

Domestic Adjustments to Globalization

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FOR THE PAST TWO years, Hadi Soesastro, executive director of the Centre for Strategic and International Studies in Jakarta, and I have been engaged in a survey of domestic adjustments to globalization in selected countries for a Global ThinkNet project sponsored by the Japan Center for International Exchange. The project put heavy emphasis on developing Asian countries but also included surveys from Canada, Japan, New Zealand, and the United States, as well as inputs from Europe. The result is a snapshot of globalization pressures and domestic policy debate on the eve of the Asian financial crisis, which, by exposing the dark side of globalization in all too great relief, has intensified debate on many of these issues.

DEFINITIONS

Globalization is a relatively new buzzword in the media and think tank world, and it is often not well defined. In business school literature, it appears to refer mainly to company-specific strategies to overcome the constraints of national political boundaries through globalized production and marketing. In other contexts, it has been treated almost akin to economic interdependence, covering increased trade and capital flows. In the political debate, however, the term seems to be used for virtually all kinds of integrative forces drawing national societies into a global

community, including speculative capital flows, direct foreign investment, technology transfer, increased trade in goods and services, the movement of legal and illegal labor, tourism flows, and even the spread of ideas, norms, and values. Since the purpose of the project was to survey issues and debates, authors were allowed to define globalization as best fit given national debates, and most focused on economic phenomena having economic, social, and political consequences.

Soesastro distinguishes between two kinds of adjustments. First-order adjustments involve the process of opening up the society to forces of globalization in the first place, whereas second-order adjustments entail coping with domestic changes that come as a consequence of opening up. Both kinds of adjustments take place simultaneously, but the papers for our project from Northeast Asia focused primarily on first-order adjustments. These dealt with such issues as Japan's financial "big bang" and the deregulation debate, South Korea's trade and capital liberalization policies, and China's concerns about the future of its large state-owned and subsidized enterprises. A survey of New Zealand also gave considerable emphasis to that country's experience in making first-order adjustments. The other surveys in Southeast Asia and North America tended to focus on social and economic issues that came as a consequence of opening up.

OPEN AND CLOSED SOCIETIES

These differences seem to reflect the current degree of globalization, itself a reflection of historical legacy. All societies, of course, have been subject to foreign influences, but China, Japan, and South Korea have gone through long periods of isolation in their relatively recent histories as they attempted to shut out foreign influences and foreigners, especially the Europeans and Americans. China has oscillated between outward-looking and inward-looking policies; currently, it is finishing a second decade of an outward-looking approach against some significant opposition. Although the postwar economic development of Japan and South Korea depended heavily on exports, resistance to globalization is reflected in very low rates of inward foreign investment in both countries and negative attitudes and sometimes policies toward foreign products.

In recent years, the governments of these three countries have pushed first-order globalization under rubrics like "open door," "internationalization," and "big bang." Opposition comes from affected industries as

well as publics that remain quite skeptical of foreign influences. The author of the survey on China notes, for example, the grass-roots opposition to foreign brand names, and in Japan and South Korea globalization projects often seemed to have an idealistic quality that failed to come fully to grips with the nature of adjustments required of true globalization.

In contrast to the countries of Northeast Asia, parts of Southeast Asia have long been "globalized." Located along transportation routes between the Indian Ocean and the South China Sea, the island and peninsular parts of Southeast Asia have always depended upon the sea both for food and trade. With trade came infusions of foreign commercial communities and new religions, leading to pluralistic societies with substantial overseas connections. With their poorly developed interiors, these Southeast Asian countries lacked depth and succumbed relatively easily to European colonialism, which further oriented their economies and cultures toward the global economy of the days of Western imperialism. While there is, of course, resistance to many aspects of globalization and some of these countries adopted import substitution policies in the 1950s and 1960s, their historical orientations, geopolitical positions, and high levels of dependency on international markets force them in the opposite direction. The continental Southeast Asian countries of Cambodia, Myanmar, Vietnam, and even Thailand have been less open.

