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ABSTRACT

I am very grateful to the organisers for giving me the opportunity to address this distinguished audience and to participate in the work of the study circle.

A main purpose of my contribution is to provide a constructive critique of the present organisation of European economies under liberalisation and globalisation. Contrary to the exaggerated claims in leading economic circles about the virtues of this economic regime, its actual record has been uninspiring at best, at worst abysmal. The most obvious failure of these arrangements in European countries is reflected in the mass unemployment which has afflicted these economies since its implementation in the 1980s and 90s. Productivity and GDP have also been much lower than before. Yet less than twenty five years ago countries like France and Germany not only enjoyed prolonged full employment but indeed over-full employment, with 10 per cent of the labour force coming from abroad.

I shall argue here that the poor economic performance of the European economies during the last two decades is not due to exogenous factors, (e.g. technology), but derives in large part from the intrinsic features of the liberalised global regime itself, specifically financial liberalisation and the increasing global integration of the world's financial markets.

There has been considerable discussion in this study circle on the question of security. Insecurity does not today derive from two rival blocs and their struggle for hegonomy and power. That battle is over - the US has won the Cold War but it is not the end of history. The world today is afflicted with rather different kinds of insecurities. These derive in part from the workings of the economic system and particularly the global financial markets. The devastation and insecurity which the financial markets can cause is graphically illustrated by the experience of the Asian countries in 1997 - 1998 when they suffered a financial meltdown.

The 'meltdown' is indeed the right phrase for describing the experience of countries like Thailand or Indonesia. Over a short span of time, at the end of 1997, the Indonesian stock market fell by 80 per cent and the exchange rate was devalued by another 80%. This led to a deep financial crisis, which in turn produced a severe economic downturn. These events led to the overthrow of the government of Suharto and ultimately to a virtual breakdown of the social fabric of the country. If Indonesia had been invaded from outside, it arguably would not have suffered as much damage as has been caused to it by these changes in financial and economic circumstances. One might argue that the Indonesians were themselves to blame for the financial crisis due to their poor economic management but, bear in mind, that until the eve of the crisis (well into the summer of 1997), the International Monetary Fund and the World Bank were praising Indonesia as a country with sound economic policies and an extraordinary economic record. At one level the record is indeed extremely impressive. When Suharto took power 30 years ago, 60% of the Indonesian population was living in poverty. When he was deposed, only 12% of Indonesians were still living in poverty. This is an unparalleled achievement of poverty reduction and of fast economic growth, but it did not matter in the end. The financial markets were merciless.

In a global economy that is organised on the basis of free financial markets, unrestricted capital movements and generally free trade, such episodes are unfortunately far from being rare. The world has been experiencing growing instability under this regime. Before the Asian crisis, a meltdown occurred in Mexico in 1994-1995 and the country had to be rescued with an enormous bail-out package of fifty billion dollars. We were assured at the time by the International Monetary Fund that the financial markets had learned their lesson, and that such financial episodes are unlikely to be repeated. Now, however, in the light of the Asian crisis and its huge adverse implications for people’s standard of living, poverty and basic security, such claims are no longer being made.

To bring the subject nearer to what is going on in the Mediterranean region and in Europe, let us reflect on a striking fact that emerges from Table 1. This table gives figures for the period 1964 - 1999 for unemployment rates in G-7 countries, the European Union and OECD as a whole. Let us concentrate on one line in the third row- the case of Germany. The German unemployment rate averaged, between 1964-1973 at only 1.1 per cent of the labor force over that ten-year period. Subsequently, it started to increase and the average for the most recent ten-year period (1990-1999) is 9 per cent. The actual unemployment rate in 1999 is even higher. The question is, why has there been such a steep increase in unemployment? The table indicates that until 1973, not only Germany but other European countries also had more or less full employment, and now most suffer from mass unemployment. Why did this happen?

Table 1. Standardised Unemployment Rate, 1964 - 1999 (average annual percentage changes).

	1964 - 1973	1974 - 1979	1980 - 1989	1990 - 1999
United States	4.5	6.7	7.3	5.8
Japan	1.2	1.9	2.5	3.0
Germany	1.1	3.2	7.0	9.0
United Kingdom	3.0	5.0	9.0	7.3
Total of G7 countries	3.1	5.0	6.9	7.1
Total EU 15	2.7	4.7	9.0	10.3
Total OECD	3.0	4.9	7.2	7.4

One answer commonly given is that in Europe the labor markets are inflexible as a consequence of the welfare state. This leads to higher unemployment in Europe compared with the United States, which is thought to have much higher and fuller employment because of its freer labor markets. Evidence suggests that although this theory may be believed in influential circles, it is far from being the whole truth. Between 1964-1973 the German welfare state was, if anything, even stronger than it is today and yet the unemployment was barely 1 per cent of the labor force. With more flexible labor markets the current unemployment rate is several times greater. Moreover, the US labor market during 1964 - 1973 was even at that time more flexible than the German labor market. However the US unemployment rate, as the table indicates, for the period 1964 - 1973 was nearly four times as large.

