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28/8

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The Role of Governments in the Global Economy

in W. HUTTON and A. GIDDENS (eds), On the Edge: Living with Global Capitalism.

The world's top corporations are now engaged in a bout of unprecedented global merger, acquisition and concentration. They have become not only centres of concentrated economic and financial power; they have become bearers of the prevailing *laissez-faire*, globalist ideology. As their economic power grows, so does their political and intellectual reach, at the expense of nation-states that once balanced their private economic power with public purposes and national stabilisation policies. The very economic success of global corporations is taken as proof that their world-view has to be correct: that global *laissez-faire* is the optimal way to organise a modern economy.

Before examining that claim, it is worthwhile to consider the new context of corporate power. In the past, there were barriers of both law and custom against the current degree of corporate concentration. In the United States, the first period of intense industrial combination in the late nineteenth century gave rise to the world's toughest antitrust laws. Under the Sherman (1890) and Clayton (1914) Acts, and under state public utilities regulation, large monopoly corporations, such as the old AT&T, could operate only as strictly regulated monopolies. The theory was that these corporations were in industries with natural economies of scale, making competition inefficient and wasteful.

The regulatory regimes, therefore, protected such monopolies from competition, and they regulated rates and profit margins – but also prohibited the corporations from venturing off their own main lines of business. AT&T, for example, dominated the telephone business. Not only could no prospective competitor come in; AT&T could not use its economic power to venture out from its fortress, into other lines of business. While such public utilities in America were typically regulated private companies, in Europe they were often state enterprises. A side-effect of these regimes, of course, was that conglomeration across neither lines of business nor national boundaries was possible.

In Europe and Asia, competition policy was not as highly developed. Indeed, Germany and Japan explicitly permitted (and often encouraged) industrial and financial cartels. Because these cartels, conglomerates and state enterprises were instruments of neo-mercantilist national economic policy, merger among large corporations from different countries was almost unknown. Except for a brief period of acquisition and concentration among the oil companies, leading to such hybrids as Royal Dutch Shell, and direct foreign investment mainly by British and American multinational corporations, merger and acquisition across national borders was rare until the late 1980s. Books such as Richard Barnet's *Global Reach* (1972) were in a sense premature, if prescient, since they were dealing with multinational corporations venturing into export markets, producing overseas for foreign home markets and, later, outsourcing production – but not yet combining with each other into truly global behemoths.

The last decade of the twentieth century, by contrast, saw enormous mergers on a global scale, in industries where countries had previously guarded their 'national champions'. These mergers were partly facilitated by national policies of deregulation and privatisation. The mergers created, for the first time, genuinely transnational enterprises, in formerly fortress industries as diverse as banking, pharmaceuticals, telecommunications, aircraft and airlines, autos, insurance and, of course, information technology. Their existence changed the dynamics of assessing what was in the national economic interest, and seemed to mute earlier debates about industrial policy. It no longer seemed to matter whether Britain owned auto companies, as long as some auto production was located in the UK. In a famous article in the *Harvard Business Review* titled 'Who Is Us?' (January/February 1990) Robert Reich called on his fellow liberals to stop worrying about the national identity of firms and rather to concentrate on the location of production and, by extension, the quality of the national workforce. If Honda produced in Ohio, and even re-exported some American-made cars to the Japanese home market, what did it matter that its top management and most of its shareholders were Japanese? The British government, working with Japanese auto-makers, adopted this strategy even more explicitly. After all, truly stateless companies would eventually be owned by shareholders all over the world. If a nation wanted to pursue 'competitiveness', the trick was to have a workforce and a national regulatory climate congenial to multinational enterprise.

Thus did these giant corporations become bearers not just of goods and services, but of an ideology. And their commitment to this ideology was hardly armchair philosophy. They also worked politically to elect ideological confrères, to influence policy and to carry out global rules of engagement that made congenial habitats for themselves. They won allies in the financial press and in the economics profession. They invested large sums to promote compatible scholarship.