The North American countries remain quite ambivalent about globalization. The author of the survey on Canada notes several waves of economic nationalism in Canadian history, mostly directed toward its southern neighbor. As for the United States, despite its heritage as an ethnic melting pot and its dependence on European capital and technology in the nineteenth century, it was one of the least globally integrated national economies a half century ago, with imports and exports each amounting to less than 4 percent of gross national product. The shocks of a new wave of globalization came in the late 1960s and early 1970s when American companies expanded their investments abroad to reduce labor costs: the share of imports in gross national product doubled (but increased much faster for labor-intensive manufactured goods); the Nixon administration was forced to delink the dollar and gold, in effect devaluing the dollar; and the Organization of Petroleum Exporting Countries forced a dramatic increase in petroleum costs. This period of globalization was associated with the hollowing out of certain manufacturing industries and a growth in protectionist sentiment, which took its most

virulent form in the labor-supported "Vance-Hartke" legislative proposal to restrict imports and investment outflows.

GLOBALIZATION ISSUES

If there is a central fault line in the debate about globalization, whether in East Asia or elsewhere, it comes between those who emphasize the macroeconomic benefits of globalization and those who focus on its social adjustment costs. The former stress the need to strengthen competitiveness, consumer benefits, and macroeconomic statistics such as increasing overall employment and income levels. The latter worry about growing income disparities, influxes of foreign workers, the impact of new values on traditional society, and problems of microeconomic adjustments for smaller firms and the less advantaged groups in society. Let us look at several of these aspects.

Trade and Investment Liberalization

All of the East Asian economies are currently engaged in trade and investment liberalization. This is seen as being almost inevitable because of the need for companies and countries to take advantage of the most cost-effective supplies of goods, capital, and labor. In theory, it should still be possible for central authorities to wall off their economies, as North Korea has done, but the costs of so doing are very high. As Japan's experience in the financial sphere has demonstrated, it is difficult for even the strongest national industries and firms to remain competitive if the economy is overregulated and protected from the forces of foreign competition.

While much of the trade liberalization in the region is unilateral and even private-sector driven, global and regional organizations such as the World Trade Organization (WTO), the Asia-Pacific Economic Cooperation (APEC) forum, and the Association of Southeast Asian Nations (ASEAN) play a continuing role in justifying policy changes. Because of this, domestic forces opposed to globalization may target these organizations. The November 1996 APEC Leaders' Meeting in the Philippines, for example, attracted protest demonstrations from several domestic nongovernmental organizations (NGOs) that argued that APEC was a conspiracy of the advantaged and thus not sufficiently attentive to the plight of the poor.

The WTO is the key institution, because countries undertake legally binding liberalization efforts through its periodic negotiating rounds. Its importance is illustrated by the lengthy process of admitting China into the WTO. China's trading partners are insisting that a requirement for membership be a satisfactory program to bring its trading system into conformity with long-established international standards. While China is engaged in substantial liberalization, it is also wary that WTO obligations might undercut national sovereignty and force a pace of liberalization that will be difficult or impossible to sustain politically. Some observers are concerned that if the standards are set too high, China will be unwilling to pay the price of WTO membership.

APEC is a new player in the trade and investment liberalization game, but it may also become a critical factor simply because its member economies have agreed to a program of free trade and investment in the region by 2010 for developed countries and 2020 for all other members. Although commitments made through APEC are not legally binding, the members have a political commitment to achieve this goal. Each economy is obliged to come up with individual action plans for liberalization. This process keeps pressure on the governments to continue opening their societies to globalizing forces. APEC liberalization is still quite abstract, but if and when the liberalization of Northeast Asian agricultural markets must be undertaken because of APEC commitments, APEC could suddenly become very controversial indeed.

ASEAN has a program for a free trade area to be achieved as early as 2003. Because ASEAN countries do not trade with each other that much, except for border trade between Singapore and its two neighbors, the ASEAN program in and of itself is unlikely to generate significant controversy. However, because some ASEAN members may "globalize" their trade reductions made for ASEAN, the tariff and nontariff reductions in ASEAN may become more significant than it now appears.

Foreign Labor

Aside from the movement of goods, services, and capital, the movement of labor has become a significant element in the globalization debate. In terms of the size of their economies, Malaysia and Singapore have the greatest numbers of foreign workers; in fact, it is estimated that 15 percent of the Malaysian work force is foreign and one in every seven

Singaporean households has a foreign maid (mostly Filipina). In contrast, the foreign proportion of the work force remains minuscule in Japan, South Korea, and Taiwan, although the numbers of foreign workers are sharply higher and very visible to the urban citizens of these relatively homogeneous societies.

