Speech

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Democracy, markets and globalisation

Church of Sweden seminar in Rättvik:
"If the World Bank were directed by Jesus Christ ... "

First a word of thanks for inviting me to take part in this seminar. Accepting the invitation was an easy decision. An involvement in the poor countries and in setting up a functional economic order that can contribute to greater prosperity for everyone in the world is something I truly share with the rest of you here today.

In the 1970s I travelled a good deal in what was then known as the Third World. One of the countries I visited was Peru, about which some friends and I also wrote a little book. Recently I re-visited Peru to discuss monetary policy and other matters with some Latin American colleagues. Three things struck me as being fairly typical for what has happened in the global economy in recent decades.

One is that today the poor and rich countries are even more clearly interlinked. Back in 1975, Sweden and Peru had little in common, whereas now I and my Latin American colleagues could share experiences of working with inflation targeting, as well as of banking and currency crises, aspects of economic policy that are as relevant for them as they are for us. We are being tied together more and more by trade, by emerging financial markets and, of course, by modern forms of communication.

Secondly, in the past twenty-five years a great many people have become materially better off. Lima's streets and shops are evidence of this. Yet Peru is not one of the developing countries that have benefited most from the economic developments in recent decades. On the contrary, whereas the developing countries' aggregate GDP has grown by 89 per cent since 1980, the figure for Peru

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is 60 per cent. Due to differences in population growth, moreover, the corresponding per capita figures are 35 and 10 per cent.

Thirdly, despite all the improvements, many people are still living in poverty. Income gaps in Peru were glaringly large throughout the twentieth century and remain so today. In 1996 the income of the richest fifth of the population was twelve times that of the poorest fifth. Turning now to the developing countries as a group, in the past fifteen years the proportion of poor people has admittedly decreased but it is still the case that the favourable trend in recent decades has failed to benefit large numbers — even practically entire countries, particularly in Africa.

To me it is a healthy sign that this situation is raising questions about how the global economy functions. Personally, I do not think we should rest content with aiming for a general improvement in living conditions for everyone. Our sights should be raised instead to achieve an order whereby those who are worst off benefit more than others, so that gaps in the world are narrowed.

Today I shall begin with some reflections about the concepts of democracy and market. I am prompted to do so in that those who arranged this seminar first asked me to speak about "a democratic world economic order". Then I shall concentrate on some of the issues of a mainly economic nature that have featured in the debate in recent years on globalisation. In doing so I will be drawing on some of my personal experience of economic cooperation. Then I shall sum up and draw some conclusions.

Democracy and markets

In my opinion there is no contradiction between democracy and markets. It is rather the case that they are two complementary components of a viable social system. A market economy is the form for organising economic activities that in almost every situation has proved superior to other alternatives, such as a centrally planned economy. Democracy is seen today as the self-evident form for political decision-making.

One of the points about a market economy is that it allows for decentralised decisions about economic matters — agents can conclude agreements that are mutually beneficial. Political intervention is normally warranted only when a third party stands to lose. However, such situations are relatively common, for instance in environmental questions. There is also a self-evident need for political decisions concerning the legal system and other matters to do with the necessary foundation or infrastructure both of markets and of society in general. Finally, there is a place for political decisions when it comes to basic welfare issues and matters to do with the distribution of the assets that economic activities generate.

It is clearly essential that political decisions are reached in such a way that they reflect the interests of a majority. A democratic system presumably provides the best assurance of this. But that does not mean that decision-making by political assemblies is an end in itself. On the contrary, a prudent division of responsibilities between the political system and markets is essential. A great deal of the political debate is, in fact, about this dividing line between political and market decisions.

Economists have quite a lot to say about this; they can elucidate the pros and cons of alternative solutions. But it is also a question of value judgements. Moreover, the political system needs to be sufficiently robust to stand up to pressure when special interest groups and other lobbyists try to secure preferential treatment, not to mention outright corruption. Another important matter is to ensure that market systems work properly as regards competition. There are certainly problems in all these respects, not least in developing countries but by no means only there.

The problem of which decisions belong to the government sphere as opposed to markets is not confined to the nation state. At the international level there are also differences of opinion as to what should be left to individuals and nations to decide instead of being settled in joint political assemblies. The global level lacks overriding democratic structures that could help to establish common rules that are broadly supported. In the debate on the globalisation process there are also many who consider that the global market is not sufficiently 'democratic' and that 'the struggle is about securing the shared values that transcend economism'. Another criticism is that the poor countries have too little say in the global markets.

