

Europe's Role in Global Governance and Challenges to East Asia / Korea*

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All of us are still under the shock of the unspeakable act of barbarism that filled our TV screens on September 11. A few commentators have claimed that these terrorist acts were somehow the symptom of the profound inequities associated with liberal globalization. Of course, this is totally preposterous. Nothing can either explain or justify the contempt of human life embedded in such atrocities. The reactions to these acts in some places, however, suggest that the set of values embedded in the pursuit of an open, liberal world economy is not universally shared and understood, that the standard of living reached in OECD countries is so grossly out of line with that in many places of the world that it antagonizes rather than attracts, and that, indeed, we live through a defining moment with respect to the evolution of the international system.

To be sure, the tragedy of September 11 acts as a revelator of a disease whose symptoms had been visible for many years already, through major dysfunctions of the world economy as well as through the recent failures of highly visible multilateral initiatives. Since the 1980s, severe financial and debt crises have imposed huge costs on many least developing and more developed countries, leading to the foregone conclusion that most of the world is not really mature enough to enjoy the promises from financial liberalization which actually makes it more vulnerable. Moreover, industrial countries have set to themselves agendas that they could not even implement, as demonstrated by the failure, in 1998, of the initiative to negotiate a Multilateral Agreement on Investment (MAI) at the OECD or, more recently, by the fiasco in Seattle or the failure of the Conference on climate change in The Hague. And, since the end of the 1990s, and most notably since Seattle, so-called anti-

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globalization movements have gained impressive momentum. Opposition to capitalism and globalization has been present for long, of course, but it has, recently, more authentically internationalized, developed an anti-globalization solidarity across various themes, and, ominously may be, radicalized.

Thus, the open, multilateral world economy is in danger, despite the fact that it has underpinned much of the world prosperity in the second half of the 20th century. Business-as-usual is not the appropriate response. We should remind ourselves that the previous episode of globalization, in the late 19th century, was finally undone through policy mistakes in the early 20th century, that this opened a sad period of conflicts and economic crises, and that it took several decades to restore a international framework more conducive to peace and prosperity. We should therefore interpret the recent setbacks as crucial policy challenges pointing to shortcomings in the current system of global governance.

What do we mean by “governance” ? Basically governing without a government. Global interdependence, in terms of economics or security, requires action at the national, regional and international level. Governance designates the institutions, practices, procedures, modalities through which such action can take place. It has several dimensions, from the nation state through regionalization to the global level. Subsidiarity, therefore, is an essential component.

In my talk today, I would like to discuss current global governance issues and the role of regionalization in Europe and in East-Asia in that context. I will end with a few recommendations to strengthen the global governance system.

1. Challenges to global governance²

I now turn to what I see as four crucial shortcomings in the current system of global governance and to the defining tension of globalization.

(i) A vision that needs reformulation

² This section draws from a joint work in progress on global governance with my colleagues Jean Pisani-Ferry and Laurence Tubiana.

For most of the post World War II period, free trade was the inspiring vision for industrial countries and, over the years, for a number of successfully developing countries. The free trade vision was buttressed both by economic theory, which emphasized its efficiency and welfare properties, and by high politics, which made trade liberalization one of the instruments to cement the Western alliance in the face of the threat from soviet communism.

These two pillars have now substantially weakened. The end of the Cold War has freed the economy from global politics, leaving the vision of trade liberalization stand on its own merits. This has exposed the simplistic way free trade is too often portrayed as a universal recipe for prosperity, and sold as a mechanic way to reach faster growth. Well, most often, it is through proper accompanying measures and institutional reform that benefits from liberalization can be reaped. Liberalization is certainly a means toward faster growth, more successful development and higher prosperity, but it is not an end in itself. Moreover, it produces net gains, but this should not obfuscate the fact that it also creates winners and losers. It therefore immediately interferes with the domestic political process through a democratic legitimacy and equity problem that it is up for each society to address. Small, developing countries that chose to open their economies become more vulnerable to external shocks, for example terms of trade shocks. This may be costly in terms of activity, employment, and, in the absence of social protection, poverty. It may thus also lead to exclusion.

At the same time, however, economic theory developed a more sophisticated approach to trade, looking at new situations of market failures and increasing returns in which efficiency may require public intervention. Of course, financial services and financial liberalization are a case in point : to reap the benefits, not only must a proper macroeconomic and exchange rate policy be in place, but regulation and supervision must also be effective. Most of the financial crises that happened in the last two decades point to deficiencies either in policies or in domestic financial markets. This has a profound impact on the nature of trade negotiations, which the move towards services has already somewhat illustrated : the game is no longer exclusively about dismantling barriers and exchanging concessions, but increasingly

about finding the proper mix of government and market regulations, negotiating mutual recognition agreements between norms and public policies, and defining what could be called the “efficient” opening of markets.

