

# Managing the global economy

by [John Langmore](#) in the [October 7, 1998](#) issue

The riots that struck Jakarta, Indonesia, in May, forcing President Suharto out of office, were in part politically motivated; Suharto's 32-year reign was anything but democratic. But the civil turmoil that sparked fires in the streets stemmed principally from economic discontent.

During the 1990s massive amounts of foreign capital flowed into Indonesia, helping to create the conditions for economic overextension; the country accumulated huge levels of dollar-based debt. Then came the fall. The nation's currency has lost over 80 percent of its value, in part due to fierce inflation; the banking system has been seriously shaken; businesses have shut their doors; and foreign capital has packed up and gone home. Indonesians are suffering. It can be argued that Indonesia's chaos constitutes a sharp lesson in the consequences of economic globalization.

Concern about the implications of growing international integration--or "globalization"--is widespread and intense. Doubts about the benefits of globalization were openly expressed in the U.S. during the debates over NAFTA and GATT. The terrible human and economic costs of international financial turbulence have also been witnessed in countries such as Thailand. Do the benefits of globalization offset the costs being paid by a country like Indonesia? What strategies would reduce the destructive consequence of globalization and help in achieving net benefits?

Another important question is whether globalization inevitably limits the capacity of nations to provide services to their own citizens. Does global integration lead to the erosion of government services? Some argue that it does--that nations become so eager to compete in a global market that they drastically cut the taxes that pay for projects necessary to the public good.

No one can doubt that global integration has increased rapidly during the past couple of decades. More and more of the world's earnings depend on foreign trade; indeed, international trade has been growing at twice the rate of global income. Since the liberalization of financial markets, international exchanges have exploded.

At least \$1,500 billion worth of goods is traded each day.

Technological change has driven this remarkable growth in international integration, but so too has government policy. Governments have deliberately decided to liberalize policies on trade, investment and financial markets.

It doesn't take much imagination to understand why governments have acted this way. Globalization has its rewards. International integration can increase economic dynamism by widening market opportunities. Intensified competition can spark increased efficiency, leading to faster income growth. Inflationary pressure is reduced in countries that enjoy this dynamism, because the power of large firms to set prices is eroded. This combination of factors is likely a principal reason for the relatively low rates of inflation in advanced economies at present. The U.S. has experienced each of these benefits.

Moreover, the benefits are not necessarily limited only to countries that are already rich. Private financial flows to developing countries increased from \$42 billion in 1990 to \$256 billion in 1997--an astonishing increase.

A caveat should be added, however. In recent years China, a country that has not liberalized and which therefore does not fit the free marketeers' model, has received a full third of all direct foreign investment in developing countries. More than another third went to only nine other countries, including Indonesia. The remaining 140 developing countries benefited little from these flows of money. A rough rule of thumb: economic integration tends to increase the economic growth rates of those countries with sufficiently strong and diverse economies to attract investment and to rapidly increase their exports.

In countries that benefit from globalization, faster economic growth also leads to faster increases in government revenue, as is now happening in the U.S. Contrary to widespread expectations, Western countries have so far experienced no fall in the proportion of national income collected as tax revenue. In fact, revenue collections have continued to creep up, from an average of 34 percent of Gross Domestic Product in 1980 in the world's developed countries (according to statistics from the Organization for Economic Cooperation and Development) to 38 percent in 1997. This one figure alone undercuts alarmist talk heard in some quarters about the automatically destructive consequences of globalization for social policy. It shows, instead, that the fear of tax competition (actually tax-cutting competition) driving

down revenue-collecting capacity and so causing pressure for cuts in community services is unwarranted. So far, at least.

Unfortunately, globalization comes with a price, financial volatility being the most obvious. Recent events in Southeast Asia and Korea vividly illustrate the enormous economic and social costs of financial turbulence. The citizens of those countries are suffering huge losses of potential income and employment, as well as the accompanying social disruptions. These acute circumstances have been exacerbated by the fiscal austerity now being imposed as a condition for emergency lending by the International Monetary Fund.

Indonesia is a particularly vivid example of the costs of international integration. For a decade Indonesia appeared to be benefiting from the process. International capital has been permitted to move freely in and out of the country since 1970. In 1988 banking was extensively deregulated, new private banks were allowed to open and reserve requirements were minimized. Incentives for investment through the stock exchange were introduced. For extensive periods the exchange rate was tied to the U.S. dollar--a sign of a strong currency. Foreign investment boomed. National income per person grew by 5.5 percent a year between 1985 and 1995.

But conditions for collapse were under the surface--including extensive bad debt held by banks and the low capital backing of banks. After the Asian financial crisis began in Thailand, the contagion spread quickly. In Indonesia, foreign investors and Indonesians themselves lost confidence and withdrew funds; the rupiah fell to a fifth of its value within six months. Banks stopped lending, interest rates and the inflation rate soared, and bankruptcies multiplied.

