



The EU and the US in a globalised economy: politics and priorities

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'A memo for the next US President'

Whoever moves into the Oval Office on 20 January 2009 will be the first US President whose foreign economic policy from day one will so clearly need to face up to a fundamental shift of global economic and political power from West to East. In this annual Churchill lecture, delivered in New York on 9 June 2008, EU Trade Commissioner Peter Mandelson argues that this means rethinking some central assumptions about how power works in the global economy, and how American and European governments can best defend their people and their interests. "The Atlantic world is no longer the centre of the economic world", Mandelson says, "because the economic world no longer has a centre". Mandelson argues that the American and European response to that fact could have immense consequences.

Mandelson sets out why:

- the next phase of globalisation will be dominated by questions of global resource pressure for water, energy and food. He writes that while economic internationalism remains the only way of addressing these problems effectively, it is being undermined at home by a "crisis of confidence" and a slide towards protectionism and zero-sum thinking in the US and Europe. Mandelson says: "In the 1950s Western politicians asked themselves: who lost China? I think what should worry us today is the idea that a decade from now we might be looking back and asking: who lost globalisation?"
- Americans and Europeans should worry about the failure of the developing world, not its success. Mandelson argues that it is not in European or US economic or political interests to "keep the developing world down". The level of interdependence in the global economy has made the costs in stability and prosperity of disengagement from a growing global economy dramatically high.
- protectionism starts in the pockets of Europeans and Americans, so their governments need to tackle rising economic inequality. Despite huge aggregate economic gains, support for globalisation in the EU and the US is being undermined by widening levels of economic insecurity and inequality in western societies. Reviewing OECD data for the last twenty years, Mandelson argues that strong welfare states have prepared and equipped countries for globalisation much better than weak ones. He urges Americans and Europeans to "recapture some of the radicalism of Roosevelt and the New Deal and remake the case that the state is there to help people get the most out of an open economy".
- resource pressure must be met with innovation and adaptation, not resource nationalism. Mandelson argued that recent export tariff raises in response to high food prices show the huge potential costs of resource nationalism. He writes, "for food importing countries in Africa, these restrictions can literally constitute a foreign policy of hunger". Mandelson argues for a mix of market solutions, innovation and adaptation to address the intense pressure development is putting on the environment.

- the risk is not a multipolar global economy, but the failure of the ties that hold those poles together. The greatest risk the EU and the US face is not "a world of multiple powers, but a world of multiple powers without institutions to coordinate their action and bind them together". Mandelson urges the renovation of global institutions to enable the emerging economies "not just to exercise their rights, but to assume their responsibilities".

The world on January 20

It's been an intense primary season in the US, a reminder that US Presidential politics sets an endurance standard unlike anywhere else. Still, if you think the run-up to November 4 is going to be tough, it will be a cakewalk compared to what comes next. Whoever moves into the Oval Office on January 20 next year will face a highly uncertain economic world. It's a reasonable bet that oil will still be above \$100 a barrel and, despite the predicted strong harvest this summer, food prices will remain high by recent standards. Central banks in Europe and the US will be trying to hold off a downturn at the same time as they face the inflationary effects of expensive food and oil. We will be calculating the costs of the crisis in global financial markets and its knock-on effects in the real economy. The next US President will be the first US President whose foreign economic policy from day one will so clearly need to face up to a fundamental shift in global economic and political power from West to East. A shift that is only beginning. This is the context for my lecture today.

This lecture is named for Winston Churchill, who lived through a global depression and two World Wars. By the end of his life Churchill had come to believe that Western politics needed to go through a paradigm shift in its attitudes to the relations between states. He was an early defender of both the United Nations and the idea of a European Union. In neither case was he an idealist – he said the purpose of the United Nations was to "save us from hell, not to take us to heaven". He saw these institutions as radical changes forced on us by realism. But we've become so accustomed to the world that a few far-sighted leaders of that generation helped to build that we forget how much of a break it represented with what went before. That system is about to face a period of intense strain. Renewing and preserving it will require that we understand both what we need to preserve in the current order, and where we need to face up to change. That's the balance I want to set out today. And if I had to identify the theme of my remarks, I would do so by quoting Churchill himself - "Those who build the present only in the image of the past will miss out entirely on the opportunities of the future".

