

**Economic Theory**

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**GLOBAL ECONOMIC POLICY
FOR THE MODERN WORLD ECONOMY****Abstract**

The author elaborates the criteria which may be applied in a number of economic policy areas that are in the spotlight international policy debate.

Key Words

Economic policy, global governance, international coordination, quadrant of the system of coordinates, Tobin tax

1. Introduction

Globalization advances in huge steps. There hardly is an enterprise in the world, which would not be somehow tied up in the world economy, be it through exports of its own products, inputs of foreign raw materials and services, or participation in global outsourcing and offshoring networks. Thus, economic activity increasingly shifts to international level. The economic policy, however, is as before limited by national boundaries. This creates ever more problems. Tax-

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payers relocate to avoid interference of financial authorities; mega-mergers of multinational business concerns can only be powerlessly observed by anti-trust authorities; social networks under global competition turn into a trap for domestic economy; and the best energy-savings policy in the developed countries cannot protect environment, whereas thermoelectric power stations shoot up in China, as mushrooms after the rain.

From this appears an understandable wish of the countries to engage in the policy-making at the international level and, together with others, to turn from national into global policy-makers.

How should these aspirations be appreciated? Do they represent gradual expansion of globalization towards policy-making? Or are they only the aspirations of a cartel of politicians that want to eliminate an undesirable competition of location?

To give a grounded answer, one needs clear criteria, which would define under which conditions the international coordination of economic policy brings advantages and under which it does not. The relevant criteria are developed in this article, and they can subsequently be applied in a number of policy areas, which are currently in the spotlight of international policy debate.

Naturally, the matter in question is not to analyze thoroughly all relevant policy areas in order to determine whether they should be coordinated internationally or not. For that, one should refer to relevant literature, which can be found by consulting the Bibliography section. In the foreground of this article is an attempt to develop our own conceptual basis which would allow asking the right questions when the case in point is «Global Governance». The discussion of different policy areas serves only to exemplify the possibilities of applying our concept.

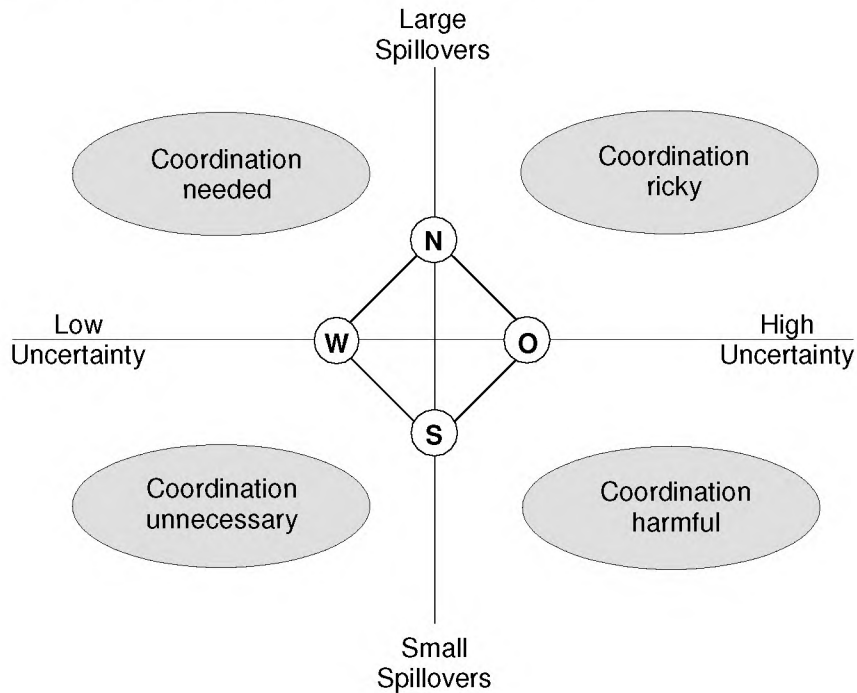
2. The Cross of Reference for International Policy

The core problem of international policy coordination lies in the conflict of goals, which arises from the necessity to limit international spillovers, on the one hand, and from the unavoidably resulting worsening of systems competition, on the other. The more expressed these spillovers are, the higher the welfare growth can be achieved through international policy coordination. Examples of such spillovers can be the green-house emissions, competition hindering by multinational cartels, or trade distortions from imposition of customs duties and other protectionist measures. On the contrary, the higher is the uncertainty of forming an adequate economic policy, the higher is the danger that international coordination will dismiss systems competition among the countries as the «discovery procedure» for determining efficient economic policy regulations (Hayek 1984). The consequences of this conflict of goals for different policy areas can

be vividly illustrated by means of a frame of reference, the axes of which are assigned to the colliding goals of policy coordination (Figure 1).

