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# Trends and Leadership Challenges in the Evolution of the Global Economic System

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The size and complexity of the world economy has expanded significantly since the 1990s. The United States and European Union economic dominance is today relative rather than absolute. The economic crisis has contributed to accelerate the rebalancing of the distribution of global economic power, and in particular the rise of China as a third pivotal actor. In this paper we focus on trade and financial flows and on the evolution of the monetary system, in order to identify new trends in world leadership. Although the transatlantic relationship is still the main axis of global economic relations, the rise of China indicates future changes in the global order. Therefore, more coordinated action between the transatlantic partners and between them and China could help drive the changes in the world economic system to a more balanced path.

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# Trends and Leadership Challenges in the Evolution of the Global Economic System

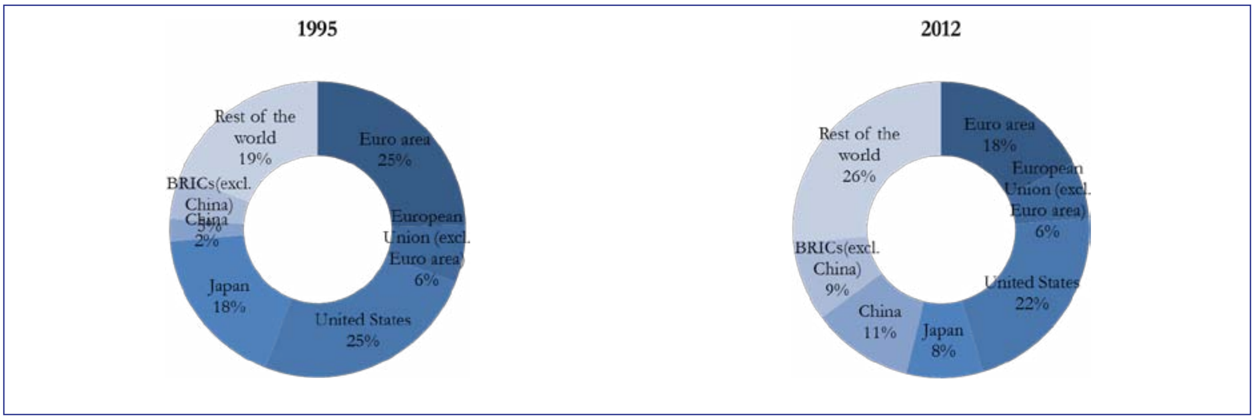
Davide Tentori and Myriam Zandonini*

Global economy International trade Currency wars Global leadership

## Introduction

The size and complexity of the world economy has expanded massively in the last two decades, and some regions – notably Asia, the European Union (EU) member states, and the United States (US) – are interdependent as never before. The US and the EU remain economically dominant but, unlike twenty years ago, theirs is relative rather than absolute dominance. They still account for almost half of the world's gross domestic product (GDP), although their share has gone down by almost ten percentage points in the last fifteen years. China's share has grown more than fivefold in the same period, which has made it the second largest world economy, with an 11 percent share of world GDP at market exchange rates.

• Figure 1 | **Share of World GDP (%, 1995 and 2012 at market exchange rates)**




*Source: IMF, World Economic Outlook April 2012.*

The change in the distribution of world GDP, characterized by the shift towards developing countries and particularly by the rise and strengthening of the Chinese economy, implies a risk that the US and the EU may lose their economic leadership. The two should think in concert about how to retain their influence in the world

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economy (see section 3). Moreover, the economic crisis, which has affected developed economies the most, has contributed to accelerating the rebalancing of the distribution of global economic power. So, what stage of this rebalancing process are we at now? We raise the question of whether this is leading to a new phase of international relations, with China as the third pivotal actor together with the EU and the US, or whether we are rather moving towards a larger, multipolar distribution of economic power that includes Emerging Market Economies (EMEs), specifically the so-called BRICS countries (Brazil, Russia, India, China and South Africa).

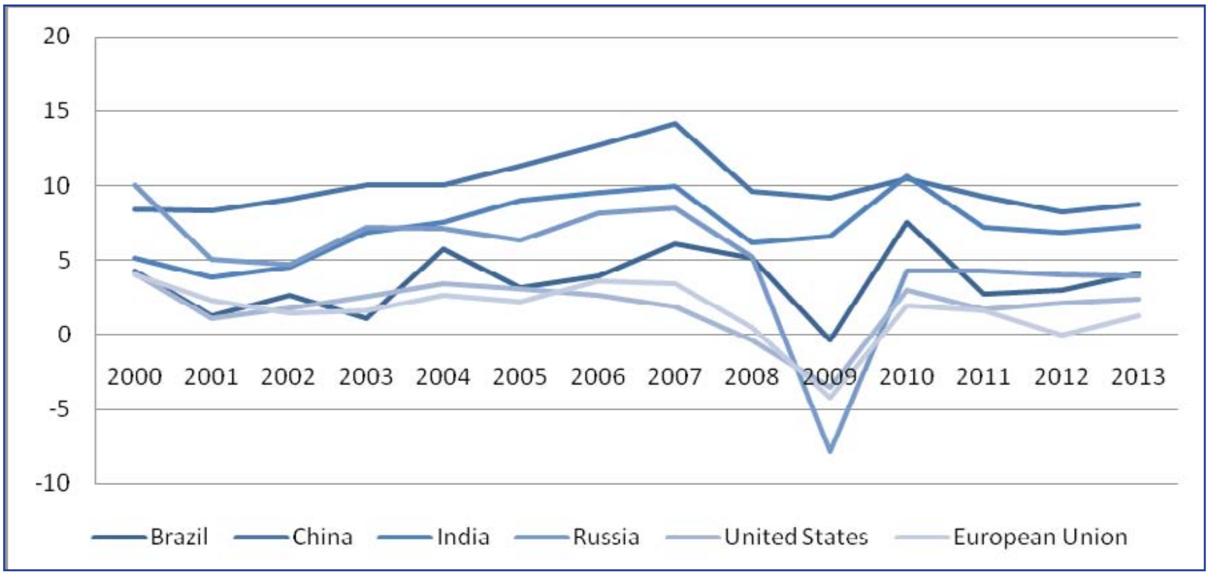
The paper aims to outline plausible future perspectives in the changing global economic order by highlighting the factors of change and discontinuity with the past in the global economy. The first section provides an outlook for the world economy, showing current trends, devoting particular attention to the definition of economic power and its distribution. The second section focuses on trade and financial flows, and on the evolution of the monetary system. After a brief analysis of the most important actors in the global economic system, both in terms of national states (juxtaposing "traditional powers", namely the US and the EU, with recent ones, the last section tries to identify new trends in global leadership and suggest the need for new theoretical frameworks to interpret better these changes. Particular attention is paid to the transatlantic relationship, in order to give some hints about its future development and evolution.

