

JEFFRY FRIEDEN

Professor at Harvard University's Department of Government

The question of the hour is whether global capitalism can survive a global crisis, and if so, what kind of global capitalism it will be. To shed some light on potential answers to these questions, I suggest two lessons from the past, two lessons from the current crisis, and one set of expectations about the future.

There are indeed important lessons to be drawn from the past, relevant to current circumstances. The world economy was tightly integrated before 1914 and for some years afterward. This was a first era of globalisation, in which goods, capital, people, technology, and ideas travelled across borders more or less as freely as they do today. That first era of globalisation was a success on many dimensions, and it also survived many crises, or panics as they were called at the time. However, it did not withstand one great panic, and succumbed in the 1930s to what turned out to be the final crisis of the first age of globalisation.

I draw two lessons from the positive experience of the period before 1914 and the negative experience of the interwar years. The first is that an open international economic order requires systematic, purposive, concerted cooperation among national governments. There was a widespread view in the 19th and early 20th century that the international economic order was self-regulating. International markets may have been self-correcting, but the international economic order, that is, the system itself, relied upon cooperation among governments, especially upon cooperation in times of crisis. An open international economy requires cooperation among governments.

The second lesson is closely related, and that is that governments can and will work together only if they have the domestic political support necessary to undertake the policies associated with international cooperation. National governments are, after all, responsible to their constituents, and if their constituents are hostile or indifferent to the international economy, governments have little incentive to undertake the activities necessary to sustain an open international economic order. Without that cooperation, an open international economic order cannot survive.

The first lesson from the current crisis is that governments remain central to the international economy. There was a common view in the early days of this era that the globalisation of markets would make national government policies either impossible or obsolete, that is, that markets would make it very difficult for national governments to undertake independent policy. Some people looked upon this possibility with fear, while others did so with longing. What has turned out to be the case, especially in the current crisis, is that what governments do is, if anything, even more relevant today than in the past. The crisis, after all, cannot be understood except as a more or less direct result of national government policies.

The crisis is in many ways the result of American fiscal and monetary policy, of Chinese currency and reserve policy, and of financial and regulatory policy on the part of dozens of countries. Markets are exquisitely sensitive to what national policies are, so national governments remain a central component part of the contemporary international economy. Capital flows have in fact been driven largely not by underlying differences in factor endowments but by government policies.

The second lesson concerns the impact of today's globalisation, especially financial integration, on the transmission of economic impulses from country to country. We have seen in the current crisis how the extraordinary depth and breadth of today's international financial linkages leads to an extraordinarily rapid transmission of economic trends from country to country in a matter of minutes. That transmission can be of good impulses, bad impulses, and in some cases disastrous impulses. The world economy is so tightly tied together, especially financially, that there is a much quicker and greater effect of national government actions on other governments than there has been in the past. These are the externalities that are imposed by individual governments on other governments.

Financial integration, and the speed with which externalities are transmitted from country to country, heightens the stakes in international cooperation. The future of capitalism depends on cooperation among governments; and cooperation among governments depends on their willingness and ability to take account of the impact of their policies on other nations.

The world economy has followed a particular model or pattern of economic growth for the past 10-15 years. It is no longer sustainable. One group of countries relied for its economic growth on debt-financed consumption and, to some extent, investment. They relied on borrowing from the rest of the world to finance an extraordinary increase in consumption and economic activity while another group of countries relied on exports to the first group as their engine of economic growth.

These are the global macroeconomic imbalances that we have been talking about. There is nothing necessarily wrong with global macroeconomic imbalances, except when they cannot be sustained, and I would argue that the imbalances that built up over the past 15 years are no longer sustainable. There will need to be substantial economic changes, both among countries and within countries. It is clear what is implied by these changes. We are looking towards a period of austerity for the next 5-10 years in some of the deficit countries, a period in which consumption will have to decline, real wages will have to decline, and in all likelihood real living standards will have to decline. We know that will not be popular. The surplus countries will also have to adjust to a new economic reality. Countries that have relied for their economic dynamism on access to booming markets in deficit countries like the US, UK or Spain will no longer be able to rely on those particular markets as their engines of economic growth.

There will be substantial economic adjustments, whether in deficit countries or surplus countries, and these domestic adjustments are likely to be difficult, socially disruptive, and politically conflictual. Political conflicts over the adjustment process could well threaten the structure of international economic cooperation.

What do I think is likely to be the future of capitalism? The future of capitalism is a world in which national government policies are crucial, and a world in which governments can harm or help each

other with great speed and great effect. It is a world in which the international economy is likely to raise very controversial political issues both within and among countries, and in which these controversies may threaten cooperation among the nations of the world. It is a world in which we face substantial challenges in trying to reconstruct a just and open international economic order.