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**ADB Working Paper Series**

**EUROPE AND NORTHEAST ASIA –  
DIFFERENT RESPONSES TO FINANCIAL CRISES**

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**Abstract**

This paper focuses on the critical differences, but also some commonalities, between the EU and three countries in Northeast Asia – the People’s Republic of China (PRC), the Republic of Korea, and Japan – in responding to financial crises. The EU’s response is naturally multilateral, but the stress test of the sovereign debt crisis showed weaknesses in the integration of economic and monetary policy. The EU strengthened its integration during and after the crisis, oscillating between intergovernmentalism and supranational institutions. This cannot be explained by rational models of stepwise integration, but is eminently political. By contrast, Northeast Asian countries have handled the crisis more successfully in the short term (the jury is still out on the longer-term impact on the massive increase in debt and on slowing growth), but their policy was largely a nationalist one with very limited multilateral coordination, let alone integration, between them. While there are parallels with the objectives of the stabilization measures in the two regions, the design is clearly a major difference that would allow the conclusion to be drawn that the EU is a model of polycentric economic and monetary integration with a number of difficulties revealed in the crisis, while Northeast Asia (and in fact ASEAN+3) is a model of nonintegration with a limited set of grouped bilateral cooperation mechanisms. Neither of the two models is intrinsically superior to the other, but each reveals different political trajectories (or pathways). The global economic impact of the COVID-19 pandemic may allow this analysis to be tested.

**Keywords:** Asian financial crisis, European sovereign debt crisis, global financial crisis, financial safety nets, eurozone

**JEL Classification:** F55, F33, F36

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## 1. INTRODUCTION

The EU's handling of the sovereign debt crisis was seen by many analysts and policy makers as disastrous (Tooze 2018). It has probably made East Asian policy makers even more cautious about regional financial and monetary integration. This chapter will give a more nuanced and comparative view on how the EU and East Asia handled financial crises in the past and what the lessons could be. The two cases of Asia and the EU will show the staggering challenge for global and regional governance of the globalized financialized economy posed by the tensions between national sovereignty, the need for democratic accountability, and the hierarchical structure of global finance.

A number of mostly American economists have long argued that the design of Europe's Economic and Monetary Union (EMU) was so flawed that it was bound to disintegrate. This argument was based on optimum currency area (OCA) theory (Mundell 1961). But later iterations of this theory have relativized this criticism by including monetary and trade integration aspects (Rhodes 2011; Vollaard 2014, 1145; Krugman 2013). The question is less the creation of the EMU as such than how it should be governed – essentially the degree of centralism of institutions and the symmetry of decision-making (Priewe 2017, 8–10). EU policy makers knew about these theories and were aware of design flaws (Eichengreen 2012). The EMU was not the result of a stepwise functionalist integration logic (Balassa 1961), but a political project. The Maastricht Treaty enshrined an asymmetry: centralized monetary policy (with a limited scope) and decentralized but coordinated fiscal policy (Buti and Krobath 2019, 3). It is important to remember here that the 27 member countries of the EU are still sovereign countries, even though in many policy areas they have pooled decision-making, including, for 19 of them, in monetary policy, by adopting a common currency. However, macroeconomic and fiscal policy and financial supervision have been far less integrated. The EMU was left without a central fiscal capacity and thus decision-making during the crisis was largely intergovernmental (Buti and Krobath 2019; Priewe 2017). At the beginning of the crisis the EU had 27 different regulatory systems and bank rescue measures in place. There was no common financial safety net, nor was the European Central Bank (ECB) conceived as a lender of last resort or as competent for microprudential supervision of European financial institutions. Macroprudential regulation and supervision were even more limited due to the fragmentation of national regimes. The criteria for EU countries to join the EMU laid out in the 1993 Treaty of Maastricht were believed to be sufficient for EMU stability (Draghi 2019).

As the financial crisis hit, the EU budget managed by the supranational institutions was about 1% of the EU's total GNI, whereas the overall share of member states' public authorities was about 47%. EU funds were not designed for bailouts or fiscal stimulus. Instead, member states used their own budgets largely as they saw fit. Consequently, subsequent policy negotiations and coordination were largely intergovernmental. This aspect is crucial, as the intergovernmental decision-making process is very different from the "normal" EU community method (Buti and Krobath 2019, 1). Intergovernmental bargaining is the very thing that also makes Asian regional mechanisms stutter and perform below potential. The asymmetry in the eurozone slowly evolved during the crisis through the establishment of common mechanisms, for instance to regulate financial markets and banking supervision (Buti and Krobath 2019, 3; Kudrna 2016). In the EU, the tensions resulting from bargaining about bailouts for other countries and accompanying conditions (austerity) caused the emergence of nationalist and Euroskeptic political parties (Börzel and Risse 2018).

Nevertheless, the severe global financial crisis, which started in the US and mutated into a sovereign debt crisis, did not lead to disintegration of the EMU (Wissenbach 2020, 75–94). Instead, the EMU was further developed and became more integrated through a number of reforms of existing, and the creation of new, institutions (Kudrna 2016), which are well covered in other chapters of this book. This governance reform has made the EMU governance more polycentric (Wissenbach 2020, 82–3) but at the same time more centrally regulated and supranational and probably better prepared for the next crisis than Northeast Asia (De Brouwer 2018; Rana 2017; Rhee, Sumulong, and Vallée 2013).

