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The Post-2007 Crises and Europe's Place in the Global Economy

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A related paper, focusing on Asian reactions to the 2007-9 crises and with a more US-oriented perspective, served as background to a presentation at the GLOBE Leadership Seminar on "Fiscal Imbalances and Global Instability" held at the Tufts University European Center in Talloires, France, on 30 September 2011, and is available as University of Adelaide School of Economics Working Paper 2011-33 at http://www.economics.adelaide.edu.au/research/papers/doc/wp2011-33.pdf
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Abstract

What is often abbreviated to GFC included three distinct crises: the 2007-8 North Atlantic financial crisis, a 2008-9 global economic crisis and public finance crises which became increasingly focussed on the eurozone in 2010-12. The relative weight of emerging market economies in the global economy, which had been increasing for several decades, grew even more rapidly in 2008-11 as the economies of the USA and Europe faltered, and other open economies recovered rapidly from the global economic crisis. This poses challenges for global economic governance, although there are constraints on Asia being a more assertive force. For the EU the greater dangers are, first, that if EU leaders see their economies as victims of a GFC then they will fail to address their economies' own shortcomings, and, second, that preoccupation with internal crises will distract EU leaders from rising to the challenges and opportunities associated with the evolving multipolar global economy.

Introduction

European Crises And The Asian Economies[1]

The post-2007 crises, often abbreviated to the Global Financial Crisis (GFC), included three distinct crises. The North Atlantic financial crisis of 2007-8 hit the USA, UK and some small European economies (e.g. Iceland, Ireland, Latvia), but there was no general financial crisis in Latin America, Africa or Asia. The 2007-8 financial crisis was less global than the 1997-8 financial crisis which started in Southeast Asia and spread to Korea, Russia, and South America as investors questioned the riskiness of emerging market debts, and reached the US financial system through the collapse of Long-term Capital Management. Even countries closely linked to the US economy, notably Canada, did not suffer from financial contagion effects in 2007-8, and nor did countries such as Australia that experienced similar housing booms to those in the USA and UK. In Europe the 2007-8 financial crisis had little impact on the financial sectors of major eurozone countries such as France, Germany and Italy.[2] The GFC only seemed global when viewed from the media centres in the north-eastern USA and London

A global economic crisis followed in 2008-9 because recession in two of the world's largest economies (USA and UK) impacted on global demand and world trade. However, the consequences of exogenous negative trade shocks are short-lived compared to the direct consequences of financial crises, and the global trade crisis was over before the end of 2009.[3] Indeed, the US economic crisis was over by 2010, although recovery was slow as firms and households deleveraged and there were fears of a double-dip recession.

In 2010-12 public finance crises resulted from large bail-out or stimulus packages, exacerbated by falling taxes due to recession (as in Ireland, USA, or the UK). If central banks are committed to low inflation, then increased budget deficits mean larger public debts and potential sovereign debt crises. However, at the time of writing governments of these

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[1] The author is grateful for very helpful comments from James Riedel and Marek Dabrowski.

[2] Many large banks suffered losses on "toxic" assets issued by US and UK financial institutions, but these losses were not sufficient to cause crises. In contrast to the situation after July 1997, when investors questioning the creditworthiness of foreign issuers found some large countries' debts unpalatable (notably Russia and later Argentina), there was no such discovery after September 2008.

[3] Eichengreen (2011, 386-9) provides references, and discusses the difficulty of determining the counterfactual with which to compare the aftermath of financial crises. Giles et al. (2012) date China's recovery from the middle of 2009.

countries appeared to be taking adequate measures to maintain sovereign creditworthiness. At the same time, and to some extent coincidentally, other sovereign debt crises occurred, most notably in Greece due to cumulating budget deficits fuelled by cheap debt since joining the euro.

By 2011 the sovereign debt crisis was clearly a European crisis. Although European policymakers were understandably focussed on resolving their crisis, it is important to keep it in perspective. The post-2007 crises have exacerbated an already important redistribution of global economic power, as emerging market economies continued to enjoy economic growth while the established economies largely experienced economic stagnation. In particular, the three largest eurozone economies (Germany, France and Italy) grew at less than two-thirds of the speed of the world economy in the fifteen years before 2007; the gap widened further in 2007-10.

The first three sections of this paper briefly review the three economic crises of 2007-12. The fourth section analyses the impact of these crises on Asian countries. The Asia-Pacific region did not experience significant financial crises. The open economies were affected by the global economic crisis, but they recovered relatively rapidly after a drop in exports and in economic growth in 2009. In consequence, the weight of Asian economies in the global economy, which had been increasing for several decades, grew even more rapidly in 2009-11 as the economies of the USA and Europe faltered. Section 5 analyses the challenge posed for global economic governance, currently dominated by the USA and western European countries, and concludes that competition for leadership among the larger economies and limited leadership resources within the smaller economies constrain Asia from becoming a more assertive force. The sixth section analyses the challenges Europe faces as a result of Asia's increased weight in the global economy, focusing on the risk of being absent from the negotiating table for plurilateral trade agreements among the major economies. The final section draws conclusions.

1. The North Atlantic Financial Crisis of 2007-8

The USA experienced a major financial crisis in 2007-8. The trigger was falling house prices from a mid-2006 peak, which led to the subprime mortgage crisis. The crisis was realized in April 2007 when New Century Financial filed for bankruptcy, and in the remainder of 2007 many institutions announced losses associated with delinquent mortgages. An additional component of the US financial crisis was the collapse of the investment banks which first became apparent in March 2008 when Bear Stearns was bought by JP Morgan Chase in a fire sale (paying $240 million for a company worth $18 billion a year earlier) supported by a loan from the Fed.

The US financial crisis peaked in September 2008. On September 7 the U.S. government placed Fannie Mae and Freddie Mac into a conservatorship, effectively nationalizing them at the taxpayers' expense. On 15 September 2008 Lehman Brothers went bankrupt and Merrill Lynch was bought by Bank of America. The following day the Fed announced an $85 billion rescue package for AIG, the country's biggest insurance company, in return for an 80% stake in the firm. On 25 September 2008 Washington Mutual, which had assets valued at $307 billion, was closed down by regulators and sold to JPMorgan Chase.

The US government moved quickly to provide support for the financial sector. On 28 September US lawmakers announced a bipartisan agreement on a rescue package, allowing the Treasury to spend up to $700 billion buying bad debts from ailing banks. The plan was rejected by Congress the next day, but a revised plan was passed on 3 October. On 14 October the US government unveiled a $250 billion plan to purchase stakes in a variety of banks in an effort to restore confidence in the sector. On 23 November the US government announced a $20 billion rescue plan for Citigroup after its shares plunged by more than 60% in a week. On 25 November the Fed announced that it would inject a further $800 billion into the economy to stabilise the financial system and encourage lending; about $600 billion would be used to buy up mortgage-backed securities while $200 billion would be targeted at unfreezing the consumer credit market.

More or less at the same time and speed, the UK faced a financial crisis triggered by mortgage loans. In September 2007 Northern Rock sought and received a liquidity support facility from the Bank of England, and in February 2008 Northern Rock was taken into state ownership; the bank's principal problem was non-performing mortgage loans. In September 2008 the mortgage lender Bradford & Bingley was nationalized; the British government took control of the bank's £50 billion mortgages and loans, while its savings operations and branches were sold to Santander. The banking crisis spread and on 3 October 2008 the UK government announced plans to pump £37 billion of taxpayers' money into three banks: Royal Bank of Scotland, Lloyds TSB and HBOS.

