Speech

Deputy Governor Kristina Persson

WEDNESDAY 20 FEBRUARY 2002

Globalisation and Sweden

A discussion of the new terms and opportunities in politics

Thank you for the invitation to come here, it is great to see once again many people who played an important role during my active political years in the 1970s and 1980s. My speech today will consist of two different parts:

Firstly, a look back and attempt to analyse what has actually happened, both politically and economically, in Sweden since the early 1970s. Then I shall go through what globalisation actually involves. Does it cause problems - and if so, how can they be dealt with? Finally, I will comment on the criticism against globalisation, including the demands raised at the World Social Forum in Porto Alegre recently.

Record years at an end

The 1970s meant that an in many ways unparalleled period of economic growth in Sweden came to an end. One hundred years of industrial revolution had raised Sweden up from being one of the poorest countries in Europe to become one of the richest in the world. Growth created the right conditions for a welfare policy that aroused admiration among other countries and this welfare supported our economic growth in many ways. Sweden became famous throughout the world for its political and social successes - the concept of the Swedish model became part of our self-image.

I travelled a good deal during the 1960s and 1970s and I was very proud to be Swedish. Perhaps that was our big mistake - that we perceived ourselves as successful, almost invulnerable. When one fails to listen humbly to others, one is poorly equipped to deal with crises when they arrive. It was precisely that which had

Telephone +46 8 787 00 00
Fax +46 8 21 05 31
E-mail registratorn@riksbank.se

built up our welfare during the whole of the 20th century that proved part of our problem and a threat to our welfare from the 1970s onwards.

The increases in oil prices that came at the beginning of the 1970s triggered a structural crisis that wiped out large parts of Swedish industry. The shipyards and textile industry disappeared almost completely. International competition forced far-reaching rationalisation programmes in industry. However, the people who were no longer needed in industry did not start up new companies, but were mainly absorbed into the public sector, which continued to grow, despite the fact that resources had actually begun to dry up.

Sweden had a deficit in its central government budget and in its trade exchange with other countries - the balance on the current account. The renewal of trade and industry that we needed then in the form of new technology and new products with a greater knowledge content did not happen. This meant that no foundation was created for a continued increase in welfare. However, wages continued to rise, inflation amounted to an average of approximately 8 per cent a year between 1975 and 1995. The value of the wages was undermined; those who benefited were owners of real capital, property or equity.

Other countries succeeded better, and Sweden plummeted in the welfare league. We also lost ground in comparison with our neighbours; if we had had the same growth as Norway, Denmark and Finland between 1975 and 1995 our standard of living would have been 20 per cent higher today.

The solution that was adopted - by both the non-socialist and Social Democrat governments - was devaluation. No less than five devaluations took place between 1976 and 1982. The krona lost 40 per cent of its value. The write-downs of the exchange rate were necessary to some extent, as Sweden had lost a great deal of competitiveness, but as a solution to the problems they were quite insufficient. The idea of the large competitive devaluation in 1982 was that by selling its products cheaply to other countries, Sweden would get its production going. However, devaluating more than necessary is a short-term cure that risks making the patient more sick, as it does not stimulate the transformation and renewal required for sustainable competitiveness and growth.

The boom years in the 1980s, the big profits and the deregulation of the credit and foreign exchange markets gave rise to a substantial expansion in credit granting during the 1980s. We experienced a property boom in Sweden and a rapid increase in investment abroad, particularly in property. Deregulation was necessary, for three main reasons. Firstly, IT, electronic money and new financial instruments had already seriously impaired and partly made impossible the regulations on the foreign exchange and capital markets. Secondly, it was primarily the smaller companies that were hampered by the regulations, and thirdly, the deregulation was necessary to increase efficiency in trade and industry and the economy.

The problems were made worse by the fact that the deregulation and the major tax reform came in the wrong order. Real interest rates after tax were actually negative for households for a period and thereby pushed up the demand for credit substantially. In this situation a considerable measure of fiscal policy restraint would have been necessary. The fixed exchange rate meant that monetary policy was blocked, the responsibility for pursuing an economic policy compatible with a fixed exchange rate thus rested with fiscal policy.