To examine the lessons for the current situation, a comparative look at how Europe and Asia (here Northeast Asia) have handled financial crises in their regions is important. In Asia, even intergovernmental coordination proved to be very limited in line with the traditional emphasis on national sovereignty, but as the Asian financial crisis (AFC) showed, this also proved challenging, especially when looked at through a global governance lens appropriate for the 21st century and the recent surge of nationalism and protectionism that are threatening global economic governance (Wissenbach 2020).

## **2. THE GOVERNANCE CHALLENGES OF FINANCIAL CRISES**

### **2.1 Challenge 1: National Sovereignty and Contagion – The Asian Financial Crisis (AFC)**

*The AFC as a catalyzer for nationalism cum globalization:* The key lesson drawn by most Asian countries was to defend national sovereignty as much as possible from intrusive multilateral or foreign conditionality, while preserving the openness of the global economy for Asian trade (Tangkitvanich and Rattanakhomfu 2018, 203). This is in line with Northeast Asia’s “conflicted regionness” (Wissenbach 2020, 119–42). In East Asia, regional financial safety nets are viewed with skepticism while any conditionality from the International Monetary Fund (IMF) is resented. Regional networks such as the Chiang Mai Initiative haven’t been used in any crisis while the national policy responses seemed effective in the short run, but may turn out to be costly and challenging for regionalization in the long run. Self-insurance was more by default than by design (Rhee, Sumulong, and Vallée 2013); Japan was less vulnerable because its debt burden is largely domestic, while the PRC had effective capital controls and the means to borrow domestically for large stimulus measures (but its domestic debt is now huge; IMF 2019). Hence, large-scale fiscal stimulus has so far not been implemented in the COVID-19 crisis (Anderson 2020, 96, 100–1). The Republic of Korea was more vulnerable, but at least had reformed its banking sector after the AFC in 1997/8.

In Northeast Asia, after the AFC, countries pursued domestic reforms and regional cooperation as an integral part of each country’s globalization agenda (Shu 2015, 104). The PRC reformed state-owned enterprises and after it joined the World Trade Organization (WTO) in 2001 it entered a period of super-high growth (Mühlhahn 2019, 549–59). Japan reformed its economic bureaucracy during a phase of stagnation and the Republic of Korea reformed its chaebols and pursued FTAs with partners inside and outside its region (especially the US and the EU). During the global financial crisis, the PRC and the Republic of Korea were among the main advocates for preserving the open trading system against protectionist reflexes. After the GFC, however, the PRC, given the environmental and economic unsustainability of its high-growth economic model, structurally changed to a “new normal” of lower growth while the total debt in the Chinese

economy quadrupled from \$7 trillion to \$28 trillion between 2007 and 2014 (Mühlhahn 2019, 562, 591–614; Green and Stern 2017, 426). That “new normal” of Chinese growth and its massively expanding financial sector will undoubtedly shape its COVID-19 response (Anderson 2020, 100–1) and have major long-term impacts on the Asia region. Even so, while intraregional trade increased slightly during the period 1995–2015 from 45 to 47.2%, nontariff measures between ASEAN countries increased significantly during the same period (Tangkitvanich and Rattanakhamfu 2018, 186, 192). Most intraregional trade is not covered by trade agreements, especially Japan’s (Tangkitvanich and Rattanakhamfu 2018, 189). The trade and investment linkages between ASEAN and Northeast Asia are stronger than the intraregional linkages in each subregion. The Asia region maintains strong linkages with the outside world in a triangular trade structure (open regionalism). Financial and banking integration is even weaker and advances very slowly (Tangkitvanich and Rattanakhamfu 2018, 186, 198).

## **2.2 Challenge 2: Past Crises as *Laboratories* for Global Governance**

The lessons from a past crisis tend to focus on past issues and may overlook new challenges and new disruptive complexities (Wissenbach 2020, 11–14). After the AFC, regional and global mechanisms were established that were further developed during the GFC. The G20 group of finance ministers and central bankers was created in 1999 to improve coordination of national economic policymaking and in 2008 was elevated to summit level. The FSF (Financial Stability Forum) was also created as a reaction to the AFC and the G20 upgraded it to the Financial Stability Board (FSB) in 2009. In fact, international crisis management for the AFC was undertaken to a large extent at the global level rather than at the regional level. This was due to the absence of effective regional mechanisms (Rhee, Sumulong, and Vallée 2013). But given the changes in doctrine and instruments the reformed IMF now has at its disposal after drawing (self-critical) lessons from its misdiagnosis during the AFC (Hill and Menon 2012, 3; Rana 2017 Rhee, Sumulong, and Vallée 2013; Wissenbach 2020, 143), and considering the inadequacy despite all these reforms of the IMF as a potential backstop (Truman 2018), it is not wise to vilify the IMF, nor is it wise to rely entirely on it. During the GFC it was the US that “bailed out” directly or indirectly the rest of the world, but it is not very likely that they will do so again. Even during the GFC there had been a lot of behind-the-scenes tensions within the US (Tooze 2018) and the tide would seem to have turned against action by the US to bail out foreigners. The prime role of the US in the GFC and its containment was even more obvious (Tooze 2018). That seems to suggest that crises are (costly) opportunities to strengthen multilateral cooperation (as the EU and other cases also show; Rhee, Sumulong, and Vallée 2013). But multilateralism has fragmented and become more unpredictable both because of the structurally chaotic dynamics of financial globalization and because of a rise in nationalism and protectionism. Moreover, the existing global financial safety nets have not been reformed sufficiently to keep pace with the global challenges. The US and the IMF remain the financial backstop for the region, but how reliable and capable are they now? (Rhee, Sumulong, and Vallée 2013; Sussangkarn 2017; Truman 2018, 6). The reactions to the COVID-19 pandemic – a disruptive health crisis with potentially disastrous economic consequences that will stress the global financial system – will tell, but at the time of writing (March 2020) the shutting down of borders and market reactions do not augur well (IMF 2020).

