer reflects this phenomenon; contrary to traditional numbers, trust of elite institutions is significantly higher among developing countries than in the developed democracies.⁸² Since most analyses of global governance structures have been anchored in the developed world, it is not surprising that this literature suffers from a pessimistic bias.

⁸⁰ Matt Ferchen, “Whose China Model is it Anyway?” *Review of International Political Economy*, forthcoming; Scott Kennedy, “The Myth of the Beijing Consensus,” *Journal of Contemporary China* 19 (June 2010): 461-477. .

⁸¹ On free trade and the gold standard, see http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_cwInNUYOXSAKwrq and http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_0dfr9yjnDcLh17m, accessed July 2012. On monetary policy, see http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_9yFWHquReQZjC6w. For further evidence of the absence of consensus on monetary policy, compare Martin Wolf, “We Still Have that Sinking Feeling,” *Financial Times*, July 10, 2012 with Mohamed El-Erian, “Central Bankers Can’t Save the World,” *Bloomberg View*, August 2, 2012. See also Joe Weisenthal, “The Biggest Tragedy in Economics,” *Business Insider*, September 7, 2012.

⁸² The Edelman Trust Barometer data can be accessed at <http://trust.edelman.com/trust-download/global-results/>.

Pessimism about current economic conditions in the developed world might also be causing analysts to conflate poor domestic and regional governance with poor global governance. The primary causes for domestic economic weakness in the United States, Europe and Japan are not global in origin – and neither are the best policy responses.⁸³ Japan’s current economic woes are a function of two decades of slack economic growth combined with the aftereffects of the Fukushima disaster. U.S. economic misfortunes have little to do with either the global economy or global economic governance. Indeed, the United States has benefited from the current state of international affairs through lower borrowing costs and higher exports. Domestic political deadlock and uncertainty, on the other hand, have contributed to the anemic U.S. recovery. Already, concerns about the coming “fiscal cliff” have dampened economic activity.⁸⁴ Without more expansionary fiscal and monetary policies, it will take even longer for the necessary private-sector deleveraging to play itself out.

Europe’s situation is more complex. To be sure, the Great Recession was the trigger for the eurozone’s sovereign debt crisis. The international response to the crisis has been that of a modest supporting role. The IMF has proffered both its technical expertise and financial support in excess of \$100 billion to Greece, Portugal and Ireland. The United States and other major economies have offered to re-open swap lines with the European Central Bank to ensure liquidity. European and national policy responses to the crisis, however, have badly exacerbated the economic situation. Greece’s reckless pre-crisis levels of government spending and borrowing made that economy a ripe target for market pessimism. The initial European bailout package for Greece was woefully inadequate, allowing the crisis to fester. The austerity policies advocated in some quarters have not panned out as expected. The European Central Bank’s decision to prematurely raise interest rates in early 2010 helped to stall out the nascent recovery on the continent. On the fiscal side of the equation, austerity-related policies have led to a double-dip recession in Great Britain, higher borrowing costs in Spain and Italy, and continued uncertainty about the future of the euro. Europe’s fiscal and monetary policies have been less expansionary than in the United States. This, in turn, has prevented any appreciable private-sector deleveraging in Europe, thereby guaranteeing a longer downturn before any sustained recovery is possible.⁸⁵

The IMF has come under criticism for failing to exert more influence over the eurozone crisis. One official recently resigned, blasting the Fund for its “European bias” and the consensus culture that keeps the Fund from criticizing countries in the middle of lending programs. There are two counterpoints to this argument, however. First, the IMF *has* been critical at various moments during the eurozone crisis. Fund staff issued warnings about the health of the

⁸³ Friden, Pettis, Rodrik and Zedillo, *After the Fall: The Future of Global Cooperation*.

⁸⁴ Nelson D. Schwartz, “Fearing an Impasse in Congress, Industry Cuts Spending,” *New York Times*, August 5, 2012.

⁸⁵ Reinhart and Rogoff, *This Time Is Different*; Charles Roxburgh *et al*, *Debt and Deleveraging: Uneven Progress on the Path to Growth*. McKinsey Global Institute, January 2012.

European banks in August 2011, and IMF Managing Director Lagarde called explicitly for debt sharing among the eurozone in June 2012.⁸⁶ The first criticism received significant pushback from the European Central Bank and eurozone governments, and Germany ignored the second criticism. This leads to the second point: it is highly unlikely that national governments would feel compelled to respond to IMF criticism in the absence of a market response. The Fund must walk a tightrope between transparent criticism and setting off market panic. This is hardly an ideal vantage point for strong-arming governments with sizable IMF quotas.

