World Market Governance: What the EU Experience Can Teach Us

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The market economy has so far proved to be the best system to create wealth ever imagined. But, just like a good game of soccer, it needs fair and transparent rules and a judge to see that the rules are followed. A soccer game does not need committees sitting on the sidelines directing the players what to do. The players can and should be trained, but when they are out there on the green field they are on their own. They have to take the decisions on how to play - offensively or defensively, cooperatively or individually, traditionally or innovatively, but without the rules and a competent judge the games would be ugly and the outcome would not be generally accepted. The same is true for the market economy and as long as the "market matches" were mainly national and regional and the rules decided by the nation states or on a regional level the system was reasonably under control. The problem now is that the market economy has moved to a global arena and that there is a lack of both global proper rules and global functioning surveillance and that the global scale has made the economy not only more dynamic, but also more vulnerable.

Emergence of Global Market Economy

The emergence of a winning market economy model has been one of the factors driving the development of a global integrated economy. Another factor is the failure of protectionism. During the Great Depression of the 1930s, countries attempted to shore up their failing economies by sharply raising barriers to foreign trade, devaluing their currencies to compete against each other for export markets, and curtailing their citizens' freedom to hold foreign exchange. These attempts proved to be self-defeating. World trade declined sharply and employment and living standards plummeted in many countries. But it took time to learn the lessons and the trade between countries remained limited in the immediate aftermath of the Second World War.

The internal and protectionist focus has successively given way to a more open attitude in which markets have been deregulated and trade between countries has been liberalized, step by step. This opening up of the economies, especially of trade, has been perceived as a success as it has coincided with a rapid growth in living standards in those economies that have participated in the globalization process most actively. The information technology revolution enables companies to put together supply and production chains that can ensure quality and just-in-time delivery that were not achievable before and as a consequence companies are increasingly globalised. The deregulation of the financial markets that has taken place step by step after the Second World War accelerated in the late eighties and early nineties and is another factor that has contributed to the development of a truly global market economy. The order of events can also be seen in the opposite light, namely that it is the global business opportunities and the imbalances between savings and investments on a country basis that have been driving the deregulations; global companies need global financial partners, and financial actors, who have a responsibility to invest the assets entrusted to them, need access to global markets in which they can find a reasonable return.

Photo: PANA

WTO's headquarters, Geneva, Switzerland

European Project Now Mainly an Economic Project

The European project started as a peace project, but has rapidly developed into an economic project that has captured these opportunities, the single market being its flagship. The EU experience is that the opening up of the European markets has proved to be an economic and social success as it has increased business opportunities, growth and jobs. The challenge facing the EU now is that the globalization process has overtaken not only the national but also the regional level and that the EU has lost its capability to decide upon the market rules on its own.

Globalization is, if anything, increasing in strength and speed. The global trade has for a long time been growing much faster than the global GDP. In other words, we are on a global scale consuming relatively more of imported products and exporting more of our own production. The dip in global trade following the latest financial crisis is already overcome, mainly thanks to the emerging economies. In 2010 China increased its exports by 37% and its imports by 51%. Of the exports, 55% was produced by companies with foreign owners. China has become the first or second trading partner to most developed countries and the buyer of 30% to 50% of the worldwide output of minerals and other commodities. *(Table)*

The official Chinese position is that it is a developing country that needs to concentrate on domestic development, and it is true that China has many facets. While more skyscrapers are built in cities such as Beijing and Shanghai than in any other part of the world, and China has overtaken Japan as the second largest economy in the world, it is still a country in which a hundred million people are living on under two dollars per day and in which most people are in want of health care and pensions. The Chinese government has made it a top priority to address these inequalities in order to keep the support of the rural population for the direction of the country.

However, an export- and import-dependent China needs global common rules just as much as everyone else. The same is true for an increasingly global business community. Global companies that are active in many countries as well as exporters and importers in general need a level playing-field for the markets to work efficiently. A lack of governance shows up in recurrent financial crisis, but also in transaction costs. Companies have to tackle not only transportation costs, but also costs for uncertainty in rules, and in the stability of the financial markets, in the enforcement of contracts, patents and the like. The lack of governance also shows up in diminished sovereignty of nation-states, especially if they are dependent on the global financial markets in order to finance public deficits. The nation-states find themselves in an unpredictable global environment on which they have little influence.