In September and October 2008 other large EU economies faced specific banking problems, which were met by bail-outs, but the systemic impact was nowhere near as large as in the UK. For example, the Belgian, French and Luxembourg governments contributed 6.4 billion euros to bail out Dexia, and the German government announced a €50 billion deal to save Hypo Real Estate, but these were isolated cases rather than severe shocks to the national financial system. A much larger national crisis occurred in Ireland, whose government foolishly guaranteed all deposits in the country's main banks. Relative to the size of the national economy, the largest banking crisis was in Iceland, whose banking system collapsed in October 2008, leading the government to negotiate a $2 billion loan from the International Monetary Fund, the first IMF loan to a western European country for over a quarter of a century.[4]

A striking feature of the 2007-8 financial crises was that they did not have serious transcontinental contagion effects. The 1997-8 Asian Crisis triggered a reconsideration of emerging market debts that led to crises in Brazil and Russia, with the latter contributing to the Long Term Capital Management crisis in the USA. In 2007-8 there was no financial crisis in South America, Africa or Asia. Even countries closely linked to the US economy, notably Canada, had no financial crisis. Although financial liberalization, and the associated pre-2007 economic boom, contributed to the likelihood of a crisis, Australia illustrated that a crisis was not inevitable.

In the USA and the UK the financial crisis was over by the end of 2008. In the first half of 2009 most banks were back to good health. In June 2009 ten of the largest US banks announced that they would be able to repay the US Treasury the money they were lent under the October 2008 bail-out. Goldman Sachs announced a net profit of $3.44 billion for April to June, and set aside $6.65 billion for pay and bonuses in the quarter. In the UK, Barclays announced an 8% rise in first-half profits, and other banks announced mixed results for the period (profits at HSBC and RBS, losses at Lloyds and Northern Rock).[5] In both countries the popular focus had shifted from worrying over a financial crisis to outrage over high earnings in the financial sector.

The financial crises were important for their impact on the real sector. As people's financial and real estate wealth declined, aggregate demand fell, starting with deferred purchase of

[4] Other countries, notably in Eastern Europe (e.g. Latvia), experienced financial crises that were related to the difficulties of western European banks or to a sudden stop in capital inflows. In Central Asia, Kazakhstan had a financial crisis that was largely home-grown, resulting from a real estate bubble that was fuelled in part by foreign depositors and that burst in 2007. None of these had serious impact beyond the affected countries' national borders.

[5] The common pattern was that, although some financial institutions were hard hit (albeit with a blow often softened by public assistance), other banks, such as Barclays, benefitted from selective purchase of assets sold by the ailing institutions or by their liquidators.

consumer durables.[6] Already by December 2008 governments in the USA and EU were becoming as worried about the health of their automobile sector as about that of the financial sector. On 4 December French President Nicolas Sarkozy unveiled a 26 billion euro stimulus plan, with money to be spent on public sector investments and loans for the country's carmakers. On 19 December President George W Bush announced that the US government would use up to $17.4 billion of the $700 billion meant for the banking sector to help the Big Three US carmakers, and on 29 December the US Treasury unveiled a $6 billion bail-out for GMAC, the car-loan arm of General Motors. Over the following year the US and EU economies would experience a deep recession, whose impact would be transmitted to the rest of the world through reduced demand for imports.

2. The Global Economic Crisis of 2009

In 2008 average growth in the high-income countries had slowed to a standstill and in 2009 their GDP fell by 3.5 percent (Table 1). The decline was driven by the recessions in the USA and UK and was transmitted through reduced demand for imports, which first hit countries exporting consumer durables whose purchase could be postponed, e.g. car exporters in Japan, Germany and France.[7] By the start of 2009 the volume of world exports had fallen to about three-quarters of their level in April 2008, and alarm bells were sounding about the scale of the decline in world trade (Baldwin and Evenett, 2009); analysis of the causes was in full swing by November (Baldwin, 2009), although by then trade volumes were starting to recover.[8] Over the year 2009 the world's real output fell by 0.5 percent, after growing by 3 percent per year in 2000-8, and the volume of trade in goods and services fell by 10.9 percent (IMF, 2011, Table A9). In sum, the financial crisis was not global, but, when two of

[6] This contributed to falling share prices. The world's stock markets fell by about a third in the final quarter of 2008, in many countries continuing to decline to a trough in the first or second quarter of 2009, which added to the negative wealth effect on aggregate demand.

[7] Alessandria et al. (2010; 2011) show that sales of foreign cars began to decline in the USA in mid-2008 and the ratio of inventories to sales increased by 45 percent over the next six months. Car sales began to revive in early 2009, but imports only picked up after inventories had been run down. In 2010 the car cycle benefited especially Germany whose carmakers had competitive model ranges.

[8] Some authors saw a direct link between the financial crises and the decline in trade. Ahn, Amiti, and Weinstein (2011) claim that financial factors may explain about 20 to 30 percent of the decline in world trade that occurred in the 2008-2009 crisis, and they support this claim by showing that the prices of manufactured exports rose relative to domestic prices during the crisis and that U.S. seaborne exports and imports, which they assume to be more sensitive to trade finance problems, saw their prices rise relative to goods shipped by air or land. Others have argued that trade finance was not a major contributor to reduced trade volume in 2008-9. One difficulty is the lack of hard data on trade finance (Korinek, Le Cocguic and Sourdin, 2010).

the world's largest importers (the USA and UK) run into a serious domestic recession, the world economy is affected.

The global economic crisis struck countries with differing degrees of severity. Countries which suffered both from a financial crisis and the slowdown in global demand inevitably saw large dips in economic activity. The countries of Eastern Europe and the former Soviet Union, which had grown rapidly over the previous decade and in many cases had become closely connected to the economies of the pre-2004 EU15, saw the largest declines in output in 2009. In some cases, notably the Baltic countries and Bulgaria, the immediate effect was exacerbated by a strong policy response in the form of cutting budget deficits, driving an internal devaluation (i.e. falling wages and prices) while maintaining a fixed exchange rate.[9] Countries less integrated into the global economy, such as low-income countries in Africa, were relatively less impacted by the global crisis. Asian economic growth dipped in 2008-9, but recovered to a historically high rate in 2010 (Table 1).

Table 1. Growth by Region, 2000-2010

	Ave 2000-7	2008	2009	2010
High-income countries	2.4	0.3	-3.5	2.6
Asia	7.7	6.5	5.1	8.8
Eastern Europe & Central Asia	6.1	4.1	-5.4	3.9
Latin America & Caribbean	3.6	4.1	-2.0	5.8
Middle East & Africa	5.5	5.3	1.6	4.3

Source: real GDP growth from IMF *World Economic Outlook*, as reported in Didier et al. (2011, 33).

Notes: regional averages are weighted by 2007 nominal GDP in USD; high-income countries are as defined by the World Bank July 2010 classification; Asia includes South and East Asia except Japan, and Pacific except Australia and New Zealand.

A noteworthy pattern was that emerging market economies as a group weathered the storm better than the high-income countries. Several authors confirm that GDP growth declined less in emerging economies, even after controlling for several variables (Frankel and Saravelos, 2010; Rose and Spiegel, 2010; Rose, 2011). Didier et al. (2011) argue that, using the drop from pre-crisis highs as the criterion, there is no significant difference between high-income and emerging economies, but they acknowledge that emerging economies recovered faster and as a group had returned to pre-crisis levels of industrial output in 2010, whereas high-income countries did not achieve this until 2011. A superior recovery was evident in the large emerging economies with sound economic policies before the crisis, such as China, India, Brazil and Indonesia.

[9] Aslund (2011) argues that the policy response helped the countries to a rapid recovery and improved long-term growth prospects. Darvas (2011) claims that in Latvia internal devaluation was a failure because private sector wages hardly changed and because of harmful social consequences, although given the size of Latvia's crisis the latter would accompany any policy.

