



**'The Political Dimensions of the World Economic Crisis:
A European Perspective'¹**

FINAL REPORT

The political dimensions of the financial crisis are still being played out. Judging their impact requires much speculation for the present. But the outlines of the challenges are beginning to be detectable. As stated by Ricardo Lagos, President of the Club of Madrid '*Politics is back*'. Politically, Europe is embroiled in the financial crisis at three different levels. A first concern is with the impact of the financial crisis on the politics of integration within Europe itself. As second issue relates to the way in which the crisis threatens to pull the European Union (EU) back from a broadly liberal policy in its external economic relations and its views on multilateralism. A third trend is towards a less cosmopolitan political dimension of European foreign policies.

On March 26, 2009, the Club of Madrid² launched its programme on 'The Political Dimensions of the World Economic Crisis' with a Roundtable focusing on the European perspective of this crisis.³ This event gathered Club of Madrid Members, all democratically elected former Heads of State or government, with high-level representatives of intergovernmental organisations, civil society and academia, to discuss the issues outlined above. The following report offers a summary of the key points and recommendations addressed during the meeting, exploring these three levels of linkage between the economic crisis and considerations of a more political nature.

'This is not just a crisis but a change in paradigm'

Diego Hidalgo, President,

**Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE) and
Member of the Board of Directors of the Club of Madrid**

Cracks in European solidarity

First, the crisis has impacted in a profoundly political sense on the dynamics of integration within Europe itself. Few days have gone by without Czech, French, and other ministers crossing swords in public. The spirit if not the letter of the single market has been torn asunder. State aid rules have been relaxed. France has offered soft loans to companies on condition they use local suppliers.⁴ Competition rules in the financial sector have been

¹ This summary report was prepared by Richard Youngs, Coordinator of the Democratisation Program, of the *Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE)* and Agustina Briano, Junior Programme Officer at the Club of Madrid.

² The Club of Madrid promotes "Leadership for Democracy that Delivers." It is an independent organization dedicated to strengthening democratic values and leadership around the world to meet political challenges at the local, national, regional and global level. Drawing on the unique experience and resources of its Members – more than 70 democratic former heads of state and government from 50 countries– and in partnership with organizations, governments and individuals that share its goals, the Club of Madrid addresses issues of global concern and provides peer to peer counsel, strategic support and technical advice to leaders and institutions working to further democratic development. The Club of Madrid constitutes the world's largest forum of former Presidents and Prime Ministers and offers today's leaders an unequalled body of knowledge and political leadership.

³ See Annex 1 for Roundtable programme and list of participants and Annex 2 for information on this new programme area.

⁴ Financial Times, 5 February 2009, p. 9

suspended and consideration of advancing liberalisation in the services sector – which accounts for two thirds of economic activity in the European Union (EU) – is now off the agenda.⁵

The Commission has speeded up the delivery of structural funds to central and eastern Europe and made rules more flexible (dropping so-called ‘co-financing’ requirements). But requests for new money from these sources were refused. These new member states still feel embittered at how they have had to turn to the IMF in the absence of more generous EU assistance. Such support was belatedly increased at the April G20 summit. But, the core feeling of solidarity has been ruptured.

‘My proposal is that all these countries (Members of the EU) that are to commit to an agreement with the IMF do so through the EU. That would be a guarantee. The anger of the population, this feeling that they are paying for broken china, could be very damaging for our democracies.’

**Petre Roman, Former Prime Minister of Rumania
and Member of the Club of Madrid**

‘There is still a discrepancy between the degree of integration we have (at the EU) and the governance system...clearly the European system is not built to respond to a crisis...So in fact the problem so far has been solved by improvisation and leadership.’

**Jean Pisani-Ferry,
Director of the Brussels European and Global Economic Laboratory**

Within the EU the crisis has unleashed a fundamental tension between the economic and political spheres. Rescue packages and broader stimulus measures have been introduced at the national level. The political impact is to have increased the pressure of accountability on governments to their national populations. Observing the EU’s difficulties in articulating a common response to the crisis, some have observed a re-nationalisation of economic policy-making. But at the same time it is recognised that effective solutions to the crisis require deeper coordination between governments. This tension requires European governments to recognise that ‘more Europe’ in the economic and financial spheres is not enough. Such measures cannot be divorced from the need to re-energise the EU’s democratic legitimacy. The lesson of European integration is that economic divergence can easily spill over into political divergence. The crisis cannot be solved while parking the political dimensions of integration.

‘A system in which profits are private but losses are socialised cannot possibly be sustained politically.’