Global Market Economy Needs Regulatory Framework

Globalization is setting limits to what most individual governments can do, limits that create unrest among citizens. Those that are living old battles often misread the concerns of people. They see a fight between a free market economy and "socialist" ideas that are already defeated. They do not recognize that it is the lack of a generally acceptable outcome that the mainly unregulated global economy offers that is the issue. Taxpayers in many countries have been forced to accept the socialization of bank debts and contribute to stabilizing the debts of other countries. They feel that they have to suffer for something they had no part in creating. The price for the mismanagement by "the elite" has been forced upon ordinary people to pay in the form of austerity measures and unemployment; it is starting to weigh down on the trust between the rulers and the ruled and has created a fertile ground for parties with extreme agendas. Leaders in the developed countries have difficulties in responding to

TABLE

BRICs leading the world economy ($1 Billion)

	2007	2014	2030
Japan	4,380 (7.9)	5,792 (7.8)	17,503 (7.6)
US	14,078 (25.5)	17,419 (23.0)	49,267 (21.4)
EU	16,939 (30.6)	19,055 (25.5)	48,992 (21.3)
BRICs	7,111 (12.9)	14,475 (19.4)	69,884 (30.3)
China	3,382 (6.1)	8,283 (11.1)	46,366 (20.1)
India	1,101 (2.0)	1,908 (2.6)	7,560 (3.3)
Brazil	1,334 (2.4)	2,156 (2.9)	7,965 (3.5)
Russia	1,294 (2.3)	2,128 (2.9)	7,993 (3.5)
World	**55,270**	**74,660**	**230,523**

Note: Figures in brackets denote ratios to World GDP.
Source: "World Economic Outlook Database," International Monetary Fund, October 2009

these sentiments and delivering the growth and jobs that their constituencies are demanding, simply because they do not have access to the necessary tools. There is as a result a declining support among people in general both for the public order and for the markets. In that respect the public sentiments and the state of affairs in some European countries remind us of the situation in the thirties, when democratically elected governments fell and were replaced by fascist alternatives.

The situation in developing countries is not all that different. It is not a coincidence that the uprising in many Arab countries has happened now. Their economies have been hit by the global financial crisis and by food prices sky-rocketing due to a combination of poor harvests and an unfair global trade regime. It is not obvious to what extent the new leaders will be able to meet the expectations. Like their counterparts in the more developed countries, they have little influence on the surrounding economic environment.

Besides a proper regulation of the financial markets the following elements are central to a functioning global market economy (the list is not intended to be exhaustive, only illustrative):

- Agreed rules for acquisition and sales of assets
- A common foundation for the exploration of natural resources
- Harmonized competition rules
- Recognition of Intellectual Property Rights
- Basic labor and migration conditions
- Agreed ways of internalizing "externalities," such as environmental impact, into the market economy system

Globalization in itself is also demanding a regulatory framework that nation-states don't need. Three examples are regulations that support:

- Free and fair trade
- Stable currency relations
- Fair domiciliation of companies and citizens for taxation

The latter is important to avoid some of the regulatory arbitrage used by wealthy citizens and global companies to avoid taxation, a practice that is undermining the financial situation of nation-states.

Present Governance Insufficient

Does any of this governance exist? The answer is that it does to a certain extent, but that the governance is insufficient and that the shortcomings will become more and more obvious as the globalization process continues.

The present governance of the global market is based on two pillars. One is the exercise of military power; the other is a mainly inter-governmental order. It can be perceived as a bit controversial to recognize that military power has an important role in the steering of the global market economy, but it is a historic fact. The latest globalization period that ended a hundred years ago was driven mainly through military conquest, colonialism and the exercise of imperial power. The role of military power did not end with the conclusion of that period. It still plays a role, especially in access to commodities and exploitation of natural resources. Many bilateral trade agreements in which militarily strong powers get preferential treatment are connected to security arrangements and arm sales. The US has a position in international affairs that is stronger than its role in the global market economy and it is motivated mainly by its superior military strength.

The other element, the inter-governmental order that was established after World War II, and that today consists of the International Monetary Fund, the World Trade Organization, the World Bank and some other supporting bodies, was created in the pre-globalization era. That this order is insufficient to meet the present challenges has become more and more obvious and world leaders are now taking steps to develop governance. The latest financial crisis added a layer to global governance in one important way. The so-called Group of 20 consisting of the largest economies and the largest emerging economies was created on the initiative of the French President Nicolas Sarkozy and the British former prime minister Gordon Brown. The G20 was a response to the perceived need of a more powerful and decisive structure – and for a while it managed to channel and initiate common approaches. The G20 has met several times in order to coordinate national responses to the crisis and to strengthen global cooperation in managing the financial markets. It was also instrumental in preventing the financial crisis from developing into a severe recession and has taken important initiatives to address pressing issues.

Impressive progress has been made by the G20, but the general feeling is that the momentum is fading away as the initial financial crisis is starting to become history and the G20 members are focusing on domestic (and Euro-zone) consequences of the crisis. The US as well as all of the European countries have to learn quite urgently how to live within their means, reduce their energy consumption, and make better use of available resources for, e.g., health care. Hundreds, if not thousands, of officials from the leading nation-states are still involved in international discussions on what actions to take for the future, and UK Prime Minister David Cameron has tabled proposals on how to make their work more coordinated, but their engagement lacks a clear receiver as the willingness to take joint long-term decisions is perceived to decline.