# 1. The Outlook for the World Economy

## 1.1 The Evolution of Global Economic Power

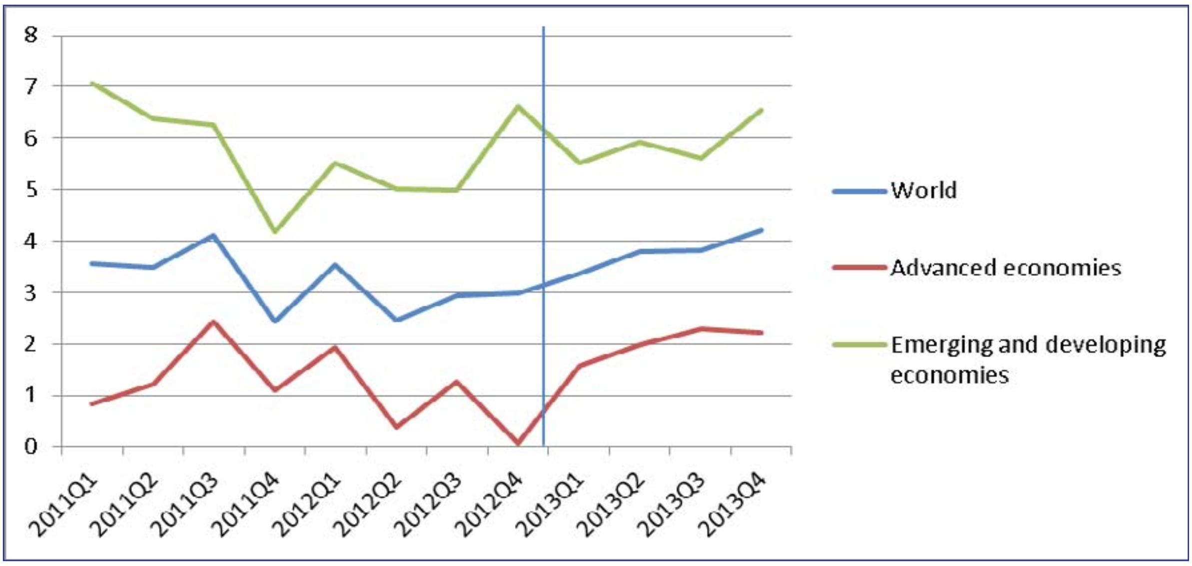
Contrary to the not too distant past, today the world economy is increasingly reliant on Emerging Market Economies for growth. For instance, the Chinese economy has experienced an annual growth rate of about 10 percent for the past thirty years, expanding from 59 US billion dollar in 1978 to 7.3 trillion in 2011 (Subacchi et al. 2012).

• Figure 2 | **GDP Growth in main world countries and regions (%, 2000-2012)**




*Source: IMF, World Economic Outlook Database, April 2012.*

• Figure 3 | **Contribution to World GDP Growth (%, 2011-2013)**




*Source: IMF, World Economic Outlook October 2012.*

The global financial and economic crisis has further lowered growth prospects in advanced economies. In particular, according to the latest projections the economy of the euro area contracted in 2012 and is expected to grow by a mere 0.1 percent in 2013 (Table 1).[1] Although the US has been experiencing a tepid recovery since the end of 2010, the crisis has undoubtedly accelerated a trend in the redistribution of global economic power which was already taking place. Emerging economies recovered quickly from the crisis and are growing at three times the rate of developed countries (Figure 2). It has been estimated that China could surpass the economy of the US within the next decade, if calculated on the basis of purchasing-power parity (PPP) (Economist 2011; IMF 2012b). China's GDP has grown at a 10 percent average rate since 2000 (Table 2), but its speed has decreased during the last few years, giving space to "hard landing" theories.[2] For the time being, US GDP at current market prices still accounted for more than double that of China in 2011, accounting respectively, for US 15.1 trillion and US 7.3 trillion dollar.

• Table 1 | **GDP Growth Rate in the Euroarea (%, 2012-2014, forecasts)**

| | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| *Eurostat* | 1.4 | -0.4 | 0.1 | 1.4 |
| *IMF* | 1.6 | -0.2 | 0.2 | 1.4 |

*Source: Eurostat, IMF.*

1 It has to be noted that Germany stands out in the euro area, since it was able to respond to the increasing demand from emerging markets, thanks to its existing strengths in advanced manufacturing (Subacchi and Jenkins 2011).

2 Given a property market downturn and weaker export figures, the forecast for 2012 sees a 7.8 GDP growth, the slowest since 2009. See National Bureau of Statistics of China at http://www.stats.gov.cn/english.

• Table 2 | **World GDP per Capita, PPP (in million US$, 2000-2011, current prices)**

| Country | 2000 | 2005 | 2011 |
|---|---|---|---|
| Brazil | 7,017 | 8,509 | 11,640 |
| China | 2,366 | 4,115 | 8,400 |
| European Union | 21,879 | 26,847 | 32,644 |
| India | 1,528 | 2,209 | 3,627 |
| Russian Federation | 6,833 | 11,853 | 21,246 |
| United States | 35,082 | 42,516 | 48,112 |

Source: World Bank, World Databank.

While describing the reshaping of the map of global economic power, the widely debated and comprehensive concept of economic power itself comes into the discussion (Cooper 2004; Whalley 2009). It is deeply entrenched with the concept of influence, which implies the potential to be a determinant in the arena of international relations and to condition other actors' behaviour (Subacchi 2008). Accordingly, the concept of economic power stretches beyond the calculation and the dynamics of GDP, which cannot explain alone the highly complex network of economic relations in the current international environment: for instance, a country can be economically dominant without being powerful (Cooper 2004). Attempts at finding other indicators to encompass the width and evolving dynamics of economic power (Treverton and Jones 2005; Whalley 2009; Basu et al. 2011) hint in the same direction in the on-going process of global reshaping, which is mainly advantaging China and, to a lesser extent, India.[3]

## 1.2 Challenges Ahead

The current changes in the global economic environment were amplified and accelerated by the financial crisis which broke out in the US in 2008. The high speed at which the on-going processes are taking place shows that economic international relations will be challenged by new issues in the next few years. We envisage at least three major challenges. Firstly, fiscal imbalances need to be addressed and adjusted: specifically concerning transatlantic economies, fiscal rebalancing would involve deleveraging, mostly based on the reduction of high public debt. Secondly, the restoration of economic growth is imperative, both in developed and in developing economies. In the latter, growth has relied very much on the high prices of commodities in international markets.[4] The prospect of economic growth for the EU is highly varied as the southern members of the Eurozone are unlikely to recover in the near future. Finally, there are signs of a potential slowdown of the Chinese economy in the short run. This might be caused by an appreciation of its currency after a protracted period of undervaluation of the exchange rate (Yang, Zhang and Tokgoz 2012) and by a steady fall in the demand for domestic products from the other countries as a result of a protracted economic crisis in the West.

