



**GLOBAL
EUROPE**

Europe's openness and the politics of globalisation

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Summary

In this Alcuin lecture, delivered in Cambridge in February 2008, Peter Mandelson draws on three years of experience as EU Trade Commissioner with a wide-ranging assessment of the state of what he will call 'the openness boom' – the unprecedented surge in global economic integration and prosperity since 1990.

Assessing the credit crisis, the rhetoric of the 2008 US Presidential election and a growing anxiety in Europe and the United States about globalisation, Mandelson challenges those who claim the boom is not sustainable, or argue that it is being undermined by its own environmental, economic and political consequences. Mandelson argues that in order to "humanise" the openness boom and preserve its huge global benefits, Europeans need to reassess some of their basic approaches to politics.

He sets out why:

- the integration of the global economy would make disengagement by Europe or the US not only economically destructive, but a genuine threat to global development;
- the return of the state as a global economic actor in large economies such as China and Russia is not an argument for economic nationalism or protectionism in Europe;
- Europe's more activist social models are much better equipped to manage and preserve globalisation than minimal models like that of the United States;
- in the wake of the credit crisis and the climate change agenda, there should be renewed emphasis on global governance;
- Europeans need a more coherent and effective EU built around the concept of 'projectionism' not protectionism – the ability to project European interests and values globally in the twenty-first century;
- the European Reform Treaty should not be judged by how little it changes the institutional structure of Europe but by what it does differently and better.

The Openness Boom

The idea for this lecture started, oddly enough, with a line graph that I saw a few months ago in an old article from the mid-nineties by Jeffrey Sachs and Andrew Warner. The graph simply mapped the number of people in the world living in open economies, from 1960 until 1996. It resembles a long straight line with a steep upward angle at its very end. For thirty years, between 1960 and 1990, the number of people on the planet living in economically open societies was largely steady at twenty percent. One person in five. Then, after the fall of the Berlin Wall, something dramatic happens. Almost overnight, as countries begin to liberalise their economies it becomes five in ten. Sachs and Warner were writing before China's accession to the WTO in 2001. But if you update their graph to the present, depending on where you put Russia, it takes in almost all of humanity. So, in 1990, two in ten people on this planet lived in societies that were significantly integrated into a global economy. Today about nine in ten do. These may not be politically open societies, but they are economically open enough to have allowed for membership of the WTO and with it the open global trading system. That is more than three billion people and probably one billion

workers entering the global economy – pretty much *creating* the modern global economy - in less than two decades. This is the single most important change you need to grasp to understand the modern world. We are living in the wake of an openness boom.

We have started 2008 in a fairly grim mood. The depth of the financial markets crisis has, I suspect, yet to be fully exposed. Oil and global food prices are both at historic highs, which is raising the prospect of inflation, already at a 14 year high in the Eurozone. The political atmosphere is defined by greater anxiety and greater uncertainty.

There is a real risk of a popular backlash against the openness that underpins our prosperity. There is a growing sense not just in Europe but in the US also that globalisation is something that is being done to us, rather than something we can control or can hope to shape. This year's US Presidential election will be fought against the threat of economic recession, a painful slump in house prices and stagnant real wages for many Americans. We can expect any or all of the candidates to suggest in one way or another that "it's the *global* economy stupid", stirring powerful isolationist instincts.

Tonight I want to address those instincts. I will argue that the densely integrated modern global economy raises new challenges of governance and global equity. It raises new challenges of risk and responsibility. But I also want to suggest that it is a place of unprecedented opportunity, for Europeans as much as anyone. I want to set out some of the ways in which I believe we need to rethink our politics after the openness boom. In particular what it means for our *states*, which far from being put out of business by global economic change are in fact making something of a comeback.

I would summarise our challenge in this way: it is to protect the opportunities at the heart of the openness boom from some of its consequences by using sensible, 21st century models of governance, and guarding against over-reaction. I want to make the case for something I will call 'projectionism' – a politics in Europe and a conception of the European Union that equips us to shape the openness boom not abandon it and, in doing so, project our values and our interests in a changing world.

The interlinked world

When Hillary Clinton said two months ago that the principle of comparative advantage between countries is no longer what it used be, she was right in one important respect. We are not trading Portuguese wine for English cloth anymore. We are not generating comparative advantage simply on the basis of our home market labour costs and technology base. We are building it by looking for efficiency advantages at a dozen points down global supply lines. Even countries that specialize in making the same things will generate trade and growth if they can find innovative ways to produce differentiated product ranges and lower their costs through specialisation. The EU and Korea both make cars. They trade a lot of cars because they make different *kinds* of cars.

