



Lucio Loubet

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(61 x 55 cm)

## Part I

# The triple challenge of legitimacy, security and complexity

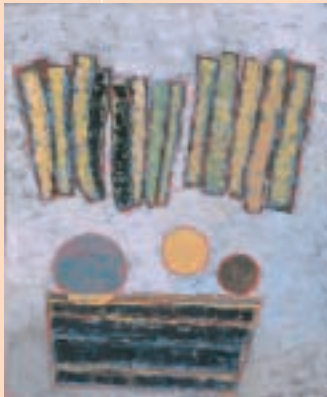
## Part I The triple challenge of legitimacy, security and complexity

*"The reasoning in terms of efficiency and legitimacy cannot be the same at the national and supra-national levels as, for individuals and public opinion, legitimacy is watered down by distance to power, which can be considered in some ways as quite... legitimate!"*

**Pascal Lamy**

*"We, Europeans, believe that multilateral trade negotiations must also acknowledge non-market concerns, particularly with regard to cultural diversity and identity, public services, food security, the environment and, of course, agriculture – what I have labelled collective preferences."*

**Pascal Lamy**



*"We need to fulfil a paradigm shift: we need to move from the notion of 'danger' to the notion of 'vulnerability', from 'threat' to 'risk'.[...] Thinking in terms of danger or vulnerability generates totally different attitudes. In the first case, the classical answer would be trying to gain superiority over the opponent whilst in the second case, the risk being blurrier, it is necessary to identify one's own weaknesses and vulnerabilities and to eventually purge them so as to prevent someone else from taking advantage of, or stressing them."*

**Jean Dufourcq**

*"We face several challenges when operating cross-border. The three most significant are regulation, corporate governance and the combination of both excellence and competence.[...]"*

*We need to make sure that we have the same level of competence in every country in which we operate. As you can well imagine, this is hardly an easy task!"*

**Lawrence A. Weinbach**

*"There are clients who are truly global, and they need a truly global supplier that has the deep experience to deal with multinationals and the macro and micro challenges they face."*

**Lawrence A. Weinbach**

*Securing the benefits of globalisation • Part I, Chapter I***Conducted  
by****Catherine Distler (PROMETHEE) and  
Olivier de Conihout (Unisys)***Strategic  
conversation  
with***Pascal Lamy**  
*Former European Trade Commissioner<sup>1</sup>***The efficiency / legitimacy  
dilemma**

**While preparing this book, we were surprised to find that many managers of European corporations reputed for their global strategies declined the invitation to be interviewed, arguing that communicating on that matter was not timely. The financial services sector has been the only exception. How would you interpret this diverging approach between finance and the other sectors?**

**Pascal Lamy:** Anti-globalisation (or 'altermondialism' as we prefer to say in France) movements have been very successful in opposing globalisation as a phenomenon that exclusively benefits multinationals, and in putting them on the defensive. At the corporate level, one must understand that power systems remain strongly rooted at the local level, whether this refers to geography or lines of business: most companies rely on matrix organisations, and to openly discuss globalisation can be risky if and when a CEO has also internal organisational problems to solve.

1. This interview was conducted as Mr. Pascal Lamy was still Trade Commissioner at the European Commission. Since September 1, 2005, Pascal Lamy is Director General of the World Trade Organisation (WTO).

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In addition, few corporations have the necessary resources to devote considerable thought to the globalisation process from a general point of view. Rather, those that have enough resources prefer to devote them to their own globalisation affairs in extremely practical terms.

We have seen the same phenomenon with the European unification process, a laboratory of sorts for an integrated global economy at large. At the beginning, when the benefits of integration in terms of economies of scale were the most visible, corporations actively promoted this process. They were in favour of harmonised European regulations, whether in consumer protection, security norms, sanitary guidelines, the environment, and even some social rules. However, eventually you reach a point where the balance between the costs of new harmonised rules – which may generate more constraints – and their benefits in terms of economies of scale are no longer obviously positive for companies: nobody is really quantifying this but corporations intuitively understand that they may no longer have an interest in further pursuing harmonisation. They still benefit from other aspects of globalisation – localisation of their activities, market access, and reduced transportation costs and custom duties – but to adjust to local regulatory constraints is more profitable than to push toward further harmonisation; the direct and indirect costs linked to the polarisation of globalisation are simply excessive.