Why did emerging economies ride out the crisis so calmly? They were open economies and hence exposed to sharp drops in export demand. However, trade shocks typically are shorter-lasting than financial crises, which may be followed by a lengthy period of deleveraging and domestic recession. Moreover, and in contrast to earlier decades, many emerging economies had shifted from being net external debtors to net creditors and held liquid foreign assets (e.g. in the form of reserve assets) and illiquid foreign liabilities (e.g. as direct foreign investment), so they were not exposed to a sudden deterioration in the capital account of the balance of payments. Finally, some countries, notably China, introduced pre-emptive stimulus packages to prevent the initial negative shock from turning into a major recession.[10]

3. Public Finance Crises

By 2010 all regions of the world were enjoying positive economic growth. However, the sense of crisis persisted as a number of countries experienced difficulties reducing their public sector deficit and ran into debt problems. Some of these debt crises were related to the financial crisis in cases where governments had been involved in expensive bail-outs (e.g. Ireland or Iceland) and others to the size of the stimulus packages adopted to deal with the economic crisis (e.g. the USA and UK), while other debt crises were essentially independent of the financial and economic crises but came at a bad time (e.g. Greece).

In 2010-11, public sector budget crises were debt crises because all governments were committed to not monetizing budget deficits. This was, of course, not an option for individual eurozone countries (or for countries like Latvia which remained committed to a fixed exchange rate), but neither the USA, nor the UK nor the ECB appeared to be contemplating the inflation option.[11] The US, UK and eurozone central banks sought to expand the

[10] Warnings by the US government of systemic risk and a new Great Depression contributed to global uncertainty (Taylor, 2009). The media working out of the northeastern USA and London, spooked by the dramatic US and UK financial collapses in September and October 2008, may have contributed to panic among policymakers in late 2008, even in countries which experienced no financial crisis such as Australia or China.

[11] Iceland, with a population of just over 300,000 was small enough to be a special case (Benediktsdottir et al., 2011). In the last quarter of 2008 the three major banks went into receivership and at year's end the external debt to GDP ratio was around 1000%. The government guaranteed deposits held in Iceland, but not deposits held elsewhere, and introduced capital controls to insulate the economy, while allowing the currency to depreciate by 50%. This policy combination led to a reasonably soft landing given the size of the debt, but the capital controls probably contravened the country's obligations as a member of the European Economic Area and by a larger economy the external defaults would have been sufficiently unacceptable to have triggered retaliation. Moreover, the recovery in the BOP was helped by increased aluminium exports (26% of Iceland's exports in 2010), which

monetary base sufficiently to accommodate deleveraging without fuelling inflation, so far with reasonable success.[12] The specifics of the fiscal tightening required to reduce debt burdens were politically controversial, but there was little question of its necessity. By 2011, the countries that had run up debts while stimulating their economies during financial crises appeared to be largely on track, and fears of default (or even of further downgrades of these countries' credit ratings) had diminished by the year's end.

The eurozone sovereign debt crises had varying origins. The Irish government made one foolish policy decision, guaranteeing all creditors of the major Irish banks and had to pay a large price for that error.[13] The Spanish economy had experienced a construction bubble in some respects like that of the other Atlantic crisis economies and, although concerns were raised about it being one of the indebted PIIGS, Spain's debt/GDP ratio was not exceptionally high (Table 2). Italy had a much higher debt/GDP ratio, indeed the highest in the eurozone in 2007, but this was inherited from poor public finance management in the 1990s rather than something that emerged in the 2000s. The Greek debt differed in that it had mushroomed after adoption of the euro and the use of the borrowed funds was opaque.[14]

Table 2. Eurozone Debt/GDP Ratios, end of 2010

Country	Debt/GDP		Country	Debt/GDP
Austria	72		Italy	118
Belgium	96		Luxembourg	19
Cyprus	62		Malta	69
Estonia	7		Netherlands	63
Finland	48		Portugal	93

was due to increased capacity in preceding years rather than to currency depreciation (Darvas, 2011, 22), and the $2 billion IMF package was supplemented with $3 billion from Nordic countries (Gylfason, 2011, 2).

[12] In 2008 the monetary base (notes and coins plus reserves held with the central bank) was 4-6% of GDP in the US and UK and 10% in the eurozone. By early 2012 the ratio had increased to 16-18% in all three, but the increase in the money supply (M2) was much smaller because banks used easier access to central bank funds to improve their capital ratios rather than for loans to the private sector. The US Fed was the most successful in 2010-11 in stimulating easier private sector credit without an inflationary surge and notably refrained from further quantitative easing in the first quarter of 2012. The ECB was the least successful in moderating the economic slowdown, and hence became the most active in providing liquidity to banks in the first quarter of 2012.

[13] This was a choice. The Icelandic government pointedly refused to guarantee foreign deposits in Icelandic banks that went under, and stuck to this position despite heavy pressure from the UK and Netherlands in both of which subsidiaries of Icelandic banks had attracted large numbers of depositors. Whelan (2011) argues that the Irish economy already faced serious problems in 2007-8 after a real estate bubble had burst, which made it even more incredible that the government on 30 September 2008 announced a near-blanket guarantee to the creditors of Irish banks. When Allied Irish Bank's losses were assessed at €30 billion in September 2010 and the government issued promissory notes to cover the bank's debts, Ireland's budget deficit reached 32% of GDP. By spring 2011 the total bill to Irish taxpayers for bank bailouts had exceeded €70 billion, for a country of less than 4.5 million people.

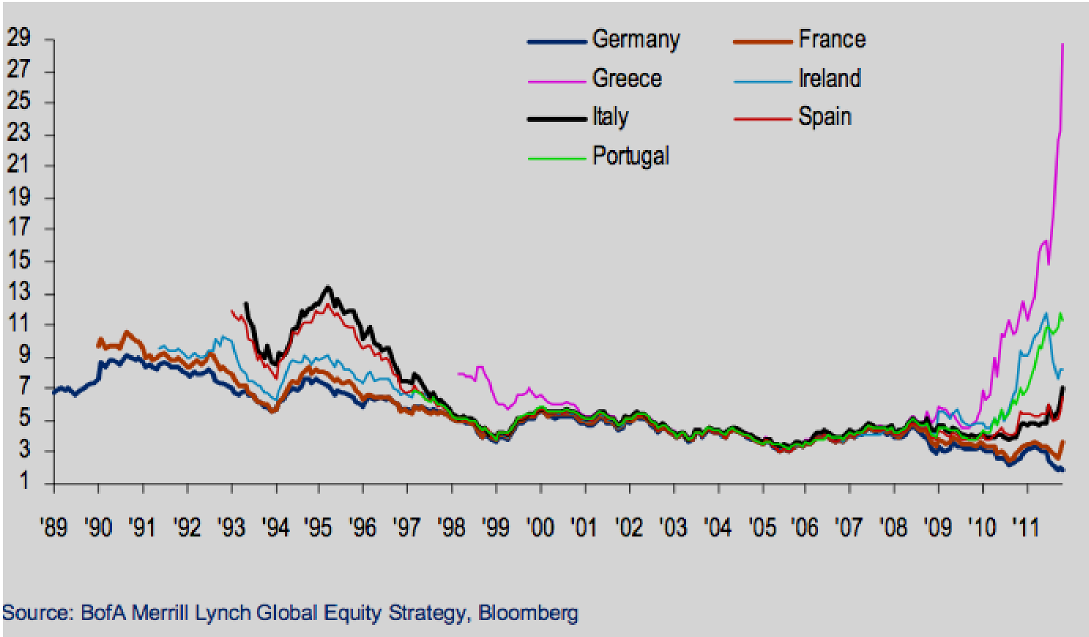
[14] Greece had accumulated a substantial debt since the early 1980s, but high and increasing interest rates on drachma-denominated debt would have forced a much earlier reckoning had Greece not adopted the euro. Low global interest rates due to major central banks' expansionary monetary policies facilitated debt accumulation by many countries in the early 2000s, but for Greece the impact was magnified by the absence of country risk premia. With lenders only requiring standard eurozone interest rates in the 2000s (Figure 1), Greece's day of reckoning was postponed by many years.

