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World Economic Policy – What's It All About

by Emil Küng, St. Gallen *

A world government does not seem to be indispensable for a world economic policy. The work of international agencies, as inter alia IMF, GATT, ILO, WHO, UN Economic and Social Council and World Bank, proves the contrary. Global tasks can in many instances be tackled through treaties and specialized organisations with appropriate mandates.

If one hears or reads of a "World Economic Policy", one will at first be inclined to assume that the term is misconceived, for any economic policy is predicated on a subject which pursues this economic policy. Normally the state, which decides on measures for the area under its sovereignty, will be the subject. But on the level of the world economy there is no such subject in view nor is there likely to be one in the foreseeable future. How can an economic policy be pursued in want of the basic prerequisite for it – i.e. a decision-maker?

This is an objection which at first glance seems to be fully justified but is not quite convincing. The role being played by the state in the individual economy need not, after all, be assumed on the global scale by a *world government*. Acting subjects could conceivably appear in other guises and as a matter of fact already do so. We need only think of the International Monetary Fund with its sphere of responsibility for lending and its influence on internal economic measures in debtor countries and their exchange rate policies. GATT springs to mind as another example of international action: brought into being as a substitute for a proper "World Trade Charter", it performs analogous functions for trade policy.

Mention may be made of other organizations of a similar kind: the International Labour Office which strives to turn the social policies of the member states in a certain direction, the World Health Organization which has been signally successful in preventing epidemics from spreading, the Universal Postal and Telegraph Union, the UN Economic and Social Council, the World Bank with its development aid policy, and many other bodies. In other words: there is no complete vacuum, but most observers will agree that what does exist on a worldwide scale is still far from perfect.

This then is the situation which gives rise to the question how things can be improved. In this

sense World Economic Policy is not an empirical concept but a utopia, and the question to be examined is what the position would be if the whole of the world economy were in fact optimized as a universal system rather than that each national economy as at present optimizes its own subsystem. In this kind of analysis a geocentric approach takes the place of the ethnocentric approach; global economics supersede the present national economics; and theories and policies bearing on the world economy supplant theories and policies concerned with external economic relations. The national egoism which has until now been a marked feature of international negotiations and resolutions, kept in check only by the need to compromise, will be replaced by an attitude of mind – if not by actual action – aiming to promote the welfare of the world as a whole and not merely its individual parts.

Such reflections may invite the criticism that they are pipe dreams. So they are: they are utopian. But we are entitled to indulge in *fruitful conjectures about the future* as we do when we try to leave irreplenishable raw materials and energy behind for the sake of future generations. There is a need for prophylactic measures on a global level to prevent the extinction of more species and animals. It is much to be desired that national employment problems should not be solved by shifting the burden on to other shoulders. To put it in a nutshell: It is sensible and advisable to give thought to what would have to be done if we had the earnest wish to overcome the difficulties which can only be tackled with any prospect of success if our planet is treated as an entity.

This is not to say that a world government is indispensable. The work of the mentioned international agencies proves the contrary: global tasks can in many instances be tackled through *treaties* and *specialized organizations* with appropriate mandates. The sole prerequisite is an understanding to let global considerations prevail over national egoisms. A global solution must as a matter

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of course be sought only for the problems relating to a World Economic Policy which cannot be taken hold of, or at least not adequately, on a lower level: there must be no encroachment on the principle of subsidiarity.

Trade Policy

It was suggested earlier that a World Economic Policy would have to ensure that no attempts are made to counter underemployment of a national economy by increased efforts to keep foreign goods away from the domestic market. This is of course one of the questions which are currently attracting most interest, also in the context of the Tokyo round. A global economic approach reveals that the imports of industrial manufactures from "low-wage countries" into the advanced economies often encounter the greatest opposition even when there can be no question of dumping. Spokesmen for the menaced industries tend to point to cases of price cutting and threatening shrinkage of their markets, to capital losses and adverse effects on employment. From the viewpoint of the global economy however it needs stressing that the exporting countries are often suffering from an incomparably higher unemployment and possess only insubstantial financial and other means of job creation. The point must therefore be made that this "substitutive foreign trade" should be impaired as little as possible and that, to give an example, the "multi-fibre agreement" should not be used to slam the doors to the West too much – or for that matter to the Eastern states!

It goes without saying that as a component part of a World Economic Policy the trade policy would have to be ordered so as to rule out injury to any country by another country. The problem of *optimum duty levels* appears in an entirely different light if this is the aim. Much ingenuity goes now in the literature into efforts to show the kind of tariff system and in particular the level of tariffs required to give a country the best possible terms of trade. This manifests very clearly indeed the national-egoistic approach without thought to the disadvantages which such a policy implies for others. As this kind of optimum duties can in practice only be applied successfully in a "large economy", the economists which have prepared models and drawn conclusions from them have evidently put their energies at the service of a cause which can only do harm to the "small" economies and especially to the developing countries.

