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COMMENT

A G-Zero World

The New Economic Club Will Produce Conflict, Not Cooperation

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This is not a G-20 world. Over the past several months, the expanded group of leading economies has gone from a would-be concert of nations to a cacophony of competing voices as the urgency of the financial crisis has waned and the diversity of political and economic values within the group has asserted itself. Nor is there a viable G-2 -- a U.S.-Chinese solution for pressing transnational problems -- because Beijing has no interest in accepting the burdens that come with international leadership. Nor is there a G-3 alternative, a grouping of the United States, Europe, and Japan that might ride to the rescue.

Today, the United States lacks the resources to continue as the primary provider of global public goods. Europe is fully occupied for the moment with saving the eurozone. Japan is likewise tied down with complex political and economic problems at home. None of these powers' governments has the time, resources, or domestic political capital needed for a new bout of international heavy lifting. Meanwhile, there are no credible answers to transnational challenges without the direct involvement of emerging powers such as Brazil, China, and India. Yet these countries are far too focused on domestic development to welcome the burdens that come with new responsibilities abroad.

We are now living in a G-Zero world, one in which no single country or bloc of countries has the political and economic leverage -- or the will -- to drive a truly international agenda. The result will be intensified conflict on the international stage over vitally important issues, such as international macroeconomic coordination, financial regulatory reform, trade policy, and climate change. This new order has far-reaching implications for the global economy, as companies around the world sit on enormous stockpiles of cash, waiting for the current era of political and economic uncertainty to pass. Many of them can expect an extended wait.

THE OLD BOYS' CLUB

Until the mid-1990s, the G-7 was the international bargaining table of greatest importance. Its members shared a common set of values and a faith that democracy and market-driven capitalism members shared a common set of values and a faith that democracy and market-driven capitalism were the systems most likely to generate lasting peace and prosperity.

In 1997, the U.S.-dominated G-7 became the U.S.-dominated G-8, as U.S. and European policymakers pulled Russia into the club. This change did not reflect a shift in the world's balance of power. It was simply an effort to bolster Russia's fragile democracy and help prevent the country from sliding back into communism or nationalist militarism. The transition from the G-7 to the G-8 did not challenge assumptions about the virtues of representative government or the dangers of extensive state management of economic growth.

The recent financial crisis and global market meltdown have sent a much larger shock wave through the international system than anything that followed the collapse of the Soviet bloc. In September 2008, fears that the global economy stood on the brink of catastrophe hastened the inevitable transition to the G-20, an organization that includes the world's largest and most important emerging-market states. The first gatherings of the club -- in Washington in November 2008 and London in April 2009 -- produced an agreement on joint monetary and fiscal expansion, increased funding for the International Monetary Fund (IMF), and new rules for financial institutions. These successes came mainly because all the members felt threatened by the same plagues at the same time.

But as the economic recovery began, the sense of crisis abated in some countries. It became clear that China and other large developing economies had suffered less damage and would recover faster than the world's wealthiest countries. Chinese and Indian banks had been less exposed than Western ones to the contagion effects from the meltdown of U.S. and European banks. Moreover, China's foreign reserves had protected its government and banks from the liquidity panic that took hold in the West. Beijing's ability to direct state spending toward infrastructure projects quickly generated new jobs, easing fears that the decline in U.S. and European consumer demand might trigger large-scale unemployment and civil unrest in China.

As China and other emerging countries rebounded, the West's fear and frustration grew more intense. In the United States, stubbornly high unemployment and fears of a double-dip recession fueled a rise in antigovernment activism and shifted power to the Republicans. Governments fell out of favor in France and Germany -- and lost elections in Japan and the United Kingdom. Fiscal crises provoked intense public anger from Greece to Ireland and the Baltic states to Spain.

Meanwhile, Brazil, China, India, Turkey, and other developing countries moved forward as the developed world remained stuck in an anemic recovery. (Ironically, the only major developing country that has struggled to recover is the petrostate Russia, the first state welcomed into the G-7 club.) As the wealthy and the developing states' needs and interests began to diverge, the G-20 and other international institutions lost the sense of urgency they needed to produce coordinated and coherent multilateral policy responses.

