How the rich OECD nations should handle the emerging giants

A new world is dawning, warns Patrick Messerlin, in which the comfortable certainties enjoyed for so long by the world's industrialised countries are to be challenged by the emerging economies. The answer should be for OECD members to improve their own governance and lead by example

There are now stark differences between OECD countries burdened by negative growth along with skyrocketing debt and key emerging economies that are already back to their pre-2008 growth levels. Europeans in particular have to recognise their shrinking weight in relative terms at the IMF, a forum much closer to their finance ministers' heart than the WTO where over the last two decades the Europeans have already suffered from "diminishing giant" syndrome.

In the aftermath of the G20 Pittsburgh Summit last year bruised European and American officials insisted heavily on the fact that G20 membership was imposing "new responsibilities," and they invited policymakers from the emerging giants to be more fully involved in designing a new global economic framework – implicitly suggesting that it has not been the case so far.

Yet the evidence does not support this European and American view. Rather, it suggests that the "core" emerging economies – Brazil, China, India, Korea and Mexico – have already played a decisive role in two major international economic issues – the world trade regime and the management of the worldwide economic crisis – while the jury is still out on the third one – the global environment.

Few people appear to realise the fundamental contribution of the emerging economies to the success of the current world trade regime, something that has been of great benefit to OECD countries as well as to themselves. During the last three decades, the amazing success of China's trade liberalisation has done much more to convince the other developing countries of the gains from trade than all the OECD countries' exhortations. China has undertaken over the last 20 years a liberalisation process that it took 40 years for the U.S. and Europe to do. And China is the WTO member that has made the deepest liberalisation commitment on services, while Brazil has been decisive in cracking U.S. and EU agricultural protection and India in raising high the issue of services liberalisation. During key WTO ministerial negotiations in July 2008, Brazil was the most pro-active negotiator. The immediate reasons for the failure of those negotiations are generally attributed to India and the U.S., yet most observers seem to agree that the responsibility of the U.S. was the greater.

On crisis management in the wake of the financial meltdown of autumn 2008, the emerging economies have certainly been as diligent and active as the U.S. and the EU, judging by IMF indicators. The deterioration of the overall fiscal balances of South Korea, China and India has been just as severe as in the larger EU member states. Crisis-related discriminatory measures taken in 2009 by all the main emerging economies other than India and Brazil are comparable to those in the U.S. and throughout the EU. The general levels of government debt forecast for 2014 are better controlled in the core emerging economies than in either the U.S. or the EU. Last but not least, these core emerging economies have abstained from increasing tariffs, and their stimulus packages grant much more limited subsidies to the banking and car sectors than do comparable packages in OECD countries. The exception to this, of course, has been China's dramatic stimulation measures in a dozen or so sectors. But these have been industrial policies, and hence will be a source of severe trouble in the future.

As to the environmental issues and the overall problem of climate change, the positions of the emerging economies were until mid-2009 negative or defensive. But India did much to change the mood when it became pro-active in the climate change

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By Deisy Ventura

Yes the OECD must get its act together, but these emerging countries don't really need it

Patrick Messerlin thinks that the failure of OECD countries to address pressing issues like trade, the economic crisis and the environment, will have dramatic consequences for the main emerging economies – Brazil, China, India, Korea and Mexico. He even goes so far as to argue that deficiencies among the OECD's members threaten world peace.

These points must surely raise questions about the OECD itself. Is it really the right institutional arena for the world's emerging economic powers? Mexico has been in the OECD since 1994 and Korea since 1995, and the future membership of Brazil, China and India has become an OECD priority, even though their accession still seems like a distant goal. Of the South American countries, small and highly-liberalised Chile was the first to join the organisation, an event that coincided with the coming to power of Chile's first conservative government.

This raises the question; does the prospect of OECD membership exert a positive influence on the governments of would-be member countries? And do these countries really want to become members? By and large, these emerging economic powers are debate in the run-up to last December's Copenhagen summit, and then just before the meeting opened China announced a substantial cut in the increase, although not the level, of its emissions. The initial hesitation of most emerging economies on climate change was no great surprise, given that attitudes to these issues depend heavily on income levels; the higher incomes are the more attention environmental issues receive and the stronger public support for solutions. This has been illustrated within Europe itself where the poorer EU member states have opposed the measures being proposed by the richer ones. Where the emerging economies have been more sensitive than OECD countries is on environmental issues like fisheries. At the same time, Brazil has improved its forest and agricultural land management while the U.S. and the EU have been massively subsidising production of environmentally-unfriendly (particularly detrimental to forests) first generation bio-fuels.

So much for the core group of emerging economies. The credentials of other G20 countries like Argentina, Indonesia, South Africa, Russia, Saudi Arabia, South Africa and Turkey has been less convincing. These are countries that have been more hesitant in trade matters, more ambiguous in the instruments they have chosen for managing the crisis, and that are still more reluctant to deal with environmental issues. These attitudes also largely echo their less than convincing economic performances.

