Multinational Corporations, Capital Mobility and the Global Neo-Liberal Regime: Effects on Northern Workers and on Growth Prospects in the Developing World

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In this paper we analyze two related aspects of the current globalization process. The first is the relation between the activities of multinational corporations(MNCs) and the economic well being of workers in the North. In particular, we ask whether the increase in capital mobility associated with the world-wide movement of liberalization, deregulation, and privatization has contributed to the problems of high unemployment, wage stagnation and rising inequality. The second concern of the paper is the impact of the evolution of the Neo-liberal global regime(NLR) itself on economic well-being in the North and South.

Here we make two basic arguments. First, Neo-liberal institute and practices tend to generate inadequate global aggregate demand growth and thus high global unemployment, unleash destructive competitive processes, and weaken government's

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ability to regulate business in the interest of the public. Second, the force of global Neo-liberalism is so powerful that it has become difficult if not impossible for countries to maintain non-Neo- liberal economic structure. (*JEL* Classification: F01)

I. Introduction

Concern that global economic integration might impede the development of social progress within nations is nothing new. Marx wondered whether the process of globalization would crush incipient revolution in his "small corner of the planet". Today we wonder whether the recent acceleration of globalization will crush all national aspirations for egalitarian and sustainable development.

In this paper we analyze two related aspects of the current globalization process. The first is the relation between the activities of multinational corporations (MNCs) – especially foreign direct investment (FDI) – and the economic well being of workers in the North. In particular, we ask whether the increase in capital mobility associated with the world-wide movement of liberalization, deregulation and privatization that we refer to as the Neo-liberal global regime (NLR) has contributed to the problems of high unemployment, wage stagnation and rising inequality that have plagued Northern workers since the early 1980s.

The second concern of the paper is the impact of the evolution of the NLR itself on economic well being in the North and South. Here we make two basic arguments. First, Neo-liberal institutions and practices tend to generate inadequate global aggregate demand (AD) growth and thus high global unemployment, unleash destructive competitive processes, and weaken government's ability to regulate business in the public interest. Since all these effects are harmful to workers, it is not surprising that countries in which ordinary citizens have fared best in the past twenty years are countries that have resisted the adoption of Neo-liberal institutions and policies. Second, the forces of global Neo-liberalism are now so powerful that it has become difficult if not impossible for countries to maintain non-Neo-liberal economic structures. We support this proposition by examining the collapse of the Swedish economic "model" in the early 1990s, and the long-standing attack on the East Asian "model" that recently culminated in the onset of the current Asian crisis.

We focus on the effects on MNCs and FDI on Northern workers in Sections II through V of the paper. Sections VI-VIII deal with the even broader question of the impact of the NLR itself on prospects for strong and equitable economic growth around the globe.

II. Five Views on the Effect of Capital Mobility on Economic Performance

We identify five views of the likely effect of MNCs and FDI on the trajectory of the world economy. We label these views "The Race to the Bottom", "The Climb to the Top", "Neo-liberal Convergence", "Uneven Development", and "Much Ado about Nothing". According to "The Race to the Bottom" view (Bluestone and Harrison 1982; Barnet and Cavanagh 1994; Greider 1997), capital will increasingly be able to play workers, communities and nations off against one another, threatening to run away if demands for tax, regulatory and wage concessions are not forthcoming. In this perspective, increased capital mobility benefits corporations, while workers and communities lose. A modified version of this view is that the winners in the race to the bottom will include highly educated and skilled workers, and those in privileged professions, no matter where they live. The losers will be the less killed and the unemployed everywhere.

"The Climb to the Top" view takes the opposite position. It suggests that multinational corporations are attracted less by low wages and taxes than by highly educated workers, good infrastructure, high levels of demand and agglomeration effects arising from the clustering of companies in a particular location. According to this view, competition for FDI will lead countries in both the North and the South to try to provide well educated labor and high quality infrastructure in order to retain and attract foreign investment (Reich 1992). Thus footloose capital and national competition for FDI will induce a global climb to the top.

This climb to the top could lead to the outcome represented by "Neo-liberal Convergence". This is the widely held mainstream belief that free mobility of multinational corporations, in the context of deregulation and free trade, will produce increased living standards in all countries. This process will, moreover, transfer capital and technology from North to South, thereby raising the standards of living of those in the poorer countries at a faster rate than those in the wealthier ones, eventually generating a world wide convergence in living standards (Sachs and Warner 1995; Williamson 1995).

These same processes could, however, lead to the outcome envisaged in the fourth view, "Uneven Development". "Uneven Development" holds that some regions of the world will grow at the expense of others. For decades the dominant version of this view was the theory of imperialism: if the South integrated itself with the North, the North would grow at the expense of the South. Now, the reverse fear holds: by forcing Northern workers to compete with cheap Southern labor, an integrated world economy will help the South grow at the expense of the North (Blecker 1995; Krugman and Venables 1995).

The previous four views take for granted that FDI and MNCs have a substantial effect on national economies. In contrast, the "Much Ado About Nothing" view (Krugman and Lawrence 1994; Gordon 1988) asserts that FDI and MNCs play a rather modest role in global economics. Adherents argue that FDI is still a relatively small percentage of national income and most of it is between rich countries; thus, FDI can generate neither convergence nor a race to the bottom.

Which of these views is correct? We cannot provide a complete answer, nor, we suggest, can anyone else, given the current state of knowledge.[1] In this paper is present a framework for thinking about these questions and develop a set of hypotheses about them which only future research can fully assess.

We argue that *foreign direct investment is neither inherently good nor bad; its effects are conditioned by the overall national and international context within which capital mobility occurs.* When FDI occurs in the context of high aggregate demand and tight labor markets, effective regulatory institutions, and non-destructive competitive processes, it may indeed have a positive impact on nations

[1] In fact, there is an enormous amount of recent research on these issues, much more than we can review here. See for example the excellent essay by Kozul-Wright, 1995.Also See the Journal of Economic Perspectives, Summer 1995, and Federal Reserve Bank of New York, Economic Policy Review, January, 1995, Vol. 1, No. 1 for recent surveys of this rapidly growing literature.

and communities. Absent these conditions, FDI can have destructive economic and political consequences on both home and host countries.

For example, during the 1960's in the US, outward FDI was of roughly the same order of magnitude relative to the size of the economy as in the 1990's. In the high employment, high growth era of the 1960's, FDI was more likely to increase exports from domestic companies, rather than substitute for them (Epstein 1993). But even when FDI led to domestic plant shutdowns, equivalent replacement jobs were much easier to find for workers and communities. As a result, the threat to run away did little to lower wages or shrink the tax base. By contrast, in the 1990's, with a chronic shortage of good jobs, government budgetary problems, and emaciated unions, workers and governments are much more likely to be adversely affected by capital flight and its threat.

We believe that within the structures of the current "Neo-liberal" global economic regime increased capital mobility is contributing to a race-to-the-bottom tendency. Within the Neo-liberal regime, there are strong *secular* forces which destroy the preconditions required for FDI to benefit workers and communities. These forces arise from key components of the Neo-liberal regime such as financial liberalization, privatization, increased labor market "flexibility", trade and investment liberalization, and austerity macro policy.

To be sure, at this point both capital mobility and the Neo-liberal model or "Washington consensus" have spread themselves unevenly around the globe. But as the NLR strengthens, negative effects of FDI and capital mobility will spread to more countries and communities, as the recent Asian crisis makes clear. So while our view is relevant to the explanation of current phenomena, it is, perhaps, more important as a cautionary tale about the future.

III. How Mobile Are the MNCs?

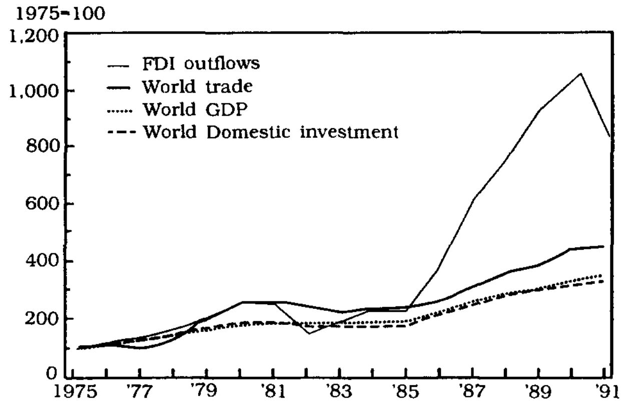
Many economists subscribe to the view that MNC's and FDI have little impact on national economic activity in general or on the development of the three largest problems facing Northern workers since the end of the Golden Age in the 1970s – wage stagnation, high unemployment, and rising inequality.[2] Their argument against the "race to the bottom" view in the North has a number of components. First, as noted, most FDI continues to go to the wealthier countries rather than to the low wage countries in the South. Second, even when FDI does go to the Southern countries, econometric studies show that wage and tax costs are relatively unimportant determinants of investment, compared with market size, political stability, and infrastructural investment. If FDI is not primarily attracted by lower wages and taxes in the South, how can it be driving down wages and taxes at home? Third, even if investment were mostly going to the South and were primarily attracted by low wages and taxes, FDI still constitutes a relatively small percentage of Northern investment.

