

MAS-ESS ESSAY COMPETITION 2002

The Role of the State in an Increasingly Borderless World

First Prize-Winner, Students Category

By

**Mr Seow Zhixiang
Hwa Chong Junior College**

THE VIEWS IN THIS ESSAYS ARE SOLELY THOSE OF THE AUTHOR AND SHOULD NOT BE ATTRIBUTED TO THE MONETARY AUTHORITY OF SINGAPORE.

Synopsis

Governments have always played a dominant role in the development of a country's economy. However, as the world increasingly comes to resemble a single integrated market, with paradigms that are markedly different from what has come to be known as the Old Economy, the manner and level of government involvement needs to be re-evaluated. This essay first of all outlines the parameters of the new global economy, how these differ from the old economic model and the potential benefits and setbacks in embracing the new model. It would look at how this would affect policymakers as they seek to harness the global economy while safeguarding their constituents from its worst excesses. It examines the necessary creation of new roles, the redefinition of old roles, the decentralisation of decision-making power to market agencies, and the problems countries will face in creating a globalised, knowledge-based economy. Changes to social structures and priorities will also be explored. Finally it stresses the necessity of international co-operation and consensus building in order for the fruits of globalisation to be more equitably distributed.

Introduction

The collapse of Communism and its advocacy of central planning in the preceding decade has been seen by many as the final triumph of capitalism. At the same time, developments in Information and Communications Technology have reached critical levels, enabling information to be processed and transmitted at a low cost on a large scale, with profound effects on lifestyles and businesses. In the following years, the world has come to resemble an integrated market, presenting us with an array of challenges. Chief among these is the necessary re-evaluation of the role of the government.

Globalisation: Definition and Parameters

Globalisation is an integration of people, cultures and countries everywhere. Economically, it represents the breakdown of traditional economic barriers—quantitative controls, tariffs and national monopolies. People, capital, goods and ideas have greater mobility than ever before.

The ICT revolution has catalysed this process. The Internet connects everyone with access to a PC and a modem, essentially creating a global marketplace. Its ubiquity has accelerated the process of knowledge diffusion, fuelling technological progress and enabling its fruits to be enjoyed globally and almost immediately. The lowered cost of knowledge has moved markets closer to the ideal model of perfect competition. Electronic mail, cell phone technology and other communications breakthroughs have enabled firms to expand their operations globally, where previously costly and inefficient communications processes limited command and co-ordination links between headquarters and branches.

The advent of multinational corporations with interests spanning the globe has made the reversion to isolationism extremely costly. ICT offers governments an unprecedented opportunity to streamline bureaucracies, to eliminate red tape, and to better understand the circumstances of their countries and constituents.

Expectations of the quality of governance will rise. With a better understanding of global situations at the grassroots level, there will be an inevitable comparison between local and foreign conditions. Price and wage differentials will become immediately obvious. Governments who cannot meet citizens' aspirations will find themselves looking at an exodus of talent from their countries, or facing social unrest.

The economics of growth have been altered. Technology has improved the efficiency of agriculture and manufacturing. However, as markets for primary and low-end secondary products become fully exploited, this would also mean that these sectors would be shedding employees.¹ In the global economy, the greatest profit is derived from knowledge—knowledge of consumers' needs, of how to fulfil those needs, and fulfilling them better and more cheaply than your competitors.

Globalisation is more than an economic phenomenon. The shrinking of the world has magnified problems like environmental degradation and the rich-poor divide. Countries

¹ This is true even for tertiary sector products. In an article from its August 10th issue this year, commenting on the lacklustre performance of AOL Time Warner (*New boss, same problems*), *The Economist* quoted Peter Kriesky of Kriesky Media Consultancy as saying, "When your market has begun to mature (referring to AOL's one-size-fits-all dialup service), you need to segment the market and develop a family of must-have services targeted to different customer groups."

face ever-increasing intrusions on sovereignty, either through the expanded areas of jurisdiction of international bodies like the World Trade Organisation or the surrender of prerogatives to associations like the European Union. The ability of governments to influence the operation of economies is also diminished by the increased clout of MNCs, whose interests are not aligned with any particular state.