To be sure, this certainly does not support protectionism. Even in the limited number of cases where economic theory may come in support of protection, political economy will not, not only because it may invite retaliation, but also because any protection or regulation represents a potential hindrance for innovation and productivity gains. It leads also, more often than not, to giving rents to those who receive it, thus creating inefficiency and social inequity. Moreover, once in place, it supports a category of agents who will lose much through its dismantlement and will therefore organize themselves to maintain it. This is where the most important benefit of liberalization lies: it puts an ongoing pressure on existing protection, makes it contestable, thus allowing to use it as a temporary, efficiency enhancing measure, because people know it will not last. Liberalization thus appears as a powerful engine for change.

Obviously, what matters is the process of liberalization, more than the end result of “free trade”. It is a process that allows to use competition and the foreign constraint to continuously adapt the scope and methods of protection and of market regulation. It is therefore intimately linked with domestic reform. For all countries, especially developing countries, further opening one’s economy is an exercise in domestic reform, and this is where the largest benefits lie. When reform does not take place swiftly enough, liberalization may rather expose the weakness of the economy and increase its vulnerability.

Of course, this vision is not the conventional wisdom about the benefits from trade; nor is it propelled by rich and advanced countries, already very open, and in which industrial lobbies militate for opening third markets. One of the challenges of multilateral trade negotiations is to focus on the process of liberalization rather than the end result in terms of the degree of openness. It requires political will and vision.

(ii) A crisis of global leadership

Traditionally, the leadership of global governance finds its source in the so-called “club-model” whereby a limited number of countries shows the way forward and prepare the agenda and the decisions that others will be invited to follow. In international trade, leadership was thus aptly produced by the United States and its allies in the Quad group (Japan, the EU and Canada). In international finance, it took place similarly between the most powerful economies, through their ministers of finance. This club structure is also reflected in the G7. The club model is a source of efficiency in decision making given the number of potential participants: it is hard to see how to take decisions between more than a hundred countries. However, it necessarily biases the scope and nature of decisions toward those which are felt to be most in the interest of their proponents. One of the elements of the North-South gap which has reopened in the last five years stems from the limits of the club model. Not only does the club itself expose the differences between its members, but it also alienates those, in great numbers, who do not belong to the club and are increasingly less willing to submit to an agenda that is not theirs or to decisions that are pushed by dominating countries.

This is an area in which efficiency and legitimacy seem to oppose each other. The dilemma has now reached all aspects of multilateral decision making, between governments and within multilateral institutions such as the WTO.

(iii) Unbalanced institutional architecture

The current international architecture does not reflect the hierarchy of current issues. For example, environment or health do not have the institutional basis that their importance would deserve. The ILO is the guardian of labor rights and social standards, but it is a weak institution. The institutional architecture is naturally biased toward trade and economic efficiency concerns. This indirectly affects the legitimacy of the WTO as a number of critiques question the bias in international collective decision making that implicitly gives trade the priority over other dimensions of global public goods. Admittedly, this imbalance is hard to redress. There are increasing returns in international negotiations : once the structure is in place, the negotiation can proceed more easily. There is a long-time culture of multilateral negotiations between trade ministers and governments that gives trade negotiations a

comparative advantage over other sets of negotiations. Moreover, trade is an area where implementation of commitments can be based on effective sanctions, which also gives trade a comparative advantage in the development of a quasi-judiciary order.

(iv) The democratic conundrum

Finally, the legitimacy of international decisions by governments and multilateral institutions seems to be increasingly questioned. In traditional democracies, this legitimacy comes from the legitimacy of national governments, who negotiate with other governments or who delegate to multilateral institutions a specific mandate in a specific area. However, citizens in many countries increasingly feel that the locus of decision making has shifted away from the national government and that they are increasingly deprived from their democratic power of control and influence. This problem is here to stay, and points to that of the political status of multilateral institutions. It is not enough to delegate to multilateral institutions a specific, technical mandate. There is a natural mission creep that takes place, due to the fact that institutions have to react to new situations, and have to take into account issues that are not dealt with in other institutions. Whatever their original mandate, therefore, multilateral institutions tend to become complex actors intervening in a complex array of issues and interacting with each other, eventually behaving as political actors without the control of the national governments which gave them the original mandate.

Part of the solution to this difficulty hinges on national governments better playing their roles as shareholders in multilateral institutions. Part of it, too, has to come from inventing a more legitimate way to exert global political leadership than the G7, since one needs a political structure at the top to rank and focus priorities and to solve potential conflicts.

(v) The defining tension of globalization

Global governance also needs to take into account the central tension of globalization, namely the tension between forces of fragmentation on the one hand

and requirements of solidarity on the other. Indeed, globalization can be measured through the increasing integration of the world economy. At the same time, however, what is really conspicuous is the extent to which the world economy remains in fact fragmented. The pace of integration has hardly dented that fragmentation. All economic studies confirm that frontiers do have an economic impact. For example, it is well known since the work of McCallum that Canadian provinces trade between themselves 20 times more than with the neighboring American states. Similarly, within the EU, the single market has brought this ratio down from 20 to 12 : regions within countries trade between them a volume 12 times larger than with the neighboring regions of other countries. And this occurs despite the fact that member countries, as well as the US and Canada, maintain between them a regime of free trade.

