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Current State and Evolution of the Global Economic Order

A Grand Bargain to Strengthen the Global Economic Order

Matthew P. Goodman

The global economic order is under stress. The institutions and rules set up at the end of World War II to provide a framework for global prosperity are under mounting attack, for both failure to deliver and failure to adapt. But the order is arguably "too big to fail," with a breakdown of these institutions and rules likely to cause broad economic harm. And critics have yet come up with an alternative set of arrangements that would deliver more benefit to more people. Thus the world's largest economies—starting with the United States and China—have a strong incentive to work together to fix the current order rather than see it fall apart. The good news is that a grand bargain to achieve this objective may be achievable.

There have been two main lines of attack against the existing order. One comes primarily from within the advanced countries of the North Atlantic and holds that the institutions of postwar economic governance are no longer delivering strong, sustainable, balanced, and—above all—inclusive economic growth. The other comes from emerging states, which argue that governance structures set up over 70 years ago no longer reflect the actual distribution of economic weight in the world and are thus unfair.

To be sure, over the past decade since the world was rocked by financial crisis, global growth has been disappointing. Annual real GDP growth of the world economy between 2008 and 2016 averaged 3.27 percent, compared with 4.5 percent in the period between 2000 and 2007.[1] Europe and Japan, the world's first- and fourth-largest economic areas, have only recently begun to emerge from the growth doldrums. The United States has been the star performer among large advanced economies yet has seen only mediocre growth of around 2 percent per annum since the global financial crisis. Meanwhile, China's economy has slowed substantially (from admittedly unsustainable rates close to 10 percent annually).

[1] International Monetary Fund, *Report for Selected Country Groups and Subjects: World*, 2017, http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?pr.x=64&pr.y=20&sy=1990&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&c=001&s=NGDP_RPCH&grp=1&a=1.

Moreover, inequality has grown in both advanced and emerging countries.[2] In the United States, the share of national income of the top 10 percent of the population rose from 35 percent to 47 percent from 1978 to 2015, while the share of the bottom half dropped from 20 percent to 12 percent. Similar trends were seen in China, where the share of the top 10 percent rose from 35 percent to 41 percent over the same period, while the share of the bottom half fell from 27 percent to 15 percent.

Behind these numbers is a growing sentiment, especially in advanced economies, that the workforce is not being prepared for the realities of a twenty-first-century economy that is both more globalized and undergoing rapid technological change. This has fed populism and was a major factor in two political earthquakes in 2016: the British vote to leave the European Union and the election of Donald Trump as U.S. president. Both Brexiters and Trump pointed to remote multilateral institutions, whether the European Union or World Trade Organization (WTO), as principal sources of voters' discontent.

Thus a leading threat to today's order is not from outside forces, but from within.

Meanwhile, rising states have a point about the unfairness of today's global economic governance. Emerging economies remain underrepresented in institutions like the International Monetary Fund (IMF) and World Bank. China, for example, accounted for nearly 15 percent of the global economy in 2016 but held only 6.09 percent and 4.56 percent, respectively, of the voting shares in those institutions. (It is worth noting that the United States, too, is underrepresented, holding only 16.5 percent of the shares of the two institutions against its roughly 25 percent weight in the global economy; it is European countries that retain disproportionate shares.)

The perceived unfairness of global governance has not only fed resentment and criticism from rising states; it has also encouraged them to block rulemaking efforts in existing institutions. India's upending of a multilateral deal on trade facilitation in 2013 is one example. And emerging countries have begun to set up alternative institutions, including the New Development Bank (NDB, the so-called "BRICS Bank") and the Asian Infrastructure Investment Bank (AIIB) initiated by China. Rising states appear to be moving along a spectrum of institutional choices described by G. John Ikenberry: from status quo stakeholder to authority-seeking stakeholder, institutional obstructionist, external innovator—and ultimately, as in the case of China's ignoring of international legal rulings on its island-building in the South China Sea, to outright opponent of existing institutional arrangements.[3]

Yet the criticism from both sides is exaggerated. In broad historical terms, the postwar economic order has delivered unprecedented prosperity, stability, and predictability for over 70 years—and continues to do so. Europe's postwar recovery and integration, Japan's growth miracle, China's spectacular rise over the past 40 years, the lifting of over 1 billion Asians out