The global ratio of trade to GDP, which is a rough measure of global economic integration, has grown faster than total output since the openness boom began and is still growing. Half of the UK's national income is tied to trade, half of France's, half of Germany's; almost 70% of China's. More than a third of all the manufactured consumer goods we buy are now the result of a global supply chain, and for complex goods like computers the figure is well over two thirds. More than half of global trade is now in intermediate goods. Your Nokia phone contains more than nine hundred components sourced in more than forty countries and the phone is then sold on in over eighty markets around the world. The supply chain is redefining what trade is, and how trade policy functions.

The most important thing about this increasingly dense economic integration is that it has drawn the developing world into the global economy and operated as an unprecedented ladder out of poverty. Twenty years ago, just 50 cents from every hundred dollars of foreign direct investment in the global economy went to developing countries. Last year that figure was thirty six dollars. Developing countries now account for a third of all global trade. By opening their economies to investment, focusing on state-directed export growth and producing goods for western markets the economies of Asia and Latin America have leveraged the fastest economic growth and the steepest reduction in poverty the world has ever seen. Measured objectively, in the last twenty years the EU's single biggest contribution to global poverty reduction has little to do with development aid and debt relief. It is the openness of our markets.

Many Europeans intuitively believe that a world in which China and India achieve export superpower status must be a world in which Europe's own measure of prosperity is proportionately reduced. But that is not what has happened. The European economy has had a net job creation rate for the last ten years of eighteen million jobs, despite steady increases in productivity and increased trade competition. Globalization turns out to be a striking example of the 'lump of labour' fallacy – the mistaken notion that there are only a fixed number of jobs to go around in the global economy. A hundred million new jobs in the developing world have not cost Europe a single job on aggregate.

Asian competition has also been good for Europe. European companies have responded to the new competitive pressure by looking for new areas of specialization, both in manufactures and especially in the services sector. Asia may have pressed on the accelerator, but we have kept a steady hand on the wheel. Just as the individual economies of the European Union have benefited hugely from the dynamic trade effects of the European Single Market, so the EU as a whole has prospered from the openness boom.

The challenges of openness

Now, that is what you might call the Davos picture of globalisation. But, of course, it is not the full picture. The openness boom also poses immense challenges, both for us and for the developing world.

First, and perhaps most importantly, the openness boom has its environmental costs. It is powered by carbon based energy and is, to some extent racing ahead of the ability of governments in the emerging economies to make its impact on the environment a sustainable one. If we do not wish to deny the billions of the developing world the same level of basic material prosperity that we take for granted, then our economic growth will have to be weaned off greenhouse gases, and its impact on our climate and our environment dramatically reduced. In environmental terms the openness boom shows no signs of being self-correcting – it is, as Nicholas Stern has said, probably the most important market failure in the history of markets.

Second, in our own societies, the overall employment figures and relatively strong fundamentals conceal the fact that the openness boom and technological change have caused painful adjustment for many in Europe because of the intense competitive pressure applied in labour-intensive manufacturing. We are competing harder both for our domestic and export markets. Old economic certainties have been eroded and as individuals we live in a much less certain economic world. That anxiety demands and requires a political response.

Third, a highly integrated global economy creates new risks as well as benefits. A glance at the business pages is enough to tell you why. Integrated global financial markets have proven to be good at both moving capital around the world but also at amplifying the volatility caused by imprudent lending, greed or speculation.

Nor, ultimately, have the benefits of the openness boom for the developing world been unqualified. Integration into the global economy has brought growing prosperity for many, but also the challenges of industrialization, with its complex internal trade offs between the needs of the rural poor and those of a growing urban class. The competition between developing countries for the markets of the developed world inevitably produces winners and losers – as when Bangladesh's or South Africa's textile industry felt the brunt of Chinese textile liberalization three years ago. The Tata Nano car is an interesting measure for both how far these economies have come and how far they have to go. The Nano is the cheapest car in the world. It is produced by an Indian company that is close to buying the British carmaker Jaguar, that makes some of the most expensive cars in the world. But at one hundred thousand rupees the Nano costs more than thirty years income for some 300 million Indians. Which is to say that the demographic and poverty challenges remain daunting.