No government in the region allows for the free movement of labor. But migrant workers, seeking higher wages and in collusion with domestic groups looking for cheap labor, have often found ingenious methods to escape detection. Because foreign labor is often illegal or of marginal legality, foreign workers can easily become prey to exploitation. The movement of labor thus raises many difficult questions. What level of foreign employment should be allowed? How should it be regulated? What rights and protections should foreign workers be given? Today, in the wake of the Asian financial crisis, foreign workers are becoming immediate targets for deportation. Thailand has plans to deport 300,000 foreign workers, mostly from Myanmar. Indonesia is deporting 70,000, but will be on the net receiving end of this game as Malaysia is discussing sending up to one million foreign workers packing, many of them Indonesians.

Domestic Income Disparities

It is widely believed that globalization increases the gap among individual regions making up national economies, as well as between workers most able to take advantage of it and those less able. For example, employment generation associated with foreign investment in manufactures has usually been in major cities with established transportation routes. This has favored such cities as Bangkok, Jakarta, Manila, Saigon, and Shanghai, whereas it has disadvantaged northeast Thailand, Mindanao, eastern Indonesia, and the interior provinces of China. The result has been both domestic labor movements toward the cities and increased income disparities between globalized enclaves and their hinterlands. While even the hinterlands may be experiencing absolute gains in income, the growing size of the relative gap may create social unrest.

In theory, countries should be able to compensate for these disparities through programs of social adjustment and income transfer. In practice, such programs are often difficult to achieve. Moreover, competitive economic forces have discouraged taxation or large social adjustment programs. On the whole, those disadvantaged by globalization have lower

education and political participation and access, and thus they have not been very effective in slowing down globalization. However, it is difficult to imagine that globalization policies can be effectively pursued indefinitely without addressing this very important set of second-order consequences.

Growth of Civil Society

Although not always perceived as such, the growth of civil society throughout East Asia is also in part a consequence of globalizing forces. Globalization has increased pluralization, enhanced international education opportunities, and strengthened awareness of the global issues of importance to civil society, including the environment, social justice, and political representation. The international mass media and the telecommunications revolution have encouraged the rise of NGOs and promoted the international transmission of independent perspectives.

Whether civil society in turn promotes or inhibits globalization is a complex issue, because it does both. On the one hand, the emergence of vibrant civil societies enhances activities that depend upon global contact and collaboration. On the other hand, many of the newly emerging independent organizations are concerned about the impact of globalization on social stability and well-being. Internal debates in more democratic societies allow expression for those opposed to globalization as well as those in support of it.

IMPLICATIONS OF THE ASIAN FINANCIAL CRISIS

The Asian financial crisis has intensified debate on globalization issues since the Global ThinkNet project was initiated and has already resulted in a significant backlash against globalizing forces in the most affected countries. While it is difficult to put fast-moving, contemporary developments into perspective, it is clear that the crisis is testing many ideas and institutions associated with globalization. We focus on three dimensions of tests: economic strategies, governance, and leadership.

Economic Strategies

Where concerns already existed in many countries about the impact of globalization, the financial crisis has certainly heightened these. Some in the West have been quick to argue that the crisis has fully discredited the notion of a special Asian (or Japanese) road to development. Proponents of Asian values and models have been notably less voluble since the economic turmoil began. But the crisis has hardly vindicated any other model. Today, it can be argued that what is being tested is less Asian values than Western notions of globalization and economic liberalization. These strategies are associated with the flood of mobile capital, which for a period brought untold wealth but which basically could not be absorbed by Asia's underdeveloped financial markets and supervisory systems.

Of course, those countries that have received bailouts from the International Monetary Fund (IMF) are already so economically dependent on the global economy that they had little real choice of direction. In the area of financial access, the IMF agreements are forcing liberalization that would have taken years to negotiate through the WTO. But for those countries with policy choices still to be made, it is unclear what lessons will be drawn from the financial crisis. China is patting itself on the back for its slower pace of capital liberalization even as it accelerates banking reforms. The privatization of state-owned enterprises, reaffirmed at the 15th Party Congress in September, now seems sure to be delayed and with it China's admission to the WTO. Vietnam appears to be moving away from liberalization policies, although it is unclear how much this is tied to current regional economic turmoil. Throughout the region, there is strong sympathy for some forms of control over short-term capital movements, and depending on whether and how these are implemented they could considerably slow the pace of liberalization.