Fragmentation also appears through the diversity of national collective preferences. It suffices to look at the weight of the public sector in various countries, or the way people rely on the State versus the private sector, or the attitudes with respect to risk and the measurement of risk, or yet the weight given to redistribution concerns in various societies, to realize that globalization has not produced the feared homogenization of preferences, sometimes to the contrary. All this means that the State is bound to remain for the foreseeable future a very relevant level of regulation.

At the same time, requirements for solidarity have emerged. First, new global issues such as the environment, or public health, or the fight against international crime and money laundering have become increasingly important issues in managing globalization, even though the format for dealing with them has not been fully designed yet. Second, recent anti-globalization movements, which in fact generally are not really anti-globalization but rather oppose the current way globalization is, or is not, managed, signal the emergence of something akin to a world civilian conscience aiming at providing the system of global governance with checks and balances. In my country, for example, most of the anti-globalization movement feeds more on an acute perception of world inequalities than on purely domestic concerns with the impact of globalization.

2. Regional or global solutions ?

The question to be asked should not be whether solutions to the problems mentioned above should be found globally or regionally : whatever the answer, both dimensions coexist and will coexist. The real challenge is how they interact, and what the implications should be at the multilateral level.

In fact, regionalism has been a powerful trend since the end of the Cold War. High politics during the Cold War had ignored geography. Proximity was defined not in geographical terms, but in ideological and political terms, and that is what also drove economic relations. Naturally, the end of the Cold War has also meant a return of geography, leading to de facto regionalization through increased trade flows in many parts of the world. This de facto trend has also led to conscious policies to try to promote regional integration, sometimes as a response to disappointing results at the multilateral level. In the discussion about regionalism, one finds two polar views : one sees regionalism as leading to a world of autarkic fortresses; the other one sees it as building blocks buttressing multilateralism. I stand with this second line of approach, even though I fear that regional dynamics may sometimes absorb political energies that might be employed to advance the multilateral agenda, and I also think that the multilateral framework must be consolidated in order to accommodate regional diversity. But there are many reasons to expect regionalism to be a very useful contribution to managing global interdependence.

(i) Asia versus Europe

Regionalism has been on the rise in Asia recently. The financial crisis of 1997-98 has exposed weaknesses in domestic policies and institutions and left Asian countries with the feeling that the international financial system was not able to provide adequate support in such cases³. They have started to intensify regional policy cooperation and to develop regional institutional capacity. Moreover, the paralysis in the WTO has led many governments to focus on regional and bilateral approaches,

³ Wendy Dobson, « Deeper integration in East Asia : Regional institutions and the international economic system ». Mimeo, Toronto, Rotman School of Management, 2001.

leading to a multiplication of Free Trade Area initiatives at the sub-regional level within the APEC-sponsored liberalization process, from the Asean FTA (AFTA) project to a study of a Japan-South Korea FTA. ASEAN+3 (the ASEAN 10 + China, Japan and South Korea) has been developing tighter links and cooperation. There is a long list of proposals on the table, in bilateral and regional trade deals, regional financial arrangements and prevention and management mechanisms. Some proposals for regional monetary integration have also been floated and studied.

It is interesting to confront this recent experience with Europe's long standing process of regional integration⁴. On the face of it, the two processes are very different and should not be compared. Nor should European integration emerge as a "model" to emulate, even though it takes the center stage in any study of regionalization because it is the most advanced and successful experience to date and has survived the test of time and acquired its own dynamics. But it is important to recall that European integration has been the product of very specific historical conditions. After World War II, there was a widespread interest in trying to organize governance beyond the Nation State, notably in Europe. In that context, European integration pursued a threefold purpose : reconstruct the economy and restore market mechanisms, create a framework to promote reconciliation, and secure regional cohesion in the context of the emerging Cold War within Western Europe as part of the Atlantic Alliance.

Hence, European integration has been from the start very consciously pursued, for motivations largely beyond economics. A large weight was placed on the role of regional institutions, with the Monnet method implying an interaction between an intergovernmental process and institutions promoting the sharing of sovereignties. In contrast, if one excepts ASEAN, regionalization in Asia has been so far driven by a de facto, market driven rise in economic and trade interdependence and remains a fundamentally intergovernmental process focusing on economic cooperation. Even ASEAN, which emerged as a regional arrangement to promote regional security, has remained an intergovernmental process aiming at restoring mutual trust short of infringements on national sovereignties.

⁴ See Ben Rosamond, « Regional Integration in Europe and Asia », mimeo 2001, ASEF University Library.

A third major difference, beyond History and the institutional approach, has to do with the meaning of the “region”. Of course, the question is not settled in Europe, where the regional geography still remains open, as demonstrated by the debates on enlargement. And, during a few decades, they were competing regional European arrangements. However, what drove the process of EU integration was the existence of a core group of countries taking the lead and managing both deepening and widening. By contrast, Asia is beset by competing geographies, from North-East to Central, South, East and South-East. Asian countries also exhibit a marked tropism toward the US economy – hence the relevance of APEC-. Finally, although the EU is an exercise in managing diversity, it can be argued that diversity is much wider between Asian countries, about cultures, relations to models of capitalism, religions, levels of development.

