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Summary: The world has changed, and the rules and institutions that govern it will need to change with it if stability and order are to prevail. As guardians of that order, neither Japan nor Europe has an interest in seeing the global economic order fragment. The more the two sides can work together on issues such as pressing the U.S. Congress to approve IMF reform, in spite of differing perspectives on China, for example, the more likely it will be that the order will simply evolve.

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Japan, Europe, and the Global Economic Order

by Amy Studdart

Over the last 70 years, the global economic order — underpinned by the International Monetary Fund (IMF), the World Bank and the World Trade Organization (and the GATT before that) — has created the conditions for a sustained period of growth and relative peace. That order is now at an inflection point. The rapid pace of technological progress and globalization means that there are now large swathes of economic activity that are either ungoverned or governed using outdated structures and rules, from the rise of instantly multinational internet companies to financial services and energy markets. That progress is in and of itself cause to revisit the global economic architecture and rules, but the urgency of reform is the result of the increasing demands of countries with a new-found economic strength like Brazil, China, and India. They and other developing countries feel little loyalty to a system they did not create and that does not afford them the weight at the table that their populations or economic size warrant. How Japan and Europe respond to these pressures, and whether or not they do so in step with one another, will be of great consequence to the future of the global economy.

Between them, Japan and Europe have five seats at the table of the G7. The BRICS have none. Within the IMF, Europe has 35.6 percent of the voting power, Japan has 6.7 percent, and the BRICS share 11.5 percent. As seen from China, Brazil, India, and other emerging economics, these numbers represent an outdated sense of economic power and reflect neither the emergence of new major economies nor the impact of the 2008 financial crisis. But, despite slow growth, Japan and the European Union continue to represent one-third of global GDP. These two sides are major stakeholders in the existing global economic order and will continue to be so for the foreseeable future. Whether or not they will meaningfully cooperate on how that order evolves is uncertain. There is little space between them on areas of substance, but while it is clearly apparent to both sides that the global economic order is under threat, the manifestations of that threat and the immediate risks they face are vastly different.

Until 2008, Europe had a grand vision of how it wanted to see the global economic order evolve. Based on the success of the European Union and its precursors in preventing war and facilitating economic progress, Europe imagined a world built in its image, with greater economic integration and an accompanying decline of national boundaries. There were multiple willing buyers for that model. The African Union, Mercosur, CARICOM, and ASEAN all, to varying extents, drew lessons and inspiration from the European Union and the promise of a post-Westphalian order based on reducing barriers to trade, movement of people, and minimizing conflict. Nowhere was the pursuit of this vision more important to Europe than on its eastern borders. In an effort to moderate Russian influence and bring prosperity to the region, Europe had gradually worked to bolster the economies and governance structures of countries in the region with an eye to integrating them into the European Union, and bringing Russia itself closer to a European vision of the regional order. Among the primary ways it exercised influence was through a variety of preferential trade and other economic measures and — at the last — the "Deep and Comprehensive Free Trade Agreement" that precipitated the Euromaidan movement and the subsequent conflict in Ukraine. Needless to say, that model is now in the midst of an existential crisis: a resurgent Russia has demonstrated that economic power means little without the military means to defend it; sputtering growth and high youth unemployment make Europe seem more like a continent of stagnation than of promise and opportunity; and the crisis in Greece threatens to undermine the concept of a Union entirely.

Japan, meanwhile, had been motivated more by specific interests and goals than by a master vision of how the global economy should function. As a result of its "lost two decades," Japan's role on the global economic stage for the last few years has been that of a quiet giant. That has all changed, however, with the rise of China. Japan, more than any other country, is on the front lines of what a China-dominated global or regional economic order might look like. In the midst of the flare up over a Japan-China territorial dispute in the East China Sea, the embargo on rare earth exports to Japan was a prescient example of how effectively China can marshal its economic power to serve non-economic objectives.

