

REGIONALISM IN A CONVERGING WORLD

TOYOO GYOHTEN



A REPORT TO THE TRILATERAL COMMISSION: 42

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A Report to
The Trilateral Commission

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The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.

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THE TRILATERAL COMMISSION

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The Trilateral Process

The project work of the Trilateral Commission in 1991-92 was organized around three working groups, composed largely of Commission members. The working group on economic interdependence issues was led by Toyoo Gyohten and focused on regionalism and globalism in the international economy.

The paper which follows is the responsibility of Toyoo Gyohten, although he was aided by a number of other members of the group. Particularly helpful were those members who participated in and/or provided papers or memoranda for the group's workshop in Tokyo on January 16-17, 1992. From the European side, these members were Mario Monti (Dean of Bocconi University in Milan), Sir Michael Palliser (Chairman of Samuel Montagu & Co. in London and former Permanent Under-Secretary of State in the Foreign and Commonwealth Office), and Niels Thygesen (Professor of Economics at the Economics Institute of Copenhagen University and an independent member of the Committee for the Study of Economic and Monetary Union in Europe). From the North American side, they were Jake Warren (Principal Trade Policy Advisor to the Québec Government and former Canadian Coordinator for Multilateral Trade Negotiations), C. Fred Bergsten (Director of the Institute for International Economics and former U.S. Assistant Secretary of the Treasury for International Affairs), and Lester Thurow (Professor of Economics and Dean of the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology). From the Japanese side, they were Yoichi Funabashi (Columnist for *Asahi Shimbun*), Yotaro Kobayashi (Chairman and Chief Executive Officer of Fuji Xerox Co.), Takashi Hosomi (Chairman of the NLI Research Institute and former Chairman of the Overseas Economic Cooperation Fund), Akira Kojima (Senior Editor of the Editorial Bureau and International News Editor at *Nihon Keizai Shimbun*), Kaneo Nakamura (Advisor to the Industrial Bank of Japan), Kazuo Nukazawa (Managing Director of the Keidanren), and Tadashi Yamamoto (Japanese Director of the Trilateral Commission and President of the Japan Center for International Exchange). Also participating in the workshop and of central importance in the subsequent drafting of this paper was Charles E. Morrison, Senior Research Associate at the Japan Center for International Exchange and Director of the International Program on Economics and Politics at the East-West Center in Hawaii.

Fourteen other Japanese members joined the workshop for its concluding luncheon session. At earlier meals the group was joined by Koji Watanabe, then about to step down as Deputy Minister of Foreign Affairs, and Noburu Hatekeyama, MITI Vice Minister for International Affairs.

The papers prepared for the January 1992 Tokyo workshop by Yotaro Kobayashi, Jake Warren and Lester Thurow appear in a Trilateral Commission publication entitled *Working Group Papers 1991-92*, a collection of individual papers prepared for the three working groups in operation in 1991-92.

The paper which follows was prepared after the January workshop for discussion at the 1992 annual meeting of the Trilateral Commission, held in Lisbon, Portugal, on April 25-27. Minor refinements followed the Lisbon meeting before publication.

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I. INTRODUCTION

Like the global security system, the international economic system is facing uncertainty. The writings of the Trilateral Commission have long acknowledged one source of tension—that between economic nationalism and economic interdependence. The alternative to globalism was principally assumed to be nationalism. More recently a new spectre has arisen—a world economy in which global economic arrangements are overshadowed by regional economic blocs.

This vision is an extrapolation from strands of current reality. At least one "bloc" already exists—the European Community. In North America a free trade arrangement is in place between Canada and the United States, a North American Free Trade Arrangement (NAFTA) is being negotiated on a triangular basis with Mexico, and there is talk of further expansion. There is also discussion of Asia-Pacific regionalism (including North America) and East Asian regionalism. The loss of momentum in the GATT Uruguay Round global trade negotiations is another strand of reality that gives rise to the perception that regionalism is on the rise. Perhaps even more important have been the continuous economic frictions between Western Europe, the United States, and Japan, which overshadow (at least in terms of media and political attention) extensive trilateral business and government cooperation.