The fixed exchange rate is abandoned

The overheating in the economy (when all attempts at restraint had failed) led to rapid wage increases and exports began to stagnate once again towards the end of the 1980s. When growth slowed down and the weak competitiveness became evident, the storm clouds began to gather. The turnaround was rapid and dramatic; the causes were both international and domestic.

The reunification of Germany led to inflationary pressure in Germany that was met with rising interest rates, which in turn triggered an economic downturn in Europe. Here in Sweden the downturn was reinforced by a tax reform that led to a large increase in saving - a correction of the heavy indebtedness that had arisen earlier. The bubble in the property sector burst and a long line of bankruptcies hit the property and financial sectors. The stability of the banking sector was threatened and the central government was forced to provide a general guarantee to the banking sector to prevent a breakdown in the payment system.

The economic downturn now made a full impact on the Swedish labour market. The deficit in the central government budget and the national debt also began to increase heavily. Sweden had tied the krona to the ECU since 1991, in order to make it clear to other countries that the days of devaluation policy were over. In this situation (1992), the unease in the foreign exchange markets began to spread. Today we know that it is a dubious combination to have a small currency, a deregulated foreign exchange market and a fixed exchange rate. Following a heroic but fruitless defence of the krona, with massive interventions and marginal rates of up to 500 per cent, the Riksbank was forced to give up. The krona was allowed to float (for the first time since the 1930s) and during the first year it lost 30 per cent of its value. Swedish industry's competitiveness was restored, but Sweden had once again become poorer in comparison with other countries. An inflation target was introduced instead of the exchange rate target, and was defined by the Riksbank as 2 per cent.

New terms

I have provided this rather detailed description of the economy during the 1970s to 1990s because it is important to understand the economic course of events that comprises the new terms for politics. Developments in Sweden can be said to have been a part of the international trend towards increasing globalisation. It is possible that the turn of the tide was particularly marked in Sweden, as we had postponed a number of the changes as long as possible. The financial imbalances that accumulated during the late 1980s were also an important reason behind both the bank crisis and the fact that economic growth was so weak at the beginning of the 1990s.

It was not just the economic changeover that was far-reaching. The political and (in the broader sense) cultural changeover was at least as marked. One question that many people ask themselves is whether it could have been avoided. The demands on the Swedish economy and politics could not have been avoided in my opinion. On the other hand, Sweden could have prevented or at least alleviated the effects of the crisis by acting differently. However, it is easy to be wise with hindsight. Deregulation and adaptation to the requirements of international competition were and are unavoidable. The terms are decided in a global environment over which Sweden alone has very little influence and where various types of market set limits and create opportunities. Sweden's dependence on this market for its welfare is very heavy. However, we do not always need to adapt to the regulatory systems that are the most liberal - there are several examples of the reverse applying, i.e. that other industrial nations have stricter regulations. However, to put it simply, we are forced to accept the situation, to deal with the problems and take advantage of the opportunities and, in co-operation with others, to try to change the terms - if we do not find them reasonable.

Both with regard to the openness in commerce and deregulation on the capital market, Sweden chose in 1992 to bear large costs to society in the form of production losses and mass unemployment in order to achieve good growth in the long term. This strategy gave results and during the second half of the 1990s the clouds began to disperse. Today the central government finances are in good condition, the current account has shown a surplus for several years, inflation expectations are stable around 2 per cent and unemployment is down around 4 per cent. Perhaps we are at the beginning of a new stable period of growth. However, the question is whether this will require changes in the institutional field at least as large as those during the post-war period.

The meaning of globalisation

Although globalisation is the one factor above all others that has changed the terms for economics and politics over the past 25 years, it is no new phenomenon. As early as the 1870s and up to the end of the Second World War, Sweden's foreign trade covered approximately 20 per cent of the Swedish economy. After the Second World War, trade increased substantially and now constitutes approximately 40 per cent of our total production. This means that Sweden has a very open economy, exposed to competition on the global market.