Country	Debt/GDP		Country	Debt/GDP
France	82		Slovakia	41
Germany	83		Slovenia	39
Greece	145		Spain	61
Ireland	93			

Source: Eurostat at
http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=1&language=en&pcode=tsieb090
accessed 9 March 2012.

The adoption of the euro led to rapid convergence of interest rates on debt issued or guaranteed by eurozone member governments, and between 2001 and 2008 these rates were practically identical (Figure 1). After adopting the euro the Greek government) "went on a borrowing spree at artificially low interest rates" (Sally, 2012) to finance non-transparent budget deficits, including for prestige projects like the 2004 Olympic Games.[15] A Greek default was a potential contagion event for two reasons. First, it sounded a warning to creditors that they should check whether other eurozone countries had been borrowing heavily on the basis of low interest rates which ignored individual countries' default risk; they found Portugal, which like Greece had been running large current account deficits since introducing the euro (Table 3).[16]

Figure 1. Interest Rates on Eurozone Sovereign Debt, 1989-2011



[15] Some of the non-transparency was due to fraudulent presentation of macro data, while some was expenses ballooning out of control. The original budget for the 2004 Athens Olympic Games was $1.6 billion, but actual spending is believed to have exceeded $16 billion and, while this was not unique (the public debt from the 1976 Montréal Olympics was only paid off in 2005), in Greece's case it added to a debt that was already passing beyond hope of repayment.

[16] The argument here is not that a current account deficit is necessarily a problem, but that it did provide an indicator of the size of net capital inflows and this magnitude may be a cause for concern.

Table 3. Balance on Current Account, Selected Countries, 2003-2010 (per cent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010
USA	–4.7	–5.3	–5.9	–6.0	–5.1	–4.7	–2.7	–3.2
Canada	1.2	2.3	1.9	1.4	0.8	0.4	–2.8	–2.8
UK	–1.6	–2.1	–2.6	–3.4	–2.6	–1.6	–1.7	–2.5
Eurozone	0.4	1.2	0.4	0.4	0.2	–0.6	–0.2	0.1
Germany	1.9	4.7	5.1	6.5	7.6	6.7	5.0	5.3
France	0.7	0.5	–0.5	–0.6	–1.0	–1.9	–1.9	–2.1
Italy	–1.3	–0.9	–1.7	–2.6	–2.4	–2.9	–2.1	–3.5
Spain	–3.5	–5.3	–7.4	–9.0	–10.0	–9.7	–5.5	–4.5
Netherlands	5.6	7.6	7.4	9.3	6.7	4.3	4.6	7.1
Belgium	3.4	3.2	2.0	1.9	1.6	–1.9	0.8	1.2
Austria	1.7	2.2	2.2	2.8	3.5	4.9	2.9	3.2
Greece	–6.6	–5.9	–7.4	–11.2	–14.4	–14.7	–11.0	–10.4
Portugal	–6.5	–8.4	–10.4	–10.7	–10.1	–12.6	–10.9	–9.9
Finland	4.8	6.2	3.4	4.2	4.3	2.9	2.3	3.1
Ireland	–0.0	–0.6	–3.5	–3.6	–5.3	–5.6	–3.0	–0.7
Japan	3.2	3.7	3.6	3.9	4.8	3.2	2.8	3.6
China	2.8	3.6	7.1	9.3	10.6	9.6	6.0	5.2
India	1.5	0.1	–1.3	–1.0	–0.7	–2.0	–2.8	–3.2
Korea	2.4	4.5	2.2	1.5	2.1	0.3	3.9	2.8
Taiwan	9.8	5.8	4.8	7.0	8.9	6.9	11.4	9.4
Indonesia	3.5	0.6	0.1	3.0	2.4	0.0	2.6	0.9
Malaysia	12.0	12.1	15.0	16.4	15.9	17.5	16.5	11.8
Philippines	0.4	1.9	2.0	4.5	4.9	2.2	5.8	4.5
Singapore	22.7	17.0	21.1	24.8	27.3	14.6	19.0	22.2
Thailand	3.4	1.7	–4.3	1.1	6.3	0.8	8.3	4.6

Source: IMF *World Economic Outlook*, April 2011 (Tables A11 and A12), at http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/tables.pdf (accessed 9 September 2011).
Notes: Eurozone calculated as the sum of the balances of individual eurozone countries excluding Estonia.

A second source of contagion arose because banks in other eurozone countries held large amounts of the sovereign debt or, equally disastrous, loans to Greek banks that would go under if the Greek government defaulted. This was especially true for banks in EU countries, such as France and Germany, which had not been involved in pre-2008 real estate lending to the same extent as banks in Spain, Ireland or the UK. The French and German banks weathered the 2008 financial storm better, but in 2010 found themselves over-exposed to Greek borrowers. Thus, EU leaders, with the French President and German Chancellor in the vanguard, spent much energy in 2010 and 2011 organizing relief for Greece, ideally to avoid default but at a minimum to buy time so that foreign banks and others could reorganize their balance sheets before they had to write down the value of their Greek assets.[17]

[17] Some confusion surrounds the term "default". As Reinhart and Rogoff (2009) point out, any outcome that leaves creditors short of their contracted real returns, including "voluntary" rescheduling or inflation, is tantamount

The debt crises, earlier financial crises and debt resolution programs illustrated the ubiquity of time inconsistency problems. Short-run measures that buy popularity for governments may have long-run implications that are recognized as adverse but are ignored. Governments that had accumulated assets in sovereign wealth funds (e.g. Chile or Kazakhstan) or as reserves held by the central bank had foregone opportunities to spend during the boom, but were better placed to weather the storm in 2009. Countries which used crises as opportunities to cut out wasteful government expenditures and carry out difficult but desirable reforms (e.g. the Baltic countries) experienced deeper recessions but emerged in better shape. A key question for creditors of eurozone governments was which countries would fall into this category, and which would simply have an unsustainable debt burden. By March 2012 the emerging consensus seemed to be that Italy and perhaps Spain would remain solvent, but Greece's debt problems would be resolved by a mixture of financial bailout from other eurozone countries and the ECB and a massive write-down of private sector debts, led by French and German banks under pressure from their respective governments. Whether the mix will be sufficient to defuse the Greek crisis remains unclear, but it does generate a new time inconsistency (or moral hazard) problem if creditors believe that the eurozone countries collectively will bail out future profligate eurozone members.[18]

Another apparent dilemma was that countries more integrated into the global economy or with more liberal financial sectors were likely to be hit the hardest, whereas countries outside the global economy were insulated from the crises. This is, however, not an argument for autarchy or financial reregulation. Countries with more liberal financial sectors enjoyed superior growth in the decades before 2007, which far exceeded the size of the decline in GDP in 2008-9 (Pomfret, 2010); Table 4 provides some comparisons. The gains from financial liberalization are primarily in terms of improved allocation of capital rather than increased saving and investment, as evidenced from financially repressed economies in the twentieth century[19] and also in recent empirical work based on a broader range of countries

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to default. Legally, however, the semantics matter because many institutions are barred from holding assets whose issuer is in default. The March 2012 rescheduling of Greek debt was not labelled "default" because formal default would force pension funds and others to hold a fire sale of assets, but it was a "credit event" which triggered payments to creditors who held credit-default swaps (CDSs) as insurance against their Greek bonds turning into bad debts.

[18] There may also be a psychological issue, if policymakers who laboured to avoid formal Greek default in 2010-12 do not want default to happen on their watch. President Sarkozy and Chancellor Merkel may have continued to organize aid packages beyond the point at which new leaders would be ready to draw a line (and blame their predecessors for failing to recognize Greek insolvency sooner). As Dean (2012) points out, already in early 2010 it was known that Greece was insolvent, and for most economists the sensible policy would have been a quick write off, whose wider impact would have been trivial given that the Greek economy is smaller than that of Greater Miami.