Evidence can be mustered in support of all of these arguments. While there is an undeniable upward trend in the share of FDI flows going to developing countries in the recent period, more than 60% of the flows still go to the developed countries. Similarly, in 1994, developing countries held only about 25% of the stock of the world's FDI. This percentage is actually below what it was in the 1960-1970 period when 31% of FDI was located in the developing world. The stock of FDI is spread unevenly across the developing countries, with the least developed, lowest wage economies getting only 0.5% of the world's FDI (UNCTAD, 1997, and earlier issues).

However, it is important to recognize that there are serious problems with this data, perhaps the most important of which is that MNCs increasingly engage in international activities that do not necessarily involve foreign direct investment. These include licensing, joint ventures and outsourcing (UNCTAD, 1995, 1997; Feenstra and Hanson, 1996; UNCTAD, 1997). We do not yet know how to incorporate these activities into a single measure of the overall international mobility of MNCs, but their growth would certainly suggest that standard measures of FDI underestimate the activities of MNCs.[3]

[2]For an extensive review of the evidence demonstrating that Northern workers have indeed suffered from high trend unemployment, stagnant or only slowly rising wages, and rising inequality, see Mishel, Bernstein and Schmitt, 1997; Federal Reserve Bank of Kansas City, 1994; and Federal Reserve Bank of New York, 1995. All three sources also present and evaluate alternative explanations of the data.

[3]On the other hand, some FDI actually behaves more like portfolio investment and it is not known whether the share of such investment has been increasing over time.



Sources : FDI outflows and world trade : IMF Balance of payments Statistics Yearbook : world GDP and investment. The World Bank, International Economics Dept. unpublished data.

Source : Foreign Direct Investment: An Update, Jun 1993.

FIGURE 1

INDEXES OF WORLD FDI OUTFLOWS, TRADE, GDP & DOMESTIC INVESTMENT, 1975-91

Still, looking only at standard measures, one can see that FDI flows are growing rapidly. Figure 1 shows the increase of FDI relative to other measures of international interactions in the period since 1985. Clearly, *FDI has been growing much more rapidly than trade and other measures of economic activity.* FDI is a relatively small percentage of domestic investment in most regions, but there has been a big jump in the importance in FDI inflows in most regions of the world. In the developing world in particular, there was more than a doubling of the share of investment accounted for by inward FDI between the period 1981-85 and 1993 (UNCTAD, 1995). Finally, to understand the effects of FDI, it is important to look at *gross FDI flows*—inflows plus outflows—as well as net flows; we argue in section IV that under current conditions capital mobility per se, with its effect on job turnover or job churning, can have significant impact on wages, income distribution and the incidence of unemployment. Table 1 shows how gross FDI relative to the stock of capital has changed in recent years in different regions of the world; it demonstrates that *gross capital mobility has increased dramatically.*[4] In Asia, for example, it has almost quadrupled,

TABLE 1

THE RATIO OF FOREIGN-DIRECT-INVESTMENT INFLOWS AND OUTFLOWS TO GROSS FIXED CAPITAL FORMATION

	1981-1985	1986-1990	1991-1995	Memo:1995
All Economies	4.4	8.8	8.7	10.8
Developed Economies	4.9	11.3	9.0	10.7
Western Europe	6.9	14.6	13.6	16.2
Developing Economies	4.7	4.4	9.2	12.2
Latin America	4.3	5.1	10.0	16.2
Asia	3.4	4.1	9.2	12.7
S.E. Asia	2.2	5.0	10.7	14.7
Developing Economies minus China	5.2	4.8	9.2	10.3

Source: UNCTAD, 1995, 1997, *World Investment Report*, Annex table B5.

while in the developing economies it has more than doubled.

Why is capital mobility rising so rapidly now? The standard explanation, favored by mainstream and heterodox economists alike, is that dramatic reductions in transactions and communications costs spurred by the revolution in computer technology dramatically reduced the cost of creating or enlarging multinational production systems (See Barnet and Cavanaugh 1994). While technological change is undoubtedly important, recent years have also witnessed enormous change in what has been called the "*enforcement structure*" within which cross-national economic transactions take place (Epstein and Gintis 1992).[5] The domestic and international institutions and rules

[4]To get a full picture we want a measure of mobility within nations as well; but this will have to await future research.

[5]Epstein and Gintis (1992) propose the idea of an "international credit regime". Such a regime consists of both an "enforcement structure" and a "repayment structure". The "enforcement structure" is the set of institutions and practices, which creditors create internationally and in their home countries, to try to enforce their credit relations. The "repayment structure" is the set of institutions and practices which debtor countries try to establish to attract credit. In this paper, we will refer to the whole international credit regime as the enforcement structure to simplify the terminology.

which secure the property rights and enhance the prerogatives of multinational corporations have undergone a revolution in the last twenty years at least as dramatic as changes in technology and transaction costs. There has been a substantial increase in both developed and developing countries' willingness to accept multinational capital without restrictions, and to enter into treaties to protect the rights and privileges of foreign investors, real and financial. The North American Free Trade Agreement, while one of the most significant multilateral treaties offering protection to foreign investment, is by no means the only such recent agreement. Over the period, 1991-96, 95% of the 599 changes in countries' regulatory FDI regimes were in the direction of liberalization. "They mostly involved the opening of industries previously closed to FDI, the streamlining or abolition of approval procedures and the provision of incentives" (UNCTAD 1997, p. xviii). The enforcement structure has also been enhanced by bilateral investment treaties signed for the protection and promotion of investment. As of January 1, 1997, there were 1,330 such treaties involving 162 countries, a threefold increase in five years. Approximately 180 such treaties were concluded in 1996 alone. Moreover, the OECD continues its efforts to formulate a broad investment agreement—the Multilateral Agreement on Investment. Also of importance was the conclusion of the Uruguay Round of Multilateral Trade Negotiations and the establishment of the World Trade Organization (WTO). While the Uruguay round failed to achieve one grand treaty dealing with foreign direct investment, the UNCTAD concluded that the agreement "is of major importance for the investment climate around the world…" (UNCTAD 1994, p. 278).

This dramatic improvement in the effectiveness of enforcement structures helps explain the growth of FDI in recent years, and suggests that this upward trend is likely to continue, if not accelerate. In addition, the promotion by international agencies and others institutions of Neo-liberalism of the idea that FDI is essential for successful development has increased the desire of countries around the globe to attract and retain FDI. Meanwhile, the disintegration of the Soviet Union, and the evident discrediting of its economic model, along with decades of attempted sabotage of non-Neo-liberal development models by the U.S. and various international organizations has dramatically enhanced the *TINA* view prevalent among today's governments—*There Is No Alternative* to relentless liberalization, privatization and unrestricted integration into world markets. Finally, the rising demand for inward FDI has also improved the bargaining position of capital relative to labor, and undermined the ability and willingness of governments to create and maintain institutions and regulations that force FDI to enhance national economic independence and well-being.

IV. The Effects of FDI and MNCs: Theory and Evidence

While most mainstream theorists subscribe to the Neo-liberal convergence (Sachs and Warner 1996) or much ado about nothing schools of thought (Lawrence 1994; Krugman and Lawrence 1994; Slaughter 1995), there are a number of interesting mainstream models which predict uneven development rather than convergence from the joint impact of capital mobility and technological change (Krugman and Venables 1995). Johnson and Stafford (1993) also develop a model which shows that as technological development permits more outsourcing, the average real wage can fall while skilled wages rise. Markusen and Venables (1996) present a model of trade and investment in North and South which can be used to generate a number of possible outcomes: these include uneven development and a race to the bottom in which skilled labor becomes better off relative to unskilled labor in both the North and South. Another possibility is that as capital moves from the North to the South, skilled labor in the South becomes better off and skilled labor in the North becomes worse off. A recent book on globalization and labor markets by Dani Rodrik (1997) is especially important. Though Rodrik's model is neoclassical and assumes full employment, he concludes that gross capital mobility and trade, even between countries with similar levels of income, increases the elasticity of the demand for labor, and thereby negatively effects labor's share of income.

In short, there are numerous mainstream models of MNCs, trade, and technological change which allow for the possibility of either uneven development or a race to the bottom. *Even within mainstream theory, Neo-liberal convergence is only one of a number of possible outcomes, and, therefore, it has no theoretical priority over alternative views.*

Turning to econometric evidence, a number of economists, both mainstream and heterodox, have investigated the effects of FDI and technical change on the average level of real wages, inequality, and employment. Many early influential studies presented evidence that MNC's and FDI had only a small impact on inequality in the U.S. (Lawrence and Slaughter 1995; Slaughter 1995). Feenstra and Hanson, on the other hand, argue that the common definition of FDI used by Lawrence and Slaughter and others is too narrow. They adopt a broader definition of MNC outsourcing which includes imports by multinationals as well as the imports of intermediate or final goods used in the production of, or sold under the brand name of, domestic firms. Using this definition, Feenstra and Hanson found a substantial negative effect of "outsourcing" on the demand for unskilled labor in the U.S. According to their estimates, *"outsourcing" can account for 30-50% of the increase in the skilled labor share of wage income* (Feenstra and Hanson 1996, p. 243). While their analysis uses U.S. data, it is likely that similar results could be obtained in other OECD countries. Clearly, more econometric work will be required to more definitively establish the effects of FDI.