3 The Index of Government Economic Power (IGEP) provides a ranking of world states according to a statistical matching of four variables: government revenues, foreign currency reserves, export of goods and services, and human capital (Basu et al. 2011). In 2009 the first ten positions were occupied by the US, China, Japan, Germany, India, Russian Federation, France, Brazil, South Africa and Italy. The CIA Strategic Assessment Group indicator (Treverton and Jones 2005) includes GDP, population, defence spending and innovation in technology. The US holds about 20 percent of total global power, China and the EU (here as a single actor) around 14 percent each, India about 9 percent, Brazil, South Korea and Russia about 2 percent each. Forecasts towards 2015 see China and India as the main gainers. An econometric simulation (Whalley 2009), which is based on an utility function where the main argument is expected GDP, foresees a shift of relative power mainly to China and India from OECD countries in the forthcoming years.

4 Commodities prices remained high because of effects on the side of demand as well as of supply. Demand stood at a high level also after the 2008 crisis broke out, especially for the contribution of developing economies, while supply was affected by some negative shocks due to weather disruptions (floods, droughts and wildfires) (Helbling 2012).

Clearly, low growth trends in advanced economies and the rise of emerging economies, especially China, have challenged the pre-eminent position of the US economy, which is heading towards a position of "primus inter pares" in an increasingly multipolar economic order (Subacchi 2010a). Therefore, the following section tries to assess to what extent this is true and, if so, at what pace the world is going in this direction.

## 2. The World Economic System: A Fluid Evolution

Trade and financial integration have deepened as never before since the beginning of the globalization process, at the end of the 1980s. This trend has gathered pace dramatically since the explosion of the financial bubble in 2008, leading to a period of high instability and rapid and fluid evolution of the world economic system. Why is the outcome of this evolution widely unclear? Addressing trade, financial and monetary issues helps highlight the main uncertainties.

### 2.1 Trade: Is "Two" Better Than "Many"?

Increasing steadily since the end of World War II, global trade rose from only 59 US billion dollar in 1948 up to 17.8 US trillion dollar in 2011 current prices (WTO 2012). In the last seven years trade increased with an annual growth rate of 3.5 percent. Nevertheless, trade patterns have been heavily affected by economic instability and do not seem able to follow a clear trend. Dropping almost five times more than the fall in world GDP, the "sudden, severe and synchronised [...] great trade collapse" of 2009 (Baldwin 2009), which was caused by a demand shock following the crisis the year before, was amplified by consumers' uncertainty and concerned almost all world regions.

Unsurprisingly, China and emerging economies are mainly responsible for the increase in global trade. As a whole, South America recorded the highest increase in exports performance, with an annual 10 percent in the period 2005-2011. Led by a labour-intensive manufacturing sector for export markets (a thoroughly conceived and implemented strategy of economic growth by the government), the Chinese economy overtook Germany and became the second largest exporter in 2009, expanding six times since it joined the World Trade Organization (WTO) in 2001.[5]

The world economy has undoubtedly become increasingly more open. Tariff barriers have mostly been removed, at least among developed economies, while forms of protectionism, both in terms of tariff and non tariff barriers, still tend to persist among developing countries (Mohan, Khorana and Choudhury 2012). Although an agreement within the WTO might sustain the process of global economic recovery at least by increasing security in international trade relations, efforts towards further multilateral reductions have come to a halt following the failure of the Doha round on global trade liberalization in 2011[6] and Preferential Trade Agreements (PTAs) mushroomed.[7] At present, there are 243 PTAs in force (WTO 2012) and they are generally bilateral agreements

5 The countries that performed the best are India (14 percent increase) and China (11.5 percent) Moreover, it is worth noting that China's imports have grown almost at the same as its exports (11.5 percent) (Table 1). This can be explained by the increasing need of intermediate goods for manufacturing and by the rise in the internal demand from Chinese consumers alike.

6 The Doha Development Agenda (DDA) was launched in Doha (Qatar) in 2001 as a new round of negotiations towards further trade liberalization. The focus of negotiations has mainly been on removing agricultural subsidies, improving the access to global markets and dealing with other trade-related aspects in the sector of services and intellectual property. The failure of the DDA is mainly due to issues in the agricultural field, especially around the request, raised by the biggest developing countries (Brazil, China, India, South Africa, South Korea) for the removal of agricultural subsidies from the richest countries (EU, US and Japan). See also Bhagwati 2012.

7 A PTA consists in a reduction of tariffs for some specific products which involve only a restricted number of countries that decide to sign the agreement. Therefore, the tariff reduction for that specific good does not apply to the other countries which are not part of the agreement.

or take the form of Regional Trade Agreements (RTAs). While the most famous RTA is the European Community Treaty (ECT), RTAs have proliferated in Latin America and Asia and in both the EU's and the US's trade relations with developing countries. The dominance of this approach seems to represent the only way to push forward the global process of trade liberalization at the moment. However, the multiplicity of bilateral trade agreements is inefficient and detrimental to the global economic system, since overlapping PTAs and the lack of clear and unanimously agreed rules cause uncertainty (Tussie and Quiliconi 2005; Baldwin 2006). Provided that new efforts are made to restart the multilateral approach to trade liberalization, it would take years to achieve a widespread agreement. Bilateralism – or, at best, regionalism – is likely to be the key approach for further trade negotiations.

• Table 3 | **Growth in World Trade, regions and main countries (% values, 2005-2011)**

| | Imports | | | Exports | | |
|---|---|---|---|---|---|---|
| | 2005-11 | 2010 | 2011 | 2005-11 | 2010 | 2011 |
| **World** | **3.5** | **14.0** | **5.0** | **3.5** | **14.0** | **5.0** |
| North America | 1.0 | 15.5 | 4.5 | 3.0 | 15.0 | 6.0 |
| Canada | 3.0 | 14.5 | 8.5 | -2.0 | 8.5 | 3.0 |
| Mexico | 0.0 | 23.5 | 6.5 | 3.5 | 21.5 | 4.5 |
| United States | 0.5 | 15.0 | 4.0 | 4.5 | 15.5 | 7.0 |
| South and Central America | 10.0 | 23.0 | 12.0 | 2.0 | 5.0 | 6.0 |
| Brazil | 20.0 | 43.0 | 24.0 | 14.0 | 32.0 | 27.0 |
| Europe | 1.5 | 10.0 | 2.5 | 2.0 | 11.0 | 5.0 |
| Europe Union (27) | 1.0 | 9.5 | 2.0 | 2.0 | 11.5 | 5.0 |
| Germany | 8.0 | 14.0 | 19.0 | 7.0 | 12.0 | 17.0 |
| France | 6.0 | 9.0 | 17.0 | 4.0 | 8.0 | 14.0 |
| United Kingdom | 4.0 | 16.0 | 13.0 | 4.0 | 15.0 | 17.0 |
| Russian Federation | 17.0 | 30.0 | 30.0 | 14.0 | 32.0 | 30.0 |
| Africa | 14.0 | 15.0 | 18.0 | 11.0 | 29.0 | 17.0 |
| South Africa | 12.0 | 27.0 | 29.0 | 11.0 | 31.0 | 20.0 |
| Asia | 6.0 | 18.0 | 6.5 | 7.5 | 23.0 | 6.5 |
| Australia | 5.5 | 10.0 | 7.0 | 3.0 | 12.5 | 0.5 |
| China | 11.5 | 22.0 | 9.5 | 12.0 | 28.5 | 9.5 |
| Hong Kong, China | 5.5 | 17.5 | 7.0 | -5.5 | -16.5 | 7.0 |
| India | 14.0 | 22.5 | 9.5 | 12.5 | 25.5 | 15.5 |
| Japan | 0.5 | 10.0 | 2.0 | 3.0 | 27.5 | -0.5 |