(ii) Lessons from Europe

Nonetheless, the comparison can be useful in highlighting some of the deeper questions raised by regionalism. I wish here to emphasize 5 characteristics.

(1) Even after more than four decades, the major drive of EU integration remains the national interest. It proceeds through projects whose specific benefits can be identified, explained and can rally support from public opinions and governments. This is why it is always difficult to discuss voting procedures or institutional design per se. Regional identity emerges through concrete steps of tighter cooperation, that invite limited delegations of sovereignty perceived to be welfare improving to institutionalized common bodies. The genius of Monnet was in understanding the virtues of this slow, gradual but concrete approach.

(2) Europe is not only, or may be even mainly, an exercise in “integration”: it has been an exercise in managing differences and fragmentation in the context of tight interdependence. Or, to put it differently, an exercise in how to allow national identities to prosper while exploiting the benefits from economic interdependence. This relates to the central tension I mentioned above. This is, in my view, one of the most important successes of the process of EU integration, namely its capacity to

create unity from diversity without infringing on that diversity. Some may find it frustrating because our integrated Europe does not resemble a Nation State. But it is no small feat.

(3) In that sense, EU regionalization has been an experiment in methods to structure governance without a government, an experiment in what came to be called “positive” integration by opposition to the “negative” integration simply based on dismantling all barriers to trade. To be sure, much remains to be done, but European countries have gone further between themselves than is the case globally. The integration process has produced promising concepts, such as mutual recognition : the idea that conflicts between standards can be addressed by minimal harmonization (to avoid intense conflict) together with the recognition of differences (comparable to a peace clause). This was central in the creation of Europe’s single market.

Policy competition has been quite central in conducting this experiment. For example, one can interpret monetary union as the outcome of a competition between national monetary policies that was finally won by the Bundesbank way of conducting monetary policy. This competition really started in the 1970s when European governments tried to contain exchange rate fluctuations between themselves. It amplified in the 1980s under the regime of the European monetary system. Competition produced a gradual convergence between the monetary cultures of member states. Weak currency countries, such as Italy, or for that matter also France in the early 1980s became convinced that the proper way to conduct monetary policy was through an independent central bank with a clear and exclusive mandate of fighting inflation. While life within EMU might occasionally lead to questioning this precept, it is this convergence that allowed to proceed to EMU. In effect, monetary union in the end amounts to conducting a single monetary policy and could not have taken place if the tenets of monetary policy had remained divergent among member states.

This experiment in governance is by no means over : much remains to be done in terms of governance at the EU level. For example, the EU has been quite successful in creating rules of behavior that its member states commit to (for example, the

Maastricht criteria). But it has been less convincing in creating a culture of policy coordination through which something such as a “European policy” could emerge. In many cases, including macroeconomic policy even after monetary union, Europe is a framework, not a center for policy elaboration.

(4) Regionalism is a powerful engine for domestic change. For a number of EU member countries, EU integration has been consciously used as the engine of domestic reform. This is notably the case in Spain or Italy, but also in France. There are two ways in which regionalism can perform this task. First, it contributes to the legitimacy of the reform process, by making decisions appear as collective decisions of several countries rather than the single isolated decision of one political party currently in government. Second, it provides for a commitment cum monitoring and peer pressure mechanism, helping national governments to resist hostile interest group pressures likely to oppose reform even after it has been decided.

(5) Regional economic integration gives shape to the regional entity but does not per se lead to the regional entity becoming a unified political actor. It does produce *some* political integration, since it provides, in the EU case, for sharing sovereignty in many areas of decision. But the idea, very common in Europe, that economic integration, culminating with monetary union, would lead to political integration has been found wanting.

(iii) Regionalism and global governance

It is of course not always the case that decisions need to be taken at the global level. Sometimes, they will be better left in charge of the local, or the national level. In some cases as well, the region – or a group of neighboring states- may well be the proper locus : regional peace, environmental issues (for example linked with water supply), are examples of regional public goods. A simple subsidiarity argument therefore suggests that regional decisions may be most efficient. Moreover, regional governance itself is an exercise in subsidiarity. Regionalism may therefore help the quest for the proper level of decision making, thus contributing to global governance.

There are several other ways in which regional integration can breed efficient decision-making. First, the number of actors involved in the region is much less than the total number of actors needed to take a multilateral decision. It is customary to fault the EU Commission for a cumbersome decision making process between 15 member states, and to fear the consequences of the forthcoming enlargement of the European Union to Eastern and Central European countries in terms of further overburdening this decision making process. Obviously, the situation is much worse between the 140 members, one-country-one-vote, of the WTO. This is why the “club model” has been extensively used (its counterpart in the EU is the Franco-German couple, whose legitimacy also often comes into question). But clearly, decision making at the regional level is more palatable. For countries interested in liberalizing their economies, the regional route may appear more promising than the WTO, especially since the second half of the 1990s, when it appeared that the momentum of multilateral trade negotiations would be hard to revive.

