THE TRANSFORMATION OF GLOBAL GOVERNANCE PROJECT

14 NOVEMBER 2018 SEMINAR

THE GOVERNANCE OF TRADE, FINANCE AND MACROECONOMIC COOPERATION: A HISTORICAL PERSPECTIVE SINCE THE 1970S

Seminar insights – Emmanuel Mourlon-Druol, George Papaconstantinou and Jean Pisani-Ferry

1. **The 'paradise lost' feeling that there was a golden age of global governance dominates policy reflections.** Nostalgia of this golden age inspires recommendations to make globalisation sustainable again by revamping its rules and by strengthening the institutions that support it. Recurrent calls for a "new Bretton Woods" illustrate the attractiveness of an idealised past.
2. **But the core task of historians is to de-idealise the past** and this applies very well to global governance. Even a cursory assessment of a few key episodes of the recent decades leads to question the widely held assumptions that there was a time when the global economic governance framework was comprehensive, unified, rules-based and cooperative.
3. **The framework of governance rules and institutions was never comprehensive enough to cover adequately the multiple channels of interdependence.** In fact, tension between the actual pattern of integration and the institutional set-up has been nearly permanent and the history of global governance is one of institutional arrangements catching up slowly and haphazardly with reality.
   - International trade offers a case in point: the Uruguay round launched in the 1980s was intended to fill existing gaps in the sectoral coverage of the international trade rules, while an enlargement of membership in the GATT (not least to China) was being pursued in parallel. It was an ultimately successful, but conflictual and imbalanced process, the outcome of which generated frustrations and grievances on the part of emerging as well as advanced countries;
   - Supervisory coordination in banking and finance is another case. Attempts to define an international regime for supervision and resolution started in the 1970s but failed to produce meaningful results and degenerated into weak cooperation procedures. It is only in response to successive crises (the Latin American debt crisis of the 1980s, the financial accidents of the late 1990s, the global financial crisis of 2008) that rules were tightened and that monitoring procedures were strengthened.
4. **Complaints about the fragmentation of the global governance regime go back to the 1970s at least.** The lack of a coherent, or even unified regime was actually one of the key motivations for instituting regular summits of the heads of state and government (the Gs). At the first summit in Rambouillet in 1975, British PM Harold Wilson already complained about the proliferation of institutions; but he, and his colleagues, noted at the same time that these institutions gathered officials at ministerial level only. Heads of government did not have an international forum where to meet on a regular and frequent basis. The G7, and later the G20, took up the responsibility of orchestrating the responses to prevailing challenges – by coordinating national policies but more often by setting priorities and tasking institutions. Whether the emergence of this rather informal mode of governance (and of the parallel institution of the European Council, whose creation occurred a little earlier, in 1974) should be regarded as a testimony of the failure of the rules-based institutional order, or as a necessary complement to it, is a matter for debate.
5. **The "rules-based" regime was never entirely rules-based – or when it was, rules could be breached.** This is very apparent in the monetary field. Surveillance of national policies has generally been toothless and even the concepts that underpin it have been left trailing reality. In the early 1970s the US unilaterally departed from the rules of the Bretton Woods system by taking the dollar off gold, devaluing it and ultimately going for a floating exchange rate regime. This was a major break away from a fundamental rule of the post-war system. Their decision represented a trauma for Europe. It created confusion and international tension, before cooperation resumed and eventually resulted in defining new rules.
6. **A recurring theme of the history of global governance has been whether it changes because of the need to adapt to evolving interdependence structures or as a result of power struggles between participating nations.** If anything, the question has gained relevance in today's context.

