EU Contribution to Global Governance

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The EU is in the middle of a deep crisis and few – even within the region – believe that the forerunner in multilateralism and international governance currently has much to offer for the solution of global problems after the financial crisis. What went wrong?

Euro Crisis

The EU's most ambitious governance project, the euro, has been hit by the potential bankruptcy of Greece, which undermined not only financial stability but also the fundamentals of eurozone integration. The idea of the common currency was to enforce EU integration by binding the hands of governments and putting an end to unsustainably lax monetary policy and devaluation races while limiting public debt and deficits. Without these macroeconomic tools, governments were thought to focus on structural reforms to get their economies growing and attract capital inflows for additional investment and catch-up growth in the less developed regions.

The idea has not been working out. Instead of investing in future growth, structurally challenged countries in the EU's south used their strong new currency and funding possibilities for additional consumption, including construction. The competitive countries in the north such as Germany, on the other hand, felt that they had to make up for the loss of their strong currencies, and part of their wealth, by saving and pushing for even more productivity. The EU's banks at the same time transferred excessive funds from the north to the south without much risk assessment because they expected the common currency and implicit government guarantees to back them up with bailouts if needed.

Fortunately for the EU, the financial crisis came before this imbalance pushed any major member state such as Spain or Italy into an unsustainable situation. The eurozone is still far from bankrupt, and terminating the union remains a non-issue for all member states. But the eurozone is in dire need of governance reform today. The first steps after the heavily criticized bailout of Greece look encouraging. The European Central Bank has survived the crisis well and now gains additional surveillance rights on member state finances. Common fiscal policy, which has always been stressed as a condition for effective governance in a diverse region by the critics of the euro project, but has been fiercely resisted by the member states, now heads the reform agenda.

Does this mean that the euro remains a model for currency integration and economic governance in other regions, in particular Asia? The answer is no, and it has never really been. An important role of the euro is to enforce the EU's top-down approach to integration by transferring sovereignty of an important policy instrument to an international organization, which creates ripple-down effects of more policy integration needs on the way. In Asia, with its bottom-up approach to integration and strong emphasis on sovereignty and competitive growth, such top-down integration enforcement would certainly look much less feasible than it does in the EU today.

EU's Contribution to Governance Reform after Global Crisis

The financial crisis has unearthed even more structural problems in the EU than in other regions. The EU had the most reckless lenders among its major banks and the imbalances between surplus and deficit countries were as severe as anywhere. The *Chart* shows to which extent government and international deficits have been building up over the last 15 years. In some countries, Germany and Japan in particular, government deficits were somewhat counter-balanced by current account surpluses, but this does not help global imbalances and also resulted in painful output gaps caused by a mismatch of overproduction and domestic consumer interest.

The EU could therefore have been expected to be at the forefront of multilateral re-regulation of banking and financial services, a leader of rebalancing initiatives, and one of the strongest supporters of a multilateral G-20 organization where its members occupy five seats. But so far, such determined support for multilateral reform has not materialized.

On financial reform, the United States has been a leader where Europe followed reluctantly because it cannot agree on how to deal with its state-held or government-supported banks that finance a huge share of the member states' deficits. Germany, for example, had been fighting against timely implementation of new Basel III banking regulations that ask for much higher capital requirements and risk-buffers from Germany's state-held banks as well. This lack of reform enthusiasm is a big loss for global governance because the EU should have learned the most about the importance of appropriate banking regulation and risk allocation on an international level.

This astonishing deficit of the forerunner in multilateralism can be attributed to a set of deeply rooted governance issues that need to be addressed before real progress in global governance can be expected. For decades, the EU has focused on developing its own approach of regional integration and governance with great success. It did not, however, develop a coherent approach towards global governance. The EU is now addressing this deficit by building a new diplomatic identity: adding a foreign minister to its governance framework, and allowing the European Commission to reach out to Asia and South America with bilateral trade and investment negotiations, as most recently in the case of an FTA with South Korea.

