

# Policy Implications of Trade and Currency Zones: A Summary of the Bank's 1991 Symposium

*By George A. Kahn*

**T**he world trading system may be coalescing into a set of geographic free trade zones. Europe 1992, the U.S.-Canada Free Trade Agreement, and the initiatives to include Mexico and Latin America in a Western Hemisphere free trade zone provide recent examples of efforts to remove tariff and nontariff barriers to trade among countries in geographic regions. If accompanied by currency zones—the adoption within regions of fixed exchange rates or a common currency—this move toward trade zones could bring major changes in the international monetary system and in domestic economic policies.

The move toward trade and currency zones comes at a time of great change in the world economy. International financial markets have become increasingly deregulated. International trade in goods and services has increased. The world economy has moved closer to a tripolar monetary system with the U.S. dollar, German mark, and Japanese yen serving as principal currencies. And multilateral negotiations to promote free trade, such as the General Agreement on Tariffs and Trade (GATT), have stalled.

To explore possible ramifications of trade and currency zones, the Federal Reserve Bank of Kansas City invited distinguished central bankers, academics, and industry representatives to a symposium entitled “Policy Implications of Trade and Currency Zones.” The symposium was held August 22-24, 1991, in Jackson Hole, Wyoming. In opening comments, Federal Reserve Chairman Alan Greenspan underscored the importance of the topic and surveyed the issues to be addressed. Acknowledging our limited experience with trade and

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currency zones, he argued that answers would have to come both “from the abstract world of economic models and from the ongoing experience gained in the cases of European economic and monetary union and the North American Free Trade area that are already being planned.” He also stated that “insights into the economic implications we can expect from trade and currency zones should guide us in choosing appropriate macroeconomic policies now and in the future—whether we are ‘inside’ or ‘outside’ a zone.”

This article summarizes the symposium papers and the discussions they stimulated. In general, most of the program participants supported the move to a trade and currency zone in Europe, although some expressed doubt about the benefits of trade and currency zones in other parts of the world. The first section of the article discusses whether the move toward trade and currency zones will promote trade among countries. The second section describes financial market and macroeconomic policy implications of trade and currency zones. The third section explores global implications.

### ***Will Trade and Currency Zones Promote World Trade?***

Two areas of heated debate at the symposium were whether the move toward free trade zones will promote world trade and whether currency zones will be necessary to achieve the full benefits of trade zones. Participants agreed that if the move to free trade zones is accompanied by further progress on the GATT, trade zones will help foster world trade. But participants disagreed sharply about the effects of trade zones in the absence of further progress in reducing trade barriers on a multilateral basis. Participants also disagreed about whether currency zones will be necessary to realize the full benefits of trade zones.

### ***Effects of free trade zones on world trade***

Conference participants disagreed about the effects of free trade zones on world trade. Paul Krugman argued that free trade zones will foster trade regardless of whether further progress is made at the global level. C. Fred Bergsten countered that free trade zones will impede world trade unless they are accompanied by further progress toward global trade liberalization.

*Bad in theory, good in practice.* Krugman acknowledged the solid theoretical arguments against free trade zones but still argued that such areas will probably help rather than hurt the world economy. Moreover, problems with the GATT negotiations are so deep seated that further progress is unlikely. As a result, regional free trade zones are a promising alternative to multilateral negotiations for promoting free trade.

Krugman’s central point was that free trade zones are bad in theory but good in practice. He indicated free trade zones are bad in theory because they potentially divert trade from low-cost to high-cost suppliers. Trade diversion occurs when a member of a free trade zone imports a good or service from a country inside its zone rather than from a lower cost, nonmember country. He also indicated free trade zones can harm nonmember countries, not only by reducing the demand for their exports, but also by reducing the relative prices of their exported products. The decline in prices in nonmember countries relative to prices in member countries—a “beggar-thy-neighbor” effect—reduces nonmember country welfare. Additionally, he held that trade zones potentially impede trade by promoting trade warfare.

Krugman nonetheless argued that, in practice, free trade zones are likely to help more than they hurt the world economy, largely because they increase the size of markets. Larger

markets lead to greater productive efficiency and competitiveness. Thus, trade zones are likely to create more trade than they divert.