V. An Alternative Framework for Analyzing the Effects of Foreign Direct Investment and Multinational Corporations in the Neo-liberal Regime

In this section we propose an alternative framework for thinking about these issues. We argue that the growth of the NLR fundamentally altered the environment that conditions the effects of FDI on the lives of working people. As a result, capital mobility now contributes to wage stagnation, high unemployment and inequality in the North.

The general outline of our argument is as follows. We take an institutionally contingent "bargaining" or "conflict" view of the industrial relations process through which wages, working conditions and job requirements are determined, a view especially well suited for analyzing core Northern industries. In this view, the relative power of labor and capital are profoundly affected by AD, the institutional environment within which bargaining takes place, and the "competitive regime". In the institutional environment or rules of the game we include the legal, judicial and regulatory framework of bargaining, including restrictions on the domestic and international mobility of real capital, the character of enforcement of government regulations; the strength of unions, whether bargaining is done on a firm, industry or national level; the norms, conventions and informal understandings that shape the bargaining process; and the social wage that determines the fallback position of workers when bargaining fails.[6]

The rise of the NLR contributed in complex ways to key changes to the bargaining process that were harmful to Northern labor: it reduced the incomes available to be divided between the bargainers by lowering AD growth and raising the rentier share of income; it created a more destructive competitive environment that led firms to adopt aggressive anti-worker bargaining strategies; and it reduced workers' ability to resist corporate aggression.

We argue that in the NLR, forces operating to raise AD are structurally weak, while competitive pressure on firms to lower costs through downsizing or "labor shedding," speedup, and wage cutting are structurally strong. Given the sluggish growth of AD, competition-induced downsizing and speedup are creating a slow trend growth in the demand for labor. Even normal patterns of labor supply growth, therefore, generate persistent problems of excess labor supply, which appear in the form of "disguised" unemployment in countries—both North and South—without an adequate social wage.[7] Moreover, countries such Russia, India, China and the nations of Eastern Europe that were previously insulated to a substantial degree from the global capitalist market-place are now in a slow, uneven, and incomplete process of integrating themselves within it. Many of these countries have substantial quantities of skilled and educated workers who are low priced by OECD standards and thus provide MNCs with an attractive substitute for Northern workers. The NLR is creating secularly high unemployment in the North and elsewhere, destroying the institutions that sustained Northern workers' economic and political power in the Golden Age regime, and making capital flight easier and more attractive.

[6]See also Fortin and Lemieux, 1997, for an institutionalist explanation of wage determination and wage inequality.

[7]We thank John Eatwell for his insight on the subject of disguised unemployment.

Workers' bargaining power has thus been eroded by a dramatic rise in worker's fear of job loss, and an ongoing deterioration in their fallback position or exit option. Rising fear of job loss was caused not only by the increased incidence of actual job loss, but by relentless corporate "downsizing" and increased capital mobility, both within and between countries, which have raised the level of job churning—cycles of job loss followed by unemployment, then reemployment, usually at an inferior job. This has created an environment in which the *mere threat* to downsize or to run away is increasingly credible, and where even modest rates of downsizing and capital flight can keep workers and unions perpetually weak. It is our contention that all these factors creating unemployment, fear of job loss, wage stagnation and rising inequality are likely to increase in intensity as the NLR solidifies.

A. Changes in the Mode of Competition and the Institutional Environment of the Bargaining Process

The idea of a competitive "regime" and its affect on economic performance is discussed in Crotty (1993). In the "corespective" competitive regime of the early post World War II Golden Age, cooperating oligopolistic firms in key Northern industries took advantage of fast market growth and limits on both domestic and international competition to generate substantial, dependable profits and rents. Under the institutions and practices characteristic of the Golden Age, firms could accumulate capital without the excessive concern experienced in the NLR that national AD would fail to grow, that importers would steal their customers, that financiers would take huge chunks of their profit, or that investment would be made prematurely obsolete by the outbreak of fierce cost cutting battles over market share. High rates of investment and productivity growth followed. Strong unions, government support for the maintenance of a fair share for labor, distributive accords or understandings between capital and labor, and sustained full employment produced strong real wage growth, an increasingly generous social wage, and held inequality in check. Strong real wage growth in turn helped sustain the rate of growth of AD.

This regime broke down in the 1970s and early 1980s, partly from internal contradictions to be sure, but partly under the pressure of the increasingly open national borders associated with the globalization process. It was eventually replaced by a new regime of "anarchic" or "coercive" competition (Crotty 1993). The stronger the NLR becomes and the more mobile capital becomes, the more destructive competition will become.

Corporate response to these altered circumstances differed substantially across the OECD, though as time goes on the general direction of strategic change is becoming ever more convergent. We focus on the American response because, ideally suited to Neo-liberal ideology, it is clearly a harbinger of developments to follow around the OECD. The two most important aspects of corporate America's new competitive strategy in the late 1970s and early 1980s was the choice of conflictual rather than cooperative relations with labor and a withdrawal of support for an effective social "contract" that assured both full employment and the maintenance of an adequate social wage. The retreat from a full-employment macro policy and an attractive social wage severely weakened labor's bargaining power at the firm level, while new corporate policies of "speed up" and labor saving organizational and technical change poured recruits into the reserve army of unemployed workers. The corporate attack on labor included a war on unions, political support for stripping workers of their legal rights, the widespread use of replacement workers during strikes for the first time in the post World War II era, outsourcing and FDI.

It is crucial to analyze the effects of technical change on Northern labor markets in light of this competitive regime shift and the subsequent move to anti-worker corporate strategies. Under severe competitive pressure, companies took advantage of union weakness, a more business oriented government judicial and regulatory framework, and advances in information processing and computerized machine control to invest in technologies that helped them implement their anti-worker strategies. Where neoclassical economists posit exogenous technical change that just happens to be skill-biased, *we see instead an endogenous process in which corporations under intense competitive pressures chose to develop and/or adopt technologies that helped them reduce labor costs through downsizing, speedup and wage cuts*. Technical change in the 1980s probably was on balance skill-biased, though no more so than in previous decades (Mishel and Bernstein 1993). But it's distinctive characteristic was that it was *labor-saving and labor disempowering* as well. As such, it was ideally suited to help implement the more antagonistic industrial relations strategies of the new competitive regime with their emphasis on wage cutting for all skill levels except those at the top of the distribution. This strategy has contributed to both the sharp decline in median real wages in the U.S. in the past 15 years as well as to the rise in wage inequality of the period. Blue collar workers may have been the earliest victims of these changes, but white collar labor has been hit hard in recent years. This perspective is consistent with the "shifting wage norms" hypothesis presented in Howell (1994) who demonstrates that the 1980s shift to both wage cutting and skill upgrading took place primarily between 1979 and 1983 in the U.S. before the bulk of the information processing investment took place, and therefore was *strategically rather than technologically driven.*

Looking at wage determination in this bargaining framework helps undermine the "Much Ado about Nothing" view of MNC's in two important ways. First it suggest that the debate over the effects of FDI has focused on the wrong variable. Within a bargaining model what matters to outcomes is not unemployment per se, but the *perceived threat* of job loss. In the new environment of high trend unemployment and constant job churning due to greater capital mobility, corporate downsizing, and rising job loss from imports, *the threat effect caused by FDI and outsourcing may be substantial even if FDI and outsourcing are not very large.* Brofenbrenner (1997) reported on a US survey covering 1993 through 1995, which showed that 50% of all firms and 65% of manufacturing firms who were targets of union organizing campaigns threatened to close down and move if their workers unionized. Though only 12% of those firms which ended up unionized subsequently shut down, workers found the threats credible—where threats were made, unions lost a larger percent of elections. In the current environment, plant closings by even a few firms can create a wide-spread fear of job loss. Polls show that workers in the US live in constant fear that they will lose their jobs; in 1996 the New York Times reported that 46% of those polled were "worried" that someone in their household would lose their job within the next year.[8]

Second, adherents of the Much Ado about Nothing view argue that since most FDI is still within the North, it can't hurt Northern

[8]Extensive US survey data on people's attitudes about their employment status are reported in The New York Times, 1996.

workers. But *the threat effect of FDI depends on gross as well as net mobility*. At times like the present when there are never enough good jobs available, all experience of job loss, even job churning, creates job insecurity. Outward FDI creates job loss. Inward FDI does bring new jobs, but it is not costless to the workers, communities, and nations that get them. They must compete for these jobs against other workers, communities and nations by offering wage cuts, disavowal of unions, and tax breaks. *This competition for the jobs created by inward FDI thus itself contributes to a race-to-the-bottom process that bids down wages, worsens job conditions and cuts corporate tax revenues*. And as we have seen, gross FDI is large and growing rapidly. In the North, it almost doubled between the early 1980s and the early 1990s and is almost three times the size of net FDI.

B. Global Aggregate Demand Growth

We know that global AD growth has in fact been relatively sluggish in the quarter century since the end of the Golden Age and the birth of the NLR−in spite of the high growth rates experienced in Asia over this period. In Europe, for example, real GDP has grown since 1973 at about half its previous post war, so that even with relatively slow measured productivity growth, unemployment has risen to double digit or depression-era levels. Outside East Asia, the Neo-liberal era has been a low growth, high unemployment era. But is growth likely to pick up substantially in the coming years?

