Economic globalization and risk mitigating public policies

By Frederic Gaspoz

According to most economists, globalization is a source of economic growth and prosperity. On the other side, as exponents of a mix of interests ranging from labour advocates to environmentalists argue, it is a threat to social stability and the natural environment. Frederic Gaspoz asks: Has economic integration advanced so far that national governments are virtually powerless to regulate their economies and use their policy tools to mitigate risk? The shift of manufacturing activities to low-wage countries could affect the global purchasing power and the safety nets of industrialized nations. According to Frederic Gaspoz, for most developing countries, global market access barriers penalize the export capacity, and capital account liberalization often induces an increased probability of a currency or banking crisis. Facing complex and interdependent global challenges, public policies, conceived primarily to mitigate risk and inequalities and achieve macroeconomic growth in equilibrium, are tempted to maintain or create restrictions to deeper economic integration. After a conceptual definition of economic globalization, Frederic Gaspoz will identify and analyse the different types of risks currently faced by public societies (welfare, trade and growth, demography and poverty, financial risks, environmental and health risk, inequalities and terrorism). For each risk category, Frederic Gaspoz will demonstrate that effective risk mitigating public policies do not negate further economic integration per se, but shape the global macroeconomic and financial architecture in a more efficient way in order to address the emerging global challenges.

One definition of economic globalization is the historical process referring to the secular increase in flows across national boundaries of goods and services, capital, people, technology, ideas, and culture. Speed and density of economic interdependence increase and national borders become less relevant as a result of technological changes explains Frederic Gaspoz. Despite the difficulties in measuring economic globalization in absolute terms, the last few decades are generally accepted as ones in which globalization clearly advanced (Dawson 2003).

In developed countries, public policies related to global economic integration concern firstly the risk of **undermining the welfare states**. For Frederic Gaspoz, the anxieties generated by globalization must be seen in the context of the demands placed on national governments, which have expanded radically since the late 19th century. At the height of the Gold Standard, governments were not yet expected to perform social-welfare functions on a large scale. Prior to the Second World War, government expenditures averaged around 20 per cent of the gross domestic products (GDPs) of today's advanced industrialized countries. By the mid-1990s, that figure had more than doubled to 47 per cent (OECD 2003). According to Frederic Gaspoz, today's governments are less able to sustain social *safety nets*, since an important part of their tax base has been reduced because of the increased mobility of capital and the demographic changes (Rodrik 1997). In many countries, the domestic consensus in favour of open markets starts to erode, and protectionist pressures soar (Crafts 2000: 31). But *protectionism* is not an alternative: it is expensive, because it encourages inefficiency and increases costs. As an example, agriculture subsidies in industrial countries are worth $ 250 bio. a year. (Annan 2003: 22). In protecting the benefits from the welfare states, public policies should therefore avoid inefficient protectionist measures and promote integrative structural adjustment policies.

A majority of recent studies find that **trade integration** does help to promote economic growth rates in low-income countries (LICs) and therefore improves their standard of living (Masson 2003 ; Dollar and Kray 2001; Greenway et al., 2002). Frederic Gaspoz notes that the realization of the growth effect of trade reform in a LIC is contingent on two sets of conditions, one internal and the other external. Internally, trade reform is most effective when it is combined with the maintenance of macroeconomic stability and sound institutions. On the external front, a supportive environment - in particular external market access - is crucial. Current market access barriers are especially high in agriculture and labour intensive manufactures with *tariff peaks* (i.e. tariffs in excess of 15 percent) and *tariff escalation* constituting special problems. Frederic Gaspoz explains that with tariff escalation, tariffs rise with the level of processing; this has the effect of reducing the demand for processed imports from LICs, and frustrating diversification into high value-added exports. Furthermore, the unwanted production surpluses of developed countries are typically *dumped* into world markets, with the aid of *export subsidies,* where they depress prices. *The Doha Development Agenda* – if adopted – would improve market access for agricultural commodities from LICs, reduce tariffs on industrial goods (particularly on products of export interest to LICs), and improve the participation of LICs in the WTO's dispute settlement mechanism. (WTO 2002: 22-34).