THE NEW ROLE OF THE STATE

Among all the uncertainties of the new economic paradigm, the permanence of economic needs remains constant. This must be the utmost consideration as policymakers seek to meet the challenges of globalisation. Policymakers should not be encumbered by expectations placed on them to conform to a set of “acceptable” policies, and should continue to be guided by realpolitik dictates in policy formulation.

Countries should integrate with the world market in a manner and extent that is compatible with their state of development. There is no shame in erecting trade barriers when an economy is mostly made up of fledging industries. There is no sense in investing vast sums on so-called New Economy projects when a country lacks the requisite human and physical capital, and when a country’s comparative advantages obviously lie in other areas, like Malaysia and that country’s sputtering Multimedia Super Corridor. This is not to deny the many advantages of globalisation, but to make a case for understanding both these advantages and a country’s economic disposition, and for flexibility in the pace and manner of integration. Governments should retain powers of safeguard, to be able to intervene swiftly and effectively in event of market failures. Dr. Mahathir’s unorthodox

response to the threat of a capital exodus—currency controls—has arguably saved Malaysia’s fledging financial markets and its economy from being laid waste by Mr. Soros and his associates.

Governments are instituted to insure the well being of the governed, of which economic welfare is only a part. Although developments, discussed below, may have diminished the conflict of interest between profit and social priorities, it is still hard to balance the two, and governments must remain committed to finding an optimal combination.

Legislation and Regulation

Capitalist economies are founded on the rule of law and the enforceability of contracts. Regulation has always been a key function of government. In the past, enforcement was easily undertaken—good and services traded were clearly defined, the opportunities for fraud and malpractice were foreseeable. However, the goods and services traded today are not as tangible, and the complexity of market operations lends itself to abuse, like the analysts in America who wilfully led their clients to invest in failing stocks. This situation exists in part due to an asymmetry of knowledge. Information is cheap and widely available, but not all people can make sense out of it—it will take even experts many months to unravel the accounting antics of Enron. It is often in the interest of knowledgeable parties to withhold this knowledge, because an edge in knowledge often translates into profit. Recently a letter was written to *The Straits Times* protesting the disclosure of customer databases by Singapore Power to third parties for commercial

purposes, a grave violation of consumer privacy. Internet phenomena like mp3.com compromise the integrity of trademarks and copyrights.

A reform of old regulatory regimes is in order. However, in their anxiety to punish, governments may run a risk of over-regulation. Already there are concerns that the legislation and lawsuits slapped on post-Enron capital markets is suppressing one of America's greatest competitive advantages. Applied carefully, regulation prevents malpractice. Applied excessively, it stifles business sentiments. Perhaps governments should keep in mind that the erosion of confidence generated by their own folly is the greatest punishment that errant businesses can receive. Governments should outlaw specific detrimental practices and not institute well meaning blanket legislation that burdens commerce with arbitrary restrictions. They should also understand that market developments often outpace policy formulation, and that a constant review and renewal of legislation is necessary for its relevance.

As consumers become better educated and in a better position to make informed decisions, governments should encourage them to rely less on state protection but to exercise the old market maxim of caveat emptor—buyer beware. As voluntary and informed participants in a legal, buyer-willing-seller-willing transaction, buyers can and should be expected to be fully cognisant of the risks involved in their purchases.

Besides the need to safeguard consumers' interests, there is also a need to provide a legal framework for the development of New Economy businesses. The validity of electronic

contracts and mechanisms for their enforceability has not been addressed by many legislatures, despite the increased popularity of electronic commerce. The authenticity of contracting parties often cannot be verified. Countries who fail to clarify the legal positions of new businesses that fall outside of conventional definitions will be left out in the exploitation of new niches.

The Enron and WorldCom accounting scandals provide ample evidence of the fallibility of even the most transparent and vigilant regulators in the world. The changing world will continually test the integrity and adaptability of established institutions. Corruption and abuse continue to be rampant in countries like China, where civil servants are underpaid and government watchdogs are either toothless or themselves partners in crime. Governments must exercise zero tolerance of corruption and incompetence, and uphold transparency and legality. Only then can investor and consumer confidence be sustained.