Figure 1

The Cross of Reference for International Policy



The assessment of international cooperation from an economic standpoint can become possible only after each policy area is placed within the respective quadrant of the frame of reference:

- In the North-Western Quadrant, where international spillovers are large and the uncertainty about optimal formation of the system of regulations is low, should be the core area of international policy coordination.
- In the North-Eastern Quadrant, where large spillovers are combined with high uncertainty, lies the actual problem area of international coordination. To harm systems competition as little as possible, it is es-

pecially important to exclude market intervention unless there is absolute necessity and to bring international regulations to minimum.

- In the South-Western Quadrant, where international spillovers are small, the international coordination of economic policy should not take place.
- In the South-Eastern Quadrant, where high uncertainties exist, the international cooperation would even diminish welfare, since the competition among different national systems of regulation would become defective, however, without preventing the otherwise noteworthy spillovers.

International spillovers, the reduction of which is the question of economic policy coordination, are usually easy to name, so that the advocates of coordination are, as a rule, ready to hand a convincing argument. The evolutionary improvements in economic policy, which could be discovered under international competition of different regulation systems, are, on the opposite, incomparably more difficult to establish, since they inevitably remain unknown *ex ante*. Thus, there is an obvious asymmetry between the predetermined benefits and the possible costs of international policy coordination.

The examples of the importance of international systems competition for the long-term economic development are brought forward primarily by the historical experience. Thus, different economic historians have elaborated persuasive arguments that the cultural diversity and the nature of competition among state systems in the Europe of eighteenth and nineteenth centuries were the deciding factors of success in technological and economic development as, for example, compared to Asia (Jones 1981). The failure of the planned-economy experiment in the twentieth century underscores again the importance of international competition for optimal economic policy regulations.

3. The North-Western Quadrant: Promoting Welfare through International Coordination

According to the scheme developed, the international trade policy obviously fits in the North-Western-Quadrant, since the impact of national protection measures on other countries can be significant, whereas the uncertainties as to whether the WTO-contract regulations actually contribute to supporting welfare seem rather low. Should (despite the failure in Seattle) one succeed in bringing the current negotiations round of the World Trade Organization (WTO) to a fruitful end, the results of the so called «Doha-Round» would primarily be related to the unsettled tasks stemming from the previous «Uruguay-Round», including trade in agrarian produce and textiles, which can be said to build the last refuge of classical protectionism. As the remainders of the «Uruguay-Round», the trade

in services (GATS) and the trade-related investment barriers will again become the subject of negotiations.

In view of the both above-mentioned topics, trade liberalization reaches beyond the elimination of purely customs barriers and intervenes in the internal economic policy of partner countries. Respectively large are the reservations of many countries to agree to contract liabilities, since national sovereignty is in this case much more affected as with the ordinary trade liberalization. The international trade policy will have to overcome these obstacles, since to ensure free trade, it must press stronger for opening of the internal markets, whereas trade barriers are noticeably losing in importance (Moore 2004).

The insufficient readiness to give up national competencies is also the main impediment for introducing the international competition policy. At that, the urgency of international coordination in view of the strong increase of multinational mega-mergers has become immense. Even if the establishment of international control over mergers is a welcome thing from the general economic standpoint, it is hardly realizable politically. It seems more promising to get attached to the existing international trade policy and to approach the international competition policy step by step. The catchword for that is already coined, it is the notion of TRAPs (Trade-Related Antitrust Principles). The first approach could be the international agreement on control over cartels clearly going against the rules of fair competition. This ban on cartels should primarily be applied within the cross-border agreements, so that different national cartel-policies could continue to exist (Klodt 2004).

In the long-term perspective, the trade and competition policies will anyway become strongly amalgamated, since the differentiation of traded goods and the service-intensity of their production and marketing constantly increase. Thus, anyone who wants to put his products successfully on the foreign markets must, therefore, be represented in these markets with his own branch offices. The growing overlapping of trade- and competition policy questions also speaks of the fact that the sphere of international competition policy does not need any separate institution, but it should be placed under the auspices of the WTO.

