Globalization, Openness and Economic Nationalism: Analytical and Conceptual Issues A Foreword to Globalization and Economic Nationalism in Asia

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6 July 2011

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by

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July 2011

This is a revised text of a keynote address given at the conference on globalization and economic nationalism in Asia, organized by the Asia Research Centre, Copenhagen Business School, December 3 2009. Financial Support from Cambridge Endowment for Research in Finance and the Malaysian Commonwealth Trust is gratefully acknowledged. The author also wishes to thank the Centre for Business Research at Cambridge for the general support of this research.

I. Introduction

This book to which the present paper provides a foreword, investigates the interactions between globalization and economic nationalism in Asian countries. In this foreword, for South Asian countries the question of economic nationalism is considered through the lens of economic openness. Full globalisation, which connotes close or total integration of countries' economies with that of the world economy, is the antonym of economic nationalism. The paper argues that economic openness is a multi-dimensional concept. A country can be open or not so open, in all or some of the following directions: trade, exports, imports, finance, science, culture, education, migration, foreign investment, investment by its citizens and companies abroad, among other things. There is no economic theory that suggests that a country has to be open in all dimensions simultaneously. Given its economic and geographical situation, a country may choose to be open in some areas and not at all, or only partially in others. The foreword examines the analytical question: what is the optimum degree of openness for an economy?

At the simplest level a policy of total autarky is not necessarily one that coincides with economic nationalism. National economic benefits may increase with some trading compared with no trade at all. Orthodox economists would argue that a nation's gains from trade with the rest of the world are best enhanced by the policy of free trade. This proposition which has long been a bedrock of orthodox economics is challenged in this essay in relation to its theoretical basis and its application in the real world. It is argued that there are only narrow circumstances in which the orthodox proposition is either analytically or historically valid.

II. Optimal degree of openness and economic planning[1]

In principal, one way of defining the optimum degree of openness is by using the theory of national planning for this purpose. There is a considerable literature on this subject and with increasing ability to handle complex optimization models on more powerful computers, it led to some improvements compared with the initial exercises carried out by Chenery, Bruno and several others in the late fifties.

However, as Chakravarty and Singh (1998) pointed out long ago that there may be many reasons to believe that the approach is not entirely satisfactory. While a planning approach does avoid easy and facile identification of the optimal degree of openness with a regime of "free trade" it suffers from a number of limitations. Firstly, the planning analysis cannot take into account issues connected with irreversibility over time excepting by resort to very ad hoc procedures.

Secondly, the only bit of connection of this approach with history is through initial specification of vectors of primary factors, which are easily quantifiable. There are no simple and convenient ways of quantifying the states of knowledge to the community or its degree of absorptive capacity if inflows of factors from the outside world are considered to be relevant.

Thirdly, national planning models are rich in details for a single country. However to be operationally, meaningful they have to assume that the rest of the world is either going to stay constant or change only in a predetermined way. Strategic choices are excluded.

[1] Sections II and III adapt the arguments first presented in Chakravarty and Singh (1988) and more recently, in Singh (2011) to the requirements of this subject.

If one were to take these criticisms seriously, then the alternative to planning exercises would be a somewhat looser but a more historically grounded approach which not merely emphasizes the advantages that are likely to accrue to a national entity from exploring opportunities to trade with the rest of the world but also emphasizes certain factors which may make it more vulnerable to outside influences. These may produce long term irreversible effects on the country's pattern of production and its ability to generate productive employment, etc.

It is important to note that such an alternative approach is quite consistent with the paradigm of classical economics, including in this respect not only Ricardo, but also Marshall in his capacity as a classical economist. Contrary to text book analysis it should be emphasized here that Ricardo was much more concerned with the effects of foreign trade on the rate and pattern of accumulation, than with the mere demonstration of the theorem of `comparative advantage', as an exercise in static optimization. When Ricardo pleaded for a greater degree of openness of the British economy, he was not being guided merely by his artificial example of trade in cloth and wine between England and Portugal, but because of the need to capitalize on the emerging features of the British economy in the light of revolution in textiles production. Marshall understood this very well when in his `Memorandum on the fiscal policy of international trade', he wrote "The principles on which our present fiscal system was based sixty years ago seem to me to be not ultimate derivative. They were obtained by applying certain truths, which are as universal as the truth of geometry or mechanics, to certain conditions which were transitional" (Marshall, 1926; p.386). He displayed a clear understanding of the historical specificity of maxims of policy of free trade which have been treated by many as ahistorical truths.

