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ECONOMICS

DOES A FREE MARKET ECONOMY MAKE AUSTRALIA MORE OR LESS SECURE IN A GLOBALISED WORLD?

by

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DISCUSSION PAPER 13.30

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The impact of globalization on security is explored with a focus on its impact on the abuse of corporate political power, the risk of external or internal conflict and the link between globalization, growth and security. I argue that globalization may exacerbate problems of governance. Likewise increasing interdependence does not necessarily reduce the chance of internal or external conflict. Nevertheless, post-war globalization has generated economic growth and poverty reductions that ultimately leave the world and Australia much more secure.

This paper is a contribution to *Australian Foreign Policy: The key Debates* Daniel Baldino, Anthony Langlios and Andrew Carr (eds) Oxford University Press (forthcoming)

1. Introduction

Fourteen years ago, in Seattle in 1999, an estimated 40 000 protesters had also gathered in front of the State Convention and Trade Centre to protest at the World Trade Organization's Ministerial Conference. Several years earlier such a conference had barely made the headlines of the financial press. Yet mass organised protests expressed wide-spread frustration, even disillusion, with globalised, free-market forces. For instance, cheap imports were flowing in from Mexico and China, displacing manufacturing jobs and service jobs were being off-shored. Governments were signing onto to WTO membership that committed them to free trade – even if the imported goods were produced using methods that would be illegal in rich countries, such as drift net fishing and child labour. And this emerging coalition of labour and environmental groups successfully shut down the meetings and, in the eyes of many, the anti-globalization movement was born.

So to many of its detractors, globalization represents a free trade movement that facilitates big company's abuse of power and undermines democracy. But many questions remain unanswered, opinions are widely varied and globalisation has many shapes and forms.

Globalisation is also associated with non-economic forces - the homogenization of culture, Americanisation, anti-welfare state and anti-environment, the decline of manufacturing, and the rise of McJobs and Walmart. Alternatively, it has been argued that Australia has in fact greatly basked in the growth benefits of a 20 year commodity boom. More broadly, globalization is promoted as making the world more interdependent and more integrated - and hence safer. Changing economic patterns are seen as increasing a richness of economic life around the globe, with some 'growing pains', but has overall generated great benefits to vast numbers of people. And any country's unwillingness to jump on the free-market globalization train is portrayed as counter-productive and short-sighted. So what has the post-war era of globalization done for Australians and the security of our country and region?

2. Global Corporations and Power

One of the key messages of the anti-globalization movement is that large companies can use their ability locate off-shore, and bargaining power over to corrupt democratic processes and abuse human rights (Klein 200, Ishay 2004, Wolf 2004). On the face of it history suggests we should be concerned about this. Consider, for example, the first global company - The Dutch East Indies Company (VOC). It had 150 merchant ships, 40 warships and employed 50 000 people, thus dwarfing the naval capacity of other wealthy countries (Brown 2009). It was, in essence, a private Navy.

The warships were needed to protect its fleets which brought back nutmeg cloves pepper and other spices from South East Asia as well as trading in sugar, cloth, tobacco, and spirits. But the VOC is infamous for the use of force as a means to secure trade (Brown 2009, Findlay and O'Rourke 2007). In

the words of one of its Governor's General "we cannot make war without trade nor trade without war". But they went beyond even war, engaging in a policy of genocide in the Banda Islands replacing the local population with slaves to secure a monopoly control of nutmeg.¹

The English East India Company, however, took the VOC's model of "power and plenty" to new heights by installing itself as the government of India. Their indifference to the plight of local population was highlighted during Bengal famine in 1770. At a time when an estimated 10 million people starved to death, the Honourable Company decided to increase taxes (Keay 1993, *The Economist* 2011).

The subjection of humanity in the interest of profits is also the story of slavery in the New World. According to Fogel and Engerman (1989) the transatlantic slave-trade brought in hundreds of thousands of Africans through the 18th and 19th centuries, with up to up to a 100 000 in a single year. By 1825 slave imports and natural growth meant that there were 1.75 million slaves in the Southern United States and about 4.8 million slaves in the western world. This was all in the interest of producing sugar and cotton for global markets.

So clearly corporations can behave appallingly. Moreover, as discussed above by Doyle and Alfonsi, the lack of accountability of large global corporations for their actions outside their home countries has some contemporary resonance. There are other examples such as the Bhopal tragedy which resulted in 2500–6000 deaths and debilitating over 200 000 people, (Mishra et al 2009) or the recent the recent collapse of the Rana Plaza garment factory collapse in Bangladesh which killed over 1100. There is also a similarity to recent cases of corporate irresponsibility, such as the 2010 BP Gulf of Mexico oil spill which released over 200 million gallons of oil (20 times more than the Exxon Valdeze spilled in 1989 of Alaska), or the BAE's (UK arms manufacturer) Al Yamamah deal, which paid millions of taxpayer money in bribes to wealthy Saudi families to implicitly subsidize British arms manufacturers (Feinstein 2011).

