Stanley Fischer

Biography

E-Mail Notification

Subscribe or Modify your subscription

# Global Markets and the Global Village in the 21st Century: Are International Organizations Prepared for the Challenge?

Stanley Fischer[1]
First Deputy Managing Director
International Monetary Fund
prepared for delivery to the Deutsche Gesellschaft fur Auswartige Politik
(German Society for Foreign Affairs)
Berlin, Germany
November 19, 1999

## The Global Village

It is almost 40 years since Marshall McLuhan coined the phrase "global village" in his book *The Gutenberg Galaxy*. He argued that electronic technology was shrinking the planet, that "Time has ceased and space has vanished".

That was not true then. CNN did not exist, nor did the internet, and the explosion of telephone communications was just beginning. Only a few years before McLuhan wrote, when the first telephone cables were laid across the Atlantic in 1956, they carried 36 simultaneous conversations. Today's fibre-optic counterparts carry no fewer than 10 million conversations.

No, time has not ceased and space has not vanished -- but life does seem to be moving rapidly that way. Taken together, telecommunications, satellites, computers and fibre-optics are halving the cost of processing, storing and transmitting information every 18 months. The global village even has its own market square in the shape of the internet -- a forum for commerce, information, entertainment and personal interaction that makes previously undreamed of access to information available almost instantly and at extraordinarily low cost. Estimates suggest that 250 million people around the world use the internet already, with the number rising every day.

Globalization is not only the internet and telecommunications, it is also the more traditional fare of economists: trade in goods; and trade in assets. The theoretical case for free trade is that it permits countries to concentrate on activities in which they enjoy comparative advantage and subjects firms to the healthy discipline of foreign competition. This means higher productivity and increased living standards, while

consumers enjoy access to a wider variety of goods and services at lower cost. This is true not only in theory, it is true also in practice: our post-World War II prosperity is based in large part on the rapid expansion of international trade in goods and services, which year after year has grown more rapidly than production. The theoretical argument for the free movement of capital is essentially the same as the argument for free trade in goods: money can be channeled to its most profitable uses worldwide, financing productive investment opportunities even where domestic savings are scarce. However the recent crises have made that a more controversial proposition.

Globalization can create losers as well as winners. And it is human nature that those who lose will be more vocal than those who gain. Free trade prompts fears that competition from low wage economies will displace workers from well-paid factory jobs into less attractive service sector work -- a process that Europeans tend to see in terms of McDonald's, but which applies also to the shift of employment towards high tech industries. Globalization is also seen as a constraint on national economic policies. Huge swings in capital flows have been associated with severe financial crises and economic disruptions in a succession of previously rapidly growing emerging market economies. And there are other concerns, particularly over cultural homogenization, with some intellectuals around the world despairing at what they see as the vulgarizing influence of Hollywood movies and Disney theme parks.

I will concentrate in my presentation on the role of the international organizations. I am sure you will understand if I focus on the IMF and particularly on the lessons we are now drawing from the recent crisis -- a crisis that was repeatedly described as the crisis of globalization. Strikingly, most policymakers resisted the siren voices urging them to reject globalization, to close off their capital markets and their economies, and retreat into isolation. Their steadfastness under fire obliges us to press ahead determinedly with reforms to the international financial system.

The challenge for the IMF, and for the other international organizations, is to help countries enjoy the benefits of globalization, while minimizing both the risks it implies and the costs it imposes on vulnerable sections of society.

We must also do what we can to ensure that more people see and understand the benefits of globalization. Many billions are excluded from the global village of communications and have been left largely untouched by the technological advances that fostered it. By 1995, for example, low-income countries averaged only 2.6 telephone lines for every 100 inhabitants, compared to 54.6 in high-income countries. Similarly, there were less than 2 computers for every thousand inhabitants in low-income countries, against almost 200 in high-income ones. Access to the internet is skewed even more dramatically, with 85

per cent of internet users to be found in just 10 industrialized countries at the end of 1997. Exclusion is not confined to technology. Flows of investment capital are also distributed unevenly, with more than 70 per cent of foreign direct investment in developing countries flowing into just 10 economies. But exclusion from the benefits of globalization is not total, for the vast majority of people in the world benefit personally every day from the growth of world trade. Support for an open world economy will be all the stronger if more people both understand and feel they have a stake in its success.