*Source: WTO.*

## 2.2 Capital Flows

Together with trade, capital flows are the main forces that have driven the expansion of the world economy and the rise of EMEs (Subacchi 2010b), and challenged the existing equilibria and institutions of economic governance. Over the last ten years financial integration has expanded considerably: annual gross international capital flows rose from 5 to a peak of 17 percent of world GDP from 2002 to 2007, particularly to and from advanced economies.[8] With respect to Foreign Direct Investment (FDI) flows, the financial crisis has seriously affected the capital available for investment in the EU, which has experienced a dramatic fall both in inward and outward flows since 2005 (Figures 4 and 5).

• Table 4 | **World FDI Inflows 2005-2010 (in million US$, current prices)**

| Country | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Brazil | 15,066 | 18,822 | 34,585 | 45,058 | 25,949 | 48,438 |
| China | 72,406 | 72,715 | 83,521 | 108,312 | 95,000 | 105,735 |
| European Union | 496,075 | 581,719 | 850,258 | 487,968 | 346,531 | 304,689 |
| India | 7,622 | 20,328 | 25,350 | 42,546 | 35,649 | 24,640 |
| Russian Federation | 12,886 | 29,701 | 55,073 | 75,002 | 36,500 | 41,194 |
| United States | 104,773 | 237,136 | 215,952 | 306,366 | 152,892 | 228,249 |

Source: UNCTAD, World Investment Report 2011.

• Table 5 | **World FDI Outflows 2005-2010 (in million US$, current prices)**

| Country | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| Brazil | 2,517 | 28,202 | 7,067 | 20,457 | -10,084 | 11,519 |
| China | 12,261 | 21,160 | 22,469 | 52,150 | 56,530 | 68,000 |
| European Union | 608,515 | 690,030 | 1,199,325 | 906,199 | 370,016 | 407,251 |
| India | 2,985 | 14,285 | 17,234 | 19,397 | 15,929 | 14,626 |
| Russian Federation | 12,767 | 23,151 | 45,916 | 55,594 | 43,665 | 51,697 |
| United States | 15,369 | 224,220 | 393,518 | 308,296 | 282,686 | 328,905 |

*Source: UNCTAD, World Investment Report 2011.*

Transatlantic financial markets continued to have the lion's share of the global financial sector in 2011.[9] With a three-fold increase since the mid-1990s[10] , global FDI flows mark an overall pre-eminence of the EU and the US. The EU is the world's largest source and host of FDI, with outflows to the US still accounting for twice as much as those of the BRICS and an inflow of more than 200 billion dollar from the US, ten times more than the amount of US FDI flows to the BRICS countries in 2011 (Figure 8 and 9). Conversely, China, despite showing an extremely internationally integrated economy with regard to production and trade of goods, has limited connectivity with the international financial system (Subacchi et al. 2012). Europe has been the fastest growing destination

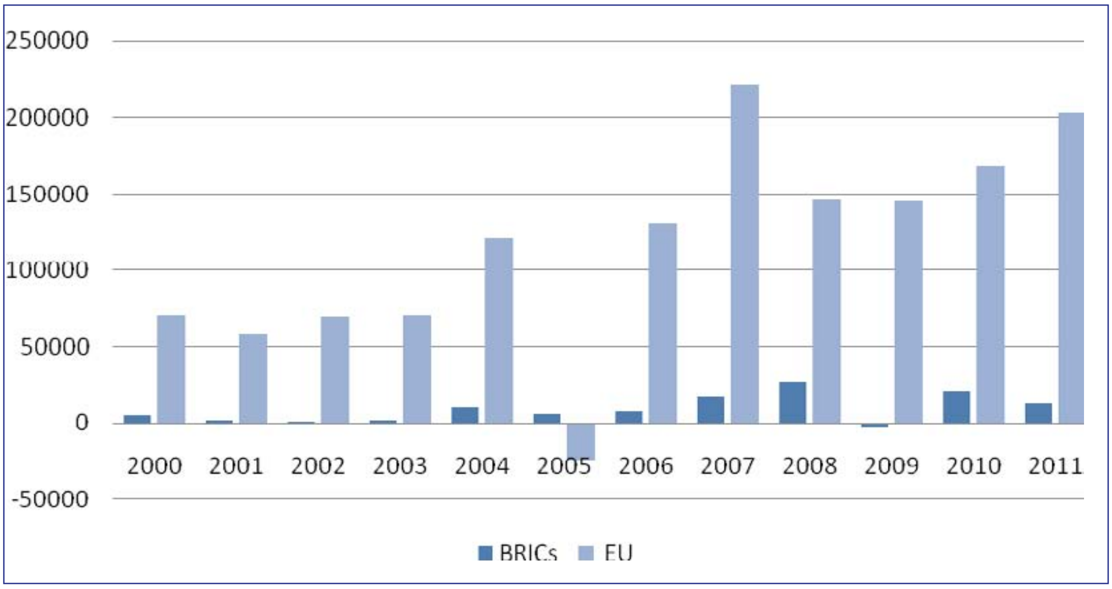
8 They plummeted to less than 1 percent at the outburst of the crisis in 2001, but have shown significant recovery ever since.

9 They account for over two-thirds of both global banking assets and all private and public debt securities, for over three-quarters of global financial services and of all new international debt securities, and also for almost 80 percent of interest-rate and equity-linked derivatives (Hamilton and Quinlan 2012).

10 Specifically, outward flows increased threefold since 1995, accounting for 1.5 trillion dollar in 2011. Inward flows followed a similar pattern, rising to an estimated 1.66 trillion US dollar in the same year (UNCTAD 2011: 16).

for Chinese investments since 2008, which however are still minuscule (UNCTAD 2011). Nevertheless, Chinese outward FDIs are on a trend of steady growth, since they doubled to 5.3 percent of Chinese GDP in a decade, with a total stock of 364 billion US dollar worldwide (Hanemann and Rosen 2012), and are likely to continue for the years to come.