Moreover, he stated that trade zones seem to be forming along “natural” geographic boundaries. Countries naturally tend to trade more with their neighbors than with distant countries because transporting goods and services and communicating over long distances is costly. As a result, free trade zones among neighboring countries may, in practice, be good for the world. The gains from freeing trade within regional zones will be larger and the costs of reducing trade across zones smaller than implied by moving to zones that are not based on natural geographic boundaries.

Finally, Krugman argued that moving toward global trade liberalization through the GATT process is hopelessly stalled, making free trade zones the only viable alternative. Among the reasons Krugman cited for the demise of the GATT are the decline of the United States as the principal world economic power, the increasing importance of such non-tariff barriers as domestic regulatory and investment policies, and the growth of new players in the world economy, such as the Japanese, who arguably play by a different set of rules.

*Bad in theory, bad in practice.* In sharp contrast to Krugman, C. Fred Bergsten claimed that moving toward free trade zones was bad in both theory and practice. Moreover, Bergsten argued that free trade zones are particularly bad when viewed as an alternative to further progress toward global free trade. Finally, Bergsten maintained that free trade zones need not be viewed as an alternative to globalism, because the GATT negotiations are still viable.

Bergsten cited a number of reasons to support his view that free trade zones are bad in practice. First, he argued that geography is not nearly as important as in the past as a determinant of “natural” trade regions. With tech-

nological advance, transportation and communications costs are no longer central to trading patterns. Second, while Europe and possibly North America may be “natural trading areas,” no other such areas exist. Third, trade diversion may not be simply a consequence of trade zones but, in some cases, a goal. And finally, a Western Hemisphere free trade zone is likely to divert trade from lower-cost producers in Europe, Asia, Australia, and New Zealand to higher-cost producers in the Western Hemisphere.

Assuming that the movement toward free trade areas is likely to continue, Bergsten argued that the movement should occur in the context of an effective and credible global trade system. One way to ensure that the movement toward free trade zones supplements rather than replaces globalism is to enforce and expand the GATT. The GATT process can still work, according to Bergsten. Trade patterns in the Americas and in Asia remain “quintessentially multilateral.” The markets of the three economic superpowers—Europe, Japan, and the United States—remain deeply intertwined. The superpowers have worked closely together on economic issues in the past and should be able to cooperate in the future. And although recent GATT negotiations have stalled, the GATT process has always been a messy one, filled with false starts and stops.

#### *Are currency zones necessary?*

In addition to differing on the net benefits of trade zones, conference participants expressed a range of views on currency zones. Although participants agreed that moving to currency zones will make it harder to conduct independent national monetary policies, they disagreed about whether this cost of currency zones exceeded the benefits. Martin Feldstein argued that currency zones are unnecessary and

potentially harmful. Miguel Mancera argued that while the benefits of currency zones might be “impressive,” floating exchange rates are more desirable. Other participants, including David Laidler, Michael Emerson, and Salvatore Zecchini, argued that currency zones might be beneficial to some, such as the Europeans, but not to others.

According to Feldstein, the cost of currency zones is high relative to their benefits. The primary economic benefit of currency zones is the boost to trade from eliminating uncertainty about exchange rate fluctuations. Exchange rate fluctuations inhibit businesses from importing inputs because unanticipated exchange rate movements in the wrong direction can potentially eliminate profits. Thus, eliminating exchange rate fluctuations would reduce uncertainty about the value of international transactions and, thereby, promote international trade. Feldstein argues, however, that these benefits are likely to be small. Econometric studies have failed to detect an adverse effect of exchange rate volatility on international trade. Moreover, businesses can hedge exchange rate risk through futures markets for foreign exchange.

In contrast, the costs of currency zones are possibly quite large. The primary economic cost of currency zones is the loss of independent national monetary policies. Under fixed exchange rates, central banks use the tools of monetary policy to keep exchange rates constant. As a result, these tools are unavailable for pursuing other national economic objectives. Under a single currency, countries surrender policy autonomy to a supranational monetary authority.

For example, with a freely floating currency, national monetary policymakers can counter a decline in the demand for a country's products by stimulating monetary growth and reducing interest rates. This response to a decline in demand is not possible if there are no

national currencies or if exchange rates are irrevocably fixed. And without such a response, the output and employment costs of adverse demand shocks could be high.

