

GLOBALIZATION, IMPERIALISM AND REGULATION

by

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Abstract

This paper challenges the idea that globalization should be viewed as a damaging western ideology. Rather than being an expression of US imperialism, the benign process of globalization is threatened by the unwillingness of the US to maintain its Pax, whilst simultaneously attempting to legislate the affairs of the world through a form of 'ethical imperialism'. The argument is developed through an examination of the debate over global public goods, in particular the maintenance of peace, and the role of international financial institutions in dealing with recurrent financialcrises.

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INTRODUCTION

Elementary economics tells us that, the growing integration of the world economy through increasingly free movement for goods and capital- though not for people²- labelled 'globalization', which essentially creates a common economic space, is a potentially beneficial process. As an economic process, in itself, it is value neutral. It cannot be an ideology. There are, however, many concerns expressed about its impact that may have an ideological basis. The major concerns relate to its distributional consequences, its political and cultural nature as a form of American imperialism- both concerns relating to values- and its possible fragility because of the instability caused by the 'creative destruction' of global capitalism- a question of fact. Thus, there are demands from a wide part of the political spectrum for the process to be regulated and tamed through the creation or expansion of various

¹ This paper is based on part on two lectures, one given to the Friedreich Naumann Foundation in Berlin on "Cultural Self-determination, decentralization and economic prosperity", the other to a Goodenough Trust-Chatham House- City University Business school conference on "The Structure of International Capital Markets".

² The reason why unlike the 19th century we no longer see free movement to people, particularly to the developed world, is because of their welfare states. These have created property rights in 'citizenship', as in them citizens have access to the purses of their fellow citizens who are then naturally concerned about who can have such rights.

international institutions to deal with the problem of 'global public goods'. (see Kaul et. al.(1999))

In this paper I will deal with the questions of globalization and imperialism and the purported instability (mainly through globalized capital markets) resulting from the process. I shall be arguing that, (a) paradoxically far from being an expression of American imperialism, the current period of globalization is threatened by the reluctance of the US to maintain its PAX, while at the same time attempting to legislate its 'habits of the heart' through a form of 'ethical imperialism', and (b) the demands for a new global financial architecture are misguided.

The notion of global public goods provides an obvious way to organize this discussion. For many of the critics of globalization have cited their under-provision as leading to at least inefficiency, if not worse, in the working of the global market mechanism by analogy with the domestic economy. But, many of the claims made for global public provision are unfounded as are those for most national, excludable, publically provided goods (see Lal (1997)). For instance, the demand for international distributive justice is vitiated by the fact that (a) there is no global state where this 'good' could be provided analogously with western welfare states (see Lal (1994) Chp.4) and (b) there is no universally accepted morality which could underpin these demands (see section I below). For other purported global public goods, such as the externalities associated with trans national pollution, international action is required and is provided by various international agreements promoted by an existing international institution, the United Nations Environment Program (UNEP), and as such no new global institution is needed. Much of the controversy about these environmental externalities concern questions of fact (eg. about the extent and impact of global warming) as well as the relevant costs and benefits of alternative solutions. I remain a skeptic about these purported environmental

dangers (see Lal (1990), (1995)). Similarly, there are international externalities associated with the spread of infectious diseases, but an international institution- the WHO- already exists to deal with them.³

There is of course the classical public good relevant for prosperity, viz. peace, and with the continuance of a large number of deadly conflicts around the world, there is the question whether some global institution is needed to end them. In the purely economic sphere there maybe a case for international action in maintaining globalized free trade and capital mobility. For trade, despite the incontrovertible case for the unilateral adoption of free trade by every country, there is the theoretical possibility that a country with monopoly or monopsony power in its foreign trade may choose to garner a larger share of the cosmopolitan gains from trade by levying the so-called optimum tariff. To prevent this eventuality some 'supranational contrivance' maybe needed for countries to mutually disarm (Robbins (1961)). The GATT and its successor the WTO have provided the necessary 'supranational contrivance'. No new international institution is needed in this sphere. This leaves capital flows, for which, given their volatility in a globalized economy, some international 'contrivance', it is argued, is needed to assure financial stability.

