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GLOBAL PROSPECTS IN AN INTERDEPENDENT WORLD

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Global Prospects in an Interdependent World

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Dominance: the condition for an international order?

As one born into the expiring Austro-Hungarian empire, who spent most of his life in post-imperial Britain, and who came to the post-Watergate, post-Vietnam United States in 1976, I regard myself as something of an expert in imperial decay. This is a useful vantage point for examining the present post-hegemonic world.

What functions do we expect to be characteristic of a working international order that is concerned with developing underdeveloped regions, in the context of a growing world economy, and with an equitable distribution of the gains from growth? I think we can name at least three or four.

First, it is helpful, if not essential, that there should be a centre that generates balance of payments surpluses, an excess of exports over imports, for the benefit of the developing regions.

Second, there should be financial institutions that convert these surpluses into long-term loans or equity investments on acceptable terms. This requires banks, corporations and aid agencies. In addition to the need to convert an excess of exports over imports into long-term financial instruments, certain additional financial functions are useful to support these loans and investments. For example, the foreign lending should be counter-cyclical, so that when the centre contracts the periphery can expand and contribute to the stabilization of the system. It is also helpful if the centre acts as lender of last resort and as the provider of the means of payment for international transactions.

Third, there must be the industrial capacity to produce the capital goods or intermediate products required for industrialization, on which the loans are spent, and which contribute to the trade surplus. This capacity will be, at least in the early stages of the development process of the periphery, mainly in the centre, from which the surpluses and the loans originate.

Fourth, and here one hesitates because the exercise of this function is controversial, it seems helpful if the previous three functions are supported by a strong military power that enforces contracts and keeps the peace.

Between the Napoleonic wars and 1914 these functions were carried out by Great Britain under the Pax Britannica. The surpluses were generated by Britain; the financial institutions were established in the City of London; the 'dark satanic mills' of the North of England manufactured the industrial products, and the British navy ruled the waves. Critics have said that, when benign dominance was replaced by predatory dominance around 1910, the British navy waived the rules. The management of the gold standard after 1910 placed the burden of deflationary adjustment on other countries. But, though this was an order dominated by Britain and run in the interest of Britain, it contributed to the development of large areas in North and South America, South Africa, Australia and New Zealand.

There was not much of an order between the two world wars. Britain had become unable, and the USA was still unwilling to assume the leadership functions. When agricultural prices fell, the US imposed the Smoot-Hawley tariff in 1930. The US did not function as lender of last resort (discounting in a financial crisis), and did not keep markets open in periods of glut for the purchase of distress goods. There was no counter-cyclical lending; on the contrary, a boom at home caused an increase in foreign lending, and in a depression the U.S. reduced both lending and imports. The result of the absence of the coordination of the four functions was the depression and the war.

For twentyfive years after the second world war, and largely as a result of it, the United States assumed these functions under the Pax Americana. Large balance of payments surpluses were generated by the United States, which led for a time to the fear of a chronic dollar shortage. But the U.S. opened its market, and the Marshall Plan, reconstruction aid, and long-term direct investment by multinationals soon converted the dollar shortage into a dollar glut, and made Keynes's prediction of America becoming a high-cost, high-living economy come true. Jean Servan-Schreiber's book *The American Challenge* even predicted that the power of U.S. multinational corporations constituted a long-term threat to Europe. The U.S. trade surplus fell from 4.5 per cent of her GNP in 1947 to 0.5 per cent in 1950.

The mighty dollar replaced sterling and New York became an important financial centre. Its financial institutions soon matched and overtook those of the City of London. The United States became, for a while, the industrial workshop of the world. America held a nuclear umbrella over Europe and Japan, and used its military power to enforce the peace as she saw it. As in the case of Britain half a century earlier, in the 1960s benign dominance turned into predatory dominance. The USA began to exploit the foreign acceptance of its reserve currency to extract goods and services from abroad. During the inflationary period of the Vietnam war America offered, in return for large purchases of goods from the rest of the world, depreciating short-term assets in the form of dollar balances in American banks.

After 1970 the power of the U.S. declined and we witnessed what Bhagwati calls the diminishing giant syndrome. The share of US GNP in the world's fell from about 40-45 per cent in the 1940s to 16-17 per cent in 1988. Her competitiveness in both old and new industries, and her economic growth rate declined. The large twin deficits, in the budget and the balance of payments, are symptoms of this decline. In 1970 imports were 4.1 per cent of America's GNP; in 1980 9.1 per cent; and in 1989 18.1 per cent. Other symptoms are the decline in research and development, the failure of primary and secondary education, the falling production of scientists and engineers, and the low savings and investment ratios.

