Global and Domestic Politics in the Wake of the Financial and Economic Crisis

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Abstract

The December 2012 issue of SPSR featured a collection of short essays that explored the domestic politics of the financial crisis, the ensuing international recession and the ongoing difficulties of managing the debt problems and trade imbalances of the Eurozone. The contributors to the first installment of our debate on crisis politics engaged in historical and comparative discussions of government responses to the crisis of 2007-10 and the political repercussions of the crisis. For this, the second and final installment, we have invited prominent scholars in the field of international political economy to comment on how institutions of global governance have performed since 2007 and the long-term implications of the crisis for the prospects of international cooperation in trade, finance and investment. We have also included an essay on the domestic politics of labor market reforms in Western Europe, thematically linked to several essays in the December 2012 issue. By way of introduction, I will briefly summarize and comment on the main ideas of the four essays that follow.

Reference


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Debate

Global and Domestic Politics in the Wake of the Financial and Economic Crisis

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The global trade regime

The essay by Vinod Aggarwal and Simon Evenett provides a remarkably comprehensive and concise assessment of the changing international politics of trade in goods and services. According to Aggarwal and Evenett, the global crisis of 2007-10 has reinforced pre-existing trends towards increasing fragmentation of the global economy or, in other words, a retreat from multilateralism. Their story is essentially as follows. Multilateral trade negotiations have faltered on account of conflicts of interests between, on the one hand, the US and the EU and, on the other hand, developing countries. While these conflicts have become more intense, differential growth rates have shifted the balance of power in favor of developing countries. As multilateral progress has stalled, bilateral free trade agreements (FTAs) have flourished and the major trading powers have increasingly pursued regional free-trade pacts or “mega FTAs” as a substitute for multilateral trade negotiations. Finally, the economic crisis of 2007-10 has triggered a new wave of protectionist measures in developed as well as developing countries.

The new protectionism documented by Aggarwal and Evenett is a murky form of protectionism that involves the bailout of failing firms, export subsidies and performance requirements (e.g., rules to buy local content) rather than traditional tariffs and defensive trade measures. In Aggarwal and Evenett’s words, “WTO rules have probably done more to alter the composition of crisis-era protectionism than to restrain it.” As indicated by the
word “probably,” this statement raises thorny counter-factual questions as well as the problem of “adding up” different kinds of protectionist measures. How much trade-distorting intervention would national governments have undertaken in the absence of multilaterally-agreed rules?

Aggarwal and Evenett’s essay also makes me wonder about the political-economic rationale behind protectionist measures and whether “murky protectionism” might be seen as a temporary crisis-induced phenomenon rather than a new, enduring feature of the global economy. As Aggarwal and Evenett point out, all trade liberalization that occurred before the GATT treaty was signed in 1947 took the form of bilateral free trade agreements and unilateral policy changes by the major trading powers. It is not altogether obvious whether (or why) the retreat from multilateralism described by Aggarwal and Evenett amounts to a “bastardized form of globalization riddled by massive resource misallocation.”

International cooperation in regulating finance?

As everyone knows, the international recession of 2008-09 was triggered by a global financial crisis. One might reasonably have expected that this experience would have led to the establishment of more effective international coordination in the domain of financial regulation. Hailed by US Treasury Secretary Tim Geithner as a fourth pillar of global economic governance (along with the IMF, the World Bank and the WTO), the Financial Stability Board (FSB) was apparently created, in 2009, for this purpose. In his contribution to this debate, Eric Helleiner provides a sobering assessment of the FSB as an institution of global governance. In his words, echoing Aggarwal and Evenett’s assessment of the global trade regime, “the FSB appears to be presiding ineffectively over a trend towards a more decentralized international financial order characterized by greater financial market and regulatory fragmentation along national lines.”

Helleiner shows that the peer review process at the heart of the FSB’s activities has had very little impact on the regulatory activities of the member states. The administrative resources of the FSB are limited while member states have been reluctant to highlight each other’s problems. Most importantly, the peer review process is toothless, for unanimity among the member states would be required in order for the FSB to sanction one of the member states. So far, the FSB has only identified two member states as not complying with very basic regulatory standards and has largely shied away from implementing post-crisis standards that intrude on the activities of national regulators.

Why, then, has so little come of the FSB initiative? Helleiner’s answer to this question seems to be that the financial crisis of 2007-08 triggered the FSB initiative, but also—and more importantly—brought financial regulation to the forefront of domestic politics and rendered national policy-makers more reluctant to surrender regulatory authority to international institutions. Helleiner’s essay thus raises the interesting question of whether national policy-makers are more or less likely to “tie their own hands” through international cooperation when regulatory issues become politicized.