Why then has Europe moved toward a currency zone? Feldstein argued that the reasons are more political than economic. Proponents of a currency zone believe a single European monetary authority could limit the ability of national governments to pursue inflationary monetary policies. More important, however, a single European currency would accelerate the political unification of Europe which, in turn, would result in greater centralization of fiscal policies.

Miguel Mancera took a more eclectic view of currency zones. Mancera recognized significant benefits from currency zones, including reduced investment risks, the equalization of interest rates across countries, and lower international transactions costs. Nevertheless, because inflation rates vary widely within and among countries, Mancera questioned the advisability of currency zones. Under floating exchange rates, a country can potentially insulate itself from inflationary shocks affecting other countries. In a currency zone, these shocks might spread to all countries. Mancera indicated that for this and other reasons Mexico could not possibly participate in a currency zone, although it probably will participate in a trade zone.

Other conference participants viewed currency zones somewhat more favorably, especially in the case of Europe. Salvatore Zecchini argued that a move to currency zones could be beneficial because without them businesses might face significant exchange rate risk. In contrast to Feldstein, Zecchini argued that futures markets in foreign exchange were too thin and underdeveloped to sufficiently reduce exchange rate risk. In addition, political institutions must be in place to ensure that smaller

countries retain some influence over the policies of the trade or currency zone. This influence over policy should be viewed as compensation for the loss of political autonomy. While Zecchini felt that these conditions did not apply in North America, he felt they did apply in some of the countries of the European Community.

David Laidler viewed the formation of a currency zone as possibly good for Europe but definitely bad for North America. Like Feldstein, Laidler viewed the move toward currency zones as a political as well as an economic development. The move to either a common currency or irrevocably fixed exchange rates implies a loss of national sovereignty. Any move to give up national currencies must be viewed in part as a move toward political unity.

Although countries could maintain national currencies under a system of irrevocably fixed exchange rates, Laidler suggested that this form of currency zone also reduces political autonomy. The choice of an inflation rate is a political as well as economic decision. Moving to fixed exchange rates—or to a common currency—takes the issue of inflation out of the national political arena. It also removes from political accountability any national authority that might otherwise be responsible for a country's inflation performance.

Laidler added that while the move to a trade zone in Europe has been accompanied by closer political ties, no such political movement has occurred in North America. European countries have already surrendered considerable authority to European political entities, but no such surrender has occurred or is likely to occur in North America. Therefore, while a currency zone might work in Europe, it would not likely work in North America.

Michael Emerson agreed that while the political and economic prerequisites for a currency zone were probably in place in Western

Europe, they are not well established in other regions of the world.<sup>1</sup> For example, before joining a trade or currency zone, the Eastern European countries must first join the world economy. They must adopt convertible currencies and world price structures. Only as a second stage of development can they consider regional trade and currency agreements. Even then they must work toward economic convergence with the rest of Europe before considering economic integration. Likewise, the USSR must grapple with its own problems of currency convertibility and determine whether its new federalist structure makes a compelling case for a currency zone. Finally, the Pacific region appears to be more interested in open trade on a global basis than in integration along economic, monetary, or political lines.

### *National Policy Implications of Trade and Currency Zones*

The move toward trade and currency zones has implications not only for world trade in goods and services but also for national financial markets and macroeconomic structure. For example, financial markets within a trade zone may need to be harmonized so that capital, as well as goods and services, flows freely across countries. In addition, as monetary policy becomes more harmonized across countries in a trade zone, monetary policy will increasingly be determined at a supranational level. National fiscal policies could play a more important role in economic fluctuations at the national level and therefore may need to be harmonized to ensure fiscal discipline.

### *Financial market implications*

Andrew Crockett and John Heimann examined four questions relating to the financial market implications of trade and currency

zones. Do trade zones lead to increasing financial market integration across countries? Does economic integration lead to changes in financial market structure? What supervision and regulation will be required to ensure the efficiency and safety of financial markets? And, how will financial relationships across major trade zones be managed?