A final reason for misperception about global economic governance is exaggerated nostalgia for prior eras of global economic governance. The presumption in much of the commentary on the current global political economy is that both governance structures and hegemonic leadership were better and stronger in the past. Much of this commentary evokes the era of the 1940's, when the creation of the Bretton Woods institutions, backstopped by the United States, that ushered in a new era of global governance. The contrast between U.S. leadership then and now seems stark.

This comparison elides some inconvenient facts, however. The late 1940s were indeed the acme of American hegemonic leadership. Even during that peak, however, the United States failed to ratify the Havana Charter that would have created an International Trade Organization with wider scope than the current WTO. With the Marshall Plan, the U.S. decided to act outside the purview of Bretton Woods institutions, weakening their influence. After the late forties, American leadership and global financial governance experienced as many misses as hits. The logic of the Bretton Woods system rested on an economic contradiction that became known as the Triffin dilemma. Extravagant macroeconomic policies in the United States, combined with a growing reluctance to accommodate the U.S. position, eroded that global financial order. As the logical contradictions of the Bretton Woods regime became more evident, existing policy coordination mechanisms failed to correct the problem. By 1971, when the United States unilaterally decided to close the gold window, all of the major economies had chosen to ameliorate domestic interests rather than coordinate action at the global level.⁸⁷ In ending Bretton Woods, the United States also undercut the IMF's original purpose for existence.

Post-Bretton Woods global economic governance was equally haphazard. An increase in anti-dumping, countervailing duties, and non-tariff barriers weakened the rules of the global trading system over the next two decades. Neither the United States nor any global governance structure

⁸⁶ Alan Beattie and Chris Giles, "IMF and eurozone clash over estimates," *Financial Times*, August 31, 2011; James Kanter, "IMF Urges Europe's Strongest to Shoulder Burdens of Currency Bloc," *New York Times*, June 21, 2012.

⁸⁷ Joanne Gowa, *Closing the Gold Window: Domestic Politics and the End of Bretton Woods* (Ithaca: Cornell University Press, 1984).

was able to prevent OPEC from raising energy prices from 1973 to 1986.⁸⁸ Exchange rates and macroeconomic policy coordination devolved from the IMF to the G-7. A predictable cycle emerged: other G-7 countries would pressure the United States to scale back its fiscal deficits. In turn, the United States would pressure Japan and West Germany to expand their domestic consumption in order to act as locomotives of growth. Not surprisingly, the most common outcome on the macroeconomic front was a stalemate.⁸⁹

Even perceived successes in macroeconomic policy coordination have had mixed results. While the 1985 Plaza Accord helped to depreciate the value of the dollar while allowing the yen to rise in value, it was also the beginning of an unsustainable asset bubble in Japan. In Europe, the creation of the euro would seem to count as an example of successful coordination. The Growth and Stability Pact that was attached to the creation of the common European currency, however, was less successful. Within a year of the euro's birth, five of the eleven member countries were not in compliance; by 2005, the three largest countries in the eurozone were ignoring the pact.⁹⁰ Regardless of the distribution of power or the robustness of international institutions, the history of macroeconomic policy coordination is not a distinguished one.⁹¹

None of this is to deny that global economic governance was useful and stabilizing at various points after 1945. Rather, it is to observe that even during the heyday of American hegemony, the ability of global economic governance to solve ongoing global economic problems was limited.⁹² The original point of Kindleberger's analysis of the Great Depression was to discuss what needed to be done during a global economic crisis. By that standard, the post-2008 performance of key institutions has been far better than extant commentary suggests. Expecting more than an effective crisis response might be unrealistic.

Conclusion

Five years ago there were rampant fears that waning American power would paralyze these regimes. The crisis of the Great Recession exacerbated those fears even further. A review of policy outcomes, policy outputs, and institutional resilience shows a different picture. Global

⁸⁸ Robert Keohane, "Theory of Hegemonic Stability and Changes in International Economic Regimes, 1967-1977," in *Change in the International System*, Ole Holsti, Randolph Siverson, and Alexander George, eds. (Boulder: Westview Press, 1980).

