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MARTIN WOLF

## The Future of Globalisation in an Era of Financial Crisis

*Essay in Honour of Pradeep Mehta*

Pradeep Mehta has been a remarkable campaigner for rational trade and competition policies in India. Through the Consumer Unity & Trust Society (CUTS), which he founded, he has played a noteworthy part in what I thought almost impossible when I first visited India almost 40 years ago: to shift the consensus of informed Indian opinion towards welcoming competition and openness to trade. In doing so, he has served the immediate interests of Indian consumers and the longer-term interests of the Indian economy.

The decisive moment in India's trade and industrial policies came just over twenty years ago, in 1991, when a foreign exchange crisis provided the opportunity for fundamental reforms. These went well beyond lifting barriers to trade and lowering tariffs. They also brought about the end of the 'license *raj*', which governed every aspect of the economy, not least manufacturing. The subsequent performance of the Indian economy shows the clear benefits of these reforms.

The next 20 years are likely to be very different. This is partly because of the economic crisis that has fallen upon the advanced countries. But it is also because the crisis is accelerating a transition that would have happened, in any case: the end of the domination of the advanced countries not only over the world economy, but also over the making of global economic policy. The transition from discussions limited to the heads of government of the group of seven high-income countries to discussions with leaders of the

group of 20 leading economies, which includes all the important emerging economies, is a clear indicator of this upheaval.

In itself, this transformation is of course, welcome. The world cannot be—and should not be—run by countries that account for an eighth of the world's population. But such transitions create huge challenges for policymakers, particularly at times of economic difficulty, as the world learned in the 1930s.

In particular, the rising giants, China and India, will have to play a leading role in sustaining an open and dynamic world economy. As a market-oriented democracy with a relatively balanced, consumption-oriented economy, at least compared to China's, India has a very special role to play.

Let us look more closely at events inside the high-income countries and the implications for the rest of the world economy.

The obvious point is that, overall, the economies of the high-income countries have failed to recover fully from the crisis. Even in those major countries whose economies are a little above the pre-crisis peak, such as the US and Germany, the recovery has been remarkably weak. But a number of the large high-income economies are still languishing well below their pre-crisis peak output: Japan, Italy and the UK all fall into that category. These weak economies mean high unemployment, notably so in the US, and stagnant or falling real incomes for large parts of the population.

The crisis has also resulted in large fiscal deficits and a rapid rise in public sector debt in a number of important high-income countries. This is particularly true for the UK and the US, where the crisis hit particularly hard, and Japan, which entered the crisis with an already weak fiscal position. Other important countries, notably Italy, entered the crisis with large public sector debts even though their deficits remained under control.

Nothing better reveals the economic weakness of the high-income countries than the fact that at the time of writing, in the summer of 2012, the four most important central banks in the developed world had official intervention interest rates of ¾ per cent or less, not to mention a host of unconventional policy

measures. Moreover, long-term interest rates on the bonds of safe governments were near to, or below, all-time lows. The state of these economies may be best described as a 'contained depression'. Nothing suggests that the most important developed countries will escape from this condition soon.

The crisis then has bequeathed severely weakened high-income countries: large private sector debts; heavy public sector debts; weak economies; and high unemployment. To a varying extent, these countries must also cope with ageing populations and stagnant or even declining work forces. Thus, the current difficulties have brought into the present what was set to be an indefinite period of fiscal strain and economic weakness.

In brief, the crisis has revealed, caused and worsened significant weaknesses in the economies of high-income countries. But no more important fragility stands revealed than that of the eurozone. The external imbalances and associated credit booms characteristic of the global crisis ran right through the eurozone, dividing creditor from debtor countries.

Since the crisis broke out in 2010, it became evident that the eurozone, as constructed, was unable to cope with the consequent economic, financial and fiscal stresses. What the members have had to do is attempt a rebuilding of a badly designed aeroplane while still in flight.

It is unclear what is going to happen inside the eurozone.

If all goes as well as can be imagined, the eurozone will experience a long period of weak growth punctured by periodic crises and accompanied by severe political stresses, while the necessary adjustments and longer-term reforms are slowly and painfully secured. This is likely to take the rest of the decade.

If all goes badly, the crises will be so severe that some countries will exit, voluntarily or involuntarily, in an atmosphere of intense resentment accompanied by waves of panic, and economic and social disorder. In this case, the European single market and perhaps even the European Union itself will be at risk. Terror over the consequences of such an outcome may well prove the main reason the euro will survive.

What are the implications of all this for the rest of the world? I suggest there are five.

First, the developed world is going to be a weak market for the indefinite future. For the businesses of the world, the advice has to be: "go south, young man." Southern markets are going to be the most dynamic and quite soon, the biggest for most goods and services.

Second, the possibility remains that the contained depression will turn into an actual one, possibly triggered by a meltdown in the eurozone and collapse of substantial parts of the global financial system.

Third, there is a substantial chance of severe protectionist pressure in the high-income countries, as the long-term nature of their plight becomes more evident. Such protectionism is likely to affect not just trade, but also openness to immigration and perhaps even willingness to export technology. The barriers to protectionism are strong nowadays.

Fourth, the high-income countries will be unable to provide positive leadership to the world economy, in general, and the trading system, in particular, over the coming years. If such leadership is going to come from anywhere, it will be from emerging economies, particularly large emerging economies.

Fifth, the configuration of the world economy is going to have to change in important ways. Export-led development strategies must be substantially modified. In particular, the possibility of sustaining domestic demand by running huge current account surpluses will be substantially smaller than it was before the crisis.

For India one can envisage three possible strategic responses. The first would be to change nothing, either because changing policy is too difficult or is deemed not to be worthwhile. The second is to conclude that the world economy is too dangerous to be trusted and so to turn away from it, once more. The third is to be a true leader in sustaining and developing the open world economy.

The first option is perhaps the most likely course. It is surely the easiest. But it would be a mistake. Over time, a country of India's

enormous size must take substantial responsibility for the world in which it lives. The crisis has merely brought this time forward. Furthermore, sustaining the open world economy is in India's own interests as a rising power.

The second would be a huge mistake. It remains the case that for a catch-up country, such as India, with a need to access the world's best technologies and managerial practices, openness to the world economy is essential and so is an open world economy. Moreover, participation in an open world economy is also the best guarantor of a dynamic and competitive economy at home.

That leaves the third option, which is the most difficult and also the most rewarding option. Like it or not, the crisis is thrusting greatness on China and India, two rising giants that are increasingly responsible for developing and sustaining an open world economy.

This last option has important implications for policy. The most obvious is that India cannot assume that it can be a free-rider. It needs to take into account the global repercussions of domestic policies. One aspect of this is that India needs to sustain the opening of its own markets, which is also in its own interests. But it also needs to develop its own views on the future of the world trading, financial and monetary systems and then act upon them. A credible plan for completing the Doha Round would be a good place to start.

The world economy is becoming a much tougher place. It will take determination and intelligence to sustain and develop the dynamic and increasingly open world economy that existed before the crisis. India has an opportunity to emerge as a leader. That is in the world's interests. It is in India's, too.