These cases differ in scale and severity from the historical examples, and it's not so clear that they display the same trait of unfettered power. But there is a common thread of indifference to social or moral obligations. They are contemporary examples of apparent indifference to society, dubious ethics and/or corruption due to the power of a large corporation over a government.

3. Globalization and Governance

The question remains, however, is this due to globalization? What is common to many of these examples is the imbalance of legal or political protection between countries. For example the laxity of

¹ This quote is accredited to the VOC's Governor General Jan Pieterzoon Coen, 18870-1629 by Findlay and O'Rourke (2007).

labour standards or human rights in some countries provides an opportunity for profits to multinational companies that they would not receive in wealthy western countries. The lack of any effective State to protect the rights of inhabitants of Indonesia's spice-islands, or the enslaved Africans, led to open exploitation of those rights in the pursuit of greater profits.

It follows that if companies can exert power over foreign governments, or increase profits by taking advantage of lax regulations for human rights in foreign countries, then there is indeed a dark side to globalization. The expansion of international trade and investment, with large rich companies operating in small poor countries, may indeed create an imbalance of power or corrupt weak governments. The relevant question is, what should we do about it? Should we attempt to restrict or retain the forces of globalization, or seek to improve the regulatory environment in which international trade takes place?

Arguable what is needed is better governance - such as stronger law enforcement, more checks on corruption and more accountability (Bhagwati 2004). But better governance is not ensured by less globalization or stronger national governments. Specifically the horrors of unfettered capitalism described above are matched, if not surpassed, by the horrors of unfettered government. For example Stalin's collectivization is estimated to have caused 12 million deaths and Mao's great leap forward 45 and 50 million premature deaths (Dikötter 2010). Unfettered government is equally guilty, if not more so, of crimes against humanity.

Thus globalization is not the antithesis of good government or strong intuitions. In the examples above it is poor governance that is primarily to blame, not globalization. Powerful corporations operating in an environment where there is weak, unaccountable or corrupt government, or governments of countries that are too poor to afford the institutions that protect human rights, is a recipe for tragedy.

Nevertheless globalisation may, in some circumstances, exacerbate an existing problem. For example if human rights are not up-held through sufficient legal and police protections, then globalization may lead to this abuse happening on a greater scale. If children are being abused in small scale sweatshops, globalization may result in more children being abused in more sweatshops. If the environment is polluted recklessly due to lax environmental laws, globalization, by expanding industry, may also make this worse.

But in each case there are many possible policy responses, including restricting international trade and investment, but that is not likely to be the best policy. Corden (1997) introduced the idea that we can rank policies according to their effectiveness. The best policy is always the one that directly addresses the cause of the market failure. In this case the best response would be to improve the institutions that protect those rights. Preventing trade might lead to a scaling back of the extent to which rights are being abused in factory-sweatshops, but that would also introduce other problems. For example, in very poor countries having child factory workers may be undesirable, but a better choice than the alternative, which may be child street workers or child soldiers.

Thus the appropriate response to a threat of misuse of power by global corporations is to reduce corruption and improve the legal systems and supporting institutions that lead to good governance.

The problem remains however for very poor countries that simply cannot afford these legal and law enforcement institutions. This is an important question. Though it doesn't refer directly to Australia, it does refer to countries in our region. Yet, as I shall argue below, even in this case, globalization is part of the solution, not the problem.

4. Globalization, Growth and Security

Economic historians argue that what we now refer to as globalization is in fact its "second coming". The first wave of globalization occurred in the late 19th century with the expansion of trade through the dismantling of mercantilist trade barriers in Europe and the colonies, falling transport costs due to the introduction of steam, and large trans-Atlantic migration and investment flows (Williamson 1997, 2011). As a result of this growing world interdependence Angell (1909) argued that international conflict is self-defeating, thus implying that interdependence had made the world more secure from military conflict. Likewise Thomas Friedman's in his 1999 best seller, *The Lexus and the Olive Tree* observed that no country with a McDonalds had declare war on a co-other country with a McDonalds.

Angell's (1909) theory was dealt a blow by the outbreak of WW1 two years later. Likewise, as Friedman admits, his theory was inconvenienced by the NATO attack on Yugoslavia just before his book went to print. This could be interpreted as bad timing, but Findlay and O'Rourke (2009) suggest that, to the contrary, the outbreak of WWI was in part a consequence of political tensions resulting from first wave of globalization. Economics who have looked at these issues theoretically likewise find that the net effect of interdependence on conflict is ambiguous.