Indonesia is now in a deep depression. National income has already fallen by 13 percent. At least 20 million people are expected to lose their jobs. Two out of three Indonesians will fall below the poverty line in 1999 because of skyrocketing food prices. An estimated 140 million Indonesians will have daily food consumption of less than 2,100 calories. Environment programs have been abandoned.

In response, the World Bank and other donors have announced a range of initiatives, including development projects, establishment of a social safety net fund to support the hungry and sick, and a national education campaign to keep 25 million children in school. No one would have predicted such developments a few years ago. But as things now stand, Indonesia's policy options are severely limited.

Indeed, financial liberalization frequently reduces the autonomy of developing and developed countries alike. Increased vulnerability to financial turbulence causes governments to become more cautious as they attempt to appease the financial markets and the powerful credit-rating agencies. Developing countries especially tend to keep credit tighter and interest rates higher than they would otherwise, and it is these monetary policies that retard both private and public investment and constrain economic development and employment growth.

In the face of stiff international competition, budgetary policy has also tended to be more restrictive, which ends up constraining improvements in human services that are desperately needed in both high- and low-income countries. Employment in human services is also slowed by such restrictions. Tight fiscal policy commonly involves cuts in human services: schools and hospitals are closed; increasing class size reduces the quality of schooling; the hospitals that remain open reduce staff levels, eroding support staff and services, and so on.

Another cost of globalization is the decline of some industries in which tariffs and other protections have been reduced or removed, as has happened in both the U.S. and Canada following NAFTA. In those industries that contract labor, employees lose their jobs, unemployment increases, families are disrupted, youth are alienated and communities decay unless effective support measures are adopted.

More generally, globalization makes life especially precarious for countries that lack the capacity to increase exports quickly or to attract investment. Therefore inequity increases both within and between countries. Ironically, globalization is leading to the further exclusion of some countries, communities and individuals from the international market.

Market fundamentalists often cite globalization as the reason for "inevitable" cuts in social and labor standards. Their argument is that the costs of the welfare state undermine national competitiveness. Such statements of economic determinism are no more than ideological assertions. Competitiveness is determined by productivity. The productivity of advanced economies with developed welfare states is much higher than that of even the rapidly growing middle-income countries. Growth depends on many factors, of which tax levels--the revenue source for social programs--are only one.

Scaremongering or special pleading by those with an economic or ideological interest in cutting public outlays is behind many current proposals to reduce community services. Francis Fox Piven and Richard Cloward write in *The Breaking of the American Social Contract* that the "slogan of globalization . . . is a cover under which a politically mobilized business class has driven down wages and benefits, weakened unions and civil-rights groups, and undermined government help for the poor."

For economic as well as humanitarian reasons, it is essential to be as rigorous about the benefits of social programs as some ideologically driven economists say they are about the cost of such programs. Padraig Flynn, commissioner of the European Union for Social Affairs and Employment, has said that we should "not take the social order for granted. The social order--the laws, practices and institutions of life--provide constant support and vigilant protection for all of us. . . . It is built on many decades of political, economic and social investment. If we do not maintain our systems, the thread of the contract may break. If we want civilized societies, we must invest in our societies."

Many governments and commentators have been unconcerned about the human cost of repeated economic policy change, and certainly during the '80s economic policy-makers commonly neglected those costs. Peter Marris writes that leaders mistook "self-inflicted social wounds for economic realism." Market fundamentalists neglected the human and social destruction caused by their policies.

The dominance of free-market discourse has diminished the proper functions of politics--the articulation of interests by different groups and the reconciling of differences within certain agreed-upon constraints. It is ironic that, to a degree, governments have chosen to reduce their own power by deregulating and privatizing the economy. As a result, groups within larger political polities feel that their interests have become peripheral. This is one of the principal reasons for the increased political alienation in both developed and developing countries.

When politics is abandoned for economics, the capacity to imagine new solutions is also abandoned. Pollsters report that when people are asked what they want governments to aim for, they most frequently point to such goals as high employment, improvements in health services and education and care for the environment. Each of these contributes to growth of personal, family and community security. How do we move to political processes in which the preferences of the

electorate rather than those of international financial markets are the dominant influence in what are supposed to be representative democracies?

Part of the answer is to articulate a compelling vision of the relationship between politics and economics. During the '90s there have been hopeful signs that such a vision will emerge and that it is developing political momentum.