[19] Countries that repressed their financial sectors during the 1950s and 1960s import-substitution era suffered negative consequences for long-term economic growth; there was little loss of savings because the interest elasticity of supply of saving is low, but excess demand for loans at low interest rates was associated with misallocation of capital (Fry, 1988). In countries like India or the Soviet Union in the 1970s and 1980s inefficient

(Kukenova, 2011; Buera et al., 2011). These benefits tend to be more pronounced in the longer term, although financial liberalization inevitably exposes an economy to greater volatility.

The less dynamic EU financial sectors, notably those of France and Germany, did not stoke real estate bubbles in the first decade of the twenty-first century, but instead they took the conservative path of lending to European governments or to borrowers assumed to have sovereign backing. The French and German banks that took this path failed to recognize that eurozone sovereigns' creditworthiness differed and that some governments might irresponsibly borrow beyond hope of repayment. The most positive outcome, from an early 2012 perspective, would be if this characterization only applied to Greece, but even for an economy as small as that of Greece debt resolution is dragging out.

Table 4. GDP in Current US Dollars (billions), 1992-2007

	1992	2007	% change			1992	2007	% change
USA	6,286.8	13,811.2	119.7		Germany	2,062.1	3,297.2	59.9
UK	1,074.0	2,727.8	154.0		France	1,372.8	2,562.3	86.6
Spain	612.6	1,429.2	133.3		Italy	1,265.8	2,107.5	66.5
Ireland	54.3	255.0	369.6		Greece	128.4	360.0	180.4
Australia	320.6	821.7	156.3					
High-income OECD	19,764.1	38,219.0	93.4		World	24,533.6	54,347.0	121.5

Source: Pomfret (2010, 26) -- data from World Bank *World Development Indicators*.

The Greek debt crisis differed from the 2007-8 crises in which private borrowers defaulted, financial institutions collapsed and the government had to accept the cost of a bankrupt institution (like Lehmann) or of nationalizing (the UK) or bailing out (the USA) financial institutions. The latter costs quickly appeared on public sector balance sheets. The size of the increased public debt was known, and responsibility accepted. On a political level, the population recognized the need for policies to maintain public sector creditworthiness, even if the government that had accumulated the debt was thrown out (as in Ireland) or the prime minister was formally charged and tried for incompetence (Iceland).[20]

allocation of capital was indicated by increasing incremental capital-output ratios (ICORs). India's ICOR increased from 4-4.5 in the first half of the 1960s to a peak of 10.5 in 1975 (reported in the Asian Development Bank's *Asian Economic Outlook 1990,* p. 138), i.e. an additional unit of capital made less than half the contribution to output in 1976 than it had made a dozen years earlier. In the Soviet Union the ICOR increased from 3.7 in the period 1950-60, to 5.0 in 1960-75 and 14.8 in 1975-85 (Gregory, 1994, 129). Countries with well-functioning financial sectors typically have ICORs that remain in the 3-4 range.

[20] Darvas (2012) describes how three of the countries with the highest debt/GDP ratios (Iceland, Ireland and Latvia) adopted a variety of drastic measures, and in each case reduced the debt successfully.

By contrast, Greece was kept technically solvent and the main lending banks neither folded nor were nationalized, so the Greek debt crisis dragged on with ongoing uncertainty about the eventual costs to public and private balance sheets and about the systemic outcome. The likelihood is that such uncertainty will delay resolution of the regional imbalances in Table 3 and a return to sustained economic growth in the eurozone, as leaders continue to argue over who bears the cost of debt resolution and over long-term systemic reform within the eurozone. Moreover, unlike the cases described in the previous paragraph, a lengthy resolution process may erode the population's willingness to accept responsibility for accumulating the past debt and contribute to a tendency to blame external actors (the IMF or leaders of other EU countries) for imposing harsh policies on the country. By the March 2012 agreement, Greece has already defaulted on a large portion of its debt, but the debt/GDP ratio remains high and disagreement over "blame" will complicate further resolution. Meanwhile, EU leaders focus on designing pre-emptive measures to prevent recurring debt crises due to eurozone members accumulating unsustainable debts.

In sum the public financial crises that emerged in 2010 had two different complexions. Those that arose from the financial crises of 2008 have been tackled – more purposively by the smaller economies concerned, and less purposively by the USA and UK which being without original sin (i.e. not having debts denominated in a foreign currency) can, in the last resort, reduce their real debt by inflation. The debts accumulated by eurozone members, which over-borrowed on the basis of low interest rates fuelled by banks' foolish misconception that all eurozone sovereign debt was equal, are being resolved by drawn-out political negotiations whose endpoint is uncertain.[21] The eurozone crisis could have global implications, if the problem is not restricted to the small economies of Greece and Portugal, but more certainly it is a European problem distracting EU economic policymakers from global issues.

[21] Article 125 of the Treaty of the Functioning of the European Union prohibits any direct bailout of member states, but especially in March 2012 this appeared to be being subverted by the ECB providing indirect bail-out funds via increased liquidity for banks which were being pressured to write down their Greek loans (Dabrowski, 2011, 31). Commentators, especially in Germany, became increasingly concerned about the potential impact on inflation, e.g. on 26 February 2012 *Welt am Sonntag* carried the front-page headline "Europa ertrinkt im Geld" (Europe is drowning in money) and a four-page report detailing the ECB's out-of-control money creation. As long as Sarkozy and Merkel remain in power, however, there is unlikely to be admission of policy error in handling the Greek crisis in 2010-11 or acceptance of the fact that sovereign default is not incompatible with continued use of the common currency (e.g. many countries defaulted before 1914 and remained on the gold standard, and US states and cities have defaulted without leaving the dollar-zone).

4. The Post-2007 Crises beyond the North Atlantic

There was no significant financial crisis in Asia (except Kazakhstan, and that was largely home-grown), Latin America, Africa or Australasia. There was an economic crisis in 2009 as global demand fell, but outside the USA and EU recovery was relatively rapid and emerging economies' share in world trade continued to increase. There are no public finance crises, as in the USA and Europe, although some governments undertook large prophylactic stimulus packages (e.g. China and Australia),[22] and some faced independent shocks (notably Japan's natural disaster in March 2011).[23] These are ad hoc and need not be long-term negatives (although they could turn out to be negative if the monies were poorly used or if returning to prudent budgets is difficult).

An important reason for Asian financial stability in the first decade of the twenty-first century was the lessons drawn from the 1997-8 Asian Crisis. The strongest image from that event was of the managing director of the IMF standing over the President of Indonesia who was signing a loan request, and many in the region resolved to reduce their dependence on the Euro-US-dominated IMF. A Japanese push for greater Asian financial integration and creation of Asian multilateral financial institutions met with little success.[24] Countries did not want to compromise their monetary policy autonomy and looked to their own defences by building up national reserves (Table 5).

By 2010 China and Japan were the largest holders of US Treasury securities, with over two trillion dollars between them, and South Korea and Taiwan also held large amounts of US government debt. The desirability of monetary stability to facilitate trade was, however,

[22] China's stimulus program introduced in 2008Q4 included RMB 1.18 trillion in central government funding, but more importantly it unleashed massive spending from sub-national governments much of which was funded by local investment corporations (*difang zhengfu rongzi pingtai*) whose activities are often non-transparent. LICs had been successful in promoting growth, e.g. in Shanghai which had provided the inspiration for the model, but before 2009 they tried to maintain a low profile. The stimulus announcement released any perceived political constraints on the LICs' scale of activities, and in 2009 the actual gross stimulus from all levels of government reached about a fifth of GDP (Wong, 2011). Many of these loans had a three-year maturity, and in March 2012 the central government instructed lenders to roll them over; the London *Financial Times* (13 February 2012, page 1) reported that the debt of provinces and cities was equivalent to $1.7 trillion or about a quarter of Chinese GDP.