**Vitor Gaspar, Director General,
Bureau of European Policy Advisers, European Commission**

Intra-EU and broader international considerations have conditioned each other. Many of the most acute tensions have revolved around challenges within Europe. Member states have accused each other of adopting protectionist measures that undermine the single market. Hard-hit central and eastern European states lament the lack of support from their EU partners, especially Angela Merkel’s refusal to assent to a common rescue plan for the region. At the same time, there has been a clear read-over to the EU’s global agenda. Deepening divisions within Europe have nourished a return to beggar-thy-neighbour thinking within the EU’s external relations too.

⁵ Simon Tilford, How serious is the threat to the single market?, CER Bulletin, 19 March 2009.

'If we look at the situation in various countries we can see how they differ in their responses...nation-based policies do not mean failure and...coordinated ones do not mean success'.

**Antonio de Lecea,
Director of International Economic and Financial Affairs,
European Commission**

Moreover, the crisis has intensified the debate over the borders of the EU. More solidarity is needed towards the new member states of central and eastern Europe. But the EU must address the fact that the countries beyond its borders have been hit hard. This applies especially to Ukraine and the Balkans. The EU cannot solve its own problems if it abandons these fragile new democracies. A Crisis Response Package was formulated under the Pre-Accession Instrument. However, member states have become more reluctant to accept further enlargement just when the political costs of retracting from their promises to the Balkans and Turkey will be even higher. Angela Merkel has insisted that the crisis requires a 'time-out' on enlargement, after Croatian accession. In the middle of the crisis the EU has rolled out its new Eastern Partnership offering various areas of cooperation with six countries on its eastern periphery. But France and other states have refused to grant this partnership more significant amounts of money, insisting that two-thirds of overall Neighbourhood Policy money go to the Mediterranean. This looks like inflexible clientelism. The Partnership needs to be linked much more tightly to the means needed to combat the crisis in Ukraine and other eastern states.

'We must recognise that in the face of this crisis the EU and its neighbours are in fact sailing in the same boat, a maybe 'Shengenized' boat...We must think about South-East Europe and what would happen if we continue to widen the gap between the waiting room for the EU and the EU as such'.

**Zlatko Lagumdžija, Former Prime Minister of Bosnia and Herzegovina
and Member of the Club of Madrid.**

Furthermore, this issue is also related to the idea of a 'Social Europe' and the effects the crisis is having on unemployment, inequality and poverty, both inside and outside the EU borders. As part of its response to the crisis, the EU must not forget to keep its active population as close to the market and employment as possible in order to contain social unrest and increase competitive prospects for the future, once the economy starts to grow again. Inter-generational issues and social cohesion are an increasing concern as Europe experiences increasing social inequalities and the middle class begins to wither. These may be fertile ground for unexpected political consequences across the EU where we are already beginning to witness serious threats to and even the collapse of incumbent governments. It is vital for the governmental stimulus packages to envisage budgetary projections to protect the most vulnerable sectors of society and the social security safety nets.

'If there is no money to create new jobs, if there is no money to create new business, there is no future at all'.

**Valdis Birkavs, Former Prime Minister of Latvia and
Member of the Club of Madrid**

'The effects of the crisis on Europe may widen the gap between and within states along poverty and welfare lines. This may not only jeopardise economic prospects but the very basic idea of a shared society in Europe.'

We may, in the end, resolve the economic crisis but also have a new social crisis.'

**Zlatko Lagumdžija, Former Prime Minister of Bosnia and Herzegovina
and Member of the Club of Madrid.**

Reshaping the global economy

'Global complexities and global problems can only be solved by global solutions. What we do at the European level should always be with a mindset of helping global structures.'

**Wim Kok, Former Prime Minister of the Netherlands
and Member of the Club of Madrid**

Second, the financial crisis has deepened the illiberal drift in EU external economic policies. In general terms, the aftermath of the crisis has witnessed a massive decrease in cross-border financial exposure and contraction in international trade. A number of specific responses to the financial crisis have compounded the general tendency to protectionism. Since the outbreak of the crisis, European ministers have ritually promised that there will be no slide towards protectionism. They did so at the G20 summits in both November 2008 and April 2009. The more ardently they state this, the more they contemplate just such measures.

'In a globalised economy, the State cannot simply be the saviour called upon in exceptional circumstances. States have an organizing purpose and a regulatory role to be exerted in normal times.'