Consider the components of global AD. If our argument about labor-saving organizational and technical change in the North is correct, unless Northern AD growth picks up substantially, high unemployment and stagnant wages will continue to constrain the growth of consumption spending. Investment spending in the North has also grown at a modest pace in the past 20 years, and there are no strong reasons to believe that its trend rate of growth will increase substantially. Export growth had been rapid, but whether such growth can be sustained is an open question. Should the current collapse in Asia continue for an extended period, prospects for rapid global AD growth will be even dimmer. Indeed, belief that we may be entering an era of global deflation and persistent aggregate excess supply is growing rapidly. Deflation in the global market for goods is already with us.

Therefore, hope that future global AD growth will accelerate has to rest primarily on a belief that government macro policy—North and South—will be substantially more expansionary than it has been in the past 20 years. Yet there are many reasons to believe that macro policy is likely to be even more restrictive in the future than it has been in the recent past.

First, central banks around much of the world have adopted the Neo-liberal credo that pursuit of low inflation is their sole responsibility. In much of the South, this belief has been reinforced by the threat and reward structure of the IMF and the World Bank. Using the leverage gained by the Asian crisis, Neo-liberal forces are now in the process of imposing anti-growth monetary policy across that region. Second, the enormous buildup of government debt in the hands of both domestic and foreign rentiers over the past two decades has given them enormous power to punish both fiscal and monetary authorities who adopt expansionary policies. Third, both internal and external pressure has mounted in virtually every country to put a stop to the ongoing rise in government deficits and debt-to-GDP ratios brought on by the slow growth and rising unemployment of the Neo-liberal era. The upper limit on allowable government deficits in the Maastricht Treaty is but one important reflection of this restrictive pressure. In much of the South, rentiers, international organizations, and domestic elites have put enormous pressure on governments to follow "responsible" fiscal policies that guarantee low growth. And, in the aftermath of the current crisis, we can expect deflationary fiscal policies to be imposed by the IMF across Asia.

In sum, it seems unlikely that expansionary macro policy will cause an acceleration of AD growth capable of counteracting the effect on wages, unemployment and inequality of labor-saving technical, organizational and strategic change and increases in the global supply of labor should the Neo-liberal regime continue to expand and solidify. The *Wall Street Journal* expressed this view when it led off an article on the obsession with low inflation and deficit reduction shown by policy makers around the globe with the following sentence: "In the global economy, austerity reigns" (4/10/96).

C. Changes in Enforcement Structures and the International Rules of the Game

Until the late 1970's many countries, both in the North and the South, imposed numerous conditions and controls on the entry and domestic operations of MNCs. Up to that time, laws and policies to ensure national control over FDI were predominant, even in economies favoring foreign investment (Fatouros 1996, p. 47). As we have seen, this is now changing dramatically. The general trend is toward much stronger protection for foreign investors and increasing constraints on the ability of host governments to regulate their activities. By weakening host governments ability to see to it that FDI contributes to national economic objectives, the evolution of enforcement structures is making it more and more difficult for states to achieve equitable national development. The effect of all the new agreements deregulating MNC activity will be to enhance the bargaining position of mobile capital relative to workers and governments.

Thus, our alternative framework suggests that workers in the North can expect to continue to experience wage stagnation, high unemployment, rising inequality and deterioration in the social wage as the NLR strengthens and capital mobility continues to rise.

VI. National Institutions Matter

Having argued that all nations have had to confront debilitating economic pressures emanating from the emerging Neo-liberal global regime, we wish to emphasize that *there are enormous differences across countries in the institutions, structures and social and political priorities that intermediate between firms, workers and governments on the one hand, and MNCs, international rentiers, international organizations and global markets on the other*. We believe that these structures have made a significant difference in the way national economies have experienced global economic forces and responded to them. Many nations in both North and South have been hurt badly by the impact of the Neo-liberal regime, while others have been able to operate reasonably effectively within it. *Thus, it is not possible to enunciate universally applicable principles concerning the effects of globalization in general or FDI and MNC's in particular on* *workers, citizens or national economic performance: the character of these effects is institutional and regime contingent.* However, it must also be acknowledged that *the national institutions that have protected workers from many of the harmful affects of globalization over the past twenty years are deteriorating under Neo-liberal pressures*; no national economy has come through the experience of increased global integration with its institutional structure and its economic performance unscathed.

Consider first the proposition that institutional structures filter and transform even as they transmit the effects of globalization on national economies. In the "South", the state-guided economies of the East Asia have taken advantage of increased global openness to industrialize and grow. Their institutions enabled them to interface with global markets on terms that have been, until recently, favorable to them. In contrast, most other developing nations, particularly those in Latin America and sub-Saharan Africa, have suffered stagnation and rising inequality in the past 15 years. In general, *those countries in the South which have followed the Neo-liberal guidelines or the "Washington consensus" most faithfully have fared worst under globalization while countries that have performed best have done so using anti-Neo-liberal models*. But, as explained in Section VIII, it is also true that East Asia is currently moving toward greater international openness and less effective state intervention. Even prior to the onset of the recent Asian crisis, *the pressures of Neo-liberalism—exerted through markets as well as by MNCs, the US government, the IMF and World Bank, the WTO and GATT, and powerful MNCs—were becoming increasingly difficult for developing countries to resist*. The story in the North is similar. All countries have been affected by the pressures of globalization in recent decades, but some, by virtue of distinct institutions and political values, were been able to protect both workers and citizens from the worst effects of global competition for much of the period. Consider again the institutional bargaining process through which wages and working conditions are determined in the North. On the one hand, in the past two decades workers have fared best in those countries in which powerful institutions and regulations, such as national or industry-wide bargaining between unions and management groups and government legislation to influence wages, benefits and working conditions, have restricted the freedom of capital to dictate the terms of industrial relations. Structures matter. On the other hand, *globalization is almost certainly contributing to a decline in the ability of anti-Neo-liberal structures to protect Northern workers' interests.*

Both dimensions of the current reality are clearly presented in a recent survey of research on comparative industrial relations by Locke, Kochan and Piore.

> In all countries covered in this study, the individual enterprise has emerged as an increasingly important locus for strategy and decision-making on human resources and industrial relations. This implies that managers … have been the driving force for introducing changes in employment practices in recent years. This was not always the case. In the past, in most European countries and in Australia, national or industry-level union/management bargaining or even tripartite negotiations with government established basic wages, benefits and conditions of employment. (1995, p. 144)

They note that: "In almost every country covered in the study, various government regulations and norms governing recruitment, dismissal/redundancy, lay-offs and the allocation of labor have been relaxed or modified so as to give individual employers greater discretion" (p. 145); "Everywhere unions are in decline and management is resurgent" (p. 147); and "in all countries, there was a resurgence in inequalities in income or in employment opportunities" (pp. 151-2).

VII. The Neo-liberal Regime, FDI and the Destruction of the Swedish Economic Model

To see how FDI and Neo-liberal structures can interact with one another to create an economic and political crisis for workers, we first consider the case of Sweden, one of the outstanding Northern success stories of the Post WWII era. In the next section we look at the effect of globalization on South Korea's version of the East Asian economic "model".

Swedish MNCs have always been a dominant force in the domestic economy, accounting for 69% of manufacturing employment in 1970. Yet in the Golden Age FDI was probably helpful to Swedish workers and the Swedish economy. Outward FDI was modest through the 1970s. Given Sweden's record of sustained full employment, FDI was not a threat to domestic jobs, and under a centralized bargaining structure that had the allegiance of corporate leaders, it did not restrain wages or disrupt the ongoing decline in inequality. To the extent that outward FDI helped facilitate and maintain a high level of Swedish exports (through the maintenance of effective marketing and distribution networks), it helped Swedish firms take advantage of technical change, gain economies of scale, and achieve higher productivity growth rates than would have been possible if production were primarily for the small domestic market. At worst, FDI did not prevent the Swedish economy from posting an outstanding post war economic performance. Its impressive combination of sustained low unemployment and an egalitarian income distribution was maintained through most the 1980s.

However, by the early 1980s global instability, world recession and a falling domestic profit rate began to exacerbate emerging strains in the Swedish corporatist economic system. While unemployment remained extremely low, inflation picked up, creating problems in the crucial export sector. By the mid 1980s Swedish MNCs had become openly antagonistic to the set of traditional relations and mutual obligations connecting business, labor and the state that had come to be known as the "Swedish model." Lindbeck points to the onset of an "ideological offensive" by capital in the early 1980s designed to replace corporatist arrangements with a "more free market oriented position" (1997, p. 1277). Employers first pulled back from the centralized bargaining system. Sweden's "long-standing solidaristic wage policies followed throughout most of the 1970s gave way somewhat as business pushed hard to decentralize bargaining structures and to lower labor costs" (Locke, Kochan and Piore 1995, p. 151). They also pressured the state to deregulate the economy.