The Atlantic world is no longer the centre of the economic world, because the economic world no longer has a centre. For thirty years globalisation was funded by western capital and structured to meet western demand. That has already begun to change – one in every six dollars in foreign direct investment last year came from outside the developed world. This is the first sign of a deep shift. Where the politics of globalisation have, up to now, revolved around foreign competitive pressure on our industry, or changing global patterns of production and supply, they will now also be dominated by questions of global resource pressure. For water, energy, and food. For a world of six billion and growing, in a global economy that is set to double in size during the next twenty five years. Who can deny that we need better global institutions and new ways of working together to address the strains and stresses that the resulting resource competition will create?

This poses immense risks for the open global economy we have benefited from for twenty years. Risks from within and without. If ordinary Europeans and Americans felt

fairly relaxed about their place in the international economic order after 1989, when the Berlin wall came down, they now feel a new anxiety about displacement by Asia. Conviction in the value of open economies and free trade is faltering. There is a sense that globalisation is something that is being done to us, rather than something that we control. The consequence is rising pressure for protection; we see it in growing economic nationalism at home, a return to fashion for zero sum thinking about resources and public goods. Our politics are full of examples. Who would have thought, ten years ago, that you would hear serious US Presidential candidates putting NAFTA in question? Or calling into question the desirability of concluding a world trade round? There are still too few leaders willing to stand up and make the opposite case: British Prime Minister Gordon Brown being one notable exception.

We have to address this crisis of confidence before it does some real damage, to us and to others. It is a mistake to believe we can play to the populist gallery on economic openness in the US and the EU without consequences. Consequences, not just for our immediate economic interests, but also for our ability to shape and manage globalisation as a whole. We have a far greater capacity to continue to benefit from globalisation than we seem to recognise. And far more to lose from a retreat from openness than we sometimes imagine.

Some new risks, same big opportunities

We are undergoing the biggest re-structuring of economic life since the industrial revolution. Yet, while in this further phase of globalisation, the risks and players have changed, the opportunities essentially have not. Most obviously, the EU and the US are no longer going to dictate the contours of global economic change. Globalisation's adolescents are growing up fast and starting to demand a bigger say in who gets to use the car and who chooses the TV channel.

We live in a world dominated by problems that Malthus would have enjoyed: above all, an increasingly large number of people, competing for an apparently finite amount of resources. The expectations of billions of people in the developing world for a life that pretty much resembles ours will exert huge new pressures on resources and on the environment. If the current patterns of excessive energy consumption by about one billion in the developed world are increased by a factor of 6 it is hard to see how we avoid consequences so severe they border on catastrophic. Yet the idea that this growth should be countered or contained is as morally unacceptable as the argument that the growth of, say, Kansas, or Portugal, should be contained. It would also be both economically and politically counterproductive. Running through everything I say today is the argument that it is not in our interests to keep the developing world down.

But that means that the economic internationalism that created and supported globalisation must be bolstered and extended. Why? Because only globalisation provides the economic tools to increase everybody's welfare in a way that meets people's expectations and needs. It can give us both a ladder out of poverty for the developing world and a tool for greater equity both between states and within our own societies. And it can drive the economic integration between states which can support – even if it cannot guarantee – a stable international system.

The last twenty years have been a bull market for liberalisation and trade. The openness of the global economy has only moved in one direction. Like any bull market, it is tempting to believe that there is no reverse gear. But history warns us against such presumptions. If it is not supported and shaped by political action, economic internationalism can easily give way to resource nationalism and economic isolationism. We are seeing that in our own politics. Without a new sense of leadership, without a concerted attempt to address the casualties and anxieties that have accompanied global economic change, we will find openness being resisted. The tools of economic internationalism will become increasingly hard to use. So, how do we get our response right? If I could see one memo on the Resolute Desk next January 20 it would contain four basic pieces of advice. Entirely unsolicited – because surprisingly neither John nor Barak has yet been in touch – they are as follows.