**Lionel Jospin, Former Prime Minister of France and
Member of the Club of Madrid**

Of course, the financial crisis represents a major case of market failure. In the face of over-extended debt, markets clearly were not self-correcting. There is widespread agreement that tighter regulations are required in the financial sector. Sceptics insist that any further economic liberalisation would be akin to 'trying to cure a state of inebriation by having another whiskey'.⁶ Prior to the crisis, economic policies were based on the West providing capital to emerging economies and supporting a liberal trading regime as a means of importing goods back into European markets. The whole geopolitical balance of this bargain has now shifted. The West is set to export less capital, while China's unparalleled liquidity will enhance its power. The 'liberal equation' has been undermined.⁷

And a defensive scepticism of markets has certainly pervaded European reactions to the crisis. The trend is towards 'protection lite' – or what some practitioners now refer to as new means of 'covert' or 'accidental' protectionism. The EU has not adopted out-and-out trade restrictions but a series of actions that militate against international interdependence. The EU reacted vigorously against the 'Buy America' provisions launched under the new Obama presidency, but several similar 'buy national' campaigns have been supported in Europe too.

Financial bail outs have gone hand in hand with governments exhorting banks to lend only to national markets. The retrenchment of private capital encouraged by European countries is set to hit emerging economies particularly hard, and in some cases has already done so. The new protectionism is in finance rather than trade.⁸ Western governments' guarantees of deposits in their banks have had the perverse effect of dragging capital out of emerging economies into the developed world. Some also accuse the UK of letting the pound fall as a protectionist measure.

⁶ Robert Skidelsky, 'Where do we go from here?', Prospect, no. 145, January 2009

⁷ Roger Altman, 'The Great Crash 2008: A Geopolitical Setback for the West', Foreign Affairs, Jan-Fen 2009

⁸ George Soros, '.....should be the central concern', Financial Times, 23 March 2009, p.9

The French finance minister urges protectionism as ‘a necessary evil’.⁹ Of the twenty governments signing up to G20 statements, solemnly rebutting protectionism, seventeen have adopted protectionist measures. EU populations now perceive open trade very much as a risk more than opportunity. The rise of the Linke party under Oscar Lafontaine in German polls is seen as the result of its highly protectionist platform. Much focus has centred on differences between member states on the right balance needed between more stimulus and more regulation – the UK pushing harder for more spending, France and Germany for more regulation. But these differences mask a common retreat from economic liberalism.

‘The World Trade Organization should be empowered to monitor the application of policy measures in this crisis resolution, and to avoid again tariff barriers and other forms of market distortion and spill overs’.

**Paola Subacchi, Research Director of the International Economics Department,
Chatham House**

Gordon Brown lectures the world on the dangers of protectionism; but, for one commentator, the prime minister’s own inward-looking policies render him ‘hypocrite-in-chief’.¹⁰ In the US, Democrat free traders have refused to criticise the ‘Buy America’ initiative in part because they insist that European procurement rules are still far more restrictive.¹¹ It is notable that the supposedly well integrated transatlantic business class has not emerged as an influential brake on these trends. Middle Eastern, Russian and African interlocutors have all ironically suggested to diplomats that the European spree of bank nationalisations mirrors the statist route for which the EU has for so long admonished developing countries.

Member states such as Germany, France and Italy have introduced restrictions on Sovereign Wealth Funds – at the very least sitting uneasily with a Commission-led code of conduct offering access to SWFs where a minimal degree of transparency exists in such funds. A new German law restricts access of foreign buyers, in particular big Chinese and Middle Eastern SWFs. President Sarkozy has moved ahead with creating a French fund explicitly to fend off such foreign ‘predators’. The so-called Santiago principles agreed in October 2008 to open up east-to-west investment are now in doubt. Some member states have fought for more governmental control over IMF loans, wishing to move away from a focus on liberal reforms.

The EU has come to back some reforms to international financial institutions. European governments have backed G20 statements agreeing to bring forward a reweighing of IMF votes from 2013 to 2011. But in practice, they have contemplated change within a relatively limited range, resisting any commitment to far-reaching change in 2011. The EU has been able to hide behind the US’s long-standing reluctance to accept reduced power at the IMF. This has enabled European countries to maintain a studied ambivalence on the question of their own willingness to accept diminished sway. At the end of March 2009 a significant reform of IMF lending was agreed, involving a dilution of conditionality. With parts of Europe itself in need of emergency funding, for the first time most EU states sided with developing states in advocating such a weakening of structural conditions.

⁹ Le Monde, 4 February 2009

¹⁰ Martin Wolf, ‘Why Davos man is waiting for Obama to save him’, Financial Times, 4 February 2009, p. 11.

