Part I

Globalisation, Regionalisation and Governance

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Globalisation and Regionalisation

Jan P. Pronk[1]

I Introduction

The last time I had the pleasure of participating in a Fondad conference, Fondad was following up on its pioneering work on the debt problem of developing countries and the role of the international financial institutions. In the last three years, Fondad's attention has shifted to the issue of regional integration. While the financial and trade aspects of this subject have received substantial attention, Fondad has also included the very important issues of public policymaking and politics in its approach. Regional integration and how it effects global economic cooperation are indeed central themes in today's discussion on the future of global governance. Is regionalisation the answer to the globalisation of markets? Is the second wave of regional integration qualitatively different from earlier attempts? The volume of literature on these subjects is already impressive, but the three-year Fondad research programme that we bring to a conclusion during this conference aims to do more than just add to the existing theory. Fondad's strength has always been in its ability to bring together theory and policy practice, financial experts, development cooperation experts and politicians, from both the North and the South. This mix of expertise contributes to the broader view and lively discussions that distinguish Fondad's meetings.

My contribution to your discussion will concentrate on the two key subjects of the research programme: globalisation and regionalisation. I will first try to draft in broad outline a developmental approach to the globalisation process, and then I will discuss under what circumstances regional integration can make a positive contribution to that approach.

II Globalisation

Although the influence of the globalisation process is, to some extent, counterbalanced by other forces, global trends make clear that we face a number of fundamental worldwide challenges. The globalisation process is

1 Opening Address by Jan P. Pronk, Minister for Development Cooperation of the Netherlands.

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a revolution in the true sense of the word. It is irreversible, and it is profoundly transforming our societies. Technological advances are the driving force behind globalisation and they continue to accelerate our potential in communication and information. Communication and information technology are intensifying economic interdependence on a world scale. This revolution is adding substantial new capacities to human intelligence, and it constitutes a resource that is changing our economies and our ways of life. Thus, the development of technology and its widespread use are preconditions for successful globalisation. Access to it is also a necessary precondition for attaining full membership in the global economy.

In the meantime, it is becoming very clear that economic progress and the maintenance of our natural environment are coming into conflict. We are degrading the world's environment, that is to say we are using up nature as though it was an inexhaustible resource. The present-day methods of production and consumption are clearly not sustainable. Scientific evidence is overwhelmingly convincing that the environment sets limits to human endeavours and that we may, in fact, already be damaging the environment in irreparable ways.

Globalisation confronts us with an additional challenge, and this concerns the world's financial markets. Between 1986 and 1992, global currency transactions increased threefold. As long as enormous profits can be made from the wild swings in exchange values between currencies, the volume of international monetary capital transactions will continue to grow. The resulting volatility and instability of the global financial market are obvious. They are potentially very dangerous. Recent history provides many examples of what may ensue. In 1982, many developing countries, particularly in Latin America, defaulted on their debts. In 1989, Japan's 'bubble economy' of inflated financial values burst. In 1992, the British pound and the Italian lira came under attack. The following year, it was the French franc's turn. In 1995, the Mexican peso collapsed and recently the economies of Southeast Asia unexpectedly became unstable and lost ground.

Of course, the Southeast Asian monetary crisis was caused by local failings. Too much reliance was based on real estate resulting in speculation; the hasty expansion of financial service industries led to uncontrolled excessive bank credits. This revealed the weakness of the financial system. Savings were wasted on unproductive investment, there was an increasing imbalance between the expansion of wealth creating machineries and investment raised for the improvement of the productive potential of society, there was insider profiteering and unscrupulous speculation, monetary policies were undisciplined, fiscal policies inadequate and currencies were overvalued. Obviously, it is necessary for governments and private actors in the region to redress these inadequacies and to clean up their act.

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But when all is said and done, I cannot agree with the US Deputy Treasury Secretary when he states that "(the) process of market opening is like peeling an onion ... it happens slowly, layer by layer, and there will be plenty of tears involved". That is a recipe for 'cold turkey' treatment as the essential pre-condition to membership in the global economy. For weaker developing nations, this is simply too harsh and socially much too disruptive. It is not the kind of advice that we in the industrialised world would accept for ourselves. The IMF and the WTO are the essential organisations for the regulation of the open, integrated global economy. They must not unwittingly exact a price of social disruption for membership in that community.

These issues, then, are global challenges that need to be guided into acceptable channels. All of humanity should be concerned. Hence, the answers we seek must also be globally coordinated. I emphasise that this does not mean that the worldwide framework is the only one of value. Enhanced regional cooperation is another indispensable international tool that I will come back to. But at the global level, the answers are to be sought in four directions.