The IMF's definition of globalisation is "the growing mutual dependence between countries around the world through the increasing volumes and amounts of cross-border transactions in goods, services and capital flows." Pope John Paul has emphasised that "globalisation is present in every aspect of human life" and that "solidarity must also become global".

What we mean by globalisation in our daily speech is primarily the strong growth in the international financial markets. The increased mobility of capital across borders and the increasing scope of the capital market over the past 20 years are connected with both deregulation and developments in electronics and information technology. It is difficult to find comparable figures over time, but in the UK cross-border equity and bond trading rose from almost nothing to ten times GDP during the period 1970 to 1993.

The new element is not the mobility of the capital, but the scope - particularly in relation to trading in goods and services. Prior to 1914 capital also moved freely and there were extensive investments across national borders. At its highest level during the previous turn of the century, the outflow from the UK comprised 9 per cent of its GDP, which is approximately twice as much as the record high flows from Japan and West Germany during the 1980s.

The Swedish railway network and hydroelectric power were built up largely with the aid of foreign capital. The mobility of the capital also enabled the rise of large multinational corporations with production units in many different countries. The industrialisation of Sweden was hastened - it has been estimated that the Swedish productive capital stock was 50 per cent greater than it would have been between 1870 and 1914 through the import of foreign capital.

With the abolishing of the barriers to capital in the 1980s, Sweden also became the object of close scrutiny by international investors and capital owners. The slightest indication of mismanagement of economic policy, such as a growing budget deficit, wages rising too rapidly or inflation could lead to foreign investors selling their holdings of Swedish treasury bonds and equity. Signs of mismanagement could also lead to Swedish households and companies choosing to invest their money abroad instead of in Sweden. It was this, combined with Sweden's history of high inflation and other imbalances that made it impossible for us to retain the fixed exchange rate in 1992.

Financial capital is very volatile, if not "nervous". The speed of movement and herd behaviour in the financial markets mean that a sequence of events can become overly dramatic before measures are taken. What normally encourages speculators is when an economy is out of balance, e.g. has a high central government debt, poor public finances or weak competitiveness as a result of a high cost situation. A recent example of this is Argentina.

There is a long list of examples where speculation has made it impossible to retain a fixed exchange rate. Following the experiences of Sweden, Finland and the UK in 1992, Mexico suffered the same fate in 1994-95, South East Asia in 1997, Russia in 1998, Brazil in 1999, and Turkey and Argentina in 2001. All of these crises have at least one thing in common: the countries had a fixed exchange rate.

Why are the financial markets so important?

An efficiently functioning financial sector is an important part of a country's economic infrastructure. If it ceases to function well, this could have serious consequences for economic growth. However, it is much easier to see the importance of, for instance, transport and energy systems.

The deregulation of the international capital markets means that savings capital can now be moved in seconds and almost cost-free from one part of the world to another. Capital is not actually so different from other goods: Some people need capital and are willing to pay to borrow it. Others have savings capital and can sell the opportunity to use this for a period. Deregulation has meant that savings can be channelled to a greater extent to where they will do most good. Growth economies currently finance their rising industries and their infrastructure with the aid of savings capital from us in the richer part of the world, just as we once borrowed money from other countries during our industrialisation process. At the same time, those who save money can make use of the growth potential that exists outside of their own country. Free movement of capital has also made it possible to spread the savings capital and thereby reduce risks. This provides economic security both for those investing and those using the borrowed capital.

As pension savers (which we all are), we want to be sure that our capital will retain its value; it should preferably grow as much as is compatible with a secure investment. We thereby also become owners of mobile capital that immediately flees a country in which the asset managers have lost confidence. The question is what these fluctuations do to the national economy. The liberalisation processes have not gone hand in hand with the corresponding development in financial control mechanisms in the national economies, and no international regulatory systems or supervisory authorities have been created. There is thus still an imbalance around the world between the freedom enjoyed by capital and the forces that can balance and counteract effects that could be damaging to society.