So what do we mean by 'globalisation'? Pope John Paul has said that "globalisation is something that is present in every aspect of our lives". Others see globalisation as the emergence of a common global culture, perhaps at the expense of national and local cultures. One is inclined to agree with His Holiness — globalisation is not a straightforward phenomenon that is easily explained. I would say that globalisation stands for the growing interdependence of individuals and countries that is resulting from the increasingly comprehensive exchange of everything from goods, services and capital to ideas and know-how. Defined like that, globalisation is not something anyone would want to abolish but a fundamentally positive process that contributes to an increasingly prosperous world, as well as to the democratisation of a great many countries.

That there are problems cannot, however, be denied. They have to do, for instance, with the prevailing conditions for world trade and how the resultant gains are to be distributed. Another issue is the free movement of capital, which played an important part in the positive economic trend in the 1990s but has also contributed to a situation where economic unrest spreads more quickly from country to country and is sometimes a major ingredient of financial crises in developing countries. Then there is the question of how the international financial organisations have functioned and the problem of debt in certain poor countries. These are some of the issues I shall now discuss.

The globalisation debate

Trade is crucial

The first issue is about trade. The critics argue that the expansion of world trade to include more countries as well as additional goods and services leads to the poorest countries being marginalised — developing countries are unable to compete with the wealthy nations in this process. Some consider it would be better for the poorest countries to close their borders and build up their own industries. They would then be in a stronger position when perhaps they are ultimately incorporated in the world economy.

A similar policy was advocated by some in the 1960s and '70s and it was implemented in various guises in many countries, for instance in Latin America. But the subsequent course of events provides strong arguments against such an approach; isolationism has not been a good way of generating prosperity. On the contrary, countries that have staked their future on trade and international commitments have managed considerably better both in terms of growth and in combating poverty. There are many instances of this in Asia, for example. As is clear not least from Sweden's own history, foreign trade is more or less essential for economic development, particularly in the case of small countries.

In the past two decades world trade has expanded at an average annual rate of 6 per cent, which is twice the rate of global economic growth in this period. Outward-looking countries have tended to grow faster than those which have been more introvert. Countries such as India, Vietnam and Uganda, where the economy has been opened to the rest of the world and trade barriers have been reduced, have been able to combine stronger economic growth with greater success in overcoming poverty. World Bank calculations indicate that the potential benefits from the elimination of all the existing trade barriers amount to between USD 250 billion and 680 billion. Approximately two-thirds of the total would accrue to the industrialised countries but for the poor countries the gains would be twice as large as all the assistance they are currently receiving.

Neither are the poor countries' difficulties in competing with the industrialised countries the primary problem. When borders are opened, companies tend to locate their activities where production costs are lowest; this frequently means developing countries, which accordingly get additional jobs, rising production and increased tax revenues. To attract investment on a large scale, however, it is necessary to have a reasonably effective judiciary, an adequately skilled labour force and other facilities; these are by no means always available and here it is the developing countries that need to act. It is on account of problems such as these that investment from the industrialised countries still goes in the first place to so-called emerging markets and to only a minor extent to the poorest countries. The situation also calls for structural adjustments in the industrialised countries, a process that leads in turn to new job opportunities; these countries have to focus on new activities of a different kind that can carry higher wage costs, for example.

This is the same in principle as what happened earlier in Sweden, for instance. We have moved from a state more than a century ago when nearly everyone worked in agriculture to one where first manufacturing and now service industries have taken over as the dominant source of employment. This is the process that has doubled our material prosperity many times over. But it has not been painless. While many people became better off, the need for adjustment excluded others from production. Countries like Sweden can now afford extensive social safety-nets but in developing countries these are often absent.

And although barriers to international trade have been greatly reduced in recent decades, there are still a good many obstacles in both industrialised and developing countries. They apply in particular to agriculture and labour-intensive manufacturing, that is, to just those activities where the poorest countries have advantages over the industrialised world. The European Community spends, for

example, EUR 2.7 billion annually to make sugar a profitable crop for its farmers at the expense of cheap sugar from developing countries. At the global level, agricultural subsidies, which according to IMF estimates are currently equivalent to over two-thirds of Africa's total GDP, are definitely not helping to improve the situation for the poorest countries.

So there are good grounds for believing that increased trade does benefit the world in general as well as the developing countries. In this respect the industrialised countries could do quite a lot to improve conditions for developing countries simply by reducing their barriers to trade in agricultural products, for instance. It is also the case, however, that the gains from increased trade are not automatically distributed fairly. There is scope here for the industrialised world to take initiatives in the context of trade negotiations. More can also be done, in industrialised as well as developing countries, to facilitate adjustments and distribute the gains more equitably. On the whole, trade is a field where we know what ought to be done if only the political will were there.

