

## **Europe, Managed Globalization, and the Geneva Consensus**

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Prepared for the conference, *Europe and the Management of Globalization*,  
Princeton University, February 23, 2007. Not for quotation.

Globalization has exacerbated the core governance dilemma that confronts open economies. This dilemma is about how states reconcile the pursuit of an international economic system without barriers to exchange in ways that do not undermine national institutions that are critical to succeed economically and to sustain political support for economic openness. For Europe, the governance dilemma is said to be particularly difficult to resolve because attempts to scale back social programs or hasten reforms that enhance economic dynamism have often proven to undermine popular support for economic openness.<sup>1</sup> At the same time, Europe is said to be losing the international muscle needed to shape global rules in ways that prevent the erosion of valued national designs.<sup>2</sup>

To resolve the governance dilemma, Europe has adopted two general types of institutional strategies (Jacoby and Meunier 2007; cf. Ikenberry 1986). One type of strategy is domestic and is designed to improve the prospects of effectively resolving the domestic trade-off between social protection and economic competitiveness. Defensive domestic strategies have historically entailed protectionist measures, but in recent decades they have been more heavily geared toward securing popular support for

economic openness through the promotion of social risk insurance. Examples of such measures include legislation that protects citizens' access to social programs, including unemployment, old-age, and sickness insurance, and also more recently active labor market policies. Offensive solutions are also pursued at the domestic level, and often focus on the promotion of industrial research and development and state-backed risk capital for companies struggling to succeed in the knowledge-intensive industries.

Europe has also availed itself of two types of international strategies in attempting to reduce its vulnerability in an era of globalization. In the context of the EU, European countries have introduced numerous defensive strategies, including most notably the Common Agricultural Policy and more recently the Globalization Adjustment Fund. Offensive strategies have been employed at the international level, including the promotion of common minimum regulatory standards in the environmental and data privacy protection areas.

While Europe has been able to use both defensive and offensive instruments within the context of the European Union, it faces more significant hurdles when employing offensive strategies at the global level.<sup>3</sup> The extent to which Europe will be successful in giving global rules European imprints that are palatable with its goals at home depends on whether globalization itself can be managed and whether Europe has sufficient power to have its preferred designs adopted at the global level. The remainder of this memo looks closer at the manageability and power questions before proceeding to a brief discussion of Europe's role in shaping a new global consensus on the social purpose of global governance in an era of globalization.

## The Manageability Question

Policy-makers and academics who today think it wise and possible to manage globalization often face scorn that is reminiscent of the type of criticisms that have been levied against progressive policy programs for centuries (Hirschman 1991). Albert Hirschman documents how from the 17<sup>th</sup> century through the early stages of the neoliberal era, progressive ideas embracing liberty, representation, and fairness have been subject to three types of reactionary rhetorics which he calls the rhetorics of perversity, futility, and jeopardy. Today, supporters of the notion of “managed globalization” routinely face the same type of rhetorical attacks.

Policy-makers who suggest that globalization can be managed are often said to overlook the unintended consequences that follow from their efforts to tame markets. Such arguments are based in rhetorical claims about the *perverse effects* that attempts to improve the economic order will have on a polity. One among many examples where this type of criticisms is levied is in the context of European efforts to promote global environmental and labor standards. Indeed, opponents of such standards say that having global standards reflect European preferences will generate two sets of unintended consequences—it will delay “necessary” national reforms as well as reduce the prospects for economic growth in poorer countries that cannot compete effectively if higher global standards are imposed.<sup>4</sup> Other policy-makers are said to be placing the good aspects of globalization in *jeopardy* when they attempt to preserve Europe's social models. Such actions, it is frequently charged, will also delay national reforms and may in the process place the whole society in danger of permanent relative decline.<sup>5</sup> Finally, beyond charges

that attempting to manage globalization generates perverse and dangerous consequences, policy-makers are warned that attempts to organize global rules are nothing but acts of *futility* since it is ipso facto “impossible” to manage globalization. At the recent G-7 meeting in Germany, arguments of futility were frequently raised by opponents to regulatory oversight of the \$1.4 trillion global hedge fund industry.<sup>6</sup>

The conclusion one draws from criticisms invoking the rhetoric of perversity, jeopardy or futility is that if Europe wants to be successful it must adapt national designs to global institutions, not the other way around. But while these types of rhetoric are found widely in European debates over the future of globalization, there is also growing evidence that global rules can be managed and that they often have European imprints. For example, recent studies show the key role played by Europe in shaping the evolution of global trade rules (Meunier 2005) and global capital markets (Abdelal 2007). Europe’s imprint is also seen in areas that have become the subject for regulation more recently, including the international environmental (Kelemen 2007) and data privacy protection domains (Newman forthcoming).