Hence, in this paper I examine the two cases where there may currently be under-provision of global public goods: one, the maintenance of peace in a world increasingly prone to civil wars based on cultural self-determination and the other for dealing with financial crises in a world of nearly perfectly mobile capital. Though particular ideological lenses maybe used in this examination, I will argue that questions of fact and

³ There is some question of whether the WHO is still fulfilling its primary mission, as recently it seems to have joined the wholly unwarranted Western culture wars by launching a global crusade on smoking. See (Lal (2000b), Scruton (2000)).

'positive' economic analysis is all that is required. In fact, as I will argue it is the attempt to legislate particular ideological preferences in the name of taming the globalization process which not only threatens this economically benign process but also the prospects of perpetual peace.

I GLOBAL PEACE

The first point to be made about the process of integrating previously loosely linked or even autarkic countries and regions through freeing flows of goods and services and capital, labelled globalization is that it is not a new phenomenon. Globalization has been a cyclical phenomenon for millennia, being associated with the rise and fall of empires. By integrating previously separated areas into a common economic space under their Pax, these empires promoted those gains from trade and specialization emphasized by Adam Smith, leading to what I have labelled Smithian intensive growth (Lal (1998)). Thus the Graeco-Roman empires linked the areas around the Mediterranean, the Abbasid empire of the Arabs, linked the worlds of the Mediterranean and the Indian Ocean, the various Indian empires created a common economic space in the sub-continent, while the expanding Chinese empire linked the economic spaces of the Yellow river with those of the Yangtze. In more recent times the British for the first time knit the whole world through their Empire. But most of these empires have been ephemeral. Given the existing technology and the inevitable predatoriness of the State, most of these empires over-extended themselves⁴. Their decline was followed by a disintegration of the enlarged economic spaces they had created. In our own times, the death of the 19th century liberal economic order (LIEO) built by Pax Britannica on the fields of Flanders led to a near century of economic

⁴ see my model of the predatory state in Lal (1988) and Lal (1998).

disintegration and disorder which has only been repaired with the undisputed emergence of the United States as the world hegemon in the last decade.⁵ Once again this new Imperium- the American- is associated with the resurrection of another LIEO, so that the world economy is roughly back to where it was at the end of the 19th century.⁶

Apart from the creation of a common economic space (which is what globalization amounts to) there was another reason why past empires promoted prosperity. For economic prosperity, a State is needed to provide the classical public goods which protect the life, liberty and property of their citizens. Liberty needs to be protected against external predation. Life and property against both external and domestic predators. Hence the essential public goods are to provide for external defense and internal law and order.

The centers of the ancient civilizations in Eurasia- where sedentary agriculture could be practiced and yielded a surplus to feed the towns ('civitas'- the emblem of civilization)- were bordered in the North and South by areas of nomadic pastoralism: the steppes of the North and the semi-desert of the Arabian peninsula to the South. In these regions the inhabitants had kept up many of the warlike traditions of our hunter- gatherer ancestors, and were prone to prey upon the inhabitants of the sedentary 'plains' and at times attempted to convert them into their chattel like cattle. (see McNeill (1983)). This meant that the provision of one of the classical public goods- protection of its citizens from invaders- required the extension of territory to some natural barriers which could keep the barbarians at bay. The Roman, Chinese and various Indian empires were partly created to

⁵ Kindleberger (1986) has argued that the inter-war collapse of the world economy was due to the decline of the British empire and the failure of the US to assume its emerging Imperial responsibilities.

⁶ See Lal (1999)

provide this PAX which was essential to keep their labour intensive and sedentary forms of making a living intact. The Pax of various Imperium has thus been essential in providing one of the basic public goods required for prosperity.

These empires can further be distinguished as being either multi-ethnic or homogenizing. The former included the Abbasids, the various Indian empires, the Ottoman, Austro-Hungarian and the British , where little attempt was made to change 'the habits of the heart' of the constituent groups- or if it was, as in the early British Raj, an ensuing backlash led to a reversal of this policy.