While Marshall clearly recognised how the changes in configuration of production forces can alter the degree and character of openness of the economy, Keynes, it would appear, was worried about a somewhat different set of factors when he was devoting his thoughts to working out schemes for post-war national reconstruction. This has to do with maintaining equilibrium in the balance of payments of different countries. As he once put it, " To suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium if only we trust to methods of 'laissez-faire' is a doctrinaire delusion which denigrates the lessons of historical experience without having behind it the support of sound theory" (Keynes, 1980; pp.21-22). Now it is clear that in history there have been periods, which as Keynes himself acknowledged, payments arrangements have worked out satisfactorily. This permitted large expansions of trade and trade-induced growth. However these have been episodes that have been characterised by the presence of suitable conjunctures, as the study of the economy for the period after the Second World War, the 'golden age', demonstrates (Glyn, Hughes, Lipietz and Singh, 1992).

A country wishing to open up when the conjuncture is adverse in Keynes' sense (that different economies are characterized by ' persistent surpluses' or 'deficits' without there being any mechanism to restore global equilibrium) may benefit much less and, in certain cases, may end up being much worse off than if its opening-up process were differently timed.

If timing makes a difference, and timing is indeed important, and if returns to scale are increasing, openness by virtue of assuring higher levels and growth rates of external demand may facilitate major structural changes in the economy and permit labour productivity and the per capita consumption level to increase over time. If on the other hand, the timing is wrong, a country may have to go through painful processes of adjustment precisely because it is more 'open' than otherwise.

This would once again suggest that we ought to deal with the problem of openness in terms of rate and pattern of growth of output with due recognition to carry out structural changes as and when circumstances so warrant.

III. Free Trade – A Critical Review

The traditional economic answer to the question "What is the optimal degree of openness for the economy?" is given in terms of the theory of free trade. This theory is, however, extremely restrictive. Its validity depends on the existence of full employment in all economies, all round convexities in production functions, no indivisibilities together with other neoclassical assumptions such as no externalities, no information asymmetries, perfect knowledge about goods and services being traded.

However they can be realised only in specific world economic conjuncture coupled with an appropriate set of domestic policies that go considerably beyond the limits of commercial policy as traditionally defined. Two well-documented historical episodes where trade and growth-promoting forces interacted in a positive manner were connected with the hegemonic roles played by Britain and US respectively. It has been pointed out by economic historians that Britain's decision to adopt 'free trade' as the major thrust of their commercial policy helped to trigger the secular boom of the second half of the 19th century. But with changes in geo-political situation, coupled with altered industrial leadership consequent on the maturing of major new innovations during the second Kondratieff, as described by Schumpeter, led to severe strains towards the end of the 19th century, and led to the violent demise of the system.

The question of increasing returns to scale and imperfect competition has received considerable attention in the recent developments in the theory of free trade. This literature has been reviewed by Paul R. Krugman, (a leading trade theorist and Nobel Prize winner) in his classic survey article. (Krugman, 1987)

Krugman noted the work of Dixit, Spence, Stiglitz and others who tried to model trade in the context of Chamberlin-type imperfect competition along with the presence of increasing returns. He carefully noted that in the type of 'second-best' world which alone is relevant in the contemporary context, there is no automatic tendency for gains from trade to be realised. While the scope of gains from trade does not necessarily go down, the composition of trade changes significantly from inter-industry to intra-industry trade. Furthermore the need for government intervention can no longer be ignored.

While Krugman himself ends up with a justification for free trade, he noted that 'this is not the argument that free trade is optimal because markets are efficient. Instead, it is a sadder but wiser argument for free trade as a rule of thumb in a world whose politics are as imperfect as its market" (Krugman, 1987; p. 143).

The main reason behind Krugman's cautionary ending is that sophisticated interventionism is likely to be a difficult exercise in political economy. However, in essence, it is difficult to expect, for the reasons that he has elaborated as well as for others, for the world trading system to gravitate to free trading as a generally accepted rule of thumb. Instead the argument is better viewed in terms of the need for 'managed trade'.

There are several reasons why trade needs to be managed. These have to deal, in a basic sense, with the fact that 'openness' can be a mixed blessing. The point was well understood by John Maynard Keynes when he changed his position from being a champion of free trade to that of an advocate for 'national self-sufficiency', in the midst of depression during the 1930s. However Keynes's argument was more subtle than that of simple-minded economic nationalism. He was all in favor of free movement of people between countries, freedom from passport controls, free educational culture exchange, he was nevertheless opposed to the free movement of capital and goods as that led to mass unemployment.