[2] Thomas Piketty, *Capital in the Twenty First Century* (Cambridge Massachusetts: The Belknap Press of Harvard University Press, 2014), https://www.amazon.com/Capital-Twenty-Century-Thomas-Piketty/dp/067443000X.
[3] G. John Ikenberry and Darren J. Lim, *China's emerging institutional statecraft: The Asian Infrastructure Investment Bank and the prospects for counter-hegemony*, Brookings Institution, April 2017, https://www.brookings.edu/wp-content/uploads/2017/04/chinas-emerging-institutional-statecraft.pdf.

of extreme poverty—none would have been possible without the underpinning of institutions and rules established in the wake of World War II.[4]

Moreover, the order has proved adaptable and has continued to deliver meaningful results, both in substance and institutionally. At the high-water mark of international cooperation following the global financial crisis, G20 leaders at the London Summit in April 2009 agreed to provide $5 trillion in new stimulus by the end of the year—and did. The G20 has also driven meaningful reforms in international rules on issues from bank capital to tax avoidance and evasion. The addition of the Chinese renminbi (RMB) to the basket of currencies in the IMF's special drawing rights (SDR) facility in 2016 is another example of the order's substantive adaptability.

There have also been important reforms in institutional processes. The elevation of the G20 to leaders' level, and the implicit downgrading of the G7 as the "steering group" for the global economy, was a major shift in the center of gravity of global governance toward the emerging world. China hosted the G20 in 2015, and India will do so in 2018. Promised adjustments in "shares and chairs" at the World Bank were implemented shortly after the G20 agreed to these at the Toronto Summit in 2010.[5] Similar reforms at the IMF admittedly took longer, due to foot-dragging in the U.S. Congress, but these eventually came into effect in 2016.[6] Meanwhile, the existing order has been able to accommodate the establishment of new institutions led by emerging states, such as the NDB and AIIB.

The burden on critics of the existing order is to come up with a set of institutional arrangements, rules, and standards that would produce broader benefits. American or British nationalists may prefer unilateral or bilateral approaches but are unlikely to find that those deliver better economic outcomes. China's leaders may have a preference for state capitalism or Internet sovereignty but are unlikely to find many followers if they insist that international arrangements be based on these approaches, particularly if they are tilted toward China's economic and political interests. Beijing seems to recognize the lack of acceptable alternatives: in establishing new institutions like the NDB and AIIB, Chinese officials have been at pains to say they are designed not to replace the existing order but to enhance it.

If the existing order is flawed but can still deliver and adapt, and if there are no good alternatives, then both the United States and China should want to preserve and reform it. This suggests the makings of a grand bargain between Washington and Beijing. Under this deal, the United States would continue working to give China a bigger seat at the table of global economic governance, while China would help to substantively improve the order for the benefit of all. Both would commit to support equitably governed, effective institutions and to follow agreed rules.

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[4] Max Roser and Esteban Ortiz-Ospina, "Global Extreme Poverty," Our World in Data, March 27, 2017, https://ourworldindata.org/extreme-poverty/.
[5] G20 Research Group, "The G20 Toronto Summit Declaration," June 27, 2010, http://www.g20.utoronto.ca/2010/to-communique.html.
[6] International Monetary Fund, "Press Release: Historic Quota and Governance Reforms Become Effective," January 27, 2016, https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr1625a.

A U.S.-China agenda for reform of the existing order should center on three priorities. The first is to improve the governance of existing institutions like the World Bank and IMF. This means both giving more "shares and chairs" to underrepresented countries and streamlining the operations of these institutions.

Second, Washington and Beijing should work together to update and strengthen the substantive rules of the global economic order. There are many areas of international economic activity—trade, investment, finance, etc.—where the rules are either out of date, not well enforced, or, as with much of the new digital economy, nonexistent. A healthy competition over the best approach to the rules, such as different trade arrangements in the Asia-Pacific region, is natural and salutary, as long as the end result is widely accepted and accessible by all.