Do poor countries suffer as a result of globalisation?

A common objection has been that globalisation possibly benefits countries that are already rich, but it makes poor countries suffer even more.

Let us look at the economic growth of recent decades, when the rate of globalisation has been particularly high. Since the beginning of the 1980s, purchasing power per capita has more than doubled in the world as a whole. Developments have been particularly astonishing in Asia. In 1975, six out of ten people were living in absolute poverty - on less than a dollar a day. Today the figure is two out of ten people. In China alone the number of poor has declined from 60 per cent to just under 30 per cent in less than twenty years.

At the same time as conditions for many people have improved, there are still large differences between the countries and within countries. Almost three billion people are trying to survive on a daily income of less than two US dollars. One billion people are living in absolute poverty. The largest percentage of these can be found in Africa south of the Sahara and in South East Asia (46 per cent and 40 per cent respectively of the regions' inhabitants). In Africa the per capita income actually declined by an average of 1 per cent during 1975-99.

The reasons behind the poor development in Africa are, of course, several and complex; deteriorating prices on raw materials exports, trade obstacles, corruption, poor management, unsuccessful reforms, climate, AIDS, internal conflicts, population increases, etc. Africa's prospects for the coming years are uncertain. The fall in raw materials prices and the decline in tourism recently have hampered developments. If growth is only 3-3.5 per cent a year, there is no possibility of achieving the target of halved poverty in 2015, which is one of the UN's millennium targets.

So what lies behind the rapid growth in other parts of the world? The two most important explanations are the technological progress and that there has been a rapid increase in trade as a result of the dramatic reduction in tariffs and other trade barriers. World trade has increased by 6 per cent annually over the past 20 years, while growth has increased by 3 per cent. This has meant that the total trade in goods and services in the world today has increased sixteenfold. The markets have become many times larger, which has meant that workers and companies in different parts of the world have been able to concentrate on the production at which they are best. Specialisation and increased competition have pushed prices down. Households have more money to spend. The increased economic growth has led to better schools and medical care.

Globalisation also has other advantages. Increased contacts with other countries have made it increasingly difficult to isolate one country, something that was an important factor behind the fall of the iron curtain. And this was before the days of the Internet, which is a difficult to control and extremely powerful tool for spreading information - also for those who are against globalisation.

The criticism against globalisation

Despite the in many respects positive effects of globalisation, there are many people who see it mostly as a threat. As a rule they normally refer to one or more of the following:

- ?Trade and new technology increase competition. Companies are closed down because there is greater profitability elsewhere. (Gislaved is a recent example of this.) Other companies cannot cope with the competition and employees lose their jobs. Some people claim that the poorest companies would benefit by closing themselves against the outside world and building up their own industries protected from superior competition from the richer countries, and then gradually letting them be incorporated into the global economy.

- ?Free capital movement makes countries more vulnerable if they pursue a policy considered less credible by capital owners/managers. Investments flow in rapidly when economic prospects are good, but can flow out again just as quickly when the financiers suspect that growing problems threaten the value of their capital.

- ?Although an increasing number of people are experiencing better conditions, the gap between rich and poor is still growing. 20 per cent of the world's population receives more than 80 per cent of the global income generated. Many countries risk lagging behind for various reasons.

How can we manage the drawbacks/challenges of globalisation?

The first point concerned trade. There is plenty of evidence that countries pursuing an open and outward policy grow more quickly than those choosing to isolate themselves from the rest of the world. The problem is not that the poorest countries cannot compete with the industrial nations. Companies tend to turn (at least with regard to some production) to the countries with the lowest labour costs. This means that globalisation makes considerable demands for structural change and refining in the rich countries, i.e. that we find the niches where our high costs are less important.

The problem is rather that the rich countries still protect their own production to a large degree. Although the trade barriers between countries have declined considerably in general over recent decades, there are still some remaining. This applies particularly to the food and textile industries, where the poorest countries have their greatest comparative advantages. For instance, the EU invests EUR 2.7 billion a year on keeping sugar production within the EU profitable for European farmers. This is while the poorest countries are kept outside the European markets. The USA pursues a similar policy; in total the industrial nations spend more than USD 300 billion a year on protecting their own agriculture from competition.

