

APPROACHES TO INTERNATIONAL ECONOMIC AGREEMENTS IN THE NEW STRATEGIC BALANCE

Notes

The relative weight of major economies has been shifting steadily since the large Asian countries began to participate deeply in modern internationally-oriented economic growth in the last quarter of the twentieth century. The shift has accelerated since the global financial crisis of 2007-8 and its recessionary aftermath in the North Atlantic economies. The crisis placed economic growth in the developed countries onto a lower trajectory while having less effect in the Asian developing countries.

The increase in relative weight of China has been most significant. Over recent years China has become by far the world's largest source of savings and the world's largest trading economy. It is set to become the world's largest economy by purchasing power over the next few years and by national accounts measures converted into international currency at contemporary exchange rates a few years after that.

Although experiencing a slowing of growth in 2013, India has demonstrated a capacity for sustained rapid growth that will make it one of the top four economies (taking the European Union as a single entity) within a time frame that is relevant to today's discussion of architecture for future international cooperation. Sustained strong growth is making several of the ASEAN economies significant global entities. Indonesia is of major importance in its own right as well as being the leading and largest country in Southeast Asia.

The United States remains overwhelmingly the dominant military power. Like the Soviet Union through the 1970s and 1980s (and Russia today), it could sustain exceptional military capacity out of proportion to its economic weight for a considerable time. However, it could not sustain military dominance indefinitely, and to prolong its dominance long after it ceased to be the world's largest economy would require unusual forbearance on the part of the United States electorate. It is therefore wise to think of the strategic balance, too, becoming multi-polar, albeit with a lag from the shifts in economic power.

The emerging international system is qualitatively different from the bi-polar world of the Cold War (1945-89) and the uni-polar world between the collapse of the Soviet Union and the early twenty first century (1989-2001). We are moving to an international environment in which each of four great powers has such weight that no act of international cooperation is effective if one of them is actively opposed to it, and in which international cooperation is much more likely to succeed if all four are active supporters. In this multi-polar world, which began to emerge early in the twenty first century and took more solid form after the global financial crisis of 2008-9, each occupant of a second tier of substantial powers has more influence than in the bi-polar

and uni-polar worlds. The multi-polar world also creates opportunity for substantial lesser powers to exercise influence through persuasion built on well developed analytic and diplomatic capacities.

The multi-polar world is unlikely to provide a congenial environment for the exercise of influence of global entities built around the ideal of all states participating in decisions and having a veto over them—such entities as the WTO in full ministerial session, the General Assembly of the United Nations and the United Nations Framework Convention on Climate Change. Difficulties of managing the multipolar international community are likely to lead to major powers becoming intolerant of the added layers of delays and compromise associated with requirements to satisfy the interests and arguments of myriad minor powers. The great powers and the substantial lesser powers will need to be alert to the interests and perspectives of other countries, because globalisation in its many dimensions will continue to increase the capacity for any part of the international system to impose costs on all parts. But they are likely to take decisions of systemic importance in smaller fora.

The veto powers of small states could be tolerated when it was clear to all that the veto would not be applied against the interests and declared wish of one or other of the great powers in the bi-polar world, or the one great power in the uni-polar world. They are more problematic now that the influence of the great powers over the exercise of the veto has diminished.

The United States and China are the most secure members of the quadrumvirate of great powers.

The future influence of Europe depends on the evolution of the current exchange rate crisis in the Euro area and post-financial crisis in much of Europe. Deeper European integration (at least for those parts which remain in the European Union) and disintegration are both possibilities, while continuation indefinitely of the current intermediate position on integration is not. My own expectation is that the problems of deeper integration will in the end prove to be less daunting than the problems of disintegration. Germany will be the crucial state in the choice between deeper integration and disintegration, and for that great community the disintegration choice would have manifold problems and costs.

India's membership of the quadrumvirate depends on continuation of reasonably strong economic growth—although not necessarily the heady levels of the couple of years immediately preceding the global financial crisis. This is not the place to explain my considerable confidence (falling short of certainty) that India will meet this test.

The next tier of substantial states seems likely to comprise Japan, Russia, Indonesia and possibly Brazil. Amongst these, Indonesia will eventually emerge as the most influential if it is able to restore and to sustain its historic role as the leader of the Southeast Asian community of States—the members of the Association of Southeast Asian Nations. Indonesia, with twice the population of Japan and a demographic structure favourable for growth is likely to be challenging Japan in economic size in the late 2020s, and may choose to exercise influence as the most populous of the states with Moslem majorities in their populations.