Governance

At the domestic level, governments of the hardest-hit countries—Indonesia, South Korea, and Thailand—face excruciating economic and social adjustments as their IMF austerity programs bite more deeply. The closure of weak or insolvent financial firms is but the tip of the iceberg. Construction projects that employed thousands are halting and companies are going bankrupt under the burden of dollar-denominated debts,

whose repayment costs have massively escalated with the dramatic drop in local currency values. In South Korea, the unemployment rate is expected to double to about 6 percent, and in Indonesia two million temporary workers are said to have lost their jobs in the Jakarta area alone.

With unemployment and social tensions rising, and particularly as economic difficulties affect the middle and professional classes, the pressures on government will increase exponentially. Long-established governments, such as Suharto's thirty-two-year-old Indonesian regime, have the most difficulty in shifting policy gears or placing the blame on others. In the short run, democracies are more flexible. In South Korea and Thailand, new governments already in place or newly elected can put the blame on previous governments and policies and make a break with discredited policies and practices. Malaysia has also proved more flexible as Deputy Prime Minister Anwar Ibrahim has become the principal architect of new economic policies in place of Prime Minister Mahathir bin Mohamad.

The point is frequently made that political legitimacy has rested on economic progress in much of East Asia. But this is not uniformly true—in some cases, as just cited for Thailand and South Korea, regime legitimacy also rests upon democratic election. But democracies are typically new and fragile in developing East Asia, and none has faced a challenge of the magnitude coming up this year. In both the Thai and South Korean cases, for example, recent developments have generated a nostalgia for former strongmen Sarit Thanarat and Park Chung-hee. Indeed, if the crisis is prolonged and effective responses are not forthcoming, people may fasten onto the democratic systems themselves as the problem.

The crisis has underscored not just the weakness of national supervisory mechanisms in the face of huge inflows, and now outflows, of capital, but also the inadequacies of global governance in the finance/banking/foreign exchange arenas. Until they get into trouble, national governments basically go their own regulatory way. The IMF acts after the fact and only when governments are so desperate that they have no alternative.

The IMF is now being seriously challenged. Some reject the very notion of assistance, arguing that it rewards irresponsible risk-taking. Such critics question why taxpayers should bail out irresponsible lenders and borrowers. Others accept that the IMF loans are critical to stopping the crisis and protecting the world economy, but they question their specific efficacy for Asia. They maintain that the IMF's austerity measures address a past Latin American/African syndrome (government budget deficits, high inflation, and poor macroeconomic policy making) rather than the

contemporary Asian one (government budget surpluses, low inflation, and strong macroeconomic policy, but with private-sector debt and a lack of confidence in the banking system). From this perspective, the IMF threatens to make a bad situation worse by further undermining confidence unless its policy formula is changed. Still others argue that if IMF assistance is to be given, it should be accompanied by demands for reforms in such areas as labor practices, human rights, and environmental legislation.

Much of this criticism ignores the fact that given the crisis psychology and the lack of a single country to provide policy leadership, as the United States did for Mexico, the IMF has played an indispensable role in coping with the crisis. Since the governments of the affected countries themselves lacked legitimacy with investors, their ability to reach agreements with the IMF provides a necessary symbol of their will to reform. The IMF also provides essential bridging capital until debts can be restructured or new capital sources tapped. Without the IMF agreements, defaults would surely have occurred in Indonesia, South Korea, and Thailand, with cascading repercussions for the regional and global economies. This is not to whitewash past IMF policies, because surely the IMF is also breaking new ground and needs to learn and adapt from its Asian experiences.

Regional institutions are also being tested. APEC, whose annual ministerial and leaders' meetings came in November 1997, seemed ill-prepared for the crisis and was slow to react. The organization has focused on trade and investment liberalization and facilitation, and senior officials are preoccupied with action plans in these areas. These officials are based in foreign and trade ministries and generally have weak relationships with their finance ministry counterparts. Finance ministers meet separately in APEC rather than in conjunction with the leaders' meetings, and no APEC finance ministers' meetings were scheduled in the second part of 1997.