[23] The Japanese central government approved 14.3 trillion yen ($175 billion) in extra expenditures for recovery from the disaster that killed 19,000 people and made 325,000 homeless and caused huge environmental and property damage.

[24] The 2000 Chiang Mai Initiative, a swap arrangement among the ASEAN+3 group (the ten ASEAN members plus China, Japan and South Korea), was expanded and multilateralized in 2009, but the amounts remained small compared to, say, the credit lines some of the participants had with the US Fed and the facility proved to be redundant during the 2008-9 crises (Pomfret, 2011, 58-73).

recognized; Asian governments mostly maintained a loose *de facto* dollar peg and low inflation, so that bilateral real exchange rates within East Asia did not fluctuate greatly in the 2000s.

Table 5. Foreign Reserves held by Emerging and Developing Countries, 2003-2010 (billion US dollars)

	2003	2004	2005	2006	2007	2008	2009	2010
Total	1,341	1,792	2,304	3,073	4,369	4,950	5,597	6,481
Developing Asia	670	935	1,156	1,489	2,129	2,534	3,078	3,658
China	409	616	823	1,070	1,531	1,950	2,418	2,890
India	100	127	133	171	268	248	266	292
CIS and CEE	206	282	378	564	813	764	813	902
Russia	74	122	176	296	468	413	418	456
LAC	195	221	255	310	445	497	548	651
Brazil	49	53	53	85	180	193	237	288
Mexico	59	64	74	76	87	95	100	120
MENA	230	294	434	596	837	1,000	1,001	1,108
SSA	39	61	81	114	145	156	158	162

Source: IMF *World Economic Outlook*, April 2011 (Table A15), at http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/tables.pdf (accessed 9 September 2011).
Notes: CIS= Commonwealth of Independent States, CEE = Central and Eastern Europe, LAC = Latin American countries, SSA = Sub-Saharan Africa.

A second and more long-term lesson taken from the Asian Crisis was the desirability of reducing dependence on international financial markets by building up Asian bond markets. Artificial attempts to stimulate Asian bonds made limited progress but by 2010 some domestic bond markets had become substantial, and between 2010Q2 and 2011Q2 local currency bond markets in emerging East Asia grew by almost eight percent to US$5.5 trillion, of which China accounted for $3,052 billion, South Korea $1,149 billion, Malaysia $247 billion, Thailand $225 billion, Singapore $179 billion and Indonesia $107 billion (ADB, 2011, 5-6).[25] Capital inflows were primarily in the form of foreign direct investment, which in combination with the large official reserve assets holdings, meant that the Asian countries were in the happy position of having external assets which were more liquid than their external liabilities (in contrast to the situation faced by the crisis countries in 1997 which suffered a sudden and large call on their external liabilities).

Whatever the role of these individual drivers, East Asian countries have not experienced a financial crisis in the twenty-first century. After the financial turmoil of September 2008 in New York and London, financial markets showed concern about the creditworthiness of some Asian countries, but the concern was misplaced. In October-November 2008 credit default swap spreads soared to 1200 basis points for Indonesia and lower (but still high) peaks for the Philippines, Thailand, South Korea and others, but the spreads fell during 2009

[25] Emerging East Asia is defined here as China, Hong Kong, South Korea, Malaysia Philippines, Singapore, Thailand and Vietnam.

and by the end of 2010 the spreads were less than 200 basis points for all Asian countries, which was less than the spreads for Italy or Spain (ADB, 2011, 5).

Since 2000 Asian economic integration has centred on a network of bilateral trade agreements, especially in East Asia. This has been driven by the increased density of regional value chains, and perhaps by lack of progress on trade facilitation in the Doha Development Round (Pomfret, 2011; Orefice and Rocha, 2011; Xing, 2011; Sourdin and Pomfret, 2012). A consequence of the value chains is that the extent of the decline of global trade, which is measured by summing gross value at each border crossing, relative to the decline in GDP, which is measured by summing value-added, was exaggerated. Factory Asia was hit in 2009 because North America and Western Europe are still major markets for the final products of the regional value chains, but this is changing as consumers in Asian and other markets become more affluent. Between 2009 and 2011, the Chinese economy grew from just under $5 trillion to $6.5 trillion and the Indian economy from $1.3 to $1.7 trillion, while ASEAN has a combined GDP of over $1.5 trillion.[26]

In sum, East Asia did not suffer a major crisis in 2008-9 - certainly nowhere near as bad as that of 1997-8 - and the reasons are sound.[27] Creation of deeper domestic financial markets, avoidance of large balance of payments or public sector deficits, outward-oriented trade policies and specialization by comparative advantage are all part of a recipe for continued economic growth. Such growth will narrow the income gap between East Asia and the USA and European countries that continue to experience deleveraging and slow growth.

5. Implications for Global Economic Governance

The major shift in global economic weight described in the previous section poses challenges to the system of multilateral institutions established in the 1940s and other fora for global economic governance. The G7/G8 grouping has been challenged by the rise of the G20, which includes six Asian economies (not counting Russia): Australia, China, India, Indonesia, Japan and South Korea. However, despite dissatisfaction in Asia, the IMF and World Bank

[26] For more details see Sanchita Basu Das "Asia Holds Promise as US, Eurozone Falter", *The Business Times* (Singapore), 24 August 2011.

[27] Asia may have been helped by the collapse of commodity prices in 2008-9. Flexible labour markets also facilitated rapid recovery in some countries. In China, where 20-36 million jobs were lost between October 2008 and April 2009 and unskilled wages fell by over 10%, those dismissed were overwhelmingly migrant workers; the decentralized stimulus package alleviated hardship by case-specific interventions, and employment and wages were increasing again in the second half of 2009 (Giles et al., 2012).

remain US/EU dominated, e.g. with no Asian candidate to challenge Christine Lagarde's IMF nomination in 2011 or nominated to head the World Bank in 2012. These situations are clearly unstable.

By contrast, the emerging Asian economies have managed to make substantial progress in liberalizing trade to meet the needs of their strengthening regional value chains. The WTO is the only one of the three major economic multilateral organizations that has had an Asian head, and there is almost universal WTO membership and acceptance of its international trade law and dispute resolution mechanisms. The slow process of multilateral trade negotiations has been augmented by substantial unilateral trade liberalization in East Asia and by trade facilitation measures within ASEAN. [28] In the twenty-first century, these patterns continue in bilateral and plurilateral agreements and in Asia-Pacific Economic Cooperation (APEC) and in negotiations to create a TransPacific Partnership (TPP). A regional approach to trade liberalization may be second-best, but as emphasis shifts from tariffs to trade facilitation regional agreements are less likely to be discriminatory; measures such as simplified customs procedures or single windows benefit all trading partners.

There are, however, constraints on a concerted Asian push for greater global influence. The region lacks a clear hegemon, and is characterized by pervasive competition between the big states (China-Japan, and to lesser extent India) and historically based distrust (China-Japan-Korea). There has been no counterpart to the post-1945 Franco-German agreement on Europe or the North Atlantic security alliance.[29] In the emerging economies there is a further constraint of scarce leadership resources, which is perhaps exacerbated by domestic political uncertainties in China, India, Indonesia, Thailand, Philippines, and elsewhere. At the same time, in southeast Asia ASEAN does not have even the limited degree of unity of the EU, and the governments of other large ASEAN economies may have reservations about Indonesia being the only country from their region sitting at the G20 table.

Finally, EU assumptions that the Asian economic powers will be concerned by their eurozone woes and may help out financially are likely to be misplaced. China has diversified its foreign exchange holdings and is hence concerned about the value of the euro.[30] However, Chinese

[28] Asian regional agreements in the 1990s and 2000s are described and analysed in Pomfret (2011). Pomfret and Sourdin (2009) provide evidence of trade facilitation within ASEAN also reducing the costs of trading with non-members.