There are some who dispute the thesis of the decline of American power in the world economy. Sam Huntington writes of renewal, of a return to a more long-term, pre-war trend. Seizaburo Sato writes, "The 20th century was the American century. The 21st century will be the American century." America is losing confidence just when others seek to accept her as leader and imitate her. The Chinese protesting students hold up the Statue of Liberty as their symbol. But the evidence of reduced assumption of the leadership role as well as of reduced world power is too strong.

Since 1970 there has been a lack of coordination of the four functions sketched out above. The world has become fragmented, schizophrenic. The U.S. went off gold in 1971, just as Britain had done in 1931. The current account surpluses were generated, first, by the capital surplus countries of a few oil exporting desert sheikhdoms and, in the 1980s, by Japan and Germany. The financial institutions proliferated, not only throughout Europe, East Asia and Japan, but also in the Cayman Islands, the Bahamas, and other tax and regulation havens. Anyone with $ 3,700 can buy a licence to operate a bank in the Caribbean island Monserrat. The industrial capacity has shifted to Germany, Japan, and the newly industrializing countries; but these new economic giants are military pigmies, while the military giants, the USA and the USSR, are weakened in their economic power partly by their large military expenditure. One does not have to subscribe to the thesis of Paul Kennedy's book *The Rise and Fall of the Great Powers* to see that America was weakened by its large military expenditure. Of course, other factors than defence spending contributed to the economic decline, such as growing rigidities, distributional coalitions, and over-consumption. But the overstretched defence budget was one of the factors, and the resulting unfavourable trade balance led to the desire for reduced military commitment in Europe, Asia and the Pacific.[1]

What future scenarios are likely? I shall try to sketch out three possible developments of the world economy. But before doing this, let me rule out certain possibilities. In the seventies there was some talk about a Pax Arabica, with the Arab OPEC countries taking over the functions of the dominant economy. Even if the price of oil were to rise again, this scenario has never been a likely one. More plausible is a future Pax Japonica or Nipponica. Some observers have compared the present situation of Japan and the US with that of the U.S. and the U.K. between the wars: as Britain then, so the U.S. now is unable, and as the U.S. then so Japan now is unwilling to assume the leadership role. It is not inconceivable that the Japanese, with their immense adaptive power, will eventually become the dominant economy. But at present they lack some important ingredients for this role. They have no large domestic market for manufactured goods; their imports are not labour-intensive raw materials, they have no military power, they are not internationally-minded and there is, at least at present, no global appeal or prestige in the Japanese ideology, message or life style.

If Gorbachev's reforms succeed, the Soviet Union could become the dominant economy, but both the likelihood of his succeeding, and of successful reforms raising Soviet power to become the number-one economy are doubtful. One hears murmurings about a future Pax Sinoica, with the Chinese taking over, or a Pax Europa, but these do not look like probabilities on present evidence. I shall briefly discuss three possible

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[1]There is, in general, no clear correlation between the proportion of GNP spent on defence and economic performance. Britain was spending 5.7 per cent in 1937, against 28.2 per cent for Japan, 36.4 per cent for the USSR and 23.5 per cent for Germany. Yet, Britain's economy was one of the weakest. In 1985 South Korea spent a higher proportion than any NATO country except the USA and Greece. Sweden, a successful economy, spent about as much as most NATO countries (3 per cent). Singapore and Taiwan, highly successful economies, spent even more than South Korea (6.8 per cent), while the economically weak countries of Eastern Europe spend far less. See Philip Towle, "Last Days of the American Empire", *The London Review of Books,* 19 May 1988, p. 8.

developments: a Utopian global solution, a block solution, and an oligarchic solution.

Utopia: the global solution

The fragmentation of the four functions of an international order contributes to the current confusion, but it also holds the opportunity for a much better solution. Our present interdependent, pluralistic, multi-polar world is less stable, and more in need of promotion of peace, prosperity, and global leadership than past orders, but no single power is both able and willing to assume these functions. This presents us for the first time in history with the opportunity to create a world order based not on dominance and dependence, but on equality, pluralism and cooperation. But this would call for the exercise of our creative institutional imagination and sacrifices of national sovereignty.