I will start by discussing global capital markets, an area in which the IMF is playing a large role in trying to implement some of the lessons of the recent crisis. I will then turn to trade in goods and services, an area where the WTO plays a critical role; and after that to development, in which our Bretton Woods twin, the World Bank, takes the lead among the international organizations.

**Global capital markets**

By their nature capital flows will never be entirely smooth or predictable. But as the recessions in several East Asian countries demonstrated last year, the volatility of capital flows has been excessive. It has subjected recipient countries to crises that are bigger and more frequent than they need to be. The way in which Russia's devaluation and unilateral debt restructuring saw the crisis leap to Latin America also indicates that there is too much contagion in the system. To address these problems, actions are required: from governments and the private sector in emerging markets; from governments and the private sector in capital exporting nations; and from the international institutions themselves.

For the emerging market countries, as for all countries, prudent macroeconomic policy is a prerequisite. Sound public finances and the pursuit of low inflation are hardly controversial recommendations, although they are easier to prescribe than to pursue. More controversial is a country's choice of exchange rate regime, a topic over which economists have argued for a century without reaching any firm conclusion. But it is surely no coincidence that the countries that experienced the major external crises of the last two-and-a-half years -- Thailand, Korea, Indonesia, Russia and Brazil -- all had fixed or essentially pegged exchange rates. Countries with more flexible arrangements -- including Mexico in 1998, South Africa and Turkey -- also suffered, but to nothing like the same degree. So most countries with open capital accounts are now more likely to choose flexible regimes. If they fix, they may well emulate Hong Kong or Argentina and do so definitively through a currency board. The currency board regimes have withstood the recent hostile fire.

What about using controls to moderate capital inflows and outflows?

There is no good reason to restrain inflows of long-term capital, especially of foreign direct investment. But recent experience suggests a stronger case for market-based controls (like those adopted by Chile) to restrain potentially destabilizing inflows of short-term capital. It may be tempting to impose controls on capital outflows in response to short-term problems, as Malaysia did last year, but the longer term consequences are likely to be adverse, and indeed Malaysia has gradually removed some of the controls imposed in 1998. Experience in Latin America during the 1980s showed that controls of this sort tend to be inefficient, widely circumscribed and a barrier to future borrowing. It is surely significant that policymakers in the region have chosen not to travel this road again.

Weak banking and financial systems have been at the centre of most recent crises, and they need to be strengthened. This has been a key objective in IMF-supported programs in the Asian crisis countries. It is also an increasingly important focus of our work in other member countries of the IMF. As the Basle Committee's Core Principles make clear, the ingredients of a strong banking system include good bankers, strong supervision and healthy competition, especially from foreign institutions. Emerging market countries also need to strengthen corporate governance and finance, adopting appropriate auditing and accounting standards and rigorously enforcing bankruptcy laws.

The countries from which capital flows originate also have their part to play. Global prosperity is impossible if the industrialized countries that produce two-thirds of world output are not prospering. So they must pursue policies to achieve sustained growth with low inflation. Fortunately, around the world most recent growth surprises have been favorable, and growth looks as though it will be significantly better than forecast just a few months ago. In addition, the industrialized countries can take further steps to try to stabilize capital flows originating in their countries, for example by supporting the conclusions of the Financial Stability Forum studies on highly leveraged institutions and offshore financial centers now in progress. One important contribution will be the reform of the Basle capital adequacy standards, which in the past have made short-term bank loans more profitable relative to long-term ones.

While the responsibility for implementing these measures lies ultimately with the emerging market and industrial countries themselves, international organizations have an important role in encouraging and helping them to do so. The international community has placed particular emphasis on the development of international standards and principles. Those completed or in the pipeline cover banking supervision, securities market regulation, accounting, auditing, corporate governance, fiscal transparency, statistical dissemination and the transparency of monetary and financial policies. Of these, the IMF has been responsible for the development of statistical standards, and those for the transparency of fiscal policy, and of monetary and financial

policies.

Monitoring of how well countries are implementing these standards will be undertaken mostly in the context of regular IMF surveillance, drawing on the assistance of relevant experts. Together with our colleagues in the World Bank, IMF experts are also beginning to carry out FSSAs -- Financial Sector Stability Assessments -- to help countries identify the weaknesses in their financial system and repair them.