For example, the World Summit for Social Development, convened by the UN in Copenhagen in March 1995, expressed dissatisfaction with existing economic models and called for a better balance in national and international policies between political, economic, social and environmental goals. One hundred and seventeen heads of state and government attended the Social Summit--more participants from that level of government than had met at any other international meeting held up to that time. The ultimate goals adopted at the Social Summit were the eradication of poverty, the achievement of full employment and the fostering of secure, stable and just societies.

These are, of course, extraordinarily ambitious goals. But merely holding the Social Summit was a significant triumph. It was the clearest and most authoritative statement in the past two decades that priorities are changing among world leaders and that social goals should be central to national and international policy-making. The Summit Declaration inaugurated a global campaign to end desperate poverty--a social-moral effort equivalent to the various international abolition movements of over 100 years ago.

Since the summit, many countries and international organizations have been working to implement the commitments and programs. One hundred and ten countries have so far reported taking some action. Many countries have set themselves goals for poverty reduction, as recommended by the summit. Many countries--all those of Western Europe, for example--are giving more attention to providing employment than they did five years ago.

On the downside, many governments have dropped the priority given to education, health, housing and social protection at the Social Summit, and have otherwise ignored or acted inconsistently with the summit's recommendations. The summit consensus, it should be noted, reflected the agreed position of those who spoke for their governments at that moment. It did not reflect the views of everyone in participant governments at the time, let alone the policies of those elected since.

Since the Summit, some international organizations have also implemented major changes. The World Bank and the UN Development Program have made poverty reduction their principal priority. The World Bank's structural adjustment policies, which have been in place since the 1980s, are being replaced by more broadly based strategies for human development. The Development Assistance Committee of the OECD has adopted demanding social targets based on those set out in the Summit Declaration. Nevertheless, the IMF and the World Trade Organization have stubbornly retained their narrow policies.

The next stage of the international discussion will take place at the Special Session of the UN General Assembly in Geneva in June 2000. This conference will review progress and discuss ways of more effectively achieving the goals of equity, employment growth and social solidarity. The preparatory meetings will be opportunities for both governments and civil society to present new policies.

Key among the accomplishments of the Social Summit was that participants came to recognize that countries cannot achieve social goals, let alone cope with the consequences of growing international integration, by themselves. International cooperation has become an imperative for social and economic development. The steady growth of global integration requires several responses, both corporate and individual.

First, and most important, is the recognition that no government is powerless. Though the integration of financial markets does indeed reduce governments' capacity to act intentionally, commentators and theorists are being simplistic and inadequate when they count such a limitation as a confirmation of their belief in government passivity.

All countries can shift the pattern of public spending in directions that will maximize the benefit to economic and social development and employment growth. Increasing spending on education, health and support services and building infrastructure, while at the same time reducing wasteful military and "intelligence organization" spending serves to improve human well-being and invest in the future. All countries have the capacity to increase economic opportunity by increasing the availability of credit and encouraging small business.

Second, countries need to be cautious about liberalizing their economies and careful about the timing and speed of such liberalization. Recent experience, such as

Indonesia's, shows starkly that a comprehensive and rigorous supervisory regime must be in place before financial deregulation. The responsible policy for the IMF at present would be to advise governments about appropriate financial regulation, instead of simply urging them toward liberalization.

In relation to trade, too, caution should be exercised. There is much hypocrisy in this area, with the major industrial powers urging free trade on everyone else while they persistently retain restrictions and even increase subsidies that are in the interests of particular industries or companies in their own countries. Countries must evaluate their own interests rigorously. Both theory and historical experience show that infant industries--broadly defined--need opportunity and time to become established and to grow.

Third, countries can act together to reduce threats of international volatility, instability, inefficiency and inequity. For example, all countries benefit if they make employment growth a higher priority, for employment growth is mutually reinforcing.

The standards and infrastructure of international exchange will have to be established by countries acting together. The norms and structures of trade and finance, communication and travel and some aspects of public health, social policy and crime prevention must be universal if they are to be effective. Global norms and standards will have to be extended and strengthened and the range of global public goods increased.

The Social Summit's commitments and parts of its Program of Action are examples of international standard setting. Others are the UN conventions on human rights, women, and the rights of the child, and the labor standards in International Labor Organization conventions. The ILO recently agreed on a declaration on workers' fundamental rights as one means of setting a floor below which no country can reduce its social framework. This is one essential approach to stopping "a race to the bottom" which some critics of globalization fear.

Many people around the globe share a sense of political powerlessness. Yet people can be empowered by a reasonable sense of hope. In countries around the world, groups and individuals, as well as legislators, have begun working to address distortions in economic strategy. The world is wealthier than ever before. The technical capacity to resolve problems is greater than ever before. This is a time of extraordinary opportunity. We are fortunate to live in democracies where opinions

about priorities can be freely expressed. Everyone can be influential in movement toward a more secure, just, harmonious and inclusive global society.