Looking for models in pursuit of prosperity

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Do not underestimate some of the economic and political achievements of the last few decades. And do not overestimate some of the present transformations either. In the search for stability and prosperity, there is much to learn and no country has all the answers.

Looking at the economic difficulties of Europe and Japan these days, it is all too easy to forget some basic historical truths: in particular, that over the last forty years, western Europe and Japan have achieved unprecedented economic prosperity, and that their progress followed two devastating and debilitating world wars. Anyone that witnessed the flattened cities of Dresden or Hiroshima must never have imagined the recovery that was to follow. Within two short decades Japan and the former West Germany had established themselves as the second and the third industrial powers after the United States.

How did these so-called economic miracles come about? One reason was a sheer lack of choice. Deprived of military power to secure export markets and access to natural resources abroad after defeat, the onus fell on their well-educated workers, business managers, bankers and an eager new state to achieve results. True, they were helped in these efforts by post-war international trade liberalisation and a generally favourable external climate, but it was by working together and targetting high value-added products, from automotive goods to science and technology, that high economic performance and social progress became possible. In effect, West Germany and Japan each forged their own market-based economic models whose efficiency and social equity were exemplary of how free market economies could succeed in the face of centrally commanded economies in the Cold War period.

This does not mean that the international relationships of free market economies were always smooth. In the 1960s, expenditure increases associated with the Vietnam War and increased inflationary pressure in the United States started gradually to undermine the gold and foreign exchange system with the US dollar as the primary reserve currency. The shift from the fixed exchange rates of Bretton Woods to the floating rate system introduced for major currencies in 1973 strengthened the capacity of free market economies to absorb external shocks. Indeed, had the floating rate system not been in place, the economic management of countries highly dependent on imported oil would have been disrupted far more by the two oil crises of the 1970s than it actually was. However, floating currencies did not provide a panacea for curing imbalances in external payments, nor could it free domestic economic policy from external constraints. Flexible rates have sometimes moved in abrupt and erratic ways that were difficult to explain in normal economic terms. Sustained misalignments upset the allocation of productive resources across free market economies and fuelled protectionist sentiment in deficits countries, notably the United States.

This caused particular concern in the late 1970s and 1980s as both Japan and West Germany each ran persistent surpluses. These imbalances became subject to both bilateral and multilateral surveillance. However, uncertainties about the balance-of-payments effects of domestic demand

and exchange rate changes as well as failures of various attempts, including those by the IMF and the OECD, to identify precisely the equilibrium levels of exchange rates left room for ad hoc arrangements and at times unhelpful political intervention.

We still face this core challenge today: how and on what basis to bring large global economies together so that they might manage their affairs in “mutual self-interest”. Bilateral co-operation, multilateral co-ordination, unilateralism, independence: all these are possible, and not necessarily in mutually exclusive ways.

Take the European Union. It was born in large part from a desire to secure economic and monetary independence from the United States while fostering peace, co-operation and economic and social progress among Europe’s main protagonists. It now has a single (albeit still evolving) market for goods, services, people and capital, while the euro has been introduced as the single legal currency in 12 EU countries. Moreover, despite widespread concern inside and outside the EU about the risk of increased European protectionism, the average level of its trade protection against non-EU countries has continued to decline. In terms of international institutional set-ups, the EU is the most complete model of regional integration and it marks one of the most significant achievements of the last four decades.

Another boon to Europe came from the unification of Germany in October 1990 and the shift of former Soviet bloc countries towards market economies. But this transition has had a less significant impact on world economic relationships than expected. A greater impact was to come from the emergence of high growth markets in Asia, notwithstanding their financial crisis of the late 1990s.

Nevertheless, the dissolution of the former Soviet bloc and the rapid economic development of China, which has started to open its market to foreign trade and investment, have changed the basic framework for international economic co-operation and reduced the risk of worldwide military confrontation.

China's opening up has given new promise to the burgeoning regional economic and monetary co-operation in Asia that also involves Japan, Korea and member countries of the Association of Southeast Asian Nations (ASEAN). This, and arrangements like the EU and the North American Free Trade Agreement (NAFTA), have raised the question of how to reconcile regionalism with the multilateral efforts towards liberalisation of international trade and investment that have been key to achieving prosperity in the post-war era.

Meanwhile, greater regional integration and globalisation present their own challenges. The latter, more often than the former, has been blamed by many as a cause of social and environmental distress, including job losses for unskilled workers, widening income disparity within and across countries, and deteriorating ecological and social standards, as well as increasing the instability of the international financial system. There is also a growing concern about ageing populations in most OECD countries and the economic, social and political strains that will arise in 2010-30 when the baby-boom generation reaches retirement. Policy response to these challenges should involve cutting across traditional boundaries of economic, financial and social disciplines.

No country has got all the answers. Even in the United States where spectacular overall economic growth in recent years has been accompanied by a soaring political and cultural influence around the world, the country's growing income inequality, its endemic violence and other deep social problems have raised serious doubts about the sense, let alone desirability, of the universal application of the so-called US model.

At the same time, there has been delay in structural reforms that are needed to help Japan, Germany and several other European countries to remain efficient in the new age of globalisation and to meet the challenges of population ageing.

In all of these countries, social conflicts in the reform process and inward-looking, myopic politics for balancing economic and social concerns run the risk of compromising the needs of partner countries and narrowing the scope for international co-operation. This would undermine other objectives too, including development assistance efforts required to reduce poverty in less developed regions of Africa, Asia and Latin America and so tackle the source of so much domestic insecurity and perhaps international terrorism. Domestic policy formation and execution in rich countries and international policy co-operation in pursuit of economic prosperity and security must be buttressed by a better understanding of social partners' needs and wishes and of the economic and social concerns of all peoples around the globe.

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