Although the past has shown that Europe can effectively use offensive strategies to shape global rules, it faces significant constraints in the future. In particular, the institutional power on which it has relied to shape rules within international organizations may be in relative decline at the same time because there are growing demands for a more inclusive approach to global economic governance. Europe’s ability to manage globalization in the future through global institutions therefore depends to a great degree on its ability to construct a global consensus on what ought to define the social purpose of the international economic order.

## The Power Question

Europe's ability to use offensive strategies to shape global rules come not primarily from hard or compulsory power. Rather, its ability to shape global rules has been a function of its *institutional power*, which it has enjoyed by virtue of the privileged positions it was given within the major post-war international organizations that govern the global economic system.<sup>7</sup> Europe's privileged position within the GATT/WTO, IMF, World Bank, OECD and large parts of the UN system has allowed it to shape significant aspects of global capital and trade rules. In addition to giving it a strategic advantage in defining new agendas within these organizations,<sup>8</sup> Europe has employed its institutional power to shape the evolution of global rules, norms, and organizations in many domains, including in the areas of sustainable development, core labor standards, and human rights.

Europe's institutional power was particularly significant in the early post-war decades for it allowed Europe to exert significant influence over the structure and objectives of post-war global economic institutions. By fusing its institutional power with a social purpose that was widely accepted globally (and strongly backed by the US), Europe played a major role in defining what has become known as the compromise of embedded liberalism (Ruggie 1982). During this compromise, as Ruggie outlines, multilateralism was "predicated on domestic interventionism" (Ruggie 1982, 393). In other words, the stability of global institutions was dependent upon governments' ability to intervene in the domestic economy in ways that ensured political support for

multilateralism. The strongest manifestation of this economic order was that governments were given extensive authority in financial markets (unlike during the Gold Standard), which they used to strengthen domestic social programs that ensured strong political support for a multilateralism of economic openness. The governance dilemma, in short, was resolved because the embedded liberalism compromise was a self-reinforcing system that ensured that the structural transformation of Europe's postwar economies was successful without generating political instability.

Today, however, Europe's institutional power is not what it used to be. Europe must now accommodate demands for a greater voice by making non-European, primarily developing, economies and non-state actors who have argue that their lack of institutional influence undermines the legitimacy of existing global structures. Since the viability of the major economic multilaterals is a high priority to Europe, Europe must inevitably accept a decline of its institutional power if it aims to sustain the viability of the major economic multilaterals. Moreover, as new areas for global governance experience less institutional growth and other states catch up to Europe in the race to define global rules, the type of first mover advantage Europe enjoyed in the environmental and data privacy areas may come to be significantly compromised over time.

In addition to the relative decline in its institutional power, Europe witnessed a major decline in its ideational power in the last two decades. The end of Keynesianism and the decline of the embedded liberalism compromise in the 1970s, followed by the poor economic performance of many countries in the last two decades, has made Europe's prospects of defining a new social purpose for global organizations appear highly constrained. The decline of Europe's ideational power was particularly evident

during the heydays of the Washington Consensus when deregulated capitalism shaped the global development agendas.<sup>9</sup>

However, as the Washington Consensus has lost credibility, there is a new window of opportunity to recast what should be the social purpose of global economic governance. The chief lesson from the two decades of the Washington Consensus was that fast market liberalization without mechanisms for social protection did not generate sustainable results and often jeopardized political stability.<sup>10</sup> Indeed, when someone calling himself the “world’s foremost free trader” acknowledges that the lesson of the 1990s was that “optimal, rather than maximal, speed” is the goal (Bhagwati 2004: 8, 34-5), the intellectual window is open for a new debate on what ought to be the social purpose of global institutions. It is in this context that Europe has one of its best opportunities to employ an offensive instrument, namely to shape the global agenda with a social purpose that is palatable with its goals at home and that of other countries looking to resolve the governance dilemma.