As an additional part of the international effort to strengthen financial systems, the Financial Stability Forum was established in April. It brings together officials from G7 finance ministries, central banks and financial sector supervisory bodies, as well as representatives of the international supervisors, the BIS, the IMF and World Bank. By bringing all these bodies together for the first time, it should be possible to improve coordination between them.

The IMF is also endeavouring to reduce the risk and cost of financial crises by strengthening its surveillance of national economic developments and policies, as well as the world economy and global capital markets. We are paying closer attention to capital account and financial sector issues, the sustainability of exchange rate regimes, debt and reserve management practices, vulnerability analyses, international aspects of a country's macroeconomic policies, cross-country comparisons and regional developments.

National authorities are also being given greater incentives to heed the advice they receive. Governments are encouraged to publish the executive board's annual Article IV assessment of their economy and policies. A pilot project has been set up allowing countries to publish the staff reports that underlie the surveillance process -- and Germany has just published its Article IV report for the first time.

The IMF is also encouraging sound policies by offering Contingent Credit Lines (CCLs) to countries that feel threatened by the sort of contagion that saw the recent crises spread so widely. But these will only be available to countries that have good policies, that are attempting to meet relevant international standards, that manage their external debt sensibly and that are pursing credit lines from private sector lenders.

The most difficult element in the reform of the international system, on which we are still working, is that of private sector involvement in the solution of financial crises. The official sector cannot allow the private sector to believe that its investments in emerging market countries carry an implicit official guarantee, and the only way that can be done is to make sure that the private sector plays its appropriate share in financing the resolution of crises. The issue of private sector involvement is currently to the fore in IMF programs with several countries, Ukraine, Pakistan, Romania and Ecuador. The circumstances of each country are

different, and we are evolving towards a new strategy. The general outline is clear: there will be occasions, for instance if a country has become excessively indebted, has not been well managed, and requires very large scale public sector assistance, that the public sector will not provide enough financing to enable it to service all its debt. The country will then have to seek an arrangement with its private sector creditors to reduce its current debt service burden, for instance by restructuring the debt. For the country to receive public sector support in these circumstances, it will have to be implementing a program of macroeconomic stabilization and seeking a cooperative solution with its creditors -- the principle that contracts should whenever possible be honored, is essential to the efficient operation of the international financial system.

These measures -- greater transparency, standards and their monitoring, the emphasis on strengthening domestic policies and financial institutions, greater private sector involvement -- are a large part of the what has become known as the reform of the architecture of the international financial system. They are focussed on the 30 or 40 emerging market economies that enjoy access to global capital markets, with all the risks and rewards that this implies. Some of these reforms are needed also in the advanced countries, and most are needed too in the other developing countries -- those yet to emerge fully into the international capital markets, but all of whom are engaged in international trade.

**Trade**

The free trade agenda is very much before us. Representatives of the 135 member countries of the World Trade Organization will meet in Seattle later this month to begin a fresh round of negotiations aimed at further opening of markets for goods, services and agricultural products. Success would bring valuable benefits. As I mentioned earlier, trade has been one of the main engines of world growth since the end of World War II. And that is not just rhetoric. Every country that has grown fast in the post-War period has done so through a strategy of integration with the world economy, through rapidly growing exports and the accompanying imports. Germany knows that, so does Europe, so does Japan and East Asia. We must enable other countries to benefit in the same way.

But trade liberalization is not without vocal critics, many of whom will be protesting on the sidewalks of Seattle. Some objectors argue that free trade damages the environment. They point, for example, to the degradation of Mexico's industrial border region, where foreign investment stimulated by NAFTA has been accompanied by inadequate attention to wastewater treatment and the disposal of hazardous waste. Trade growth affects the environment through several channels. On the negative side, it tends to increase the scale of economic activity, which

might be expected to imply more wear and tear on the environment. But the relationship is not a linear one. The incidence of many pollutants increases to begin with as incomes rise, only to fall again once living standards pass a given threshold.

