Policy Cooperation in a Post-Interdependent World[1]

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Contrary to many of you, I did not have the privilege and fortune to work with Mr. van Lennep and thus to benefit from his experience, insights, knowledge, and, most importantly, tireless dedication to the fundamental principles of an open, fair and sustainable international order. However, I did have the honour of meeting him once in Washington some years ago during a meeting marking the 5oth anniversary of the Bretton Woods institutions; an occasion that I will never forget. What struck me at the time was his vision of the rapidly changing world in which we live, the challenges - even dangers - that this change entails and his willingness to confront those challenges head-on and seek solutions. Equally noteworthy was his consistent reminder that we cannot separate politics from economics; that we must show respect for the habitat that we share with others; and that we cannot leave the less fortunate and privileged behind but have a responsibility to make sure that they too can benefit from the multilateral order to which he dedicated his life.

Around these themes - change, the risks that this change entails, a recognition of not just the economic but also political and social forces that shape our societies, and a search for solutions - I want to structure my remarks today. Before I begin, let me just make the usual disclaimer that my comments do not necessarily represent the official view of the Brookings Institution or the World Bank, nor that of its Trustees or its shareholders, respectively.

Interdependence

Cooperation in a 'post-interdependent' world - another new catch phrase? I hope not! The choice of this terminology reflects our desire to indicate that indeed we have entered a new phase in international economic relations and that, as far as policy implications are concerned, it is markedly different from the period of interdependence in the 1970s and early ig8os.

The term much more commonly used for this post-interdependent world is, of course, globalisation. But upon reflection, it is striking how little is known about it. In most cases, the condition is asserted but never defined. Most would and do characterise it as a continuous increase of cross-border financial and economic activities leading to higher degrees of economic interdependence. Essentially, interdependence and globalisation are used interchangeably. And yet, if we can capture the current shift in mere quantitative terms, there may be little need nor incentive for governments to reassess, in the light of globalisation, either their own role or that of the multilateral institutions and principles that have governed the world economy since the end of World War 11. On the other hand, if we are in the midst of a truly qualitative transformation, then it becomes necessary to draw a more formal distinction between economic interdependence and

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globalisation, in order to help us assess not only the need but also the appropriate direction for change.

What is that key distinction?

Contrary to economic interdependence, which narrowed the distance between sovereign nations and necessitated closer macroeconomic cooperation among public sector actors (i.e. governments), the principal drivers of globalisation are microeconomic actors, requiring us to reconsider traditional forms of international cooperation suitable for managing economic interdependence. Globalisation is a corporate-level phenomenon. It commenced during the mid-ig8os as companies responded to the heightened competition brought about by deregulation and liberalisation during the era of economic interdependence. Thus, globalisation represents the integration of a cross-national dimension into the very nature of the organisational structure and strategic behaviour of individual companies. The growing amount of cross-border movement of increasingly intangible capital, such as finance, technology, information, and the ownership and control of assets, allows companies to enhance their competitiveness and creates a cross-border web of inter-connected nodes in which value and wealth are being generated.

Data on corporate activity substantiate the emergence of such global corporate networks and signal a truly qualitative transformation. In the 1960s and 1970s, for example, foreign direct investment grew in close correlation with tangibles such as world output and trade. But from 1985-95, it expanded at an annual average rate of 16 percent compared to 2 percent and 7 percent for output and trade, respectively. Most of this additional investment was concentrated in the OECD countries and a few select developing countries, and consisted of mergers and acquisitions in R&D intensive industries. With the exceptions of both China and the former Soviet bloc, which attracted almost no investment prior to 1985, the share of foreign direct investment going to the developing world actually dropped. This picture is confirmed by the pattern of corporate alliances and collaborative agreements, which have grown dramatically during the past decade.

International trade is also undergoing a qualitative transformation, restructured by foreign direct investment and international alliances. The OECD estimates that about 70 percent of world trade is intra-industry and intra-firm trade. In the financial world, the advent of securitisation meant a qualitative transformation facilitating global corporate strategies that gave foreign debtors and creditors access to dom6tic financial markets. In particular, the market for derivative instruments has led to the greater growth and volatility of international capital flows, evidenced by the fact that in 1995 the combined annual value of global trade and foreign direct investment was equal to only six days of turnover on the global foreign exchange markets.