Multiple Centres of Decision-making and Concerted Unilateral Action

The multi-polar system will be characterised by multiple centres of decision-making. On most issues it will be helpful for global peak bodies to play roles in formalising and generalising decisions and developing frameworks for implementation of decisions that have been shaped in smaller bodies that have emerged because they are effective. Decision-making processes are likely to be long and untidy. Participation will tend to be voluntary, with particular States leading on some issues and lagging on others. Early progress will depend on coalitions of the willing defining issues and mechanisms for cooperation and seeking support for them. International cooperation is unlikely to be effective unless there is widespread tolerance of rough justice about the sharing of burdens across issues and countries, characterised by diffuse rather than specific reciprocity. Cooperation will become more comprehensive through concerted unilateral action, coordinated through each country's respect for shared objectives and approaches.

The complexity and difficulty of coordinated decision-making in the multi-polar world will place a premium on established international institutions with legacies of good practice, administrative capacity and trust that has grown around a history of successful action.

The locus of and participants in various stages of decision-making will vary across areas of international cooperation. Here I will briefly examine cooperation on strategic matters, and say a little more about cooperation on macro-economic stabilisation, trade and climate change.

Strategic Cooperation

The established framework of the United Nations Security Council, with a small core of veto-exercising powers and a larger number of participants is actually better suited for the multi-polar than for the bi-polar or uni-polar worlds. The membership of five permanent members with veto powers is reasonably well suited to emerging power realities.

India is absent, and the correction of this anomaly would make the organisation more effective. Europe is over-represented with two permanent members. One of the two European positions could be allocated to India. The second European position on the Security Council could become one of about five non-permanent Security Council positions without veto, each of which rotated within a community which shared regional or other interests.

Russia's likely economic and strategic weight may not justify permanent and veto-holding membership of the Security Council. However, the historical origins of Russia's current status, its substantial continuing economic weight and its exceptional continuing military capacity argue for retention of its current role for the foreseeable future.

Macro-economic Stabilisation

There are important external effects on international macro-economic conditions of one of the largest economy's decisions affecting domestic expenditures, interest rates and exchange rates.

Three examples make the point.

The exceptionally large current payments surpluses in the years up to 2008 of China and deficits of the United States were amongst the causes of the global financial crisis (Garnaut with Llewellyn Smith, *The Great Crash of 2008*). It would have been recessionary for the world as a whole if the United States had moved to correct its surplus without corresponding demand expansion in other countries, most importantly in China. It would have been inflationary for the world as a whole if China had sought to reduce its surplus without corresponding contraction of demand elsewhere. The absence of understandings on concerted action inhibited policy adjustments to moderate the imbalances.

As crisis struck in September 2008, strong expansion in one economy alone would have created risks of external payments weaknesses in that economy, and the expansionary effects would have been substantially dissipated in impetuses to increased activity in other countries. The understandings on policy responses to the crisis that were reached in bilateral and G20 Heads of Government meetings in late 2008 and the first half of 2009 provided reassurance to each government that its own anti-recessionary action would be accompanied by expansion of greater or lesser strength in other major countries. This was an international underpinning of the Chinese fiscal and monetary expansion that played an important part in arresting the downward spiral in economic activity in the Western Pacific and global economies from late 2009, and to strong fiscal and monetary expansion in many countries.

It would be possible to see the premature ending of post-crisis fiscal expansion as a failure of macro-economic policy coordination. Be that as it may, the subsequent widespread adoption of radical monetary expansion and the associated tendency to depreciation of currencies in the largest developed countries transmitted a powerful impetus to monetary expansion and currency devaluation across the global economy. We will learn in future whether this was dangerously inflationary for the world as a whole; the risks would have been reduced if major economies had discussed the systemic effects in advance of national action.

In none of these cases would prior agreement on international macro-economic policy settings have been possible. However, the concerted expansionary activity in the early stages of response to the global financial crisis demonstrates the advantages of close consultation and the sharing of perspectives. Here the G20, comprising the largest and systemically important economies, supplemented by more detailed bilateral consultation amongst the largest economies, turned out to be a suitable forum. Making the international system work in a multi-polar world requires more effective use of established arrangements rather than the invention of new institutions.