Worry about the failure of the developing world, not its success

First, what should worry us is not the success of the developing world, but its potential failure. Once we feared strong states opposing us. Now we have more to fear from weak states failing on us. If there is one condition that defines the global economy it is interdependence. There is no longer a drawbridge to lift up between “them” and “us”. The openness of our economies not only drives our own growth, but is the ladder that much of the developing world is using to climb out of poverty. The emerging world is now the new engine that is taking up the slack as demand cools in the US and European economies. This is likely to become even more important as populations age in the developed world.

Competition from the developing world has put intense pressure on parts of our economy and those pressures are not going away. But that pressure is also a stimulus to innovation and an engine for our growth. The emerging economies are the fastest growing markets for the things we are best at producing. The European economy has managed a net job creation rate of 18 million over the last decade, despite increased productivity and greater Asian competition. And the competition pays back in other ways. For the last ten years, price inflation has been six points lower for blue collar Americans than wealthy ones. Why? Because lower cost goods from Asia have kept down the prices of the consumer goods working class Americans as well as Europeans buy.

And the interdependence is not just economic. If growth in the developing world stalls the world would become less secure. A stalling or a crash of growth in China would be a disaster, not just for China but for us too. Young or rising populations in many parts of the developing world mean that governments need to create tens of millions of new jobs every year just to meet the basic expectations of their people. Effectively managing rising global demand for energy, water and access to food will only be possible in a system of stable, open and co-operating states. Like the Marshall plan, the enlightened self-interest at the core of globalisation is that your neighbours' stability is your security.

Protectionism starts in your pocket, so tackle rising economic inequality.

Second, if we do not act to address inequality and economic uncertainty in our societies, openness - in the broadest sense of economic, political and cultural openness - will become impossible to sustain against the inevitable backlash. For most Europeans and Americans their deepest concerns about economic internationalism relate to its impact on their personal economic security. They may have applauded the narrowing gap between the rich and the poor globally, but they now worry a lot more about the same gap widening in their own societies. There is a growing sense in the US and Europe that the gains from globalisation are not being shared equitably and that the victims are outnumbering the beneficiaries. Protectionism starts in your pocket. Unless we can demonstrate that the economic interests of middle and working class Americans and Europeans are compatible with the progressive enrichment of the developing world, support for globalisation will shrink.

Now, here we confront probably the most important piece of political misdirection associated with globalisation. The argument that globalisation makes active welfare states untenable: too unwieldy to cope with the flexible conditions that globalisation demands. Yet if you look at the data for the last twenty years it is clear that where they are designed right, flexible social welfare systems and high levels of spending on basic public goods in OECD countries have not had a negative effect on national income growth – and have actually helped boost it. Across the OECD, some of the most open and economically competitive societies in the world also maintain high levels of public spending and active safety nets. The most effective models favour flexibility in labour markets, but protect individual workers with wage insurance as they move between jobs. They fund a high level of education, at all levels, and support retraining because if we cannot keep people in their last job, we can help them obtain their next job.

Sustainable globalisation demands not only a sort of global social contract, but a domestic one also. Only by reducing some of the biggest economic risks in individual lives – particularly healthcare and unemployment - are societies psychologically ready to face the buffeting conditions of globalisation. 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 economic benefits that have come with it. Ultimately those choices may determine whether openness to globalisation can last. Only one in ten Swedes believes that their country's openness to globalisation is a bad thing, compared to 50% of Americans.

This is not to argue that Europe as a whole has struck the right balance. Some European social models meet these criteria for active and flexible support, but many still strengthen the position of labour market insiders over outsiders. They make it difficult to expand businesses and provide little encouragement for women or older people to enter or remain in the workforce. We still invest too little in innovation and research. It is also important to be clear: this argument for greater reduction of economic risk in our societies is not an argument for state socialism, direct market controls, import barriers and national ownership or direction of industry. But the state has to have a defining role in the global age in ensuring that lives of greater economic change are not lives of ever greater insecurity. This needs to be the new point of departure for thinkers on the centre right as much as the centre left. Protective states do not have to be protectionist ones.