First, we must maintain our policies to integrate less strong, developing countries into the world economy. But that transition must be given sufficient time. A big bang entry into the globalisation process without further ado will occasion more victims than the states concerned can permit without regressing into violence. Thus, the process of becoming full member of the economic world community will, for many developing countries, need to be very carefully phased and sequenced. While this manner of managing the enlargement of the global village may be difficult, it is certainly not impossible.

Second, we must strengthen our international institutions. These institutions – notably the WTO, the IMF and the World Bank – are the ones that must guide the transition process I just mentioned. Inter-regional cooperation can certainly assist in smoothing out global differences, but the pre-eminent place of these three international institutions in this respect is equally important. The urgent task is to better equip them so that they can elaborate international rules, guidelines and codes of conduct. Without clear rules and regulations, the globalisation process is not sustainable in the long run. Thus, the strengthening of existing and the establishment of new international organisations is needed as a countervailing power to transnational corporations and the financial sector.

The third area which requires answers to the challenges posed by globalisation concerns the non-economic dimensions of the global market. In its present form, globalisation is an economically and technologically driven process that disregards political considerations. To put it somewhat

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bluntly, it is a 'mindless' process that will accelerate inequality, ecological disaster, poverty and identity conflicts in many parts of the world. An increasingly commercially financed world, which only extends materialistic western lifestyles without regard to the non-economic bonds that form the essence of societies, will end up in dissent, strife and resistance. It will cause debilitating backlashes against the very progress people need and want. It is also an extremely dangerous illusion to think that these disasters will only happen elsewhere. A globalised world means precisely that.

Fourth and finally, we must do more to promote democracy, human rights and cultural pluriformity. The liberty and intrinsic worth of the individual are the very basis of western culture. These values must be cherished and strengthened. They are the heart of what makes our societies work. They must also be at the heart of our relationship with non-western societies. Without them, policies to promote and protect long-term, peaceful global relationships are doomed to fail. A global world must have a global, inter-cultural dialogue. Such a dialogue can only be useful if it is based on a shared, deep mutual respect. This means that we give others the benefit of the doubt. We live in multicultural societies or in ones that are rapidly acquiring a multicultural character. Inter-cultural collisions are frequent everywhere. To solve these problems, we need to make globalisation more than just an economic and technological process.

III Regionalisation

While I have just stated that international governance must be strengthened in order to cope with a globalised economy, I should also add that a workable system of international governance does not and cannot exist solely on the basis of global institutions. Some issues are best dealt with regionally. Even an outspoken proponent of multilateralism like myself agrees with this statement. Within an overall global framework of rules and order, the principle of subsidiarity or optimal decentralisation can be usefully applied. As has also been noted in the report of the Carlsson Commission[2], it is not difficult to realise that there are limits to the capacity of multilateral institutions to regulate and coordinate effectively at a global level. In my view, regional arrangements can be seen as a necessary complement to – and even as building blocks for – a system of global

2 In 1991, the Carlsson Commission, also referred to as the 'second Brandt Commission', published a memorandum entitled *Common Responsibility: An Initiative on Global Security and Governance for the 1990s.* The memorandum, which developed the work of the Brandt, Palme and Brundtland Commissions was jointly prepared by former Swedish Prime Minister Ingvar Carlsson, former Commonwealth Secretary General Shridath Ramphal and Jan P. Pronk.

governance. The differences between regions are real. Their different paths towards development and integration in the world economy can best be accommodated by using the stepping stone of regional integration.

Regionalisation is, first of all, a concrete reality. It is sometimes said that globalisation is market-led and regionalisation is policy-led, but in many ways regionalisation is driven by the same market forces and technological developments as globalisation. Intra-regional trade is growing faster than trade between regions. Relocation of production is primarily a regional phenomenon. As Charles Oman has shown in his paper, physical proximity between firms and both their customers and suppliers has become more, not less, important. Regional integration can thus be seen as the logical follow up to these market developments. But regional integration has a broader motivation than free trade and investment.

Much of the inspiration of present day regionalism is indeed political. I might describe it, in part, as a political reaction to the globalisation of markets, stemming from the desire to retain a certain amount of policy autonomy of governments vis-à-vis market forces. The strong growth, some say proliferation, in the number of regional arrangements is part of the new post-Cold War context. In that multipolar world, regional initiatives are often stimulated by regional agreements elsewhere. In this respect, the European Union has set off integration efforts in many other parts of the world.