The idea of an Asian monetary fund was touted during the AFC but it never materialized. Instead a weak mechanism of bilateral currency swaps, the CMI, was set up and during the GFC was multilateralized and accompanied by a minuscule



macroeconomic surveillance office (AMRO), but no one seemed to believe that these institutions could in fact constitute an adequate regional financial safety net. Instead, the Republic of Korea, the most vulnerable country in Northeast Asia, proposed a new set of global financial safety nets during its G20 chair period in 2010, with limited success. Neither Asian nor global financial safety nets are ready for the next crisis in the region (Rana 2017; Truman 2018, 5). Regional cooperation is not a priority, although it is clear from the financial network structure that without regional cooperation Asia depends on US (and IMF) support in critical times (Oatley et al. 2013). This lack of cooperation in a world characterized by disruption and complexity is risky:

The world – and the Asia Pacific region maybe more than other regions – is vulnerable to spillovers from events like trade and currency wars, military conflicts, and security posturing getting out of hand.

(De Brouwer 2018, 13)

By contrast, in 2017 the EU embarked on setting up a European Monetary Fund (see below 4.2). The underlying reasons for a lack of regionalization in Asia are the rivalries between Northeast Asian countries due to nationalism and ensuing moralization gaps in their past (Wissenbach 2020). Those, from an international relations perspective, will need to be addressed. In this sense, this chapter complements economic analysis on regionalization in Asia.

### **2.3 Challenge 3: Complexity – The Network Structure of Global Finance**

Financial crises follow the hierarchical network structure of transnational finance (Oatley et al. 2013). The AFC was a peripheral crisis that hardly affected the network center (the US and European financial institutions). The GFC, by contrast, was a crisis in the center with immediate and disastrous repercussions around the globe. Global coordination led by the US was necessary because of the hierarchical structure of the global financial networks centralized on the US and a strong transatlantic link that lacked a regional system in Asia (Oatley et al. 2013). Therefore financial crises cannot be addressed on the basis of national interest and sovereignty alone, but neither can it be expected that the center will always intervene to bail out the periphery – except now in the EU with an *incipient* but still weak central fiscal capacity and the European Central Bank (ECB) for centralized monetary policy and polycentric prudential supervision.

Nationalism and an excessive emphasis on sovereignty impose an important limit on governance of critical collective goods such as financial safety nets. Conversely, many states have disempowered themselves in the past by abandoning political responsibility for financial and banking regulation to the market players themselves. Meanwhile, multilateral institutions, designed in another age for other purposes, proved inadequate:

The IMF financed trade deficits and handled public debt crises. It was not in the business of filling gigantic private sector funding gaps. Its programs were denominated in tens of billions of dollars. It was not conceived for an age of trillion-dollar transnational banking.

(Tooze 2018, 206)

That – and the relative success of Asian development states in avoiding the worst in the GFC after 2008 – is not an argument to reject multilateral regional and global regulation. The Covid-19 induced economic and financial crisis is an unprecedented complex external shock with enormous global ramifications. It affected the centers of the network structure (and Asia has become more central than it was in 1997). In

the recovery the impact of nationalism on global governance will likely be exposed (Rogoff 2020).

### **3. COMPARING THE INCOMPARABLE? FINANCIAL CRISES IN THE EU AND IN ASIA**

Comparison between the EU and Asian crisis management is not straightforward as the two regions are very differently constituted. But there are important similarities nevertheless in the causes of the AFC and the GFC:

In each case the fundamental problem was one of perverse incentives and tendencies toward herding by financial-market participants that resulted in excessive risk taking and overinvestment in particular areas.