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Seminar minutes

▪ Session 1: Macroeconomic cooperation and leadership in the 1970s

The speaker introducing the first session noted that the early 1970s were a time when international relations were widely perceived to be in the throes of a multifaceted crisis. The decision of the US to unilaterally terminate convertibility of the dollar to gold in 1971 effectively brought the Bretton Woods system of fixed exchange rates to an end. This was compounded in 1973 by OPEC's decision to proclaim an oil embargo against nations perceived as supporting Israel during the Yom Kippur War, quadrupling the price of oil. The sense of urgency in the face of generalised crisis was underscored by a shared epistemic script based on a fear of a repeat of the crisis of the 1930s and the Second World War that ensued. Also furthering this sentiment was the Cold War context, where leaders felt they had to present a united front to prove the superiority of their values and economic system.

> *"We need to look at the 1970s and 1980s for the norms that still govern our international organisations."*

The situation led heads of state and government to look for new venues where they could discuss macroeconomic cooperation. Existing fora such as the UN, the IMF or the OECD (or on the European level, the Council of the EU) were felt to be unfit for that purpose, too formal or too technical. Other international gatherings were emerging at the same time, such as the meetings in Davos and the Trilateral Commission, but they were private endeavours. It was also felt that reliance on expert solutions was fuelling a democratic deficit, and that global governance was impaired due to a fragmentation of issues. In the context of increased interdependence, specialised institutions were perceived as unfit for the purpose of strengthening across-the-board cooperation.

December 1974 saw the creation of the European Council, bringing together European heads of state and government (of Belgium, France, West Germany, Italy, Luxembourg, the Netherlands, plus the newly joined Denmark, Ireland and the U.K.). The creation of what would become a key pillar of the EU institutional architecture followed informal summits in 1961 and 1969. In a similar vein, November 1975 marked the first G6, bringing together for informal exchanges the heads of state and government of the world's major industrialised countries (France, West Germany, Italy, Japan, the UK and the US). Canada was invited to join in 1976, completing the G7. Annual G7 summits soon became a pillar of global economic cooperation (and they lost their informality).

Three historical milestones stand out: the 1975 Rambouillet Summit, the 1978 Bonn Summit, and the 1985 Plaza Agreement on exchange rates, which was followed by the 1987 Louvre Accord. The Rambouillet Summit is noteworthy in that it was the first of its kind, acknowledging the collapse of the Bretton Woods architecture and the new international monetary non-system. While French President Valéry Giscard-d'Estaing had initially envisaged a summit on narrower monetary issues, German Chancellor Helmut Schmidt helped broaden the scope, setting the themes of macroeconomic cooperation that have remained on the agenda since.

The Bonn Summit is remembered for producing a comprehensive agreement on Japanese and German reflation as well as on the US fight against inflation. More generally, it reflected the shifting international balance of economic weight, away from the US dollar and towards Europe and Japan. The agreement was celebrated at the time, but was short-lived; despite this, it is remembered by some as having been very successful, while others (especially in Germany) regard it as having produced ill-conceived plans. In contrast, the Plaza and Louvre Accords were landmark international agreements between G7 member states (France, West Germany, Japan, the US and the UK, joined by Canada for the Louvre Accord). Beyond the agreement to depreciate and the stabilise the US dollar, they delivered an exchange rate coordination regime that lasted for several years.

> *"The core job of the historian is de-idealise the past."*

While the G7 meetings are not treaty-based, their creation resulted in lasting governance changes, plugging a glaring gap in global governance and enabling leaders at the highest level to exchange and develop shared diagnoses of the economic situation and the economic challenges. These changes were not necessarily major in terms of *outcome*, but certainly in terms of *process*: a permanent forum for cooperation and trust-building was established that offered the leader the possibility of setting priorities for technical discussions and of reaching agreements that involved cross-sectoral trade-offs (for example on trade and at the same time on exchange rates). Nevertheless, these arrangements remain informal, with a low level of enforcement. This executive deficit in global governance persists today.

In the discussion that followed the presentation, one participant reflected on the role of the US then and now in setting up and maintaining governance arrangements, seeing concern over the lack of rules and constructive search for political discussion arrangements at the time; this was met with a rejoinder that it was the US which had toppled the Bretton Woods system to begin with. One participant recalled that the Bretton Woods rules-based system was far from autonomous, requiring significant intervention to keep exchange rates stable.

"It's all about the US."

Participants debated whether the establishment of the G7 reflected a failure of formal institutions and a breakdown of a rules-based system, or whether it simply filled a gap in that same system. One participant noted that the continuation of G7 meetings was by no means acquired from the start, only resulting from an informal agreement in 1977, comparing it with the institutionalisation of the European Council in the 1986 Single European Act. Another contested the parallel, arguing that the European Council resulted from the European Community's institutional development whereas the establishment of the G7 reflected institutional failure. The same participant expressed surprise that the involvement of heads of state and government was not seen as necessary until then, and reflected on the evolution of the method of their meetings, from a direct, "hands-on" approach to one of agenda-setting.

- **Session 2: The challenges to the governance of trade in the 1980s**

The speaker introducing the second session suggested that the trade governance regime was under great pressure by the 1980s for five main reasons. First, several commodities like agricultural products and textiles were exempt from GATT disciplines, and the absence of an agreed framework led to tensions between developed and less developed countries. Second, trade in services was expanding without corresponding GATT rules. Third, advanced countries were beginning to feel frustration over the lack of protection of intellectual property rights. Fourth, emerging economies had an increasing weight in global trade but they were either acting as free riders within, or weren't part of GATT. Fifth, finally, GATT's relevance was diminishing: China was not (yet) part of it and major geopolitical and economic changes (such as China's economic reform and the opening up of formerly socialist countries) were not reflected in the governance of international trade.

These tensions provided the impetus for an American-European "deal" to seek to strengthen the rules and institutions of the multilateral trade regime while integrating new members: this was the origin of the Uruguay Round and the resulting creation of the WTO.

GATT rounds until the 1960s had mostly focused on reducing tariffs. The Kennedy Round, started in 1964, added anti-dumping as a concern; the Tokyo Round, started in 1973, significantly expanded the agenda by including non-tariff issues. The Uruguay Round began in 1986, concurrently with China's accession request, and ended in 1994: it not only achieved further tariff reductions, but also saw the inclusion of services (GATS), intellectual property rights (TRIPS) and investment (TRIMS) under its remit, as well as an agreement to gradually include textile and agricultural products in its disciplines. It also transformed the GATT into the WTO, a full-fledged international organisation equipped with a binding dispute settlement mechanism. Its creation had been strongly advocated by European countries and Canada, with the argument that liberalisation had to be matched by institutionalisation.

"As Pascal Lamy said, 'If you liberalise you must organise'."

In hindsight however, institutionalisation went against long-held US preferences, concerned with maintaining their sovereignty and wary of creating more international bureaucracy. As far as trade negotiation were concerned, developing countries have considered that they gave up more in the Uruguay Round negotiations than what they gained; and while international trade volumes increased, it is unclear whether the negotiated tariff reductions and assorted agreements can be held directly responsible, though it has become part of the WTO's self-promotional narrative.

China's bid for GATT/WTO accession took 15 years of negotiation, but it finally gained membership in 2001. Its aim was to stabilise and gain larger access to Western markets in order to support its export-led economic growth. On the other hand, the US's aim was to oblige China to abide by enforceable trade rules, while pushing Chinese leadership to reform the country's economy so as to make it more compatible with the global capitalist economy. In this, the US's strategy changed from containment under George H. W. Bush to engagement under Bill Clinton, the latter being a driver for Chinese accession. In contrast, the

European priority was to place economic and trade relations with China under a legally binding framework. China did not gain its accession cheaply however, having to make protocol commitments substantially exceeding those of other members. However, one seminar participant noted that China effectively retained a number of tariffs, while gaining by being freed from its burdensome annual review of trade relations by the US Congress.