The threat of capital flight (moving operations overseas) and capital strike (refusing to invest at home) are two key structural sources of power business can use to pressure labor and the state to bend to its will. The ability of Sweden's MNCs to flee the domestic economy through outward FDI and to substitute foreign for domestic investment gave them leverage over labor (through the threat to jobs and wages) and the government (by making its traditional economic objectives impossible to attain). This leverage was magnified by technical change that made FDI easier, and by the evolution of the new global regime, which created external pressures to liberalize. Outward FDI was both a major contributor to the deterioration of Sweden's economic performance in the 1980s and, especially, the 1990s, as well as a powerful weapon used by capital to force its Neo-liberal political and economic policies on the rest of society. As Wilde noted:

> In seeking to move away from corporatist arrangement and to reduce the level of taxation (and with it social expenditure), the greatest threat of powerful employers is to move out of the country altogether, and this places a tremendous constraint on the ability of a social-democratic government to maintain corporatist arrangements (1992, p. 11).

Sweden's MNCs virtually fled the country in the second half of the 1980s. This created enormous pressure on both labor and the state to accept the MNCs Neo-liberal economic and political agenda. Between 1981 and 1992 outward FDI averaged an astounding 13.1% of domestic investment while inward FDI was just 3.2% of domestic investment (Glyn 1995, p. 44). But the "flow of outward FDI during the 1986-90 period was almost five times higher than in the 1981-85 period," so that the "Swedish share of the MNCs production had fallen to below 40 per cent by 1990," down from 61% *just four years earlier*, and from 72% in 1978 (Blomstrom and Kokko 1994, p. 5 and p. 34). Outward FDI went from one percent of GDP in the early 1980s to two percent by 1985, then sky rocketed to an unprecedented six percent (or 28% of all investment) by 1989. MNCs were directing the high profits of the late 1980s to finance outward FDI rather than domestic investment.

The problem was not just that this flight of capital cost jobs, income and exports. Having renounced their commitment to the domestic economy and to the institutions of the Swedish "model", Sweden's MNCs were hollowing out domestic manufacturing, exporting primarily the high value added, high-skilled parts of the production process to their foreign affiliates while leaving lower skilled raw material processing and intermediate goods production for their home operations. Blomstrom and Kokko argue that this FDI outflow harmed the economy in numerous ways: the big MNCs now employ a lower share of high skilled workers than the rest of Swedish industry; the fruits of Swedish R&D appear in their high-tech foreign operations rather than at home; and there have been serious negative spillover effects on domestic suppliers and subcontractors.

Capital flight made it difficult for the state to continue to play its traditional role. Under business pressure, the government began to dismantle important components of its regulatory apparatus. The domestic financial system was deregulated in 1985, which forced domestic interest rate upwards, toward global levels. Credit rationing had traditionally been one of the state's most important tools of counter-cyclical macro policy. Thus, the deregulation of domestic financial markets drastically reduced the ability of the state to avoid speculative booms and maintain full employment. Capital controls were weakened, then, in 1989, virtually eliminated. The dismantling of capital flows in turn induced a huge inflow of short-term foreign funds. This helped facilitate a subsequent explosion of credit-financed speculation, creating a cyclical upturn, but also over-leveraged households and businesses. When this speculative boom eventually went bust, the financial fragility it left behind constrained consumption and investment spending. In the absence of capital controls, funds quickly left the country, putting downward pressure on the krona that the government resisted through the maintenance of high interest rates right through the recession. The broad outline of this story will be familiar to observers of the current Asian crisis.

The MNC-led business sector was now in a position to launch an all-out assault on the remaining elements of the Swedish model. Glyn reports that their strategy was described by the *Financial Times* (8 November 1990), under the headline "Business plans five-year campaign to end Swedish economic model", as a plan "to destroy the vestiges of the famed Swedish economic model, with its collectivist values of equality and solidarity" (1995, p. 53). Stripped of many of the tools traditionally available for use in resisting recession, and pressured by its MNCs not to do so, the Swedish government turned its back on it's half-century old commitment to full employment and embraced overly restrictive monetary and fiscal policy (in part in order to converge to EC inflation rates as a prelude to hoped-for membership). The early 1990s saw the deepest recession since the 1930s. Real GDP fell by 5% between 1990 and 1993 and unemployment rose to unprecedented heights – from 1.5% in 1990 to 9.5% in 1994. Yet the government maintained high interest rates and restrictive fiscal policy.

There is no doubt that the Swedish model was destroyed by internal contradictions as well as external pressures: rising capital mobility was hardly the only threat to its reproduction. But it seems reasonable to conclude that the ability to "flee" the country gave Swedish MNCs enormous leverage in their successful campaign to change the structures of domestic industrial relations and the role of the state in the economy. The unprecedented flight of real capital in the 1980s, while to some degree a response to the economic strains that had developed in the late 1970s and early 1980s, clearly helped create the economic crisis that severely damaged the Swedish "model" in the 1990s and gave capital the power to shape the reconstruction of Sweden's political economy. Society was being forced to pay a high price, in terms of rising unemployment, falling real wages, rising inequality, and a deteriorating social safety net, to enlarge capital's freedom to seek profit wherever it saw fit.

Sweden's recent decline demonstrates that within the Neo-liberal regime, the greater the importance of MNCs in the economy and the weaker the state's control over cross-border capital flows, the greater the economic and political damage that MNCs can cause to domestic economic performance.

VII. The Neo-liberal Regime and Development in the South: The End of the East Asian Model?

Under the heading "National Institutions Matter" we made the following arguments: the effects of the NLR on individual countries are mediated by the distinctive institutions and practices specific to each; those countries that have achieved the best economic progress for the majority of their people in the Neo-liberal era are also countries that have consistently violated the principles embodied in the "Washington Consensus"; and, the pressures of Neo-liberalism are everywhere eroding those mediating institutions that have protected the interests of ordinary people from global forces generating wage stagnation, inequality, erosion of the social safety net and slow growth. In this section we consider the history of East Asia to show that the last of these arguments applies to developing nations.

Most of the developmental success stories of past three decades are in East Asia. Indeed, the outstanding economic performance of Japan, Korea, Taiwan, China and others over recent decades, especially in contrast to slow growth and high inequality in most other nations of the South, led to widespread recognition of an East Asian "economic miracle" and admiration for what came to be known as the "East Asian model" of economic development. Of course, recognition of the outstanding economic performance of these countries does not imply support for all aspects of their political economy. For example, democratic processes are severely constrained in many of these countries, attempts by workers to organize in support of higher pay or better working conditions have at times been met with brutal repression, and corruption in the economy and polity are not uncommon. Nevertheless, there is no denying that in countries such as Japan and Korea, enormous economic progress has been made in recent decades and prosperity has been widely shared.

Though the East Asian model is anti-Neo-liberal, the nations involved integrated themselves to varying degrees in international markets (though some, such as Korea and Japan, purposely minimized the role played by foreign MNCs and inward FDI). Export-led growth is obviously not autarky. But they did so, at least until recently, more or less on their own terms and in pursuit of their own economic interests, not in accordance with IMF and US free-market dictates.

Contrary to popular Western belief, there is no single East Asian model—each of the Asian "miracle" countries selected a different development path. Yet they did share one thing in common. Not one of these countries left its future development hopes to the vagaries of the unregulated market system. Development has been guided in every case by some form of *state-led industrial policy*, utilizing credit allocation, regulated and differential interest rates, government controlled Central Banks, prioritized and privileged industries and technologies, coordination of investment plans, regulation of labor markets, high state spending on education and infrastructure, managed trade, controls over the movement of money capital into and out of the country, regulation of inward and outward FDI, and so forth.

This is not to say that the key to, or cause of, their high growth was government planning; innovative private sector institutions and practices, such as the labor policies of the Japanese firm, the distinctive industrial structure of the Japanese keiretsu and Korean chaebol, close bank-firm relations, and high savings rates were of central importance as well. But the East Asian nations integrated state and private elements tightly enough, with the state in ultimate control, to earn such labels as "Japan Inc." and "Korea Inc."

Because they adopted sensible state-led industrial policies rather than destructive Neo-liberal principles, Asia became the only area of the globe to experience high rates of GDP and per capital GDP growth in the Neo-liberal era. Should the rate of growth in Asia slow down substantially for an extended period, the fundamental problem of inadequate global AD growth we have stressed in this paper would be seriously aggravated.

All of the East Asian models have evolved and adapted over time; no specific national political-economic structure can remain effective across decades of growth and change. The very success of particular policies and programs creates substantial structural change and generates impediments to further growth or to distributional equity. For example, rising real wages in Japan and Korea made it necessary for domestic firms to move production of low value-added goods out of the country, US threats of higher tariffs and lower quotas on auto imports led Japanese firms to put more emphasis on FDI in the US and less emphasis on exports to the US, and the enormous growth of Japanese financial institutions in the 1980s created internal pressure to loosen state controls over financial capital flows. Moreover, as middle and working classes became more educated and assertive, they fought for democratic political reforms, while stronger working class movements demanded a greater share in national income. For a variety of reasons, then, in the late 1980s and 1990s it became necessary to make significant changes in both state and private sector practices in all of the Asian countries. Over this period, debates arose in every country over how the structures of the "model" should be adapted. Most of the proposals for change involved some degree of deregulation.

Of course, the composition and perceived interests of various class strata had evolved over time as well. Powerful domestic financial and industrial enterprises and wealthy and politically influential families, having enriched themselves in the process of economic development through state-led industrial policy, now believed that substantial deregulation, especially of domestic and international financial markets, rather than revision or reform of state-controls was in their individual economic interest. The changes they pushed did not constitute a coherent or viable stable model, nor a full Neo-liberal package; indeed, they maintained allegiance to those dimensions of state regulation that continued to suit their interests.