The homogenizing empires, by contrast, sought to create a 'national' identity out of the multifarious groups in their territory. The best example of these is China, where the ethnic mix was unified as Hans through the bureaucratic device of writing their names in Chinese characters in a Chinese form, and suppressing any subsequent discontent through the subtle repression of a bureaucratic authoritarian state (see Jenner). In our own time the American 'melting pot' creating Americans out of a multitude of ethnicities by adherence to a shared civic culture and a common language, has created a similar homogenized imperial state.

Similarly, the supposedly ancient 'nations' of Britain and France were created through a state-led homogenizing process. India, by contrast is another Imperial State whose political unity is a legacy of the British Raj, but whose multi-ethnic character is underwritten by an ancient hierarchical structure which accommodates these different groups as different castes.

With the end of the Cold War and the fears it engendered- which kept this broad structure of nation states with their distinct forms of 'national identity' intact- we are seemingly moving into a post modern world where there are varying currents which are undermining these familiar structures.

In the multi-ethnic imperial nation states, on the one

hand, we have assertions of cultural self determination, leading in many cases to bloody conflicts: from the successor states of the former Yugoslavia, the Kurds in Turkey, the Kashmiris and Sikhs in India, the Tamils in Sri Lanka, the various regional separatists in Indonesia and numerous ethnic conflicts in Africa of which that between the Hutus and the Tutsis was the most bloody. This desire to assert a distinct cultural identity is not limited to the multi-ethnic imperial nation states. It is also happening in the 'homogenized' nation states. The partial deconstruction of the United Kingdom- with the establishment of Scottish, Welsh and Irish parliaments- the continuing demands for Quebec to secede from Canada, the continuing tensions between the Wallons and the Flemish in Belgium, and the rise of separatist movements (still without mass appeal) in the US are all part of this trend.

But side by side with these centrifugal decentralizing tendencies there are also centripetal ones as represented by the attempt to resurrect a new Holy Roman Empire through the ongoing process of European integration, as well as the growing demands - which are being partially and fitfully satisfied- from a host of international non-governmental organizations (NGO's) for the creation of a new international moral order. The latter is part of a general revolt of the 'border' against the 'center' (see Toulmin (1990), Douglas and Wildavsky (1983), Lal (1998)) and the questioning of the international system of nation-states established by the Peace of Westphalia. This system got a fillip when at the end of the First World War, President Wilson pronounced the dawn of a worldwide Age of Nations and the ending of that of Empires. Most of the Third World has naturally embraced this globalization of the Westphalian system, while it is in the West that it is increasingly coming into question.

This Age of Nations has also let the ethnic genie out of the bottle, and the most common form of deadly conflict today is a civil war in the name of cultural self-determination. (see Mendez

(1999). Apart from the obvious detrimental effect on the prosperity of the countries concerned there are also spill-over effects from these civil wars on other countries, for instance through the mounting number of refugees.⁷

Some interesting recent research by Paul Collier of Oxford and his associates⁸ on the causes of civil wars finds that the relationship of ethno-linguistic fragmentation in a state and the risk of a civil war is an inverted U in shape. The most homogenous as well as the most fragmented are least at risk of civil war. Thus there is likely to be a bipolarity in the institutions best able to deal with ethnic diversity. One, (complete fragmentation) is to be found in empires. The other (homogeneity) is surprisingly a course advocated by Keynes during the Second World War when speculating about the ideal political post war order in Europe. Skidelsky (vol.3, chp 5. p.38)⁹ reports on one of Keynes' fancies:

"A view of the post-war world which I find sympathetic and attractive and fruitful of good consequences is that we should encourage small political and cultural units, combined into larger, and more or less closely knit, economic units. It would be a fine thing to have thirty or forty capital cities in Europe, each the center of a self-governing country entirely free from national minorities (who would be dealt with by migrations where necessary) and the seat of government and parliament and university center, each with their own pride and glory and their own characteristics and excellent gifts. But it would be ruinous to have thirty or forty entirely independent economic and currency unions".

But as Skidelsky notes "this pleasing picture of a re-medievalised Europe did not survive in later drafts." This homogenized solution, which as Keynes recognized could involve

⁷ Thus Mendez (1999), p.395 estimates that there were more than 22 million refugees and displaced persons worldwide in 1997-excluding economic migrants.