The dumping problem plays no insignificant role in trade policy. Let us assume that goods from a certain country of origin are offered in a foreign country A at prices demonstrably below those in

the exporting country itself, in a third country or below the producing costs (incl. the cost of transport and customs duties), so that a case of dumping as defined by the pertinent international law exists. In this case country A will nevertheless have not the slightest objection to the dumping unless the goods in question are also being produced in country A. If they are not made in country A, no domestic producer will be harmed while domestic consumers enjoy the benefit of low prices.

As seen from the point of view of the world economy this is not the whole story, however. From the global viewpoint it matters that a third country B supplies similar products or closely related substitutes to country A and that country B is therefore affected by the distortion of competition through dumping. Country B will lose out in country A although it would still be competitive in this market were the competitive conditions not distorted by dumping. In such circumstances a supra-national authority upholding international competition would be under an obligation to intervene. It could do so by requiring country A to provide anti-dumping assistance, i.e. to impose countervailing duties on the products which are subsidized by the country of origin or to erect an anti-dumping barrier of bilateral quantity restrictions on imports – not for its own sake but out of solidarity with country B.

Most-Favoured-Nation Treatment

The most-favoured-nation treatment may be mentioned finally as showing how the macro-economic appraisal of a trade policy issue can lead to conclusions differing from those reached when the question is viewed from the angle of the external economic relations of individual countries. The pertinent definition of most-favoured-nation treatment is that all arrivals from whatever country of supply must be treated alike. We are faced here with one particular interpretation of the concept of equity. This concept however implies not only equal treatment for equal objects but, beyond this, unequal treatment for unequal objects – admittedly in accordance with uniform standards.

However, what is "significantly unequal"? Do major differentials of prosperity or substantial differences in employment count according to this criterion? A global economic analysis will lead to the conclusion that this is indeed the case between North and South. Strictly equal treatment should therefore logically be demanded among industrialized countries, on the one hand, and among developing countries, on the other, but the rich economies should be allowed and even required, without coming in conflict with the most-

favoured-nation clause, to grant preferences for imports from the poor countries. The preferential tariffs now in operation bear out this view.

Distribution Policy

With the discussion of this "aid by trade" we reach the purlieu of distribution policy. Such aid is a common feature of economic policy on the national level: transfer payments usually account for a substantial portion of the state's budget. The thinking behind this kind of resource transfer is however still far from common on the supra-national level. The unilateral raising of the oil prices by the OPEC countries has certainly led to a drastic redistribution of the global product. Indeed, it has done more: it is still shifting the "world's wealth" into different hands. But this has happened as a result of autonomous arrangements on the national level (or by an international producers' cartel) and certainly not out of consideration for those in greatest need.

A global distribution policy may be defined as a kind of *international financial compensation arrangement*. Its principles and methods correspond to those applying to internal redistribution. There is a difference however: little has been done to develop organs and define functions because, in contrast to the internal situation in the national economies, there is a conspicuous lack of solidarity on the international level and because international law requires unanimous decisions whereas the principle of majority decision is the rule on the national level. There is also a want of unanimity on value judgments, between East and West for instance, which rules out any significant coordinated purchasing power transfer to the poorer countries although the "overall benefit" of such action would be maximized in the same way as in the case of internal redistribution.

Transfer Problems

One difficulty which is apt to hinder international financial compensation arrangements must be pointed out. In the individual countries purchasing power is absorbed and redistributed in the national currency. Subscriptions to international organizations concerning themselves with relief for "the poor members of the world economy" on the other hand must as a rule be paid in a "key currency" such as the US dollar. This involves all countries except the key currency country itself in a special *transfer problem* because they have to convert their own money into a foreign currency.

That complications can arise on this account is easy to see. In country A the real per-capita income may be very high but the balance of payments in deficit and the currency reserves at the

indispensable minimum. In the industrialized country B on the other hand the level of supplies may still be far below country A but the current account may be in surplus and the currency reserves already of substantial dimensions and continuing to rise. Are the two economies in these circumstances to be obliged and expected to agree to the same subscription rate – say, 1% of gross national product?

If so, country A will be entitled to point out that the "*balance of payments burden*" which it is expected to shoulder – a burden which would not arise in purely internal redistribution processes – is inordinately heavy and that further loss of foreign currency reserves would gravely impair its freedom of action in the external economic sphere. After all, a country cannot be seriously expected to run up debts in order to help others.