As I said, regionalism as a form of international governance is related to the changing position of the state. It is no longer possible to regulate purely on the basis of national jurisdiction. The alternative of multilateral rule-making is not only difficult to achieve, but it is often too remote from national interest groups to be acceptable. Regional integration can offer a middle way that preserves the notion that citizens and their nations are still in control of events. This makes deeper integration possible in certain regions. Deeper in the sense that the concept is broadened to cover competition policy, investment, and even the free movement of persons. Integration in world markets through regionalism can thus be phased according to the differing economic circumstances of the countries concerned.

There are many other political motives for regional integration. Increasing the bargaining power of smaller states in multilateral economic negotiations is an example. But non-economic policy goals are often just as important, if not more so. Regional security plays a role, as has been the case in Europe. I fully sympathise with the WIDER approach towards regionalism as outlined in the paper of Björn Hettne, who stresses the political basis of regional integration. He rightly mentions security and development as the key elements of regionalism in Third World regions

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today. Such a broadening of the concept of regionalism adds to the complexity of the phenomenon. There are many forms of regionalism and any assessment will have to take into account the different goals and positions of various regional groupings.

IV A Developmental Approach

In my analysis of regionalism I have stressed its multidimensional and differentiated character, its political motivation and the complementary role it can play in strengthening international governance. How does this analysis relate to the central theme of this Fondad conference, i.e. the relation between regionalism and global economic cooperation? Three key questions emerge as possible focal points for your discussion in the coming days: (1) the definition of the concept of openness; (2) the specific character of regionalism in different parts of the world; and (3) the way in which cooperation between regions can best be organised.

What sort of regionalism will be most conducive to the emergence of a strong multilateral system? The ideal model is often called 'open regionalism', but this term is ill-defined and contains an uneasy sort of paradox. At best, the openness of an arrangement can be described in general terms as a non-static, flexible and differentiated process, transparent and open to new members. Defensive, inward-looking regionalism can indeed interfere with the principles of the multilateral trade system. There is a risk of an escalation of defensive regional agreements, leading to a fragmentation of the world trade system. The costs of such a development would fall disproportionately on weaker countries outside the major blocs. WTO rules provide some criteria for an assessment of the character of regional agreements, but these criteria are not as yet very operational. In any case, traditional economic analysis of trade creation and trade diversion is too narrow in scope for a multidimensional phenomenon like regional integration. I believe we need a broader framework for assessment which includes non-economic elements.

Differentiation might be the second point for discussion. The optimal degree of regionalism will be different for the various regions. Each region is confronted with its own challenges. The European Union has accomplished deep integration in a number of fields, but is now facing difficult choices regarding further (especially monetary) integration, enlargement and liberalisation of agricultural policies. East Asia and Southeast Asia are examples of a market-led, open type of regional cooperation. The recent financial crisis in that part of Asia might provide a boost for new formal regional mechanisms. In the Western Hemisphere, the initial drive of the

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United States towards regional arrangements seems to be waning. In Africa, regionalism is still in its infancy. Security and investment cooperation are obvious priorities for cooperation in that region.

Differences exist within regions as well. A region like East Asia is far from homogeneous. What determines the borders between regions and how can this be related to their development strategies? I hope that the discussion on the particular situation in the various regions, based on the outcome of the regional Fondad conferences, will shed some light on these difficult questions during the following days.

My third point concerns the interaction between regions and its relation to the multilateral system. The number of inter-regional cooperation fora has grown rapidly in the last few years. APEC, the Transatlantic Agenda and EU-ASEAN are among the most important. These fora can contribute to international governance but only if they do not develop into alternatives to the multilateral system. The dominance of the three major regions can undermine the position of developing countries falling outside these regions. As co-founders of the multilateral system, Europe and the US have a special responsibility for preserving the spirit of multilateralism. Strengthening the multilateral system should therefore be a key objective of the new transatlantic agenda.

An outward-looking European Union will have to take the initiative to prevent the exclusion of developing countries, especially those in Africa. At this moment, the EU is already confronted with this challenge in two concrete cases. The first is the renewal of the Lomé Treaty. The group of ACP countries is comprised of three different regions which run the risk of becoming marginalised. The second case is the commencement of the EMU. What is the significance of further monetary integration in Europe for countries outside EMU, in particular developing countries and countries in transition? Can monetary cooperation with the franc zone in Western Africa be extended to the EMU or is this form of cooperation no longer viable? I realise that this is more than a technical question, but it would be interesting to hear the opinion of the experts gathered here today.