Better globalization, not better off without globalization

So the openness boom has not been a panacea for economic development, nor will trade liberalization ever be. It is a powerful transformative force, but not a magic wand. Yet in my three years as European Trade Commissioner I have never met a policymaker in the developing world who denies that integration into the global economy is the best tool they have for development. Interestingly, I can't say the same for some Western development NGOs, but that is, as they say, another story. It is often pointed out that India has more people living on \$1 a day than all of Sub-Saharan Africa. But India also has a growing economy, plugged into the global economy, that can in principle provide the tools over time to reduce that poverty. A new generation of African economic reformers is increasingly recognizing that the challenge for Africa is to break out of dependence on basic commodity trade by gradually integrating into global markets and building up a greater capacity to trade through private and public investment. Not throwing their markets open overnight, but trying to claim a greater share of the openness boom that has so far largely left them behind.

The arguments against excessive optimism about globalization are sobering ones. They are compelling arguments for effective governance. They are compelling arguments for the better policing of risk and a better enforcement of global responsibility. But there is a need to be careful that we do not allow the unquestionable argument that globalization could work better to become the argument that we are better off without it.

The global financial system that exported subprime risk is the same global financial system that we will need if we are to bring foreign direct investment into the overwhelming majority of African economies that still have total banking assets of less than \$1 billion. The global economy that is changing our economic reality in Europe is also the single most effective tool we have ever seen for reducing global poverty and a vital source of dynamism in our own economy. The openness boom has been overseen in many cases by states that are far from democratic, but there is good reason to believe that the aspirational middle classes it is producing will eventually demand the legal security and cultural and political pluralism that turn an open economy into a free society. So there are no simple answers. But there are also no convincing arguments for seeking to put the openness boom into reverse. There are only arguments for trying to shape it better. Here I think we are confronted with some important political choices about how we govern ourselves. I want to highlight three of them in the concluding part of this lecture.

The return of the state

The first is about the role of the nation state. The state has survived the openness boom in fairly robust health. The idea that globalization meant the end of government was either undue pessimism or wishful thinking – depending on your politics. Most of Europe's major

trading partners are not exactly liberal purists: they are interventionist states that have made a pragmatic accommodation with the global economy and export-led growth and are willing to distort fair competition and conditions of trade if they believe it is in their interests. They also now control some of the world's largest reserves of capital in the form of the Sovereign Wealth Funds and similar state-backed investment vehicles. The response of some in Europe to this has been to argue that Europe's less interventionist approach is naïve. But it's important to draw the right conclusions from this fact about the role of the state in the global economy – because it's easy to draw the wrong ones.

The return of the state – particularly the return of a state whose democratic credentials are dubious – is not a justification for economic protectionism. Vigilance, absolutely. Protectionism and containment no. Why? Because openness is in our economic interest. And because if we get our response to the rise of countries like China and Russia right and integrate them into the global economy, economic openness, will I believe, over time translate into greater political openness.

Large state-backed investment in our own economies does require us to keep a watchful eye to ensure that it is open and commercially motivated. There are sectors like defence that have a strategic role that makes them inappropriate for foreign control. Or like energy, where we should be open to participation in our markets by state-owned foreign companies only under certain conditions.

State interventionism abroad also makes it harder politically to justify openness in our own economies when our largest trading partners maintain barriers in theirs – even if our own openness makes economic sense. It requires that we take a robust line in defending ourselves against below-cost subsidised imports and to insist on a certain degree of reciprocity from these trading partners in terms of market access. An open trade policy will not remain open for long otherwise, because it will not be politically sustainable. In trade politics, a simple-minded liberal very quickly gets mugged by reality.

But it should not be seen as an invitation to return to an interventionist "picking-winners" industrial policy or protectionist trade policy of our own. Governments have an essential role in correcting market failures and providing regulatory frameworks, but economic nationalism in our own economy and in those of others has a bad track record – even if others keep doing it. As the Cambridge economist Joan Robinson put it "just because others are throwing rocks in their harbours doesn't mean we should do the same". Our deep economic integration in the global economy means that policies that try and shut Europe off from competitive pressure or imports can easily damage the very European economic interests they intend to serve. The European economic interest is not the sum of what happens within our borders.

Essentially, we are faced with the choice between capturing our domestic market for ourselves, or using the open global economy to grow aggregate global demand – and then enlarging our slice of that much bigger pie. Protectionism is about the former. We need both the economic understanding and, crucially, the political confidence, to choose the latter. We have much more to gain economically by using our openness to open the markets of others, removing barriers to trade, protecting and deepening the open global trading system, than we do by closing or restricting access to our markets. It is what I have termed "positive reciprocity". That is the chief reason why I have always been such a strong advocate of a new WTO trade agreement. It is why I pushed hard to re-orient European trade policy towards growing markets in Asia, both in terms of how we focus our resources and in the partners we choose for prospective free trade agreements. It was this progressive approach to Europe's place in the global economy that I sought to set out in the Global Europe trade policy strategy that I prepared for the European Commission in 2006 and which was endorsed by all its Member States.