Frederic Gaspoz explains that **demography and poverty** remain major risks in LICs. Current estimates suggest that 2 billion people will be added to the world's population over the next 30 years. Most of this increase will take place in LICs where 2.5 billion to 3 billion people now live on less than $2 a day (World Bank 2003a: 1-11). According to Frederic Gaspoz, widespread poverty characterized not only by insufficient incomes, but also by limited access to land and capital, poor health and education, and the scarcity of economic and social infrastructure. Since 1999, the IMF has established the *Poverty Reduction and Growth Facility* (PRGF) considered by the IMF and the World Bank as the basis for concessional lending from each institution and debt relief under the joint Heavily Indebted Poor Countries (HIPC) Initiative. (Woods 2002: 956).

Recent **financial liberalization** efforts, as inherent part of economic integration, have been accompanied by major crises such as the East Asia's financial crisis, Russia's failed conversion to a market economy, and financial meltdown in Argentina. For Frederic Gaspoz, it is empirically hard to find a strong causal relationship between more financial integration and higher growth rates. Rather, financial integration might have increased the consumption volatilities (Prasad et al. 2003: 58). In the short-term, volatile capital flows can threaten macroeconomic stability through phenomena like *herding behaviour* of investors, regional *contagions* and *spill over* effects. Kaminsky and Schmukler (2002) found evidence from emerging markets that stock markets booms and crashes are larger in the immediate aftermath of liberalization, but not in the long run. Developing countries generally display the “unblessed trinity” (weak currency, fear of floating, and weak institutional framework) that makes it difficult for them to integrate successfully into the world financial markets (Torre et al. 2002: 335-357). However, Frederic Gaspoz denotes that, in the past, the Bretton Woods Institutions and the IMF in particular strongly advocated "shock therapy" (rapid privatizations and premature capital account liberalization): with rising inflation, the IMF loan conditions imposed fiscal austerity and dramatically rising interest rates. This led to widespread bankruptcies, unemployment, and the withdrawal of foreign capital (Stiglitz 2002). Detragiache and Spilimbergo (2002) found strong evidence that debt crises are more likely to occur in countries where external debt has a short maturity. Carlson Hernandez (2002) found that the currency composition of external debt also matters: during the Asian crisis, countries with more yen-denominated debt fared significantly worse. Foreign Direct Investments (FDI) are generally more stable than other types of external finance and speeds up both capital accumulation and the absorption of foreign technologies. De Long and Summers (1993) found a positive relation between machinery investment and growth across all developing regions. However, more recent research shows that in Latin America – contrasting with Asia- there has been little or no improvement in the level or the composition of investment and that the investment ratio fell while FDI increased in most countries. (UNCTAD 2003a). Therefore Frederic Gaspoz argutes that successful financial risk mitigating strategies -such as China’s policy- adopt a *gradual and selective* approach to financial integration in order to avoid risks of currency or banking crisis.

Controversies about economic globalization are not about just trade or traditional economic risk concerns, but also about its impact on the **environment**. For Frederic Gaspoz, FDI and global trade, induces an increase in transportation by land, sea, and air, with each resulting in tremendous environmental impact. The global economy still lags behind in schemes to tackle the growing environmental and health risk concerns. New measures are needed to resolve what one could term "*food fights*" and "*shrimp/turtle*" types of problems (lack of protection of endangered species)[1]. As the case of import restrictions imposed by the EU on genetically modified organisms (GMO) shows, public policies mitigating risks can restrict market access. However, policy-makers dispose of institutions that are –or should be- able to deal with these problems : the WTO, the World Health Organization (WHO), the UN Food and Agriculture Organization (FAO). For Frederic Gaspoz, international non-governmental organizations (NGO) are necessary to monitor and discuss policies that could have adverse effects globally, although their transparency and accountability are controversial.

The gravity of the **public health** problems afflicting many LICs, especially those resulting from HIV/AIDS, tuberculosis, malaria and other epidemics, are risks that will modify but not negate further economic integration. Also, Frederic Gaspoz notes that there is a need for the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (*TRIPS Agreement*) to be part of the wider international action to address these problems. Intellectual property protection is important for the development of new medicines, but the TRIPS Agreement should not prevent members from taking measures to protect public health and, in particular, to promote access to medicines for all. For Frederic Gaspzo, it is necessary to amend the existing WTO agreements to confront the impending trade problems and to safeguard the world health and environment, since local policies have no sufficient infrastructure to do so. (Martin 2003: 137-154).