Pros and cons of capital flows

Another topical issue in the globalisation debate is the increasingly large and rapid cross-border capital flows. I see the freer movement of capital as basically desirable. It has given developing countries increased borrowing facilities to mitigate acute effects of other economic shocks, be they crop failures or lower prices for major export products. The process has also led to increased investment in developing countries. At the same time, investors in industrialised countries have had new opportunities of diversifying risk and obtaining the higher return that may come from projects in developing countries. This should have tended to improve the utilisation of capital in individual countries as well as in the world as a whole. Some observers argue, for example, that the efficient capital markets in the United States were a major factor behind the favourable economic trend there in the 1990s, a trend that also benefited developing countries.

But this has not been a straight-forward matter. When the process was initiated, the effects that capital liberalisation in recent decades has had on the stability of both national and global capital markets were clearly underestimated. There has now been a change in the international discussion. Much has been written about the ways in which deregulations were implemented, both in countries like Sweden and in developing countries. The process was sometimes too rapid, sometimes wrongly designed and often lacked a thorough assessment of the consequences. These lessons are now being taken into account in advice to countries that have not yet opened their markets. In the international discussion there is also a greater understanding of temporary restrictions on short-term capital movements, although the effects of taxing short-term capital, as Chile has done, or exchange controls must be considered uncertain.

Just as investment capital rapidly flows into a country when economic prospects are bright, so it has tended to be rapidly withdrawn when those who manage the funds suspect that their assets are threatened by growing economic problems. The major economic crises in recent years provide examples of this, in Mexico, Asia, Russia, Brazil and, most recently, Turkey and Argentina. It is, for that matter, a process that Sweden experienced in the early 1990s. When our crisis spread from

manufacturing to the economy as a whole, real interest rates shot up and the bank crisis loomed, foreign investors pulled in their horns. That in turn added to the difficulties in defending the fixed exchange rate and led to the krona's fall.

At the same time, the Swedish case exemplifies a couple of matters that are also relevant here. Our crisis was largely self-inflicted; with a more adequate economic policy in the 1980s, the flight of capital could have been avoided. And even though we have left the crisis behind us, it has not been forgotten, which means that in times of international unrest, Sweden is still affected to a greater extent than many other industrialised countries. Another conclusion from the Swedish case is that international reactions are not necessarily a bad thing; they can be just what is needed to overcome a political deadlock and pave the way for necessary changes. When foreign creditors turned down Swedish banks, we were forced to take resolute measures to resolve the bank crisis. This has not yet happened in Japan, presumably in part because there is not the same dependence on foreign capital; the crisis in Japan has therefore been more protracted and costly.

A tax on currency transactions (a so-called Tobin tax) has been proposed in the globalisation debate as a way of curbing capital movements and reducing the risk of international financial crises. A tax would restrain these flows; its effect would depend on the size of the levy. It is by no means certain, however, that it would be just the more speculative flows that are checked; it could equally well be the more stabilising regular currency flows. There is, in fact, little indication — either in theory or in experience from earlier centuries — that an economy with sand in its wheels works better than one that is well-oiled.

Just rejecting a Tobin tax won't do, however, at least not if one considers, as I do, that, notwithstanding the problems, free capital movements are good for the global economy. Other methods must be found to reduce conceivable negative effects. Much is being done in this respect in various international fora where I represent the Riksbank. Under the auspices of the IMF and the Bank for International Settlements, work is in progress on drafting rules and principles for the operations of financial institutions. It is dealing with such tangible matters as accounting, increased transparency and, not least, principles for managing risks. It is hoped that more uniform rules and greater transparency in accounting, capital adequacy and credit assessments, will improve financial market conditions and ultimately lower the risk of financial crises. In addition, countries must be alert in the general conduct of economic policy so that lending to them is not considered to be unduly risky. Other important matters include a sound banking system and effective supervision of the financial sector. In Sweden, the events in the early 1990s have led, for instance, to the regular publication of a so-called Stability Report on the situation in the financial sector. This has been followed by many similar reports at the international level; the IMF, for example, now presents regular assessments, so far for more than forty countries.

Before leaving the issue of free capital movements, I want to note that compared with the earlier question of trade, the problems here are not primarily political. As I see it, there is a strong will to do something about financial market instability and much work has been done internationally to mitigate the risks. At the same time, it

is difficult to see how the risks could be eliminated entirely without this leading to serious disturbances in and high costs for the world economy.