In 1999, the Clinton administration found itself caught up in a nasty scandal involving revelations that nuclear secrets had been stolen by the Beijing government from America's national laboratories. This did not deter American corporations from a furious lobbying campaign to extend 'most favoured nation' (MFN) trading status to China and to bring China into the World Trade Organisation. Other issues, such as China's human rights violations or its treatment of workers, as well as its flagrant espionage, fell by the wayside, and the Clinton administration faithfully embraced the corporate agenda. The large corporations were interested in their ability to outsource production freely to China and to sell in China's growing domestic market, eager to beat other corporations to deals. The corporate agenda became the national agenda. Indeed, in the run-up to the Seattle WTO ministerial meeting in November 1999, a 'host committee' chaired by the chief executives of Seattle's two largest companies, Microsoft and Boeing, became a quasi-official part of the American delegation, and seats at the host committee meetings were actually sold to corporate representatives; corporate goals for the session essentially drove out human rights and labour goals – and, remarkably enough, even national security goals.

Now, finally, corporations are becoming truly global and we are beginning to see mergers of former national champions yielding such improbable combinations as DaimlerChrysler and Upjohn+Pharmacia. In the 1980s and 1990s, publishing conglomerates based in Germany, the Netherlands and Australia owned the premier publishing houses in the UK and the USA. Such former fortresses as telecommunications, insurance and banking became fair game for mergers and acquisitions.

By the dawn of the new millennium, global corporations were both the carriers and beneficiaries of a hegemonic world-view whose essence went something like this:

There is one true path to the efficient allocation of goods and services. It includes, above all, the dismantling of barriers to free commerce and free flows of financial capital. To the extent that there is a remnant regulatory role, it is to protect property, both tangible and intellectual; to assure open, non-discriminatory access; to allow any investor to purchase or sell any asset or repatriate any profit anywhere in the world; to remove and prevent subsidies and other distortions of the *laissez-faire* pricing system; to dismantle what remains of government–industry alliances.

Thus, the remaining role for government should be mainly to assist this *laissez-faire* agenda. In the aftermath of the Asian financial crisis of 1997–8, conventional wisdom acknowledged something of a herd instinct in short-term speculative investments, with destructive results – but the remedy called mainly for tougher regulatory measures to assure 'transparency'. In other words, all that was really necessary was for Third World countries to become more like advanced industrial countries in their systems of corporate accounting and reporting, and in their supervision of banks and stock exchanges. This greater transparency in turn would lead to better informed investors, and the market in transnational investments would logically become more rational and less unstable – more like textbook economics. By the same token, conventional reformers called for measures such as refinements in the accords (defined by the Basle Committee on Banking Supervision) which set standards for banks, and for agreements that would 'harmonise' the tax laws, competition policies, intellectual property regimes, reporting requirements and other conditions of doing business across national borders – for the greater convenience of private business. Such harmonisation was almost invariably in the direction of reduced interference with flows of goods, services and capital.

This emergent regulatory role, of course, was very different from the regulatory role that nation-states assumed throughout the twentieth century, in several distinct respects. It was supra-national rather than national. The nascent supra-national agencies were undemocratic or democratically accountable only at several removes. Some were explicitly creatures of business itself – rather more in the spirit of global trade associations than global regulatory bodies – with little if any role for national governments.

Domestically, central bankers operate at one remove from political accountability. Globally, the IMF and the World Bank operate at two removes. The World Trade Organisation addresses issues of fair play that concern investors, but not workers or citizens. Even worse, the WTO lacks evolved rules of evidence, due process, public hearings, or the strictures against conflicts of interest that characterise courts in mature democracies. Moreover, while the regulatory role of the nation-state in the twentieth century was based on an understanding of the instability of *laissez-faire* and a necessary set of countervailing interventions, these new regulators were the opposite – institutions intended to enable *laissez-faire* to operate at its pleasure.

The more centrist of corporate ideologues agreed that the state might still have a residual role to play in subsidising the education and training of workers; in cushioning periodic dislocations; in financing pre-competitive research, and in providing (reduced) forms of social income. But the corporate community insisted that these remaining state activities be consistent with private sector implementation wherever possible; that tax levels be low and relatively flat; that public sector deficits be minimal; and that state-led economic stabilisation policies be scrapped as archaic, except in the case of monetary policy, whose paramount goal was to assure price stability.