International FDI disputes

Written by Cédric Dupont and Thomas Schultz, our third essay on global economic governance focuses on international arbitration disputes pertaining to foreign direct investment. Many bilateral investment treaties provide foreign investors with recourse to arbitration if they believe their interests have been damaged by the abuse of state authority. According
to Dupont and Schultz, legal disputes of this kind are both costly and risky for the parties involved. In the absence of serious information asymmetries, rational actors should be able to negotiate settlements that would be preferable to legal disputes. Yet the number of cases submitted for international arbitration has risen markedly since the 1990s, reaching record levels in 2011 and 2012. By contrast, legal trade disputes did not rise noticeably during or after the global crisis of 2007-10.

Dupont and Schultz hypothesize that economic crises may be an important factor in explaining the occurrence of arbitration disputes. In crisis times, they argue, “government often have to adopt quick measures that are likely to hurt, inadvertently or intentionally, the rights and interests of foreign investors.” In addition, the political dynamics of severe crises are such that “governments have a hard time reverting to ‘normal’ behavior.” A number of individual cases lend credence to this argument, but Dupont and Schultz report that they have yet to find any strong quantitative evidence of a link between GDP contraction and the filing of arbitration claims against states. As they themselves point out, GDP growth may not be an appropriate crisis indicator and their quantitative analysis does not (yet) include data for 2011 and 2012. Nonetheless, their essay cautions us against exaggerating the impact of crisis conditions on global economic affairs.

The essay by Aggarwal and Evenett arguably steers a sensible middle path in that it identifies longer-term trends that pre-date the crisis (the retreat from multilateralism) as well as new, crisis-induced trends (the rise of protectionism). Relatedly, an interesting issue worthy of further exploration is whether investment-related disputes of the kind captured by Dupont and Schultz’s dataset should be seen as a particular manifestation of “murky protectionism.” It may be that this holds for some disputes but not for others.

**Back to domestic politics: why no reform of dismissal protection?**

As noted at the outset, the last of the following four essays, by Patrick Emmenegger, brings us back to themes featured in the first installment of our debate on crisis politics. Emmenegger’s essay proceeds from the observation that mainstream economists all seem to agree that employment protection represents a major obstacle to economic recovery in Western Europe. Why then, Emmenegger asks, have most European failed to reform dismissal protection since the onset of the crisis in 2007-08?

Following a long tradition in comparative political economy, Emmenegger answers this question by invoking the power of organized labor, but his essay introduces an important new element, captured by the concept of “institutional power.” Emmenegger argues that in defending dismissal protection unions are not only concerned about the interests of their members, but also, and perhaps more importantly, about their own institutional power (or leverage vis-à-vis employers). Simply put, unions are not necessarily against lay-offs, but they want to have a say in how lay-offs are carried out.

While I find Emmenegger’s argument about union motives quite compelling, I am inclined to think that his essay exaggerates the role of union power as the reason why governments have not reformed (reduced) dismissal protection since the onset of the global economic crisis. I am struck by the fact that his essay fails to take note of the very extensive deregulation of temporary (fixed-term) employment that many European countries undertook in the 10-15 years preceding the crisis and the spread of temporary employment that has followed in the wake of these deregulatory reforms. Arguably, the partial deregulation of employment leading up to the crisis enabled many employers to adjust their labor force in response to the sharp downturn in 2008-09. At the same time, most governments...
were reluctant to increase spending on unemployment insurance and other social programs to compensate the unemployed, making the reform of dismissal protection a politically risky project. An alternative answer to Emmenegger’s question readily suggests itself: in the absence of strong employer pressure to the contrary, governments have chosen to prioritize fiscal austerity over reducing dismissal protection.

**Bridging comparative and international economy**

As the contributions to the two installments of this debate on the economic crisis illustrate, comparative political economy and international political economy constitute two vibrant research fields. Scholars working in these fields often ask very different questions and, as a result, end up emphasizing different explanatory variables. Taken as a whole, however, the contributions to this debate also illustrate the extent to which the experience of the global economic crisis as brought these two fields of inquiry together. On the one hand, the essays by Aggarwal and Evenett, by Helleiner and by Dupont and Schultz all emphasize that national governments remain critical “players” in global economic affairs. Indeed, they all suggest that national governments and domestic politics have become more important as a result of the economic crisis. On the other hand, several of the essays included in the first installment (notably those by Hall and by Pontusson and Raess) signal a new recognition of the need to take into account international politics, as well as pressures generated by the global economy, among erstwhile “comparativists.” Developing research programs that bring together the concerns of comparative and international political economy in a more systematic fashion is the most important challenge confronting us in the wake of the global economic crisis of 2007-10.

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