(Willett 2009, 118)

The EU was badly hit by a prolonged sovereign debt crisis whereas the Asian countries managed the impact of the global crisis through national stimulus measures and US liquidity provision (Tooze 2018). Importantly, Northeast Asian countries didn't have to rescue a common currency, an integrated financial market, or an integration project like the EU had to. They "only" needed to protect their national banking and corporate sectors and to some extent those of their main trading partners (such as ASEAN, hence the regional ASEAN+3 upgrades). They achieved that through national stimulus programs and with the help of the global liquidity provision by the Fed (Rhee, Sumulong, and Vallée 2013; Tooze 2018). Besides national measures, Asia reinforced its very weak regional safety nets built up after the AFC out of concern about contagion from the eurozone sovereign debt crisis and global instability. However, they were not used. Northeast Asia has avoided (for now) a sovereign debt crisis, although in all countries public debt (notably regional and municipal) has risen sharply due to massive, and in the PRC's case gigantic, stimulus programs launched in 2008 (IMF 2019; Tooze 2018, 243–51). Therefore one cannot speak of effective regional economic and political governance in Asia. Accumulated debt (from the GFC stimuli) has reduced the fiscal firepower in another liquidity crisis such as the one prompted by the global health emergency Covid-19 (Anderson 2020).

Despite obvious differences between the European and Asian cases, several economists have compared the two and concluded that the Asian financial safety nets are unlikely to be used in the next crisis. Based on the EU experience, Asian experts have called for a more structured and institutionalized cooperation in Asia (Rana 2017; Rhee, Sumulong, and Vallée 2013).

The EU was affected by the GFC in both similar and different ways to Asia. The European integration process, notably the eurozone, was deeply challenged, but was itself also a cause of the mutation of the global financial and banking crisis to the European sovereign debt crisis. Regional multilateralism, much deeper than Asia's, was subjected to a severe and costly stress test. But the multilateral fabric and the EU's multilateral development path did not unravel and revert to nationalistic ones, unlike, for instance, during the Eurosclerosis in the wake of the economic crisis in the 1970s after the Nixon and OPEC shocks. Instead, integration was reinforced despite the more intergovernmental tendency of the EU as a whole since the Lisbon Treaty (2010).

The EMU has revealed at least five deep flaws and weaknesses (Buti 2020; Priewe 2017):

1. divergence of inflation and real interest rates among EMU members (the most fundamental and most difficult to tackle);
2. too little, too late reactions of the ECB before 2012 and its enduring lack of competence to act as a lender of last resort;
3. excessive austerity at the wrong time coinciding with excessive debt;
4. a lack of centralized fiscal policy capacity;
5. insufficient (and before the crisis decentralized) banking supervision.

Asia does not have a currency union, and a lack of coordinated banking supervision and a lack of regional fiscal policy capacity (regional financial safety net) are also issues for the region.

Northeast Asia's multilateral mechanisms played more of a symbolic role than a real one during the crisis. In both the AFC and the GFC, the Republic of Korea was more affected than the PRC and Japan due to its openness and integration with the global financial markets (Tooze 2018, 256–61). Interestingly, the Korean case resembles the Greek one in one aspect: In both cases the joining of an international institution (the Republic of Korea the OECD, Greece the EMU) led to an uncritical lowering of risk category by banks and subsequently excessive inflows of capital (Wissenbach 2020, 146). The financial crisis revealed the real underlying risks and weaknesses of each country.

Asia's reaction to the financial crisis is comparable in some technical aspects to the EU's because there were efforts to expand and improve global and regional safety nets and macroeconomic surveillance (Rhee, Sumulong, and Vallée 2013). These regional mechanisms, such as the Chiang Mai Initiative (CMI), were created in the larger context of ASEAN+3. The "+3" (the PRC, Japan, the Republic of Korea) are the creditor nations and potential backstops (like Germany, the Netherlands, Finland, and others in the eurozone), but they are not full members of ASEAN where all three Northeast Asian countries have major trade and investment interests. Regional measures were only token lines of defense after national currency reserves and bilateral swap agreements, which are faster to activate and nationally controlled. They were not actually used in either the Asian financial crisis or during the global financial crisis due to major shortcomings in design (Hill and Menon 2012; Rana 2017; Willett 2009). In the midst of political rivalry there was little political will to conceive of regional institutions (Park 2013). Moreover, Asia did not have the type of institutional foundation of a regional single market like the EU or a currency union. Safety nets and financial assistance require financial solidarity and trust (Rhee, Sumulong, and Vallée 2013). Instead, national programs and bilateral assistance were preferred mechanisms, while the IMF played a central, but ultimately problematic, role notably in the Republic of Korea and Indonesia during the AFC with deep social consequences. As a result, the IMF has become associated with stigma, and at least in the Republic of Korea and Indonesia it had a major impact on democratic processes. This leaves the question of what would happen in the next crisis with no coordinated strategy and every country scrambling for itself. The situation for the EU is more predictable given that the EU has created preventive and defensive measures and monitoring and surveillance mechanisms both at macroeconomic and macroprudential levels as well as more integrated microprudential institutions. In Asia, where such measures are largely symbolic, the question is how long national financial policy can withstand both the integration and the potential disruption dynamics.

## 4. LESSONS FROM FINANCIAL CRISES

### 4.1 East Asia

The first proposal for a regional financial safety net came from Japan just before the AFC in 1996 (Rhee, Sumulong, and Vallée 2013). Japan proposed an Asian monetary fund (AMF) to limit the IMF's role and boost Japan's influence in the region (Park 2013, 95; Shu 2015, 98; Sussangkarn 2017). Japan underestimated the resistance by Washington and failed to enlist the PRC and this project failed.