This set of convictions and policies, in turn, was reinforced by the romance of the new information economy. The emergent consensus view held that the structure of the new economy comported perfectly with *laissez-faire* theory. *Laissez-faire*, on this account, was finally vindicated because of the immediacy of information flow, the frictionless ease with which supply could rendezvous with demand, the decentralisation of labour (which makes labour markets less sticky and more like goods markets) and the fact that technology truly enables markets to be global. Because of the swiftness of innovation and information flows, government could not possibly improve on the inventiveness of entrepreneurship; government could only slow things down. Hence, government needed mainly to get out of the way. Entrepreneurs needed to be free to move capital and production and to seek markets anywhere in the world, without political intrusion.

In this view, it was something in the structure of the old industrial economy, and not the essence of capitalism itself, that had led to the instability and inefficiency of *laissez-faire*. Imperfect information led markets to overshoot. Long lead times and rigid production schedules led to periodic oversupply and mismatch with shifting consumer tastes. The national boundaries around markets kept producers in advanced countries from accessing willing labour supplies in the Third World, and led to inefficient forms of national protectionism among the advanced countries, such as the European Union's common agricultural policy and the competitive subsidy of aircraft and steel production. Trade unions and archaic customs that were centred around the permanent business firm kept the price of labour from efficiently reacting to the demand for it, leading to bouts of unemployment in weak periods and wage inflation in strong ones.

The idea that social bargaining and state stabilisation policies might lead to non-inflationary full employment was now considered an outmoded concept. The new economy solved the problem, by making labour markets more like product markets, with the price of labour more variable and the supply of labour more flexible. Thanks to mobility of both financial and production capital, workforces are becoming increasingly 'virtual' – subject to easier adjustment of both price and quantity in response to shifts in demand. Because workers are increasingly paid a spot-market price, the cost of labour adjusts itself more as do costs in product markets. Enthusiasts also contend that these shifts allow workers to be paid more nearly in line with their actual contribution to marginal product. This increases inequality but also efficiency. Loyalty between worker and firm is also an archaic idea, since in a spot market loyalty is a sentimental and inefficient notion, and each transaction must be justified anew.

This general story of how the new economy works and should work is fervently held by today's captains of industry, who see themselves as the vanguard of a new, stateless elite. It is the subject of countless books, both scholarly and popular. This account is mainly held by the right but, with minor differences having to do with the role of the state in training workers and cushioning shocks, it is also embraced by the neo-liberal centre. Even some on the left, such as Michael Piore and Charles Sabel (in *The New Industrial Divide*), have argued that structural changes in the economy allow 'flexible specialisation' and short-term, customised production, substantially solving the problem of macro-economic equilibrium.

But is this new story essentially true? Has globalisation, in combination with the new information technology, truly led to a capitalism that is at last self-regulating as every *laissez-faire* prophet from Adam Smith to Milton Friedman has insisted? Or is it that the forms of instability have simply changed with the technologies, requiring different forms of state intervention? Moreover, how does the new economy affect the balance of political forces, on which the presence or absence of appropriate stabilisation policies depends?

Among the great political achievements of the twentieth century was the domesticating of *laissez-faire* capitalism's brute power, under democratic auspices. The nation-state accomplished this task in multiple ways. It pursued economic stabilisation and steady growth through an active macro-economic policy. It regulated the more self-destructive tendencies of markets, especially banks and financial markets. It empowered trade unions and put a floor under labour, and later created environmental standards. It provided social income in various forms of social insurance. It financed the education and training of schoolchildren and workers. And it made direct public investments.

All of this made for a more socially bearable, as well as a more economically efficient, brand of capitalism. It tempered capitalism's extremes, both the volatility and the inequality. Increased stability also enhanced the political and economic bargaining power of ordinary people, which rooted the mixed economy in a majority politics. These political majorities then reciprocated by providing reliable constituencies for parties that believed in a mixed economy. So strong was this consensus during the post-war boom that even centre-right parties did not dare challenge the basic social entente or the conception of what was required to domesticate a market economy.

Despite new technology, what has changed is less the fundamental dynamics of markets than the venue of their regulation and with it the balance of political forces. If markets are global, their regulators must also be global. But we have no global government (nor, probably, should we) and only the very weakest of transnational institutions of governance. Corporations, it is said gleefully, have outrun the writ of nation-states.

