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INTERNATIONAL ORDER AFTER THE FINANCIAL CRISIS

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How is international order built, and how is it legitimate, in a world in which political and economic foundations are rapidly shifting? The geography of power is being transformed, in particular by the rise of China. What are the consequence of the rise of major new powers for the structure and the functioning of the international system? In the past seismic changes, associated with great wars or great financial crises, led to a disorientation about the moral foundations of society, domestically and internationally, and led literally to confusion and uncertainty about values. Not just in a technical sense: can we believe in gold as money, in the pound sterling, or in the U.S. dollar? But also in a broader sense: what is the best way of ordering an economy, a society, or a polity? How can policies be legitimated?

An international order is not just an exercise in power projection. It also is built around a set of ideas. We often like to think of past versions of order as generated by particular countries which propagated a grand vision: such as the nineteenth century British view of John Bright or Richard Cobden about the universal beneficence of commerce; or the universalization of an American vision of commercial prosperity in the second half of the twentieth century. But even visionary international orders do not last forever. Some events or dates—1688, 1776, 1789, or 1914—mark off an

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epochal shift. We are now at one of such great historical caesuras. What historians will call the "long twentieth century" ended not with the terrorist attacks of 2001, but with the financial crisis that started in 2007.

A particular historical example holds a powerful analogy to the current transition of economic leadership and political power. Great Britain's economic position took a bad tumble in the financial crisis of 1931, when the pound was taken off the gold standard, but it was only some twenty-five years later that the full implications for power politics were really felt. In 1956, the humiliating fiasco of the Suez crisis combined military incompetence and failure with vulnerability to financial pressure, and marked the end of Britain's claims to be an arbiter of the international order.[1]

There is an obvious parallel between Great Britain at the time of Suez and the travails of the United States after the 2003 invasion of Iraq and subsequent confusion at the prospect of a shift of the geography of economic influence and political power. Americans are hearing the echoes of another crisis: the financial and economic disaster of the 1930s that brought about the transition from a world built around the *pax Britannica* to the so-called *pax Americana* of the late twentieth century. Seeing how that transition of the mid-twentieth century was understood may help us grapple with the challenges of our currently unstable world order. There are two dimensions of the response, one concerned with the economics of the world, the other with economic geo-politics.

I

In the Great Depression, it looked as if existing economic ideas were completely discredited by the severity of the crisis. Today, there are analogies to that 1930s belief in a need for a paradigm change. In the aftermath of the sub-prime crisis and the Lehman

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[1] *See* DIANE B. KUNZ, THE ECONOMIC DIPLOMACY OF THE SUEZ CRISIS (1991); *see also* BARRY EICHENGREEN, EXORBITANT PRIVILEGE: THE RISE AND FALL OF THE DOLLAR AND THE FUTURE OF THE INTERNATIONAL MONETARY SYSTEM 57-58, 154-59 (2011) (presenting the Suez crisis as the critical moment in the collapse of Britain's currency and claim to international leadership).

collapse the fingers pointed at the United States as an example of how badly things could go wrong. It was now generally supposed that the American model had failed. America's reputation in the new millennium took a double whammy, first with the Iraq invasion, then with the financial crisis. Anyone who dreamt of the American way of life now looked stupid.

Immediately after Lehman collapsed, the German Finance Minister, Peer Steinbrück, put this diagnosis as a challenge not just to the U.S., but to other countries—notably the U.K.—which seemed to have Americanized their financial system.[2] The problem lay in over-reliance on highly complex financial instruments, propagated by globalized American institutions. Steinbrück commented: "The financial crisis is above all an American problem. The other G7 financial ministers in continental Europe share this opinion."[3] Criticism of America did not stop there. His successor Wolfgang Schäuble continued in the same tone, with comments about "clueless" American monetary policy that was designed only to feed the American financial monster.[4]

Then came the European crisis, with its roots in lax government finance in some (mostly southern European) countries. Critics now had a new focus. Naturally, many conservative Americans were delighted by the imminent failure of what they saw as a tax and spend society, addicted to a costly and inefficient welfare state. They were not the only critics. The chairman of China Investment Corporation, Jin Liquin, commented skeptically on ideas that China should bailout Europe. It was "a worn-out welfare

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[2] *See* Harold James, *Schadenfreude Capitalism*, PROJECT SYNDICATE (Jan. 4, 2012), http://www.project-syndicate.org/commentary/schadenfreude-capitalism.