What all of this indicates is that a growing share of international economic activity during the past decade reflects the internal but cross-border restructuring of corporate activities. In many cases, corporations absorb foreign capital stock, internalising economic activities that were once conducted on the open market. Alliances such as long-term supplier agreements, licensing, or franchising contracts are not fully exposed to market forces. As far as the growing importance of mergers and acquisitions is concerned, the OECD reminds us that 'even the largest single investment in any given year may represent nothing more than the change of ownership, with no effect on resource allocation between two countries.'

Turning to trade, reasonable data exist only for the United States, but in 1995 approximately 40 percent of total us trade was accounted by for intra-firm trade - or as the OECD calls it, offmarket trade. Governments continue to register these internal transfers of corporations not because they are traded but because they cut across multiple political spaces. Thus I want to suggest that we should be more careful in automatically equating globalisation with the emergence of a global market economy, unless we can assure that there is an appropriate infrastructure in place within which these corporate networks can compete and flourish.

By no means do I want to imply that macroeconomic performance and management is no longer important. To the contrary, interdependence and the need for closer macroeconomic cooperation were important precursors to globalisation and remain the most critical factor in sustaining it. Along with technological innovation, this liberalisation of cross-border economic activity created an environment that not only permitted but compelled companies to adopt global strategies. And yet, the growing importance of non-tariff barriers to trade and the need to focus our attention on global competition policies are but two examples indicating that the microeconomic dimension needs greater attention. Indeed, nowhere has the importance of the structural, institutional, and legal dimension of a market economy become more apparent than in the recent Asian financial crisis. Not surprisingly, many of the responses to the crisis will have to focus on that level as well, creating numerous new challenges - not just economic, but also legal, political, and cultural - for multilateral institutions like the Bank and the Fund, including closer cooperation between the two institutions in integrating their efforts based on their respective comparative advantages and taking advantage of the existing synergies.

Moreover, whatever solutions will be developed will take more time to succeed. This does not even address the difficulties in measuring success, given that many of the structural indicators will be difficult to capture quantitatively and are subject to manipulation. No doubt the international policymaking community will have to respond in new and innovative ways in order to remain not only effective but efficient. However, before considering some of those responses, let me pause for a moment, follow the example of Emile van Lennep, and remind us that political aspects cannot be left out from this discussion.

Defining the Challenge

What kind of challenge does globalisation present to governments and how - if at all - does that challenge differ from interdependence? Does globalisation challenge sovereignty? The intuitive answer is yes - but then so does interdependence, and so once again we must differentiate. To do so, some crucial distinctions must be made. First, neither interdependence nor globalisation can challenge the legal sovereignty of a state - only other states can. If anything, these forces challenge the operational sovereignty of a government (i.e. the ability of a government to conduct public policy). Second, the concept of sovereignty has two dimensions -an internal and an external one. The internal dimension depicts the relationship between the state and civil society. Paraphrasing the sociologist Max Weber, a government is internally sovereign if it enjoys a monopoly of the legitimate power over a range of social activities, within a given territory. With respect to the economy, governments operationalise their internal sovereignty when they collect taxes or regulate private sector activities.

The external dimension of sovereignty refers to relationships among states in the international system. For example, countries exercise external economic sovereignty when they collect tariffs and alter their exchange rates. Economic interdependence is considered a challenge to the external dimension of sovereignty. Responding to this challenge, governments have followed the principles and norms of liberal economic internationalism, endorsing the grad ual, but reciprocal, reduction of their external economic sovereignty by lowering tariff barriers and capital controls in the context of international regimes.