Thus, *the issue was not whether change was needed—everyone agreed it was*, but what form change should take. The need to make substantial alterations in the various models of development arose endogenously; it would have occurred even in the absence of external pressure. However, this internal pressure for deregulation was strongly reinforced by the forces of global Neo-liberalism, which had increased in power throughout the 1980s and 1990s. The US and other large Northern countries, important transnational industrial firms and banks, global rentier interests, and world organizations like the IMF, the World Bank and the WTO came together to pressure Asian nations in the direction of full-blown Neo-liberalism. The ultimate objective of this array of Neo-liberal forces was the elimination of *all* aspects and variants of state-led industrial policy. The East Asian model was to be outlawed. Their position, pursued with increased aggressiveness after the dissolution of the Soviet Union, was that Neo-liberalism was now the only acceptable development model.

This brings us to the final proposition of section VI: *external Neo-liberal forces profoundly influenced, and in some cases may even have determined, the outcomes of these national debates by substantially altering the perceived costs and benefits attached to the various possible new development strategies and structures available.* In so doing, they empowered certain domestic class strata and weakened others. In other words, external global forces deflected structural change away from evolution within the tradition of the East Asian model, and toward the Neo-liberal path of deregulation, liberalization and privatization. For those who backed a free-market model, Neo-liberal forces offered ideological support, technical experts to support and help implement deregulation, and material incentives in the form of improved relations with the IMF and World Bank, access to international loans on attractive terms, military support from the US, and, most important, assured access to large Northern markets for their exports. To those who backed continuity with the general principles of the East Asian model, they offered political hostility and economic warfare. And, to state the obvious, it was the existence of the sophisticated structures of the

NLR – its markets and other institutions – that made liberalization a viable strategy.

The combined influence of this coalition of domestic elites and global forces turned out to be determinate in what we might call *Phase One* of these Asian debates, the period from around 1980 through mid 1997. At different times and to different degrees in different countries, governments which had formally regulated domestic financial markets, set interest rates, carefully monitored the allocation of credit, and orchestrated investment policy began to cede these functions to the private sector. In like manner, governments which had imposed controls on the movement of money capital across their borders, began to loosen them. Thus, conditions were constructed that could easily lead to super-heated Keynes-Minsky speculative boom and bust cycles; super-heated because if and when the inflow of foreign "hot" money became substantial, it would accelerate speculative fever. And, in the absence of capital controls, the bust phase of the cycle was likely to be exacerbated by a run on the currency by foreign and domestic investors. The downturn might even be initiated by such a run. It should have been clear by the end of the 1980s to anyone not ideologically blinded by Neo-liberal economic theory that if taken too far, deregulation of both domestic and international financial markets could be a potentially deadly combination of "reforms," particularly for countries heavily dependent on international trade and thus subject to serious destabilization in the event of excessive volatility in the exchange rate.

In the second half of the 1980s, credit-fed speculative booms appeared across Asia. Banks and other financial institutions feeding these booms became swept up in speculative euphoria as well. This was a major change for countries such as Japan and Korea in which the state, in the tradition of the East Asian model, had exercised tight control of the credit allocation process. Again at a pace that differed across countries, banks, industrial and commercial enterprises, and wealthy individuals took advantage of the erosion of capital controls to increase foreign borrowing.

This process accelerated in the 1990s. Foreign capital inflows to Asia rose dramatically as did the portion of these flows represented by portfolio investment. The existence of significant cross-country differences in interest rate levels quickened the pace of capital flows. Banks in Thailand or Malaysia or Korea could borrow yen at exceeding low short-term interest rates or US dollars at moderately low rates, convert the yen or dollars into local currency, and lend it to domestic borrowers at much higher rates. Large industrial firms could also tap these sources of funds directly. Borrowing yen short term to invest in long-term US treasury bonds became a fairly common practice. As long as the optimistic expectations of the speculative boom continued, there were always more than enough domestic borrowers willing to pay even very high interest rates for as much money as global markets could provide, and in the last few years at least, there was no shortage of international investors anxious to lend to Asians.

One might have thought that the collapse of the Japanese "bubble economy" in the early 1990s, which led to years of stagnation in what had been for decades one of the world's fastest-growing economies, would have alerted neighboring countries to the danger of domestic financial deregulation and a dramatic weakening of government oversight of financial markets. On the contrary, the Asian speculative boom picked up intensity, and in countries which relied much more heavily than the Japanese on short-term foreign borrowing. Predictably (given their ideological fervor), this deregulation process and its effects on the regional and global economy were certified as generally sound and healthy by the IMF, the World Bank, global investors and mainstream economists, who said it increased global allocative efficiency and would create a higher regional long-term growth rate. They continued to give the whole process their seal of approval right up to the day disaster struck the region in mid 1997.

If global Neo-liberal forces can be said to have been extremely influential in determining the evolution of the Asian economies in Phase One of their transformation, one might argue that they made a bold bid to take direct control of Asia's economic future in *Phase Two*—the ongoing Asian economic "crisis" kicked off in July 1997. Even Neo-liberalism's most persistent critics were shocked by the speed and audacity with which the US, the IMF, and international capital attempted to usurp control over key economic decisions from legitimate domestic agents in those countries hit hardest by the crisis. Though it is far too early to make predictions about how this crisis will play itself out, at the moment it does not seem out of the question that global forces may end up with near-Imperial control over the ongoing transformation of economic institutions and practices in several Asian countries.

Korea is perhaps the crucial case, both because its economy is by far the largest of the most threatened nations and because, next to Japan, it has produced the most impressive of the East Asian "miracles". Though no one would dispute that as of the mid 1990s Korea had a number of pressing economic problems that needed to be addressed, its economic record was extremely impressive. Real GDP per capita had grown by about six percent a year over the past two decades and real GDP growth averaged well over seven percent a year in the 1990s. Since inflation was low and the government budget was in surplus, the only troublesome real-sector "fundamental" was the relatively large trade deficit after 1994, which combined with a contemporaneous investment boom, contributed to the development of substantial excess capacity in key industries. On balance, the economy was thought to be in fairly good shape and had been certified as fundamentally sound by the IMF in 1997. Certainly, no respected observer predicted that serious problems would erupt in Korea in the foreseeable future.

On the other hand, Korea's domestic financial deregulation process, begun in the early 1980s, accelerated toward completion in the 1990s, and its borders were thrown open to short-term financial capital flows, thereby eliminating the state's ability to control speculation against the won. The 1994 to 1996 period saw a burst of liberalization related to Korea's bid for membership in the OECD. According to Amsden and Yoon: "In 1995, South Korea made a Faustian bargain with the United States. In return for membership in the prestigious OECD, it agreed to loosen almost all controls on financial institutions, both international and domestic" (*New York Times*, 11/27/97).

Financial deregulation did stimulate some elements of the Keynes-Minsky speculative process discussed above. The late 1980s witnessed a "bubble" similar to, though less destructive than, Japan's. For example, the market value of Korean stock leapt from 9% of GDP in 1985 to 57% by 1988 (Woo-Cummings 1997, p. 90). By the mid 1990s the effects of the deconstruction of short-term capital controls became evident; between 1994 and 1996 foreign banks more than doubled their lending to South Korea, from about $50 billion to over $100 billion (*New York Times*, 12/22/97). Almost all the foreign borrowing was done by the private sector, and most of it was short term. In contrast to other Asian nations, foreign credit to Korea appears to have been channeled primarily into industrial expansion by Korean firms at home and around Asia, though an unknown percentage of the loans was recycled by merchant banks into more traditional speculative activity.

By late 1997 Korean foreign debt had reached $160 billion. Almost 60% was short term, with about 20% due in the first quarter of 1998 (*New York Times*, 12/30/97). Borrowers had come to expect foreign creditors to automatically roll the debt over as it came due. But the situation was now objectively precarious. Excess capacity and falling profits had created problems in the quality of loans at many Korean banks. And a number of merchant banks were burdened by non-performing speculative loans as well. The ability of Korean companies and banks to pay off their foreign loans depended both on continued healthy earnings in local currencies and the absence of a decline in the their exchange values. The boom had thus evolved to a fragile phase, one that could easily be ruptured by any number of developments – a slowdown in domestic growth, further loss of export markets, or any other source of disappointing profits; rising domestic or international interest rates; a decline in the price of stocks or real estate; a refusal, for any reason, of foreign banks to roll over short-term loans, or a large fall in the value of the won and other Asian currencies. Yet no one seemed to notice the potential danger. No one called attention to the gross irresponsibility involved in making the well being of a country with a extremely domestic savings rate dependent on massive short term capital inflows and, therefore, on the whims of notoriously volatile global rentiers.

Of course, when the Asian crisis erupted there was a general flight of investor capital from Asian markets and Asian currencies. Foreign banks now refused to roll the loans over. Real and financial asset prices plummeted around the region, and exchange rates went into free-fall. After losing reserves in a futile attempt to support exchange rates, countries raised interest rates to try to stop the panic. The initial declines in asset prices in turn induced further "forced" asset sales by investors unable to meet their interest payments.