Second, regions may help in structuring global leadership. The only way forward to reach multilateral decisions still is the club model. To make it more legitimate, the club must incorporate the interests of a much wider set of countries. It could consist in countries representing regional approaches, not unlike the role played by the EU through the common trade policy of the Union. This, of course, raises the question of the external representation and policy of the region, an issue that even the EU has been unable to solve so far, except on specific issues such as trade policy, or, since monetary union, monetary policy. Nonetheless, this could be one of the global benefits from regionalism.

Third, regional approaches may sometimes be better than one single global approach, as it allows for competition – or cross-fertilization- between various approaches and can lead to better policies. This relates to a point I emphasized earlier, about interpreting regionalism as a laboratory for managing interdependence, in which there is a learning and discovery process that can benefit from benchmarking with other regional experiences.

Fourth, as emphasized above, regionalism is a useful instrument of domestic reform. Once committed to decisions at the regional level, inviting monitoring and peer

pressure, domestic governments are in a better position to resist to domestic groups opposed to reform. Of course, a multilateral commitment will have a similar effect. For example, one of the reasons behind China's desire to join the WTO is that it counts on its WTO commitment to help it pursue what promises to be a difficult path of domestic reform. However, in many cases, it is easier to reach a decision at the regional level than directly at the global one. Hence, regional integration will also prepare countries more efficiently to the requirements of an open world economy.

For regionalism, however, to deliver these benefits, there must be a vibrant multilateral framework maintaining close cooperation between countries and regions and organizing at the global level mutual recognition, the adoption of common rules, and collective action when necessary. This is why regional integration should never be construed as an alternative to multilateral action. It is crucial that both dynamics proceed simultaneously. This requires a lot of political energy. It also means that progress at the WTO is one of the keys of successful regionalism.

3. Conclusion : Asia and Europe. Partners in governance ?

Where are we after this discussion ? I would like to conclude with three ideas.

(i) I think there are a lot of benefits to expect from a dynamic, open regionalism in Asia. First of all, regional integration in this part of the world will boost domestic reform. It will also nurture new ideas about how to manage interdependence, and we can all learn from new experiments, especially if one considers that the world institutional structure was established in the context of the post world war II period. What will happen in Asia will take place in a totally new context and is likely to bring a significant contribution to the evolution of the world system. This being said, however, the path toward regional integration in Asia is fraught with difficulties given the diversity of the region. Open regionalism is a fine idea. From the EU experience, however, one could think that regionalism will start from a small group of leading countries embarking on an ambitious common project involving "positive integration" and showing the way forward. One of the problems with FTA is that they do not lead to a sense of a regional policy.

(ii) ASEM – Asia Europe Meeting – is a unique framework in which to discuss a shared doctrine of global governance. If done seriously, this could provide a base for global leadership on these issues. From my earlier discussion of governance, I think that three directions would deserve further discussion and would benefit from a closer cooperation between Europe and Asia :

- How to structure political leadership at the global level ? What could be the proper membership of a “club”, more legitimate than the current G7 but effective in moving things forward ?
- How to rebalance the international institutional structure so as to better reflect current priorities, for example by creating a World Environmental Organization ? How to give more “teeth” to existing multilateral institutions that blatantly lack the power of inviting and enforcing commitments in many important areas, including labor.
- How to construct a world order in which developing countries, notably the poorest, have a greater voice and share more of the benefits from globalization? The question is not only one of development aid, be it in terms of volume or in terms of nature and quality. It also requires a more forthcoming attitude from the North, notably in terms of market opening, and a conscious effort to associate the poorest countries in the decision making procedures at the international level.

(iii) Whether the WTO ministerial scheduled in Doha next month takes place as scheduled or has to be postponed is probably still uncertain given the current context. But whatever the decision taken, it is an important meeting that should not be taken hostage by terrorist acts. We should not make a fixation on the date and place, even though one might argue that it is even more important, today, that the meeting takes place as scheduled and in Doha. What matters is that it eventually takes place and makes progress on the launching of a new round. Yet, even before September 11, the outcome was uncertain. Many gaps still need to be filled, most notably between the “North” and a number of vocal countries in the “South”. Finding a common ground will require political will and wisdom. Being from Europe, I think that for this round, consistency is more important than a new ambitious opening. World trade needs consolidation in two ways : first, anchor what has been done already in a stable, credible set of multilateral rules accepted by the largest number; second, provide for

a more satisfactory interaction between this set of rules and other dimensions of international interdependence. Insofar as the WTO is concerned, I think that the EU is right to recommend the inclusion of competition policy and of direct investment issues. But, as I argued earlier, the international community must also make progress in other areas, such as labor rights, health, crime and environment, and in order not to burden the WTO with such issues through focusing on their interaction with trade, other places must be found where they are seriously addressed and where international cooperation eventually delivers.