After the AFC, Japan proposed that ASEAN extend the ASEAN Swap Arrangement (ASA) to include Japan, the PRC, and the Republic of Korea (ASEAN's three partners since 1999). This financial safety net relying on the currency reserves of the "+3" was called the "Chiang Mai Initiative" (CMI). The CMI was linked to the IMF at the PRC's insistence to counterbalance Japan's endeavor to use it to internationalize the yen (Park 2013, 100; Shu 2015, 98–9; Rhee, Sumulong, and Vallée 2013). The competition between the PRC and Japan impeded a truly regional multilateral solution (Park 2013, 87). Moreover, the CMI bilateral swaps were agreed in 2002 between ASEAN and the "+3" countries. However, both arrangements were strictly national in character and did not create a central institution where funds would be managed jointly or could be drawn upon quickly in an emergency. Furthermore, and as in Europe before the European Stability Mechanism (ESM) was created, the pledged funding was inadequate.

When the GFC hit Asia with a short-term liquidity crisis (capital outflows) the CMI failed the test, as the countries in need of liquidity support instead used bilateral swaps with the US, the PRC, Japan, Australia, and multilateral development banks (Hill and Menon 2012, 2; Rhee, Sumulong, and Vallée 2013). Therefore, the CMI was multilateralized in 2009 (CMIM) by repackaging the set of bilateral swaps into one self-managed reserve pooling arrangement. In 2012, during the eurozone crisis, CMIM participants doubled its scope to \$240 billion (the share that could be mobilized without an IMF program was elevated to 30%). In 2011, the ASEAN+3 Macroeconomic Research Office (AMRO) was set up to enhance surveillance. It took until 2012 for a joint ASEAN+3 meeting of finance ministers and central bank governors to take place (Hill and Menon 2012, 6). The new group launched preventive and precautionary credit lines similar to those created earlier by the IMF under the impulse of the G20 (Hill and Menon 2012, 6). The three Northeast Asian countries, in parallel to supporting the CMIM, set up bilateral currency swaps and bond-buying programs among themselves, but because of political tensions, the Republic of Korea, for instance, didn't prolong its swap arrangements with Japan.

The rationale for the CMIM was for the Northeast Asian countries to provide a financial safety net to their weaker ASEAN neighbors (in which they have all invested for industrial production (Hill and Menon 2012, 4). But it is not an Asian mutual assistance pool, in the way that the EU has embarked upon.

AMRO complements the CMIM with independent monitoring and analysis for due diligence to minimize moral hazard in the borrowing process (Watanabe 2018). So while these later financial safety mechanisms look more multilateral than those created after the AFC and have similar objectives to those of the EU, their structures are far weaker (Rhee, Sumulong, and Vallée 2013). The CMIM in its present shape is unlikely to be used or to be effective in a future crisis. It cannot be seen as a complement or an alternative to the IMF, even though that had been the ambition for its creation (Hill and Menon 2012, 7–13; Rhee, Sumulong, and Vallée 2013; Sussangkarn 2017). The ASEAN +3 arrangements mostly require a link to an IMF program and the process is slow as decisions have to be taken in each capital without empowering coordinating institutions,

which have correspondingly very limited personnel and resources and no institutional autonomy (Hill and Menon 2012, 4–5; Rana 2017). Not surprisingly, during the GFC, the Republic of Korea, when it chaired the G20 in 2010, promoted the idea of global financial safety nets rather than a series of regional ones (Rhee, Sumulong, and Vallée 2013).

The weakness of the Asian regional financial safety net is that it is still essentially an accessory to national currency reserves, programs and controls, and bilateral swaps, in particular with the US Fed. Functionally and technically it may be similar to the EU's, but because of these limitations the Asian financial safety nets cannot be characterized as a truly multilateral or regional institution. For Northeast Asia, this is even more so, because the CMIM and AMRO are focused on potential borrowers, with the “+3” in the role as potential lenders for ASEAN countries. For the “+3” countries the IMF link provides decidedly more assurance against moral hazard than AMRO. This is very different from the EMU, in which after the GFC the supranational institutions (European Commission and European Central Bank) were empowered to perform surveillance and supervision tasks for the creditor countries based on legally binding treaty provisions (Rhee, Sumulong, and Vallée 2013). Before the reforms during the GFC, the IMF was involved – after some controversy – in the large bailout programs launched at the beginning of the sovereign debt crisis. In the future, this may no longer be necessary (Buti 2020).

Asia's response to the financial crisis was intrinsically different from the EU response, relying on national development state approaches to solving international banking and debt crises. While successful, these self-help solutions only produced a weakly institutionalized regional or multilateral financial safety network, which looks almost designed not to be used (CMIM, AMRO). This situation leaves Asia's indebted countries vulnerable to another crisis.