But this is not an argument for a minimalist state. The state has a fundamental role in European society in ensuring that lives of greater change are not lives of greater insecurity. We need to make domestic policy in Europe that reinforces our international competitiveness, but not for the sake of competitiveness itself. International competitiveness is what underlies the strength of our economies and their capacity to provide private and public goods. That means profound changes in the way we think about the welfare state. I believe it means continuing high levels of public spending on basic social goods, even if we change the way these goods are provided and delivered to the individual. The Danish social model is not cheap. But it spends on goods – such as wage insurance – which promote social inclusion, employment and economic growth. It favours flexibility in labour markets, but protects individual workers as they move between jobs. It underwrites a strong, prosperous society with high levels of social equality.

The single greatest piece of political misdirection associated with globalization is the idea that it puts governments out of business. Scandinavia and the United States are part of the same global economy, but they have made very different political choices about how to distribute the prosperity it generates. The fundamental contradiction in the neo-liberal or neo-conservative approach to economics and politics is that it advocates both the benefits of an open global economy *and* the minimal social model and limited redistribution that ultimately makes exposure to an open global economy politically impossible to sustain. How much of the rising anxiety in the US about globalization is due to stagnating middle-class wages, limited redistribution and a different model of the welfare state I am not sure – but I have no doubt it plays a large part.

Education is of course also vital, and it means education for life. Our comparative advantage in the global economy is in skills and intellectual and creative content. We need to continue to invest heavily in research and development and highly skilled people, right down to the general level of education.

These are long-term investments with long-term dividends. Education is the long-term guarantor of openness and a bulwark against protectionism. It is true that European workers are expensive, but in competitiveness terms Europe's high wages are not the point. Paying the world's highest wages has not stopped Germany or Finland or Ireland from becoming some of the most competitive exporters in the global economy. What matters is what those wages are buying in terms of the quality of the labour or the value it adds. An iPod is made in China. It costs \$299 in the United States. Of that \$299, \$4 stays in China with the assembly companies. \$160 goes to the US companies that design, transport and retail the product. The ring of product development sites around this small city is testimony to the value that is added by the *conception* of a product, or a component or a vaccine, as much as by the act of making it.

The importance of rules

If government is making a comeback, so is global governance, the second aspect I want to highlight. Gordon Brown was absolutely right to raise this question on his recent trip to India. It is not just the rapidly changing political geography of the openness boom that is driving us to that inevitable conclusion, but the very nature of the problems we face. These are problems for which effective international policymaking can be crippled by those who choose to free-ride. We cannot afford – either in competitiveness or environmental terms – a new climate settlement, for example, that leaves major players outside the fold without serious, binding commitments of their own. This is why I have argued that we should lead, engage and encourage others rather than pursue a policy of negative reciprocity based on the threat of carbon taxes if others do not follow us. I took the same approach in the WTO Doha context: making strong conditional offers, predicated on others matching our ambition. I am

sorry that this approach has not been taken by everyone. The arguments against being the first to move are not arguments against moving at all. That is why multilateralism and global rules are the only credible option.

The WTO already governs the multilateral trading system with striking effectiveness. Brazil, India, China and other emerging economies now need to become genuine custodians of this open trading system – by which I mean, paying into it with further openness, in a way that reflects the benefits they are already taking from it.

Strengthened by these new global powers, the WTO will continue to be the bedrock of an open global trading system. Beyond the current round, the WTO will be an obvious platform for future global policy-making on difficult questions like investment and trade in energy. I plan to return to the future of the global trade agenda before the summer, when we know how the Doha round is going to end.

In the same way, the IMF provides much of the reach and expertise for better risk management in global financial flows. It should have a stronger role in overseeing macro financial stability and enforcing transparency. It should have a more clearly defined role as an independent international counselor to regulators and markets.

Aside from these policy choices, the same essential political renovation will confront all the major international institutions and standard-setting bodies. The Bretton Woods machinery was rooted in what you might call "the Atlantic consensus" - the assumption that the global economic and political order could be governed largely by the Atlantic world. In the wake of the openness boom that assumption now no longer holds. The multilateral institutions that survive will be the ones able to adapt to the new 21st century landscape. Survival and continued legitimacy means effectively integrating the rising political heavyweights of the developing world. This is not just a mark of their new strength, but of their new responsibilities. There is no imaginable global problem in the twenty-first century to which China and India, for example, are not a necessary part of the solution. Integrating these new players into the machinery of global governance may force us to reassess some of our assumptions about the balance of global power, but we have far more to lose from Russia or China's failure than we do from their success.