Country crisis programmes and IMF stipulations

A third topic in the ongoing globalisation debate is the role of the international financial institutions, not least in the management of financial crises in recent years. The International Monetary Fund (IMF) has been criticised in particular from both the left and the right of the political spectrum. On the one hand the IMF has been accused of pumping in too much money in the form of massive support for countries with a medium income level and thereby disrupting the market's normal credit assessments by protecting private creditors from losses. On the other hand, the measures required of individual countries have been said to be inappropriate and unduly harsh, leading to negative economic, social and political effects.

During the past decade the IMF has provided support for countries with payment difficulties. This has amounted in practice to guaranteeing short loans in particular so that the country in question did not have to engage in onerous renegotiations with creditors and perhaps ultimately suspend payments, with serious potential consequences for its economy and standards of living. It is debatable whether this approach is sustainable in the longer run, although in each case acceptable alternatives have been hard to find at the time of the crisis. One consequence, of course, is that for such countries borrowing has been 'cheaper' than would otherwise have been the case. International banks and other creditors could make do with less compensation than if they had had to reckon with taking the losses in full. The support programmes have accordingly accentuated the problems associated with the growing flows of volatile capital. Neither has the corresponding support been provided in practice for more long-term direct investment, which presumably would be at least as valuable for developing countries in that such investments primarily depend on domestic economic development in the longer run.

This policy has in fact been questioned all the time. It has been maintained on account of an interest in avoiding failures that would be costly both socially and politically. Moreover, the provision of government funds has been frequently advocated by strong private interests in the major industrialised countries, particularly the United States. It should also be underscored that problems of this kind do not have self-evident solutions. A way out in some cases has been for private creditors, with government encouragement, to agree voluntarily to prolong their loans. One difficulty here is that the discussions with private creditors have to be initiated by the country that is in a crisis. In practice, the countries in question have been reluctant to take measures that might harm their future access to international capital markets. An international bankruptcy procedure, which should have been instituted long ago, is now being officially discussed again in the IMF. Such a system would probably help to make the management of acute financial crises more predictable.

Another subject for criticism has been the conditions attached to the loan programmes. This was the case not least in connection with the Asian crisis, when critics considered that the IMF's economic policy stipulations were inappropriate

and unduly harsh, being more likely to lessen instead of enhance the chances of a recovery. Once again, we can refer to Sweden's problems in the early 1990s. When the fixed exchange rate had finally been abandoned in 1992, many argued that interest rates ought to be lowered both more quickly and further than was actually the case. I was one of them because I believed this was needed both for a quick end to the economic decline and to facilitate the consolidation of the government finances. In addition , it ought to aid a faster recovery in the banking sector. Others, including the Riksbank at that time, preferred a more cautious path in the hope that this would prevent a further weakening of the krona. Striking the right balance in these respects is difficult and even with hindsight we cannot be sure who was right.

The problems in Asia were similar. Would it have been more appropriate to lower interest rates in order to avoid the failure of companies with loans in the domestic currency and the collapse of the banking system, or to stimulate demand to a greater extent so as to keep the economy going? Or were high interest rates on the contrary needed to prevent the flight of necessary capital, a weakening of the exchange rate and the failure of companies with foreign-currency debt? Or was it perhaps the case that the high interest rates led investors to expect additional business failures and social unrest, so that they withdrew their capital for precisely this reason? As we do not know what a different direction of policy would have led to, even today we cannot tell what would have been most appropriate. But we do know that the tight nature of many of the programmes was eased as time went by, partly as the crisis became less acute and the shortage of foreign currency less troublesome.

Another question concerns the structural changes and reforms that were required in connection with some programmes. Such conditions may be justified as regards the banking sector or bankruptcy proceedings, for example, as these are often clearly a part of the problems. They are more questionable, however, when they concern components of the economy that are not self-evidently connected with the current stabilisation problems. There were elements of this in, for example, the programme for Korea, which stipulated measures for the liberalisation of imports. Such matters are liable to discredit the IMF, besides leading to the IMF's proposals encountering more opposition than otherwise in the borrower countries.

Before turning to the next issue — the problem of the poor countries' large debts — let me summarise the discussion about the IMF, its lending operations and requirements. In my opinion, the criticism of the massive loans contains several grains of truth. Solutions are admittedly difficult to find when problems have already accumulated but a considerably stricter position at an earlier stage, together with greater transparency about the actual situation, could have resulted in a better policy. I am more hesitant about the criticism of conditions imposed on particular countries. There have certainly been mistakes — policy has, for instance, been constructed all too frequently on the premise of a fixed exchange rate — but even retrospectively, the answers are seldom as obvious as they are said to be. Macroeconomic policy in a crisis is almost always a question of arriving at the right balance between different alternatives.