Trade growth will also affect the environment when it prompts changes in the composition of economic activity, for example shifting the balance between heavy manufacturing and less polluting service sector outputs. Trade growth may also induce technological innovations that increase profitability and reduce environmental damage simultaneously, for example by using energy more efficiently. Consumers may also be prepared to pay more for products and services that they perceive to be friendly to the environment. In most countries these influences all play out in the context of increasingly stringent government regulations.

The net effect of trade on the environment is therefore ambiguous, depending in large part on the industry, country or pollutant involved. But in many cases the spillover effects of economic activity on the environment clearly do not respect national borders. The challenge for the international community is therefore to develop rules and incentives that accomplish legitimate environmental objectives without incurring excessive economic costs. We should support such measures, but at the same time we should be wary of essentially protectionist measures in the guise of environmental regulations.

Another concern raised by the trade liberalization agenda centres around the labor standards. Some argue that trade agreements -- or possibly the conditions that the IMF applies to its loans -- should require the observance of core labor standards. As enshrined in the various Conventions and Recommendations of the International Labour Organization, these standards include the right to organize into trade unions and bargain collectively, the right to equal pay and treatment for equal work, as well as the abolition of forced and child labor. The fear is that opening markets to countries that do not observe these standards may result in a "race to the bottom" in labor standards worldwide as businesses struggle to maintain market share against competitors who can exploit their workers to reduce costs.

The core standards form a set of principles with which most reasonable people would find it easy to agree. But as with environmental regulation, we should be wary of measures that disguise protectionism behind apparently noble motives. Interestingly, the evidence suggests that countries have little incentive to see their workers exploited. Recent studies by Dani Rodrik suggest there is no statistically significant relationship between a country's observance of core labor standards and its trade performance. Neither do weak labor standards encourage foreign direct investment by companies seeking workers to exploit.

Well-treated workers are generally more productive than exploited ones.

So as long as competition forces companies to be as efficient as possible, strong labor standards should emerge naturally through enlightened self-interest. Will Martin, at the World Bank, and Keith Maskus, at the University of Colorado at Boulder, argued recently that this process characterized policy change in the US and Western Europe in the first half of this century and in Japan and Korea more recently. Erecting trade barriers to punish countries with poor labor standards could be a blunt instrument that worsens the problem at which it is aimed.

A free and open trading system can make a powerful contribution to the welfare of poorer nations. There is plenty of evidence -- and strong evidence -- that countries which are open to trade and investment grow more rapidly over time than those which shut themselves out of the global economy. Openness facilitates specialization and gives countries access to best practice technologies. But if less developed countries are to make the most of their participation in the global economy, then they need greater access to the markets of richer nations as well. We should all hope that the discussions getting under way in Seattle this month will help to achieve just that. And we should also work towards that end.

**Development**

To spread the benefits of globalization more widely, we must learn from past experience what works and what does not when it comes to promoting development and poverty reduction. Just as importantly, we must ensure that the international organizations work effectively together in supporting the strategies that countries choose to adopt. Support rather than leadership is the key. For we know that development strategies are more successful when they are "owned" by the countries directly concerned rather than imposed from outside.

From the perspective of the IMF, sound macroeconomic policies and market-oriented structural reforms have a vital contribution to make. There should be no doubt now that price stability, fiscal discipline and structural reform promote economic growth. And growth is the single most important factor that contributes to poverty reduction. Low inflation helps foster greater equality of incomes. And structural policies that ease factor and product market rigidities increase both the supply of essential goods and their availability to the poor.

But we have recognized increasingly that growth itself is not enough, and that the cause of poverty reduction and development in poor countries can be significantly advanced by policies directed at reducing poverty. Market reforms should be accompanied by the creation and maintenance of adequate social safety nets, for example, to limit the impact of necessary adjustment on the most vulnerable. And where fiscal retrenchment is necessary to stabilize the economy, we should do what we can to protect spending on the efficient provision of health,

education and other social services. Growth-oriented economic policies and investments in social and human capital can be mutually reinforcing. Higher levels of economic activity reduce the costs of social dislocation and increase the revenues that governments have to spend on social goals. Investing in a healthier and better educated workforce can in turn promote higher productivity and stronger income growth.