⁸ see Collier and Hoeffler (1998)

⁹ see Skidelsky (forthcoming)

'ethnic cleansing', has clearly been eschewed by the West- as witness its actions in Bosnia and Kosovo. This reflects the hopes of much progressive thought over the last two centuries stemming from the Enlightenment that, transnational and 'modern' forms of association such as 'class' would transcend primordial forms of association such as 'ethnicity' and 'culture'- of which nationalism is an offshoot. But, contemporary history continues to show the power of these primordial forces. The much derided socio-biology provides some cogent reasons for their survival.

Evolutionary anthropologists and psychologists maintain that, human nature was set during the period of evolution ending with the Stone Age, since there has not been enough time for further evolution. (see Trivers (1985), Tooby and Cosmides (1989), Barkow, Cosmides & Tooby (eds)(1992)). One salient feature of this Stone Age environment was that, rapid 'species'- relevant judgments had to be made on the basis of quick impressions. Our brains, according to the evolutionary psychologists, have been hardwired to deal with the problems faced in the primordial environment- the savannahs of Africa. Here it was a matter of life and death to judge from whatever signs were available that a dangerous member of a predatory species was at hand. The decision moreover had to be instantaneous, without any time being spent on continuing sampling to confirm one's conjecture that a yellow shape with stripes in the distance was indeed a tiger. This has meant, say the evolutionary psychologists, that we are naturally

primed to make instantaneous 'species' judgments.¹⁰

Given, the divergence between different human groups in physiognomy and culture, once our ancestors spread throughout the world and then rarely came in contact with their genetic cousins- as with the ending of the Ice Age, the ice bridges linking the continents melted- it is hardly surprising that when we do come across another ethnic group we are primed to look upon it as a different species. Intermarriage and long familiarity might change these natural instincts, but as the bloody outcome in the successor states of Yugoslavia demonstrate this might be a very long run. This provides one important reason, rooted in our biology, why the Enlightenment hopes of the reduction -if not ending- of ethnic differences and conflicts have not been fulfilled.

So, at least in principle, the Keynes solution seems to be in keeping with human nature. As, in a globalized economy, size does not matter for prosperity- demonstrated by the shining examples of the city states of Hong Kong and Singapore - it would also be feasible, as long as there is someone to maintain a global PAX.

But, in this confused and confusing picture, the effectiveness of the current global hegemon, the US, in providing this effective Pax is increasingly in question- largely due to

¹⁰ Some natural experiments conducted by Francisco Gil Diaz of the department of anthropology at UCLA and reported at a conference on "Norms", Center for International Relations, UCLA, 1999, provide empirical support.

its domestic politics. While the continuing domestic resonance of the 'idealism' in its foreign policy emphasized by Woodrow Wilson has the potential of creating a backlash against the LIEO it has helped to recreate.

Given its domestic homogenizing imperial tendencies, the US (along with various other Western countries, which Huntington (1993) has aptly described as a directorate seeking to run the world) the US is attempting to legislate its 'habits of the heart' around the world-'human rights', democracy, egalitarianism, labour and environmental standards etc. Its claim that, it is thereby promoting universal values is unjustified.

For there is an important difference between the cosmological beliefs of what became the Christian West and the other ancient agrarian civilizations of Eurasia.¹¹ Christianity has a number of distinctive features which it shares with its Semitic cousin Islam, but not entirely with its parent Judaism, and which are not to be found in any of the other great Eurasian religions. The most important is its universality. Neither the Jews, nor the Hindu or Sinic civilizations had religions claiming

¹¹ In Lal (1998) I make an important distinction between the material and cosmological beliefs of different cultures. The former relate to beliefs about the material world including how to make a living. The latter to how Man relates to his fellow human beings and his place in the world- to in Plato's words "how one should live". There is considerable cross-cultural evidence that while material beliefs are highly malleable, cosmological beliefs are not and are, moreover, derived from the common linguistic parent of the given culture. That is why the modernization promoted by globalization which requires changing material beliefs need not require Westernization, which implies a change in cosmological beliefs.

to be universal. You could not choose to be a Hindu, Chinese or Jew, you were born as one. This also meant that, unlike Christianity and Islam, these religions did not proselytize. Third, only the Semitic religions being monotheistic have also been egalitarian. Nearly all the other Eurasian religions believed in some form of hierarchical social order. By contrast, alone among the Eurasian civilizations, the Semitic ones (though least so the Jewish) emphasized the equality of men's souls in the eyes of their monotheistic Deities. Dumont has rightly characterized the resulting profound divide between the societies of Homo Aequalis which believe all men are born equal (as the philosophes, and the American constitution proclaim) and those of Homo Hierarchicus which believe no such thing. The so called universal values being promoted by the West are no more than the culture-specific, proselytizing ethic of what remains at heart Western Christendom.