### **Do you think that globalisation is a one-way street, and that we can now only move toward more integration or do we run the risk of returning to fragmentation?**

**PL:** The *risk of fragmentation* exists, and most corporate and political leaders have realised that the status quo is not possible and that the global economic environment remains unstable. Moreover, academic researches actively document the growing number of bilateral agreements, at the expense of multi-lateral ones, a trend that may be costly for corporations.

On the other side, protests that were so successful in Genoa and Seattle in mobilising broad anti-globalisation support have started to lose momentum due to their inefficacy in making any concrete alternative proposition: they agreed to oppose globalisation, but have failed to coalesce around a common vision.

Keeping in mind that economies of scale is the key rule of market capitalism, whether you like it or not, globalisation has indeed offered big corporations the ability to expand and to benefit from a geographical reach they did not previously have. The key question that would be worth looking at more seriously

is what benefits a further harmonisation of regulatory constraints would provide for them in terms of economies of scale.

The trade liberalisation that is discussed today at the WTO is not the same as that which we have experienced since the 19<sup>th</sup> century, focused as it historically has been on the lowering of tariff barriers and the establishment of global trade authorities to arbitrate trade conflicts. Indeed, trade liberalisation is no longer the acceptance of market forces anywhere and everywhere. Rather, we, Europeans, believe that multilateral trade negotiations must also *acknowledge non-market concerns*, particularly with regard to cultural diversity and identity, public services, food security, the environment and, of course, agriculture – what I have labelled *collective preferences*. I have launched some research (and some less formal discussions) on this subject to try to establish what the world would be like if the only differences between markets were limited to collective preferences: examples are numerous with GMOs and asbestos, consumer protection and environment rules, just as in the social field, a sign that labour markets are opening at the world level. The key question is thus to focus on what rules may legitimately be harmonised versus others that should be left alone.

#### **What are the aspects of their strategies that corporations are not trying to globalise, but prefer to keep local?**

**PL:** There are at least two aspects of business that will not harmonise, in the medium term: marketing and client relations. Take jeans, an emblematic global product: nobody would argue that this is uniform, and that the same jeans are sold everywhere. The appropriation process by local consumers is different: producers target a certain type of customer and adapt the 'global' product to local customers' requests. Conversely, the homogenisation of client relations is in most cases impossible, and is not a corporate priority. L'Oreal, for example, has no reason to seek to harmonise client relationships: their product marketing will be different in Greece and Sweden, to name but one example within Europe, as women in these two countries do not share the same approach to cosmetics. Indeed, it has never been an objective for L'Oreal to make these approaches converge; they prefer to divert attention to business strategies that may generate economies of scale or could have unanticipated spill over effects. Harmonisation of testing rules of cosmetics on animals is thus important for L'Oreal as it relates to issues that are no longer 'value neutral.' We are no longer discussing a lowering of trade barriers or relative tariff bargaining – rates between steel and toys, for instance. What is at stake

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relates to our *underlying value system*, the maintenance of a symbiotic relationship between surrounding environs and us.

To be honest, I actually anticipate a comeback of ideology in trade negotiations. This is already visible in the framework of ongoing discussions relating to intellectual property, foreign investment and competition – areas, in short, which no longer constitute pure trade negotiations

In the case of GMOs, it is a question of collective preferences and value systems: we discuss whether the use of GMOs is beneficial, or not, and what level of precaution is needed for Europeans to accept them, but no longer whether they are in ‘the people’s best interest’ in the sense generally used in trade liberalisation literature. In practice, people demonstrating against GMOs are not ‘vested interests’ complaining about foreign competition but the civil society, reluctant to accept practices about which they are suspicious.

What is new is that the solution can no longer be sought in accommodating ‘vested interests’: everyone is entitled to push his / her own interest through democratic avenues. Corporations, on the other hand, need to identify elements within the regulatory environment which are essential for their overall competitiveness and others that need to be amended – in the international trade context, often those that relate to the value system.

One key example is retail banking. Within Europe, consolidation is very slow due not only to differences in national regulation, but also, and *mainly*, to local privacy and fiscal laws whose harmonisation would require lobbying efforts on behalf of banks wholly disproportionate to expected economies of scale.