The world is a long way from three antagonistic, protectionist regional blocs. But economic blocs represent a real danger to global welfare and organization because regionalism can so easily align itself with the forces of economic nationalism rather than globalism. Indeed, several short- and longer-term factors are pushing regionalism in the direction of protectionism:

- The near-term economic outlook is not good for any of the trilateral regions. While the recession in the United States has not been deep, there is yet little sign of a strong economic upturn. Europe is experiencing slow growth, and, in Japan, despite a growth rate that

is still the envy of other regions, economic pessimism is the order of the day. In recessionary times, the climate for global economic liberalization worsens, and the forces of protectionism increase. This may benefit nationalism more than regionalism, but to the extent that regionalism continues, its thrust is toward a more closed, protectionist direction.

- The Uruguay Round of GATT negotiations, launched in 1986, continues to slip successive deadlines for compromise. This needs to be placed in the context of the especially ambitious agenda for this round as compared to previous ones, but nonetheless it contributes to disillusionment with global trade harmonization.
- In Western Europe and North America some argue that increased global openness will benefit Japan more than the other regions because of differences in the nature of government-business and inter-firm relationships in Japan. Whether or not these arguments are true (they have not been carefully investigated), they appear to be gaining wider acceptance among political and government elites. The recent growth in Japan's trade surpluses with the other two regions, after several years of decline, gives more ammunition to those espousing this argument. At the same time, fear of exclusion from other potential blocs is a force behind arguments in Japan that it needs to be thinking about an Asian bloc option as an alternative to trilateralism.
- Finally, the rhetoric about regional trade "blocs" may be a self-fulfilling prophecy. Except for Europe, which is moving toward a comprehensive integration, there are few signs of true "blocs." Nonetheless, in each region the perception that the others are moving in the direction of economic blocs can be used to justify such moves on the part of that region. Such pressures need not come first or primarily from the leading economies in each region. In particular, in a time of apparently increasing protectionist pressures, developing countries and smaller advanced countries will be increasingly concerned about their access to their major markets, and may see regionalism guaranteeing a means of liberal access to at least one advanced country market. The concern to maintain markets, for example, motivated Canadian and Mexican interest in a free trade arrangement with the United States despite their historic fear of economic exploitation by their superpower neighbor and sparked a proposal by Malaysian Prime Minister Mahathir for an East Asian economic grouping.

It is important, however, to place the current movement toward regionalism in a balanced perspective. The discussion in the media on the growth of regionalism is frequently misleading in several respects. First, the public discussion often assumes that regionalism is developing in the same direction and at the same pace in Europe, North America, and Japan. In fact, the processes leading toward regional cooperation in these areas are occurring under very different political, economic, and social conditions, affecting their nature and speed. The three regions should not be equated with one another.

Second, the growth of interdependence and regional cooperation among geographically neighboring countries does not necessarily imply a "bloc." Most countries are experiencing a process of increased interdependence with neighboring countries and with the rest of the world simultaneously. Cooperative relations are developing both within the three regions and among the regions on a trilateral basis. Indeed the Group of Seven, cutting across the three regions, is a quite remarkable example of economic consultation and cooperation.

Finally, and most importantly for this paper, regionalism need not be opposed to globalism. The world should not have to choose between one or the other. It needs to live with both. *The challenge—and central topic of this paper—is how to channel the forces of regionalism in directions compatible with and supportive of globalism.*

* * *

In the next section, this paper will review the relationship between regionalism and globalism in more detail. In the third section, it will examine the development of regionalism in Europe, North America, and East Asia, and the implications for global economic cooperation. The fourth and final section will examine the relationship between regionalism and globalism in the fields of trade and investment, macroeconomic policy, and financial regulation.