The third important area of the North-Western-Quadrant is represented by the international environmental policy. The protocols of Montreal and Kyoto have set the important foundations for protection of the ozone shield and reduction of greenhouse gases. At present, the matter in question is primarily to put as many countries as possible under the obligation to perform the measures stipulated by these protocols and to regulate the procedures of their conversion. The Kyoto protocol has been ratified since 2004 by many countries, but there still misses the signature of the United States (the largest emitter of greenhouse gases), and unresolved are the many problems of conversion (Michaelowa 2004).

At that, it becomes more and more clear that behind the international environmental problems, there finally appears the North-South conflict of distribution of the worldwide emission rights. The rich countries keep status quo for the respective starting point for emission rights distribution («Grandfather clause»).

The poor countries, on the contrary, consider environment as a «common heritage», which presumes that all countries per se should have equal emission rights. They should also have the same right to energy-intensive industrialization, as did the rich countries in the past.

However, since the global climate problem can only be solved by the developed and less developed countries together, both sides will have to reach a compromise: the poor countries will have to accept that the climate-sparing economic development is also within their interests. And the rich countries will have to provide financial means and technology for the poor countries in order to enable climate-sparing industrialization. Despite all diplomatic achievements on the climate conferences, the international state community is still far from reaching such a consensus.

From this point of view, it appears that forcing the less developed countries to environment-friendly behaviour through threats of trade sanctions is an incompetent attempt of the industrial countries to defend their property rights under the Grandfather clause. Moreover, there is a danger that the environmental argument of the lobbyists of «green protectionism» will be misused, and the conflict of goals between the trade and the environment policies will be solved with a rotten compromise at the expense of both sides. Thus, the international environmental policy should not be put into the hands of the WTO, but there should be an independent organization (something like the WorldBank) established.

4. The North-Eastern-Quadrant: Coordination with Risks

In the course of the above-discussed policy areas, the matter in question was primarily the questions of implementing and realizing international rules that would contribute to welfare. In the North-Eastern Quadrant, the problems are by far more fundamental. Here, one must thoroughly weigh the potential gains in welfare, which can be achieved through international regulations, on the one hand, against the dynamic efficiency losses coming from the restrained systems competition, on the other.

Little competently runs today the economic policy discussion on international tax policy. In many places appeared a threat of the ruinous «tax race to the bottom», at the end of which none of the involved states will have the necessary means to finance its tasks (Sinn 2003). This argumentation resists neither theoretical nor empirical examination. Despite progressive globalization, worldwide state quotas are still more likely to be too high than too low. If the sharpened international competition of location forces regimes to become «leaner» and more careful with using scanty tax means, the welfare of citizens can only improve.

The obvious problem is that the internationally mobile capital can always easily avoid taxation, and therefore, the tax load must be placed more on the immobile factor of labour. However, even here the solution does not consist in international standardization of tax-rates (which however could hardly be introduced on the Bahamas or the Cayman Islands). Since capital owners are much less mobile than the capital itself (except for several Tennis professionals), the tax race to the bottom, in principle, is slowed down already by the fact that the capital gains are taxed at the place of capital owner's residence, and not at the place of the use of capital. The core problem consists then not in internationally different tax-rates, but only in tax-avoidance, from which the state must defend itself when realizing every single type of taxation. The central point is, therefore, the need for imposition of the standardized rules of calculating transfer prices inside multinational enterprises¹.

In view of the currency crises in Latin America and Far East, it becomes understandable that for the global economic policy-makers the new order for international financial markets holds a top position on the agenda, since the recurrence of the events of the eighties and nineties is dangerous. At that, the focal point is the role of the International Monetary Fund (IMF), which vainly endeavoured again and again to help the involved countries with stand-by credits for protecting their currencies.

At that, it seems completely illusory to hope to prevent future currency crises just by providing IMF with more financial resources. With large transaction volumes and high volatility, which are typical of today's international foreign exchange markets, even a ten-fold increase in the fund's means would be nothing more than a drop in the sea. The need for stand-by credits have primarily the international investors, which, in this way, can remove their capital from every region in crisis at a still favourable exchange rate.