*Financial market integration.* Crockett argued that realizing the full benefits of trade zones requires liberalizing financial flows. As a result, trade zones create an incentive to liberalize finance. Removing international barriers to trade in banking, insurance, and other financial services results in greater specialization and competition in the supply of these services. As a result, costs of supplying financial services decline. By increasing competitive pressures, financial market liberalization also promotes productivity growth and innovation in the financial services industry. Finally, removing capital controls improves the flow of funds from savers to investors and channels investment funds to their most profitable use.

Liberalizing capital flows, in turn, requires closer harmonization of exchange rate policies. Large capital movements can undermine exchange rate stability. If capital liberalization leads to speculation and wide swings in exchange rates, it may undermine the benefits of trade zones. As a result, Crockett suggested that financial market liberalization may call for closer cooperation on exchange rate policies and, possibly, currency zones.

In discussing Crockett's paper, Heimann agreed that trade zones lead to financial market liberalization, which in turn leads to closer cooperation on exchange rate policies. Heimann also pointed out that these tendencies have been at work at the global level. In particular, as the G-7 countries have become more economically integrated, international capital flows have increased. At the same time, increas-

ing speculation in capital markets has led to exchange rate volatility. This increased volatility of exchange rates underlies the management of exchange rates by the G-7 countries since the Louvre accord was reached in 1987.

*Financial market structure.* Crockett argued that financial market structures are likely to evolve slowly in response to freer capital flows. A variety of different structures coexist in the world today and freer financial markets are likely to have only a gradual effect in harmonizing these structures. While least-cost producers of financial services will tend to displace higher-cost producers, it is not clear that market structures will change dramatically.

Most studies of financial markets have shown that structure has little effect on efficiency. For example, economies of scale in financial services are small relative to the size of financial markets. As a result, many small firms can supply these services as efficiently as a few large firms. Thus, despite significant international differences in financial market structure, little movement toward homogenization can be expected in the short run. And, even in the long run, complete homogenization of financial markets is unlikely.

Heimann agreed with Crockett's assessment of the short-run effect of trade zones on financial market structure. Over the longer run, however, Heimann sees the financial system evolving into two tiers—global markets served by global institutions and regional and national markets served by regional and national institutions. This development represents the continuation of events that have been going on for years.

*Regulatory and supervisory issues.* Financial market regulation and supervision grows more complex as financial firms reach across national boundaries. Crockett gave three guiding principles for regulating and supervising

financial markets in trade and currency zones. First, let financial institutions offer financial services throughout the trade zone. Second, issue firms a single license so they may operate freely across national boundaries. The license should be issued by either a supranational regulatory authority or, providing mutual recognition by other countries, by a national regulatory authority. Third, regulators should concern themselves more with harmonizing capital standards for credit institutions than with harmonizing market practices. Given limited information about the optimal structure of securities markets, alternative structures should be allowed to coexist and compete.

Heimann echoed Crockett's views on supervision and regulation. Specifically, Heimann argued for an "international supervisory system of harmonized standards" and urged regulators to closely supervise capital market activities.

*Financial relationships between trade zones.* With the world trading system moving toward several trade zones, Crockett suggested that negotiations between zones for market access in the financial sector will become increasingly important. Two main approaches are possible. The "mirror image" approach would require "identical conditions of establishment for financial institutions in different markets." In contrast, "national treatment" would require a zone to apply the same rules and regulations to all financial institutions within its borders—but the zone would not have to offer the same privileges and regulations as other zones. Of the two approaches, national treatment holds the greater promise as a basis for financial relationships between countries or trade zones.

In regulating market access, Heimann cited proposals for strengthening the regulatory system using three sets of regulations—home country, host country, and harmonized rule.

These regulations underlie the principles of national treatment, mutual recognition, and effective market access.

### *Macroeconomic implications*

Trade and currency zones have important consequences, not only for financial market policy, but also for domestic macroeconomic policies. Jacob Frenkel and Morris Goldstein, focusing on the implications of currency zones, discussed both monetary and fiscal policy. They argued that price stability is the appropriate goal of monetary policy and recommended a two-speed approach to currency union. They also stressed the importance of adopting mechanisms to ensure fiscal discipline. Michael Mussa and Tommaso Padoa-Schioppa, panelists in a session on macroeconomic policy implications, largely agreed with Frenkel and Goldstein on monetary and fiscal policy.