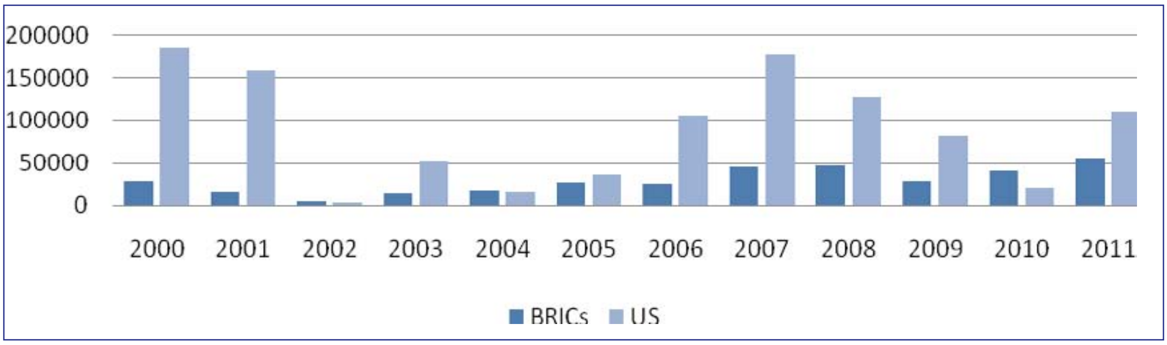
• Figure 4 | **US FDI Outflows (in million US$, 2000-2011)**




Note: Financial outflows without current-cost adjustment.

Source: Bureau of Economic Analysis, 2012.

• Figure 5 | **EU FDI Outflows (in million €, 2000-2011)**




Note: Data are for EU15 until 2000, for EU25 2001-2003 and for EU27 as from 2004.

Source: Eurostat, 2012.

The growth of international transactions has led to increased demand for US dollars, in the form of various financial instruments. This has allowed the country to significantly expand both its debt and deficit without experiencing a corresponding rise in debt service costs (World Economic Forum 2012). In other words, China's significant share of dollar denominated assets and account surplus help sustain and fund the US's "twin deficits" of current account and budget (Subacchi et al. 2012). This signals a trend of increasing global interdependencies and of an increasing financial power by EMEs. The EMEs' small share of financial markets shows that their integration in this field is still low. Nevertheless, a "reversal" in global finance is taking place, since the liabilities of emerging economies are not dominated anymore by external public debt but rather by FDI and portfolio equity flows, while their assets are increasingly in the form of foreign exchange reserves. Moreover, emerging markets have also become net exporters of capital to the advanced economies and have substantially reduced the risk emanating from the structure of their external liabilities (Prasad 2011). This represents a sharp contrast with the public accounts of the economies of the Organization for Economic Cooperation and Development (OECD) member states, which have been affected by a massive increase in their liabilities during the last few years.

## 2.3 Monetary Issues: From a Single Currency System to … What?

Financial flows are indicative of global economic power balances, especially with regard to the dominant currencies at any given time. Given the expansion in size and the changing shape of the global economy, debates about a reform of the International Monetary System (IMS) as a consequence of its (in)adequacy have recurred since its early days and have been on the leaders' agendas since the crisis broke out. The system needs to tackle its flaws that arise from a framework designed for a completely different and less integrated world economy. It is still not clear what shape the reformed system will take, but in the short term we are more likely to expect a long interregnum, characterized by few abrupt changes and prolonged dollar hegemony, since the US dollar is still the most important reserve currency and the one to settle international transactions. More than 80 percent of international transactions and almost 40 percent of total allocated foreign exchange reserves were still held in US dollars in 2011 (Figure 6, 7 and 8). Plus, no major trends of flight from dollar assets have been recorded recently.

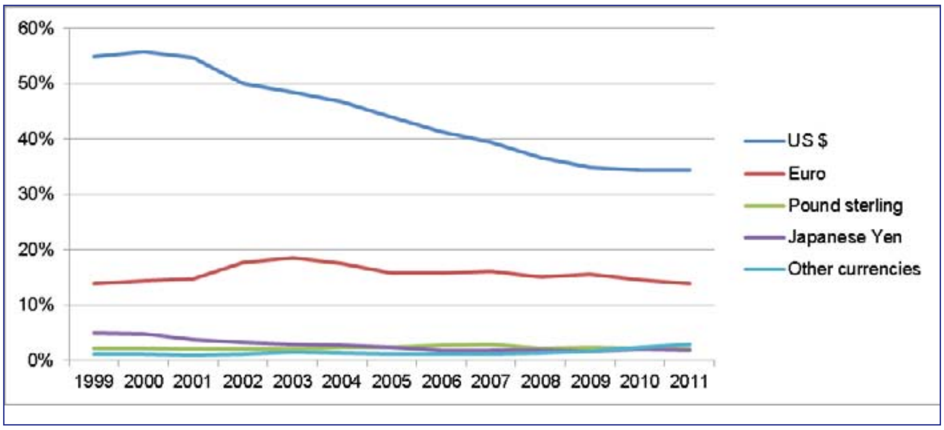
The intrinsic asymmetry and inherent instability of the continuing existence of a monetary hegemon that issues the primary reserve currency as the world moves towards a multipolar economy have however become more evident. The long debated Triffin's dilemma, which emerges when a national currency serves as an international reserve currency, has garnered renewed popularity in terms of conflicting short-term domestic and long-term international economic objectives and with respect to the long term confidence risk in a currency that is constantly running deficits.[11]

The crisis has also highlighted the risk of relying too heavily on the dollar, especially in case of liquidity scarcity. However, both the euro and the Chinese renminbi (RMB) are far from threatening to replace it. Although the euro accounts for almost a quarter of total reserves, its intrinsic problems were highlighted by the sovereign debt crisis in a number of peripheral EU member states. Steps in the direction of building up a fully convertible currency for international transactions are in their initial phases.[12] Beijing has for instance started to boost cross-border usage of the RMB in trade settlements, and to develop its offshore market in Hong Kong (Subacchi and Huang 2012). Also, China decided to extend loans in RMB to the other BRICS countries in March 2012 (Sender and Leahy 2012). It is also still highly uncertain whether China is ready and willing to challenge the current monetary hegemony and, therefore, which role the RMB is going to play in the near future.

11 The Triffin Dilemma originally referred to the tension inherent within the gold exchange system of the Bretton Woods Agreement in which the dollar could be exchanged for gold. If the US stopped running balance-of-payment deficits, there would not be sufficient liquidity in the international economy. If the US continued its deficits, confidence in the dollar (or more specifically, the link between the dollar and gold) would be undermined. A persistent trade deficit by the reserve currency issuer has benefits for both the country and the rest of the world, but at the risk of triggering a crisis of confidence in the currency itself in the long run. See for instance Portes 2012, Farhi, Gourinchas and Rey 2011, Bini Smaghi 2011, Obstfeld 2011.