- When regional arrangements encourage the members to become more open to the freer global flow of goods, services, and capital. It has been argued that the European integration process has a positive effect on the trade policy of some of its least open members. For example, because of their participation in creating a single European market, France and Italy had to agree to a phased liberalization of Japanese car imports. And, as noted below, one of the principal motivations behind NAFTA is the positive effect it will have in consolidating Mexican economic reforms.
 - When there are significant political benefits to regionalism. Economic regionalism in Europe was initiated in the 1950s not primarily for its economic impact, but for the political purpose of linking the economies of the two main rivals of continental Europe, Germany and France, so tightly together that war would become unimaginable. In this respect, the European integration process has been very successful. The political stability wrought by European Community processes has had tremendous economic benefits for Europe and the world.
- On the other hand, regionalism is destructive to global welfare under the following conditions:
- When regional arrangements are inward-looking and intended to shut out outsiders, minimizing competition within the region. In this case, the trade-diverting effects exceed the trade-creating ones, and there is less than optimal economic welfare both within the regions themselves and globally.
 - When efforts to create regional institutions come at the expense of governmental attention and political will for global arrangements.
 - When regionalism reinforces perceptions of economic or racial differences and frictions and aggravates political tensions.

Clearly an international economy dominated by large, closed regional blocs is far less desirable than a world in which open regional arrangements supplement and push forward a process of worldwide economic liberalization. A world of two or three economic blocs would inevitably exclude some countries and even whole regions. Three regional blocs in Europe, the Americas, and East Asia, each powered by at least one major advanced economy, would probably exclude Africa, the Middle East, South Asia, and the former Soviet republics from non-discriminatory access to any of the great economic regions of the world.

II. REGIONALISM AND GLOBALISM

In this section we review in more detail both the constructive and destructive potential of regionalism from the perspective of global welfare. It has long been recognized that regional arrangements can be complementary with and supportive of globalism. Regional arrangements benefit global welfare:

- When the dynamic trade-creating effects of regionalism exceed the trade-diverting effects. Although trade regionalism runs counter to the central "most-favored nation" nondiscriminatory principle of the GATT, GATT Article XXIV acknowledges the desirability of closer economic integration on a regional basis when the agreements do not raise barriers to trade with third parties, cover substantially all trade among the member countries, and are reported to the GATT. The argument is typically made by the supporters of these arrangements that by creating a wider market and improving efficiencies and economies-of-scale, dynamic growth processes are unleashed that increase imports beyond what they would have been otherwise, creating gains for outsiders. In most instances, it is impossible to measure precisely the trade-creating and -diverting effects, but undoubtedly regionalism can be a positive benefit not just to members but also to outsiders.
- When regional arrangements provide models or building blocks for increased or strengthened globalism. When the arrangements made among members not only meet the standards of global international organizations but improve upon those standards, they may serve as potential models for global arrangements. For example, some have argued that the European Monetary System (EMS), which provides a band within which European currencies fluctuate against each other, should be emulated by the trilateral countries. Similarly, the U.S.-Canadian Free Trade Agreement went beyond the GATT in its coverage of trade-related investment measures and services and in its dispute-settlement mechanisms.

A world of sharply defined, inward-looking regional blocs would also be associated with dramatically increased political tensions among the blocs. The process of standardizing economic regimes within each bloc would likely accentuate the differences between blocs and make each regime more resistant to compromises with non-members. In turn, these differences would augment mutual suspicions and economic frictions with potentially very dangerous political consequences.

In actual practice, as the next section illustrates, regionalism is not either fully open or fully closed. The question is where the balance is struck.

III. REGIONALISM IN EUROPE, NORTH AMERICA AND EAST ASIA

What are the forces that are driving regionalism in each region and what are the implications for global arrangements? This is not the place to describe the developments in each region in detail. Rather the intention is to paint these developments in broad strokes, providing a general sense of the differences across these regions and the forces for increased regional cooperation.

A. EUROPE

Western Europe represents regionalism in its truest form. The comprehensive political and economic goals of the European integration movement were evident from its initiation, although it was not clear that it would succeed. The 1957 Treaty of Rome establishing the European Community called for an "ever closer union." Movement in this direction accelerated after the 1985 Luxembourg summit, which adopted the "Single European Act" intended to realize a single market by the end of 1992. This process required the reconciliation of national laws in many areas, but as the process gathered steam in the late 1980s, the single market became only the next step on the way to a grander vision of a united Europe.