[29] There is, in fact, an emerging arms race in East and South Asia. Between 2007 and 2011, the world's five largest importers of conventional weapons were India, South Korea, China, Pakistan and Singapore (Holtom et al., 2012).

[30] China may have supported the euro by diversifying its stock of reserve assets from US dollars to euros, which helped to limit the fall in value of the euro as the eurozone crisis emerged. However, this was done in China's own interests after the US financial crisis reduced faith in the US dollar. China will not to want to put all its eggs in

offers of assistance do not include gifts of cash or loans to an insolvent debtor. Chinese financial support will be channelled through international agencies such as the IMF, accompanied by calls for reforming of voting in the institution. Alternatively, Chinese funds may flow into Europe as direct foreign investment. Neither of these outcomes will be uncontroversial in the EU.

6. The Significance for Europe of Asia's Economic Rise

The outstanding feature of Asian economic dynamism in the 1990s and 2000s has been the establishment of global value chains in which Asian producers play a key role. The many sources of political discord in East Asia have rarely affected trade relations. Even between China and Japan, two countries vying for leadership with a fraught history and easily evoked nationalist emotions, trade has not been disrupted by spats like EU turkey wars or NAFTA lumber disputes. Individual European firms participate, of course, in these chains even if the highest profile poster children for offshoring have been US icons such as Barbie dolls or iPhones.

What should be of greater concern to European policymakers is the US embracing of the need to engage in trade facilitating negotiations, as in the TPP, while EU engagement as in, for example, ASEM is feeble. APEC has for two decades been a forum where the major non-European leaders meet, but since the mid-1990s Europeans could take some comfort from APEC's descent into apparent irrelevance (Pomfret, 2011, 27-38). President G.W. Bush appeared uninterested in Asia. President Obama has, however, taken steps to reorient US policy towards the Pacific, hosting the 2011 APEC summit in his birth-state, Hawaii. Even more striking was US participation in the 2011 East Asia summit together with the ASEAN+3, India, Russia, Australia and New Zealand.[31] The third element in the US tilt towards the Asia-Pacific region has been its participation in the Trans-Pacific Partnership (TPP) negotiations.

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a euro basket, especially as the dollar's continuing weigh in China's reserves ensures that China does not want to precipitate a sudden fall in the dollar's value.

[31] ASEAN+3 consists of the ten Association of Southeast Asian Nations members plus China, Japan and South Korea. Half-hearted EU attempts to be invited to the summit were undermined by substantive concerns about what the EU had to offer and by procedural concerns about how big, and hence disproportionate to its current world role, an EU delegation would be (Parello-Plesner, 2010). Before the Summit US Secretary of State Hilary Clinton attended the ASEAN Regional Forum and made a strong presentation of US concerns about peace in the South China Sea, an issue that resonated with the ASEAN hosts. Russia, like the USA, has signed the ASEAN Treaty of Amity and Cooperation, a step upon which EU leaders cannot agree.

The TPP negotiations grew out of a few countries' disappointment with APEC's failure to move towards a Free Trade Area of the Asia-Pacific (FTAAP). The Trans-Pacific Strategic Economic Partnership Agreement, commonly known as the P4, was announced at the 2005 APEC Trade Ministers' meeting. Since the Four were small economies (Brunei, Chile, New Zealand and Singapore) the P4 agreement was not of major concern to others – especially as the largest bilateral trade flow (Singapore-New Zealand) was already covered by a bilateral trade agreement. The game changer was the September 2008 announcement by the US Trade Representative that the USA would seek to join the P4; this was quickly followed by similar announcements by Australia and Peru. After a hiatus due to the change in US Administration, formal negotiations among the now P7 began in March 2010 in Melbourne. Vietnam and Malaysia joined the negotiations during 2010. Although negotiations were not finalized by the target date of the November 2011 APEC summit, an outline of agreement was publicized there. At that point, Japan, Canada and Mexico announced their intention of seeking entry into the TPP.

The TPP is intended to supersede existing agreements, going beyond them both in traditional areas of trade liberalization and, more importantly, in new areas. For example, TPP negotiations specifically include regulatory coherence and supply chain management.[32] Thus, it aims to deepen integration among members by reducing trade barriers and simplifying rules of origin (compared to the existing "noodle bowl" of bilateral agreements), and to do this in the context of facilitating participation in international supply chains. With the new members, the TPP will cover a large share of global trade, but there are major non-members in Asia. China, Korea and the seven ASEAN non-TPP countries may be relying on the less comprehensive ASEAN+1 free trade agreements, or the East Asian regionalism advocated by Japanese economists associated with the Asian Development Bank (ADB, 2008). However, the content of the two tracks does not differ so much, and Petri et al. (2011) argue that the momentum of liberalization in both tracks could lead to the establishment of a Free Trade Area of the Asia-Pacific within a decade, and that this would yield substantial benefits to all participants.

The issues being negotiated in the TPP Agreement, and potentially providing the basis for a FTAAP agreement, are issues that could be dealt with at the WTO, but the Doha Development Round is not progressing because there is no global consensus on deep integration. The TPP is a bold step for a group of like-minded countries to move forward on a trade agreement in tune with a world economy characterized by global value chains. If it

[32] The seriousness of this topic is illustrated by the rejection of Canada's 2010 request to joint the TPP. Canada's unwillingness to negotiate its supply management system for dairy products, eggs and some other food items was considered unacceptable (Elms and Lim, 2012, 12).

turns into an FTAAP, the group will include the world's three largest economies, plus other complementary economies at various levels of economic development. It will not include any European countries.

Meanwhile the Asia Europe Meeting (ASEM) convenes every two years (2010 in Brussels and 2012 in Vientiane), to little purpose. The number of participants is large for meaningful negotiation, and the "three pillars" of ASEM (political dialog, security and the economy, and education and culture) represent a vague mandate, with economic matters reduced to half a pillar.[33] The EU is pursuing new generation FTAs, but the speed with which the first of these was concluded with Chile, contrasts to the halting progress of Asian Negotiations. The only EU-Asian FTA was negotiated with South Korea in 2007 (a month after the US-Korea FTA was negotiated), and signed in October 2009, but provisional implementation was delayed until July 2011 as an intra-EU compromise was hammered out with Italy, which feared increased car imports. A mandate to negotiate with ASEAN in 2007 was negated by the EU's inability to negotiate region-to-region, and negotiations with seven ASEAN countries (excluding Cambodia, Laos and Myanmar) broke down. Bilateral negotiations with Singapore were initiated in 2009, and the Singapore agreement is expected in 2012, and in March 2012 negotiations with Vietnam were announced. The current state-of-play resembles something from the first decade of the twenty-first century.

EU absence from the major negotiating tables could affect the design of trade facilitation measures in ways inimical to European best interests. It is in striking contrast to the origins of the GATT/WTO system where seven of the twenty-three GATT signatories in 1947 were European.[34]

[33] ASEM8 in Brussels had 48 participants: the 27 EU member states plus the Commission, ASEAN+3 plus the ASEAN Secretariat, India, Pakistan, Mongolia, Russia, Australia and New Zealand.

[34] The 23 founding members were: Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Syria, South Africa, United Kingdom and the United States.

7. Conclusions

Europe's Role in a Multipolar Global Economy

Semantics can be important in political debates and for public perceptions. As a description of the post-2007 financial crises, "global" obscured the ongoing economic prosperity of countries such as China, India, Brazil, Indonesia, Canada, Australia and many others outside Europe that did not suffer from a crisis other than the brief downturn in global trade in 2009. Japan had a crisis in 2011 with roots in a natural disaster, and oil exporters such as Russia suffered from the fall in oil prices in 2008-9, but these are only indirectly part of a global financial crisis. The "global" in GFC is a figment of the view of the world as seen from leading North Atlantic economies.