The Uruguay Round was the last to be dominated by American and European interaction and preferences, as evidenced by the stalemate of the Doha Round where developing countries have reshaped the bargaining dynamics. Both the US and the EU shifted priorities to pursuing plurilateral agreements like TTIP and TPP, with the more or less explicit goal of isolating or forcing compliance on China. While TTIP foundered for political reasons, TPP, however, was repudiated by President-elect Trump, whose approach to trade governance has been explicitly transactional and bilateral. Participants agreed that while US grievances against the WTO began before his tenure, he has imposed tariffs on steel and aluminium under the dubious pretext of national security, and has been blocking the nomination of judges to the Appellate Body, gravely threatening the multilateral trade regime.

In the discussion, participants agreed that challenges in trade governance have stemmed from both geopolitical and structural factors. On the one hand, the system was dominated by the US and European countries, refusing to play by the agreed-upon rules once they suited them no longer and cede some of their power to newcomers, provoking a backlash on their part. On the other, it was changing patterns of trade that made the system meant to govern it obsolete. Participants questioned the degree to which the WTO could function with the US acting in bad faith, groundlessly invoking the national security "nuclear option", or indeed without the US, to which the answer was pessimistic.

One participant asked why the establishment of the WTO coincided with the rise of regional trade agreements, taking the example of NAFTA. Another explained that NAFTA was designed as an alternative to the Uruguay Round by aiming for deepening regional integration, and that opinion is mixed on whether it was a stumbling block or a stepping stone to further trade liberalisation. The same participant noted however that other trade agreements of the time were mainly geopolitical and had little to do with trade *qua* trade.

- **Session 3: Financial account liberalisation and the challenges to the governance of finance**

The speaker introducing the second session suggested that the late 1970s and the 1980s were a transformational period for the international monetary system, whose governance challenges bear more than a passing resemblance to those of the 2000s. The period saw a rapid internationalisation of banking and finance, with corresponding financial innovation and risk; accompanied by, on the other hand, trade protectionism, commodity shocks (especially oil), and accumulation of sovereign debt. Accordingly, attempts were made to bolster existing and set up new governance frameworks to face these challenges. Elements of these comprise the IMF and bilateral central bank swaps, to provide emergency liquidity, and the Basel Committee, to provide uniform banking guidelines: an incipient global financial safety net.

Bilateral central bank swaps were part of a two-tier global financial safety net before the 1970s. Renewable swap lines were established in the 1960s, climbing to significant amounts. Recourse to these lines was a "first line of defence", before having to go to the IMF.

When the US suspended dollar convertibility, effectively kicking off the world floating exchange rate regime, the IMF attempted to head off and mitigate potential effects by publishing its important surveillance decision in 1977, which remained unchanged until 2013. It puts forth the *obligation* for members avoid manipulating exchange rates or the international monetary system; and *recommends* that members intervene in the exchange market to counter disorder, while taking into account other members' interests. An additional provision was added in 2007 to the surveillance decision, that members should avoid exchange rate policies that create external financial instability. The decision specifies the situations in which the IMF can engage a dialogue with a member state; but appreciation of when this is warranted is inevitably very difficult due to the political sensitivity of such a decision. This kind of dialogue is in any case only advisory and bilateral, and has displayed a mixed record in effectiveness.

The IMF's Special Drawing Rights system had been introduced in 1969 to supplement a shortfall of preferred foreign-exchange reserve assets. They underwent reform in the 1970s and 1980s. The SDR was made the unit of account of the Fund in 1972, but more ambitious plans such as devising a "market SDR", to be used widely in global financial markets, or allowing the creation of an SDR-denominated substitution account housed in the IMF to facilitate reserve diversification and shift exchange rate risk away from the dollar, foundered mostly due to US disinterest.