What is the role of the IMF in the new multi-polar world order? Its demonstrated comparative advantage is in developing adjustment programmes alongside the provision of large-scale international financial support for economies seeking to minimise the costs of correcting fundamental disequilibria in external financial relations. The IMF has made mistakes (notably in response to the Asian Financial Crisis 1997-8) and learned from them (for example in different prescriptions offered to financially troubled economies during and after the global

financial crisis). New institutions for regional financial cooperation (notably the Chiangmai initiative amongst countries in the Western Pacific region) emerged in reaction to failures of or disappointments at IMF advice, but have evolved pragmatically to be complementary with use of the IMF's special expertise.

Institutions for international cooperation in macro-economic stabilisation have evolved in ways that meet the multi-polar system's requirements as defined in the first section of this note.

Trade Rules and Trade Liberalisation

The GATT/WTO has played an important role in defining rules of international trade on a global basis and providing mechanisms for resolving disputes about the rules. This role was enhanced by the success of the Uruguay Round and its establishment of the WTO. The GATT/WTO also played a substantial role in trade liberalisation, most importantly through the successive rounds of multilateral trade liberalisation in the Kennedy, Tokyo and Uruguay Rounds, and through the liberalisation on entry or re-entry of new members, especially China, Vietnam and Russia.

It is important to preserve and where possible to enhance the rule-making and disputes settlement roles of the multilateral body. However, as demonstrated by the extended failure to bring the Doha Round to a conclusion, the WTO is no longer a fruitful forum for negotiating reductions in trade barriers. While it is worthwhile now to make a major effort to salvage any liberalising opportunities from the remnants of the Doha Round, there is no point in similarly comprehensive attempts to negotiate agreement on reductions in trade barriers in future.

One area of productive enhancement of the rule-making role of the WTO would be to establish principles to guide formation of bilateral and plurilateral trading arrangements. It is highly desirable that this should be focussed around restoration of the primary role of Article 1, the Most Favoured Nation Principle. Article 1 has been violated with negotiation of more and more distorting preferential trading arrangements, culminating in the current discussions of the TPP and RCEP.

It has become common to justify expanding the number and scope of preferential trading arrangements through reference to the failure of the WTO to deliver new trade liberalisation. That is an argument that doing anything under the rubric of trade liberalisation is better than nothing. It is not at all clear that this is the case, or that the negotiation of preferential trading arrangements is the most productive way of "doing something" in the absence of successful multilateral negotiations.

Here the far-reaching trade liberalisation of Western Pacific economies between the mid-1980s and the Asian financial crisis of 1997-98 is instructive. Over this period, virtually all Western Pacific economies reduced barriers against imports by large amounts. Australia and New Zealand went from being the most inward-looking of the OECD economies to having the lowest barriers against imports of goods. All of the ASEAN economies engaged in major trade liberalisation, with the largest movements being in the economies with the highest protection

(Indonesia, the Philippines and the centrally planned economies). There were large reductions in manufacturing protection and some liberalisation of agricultural imports in Japan, Taiwan and the Republic of Korea. China moved from autarchic central planning to an internationally-oriented economy contributing a substantial part of global trade expansion.

Virtually all of the Western Pacific liberalisation of this period followed from unilateral decisions rather than tit for tat negotiations at a global or regional level (Garnaut in Bhagwati (ed) 2002 "Going Alone"). Virtually none involved preferential as distinct from Most Favoured Nation liberalisation. However, it was concerted unilateral liberalisation, as it was strongly influenced by discussions within Asia Pacific Cooperation and ASEAN, as well as bilateral political meetings, which increased confidence in each country that its own liberalisation would be accompanied by similar action in neighbouring countries. While each country stood to gain from its own liberalisation whatever others did, the liberalisation of neighbours enhanced the gains of each country's own liberalisation.

The successful trade liberalisation in the Western Pacific for more than a decade from the mid-eighties can be taken as a prototype for the concerted unilateral action that is favoured in the multi-polar international system. The role of APEC was to build confidence in each country of the value of trade liberalisation to its own development, and in its neighbours' commitment to concurrent liberalisation. Western Pacific economies' membership of the GATT/WTO (China from 2001) locked these gains into commitments to the global community, and provided the vehicle for resolution of trade disputes.

APEC and the WTO can continue to play these roles in support of renewed commitment to concerted unilateral liberalisation.