The third, and arguably most important, agenda item for the United States and China is to prepare the global workforce for the challenges of the twenty-first century. Technological and broader societal shifts are fundamentally changing the nature of work. For example, one of the most common jobs in many countries today—truck driver—may be obsolete within the next two decades. Governments need to rethink the basic investments in education, training, and social safety nets needed to adapt to these new economic realities. Sharing experiences and policy solutions in these areas should be a core part of the agenda of the G20 and other international forums in which the United States and China play leading roles.

A grand bargain like this that strengthens the global economic order would support both President Donald Trump's promise to "make America great again" and Chinese President Xi Jinping's vision of "the great rejuvenation of the Chinese nation." It is also essential to extending the unprecedented prosperity and stability the world has enjoyed over the past 70 years.

World Economic Order: Present and Future

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The global economic landscape has undergone profound changes since the end of the Cold War. After the global financial crisis, the world economy entered a "new normal," and there are mounting challenges that need to be managed. Unfortunately, the global governance system has not kept pace with the scale and complexity of these challenges.

The postwar architecture of world economy was to a large extent fashioned by the United States, with the hope of reconstructing a liberal international economic system. The International Monetary Fund (IMF), the World Bank, and General Agreement on Tariffs and Trade (GATT) laid the foundation for the postwar global economic order, and international trade and capital flows gradually started to resume. To solidify its supremacy in the shadow of Cold War, the United States supported the economic development of its allies through aid, such as the Marshall Plan aimed at Western Europe and enormous funding directed to Japan during the Korean War. In the 1970s, however, U.S. hegemony began to wane, as a host of developing countries arising from the postwar National Liberation Movement flocked to the United Nations, pressing for a so-called New International Economic Order that would be more in favor in Third World countries. Moreover, the collapse of the Bretton Woods system in 1973 meant that the United States had to rely more on macroeconomic policy coordination mechanisms with other developed countries to maintain the international monetary order.

The eruption of the 1997–1998 Asian financial crisis sparked extensive suspicion of the manner of governance adopted by the IMF and the "Washington Consensus" behind it, and accelerated a rising awareness of regional cooperation across Asia. The outbreak of the 2007 subprime mortgage crisis in the United States, as well as the 2010 sovereign debt crisis in Europe, changed the long-established belief that developed economies are immunized from financial crises. As the international economic system has become increasingly incapable of dealing with the detection, prevention, and treatment of crises caused by the wave of globalization, regional or cross-regional economic governance platforms are playing an ever more important role. This development can be seen in the multilateralization of the Chiang Mai Initiative, the strengthening of the BRICS, and the rise of mega-regional free trade agreement negotiations like the Regional Comprehensive Economic Partnership (RCEP), Trans-Pacific Partnership (TPP), and Trans-Atlantic Trade and Investment Partnership (TTIP).

Despite numerous challenges, the primary architecture of world economy remains largely unaltered. And the reform of the current international economic system should focus on three main issues.

First, the United States' superpower status is challenged by its comparative decline in strength. U.S. gross domestic product (GDP) was in the lead until 2003 when it was overtaken by the European Union (EU). According to statistics released by the World Bank, U.S. GDP amounted to 30.6 percent of the world's total in 2000, whereas by 2015 the figure had fallen to 24.3 percent.[1] At the same time, the U.S. share of international trade and investment has dropped considerably. Despite the monetary hegemony that the U.S. dollar has maintained for decades, the creation of the euro has undermined its absolute dominance, which, together with the simmering debt problem plaguing the United States, will gradually shake its status as a safe "currency haven." Plus, as the lukewarm economy and rising unemployment have become its main concerns, the United States is no longer capable of driving global economic growth and is shifting its focus to transplanting the domestic crisis overseas in an attempt to maintain its competitiveness in global economy. In the realm of security and diplomacy, irresponsible behavior by the United States and some of its unsuccessful economic and diplomatic policies have also caused damage to the international order and the country's own leadership.