Global corporate networks do not challenge the external sovereignty of a country, but they do challenge the internal sovereignty of a government by altering the spatial relationship between private and public sectors. Since globalisation induces corporations to fuse national markets into a single whole, they operate in an economic space that now subsumes multiple political spaces. As a result, a government no longer has a monopoly of the legitimate power over the territory within which corporations organise themselves, undermining its internal sovereignty. The rising incidence of regulatory and tax arbitrage is a telling indicator that this monopoly is waning. This by no means implies that private sector actors always make a deliberate effort to undermine internal sovereignty. Rather they follow a fundamentally different Organisational logic than states, which are boundary-maintaining systems. Indeed, states' legitimacy derives from their ability to maintain boundaries. Markets, however, do not depend on the presence of boundaries. Thus, at the very same time that globalisation integrates markets, it also fragments politics.

And while it is true that this threat is only to the operational dimension of internal sovereignty, we should not underestimate the challenge. Why? Because a threat to a government's ability to exercise internal sovereignty implies a threat to the effectiveness of democracy. Although individuals may exercise their legal right to vote, the actual power of that vote in shaping public policy decreases with the decline in internal sovereignty. A persistent weakness in internal sovereignty will cast doubt on democratic institutions. And while this dynamic is not the only explanation for the declining trust in institutions of governance in many OECD countries, it is an important contributing factor. Governments, which see their legitimacy, their very ral'son d'~tre, undermined, have no choice but to respond.

Responses to Globalisation

To date, these responses to globalisation for the most part have been reactive and fall into two camps, both variants of what are essentially interventionist strategies. Those who consider globalisation a threat call for defensive intervention, advocating such economic measures as tariffs, non-tariff barriers, and capital controls, forcing companies to reorganise along national or regional lines. If economic nationalism falls to arouse broad popular support, its political counterpart may be more successful. Increasing calls for greater regional independence or even territorial secession and partition in the hope of regaining internal sovereignty is a political strategy that has gained in popularity around the world during the past decade.

Others have called on policymakers to intervene offensively with investment incentives and competitive deregulation. Under these circumstances, states themselves become global competitors, seeking to entice corporations to operate within their own territory. Offensive intervention has also become popular as a political tool, as some countries attempt to broaden the reach of their internal sovereignty to match the economic geography of global corporate networks. Two of the more prominent examples are California's attempt to tax resident companies on a global basis and the Helms-Burton Act.

None of these responses bodes well for the future of international relations or for our economies. Protectionism by a country or a region leads to retaliation and puts the world economy on a path of disintegration. Subsidising an industry with the sole purpose of gaining competitive advantage will not advance integration but rather divert scarce public funds from important public policy goals. Competitive deregulation defeats the original purpose of the policy. To quote from Emile Van Lennep: 'Both nationally and internationally the market economy cannot function in a vacuum; it requires a framework of rules, rights and obligations and there have to be institutions ensuring the application and enforcement of these rules.' By no means do I want to question the importance of structural reforms, which are long overdue in a number of European economies. But it is a reminder that an obsession with competitiveness among nations will lead to a win-lose situation and strengthen those political forces that favour economic nationalism (i.e. defensive intervention), making structural adjustment even more d'fficult.

Extraterritoriality, as in the case of the Helms-Burton Act, is no friend of deeper integration either. Other states will retaliate against such a dictate. Finally, redefining political geography through partition only gives the appearance of greater control of policy. Partitioning a country focuses exclusively on the external dimension of sovereignty. In no way does it insulate governments from the challenges of globalisation. If anything, it makes them more vulnerable.

Note that all of these responses emphasise territoriality as an ordering principle of international relations, a condition that interdependence has tried to overcome. All are at odds with globalisation and will succeed only if the achievements of the postwar era are reversed. To some this possibility seems remote, but I cannot fall to point out that the popularity of these policies has increased considerably since the early 1990s. In many countries, political opportunists have taken advantage of the public's fear concerning the declining effectiveness of internal sovereignty and are advocating greater economic nationalism and/or closed regionalism. Unless we find a better alternative, governments will soon be forced to rely on these interventions to halt the loss of internal sovereignty and the further erosion of confidence in our democratic institutions.

Shaping Globalisation

Let me outline the broad contours of such an alternative road. If governments want to shape globalisation rather than react to it, they will have to operationalise internal sovereignty in a non-territorial context. Forming a world government would be one response, but it is doomed to fall - and there is no need for me to elaborate on this. A more promising strategy builds on the earlier differentiation between operational and formal sovereignty. Governance, a social function crucial for the operation of any market economy - national, regional, or global - does not have to be equated with government. Accordingly, a global public policy would de-link the operational elements of internal sovereignty (governance) from its formal territorial foundation (the nation-state) and institutional environment (the government).