The Maastricht summit of 9-10 December 1991 produced agreements on Economic and Monetary Union (EMU) and political union, together forming the "Treaty on European Union," the most significant step in European integration since the Treaty of Rome. How rapidly the integrative process will proceed remains to be clarified, but at least three conclusions can be reached.

First, the steps toward deepening are dramatic and designed to be irreversible. The process toward EMU was initiated in 1990. Capital liberalization has been completed. A common currency (the European Currency Unit) will be adopted as early as 1997 (if at least seven

countries have met a set of tough economic criteria) or 1999 at the latest. A European Monetary Institute will be established in 1994 to prepare for the Community's central bank later in the decade. The United Kingdom has reserved its position on this—the "opt out" clause—retaining for the British Parliament the right to take or refuse the final decision to join the process. Other European supranational institutions—the Commission's bureaucracy, the court, and parliament—will have expanded powers. These vary by subject, but together they signify a European political process in most matters of governance, including social and labor policies for all members except Britain, which again insisted on the right to opt out. After the Maastricht summit, an *Economist* editorial pronounced the verdict: "Call it what you will: by any other name it is federal government."

Second, Europe will be fashioning common foreign and defense policies but at a slower pace than economic and monetary union. In these areas of high politics, the principle of unanimity is still the order of the day for important Community initiatives, but national governments will be under increased pressure to coordinate their policies. Defense will be discussed in the Western European Union (WEU), which also may become an arm through which defense-related decisions are implemented. These defense arrangements are not exclusive, but will exist alongside and be compatible with NATO.

Third, the process of widening Europe will continue simultaneously with deepening. The seven-member EFTA group has access to the common market through the October 1991 agreement establishing the "European Economic Area" (EEA). Although the EFTA countries must adhere to EC rules and policies under the EEA, they have no access to European decision-making, a situation that impels its members to seek EC membership. Austria, Finland, and Sweden are leading the way. Beyond EFTA, Czechoslovakia, Poland, and Hungary now have agreements of association with the EC providing for a gradual phase out of tariffs, and similar arrangements are envisaged for Bulgaria and Romania. There is also now discussion of the EC's relationship with some of the members of the CIS. There is no agreed view within the Community on the attitude to take towards eventual membership for some or all of the East European states, let alone those of the CIS.

There is indeed a growing debate within EC countries about the merits of the Maastricht Treaty, as the parliaments of the member countries approach the task of ratifying it. Sceptics claim either that ratification will not be achieved, or that, even if it is, the Maastricht

deadlines cannot possibly be met and that the widening of the Community will negate the deepening agreed at Maastricht. In part, these doubts are prompted by general economic recession; and in Germany also by the major problems posed by the integration of East Germany. But, whatever the strength or validity of these doubts, it is wiser to plan on the basis of the ratification of the Maastricht Treaty and the effective pursuit of the objectives it established.

As the European economic integration process accelerated in the late 1980s, there was considerable fear in the other regions that Europe could become a closed region, or "Fortress Europe." These fears have gradually receded as it increasingly appears that there are solid benefits to the rest of the world in the acceleration of the European integration process. The Europeans argued from the beginning that the economic efficiencies associated with the single market would result in increased European growth and exports from other regions. They also promised that the European codes would not make Europe as a whole less accessible than before. It appears these pledges are being borne out.

Although outsiders (like Europeans) justifiably complain of excessive bureaucracy in Brussels, the basic thrust of the integrative process is to simplify the interaction of outside businesses with Europe as a whole. The common currency will not only save Europeans vast sums in foreign exchange commissions and hedging costs, but reduce foreign exchange and other banking costs for outsiders wishing to operate throughout Europe. The use of a single currency should also facilitate corporate planning and pricing strategies and hence increase efficiency.

Moreover, if the single market strengthens the competitiveness of European firms, as it is designed to do, this increases global economic efficiency, and may reduce protectionist pressures in Europe from non-competitive small industries.

In sum, the regional integration process in Europe can be seen as akin to an exercise in nation-building. Although there are many steps yet to be taken, Europe will increasingly act as a united economic unit and may eventually become a political unit as well. The rest of the world should support the process of integration itself, insisting at the same time that the new European Union be firmly committed to be outward-looking and non-protectionist, thus strengthening trilateral economic and political relationships.