⁸⁹ Robert Putnam and Nicholas Bayne, *Hanging Together: Cooperation and Conflict in the Seven-Power Summits* (Cambridge: Harvard University Press, 1987); David M. Andrews, ed., *International Monetary Power* (Ithaca: Cornell University Press, 2005).

⁹⁰ Kathryn Dominguez, "The European Central Bank, the Euro, and Global Financial Markets." *Journal of Economic Perspectives* 20 (Fall 2006): 67-88.

⁹¹ Thomas Willett, "Developments in the Political Economy of Policy Coordination," *Open Economies Review* 10 (May 1999): 221-253.

⁹² This parallels the recent argument by Robert Kagan that people exaggerate the effectiveness of American hegemony in the past as well. Robert Kagan, *The World America Made* (New York: Knopf, 2012).

trade and investment levels have recovered from the plunge that occurred in late 2008. A mélange of international coordination mechanisms facilitated the provision of key policy outputs from 2008 onwards. Existing global governance structures, particularly in finance, have revamped themselves to accommodate shifts in the distribution of power. The World Economic Forum's survey of global experts shows rising confidence in global governance and global cooperation.⁹³ The evidence suggests that global governance structures adapted and responded to the 2008 financial crisis in a robust fashion. They passed the stress test. The picture presented here is at odds with prevailing conventional wisdom on this subject.

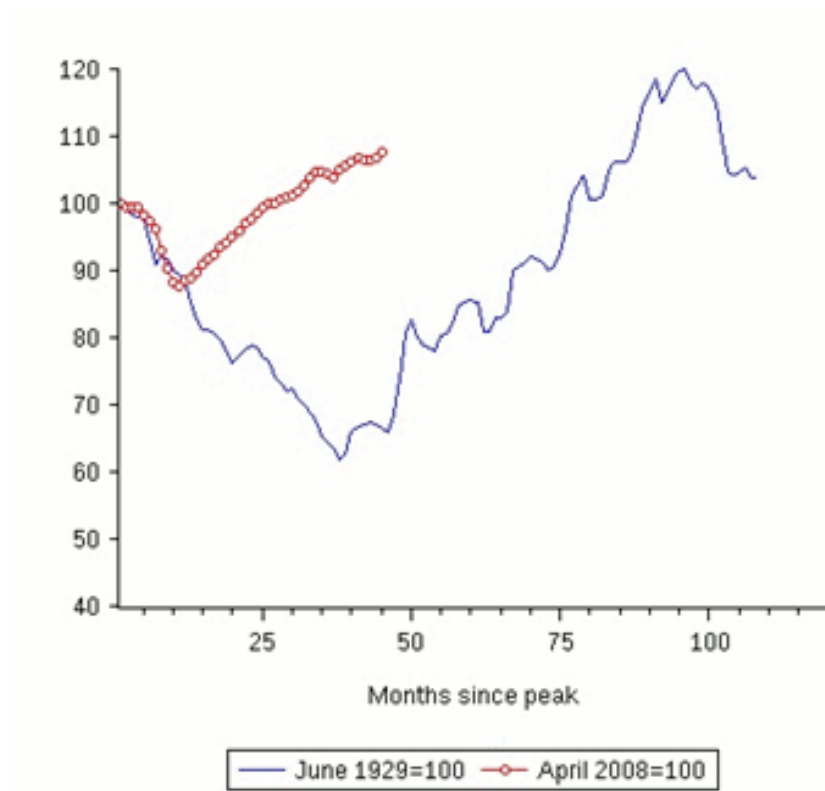
This does not mean that global economic governance will continue to function effectively going forward. It is worth remembering that there were genuine efforts to provide global public goods in 1929 as well, but they eventually fizzled out. The failure of the major economies to assist Austria after the CreditAnstalt bank failed in 1931 led to a cascade of bank failures across Europe and the United States. The collapse of the 1933 London conference guaranteed an ongoing absence of policy coordination for the next several years.

The start of the Great Depression was bad. International policy coordination failures made it worse. Such a scenario could play out again. There is no shortage of latent or ongoing crises that could lead to a serious breakdown in global economic governance. The IMF's reluctance to take more critical actions to address the eurozone crisis have already prompted one angry resignation letter from an IMF staffer. The summer 2012 drought in the midwestern United States could trigger another spike in food prices. The heated protectionist rhetoric of the 2012 presidential campaign in the United States, or the nationalist rhetoric accompanying China's 2012 leadership transition, could spark a Sino-American trade war. If global economic growth continues to be mediocre, the surprising effectiveness of global economic governance could peter out. Incipient signs of backsliding in the WTO and G-20 might mushroom into a true "G-Zero" world.