Address resource pressure with innovation and adaptation, not resource nationalism

Third, the answer to a global resource squeeze is not to adopt beggar-thy-neighbour tactics by trying to grab a greater share for ourselves. Most of us remember what Malthus said about resource competition, but we must also remember why he was wrong about its consequences. Malthus' model assumed resource efficiency would always be outstripped by population growth. He didn't count on the revolution in crop science and agricultural productivity that made it possible to feed industrialising Britain. Or the effect that birth control and prosperity has on birth rates.

The price of oil reflects a lot of things. But fundamentally it reflects the fact that it won't last forever – especially with demand from China and India set to rise by 45% by 2030. The market is telling us that we should be focusing on the shift to alternative energy and a low-carbon economy, including nuclear power. Attempts to shield voters or business from this reality are ultimately as irresponsible as they are unrealistic.

Resource nationalism in agriculture carries similar risks, as the last few months have shown only too clearly. As one government after another has imposed new export tariffs in response to rising global food prices, they have pushed up prices for everyone else. They have obscured the market signals that would encourage their own farmers to improve productivity, which is what global food markets really need. For net food importers like Africa, these restrictions can literally constitute a foreign policy of hunger.

The answer is not purely free markets, because many of the poorest simply can't pay for food and have to rely on subsistence or aid. But we do need to exploit the market mechanism to encourage farmers to grow more food to meet rising global demand. In the same way, we must ensure that a high oil price imposes some rational thinking about energy security and pushes all of us – including China and India – into proportionate but binding commitments to reduce greenhouse gases.

Technology and human behaviour both proved Malthus wrong. Obviously innovation matters hugely. The current distrust of genetic modification in parts of the west is often irrational and a block on progress in the fight against world hunger. Technology can and will deliver solutions for greater energy efficiency and generation. But it is also a question of behaviour. No technological fix will remove the imperative for all human societies to rethink their impact on the environment.

The risk is not multipolarity but fragmentation, so focus on global governance.

My final point relates to institutions. How very apt, in the 21st Century, are President Kennedy's words used on Independence Day 1962, proposing a new and global declaration of inter-dependence: "Today Americans must learn to think inter-continentially. Acting alone by ourselves, America cannot establish justice throughout the world". We are in other words, all in this together

We agonise over the emergence of a multipolar world because we fear the decline in our relative weight. But the greater risk is not a world of multiple powers, but a world of multiple powers without institutions that coordinate their action and bind them together. The fact that China, India and the other emerging economies attain export superpower status is not contrary to our interests provided we continue to maintain competitive economies and focus on our comparative advantages. What none of us can afford is for the institutions that allow us to coexist to fall into disuse or irrelevance.

The major challenges that we face all require the building of global coalitions. The institutions of the international system, however imperfect, help us avoid conflict, manage tension, and broker solutions. Climate change and reducing the impact of growing consumption on the environment is perhaps the most obvious example. But the same is true for issues from international trade to nuclear proliferation. Multilateral solutions may not be perfect solutions, but they are better than the alternatives. For 60 years, Europe and the United States have underwritten institutions like the WTO, the UN, the GATT, the IMF and the World Bank. The challenge over the next decade is to renovate these institutions to accommodate the world's rising powers, to strengthen the multilateral system by giving them a greater stake. Renovation should not mean overturning the values and the principles these institutions represent, or diluting their agendas. Indeed in some cases there are good arguments for extending existing remits. Giving the IMF a greater role as a counsellor to central banks on global financial flows in the wake of the credit crisis. Or extending the World Bank's work to include environmental sustainability.

I am in absolutely no doubt that the rising powers in the developing world need to take on greater responsibilities to go with their greater rights – not least in the area of trade. If they do not, then inevitably the United States and Europe will start to step back and review what they are prepared to keep paying into the system. In a rules based system, there cannot be one set of rules for some and another set for others. But in all cases there is no question that international institutions will be risking irrelevance until the emerging economies feel a shared sense of custody. I simply see no alternative to a more balanced representation in the multilateral system.