Poor-country debt

A fourth area of problems in the debate on globalisation concerns the debts of the poorest countries. This is something that has not least engaged representatives of the Church, for instance in the context of the Jubilee 2000 campaign. It has been argued that the international community is not doing enough to tackle the debt problems of poor countries.

I agree that the debt situation in many developing countries can hamper economic development, although a majority of the poorest countries also face problems of a more fundamental nature, for instance as regards internal institutional conditions. In any event, it is important to work for a level of debt that is more sustainable, particularly in the poorer countries. Much has in fact been done in this respect. The IMF's and the World Bank's joint initiative for debt relief for the poorest and most indebted countries[1] was launched in 1996. In contrast to earlier efforts here, this initiative assembled all a country's creditors, including the international financial institutions, to provide debt relief. The aim was to reduce the debts of poor and heavily indebted countries to sustainable levels and combine this with better conditions for increased growth. In 1998 it was decided to increase and accelerate debt relief in the context of the initiative. To a large extent this decision was a result of representations by church and other non-government organisations.

To date, 24 countries have been promised debt relief equivalent to a total of over USD 20 billion at current values. Debt relief for the countries included in the initiative is calculated to cost a total of USD 33 billion. It is envisaged that the funds which debt relief makes available in the countries concerned will be used in the first place for increased efforts to combat poverty.

Why, it may be asked, do we not write off all the debts of the poorest countries? The amounts involved may seem relatively small for the international community as a whole but that is not the case in relation to the resources that are currently available. A total write-off would use up all of the IMF's resources for soft loans, accompanied by similar effects for other relevant institutions. That would leave nothing for future IMF soft loans to other poor member countries. Would that be a reasonable policy? Is it just those countries with the largest burden of debt that deserve most support? Put differently, given a certain amount of resources for combating poverty, would one concentrate them to just the most heavily indebted countries? I don't think so. Then there is the problem that if the criterion for obtaining help is an earlier accumulation of large debts, what would this signify to potential borrowers in general?

Here, too, it is thus a question of striking a difficult balance. It should be possible to waive debt, which is sometimes a major obstacle to development. But this must be done in ways that underpin a country's ability both to generate growth on its own and to combat poverty. Moreover, the assistance must be acceptable to taxpayers in the donor countries, which in view of the nature of the regimes in some debtor countries, is not always easy. When all is said and done, poor-country debt cannot be waived unless people in rich countries are prepared to give up

[1] The Heavily Indebted Poor Countries (HIPC) initiative.

something in turn. It is only we — not some international organisations — that can transfer resources to the poor countries.

Conclusion

A crucial aspect of globalisation is unquestionably our increased interdependence. This has been largely beneficial in terms of increased prosperity, more widespread democracy and so on. But it has also had negative consequences, ranging from environmental destruction across national borders to higher interest rates and currency crises generated by circumstances in some distant region. The management of such problems calls for increased international cooperation. For Sweden today this amounts in practice to collaborating to a growing extent with our European colleagues and then acting with greater weight in the global arena. We can also learn more and more from the experiences of others, as was in fact the direct purpose of my stay in Peru.

Whereas the number of people in absolute poverty (living on less than a dollar a day) rose up to the early 1980s, in the past two decades the number has decreased. Moreover, life expectancy in developing countries has lengthened from 40 years in 1950 to 65 years in 1995. Another example is literacy, which increased in this period from 40 to 70 per cent. However, the positive trend has not spread to all parts of the world. Poverty is still widespread in countries such as Peru. But this does not have all that much to do with globalisation as such. It is essentially bound up with internal conditions, for example various power relationships, corruption, a lack of education, harsh climatic conditions and other obstacles to development. So providing money is not enough. Political as well as economic reforms are also needed.

The most important step the rich countries can take is to open their markets to imports from developing countries. Let me take a topical example. Additional support for Argentina has been discussed in recent weeks, in reality to support banks in industrialised countries, among other things. How much better would it not be, both for them and for us, if instead we opened our borders for their exports of beef and other products on reasonable terms? In addition, there are sound reasons both for debt relief and for greatly increased assistance, particularly for the poorer developing countries. These measures should, however, be accompanied by demands for reforms. A reasonable ambition is that all industrialised countries at least achieve the assistance target of 0.7 per cent of GNI.

I mentioned initially that aiming for the poor people in the world to share in our rising material prosperity is not enough. As I see it, the criticism of globalisation should be met with a policy that aims to narrow the economic gaps. More open trade and increased assistance, together with political and economic reforms in the developing countries, can contribute to this.