Second, the rise of emerging powers was expected to reorder the global economy's architecture. Since the beginning of the twenty-first century, developing countries have maintained rapid economic growth, and their united strength is approaching that of the Group of Seven industrialized countries (G7). According to IMF estimates, in 2001 G7 nations accounted for nearly 43.435 percent of the world's total GDP in terms of purchasing-power parity, but in 2015 their share declined to 31.5 percent. During the same period, the economic share held by BRICS countries has increased from 19.3 percent to more than 30.8 percent of the world's total.[2] Over the past several years, developing countries have become a new driving force in the global economy. Besides, they have begun to participate in top-level global governance design and thus play an increasingly important role in certain important global institutions. This situation is reflected above all in the rise of the Group of Twenty (G20), which encompass major developed and developing economies, and acts as the most important platform for international economic cooperation. Unfortunately, developing countries have still not gained the status or voice proportionate to their strength and the momentum of their economic growth in the international economic system. One reason is that emerging powers are facing the dilemma of "double identity" as large but developing countries. All in all, the redistribution of interests, obligations, and power entailed by the rise of developing countries will have an explosive impact on the international order. The question as to whether or not to accept and manage the rise of developing countries is key to deciding whether the current international system is elastic and stable.

Third, the new problems that have loomed large since the eruption of the global financial crisis called into question the liberal international economic system. As the principle of free trade marked the postwar global economic order, the past decades have witnessed large-scale economic globalization, and countries adopted reform measures and a policy of opening-up, handled international affairs in a cooperative manner, and coordinated effective

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[1] World Bank, "GDP (current US$)," 2017, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD.

[2] International Monetary Fund, *Report for Selected Country Groups and Subjects: Major Advanced Economies (G7)*, 2017, https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?pr.x=50&pr.y=10&sy=1980&ey=2015&scsm=1&ssd=1&sort=country&ds=.&br=1&c=119&s=PPPSH&grp=1&a=1; International Monetary Fund, *Report for Selected Countries and Subjects: Brazil, China, Russia, India, and South Africa*, 2017, https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?pr.x=16&pr.y=9&sy=2001&ey=2015&scsm=1&ssd=1&sort=country&ds=.&br=1&c=223%2C924%2C922%2C199%2C534&s=PPPSH&grp=0&a.

policies. However, globalization has been ebbing in the wake of the global financial crisis for it revealed economic imbalances, inequality, and other social conflicts that had been concealed by rapid global growth. What's worse, side effects of the global financial crisis began spilling from the economic and financial to the social and political sector, causing turmoil in some regions and countries. Having suffered from global financial woes, widespread unrest, and internal conflicts, people across the world became more concerned with injustice in the distribution and consumption of global wealth, and the pursuit of equity and justice has become an irreversible and increasingly popular trend.

As the United States predominance in the global economy is expected to decline further now that China will be becoming the world's biggest economy by 2024, developing countries expand, and the new problems are fermented, the global economic order enters a seemingly fragmented stage. Some may point to the downside of China's rise and are concerned that China intends to challenge the dominant status of the United States in the global economic order. It's hardly the truth. Admittedly, the Asian Infrastructure Investment Bank (AIIB) and Belt and Road Initiative are likely to reshape the economic geography in the affected regions and thus exert an influence on the global economic landscape, but it doesn't necessarily mean that China has the ambition to replace U.S. leadership in the global economy. Instead, China aims to abide by current global rules and institutions while assuming deserved responsibilities commensurate with its international status. It's not only because emerging powers, including China, have all benefited a great deal from the postwar global economic order and a peaceful international environment, but more importantly, the international community is calling for a new approach to growth and a competitive outlook with tolerance for the development of other countries as the core value, which means absolute authority in the global economic order must become a thing of the past.

Indeed, every bit of change in the global economic order entails the redistribution of international responsibility as well as international power. Emerging powers, including China, should encourage a perspective that tolerates development across the world. Cultivation of such a core value will help emerging powers undertake international responsibilities proportionate to their current national strength and historical suffering from colonialism, and prevent them from being trusted with responsibilities and obligations beyond their capacity. At the same time, such an attitude toward the development of other countries will also demand that developed countries undertake their responsibilities, fulfill their commitments, and pay more attention to the reasonable demands of less-developed countries. This will certainly have a global impact and will translate into a more inclusive global economic order in the near future.