It is equally possible, however, that a renewed crisis would trigger a renewed surge in policy coordination. As John Ikenberry has observed, "the complex interdependence that is unleashed in an open and loosely rule-based order generates some expanding realms of exchange and investment that result in a growing array of firms, interest groups and other sorts of political stakeholders who seek to preserve the stability and openness of the system."⁹⁴ The post-2008 economic order has remained open, entrenching these interests even more across the globe. Despite uncertain times, the open economic system that has been in operation since 1945 does not appear to be closing anytime soon.

⁹³ <http://www.weforum.org/content/pages/global-confidence-index>.

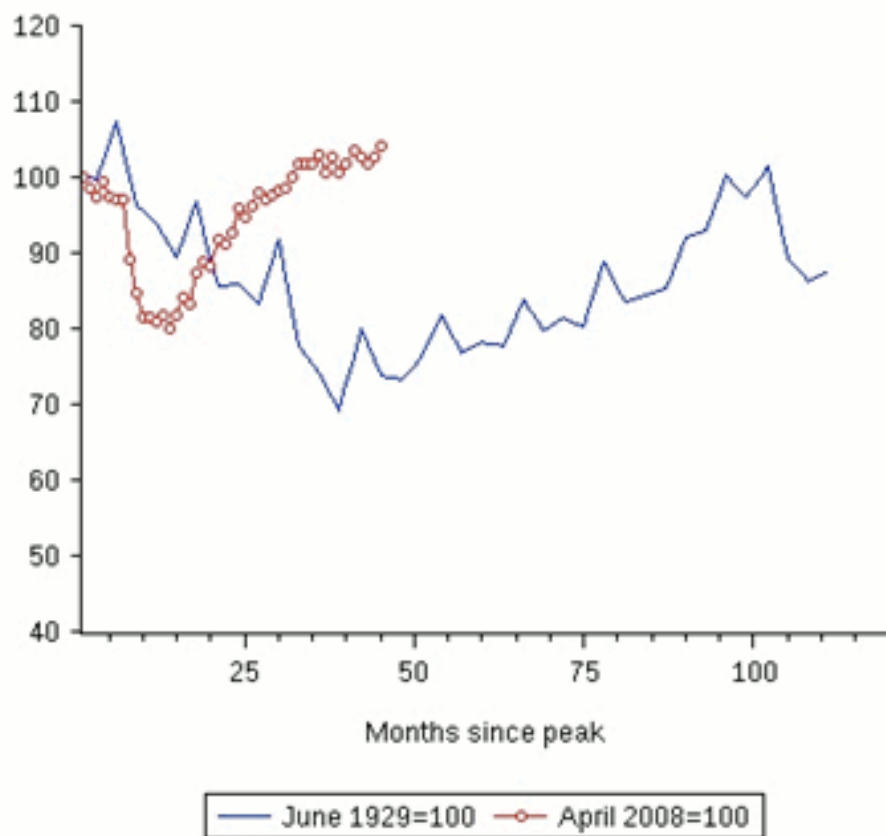
⁹⁴ G. John Ikenberry, *Liberal Leviathan*, (Princeton: Princeton University Press, 2011), p. 340.

FIGURE 1**World Industrial Production: Great Depression vs. Great Recession**

Source: Eichengreen and O'Rourke, "A Tale of Two Depressions Redux."