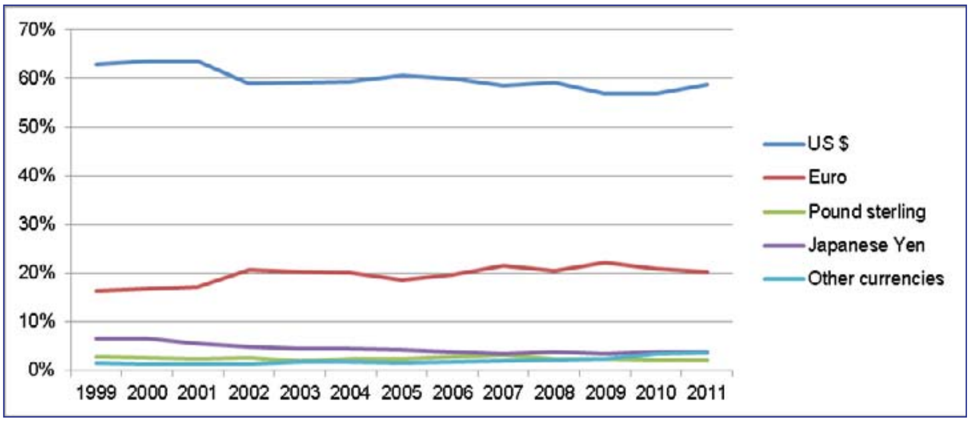
12 It has to be noted that major obstacles still remain, such as little international exposure and limited liquidity in the bond market, the lack of full convertibility and of sound international framework in the country, an underdeveloped domestic financial market, and controls on capital inflows and outflows. See Subacchi and Huang 2012.

• Figure 6 | **Total Foreign Exchange Holdings, world (%, 1999-2011)**



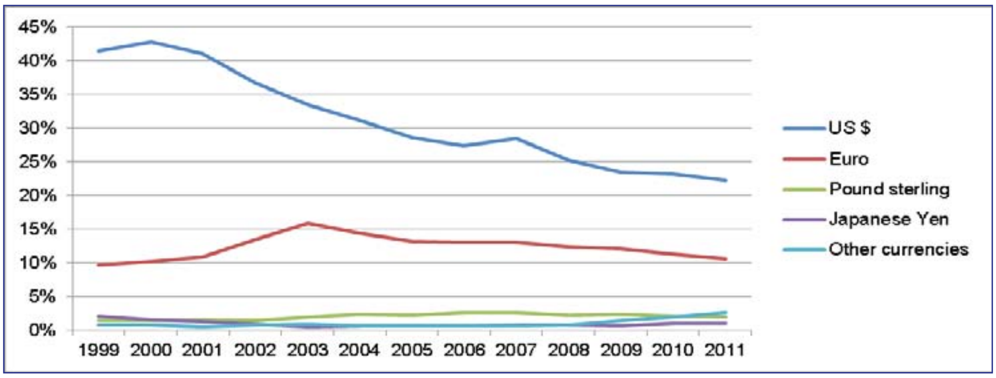

Source: Chatham House elaboration on IMF-COFER data.

• Figure 7 | **Total Foreign Exchange Holdings, advanced economies (%, 1999-2011)**




Source: Chatham House elaboration on IMF-COFER data.

• Figure 8 | **Total Foreign Exchange Holdings, emerging and developing economies (%, 1999-2011)**




Source: Chatham House elaboration on IMF-COFER data.

Moreover, at a regional (or sub-regional) level, there have been some small, or still unimplemented, projects to decrease the use of the US dollar as a means for bilateral transactions by replacing it with domestic currencies or with other forms of payment. In Latin America, members of the Bolivarian Alliance for the People of Our America (ALBA) established in 2009 a virtual currency used for the payment of common commercial transactions with the aim of stimulating intra-regional trade (Riggirozzi 2012). For instance, Brazil decided to use local currencies in its trade with Argentina (2008) and China (2012). A number of newly emerging powers also agreed on currency swap agreements for their trade with each other, such as the one between China and Turkey in 2012. These examples reveal the existence of a debate about replacing the use of the US dollar in a progressive way. Certainly driven by economic reasons, and aiming to avoid tensions between the financial markets of the countries involved, these decisions are also intrinsically political and ideological, as in the case of South American countries led by Venezuela's hostility to the current dominating global economic model.

Although it is a "stable disequilibrium" (Subacchi 2010b: 668), the status quo carries the lower risk for most players in the short term. The US is still taking advantage from issuing the reference currency and China has only recently started to implement its new monetary and financial strategy. Not only does the current system show its resilience, but an economic theoretical framework to codify potential changes and outcomes of this process remains also elusive. Even though a shift towards a basket of currencies seems a probable option only in the long run (Astrow 2012) the path to a shift away from the dollar hegemony is long and not clearly defined.

## 3. Emerging Trends and New Leaderships

### 3.1 "Old" and "New" Leaderships?

We have shown in the above that, in the current global context, the supremacy of Western economic powers is being challenged by the rise of EMEs. Nevertheless, the dynamics of economic power are deployed not only by national states but also via the action of multilateral economic and financial organizations.

The question whether we can still define the partnership between the EU and the US as "inevitable" (Parsi 2003) remains open. Although they still represent the most powerful economic actors on the global stage, internal and external challenges seem to be jeopardizing their leadership. Domestically, fiscal and debt crises in both regions undermined their economic growth; internationally, the rise of non-Western countries points to the existence of alternative sources of economic power. The possible beginning of negotiations for a Transatlantic Trade and Investment Partnership (TTIP) has spurred hopes to revamp the relationship as well as to trigger a new wave of international trade liberalization. A positive outcome might also help avoid the risk that the EU and the US engage with each other only in an irregular fashion, when specific domestic interests are concerned and when the issue in question is on top of either region's domestic agenda (Zandonini 2012).

A group of big, emerging economies stands in front of Western powers. Originally conceived as an asset class, the BRICS concept is now often associated with the idea of a waning Western capitalism, wherein economic power is being "rebalanced" to the benefit of Asia and, particularly, of the big EMEs of Brazil, Russia, India, China and South Africa (Valladão 2012). Although it is certainly true that one way for the BRICS to increase their influence on a global level would be to act as a single unit, they can hardly be defined as a bloc (Emerson 2012). They share some commonalities, such as their improved economic performance and growth potential in the 21st century and their rapid structural change and accumulation of industrial capabilities (UNIDO 2012).[13] However, they do not share a vision about the world system and are only at the initial stages of what could or could not become a truly strategic partnership. For the time being, the BRICS have made some steps towards speaking with a single voice in multilateral fora, in particular the G20 and the IMF.[14] Their trade and investment interests, their different economic structures and respective stages of development, as well as their specific domestic concerns narrow the path towards deeper integration. Moreover, China clearly stands out. Its economic size and growth rate, its appetite for resources, and its massive demographic power enable China to have a global status which is not comparable to the other BRICS.