It is true that globalization reinforces all sorts of **inequalities**: inequalities of power in the traditional sense of the term in favour of the US unilateralism; inequalities of wealth; cultural inequalities. The average income in the richest 20 countries is now 37 times that in the poorest 20. This ratio has doubled in the past 40 years, mainly because of lack of growth in the poorest countries (World Bank 2003a: 2). Much of the discussion surrounding the new issues in trade policy--e.g. *labour standards* ("child labour"), *market access* -can be cast in the light of procedural fairness needed to fight these inequalities.

[1] The traditional interpretation of the WTO Agreements holds that imported products that are physically the same as domestic products are considered to be "like" products regardless of how they are produced, and thus, cannot be discriminated against according to Article III of the GATT, which requires treating imported products from a party no less favorably than like domestic products (Sampson 2000: 18).

Global inequalities result in one of the paradoxes of globalization, namely that it engenders **terrorism** (Cocker, 2002). In transforming traditional cultures and identities, it encourages religious *fundamentalism* and produces new network centred terrorist organizations which functions through state-less networks. In addressing global security risks, policy-makers can use - through *pre-emptive* action - the instruments of economic and financial integration, such as the possibilities of fighting money laundering and terror financing internationally. Effective security policies do not negate further integration but use and promote further economic integration for security purpose. Terrorists play on our uncertainties and anxieties; our anxiety about the side effects of our own technological advances, and in the case of September 11 our anxieties about the underside of globalisation. "For the foreseeable future", claimed the US Defence Secretary a few years ago "there are few who will have the power to match us militarily … but they will be dedicated to exploiting the weakness of our very strength". For Frederic Gaspoz, the more globalised the more vulnerable we apparently become. As we introduce more sophisticated technology new risks proliferate at an exponential rate. The information technologies of the 1980s facilitate international crime and assist terrorism. And it is now a commonplace idea that the risks we face are more catastrophic than those of the past because they are global. We live in an age of globalisation. How quickly we forget the lessons of history, or the warnings it throws up. 'You may not be interested in war' warned Leon Trotsky, 'but war is certainly interested in you'. In that sense, Trotsky may have been speaking for our age as well as his own - a sobering thought according to Frederic Gaspoz.

How will the world look in 50 years? The world economy has changes a lot over the past 50 years. Over the next 50, the changes could be at least as dramatic. For Frederic Gaspoz, a major theme of research for the next few decades is the growth generated by the large developing countries, the BRICs. In less than 40 years, the BRICs economies together could be larger than the G6. Currently they are worth les tan 15%. Of the current G6 (US, Japan, Germany, UK, France and Italy), only the US and Japan may be among the six largest economies in 2050.

In conclusion, economic globalization raises according to Frederic Gaspoz many risk-related questions: about the unchecked power of global capital movements; about the deteriorating environment and climate change; about preserving cultural diversity; about the gap between rich and poor. In minimizing risk, policy-makers should bear in mind that not less economic globalization, but better political globalization is needed. At the national level, this means social and financial safety nets. At the international level, it means cooperation in the WTO, the IMF, the Basle Committee of Banking Supervisors. However, these institutions need to be reformed in order to bring the right answers to global risks.

For Frederic Gaspoz, macroeconomic stability, financial soundness, open economies, transparency, and good governance are all essential for countries participating in the global markets, and economic integration helps to set effective and broadly accepted rules to mitigate risks. However, Frederic Gaspoz notes that multilateral coordination of single economic interests remains a difficult challenge. Recent literature describes new ways of using information technology and new financial instruments (derivatives) to hedge against a variety of risks that society faces – such as risk of job loss, macroeconomic risks, and others. (Shiller 2003). However, these theoretical models seem hardly implementable in the near future.

Since global risks need global policies, there is, in Frederic Gaspoz's opinion, no conflict between public policies that minimize risks and further – qualitative, ethical, ecological, and fair – economic integration. Long term oriented, risk sensitive economic globalization establishes the notion of *sustainable development* in the international and domestic political agenda as started with the *Agenda 21* and the *UN Millennium Development* Goals (MDG). As Walter (2001) states: "…liberalization that does not take into account other social values and interests has become both politically illegitimate and increasingly unachievable."