Nor is there a necessary connection as the West claims between democracy and development.¹² If democracy is to be preferred as a form of government it is not because of its instrumental value in promoting prosperity- at times it may well not- but because it promotes a different Western value - liberty. Again, many civilizations have placed social order above this value, and again it would be imperialistic for the West to ask them to change their ways.

¹² see D.Lal and H.Myint (1996).

If no universal claims for cherished Western cosmological beliefs are valid, it is unlikely that they will be found acceptable by the Rest. If the West ties its moral crusade too closely to the emerging processes of globalization, there is a danger that, there will also be a backlash against the process of globalization. This potential cultural imperialism poses a greater danger to the acceptance of the new LIEO in developing countries than the unfounded fears of their cultural nationalists that the modernization promoted by globalization will lead to the erosion of cherished national cultures (see Lal (1998, 1999)).

But even this backlash would not matter, or could be fought off, if like the homogenizing Chinese imperialists the US would be willing to ruthlessly impose its will. But to do this, or even to maintain the Pax in multi-ethnic empires, as every imperial power in the past knew it needed to expend its own men and materiel. But partly due to the quagmire of Vietnam, there is no stomach left in the US for any similar sacrifice. (see Rosecrance (1999)). The fatality rate in a job with the US postal service is now higher than in the US armed services! For no US president is now willing to accept more than ten body bags from an armed conflict. Nor does the US constitution allow the alternative of hiring mercenaries- the backbone of past empires. This has hobbled this potential imperial giant in imposing its PAX.

But, given the continuing resonance of 'idealism' in its foreign policy, it will probably continue to rain down missiles every now and then in impotent rage at some hapless

country or other whose domestic politics it does not like. These countries in turn are learning the lesson that the only deterrent maybe to credibly threaten the American heartland. As many Third World diplomats have observed, the lessons from the Gulf War and Kosovo is that, to maintain one's sovereignty one needs nuclear weapons. But these attempts to create some balance of power are all roads to instability. (see Jervis (1976))

With a reluctant hegemon willing to impose its Pax directly and with a balance of powers infeasible and perhaps undesirable- because of the prisoners's dilemma it creates leading to arms races- the only remaining option to maintain global peace is some form of collective security. The United Nations, and in particular its Security Council provides the requisite global institution. But, despite the end of the Cold War, which had effectively paralysed the Security Council, and the success of the coalition it sponsored in the Iraq war, its subsequent record in preventing or ameliorating the regional and intra state deadly ethnic conflicts can only be described as dismal. It only succeeded when the current hegemon led the coalition, as in Iraq, and it is the body bags coming back from its intervention in Somalia which have turned domestic opinion in the US against even the indirect form of imperialism - much favoured by the British during their period of hegemony- which it could exercise through the Security Council.

Thus I am led to conclude that the prospects of a sustained provision of the public good of peace remain clouded in

the New World Order, unless domestic US politics and its Western allies are willing to accept the associated costs and also emulate the sage Queen Elizabeth I who, when her kingdom was being torn by different groups trying to get her to impose their 'habits of the heart' on others, pronounced that she did not wish to 'make windows into men's souls'. (Elton (1955))

II FINANCIAL STABILITY

The second area, where it has been argued global institutions are required, is in establishing a new 'global financial infrastructure' - which is a euphemism for regulation and controls- to manage the consequences of the globalization of capital flows. The series of sovereign debt crises which have plagued the world since the 1980's are taken as the symptoms of a disease which needs an international cure.