Notwithstanding the limited relevance of the nostrums of free trade and absolute openness, openness can nevertheless be a great advantage. 'Openness' can be found to be a great benefit for an economy for any of the following reasons:

a) It may enable a country to concentrate its relatively specialised resources in areas of production where the world demand is highly income and price elastic;

b) it may lead to diffusion of knowledge of the kind leading to considerable upgrading of the quality of local factors of production;

c) it may lead to sufficient competitive pressure to eliminate certain forces of what Leibenstein has described as X-inefficiency;

d) trade may lead to changes in the distribution of income which can lead to a greater share of production accumulation in national income;

e) Trade may facilitate what Schumpeter and, following him, Dahmen have stressed so much-namely an accelerated process of creative destruction;

In all these cases, we are assuming that payment arrangements are such that there is no sizeable deflationary bias in the world economy or in any of the leading countries. It was already noted in section II that Keynes was of the view that the classical theory of equilibrating payments arrangements was gravely deficient. The Bretton Woods system was meant to provide a mechanism that coordinated high levels of effective demand amongst trading countries. The system lasted over the period 1945-71. Since then the world economy and its institutional arrangements have evolved as will be discussed below.

During the 19th century, the world economic system operated in a manner that gave a semblance of plausibility to the classical theory; this was because the assumptions underlying the theory were often fulfilled. As Joan Robinson (1973) put it, " There was enough unemployment to keep money wage rates in check. There were massive migrations reallocating the supply of labour between countries of low and high economic opportunity; and there was a continuous, though fluctuating, flow of international investment. (Robinson, 1973)

Furthermore, it is important to bear in mind that there are situations in which increasing the openness of the economy may harm the quality of locally available factors. This leads to the opposite syndrome to that mentioned earlier. The classical example of this is the adverse impact of British cotton textiles on Indian cotton weavers in the 19th century.

Generally, it has been seen that ‘openness’ works positively if the phenomenon of ‘learning’ from contacts with the rest of the world are suitably institutionalised, and through suitable adaptation on the policy side involving appropriate government interventions which make the domestic economy more responsive to change. The experience of Japan and that of the Asian NICs would seem to suggest that home market expansion can often trigger off growth-promoting investment which then leads sequentially to import and export substitution on highly efficient lines. In its turn, home market expansion may have much to do with increases in food productivity level. Arthur Lewis also strongly underlined the importance of food productivity growth as a method of overcoming the terms of trade loss suffered by many tropical countries that concentrated their exports of beverages, etc. to cater to metropolitan market.

In the absence of a growing home market accompanied by suitable diversification of the industrial structure, the effect of ‘openness’ can at best be a ‘once-for all gain’ from increased openness. On occasion it may lead to a subsequent accentuation of the economic difficulties of the country that which liberalized its trade and investment policies in the expectation of sustained growth but without adequate preparation on the knowledge absorption side.

To sum up it is important to pinpoint the phenomenon of learning over time as a more relevant paradigm for development gains through trade as distinct from the neoclassical emphasis on exploitation of arbitrage opportunities. John Stuart Mill was fully aware of this dimension in his classical writings on the subject, as was Alfred Marshall whose ‘Memorandum of Fiscal policy of International Trade’ was mentioned earlier. More recently, L.L. Pasinetti has always been very emphatic on this point. (Pasinetti, 1981; Chapter 11)

Despite the many conceptual and operational difficulties of the classical and neoclassical arguments for free trade there are indeed substantive benefits from economic openness which are more robust than the traditional neoclassical arguments. However they can be realised only in specific world economic conjuncture coupled with an appropriate set of domestic policies that go considerably beyond the limits of commercial policy as traditionally defined. Two well-documented historical episodes where trade and growth-promoting forces interacted in a positive manner were connected with the hegemonic roles played by Britain and US respectively. It has been pointed out by economic historians that Britain's decision to adopt 'free trade' as the major thrust of their commercial policy helped to trigger the secular boom of the second half of the 19th century. But with changes in geo-political situation, coupled with altered industrial leadership consequent on the maturing of major new innovations during the second Kondratieff, as described by Schumpeter, led to severe strains towards the end of the 19th century, and led to the violent demise of the system.