We are suffering from a lag of institutions behind technology. The revolutions in the technologies of transport, travel, communications and information have unified and shrunk the globe, but our organization into nation states dates back to the Peace of Westphalia in 1648, and to the 19th century unifications of Germany and Italy. When the nation states were founded, the city states and the feudalism that preceded them had become too small for the scale of operations required by the Industrial Revolution. The political institution therefore was adapted to the new industrial technology, to the roads, railways and canals. The nation state was then a progressive institution. But I am not a technological determinist. The adaptation of institutions to technology is not an inevitable process. The Middle Ages had, for example, lost the Roman technology about roads, baths, aquaeducts and amphitheatres, and these were allowed to fall into disrepair. But now the nation state, with its insistence on full sovereignty, has become an obstacle to further progress. It has landed us in several Prisoners' Dilemmas: each nation acts in its rational self-interest, and the result is that every country is worse off. It pays each nation to pursue this mutually destructive course, whether others do likewise or not.

I shall not discuss the desirability or the feasibility of a world government. If it ever were to come about, it would probably be the result of a trend we are already beginning to observe. Common interests and conflicts are running nowadays across national boundaries. The European farmers are in conflict with the European industrialists and the public that has to pay for the Common Agricultural Policy. The advanced countries' textile manufacturers are aligned in the Multifibre Agreement against Third World textile exporters. The nation state may become the inappropriate level at which such issues can be resolved.

Clearly, prisoners' dilemma outcomes move the world economy away from a more to a less efficient allocation of resources. There exist, therefore, potential gains, by moving back to more efficient allocations. According to Coase's theorem, in the absence of transaction costs and with full information and well-defined property rights, it pays each state to reach agreements with other states to avoid, by compensation payments, this damage and make all better off than they would have been in the outcome of the Prisoners' Dilemma. For example, the US emits acid rain to Canada. Canada could then offer compensation to the US for relinquishing the emission of sulfur dioxide, the chief component in acid rain, and still be better off than it would be in accepting the acid rain; or the US can offer compensation to Canada for accepting the acid rain and still be better off than it would be if had to clean up the mess and stop the emission. But as we all know to our regret, we are far away from outcomes according to Coase's theorem, although we are not always at the other end of the spectrum, the Prisoners' Dilemma. Coase's theorem remains useful, in spite of its unrealistic assumptions, in drawing our attention to the fact that there are unexploited mutual profit opportunities from restraint. I obviously do not wish to say that compensation always, or even often, ought to be paid. The losers, such as the English landlords after the repeal of the Corn Laws in 1846, may not deserve to be compensated; or, even if they do deserve it, the losses from imposing taxes to finance the compensation may be so large as to make the compensation uneconomic. But the fact that it *could* be paid draws our attention to potential unexploited gains.

Add to the Prisoners' Dilemma the free rider problem, according to which each country relies on others to bear the costs of arrangements that benefit everybody. As a result, public goods, such as peace, an open trading system, including freedom of the seas, well defined property rights, standards of weights and measures, international stability, a working monetary system, or conservation of the global environment, are undersupplied, while public bads, such as wars, pollution, and poverty are oversupplied. The situation has been described in parables and similes such as the Tragedy of the Commons, social traps, the isolation paradox, etc. Everybody free rides, and thereby ensures that there is no horse.

The ranking of preferences by each country is the following:

1. My country does not contribute while others do. (Free rider, defection of one.)
2. My country contributes together with others. (Cooperation.)
3. No country contributes. (Prisoners' Dilemma outcome.)
4. My country contributes while no other country does. (Sucker.)

Behaviour by each according to 1, or the fear of 4, leads to outcome 3. Although 2 is preferred to 3, we end up with 3, unless either rewards and penalties , or autonomous cooperative motivations lead to 2. Incentives and expectations must be such as to rule out outcomes 4 and 1, so that if I (or you) contribute, I will not end up a sucker. In the absence of such motivations, the result is that peace, monetary stability, an open world economy, environmental protection, debt relief, raw material conservation, poverty reduction and world development will be undersupplied.

It has been shown that iterative games of the Prisoners' Dilemma type lead to non-destructive outcomes. The partners learn and adopt mutually beneficial strategies. I have already said that we find ourselves in between the two extremes of Prisoners' Dilemmas and Coase's outcomes. For several reasons it is harder to reach cooperative agreements in international transactions than in others. There are now many states, and large numbers make agreements more difficult. We do not have a world government that could enforce agreements. Change is rapid, which undermines the basis of stability on which agreements are based. The absence of a hegemonic power also removes the sanctions against breaking the agreement. And all these factors prevent the trust from being built up, which is an essential prerequisite for international agreements.

Examples of Prisoners' Dilemmas on the global scale are ubiquitous. Above all there is the arms race, which, though we have so far avoided a major nuclear war, has contributed to hundreds of minor wars, mostly in the Third World; then there is competitive protectionism, through which each country casts its employment problem onto others; competitive exchange rate movements; research and development wars; investment wars; environmental pollution; the killing of whales and the debt crisis are only some of the areas in which these battles are fought.