The rise of new economic powers has led to the creation of new multilateral fora and stimulated proposals to reform the "old" multilateral economic institutions, whose effectiveness and legitimacy have been questioned. Yet, many signals hint at an ever-increasing global role for the IMF, such as its involvement in the so-called Troika (along with the European Commission and the European Central Bank) to save Eurozone economies, the growing amount of its available resources and its efforts to implement macroeconomic surveillance. Needless to say, its governance reform, which will result in China, Brazil, India and Russia being among the ten largest shareholders (IMF 2012a), is going to play a key role in giving direction to the Fund in the near future. The extent and depth of this overdue reform will tell much about whether the IMF's more influential members are ready to address a changing economic balance of power.

A "new" forum to address key economic issues and broad strategic objectives, such as the proposal of Mutual Assessment Process (MAP) in order to restore "strong, sustainable and balanced global growth" (G20 2009) is the G20, which was elevated to leaders' level in 2008. However, the potentially dramatic global effects of the multiple crises in the Eurozone do not seem to have caused enough international concern so far to trigger a new round of concerted action, as illustrated by the weak recommendations of the latest meeting of G20 leaders, held in Mexico in June 2012 (G20 2012). The forum has not turned into the promised world's permanent "steering committee" (Subacchi and Jenkins 2011). Yet, it would be in the interest of all its members – including the US and the EU – to explore ways to exploit the G20's potential. An empowered G20 would help the EU leverage its role internationally and with its transatlantic ally. The US should see the group as a suitable forum in which it is still the able to play the role of premier partner and leading decision-maker, and within which it can engage with pivotal emerging economies within a flexible – that is, non-binding – framework (Zandonini 2012).

## 3.2 Towards a "Trialogue"?

Even if challenged by EMEs, transatlantic economies still have the lion's share in the world economy, both in terms of GDP and of capital flows. Therefore, this strategic partnership is here to stay, at least in the medium term. At the same time, the centre of gravity of economic relations has already started to shift from the Atlantic towards the Pacific. As the third main player in the current economic scenario, China should be considered as a category on its own. Although the framework of global economic relationships looks characterized by a dense network (see section 3.3), we envisage that three main axes exist: the transatlantic relationship and the relationships between China and the US and the EU, respectively. The three actors rank in the first positions of all main economic indicators and most of transactions take place among them, revealing a high degree of interdependence.

13 For instance, their average growth rate between 2001 and 2010 was twice as high as the OECD's average, with exports playing a big role initially and being now increasingly driven by domestic consumption, investment and productivity growth.

14 Delhi Declaration, Fourth BRICS Summit, 29 March 2012, http://www.bricsindia.in/delhi-declaration.html.

As Gill and Small maintain (2012) and as shown in the previous sections, notwithstanding the increasing interconnectedness among them, no attempts at some sort of trilateral cooperation nor significant coordination at the multilateral level have been recorded so far.

Both the US and China are numbered among the EU's ten strategic partners, an umbrella concept which the EU elaborated in order to better cooperate with great powers and to put itself at the centre of coalitions to cope with global challenges (Renard 2012). Bilateral cooperation between the EU and China has expanded beyond trade and investment to encompass a wider range of areas. For instance, in addition to the High-Level Economic and Trade Dialogue (established in 2008), which deals with trade, investment, intellectual property rights and market access issues, the two actors engaged in a High-Level Strategic Dialogue in 2010, ranging from climate change to non-proliferation to regional security (Gill and Small 2012). Bilateral sectoral dialogues have increased from 19 in 2003 to more than 60 in 2012 (Chen 2012). Notwithstanding some frictions between the two economies, especially with regard to trade[15], the increasing financial flows and the diversification of China's foreign reserves away from the dollar and into the euro since 2010 (Casarini 2012) hint at increasing economic relations and incentives for cooperation. The recent change of leadership in China and its slow turn to increasing domestic consumption and investment could help produce a more symmetric economic relationship with Europe, thus making room for further cooperation (Chen 2012).

Similarly, initial trade relations between the US and China constitute now only a part of a wider "Strategic and Economic Dialogue" (S&ED), in which the two parties are engaged since 2009. The other primary forum for bilateral economic issues is the Joint Commission on Commerce and Trade (JCCT). Overall, the bilateral relationship encompasses now nearly a hundred dialogue mechanisms and an increasing number of high-level visits have been paid in the last two years, which might help ease broad strategic frictions [16], as well as trade-related issues (Lawrence and MacDonald 2012). China's partnership with the US was regarded as "a prerequisite for progress on many of the most pressing global challenges" by President Obama in 2009 (Obama 2009) which was followed by then Secretary of State Hillary Clinton's remarks in 2012 on the importance of interdependence between the two, since "one of us cannot succeed unless the other does as well" and the United States and China have to succeed in finding "a new answer to the ancient question of what happens when an established power and a rising power meet" (Clinton 2012).

An embryonic trilateral distribution of power can be traced in those relationships, which has not yet been addressed through common policies or ad hoc fora. A way to drive the on-going shift of global economic power in a gradual and no-traumatic way could be represented by a sort of trialogue among the three most influential actors in the world economic arena. On separate bilateral levels the dialogue has expanded to encompass a wider range of issues not only between the traditional transatlantic allies but also between the EU and China, and between the US and China. For instance, trade and other economic disputes among them, such as in the monetary and financial field, could be taken to a common table in the future. Such an outcome does not seem straightforward to achieve. Tighter cooperation is often difficult to achieve between long-standing partners like the EU and the US: the negotiation process towards the TTIP might represent a good case in point, since it is expected to prove long and fraught with stumbling blocks. However, given the high degree of interdependence between the three powers, economic cooperation looks like a rational strategy to accompany the reciprocal

15 China is the main target of EU Trade Defence Instruments (TDI), with four out of nine new anti-dumping anti-subsidy investigations in 2012. China accuses the EU of misusing TDIs against Chinese companies, to obstacle their access to the EU market (Library of the European Parliament 2012).

16 Critics from the US side pointed to the heavy role in the Chinese state in the management of the economy and to China's exchange rate policy, aimed at keeping the RMB artificially weak in order to promote exports. On the Chinese side, critics to the US were made for its high levels of consumption, low savings rate and alleged protectionism (Lawrence and MacDonald 2012).

convergence of interests, at least in areas where the competence of the EU is exclusive (e.g. external trade) and it can act as a single actor, independent from member states' will.