Economic Role

As mentioned earlier, the dominant source of growth in the global economy will come from the ability to innovate, to create niche markets and enrich existing ones. The challenges for economic policy in the global economy would be to ensure a smooth transition from an agricultural and manufacturing centred model to a knowledge-based economy, to secure investment and to ensure flexibility and resilience in the face of increased volatility.

Even with the best of economic and political climates, the creation of a knowledge-based economy will be fraught with difficulties. A developing country's education policy is usually

oriented towards producing engineers, technicians and other production line related expertise. A dearth of managerial and operational expertise is likely to limit competitiveness. Developing economies are characterised by a predominance of large firms reaping significant economies of scale, with a negligible Small and Medium Enterprise presence. Firms like South Korea's *chaebols* and Japanese conglomerates are notoriously inert and reliant on "winning formulas" concocted decades ago. Protected by pork barrel politics and domestic barriers to entry, these firms have no incentive to spearhead the innovation that is crucial to a knowledge-intensive economy. The exploration of niches is a long and not necessarily fruitful process, as the bursting of the dotcom bubble evidenced. While a country seeks to define its areas of competitive advantages, structural and frictional unemployment can derail progress.

The government's role as investor-in-chief remains important. As in the Old Economy, governments are more able to undertake riskier, costlier ventures where returns are not immediate—the Singapore government has invested upwards of US\$700 million into developing a biotechnology sector² as our competitive edge in manufacturing is whittled away by Chinese competition. In the absence of protective barriers, government investment has become a formidable tool to ensure domestic competitiveness against international corporations. The onus is on countries with large public sectors to ensure that those companies are subjected to market rigours, that management is competent, and that continual processes of consolidation and rationalisation are in place. Businesses not

² Asia Private Equity Review, June 2000

relevant to strategic needs or the development of domestic niches and competitiveness should be privatised.

Knowledge has replaced mass production as the basis of wealth creation. Governments have to pay especial attention to how innovation happens, and make sure it does. One way to do this is through patent policy. If firms can expect to profit from a legalised monopoly of breakthrough technology or through licensing their innovations, then they are more likely to come up with new ideas. Countries where intellectual property rights are poorly enforced, like China, are unlikely to attract knowledge-driven, high value-added industries. On the other hand, the dissemination of new technology benefits society at large, contributes to economic and non-economic welfare and inspires further innovation. Governments must reconcile the conflict of interest between facilitating innovation and spreading its benefits.

Tied to the need to innovate is the need to create a comprehensive and dynamic education system. Demanding East Asian education systems have churned out thousands of technicians that helped their countries complete their industrialisation drive and surge ahead of resource-rich but human capital-poor countries like Brazil. Now the challenge for these countries is to encourage entrepreneurial spirit and innovation in risk adverse populations. A greater emphasis on social sciences and the humanities would provide a more diverse talent pool. Employers should recognise that sending employees for skills upgrading would bear dividends and be given incentives for doing so. The workforce should understand that upgrading increases its employability in the face of the ever-

diminishing shelf lives of skills and products. Education systems should take note of the diffusion of knowledge between once-demarcated disciplines—Wall Street financiers employ physicists to conjure up the financial instruments and investment strategies that has made New York a world financial hub.

The greatest dynamism in the global economy will come from small firms, with their greater sensitivity to market fluctuations. Having no market muscle they are reliant on anticipating future demand, and in areas like software development they often lead larger firms in fulfilling specialised needs. With their informal work cultures they are more flexible than their larger counterparts and are often the first to rebound from recession. Governments should recognise the role small firms play in identifying demand patterns, eroding monopolistic dominance, and galvanising large firms to undertake their own R&D to catch up. Stringent bankruptcy laws should be eased to reduce the cost of failure. Banks should be encouraged to extend credit to small businesses without the ability to provide collateral. Given their comparatively small turnover, governments lose little in taxing them lightly. Complicated bureaucratic processes should be streamlined—perhaps rules of thumb like not more than three forms to start a company can be adopted. In their efforts to promote homegrown companies with international stature governments must bear in mind that providing opportunities for SMEs to flourish makes for more balanced growth and greater overall resilience.

