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Brace for Change as the Global Economic Order Crumbles

Asia increasingly accounts for a greater share of global revenues and financial clout. Yet power in global institutions, like the International Monetary Fund or the World Bank, is weighted toward the United States and other developed economies. Transition is underway in the global economic order. Jeffrey E. Garten, Yale University international trade and finance professor, warns that adjustment over the next decade will be rapid, turbulent, painful as the debt-ridden US relinquishes its role as informal global supervisor. Across the board, national governments reinforce dangerous spending patterns, balking at negotiating reasonable, fair, cost-saving global pacts on currency, trade or climate change. Nations ignore vast interconnections, continue self-centered approaches to global problems and pass costs onto future generations. Financial markets set the terms for adjustment. Garten concludes that economic promise is still possible: Global communication allows collaboration among innovative thinkers with rapid dissemination of the best ideas. – YaleGlobal

Nations, balking at global governance, may be shocked into cooperation by future chaos
Jeffrey E. Garten
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NEW HAVEN: As the first decade of the 21st century comes to a close, leaving the steady growth of last century's second half a distant memory, what does the future hold for the global economy? For the next several years, we can expect exceptional turbulence as the waning days of the global economic order we have known plays out chaotically, possibly destructively. For the longer term, say, 10 years from now, a more promising picture awaits as a new set of international economic arrangements gains support from governments, business and civil society, and as a wave of exceptional innovation bears fruit. The transition will be a treacherous ride that no government would rationally choose to take. Yet the die seems cast.

It was inevitable that the Bretton Woods system could not last indefinitely, even after its adaptation from fixed to floating-exchange rates in the early 1970s. After all, the world economy has changed beyond recognition. Since 1990, global GDP increased from about $20 trillion to nearly $60 trillion, world trade has increased 1½ times faster, foreign direct investment three times faster, and foreign exchange trading almost 100 times faster, according to McKinsey & Co.

Over the same

Wanted, Vision and Clout: For better global governance, the G-20 should show vision and the IMF should have serious oversight authority

period, businesses have expanded across borders at breakneck pace. In 1990 the US S&P 100 earned about 25 percent of its revenues abroad, while 20 years later the figure topped 53 percent, based on calculations done by Credit Suisse. This kind of interdependent growth has outstripped the rules made for another era. It has revealed the impossibility and even illegitimacy of governance arrangements revolving around a handful of rich western industrial countries and Japan. And it has created the need for new theories, still under debate, about how the world economy operates, including the ways shocks are transmitted across borders.

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The old order had to die also because the United States – its creator, rule enforcer, market of last resort and chief cheerleader, now racked by deficits, debts, and a polarized and inward-looking political system – can no longer shoulder the burden of these roles. No one country is remotely capable of replacing America, and effective collective leadership is nowhere in sight.

All these factors havebeen dramatically aggravated by the global credit crisis of 2008-2009 and subsequent recession in the West – obvious convulsions of the old and now discredited economic order. While an impressive international effort to bail out financial institutions and stimulate economies with government spending stopped the disaster from reaching 1930s proportions, the debacle revealed a number of fault lines that may be worsening. After all, the major global trade and financial imbalances that helped cause the financial implosion show no signs of narrowing.

In addition, gaping holes in the regulatory structure for banking still exist, including the absence of rules to wind up global banks, and scant international supervision of the shadow banking system.

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The aftermath of the credit implosion may, in fact, be leading to another set of crises less susceptible to a concerted bailout. The severe sovereign-debt and banking problems in Europe may just be gathering steam, as financial pressures careen from Greece and Ireland to Portugal and Spain. While so much attention has focused on consumer and industrial demand in the US and China, the deflationary policies enveloping the EU, the world's largest economic unit, could badly undermine global economic growth.

The difficulties could cause Europe to redouble its focus on exports at the same time that the US, Asia and Latin America are also betting their economies on selling more abroad, thereby exacerbating already-high currency tensions. It could lead to the resurgence of state-sponsored industrial policies, already growing around the world. And together, these factors could ignite the virulent and destructive protectionism that everyone fears.

In theory, we could see a major effort by key governments to develop domestic policies to take into serious account the global problems we face. But as Ernesto Zedillo and Kishore Mahbubani have eloquently argued in this space, world politics are moving in a different direction. After all, there has not been a currency accord since the 1985 Plaza Agreement or a successful global trade negotiation since the Uruguay Round in 1995. More recently, the Copenhagen Climate Change talks failed a year ago, and the Group of Twenty Summit in Seoul concluded with no progress just last month.

It's hard to imagine how this go-it-alone trend will change in the next few years, primarily because of the massive domestic preoccupations. In Washington all politics will be about cutting high levels of unemployment and federal-budget deficits. The EU will be in a fight for its very survival as an economic super-state, with the focus not just on saving national economies and banks, not just preserving the euro, but also pulling up its long-cherished social safety nets by the roots. China, too, needs to make massive internal adjustments such as stimulating sustainable consumer demand, retooling an energy-intensive industrial structure and dealing with widening income disparities.

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As the old economic order withers, the financial markets – and not governments – will be the arbiters of how capital and trade move, and how severe government adjustment policies need to be. This situation will be accompanied by more than one major financial crisis and more difficulty for global traders and investors moving across the world.

This very chaos could, however, provoke a shock effect that compels a sharply elevated level of cooperation among key governments. They could work more closely with their globally integrated firms, to advance a design of a new order. That could encompass new currency arrangements, a strengthened World Trade Organization, an International Monetary Fund with enforcement capabilities, a high authority with serious oversight for global financial regulation. A new order could involve a G-20 that has a vision and some clout, and establish a comprehensive regime to deal with climate change. Most importantly, it could be characterized by a mindset among governments that takes full account of the interconnections among national economies.

Some hope for optimism lays in the possibility that by the end of this decade, many domestic hurdles, such as US fiscal problems and European debt pressures, will be on a sounder trajectory. Also, by then, a new generation of leadership could emerge, weary of failed policies of the previous 10 years and much wiser for it. These men and women are likely to be willing to move ahead with the many new ideas that are sure to evolve during a period of chaos and instability.

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On top of that, we should not lose sight of the unprecedented possibilities that modern communications have created to tap into and amplify the innovative capacities of people in every corner of the world. Never in world history has there been such capacity to link new ideas, great talent and huge pools of money in support of progress. Nor should we forget that some of the trends now emerging, such as the hyper-urbanization of the planet, could produce unprecedented innovations in energy, transport, health care and more as the creativity produced by urban clusters is unleashed. And of course, we are on the verge of several new global industries wrought by the confluence of massive computer power, biotechnology and nanotechnology – all of which could well transform the globe for the better.

The great challenge facing our leaders is to shorten the time and blunt the pain between the chaos and its much more positive aftermath. It's a tall order.

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