In Europe, China is still believed to present more of an economic opportunity than a threat, even more so as various European countries have struggled to regain healthy growth in the aftermath of the 2008 financial crisis. This has been most recently apparent in the European response to the Chinese-led Asian Infrastructure Investment Bank (AIIB). The bank has divided the G7, with Europe's G7 members joining quickly enough to become "founding members" and Japan and the United States holding out. For the United States and Japan, the bank represents part of a larger Chinese effort to set up a parallel regional economic order with itself at the center. For the U.K., France, Italy, and Germany, the bank is — by and large — not only an understandable response to the slow pace of reforms in the established regional and economic institutions, but a welcome one. By multi-lateralizing its lending to developing countries, China is opening itself up to a great deal more scrutiny and regulation that it would otherwise have done. And, as British Chancellor George Osborne has suggested, there is a hope that direct domestic economic benefits might also be on the table for countries making gestures of good will. This should not imply that there are no tensions in the economic relationships between Europe and China (the last EU trade commissioner was famously disliked by his Chinese counterparts for his robust stance on trade disputes) but the concept of the Chinese threat is felt far less intensely in Brussels, Berlin, London, or Paris than it is in Tokyo.

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The two sides thus have a very different set of priorities, which will make any ambitious agenda for cooperation a challenge, although not impossible. While Japan and Europe might be broadly on the same page in terms of how they want to see the global economic order evolve, the day-to-day business of policymaking and politics has been informed less by a grand vision and more by the weighing up of immediate threats and opportunities. There is still, however, the capacity for a shared agenda. Europe and Japan might not have the same immediate priorities, but neither do their interests stand at odds with one another. Over the longer term, both are demonstrably committed to an integrated economic order in which China, Russia, and everyone else plays by the same rules.

Driving up growth would be the single best thing either side could do for their leadership positions in the global economy. The world's largest and fourth-largest trading powers have a great deal to offer one another in this area. After the partial implementation of the EU-Republic of Korea free trade agreement (FTA) in 2011, European imports of South Korean goods grew by 4.7 percent and exports grew by 16.2 percent. The EU-Japan FTA would have even more of an impact. In many of the areas that would be covered in the agreement, Japan and Europe have more in common with one another than either side does with the United States, the country both have looked to most for economic partnership. This is particularly true on some sensitive economic-come-cultural issues like food and agricultural standards, legal protections for workers, the provision of healthcare, and wealth distribution. Despite this, the EU-Japan FTA has languished as Tokyo has focused its energies on the Trans-Pacific Partnership, with the implicit understanding that whatever is decided in TPP will inform the EU-Japan FTA. Not only does this mean negotiations for the EU-Japan FTA have proceeded slowly, it also means that the agreement will be less ambitious than it otherwise might have been.

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On the longer-term question, both Japan and Europe have demonstrated a commitment to preserving the existing global order at the expense of their own short-term interests. Japan signed up to sanctions on Russia after a period in which the Tokyo had invested a great deal of political capital in putting its relationship with Moscow on a positive track. European countries agreed to relinquish some of their influence within the IMF to make space for the emerging economies. Those commitments have been meaningful, but over the next decade there will likely be more of the same demands.

One immediate priority in this area should be putting pressure on the United States to pass the IMF reforms mentioned above. While governments agreed to the reform package back in 2010, it has yet to be ratified by the United States Congress. G20 finance ministers have repeatedly demanded that Congress pass the legislation, but there have been few, if any, calls from G7 heads of state or government. Not only does the failure to pass the reform package make the IMF less effective, it has also made the establishment of new, parallel institutions seem more legitimate. High-level calls from Japan and Europe would do a great deal of good in helping the United States Congress understand the effect inaction is having on its role in the world. It would also be a show of good faith to emerging economies, demonstrating that the established economies are willing not only to sacrifice some of their weight in global economic decision-making, but to expend political capital in ensuring that others also act responsibly.

Japan and Europe are faced with immediate and serious threats to their security and prosperity, perhaps the gravest either has faced since the end of the Cold War. In that context, it is difficult to imagine leaders on either side prioritizing something as nebulous as the global economic order at the expense of dealing with the immediate impact of China's rise, Russian aggression, stagnant growth, or the euro crisis. Those threats, however, stem from a shared issue: the world has changed, and the rules and institutions that govern it will need to change with it if stability and order are to prevail. As guardians of that order, neither Japan nor Europe has an interest in seeing the global economic order fragment. The more the two sides can work together, the more likely it will be that the order will simply evolve.

About the Author

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