The Asian financial crisis pulled everyone down, the strong as well as the weak. The won lost about 20% of its value in the period before early December, when the IMF made its deal with Korea. Firms and banks with large dollar or yen debt were pushed toward bankruptcy and their desperate demand for dollars and yen kept downward pressure on the won. Interest rates rose again in response to a sharp upward re-evaluation of risk, while banks pushed near default began to refuse to extend credit to smaller businesses. Economic growth slowed and unemployment, almost unknown in post war Korea, rose—from 2% in November to almost 3% in December. A self-reinforcing cycle of declining growth, falling profits, rising unemployment, rising interest rates, falling interest coverage ratios, and rising bankruptcies was now well under way.

As the world watched in amazement and fear, the excessive, ill-conceived deregulation of recent years, induced in significant part by the bullying of external Neo-liberal forces, turned a number of Asian countries from economic miracles to economic disasters in a matter of weeks! The New York Times pointed to "the transformation of South Korea from industrial giant to industrial pauper" (11/22/97). Neo-liberal economists, who had been denying for years that the success of the East Asian miracles had been created by state-led industrial policy, insisting that it had been generated by free markets, now claimed that the crisis was caused by the same powerful but inefficient state industrial policies whose existence they had previously denied.

At this time (mid January 1998), only those most intimately involved with the negotiations leading to the US-IMF "rescue" of Korea know how and why they evolved the way they did. We do know that in the first week of December an initial agreement was announced by which the IMF, in concert with the US and Japan, would provide the Korean government with carefully staggered foreign currency loans that would sum, in the end, to about $25 or $30 billion. As the crisis deepened in the weeks after the agreement, the total grew to near $60 billion. The Korean government apparently believed that a huge IMF loan was necessary to avoid the economic problems that might follow large-scale defaults by Korean firms and banks on their short-term loans from foreign banks. This fear of default must have been extraordinarily deep seated because the government quickly agreed to virtually all of the IMF's unusually long list of unusually restrictive conditions.

It is not clear to all observers *why* the Korean government should have capitulated so quickly and completely to conditions so severe that they have been universally described in the Western press as the "humiliation" of Korea. First, all the debt was owed by private Korean businesses. The government could have taken the position, consistent with well established Neo-liberal principles, that if one private party violates a contract with another private party, that is no business of the state. Second, the dangers of mass default were widely shared. A failure to roll over the debt would indeed have damaged Korea, and might have led to a boycott by foreign investors (though history suggests that the boycott might evaporate once the economic crisis ended). But it would also have caused substantial damage to European and US banks, and significantly exacerbated the Japanese financial crisis. Moreover, it could have triggered a crisis and panic in the global financial system. Thus, it was not as if only one of the bargainers was threatened by a failure to come to an agreement. Given that both sides were under duress, and given that this was not public debt, it seems clear that the Korean government could have improved its bargaining position by aggressively threatening default. Third, when confronted with the full loss of their capital through default, many foreign banks might have been willing to negotiate roll overs with the least vulnerable of the defaulting banks. The Korean government might well have been able to impose a temporary moratorium on repayment coupled with a guarantee that payments would be made, by the state if necessary, over an extended period. Fourth, in retrospect at least, it seems quite clear that the problems that might have been caused by a failure of negotiations and subsequent default would not have been more damaging to Korea's economic health and independence or to the value of the won than the implementation of the IMF's "reforms".

According to press reports, the US was in effective control of these negotiations; American officials such as Robert Rubin and Lawrence Summers of the Treasury Department and Federal Reserve Chairman Alan Greenspan, apparently called the tune. When a tentative agreement been achieved, the US held the deal up for a number of days while it added numerous additional demands beyond those incorporated in the initial agreement. It seems clear that the US government, representing the interests of its multinational enterprises and wealthy investors, used the crisis to extort the Korean government into agreeing to a wish-list of structural and policy changes designed not to "save" Korea, but to force Korea to accept the dominance of American economic interests. If some domestic Korean interests supported important parts of the program, which they did, so much the easier for the US.

The breadth and depth of IMF dictates were referred to in the press as "unprecedented". Under US pressure, the IMF had acted not as a partner in Korea's attempt to survive the crisis, but in a manner more appropriate for an occupying military power. It demanded the total destruction of all remaining elements of the East Asian model, and their replacement with Neo-liberal institutions and practices—a transformation the US had struggled with only partial success to impose on Korea for several decades.

It is also worth noting that while the problem loans at the center of the negotiations had been mutually agreed to by domestic borrowers and foreign lenders, *all costs of the rescue were to be borne by Koreans*—firms, banks, government, workers and citizens. Foreign banks were guaranteed by the IMF not to lose a penny; IMF dollars would be immediately recycled their way. And this was by design, not necessity. The IMF could have chosen to offer foreign banks partial repayment over an extended period of time, which would have been a far better deal for them than the free-market alternative of default.

We list here some of the more important components of the agreement as culled from press reports. Most have nothing to do with legitimate IMF objectives or with easing Korea's economic situation; many will obviously make the crisis worse; and some simply reflect the wishes of US and other Northern corporate interests.

We begin with the demand for austerity. Though this was standard IMF medicine, it was here applied to a country which did not have the standard symptoms; unlike recipients of IMF aid in Latin America, Korea had low inflation and its budget was in surplus. The IMF insisted on cutbacks in government spending, an increase in (regressive) taxes, and a substantial rise in interest rates, which were already high in real terms. Initially the real GDP growth rate was to be halved, from 6% in 1997 to 3% in 1998. Subsequent deterioration of the economy under the agreement has led to revisions of the 1998 growth target to 1%, but private sources now forecast a decline in GDP for 1998. The interest rate on three month corporate bonds, which was 12% in November, rose to 30% in early January.

Other elements of the agreement reinforced austerity. The IMF demanded that problem banks be closed rather than preserved through merger and the injection of public funds. The large-scale forced closure of banks would obviously lower the supply of credit and disrupt essential bank-customer relations. The IMF also required that all banks meet the BIS target of capital in excess of 8% of liabilities by March 1998, and that they do so after deducting 100% of the value of nonperforming loans from their assets. While in mid January all but two of Korea's commercial banks could meet the target using the interim rule, none of them could do so under the 100% rule. The predictable effect of this IMF demand was a worsening of the ongoing "credit crunch"; to meet it, banks had to refuse to roll over most of their loans. Small and medium size businesses were being denied loans at any interest rate, so their bankruptcy rate has accelerated dramatically, causing yet further deterioration in bank loan portfolios and even greater pressure on banks to deny credit. Even firms that were in sound financial condition before the "rescue" are being forced to shrink or die by this disastrous IMF policy.

The combined effects of austerity macro policy and the banking "reforms" severely restrained domestic demand. These initial problems then started a "multiplier" process creating further decline. One of the strongest demands of the US and IMF is that Korea rewrite its laws restricting firms' ability to layoff workers, an important component of the traditional Korean "lifetime" employment policy. According to the agreement, Korea must increase labor market "flexibility" so that massive layoffs could take place, an objective that has the support of the chaebol. Though labor union resistance has thus far prevented changes in the law, unemployment is rising rapidly anyway. The projected 1998 unemployment rate is now put as high as 7%, a terrifying development in a country which has never know unemployment, which did not even have unemployment compensation until 1995, and where only a tiny percent of unemployed receive any public compensation at all. A January poll showed that four out of ten workers believed their jobs to be in serious jeopardy, a development sure to sharply decrease the propensity to consume. And, because the won had fallen an additional 30% *following the IMF agreement*, prices are rising and real wages are falling rapidly. We can see the multiplier at work here; initial constraints on investment and government spending, along with rising bankruptcies, created increased unemployment and fear of job loss, a collapse of consumer confidence, and falling real wages which, in turn, are creating a rapid decline in consumption demand.

It must be stressed that at this point no one knows precisely how much of the IMF program will, in the end, be implemented in Korea or how much resistance to its conditions, if any, Korean workers, businessmen and government officials will offer. Still, we can say with confidence that if fully implemented for a prolonged period, the IMF program will create austerity on a grand scale, and will increase, rather than relieve, Korea's (and Asia's) financial crisis. In June 1997 Korea had a reasonably sound real sector burdened with excess capacity and financial problems – a troubling but hardly catastrophic situation. The early Asian crisis heightened financial fragility. What was then needed was a period of moderate growth and moderate interest rates, with no increase in domestic or, especially, foreign indebtedness. Growth would create the cash-flow needed to service debt; modest interest rates would permit debt service without destroying companies' ability to sustain themselves. Thus, the IMF recession-plus-high-interest rate program was a cure calculated to kill the patient, not the disease, and likely to turn what was a serious problem into an economic, and perhaps political and social, catastrophe.

That the US-IMF program was likely to devastate Korea was hardly a secret. A *Business Week* editorial in December argued that "the medicine Asia is being told to swallow may make it sicker. The IMF demands that Asia cut growth and consumption. But that will hurt consumers, make for lower wages, and penalize the poor rather than the rich" (12/29/97). *The Wall Street Journal* reported that Joseph Stiglitz, former Chairman of the President's Council of Economic Advisors and current chief economist for the World Bank, along with "prominent Wall Street economists," were "wondering aloud whether the IMF is prescribing too much austerity" (1/8/98). Stiglitz cautioned that "you don't want to push these countries into severe recessions," which was exactly what the IMF programs were designed to do. The article noticed that relations between the World Bank and IMF had become "strained."