**In your book *‘la démocratie-monde*<sup>2</sup>, you suggest that stakeholders may prefer either ‘governance’ or ‘government’ depending upon whether they favour efficiency or legitimacy. The legitimacy question is valid not only in public matters but also within global corporations, as they have come to understand that the ‘local’ is absolutely critical in the mobilisation of any truly ‘global’ business platform. Is not the same needed at the political level?**

**PL:** Political scientists have discussed the trade-off between *legitimacy* and *efficiency* for a long time; it is at the core of all issues pertaining to public institutions. To be sure, corporations are highly sensitive to the fact that public opinion is a key driving force of their revenues. As a consequence, they have started applying corporate social responsibility policy, whether it is in the

2. Pascal LAMY, *La démocratie-monde* (Paris : Seuil, 2004).

French context of *'entreprise citoyenne'* or in the American model of tax shelters for community policies. Some companies even prioritise their legitimacy as a corporate actor to competitiveness and profits. Ultimately, it is a question of corporate culture, but the bounds are permeable: key managers are certainly influential in designing a socially responsible corporate culture; investors and consumers may be likewise.

Today, new environmental and social rating agencies are emerging. However, they do not yet play a significant role. This is just like 'equitable' or 'fair trade' products: there are limits to the market for virtue, and the existing rules of the game are such that I think these rating agencies will only remain 'niche' players on the long run; their ambition is limited to no more than 10% of the business.

Another force of change will take place within corporations. To the extent that some of them have affiliates in different countries, local branches will call for more equal treatment and the legitimacy of social request will counterweight the call for profit, efficiency and growth. It may be premature to argue that this is already happening but I see some signs that it is gaining in importance. Of course, this also relates to the perception of multinational companies *vis-à-vis* public opinion and various stakeholders. In a system based on market capitalism, the most visible actors (corporations, governments, public institutions) often have to account for the logic of their internal decision-making processes. As such, some – and occasionally many – of their moves are questioned. All the ongoing debate on delocalisation relates to the intimate contradiction of the system: consumers are happy to benefit from low-priced products but reluctant to see work delocalised to low wages countries. Corporate leaders know that they will have to regularly answer to these types of inconsistencies, and that the issues will almost always resurface under the pressure of public opinion.

**Do corporations not run the risk of diminished coherence when aggressively promoting their social responsibility? In their desire to enhance competitive positioning, they may, for instance, eventually make decisions that contradict the values they advocate. By seeking to reinforce their legitimacy in front of public opinion, don't you think that they may jeopardise the efficiency of their organisation?**

**PL:** This rekindles the aforementioned political dilemma between legitimacy and efficiency: some synergies exist between the two, but so do contradictory elements. It is perverse to observe that international organisations with

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strong legitimacy often have low records in terms of efficiency, while those whose legitimacy is widely contested are often considered efficient. Key examples of the two divergent situations are the General Assembly of the United Nations and the IMF: legitimacy comes at the cost of efficiency.

However, from the corporate point of view, other organisations like Codex Alimentarius<sup>3</sup> or Cenelec<sup>4</sup> that promote harmonisation at the global level are more important in practice than the better-known inter-governmental organisations. In both cases, corporations pay greater attention to the decisions of these organisations than to the advice of many governmental bodies. The general public, however, continually ignores their role, and their legitimacy is technical rather than political.

Conventional legitimising systems don't work the same at different levels of governance. The man who represents your views on the local council lives on your street, and you can easily meet him. This is hardly the case of the Member of the European Parliament, who represents your views and who shuttles to Brussels. It is more difficult to ensure that citizens' views are properly represented for the reason that they are more diverse! Who defines 'general interest'? In response to this question, NGOs fulfil a demand for new social intermediaries, which is simply not provided elsewhere.

Legitimacy is watered down by distance. The European Union, for whom development can be interpreted as a series of trade-offs between efficiency and legitimacy, is a key example of this: the EU has continually edged toward greater efficiency in the form of new EU competencies and increased use of majority voting. However, one can see that its legitimacy remains contested despite the establishment of various checks and balances, borrowing from what has been built at the national level by democratic nation-states: beyond the rational assessment of the situation, the 'feeling' element – a far more subjective criteria – is missing. However most people would accept that the nation-state is not always the best level in which to articulate collective preferences. If 'collective preferences' are the political mechanisms in democratic societies for the identification and creation of public goods, it is obvious that these very goods manifest in diverse ways, shapes and forms by different governmental bodies in Europe. However, the EU ultimately lacks legitimacy

3. Codex Alimentarius is a joint initiative of the Food and Agriculture Organisation (FAO) and World Health Organisation (WHO) in order to develop food standards protecting health of the consumers. It promotes coordination of work done on food standards by international governmental and non-governmental bodies.