Chairman, I want to reiterate my main points. Globalisation as a technology-driven, irreversible development; the threats to our very survival emanating from man-made changes to our natural environment; and the instability of world-wide capital transactions all call for stronger international governance. I have outlined the main elements of a developmental approach to these challenges. Regionalisation, as a political reaction to the globalisation of markets, can play an important role in the strengthening of international governance. The question is what kind of regionalisation and inter-regional cooperation will contribute most to the strengthening of

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international governance. We need a broad framework for assessing the openness of regional agreements, and the optimal degree of openness will probably be different for each region. I believe that Europe, as a model for regional integration and supporter of the multilateral system, will play a crucial role in this development. I trust that Fondad will provide us with some valuable guidance in finding a productive relationship between regional integration and global cooperation.

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Globalisation, Regionalism and Global Economic Governance

Mats Karlsson[1]

I Globalisation

Rapid growth in trade and international capital flows, continuous technological progress and an exponential increase in the exchange of information are transforming the global scene as the industrial revolution once did. Globalisation is the now popularised concept for the intensified interdependence that has been a phenomenon for decades, but which is currently accelerating with unprecedented momentum. Globalisation can provide the opportunity for millions of individuals to step out of extreme poverty.

The advantages of an open trade system are no longer disputed. But it is perhaps the most controversial form of globalisation – private portfolio flows – which offers an avenue of hope to the poor. It has created mechanisms for a massive transfer of resources from rich countries to low-income countries, via mutual funds, pension funds, etc. The problem is that this potential is seldom transformed into sustained improvements. On the contrary, globalisation has created new patterns of exclusion and inequality. Marginalisation, insecurity and powerlessness is the real consequence of globalisation for many. Why is this so? The explanation has to do with the widening gap between the challenges of the global market forces, including exponential technological advances on the one hand, and the capacity of the political and social institutions at local, national and international levels on the other. In short, we do not have the institutions to cope with this new and far-reaching form of interdependence.

Globalisation means a challenge to political and social institutions at all levels. At the local level, traditional structures are disrupted or even, at times, eroded. The autonomy of national governments is curtailed. And appropriate structures and institutions are lacking at the international level. There are no simple solutions. The local and national levels must continue to play the important roles they have always played. The creation of a 'global society' or 'global nation' is neither possible nor desirable. In

1 Closing Address given by Mats Karlsson, Under-Secretary of State, Swedish Ministry of Foreign Affairs.

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order to realise its potential, globalisation must not weaken but strengthen social inclusion and cohesion at all levels. This also holds true for the regional level as I will come back to later.

We can consider the example of national economic growth, the most common development indicator. Let us assume that globalisation leads to higher growth – at least in a short to medium term perspective. But since growth figures are national averages, they reveal very little about the quality of life of different groups of people in the country. They also tell us very little about the factors that are crucial for long-term sustainable growth, like the development of social capital. Fortunately, we realise now that it is not just growth that is important, but it is a special type or pattern of growth. This growth should be pro-poor, pro-women and sustainable in economic, political, social and environmental terms. The IMF calls this *high-quality growth*. What is necessary to insure that globalisation leads to high-quality growth? Basically, strong institutions at all levels. They must be strong, not to regulate or intervene in markets, but strong to guarantee that markets are not captured by elites. Strong institutions do not have to be big. It is, however, crucial that they are legitimate and open.

Many studies have concluded that the most important factor behind rapid economic growth has been a good economic policy. We should, however, add a few dimensions to the concept of 'good policies'. The macroeconomic fundamentals are important, but they are not sufficient for achieving 'high-quality growth'. Good governance, equity and environmental sustainability are other fundamental components.

II Regionalism

One has to make a clear distinction between the old and the new regionalism. The old regionalism was based on the idea of import substitution and of creating a larger 'national' market. In this way, it was opposed to globalisation. Traditional theories of economic integration suggested that it could lead to trade creation, but in most low-income regions trade structures are very similar and the potential for trade creation is limited. This is one reason behind the unsuccessful experiences of regional economic integration among low-income countries.

Globalisation means a challenge to regional integration. Björn Hettne describes the 'new regionalism' as a way of meeting this challenge. The new regionalism is not opposed to globalisation, rather it is a means to secure the benefits for the region of the globalisation process. In economic terms, the new regionalism does not aim primarily at trade creation but rather at increasing credibility and attracting sustainable private capital

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flows. But more is needed in order to realise the potential of globalisation and transform it into high-quality growth for a region. Social cohesion must be maintained at the local and national level while it is complemented by a kind of regional culture or 'regionness'. This is a complicated process as we know from the European experience.