In principle, the shift to global *laissez-faire* is an unmitigated good because of the efficiency of the price system. From this perspective, the regulations and stabilising policies are mere 'distortions', whose elimination will produce only better allocation of economic resources. But this view ignores the fact that the domestic policy interventions were necessitated in the first place by irremediable market failures, in sectors of the economy where market forces could not by themselves optimise outcomes.

For example, financial markets still are prone to overshoot, and their speculative tendencies still risk spilling over into the real economy. A *laissez-faire* global monetary system still has an overall bias to deflation and slower-than-available growth. Curiously, the new architects of *laissez-faire* are not recommending the dismantling of central banks; they are not proposing that the advanced countries turn their monetary policy over to some faceless global entity; they are not abandoning the supervision of securities exchanges and banks. And in the face of speculative mornings-after in Mexico and East Asia, they were quick to rely on central banks and international agencies for rescue operations. All of this is tribute to the fact that even the prophets of *laissez-faire* do not entirely believe in it. Indeed, even if all transactions were perfectly 'transparent', herd instincts and speculative binges would continue to characterise financial flows. Since information is ever more quickly capitalised, the smart money has ever more of an incentive to get a jump on the pack. The speculative impulse never subsides, and with it survives the tendency of financial markets to overshoot.

Further, there are still very major sectors of the economy, whether international or not, where market forces do not price things correctly. These include health care and education, which display substantial positive externalities beyond the purchasing power of individuals, as well as research, public infrastructure, and other public goods. These sectors, all alone, equal something like 30 per cent of gross domestic product in the advanced countries. In addition, there are other economic sectors with scale-economies and monopoly tendencies, such as airlines, railways, power companies and the telecom firms. If these are not substantially regulated, monopoly pricing results. Further, market forces misprice the emission of pollutants. And *laissez-faire* leads to degrees of inequality of wealth and income that begin to compromise democratic citizenship itself.

In the area of labour markets, there is a high road to productive efficiency, and a low road. Regulations that compel decent wages and working conditions are a stimulus to technical progress. The employer who has masses of desperate workers at his disposal has little incentive to innovate. The ability of industry to outsource production to areas of the world with little or no social or environmental regulation undercuts political decisions to foster a decent workplace that reflect a century of democratic struggle. These collective, democratic decisions put a social floor under wages and working conditions. They coexisted benignly with the period of the most rapid, sustained growth in the history of industrial capitalism – the boom after the Second World War. But with globalism, areas of the world that insist on retaining such standards find themselves priced out of the market, in a general race-to-the-bottom. This reality does not mean that the market is 'correct' and the social standards are 'wrong'. It means only that there are many possible roads, that the market is myopic, and that whether we have such standards must be a political decision.

When critics point to the destabilising tendencies of global capital flows, they are often disparaged as simple protectionists or allies of special interest groups. But there is something more fundamental at stake. The fact is that the mixed economy of the post-war era was a magnificent achievement, and global free markets undermine the project of maintaining a mixed, managed and regulated economy at home, in several ways. Global *laissez-faire* pulls capital into corners of the globe where there is less regulation, which in turn makes it harder for the advanced nations to police their banks, stock exchanges and capital markets, as well as their social standards. So it is an entire economic system – its institutions, its politics, as well as its economics – that is undermined by the resurrection of *laissez-faire*, with great costs to stability, security, opportunity, growth and democratic citizenship.

Globalism also influences the domestic political balance, in favour of the forces that want more globalism. The century-old project of making raw capitalism socially bearable is undermined in countless ways by globalism. Domestically, there are regulatory mechanisms, and political constituencies. These are neatly swept away by leaving everything to markets in the name of free trade. The global market trumps the domestic mixed economy.

Labour and social democratic parties seem unable to deliver the benefits they once did: secure jobs, high and rising earnings, good social insurance. Working people either stop voting, as they have in the USA, or they internalise the values of the new economy and conclude that the lower economic horizons are their own problem. Globalism depoliticises issues that are inherently political. The slogan of the new economy might as well be: 'Anyone can be Bill Gates, and if you're not Bill Gates it's your own fault.'