*Monetary policy.* Frenkel and Goldstein argued that the principal goal of monetary policy in a currency union should be price stability. In Europe and elsewhere a consensus has formed that only by achieving price stability can other goals of macroeconomic policy, such as high employment and economic growth, be achieved over the long run. This view has led to proposals that the monetary authority for the proposed European currency zone have an explicit mandate to pursue price stability as its primary goal. To ensure that the monetary authority carries out this mandate, the authority should have a significant degree of political independence and should be prohibited from issuing credit to the public sector.

Frenkel and Goldstein also addressed the issue of how countries in a trade zone should handle the transition to a currency zone. Frenkel and Goldstein recommended a two-speed approach in which one subgroup of countries takes a fast approach, while another subgroup

takes a slow approach. Countries that have achieved low inflation rates and share other economic characteristics might move quickly toward a currency zone. Such a fast track approach would give "maximum credibility to exchange rate stability by eliminating exchange rates within the union," reduce or eliminate instability caused by capital mobility and divergent national monetary policies, and allow fast-track countries to realize all of the efficiency gains from having a single currency.

Countries with disparate economic performance would move more slowly toward membership in the currency zone. The slow approach would allow these countries to remain a part of the move toward monetary union without having to converge at a faster-than-desired pace to the economic performance levels of the fast-track countries. Thus, the two-speed approach would preserve momentum in the move to a currency zone.

While generally agreeing with Frenkel and Goldstein on the monetary policy implications of currency zones, Mussa emphasized the role of politics in determining monetary arrangements. Mussa argued that currency zones have historically been closely associated with areas of political authority. Thus, closer monetary ties and tighter exchange rate agreements come not just from a desire for greater economic unity but also from a desire for greater "political solidarity." The success of the European Community in establishing a currency zone, according to Mussa, depends more on the strength of shared political views than on a tally of economic costs and benefits.

In his discussion of monetary policy implications, Padoa-Schioppa emphasized monetary relationships between currency zones. Padoa-Schioppa argued that a European currency zone would lead to a "genuine multi-currency reserve system based on a tripolar relationship." Despite the fixity of exchange rates within currency

zones, the exchange rate regime governing the three main reserve currencies—the dollar, yen, and European currency unit—should remain one of a mildly managed float.

*Fiscal policy.* Conference participants agreed that fiscal discipline was critical to the success of a currency union. Frenkel and Goldstein observed that, so far at least, moves toward currency union had not improved fiscal discipline in European countries. If sound fiscal policies are not forthcoming in a currency zone, the very objectives of the currency zone could be threatened.

Given the importance of sound fiscal policies, Frenkel and Goldstein described several mechanisms for ensuring fiscal discipline in a currency zone. One mechanism would be the marketplace itself. Member countries running excessive deficits with no recourse to finance deficits through money creation would face a rising default premium on government debt. The rising cost of government borrowing, along with reduced credit availability, would force governments to improve fiscal policies. Another mechanism would be fiscal policy rules. For example, rules might be enacted that place an upper limit on the size of budget deficits and government debt relative to GNP. Yet another mechanism would be peer group, multilateral surveillance. Under this mechanism, constraints on national fiscal policies would be more flexibly applied to discourage irresponsible fiscal policies of member countries.

Of these mechanisms, Frenkel and Goldstein prefer a combination of market discipline and peer-group surveillance. Given the right institutional setting, market discipline could be used as the primary mechanism to keep member countries' fiscal policies sound. Peer-group surveillance could be used as a supplement to encourage countries to solve pre-existing fiscal problems, preferably before they enter the

currency zone. Peer-group surveillance could also be used to prevent “large fiscal policy excesses” in member countries.

Mussa agreed with this assessment of fiscal policy, but added that the most important mechanism for imposing discipline occurs when member countries get into fiscal crunches. At such times, both creditors and debtors need to know they will bear part of the cost of a financial crisis. Debtors must know they will bear a cost so that they will avoid irresponsible behavior. Creditors must know they will bear a cost so that they will “pull the plug” on excessive borrowing by the government.

