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A New Bretton Woods Architecture and Global Governance

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SYNOPSIS

The Bretton Woods global economic architecture is no longer fit for purpose to address the present-day challenges of global governance, geopolitics, national security, and broken supply chains. How will this architecture evolve in the future and how will it affect global economic governance?

COMMENTARY

The centralised rules-based global economic architecture (GEA), established soon after the 1944 Bretton Woods conference, comprises the International Monetary Fund (IMF) created for macroeconomic and monetary stability, the General Agreement on Tariffs and Trade (GATT) – the predecessor of the World Trade Organization (WTO) to promote trade openness – and the World Bank to provide development finance for poverty reduction.

Although this GEA had several critical faults, it was broadly successful in contributing to faster economic growth and poverty reduction in all countries around the world. It also helped many countries to manage global shocks through the provision of financial and policy support. Emerging markets that opened their trading systems registered rapid growth and converged with the advanced economies.

The rules established at that time also ushered in the "golden age of globalisation" beginning in 1944 – when the volume of international trade expanded several times faster than the global GDP – until the 2008 global financial crisis.

The global financial crisis marked a turning point as the Bretton Woods GEA has run out of steam and is no longer fit for purpose to meet the present-day challenges of global governance, geopolitics, national security, and broken supply chains.

How will the new GEA of the future look like?

Likely Bretton Woods 2.0 Global Economic Architecture

In contrast to the old GEA, the Bretton Woods 2.0 GEA – the new architecture – will be decentralised where the "senior" global economic institutions, namely, the IMF, WTO and the World Bank, will co-exist and work with their newly established regional counterparts in various parts of the world. This means a multilayered decision-making structure along the lines of "fiscal federalism" at the national level with central and local governments.

The decentralisation of the GEA began in the 1990s, when the world started to witness a proliferation of regional economic institutions (REIs) mainly because of the dissatisfaction that dynamic emerging markets had with the existing global governance system. Dissatisfaction with the slow pace of governance reform at the IMF and the policy mistakes that it made in managing the Asian financial crisis led ASEAN+3 to initiate a regional self-help mechanism in 2000, namely, the ASEAN+3 regional financial safety net (RFSN). Similarly, the slow pace of governance reform at the World Bank partially spurred China and the BRICS to establish new multilateral development banks (MDBs), namely, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB).

The slow progress in multilateral trade negotiations and their focus on mostly "at the border" trade issues encouraged Asian countries to sign regional free trade agreements, including mega-FTAs (such as the CPTPP and RCEP) which cover 21st century "behind the border" issues relevant to supply chain trade.

In the future, the decentralisation process is expected to continue as emerging markets "counter the protectionist backlash" in the industrial world through tit for tat measures. The geopolitical tensions and the sanctions imposed by the US on Russia have also led the latter to deepen economic relations with China and India and to call for strengthening relationships among the BRICS countries. Broken supply chains are also being "regionalised" and "nearshored".

New REIs, Fragmentation, and Governance

The establishment of new REIs (FTAs, RFSNs and MDBs) and the decentralisation of the GEA have raised the prospects for the fragmentation of global economic governance. But our research finds that this has not happened yet.

The traditional and the most commonly used method of analysing the relationship between global and regional economic institutions is the "contested multilateralism" paradigm developed by Morse and Keohane (2014), which focuses on the conflictual, competitive, and fragmenting dynamics between global and regional institutions.

However, we disagree with this pessimistic approach and, following Kahler (2017), we argue that there could be "healthy" competition (e.g., resource additionality) and functional complementarity (division of labour) between global and regional institutions and that these benefits could outweigh the risks. Hence, unlike the "contested multilateralism" theorists who focus only on the costs, we consider both the benefits as well as the costs of the decentralisation process. For example, let us look more closely at the case of the international trade architecture.

As is well-known, FTAs are associated with several costs. First, they are discriminatory in nature. Granting preferences to some countries effectively discriminates against trade with others – which could be the more efficient trading partners – resulting in potentially costly trade diversions. Second, FTAs could lead to the so-called "spaghetti bowl" effects. This arises when overlapping FTAs create a web of trade agreements with different documentation rules, inspection procedures, and rules of origin, in effect raising the transaction and compliance costs for businesses.

On the benefits side, FTAs provide an alternative approach to liberalising trade and are useful when WTO negotiations stall as is the case at the present time. Secondly, modern FTAs typically promote deeper integration compared with the shallower integration of the WTO which mainly tackles "on-the-border" barriers. FTAs can therefore address "behind the border" issues such as rules for protecting investments, intellectual property, environment and labour rights, and regulations on product standards that are relevant to supply chain trade which now constitutes a bulk of global trade.

FTAs are, therefore, not as bad as made out to be by some quarters and countries should not be hesitant to sign them.

So far, we have found that overall, the benefits of the decentralising GEA appear to have outweighed the costs mainly because the latter are overstated. The move from a centralised to a decentralised GEA has, therefore, helped to improve global economic governance. This architecture is also more appropriate in a multipolar world.

Managing the Bretton Woods 2.0 Global Economic Architecture

Given that the establishment of new REIs and the move towards a decentralised GEA has benefits as well as costs, how should the Bretton Woods 2.0 GEA be managed to maximise the benefits of the process while minimising the costs?

Firstly, the oversight bodies (namely, the G20 and G7) should be strengthened with a clear division of labour between the two institutions.

Secondly, the governance, mandate, resources, and rules of the IMF and the World Bank should be urgently reformed to enable them to address present-day challenges, including climate change issues. The Bretton Woods institutions should also work more closely with private aid organisations and issue-specific United Nations agencies such as the UNDP and UNCTAD.

Thirdly, regional economic institutions should be designed so that they are complementary to global institutions.

Finally, the G20 should actively promote complementarity between global and regional economic institutions. A successful example is the six broad principles for cooperation between the IMF and RFSNs issued by the G20. The G20 should also develop similar principles for WTO-FTA cooperation which the G20 would oversee.

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