### **The Geneva Consensus**

The shift in the social purpose of the international economic order in the 1990s towards the priorities of the Washington Consensus meant that governments’ discretion to intervene domestically were significantly disabled.<sup>11</sup> The international economic order was now designed to promote greater international liberalization and to minimize government intervention domestically. As a consequence, governments’ abilities to secure popular support for economic openness were constrained as governments were

encouraged to reduce spending, especially in the areas of social protection and support for the public and industrial sectors. If the embedded liberalism compromise had had self-reinforcing properties by enlarging popular support for domestic programs over time, the Washington Consensus came gradually to have a self-degenerative trend as fewer and fewer of its main features enjoyed political support.<sup>12</sup> The failures of the Washington Consensus, and the reality that countries violating many of its core principles fared better than those accepting the prescriptions of Washington institutions (Rodrik 2003) has also fueled a debate on what ought to define the social purpose of global institutions.

As Trade Commissioner of the European Union, Pascal Lamy called for a global system of “managed globalization” characterized by a set of coherent and legitimate rules (Lamy 2004). Since becoming Director-General of the WTO in 2005, Lamy has expanded on this theme to promote the so-called Geneva Consensus (Lamy 2006a). In contrast to the Washington Consensus, which emphasized structural adjustment *sans* government programs to offset the social costs of adjustment, the Geneva Consensus actively promotes an economic order in which governments are given extensive authority in managing the domestic process of reform. According to Lamy, the Geneva Consensus would be a “new basis for the opening up of trade that takes into account the resultant *cost of adjustment*” (2006c). In short, unlike during the years of the Washington Consensus, governments would be allowed, if not encouraged, to put in place domestic programs that would ease economic openness and enhance popular support for economic openness.

In advocating a new global consensus on what should be the rules and the social purpose of multilateralism, Lamy points first to set of lessons from recent failures. In

particular, he argues that the failure of trade negotiations in Cancun in 2003 were due to the absence of efficient and legitimate rules that enabled countries to support international liberalization while managing the domestic costs of dislocation through activist government policies at home. To Lamy, the resolution to the Cancun impasse, which have since been accentuated in the Doha negotiations, lies in “harnessing globalization” through rules that address imbalances and divisions between *and* within richer and poorer countries through a global system that is built on *transparency* and *subsidiarity*. While the former dimension speaks to institutional power within global governance, the latter speaks to the type of national authority that Lamy and others see as necessary for the Geneva Consensus to succeed.

Greater transparency in global governance is key to ensuring that the major economic multilaterals gain greater legitimacy. This is to be achieved by a more inclusive agenda that gives more voice to developing nations and non-governmental groups. Lamy talks of “nothing less than a new politics” (p.13), which he describes in terms of a global system of *cosmopolitics* (2004; 2006b; see also Charnovitz 2002). In developing his notion of cosmopolitics, Lamy draws heavily on the example of the European Union to argue that a global system can function in effective and legitimate ways if it embraces organizational principles that proved valuable in the European context. In particular, Lamy notes, global organizations must compensate for the relative power disparities between small and large states (as has been the case within the EU), and give the former a more significant role in the institutional architecture of global institutions than has historically been the case.<sup>13</sup>

If greater transparency in global institutions aims to ensure the legitimacy of global institutions, subsidiarity is the principle that ensures that countries have great flexibility in designing domestic programs that cushion the effects of globalization. A more explicit commitment to subsidiarity in the international economic order would revise what is expected of governments in the national context. Among other things, subsidiarity would give individual states greater authority in designing national programs that internalize the costs of economic adjustment. As such, it could significantly enhance the prospects of governments reducing the erosion of popular support for economic openness that was apparent during the years of the Washington Consensus.

Privileging subsidiarity means that global multilaterals actively seek to accommodate the diversity of national economic models that make up the world economy. Again, the EU offers an instructive case. Over time, the EU has gradually introduced principles by which diversity among member-states is managed without undermining their collective goals. Variable geometry is the broad term used for the practice of (a) allowing select countries to opt-out of some arrangements because they are unpalatable domestically, (b) to delay implementation in ways that allow governments to gradually build sufficient domestic support for multilateral commitments, or (c) for those who wish to deepen cooperation to do so in non-discriminatory fashion to other members. While Lamy is not explicit in his endorsement of variable geometry within global institutions, many others advocate such solutions in ways that are consistent with the central pillars of the Geneva Consensus (Trachtman 2006; VanGrasstek and Sauv e 2006).