Questions and Answers

Q: You first raised the question, rhetorically, why should we have regionalization. You mentioned about the difficulties of dealing with the several small number of the members making all the decisions. I would put it slightly differently. First of all, I'm beginning from the premise that in free trade all is preferable. On that basis we look to the WTO for a multi-lateral progress, which is, frankly, impossible. If you hold a town meeting of 150 people, you have a problem getting any agreements. And when those 150 people in turn have so many diverse interests to represent in their own economies, you don't expect the WTO to be able to make any progress in trade agreements. And therefore the only manageable way to do that is like corporate organizations: if you have too many divisions, you have groups. Therefore we do need a kind of intermediate organization, such as regional organizations, which can then have ideally, let's say, three or five in the world. They in turn manage their free trade agreements within their region, and then the regions themselves get together. The problem is how they get there, particularly in areas like Asia. Europe took 50 years to get where they are, and we have more diverse and more different problems than Europe has. But I would say in about 50 years we might get there, with luck. That is my first position, that unless we achieve certain meaningful regionalizations,

progress toward free trade has actually stopped; we can't make any forward progress or expect to make any forward progress

The second question I'd like to raise is, we all like to see progress and growth. But that does not mean that there are economic inherent reasons that we're going to have growth. Perhaps we reached that point in Japan. You mentioned that there is no more alternatives for monetary or fiscal measures that they can take, and they have been doing this for ten years. Sometimes we blame their lack of dynamism or commitment, but in effect in small bits and pieces they have done everything they can actually do. The question now to raise is, is there any inherent reason that Japan can't grow any further from that? And my second point is, Europe's growth, you mentioned, they are not dynamic. Once you have the single currency, it is natural that you have to control the inflation. And that has to be the primary objective of monetary policy, otherwise a uniform currency cannot hold. Then obviously you cannot have stimulus policies based on the control of inflation. In effect you are resigned by having the uniform currency that you're not going to have growth policies.

A: Well thank you for affirming the possibility of speaking two hours more. Your first point, basically, if I understand you well, is that Europe's present is your future. I don't know. I don't know. As I said, we have to be very open about the evolution of the world economy. Perhaps the solution we found in Europe to deal with a very specific historical set of circumstances are not going to be the same solutions as the one that are going to be found by others to deal with interdependence in a different context. You should keep in mind that this context is also different from an economic point of view, which is that we are living in a world in which economic returns to scale are much more prevalent than they were at the end of World War II. This is due to the rise of services; this is due to the rise of new technology. Which means that free trade may not be any longer the kind of optimal solution that economic theorists had in mind after World War II. In particular, if you take financial services, free trade is part of the construct that you want, but what matters more is efficient markets. And in financial services where you have returns to scale, and other sorts of market failures linked to imperfect information, regulation is needed. So freeing trade without a proper set of regulations can be very costly. So I would argue that the rule of the game in negotiations in this kind of products, in financial services, is not about freeing trade. It's much more complex. It's about finding the proper interaction between

market regulation and public regulation, and finding the proper kind of public regulation that you want. This is very, very difficult. You could argue that we don't need to argue that at the international level. Just do it domestically. But then, if that is the case, you should do it domestically before you undergo free trade, not after that. So you see? I see the current interdependence as really the necessity to negotiate more than dismantling barriers, which we call in Europe positive integration, by your position to negative integration. Negative integration is: you dismantle everything that prevents exchange from taking place freely. Positive integration you do something more, which is to devise sets of policy, sets of standard. In the current world, even for a liberal economist, public intervention can improve efficiencies. It will not always do so. But it will do so each time it *can* do so, each time you have market failures. And you have abundant market failures. Each time, information plays some role, and this is very, very prevalent in all the new economic sectors. So I would argue that free trade areas are not the answer to that problem. They are a limited answer. They will not bring you very far. And that is why I think regionalization has to be something else than simply an FTA, but it's a personal view that I'm sharing with you here.

Your second question was on growth. First, there is a philosophical aspect there: do we need growth? Depending on your philosophy, the answer could be yes or no. My answer is yes. And yes because my view of human nature is that we always want progress, however defined. And I think that technical progress has been with us for years. And technical progress, most of the time, translates into productivity increases and higher long-term growth. Therefore, growth is with us and I think it should stay with us for the foreseeable future. Now the second this is measuring growth. Do we measure growth well? Again, my answer would be no. I would like to have economic statistics that take into account, when GDP is measured, the deterioration of the environment, for example. I think that would make a lot of sense, philosophically. Now, statistically we are not equipped for that yet. But what is interesting about these negotiations about the environment is that gradually we are learning how to give a value to these goodies, and once they have a value they will be in GDP. So in a way we are moving forward to a better definition of growth, and that is something that makes me optimistic about all economics.

Your third question was about Europe and inflation. Well, first of all, I am from France. One of the paradoxes of France is how could it achieve this high standard of living with the kind of government and economic policies that it has had for decades.