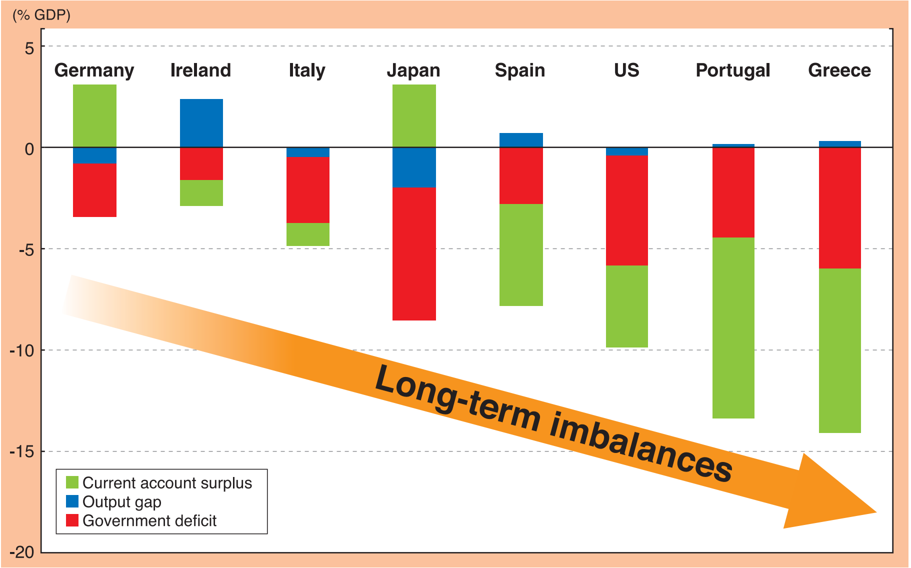
Differing Views of Multilateralism & Global Governance

In global governance, the EU strongly prefers the cooperation of power rather than a balance of power. It longs for a rule-based world of binding multilateral treaties, a transfer of sovereignty and cooperative action. It therefore faces philosophical and cultural hurdles when it confronts partners who see multilateralism as a process of multipolar power balancing and who insist on strict national sovereignty on most aspects of policy implementation.

Ultimately, EU integration could contribute to a world of "governance without governments" based on core values such as democracy and human rights, with important roles for NGOs and retreating sovereignty where global problems such as global warming need to be solved. But not only would the United States never agree to such limitations on its sovereignty, but also the major emerging countries such as China, India and Brazil envision a multipolar world of multilateral agreements based on sovereignty and domestic action. China, therefore, puts its concept of cooperative "harmony" in global governance against the EU's ideas of multilateral "global governance."

Current account, government lending & output gaps

(% GDP average; 1997-2011)



Source: Fujitsu Research Institute, 2010 (data from IMF WEO database)

Furthermore, multilateralism in the EU is seen as a tool to break domestic deadlocks and push for structural reforms that national governments could not achieve alone. This approach, which is close to Japan's concept of *'gaiatsu'* (or using pressure from abroad for domestic reform) has become extremely successful in the EU. Most new regulations and laws in the EU member states are now initiated by the European Commission and often enforced by the European Court.

But this cooperative approach seems to be at loggerheads with the competitive approach that is required at the G-20 where a broad multilateral agreement has to trigger diverse and often competitive national action on domestic structural reforms.

As an example, the strengths and weaknesses of the EU's multilateral governance approach were fully on display at the COP15 conference on global warming in Copenhagen last year. The EU managed to overcome strong resistance internally and presented the globally most ambitious CO_2 targets. But it failed to turn this achievement into an internationally successful negotiation strategy. It alienated – and felt alienated – by emerging countries, especially China, that presented their own emission targets but refused to underwrite transparent implementation processes and monitoring mechanisms that would have limited their national sovereignty.

What Can Be Learned from EU's Experience?

It has been important to stress the challenges of the EU approach to pending global governance issues because deficits have been building up over a long period and the crisis only unveiled them. Adjustment to the new realities of global governance and emerging country cooperation will therefore require some effort. But the huge success of the EU's regional integration also offers proven and effective governance strategies that can directly contribute to the next steps of global cooperation.

On trade, the WTO would not have been possible without the EU, and a new initiative should emerge after the dust of the crisis has settled. On back of the failure of the Doha Round and its own challenges of East-West/North-South integration, the EU is showing the way forward when partners disentangle trade strategies from agricultural issues by scrapping price controls and replacing incentives for farmers with income support as a means of regional policy.

For the next steps of global cooperation and market development, the EU's "regulation of deregulation" strategy has demonstrated that product safety can be achieved without tighter and cumbersome norms and standardization. Markets thrive when regulators define only necessary safety- and health-related product features while allowing for production diversity in exchange for transparency on the corporate side. Based on these principles, the EU already effectively sets the standards for most globally traded products today.

Last but not least, globalization and regionalization inevitably lead to shifts in power balances between national governments and global/regional/local actors. The EU's "subsidiarity" principle of performing functions at the level where they are most effectively carried out is therefore guiding the way to effective governance structures. It is encouraging to see that the reform of financial regulation after the crisis is already working this way. At the top, the G-20 has triggered cooperation; international organizations, the BIS in particular, have been drafting the plans; regions are closing financial loopholes; and national governments have to adjust and enforce the specifics while private corporate management will have to be in charge of actual governance reform and implementation on a daily basis again. JS

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