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Strong Governments Underpin Globalization

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The “great recession” has brought to light some of the foundations that underpin globalization, in particular state institutions required for guaranteeing private contracts, regulating businesses, providing money that allows transactions to continue, and propping up systemic arrangements of the economy. In the

conventional view of globalization these foundations have been obscured by those who believed that the market was trumping the state. A few writers had understood the critical nature of state power and had foreseen the possibility of such vigorous government action in an emergency as we have witnessed since September 2008. In this view globalization does not pit states against markets; instead, both are essential to the stability of economic processes across the world, but the state is the indispensable component.

Since the early 1980s in the United States and earlier in Britain and even earlier in New Zealand, governments have adopted neoliberal policies designed to reduce government participation in the economy, weaken regulatory agencies, privatize former government activities, and place great faith in the ability of markets to regulate themselves. These policies and the ideology that underlay them remained in place despite the need for significant governmental intervention to prevent economic disaster in the savings and loan crisis of 1988, the Mexican economic crisis of 1994, and the East Asian economic crisis of 1997. With the onset of the great recession in December 2007 and the financial crisis that made its appearance in September 2008, governments across the world have intervened to prevent the collapse of financial systems, bailing out banks, buying firms, and injecting large amounts of money into their respective national economies in an attempt to halt the hemorrhaging of jobs and to resume growth. In this case, governments have, in a halting and piecemeal fashion, questioned the premise that markets are self-regulating and have been putting forth legislation to build a more effective regulatory regime.

Piecemeal and half-hearted reform will probably do little to change behavior, so that we can expect the same risky business practices that led to the great recession will continue.

In the United States the president and Congress are promoting consumer protection legislation in the face of substantial resistance by adherents of failed neoliberal ideology and the financial services industry. The takeover of portions of the banking, insurance, and auto industries by the government of the United States included provisions for limiting the compensation of the twenty-five top executives of such companies. Underway are plans to reform bank regulation, and proposals have been made for removing government endorsement of ratings agencies. However, intermingling of elites from government and the sectors to be regulated as well as

the dependence of elected officials on the largesse in campaign contributions from the leaders of large economic units has led to the rejection of certain regulatory proposals and to resistance to a comprehensive analysis within the Financial Crisis Inquiry Commission that might lead to coherent reform. For example, in its new protocols for listing derivative instruments on a public exchange, the Obama administration has provided a loophole for exceptions for private trades. Although it seemed unlikely that the barriers between commercial and investment banking that had been in place since the 1930s until their removal ten years ago would be reenacted, Paul Volcker's appointment as an advisor in the White House improves the chances that barriers between commercial and investment banking may yet be erected. The administration has intervened within firms to limit the compensation of top executives and to restructure incentives, but almost no attention has been given to a preferable alternative, imposing marginal tax rates on high incomes of perhaps fifty percent on incomes of a million dollars or more up to ninety percent on those over five million dollars. Piecemeal and half-hearted reform will probably do little to change behavior, so that we can expect the same risky business practices that led to the great recession will continue. In time, then, another disorder will emerge that will require another massive intervention by the government. Because the regulatory system will have been tinkered with around the margins, the next crisis will be shaped differently in its particulars. Nevertheless the basic pattern of the government's stepping in to save the system from the unregulated missteps, fraud, and deliberately risky calculations will ensue.

There is an alternative path to be taken. First, a sharp distinction needs to be drawn between the government, on the one side, and powerful private economic actors in society. The distinction, at base, is an intellectual one, but it can be put into practice only by the government's assigning specific roles associated with setting rules and performing regulative tasks to itself and leaving business decisions within the constraints set to private firms. Just as the government needs to stay out of commercial decisions, it needs to keep private actors out of regulatory and legislative decisions; this can be done only by eliminating or at least minimizing private financing of election campaigns.

Second, in its regulatory capacity the government must draw sharp lines along several dimensions in the operations of the market. Among the most important is the restoration of the wall between commercial and financial investment banking as was embodied in the Glass-Steagall Act. Another border needs to be erected

between the task of rating investments and consulting for the firms being rated. In regard to the ratings agencies, they need to be separated from governmental endorsement.

Third, the government needs to correct flaws in regulatory steps already taken. For example, all derivatives trades should be required to be done through a transparent exchange, so the exceptions for “private trades” needs to be eliminated from the plan put forward by the Obama administration.

The fundamental shift required to advance globalization without the incalculable risks attending unregulated markets, especially in the financial sector, is to drop neoliberal ideology and recognize the essential functions that states perform, including the provision of security and stability in the international system and the effective oversight and enforcement of rules governing an economic system.

Fourth, the government must enact clear, relatively simple rules that have to be followed by firms and other private institutions. For example, a rule that sets minimum leverage standards for broad categories of loans would institutionalize prudence in lending. For example, the government could set a minimum down payment for any housing purchase at twenty percent of the sales price, and it could require that each commercial bank retain cash deposits equivalent to ten percent of its loans and that each investment bank maintain a cash reserve of ten percent of its assets.

The fundamental shift required to advance globalization without the incalculable risks attending unregulated markets, especially in the financial sector, is to drop neoliberal ideology and recognize the essential functions that states perform, including the provision of security and stability in the international system and the effective oversight and enforcement of rules governing an economic system. Business cycles will remain an inherent characteristic of capitalist economies, but they need not embody system-threatening features such as firms that are regarded as “too big to fail,” and they can be smoothed out considerably by prudent and effective monitoring and regulation by competent governments.

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