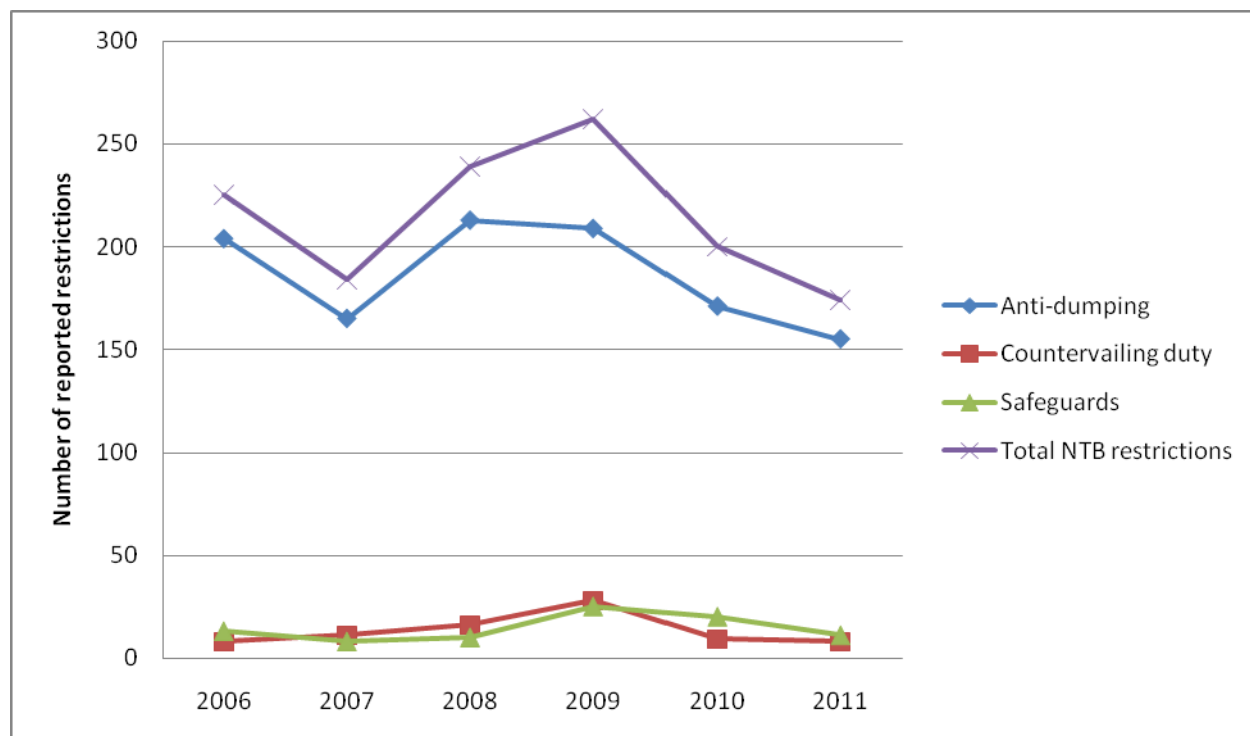
FIGURE 2

World Trade Volumes: Great Depression vs. Great Recession



Source: Eichengreen and O'Rourke, "A Tale of Two Depressions Redux."