To implement such a strategy, policymakers would invoke the principle of subsidiarity but use the concept in a much broader sense than we know from the EU. The 'sub' in subsidiarity is used in a functional sense and refers to any actor or institution that is well-positioned to support the operationalisation of internal sovereignty in the global context. We can further distinguish between two forms of subsidiarity. Vertical subsidiarity delegates public policy making to other public sector actors. As far as globalisation is concerned, this refers mainly to multilateral institutions. Though little acknowledged, the changing roles and mandates of the IMF, the World Bank, and the WTO - now dealing with corruption, financial regulation, and environmental standards - suggest that they are in fact becoming increasingly involved in matters of internal sovereignty, which in some member countries has led to a rather strong political reaction. But it should be crystal clear here that enhancing the ability of multilateral institutions to address these issues does not lead to a loss of sovereignty. To the contrary, as I have shown, internal sovereignty has already been lost and this is a collective way to regain it while avoiding the economic repercussions of defensive and offensive intervention. Moreover, this does not mean that local actors may not play an important role in enforcing and monitoring global rules and standards. Vertical subsidiarity works both ways and provides practical meaning and guidance to the often quoted line 'think globally-act locally.'

But global public policy would also make extensive use of horizontal subsidiarity and by that I mean it would delegate or outsource some aspects of public policy making to non-state actors such as business, non-governmental organisations (NGOS), foundations, and other interested civil society participants. Emile van Lennep recognised the importance of this quite perceptively: 'As a member of the Earth Council, I perceive how a wave of devoted, active involvement of the thousands of NGos all over the world is becoming a major guiding light and driving force for international cooperative action.' These actors have a direct stake in the outcome of public policy. Equally important is the fact that their range of activity is not trapped by political boundaries. In addition, better information, knowledge, and understanding on the part of these actors of increasingly complex, technology-driven and fast-changing public policy issues will not only generate greater acceptability and legitimacy of global public policy; these public-private partnerships, which is in effect what horizontal subsidiarity creates, will also produce a more efficient and effective policy process. Finally, by building bridges across civil societies, horizontal subsidiarity creates a real international community, a true global civil society by encouraging mutual learning systems and openness to change among public policy. With regard to global financial regulation, environmental protection, the fight against transnational crime, and many other global policy issues, horizontal subsidiarity would become one core principle of global public policy.

Critics of such an idea will question the wisdom of placing private and public interests under the direction of the same institution, charging that the public's interest is likely to be neglected. And indeed, the limited experience of mixed regulation supports these skeptics to some degree. But rather than abandoning global public policy, the current shortcomings of mixed regulation should be addressed. Greater transparency can be achieved by establishing strict principles of disclosure-based regulation guaranteeing other groups sufficient access to ensure that their interests are adequately represented. Second, corporations must facilitate such public-private partnerships by improving their own internal control and management structures. The better these inside controls, the lower the risk of market failure and the need for outside regulation.

Let me reiterate that formal sovereignty remains in the hands of the public sector. Horizontal subsidiarity merely permits policymakers to create a more flexible, and dynamic, but also more effective and efficient, public policy structure that can respond to the demands of a global economy and allow governments to regain their legitimacy as the principal providers of public goods.

Keeping up with the times

So far this discussion has focused for the most part on the OECD world because it is here where globalisation, as I have defined it, is most prevalent. Thus, given the still limited reach of globalisation, international relations at the end of the 20th century are characterised by the coexistence of interdependence and globalisation.

And yet this coexistence of interdependence and globalisation is not yet reflected in our approaches to a growing number of transnational policy issues. In the area of international finance, for example, the institutions of interdependence (such as the IMF) and those of globallsation (such as the BIS or the Joint Forum, which brings together regulators from the banking, securities, and insurance industries) should cooperate much more closely. In many cases, policy efforts to promote interdependence and global public policy may be best located under one roof and should not be treated sequentially but simultaneously. Such Joint efforts would help preclude bureaucratic overlap and turf fights among international institutions and permit a more integrated approach toward developing economies' dual challenge of national liberallsation and the creation of appropriate institutional and supervisory structures to better withstand the sometimes extreme pressures of global finance. No doubt this has been one of the core lessons of the Asian financial crisis, and indeed the outcome of recent meetings in Washington may point to some limited progress in that direction.