[3] *Id.*; Ambrose Evans-Pritchard, *U.S. Will Lose Status of Superpower, Says German Minister Finance Chief Demands Sweeping Market Reform*, DAILY TELEGRAPH (London), Sept. 26, 2008, at 1.

[4] James, *supra* note 2; Phillip Inman, *G20 Showdown Likely Over Fed's New Strategy: China and Germany Attack Quantitative Easing Plan: Bernanke Insists Move Will Not Raise Inflation*, GUARDIAN, Nov. 8, 2010, at 26, http://www.guardian.co.uk/business/2010/nov/07/g20-quantitative-easing-showdown.

society" with "outdated" welfare laws that induces sloth and indolence.[5]

The international criticism of large European transfer payments may have some justification in that Greek and Italian civil servants did indeed have possibilities of retiring quite young. Restrictive labor laws did indeed make it unattractive for many firms to hire new workers. But the critique only captures one small part of the European difficulty. The fiscal dilemmas of Greece and Spain were also the result of spending a great deal on high technology and high prestige projects, facilities for the Olympic Games, new airport buildings, and high speed train links.[6] Oops. Wasn't that also an increasingly important part of the transformation of China since the 1990s?[7] Chinese citizens are now frustrated not only with increasingly obvious imperfections and inadequacies in the high-speed trains, but also wondering whether their government set the right priorities. Spain and Ireland before the crisis did not have a fiscal problem, because of the dynamic growth produced by a real estate boom that seemed to indicate a new era of economic miracles.[8] Oops again. Is that not a description of how property prices soared in China?

One of the most widely used Chinese terms of recent years is 幸灾乐祸 (*xìng zāi lè huò)*, not easily translated into English but well rendered by the German word *Schadenfreude*. Somebody else—some other society—has simply tripped on an enormous political banana skin. Asian critics looking at first America and then Europe could easily convince themselves that the conventional platitudes of liberal and democratic politics and economics were collapsing. There are other versions of *Schadenfreude* too. Vladimir Putin and Christina Kirchner liked to think that their versions of a controlled economy and controlled society built in the aftermath of default on foreign debt offered a more viable alternative to cosmopolitan international capitalism. Both are now facing major problems with disillusioned populations.

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5 James, *supra* note 2.
6 *See id.*
7 *See id.*
8 *See id.*

In short, there exist many more common vulnerabilities in the world's major economies than is commonly supposed. A response to global challenges that is simply based on *Schadenfreude* may promote a short term sense of wellbeing. In one country or region, people often like to think how lucky they are to have escaped the mess that originated elsewhere. But soon they encounter their own banana skin. Today's global economy is full of the noise of slipping and falling economic models. And tomorrow may be even noisier.

All this erroneous drawing of fallacious conclusions takes us back into the era of the Great Depression, when the prevailing wisdom was that liberal economics (derided as old-fashioned laissez faire)—and also liberal politics had collapsed and that the real future lay with radical doctrines that reshaped politics but also economics: fascism, and its more extreme German variant National Socialism, or Stalin's version of Soviet communism. It is only relatively recently that we have washed away the political eyewash and realized quite how bad the economic performance of the Soviet Union or Nazi German really was in the 1930s—and we still remember how Keynes's leading Cambridge disciple exclaimed that Hitler had solved unemployment before Keynes had finished explaining what caused it.[9]

II

How does economic fortune affect perceptions of the working of international relations? The winners of late twentieth century globalization and the beneficiaries of a worldwide shift to liberalization were the small states: Taiwan, Singapore, Hong Kong, New Zealand, Chile, Ireland, Finland, Estonia or Slovenia. Why? In the first instance, small states are generally quicker and better at economic liberalization.[10] In a small state setting, an imposition of a dense network of controls is likely to lead to the loss of mobile

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[9] *See* Joan Robinson, *What Has Become of the Keynesian Revolution?*, 16 CHALLENGE 1, 7 (1974).