In discussing this issue it is useful to note a divide between what maybe labelled 'classical liberals' and various sorts of 'dirigistes'. What divides them is partly ideological (or what I like to term 'cosmological beliefs' (Lal (1998)), but also questions of fact. The major ideological difference can be succinctly expressed in terms of Oakeshott (1993)'s distinction between two major strands of Western thought on the State: the State viewed as a civil association, or alternatively as an enterprise association. The former view goes back to ancient Greece, with the State seen as the custodian of laws which do not

seek to impose any preferred patterns of ends (including abstractions such as the general (social) welfare, or 'human rights'), but which merely facilitates individuals to pursue their own ends. This view has been challenged by the rival conception of the State as an enterprise association- a view which has its roots in the Judaeo-Christian tradition. The State is now seen as the manager of an enterprise seeking to use the law for its own substantive purposes, and in particular for the legislation of morality. The classical liberalism of Smith and Hume entails the former, while the major secular embodiment of society viewed as an enterprise association is socialism, with its aim of using the State to equalize people. Equally, the other major challenge to classical liberalism in this century, Fascism (national socialism) also viewed the State as an enterprise association . Both involved collectivist moralities as a reaction to the morality of individualism. But, in judging the desirability of regulating or controlling capital flows in a globalized world economy, I shall argue that these ideological differences are immaterial, as the issue can be settled by 'positive' economic analysis.

To judge the validity of the alternative diagnoses and the suggested cures it is important to take a historical perspective and to see how the existing financial infrastructure has evolved.

Our starting point is the breakdown of the international capital market as a consequence of the Great Depression in the inter-war years. Much of the international

financial architecture created at Bretton Woods was to revive international capital flows, not least to developing countries, which had been snuffed out by the ubiquitous exchange controls around the world and the notorious 'blue sky laws' in the US. The Bretton Woods twins- the IMF and the World Bank (WB) - task was to resuscitate these capital flows. But, given the hold of Keynesian ideas at the time and the purported lessons of the 1930's, the role of these inter-governmental agencies in both financial intermediation and surveillance of the adjustable peg exchange rate system that was established, were based on assumptions which have been steadily eroded over the years.

Thus, the World Bank provided a useful intermediation role when private capital markets were virtually closed to the Third World by issuing its bonds in developed country financial markets and on-lending the proceeds to developing countries. The purely 'aid' aspects of its lending was later added on with the development of International Development Agency (IDA). But with the resuscitation of the international capital market in the 1980's and 1990's this intermediation role has rightly become redundant, while the manifest failures of 'foreign aid' to achieve its changing ends (see Lal (1999) for a fuller discussion and references) have led to the notorious 'aid fatigue' which has increasingly put this aspect of its operations also under a cloud.

Similarly, the mission of the IMF to supervise and run the Gold Exchange Standard- with its fixed but adjustable exchange rates- was predicated on the assumption that countries would be

able to discriminate between short and long run capital flows, and while progressively removing restrictions on the latter would be able to maintain controls on the former to prevent the speculative attacks which are endemic in any adjustable peg system.¹³ The contradictions of the system (eg. the inability of the US to 'devalue' its currency) as well as the practical impossibility of distinguishing between short and long term capital movements led to the breakdown of the Bretton Woods exchange rate system and mutatis mutandis of the IMF's mandated role. Since then it has been rather like the characters in Pirandello's play "Six authors in search of an author", looking for a new play! As we shall see it has craftily been finding a number of these but it is arguable whether it has done more harm than good, and as such its future must also seriously be in doubt. What cannot be gainsaid is that both Bretton Woods twins can, nevertheless, take credit for helping to recreate the liberal international economic order which died on the fields of Flanders.

If the world is, therefore, roughly back to where it was in terms of the international capital market at the beginning of this century, the question which arises is: whether the debt crises- in particular relating to sovereign debt- which have occurred since the 1980's are endemic to such a liberal order of capital flows, and whether public action can prevent or mitigate

¹³ This is because of the one way bet offered to speculators when governments are trying to maintain a misaligned exchange rate. See Lal (1993), Chp. 6.

them or will necessarily exacerbate them? This is the central issue which continues to separate what I would label the 'classical liberal' from various 'dirigiste' viewpoints.¹⁴ Underlying these differences is another major divide about the functioning of the macro-economy- both national and international. The classical liberals believe that a competitive macro economy without barriers erected by governments to adjustment will be self-correcting, the dirigistes believe that the inherent instability of the macro-economy requires public intervention. The irony is that whereas most governments have now virtually accepted the classical liberal viewpoint as regards the domestic macro-economy by eschewing the Keynesian interventions commonly accepted in the two post war decades, they and their acolytes are increasingly recommending various dirigiste means to 'control' the international macro-economy.