Changing Demands on International Security

But globalisation also places new demands on the concept of international security. Note that external sovereignty depends on the ability to exclude others (here, of course, the bipolar conflict was the most vivid example). However, internal sovereignty, as we have learned, depends on the ability to include, to create a sense of community and belonging; it is at the root of citizenship, it shapes our identities. But if we take a closer look at the data on foreign direct investment and corporate alliances that I cited previously, we see that large parts of the world economy and its participants remain excluded from globalisation. If globalisation continues and, in response, the maintenance of internal sovereignty increasingly becomes an issue in international relations, then inclusion will become one of the central themes of international security in the years to come, placing the international financial institutions, and the World Bank in particular, at the centre of international security.

For now it should be clear that for globalisation to be a success, there will continue to be a great need for North-South transfers of capital, both tangible and intangible. As you know, today the bulk of this capital comes from the private sector and is likely to do so in the future. However, if global public policy is to succeed, developing countries must participate in it. This presumes that they have the infrastructure and the capacity to exercise internal sovereignty at home. Renewed calls for development assistance may seem vain given the difficulty in rationalising foreign aid after the Cold War. But resource transfers to promote global financial stability, fight global crime, reduce environmental pollution, protect the world's species and fight poverty in a emerging global society are in truth neither foreign nor aid, but an investment that generates a return, one that is shared by all of us.

Conclusion

Let me conclude by returning to the two main themes. Global public policy does not contest internal sovereignty as an organising principle of political and social life, but does contest its organisation along traditional territorial lines. This requires political leadership and institutional change, both of which are in short supply. But it also requires the willingness and close cooperation of private and non-governmental actors to share responsibility in exercising public policy. In particular, the degree to which the global corporate community is ready and able to take on some public policy functions in conjunction with other non-state actors will be decisive in determining success.

Finally, global public policy is not some distant goal - the time to start taking practical steps is now, and let me explain why. There is a tendency to perceive globalisation as something inevitable, as something that cannot be reversed, or even as the end of history. But it is not. I don't have to tell this audience that the world economy experienced similar levels of integration in 1870-1913, a period often referred to as the golden age of international economy. You all know how that ended. Again, Emile van Lennep has consistently resisted this growing complacency and determinism and urged caution: 'Most people seem to believe that with the establishment of the WTO the multilateral trading system will be secured, I disagree. Neither the GATT nor the WTO will be able to roll back the tendency toward regionalism, which is rapidly accelerating throughout the world.'

I could not agree more. Interdependence risks becoming the victim of its own success. The interventionist strategies outlined above should not be dismissed as inapplicable. To the contrary, their popularity is on the rise and has entered the mainstream of the political debate. Examples include the recent French electoral outcomes and similar developments in a number of other European countries; the fast-track debate in the us Congress and its continued refusal to address financing issues of the IMF; the fate of the MAI, the Helms-Burton and Iran-Libya Sanction Acts; the growing popularity of secessionism; our reluctance to address global environmental threats and similar issues; and increasing tax competition and regulatory arbitrage. Last but not least, we have not even begun to comprehend the longer-term implications of the Asian financial crisis, though I predict that it will lead to a sharp rise in the general apprehension about globallsation in Asia and elsewhere.

Few will be able to accomplish as much as the man in whose memory we are gathered here today, or write such a fascinating account of it. And yet one is struck by his modesty when we read at the end of his book: 'My work consisted of merely adding a few bricks to the ever-incomplete edifice of international cooperation.' Paraphrasing Edmund Burke, he reminds us all: 'He who does nothing because he can do but little commits the gravest of errors.' It is In this spirit that I want to end my remarks here today, a spirit that is rare if not unique and will hopefully provide guidance to many of us in pursuing Emile van Lennep's cause.