As Ruggie noted in the context of the embedded liberalism compromise, the compromise was not “fully extended to the developing countries” (1982, 413). Today,

however, a stable international economic order cannot afford to exclude the fastest growing parts of the world. The Geneva Consensus is an effort to overcome the political liabilities associated with the Washington Consensus -- an arrangement that was almost exclusively extended to developing countries and that after two decades threatened the legitimacy and viability of major multilateral organizations on which Europe depends heavily.

In Sheri Berman's reading, describing the post-war arrangement as a compromise of embedded liberalism is something of a misnomer; in her view, it is better characterized as a social democratic project (Berman 2006, 179). The same label has been used to describe the project of "managed globalization," which is characterized as "an extension of social democracy at the global level" (Abdelal and Meunier 2007, 9).<sup>14</sup> Is it possible that Europe's efforts to manage globalization through a Geneva Consensus could bring about a new compromise of embedded liberalism? While there is reason to be skeptical that a new arrangement will represent a social democratic model in the way of the embedded liberalism compromise, supporting the reconstitution of the principle by which that compromise resolved the governance dilemma half a century ago may represent a practical and normatively attractive way for Europe to shape the future of globalization.

### **The Past as Prologue**

The contemporary debate on how to resolve the governance dilemma has many historical parallels. The dilemma is in essence about the structure of the relationship between global institutions and domestic designs, and the nature of power granted to each

(though, especially to national governments). With the gradual end to the embedded liberalism compromise in the early 1970s and the intellectual victory of neoliberalism, Friedrich Hayek's ideas on the proper relationship between global rules and domestic designs have received much attention. For Hayek, lasting peace among nations would *not* be possible "if states, large or small, regain unfettered sovereignty in the economic sphere" (1944:253). To limit what he considered to be the inevitable deleterious consequences of domestic interventionism, Hayek advocated an international order with "minimum powers" that would be given "essentially the powers of the ultra-liberal 'laissez faire' state" (1944:254). He defined these powers as being "of a negative kind" that would limit the authority of states to intervene domestically in ways that would be harmful to others by undermining the efficiency of the global economy. In Hayek's world, negative powers would include what today are part of the WTO "Singapore issues," including most notably competition rules that would make preferential treatment of national industry subject to global authority. But as a model for resolving the governance dilemma, Hayek's arrangement underestimates the difficulties of ensuring political support for economic openness without government discretion in managing the domestic costs of adjustment.

A very different view of how the world should be organized was offered by the economist with whom Hayek shared his Nobel Prize. With the ascendance of Hayek's ideas after his 1974 prize, it is often forgotten that he shared the prize with a Swedish economist and social democrat, Gunnar Myrdal.<sup>15</sup> Though the two winners offered very different blueprints for how national economies should be managed, they did agree on the importance of establishing a relationship of complementarity between national and global

designs. For Hayek, this translated into an international system that protected the price mechanism (Hayek 1944:254), while for Myrdal this meant a global arrangement that would mirror the national welfare state (Myrdal 1960). Myrdal argued that once developing nations joined the global economy, there was “as a matter of fact, no alternative to a continued international economic disintegration, except to strive for a Welfare World.” Myrdal followed up and concluded: “The trend towards national planning leads by a process of causation, to the creation of a need for international coordination and planning” (Myrdal 1960:198).

If Hayek’s global order was vested with only “powers of a negative kind” intended to prevent market distortions, Myrdal emphasized a world in which political authority would be of a positive kind. International organizations were to have the “force of the ideal” and promote individual liberties, political representation in global deliberations, and fairness. While Hayek’s and Myrdal’s ideal global orders are echoed in contemporary debates, both their designs are unrealistic arrangements for the contemporary world economy. Attempts to move toward Hayek’s ideal in the last two decades have shown themselves to undermine the very legitimacy of global economic governance because governments were constrained, if not prevented, from internalizing adjustment costs without losing political support. Myrdal’s ideals, meanwhile, are impractical in a world of immense diversity in which the type of global solidarity necessary to create global institutions of redistribution is limited.

Perhaps the greatest shortcoming in Hayek’s and Myrdal’s proposals is that they both assume that only one type of national economic model will exist and that it has its corresponding ideal at the global level. In the decades since the two economists wrote,

there is little to suggest that countries are converging on one type of market economy. Even within Europe where regime competition has been a feature in the process of market integration, a variety of models have persisted.