Padoa-Schioppa went somewhat further in advocating the need for fiscal policy discipline. He argued that fiscal policy rules were desirable *per se* to reduce the budgetary discretion of member countries. He also argued that, in the case of the European Community, countries should give up some of their fiscal policy independence to a central fiscal authority. This transfer of responsibility should not take the form of Community control over national budgets, but rather the form of a more flexible use of the Community budget.

### ***Global Implications of Trade and Currency Zones***

Just as trade and currency zones will alter economic relationships within geographic regions, so will trade and currency zones alter relationships among regions of the world economy. One result of these changing relationships could be a tripolar monetary and trade system. Such a system could either enhance economic cooperation or foster hostile economic relationships among regions. This issue of a tripolar system was taken up by Allan Meltzer, Leonhard Gleske, and Kumiharu Shigehara. Related broad issues were addressed by Lawrence Summers, Jacques de Larosiere,

Charles Carlisle, Pedro Aspe, Paul Volcker, and John Crow.

### ***The emerging tripolar system***

Meltzer argued that the world economy needs a new set of rules to maintain and enhance economic stability. Without new rules, the economic progress of the postwar period will not be sustained. Meltzer emphasized the importance of rules for maintaining trade and monetary stability.

*Trade rules.* Although the GATT remains in place, its rules are not being enforced. The lack of enforcement mechanisms has led to three responses. One response has been a move to managed, or “fair,” trade in which producers form cartels to divide up markets for their products. Other responses include unilateral actions and bilateral and multilateral negotiations. But with the latest round of the GATT negotiations stalling, another mechanism has emerged—the move toward trade zones.

Meltzer argued that the development of trade zones is not a viable alternative to multilateral trade agreements, despite the failure of current GATT rules. With the formation of trade zones, trade *within* zones will increase at the expense of trade among zones. Grouping countries into three zones—Europe, the Americas, and Asia—Meltzer emphasized the importance of trade among zones. In the Americas and Asia, free trade among zones, or interzone trade, is greater than free trade within zones, or intrazone trade. Hence, developing intrazone trade “as a substitute for open, international trade” would not be in the interests of Japan and the United States. The European Community is the exception to this rule. Unlike the American and Asian zones, the European Community trades more within its zone than with the other two zones combined.

Shigehara shared Meltzer’s concerns about

the formation of trade zones. He suggested that the resulting industrial reorganization in Europe may be costly to firms outside of Europe. As bigger firms begin to exploit economies of scale, smaller firms will come under competitive pressure. As a result, European governments may attempt to keep high-cost firms in business by using protectionist measures against competing firms outside of Europe.

*Monetary stability.* Meltzer, Shigehara, and Gleske agreed that most countries will continue to rely on the dollar, mark, and yen as reserve currencies. Meltzer, however, emphasized that continued use of these currencies as major reserve currencies will require the United States, Germany, and Japan to keep price levels stable. If the United States maintains price stability, Meltzer believed the dollar would provide a store of value for many foreigners, remain the primary reserve currency, and continue to be used as the currency for pricing and purchasing commodities. Gleske agreed that, given domestic price stability, the dollar would likely remain the world's principal reserve currency.

Given price stability in the major world economies, Meltzer argued that a tripolar monetary system would provide international monetary stability. Countries with flexible exchange rates would experience greater stability of prices and exchange rates. Moreover, smaller countries could avoid inflation by fixing their exchange rates to one or more of the major reserve currencies.

Meltzer, Shigehara, and Gleske agreed that, while the European Community will probably form a currency zone, North America and Asia will not. European countries have more in common economically, socially, historically, and politically than do countries in Asia or North America. For example, Shigehara argued that in East Asia, countries were characterized by different stages of economic and financial development and different historical, cultural,

and institutional backgrounds. These factors would limit the monetary integration of the Asian economies. Furthermore, Asian governments show little interest in relying on the yen as a reserve currency—the dollar still accounts for over half of the reserves of Asian governments. In addition, Shigehara argued that monetary union is a step toward political union, which is a goal in Europe but not in Asia.

Unlike North America and Asia, Europe is likely to adopt a currency zone. Gleske argued that Europe will benefit from this development. As Europe organizes its currency zone, Europe's real economy will become less susceptible to fluctuations in foreign exchange rates. The share of foreign trade in the "GNP" of Europe will fall sharply relative to the share of foreign trade in the GNP of many individual European countries. As a result, foreign exchange fluctuations will have less of an adverse effect on the European economy. In fact, the effect has already been reduced by the exchange rate mechanism and gradual stabilization of exchange relationships within the European Monetary System.