Investors, who are free to move money to locations of cheap wages and scant regulation, gain power at the expense of citizens whose incomes are mainly based on wages and salaries. That tilt, in turn, engenders more deregulation and more globalism. The global money market, not the democratic electorate, becomes the arbiter of what policies are 'sound'. In this climate, a Democratic President, a Labour Prime Minister or a Social-Democratic Chancellor can snub the unions, but he'd better not offend Wall Street or the City of London or Frankfurt. Even the nominally left party begins behaving like the right party.

For democratic electorates, there are three possible approaches. The first is simply to let market forces rule, as the proponents of *laissez-faire* globalism recommend. This path carries with it a high risk of periodic crises, slower and more uneven growth than the economy is capable of attaining, widening extremes of income inequality, the removal of many properly political questions from democratic deliberation, and the steady dismantling of social protections in the advanced countries.

The second path entails the attempt to combine the free flow of goods, services and capital with some form of social investment. This approach is seemingly attractive and efficient, but at the end of the day it is politically naïve and inconsistent with the dynamics of globalism. An exponent of this course is the *New York Times* columnist Thomas Friedman, author of the recent best-selling book *The Lexus and the Olive Tree*. Friedman constructs a four-way matrix to describe different views of globalism. According to Friedman, one can be a 'free-trader' or a 'protectionist' as well as a 'safety-netter' or a 'let-'em-eat-caker'. People like Margaret Thatcher and Ronald Reagan are in the free-trade, let-'em-eat-cake quadrant. Arch-conservative nationalists such as Patrick Buchanan are protectionist but anti-welfare state; old Labour and the Richard Gephardt wing of the US Democratic Party, as well as most French socialists, are what Friedman would call protectionist and pro-safety-net. For Friedman (and most neo-liberals from nominally centre-left parties) the preferred quadrant combines free trade with the safety-net.

Intuitively, this neo-liberal recipe seems attractive: let markets set prices; let free trade and free movements of global capital work their efficient magic. If voters don't like the social or distributive consequences, use the state to temper the extremes and give the displaced new opportunities and skills. But this view is naïve. Tempering the excesses of the market requires substantial public outlay and regulation. Yet if the world is one big free market, capital tends to avoid nations that impose burdens on it. Moreover, as the founders of the post-war financial system at Bretton Woods grasped, leaving currency values and capital movements to financial speculators leads to competitive devaluations and deflation.

The very existence of *laissez-faire* unravels the safety-net. Social programmes are expensive and require either high levels of taxation or public borrowing, both of which are anathema to *laissez-faire* capital. Moreover, it is rare in practice to see the political groups that champion *laissez-faire* commercial policies also supporting expensive safety-net programmes. The very term 'safety-net' is misleading, since it connotes a Beveridge-style set of policies for those who lose out to market forces – income transfers to widows, orphans, the unemployed and the disabled – rather than a proactive set of policies to operate a mixed economy. Contrary to Friedman, mixing *laissez-faire* commerce with costly social outlay and regulation is a contradiction in terms, politically and intellectually. Either markets always optimise outcomes, or they don't.

The third path, therefore, entails the reconstruction of a mixed economy amid new institutional circumstances and challenges. And there are only two fundamental ways of doing this. Either nation-states reclaim some of the power lately commandeered by market forces, or new transnational institutions of governance must be devised, directly or via international agreements.

This has been achieved before. At the Bretton Woods conference, the architects of the post-war financial and payments system had a profound understanding of the deflationary bias of private financial speculation. Countries subject to the workings of private money markets were under pressure to maintain sound currencies; they would respond with slower domestic growth, and try to export their unemployment through protection or competitive deflation. At best, this would lead to global slow growth. At worse, as in the early inter-war period, it would lead to depression and a backlash of desperation and dictatorship and, eventually, war.

The IMF was intended to remove the business of exchange rates from these private speculative pressures, and to create a bias towards expansion. It is ironic that an institution that was created as a bolster against the irrationality of speculative private capital flows has turned certain countries into havens for speculators, and yet become an agent of gratuitous austerity.

During the Bretton Woods era, there was not free trade in currencies; rather, there was the legacy of capital controls from the Second World War, and there were ubiquitous non-tariff barriers. While more free trade was emerging within Europe, there was little low-wage competition from outside Europe or North America. This was also a period of high growth and full employment. In the mixed economy of the post-war era, for the first time in the history of capitalism, ordinary working people had rising living standards coupled with social supports and economic security. Our task is to reinvent a mixed economy for a new era, and to figure out what kind of global economic context is compatible with a managed market economy at home, and what kind of politics is necessary to support that project.