B. NORTH AMERICA

North America presents a very different case of regionalism. First, only three countries are currently engaged in regional trade arrangements: the United States, Canada, and Mexico, the first two of which already formed a free trade arrangement that took effect in 1989. Second, NAFTA is far less comprehensive than the European Union. Trade, investment, services, and environmental concerns will be covered, the last forced onto the agenda by political pressures and handled in separate, but parallel agreements. But there will be no common external tariff and no common labor policies, much less monetary and political integration.

The three governments are committed to respecting GATT rules and incorporating the results of the Uruguay Round into NAFTA. For Canada and Mexico, more than 70 percent of their trade is with the United States, and, therefore, guaranteed access to the U.S. market might reasonably expect through the GATT process. On the other hand, more than 70 percent of U.S. trade is with countries other than Canada and Mexico. This should serve to underscore the tangible U.S. interest in strengthening economic arrangements on a broader international basis.

Moreover, a central purpose of NAFTA is to promote trade liberalization on the part of the member countries. The expansion of the U.S.-Canadian arrangement to Mexico came in response to a Mexican initiative, intended by President Carlos Salinas de Gortari to consolidate Mexico's economic opening and reform program. The free trade arrangements, Salinas hoped, would provide a stimulus to the Mexican economy while providing some assurance that the trade liberalization and privatization would stay on course. The value of the agreements in terms of assisting Mexican economic reform and development is appreciated not just by the other two NAFTA partners, but more generally in the other two regions.

The Bush Administration has suggested that free trade arrangements could be expanded to other liberalizing Latin American countries under its Enterprise for the Americas initiative. It is unclear why such an expansion should occur on a geographically defined basis. The case could be made that far more economic integration has occurred between the United States and the Asian-Pacific rim nations, and that any further expansion of U.S. free trade arrangements should not exclude the Asian trading partners.

C. EAST ASIA

Regionalism in East Asia is by far the least developed of the three regions, in part reflecting the diversity of the region and in part the strong intrusion of outside economic influence, especially from the United States. At least three different kinds of nascent regionalism can be discerned:

- At the subregional level in Southeast Asia, the six-nation Association of Southeast Asian Nations (ASEAN) has been promoting economic cooperation among its members since 1967. At the end of January 1992, the group announced plans to form an ASEAN Free Trade Area (AFTA) over a 15-year period. Although the planning of the AFTA is going forward, many technical issues are still to be resolved (including rules of origin and content requirements, criteria for excluded items, and a dispute-settlement mechanism). AFTA members account for only about 19 percent of each other's trade, and there are no current plans for a common external tariff.
- On the Asian regional level, an East Asian Economic Caucus was proposed by Malaysia's Prime Minister Mahathir Mohamad in December 1990 in the wake of the breakdown of the GATT ministerial conference. North America and Australia/New Zealand would be excluded from this grouping, which was clearly motivated by the fear that regional groupings were taking root elsewhere. The Malaysian leader argues that EAEC would permit the East Asian countries to discuss common problems, including the implications of regionalism elsewhere, but that he did not aim at creating an Asian bloc. The proposal was considered at the 1992 ASEAN summit and given pro forma endorsement on an as-needed basis. It was strongly opposed by the Bush Administration, which feared that an East Asian grouping would complicate the already sensitive U.S.-Japan relationship and encourage Congressional protectionism targeted at Asia. Japan and South Korea share some of these concerns and under strong U.S. pressure have given no encouragement to Mr. Mahathir.
- At the Asia-Pacific level, a North American, East Asian, and Oceanic group of countries in 1989 initiated a series of ministerial meetings of economic and foreign ministers called the Asia-Pacific Economic Cooperation (APEC) process. Under the APEC framework, working groups have been established for specific sectors. Statistical information and analyses are being exchanged

with a view toward strengthening trans-Pacific economic cooperation. Meetings of APEC trade officials have been keyed to the Uruguay Round, attempting to demonstrate Asia-Pacific support for pushing forward the process of global liberalization. In September 1992, the APEC group agreed to establish a small secretariat in Singapore and created a private "Eminent Persons Group" under the chairmanship of C. Fred Bergsten to make recommendations on the future of the institution. While some envision APEC as a Pacific-oriented OECD-type institution, others see it as the basis for an Asia-Pacific preferential trade agreement. APEC leaders stress that APEC is a form of "open regionalism" intended to reinforce the global trading system through regional consultations and cooperation.