It is possible to gain an impression of the amounts involved here by comparing the EU's agricultural subsidies, USD 42 billion, with the total aid in the world, which amounts to USD 56 billion. It is estimated that a 50 per cent reduction in trade barriers would generate welfare gains of over USD 400 billion a year, with one third of these gains falling to developing countries.

Rather than being a threat, trade is a necessary condition for welfare, particularly for small countries - we ourselves have experience of this. Trade is also an important channel for transferring knowledge between countries via technology and innovations of various types that spread and benefit economic growth.

Foreign aid was the most important capital supply to developing countries up until the beginning of the 1990s; since then the private capital flows have gained greatest significance. In total, foreign aid now accounts for only 18 per cent of the financial flows to developing countries. However, foreign aid is still the most important source of capital for the poorest developing countries.

The second objection concerned the mobility of international capital, which means that any sign of problems in growth or stability can rapidly have negative effects on the real economy. At the same time, we have seen that even countries that have a good macroeconomic policy can be hit by contagion effects. We saw this, for instance, in connection with the financial crisis in Asia and Brazil. What have we then learnt from the financial crises of the past decade and what can we do to prevent similar crises happening in future? Here I will limit myself to those measures being taken in contexts that affect the Riksbank:

Better crisis prevention and management

Firstly, we have learnt that it is important to have greater openness with regard to economic policy and statistics. Economic information currently steers the actions of the financial markets. By telling the rest of the world what economic policy a country intends to pursue, it creates greater predictability and uncertainty declines. The crisis in Asia originated largely from a lack of information on economic conditions, which led to incorrect credit assessments and capital flight. By publishing information on its member countries on the Internet, for example, the IMF hopes to contribute to openness.

Secondly, we have learnt that internationally accepted norms and standards are necessary in various fields, e.g. for openness in monetary policy and for bank supervision. The work on creating these norms has come a long way, now the focus is on promoting their observance. This type of work is not always given a prominent place in the globalisation debate, but the more countries that follow the current norms and standards, the better equipped the financial system will be to prevent financial crises. A financial crisis in South East Asia would also have an effect in Sweden. We can therefore also benefit if countries on the other side of the world acquire better systems for bank supervision and bankruptcy legislation.

Thirdly, we have learnt that in the long run it is not possible to combine a fixed exchange rate with an economy that is out of balance in a world of free capital movement. The common denominator in almost all of the international financial crises of recent times is that the countries have been forced to abandon a fixed exchange rate, often at a very high cost.

Fourthly, we have learnt that private investors must realise that they are taking risks and should also take responsibility for the losses. Large loans from e.g. the IMF can create the wrong type of incentive in that private investors may believe that the international society will ultimately help out countries in crisis and there is thus no excessive risk in investing in or lending to these countries.

There is currently extensive work being done on all of these issues in organisations such as the IMF, the World Bank and BIS to find regulations and methods to prevent crises and to protect innocent people from the consequences of crises.

The demands of the anti-globalisation movement

The third objection regarded the situation of the poorest countries. The demand for a more just globalisation was the theme at the World Social Forum held by a large number of individual organisations (NGOs) in Porto Alegre, Brazil recently. 60 000 people participated, including 6 French ministers. This was a kind of "antipodes" to the World Economic Forum's meeting in New York. There were many demands, including the immediate writing off of developing countries' debts and the introduction of taxes on currency transactions (a "Tobin tax").

Naturally, the debt situation in many developing countries constitutes an obstacle to growth and the combating of poverty, but it is not as simple as writing off the debts and believing that this will solve the problems. Moreover, a lot of work has already been done; in 1996 the IMF and the World Bank launched their joint initiative for debt relief for the poorest and most heavily indebted countries, the HIPC initiative. This differed from earlier efforts in debt relief in that the initiative gathered together all of a country's lenders (including the international financial institutions) with the aim of reducing external debt for poor and heavily indebted developing countries. In 1998 they decided to take further measures within the framework of this initiative.

