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"The New World Order: The Political Economy of Globalisation"

OXONIA Distinguished Speaker Event

by

Stephen King (HSBC)

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Globalisation is defined in terms of the destruction of barriers, in particular those of a political, technological, cultural and institutional nature. The destruction of barriers, in turn, has microeconomic foundations. The free flow of goods, services, labour or capital across borders make these borders either increasingly porous or completely redundant. Similar globalising processes could be found in the Roman Empire, which enabled information flows by sea, or the Silk Road, which gave opportunities for trade and cultural exchange. The British Empire, too, is an example of globalisation with its history of conquest, colonisation but also the instalment of property rights and democracy.

However, globalisation is not guaranteed. While economists focus on efficient resource allocation as explanatory framework, economics is not everything. Rather, politics is just important, in particular with regard to income and wealth distribution.

The period before the New World Order has been characterised by what King calls ´the complacent westerner´. Until the late 1980s western labour had monopoly access to global capital. Rising labour incomes were seemingly guaranteed. At the same time, the western model stood in stark contrast to poor economic performance in most other parts of the world. The only challenge came from Asia, at the time excluding China and India. Then came what King calls the

´revolution´. First of all, the price of technology collapsed. In addition, the political openness generated by, firstly, the adoption of outward looking policies by the Chinese under Deng Xiaoping in the early 1980s and, secondly, by the Berlin Wall in 1989. These are massive shocks which have rocked the competitive equilibrium of the world economy through both labour and capital flows. Since 1980, for the first time in over 500 years, the Chinese per capita incomes have started to rise faster than those in Europe.

To characterise the New World Order in its most essential form, King proposes a three-country model. Firstly, there is a developed western country, say the United States. Secondly, we have a fast developing emerging market with a lot of cheap labour, e.g. China. The set-up is completed by a raw materials producer, call it the Middle East. Under globalisation with free movements of labour and capital, King argues we would expect that cheap Chinese labour flows to the US while US capital flows to China. Global growth should be stronger as factors of production are allocated more efficiently, with raw material prices rising. At the heart of King's characterisation of the New World Order are the implications these processes have for income and wealth distributions.

Western capital wins relative to western labour as profit shares rise, as in turn access to cheaper labour increases. Furthermore, labour in the emerging country wins relative to western labour because the former can now get better access to global capital. Raw materials producers, in turn, win relative to raw materials consumers. For, stronger global growth changes the terms of grade between raw materials producers and consumers. Consumers worldwide gain as goods and services are produced more efficiently.

Looking at the data, King notes that in the US, the gap between the rich and poor has widened over the past 35 years. Interestingly, however, it turns out that China has even greater income inequality than the US. It is important to note that these developments are linked. The rise in income inequality in the US and China relates partly to urban workers in China benefiting from globalization (thereby leaving rural workers behind) while US workers find themselves exposed to more competition than before.

Drawing out the implications for the balance of payments, King argues that the Middle East should run an increasing current account surplus with the US and China as commodity prices rise. At the same time, exports of capital from the US to China should leave China with a current account deficit as it is borrowing both from the Middle East and the US. The US current account position on this account may be either in surplus or deficit, but the deficit would not be as big as that of China.

What we see in practice, however, is that the spending in the rich US is being funded by savings from poor emerging markets. In 2005, the Middle East was running a current account surplus of about 200 billion USD. Russia and China accumulated surpluses of around 100 billion USD each. The US, meanwhile, reported a record current account deficit beyond 700 billion USD. For King this is both a key feature of the New World Order as well as one which makes its stability somewhat vulnerable.

To explain the large imbalances, King recommends thinking in terms of comparative advantage. As China grows, so does its absolute level of savings relative to the US. The rise in Chinese savings, however, cannot be absorbed in China itself due her poorly functioning domestic capital markets. For this reason, China runs a growing current account surplus. China buys low-risk foreign assets to diversify away from high-risk domestic assets. King thus argues that the US essentially acts as China's bank, taking a percentage of China's savings for consumption and reinvesting the rest in both the US and China. This further augments China's growth because of the combination of cheap Chinese labour with US capital allocation skills.

As evidence for this argument, King presents data suggesting that Chinese regions enjoying strong Foreign Direct Investment grow faster, while the regions with dependency on domestic bank lending grow slowly. Furthermore, China's trade is driven by foreign-owned firms. Both regarding exports and imports the shares of foreign-invested companies of total trade are at 60%.

The dominant role of foreign firms has also meant that the best way to invest in China has been to avoid the Chinese stock market. While up to 2005 the Chinese stock market fell even below its level of 1993, the US, UK and European indices have more than quadrupled their values in the same period. At least part of this is attributable to US, UK and European firms' success in China. Emerging markets, at the same time, have huge potential command over US output, as total foreign exchange reserves held by developing countries have risen from about 1000 billion dollar in 1999 to three times this by 2006.

King argues that as the Chinese GDP grows as a share of US GDP, both the Chinese current account surplus and the US current account deficit can continue to rise. In this sense, the order of the US functioning as a bank for China is stable.

However, King urges to look at present order with ´Spanish eyes´. 16th century Spain had control of the reserve currency of the time and used the reserve currency status to fund a widening current account deficit. This lead to big rises in consumption but also the loss of economic skill to the Dutch and English. This in turn paved the way to economic and military decline. The upshot of King's argument is that with the current world order, characterised by the politics of imbalances, we are back to 16th century Spain. For Spain, the long term rivals were England and Holland. For the US, by contrast, the long term rivals are China and India.

In the politics of imbalances, a key issue will be the ownership of capital. As emerging markets run bigger surpluses their buying power over western assets will improve. This will allow them to diversify out of pieces of paper valued in dollars into real assets or other currencies.

Should the US and Europe resist the latest version of globalisation, placing limits on the assets that can be sold to emerging market regimes, the emerging markets will increasingly regard the dollar in a less favourable light. They will diversify into other currencies and countries, which points to sustained dollar weakness.

King suggests that while no one cares about the balance of payments position between London and Manchester borders between countries does matter: it's politics, not economics, which makes global imbalances difficult to work with. Hence, King concludes with a cautious note on the politics of globalisation. For him globalisation is not just a story about resource efficiency. Rather, by breaking down barriers, globalisation threatens vested interests and may raise income and wealth inequality within countries. He warns, especially, that the next phase of globalisation may be associated with currency abuse and politically unwelcome shifts in ownership which suggest that once again, globalisation will go into reverse.

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