The Euro-zone and the US as well as individual countries are now trying to receive approval for their actions from the global financial markets, on which they are so dependent, and are often upset when the markets deliver verdicts that they perceive as unfair. The problem is that the politicians try to address problems in the real markets, while the financial markets reflect expectations rather than the actual situation. Uncertainties about the future create risks but also business opportunities for the financial actors. It is left unclear whether the political conditions in the US will enable the deficit problem to be tackled, which leaves the expectation markets open to fear and speculation. Likewise, the Euro-zone countries are debating whether a member country can default or not, and whether the resolution of a future bank crisis should be a joint responsibility or not. To most politicians these are theoretical discussions as they have the ambition to take actions to avoid the events, but the expectation markets see the discussions as a sign of indecisiveness and respond more negatively than the real economic situation merits. The problem for the politicians is that, if not brought under control, the expectations can be self-fulfilling. To avoid that scenario the politicians may need to move elements of the markets into a public regulatory area that is transparent and in which actors can be held accountable. The rating institutes is one example, and automatic high-speed trading and faulty incentives another.

Photo: AP/AFLO

Leaders at the IMF/World Bank Annual Meetings, including central bank governors and finance ministers, pose for an official photo at IMF headquarters in Washington Sept. 24, 2011.

Lessons to be Learned from EU Experience

A lesson learned from the European project is that *the regional level is insufficient* to master the mainly unregulated and increasingly global market economy. The developed and emerging economies are already too inter-dependent to allow for effective regional governance.

A second lesson is that *the involvement of national leaders of the highest level* is paramount in times of crisis. The European project has

Photo: AP/AFLO

European Commission President Jose Manuel Barroso adresses the European Parliament during a debate on the economic crisis and Euro in Strasbourg, France Sept. 14, 2011.

evolved mainly through crisis management by the European Council. The role that the European Council plays is very similar to the important function that G7, G8 and G20 have performed in international crises. Presidents and prime ministers have gathered in order to find a functioning solution to a new challenge and often succeeded in finding a formula that has been acceptable to other EU institutions, such as the European Parliament, and to the national parliaments. That is how the single market, the Euro and the pass-free Schengen area were created; that is how the EU enlargement has been achieved; that is how the EU agreed to act as one in international trade negotiations, which has both strengthened the EU position and enabled the EU to play a constructive role. The difficulties in the Doha Round are not due to the EU.

Global inter-governmental forums like the G8 and the G20 would probably function better if other regions could act in the same way as the EU, i.e. if an "Asian Council," for example, could give one voice to the regional interests of Asian countries in the trade negotiations, but expectations should not be overrated. Regional cooperation will not solve the situation of the grid-lock in the US, which prevents the US from acting with one voice, a state of affairs that has successively worsened during the last decades.

It should also be recognized that there are limits to what presidents and prime ministers can do in inter-governmental discussions. They may know what they should have done, but they are restricted by their national interests, and when they return home their national parliaments may water down their agreed actions after heavy lobbying of special interest groups.

This is the third lesson of the European project. *A community order* is imperative to address issues in which there are strong conflicting national interests. The Euro-zone crisis is one example. It was from the start in principle an inter-governmental project, partly because all countries did not join. The original stability pact had no community status, but was interpreted by the European Council. At the moment of truth it fell apart. The lesson learned is that you need binding legislation and an executive and judiciary order that is independent of national interests to enforce the financial stability that is necessary in a currency union, and that is what European leaders now try to at least partially achieve.

World Market Governance

The solution to the insufficient governance of the global market economy is thus to my mind rather to accept that it has developed into a separate societal system that, although inter-linked with nation-states, needs more governance than an inter-governmental order can offer. What is needed on a global level is more of a "community order." Proper global market governance is needed that ensures financial stability, a well-functioning global market economy, and a level playing-field, and that allows nation-states to have their own social systems and make their own decisions on issues such as social conditions, welfare systems, and re-distribution of wealth.

Many have called for such proposals, but few, if any, have engaged in a discussion on what more precisely it is that needs to be done and how to achieve it. It has immediately to be recognized that there is no such thing as the perfect solution, the perfect system, or the perfect world order. There are only "good-enough-ideas" fitting a certain situation and a certain period of time. The world is too complex; man is too complex; in addition the pre-conditions are changing too fast for any solution to be final. What is urgently needed, however, is a global exchange of views on what to do.

The first task is to my mind to define the territoriality of the global market economy – a *World Market Area.* To be part of that area a country should meet the requirements that the WTO has set up for a recognized market economy. It should also be obliged to agree to abide by the market legislation decided jointly in a community order. A third criterion is that the country should belong to a currency regime that is flexible and convertible so that imbalances within the area can be levelled out.

The next step is to develop *World Market Governance* with legislative, judiciary and executive powers. In order to get there, in my view world leaders need to join in an effort to negotiate a World Market Charter that could create the basis for such governance. The Charter should define scope, objectives, and governance structure and draw a clear line between the governance of the global market economy on one hand and the sovereignty of the mainly national and regional public orders on the other.

Such an effort is urgently needed if the support by world populations for the global market economy and the present public order is to be sustained. For it to happen scientists and other intellectuals have to engage in a public debate. JS

*Disclaimer: This article expresses the author's personal views and should not be read as an official position of the EU.

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