The new globalised information economy neither solves the problem of market inefficiency nor does it address the issue of what sort of mixed economy we should have. This is ultimately a political question and not a technical one. It simply poses old questions in new settings, and tilts the political balance against coalitions that favour a more managed form of capitalism.

The core issues of political economy are still exactly the same ones for which advocates of a mixed economy have struggled for more than a century. Far from addressing these tendencies towards instability and misallocation of resources, globalisation simply makes the project of stabilisation and management more difficult, institutionally and politically.

We need, in short, a kind of global economic regime that allows the mixed economy to flourish at home. This means a global financial regime that slows down short-term, speculative movement of capital and currency trades. It means a trade regime that puts labour and environmental rights on a par with property rights. It means a financial regulatory regime with global standards, and an end to unregulated offshore havens. It means that the IMF and World Bank must be reclaimed as agents of growth and stabilisation rather than of austerity. It means conventions on taxation that prevent multinational corporations from playing national governments against each another for tax concessions. Some of this rebuilding of a mixed economy will entail the emergence of regional entities such as the EU. Some of it will involve the construction of much more robust institutions of global governance, which are not simply agents of *laissez-faire*, like the current WTO. It may require a new strategy of limiting *laissez-faire* trade to regions with roughly the same regulatory and social standards, but a retention of some barriers between this free trade area and areas that do not respect basic social standards – a shift from the principle of unconditional Most Favoured Nation treatment to a new form of conditional MFN intended to prevent that 'race-to-the-bottom'.

All of this, in turn, is based on democratic politics. Ironically, centre-left governments now simultaneously govern in every major European nation for the first time in history – London, Paris, Rome, and Berlin. Of the fifteen nations of the European Union, no fewer than thirteen are governed by democratic-left parties. Liberal democrats also occupy the executive branch in Washington and Ottawa.

This stunning convergence actually entails a double irony. Supposedly, this is the supreme capitalist moment. Yet in nation after nation, voters evidently don't like the effects of capitalism in the raw. At the same time, however, it is not at all clear that these very de-radicalised leftists can do much to temper the market. For the most part, their policies are slightly more benign versions of the same neo-liberal policies put forth by their centre-right predecessors. Indeed, many on the left have moved to the centre not so much out of choice or even political tactic, but because globalised capitalism seems to leave them little alternative. Left programmes can no longer deliver, in the absence of radical change in the rules of the global market economy. Those with a more venturesome view of taming global capital, such as Oskar

Lafontaine or Richard Gephardt, are largely marginalised within their own parties.

The question, then, is whether centre-left parties and governments can muster the imagination, the will and the strategy to change the current rules, to reclaim space for the mixed economy national policy. Europe still offers an alternative social model, but unless Europeans act in concert to challenge constraints of the global market, they do not have a viable economic model.

The collapse of the Bretton Woods system of managed exchange rates, in 1971–3, ushered in a period of slow growth. François Mitterrand learned painfully, as the first Socialist President of France during the early 1980s, that a nation that tries to grow faster than its neighbours is rewarded with a run on its currency. Since then, the market has grown only more powerful and the policy levers of nation-states more stunted. Even in a nation with fiscal discipline, tough regulatory strictures or generous social benefits (and the taxes required to pay for them) will frighten away investors. As a result, most centre-left governments are mainly reduced to accepting the discipline of the global market and tinkering around the edges. Their first priority is to reassure capital markets. In the USA, the Clinton administration is enjoying the effects of a somewhat uneven boom based on very orthodox fiscal policy designed to win the confidence of the Federal Reserve and Wall Street. Even so, new public outlay is still off the table and existing social programmes are in retrenchment.

On the Continent, where unemployment remains stuck at around 12 per cent, most left-of-centre governments are placing their bets on conservative fiscal policies combined with heroic measures to improve education and training. They hope to deregulate labour markets partially and to reform taxes that discourage job creation so that industry will take on more workers. However, they are somewhat ~~more~~ venturesome in their willingness to revise the rules of global capital flows.