Despite the limited institutional development of regionalism in East Asia, there has been considerable discussion of the potential for an "economic bloc" within the region or between it and North America. In Europe, for example, there has been apprehension about a Pacific Basin or Asia-Pacific bloc, stimulated by non-official meetings through the 1980s, leading to the establishment of APEC toward the end of the decade. Some leading citizens of both Japan and the United States have called for either a bilateral U.S.-Japan free trade arrangement or a broader Pacific arrangement. Serious studies in both countries have pointed up the complexity of any such arrangement and the adverse effect that an arrangement involving the world's two largest economies would have on nondiscriminatory global trade.

Apprehensions about the development of an East Asian bloc in Europe and North America were stimulated not only by the Mahathir proposal, but also by the growing web of Japanese investment and trade relations around the region. In one formulation the concern is that despite the lack of governmental institutional arrangements, private Japanese companies are weaving the economies of the region together in a way reminiscent of Japan's own economy, spreading a form of capitalism and inter-business relations resistant to outside penetration and influence. This perception has not been seriously analyzed, and it can be equally hypothesized that the outward spread of Japanese capital and production processes are internationalizing Japanese firms, whether they like it or not.

Japan's economic role in the development of the rest of Asia is a critical one. The growth processes in the region are sometimes likened

to a "Staircase Phenomenon," or "Flying Geese" pattern of development, with economies at earlier stages of development becoming progressively more competitive in value-added manufactures as the more advanced economies lose competitiveness. Japan, for example, has lost competitiveness in such industries as steel, textiles, shipbuilding, electrical machinery, and consumer durables as it moves toward more technologically advanced, higher-value-added products. But Japan's traditional industries move offshore, playing a major role through direct investment, joint ventures, and technology-sharing agreements in building these same industries in the economies where labor and land costs are cheaper.

In other words, leaders on the East Asia Staircase are bound to provide stimuli which encourage the economic development of the followers. They need to help develop other fledgling industrial economies in order to maintain their own advance. This vertical upward dynamic characteristic of East Asia is quite in contrast with the horizontal centripetal dynamic that has been driving the European Community toward a single market.

It is important to note that the large, open market of the United States and the growing opportunities in European markets have also been critical to the success of the staircase process of development in East Asia. The United States has also played a vital role in providing security and encouraging political stability in the region. More closed markets in North America and Europe—or a movement toward a closed East Asia bloc that could deepen protectionist impulses elsewhere—would cause serious damage to economic growth in East Asia.

In sum, there is little concrete sign of the development of Asian or Asia-Pacific regionalism in a manner inimical to global economic relationships. Regionalism in this area is more likely to be defensive in nature, that is, a bargaining tool vis-à-vis the other regions or a fall-back because of the fear of exclusion. The North American market remains very significant to most Asian exporters, and for this reason most Asian governments will avoid moves toward regionalism that might give added impetus to U.S. protectionism.

regarded as ends in themselves, but as supplements to global liberalization. To ensure that this is the case, at least two recommendations are in order.

First, the momentum toward global trade and investment liberalization needs to continue after the Uruguay Round. Even if the negotiating parties reach a final agreement, there will be many issues that will require further efforts and refinement. Exactly what form these efforts should take is beyond the scope of this paper, but some form of international trade organization with an ability to sustain negotiations on a continual basis would seem advisable.

Second, under GATT or a successor organization, there should be increased discipline in applying "Article XXIV" standards to ensure that regional arrangements are trade-creating rather than -diverting, as recommended by the 1985 GATT wisemen's group chaired by Fritz Leutwiler. In fact, the GATT has exercised little discipline over such arrangements, primarily for political reasons.

