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Is the World Economy about to Disintegrate?

There have been increasing warnings lately that the world economy is in danger of disintegrating. How realistic are such fears? Could the world's trading partners have a serious interest in such a development and be prepared to accept the risks involved? The following three articles seek to answer these questions.

Anton Brender*

The Vision of Disintegration is Scarcely Plausible

During the 1970s and 1980s, the world has been submitted to a variety of acute economic tensions. In fact, their succession has been so dense that the world economy can be viewed as having been under a permanent state of shock. The exchange markets, the money markets, the oil markets, the financial system, the stock markets each delivered its share of thunder storms and contributed to make the world economy a rather hectic place.

The same period of time has also seen profound structural movements. Slowly but surely they produced landslide changes in many compartments of the world economy. The distribution of some industries on the globe and the patterns of trade have been mightily affected. The increase of the Japanese manufacturing surplus and the decrease of the European agricultural deficit are two of the most spectacular results of those changes. It has to be added that those structural changes have also been punctuated by a series of brutal trade clashes, to the point that a rampant warfare is taking place between the US and Japan in many manufacturing branches while guerilla is the rule between the US and the EEC as far as trade in agricultural and food products is concerned.

The recurrence of systemic problems and the difficulty with which, in many parts of the world, countries adapt to structural change, have increased, in the eyes of many, the plausibility of a "disintegration of the world

economy" scenario. Its basic logic is obvious: in order to reduce its exposure to what tends to be viewed as sheer international hazard or unfair confrontation, each country will try to rely more and more on itself (or perhaps on its closest neighbours). The scenario has various variants going from the catastrophic "general breakdown" version to the milder "regional fragmentation" one.

Despite their apparent realism, the plausibility of this *grand vision* of disintegration has to be appreciated with care. In order to do so, a few facts have to be recalled here.

□ Despite all the negative features mentioned above, the intensity of world trade – the ratio of current flows of goods and services to world GNP – though stagnating at the beginning of the 1980s, has never decreased during the last decades. Actually this intensity is now higher than ever and the last GATT figures confirm the tendency of world trade to grow faster than world output.

□ Despite the severe difficulties some countries have faced in the recent past, none has chosen to move towards more autarky. In fact, the tendency seems to be the opposite: countries that have long been very inward-looking, like the USSR and China, now hope to accelerate their industrial development by relying more on international trade.

□ Since the beginning of this decade a decisive impetus has been given to another round of GATT discussions. Eventually, it will lead to the opening of a whole new set of activities – the services sector – to

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internationalization. More and more non-manufacturing enterprises will tend to sell, and also to produce, abroad. At the same time, though without any formal multilateral talks, most of the industrial countries have started to open their financial systems, thus promoting a new mode of international integration. Even if the process is far from being completed, the momentum achieved seems to make it irreversible.

□ The two last decades have seen the activities of more and more companies go international. This is a basically new fact. Twenty years ago, two thirds of the total stock of foreign direct investment was owned by American corporations, mainly giant ones. Today, two thirds of the – now much higher – stock of foreign direct investment is owned by non-American companies, many of them being medium-sized. This gives a new dimension to the very concept of a world economic system. It is now more and more imbedded in the very structure of its corporations.

What are the implications of the above observations? They clearly mean that the links tying countries to each other are becoming more numerous and tend to affect all the dimensions of economic activity. But let us not get confused: this is happening in a world where national economies can still be identified. National budgets and fiscal systems, currencies and monetary policies are still different and make the US “part” of the world economy quite distinct from, say, the Japanese or the German one. The importance of this is becoming decisive, if we add one additional point: in contrast to all other “production factors”, labour – people – tends to move less and less across borders, at least in the industrialized part of the world. This has one key consequence: the higher mobility of goods, services, capital and corporations is giving new intensity to the competition that takes place between those who live in the various national “regions” of the world economy. During most of the past decades, this competition took place through the international trade of goods. Now, quicker short cuts are available.

Where are financial resources going to be invested, where will new plants be located? When answering those questions capital owners and corporate executives do ponder the various opportunities each country is giving them. The costs/benefits ratios of, say, Thailand and Portugal or Holland and the United States are compared. The existence of this permanent arbitraging process obliges each country to take into account what the other ones are doing as far as, say, fiscal measures or labour legislation is concerned. It also makes countries very sensitive to movements in key exchange or interest rates. Thus, the same facts that

make the fabric of the world economy much more tightly knit also enhance the competition between each of its national “parts”. For those living in a given country, the stakes are high: the number and the quality of locally available jobs and the level of future incomes depend heavily on their collective ability to participate successfully in this global confrontation. Hence the recurring temptation of pulling out of such a constraining system. Hence, also, the impression that it is on the verge of disintegrating. But this last impression doesn’t take into account the depth and the resilience of the international links now at work. The dangers presently facing the world economy are less dramatic but could, in the longer term, have as pervasive effects.

