Strengthening the Existing Order

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The pages of the economic press are not the place to look if you are feeling gloomy about the future of the liberal order: “Japan’s corporate confidence fades,” “Germany slashes its economic forecasts,” “Yen tensions rise,” “The euro zone: that sinking feeling (again).” Along with the United States, Japan and Europe represent the pillars of the Bretton Woods system, but unlike the United States, confidence in their economic prospects is low. It is understandable why emerging economies have been looking for alternatives: no matter how useful the tools and rules of Bretton Woods have proven to be, the economies that underpin it don’t look hugely appealing.

Between them, Japan and Europe have five seats at the table of the G7. The BRICS have none. Within the International Monetary Fund (IMF) Europe has 35.6 percent of the voting power, Japan has 6.7 percent, and the BRICS share 11.5 percent. As seen from China, Brazil, India and other emerging economics, these numbers represent an outdated sense of economic power and reflect neither the emergence of new major economies nor the impact of the 2008 financial crisis. But Japan and the European Union continue to represent more than a third of global GDP and have historically been responsible stakeholders. Without them, Bretton Woods is a one-legged stool.

The predominant response of emerging countries to the shift in economic power over the last year has been to experiment with the establishment of new, alternative institutions, not so loosely based on the architecture of the old: the Asian Infrastructure Investment Bank (AIIB) and the BRICS bank mirror the functions of the Asian Development Bank (ADB), IMF, and World Bank; and BRICS summits are not dissimilar to the G7 format. While these institutions need not necessarily compete with their predecessors, the tendency toward creating alternatives, combined with protectionist instincts on trade, marks a worrying shift away from a mutually supportive, integrated global framework.

The similarities of these institutions to those that already exist reflect that there is much about the current order worth preserving. It is a
rules-based system that has tended to reward multilateralism and international cooperation over the pursuit of a narrow conception of self-interest. Without it, it is unlikely that the emerging economies would have developed as quickly or as robustly as they have. But that order—unadjusted to new political and economic realities—is fraying as countries start to feel that working around the system will yield more benefits than working within it. The creation of more inclusive institutions like the G20 has not been enough to stop the process.

If the global economic order is to persist, Europe and Japan will need to help create an environment in which emerging economies are incentivized to become stakeholders within the existing system rather than to create a new one. This will require the promise of economic dynamism and strong political leadership that can negotiate adjustments to the system that better reflect today’s balance of power without compromising on the need for responsibility. While reporting on frameworks like the BRICS has tended to focus on the geopolitical, the world’s emerging economies are primarily looking for new sources of growth. Over the last few years, they have largely seen that momentum and opportunity in one another, and especially in China.

But while the developing world has been seen as the driving force behind the global economy over the last decade and a half, growth rates are slowing. In July, the IMF’s World Economic Outlook revised their prediction for this year’s global growth down by 0.3 percent, citing “a less optimistic outlook for several emerging markets.” China’s promised economic reforms have progressed in fits and starts, and even the success of that plan would see a diminished demand for the resource exports that have driven the growth of countries like Brazil. The IMF predicts that the growth rate of advanced economies will see an uptick between 2014 (1.8 percent) and 2015 (2.4 percent). In contrast, China’s growth is predicted to fall from 7.7 percent in 2014 to 6.8 percent in 2015.

The net result is that Japan, Europe, and, in turn, the Bretton Woods system of global economic governance could again start to look more appealing. In Japan, this will rest on proving that the initial bout of confidence in Abenomics—Prime Minister Abe’s plan to revitalize the Japanese economy—is not misplaced. For the European Union, it will require a unified economic plan and strong enough political leadership to see that plan through. Given the recent figures on real wage depreciation in Japan and downward revisions for Germany’s economic growth, this is a tall order.

When the U.S.-Europe-Japan Trialogue was established in 1973, the statement of purpose said that the three sides “bear a special responsibility for developing effective cooperation, both in their own interests and in those of the rest of the world. They share a number of problems which, if not solved, could cause difficulty for all.” There have been few instances where that has been truer than now. The problem with the global economic order is not that the institutions are irrelevant, but instead that two of the pillars that support it look like they are crumbling. Will a new global economic order emerge? Maybe. But if Europe and Japan get their economies on the right track, it is far more likely that the existing order will simply adapt.