The fact that the core emerging economies have already contributed substantially to the shaping of the new global economic framework doesn't mean that they do not

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already introducing the reforms that are needed to join the OECD because that's how to secure their own economic future, not because of any wish to enter the so-called rich man's club. OECD membership could even be considered a prize these countries may receive for making sensible economic adjustments.

Another question raised by Messerlin's article is whether OECD countries can contribute to world peace and to the health of emerging economies. The economic crisis has shown the limitations of the economic models adopted by OECD members. Developing countries and emerging countries are clamouring for markets to be opened because exports to developed states are critical to their economic future. But the crisis has led once-staunch defenders of liberalism – the United States, for instance – to opt for a measure of protectionism.

Because the developed world is finding it so difficult to live up to its own principles, the future of the World Trade Organisation has been put at risk and relations between richer and emerging countries have been further complicated.

Among the coming economic giants, Brazil has emerged the strongest from the crisis. But neither Brazil nor other developing countries have presented an alternative to OECD's development model. All emerging countries are distinguished by deep inequalities in income distribution, which has disastrous consequences for the quality of their institutions. Human rights abuses are common, especially when it comes to economic and social rights, and environmental still face serious challenges, with the huge income discrepancies between themselves and the rich countries endangering their own long-term growth and political stability. This could yet impair their future involvement in the G20 process. Those of the emerging economies that have democratic political systems are too often confronted, just like OECD countries, by the "iron law of tiny majorities" – when governments have to rely on very small majorities which greatly complicate the taking of hard decisions. Non-democratic emerging economies are in no better shape, as is illustrated by the factionalism among China's policymakers, where there are those who support rural versus coastal provinces, and market-based reforms versus state-control. This factionalism has so far prevented China from making progress on subjecting the yuan to market forces, has fragmented China's overall stimulus package into sectoral industrial policies and is forcing Chinese people to keep high saving rates for covering health and retirement expenses. All of this is making more difficult the much-needed "rebalancing" of the Chinese economy towards more domestically-based growth.

In this context, what actions should the OECD countries envisage? It is fashionable these days to look to stricter international rules as "the solution", but that's not a strategy well-suited to times like ours that are dominated by an on-going shift of the tectonic plates in international economic relations. The combined emergence of new world powers with the diminishing influence of the current powers is not propitious for stricter disciplines. The world's rising powers will increasingly be dis-inclined to accept disciplines that they see as American or European tutelage. At the same time, they themselves are still far from being able either to exert leadership or introduce more discipline.

This means that the OECD countries will have to lead by example. When reforming their own domestic regulatory frameworks, they should avoid any dramatic swings away from allegedly "rational markets" to allegedly rational governments. Rather they should improve the quality of regulation along with enforcement and monitoring. These are things that were largely taken for granted throughout the last decade, but as the crisis revealed were far from adequate. As regulating is a form of competition between governments, focusing on improved regulation looks increasingly like the best channel of influence available to OECD countries.

What, in concrete terms, would such an approach mean? In trade matters, OECD countries should keep their markets open, and open those that are still closed – in agriculture (crucial to the sustained growth of emerging economies like Argentina, Brazil or Indonesia) or in services (crucial for countries like India or Korea). Above all, these areas hold the key to generating more domestically-based growth in all the emerging economies. All of this implies the much stronger support of OECD countries, and especially the U.S., for a successful conclusion of the Doha Round.

The OECD countries' crisis management has demonstrated a number of macroeconomic flaws, lax debt policies for instance, that have been amply underlined by the IMF. But there are equally severe microeconomic flaws that so far have been barely noticed, including over generous and largely uncontrolled subsidies to the banking and car sectors. Stern action in these areas needs to be taken by OECD countries as a matter of emergency.

Climate change also requires the strong involvement of OECD countries. Once the dust of the Copenhagen conference has begun to settle they should make concrete trend commitments to substantial financial transfers to the poorest of the emerging economies. They should also be very careful when choosing the instruments they will use; carbon taxes for instance are much more friendly to world trade, being similar to value added taxes, than cap-and-trade policies which are prone to discrimination of all kinds and so are potentially protectionist.

This year, Korea – one of the best performers during the global crisis – will hold the G20 chair, so giving strong support to Korea's initiatives offers a splendid opportunity for the OECD countries to show that while they can still be proud of today's slowly disappearing post-WWII world, because it has been the source of remarkable progress, they also do not fear the new world that is emerging. □

Patrick A. Messerlin is professor of economics at Sciences-Po (Institut d'Etudes Politiques) in Paris and from 1999-2002 was Special Adviser to the World Trade Organisation's Director General.
patrick.messerlin@sciences-po.fr

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issues don't receive the attention they deserve. Although projects like biofuel development in Brazil have been broadly welcomed, they are a drop in the ocean when set against the environmental devastation that takes place in these countries. The northern hemisphere's timidity at Copenhagen has done little to settle this matter. But the greatest common weakness of both emerging and developed countries is their failure to make sustainable development a reality. □

Deisy Ventura is a professor at the Institute of International Relations of the University of São Paul in Brazil. deisy.ventura@usp.br