If the world will continue to be one of diverse national systems of governance that are traveling at different speeds of change, the critical aspect of a new global compromise is to adopt rules that accommodate institutional diversity and differential speed of reform. This is the premise of the Geneva Consensus, and Europe could do worse than investing its resources to promote this consensus and to demonstrate how the pillars of transparency and subsidiarity enables members of the EU to reduce barriers to economic exchange while respecting diversity in national economic designs.

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## Notes

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<sup>1</sup> The themes of the costs of social protection and level of dynamism in industrial sector are major themes in recent EU initiatives like the Lisbon Process and in agenda-setting studies of the state of the European economy (e.g. Sapir Report 2003; European Commission 2005).

<sup>2</sup> “Europe” refers to the collective will of the members of the EU and its predecessors. In other words, who is Europe evolves over time as more states and supranational actors become part of what may be considered a corporate actor in the sense of James Coleman (1990). Though the states and supranational that make up this entity often vary in their views on appropriate policies and institutional designs, it is as a collectivity that they must resolve the governance dilemma.

<sup>3</sup> As long as defensive domestic strategies employed in one country do not discriminate economically against others, EU member-states have the freedom to chose their mix of defensive instruments. The latter is determined by domestic groups' propensity to absorb the opportunity costs of not reforming in ways that may generate smaller (though perhaps different types of) adjustment costs.

<sup>4</sup> This type of argument is found extensively in public debates where globalization is as a rhetorical device to define what policy options are best suited to improve economic competitiveness. For illustrations, see Hay and Rosamond 2002.

<sup>5</sup> A particularly striking account that stresses this logic is found in Alesina and Giavazzi (2006), esp. p. 3.

<sup>6</sup> Despite acknowledging that hedge funds pose “systemic risks” for the global economy, G-7 governments agreed not to institute any real regulatory oversight. Rather they settled on a minimal agreement that entails encouraging hedge fund managers to work more closely with government officials and to move towards a system of greater self-regulation. This lowest common denominator outcome reflects the frequent difficulties major European states have in agreeing on global economic rules that affect the core institutions of their respective variety of capitalism (cf. Hall and Soskice 2001). Variations in national preferences rooted in historic national economic designs also help explain why member-states of the EU often have substantial difficulties agreeing on common standards and therefore why some types of defensive and offensive strategies of managing markets lack cohesiveness and comprehensive scope (see Fioretos 2001, Fioretos 2007).

<sup>7</sup> Compulsory and institutional power are not distinguished by the use of material or non-material resources, but by the nature of relational specificity in exchange relations. While compulsory power exists when someone has direct control over someone else, institutional power is relationally diffuse and entails control over distant others. See Barnett and Duvall (2005).

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<sup>8</sup> Abdelal (2007), Kelemen (2007), and Newman (2006) all offer illustrations of the how Europe was in a position to define new rules at strategically important moments in the evolution of global rules.

<sup>9</sup> On the structure and limits of Europe's ideational, or soft, power, see Nye 2004:75-83.

<sup>10</sup> A major study notes that support for democracy in Latin America declined in many states following the reforms associated with the Washington Consensus (UNDP 2004).

<sup>11</sup> McNamara (1997) speaks of a transition to a "compromise of competitive liberalism" to capture a similar trend in Europe when agreement on EMU disabled national governments monetary discretion.

<sup>12</sup> On the distinction between self-reinforcing and self-degenerative institutions, see Greif 2006. Note that self-reinforcing arrangements need not be economically efficient. Indeed, one of the major reasons why many institutions associated with the embedded liberalism compromise have been difficult to roll back is that although some of them have proven costly, positive feedback effects have enlarged the constituencies that support their continuity. Major reform in European countries only occurred when the business sector could credibly threaten to withdraw its support for post-war institutions (see Swenson 2002, chapter 13).

<sup>13</sup> Lamy also cites the draws on the case of the EU – specifically the authority of Commission – to argue that the WTO Secretariat ought to be given the right of initiative (Lamy 2006b).

<sup>14</sup> See also Held (2004) for a longer account of the embedded liberalism compromise as social democracy and what a new global order organized around these concepts may entail.

<sup>15</sup> Some would note that it would be more appropriate to say that Myrdal shared his prize with Hayek since the former was considered a certain recipient while Hayek was added for balance.