Political stability in the US, after the confirmation of the Barack Obama administration, and the change of leadership in China, together with the stabilization of the economic situation in the EU, might provide an appropriate framework for the three powers to start thinking whether acting in a coordinated way can be a viable strategy. Since, on the basis of an increasing economic interdependence, both in international trade and in financial terms, which spills over into other areas, the relationships among the EU, the US and China represent the pivotal axes of global economic power, a cooperative scenario would give the greatest advantage to the three players. This means that while pursuing their own economic interest, which is still their main objective, they would be likely to strengthen their reciprocal relations at the same time.

## 3.3 A New Theoretical Approach for a World of Uncertainty?

The likelihood of a shift towards a multipolar world or, at least, a multiplication of "power centres" and "power brokers" (Subacchi 2008), has grown bigger and bigger. Since economic power has increasingly become a multifaceted concept, "centre-periphery" schemes do not seem suitable anymore to explain the dynamics of the global economy (Subacchi 2008). Rather, we are moving towards a "multi-centre" framework. While in the past deployment of economic power used to flow unilaterally from a restricted number of global actors (the US, the EU, the USSR and Japan) to "peripheral" countries, it flows nowadays in both directions and around new centres. This resulted into a more equal distribution of power at a global level, but it also contributed to an increase in the degree of complexity. As shown in section 2, the multiplication of international trade agreements, the reversal in global financial flows and the rise of new currencies as potential challengers to the incumbent dominance of the US dollar, indicate that a dense network of relationships characterizes global economy much more than was the case in the past. The interconnectedness of the current economic framework also implies that bargaining and retaliatory power is more important than ever, so that there is big room for potential conflicts, but also for further cooperation.

EMEs are driven by the pursuit of their own domestic economic objectives in the world arena, just as all states are. For instance, China has maintained its exchange rate undervalued for years as well as extensive state aid in order to foster its export-driven growth. Moreover, its approach in establishing relationships with foreign countries is not oriented by "conditionality", but rather by a "no strings attached" attitude, which does not include ideological values or the fulfilment of clauses such as democracy or the respect of human rights. Brazil has also adoptedquite a pragmatic approach mixed with a form of soft power in its foreign economic policy: It invests in, and seeks out resources in the countries it has strong linguistic and cultural ties with (Stolte 2012).

A process seems to have emerged (or re-emerged) whereby states – notably the most resourceful ones – stand out as the most important actors in the global economy. States are reluctant to transfer their economic sovereignty to supranational institutions for a coordinated solution of common economic problems, as noted in the previous section. The financial crisis contributed to foster, above all within the EU, a "renationalization of politics" which risked jeopardize the future of the European integration itself (Kupchan 2010).[17]

17 The EU is generally referred to as a single actor in the global arena but it is still very reliant on its member states' behaviour. Despite some progress in the approval of the Fiscal Compact, it is proving difficult to pool further sovereignty from the member states and to go further without their full consent. The next big challenge of establishing a Banking Union, as well as the debate around a potential exit of the United Kingdom from the Union (the so called "Brixit") will constitute important tests to check whether the EU is still able to achieve a deeper economic integration and to speak with one voice internationally.

The attractiveness and effectiveness of existing economic models have been recently increasingly challenged. Based on the incremental inclusion of peripheral European member states, which were driven on the path of growth through macroeconomic convergence, the European economic model seems to be currently affected by a loss of confidence, since growth in the EU is stagnating (Gill and Raiser 2012). Although the crisis might have questioned the model as such, it is probably more the case of a lack of confidence in the mechanisms put in place and the reluctance shown by European leaders to address head-on the perceived causes of the current crisis.

The resulting question is whether the redistribution of global economic power is likely to lead to increasing levels of cooperation, or, conversely, whether this would signal a move towards a higher level of conflict in economic affairs. The mixture between economic integration and the preservation of sovereignty, as well as the fading attractiveness of existing models accelerated by the deep recession which is affecting advanced economies, is producing a very special set of unprecedented circumstances, and a multipolar scheme might well be the potential outcome. This framework suggests the opportunity (and the necessity) to think about new theoretical paradigms to address the new geography of economic power and influence.

## Conclusion

The global economic order is facing a period characterized by dynamism and increasing uncertainty. The economic crises in the EU and the US have contributed to accelerating the reduction of the divide with emerging markets, especially with China, and the redistribution of economic power, so that new centres, able to be influential at a global level, emerged onto the global stage. Signs of a partial transition can be seen in the monetary system, with the Chinese strategy to internationalize the RMB, and also in the financial sector, with the beginning of a role-reversal in global capital flows. In this context, sovereign states are still the fundamental actors, as the pursuit of their interests still affects the effectiveness of multilateral institutions and fora. At the same time, the fading existence of a hegemon in the system suggests both that earlier conceptualizations are no longer sufficient and that new formulations to interpret and explain the new dynamics of economic power are needed. There does not seem to be a clear framework for the future of the global economic order and a theoretical effort for the definition of new paradigms might be appropriate.

The emergence of new players, with their demands for changes in the international institutions as well as their increased global economic share, constitutes the main challenge to the current world economic order and to the transatlantic economic partnership. This might also suggest that we are moving towards a multipolar, or at least "multi-centre", distribution of the economic power. Emerging economies will play a determinant role. Given their currently diverging interests and inability to act in a coordinated way, however, we argued that the so-called BRICS can hardly be defined as a united bloc, and therefore, as a new global "pole" in the system. Therefore we contended that only China can be considered a third pivotal actor in the redefinition of the economic system. Although the transatlantic relationship is still the main axis of global economic relations, both from a commercial and a monetary point of view, the rise of China suggests possible changes in the global order in the medium term. This poses questions to the evolution of the US-EU cooperation. The upcoming negotiations for the TTIP will represent a major challenge for the future of the transatlantic relationship. At the same time, economic cooperation with China, conducted by both the EU and the US at a bilateral level, suggests possible future benefits and opportunities. These could arise from initial attempts of coordinated policies in specific sectors among the three most powerful economies in the world arena, with potential positive spill overs at a global level through a reduction of uncertainty and complexity in economic relations.

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## The Project

In an era of global flux, emerging powers and growing interconnectedness, transatlantic relations appear to have lost their bearings. As the international system fragments into different constellations of state and non-state powers across different policy domains, the US and the EU can no longer claim exclusive leadership in global governance. Traditional paradigms to understand the transatlantic relationship are thus wanting. A new approach is needed to pinpoint the direction transatlantic relations are taking. TRANSWORLD provides such an approach by a) ascertaining, differentiating among four policy domains (economic, security, environment, and human rights/democracy), whether transatlantic relations are drifting apart, adapting along an ad hoc cooperation-based pattern, or evolving into a different but resilient special partnership; b) assessing the role of a re-defined transatlantic relationship in the global governance architecture; c) providing tested policy recommendations on how the US and the EU could best cooperate to enhance the viability, effectiveness, and accountability of governance structures.

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