To counter this argument country B will perhaps contend that the precarious balance of payments position in which country A was finding itself was its own fault. Whether true or not, arguments and counter-arguments of this kind rest on moral judgments on which full agreement can rarely be reached. Country B will also claim that indiscriminating use of a standard formula would *affect its prosperity* far more than country A. The marginal benefit of each additional income unit (and the marginal loss from a fall of disposable incomes) was greater than in country A, and it would therefore be irresponsible to call for the same percentage subscriptions from the moderately rich and the "super-rich". In other words, the paramount problem was how to raise the funds for the resource transfer whereas from country A's point of view the problem was the conversion of the subscription into other currencies.

It is shown clearly by this illustration that the transfer difficulties cannot be simply ignored. They reflect the fact that country A may have to take measures with most unpleasant effects on its own population in order to restore its balance of payments and replenish its foreign currency reserves. These measures may take the form of a currency devaluation leading to higher prices for imported goods and an escalating inflation, or restrictive internal monetary, credit and fiscal policies with adverse consequences for investment, productivity, employment and national income, or precautionary quantitative restrictions in the form of import restrictions or reduced foreign currency allocations. If it is assumed that this kind of state intervention would yield the desired results, there arises the question whether country A should be asked for an increased contribution to the international financial compensation arrangements because it has now put its bal-

ance of payments in order. Would such a request not be tantamount to penalizing a country for its laudable self-denial and self-control?

Cyclical Aspects

When there is talk of a World Economic Policy as is happening nowadays on some occasions, people usually have ideas like the "locomotive theory" in mind according to which it is incumbent on industrialized countries with ample currency reserves to take expansionary measures in their domestic economies in order to raise, in the interest of the global economy, their national incomes and spending on imports and thereby to give a fillip to world business trend — and more especially in the less favourably placed economies. Solidarity, it is argued, means that some go ahead and pull the other along with themselves. With a world government and a global economic policy out of the question, this second-best solution was the one to follow.

Is this a valid argument? It certainly calls for an outset for a *modification*: it cannot be the size of the available currency reserves alone which determines the degree of responsibility for a country's economic condition and, indirectly, for the situation in the rest of the world economy. There is a second determinant: the rate of inflation, which is the base level from which a further demand expansion has to start. It is in this connection of some importance how inflation-prone individual nations are. Furthermore, it needs bearing in mind that the financing of balance of payments deficits caused by a "recovery lead" is much easier for a key currency country: it can use its own currency for external payments. Provided that others will accept it, the balance of payments problem solves itself by an increase of the country's foreign indebtedness. An economy with an ordinary currency is not so fortunately placed.

Under the present *floating* system there is one other point to be borne in mind which tends to confound hopeful expectations and is not given anything like the attention which it deserves. Let us assume by way of illustration that "locomotive" country A has managed to pump-prime its domestic economy and is in consequence spending a larger amount of foreign currencies on its imports, with the result that its current account tends towards a deficit. Country A's trading partners however are not willing to accept currency A in lieu of payment in other currencies because country A is not a key currency country or because they wish to pursue an autonomous basically inflation-neutral money supply policy; so they add little or no country A currency to their currency reserves.

When this is the situation, the exchange rate mechanism will of course come into play: the exchange rate of currency A will tend to decline and go on declining until country A's balance of payments is in approximate equilibrium. So far — so good, it may be said. Unfortunately however this will probably not be the only result. At this point people will begin to anticipate a further fall of currency A — a rise of the other currencies — and this expectation will trigger capital movements from country A into the supposedly stronger currencies. This will depress currency A even further and thus confirm the anticipations. One could say that currency A will now be somewhat undervalued: the state of indebtedness of country A has been reversed — it now has larger foreign currency accounts.

This whole chain of events has one particularly baneful element: Originally it had been hoped that "locomotive" A would pull the other "carriages" along, leading thus the way to a general economic revival in the world. But remembering how flexible exchange rates operate, this assumption must arouse the gravest doubts, for purchasing power inflows across the borders must be of more or less the same volume as the purchasing power outflows. It would therefore be wrong to expect decisive expansionary impulses from outside. *International transfers of cyclical impulses* do not operate under a flexible exchange rate system as they would with stable rates which induced surplus countries in the past to take in foreign currencies and expand their domestic money supply almost *ad lib*.

If the surplus countries refuse to engage in major interventions in the foreign exchange markets, this will, in principle, apply to capital movements away from country A. The result will be a corresponding further decline of the exchange rate of currency A. The surplus countries' export prospects will deteriorate and the profit margins of their exporters will narrow. At the same time they will come up against more severe competition by cheap imports, so that their employment situation will be impaired in the domestic sphere as well as in the export industries. In such conditions there can no longer be much question of expansionary tendencies spreading from country A to other economies. The "locomotive theory" is thus seen to be most misleading.

Things would be different if we could regard the world economy as an entity which is not divided into separate compartments by flexible exchange rates. But it will probably be a long time before such a different situation favouring a World Economic Policy can come to pass. To think otherwise would be utopian.