

The excuse of globalisation

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The Seattle trade talks failed because they were not considered important enough to the western countries that call the shots

One way of looking at globalisation is that it is an excuse. On the left it is used as an excuse by governments that have not tried to introduce socialism. "What can we do?" is the cry. "We will be swept away by the world capital markets if we try anything really radical." On the right, globalisation is used as a threat. Instead of arguing against excessive levels of government spending on the merits of the case, people are told that their economies will become "uncompetitive".

The attitude of politicians in the centre is not so different. If they see the need to reform domestic pension schemes or liberalise labour markets the main arguments tend to be nowadays that "we live in a harsh competitive world" and will suffer if we do not carry out these reforms. These threats are largely bogus; reforms should be argued on their merits and if they are not, those who use the bogey of mysterious world economic forces will sooner or later be found out.

Adair Turner, the former director of the Confederation of British Industries, has written an important book, *Just Capital* (Macmillan 2001, £20). It was marketed as an attack on "market fundamentalism". This is a straw man. In Europe, including Britain, there are no such fundamentalists with any political influence. The true value of the book lies in its demolition of a number of common fallacies.

For instance, Turner is right to say that there is nothing in globalisation which rules out the so-called European social model under which high taxes are paid to provide an extensive network of public benefits. If European workers really valued these benefits so much that they were prepared to accept lower take-home pay to finance them, that would be their affair. The problem is that they do not - or the governments and unions who speak on their behalf do not - and the combined result of pay levels and payroll taxes is a level of labour costs which prices people out of work. Indeed, the worst aspects are a system of labour market regulation which prevents workers from finding employers who will engage them on a different basis.

These disadvantages need to be argued on their own terms and not because of fear that Europe will become "uncompetitive". It is companies that become uncompetitive. Countries or regions can be uncompetitive only if their real exchange rates are too high, a disequilibrium which is often self-correcting.

The so-called globalised economy is mainly a return to the conditions that existed before the first world war. At that time trade was roughly similar to today as a proportion of the national income and capital flows between countries were at least as large. Even so, it is still something to celebrate. After nearly a century of wars, crises and controls, the world economy has recovered some of its earlier freedom.

Has the development of information technology added a new element, as any development in any part of the world can be viewed instantly on computer screens? Surely the bigger breakthrough was made in the middle of the 19th century when we leapt from horsedrawn transport and sailing ships to the railways and transatlantic cable which transmitted to the New York stock exchange news of the 1873 Vienna financial crash.

The heretical point I wish to make is that the case for further liberalisation, either on the trade

or on the capital side, is mainly political. Barriers between Europe, North America and Japan are now extremely low <->with the important exception of agriculture. As Turner points out, the vast bulk of world trade now takes place between these areas. The main victims of the remaining barriers are the developing world and the former Communist countries. The real reason why conferences such as the Seattle gathering of the World Trade Organisation failed was not just the riots but that success was not that important to the west.

A further round of WTO talks is important mainly for the emerging countries. These are now the main victims of the barriers to trade. It is they who have the greatest interest in the continuation of worldwide capital flows. The hotly debated question of whether they should freely allow imports of purely financial capital, which can be reversed at short notice, is a secondary one.

Probably the main advantage of free movement for all kinds of capital and not just direct investment is internal. As a recent study by the US National Bureau of Economic Research suggests, "the cost to Malaysia of the recent controls may be not so much that foreign investors are wary of a repeat but that domestic financial institutions were merged in a non-transparent way during the period of controls <->a way that appears to favour the current political establishment." (The Great Reversals, R.Ragan and L. Zingales, Paper 8178).

The interest of the west in all this is twofold. There is the humanitarian motive. Trade and free capital movement are much more important than gestures of sympathy or aid in lifting them out of poverty. Second, increased prosperity among emerging countries should be a stabilising factor on the world political scene and help to reduce tensions which would otherwise be produced by migrants.

There is another way, of concern to the west, in which globalisation and financial development are political issues. In most countries equity markets were bigger relative to GDP in 1913 than in 1980. Only by the end of the 1990s did they exceed the 1913 level.

It has taken nearly a century to recover the degree of openness which existed in 1913. The most important forces behind the near century of retreats were wars and the depression. The latter provoked a widespread popular demand for insuring against market forces, which gave governments an excuse for protecting home producers.

The preservation of the degree of openness we have already achieved depends partly on cultural and ideological forces on which it would be fascinating to speculate. But it also depends on the success of world leaders in preventing both another deep depression and runaway inflation.

The record of the last few decades suggests that the business cycle will remain with us in spite of boastful talk about "stability culture" and "ending boom and bust". The world has been relatively successful in avoiding the extremes of deep slump and - apart from a shock in the 1970s - of runaway inflation. I wish I could feel confident that the inflation targets, combined with fiscal rules that are now in fashion, were a sufficient recipe for avoiding such catastrophes in future. I would be more confident if these rules did not depend for their operation not merely on economic forecasts but on forecasts with an inbuilt tendency to over-optimism, especially at turning points.