To avoid these traps, coordination and enforcement of policies are needed. But coordination means that each country has to do things it does not want to do. The U.S. has to balance its budget in order to lower world interest rates; Germany has to grow faster, but she does not want to suck in guest workers from Turkey and Yugoslavia; many say Japan should import more, but she does not want to hurt her domestic industries. And so on.

Even Mrs Thatcher, that archpriestess of free markets and state minimalism, in a speech to the United Nations in New York on 8th of November 1989, has come to recognize that in order to avoid global warming and coastal flooding, countries that emit carbon dioxide and other gases that trap heat in the atmosphere would have to act together, that restrictions would have to be obligatory, and their application would have to be carefully monitored. Any one country acting by itself would be at a competitive disadvantage by having to incur the higher costs of protecting the environment.[1]

Let me now give a few illustrations of the kind of institutional innovation at the global or transnational level I have in mind, that would avoid prisoners' dilemma outcomes. These would realign modern technology and political institutions and avoid the negative-sum games to which prisoners' dilemma situations give rise. Not all are institutions with headquarters and receptionists; some are changes in the rules, procedures, forums for negotiation or exploration.

1. Recycling Surpluses: an International Investment Trust

First, there is a need for a new institution that would recycle the current account surpluses of Japan and Germany to developing countries in need of capital. The current conventional wisdom is to exhort the Japanese to consume and invest more at home. The *New York Times* carried an editorial headed 'Japan should eat more, not sell more.' But this seems quite wrong-headed. In a world starved of capital we should be immensely grateful to any country that is prepared to generate excess savings for the rest of the world. To request a country, ready to produce and save more than it absorbs at home, to step up its consumption borders on the immoral.

Since the Japanese are inclined to invest the bulk of their excess savings in the most capital-rich country, the U.S.A., an intermediary financial institution is needed. The proposal here is to found an International Investment Trust that would issue bonds (and perhaps other assets) that are multilaterally guaranteed against devaluation and perhaps indexed against inflation. It is generally agreed that the USA will have to reduce her large current account deficit. Unless this reduction is accompanied by increased loan demand elsewhere, (or by domestic expansion in Japan and Germany), the world economy is threatened with growing deflation and unprecedented unemployment. Recycling to credit-

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[1] *The New York Times*, 9 November 1989, p. A 17.

worthy developing countries through the proposed International Investment Trust is a sensible alternative. The rate of return on assets acquired from the Trust by lenders would be lower than that on U.S. Treasury bonds, but it would be safer, and this should make it attractive to the lenders. The loans would be on commercial terms, to the newly industrializing countries. It would be desirable, though not an essential feature of the scheme, to graft an interest rate subsidy onto it, so that loans could also be made to the poorer countries.

It may be asked whether existing institutions, such as the World Bank or the regional development banks could not undertake this task. In principle they could, and this would be better than deflation. But a bit of competition in lending procedures, an invitation to experiment with alternative lending styles, and some limits to the size and monopoly power of lending institutions is clearly desirable.

I do not propose that the whole of the Japanese current account surplus, now about $ 80 billion, should be recycled in this way. We all know that Japan has a deficiency in housing. It has been said that the Japanese live in rabbit hutches. Many Japanese spend four hours a day on commuting. Infrastructure and especially the modernization of coastal ports for domestic freight transport are other candidates for investment funds. But the whole Japanese surplus could be used domestically only at the cost of diminishing returns in investment or increases in consumption of already well-off people.

It may be asked whether these surpluses will last. Some have argued that they are the temporary result of over-adjustment to the oil price rises; others of adversarial trade policies; others again of demographic factors and that, as the Japanese population ages, more will be dissaved. Others again see the reason for the high savings rate and the low consumption rate in Japanese culture. Culture is very important to the Japanese. While Gunnar Myrdal in a much quoted passage in <u>An American Dilemma</u> said 'separate must mean unequal', the Japanese say 'for Japan to be equal requires Japan to be separate. If not, it could only be inferior; a colony of the West.' But even if the surpluses were not to continue, while some countries have deficits, others must have surpluses, and it is on these that the International Investment Trust would draw.

The purpose of the proposal is to bring together, to mutual benefit, three now grossly underutilized pools of resources: the current account surpluses of Japan and Germany, in search of safe returns; the underutilized industrial capacity and skilled unemployed of the OECD countries, on whose exports some of the recycled loans will be spent; and the vast idle or underemployed unskilled manpower of the South. And all this in the service of a growing world economy.

2. A World Central Bank

Bankers are not the most popular species of men. And it is not obvious that we should hand over our fate to a new group of global central bankers. John Kenneth Galbraith wrote, 'The sense of responsibility in the financial community as a whole is not small. It is nearly nil.' (The Great Crash, 1929, Penguin Books, 1961, p. 20.) John Maynard Keynes, once listening to an astonished complaint about the stupidity of a banker, replied, 'Remember, they only compete with each other.' And in Essays in Persuasion he wrote,'Bank and bankers are by nature blind. They have not seen what was coming...Lifelong practices...make them the most romantic and least realistic of men...if [the bankers] are saved, it will be, I expect, in their own despite.' (Macmillan, London, 1931, pp. 176, 178.)

In spite of this bad press, bankers fulfil an important function. Long-term capital-intensive investments are needed for economic growth and development. Fluctuating exchange rates discourage this form of investment, because it cannot be known which will turn out to be profitable. In the past the stability of the currency of the dominant economy has played the role of an international standard and store of value. The attempt to move towards a world currency with the creation of Special Drawing Rights has been so far not altogether successful. But if we wish to move in the direction of a pluralistic, democratic world order, a world currency will have to be an important part of it. After the last War, Maynard Keynes proposed the creation of bancor, the name he gave for a world currency.

The International Monetary Fund is, of course, not a global Central Bank. Such an institution would have to be given the power to conduct open market operations to regulate the world currency for transactions purposes, to prevent panic runs on deposits, and to maintain the stability of the financial system. Even a small possibility of a financial breakdown should lead to our making provisions against it.

3. An International Debt Facility

Much has been written about the international debt, and I can therefore be brief. The proposal of international debt relief combined with government guarantees of the reduced debt is perhaps different from some of the other proposals, because it applies to the present situation, from which it would be hoped that a lesson would be learned and that it would not be repeated. On the other hand, since the possibility of repetition cannot be excluded, some global equivalent of a bankruptcy facility might well constitute a permanent feature of the global landscape.

On the assumption that some part of the outstanding international debt will have to be written off and relief will have to be granted to the borrowers, two questions arise that call for a coordinated, global solution.

First, there is the free rider problem. There is a kind of Laffer curve at work. A debt reduction would lead to increased domestic investment in the debtor countries, both because more resources would become available and because the incentive to invest would be improved. Higher investment would lead to higher growth, and this in turn to a larger amount of debt service payments. But although all banks would benefit from such a general debt relief, because growth and exports could be resumed by debtor countries, each bank has an incentive to let others make the concessions. Relief by only one or some means that the remainder of the payments goes to pay interest to those not having made the concessions, and thus frustrates the purpose of the exercise. Each bank has an interest in not giving relief, whether others give relief or not. At present, banks already sell their claims at discounted values to other institutions, including to some debtor countries, but this is no help to the debtors, unless the debt reduction is passed on to the debtor country. The buying back by the debtor country at lower value tends to be inflationary, since it involves a large current liability. But the free market does not solve the problem of this passing on of debt relief to the debtor, because of the logic of collective action. Concerted action to forgo part of the claims by all lenders is necessary.

Second, after part of the debt has been forgiven, multilateral guarantees are needed for the remaining debt. In this lies the attraction to the creditors to forgive part of the debt. Here again, concerted action by the US, the Fund, the Bank, the creditor governments and the debtor governments is needed. Only then can normal lending be resumed. Neither the market nor the uncoordinated actions of governments can bring about this solution of the debt problem. It is in the interest of any one government *not* to guarantee, whether others guarantee or not.

4. Commodity Price Stabilization

The failure on the part of the developing countries and UNCTAD to reach agreement on a working scheme of commodity price stabilization is due partly to absence of political agreement, and partly to the weak analytical basis on which it was presented. The case had been based largely on micro-economic arguments about stabilizing or raising producers' or consumers' incomes, or improving incentives. In my view a much stronger case can be made on macro-economic grounds. Lord Kaldor, Ravi Kanbur and others have shown that different pricing methods for primary and manufactured products, combined with the fact that primary products are imported inputs into manufactured goods, lead to alternations of inflation and unemployment with fluctuating and depressed incomes in the exporting countries. Commodity price stabilization schemes can contribute to reduced inflation and unemployment in advanced importing countries, and to income stabilization and enhancement in developing exporting countries. This nexus depends, however, on the continuing link between raw materials and manufactures. Peter Drucker has expressed doubts about this. He has argued that recent advances in technology have weakened or even broken that link, as well as those between employment and production and between finance and trade. But the volatility of commodity prices with the swings in manufacturing activity suggests that the link still exists.

The proposal then is, in line with J. M. Keynes's proposal after the last War, to establish an International Trade Organization with the mandate to stabilize the prices of primary products.

5. Global Energy Policy

Nobody can call the events since 1973 in the area of global energy satisfactory, either from the point of view of exporters or importers of oil. We have suffered from wild zig-zag movements of oil prices, leading to periods of conservation, high cost exploitation and exploration of alternatives, followed by periods of waste, closing down of high-cost wells and cessation of conservation. Not only are the wrong signals and incentives given in the energy sector, but the high oil prices lead to inflation, which, if countered by monetary contraction, is followed by deflation, unemployment and underutilized capacity, and deprives industry further of incentives and means to spend on conservation and the exploration of new sources and alternatives.

A more sensible course would be for selling and buying countries to agree on a future price of oil in, say 20 years' time. This might require a gradual, agreed increase by, say, 2 per cent per year. Investment would be stabilized, based on stable predictions. Inflationary and deflationary impulses and unemployment would be reduced, and the exploration of alternatives would be encouraged, while the resources for this would be made available.

6. An Industrial Investment Board

At present the world economy lurches between excess capacity and scarcity in the products of industries the plant of which takes a long time to construct and, once constructed, lasts a long time. Steel, fertilizer and ship building are examples. At a minimum an exchange of information about investment plans, on the pattern of the British National Economic Development Offices, would help to introduce greater stability. A further step would be to coordinate the planning of investment decisions, although this must not be permitted to degenerate into cartel-type market-sharing arrangements. An institution such as a board for fixed investment in durable plant with long gestation periods would provide the forum to discuss such matters.

7. A Global Progressive Income Tax

In the current climate of retreat from global commitments, this item will appear even more utopian than some of the others. Nevertheless, it is worth exploring how such a scheme might work. The main principle would be to move towards a system of automatic collection, but not automatic disbursements. These would remain conditional not only on obvious factors such as size of population and level of poverty, but also on performance in economic policy, human rights, and similar areas.

8. A Global Anti-Monopoly Policy

In the US the Webb Pomerane Act encourages firms to band together in monopolistic action against foreigners, while the Sherman Anti-Trust Act forbids similar action in the domestic market. It is true that not many companies are registered under this Act, partly because they do not wish to reveal their proprietary knowledge, as would be required, and partly because domestic anti-trust prosecution has greatly declined. But the asymmetry in treating monopolistic exploitation of citizens and that of foreigners, especially weaker foreigners, is glaring. A global order based on fairness, equality and human solidarity would apply the same principles to international transactions as are applied to domestic ones. A global monopolies commission may be required to examine the scope of competition, restrictive practices and similar problems.

9. A Global Environmental Protection Agency

Just as in an uncoordinated world each country has an incentive to pour its problem of unemployment, metaphorically, into the yards of others, so does it, literally, cast its muck into the neighbouring gardens or into the oceans, the atmosphere or the land which are the global commons. Acid rain that kills forests, the emission of chlorofluorocarbons that destroy the ozone layer, the global warming resulting from the burning of fossil fuels, overfishing in common waters, are examples of global abuse that can be stopped only by global agreements that limit national sovereignty.

The domestic environmental problems of rich countries are often in conflict with poverty reduction in developing countries, while the domestic environmental problems of poor countries both arise from, and contribute to, poverty. But the global environmental problems are shared by the whole of humanity and call for global solutions.

Desirable and Feasible?

Two types of objection can be made to these proposals: one on grounds of desirability, the other on grounds of feasibility. First, it may be said that creative institutions are not designed on a drawing board, but are the spontaneous responses to challenging situations. Designed institutions, such as the League of Nations, the World Economic Conference of 1933, the International Trade Charter, the Special Drawing Rights, all failed, while the multinational corporation, the Eurocurrency market, the globalization of the 24 hour capital market and the swap arrangements between central banks, none of which sprang from grand designs, are great successes. The Bretton Woods institutions are the exception, but they were born after a world war and the complete breakdown of a previous order. My reply would be that these spontaneous institutions themselves need designed institutions to regulate them. The current debt crisis is a direct result of the unregulated recycling of OPEC surpluses by greedy lenders to profligate borrowers. Had something like the proposed International Investment Trust been in place in the seventies, we would have been spared many of the present pains. So much in reply to the charge that the proposals are undesirable.

A different criticism is that, though desirable, they are not feasible; they are utterly unrealistic and utopian. There are three replies to such criticisms. First, the utopian vision gives a sense of direction, which can get lost in approaches that are preoccupied with the feasible. Second, excessive concern with the feasible tends to reinforce the status quo. In negotiations, it strengthens the hand of those opposed to reform. Third, it is sometimes the case that the conjuncture of circumstances changes quite suddenly and that the constellation of forces, unexpectedly, turns out to be favourable to even radical innovation. Unless we are prepared with a carefully worked out, detailed plan, that yesterday may have appeared utterly utopian, reforms will lose out by default. Nobody would have expected only a few years ago the dramatic changes in Central and East Europe, the Soviet Union and China. Although the subsequent fate of the Special Drawing Rights was disappointing, when they were established the creation and acceptability of an international liquid asset came as a surprise to many. It is for these three reasons that utopians should not be discouraged from formulating their proposals in the same detail that the defenders of the *status quo* devote to its elaboration.

Blocks

In spite of my plea for the utopian exercise of the institutional imagination, for the practice of informed fantasy, I would be the first to agree that the likelihood of any of these steps towards a global order, based on plurality and equality, being implemented is minuscule. I therefore turn now to a more probable scenario, the formation of blocks. The most recent precedent is that of the inter-war period. There was the Ottawa Agreement of 1932 and the Sterling Area or, as it was then called, the Sterling Block. There was the French Union; and the USA with the Monroe doctrine. The fragmentation of the world into blocks gave scope for the ruthless rather than the strong. Trade between blocks had been minimized. The exclusion of the Japanese from South and Southeast Asia by the British, French and Dutch was a major cause of Japanese aggression. The exclusion of Germany from the Western blocks contributed to World War 2.

The multilateral system that had been built in the quarter century after the war has been undermined by the formation of the Group of 5, Group of Seven, and the Summits. What we may see emerging is something that resembles Orwell's picture in *1984*: Oceania, Eurasia and Eastasia. Lester Thurow has recently pronounced that 'Gatt is dead', and that multilateralism will be replaced by blocks.

The liberal world order that the USA had advocated after the war had never been accepted by Europe and Japan. Germany yielded to open her market in return for American troops and defence against the Soviet Union. In the eighties the US herself retreated from liberal trade. And the US, Japan, Germany, France and Britain retreated from multilateral institutions.

If this trend is continued, we might see the formation of three blocks. Europe with her ex-Colonies in Africa will become 'Fortress Europe'. The USA, Canada, Mexico, the Caribbean Basin and parts of Central and South America will form a second block. Japan and the Pacific Rim, with the four Asian tigers, and possibly ASEAN (Indonesia, Philippines, Malaysia, Singapore, Thailand) would form an East Asian block. (But it must be remembered that Japan's largest market is now the USA, taking 39 per cent of her exports, and that South Korea and Taiwan are more integrated with the US than with Japan.)

At the same time, Japan's trade with the whole of Asia is larger than its trade with North America. Other tentacles of members of these blocks will reach out to outsiders, such as some Caribbean countries to Britain, ex-French colonies to France, Europe to Comecon, etc. and these will weaken the block formation. In particular, the unification of Germany with its possible demilitarization could cripple the European Community.

It is not clear that there is uniform support for such block formation. Singapore and Malaysia, for example, are keen to preserve a multilateral, open trading system and to maintain a strong American presence, and are suspicious of a yen block. Japan's attempt at regional block formation could be the reaction to fears that there might be a retreat from GATT-led free trade, and that it might be excluded from its two main export markets, the U.S. and Europe.

There are, however, good reasons for an East Asian block. Apart from the growth of trade among these nations, Japan has become a bigger market for Asian manufactures, rather than an exclusive importer of primary products. In addition, the yen is playing a more important role in international capital markets and other countries' foreign exchange reserves. Japanese interest rates are low, and its savings abundant. Finally, Japanese foreign investment in the region has increased. The East and South-East Asian economies are becoming vertically integrated, producing components for one another.

Much will depend on what form these blocks will take; whether, for example, Europe will be an open, outward-looking community, part of a global order, or a highly regulated, bureaucratic block. François Perroux's

L'Europe sans Rivages (1954) contains a global, cosmopolitan vision (though not one of laissez-faire or even free trade), which must be contrasted with that of an enlarged, exclusive, inward-looking super-state. If Perroux's vision is realized, blocks can be envisaged as a step towards an integrated, global system. Since a global system cannot be achieved at once, regionalism may point the way to it.

In the longer run, there will be competition in manufactured exports from Mexico, China and India. Mexico may be incorporated in the US-Canada block; China perhaps go with Japan.

This solution need not be as horrifying as Orwell painted it. It is a second-best compared with the multilateral, pluralist solution, but can produce a well-working system. We have succeeded in avoiding major wars for quite a long period. The block system would permit styles of living to be maintained within each block. The Europeans would not have to give up their long holidays, generous social welfare system, workers' participation in management, and minimum wages, or to accept the low rates of return on investment of the Japanese, more interested in maximizing market shares than short-term profits. There would be problems of origin, for excluding Japanese producers may mean excluding American products, if they were made by the Japanese in America. The trade between the blocks would be managed through market-sharing and cartel agreements.

A faster rate of growth within each block fostered by homogeneous attitudes and institutions, could lead to more trade between the blocks, even though the ratio of trade to GNP is lower for any given level of income, than in a more open, though more slowly growing, world economy.

But there are drawbacks to such a system. First, its exclusivity, like that in the inter-war period, may encourage aggression. Second, some areas might be left out. This is matter of concern, even if it were not to lead to aggression. It is not clear what would be the role of South Asia. India is a potentially important country in the global economy, but there is no clear role for her in this scenario. What would be the role of the Soviets? There might be an alignment of Europe with the Soviet Union. Comecon has already signed a cooperation agreement with the European Community. No doubt, NATO would have to undergo radical changes, some of which we are already witnessing. A reunified, demilitarized Germany would be the end of NATO.

While the pluralistic section was devoted to a normative discussion, this section's concern is more positive. But there are interesting normative questions arising from the block scenario. Apart from the question of the nature of the blocks and their policies, there is the question of the optimum number and optimum size of the blocks. Are three blocks, *ceteris paribus*, better than two? The literature on optimum currency areas is only part of this subject.

Coordination among Oligarchs

A third scenario is presented by the USA, Japan, and Germany together deciding to rule the world. Fiscal and monetary coordination between the three, plus any additionally coopted powers, would be required. This is not easy to achieve.

There are authors who oppose coordination between governments and advocate competition. But competition in the market place and even reduced government intervention in trade policy call for international cooperation -- cooperation to refrain from intervening. Free trade is not the same as laissez-faire. It has to be enforced, just as anti-monopoly legislation has to be enforced. Moreover, nations and their governments are not like individuals or companies competing atomistically in markets. They are concerned with objectives other than economic ones, and react to one another's actions. The silliness of attempting to follow national policies without regard to others is illustrated by a remark, attributed (possibly apocryphically) to a distinguished American economic adviser to Presidents. 'Let others worry about their exchange rates, and we'll worry about ours!'

At the same time, it is important to remember that coordination of policies can be ineffective (because policies are fungible) or, worse, harmful. This is the case if the coordination is based on false analysis or wrong predictions (or if there is disagreement on say, the question as to whether the deficit affects the interest rate); or if the coordination gives rise to countervailing private power, say of trade unions pushing up wages; or if the coordination removes constraints on bad, politically convenient policies, such as inflation; or if it diverts attention from domestic reforms in the expectation that others will act (e.g. US expectation that Germany and Japan will expand sufficiently to make her reduction of the deficits unnecessary).

Coordination does work, though often only in response to a crisis. After the stock market crash on Monday 19 October1987 every country expanded and the feared depression did not occur.

The oligarchic solution has the drawback that the interests of non-participants are only incidentally served. Stephen Marris has proposed a response to oligarchy: the creation of a Group of Non-Five. (It is reminiscent of the possible need to create an organization of non-state nations, such as the Kurds, the Armenians or the Palestinians.) It would include all members of the IMF and GATT who are not members of the Group of five. Its objective is to restore multilateralism in trade, payments, development, etc. This Group would lobby for representation on the Group of 5 and its Summits. But the ultimate aim would be to make itself redundant.

Conclusion

The problem is how to adjust to a world in which the power of the dominant economy, the USA, has declined, without replacing it by a single or a small group of new dominant leaders. My call for new, global institutions must not be misunderstood as a call for more international bureaucracies. They, alas, have often been not an instrument of, but an obstacle to, international reform. At the same time, the questions of recruitment, training, and promotion of a genuinely global civil service, with loyalties to the world community, sensitive to social and political issues but not the victims of political pressures, technically expert, but aware of the limits of these techniques, should be high on our agenda. But when I speak of institutions I have in mind rules, procedures, norms, valuations, as well as organizations, which, I would hope, would replace a regime of dominance and dependence by one of pluralism and equality.