Politicians in Western countries, battered by criticism that they have failed to produce a robust recovery, have blamed scapegoats overseas. U.S.-Chinese political tensions have risen significantly over the past several months. China continues to defy calls from Washington to allow the value of its currency to rise substantially. Policymakers in Beijing insist that they must protect their country during a delicate moment in its development, as lawmakers in Washington become more serious about taking action against Chinese trade and currency policies that they say are unfair. In the past three years, there has been a sharp spike in the number of domestic trade and World Trade Organization cases that China and the United States have filed against each other. Meanwhile, the G-20 has gone from a modestly effective international institution to an active arena of conflict.

THE EMPTY DRIVER'S SEAT

There is nothing new about this bickering and inaction. Four decades after the Nuclear Nonproliferation Treaty, for example, the major powers still have not agreed on how to build and maintain an effective nonproliferation regime that can halt the spread of the world's most dangerous weapons and technologies. In fact, global defense policy has always been essentially a zero-sum game, as one country or bloc of countries works to maximize its defense capabilities in ways that (deliberately or indirectly) challenge the military preeminence of its rivals.

International commerce is a different game; trade can benefit all players. But the divergence of economic interests in the wake of the financial crisis has undermined global economic cooperation, throwing a wrench into the gears of globalization. In the past, the global economy has relied on a hegemon -- the United Kingdom in the eighteenth and nineteenth centuries and the United States in the twentieth century -- to create the security framework necessary for free markets, free trade, and capital mobility. But the combination of Washington's declining international clout, on the one hand, and sharp policy disagreements, on the other -- both between developed and developing states and between the United States and Europe -- has created a vacuum of international leadership just at the moment when it is most needed.

For the past 20 years, whatever their differences on security issues, governments of the world's major developed and developing states have had common economic goals. The growth of China and India provided Western consumers with access to the world's fastest-growing markets and helped U.S. and European policymakers manage inflation through the import of inexpensively produced goods and services. The United States, Europe, and Japan have helped developing economies create jobs by buying huge volumes of their exports and by maintaining relative stability in international politics.

But for the next 20 years, negotiations on economic and trade issues are likely to be driven by competition just as much as recent debates over nuclear nonproliferation and climate change have. The Doha Round is as dead as the dodo, and the World Trade Organization cannot manage the surge of protectionist pressures that has emerged with the global slowdown.

Conflicts over trade liberalization have recently pitted the United States, the European Union, Brazil, China, India, and other emerging economies against one another as each government looks to protect its own workers and industries, often at the expense of outsiders. Officials in many European countries have complained that Ireland's corporate tax rate is too low and last year pushed the Irish government to accept a bailout it needed but did not want. German voters are grousing about the need to bail out poorer European countries, and the citizens of southern European nations are attacking their governments' unwillingness to continue spending beyond their means.

Before last November's G-20 summit in Seoul, Brazilian and Indian officials joined their U.S. and European counterparts to complain that China manipulates the value of its currency. Yet when the Americans raised the issue during the forum itself, Brazil's finance minister complained that the U.S. policy of "quantitative easing" amounted to much the same unfair practice, and Germany's foreign minister described U.S. policy as "clueless."

Other intractable disagreements include debates over subsidies for farmers in the United States and Europe, the protection of intellectual property rights, and the imposition of antidumping measures and countervailing duties. Concerns over the behavior of sovereign wealth funds have restricted the ability of some of them to take controlling positions in Western companies, particularly in the United States. And China's rush to lock down reliable long-term access to natural resources -- which has led Beijing to aggressively buy commodities in Africa, Latin America, and other emerging markets -- is further stoking conflict with Washington.

Asset and financial protectionism are on the rise, too. A Chinese state-owned oil company attempted to purchase the U.S. energy firm Unocal in 2005, and a year later, the state-owned Dubai Ports World tried to purchase a company that would allow it to operate several U.S. ports: both ignited a political furor in Washington. This was simply the precursor to similar acts of investment protectionism in Europe and Asia. In fact, there are few established international guidelines for foreign direct investment -- defining what qualifies as "critical infrastructure," for example -- and this is precisely the sort of politically charged problem that will not be addressed successfully anytime soon on the international stage.

The most important source of international conflict may well come from debates over how best to ensure that an international economic meltdown never happens again. Future global monetary and financial stability will require much greater international coordination on the regulation and supervision of the financial system. Eventually, they may even require a global super-regulator, given that capital is mobile while regulatory policies remain national. But disagreements on these issues run deep. The governments of many developing countries fear that the creation of tighter international rules for financial firms would bind them more tightly to the financial systems of the very Western economies that they blame for creating the recent crisis. And there are significant disagreements even among advanced economies on how to reform the system of regulation and supervision of financial institutions.