It is also important to bear in mind that in that golden era of 1964 - 1973, countries like Germany and France were not only able to employ almost everybody in their own labor force but also to accept imports at an ever increasing rate from the then developing countries, Japan and Italy, as well as huge migrant labor from abroad, including many of the Mediterranean countries. It is estimated that almost 10% of the German and French labor force in that boom period came from outside. In stark contrast to the mass unemployment today these countries, as mentioned earlier, enjoyed over-full employment.

The reason this was the case was not so much the welfare state or the lack of it, or the flexibility of labor markets in Europe, it was because these countries were growing at a very fast pace. Between 1950 - 1973 leading West European economies expanded at a rate of about 5% a year. This was twice the rate that they had ever grown before in the last two centuries. After 1973 the rate of economic growth has greatly diminished. It has gone back to its historic norm of about 2 - 2.5 per cent per year. That is the main reason for the mass unemployment today.

When there is large-scale unemployment, people become protectionist; they are less inclined to accept imports or allow multi-national investment abroad because it costs them jobs. If advanced countries were able to grow again at the rate at which they were growing then, developing countries in general, and the Mediterranean countries in particular, would gain because there would be less resistance to their imports, to immigration from these countries as well as to capital flows to those countries. Greater demand in advanced countries would also lead to better prices for developing countries' products. Advanced countries would, in turn, benefit from faster growth in poorer countries by being able to export capital goods and technology to them. The two sides could thus cooperate to mutual benefit and it would also strengthen everybody’s national security.

The question is, why has it not happened? Why has the trend rate of growth of the advanced countries and the world economy slowed down compared with the 1950s and 60s? One plausible theory is to suggest that the technological possibilities have been exhausted and that the world is no longer capable of producing 5 per cent growth rates. This hypothesis does not, however, accord with the facts. The facts are just the opposite: the world has, on the supply side, huge potentialities.

There are two important points that are relevant here. One is that the world is in the grip of an enormous technological revolution connected with information and communications technology (ICT). The full potential of this technological revolution has not been realized because of slow growth. Serious scholars of technology tell us that the ICT revolution is a new technological paradigm on a par with the discovery of electricity and the invention of the steam engine. Indeed in some ways it is even more important than the latter two because the rate of growth of productivity in ICT has been far higher at almost 25 per cent a year. Thus a computer that cost $10 million in 1975, today will cost, with the same computing power, something like $2000 dollars. In contrast, it took electricity fifty years after its first commercial introduction before its price was halved. Like electricity, IT technology can also affect all areas of the economy. However, unlike electricity, ICT has many direct outputs rather than simply being an input into other areas.

Notwithstanding the manifold potential uses of this technology, and considerable investment in it in advanced economies particularly in the US, there has been no overall increase in the trend rate of productivity growth. If anything, the rate has declined over the last two decades. If the scholars of technological change are right about the scope of this technology, this would suggest that on the supply side, it has yet a vast unrealised potential. Moreover, also on the supply side, there are large numbers of countries in the developing world that have now organised themselves, established a technical and scientific infrastructure, and possess sufficient human capital to give them the capacity of very fast economic growth. These acquired capabilities allow this group of countries to reap the latecomer's advantage and "catch up" with the advanced industrial countries, in the sense that they can grow very fast. To illustrate, consider China and South Korea. When Korea grows at 8% a year for twenty years, it is a very noticeable event in world economic history (as such high growth rates are historically unprecedented) and the world rightly takes note. But when China grows at 10% a year for twenty years, this is an epic-making event: Korea has only 35 million people but China has more than a billion people.

There are a number of other semi-industrialised countries which are potentially in a similar position to that of China and South Korea. All these countries, on the supply side, can today grow very fast. To sum up, the technological potential of the ICT revolution as well as the enormous "catch-up" possibilities for developing countries, together suggest that the world economic growth is not constrained on the supply side. The constraints on fast economic growth lie on the demand side. The rate of growth of demand is much slower now than it was during the 1950s and 60s. I argue in a number of my papers that the organisation of the world economy under liberalisation and globalisation tends overall to reduce the rate of growth of aggregate demand and make it more unstable than it otherwise would have been.

It is, however, no accident that the period 1950 to 1973 in advanced industrial countries was marked by a very fast rate of growth of demand, production and employment. Research shows that the world economy and the national economies at the time worked under a very different economic regime than that of liberalisation and globalisation which prevails today. The model of economic development followed then was based on co-operation - within nation states between labor and capital, and between nation states over the question of the organisation of the world's financial and trading systems.

It must of course be recognised that in that period, the world's financial and trading systems both worked well because they were guided by a single hegemonic power, the United States. And the US fortunately acted in a far-sighted way in the interests of the world as a whole so that there was a fast growth of demand and a fast growth of output in the world economy. Bear in mind that the United States not only instituted the Marshal Plan, but also allowed countries like Japan to discriminate against itself. It opened its markets to Japan while at the same time accepting Japanese import controls in that period against American imports. It followed similar policies with respect to many European countries. It is a moot point that the US' actions in this regard were dictated by altruism, or by its perception of its own strategic interests in relation to competition with the Soviet Union.