## 4.2 European Union

What started as a financial and banking crisis in the US (also affecting EU countries as banking crises) mutated into a sovereign debt crisis in Europe. The EU – after providing balance-of-payment assistance to Latvia in 2008 – soon focused on a different problem to that of Northeast Asia. The focus on the Greek sovereign debt crisis and the dominance of its creditor countries in crisis management made the EU focus excessively through a fiscal lens (Buti 2020, 6). The reform of the EMU during the crisis was an incremental, long, drawn-out, and complex process. While institutional integration, multilateral policy cooperation, and coordination were enhanced, this was not a “crowning development” of stepwise integration (Balassa 1961). The advance in integration achieved during the crisis was more muddling through than design – not unlike in previous integration phases (Schimmelfennig 2018, 974). Critical analysts bemoan the inefficient and costly muddling through (Tooze 2018) or warn that there is “no exit from the Euro-Rescuing Trap” (Scharpf 2014). The trilemma between EU integration in some areas, national policymaking, and democratic accountability continues to haunt the EU amidst persistent high unemployment and tepid growth (Bellamy 2019; Crum 2013; Macaes 2013; Dauderstädt 2014).

During the crisis, decision-makers in the EU had to manage overwhelming market pressures. However, they are ultimately accountable to national electorates, not to financial markets. Crisis management affected major concerns of their citizens such as jobs, pensions, savings, education, and how to finance all this (taxes, debt). In this respect, the EU differs from the IMF, which faced no such democratic accountability constraints towards the citizens of Asian countries during the Asian financial crisis and imposed much more bitter conditionality (Wissenbach 2020, 161–2). Yet, the effect of

national instead of collective democratic accountability on the intergovernmental crisis management led to suboptimal measures at the expense of more structural reform (Buti 2020, 4) and to the imposition of austerity due to the bargaining power of the creditors. However, as in other areas of EU policymaking – such as single market legislation – the community method ensures an EU-level democratic accountability through co-decision by qualified majority voting among member states in the Council and citizen representatives in the European Parliament (Buti and Krobath 2019, 5). EMU reforms have to contend with better and more transparent democratic accountability involving the European and national parliaments. It is actually the tension between different national interests and accountability deficits for collective EMU decisions that have led to a crisis of citizen confidence in the EU (reflected in surveys and a surge of votes for Euroskeptical or anti-establishment parties and movements; Börzel and Risse 2018). Such tensions do not arise as much in other policy areas where the community method ensures fairer compromises. However, support for the EU and the euro remains high as the 2019 EP elections showed.

All EU crisis measures were taken through complex negotiations at different levels: There were different players, games, perceptions, and cultures involved (Schimmelfennig 2018, 977–8). Markets in particular were unpredictable and amorphous “negotiation partners” with their own games (Buti 2020). The EU was confronted with an overwhelming complexity of the political and economic context and the plurality of an imperfect multilateral polity. Multilateralism as such was thus a weakness compared to the crisis management by the US or Northeast Asian countries. Decision-making was by definition slower and less efficient than in a national system, especially in the intergovernmental mode. The EU performs better when decisions can be taken through majority voting in the Council and the EP, but consensus has been the rule for a long time (Bickerton, Hodson, and Puetter 2015). Powerful member states often determine the intergovernmental bargaining (Degner 2019). This difficulty of balancing multilateralism with national interests, market expectations, and accountability to citizens is also an important lesson for global governance.

The intrinsic problem of multilateral crisis management combined with a populist backlash have shown that taking decisions at European level on financial, fiscal, and economic policies requires strong accountability mechanisms to legitimize the decisions taken in common. US decisions with major implications for other countries are taken without consulting them – the G20 activation during the GFC was an exception to that national economic management. The EU (unlike the IMF and arguably to some extent national polities in Northeast Asia) has to organize democratic accountability and political participation commensurate with the far-reaching impact that EU decisions have on the everyday lives of EU citizens. This political crisis cannot be solved by harmonizing fiscal policy or creating a political union as the fundamental citizen consent for such a move is nonexistent (Bellamy 2019). This political challenge of legitimacy for risk sharing and collective decisions is thus a constant part of the context of managing the EMU and the reason for the much-criticized muddling through. The more critical popular scrutiny for European integration is a key factor that needs to be addressed in any reform endeavor after the intergovernmental decision-making has empowered nationalists (Wissenbach 2020, 75–94).

The EU overhauled the European regulatory framework that supervises banks, insurance, and security firms, creating a European System of Financial Supervision (ESFS) building on European-level coordination committees of national supervisors that had been set up just before the crisis. The Single Rulebook for supervision was followed by the Single Resolution Mechanism (the Single Resolution Board started operations on 1 January 2016). The new bail-in rules of the Bank Recovery and Resolution Directive

provide for the orderly resolution of banks and a burden sharing between shareholders and creditors, reducing the negative feedback loop between bank and sovereign debt further. The banking union has progressed, but still *“European banks are European in life, but national in death”* (Macaes 2013, 7). This quip describes the contradiction between a single currency and a single market for financial products and services and separate, national bank regulators (Eichengreen 2012, 129). The EU put a polycentric system in place that involves private actors (banks contributing to the fund), national governments/regulators (backstop in line with EU state aid rules), and the European financial safety net (ESM). The Single Supervisory Mechanism is managed by the ECB while the ESFS is managed by the European Banking Authority (EBA) (Kudrna 2016, 79). There is as yet no European fund for deposit guarantees, but EU rules on levels of protection exist. This shows the difficult limits of financial solidarity between countries (“transfer union”) due to moral hazard. The banking union is polycentric because of its transnational (banks’ funding), transgovernmental (network of regulators), and supranational (ECB) elements. The EU’s posture is far from perfect and has not addressed all the deep flaws of the EMU. Nevertheless, it has proven resilient and the eurozone seems in a better shape to face future crises.