Overly exaggerated are the hopes for the so called Tobin-Tax law, which should be imposed on all international transactions in order to reduce short-term movement of capital and to curb the volatility of international financial markets (Tobin 1978). Even if this tax was completely suitable for diminishing short-term speculation and the resulting exchange rate fluctuations, these moderate fluctuations do not represent any serious problem for the world economy. In solving the real problems – i. e. the fundamental currency crisis – the Tobin tax won't get anywhere. When there is a threat of a double-digit devaluation, the Tobin-tax can hardly keep anyone from abandoning the currency in crisis in no time.

The one, who perceives international currency crises of the eighties and nineties as the result of the cut-loose «casino-capitalism», has little understanding. In Latin America, as well as in South-East Asia, those were the real economic problems which made the devaluation necessary. In Latin America, it was

¹ Possible approaches to estimating transfer prices can be found in the Guidelines for multinational enterprises and national tax administrations elaborated by the OECD (OECD 2001).

primarily the escalating state indebtedness, whereas in South-East Asia, those were the short-term private credits that flew in the investment projects, the profitability of which was at times assessed too euphorically. Had the regimes involved decided to adjust accordingly their exchange rates in advance, the currency crises would surely have proceeded by far more moderately (Dornbush, Fischer 2003).

At least in South-East Asia, the inflow of foreign capital was also accelerated by the fact that many private investors have by much underestimated the actual credit risks because of untransparent banking and financial market systems. It is therefore a welcomed thing that under the catchword of the new international financial architecture it is intensively discussed for how much the transparency of financial markets can improve by means of imposing minimum capital requirements of banking supervision. With this kind of crisis prevention the IMF could also regain its significance: on the one hand, it has professional expertise, which is needed for controlling the international minimum capital requirements. On the other hand, the fund could use its credit facilities as an instrument of pressure to impel every country, which hopes for support in solving the problems with the balance of payments, to keep to the rules.

In the sphere of international financial markets, the IMF should primarily go through an extensive reform. Its role in forming and realizing the international financial architecture should become much stronger and contribute substantially to mitigation of future currency crises through higher transparency. Finally, the perception of the IMF as the «lender of last resort» capable of liquidating international currency crises should be buried (Krueger 1998).

Finally, erroneous seem to be all activities within the areas of the South-Western and the South-Eastern Quadrants, since there are no international spillovers worthy of note. An obvious example could be the international coordination of wage policy, for which there is no reasonable ground and, fortunately, none support whatsoever from the countries with lower wage levels.

An additional, more debatable example is represented by social minimum standards, which caused the conference of ministers in Seattle, devoted to preparation of the Millennium-Round of the WTO in November 1999, to fail. To which extent the highly developed countries have prior moral right to thrust their ideas as to socially acceptable working conditions is only the political value judgement, which can not be explained from purely economic standpoint. It should be beyond any doubt whatsoever that such an international social policy cannot be amalgamated with the trade policy: the resistance of poorer countries towards internationally mandatory social norms could spread into the opposition against the whole international trade order, which would bring all of the involved countries – including socially weak labour force of the third world – only the disadvantages (Bhagwati 2003).

Therefore, the attempts to establish the correlation between the free market access and the adherence to social minimum norms should be abandoned. The international social policy should as before be left within the competence of

the International Labour Organization (ILO) and similar institutions, and not be passed on under the WTO, which would not be able to cope with it.

5. Conclusions

All in all, global policy-makers have a lot of work to do in order to create an international regulating mechanism that would be capable of withstanding the vehement requests of the globalized world economy. However, the over-enthusiasm is unacceptable: the main goal consists in realizing a complex act of balancing between the needed containment of international spillovers and the inevitable negative effect on systems competition. The international regulations should therefore be set as minimal regulations, and when in doubt, it is better to establish less rather than more of the rules.

On the other hand, the significance of the effective regulatory mechanism for Global Governance should not be underestimated. Globalization can provide visible welfare gains for all countries engaged in this process, but there also are those who will lose. In the highly developed countries, this is primarily the low-qualified manpower, which falls under the adjustment pressure generated by imports from the countries with lower wages, as well as by outsourcing and off-shoring. In the less developed countries, these are primarily the political leaders which find their room for manoeuvre limited because of globalization. If we succeeded in making globalization politically manageable and thus prevent political failures brought in by it, the world economy would win a lot.

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