And I have no answer, because we have no risk of inflation ahead. So, again, stable prices are stable prices. It doesn't mean necessarily declining prices or prices that grow less than 2% a year. So the definition you give to stability of prices matters a lot, and if you think about how inflation is measured, you will discover that the precision with which we can measure the rate of inflation is probably plus or minus one percent, so, again, we should probably not be too dogmatic about what stable prices mean.

Q: I'd like to make three very, very short questions. My first is a general comment and question. I studied at The Hague at an institute for social studies back in 1959, and I fully agree with your statement. But if I understand, the globalization, in a classical sense, will be retarded by Sept. 11, and the IT industry will get a break because of this war. Do you agree with me? The second question is concrete. In November, in Asia, China will join the WTO. Do you think this is the upgrade of globalization in the sense of trade and other things? The third question is, since the U.S. will spend a lot of money, as in Vietnam or the Gulf War, of course the EU will support some of the financial burden, but in the due course of a middle- or long-term war going on, the U.S. dollar will weaken and the euro will strengthen. Do you agree with me?

A: Well, let me start with the third question. For about three years, I've been arguing that the dollar was overvalued. I'm still waiting for the dollar decline. This, again, to illustrate why God created economists. You all know why God created economists? To make weather forecasts look good. But, I would agree with you that there are powerful indications the euro is bound to go down at some point. I'm still waiting for that point. The question is, going down against what? It seems to me that the sentiment of market investors in the world is still biased in favour of the U.S. economy. As a European, I would argue that market investors are wrong and they underestimate the chances of long-term productivity growth in Europe.

But I might understand why. It is true that Europe has some trouble getting its act together with respect to how to generate long-term productivity growth. That is bound to happen through structural reform and many countries in Europe have been a little bit slow in that respect. I think, for example, a good idea in Europe would be to have a joint tax cut financed over time by gradually phasing in spending cuts so you

keep a balanced budget; Tax cuts geared to promoting entrepreneurship and so on. So we have a solution.

But as long as we don't do that, I can understand why through a sort of effect market investors are still very influenced by the differences between the dynamism. Even now, during the recession of the U.S. economy and the prospect of other economies, again, I can understand it. It doesn't mean that I share that. So they market changed their expectations, you'll have a big decline in the dollar and a strong rise in other currencies, probably including the euro.

Your second question about China joining the WTO and would this push globalization and trade and so on. I think my answer is yes. Definitely so. But we shouldn't fool ourselves. Most of the discussion I have seen of China joining the WTO has been on the impact of WTO membership on China. It is an interesting question. But it doesn't answer a fundamental question, which is what will the impact of China joining the WTO be on the WTO itself, that is on the way we try to govern globalization, on the way we see the role of trade rounds, the objectives of trade rounds. I think that the politics of it is going to send tremors. You don't add more than 1 billion people to a framework without changing the framework, and you can be sure that the Chinese government will try to promote its own visions. Maybe not in the short-term, for in the short-term adjustment will dominate domestic politics. But over time China will be a major player, and for globalization this is a good thing. How could we speak of globalization without China?

Third question: will Sept. 11 retard globalization and break IT? Probably yes. But I think, again, there is a lot of uncertainty about what Sept. 11 means in terms of threat to the world, not economy, but to world security, and how responses to that will have to evolve. But I think the central scenario is we will have a rebound. IT was not only a bubble. It was a bubble, as all innovations are and should be → can't imagine financing a sewing port with a set of obligations without a financial bubble—but beyond the bubble you have very real products that are bound to increase productivity. We'll see the effect. There will be a new trade off between opening your economy and mounting security. This new tradeoff will probably imply some setback from the current seamless web of exchanges, but I think it's going to be perfectly manageable. But I don't have a crystal ball; it's a judgment

Q: In connection with your European productivity growth, you did mention that there are winners and losers in relation to free trade. Certainly free trade involves structural adjustments, and therefore there are certainly, in the short term, losers. But if you ask Milton Freedman or any Chicago School people like that, they will tell you that the market will take care of that as long as the labour market is flexible enough. In the short term we do have losers and that's why need social safety nets and everything that goes along with that.

But what is the most important problem to the EU's economic dynamism? If you ask Milton Freedman, again, he would definitely say the rigid level. But in your view, if there are any critical problems, what are the problems in comparison with the United States? The U.S. probably has income distribution and other problems. But in terms of the speed of adjustment, it's much faster there. So don't you put much weight on the problem on the side of the inflexible, rigid labour market in Europe?

A: These are difficult questions. Let me start with your remark on losers and winners. When I teach elementary economics, I sometimes play a market game with my students. I have two groups of eight students each, and in each group I have four producers and four consumers. One group is a high-income country with high costs, and the other represents a low-income country with low costs. Originally these two groups play in an autarky. They discover, then, that the market coordinates the action and they converge on a market price, which has very interesting virtues. Once this is done, I open trade between the two and the sellers in the high-cost country suffer and the consumers in the high-cost country win. And the consumers in the low-cost country suffer but the producers in the low-cost country are very happy. Then once I have done that, I have them vote about free trade. The vote is always eight against eight.