Besides these regulatory reforms, the EU enhanced budgetary and macroeconomic surveillance. It created new or reformed existing institutions. All these decisions were made under pressure from the markets, the US and other countries, and the IMF (Tooze 2018). There were a number of constraints: the need for unanimous intergovernmental decisions on fiscal measures and reforms and the limited mandate of the ECB, the fragmented legal framework for financial regulation, and prudential supervision. Complex multilevel negotiation games, notably between creditor and debtor countries, made reform slow and inefficient, often at the expense of citizens in debtor countries, notably Greece (Tooze 2018). There was no time to change the EU Treaty to overcome these constraints. Moreover, that would have had to be decided by unanimity and validated through referendums in some countries. Such a course would also have reinforced the fundamental national differences, not solved them. They were partly papered over, partly addressed in substance instead of pursuing a new grand institutional bargain (Moravcsik 1993 on that integration technique). Therefore the EU reaction was suboptimal, but this was an international and multilateral political process not a centralized national one as in the US or the PRC. The slow, intergovernmentally negotiated fiscal response was facilitated by the ECB’s creative monetary policy: The ECB (slowly and against notably German resistance) moved beyond a narrow definition of its mandate and adopted “unconventional” and more complex monetary policy measures (Draghi 2015; Prieue 2017). A similar “division of labor” is emerging at the beginning of the EU’s economic response to the COVID-19 pandemic.

After the crisis, the European Commission proposed pragmatic measures to complete the EMU in December 2017 rather than politically unrealistic fundamental reforms. European integration has long been about the politically feasible not the theoretically desirable optimum (Bickerton, Hodson, and Puetter 2015). Even proposals that sound “revolutionary” such as creating a European monetary fund (EMF) and an EU minister of economy and finance are in reality incremental steps to consolidate the haphazard legacy of crisis management decisions. The legislative proposals by the European Commission are basically aimed at avoiding parallel structures through incorporating the intergovernmental elements into the normal institutional framework (including accountability to the European Parliament (EP) and judicial review by the European Court of justice (ECJ)). The EMF is simply but importantly (Rana 2017) anchoring the European Stability Mechanism (ESM) in the EU’s legal framework without changing the distribution key for member states’ contributions and its governance structure. The intergovernmental treaty (“fiscal compact”) of 2012 is to be incorporated into the EU

framework while the “finance minister” would just combine the existing remits of the Vice-President of the Commission and the Chair of the Eurogroup (the finance ministers of the 19 members of the eurozone).

The fundamental asymmetry between a centralized monetary policy and the lack of a centralized fiscal policy has perhaps somewhat narrowed, but still persists (Draghi 2019; Buti 2020, 7–8). This has been exposed again in the management of the economic impact of the Covid-19 pandemic. However, based on the lessons learnt from the sovereign debt crisis a decade earlier, the ECB did not wait long to do “whatever it takes” to save the euro and announced a 750 billion euro Pandemic Emergency Purchase Programme with almost “no limits” on 18 March 2020 (Lagarde 2020). This gave more time to EU member states to discuss various proposals for a fiscal response, which included hotly contested debt mutualization (“Coronabonds” or “Eurobonds”), the use of the ESM, and a strengthened central fiscal capacity for the EU in the guise of a European recovery program (Grund, Guttenberg, and Odendahl 2020).

## 5. CONCLUSIONS AND POLICY RECOMMENDATIONS

The two cases of Asia and the EU demonstrate the staggering challenge for global and regional governance of the globalized financialized economy. The tensions between national sovereignty, the need for democratic accountability, and the hierarchical structure of global finance and the interdependence associated with it make efforts to pursue international coordination in what is by necessity a polycentric governance endeavor very challenging. With all its limitations, the G20 coordination was more a step toward multilateral accountability than unilateral decisions – notably US monetary policy in the hierarchical network of global finance.

- 1) Regional integration/regionalization is essentially a political project requiring citizen support, more obviously so in the case of the EU. Asian regionalization in the past mainly happened through the formation of global value chains, low tariffs, and business networks (“open regionalism”). Nation state-led economic regionalism has been a conscious policy choice of individual East Asian states in response to the domestic transformations of government-business relationships to embrace globalization as the main objective (Shu 2015, 88). Society involvement, democratic accountability, and political integration were largely absent in this strategy. The crises in 1997/8 and 2008/9 showed that this nationalist model of the development state has been resilient, but costly (Kalinowski 2008). Asia as a whole, and Northeast Asia in particular, has chosen not to pursue a multilateralist development path despite the creation of some incipient regional mechanisms and institutions by ASEAN and its Northeast Asian partner countries. This is a major difference to the EU. ASEAN countries see each other “as rivals in their pursuit of exporting to the global market or attracting FDI” (Tangkitvanich and Rattanakhomfu 2018, 200). The EU and its member states see themselves as a team playing in the global arena. Asian countries are not inclined to go beyond hands-off regionalization and to address issues that require compromises on exclusive concepts of national sovereignty. This insistence on national sovereignty and cultivation of political rivalry between economically increasingly interdependent neighbors may at some stage have to change (Cheong 2020, 118). The comparison of the EU and Northeast Asia shows that the shape and efficacy of regional cooperation does not follow a particular theory but depends a lot more on deeper political structures and ideas such as nationalism and multilateralism, not just on trade and flows of goods and services (Wissenbach 2020). Multilateralism has found its most institutionalized