The indispensability of the European Union

My third and final point brings these two arguments about government and global governance together at the point where they matter most for Europeans. If we are to foster these progressive changes in the world we need a strong EU capable of projecting its influence effectively. It seems inevitable to me that as we respond to globalization the levels at which we regard it as preferable for government to function are likely to change. With our more atomized social lives, a greater degree of countervailing local community government makes obvious sense. Because we are no longer building communities on static local identities defined by birth and origin, we should be investing more in building them through local political engagement and public participation. Localism is not the rejection of globalization. It is a rational response and counterpart to it.

But we will also have to recognise the logic of moving some of our government upwards and outwards. This is where the utility of the EU becomes compelling. At age 50, the EU is making the transition from an inward-looking political confederation to an outward looking global actor. In the complex and challenging world I have described today it is the vital multiplier of European influence that allows Europeans to engage with globalisation. Globalisation will put intense pressure on any insular notion of Europeanism that is not focused on effective economic and political projection in the world. If I have made the case today against an EU of protectionism, then this is the case for an EU that uses 'projectionism'

In the last year the EU has put down an historic marker by proposing the most ambitious package of climate change measures in the global economy, and the world's first certification system for biofuels. It has pushed African development onto the G8 agenda and kept it there. It has kept the Doha round of world trade talks alive with by far the most ambitious package of agricultural liberalisation in the history of the global trading system. We have the weight to shape these global agendas, but only as a union, using our full collective strength.

To project our weight in the WTO and the multilateral trading system we need a strong EU. To negotiate effectively with continental partners on the scale of China, or Russia or the US, we need a continental voice of our own. As the largest export market for more than a hundred countries in the global economy the EU has a huge capacity to influence global standards on everything from carbon emissions and green technology to food and product safety. The EU Single Market is increasingly going global. But to set those standards at a European level, and to then promote them internationally, we need an effective European Union.

An effective EU means efficient European institutions at the centre. This is, I believe, the point from which current debate on the Reform Treaty should begin. If ratified, the treaty will equip the European Union's institutions to represent Europeans more effectively and coherently in the world. It is not a fundamental reform, but it is an essential one. It is not a blind leap into deeper integration – where it proposes further integration it does so as a means of enabling the EU to act more effectively in the collective interest. We cannot will the end of a more coherent, effective EU in the world – and, therefore, a more effective Britain - without willing the most important means to achieve it. It is important not to fall into the trap of judging this treaty by how little it changes, or how much of the status quo it leaves untouched. Because Europe needs to change. It needs reform. The balance among member states needs to tip some way in favour of a greater capacity to project a coherent European policy internationally where we have decided to act together. So judge the treaty by what it does, not what it does not do.

Conclusion

Politics often struggles to address structural change. The openness boom, the shift in the global economy at the end of the last century that is propelling Asia back to global prominence, is as significant as the end of the Cold War in redefining the economic and political world we live in. The word commentators usually use is 'seismic' or 'tectonic' – and for good reason, because it is a shift at a fundamental level.

It is obvious that such a shift cannot take place without profoundly affecting our lives in Europe. My argument today has been that it has done exactly that, and largely for the better. It has tied the prosperity of billions of others to the openness of our own markets and our prosperity to the openness of theirs – and it has increased both. The most obvious consequence of the openness boom has been an unprecedented retreat of global poverty and a massive flowering of human potential. It brings with it a generation of new political challenges, the most fundamental of which is to preserve its benefits while limiting its costs. If the progressive challenge in the twentieth century was to humanize capitalism, its work in this century is to humanize the openness boom.

The tectonic metaphor is misleading in one important sense. The simple message of that line graph with which I started this lecture is that globalisation was created by political choices and while it has a huge amount of momentum, it could nevertheless be undone by politics, especially the anxious politics of the developed world. We need to create a positive politics of globalization, and a progressive policy that serves that politics of openness.

I have set out today some of the ways in which I think Europeans – and Americans, including the next US President - can do this. In their approach to the role of the state and government. In the way we see employment and the economy. In our renovation of global institutions and renewed commitment to the indispensability of the EU. They all return to the notion of 'projectionism': the need to build the capacity to project our values and interests as Europeans in the global age. We need to root this policy in a wider vision of European reform that remakes the European social compact for the twenty first century: equipping Europeans to live in a global economy, projecting their interests globally and ensuring the benefits of that economy are not just maximized but equitably shared.