Governments should realise, in their efforts to make countries more attractive to investors, that they should not only be concerned with the sheer volume of investment but also the

nature of investment. As barriers to the movement of capital are removed, countries should not be surprised that they are losing cost advantages driven investment to markets like China, which received US\$40 billion in foreign direct investment in 2000³ alone. Rather, governments should be concerned about the amount of investment received in a country's areas of competitive advantages. This would be a crucial indicator of a country's ability to differentiate itself. Silicon Valley, the cradle of the information technology revolution, received US\$21 billion in venture capital investment in 2000, despite sky-high operational costs. Even after the demise of the dotcom bubble, investors still ploughed in US\$6 billion, hoping to be in position to ride the next boom⁴.

As barriers to mobility break down, as employment becomes international in nature, the exodus or the influx of talent has become a top policy concern. On the surface the scramble for foreign talent seems like a zero sum game. Yet governments cannot take any significant, explicit action to insure countries against a brain drain. Perhaps a new perspective on this thorny issue is in order. People are attracted to opportunity. When a country is not receiving its fair share of talented immigrants, it needs to ask itself: do its people lack opportunity at home? Many Japanese find this to be the case. However, even net exporters of talent need not be dismayed—foreign enclaves of your own people are beachheads for further investment and expansion in that country. The Jewish and Indian diasporas are examples of communities that remain strongly attached to their homeland after generations in a foreign land.

³ Newsweek, September 3, 2001 *The Spread of China Inc.*

⁴ BBC, January 25, 2002 *Hope lives on in Silicon Valley*

Social Policy

The effects of globalisation are not restricted to the economy. As businesses and society gear up to meet the challenges of a fast-paced world, traditional values and lifestyles come under siege. Negative externalities generated by industries are felt more acutely as population densities soar. There is no simple approach to the complex challenges posed to society by globalisation.

Social structures and priorities are undergoing a transformation. The nuclear family's cohesiveness has been eroded by the high incidence of two working parents. Income gulfs have widened, sometimes coinciding with racial divides. Instead of a hierarchy based on caste or race, a social order founded on merit is emerging. An increasingly competitive and commercialised society is in danger of leaving behind the disadvantaged and forgetting such intangibles like the arts and graciousness. Governments can increase job security and benefits for part-time workers, who are often parents who work and take care of their families, or giving grants to budding artists. Subsidising basic education, healthcare, and housing, levels the playing field and ensures an equality of opportunity. Most importantly, governments will send a strong signal that a nation is defined more by these intangibles than by its economic prowess.

The global reach of businesses has exacerbated the problems they generate. Encouraging consumer activism can complement the regulatory function of government in combating these problems. By working with interest groups, and through the ubiquitous mass media, governments can benchmark firms according to compliance with labour statutes, levels of

pollutant emissions, efficient energy usage and raise awareness of the relevance of these indicators. Consumers can then actively discriminate between firms that adopt best practices and those that do not. There is therefore a dual pressure from regulatory bodies and market forces that would compel firms to update their production processes to adhere to environmental and social standards. Governments need to stress that the goals of profitability and social responsibility are not exclusive—efficiency boosts profits, investment in education and respect for labour rights boosts productivity and motivation, environmental responsibility enhances public image. In combating old problems like unemployment, governments must mix compassion and discipline—retraining criteria must go hand in hand with providing unemployment benefits. As fish become more elusive, people must be taught how to fish.

International Relations

The world has become so organically linked that countries ignore their neighbours' woes at their own peril. The EU's new eastern frontier is threatened by crime and poverty in Ukraine, Belarus and Moldova. September 11 showed how threats to our common security, working through increasingly porous societies, have also become globalised. In 1999 official development assistance to developing countries stood at US\$5.6 billion, a paltry 0.24% of the net GDP of the principal donors⁵. Developed countries need to be more generous in forgiving debt, transferring know-how and removing barriers to Third World exports. Consensus and co-operation between nations, along with the integrative effects of

⁵ World Trade Organisation, Economic Research and Analysis Division—*Globalisation Statistics 2001*

globalisation, will lay the foundation for a more equitable world, principled and prosperous, free from want and fear.

Conclusion

It would seem, therefore, that the explicit and implied responsibilities of governments have not diminished in a globalised world. Rather, they have changed in nature, from economic direction to regulator, from leader to partner. Governments must embrace their new roles with vigour and alacrity, for although it cannot be said if things would get better if we change, we must change if things are to get better.