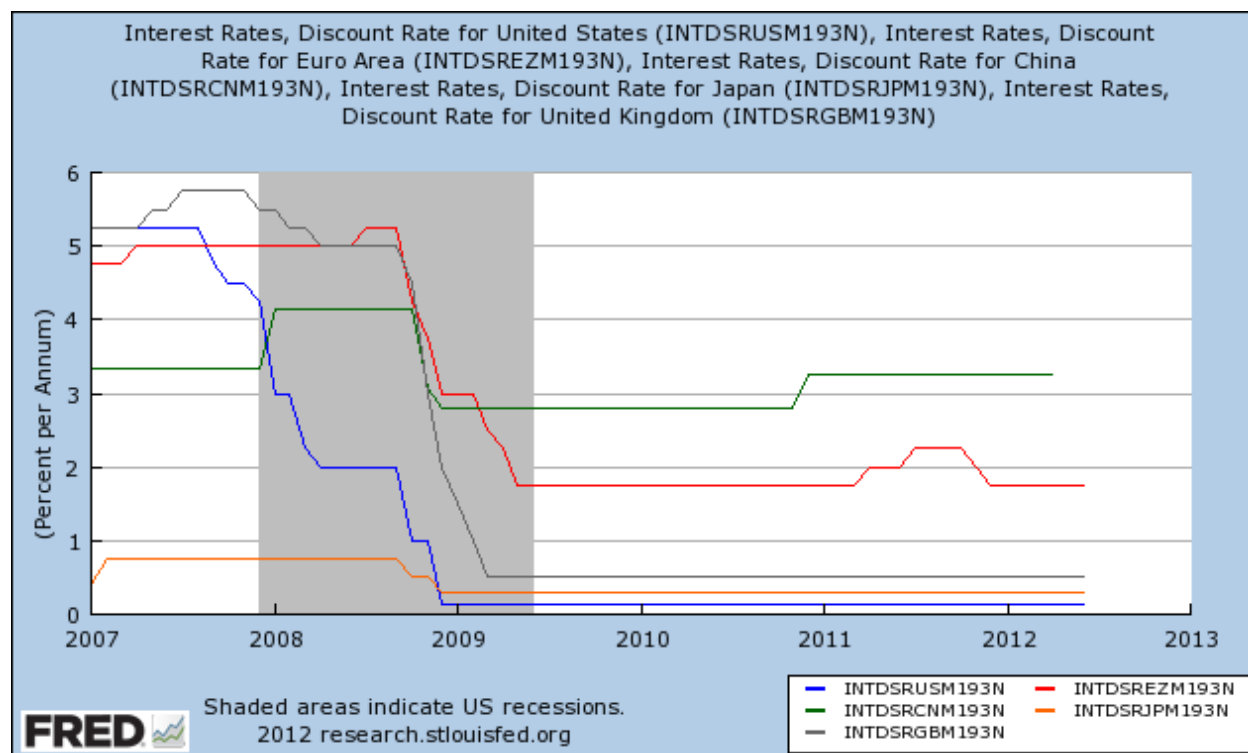
FIGURE 3
Trade restrictions, 2006-2011



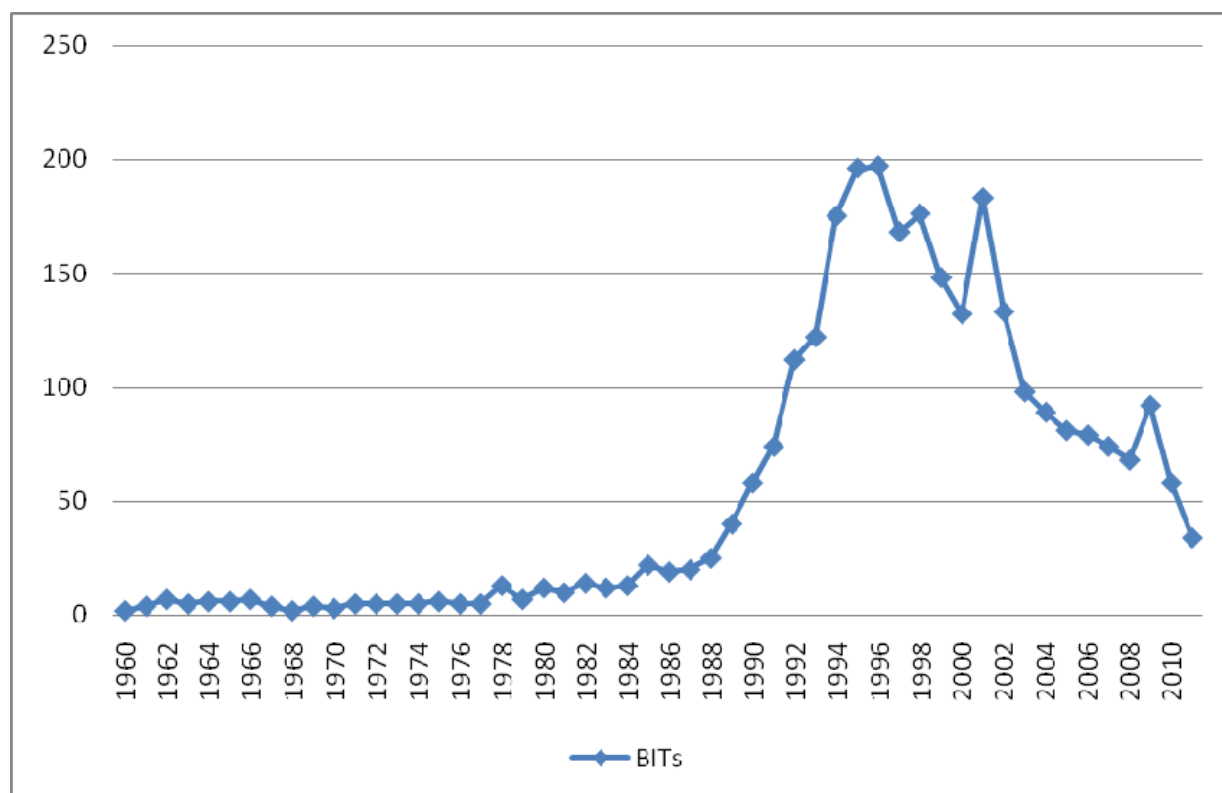
Source: WTO

FIGURE 4

Key policy interest rates, 2007-2012



Source: St.Louis Federal Reserve Bank

FIGURE 5**Annual count of Bilateral Investment Treaties, 1960-2011**

Source: UNCTAD