Similarly in the golden age of capitalism in the 1950's ad 1960's, west European economies achieved historically unprecedented growth of 5% per annum, twice the rate they had experiences during the previous 200 years. They not only obtained full employment for 25 years but in fact had overfull employment. In countries such as Germany and France, 10% of the labour force came from abroad. Analysis of this historic episode indicates that it was based on a new economic model of solidarity and cooperation both within and between nation states. This model was ushered in Western Europe with the help of the US marshal plan.

The financial and trading openness for developing countries recommended as panacea in the present world situation is based on completely a historical understanding of growth problems in an increasingly interdependent world, an understanding which, on its own logic, is by no means free from difficulties as analysed earlier. It is therefore essential that we attempt to analyse the historical forces which led to the rise and fall of the so called ‘golden age of capitalism’ in Western Europe. By the same token, we need to analyse and examine the present era of globalization in historical terms.

Since the demise of the golden age in the 1970’s, the world economy has evolved. Most developed countries have adopted more or less free trade and more or less free capital movements since the 1980’s. A number of developing countries have done the same since the 1990’s. It is this regime of globalisation which integrates global product and capital markets which provides the backdrop to the discussion of issues of economic nationalism addressed in this book. The editor is quite right to point out that economic nationalism is still widely practised, notwithstanding globalisation, by most successful as well as unsuccessful countries. All that has happened is that different measures have to be introduced to advance the national interest compared with before.

This book provides analysis of economic nationalism in five leading Asian countries: India, China, Korea, Japan and Singapore. Each of these countries has adapted its interventions to the requirements of the new international trading and financial regime. The detailed analysis of this book indicates the globalisation has not been negated by economic nationalistic measures adopted in one form or another by all five nations; nor has economic nationalism been able to overcome the institutional framework of globalisation. To use a different language what has happened is that Asian countries have sought not close integration with the world economy, but a strategic integration. They have been open in some spheres and not in others according to their national advantage. Before globalisation this was easily possible for the Asian countries to do so. Under the new WTO and international legislations, policy space for most developing countries has been much diminished compared with before.

IV. Globalisation, Economic Nationalism and The Current International Crisis

We turn now to the discussion of the relationship between globalization, economic crisis and economic nationalism in Asian countries. It is widely believed that financial globalisation and the world financial system have been responsible for the most acute economic crisis to hit the international economy since the great depression 60 years ago. The particularly poor performance of advanced countries is regarded as proof of the failure of globalisation. This is however a one sided view which ignores the fact that the crisis occurred only in rich countries and not in poor countries.

The following facts concerning the crisis are pertinent from the perspective of the developing countries:

- Since the beginning of the new millennium and until 2007 the world economy grew at an historically unprecedented pace. Between 2003 and 2005, the economy grew at a rate of 5% per annum in PPP terms which has never been achieved before.
- Developing countries growth rate was twice as fast as rich countries, thereby reducing the distance between the two groups of countries.

- World poverty (defined as earnings below a dollar a day) fell by a large margin in many countries and in the world as a whole.
- India and China, the two most populous and hitherto among the poorest countries in the world achieved stellar economic performance. Other Asian countries also performed well prior to and since the crisis.

The essential reason for the good performance of Asian countries lies in the measures adopted by these countries following the lessons they learned from the Asian crisis of 1997 – 1999. Following the crisis these countries started to strive for current account surpluses and to accumulate reserves, which stood them in very good stead during the current crisis. This was a triumph of economic nationalism over globalisation. Developing countries did not repudiate globalisation, but rather took advantage of it while protecting themselves against its dangers by adopting nationalistic economic policies towards reserves and balance payments.

It does not however help in the long run that the rich countries did not performed well in the Great Recession for that would induce them to abandon globalisation. What is required for both the north and south to grow, for the north to achieve full employment and for the south to achieve fast rates of growth to minimise poverty and improve the desperately low living standards of the people. The research by Izuerita and Singh (2010) and Cripps, Izuerita and Singh (2011) indicates that if developing countries such as India and China were to grow at the desired rate this would be incompatible with full employment growth in developed countries. However the research also indicates that cooperation between rich and poor countries, particularly India, China and the US over technical progress (such as energy saving) can resolve these difficulties. Such cooperation is much to be preferred to the economic nationalism of the 1930's, which led to stagnation and crisis. A globalised world economy is in the interest of developing countries provided they have policy space to enable them to achieve fast growth and reduce poverty.

Globalisation , together with international economic cooperation among nations states is a far better goal for developing and emerging countries to seek than economic nationalism, despite its successful use by Asian countries during the post-World War II period.

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