International financial surveillance was glaringly lacking in the 1970s. A series of bank failures and fraud led in 1974 to the creation of the Basel Committee on Banking Supervision (BCBS) by the G10[1], plus Luxembourg and Spain. The committee was established within the Bank for International Settlements and it is composed of central bank and regulatory authority representatives. Original projects for an early warning system or a coordinated supervisory arrangement were quickly abandoned due to sovereignty concerns, falling back on informal communication and best practice sharing. This "Basel Concordat", established in 1975, failed however to draw clear-cut rules about where responsibility for supervision ultimately laid between home and host countries, since international supervision had been rejected.

"BCBS members were like regulatory generals fighting the last war."

The BCBS works as an informal forum encouraging convergence towards common standards and approaches. However, its functioning at its inception was reluctant and slow, and the standards it produced were backward-looking and, since they were negotiated with the banks it was attempting to regulate, vulnerable to regulatory capture. The three painstakingly negotiated Basel Accords have done little to prevent crises, and still rely on national interpretation and implementation of their guidelines. Rules-based financial regulation may not be an optimal solution: incentives-based regulation may work better, due to the pace and depth of innovation.

In the discussion, seminar participants remarked that issues considered novel today are in fact not new, though significant qualitative changes have taken place. They agreed that some past and present governance problems were common, such as issues with the IMF's traction, legitimacy and even-handedness, or the difficulty of requesting help from the Fund due to stigma; or more broadly, the fact that the burden of adjustment still weighs on for the greater part on debtors. One participant noted that a regional/global two-tier global financial safety net system has already emerged, sharing the same problems as the bilateral/global system preceding it: the global level remains too weak, while at the infra level creditors may have difficulty refusing to extend loans to close partners. They also likened private information held by banks as a kind of wealth, which prompted another participant to observe that willingness to share this kind of information with a central repository is growing and that it would be useful to have a global authority capable of presenting a complete picture of the financial situation.

- **Wrap-up**

Summing up, it was put forward that increased systemic complexity may have favoured fragmentation; but it may be perception of complexity that is the more relevant factor. In keeping up with the core historian's task of de-idealising the past, all three speakers thus insisted that the widespread impression that today's crises were more complex than those that occurred 20, 30, or 50 years ago was often a retrospective construct: policymakers confronting these problems in the past equally felt overwhelmed by the complexity of policy challenges then. The challenges of the credibility of institutions, and of their trade-off between inclusivity and efficiency, remain. The institutions themselves display continuity through structural shifts, which have sometimes been brutal; in parallel, solutions to their problems have also displayed surprising continuity.

Adrien Bradley

[1] Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, UK, US

Seminar programme

14 November 2018

9:00 – 9:30	Welcome and introduction by Emmanuel Mourlon-Druol (University of Glasgow), George Papaconstantinou and Jean Pisani-Ferry (EUI)
9:30 – 10:30	**Session I - Macroeconomic cooperation and new international groups** Speaker: Emmanuel Mourlon-Druol (University of Glasgow)
10:30 – 10:50	*Coffee break*
10:50 – 11:50	**Session II - The challenges to the governance of trade** Speaker: Lucia Coppolaro (Università di Padova)
11:50 – 12:50	**Session III - The challenges to the governance of finance** Speaker: Catherine Schenk (University of Oxford)
12:50 – 13:00	**Wrap-up** Remarks by George Papaconstantinou and Jean Pisani-Ferry

Seminar participants

Grace Ballor	EUI, Max Weber Programme
Adrien Bradley	EUI
Klodiana Beshku	EUI
Stefano Cappiello	EUI, Florence School of Banking and Finance
Lucia Coppolaro	Università di Padova
Emmanuel Mourlon-Druol	University of Glasgow
Alfonso Iozzo	Intesa San Paolo
George Papaconstantinou	EUI, School of Transnational Governance
Antonio Padoa-Schioppa	University of Milan
Jean Pisani-Ferry	EUI, Tommaso Padoa-Schioppa Chair
Anna Sakurai	EUI, School of Transnational Governance
Massimiliano Santini	EUI, School of Transnational Governance
Catherine Schenk	University of Oxford