[10] *See* ALBERTO ALESINA & ENRICO SPOLAORE, THE SIZE OF NATIONS (2003).

factors of production, while in a large state it is harder for labor or capital to escape. Large states are thus inclined to control, while correspondingly small states are likely to be quicker in opening up their labor markets,[11] as well as in reducing rates of taxation on capital. They not only do deregulation more effectively; paradoxically they also manage social protection better. Public resources can be used to compensate the losers of the globalization process, and thus to make it acceptable to a broad political audience. This model, pioneered by Scandinavian countries since the 1970s,[12] and especially effectively in the 1990s, has rightly become a widely admired European ideal.

In debates about international order, the small states are—as they were in the interwar world too—the natural constituents of a demand for an overarching supranational international order that might protect their interests but might also represent a general interest.

The late twentieth century shift in advantage to the small state was not a permanent one, and—perhaps since the turn of the millennium—we can see at work again the classic realist logic expounded during the interwar period by the British writer E.H. Carr.[13] Advantages fall to powerful and populous states (China, Russia, the United States) that can dominate or manipulate markets in energy or other scarce commodities. The previous winners, such as Swiss banks or Finnish mobile telephony, look vulnerable because they are not backed by political power. By contrast, big states, like big banks, have come out of the financial crisis looking stronger.

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11 *See* William Easterly & Aart Kraay, *Small States, Small Problems? Income, Growth, and Volatility in Small States*, 28 WORLD DEV. 2013, 2020-22 (2000); *see also* Harvey Armstrong & Robert Read, *Trade and Growth in Small States: The Impact of Global Trade Liberalization*, 21 WORLD ECON. 563, 564, 568 (1998).

12 *See generally* ALESINA & SPOLAORE, *supra* note 10; PETER KATZENSTEIN, SMALL STATES IN WORLD MARKETS: INDUSTRIAL POLICIES IN EUROPE (1985).

13 *See* EDWARD H. CARR, THE TWENTY YEARS' CRISIS 1919-1939: AN INTRODUCTION TO THE STUDY OF INTERNATIONAL RELATIONS (1939).

III

The pendulum swing back to a world in which the advantage lies with the strong, who can muster large concentrations of economic and demographic resources, was visible before the 2007 financial crisis. It has become much more evident since then. It has been enunciated, rather brutally in Europe, by Germany's Chancellor Angela Merkel, when she laid out the conditions for aid to Greece in the crisis of spring 2010 on May 19. She stated that "the rules must not be oriented toward the weak, but toward the strong. That is a hard message. But it is an economic necessity."[14] On the global scene, we are now becoming obsessed with the BRICs (Brazil, Russia, India, China) as new giants.[15] The continuation of the crisis will turn them into Big Really Imperial Countries. The future of globalization is thus one in which power politics rather than markets will drive events. That makes for competition, rather than cooperation, or what Gideon Rachman calls a zero-sum view in a world of anxiety replacing a win-win mindset in an age of optimism.[16]

The recent news that China has surpassed Japan as the world's second largest economy in GDP terms thus did not come as a surprise.[17] Japan is a big economy masking as a small state, with all the aversion to the practical exercise of power that characterizes second and third tier states. By contrast, China has always been about greatness. The accelerated push of China to Great Power status is the major geo-political outcome of the Great Recession of the early

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[14] Angela Merkel, Chancellor of Germany, Address to the German Bundestag on Measures to Stabilize the Euro (May 19, 2010) (transcript available at http://dipbt.bundestag.de/dip21/btp/17/17042.pdf).