¹¹ Financial Times, 6 February 2009, p. 6

I fear Europeans are underestimating the magnitude of the crisis. The European Central bank is very cautious, even with the Eastern European Crisis. The Federal Reserve is very aggressive and very fearful, ready to face a problem anywhere. So I think the problem is that we have a different perception of what may happen to the world economy'

**Cesar Gaviria, Former President of Colombia
and Member of the Club of Madrid.**

Options for broad coordination of macroeconomic policy at the global level have been resisted. The EU, and especially European Central Bank, have lagged behind in policy easing and the size of fiscal stimulus recommended by the IMF. The crisis has made policy-makers in key European financial institutions, if anything, more adverse to losing control of decisions and being dragged into policies they deem not to be in the immediate European interest. No European support has been forthcoming for a powerful Economic and Social Council at the United Nations. European states are now even more reluctant to give up their vetting of membership to the Basel Committee for Banking Supervision. A preference for informal groupings of the G7, G20 and Financial Stability Forum (a club of regulators) has taken precedence over a genuine multilateralisation.

The April 2009 G20 summit held in London a few days after the Club of Madrid Barcelona Roundtable was generally hailed as a success. The G20 agreed to triple funds to the IMF; \$75 billion of the increase is to come from EU governments. It also committed to boosting trade finance by \$250 billion and extending additional credit to poor countries. The Financial Stability Forum was broadened out into a Financial Stability Board that would incorporate developing countries in the G20. But genuinely rebalancing reform was off the agenda. The Spanish and Dutch governments have squeezed their way into a 'G20 plus', rendering Europe even more over-represented – to the openly expressed chagrin of emerging powers.

'The Doha Development Round is low hanging fruit. We have the text, the divergences are not big, we still need the political decisions to be made. We do not need more technical time, We need political attention that has to come from the highest level.

**Alejandro Jara,
Deputy Director General, World Trade Organization**

In most European states the G20 summit was hailed as a victory over 'Anglo-Saxon free market capitalism'. The regulatory route was given more emphasis than measures to stimulate spending and trade. The UK moved some way to accepting the need for heavier regulation, closing the gap in positions that had loomed in the run up to the summit. Trade was the glaring omission from the G20 - beyond another non-committal pledge to avoid protectionism. No concrete steps were taken towards restarting the Doha round. Positions in that round had already reached a lowest common denominator. Yet revisiting this and re-loading the trade dossier was declared off the agenda in London.¹²

As European countries look to the IMF for economic help this has geopolitical consequences. It requires the EU to have a far more proactive and coherent position on effective multilateralism. The EU has talked for a long time about the importance of the latter but still has not been willing to take the steps necessary to achieving it. Immediate ad hoc policies are necessary to deal with the worst of the crisis.

¹² Lucy Davis, 'G20, where is the trade?', European Voice, 1 April 2009, www.europeanvoice.com

Informal solutions are necessary but we should urge our leaders to keep in mind that whilst taking action at the short term, they should also work on the new structures for the long run because we cannot afford to wait till these new structures are in place.'

**Wim Kok, Former Prime Minister of the Netherlands
and Member of the Club of Madrid**

But these must not divert attention from the structural changes that are needed in the international system. Crucially, reform of the financial institutions is not enough. This cannot be divorced from the need to reform the broad range of multilateral institutions that cover the political sphere as well.

'We need to have a 'G' that is legitimate in the context of an international institutional framework, not an ad hoc group of countries who selected themselves and selected who participates in the meetings. Europe should claim for institutional mechanisms to manage global governance'.

**José Antonio Ocampo,
Content Coordinator of the Club of Madrid programme on 'The Political
Dimensions of the World Economic Crisis' and Director of the Program on
Economic and Political Development at the School of International and Public
Affairs, Columbia University**

There is a long running debate over whether the EU is a generator of globalisation or a defence against it. The scales may be tipping towards the latter point of view. The crisis reveals serious market failures but the baby should not be thrown out with the bathwater. At the same time, the crisis has revealed that this dichotomy – EU as a dimension of globalisation versus EU as bulwark against globalisation – is a false one. The policy change needed is to make sure that the EU contributes to a different type of globalisation, effectively linking the nation state, regional and global levels.

Europe's geopolitical vision

Third, internal tensions and uncertainties over reform to the international financial institutions in turn pose acute challenges for the EU's more political, external role. More unity and effort is needed on other issues such as climate change, energy security, demographic trends and non-proliferation. The financial crisis must be understood as embedded in this broader set of international challenges, not separate from them. There are signs that the EU's commitments to climate change, security and human rights are suffering as a result of the crisis. This incipient trend must be reversed.

'We should not look into the economic crisis alone because what we are experiencing today is the accumulation of four crises that are mutually feeding each other: the climate change crisis, the food and hunger crisis, the oil and energy crisis and the economic and financial crisis. We have to see all four as the framework of the current economic situation.'