To form a judgment on this issue, it is useful to briefly outline the lessons from the various debt crises which have occurred since the 1980's. It is useful to distinguish between three types of capital flows: foreign direct investment (FDI), equity investment, and bank loans including bonds denominated in foreign currency. The major difference between these three types of capital flows is that, whereas the income and foreign exchange risk associated with all international capital flows is shared between the borrower and lender in the first two

¹⁴ see Lal (1983, 1997, 2000)

types of flows, in the last these are borne entirely by the latter. All the debt crises in the last two decades have been associated with the sudden withdrawal or diminution of this bank lending.

The second essential feature of these debt crises is that, they have hit countries which have maintained some form of adjustable peg exchange rate system, which as is well-known are subject to speculative attack. It is increasingly becoming clear that, in a word with a globalized capital market, only two exchange rate regimes are viable: a fully floating exchange rate or one rigidly fixed as in the currency boards of Hong Kong and Argentina.

The third feature is that, whereas the 1980's debt crisis and some of the 1990's crises (eg. Russia and Brazil) were associated with countries which were maintaining inappropriate domestic macro-economic and structural policies, the 1990's crises in Asia were associated with crises in the domestic banking and financial systems even when the domestic macro-economy was otherwise well managed. This needs some explication.

A central feature of the 'Asian' model- as seen most clearly in Korea but presaged by the development of Japan- is a close linkage between the domestic banking system, industrial enterprises (particularly the biggest) and the government. The fatal danger of this 'model' is that, by making the banking system a creature of the government's will, it creates tremendous moral hazard in the domestic banking system. The bank's have no incentive to asses the credit worthiness of their borrowers or the

quality of the investments their loans are financing, as they know, no matter how risky or over extended their lending they will always be bailed out by the government. This can lead in time to a mountain of bad paper and the de facto insolvency of a large part of the domestic banking system- as has happened in both Korea and Japan. But, as the example of the US savings and loan crisis showed, the mess in the domestic banking system can ultimately be cleared up, as is happening in both Korea and Thailand- with both countries bouncing back after their recent crises.

But, the crises have also been partly caused and exacerbated by a fourth feature. The problem of moral hazard common to all banking systems with deposit insurance- though more acute in the case of the countries following the 'Asian' model- has been aggravated by the actions of the IMF and the entrance of foreign banks (subject to moral hazard themselves) as major international lenders. As their loans are usually denominated in dollars linked to LIBOR, borrowing countries maintaining a quasi-fixed exchange rate find that, when faced by a shock requiring a devaluation, the domestic currency burden of the foreign bank debt rises pari passu with the changing exchange rate. If the debt is incurred by the private sector, this rising debt burden need pose no problem for the country, for if the relevant foreign banks run, the borrowers can always default on their debt. But now enter the IMF. Ever since the debt crisis of the 1980's the foreign banks faced by a default on their international loans have argued that this poses a systemic risk to the world's financial system and

asked in effect for an international bailout to prevent this catastrophe. The IMF has been more than willing to oblige. With the ending of its original mandate with President Nixon's closing of the 'gold window' (in the early 1970's), this course has provided it with continuing new plays. But, substantial international moral hazard has thereby been created for the foreign banks - already plagued with domestic moral hazard because of deposit insurance. The IMF has thus, increasingly become the international debt collector for the foreign money center banks, as well as an important tool of US foreign policy. It should be shut down.

This raises the question of restructuring the global financial infrastructure. Clearly with the IMF exacerbating rather than preventing debt crises it can have no role in this 'new order' except perhaps as an international country risk rating agency like MOODYS to make use of its existing intellectual capital and access to national statistical data. The World Bank's intermediation role is also no longer required. The only role left- if one believes this is needed- is as an 'aid agency', which in effect is what the Meltzer Commission (2000) has proposed. This would demolish the now archaic structure put in place to meet the very different requirements of a moribund international financial system at Bretton Woods.