To understand this, we should go back to the competition between countries as distinct from the one between corporations (since they, more and more, are internationalized). This truly inter-national competition is becoming the driving force of the world economic system. The oil “shocks”, the interest and exchange rate “wars” easily fit into this framework. The fact that goods, capital and corporations move more or less freely from one part of the world to another, does not mean that countries do not try, positively or negatively, to influence their movement in order to benefit more from it. Hence the combination of international openness and national activism typical of the present world economic order. (When seen in this perspective, regionalism is but a way for a group of countries that share some common features to more efficiently face the present economic challenges by gathering their forces.) Two distinct systemic risks arise from this state of things.

The first one could be termed the “dropping-out” syndrom. The competition process now going on is very selectively discriminating between the various parts of the world according to their ability to abide by the rules of this high level game. Every less developed country now has understood it should copy the example of South Korea or Taiwan. But few know how to do it! The danger here is that many countries, or even whole continents, may drop out of the world economic system because they just cannot face its increasingly demanding standards. They would not really be choosing autarky, they would just de facto be pushed in that direction by their inability to fit into the trading system.

The second risk is “sterile agitation”. It stems from the fact that free trade and free capital movements may be a factor of progress or of stagnation. It very much depends on the existence of a sound and solid international agreement on some rules of the game. It is not only decisive that competition should be fair, it is also

essential that the determination of some key magnitudes should be left out of the field of international competition (interest rates and exchange rates, for instance). There should be no more interdependency in the system than we are collectively able and willing to handle. Otherwise, a lot of energy will be wasted trying

to “muddle through” the difficulties caused by excessive instability.

Trying to prevent those two systemic risks – marginalization and macroeconomic instability – is precisely what the purpose of international cooperation should be.

Wolfgang Hager*

Protectionism: a World Divided?

Growing protectionist practices and tougher legislation in the USA and the European Community have led some observers to fear a break-up of the world economy into three parts: Western Europe, East Asia and North America.

In fact, the opposite is true: the growing integration of the world economy – which is the dominant trend – brings with it, at the margin, minor quantity and price “corrections”. If one takes into account the heterogeneity of the economic systems trading with each other and the instability of price and supply patterns caused by exchange rates, technology and dynamic newcomers, these corrections are indeed surprisingly small. One reason is that prices in final markets are much less disruptive than supplier costs: traders serving as intermediaries and local producers assimilating “off-shore” inputs in their product range act as buffers by respecting high local price levels. They prefer to take economic rents over market shares.

Leaving agriculture and textiles aside, current protectionism is heavily concentrated in two sectors: automobiles and electronics. These sectors are dominated by very large and multinational companies. So why do these global actors not adopt a global, free-market approach? Why are American-owned companies such as Motorola, UK, or Ford, Germany, among the most outspoken proponents of “fair trade” practices by the European Community? Why do Siemens and Philips, whose global strategies are wholly dependent on large volumes of trade, argue for a European “industrial policy”?

To understand the global games being played, it is useful to lump together goods and services trade on the one hand and direct investment on the other and ask

what exactly is “sold” abroad by either means. The answer must be that values from three sources are traded: labour, management, and a joint product of both, technology. Protectionism occurs if the price/performance ratio of exported output from any of those sources seriously disturbs the local status quo. In technology, that disturbance may be immediate – new generations rendering old ones obsolete – or anticipated as a future risk of marginalisation of companies or countries.

Protectionism takes two forms: trade restraints and, increasingly, local content and technology conditionality for both trade and investment access. Reduced to its essential, it is one device of several used by large companies to assure a modicum of oligopoly discipline disturbed by the textbook causes of too many suppliers and significant cost differentials – themselves the consequence of the globalization of the world economy.

Governments are not the primary actors but are instrumentalized by companies. This is often assumed to mean that they act for the particular and against the general interest. Yet going against the stern advice of economists, their political instincts are often right: this (limited) restraint of competition probably does more good than harm, as it facilitates rational planning of resources, encouraging investment in real and human capital, and R&D in large corporations (Galbraith) and, given their role as huge buyers of goods and services and as taxpayers, in the economy as a whole.

Likelihood of a Break-up

It is against these obiter dicta that we can now examine the likelihood of a break-up of the world economy. The formation of a North American free trade area creates, no doubt, a potentially autarchic economic space. But an industrial culture strongly oriented towards short-term cost minimization has made off-

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