expression in the European Union. This is not to say that the EU is the only template for such regionalization, but it has the merit of having proven its value as a polity that – notwithstanding the “disastrous” management of the sovereign debt crisis – has successfully managed to create mechanisms owned by the member states to deal with global challenges and common public goods with a minimum of democratic accountability and solidarity. The EU is a laboratory for regional and global governance in its own right.

- 2) Both regions face the challenge of regional cooperation in a globally networked financialized economy (Oatley et al. 2013 for an analysis of that structure) and their respective policy instruments have proven inadequate in times of past crises, albeit for different reasons, since their instruments and institutions differ. Hence, these instruments have to be constantly retooled. This is not so much a question of economic theory (such as in OCAs, trade creation and trade diversion, and global value chains) but an issue of political will to determine how national sovereignty should be conceived of and to what extent it should be shared in an age of globalization and chaotic complexity (Wissenbach 2020, 11–27).
- 3) Both regions, in their respective ways, need to manage polycentric governance to synchronize fiscal and monetary policy (IMF 2020, 6) beyond the state (but also beyond multinational corporations and banks with their vested and parochial interests), something that is perhaps more challenging for nation state-oriented development states than the EU, which already has a polycentric polity that includes parliaments and other channels of accountability.
- 4) Both multilateral (EU) and national (Asia) crisis responses had merits and shortcomings, both worked more or less, both focused on similar issues: banking supervision, macroprudential reforms, enhanced surveillance and monitoring of fiscal policies, and financial safety nets for different lines of defense, to name just a few. Due to their different constitution, the form of these measures naturally differs between the EU and Asia. But after a crisis is always before a crisis... Preparing for the next crisis requires strategic reforms at multiple levels: domestic reforms (Nakamura 2018), global multilateral coordination and regulation (G20; Basle III), and reforms in regional cooperation (EU, ASEAN +3).
- 5) In a new period of disruption and unpredictability and “America first,” we can no longer assume that what worked during the GFC (Drezner 2012; Tooze 2018) will work again, as all the decisions were highly politicized and the outlook of the main player – the US – on the international order has dramatically changed. During the GFC one of the main (structural) reasons for Washington’s support was that the crisis affected the US itself as the center of global financial networks, whereas crises on the periphery (such as the AFC) have limited global repercussions (Oatley et al. 2013). In a new crisis, Asians or Europeans would probably have to rely more on themselves (and perhaps each other). And here, clearly the EU has enhanced its “economic sovereignty” – a main driver of European integration since its beginnings, by reforming the governance of the EMU. In Asia, because of de facto economic interdependence (and despite the insistence on national sovereignty), many countries are dependent on decisions made elsewhere, notably in Washington (and New York) and by their bigger neighbors, but they do not multilaterally coordinate fiscal and monetary decisions – for instance, as the COVID-19 pandemic hits the economy, the Republic of Korea may need bilateral currency swaps with the US and Japan that may be politically difficult to agree (Cheong 2020, 118). While in Europe some of the reforms, notably the banking union, are still construction sites,

in Asia even the foundations are not yet in place. In both regions, banking regulation seems essential to avoid the negative feedback loop between private and public debt wreaking havoc the way it did during the AFC, the GFC, and the eurozone crisis. This is all the more important as central banks in an era of near zero interest rates have little leeway to support stimulus measures through loose monetary policy, and because most countries in Europe, but especially in Northeast Asia, have accumulated very high levels of debt.

Thus there are important political and economic arguments for strengthening regional governance (and financial safety nets) in both regions to deal with the specificities in each region and for joining forces to improve global governance and global regulation of the global financial flows, which ultimately are more important than the trade flows (Tooze 2018, 206).

The COVID-19 pandemic is an economic crisis (external shock) with an impact on the financial system (the other way around to the GFC), but its consequences (sharp deep downturn, liquidity problems, market volatility, lack of trust) have prompted similar monetary and fiscal measures in Asia and in Europe, albeit in an environment of ultra-low interest rates and cheap credit. In Asia, the decisions have been strictly national. In Europe, tensions emerged again through the asymmetry between a Europe-wide monetary policy to provide liquidity and trust, with the ECB doing “whatever it takes” “without limits” to preserve the EMU, and the initially national fiscal measures (with the use of emergency flexibility clauses to avoid the stability and growth pact fiscal constraints) to stabilize national health systems, labor markets, and companies (Lagarde 2020). The EU still has no meaningful budget for its own fiscal measures and thus intergovernmental negotiations on using the ESM are necessary.

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