So far, 24 countries have made decisions on debt relief, corresponding to just over USD 20 billion. The total cost of debt relief for all 34 countries included in the initiative is calculated at USD 33 billion. The funds that are released in the countries concerned through this debt relief shall be used to increase measures to combat poverty.

You might ask why we don't just write off the poorest countries' debts completely. The funds lent by the IMF on concessional terms to the poorest member countries comprise loans and subsidies from individual member countries. A total write-off of the countries' debts would mean that all of the funds for this concessional[1] lending would have to be used. Other poor, but less indebted, member countries would thereby be unable to receive subsidies and loans on concessional terms.

In recent times, various proposals have been put forward regarding attempts to generate more money for the poorest countries. For instance, the income from a tax on foreign exchanges, what is known as a Tobin tax, could be used as foreign aid. George Soros has also proposed the use of the IMF's special drawing rights for foreign aid. However, both of these proposals would involve major difficulties. The Tobin tax would reduce liquidity and willingness to take risk on the capital markets and thereby probably contribute to reducing capital flows, including those to developing countries. Moreover, it would be difficult to implement, as it would preferably need to cover all countries in the world in order to be effective.

Soros' proposal is probably unrealistic; there is already a decision from 1997 to increase the IMF's special drawing rights that has not yet been adopted by the US Congress, which is a condition for its implementation. It is therefore difficult to see why new proposals in this same direction would have better chance of success. The problem is that there is a lack of political willingness particularly amongst the largest and richest countries in the world, to increase the resources for foreign aid. Today there are only five OECD countries (Denmark, Luxembourg, Holland, Norway and Sweden) that have achieved the target of foreign aid to developing countries amounting to 0.7 per cent of GDP. And even if more money is needed, this is not always an adequate solution; good quality development projects and plans in developing countries, as well as competence in the management of resources are equally important.

Concluding comments

It may sound to some as though I am almost singing the praises of globalisation. That was not my intent. There are many large, unsolved problems connected with globalisation. One, which concerns me greatly as an individual is democracy. However, what I want to say is that it is impossible to turn back the tide, either in Sweden or the world as a whole. And there are also major gains with globalisation.

The question we need to ask ourselves instead is how globalisation / the international market economy can be combined with respect for human worth, consideration for others and sustainability in our economies. In my opinion, there is currently a substantial imbalance between the strength and pace of the global financial and corporate markets and the social, human considerations. It is rather like the race between the tortoise and the hare. The conflict is particularly evident in the environmental field.

I do not believe that the Tobin tax, a radical writing-off of debts or a return to old national regulatory systems will solve the problems. Part of the solution is quite

---

[1] The IMF's soft, or concessional, lending, i.e. loans with a long duration (10 years), long period of grace (5½ years) and very low interest rate (0.05 per cent). These can be compared with the IMF's normal lending, which should usually be repaid after 5 years and where the interest is at market rate.

simply "unsexy". This involves international regulations on openness, supervision, accounting, sound central government finances and, not least, functioning democracies that take responsibility for distribution of income and welfare issues. However, we also need international regulations regarding, for instance, the environment and how people are treated. We also need follow-ups and sanctions if these regulations are not observed.

In addition to the laborious and often slow-moving international co-operation pursued by governments, there are of course other arenas for political influence: consumers, popular movements and trade union organisations, for instance, which could co-operate more to create a counter-force.

In order to gain and retain the people's confidence, trade and industry must actively contribute to increasing sustainability in businesses and financial markets as well as social responsibility. The legal route is too slow and it is difficult to make laws all-encompassing. The customers, who are ultimately the people, and the media - which has considerable responsibility for the spread of short-sighted capitalism - must also contribute by rewarding economically sustainable achievements.

The events in Seattle, Prague, Gothenburg and not least in New York on 11 September have all led to issues regarding globalisation being given greater priority. Which I think is a good and necessary thing.

Thank you for listening!