For example, Hirschleifer (1991) uses a simple model to show that growing economic interdependence raises the both the benefits and costs of conflict. Similarly Robertson and Ghosh (2012) show that trade liberalization may increase the incentives for crime and Collier and Hoeffler (2005) and Dube and Vargas (2013) both find that changes in resource prices through international markets for resources can increase armed conflict within countries

The current wave of Globalization that has unfolded over the last 2-3 decades has also brought about tensions in international politics, particularly with the rise of China and other large countries such as India and Brazil. For example according to the US Department of Defense (2011), China has territorial disputes with Taiwan, Japan, India Vietnam, Malaysia, the Philippines, Brunei, as well as Taiwan. At the same time it has moved to rapidly modernize its military under the slogan of *zonghe guoli* meaning state, diplomatic, economic and military power. Likewise it wishes to protect its trade routes and access to resources, through increased naval capabilities. Even if China's intentions are entirely non-aggressive, there is an increased security threat of conflict through misunderstanding (White 2012).

Is the world therefore less secure as a result of these new challenges to the international political order? Suppose the answer was "yes", the world, and particularly our region, is less secure. What would be the appropriate response?

In considering this question it may be useful to recall the misfortune of the Luddites – the early 19th century cloth industry workers who opposed the introduction of machinery for cropping and shearing and weaving wool into cloth. The machines destroyed jobs and created mass unemployment. The workers rebelled and armed with agricultural equipment, attacked the mills, the mill owners and smashed the machines. The rebellion was eventually put down but it took massive military action using troop numbers that exceeded Wellington's peninsular army, (Thompson 1963).

The government ignored the petitions of the Luddites because they could see the advantages of the machines to the mill owners since it dramatically reduced the price of cloth. Fortuitously decisions like this paved the way for the industrial revolution. This was a difficult time of adjustment, but it raised millions form power in the longer term and set the foundations for the high living standards western countries now enjoy.

What this episode in history tells us is that economic growth begets economic change. It requires political and economic structural change which people naturally fear. It engenders job losses, redistribution of incomes and social upheaval.

Globalization is, in part, a result of technological change – for example in falling transport and communications costs. It is also the process of economic adaptation to these changes with falling trade barriers, the rise of production networks and multinational corporations. These are market and institutional responses to take advantage of new economic opportunities.

The reductions in trade and investment barriers are then, themselves, further sources of growth. The most glaring evidence for this is the experience of the East Asian economies. The freeing of trade barriers that allowed these countries to reap the benefits of investments they had made in human and physical capital (Bhagwati 2004). Likewise Dollar and Kraay (2004) looked at evidence across over 100 countries from the 1960s through to the 1990s and found that countries that increased trade generally grew faster and without any change in income distribution.²

Because globalization is a description of economic change it is, almost by definition, likely to lead to some form of insecurity in the short term. But, just as with the industrial revolution, we need to see these changes in perspective of the potential long term benefits. The costs of not embracing globalization are likely to be enormous in terms of lost growth opportunities. In the longer term this will reduce security of incomes and welfare.

For example In Latin America, protection from global manufacturing stifled competition. It led to large rents for domestic manufacturers and land owners and elites, and high income inequality. Once these interest groups were entrenched, they resisted further reforms that might have eroded their privileged positions.

² Not all economists agree of course. See Rodriguez and Rodrik (2000) for a critical appraisal.

Likewise China reversed its self-imposed exile (since 1490) in favour of markets and trade. The resulting economic expansion since opening up in the 1980s, and joining the WTO in 2000, has seen a massive reduction in absolute poverty. The rate of people living on less than the equivalent of \$1 per day fell from 64% of the population in 1981 to 17% by 2001 (Ravallion and Chen 2004). Thus over 400 million people were removed from of severe poverty - perhaps the greatest ever decline in human suffering.

Conversely there are many dictators and feudal governments ruling over masses of people in poverty. Such countries are predisposed to civil wars, drug wars and international terrorism (Collier 2007). Africa provides a model of what East Asia could have looked like had it not embraced the opportunities presented to it by an open world economy and liberal markets.

The appropriate policy responses to globalization are not to reject the economic changes it brings about through protectionist policies. Rather it is to find ways of managing this change so that society can reap the potential benefits but with minimising the costs of adjustment. This may mean appropriate targeted welfare policies, allowing free trade in a setting of strong institutions of governance.

Thus, when we consider the impact of globalization we must imagine how much worse it might be without it. Imagine a world with China as still a large country but with hundreds of millions remaining in poverty, and the constant threat of military coups or another revolution. Or imagine that the east Asian continent was splintered in into a chaos of territories controlled by local warlords using anti-western propaganda, like North Korea, Libya or Somalia. Greater security over incomes, freedom from poverty and increased welfare are all dependant on economic growth, and globalization is key part of that process.

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