Is there a productive role as well for the TPP and RCEP? I do not see the extension of preferential trade as promoting free and open trade in the Asia Pacific region. It would increase barriers to trade between TPP members and RCEP members who are not participants in both—including the largest of the Asian developing economies, China, India and Indonesia. Preferential trade within TPP or RCEP would obviously inhibit trade expansion with Europe, Africa and countries beyond the Indo-Pacific region. Optimists argue that successful negotiation of the proposed new plurilateral preferential areas would enhance the prospects for reduction of barriers between the two areas: this is mere assertion, and analysis suggests the opposite.

We would be more certain of net gains from trade liberalisation within TPP and RCEP if it were based on the pre-Asian financial crisis Western Pacific and early APEC principle of concerted unilateral liberalisation of trade on a non-discriminatory basis. All reductions in preference would be on a most favoured nation basis. This is a long way from current thinking, but is the one way to achieve genuine liberalisation in a multi-polar world.

Beyond preferential trade, there may be gains for member countries without costs for the region as a whole from "behind the border" integration of regulatory arrangements among

TPP or RCEP members. The condition for welfare-enhancing agreements is that the proposed new regulatory arrangements are themselves well designed to enhance welfare.

Climate Change

Standard analysis suggests that international cooperation on Climate Change is inherently more challenging than on trade liberalisation. This follows from the analytic reality that unilateral liberalisation enhances economic welfare in one country whatever others do, whereas unilateral action on climate change seems to impose national costs without corresponding national benefits. Comprehensive and binding international agreements may be necessary for progress in reducing greenhouse gas emissions, but not for trade liberalisation.

The earlier analysis told us that negotiations directed towards ambitious, comprehensive, binding agreements on a global basis were unlikely to be fruitful in a multi-polar world. This discouraging conclusion is borne out in the unhappy history of attempts so far to reach binding international agreements on climate change mitigation.

By degrees, the international community has groped its way to a different approach to climate change mitigation that can be effective in a multi-polar world. Attempts to move forward within a comprehensive, legally binding agreement failed diplomatically at the Copenhagen Conference of the parties of the United Nations Framework Convention on Climate Change (UNFCCC). In a series of Conferences of the Parties from Copenhagen in 2009, most importantly in Cancun in 2010, an approach was developed can be described as concerted unilateral mitigation.

The UNFCCC has been successful in coordinating the generation of scientific information on the impacts of climate change, rules on the measurement of contributions to global mitigation including for trade in emissions entitlements, and an agreed objective (a substantial probability of holding human-induced temperature increases to 2 degrees Celsius). It has provided a forum within which each country records its own commitments to reduce greenhouse gas emissions. In these ways, the role of the UNFCCC is analogous to that of the WTO. Some countries have announced that their commitments are binding, but there is no mechanism for enforcement, so they are voluntary and non-binding even for those countries. In this respect, the reach of the UNFCCC does not extend as far as the WTO.

All major countries have made substantial domestic commitments on reducing greenhouse gas emissions—in some cases absolutely (all developed countries), in others in emissions intensity terms or against “business as usual” (all systemically significant developing countries). The commitments add up to major changes in emissions trajectories, especially in the entities with the largest emissions (China, the United States, Europe, Japan, Brazil, Indonesia). All major countries are making strong progress towards meeting emissions reduction targets.

It is early days yet in the immense tasks of reducing emissions of greenhouse gases to an extent that is consistent with the agreed mitigation objective. However, progress is so far so good within a framework of unilateral mitigation that has emerged in response to the geo-political realities of a multi-polar world.

Concluding Remarks

Effective international cooperation is going to be difficult in the multi-polar world that has been emerging rapidly since the global financial crisis. Difficult, but not impossible if the international community applies the results of analysis to the development of cooperative institutions. Different areas of cooperation will require different institutions.

Much progress can be made through adaptation of institutions that have developed at various times since the postwar international political system emerged six and a half decades ago. There are examples in recent experience of how the international system can work cooperatively in the multi-polar world. Frequent and deep interaction amongst high-level political leaders on a bilateral and plurilateral basis can provide direction and impetus to reform to specialised institutions.

Plurilateral interaction at the levels of leaders has been institutionalised globally in the G20, and regionally in the Asia Pacific in APEC and Indo-Pacific in the ASEAN Plus meetings.

We have the essential building blocks for international cooperation in a multi-polar world. It remains to define objectives and approaches to make the emerging system work.

Ross Garnaut

University of Melbourne

10 June, 2013.

.