Not only was this earlier period of fast economic growth made possible by co-operation between nation states over trade and finance, it also involved co-operation between workers, employers and the government within individual advanced European economies. The government and employers agreed to the fair distribution of the fruits of economic progress (embodied in the welfare state and productivity wage bargaining) in return for wage constraint and responsible trade unionism on the side of the workers.

During the last two decades, for various reasons, the advanced industrial countries have been following a rather different model of development than before. It has involved the erosion of the welfare state, a reduction in the power of the unions through various legislative acts, as well as deregulation, privatisation and generally a much-enhanced role of the market in the economy and the society. The new economic regime of the 80s and 90s is not only characterised by growing market supremacy at a national level but even more so at the international level through liberalisation and globalisation. The United States is no longer able to act as the economic hegemon in the system that it once was because it does not possess the overwhelming economic strength, relative to competitor countries, like Japan and Germany, it did before. Moreover, there is very little co-operation between leading industrial countries who determine the contours of the system as a whole, to which developing countries can only react.

The main consequence of the lack of international economic co-operation between industrial countries has been that the financial markets today reign supreme. Orthodox economists may applaud this turn of affairs on the grounds that the markets are able to impose discipline on irresponsible governments; this, they would suggest, leads to greater efficiency, faster economic growth and improved welfare for the people.

This rose-tinted view of the international financial markets does not, however, accord either with economic theory or actual experience. As John Maynard Keynes, the Cambridge economist, who incidentally was a very successful investor himself, observed: “The problem of maintaining equilibrium in the balance of payments between countries has never been solved. The failure to solve this problem has been a major cause of impoverishment and social discontent, and even wars and revolutions. To suppose that there exists some smoothly functioning automatic mechanism of adjustment which preserves equilibrium only if you trust to matters of laissez-faire is a doctrinaire delusion which disregards the lessons of historical experience, with out having behind it the support of sound theory.” [1]

As to the actual workings of the modern financial markets, the analysis put forward recently by Alan Greenspan, the widely respected Chairman of the U. S. Federal Reserve, concerning the Asian meltdown and the stock market crash of 1987 in the United States is much closer to reality than the orthodox view. He notes,

> “At one point, the economic system appears stable, the next it behaves
> as though a dam has reached a breaking point and water (read,

> confidence) evacuates its reservoir. The United States experienced such a sudden change with the decline in stock prices of more than 20% on October 19 1987. There is no credible scenario that can readily explain so abrupt a change in the fundamentals of long-term valuation on that one day. Such market panic does not appear to reflect a simple continuum from the immediately previous period. The abrupt onset of such implosions suggests the possibility that there is a marked dividing line for confidence. When crossed, prices slip into free fall – perhaps overshooting the long-term equilibrium – before markets will stabilise.
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> But why do these events seem to erupt without some readily evident precursor? Certainly, the more extended the risk-taking, or more generally, the lower the discount factors applied to future outcomes, the more vulnerable are markets to a shock that abruptly triggers a revision in expectations and sets off a vicious cycle of contraction. Episodes of vicious cycles cannot easily be forecast, as our recent experience with Asia has demonstrated. The causes of such episodes are complex and often subtle. In the case of Asia, we can now say with some confidence that the economies affected by this crisis faced a critical mass of vulnerabilities; *ex ante*, some were more apparent than others but the combination was not generally recognised as critical"[2].

The essential point is that contrary to the orthodoxy, the financial markets are not always rational, but subject to periodic waves of euphoria and pessimism. There is often a bunching of capital flows, either a lot of money comes into a country or departs at one stroke; it depends on investor perceptions and confidence. The perceptions, the moods of pessimism or exuberance among fund managers in Chicago or New York determine capital flows to emerging markets. This in turn has a major influence on economic wellbeing, or otherwise, of these countries.

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[1] Quoted in Singh, 1995, listed at the end of this paper.

[2] Testimony of the Chairman, Alan Greenspan, before the Committee on Banking and Financial Services, US House of Representatives, January 30, 1998.

Surely the world does not have to live with this way of organizing economic activity whereby the livelihood, the social fabric of whole countries depend on the moods of pessimism or optimism which may inform the actions of fund managers and investors in advanced countries. To sum up, globalisation is not just a technical economic concept, but has very far-reaching implications for security and for people's wellbeing. It is necessary to understand these processes and to try to control them, rather than to leave them to the haphazard workings of international financial markets.

Those who are interested in the fuller details of the various parts of the argument which are briefly outlined above, may wish to consult the following of my recent papers:

"Institutional Requirements for Full Employment in Advanced Economies", International Labour Review, Vol. 134, No. 4 - 5 (pp. 471 - 496)

And this paper was also published in Spanish as:
"Requisitos institucionales para el pleno empleo en las economicas adelantadas", in Revista Internacional del Trabajo, Vol. 114, No. 4 - 5, 1995 (pp. 529 - 554).

"Global Unemployment, Growth and Labour Market Rigidities: A Commentary", Special Contribution to Perspectives on Globalisation and Employment, UNDP, New York, 1999.

Thank you very much.