In Japan, the ghost of Keynes hovers over, of all things, a liquidity trap. The Japanese government, pressured to revise its entire system along Western *laissez-faire* lines, is stuck in a 1930s-style depression. Rather than a serious programme of public spending, the government is offering modest increases in public works and handing out shopping vouchers. The risk-averse Japanese, as they do in hard times, are increasing their personal savings. Curiously enough, despite globalism, crises can still take different forms in different societies.

Globalism, as noted, undermines the capacity of the nation-state to regulate the conditions of labour and to pursue policies of high growth and full employment. Many centre-left parties, as a second-best, pursue their own brand of 'supply-side' programmes, intended to raise productivity and competitiveness by improving the quality of the workforce. This approach is fine as far as it goes, but it doesn't go terribly far. It is certainly sensible to invest public funds in better educated workers, lifetime learning policies and other measures to make the labour market work better. But these policies have their limits when macro-economic factors produce a climate of high unemployment.

Some centre-left parties are also promoting work-spreading measures such as a shorter working week. Yet as European employers emulate their American counterparts and turn to temporary workers and outsourcing, the assumption that the state can define what constitutes a 'normal' working week is unrealistic. With slow overall growth, mandating a 35-hour week with 40 hours of pay will produce inflation. But a mandatory cut in both hours and pay, while non-inflationary, will produce moonlighting, and defeat the whole purpose. Shorter working time is the fruit of higher growth, not the engine.

Labour market policies, by themselves, do not add up to higher growth rates. They can work as complements to a more expansionary macro-economic policy, but not as substitutes for it. The Swedish Keynesians figured this out more than four decades ago. The recipe is to run as hot a macro-economic policy as you dare without triggering inflation, and then complement it with active labour market policies to match well-trained workers with employers. When unemployment gets down to a level that runs the risk of wage inflation, you enlist the unions in voluntary wage restraint, and soak up the remaining joblessness with retraining sabbaticals and public employment.

But Swedish Keynesianism doesn't work very well any more. The culprit is the global economy. Global growth is held hostage to creditors and financial speculators. And countries with good wages and expensive social outlays find themselves priced out of the market. The prevailing, feeble form of social democracy is not likely to change this economic trajectory very much. And if tinkering is their only contribution, the current spate of moderately left governments will very likely be repudiated by the voters.

There is an alternative to simply accepting a downward convergence of wages and benefits as an inevitable price to be paid for the 'efficiency' of the global market. But this alternative will require a fundamental shift in how centre-left governments view global capital. For the most part, American liberals and European social democrats have not challenged the neo-liberal view that all prices are efficiently set by markets. Yet there is a surprisingly strong dissent being voiced by mainstream economists who hold that there is one major exception to this rule – the price of currencies and the flow of global capital.

In the past few years, such mainstream economists as Jeffrey Sachs of Harvard, Paul Krugman of MIT, Barry Eichengreen of the University of California at Berkeley, Joseph Stiglitz, formerly of Stanford and the Clinton White House and now chief economist of the World Bank, and Jagdish Bhagwati of Columbia, formerly economic adviser to the director-general of the GATT, have all challenged whether free flows of capital and *laissez-faire* setting of currency parities actually optimise outcomes.

In the May–June 1997 issue of *Foreign Affairs*, Bhagwati, one of the most eminent and passionate of free trade economists, wrote a startling article contrasting trade in goods with trade in capital and currencies. 'Only an untutored economist will argue', Bhagwati wrote, 'that free trade in widgets and life insurance policies is the same as free capital mobility.' The reason is simple. Trade in ordinary goods and services tends to reach equilibrium. But global capital markets often tend to overshoot, pricing currencies wrongly, pouring capital in and yanking it out, doing serious damage to the real economy.

A good case in point is the Asian crisis. Foreign capital seeking supernormal returns abruptly swamped these newly liberalised capital markets. When overbuilding ensued and returns began sagging, the capital rushed out, devastating the currencies and economies. Bhagwati wrote, 'When a crisis hits, the downside of free capital mobility arises. To ensure that capital returns, the country must do everything it can to restore the confidence of those who have taken the money out. This typically means raising interest rates.' But higher interest rates only deepen local recession. Investors are 'reassured' at a devastating cost to the real economy.