Nevertheless, APEC showed its worth as well as its limitations. The November 1997 APEC Leaders' Meeting was an action-enforcing event, with actions taken in Japan and South Korea in advance of the Vancouver summit, which would have been delayed otherwise. Also, the deputy finance ministers held a special meeting in Manila just before the summit to develop a common position on the crisis, and agreed that the IMF must take the lead and that any special Asian currency fund should be a subordinate and compatible mechanism. But APEC itself has not proved to be a venue for sustained regional action on the crisis.

Leadership

Leadership is critical where confidence is lacking. By economic size, Japan and the United States are the natural leaders. The crisis, however, brings into question both countries' individual leadership capabilities and seriously tests their relationship. With its heavier investments in Southeast Asia, Japan was quicker to make an initial response, proposing an Asian currency stabilization scheme. It was unclear how seriously the proposal was thought out in Japan itself. Certainly, it was not coordinated with the United States, which feared that it could undermine the IMF disciplines. Moreover, some analysts in Asia and the West interpreted the Japanese proposal as a cynical means of bailing out the heavily exposed Japanese financial institutions. As indicated above, the idea of an Asian currency stabilization scheme has survived as an adjunct to the IMF, and indeed Japan has contributed generously and substantially to every bailout, but its international policy role has weakened to almost the point of disappearance.

The biggest failure, however, has been Japan's inability to get its own economy back into a growth mode. Although Prime Minister Hashimoto Ryutaro took a surprise step in December following the ASEAN-sponsored East Asian summit to provide about US\$15 billion in income tax relief, this has been widely regarded as too little, too late. Japan is only gradually coming to grips with its problems, as its policy leadership remains hostage to bureaucratic rigidities, vicious internal conflict within Liberal Democratic Party factions, and the prime minister's plummeting popularity.

The United States was initially slower to react and did not contribute to the Thai IMF package, to the continuing bitter resentment of the Thai. Neglecting the very great dangers to the United States and its economic interests in the Asian meltdown, many Asians seem to believe the Americans secretly welcomed the crisis and its result of cutting upstart Asian economies back down to size. Others believe the United States and its firms will seize on the crisis to promote a narrow set of economic interests, using the IMF to shoehorn concessions that would have taken U.S. negotiators years to achieve and taking advantage of the devalued Asian currencies to gobble up competitors at bargain prices.

Since the precipitous fall on the Stock Exchange of Hong Kong in late October that threatened Wall Street, the U.S. executive branch has increasingly come to grips with the problem. Today, only the United States shows

an ability to provide policy leadership, a fact underscored by Clinton's repeated calls to leaders in the region regarding the crisis, as well as extensive regional travel and consultations by Treasury point man, Lawrence Summers. The Achilles' heel of American leadership, however, is Congress. Having distinguished itself in early November by rejecting UN funding, IMF replenishment, and "fast-track" trade authority, the Congress had gone out for an extended recess, fortunately, by the time the Indonesian and South Korean crises reached their peaks. At the end of January, the Congress reconvened, with the US\$18 billion for the IMF being a major issue for the early part of the new session. Clearly, then, ambivalent U.S. leadership, Japan's questionable leadership, a possible devaluation of the Chinese yuan, and uncertainty about the IMF wards' ability to maintain their agreements remain major shadows on the market.

Given that most Americans believe the crisis to be a substantial political and economic burden in the form of financial support (despite how limited this has been compared with Japan's efforts) and the likelihood of massively increased trade deficits, there will surely be increased pressure directed at Japan to increase its share of the burden. Japan will receive the lion's share of the U.S. attention, because it has the largest trade surplus, its companies are the strongest U.S. competitors (and will be significantly strengthened by the lower yen), and Japanese banks are the biggest foreign creditors in the region.

CONCLUSION

Globalization, taking on a virulent form in the Asian financial crisis, has created domestic pressures as well as challenges to international governance that were not envisioned at the initiation of the Global ThinkNet domestic adjustments project. The challenges associated with globalization now have taken on a new urgency in light of the profound effect of the crisis on regional well-being and order. The region and the entire world need to carefully think through whether globalization has proceeded at too fast a pace for national societies, particularly developing ones, to make needed adjustments without undue dislocation and economic pain.