IV. GLOBAL AND REGIONAL STRATEGIES FOR ADDRESSING ECONOMIC ISSUES

This paper has argued that regionalism can be compatible with global arrangements. This concluding section briefly describes the ways in which this relationship can be developed in three major areas of international economic interaction: trade and investment, macroeconomic policy coordination, and the financial system.

A. TRADE AND INVESTMENT

As the preceding survey makes clear, with the exception of Europe, it is principally in the areas of trade and investment that regional economic arrangements are being developed or contemplated. It is in these areas that regionalism thus appears to pose the greatest threat to globalism.

Existing regional arrangements, however, do not appear to contradict GATT and can be building blocks toward strengthening global international trade and investment arrangements. One exception might be the EC's Common Agricultural Policy (CAP), which has long been an obstacle to agricultural trade liberalization. But with the European Community taking on significant meaning in sectors other than agriculture, the importance of the CAP to European integration will decline, and this and other factors (such as the huge costs of the CAP) provide a better environment for European agricultural liberalization.

Most of the concerns about trade and investment regionalism, therefore, concern the future emphasis. Since regional arrangements are suboptimal to global arrangements in economic terms and potentially damaging in terms of political relations, they should not dominate the international trade and investment policy attention of the trilateral governments. Except where there is a clear intention to create a single federal unit, regional trade arrangements should not be

B. MACROECONOMIC POLICY

International macroeconomic policy coordination currently is developing in two ways. First, regional coordination is moving ahead very rapidly in Europe where economic and monetary union demands macroeconomic coordination. Second, discussion and very limited coordination has been occurring among the trilateral countries through the G-7 process.

These two processes can be described as basically compatible. European macroeconomic coordination may encourage globalism to the extent that "Europe" emerges over time as a single actor in macroeconomic coordination. The G-7 process, in fact, would be greatly simplified if "Europe" could come as a single partner to the table. There can be a rationale for macroeconomic coordination within the other two regions as well, at least for smaller countries whose currencies are closely tied to the currency of the dominant country. This should enhance, not inhibit, coordination among the trilateral countries. On the other hand, the European Monetary Union presents some risk of becoming so inward-looking that constructive trilateral cooperation to minimize exchange rate instability becomes difficult. This should be avoided.

When the regions are better structured to provide a basis for global cooperation, a workable scheme could be envisioned that would ensure a fair sharing of the burden of adjustment.

C. FINANCIAL REGULATION

A third area to be considered is that of financial regulation. As a 1989 report to the Trilateral Commission on international financial integration¹ pointed out, the globalization of financial markets produces tension with dated national structures for regulation, taxation, and policy-making. That report underlined the importance of macroeconomic policy coordination and structural adjustment in addressing the root causes of financial instability. Noting how the stock market crash of October 1987 demonstrated the vulnerability of the financial system, the authors also recommended a common framework of generalized rules to govern financial services.

With its single market and prospective common currency, the European Community will be developing a stronger European regulatory framework, and the harmonization within this unit should be beneficial globally as long as the financial markets remain open to the outside and regional harmonization is done with an eye to international practices elsewhere.

Aside from the close-knit European unit, the huge financial flows in the world today are occurring between Japan, North America, and Europe, with some other entities, such as Hong Kong, Taiwan, and Australia, as less important units. An effective framework of rules and institutions for international financial flows, therefore, should be developed across regions rather than within them.

While a strong priority should be given to global cooperation in the financial field, regional cooperation can play a useful supplementary role in more than just Europe. The former Communist countries and developing countries are seeking to develop or deepen financial institutions such as banking systems and stock exchanges. Countries whose institutions are already highly developed can provide assistance. It is natural that assistance might come from the more advanced countries within a region, although it should not be limited to them. Regional associations—public and private—of central bankers and of financial institutions can also play a valuable role in exchanging information, addressing common problems, and developing personal and institutional networks.

¹ Shijuro Ogata, Richard N. Cooper, and Horst Schulmann, *International Financial Integration: The Policy Challenges* (New York: Trilateral Commission, 1989).