[15] *See, e.g.,* Clifford J. Levy et al., *Seeking Greater Financial Clout, Emerging Powers Prepare to Meet in Russia*, N.Y. TIMES, June 16, 2009, at A6 http://www.nytimes.com/2009/06/16/world/europe/16bric.html (discussing how the economies of the BRIC countries, Brazil, Russia, India, and China, are becoming the most powerful in the world, and challenging the United States in economic supremacy).

[16] *See* GIDEON RACHMAN, ZERO-SUM FUTURE: AMERICAN POWER IN AN AGE OF ANXIETY (2011).

[17] *See, e.g.,* Chester Dawson & Jason Dean, *Rising China Beats a Shrinking Japan*, WALL ST. J., Feb. 14, 2011, at A1, http://online.wsj.com/ article/SB10001424052748704593604576140912411499184.html.

twenty-first century. That outcome carries economic hope but also political fear.

First the good news about the new role of China: it lies—at least up to now—in the economic side of the case. Alongside better monetary policy and more flexible exchange rates between the big industrial blocs, the response of China along with other big emerging market economies to the world financial crisis is the central explanation why the financial turbulence that emanated from the U.S. subprime crisis did not completely destroy the world economy and lead to a repeat of the 1930s Great Depression.

In the longer term the fallout from China's stimulus may be more mixed. Stabilizing the world economy is not a costless process, as indeed it was not in the second half of the twentieth century for the U.S. The holding of dollar assets, which probably constitute around sixty-six percent of China's current $2.7 trillion reserves,[18] are likely to produce a major book loss for the People's Bank of China. The domestic stimulus package which delivered a massive underpinning of the world economy in the financial crisis, and which also started a rebalancing of the global imbalances, will have problematical repercussions. As well as public subsidies, largely for infrastructure projects, the Chinese stimulus involved a vast expansion of bank loans (some $1.5 trillion), which may become a major problem for China's banks.[19] No less an authority than Prime Minister Wen Jinbao stated:

> In case of China, there is a lack of balance, coordination and sustainability in the economic development. The main problems include the unreasonable economic structure, weak capabilities for scientific and technological innovation, rising resources and environmental constraints, uneven

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[18] Angela Monaghan, *China Fears Depreciation of $2.45 Trillion of Reserves Still Heavy in Dollars*, TELEGRAPH ONLINE (Sept. 3, 2010, 6:00 PM), http://www.telegraph.co.uk/finance/currency/7979268/China-fears-depreciation-of-2.45-trillion-of-reserves-still-heavy-in-dollars.html.

[19] *See, e.g.,* Minxin Pei, *Superpower Denied? Why China's 'Rise' May Have Already Peaked*, DIPLOMAT, Aug. 9, 2012, http://thediplomat.com/2012/08/09/superpower-denied-why-chinas-rise-may-have-already-peaked/.

> urban-rural and regional development and lack of coordination between economic and social development.[20]

In the longer run, China will become obsessed with the challenge posed by an aging population. Thus already at an early point in its rise to preeminence, China is likely to be concerned with the sustainability of its position.[21]

IV

The real challenge for China's leaders will be to develop a coherent view of the world that does not scare its neighbors—and others. The Chinese dilemma today is not unlike the American one of the mid-twentieth century. How can a new superpower maintain and extend its power in a world playing by commercial rules? Its effectiveness as a concentration of power, its sustainability as a state, its ability to satisfy domestic claims all depend on an open world economy. There are high costs if other states try to close themselves off, and openness cannot be achieved simply at gunpoint.