Conclusion: the risky politics of zero sums

Let me sum up. Despite the rise of new powers and the intense pressure on global resources, globalisation and the benefits of the “openness boom” remain central to the solution of a more stable and equitable world, not part of the problem. Europeans and Americans in particular must adapt to a changed balance of power in the global economy, but there is no reason why this should erode our standard of living, or our security. On the contrary. We should continue to underwrite a global economy that is open to trade and investment. In future, much more of that investment will come from China, India and Brazil. If it is transparent, productive investment, I am inclined to say: good thing too. These growing markets will be growing markets for the goods and services that we supply.

We should see the shift of economic weight not only as inevitable, but as an opportunity for growth and human development. It needs to be accompanied by a more equitable global order and an effective redistribution of the burdens of

managing the multilateral system. We will only achieve this by remaking the machinery of global governance in a way that gives the rising powers a full sense of ownership. Attempts to counter or contain the growth of the emerging economies would be morally indefensible and politically and economically counterproductive.

In the 1950s Western politicians asked themselves: who lost China? That sounds rather patronising now. But I think what should worry us today is the idea that a decade from now we might be looking back and asking: who lost globalisation? Given the stakes as I have set them out today, it should be clear that politicians in Europe and the US are taking a huge gamble when they flirt with isolationism and protectionism.

The problem with economic nationalism is that it is highly politically contagious and it's hard to know just how much you stand to lose until it breaks out. A single export tax, or blocked investment, or import tariff may seem irrelevant against the openness of the global economy as a whole. But economic nationalism can quickly provoke an irrational spiral of negative reciprocity. As the biggest exporters and biggest investors in the global economy the US and Europe have the greatest weight in that economy, but, by the same token, we have a huge amount to lose from a global protectionist turn.

Rather, we should be doing everything we can to sustain openness. One of the most important ratchets to stop the global economic machine rolling backwards is the WTO. Through successive world trade rounds, the WTO and its predecessor have done a remarkable job of locking in new levels of openness in the global trading system. This is why the current failure to agree a deal in the WTO Doha Round of trade talks could have consequences not just in terms of lost trade for individual countries, not just in lost opportunities for growth and poverty eradication, but also in our ability to maintain the openness of the global economy in the long term. We have a potential deal on the table that could be worth more in new trade than any previous multilateral trade round. Yet the final trade offs that would put a balanced deal within reach are proving elusive. Negotiating fatigue is setting in. It would be gross irresponsibility if we fail where every previous trade round has succeeded. The failure could be shrugged off in the short term. But the systemic consequences for the maintenance of a rules-based international trade system would be considerable in the long term for the US and Europe, as well as for the developing world. The system would not go into free fall. But it would be damaged and weakened, and more vulnerable to abuse by those who don't want to play by the rules.

A lot has been written over the last few months about where the politics of globalisation has gone wrong in the US and Europe. I believe that both the fault and the fix lie largely in our own choices, whether on the political left or right. We need to be straight with Americans and Europeans about just how badly disengagement from the global economy would hurt their political and economic interests. And that means being honest about the extent to which protectionism is a dead end. But we also need to rethink our social contracts in a way that alleviates some of the biggest economic risks in life and thus prepares Europeans and Americans to cope with lives of greater economic change. We need to recapture some of the radicalism of Churchill's great contemporary Franklin Roosevelt and the New Deal and remake the

case that the state is there to help people get the most out of an open economy. Otherwise people will pull the door shut.

Few people would label themselves as protectionist or admit to seeing the economic world in zero-sum terms. But this barely-concealed argument still runs through far too much of our politics. So my strongest warning today is to the 'zero-summers'. They are getting both the problems and the proposed solutions wrong. The rise of the East is not against our interests, or simply at our expense, even if it changes how we defend and project those interests. On a crowded planet, with problems like ours, there are no unilateral solutions. Whether we are talking of common defence, general welfare or, liberty itself, remember JFK's words in 1962, "joined with other free nations, we can do all this and more". A statement with which Winston Churchill would have wholeheartedly concurred and which I commend to you. I hope our leaders-to-be look at the world and draw the same conclusion. More than ever, we will count on them.