Global trade imbalances remain wide and are getting even wider, increasing the risk of currency wars -- not only between the United States and China but also among other emerging economies. There is nothing new about these sorts of disagreements. But the still fragile state of the global economy makes the need to resolve them much more urgent, and the vacuum of international leadership will make their resolution profoundly difficult to achieve.

WHO NEEDS TO DOLLAR?

Following previous crises in emerging markets, such as the Asian financial meltdown of the late 1990s, policymakers in those economies committed themselves to maintaining weak currencies, running current account surpluses, and self-insuring against liquidity runs by accumulating huge foreign current account surpluses, and self-insuring against liquidity runs by accumulating huge foreign exchange reserves. This strategy grew in part from a mistrust that the IMF could be counted on to act as the lender of last resort. Deficit countries, such as the United States, see such accumulations of reserves as a form of trade mercantilism that prevents undervalued currencies from appreciating. Emerging-market economies, in turn, complain that U.S. fiscal and current account deficits could eventually cause the collapse of the U.S. dollar, even as these deficits help build up the dollar assets demanded by those countries accumulating reserves. This is a rerun of the old Triffin dilemma, an economic observation of what happens when the country that produces the reserve currency must run deficits to provide international liquidity, deficits that eventually debase the currency's value as a stable international reserve.

Meanwhile, debates over alternatives to the U.S. dollar, including that of giving a greater role to Special Drawing Rights (an international reserve asset based on a basket of five national currencies created by the IMF to supplement gold and dollar reserves), as China has recommended, are going nowhere, largely because Washington has no interest in any move that would undermine the central role of the dollar. Nor is it likely that China's yuan will soon supplant the dollar as a major reserve currency, because for the yuan to do so, Beijing would have to allow its exchange rate to fluctuate, reduce its controls on capital inflows and outflows, liberalize its domestic capital markets, and create markets for yuan-denominated debt. That is a long-term process that would present many near-term threats to China's political and economic stability.

In addition, energy producers are resisting policies aimed at stabilizing price volatility through a more flexible energy supply. Meanwhile, net energy exporters, especially Russia, continue to use threats to halt the flow of gas as a primary foreign policy weapon against neighboring states. Net energy consumers, for their part, are resisting policies, such as carbon taxes, that would reduce their dependency on fossil fuels. Similar tensions derive from the sharply rising prices of food and other commodities. Conflicts over these issues come at a time when economic anxiety is high and no single country or bloc of countries has the clout to help drive a truly international approach to resolving them.

From 1945 until 1990, the global balance of power was defined primarily by relative differences in military capability. It was not market-moving innovation or cultural dynamism that bolstered the Soviet bloc's prominence within a bipolar international system. It was raw military power. Today, it is the centrality of China and other emerging powers to the future of the global economy, not the numbers of their citizens under arms or the weapons at their disposal, that make their choices crucial for the United States' future.

This is the core of the G-Zero dilemma. The phrase "collective security" conjures up NATO and its importance for peace and prosperity across Europe. But as the eurozone crisis vividly demonstrates, there is no collective economic security in a globalized economy. Whereas Europe's interest rates once converged based on the assumption that southern European countries were immune to default risks and eastern European states were lined up to join the euro, now there is fear of a contagion within the walls that might one day bring down the entire eurozone enterprise.

Beyond Europe, those who make policy, whether in a market-based democracy such as the United States or an authoritarian capitalist state such as China, must worry first and foremost about growth and jobs at home. Ambitions to bolster the global economy are a distant second. There is no longer a Washington consensus, but nor will there ever be a Beijing consensus, because Chinese-style state capitalism is designed to meet China's unique needs. It is that rare product that China has no interest in exporting.

Indeed, because each government must work to build domestic security and prosperity to fit its own unique political, economic, geographic, cultural, and historical circumstances, state capitalism is a system that must be unique to every country that practices it. This is why, despite pledges recorded in G-20 communiqués to "avoid the mistakes of the past," protectionism is alive and well. It is why the process of creating a new international financial architecture is unlikely to create a structure that complies with any credible building code. And it is why the G-Zero era is more likely to produce protracted conflict than anything resembling a new Bretton Woods.