In the 1930s, the United States did not stabilize the world economy, and did not have a vision of the global order. That only evolved in the 1940s and later, and in response to the very fundamental challenges to human liberty and human dignity posed by Hitler and then by Stalin. International relations scholars have emphasized the extent to which international rules can be a way of externalizing domestic preferences, a way of embedding a liberal

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[20] Wen Jiabao, Chinese Premier, Speech at the Opening Ceremony of the World Economic Forum Annual Meeting of the New Champions (Sept. 13, 2010) (transcript available at http://news.xinhuanet.com/english2010/china/2010-09/13/c_13493041.htm); *see also* Arthur Waldron, Lauder Professor of Int'l Rel., Dep't of Hist., Univ. of Pennsylvania, Tokyo Univ. Lecture, The Rise of China, How Substantial? (Nov. 9, 2010).

[21] *See* SUSAN SHIRK, CHINA: FRAGILE SUPERPOWER (2007) (providing skeptical insights about how China's economic growth has caused China's leadership to become vulnerable and insecure). *See also* YASHENG HUANG, CAPITALISM WITH CHINESE CHARACTERISTICS: ENTREPRENEURSHIP AND THE STATE (2008) (arguing that the vast economic and social disparities in China's population will pose a serious problem in years to come).

order or of "tying one's hands" that produces long term benefits for domestic politics in that it defines an arena in which choices can be made.[22] The fact that the political system of the leading country is open and decentralized is bolstered by the international order; and it also acts as a guarantee to other powers that they have a mechanism for advocacy of their own interests.[23]

China in the 2000s has contributed to a stabilization of the world economy, but there is absolutely no sign that it is evolving a vision of a new global order that goes beyond *xìng zāi lè huò* or *Schadenfreude*, that the conventional platitudes of liberal and democratic politics and economics are collapsing.

The key to whether the coming order is peaceful or not will lie in the ability of Chinese leaders—and in general of those in the big emerging economies—to encompass a vision that can provide an adequate psychological foundation not just for commerce across countries, but also for more profound levels of human exchange.

Globalization is not just about seizing and exploiting market opportunities. In 2009, the Governor of the People's Bank of China, Zhou Xiaochuan, in a frontal attack on American hegemony emphasized the importance of Confucianism, which values "thrift, self-discipline, zhong yong or Middle Ground (low-key), and anti-extravagancy."[24] This sounds like nostalgia for the Weberian conception[25] of a Protestant work ethic, which the West has lost or abandoned.

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22 *See* MARTHA FINNEMORE, NATIONAL INTERESTS IN INTER-NATIONAL SOCIETY (1996); s*ee also* Andrew P. Cortell & James W. Davis, Jr., *How Do International Institutions Matter? The Domestic Impact of International Rules and Norms*, 40 INT'L STUDIES Q. 451 (1996).

23 *See* G. JOHN IKENBERRY, AFTER VICTORY: INSTITUTIONS, STRATEGIC RESTRAINT, AND THE REBUILDING OF ORDER AFTER MAJOR WARS 203-06 (2001).

24 Zhou Xiaochuan, *On Savings Ratio*, THE PEOPLE'S BANK OF CHINA (Mar. 24, 2009), http://www.pbc.gov.cn/publish/english/956/2009/20091229104810768831191/20091229104810768831191_.html.

25 *See* MAX WEBER, THE PROTESTANT ETHIC AND THE "SPIRIT" OF CAPITALISM AND OTHER WRITINGS (Peter Baehr & Gordon C. Wells trans., Penguin Books 2002) (1930).

Such appeals raise again Max Weber's fundamental question of how and why the work ethic is motivated, and in what ways it corresponds to basic human proclivities.[26] We cannot simply understand economic life by observing its operation; we need to think about an inner logic, and about how that logic corresponds with the nature and the development of human character. In that sense, the financial crisis has brought us back to basics. The Chinese leadership understands this, but does not yet know how to respond. It can see the Chinese setting very acutely, but not how that answer can apply in a universe of values that are—well, universal.

[26] *See id.*