Other eminent economists agreed with Stiglitz. Jeffrey Sachs attacked the IMF program, calling it "folly" and an "indiscriminate punishment" of Korea. He argued that "the IMF's seal of approval is a seal of doom" (*New York Times* 12/18/97). In his view: "The region does not need wanton budget cutting, credit tightening, and emergency bank closures. It needs stable or even slightly expansionary monetary and fiscal policy to counterbalance the decline in foreign loans" (*New York Times* 11/13/97). Sachs believed that the IMF was squeezing Korea so that foreign lenders could "leave the field of battle unscathed". "Looking back", he said, "it's hard to imagine that the Korean won could have fallen any further if the IMF had punished the lenders rather than the borrowers" (*New York Times* 1/8/98). Paul Krugman suggested that default would have been better than the IMF program: it might "have been better to let South Korea declare a moratorium on foreign debt problems" (*New York Times* 12/18/97).

But the US-IMF program demanded far more than austerity and bank "reform"; it sought the complete destruction of the Korean "model" and the opening of all Korea's markets to unrestricted exploitation by foreign MNCs, banks and financial investors. The IMF demanded that the government end its control over central bank policy, and give up its influence over the allocation of credit by the private sector; credit allocation would henceforth be regulated solely by considerations of private profit. These steps would destroy the government's remaining ability to direct credit and provide preferential interest rates to targeted firms and industries, a cornerstone of the East Asian model. And experience suggests that independent central banks follow policies designed to minimize inflation at the cost of growth and employment.

The program calls for the elimination of managed trade; tariffs and export subsidies are to be drastically reduced or eliminated. This would end the ability of large Korean firms to use assured dominance of domestic markets plus export production to take advantage of the productivity growth associated with economies of scale, a practice that helped some Korean firms become major competitors to Northern MNCs in world markets expansion.

Legal impediments to the foreign takeover of Korean firm and banks are to be eliminated by early 1998. Even the prohibition against hostile foreign takeovers is to be ended. This represents such a great victory for Northern multinational banks and nonfinancial corporations (who have been trying for decades to more deeply penetrate Korean markets) and such a potential blow to Korean firms that they can be expected to try to find ways to subvert its intent. Foreign ownership of Korean commercial banks would be especially devastating in a system where large industrial firms have high debt/equity ratios even in normal times, and where bank-firm relations are an integral part of the nation's economic structure. The fact that the US and IMF insisted that these changes be adopted without delay demonstrates that their goal is to dominate Korea, not help it.

Even if we accept for the sake of argument that it is in Korea's self interest to open its firms and banks to foreign ownership, *it would be completely irrational to do so in the midst of the crisis.* Given the enormous drop in the value of the won and the collapse of the Korean stock market, as of mid January domestic enterprises could be purchased by American or European firms in their own currencies for about 30% of what they would have cost just six months earlier. Under the headline "Corporate Fire Sale Seen for Korea", the *New York Times* foretold of "a wave of foreign takeovers of its companies by American and other foreign corporations" (12/27/97). No one believed that the value of the won or stock prices were then at their "equilibrium" values; practically everyone believed that these values would be substantially higher in the intermediate, though perhaps not the near, future. Moreover, the desperate need of dollars and yen by many large Korean businesses makes them likely to accept even absurdly undervalued bids for segments of their business. No friend of Korea could possibly support this plank of the IMF program. What possible rational explanation can be found for this seemingly absurd IMF demand other than the material self-interest of Northern global interests?

The last IMF dictate we consider is the demand that the government remove all remaining restrictions on cross border financial flows. Hereafter, foreigners will be able to invest in the Korean financial markets on the same terms as citizens, and all restrictions on foreign investment by Korean nationals will be removed. Yet the complete elimination of capital controls over even the shortest-term speculative loans and investments appears to many observers to move Korea and the rest of Asia in precisely the wrong policy direction. The Asian crisis was made possible by the absence of adequate controls over short-term international capital flows. From about 1993 to 1996, excessive short-term credit flowed into Asia, financing speculation in real estate and financial securities, and overinvestment in industrial capacity. Then, when the speculative boom weakened, as all such booms eventually do, there was no way for affected governments to slow down the massive speculation against Asian currencies that followed. (China is an exception; it maintains strict control over short-term capital flows.) It was the collapse of these currencies that converted a difficult period into a severe crisis.

The damage done to Asian economies has caused many economists to reconsider their opposition to controls over short-term capital flows.[9] The *New York Times* reported on extensive interviews about the Asian crisis with economists attending the January meeting of the American Economic Association: "a common theme emerged that rules should be developed to discourage the sort of short-term borrowing that can suddenly leave a country like South Korea over indebted to the industrial nations. Korea drew criticism for having gradually eliminated restrictions on such borrowing" (1/8/98). The article reported that even Stanley Fischer, chief economist for the IMF, expressed approval of Chile's tight regulation of short-term foreign borrowing: "Chile had escaped a short-term debt crisis for more than a decade in part because that country had limited short-term foreign borrowing." Having been part of the IMF team that required Korea to eliminate all controls over cross-border money movement, at the AEA meetings Fischer suggested that "governments in Korea and Thailand place ceilings on how much their banks could borrow in foreign currency." Such IMF schizophrenia is not unprecedented. The Fund briefly flirted with support for inward capital controls after the recent Mexican peso crisis, only to revert to Neo-liberal orthodoxy view when the crisis was over.

It is risky to draw general lessons from the Asian crisis at this early stage. Still, some conclusions seem warranted. First, recent events in Asia add credence to the belief that the complete deregulation of short-term capital is a disastrous policy, especially for small or modest size economies. In concert with domestic financial deregulation, it opens the economy to severe boom-bust cycles initiated or magnified by the instability of global rentiers, who suffer from recurring bouts of euphoria and panic. Such cycles obviously make stable growth impossible, but their crash phase, if severe enough, can make the nation vulnerable to external pressure

[9]See James Crotty and Gerald Epstein, 1996, for a discussion of the economic and political arguments in favor of capital controls.

to adopt structural and policy changes that may not be in the country's long-term interests.

Second, many economists who believe that short-term financial flows should be controlled by the state also argue that longer-term financial flows and FDI should be free of such restraint. Our view is more nuanced and contingent. We have argued that FDI can be helpful to ordinary people in both home and host countries, but only if the supporting conditions are present. In Asia, Neo-liberal forces represented by the IMF, the US, and multinational business, often in cooperation with segments of domestic economic elites, are using the crisis to simultaneously force the area open to unrestricted real capital flows and destroy those conditions – adequate AD, effective state regulation of FDI, and non-destructive competition – that would allow FDI to play a helpful role in creating jobs and raising wages.

Third, the NLR is now in the process of eroding the basic right of the people of several Asian countries to national economic self determination. Across Asia, under both authoritarian and democratic governments, external forces acting solely out of self-interest have, at least temporarily, taken control of key economic decisions from national political authorities. They demand that the citizenry suffer the pain of recession, unemployment, falling wages, and deteriorating public subsidies so that global rentiers and MNCs can further enrich and empower themselves. It might not be wholly inappropriate to suggest that Western imperialism is creeping back into Asia in the wake of the current crisis.

Fourth, current events in Asia raise the question of whether global forces will allow any non-Neo-liberal national economic model to survive. As events in Asia evolve over the next few years, perhaps *TINA* – There Is No Alternative – will become a fact rather than a mere ideological tenet. On the other hand, as the "pain" of the crisis spreads around Asia, there could be a political backlash against the entire Neo-liberal program. Only time will tell whether the Asian crisis will strengthen or weaken the NLR.

Finally, most forecasts of Asian growth rates predict a sharp decline over the next few years. The Asian crisis has already led to a one percentage point reduction in the consensus forecast for global income growth in 1998. But we know that even when Asian growth rates were the envy of the world, global AD was sluggish, too slow to stop the rise in global unemployment. If Asian growth slows for an extended period, there could be dire economic consequences for working people around the world.

IX. Conclusion

Though this is not a paper about policy, a few broad policy conclusions are implicit in its analysis. We have argued that the growth of the NLR and of increased capital mobility within the NLR have been detrimental to the interests of Northern workers and to prospects for sustained, egalitarian growth in less developed nations. But we do not oppose increased international economic integration per se. To the contrary, we believe that trade and cross-border capital flows can be used to increase the economic well being of the majority of people in both North and South provided they take place within an appropriate international and domestic institutional and policy framework—one that supports strong and sustainable economic growth and low unemployment, maintains an appropriate power balance between capital, labor and the state, limits the more destructive dimensions of competitive processes, and empowers democratic political processes to exercise control over the broad contours of economic development.

We do not pretend to know the precise mix of markets and state and non-state regulatory processes that would be appropriate for every country, but two lessons might be drawn from the economic experience of the past two decades. First, nations must be permitted to possess far more regulatory power over domestic and cross-border economic activity than is now possible under the NLR. Second, it would be far easier for individual nations to achieve sustainable and equitable growth if the main institutions of the international economic and financial system valued such growth over the interests of global rentiers and MNCs, and supported rather than undermined such state economic regulation as was necessary to get the job done.

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