Europe's self-centred view of an ongoing "global" crisis is even more harmful because it is nurturing a view born in the "GFC" that financial deregulation or liberalization elsewhere brought disaster upon the continental European countries, and that the response must be more regulation, which must be imposed on the entire global financial system, or failing that, on the entire EU. Yet, the reason why the eurozone is still in crisis mode is internal: a mixture of uncertain design of the zone and the role of the ECB, and excessively regulated (formally and informally) financial sectors. While countries with more nimble financial sectors enjoyed economic growth above the high-income OECD average over the decade and a half before 2007, the large eurozone countries (Germany, France and Italy) experienced economic growth below that average; even though Germany and France had a shallow recession in 2007-10 compared to the UK or Spain, their overall economic growth performance over the 1990s and 2000s was much worse.[35] Among the smaller EU economies, the less regulated Baltic and Irish economies had a more volatile ride, but ultimately to greater prosperity than the less volatile but weaker long-term economic performance (and ultimately unsustainable situation) in Greece or Portugal.[36] By assuming

[35] Italy's performance since the turn of the century has been especially anemic, the third worst in the world according to some calculations. The longer-term comparisons are in the Appendix table.

[36] Schrader and Laaser (2012) argue that Portugal is better placed than Greece because its debt problem is less severe and it had a better diversification and growth strategy after joining the EU in the 1980s, although Portugal slipped up in the 2000s by failing to respond to the challenge of competition from low-wage Eastern European countries. Portugal needs to get back on track, whereas in their view Greece has never been on track since joining the EU.

the role of economic victims, political leaders such as Merkel, Sarkozy and Berlusconi distracted blame from their national governments' past policies, but this stance makes reform harder.[37] The situation is poisoned if re-regulation is adopted as the answer to failure to sufficiently deregulate their economies, and especially the financial sector, in the past.

A second potentially harmful consequence of misperceptions about a GFC and eurozone debt is that European leaders are failing to acknowledge that much of the rest of the world, and especially East Asia, continues to enjoy rapid catch-up growth. Asia weathered the global economic recession of 2008-9 remarkably well. This was partly because no country in East Asia, South Asia or Australasia experienced a financial crisis, and these countries were also well placed to deal with an external trade shock because their economic growth in the twenty-first century had firm foundations. In addition, many countries had built up substantial foreign exchange reserves or sovereign wealth funds, which provided a cushion against balance of payments problems.[38] Continued Asian economic growth, as the EU and US faltered, accelerated a decades-long trend of increasing Asian weight in the global economy.

For the global economy, a question posed by the relative success of Asian economies as the USA and western Europe went through major recessions is whether this will be the catalyst for reform of the multilateral economic institutions established over sixty years ago by the World War II victors. Agreements such as the head of the World Bank being from the USA and the head of the IMF being European are clearly anachronistic. The composition of the Gx groups has been a little more malleable, as the G7 expanded to a G8 in the 1990s after Russia abandoned central planning, and was later superseded by the G20, but an arbitrary division between twenty important countries and the unimportant rest of the world is unstable, in Asia as much as anywhere else.[39] Economic reasons for why the potential role of Asia in reform of these institutions for global economic governance has increased are easy to find, but the political constraints within and among Asian countries will impede any clear-cut regional leadership in pushing a reform agenda. Given Asia's fissiparous political

[37] Similarly the *Schadenfreude* in some European financial circles when US, UK, Spanish, Irish and other banks encountered difficulties due to their aggressive real estate lending may have made it harder to acknowledge that French and German banks were also guilty of poor lending. Indeed, the loans to delinquent sovereigns who spent on current consumption or wasteful investment (e.g. facilities for the Athens Olympics) may be even worse than the real-estate lending which, in addition to fuelling bubbles, financed some construction of real value in Ireland (new housing) and Spain (infrastructure).

[38] Some of the larger regional economies, notably China and Australia, undertook large pre-emptive fiscal stimulus programs. The only serious long-term implication for the national economies is whether those programs can be reversed without significant political disruption before the countries run into sovereign debt issues.

[39] Membership of the G7 was on the objective criteria of the market-based economies with the largest GDP, and by chance there was a significant gap between the seventh and eighth ranking. The transition from central planning rendered the criteria obsolete and Russia, but not China, was invited to join the group. By 2012 Brazil also had a higher GDP than Canada, Italy or the UK, but breaks in the ranking list are no longer clear-cut, and can quickly change due to exchange rate or primary product price volatility.

relations, it is unsurprising that the leading outsider candidates for the top IMF and World Bank positions in 2011 and 2012 were Latin American and African. Nevertheless, many Asian countries support non-EU candidates for the IMF or non-US candidates for the World Bank, especially when the candidacies are couched in the meritocratic terms of finding the best person for the job

Battles over leadership of the IMF or World Bank or the composition of the G20 are, however symbolically significant, less important than the changes in the global economy. The major change in the world economy during the last three decades of the twentieth century was the adoption of more market-based outward-oriented economic systems by many of the world's most populous countries. Individual countries may falter in the process of integrating into the world economy, but more complex global value chains will encompass an increasing range of countries at different levels of development. It is also noteworthy that, despite an obsession with China's rise, the US policy tilt under Obama covered the wider Asia-Pacific region. US policy has also reached out to other large emerging economies. President Obama in 2010 endorsed India's bid for a permanent seat on the UN Security Council. US relations with Brazil have been more fraught, and concrete progress during President Rousseff's April 2012 visit to Washington was limited to increased security cooperation through regular meetings of defence ministers and an increase in the number, from four to six, of US consulates in Brazil, but this still represented a thaw.

The EU is a major player in the world economy and many EU firms are global leaders. Nevertheless, if the EU is to continue to maintain pre-eminence, its economy needs to move with the times, and policies must be such as to encourage, or at least accommodate, such change. Barbie and the iPhone are useful symbols: the US firms Mattel and Apple have developed products with massive global appeal not by manufacturing those products in the USA but because technically skilled or entrepreneurial workers in the USA have designed and marketed the products, entrusting manufacture to Factory Asia. For EU countries the challenge in the twenty-first century is to ride with dynamic comparative advantage, using their wealth to invest in human capital for future competitiveness.[40]

[40] A very rough parallel might be drawn with the high-income agricultural exporters of the early 1900s. Canada and Australia made an economic transformation over the twentieth century that included world-beating companies outside the farm sector, while Argentina did not. Whatever the cause of divergence, the point is that high-income countries in the early 2000s may or may not still be high in future global rankings in 2100.

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Appendix

Table. GDP in Current US Dollars (billions), 1992-2007

	1992	**2007**	**2010**	**% change**					**1992**	**2007**	**2010**	**% change**		
				92-07	**07-10**	**92-10**						**92-07**	**07-10**	**92-10**
USA	6,286.8	13,811.2	14,586.7	119.7	5.6	132.0		Germany	2,062.1	3,297.2	3,280.5	59.9	-0.5	59.1
UK	1,074.0	2,727.8	2,248.8	154.0	-17.6	109.4		France	1,372.8	2,562.3	2,560.0	86.6	-0.1	86.5
Spain	612.6	1,429.2	1,407.4	133.3	-1.5	129.7		Italy	1,265.8	2,107.5	2,051.4	66.5	-2.7	62.1
Ireland	54.3	255.0	211.4	369.6	-17.1	289.3		Greece	128.4	360.0	301.1	180.4	-16.4	134.5
High Income OECD	19,764.1	38,219.0	40,819.6	93.4	6.8	106.5		World	24,533.6	54,347.0	63,123.9	121.5	16.1	157.3

Source: Pomfret (2010, 26) -- data from World Bank *World Development Indicators*, updated 27 March 2012.
Notes: the 31 high-income OECD countries are Australia, Canada, Iceland, Japan, Republic of Korea, New Zealand, Norway, Switzerland USA and 21 EU member countries (all except Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania)