



# **UNIAPAC FOUNDATION**

## **THE EMERGENCE OF A GLOBAL ECONOMIC ORDER**

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## Introduction

At Uniapac Foundation, we have the honor to share with you the 8<sup>th</sup> Opinion Series presented by Professor Stefano Zamagni in our last Think Tank and Honors Committee meeting which formed the basis for fruitful discussion. In a clear and edifying manner, Professor Zamagni analyzes the current challenges in the reconfiguration of the global economic order as well as the important role of organizations inspired in the principles of Social Teaching of the Church, like Uniapac, in this new scenario and the influence it can play in society.

1. The emergence of a global economic order has come to represent the most characteristic feature of our age. Globalization entails many dimensions, but it is a fact that the creation of a global financial market constitutes the most relevant one. The increasing importance of the financial structure with respect to the real side of the economy is posing a novel paradox. At a time when we would need more regulation, just because financial markets are intrinsically unstable, we have less, since international financial institutions are weaker, in relative terms, than the domestic ones, or even non-existent. As we are reminded by Charles Kindleberger: "...If there is no authority to halt the disintermediation that comes with panics, with forced sales of commodities, securities, and other assets, ... the fallacy of composition takes command. Each participant in the market, in trying to save himself, helps ruin all" (1996:146).

An important implication of the paradox noted above is revealed by the recent financial crisis which has shown a peculiar nature, reflecting one novel feature of international capital transactions. Although capital and goods markets are increasingly integrated, policy making has largely remained a national matter. Most authors claim the relevance of institutions in the new global financial environment. The necessity to introduce a new global financial architecture can be seen as a first step in the direction of re-regulating the international monetary system.



Indeed, the conditions under which institutions such as the World Bank and the IMF were founded are no longer with us. There are structural flaws in the present-day system, which was conceived for the western world (and not for developing countries) to assist in adjustment of current account imbalances. Yet, there are too many different ideas on what institutions should be in place, what they should do and how. The frequency and magnitude of major disturbances such as the international financial crises reflect the tremendous asymmetry existing between an increasingly sophisticated, yet unstable, international financial system, and the institutions that regulate it. The world lacks the types of institutions that financial globalization requires. The case for the provision of emergency lending by the international financial community, eventually by the International Monetary Fund (IMF), can be strongly made on theoretical grounds. More generally, a world in which large nations gear their macroeconomic policies to internal goals (and can afford to do so) and markets are integrated generates externalities for third countries, especially smaller developing economies. It is crucial that international economic organizations, international financial institutions in particular, play a leading role in internalizing the positive externalities and in mitigating the negative ones.

2. A pragmatic contradiction should be noted already at this stage. The proposals so far put forward for a new international financial architecture, while assigning to the G-8 a major role in the steering of the monetary system, do not contemplate any form of policy coordination –not to mention cooperative behavior– among the G-8 themselves. Yet, it cannot be denied that the international repercussions of the domestic policies of the seven largest countries are a major determinant of financial stability.

The increase in economic interdependence, associated with globalization, means that even large sections of a population can be negatively influenced by events that take place even in ‘distant’ places. For example, side by side with the well-known ‘depression famines’, contemporary reality has also experienced ‘boom famines’. The expansion of the scope of the market – in itself a positive phenomenon – means that the capacity of a social group to gain access to food depends, often in an essential way, on what other



social groups do. For example, the price of a primary commodity can also depend on what happens to the price of other products. The nation state, by adopting wrong economic policies, can undermine the capacity of certain sections of the population to gain access to food (the Soviet famine of the 1930s and that of Cambodia at the end of the 1970s are clear examples of this).

In essential terms, it should be recognized that today's major social and economic problems are more a question connected to *institutional structures* than to resources and know-how. The institutions that are involved are not only economic institutions but also political and juridical institutions. To recognize this means to increase our responsibilities, since institutions are man-made.

There is still a dominant belief about the benefits of adhering to comparative advantages. However, according to the model of David Ricardo (creator of the concept) the system functions as long as there is no transnational mobility of capital. Internally, capital searches for the most adequate niche that gives it the comparative advantage. However, when capital is granted full transnational mobility, it will look for **absolute** advantages in countries that allow for lower salaries, lower taxes and less environmental regulations. As posed by John Gray, London, 1998: "When capital is (transnationally) mobile it will seek its absolute advantage by migrating to countries where the environmental and social costs of enterprises are lowest and profits are highest. Both in theory and practice, the effect of global capital mobility is to nullify the Ricardian doctrine of comparative advantage. Yet it is on that flimsy foundation that the edifice of unregulated global free trade still stands".

3. History has shown that a new international order has always become established at the end of a war of hegemony. We can see the example of the Thirty Years War, the Napoleonic Wars, and the Second World War. All these are events which, after destroying the old order, left behind *tabulae rasae*, on which the victorious powers were able to



inscribe the rules of the new order. No such situation exists today. Firstly, there is no agreement on who actually won the Cold War (assuming that there was a winner). Secondly, there is no agreement on whether we are living in a unipolar or multipolar world, or on which countries should be counted among the great powers today. (Should military force or economic muscle be used as the yardstick for qualifying as a great power?).

Another major feature of this age is the number of *agents* that are seeking to play a major part in the process of building the foundations of a new international order. One might say that international affairs have become a 'participatory democracy' issue, which helps to explain why it is becoming increasingly difficult to rapidly reach agreement. Bretton Woods and the Uruguay Round are a case in point. Bretton Woods was completed in a few months by only two men (J.M. Keynes and H.D. White), while the Uruguay Round took ten years of bitter negotiations between a dozen major parties plus about 100 international governments in the background.

A third feature that is unambiguously typical of the present phase in our history is the radical change that has occurred in the international distribution of economic and military power. For over three centuries the international system had been dominated by the Western powers, with the centre of gravity in the North Atlantic. Even the Cold War was a struggle between two 'visions' belonging to the same European civilization. Today, economic power has shifted towards the Pacific and East Asia areas that are now becoming the centre of gravity of world history, for better or for worse. This means that the emerging Asian powers will increasingly demand a part in designing the international institutions. But these (take the United Nations Security Council, the World Bank, the IMF etc.) are dominated by the ideas and the interests of the Western powers who are doing nothing to redress a situation that has now become untenable. As always occurs in international relations, where power and authority coincide, the emerging powers, dissatisfied with the status quo, are doing everything they can to change the situation.

These considerations lead us to the vast issue of cultural relations in the global village. How are we to distinguish between cultural interaction and cultural imperialism?



How can we organize cultural diversity to prevent a breakdown in communications and the development of potentially closed communities? The mismatch between centripetal globalization processes and centrifugal isolation processes, or between interaction and fragmentation, is certainly a danger and threatens to undermine the common destinies of the whole of humanity. It is not enough merely to condemn different forms of 'fundamentalism' without asking how these have come about and without seeking to look at the dark side of our Western universalism.

4. So what is to be done? There are a variety of different ways of reacting to the challenges thrown down by twenty-first century challenges. There is the way that we might call 'laissez-faire fundamentalism' that advocates a plan for technological transformation driven by self-regulated systems, with the abdication of politics and above all with the loss of scope for collective action. It is not difficult to see the risks of authoritarianism, resulting from the democratic deficit, that are inherent in such an approach.

A second way is the neo-statist approach, which postulates a strong demand for regulation at the level of national government. The idea here is to revive, albeit partially renewed and rationalized, the areas of public intervention in the economy and in social spheres. But it is clear that this would not only produce undesirable effects but could even lead to disastrous consequences in the case of transition countries. For the implementation of new free-market policies would, under current conditions, damage the already low levels of prosperity in the developing countries.

Lastly, there is the civil market economy strategy. What are the distinctive features of this approach? I would identify five of them.

a) The economic calculus is compatible with the diversity of behaviour and of institutional arrangements. It is therefore necessary to defend the less powerful varieties, to be set aside for the purposes of learning, to be used in future. This means that the selection filter must certainly be present, but it should not be too



subtle, precisely in order to make it possible for any solution that exceeds a certain efficiency threshold to survive. The global market must therefore become a place in which local varieties can be cross-fertilized, which means having to reject the determinist view, according to which there is only one way of operating on the global market.

It should not be forgotten that globalization inevitably levels down all the institutional varieties that exist in every country. There is nothing surprising about this, because the rules of free trade are unhappy with cultural variety and view institutional differences (for example: different welfare models, education systems, views of the family, the importance to be given to distributive justice, and so on) as a serious obstacle to their propagation. This is why it is essential to remain vigilant in order to ensure that the global market does not eventually constitute a serious threat to economic democracy.

b) The application of the principle of subsidiarity at the transnational level. This requires that the organizations of civil society – UNIAPAC is one of these - *recognized* and not merely *authorized* by the states. These organizations should perform more than a mere advocacy and denunciation function; they should play a fully-fledged role in monitoring the activities of the transnational corporations and the international institutions. What does this mean in practice? The organizations of civil society ought to play public roles and perform public functions. In particular, these organizations should bring pressure on the governments of the major countries to get them to subscribe an agreement which is capable of drastically curbing the benefits accruing to the sudden withdrawal of capital from the developing countries.

c) The nation states, particularly those belonging to the G8, must reach an agreement to modify the Constitutions and statutes of the international financial organizations, superseding the *Washington consensus*, which was created during the Eighties following the Latin American experience. What this basically entails is



writing rules that translate the idea that efficiency is not only created by private ownership and free trade, but also by such policies as competition, transparency, technology transfer facility policies, and so on. Over-borrowing and domestic financial repression are the unfortunate consequences of the application by the IMF and the World Bank of this partial, distorted and one-sided view of things. It should be recalled that in a financially repressed economy inflationary pressure drives a wedge between domestic deposits and loan interest rates, with the result that national corporations are artificially induced to borrow abroad, while domestic savers are encouraged to deposit their funds abroad.

d) The Bretton Woods institutions, the UNDP and the other international agencies should be encouraged by the organizations of civil society to include among their human development parameters wealth distribution indicators as well as indicators that quantify compliance with local specificities. These indicators must be taken into consideration, and given adequate weight, both when drawing up international league tables and when draughting intervention and assistance plans. Pressure should be brought to bear in order to gain acceptance for the idea that development must be *equitable, democratic and sustainable*.

e) Finally, a rich fabric of non-utilitarian experiences should be created on which to base consumption models and, in more general terms, lifestyles that are capable of enabling a *culture of reciprocity* to take root. In order to be believed, values have to be practised and not only voiced. This makes it fundamentally important that those who agree to take the path towards a transnational civil society must undertake to create organizations whose *modus operandi* hinges around the principle of reciprocity.

5. The main message I want to convey is the following. It is by now a well-recognized fact that market systems are consistent with many cultures, conceived as tractable patterns of behavior or, more generally, as organized systems of values. In turn, the type





and degree of congruence of market systems with cultures is not without effects on the overall efficiency of the systems themselves: in general, the final outcome of market-coordination will vary from culture to culture. Thus one should expect that a culture of extreme individualism will produce different results from a culture of reciprocity where individuals, although motivated also by self-interest, entertain a sense of solidarity. In the same way, a culture of peace and harmony will certainly produce different results, on the economic front, from a culture of positional competition. This is the fundamental role played by Catholic Social Thought.

But cultures are not to be taken for granted. Cultures respond to the investment of resources in cultural patterns, and in many circumstances it may be socially beneficial to engage in cultural engineering. Indeed, how good the performance of an economic system is depends also on whether certain conceptions and ways of life have achieved dominance. Contrary to what many people continue to believe, economic phenomena have a primary interpersonal dimension. Individual behaviours are embedded in a preexisting network of social relations which cannot be thought as a mere constraint; rather, they are one of the driving factors that prompt individual goals and motivations. People's aspirations are deeply conditioned by the conventional wisdom about what makes life worth living.

A second message is to call attention to a most startling paradox characterizing the present phase in international financial relations: in spite of the apparent atomization of post-industrial economies, this epoch needs more, not less, collective decision processes; more, and not less, cooperative efforts. Indeed, as the new political economy has convincingly demonstrated, at the bottom of each market failure we find the market inability to produce cooperative results, which in turn are the effect of the presence within the economic system of significant and solid networks of trust. In a well-known essay, Arrow (1972) writes: "One can plausibly maintain that most of the world's backwardness can be explained by the lack of mutual trust". The reasoning underlying this proposition is simply that development demands high levels of cooperation and the latter,



in turn, implies deep trust ties among economic agents. The strong connection between trust and development opportunities has been ascertained at the empirical level too. Suffice here to mention Robert Putnam's accurate research as well as the important work by Partha Dasgupta, and the conclusions reached by the World Bank, on the connection between the degree of trust in personal relations and private investment. As expected, these authors find that most countries with an above-average level of trust also present higher levels of investments. One can safely say that the market is an institution resting essentially upon trust, which means that trust must already be in existence before a market economy can start its functioning. In all societies an informal network evolves to structure interpersonal relations. The fabric of this framework is essentially made up of relations of trust, which, in a sense, provides a sort of common language for encoding and interpreting information for the agents.

If so, the following question needs to be raised: which conditions should be met for an economic system to generate and improve trust relations? It is the case that civil society is the privileged locus where trust inclinations are fostered; not so much the market itself which is rather a "trust-consumer", not a "trust-producer". Indeed, the two fundamental elements of trust - mutual acknowledgement of identities and engagement not to cheat nor betray even when it is feasible at no cost - cannot be generated via a reputational mechanism, since they must be offered initially as "free gifts" by the agents involved when the market process starts. If this were not so, people would never enter agreements that are not fully enforceable. It may be of interest to report the following passage from an interview to Peter Drucker: "Above all, we are learning very fast that the belief that the free market is all it takes to have a functioning society - or even a functioning economy - is pure delusion. Unless there's first a functioning civil society, the market can produce economic results for a very short time - maybe three or five years. For anything beyond these five years a functioning civil society - based on organizations like churches, independent universities, or peasant cooperatives - is needed for the market to function in its economic role, let alone its social role" (*Ottawa Citizen*, December 31st, 1996).



This is why it is conceptually misleading and practically unproductive to reduce trust (which is a *relation* between agents) to reputation (which is an *asset*), since it would prevent economic research from inquiring about the strategies to be followed in order to reach that critical threshold of generalized trust among agents beyond which the market can subsequently act both as a reputation control and as a reputation enhancing device.

The specific nature of the “tragedy” of transition economies - think of the case of Russia for all - lies in the following disquieting paradox: in spite of the fact that it is in everybody’s interest that transition to a market-type society is obtained, the cultural matrix prevailing in society and the nature of social dynamics of individual behaviors might be such that multiple equilibrium exist that can take the economy in many directions, including decline. There is no doubt that the fact that modern economics stubbornly continues to forget about the social acceptability (i.e. the justice dimension) of market outcomes bears a certain responsibility in the generation of those perverse results which we observe in many countries.

I do not wish to hide the difficulties lurking in the practical implementation of a cultural project targeted at nothing less than a “paradigm shift” in economic thinking. As in all human endeavors, it would be *naïf* to imagine that certain changes do not create conflict. The differences of vision and the interests at stake are enormous. It is no accident that a kind of widespread anguish about the future is running throughout society today. Some people and certain pressure groups are exploiting this anguish as a political tool, deriving from it, depending upon the circumstances, either a market-centered Machiavellianism or a State-centered Machiavellianism. It is precisely against this neo-Machiavellian culture that all those – like Christian entrepreneurs and managers - who believe in the principles of Social Teaching of the Church have to battle today.