**Kjell Magne Bondevik, Former Prime Minister of Norway and
Member of the Club of Madrid**

The crisis risks leading to a preference for 'strong government' in a way that undermines democratic quality – both within and beyond Europe. Those of a 'realist' bent will ask, does the financial crisis not make the issue of democracy seem rather irrelevant? Can we really preach democracy's advantage as the West's economic systems come crumbling down? Are we not even more dependent on Chinese liquidity to kick start recovery? Can we talk democracy in Africa with cash-rich China poised to extend its influence there even

further? Some experts argue that after the financial crisis the EU needs to stop trying to support democracy beyond Europe and simply safeguard it within its own member states.¹³

And indeed, as the international context has changed, the EU appears less willing to sacrifice engagement with autocratic regimes. European approaches to democracy rely heavily on the positive, modernisation scenario that as China, Russia and other non-democratic states extend their trade and investment links they will come to press for better governance to protect their own investment in third markets.

European governments and the Commission have become increasingly less minded to exert pressure for democratic reform. They increasingly eschew sanctions related to democracy and human rights issues. Many would say that the reluctance to use critical measures and sanctions is a good thing - not a sign of any lack of commitment to democracy and human rights but a correct recognition that such measures are often counter-productive. The problem is that neither has the EU engineered its positive engagement effectively to support liberal democratic values. The rewards and incentives the EU offers for democratic reform remain limited, in some cases increasingly so.

In Europe the casualty may be integration. In Eastern Europe it may be democracy. In the rest of the world the casualty may be failed states...and we might face an increasing number of time bombs. One should look at the European contribution outside the concerns of the G20, of course to the short-term resolution of the crisis, but also the longer term issues like development, poverty or the environment.

**Sadiq Al Mahdi, Former Prime Minister of Sudan and
Member of the Club of Madrid**

The Czech foreign minister laments that the EU is 'backtracking on democracy'. Germany increasingly prioritises its role as a 'coalition builder' rather than values-advocate in foreign affairs.¹⁴ One UK minister welcomes the return of the US to 'good old fashioned policies of national interest'.¹⁵ France and Spain remain generally unconvinced of the democracy agenda. In Italy, Silvio Berlusconi tilts towards Atlanticism, his rivals on the left towards Europeanism; neither side distinguishes itself in pro-democracy efforts. Diplomats from many member states argue that the financial crisis places more of a premium on political stability. Doubts have surfaced during 2009, as the Czech and Swedish presidencies have tried to galvanise support for a new European Consensus on democracy: many member states have reacted ambivalently, reluctant to firm up current policy instruments.

'The crisis and the problem is economic but the solution remains primarily a political choice so we have to consider the whole matter from a political perspective.'

**Hong Koo Lee, Former Prime Minister of Korea and
Member of the Club of Madrid**

But it would be wrong to conclude that the financial crisis renders open politics irrelevant, even harmful. Crisis often acts as the trigger for political breakthroughs. In the midst of a crisis the 'strong leader' might gain currency. But democracies offer the accountability and open deliberation that are necessary for stabilisation over the longer term. Despite the crisis it remains the case that sustainable economic development is best built on democratic

¹³ Anatol Lieven, 'Europe has to guard democracy amid crisis', Financial Times, 10 December 2008

¹⁴ Hanns Maull, 'Germany and the Art of Coalition Building', in Erik Jones and Saskia van Genugten (eds) The Future of European Foreign Policy, London, Routledge, 2009

¹⁵ Lord Malloch Brown, BBC World, 30 March 2009

foundations. Obama's caution on democracy makes it more not less imperative that the EU show some determined and enlightened leadership in supporting global democracy.

'More institutions are needed but they are no substitute to political leadership and courage.'

**Antonio de Lecea,
Director of International Economic and Financial Affairs,
European Commission**

Better understanding of the ways in which the crisis could undermine democratic quality, transparency and accountability must be reinforced. Nationalism and inequalities must be rebutted. The normative appeal of democracy must be enhanced; democracies must demonstrate they can manage the crisis in a more open and fair way than non-democratic regimes. An effective democracy must be built on a balanced and mutually reinforcing relationship between state, market and civil society. There is no trade off between effective management of the crisis and deepening democratic quality.

'Democracy that delivers requires a mutually reinforcing balance between the state, the market and the individual. The fundamentalisms of the binomial system have failed. The crisis is a result of a world without rules.'

**Ricardo Lagos, Former President of Chile and
Member of the Club of Madrid.**