### *Overview remarks*

Conference participants making broad overview comments expressed a range of views about the benefits of the move to trade and currency zones. Lawrence Summers and Jacques de Larosiere were optimistic about the trend. Charles Carlisle and Pedro Aspe had mixed feelings.<sup>2</sup> And Paul Volcker and John Crow were pessimistic.

*The optimistic view.* Summers argued that further progress was needed in liberalizing world trade. Toward that end, he supported any move to reduce barriers to trade, whether it be unilateral, bilateral, or multilateral. In particular, Summers said that most prospective trade zones were "likely to involve natural trad-

ing barriers and therefore to increase trade by more than they divert trade." And even if trade diversion occurs, it will be more likely to increase welfare rather than to reduce it. Moreover, trade zones will probably improve the domestic policies of member countries. And finally, trade zones could help accelerate the move to global trade liberalization.

De Larosiere, providing a European point of view, favored the move to trade and currency zones in Europe. He claimed that the move to a European trade zone has stimulated member countries' economic growth and trade. In the process, trade has increased not only among member countries but also with the rest of the world. As Europe has moved to a trade zone, exchange rates have stabilized, economic performance in member countries has converged, and monetary union now appears likely. Finally, de Larosiere argued that Europe's move to trade and currency zones does not imply isolation from the rest of the world. The European Community's economic integration will continue to benefit nonmember countries.

*The mixed view.* Carlisle argued that trade and currency zones could be either a positive or negative development. First, GATT statistics show that trade is not becoming more regionalized. Second, political realities make it unlikely that the world will coalesce into more than two great trade zones. Third, trade zones are not necessarily inconsistent with multilateral trade liberalization. Fourth, given that trade zones are going to develop, they must supplement, not replace, global trade liberalization. Finally, if trade zones replace global trade liberalization, all countries will be hurt.

Aspe agreed that membership in trade and currency zones could be extremely beneficial, especially to a small economy, so long as progress continues to be made at the global level. To this end, Mexico has joined the GATT and has expressed a willingness to join in various

Western Hemisphere trade zones. Aspe argued that countries should be willing to act unilaterally, multilaterally, or as a part of a trade zone to reduce tariff and nontariff barriers to trade.

*The pessimistic view.* Volcker expressed concern about the trend toward trade zones. Siding with Bergsten, Volcker felt that regional trade zones would erect barriers to trade against the outside world and divert trade from non-member countries. Moreover, he argued that trade zones could lead to greater interregional volatility in exchange rates. In response to the move to trade zones, Volcker suggested that Article 24 of the GATT, which restricts trade zones from taking protectionist actions, be more vigorously enforced. Although the article has been violated, particularly by the erection of nontariff barriers, remedial actions have not been taken.

Crow agreed with Volcker. Because of the dangers of trade and currency zones erecting protectionist barriers, Crow argued that further progress should be made on the GATT. Eastern Europe, the Soviet Union, and many developing countries are all striving to join the global trade system, and nothing should be done to prevent these emerging market-oriented economies from joining the GATT. In addition, Crow agreed with Meltzer that maintaining price stability is the best way to ensure the efficiency of world trade and payments.

## *Conclusions*

The world economy may be moving toward trade and currency zones. Conference participants generally agreed that the move would be beneficial if it occurred along with further progress toward global trade liberalization. Participants also agreed that trade and currency zones would have profound effects on domestic financial, monetary, and fiscal policies and on

trade and monetary relationships among regions of the world economy.

Conference participants disagreed about whether the move toward trade and currency zones would impede further multilateral trade liberalization or be beneficial without further multilateral progress. Participants also had different views about whether currency zones

were necessary to achieve the full advantages of trade zones. From the discussions, though, it was clear that Europe would proceed toward establishing both trade and currency zones. Participants concurred that, of all of the proposed trade and currency zones, Europe is best suited to benefit from both.

### *Endnotes*

<sup>1</sup> Although Emerson was unable to attend the symposium, he contributed a paper.

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