The new regionalism is not opposed to globalisation or the opening up of national economies, but how does it relate to *multilateralism*? There is a possibility for a conflict between regionalism and multilateralism as regionalism grows stronger – also involving North-South relations. Such a conflict is not a desirable scenario, and the best way to reduce the probability for it to come true is to strengthen the basic multilateral framework. The structure for multilateral trade negotiations must be kept and developed and the trend towards global free trade must be secured. The UN system must be guaranteed adequate and predictable financing and the international financial institutions must keep, and in some areas broaden, their mandate and receive adequate funding for this. But they must also continue their process of becoming more open and accountable, and adapt their methods to a world with strong regional institutions. To avoid misunderstandings, let me just say that this could, and will most probably, be achieved in parallel with increased regionalism.

III Global Economic Governance

The recent Southeast Asian crisis does not illustrate the problem of globalisation and capital flows, but rather the problem of weak institutions and imperfect information. The market is sometimes irrational and ignorant; it bases its decisions on irrelevant factors and treats countries with very different situations similarly only because they are close to each other geographically. This creates high risks for both depositors in rich countries and for the low-income countries receiving capital inflows. Stephany Griffith-Jones put forward a number of proposals which are interesting as a starting point discussing how we should deal with this problem.[2]

But the crisis also illustrates the challenge facing the global institutions. The IMF was successful in delivering rescue packages for Thailand and Indonesia, but questions have been raised about how long these emergency operations can continue and what incentives they create. A more crucial need is an early warning system which can signal when measures must be

2 See "Regulatory Challenges for Source Countries of Surges in Capital Flows", In: J.J. Teunissen (ed.), *The Policy Challenges of Global Financial Integration*, FONDAD, The Hague.

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FONDAD, The Hague, 1998, www.fondad.org

taken, by governments as well as by international creditors and investors, to correct the situation at an early stage.

What we are touching upon here is the area of *global economic governance*. We have an array of institutions including the well-known global institutions, the regional organisations, arrangements under binding treaties such as the Montreal Protocol or informal practices such as the Paris Club, and there is evolving interaction with the private sector in setting standards. Together, they reveal the state of global economic governance. But more than one nation has been known to say one thing here, another there, and do a third thing in practice – perhaps all in good faith and for good reasons. Regrettable, the result in terms of global efficiency will not be achieved by design. Each one of the international institutions will maintain its own *raison d'être*, decisionmaking processes and operational practices. But until we instil some coherence, nations stand no chance of closing the gap between the challenges of the global marketplace and the institutions they require.

With regard to leadership, the G-7 certainly considers itself to have a leadership role, but its interests and representativeness and, therefore, legitimacy in relation to many other economic actors, including the emerging major economies, are limited. The ECOSOC and other UN economic bodies simply do not yet have the clout. Other global organisations may have strong institutional leadership, but their mandate is limited. The European Union has hardly begun dealing with its own coherence problems. The OECD, for all its good work, is facing serious choices about what kind of organisation it will become in the future.

Take the following examples where coherent leadership is needed:

- institutional responsibility in global financial markets;
- the historic scandal that 15 years after the onset of the debt crisis, there is still no exit for many of the poorest nations;
- support in transition countries dealing with post-communist legacies or the many complex crises and humanitarian disasters;
- the confusion about roles and responsibilities in trade, development and aid;
- we have hardly begun negotiating the global issues at stake with regard to the environment, energy and water – none can have one institutional home.

We need mechanisms that can result in coherent, institution-spanning approaches by governments for these and many other policy issues and concrete situations. A new bureaucratic structure is not needed. Instead, we need a political apex forum on economic, social and environmental matters.

The idea that I support is the creation of an Economic Security Council

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or a World Economic Council anchored in the United Nations and modelled on an expanded Security Council of about 23 elected countries. It would hold a periodic meeting of top national leaders and the heads of the major global economic institutions. The Economic Security Council's aim would be to exercise leadership, instil coherence and initiate action which, for the most part, would be decided upon and carried out by existing organisations. Variants of this idea are possible.

Few institutions are created simply from the drawing-board. A pragmatic way to start would be to convene a small summit of heads of state to address the issues of globalisation. However, I have no doubt that something of the kind – a high-level forum for leadership and coherence in global economic governance – will be created. The reality of interdependence in a world where the weight of the emerging markets is rapidly increasing makes it a necessity. This will be the real test case of whether we can handle globalisation politically.

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