4. Cenelec is a non-profit technical organisation whose mission is to prepare voluntary technical standards to help develop the single European market for electrical and electronic goods and services.

because it is not visible and transparent enough in its decision-making process; many European debates therefore remain hermetic to the population at large.

**The European Union's lack of visibility is less and less obvious following the enlargement and the European Parliamentary elections – not to mention the tense debate surrounding the ratification process of the Constitutional Treaty.**

**PL:** I fully agree that the Union as such is becoming more visible. However, the constraints and framework within which she operates are not. You may argue that it is the same at the national level for some key institutions like the *Conseil Constitutionnel* in France that has been conferred a very important role by the Constitution of the 5<sup>th</sup> Republic. Nevertheless, the reproach will be more easily directed to the European Union because it represents a milieu and a system of governance that nobody is accustomed to (which is clearly not the case at the national level).

The lack of decision-making transparency at the European level is more widely denounced than at the national level because the level of trust in national institutions is higher. But this degree of trust is in place for the simple reason that those national institutions have been with us for a longer time and are closer to citizens. The reasoning in terms of efficiency and legitimacy cannot be the same at the national and supra-national levels as, for individuals and public opinion, legitimacy is watered down by distance to power, which can be considered in some ways as quite... legitimate! In democratic regimes, decisions have to be taken as close to the man in the street as possible. We should only transfer to a higher, or more general, political body those questions which individuals, families, companies, villages, regions, nations and so on cannot decide for themselves. This is what we call in Europe 'subsidiarity', and is even more valid at a *global level*: we should always ask what the right role, and right level, of government is. The reasons why a 'higher' decision level is chosen need to be made transparent if only to publicly legitimise such choices.

**In your book, you alternatively use the words of 'governance' and 'government', applying both of them to corporations and public institutions, and drawing lessons from the European integration experience. Could you explain what the main differences are between those two concepts and how they apply to the European experience?**

**PL:** For me, governance is 'rules-based', or 'processes-based'. These rules and processes are designed in order to find conciliatory solutions to complex prob-

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lems. 'Governance' has very strong procedural and regulatory dimensions, while 'government' is more project-inspired or policy-based. Governance is the overall process whereby collective rules are defined, decided upon, legitimised, implemented and supervised. At the European and global levels, past experience have shown that governance is a necessary stage: new procedures in addition to the rules of representative democracy thus emerge, cumulatively emphasising consultation and contractual agreements.

At the global level, the efforts needed to adjust and align collective preferences are so huge that the only solution is to find rules that allow some differences to remain, but that prevent divergences of policy: it is *approximation* rather than *harmonisation*, to borrow the European lingo; it is *equivalence* rather than *convergence*. This approach may conflict with the Cartesian approach of most French people, but it is the only one that can work at the global level.

This is the reason why European central banks are now independent from national governments. It would have been very difficult – almost impossible – to reach a political agreement on the policies that should be conducted; instead, it has proved easier to agree on common rules and processes. However, this does not mean that the policies these banks ultimately implement will not often be contested on the grounds of *legitimacy* and *accountability*. The same governance road has been adopted in other fields as demonstrated by the increasing number of independent regulatory authorities in Europe.

The same is true within corporations. Governance is essential, as all the internal controls and financial reporting processes provide the management with a clear idea of how the development of the various business lines is progressing in different countries. They have been put in place so as to induce an alignment of interests and priorities within the organisations.

However, one should not dismiss the critics of governance by the supporters of the government approach. Governance may be better than nothing, but cannot be considered as a panacea and a substitute to a government that benefits from democratic legitimacy. The goal is not only to create institutions of global governance that are capable of delivering new rules, but also to build political support for these rules.

In fact, as soon as we agree that the main compromises in the future will deal with collective preferences – with values and culture – we must implicitly accept that the governance road is no longer appropriate. Instead, the compromises will have to be political by nature. As such, it will be very difficult to

reach such political compromises at a higher level than the legitimate nation-state. We can already see the difficulties the European Union encounters as soon as it tries to address those very sensitive issues. However, even if some may argue that 'small remains beautiful', it is obvious that size is important and that in front of countries such as the US, China and India, European nation-states have to stand together if they want their views accounted for at the global level.

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9<sup>ème</sup> série de la Métamorphose n°9  
(130 x 89 cm)