The IMF, which comes in to 'restore confidence' (and supervise a fire sale) often serves as a handy scapegoat. But the deeper problem is the neo-liberal regime and its encouragement of short-term speculative capital flows to fragile economies in the first place. And those same speculative capital movements constrain the policy options of advanced economies.

Systemically, the effect of free capital mobility is not just periodic crises but a deflationary bias for the system as a whole, as nations competitively manipulate interest rates and exchange rates to reassure investors. In a downturn, this can take the form of competitive devaluations, as in Europe in the 1930s and Asia in the late 1990s. In an inflationary period, it can take the form of high real interest rates, as in Europe and America in the 1980s. The common effect is needless instability, creditor hegemony, slow growth and pressure on nations to jettison high wages and decent social benefits.

This critique is also tacitly shared by the world's finance ministers and central bankers. For although global capital flows are more or less free and currency values are more or less set by market forces, governments and central bankers do recognise, if only through periodic *ad hoc* interventions, that the stakes are simply too high to let speculative capital and currency swings determine the fate of the real economy.

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Five times in the past two decades, the great powers have intervened in very significant ways to counteract the impulses – and the damage – of speculative forces in capital markets. These included the concerted intervention in late June 1998 to prevent the yen from crashing and taking the Asian economy with it; the Mexican rescues of 1983 and 1995; the Louvre Accord of 1988 to stabilise the dollar against the yen; and the Plaza Accord of 1985 which produced a period of co-ordinated reductions in interest rates.

Note that three of these occurred during the Reagan/Thatcher era, under administrations that elsewhere were fiercely committed to free markets. Note also that the recent co-ordinated moves to shore up the yen were undertaken out of fear that a weakening yen would trigger a chain of devaluation throughout Asia and very serious recession – which would lead to more irrationality in the market. Western powers have pressed the Chinese to continue pegging the Hong Kong dollar to the US dollar and to continue defending the Chinese yuan – two more violations of the idea that currency values should be set by market forces.

But while Western governments are willing to engage in *ad hoc* interventions to contain crises, they are uneasy about returning to a more regulated regime for private capital flows and exchange rates. However, re-regulation of capital flows is precisely what is needed if left-of-centre governments are to reclaim the capacity to pursue policies of high growth and social justice.

Casual observers of the mid-century economy failed to appreciate the importance of the Bretton Woods system. Bretton Woods fixed exchange rates. But by committing central banks to collectively support the fixed rates, it also precluded speculative currency trade and capital movements. The latter was its more important achievement. Regulation of global capital thus created a shelter under which it was possible for national governments to build high-employment, high-growth welfare states, free from the downward competitive pressure of global money markets.

The question is whether the concert of centre-left governments will now take the next step and also pursue strategies to limit speculative global capital flows. For example, Professor James Tobin's proposed tax on financial transactions, long scorned by free-market economists, is getting a respectful second hearing, as analysts look for ways to rein in private global money markets. Another good idea was devised by Chile, certainly no enemy of free markets. The Chileans required any foreign investor to place 30 per cent of the amount of the investment on deposit with the Chilean central bank for a year, as insurance against capital flight. They suspended this requirement in 1998, because their more *laissez-faire* neighbours were successfully competing for capital. But a global regime that rewarded longer-term cross-border investments and punished purely speculative ones would be salutary. Such measures move the world back towards regulated capital markets. Removing currency values and capital movements from purely speculative swings and resulting recessions such as the current Asia panic would allow both higher growth and more managed national economies.

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Corporations, who live and die in the real, as opposed to the financial, economy, ought to be receptive to such measures. They were, after the experience of the Great Depression. But today's corporations, whether financial or industrial, are caught up in the romance of *laissez-faire*.

So it falls to the world's democratically elected governments and their citizens to take these questions seriously – to save the market system from its self-cannibalising tendencies, to create more domestic room for policy and to allow the world a higher rate of growth. The ancient question of how market forces need to be tempered for the greater good of the economy and society is now a global one. Either the irrationality of global capital flows will be harnessed once again by democratically elected governments, or those governments and their democratic electorates will continue to be enfeebled by the world's money markets. It is depressing to end a chapter by musing that it will take a crisis to stimulate a fundamental change in conventional thinking. But with so much of the sheer political and economic power cutting in the opposite direction, it is hard to see how imagination and foresight alone can achieve a dramatic change of course.