Would any replacement be needed? No, is the short answer. Without the IMF, there would be no international moral hazard exacerbating the domestic moral hazard already facing domestic

banking systems worldwide because of deposit insurance. Even though it would be logical to end deposit insurance is to prevent the moral hazard which is endemic in a system with the mismatched maturities central to banking, the political feasibility of such a course in the Age of Demos is close to nil. Hence, the calls for greater surveillance of bank portfolio's by national or international authorities. But as Mervyn King (1999) has rightly noted, in the limit this amounts to a call for the nationalization of banks!

Nor can the IMF be credibly converted into an international lender of last resort analogous to domestic central banks- which are needed to counter the bank runs to which a fractional reserve banking system is prone. There are two functions that a lender of last resort has to perform, as set out in Bagheot's famous rules (see Bagheot (1873), Harrod (1969)p.42). First, it should be able to create high-powered money quickly to on-lend to solvent banks to prevent a liquidity crisis. Second, it must be able to distinguish between good and bad 'paper' and thus judge the soundness of the banks to which it is extending liquidity, with the insolvent banks being shut down. The IMF is incapable of doing either. It can only lend after lengthy negotiations with a country's government and the approval of its board. Second it has no way of sorting out the 'good' from 'bad' loans for instance made by foreign banks to residents in the country, and to liquidate the latter. The lender of last resort function for the money center banks involved in foreign lending

must therefore continue to be provided by their parent central banks.

Does this mean that, there is no means of avoiding the volatility of international capital flows, and the periodic 'bubbles' that may occur in financial markets? The shortest answer is provided by thinking of international capital markets as merely an extension of domestic stock markets. As no one has credibly argued that, domestic stock markets- despite their undoubted volatility and proneness to bubbles- should be shut down or have 'sand thrown' in their works (as these purported cures would be worse than the presumed disease), the same line of argument applies to competitive international capital markets. Though volatile, and subject to bubbles- and remember bubbles always burst- any public intervention will only make matters worse.

So, I can only conclude by echoing the sage advice of Lord Palmerston when, faced by calls for public action in the face of spectacular defaults on foreign bonds, in a circular of 1848 eschewing any public action he wrote: "The British government has considered that the losses of imprudent men who have placed mistaken confidence in the good faith of foreign governments would provide a salutary warning to others" (cited in Lipson (1985))!

CONCLUSIONS

My conclusions can be brief. Globalization is a process, it cannot be seen as a Western ideology, as a process cannot be

ideological. It is also beneficial, as by creating a larger economic space it allows the greater division of labour which promotes prosperity. But, in the past the maintenance of this common economic space has required an imperial power to maintain the PAX which is an essential public good which provides the protection of life, liberty and property of the economic agents within the common space. The maintenance of this PAX, however, requires the expenditure of men and materiel, which the current hegemon- the US- is unwilling to provide, mainly because of its domestic politics. With the endemic ethnic conflicts, fuelled in part by our Stone Age 'human nature', and the current impossibility of any global institution to contain them, deadly conflicts can be expected to continue for the foreseeable future. These will continue to put strains on the globalized economy through their spillover effects in the form of refugees as well as the direct economic costs in the countries/ regions concerned. Equally, worrying is the ethical imperialism being espoused by the West to legislate its 'habits of the heart' worldwide through the international agencies it controls . By tying this moral crusade to the process of globalization it could lead to a backlash which could undermine this wholly benign process.

By contrast, I have argued the worries expressed about the lack of a global financial architecture to regulate and control the unbridled capital flows, which are claimed to lead to periodic financial crises, are misplaced. The current global financial 'non-system', with national central banks providing the

requisite 'lender of last resort' facilities for the banks within their domain is all that is needed in a world where there will always be 'bubbles' which will always burst.

Finally, I have been at pains to suggest that, though there may be ideological differences between the classical liberal and dirigiste viewpoints, on the two issues I have discussed in this article= global peace and the regulation of capital flows- we can form robust judgments based on purely 'positive' analysis.

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