While there is broad agreement on the policies that promote economic development, there is more debate about the speed at which they should be introduced. The experience of the transition economies is a case in point. As in other countries, anti-inflation policies and structural reforms were beneficial for growth. Some policies seem to have been more effective than others, with price liberalization and small-scale privatizations proving especially important. As for speed, the lesson of experience is that reforming quickly and comprehensively is more effective than doing so slowly and in piecemeal fashion. The boldest reformers have tended to be those countries closest to Western Europe, which spent the shortest periods under communism and which were economically most advanced when they fell under Soviet control or began transition.

With the millenium approaching, the international community has given special attention to the difficulties faced by highly-indebted poor countries, many of which are in Africa. In 1996 that IMF and World Bank launched an initiative to reduce the external debt burdens of countries with good policies to levels that could be serviced sustainably through export earnings, aid and capital inflows. By removing the overhang of unsustainable debt it was hoped to encourage investment, thereby promoting economic growth and reducing poverty. The experience of the first countries to benefit showed that our initial estimates of sustainability were too conservative to achieve their objectives. There has also been greater recognition that debt relief should do more to free resources from government budgets to pay for essential social needs. So the intiative is being expanded, increasing the number of countries likely to benefit from 29 to 36 and at least doubling the relief available to a present value of $27b.

Up to now the IMF has contributed to this initiative through the Enhanced Structural Adjustment Facility (ESAF), our subsidized loan window for the poorest nations. This has now been reformed and renamed as the Poverty Reduction and Growth Facility. The change is not a cosmetic one. It reflects greater recognition of the complementary among macroeconomic, structural and social policies. This recognition is also being reflected in a more systematic framework for our cooperation with the World Bank in these countries, with the World Bank expected to take the lead in helping countries design and implement structural and anti-poverty programs.

Among policies to reduce poverty, access to credit can be very

important. Many who are left behind by globalization lack the opportunity to borrow and invest in their own livelihoods. One powerful tool for helping in that regard is microcredit. These schemes lend relatively small sums to people who would otherwise be unable to borrow, and this is an area in which the World Bank has contributed a great deal of assistance. A survey carried out in June this year had responses from 925 microcredit practitioners with more than 22 million clients.

Microcredit is already addressing the disparity in access to communications I referred to earlier. Cellular telephones are a more efficient alternative to conventional networks in many developing countries. So in Bangladesh the Grameen Bank offered women loans of $350 to buy a telephone and pay for connection and training. These "wireless women" were then able to make a living as local service providers in rural areas. Providing women with access to credit has been an important objective of microcredit schemes, as experience suggests they are a good credit risk and that their earnings benefit other family members more than those of men. Microcredit has potential in many sectors. In Ghana, for example, many crop yields could be trebled if access to credit allowed smallholders to exploit available technology.

**Are we prepared?**

I have outlined a number of challenges which globalization has put before the international organizations as the 21st century looms. In the last decade, the Bretton Woods twins, the IMF and the World Bank, have made major adaptions in their organizations, the focus of their activities, and the ways in which they interact with member countries and the public. And this was also the decade in which the late-born third member of the global international organizations, the WTO, was born.

Across a broad variety of areas I believe that we and our colleagues are ready and willing to confront the challenges of the next century. We in the IMF are often accused of operating in a world very different than the one for which we were originally designed. But that -- the power to adapt -- is precisely what is most needed as we enter the coming century. For we can be sure that the new century will bring many unexpected challenges. Here again I think we have reason to be hopeful. In dealing with the problems of the poorest nations and with the fallout from the capital market volatility of recent years, the institutions have shown themselves willing and able to be flexible in the light of changing circumstances and a growing understanding of the problems we face.

This flexibility will be essential. When he developed the concept of the global village, McLuhan recognized that it would require all of us to be aware of the impact that our actions have beyond our national borders. "Electric speed at bringing all social and political functions together in a sudden implosion has heightened human awareness of responsibility to

an intense degree", as he put it.

Those are not precisely the words we in the international institutions would use. But we are well aware of the responsibilities that fall on us, and we intend to discharge them.

---

1 International Monetary Fund. This lecture was prepared for delivery to the Deutsche Gesellschaft fur Auswartige Politik (German Society for Foreign Affairs) in Berlin, November 19 1999. I am grateful to Robert Chote and Daniel Citrin of the IMF for their contributions. Views expressed are not necessarily those of the IMF.