In such a world, you don't decide free trade even if you could argue that the total amount of winning gains is enough to compensate the losers. This is what politics is about. Any economist ignoring that is not doing service to the cause. It's not enough to say that free trade generates resources that are going to be able to compensate the group. The difficulties are that we don't really know how to weigh the policies about distribution to the losers. When we do so, we create rents and we create behaviour that captures these rents—and this is not exactly efficient—and this,

I think, is the serious problem in liberating trade. If we are serious about it, we need to answer these questions, and these are very difficult questions.

Now what do we need in Europe? Again, here, what I would say is, I'm against any recipe. At all points in time we find people giving you the "recipe" of progress, and it's true that in Europe, now, they'll say in that recipe, "Free your labour markets." Well, again, entrepreneurship, general behaviour for prosperity growth is a product of the complex interaction of many, many factors. It is true that the flexibility of our labour markets can be improved. Would that be sufficient? I don't know. I would, again, argue that we should improve it, but I'm not sure that is the response you want to have when you ask what is the most central program of EU dynamics? Well, I would say it is the ability to change at the opportune time.

We are living in societies that don't change fast enough. Change is needed to engineer growth, and let change happen; let societies define themselves. That can be best done in an open economy where you have the challenges of competition.

In Europe we have been very good at creating instruments: the single market, the single currency. But we are much less good collectively at using these instruments and basing prosperity on them. This is a policy question and we have not been very successful at coordinating policies, in moving. Actually, instead of doing that we are encapsulating policies into frameworks of rule, like the Maastricht Criteria. I think that is not the right way to see the world, but again it's a very personal judgment. There is no single answer.

Q: In your remarks, you mentioned the presence of protection among advanced countries as one of the problems. When I hear about protection in Europe, I'm reminded of agriculture in France. How serious is the problem of agriculture protection in France and what will happen to that? How would your country go about dismantling that, if it is to be done?

Secondly, you said that European integration seems to have lost a sense of purpose and you expressed your concern about it. Now, in the area of economics, in terms of integration, what further can be done and what would you hope to see happen further, beyond what we've already seen including the successful launching of the euro?

Another question, you said European integration has been driven by political purposes. Now, we know that integration is happening elsewhere as well, especially in the western hemisphere. Does the European experience apply to this; that is the presence of political motivation? I doubt whether that is the case. If it were the case, how would you explain the dynamism toward regional integration in the western hemisphere or elsewhere, such as in East Asia, and would you say that in the absence of political motivation that such a dynamism would be durable or not?

And, what would you say are the prospects of regional integration in East Asia?

And one more question which I invite you to answer at the end of the meeting is, given what you know about the Korean economy, can you name some of the most serious challenges to the Korean economy, both external and domestic?

A: Thank you very much. I don't know enough about the Korean economy. You'll have to invite me back. Well, I'll come back to that.

Agriculture. I don't know why when people say "agriculture" they say "France" behind "agriculture". It's not only France. Be serious. Agriculture protection is everywhere. It's not only a French problem. What may be specifically French about it, and it's not even French, it's European, we have a way of protecting agriculture that displeases some of our friends. Fine, we should take that into account. It's a global world. And I think for efficiency reasons, we should.

I think that the current agriculture policy in Europe is very inefficient. You seem to imply that this is due to France. No, I don't think so. I mean, the French are very attached to the policy, but when it comes to changing the policy, all the other countries are very happy that France is there to carry the flag. I want to emphasize that this is not a French problem. It's an EU problem.

Now this problem has improved. We have been able to reform a lot of the basic tenets of the common agriculture policy over the last 15 years. We had high guaranteed prices. They are now much closer to market prices for most goods. We had high export subsidies. We have now matched out export subsidies. So in a way a lot of progress has been made across the years. It's not enough. Sure, I agree. But I'm optimistic because I don't think we can enlarge without changing further Europe's farm policy.

If you look at enlargement, you all know that we are going to take in, in the foreseeable future, probably around ten countries from Central and Eastern Europe. Most of these countries are agricultural countries where the weight of the agricultural sector is much higher and where prices are much lower. So when they enter Europe and the current agricultural policy we will immediately benefit from the higher granted price, which means that there will be a cost of transfers, which will be very high. That cannot be borne by the EU budget, especially at a time when this budget has to be used for structural reforms within Europe. So this is a powerful engine for sizeable reform. But as all reform of this kind, it won't happen overnight.

So I'm with you, frustrated with the slow pace of change. But we should understand that these kind of policies are very difficult to change politically. Farmers have—and this may be a French specificity there—since our electoral country is divided into many, many small cities in each small cities the weight of the farmers is comparatively great. That means that in the whole electoral process, they have a weight that is much larger than their total weight in the French populace.

This bias means that their interests in the domestic political debate has much more weight than it should. On top of that, when the farmers are not satisfied, they can disturb the economic life in a way that is very costly. So you could argue that we should change, but the first thing to do is to make sure that they accept the change, because if not that could be even more costly than the current farm policy. So that's a very big problem.