One World, Two Worlds or Three?
Reflections on the
New International Economic Order

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by

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I am happy to be here with you to share my thoughts on the need to create a new architecture for the international economic system, and on some of the key structural issues.

The "Old" International Economic Order

The basic structure of the international economic system crafted after World War II worked very well for the problems the world then faced. But it has become outmoded due to its very success, not its failure. After World War II, conceptually we divided the globe into three worlds based on level of development and market versus planned economic systems:

- the First World of the old advanced industrial nations, notably the US and Western Europe -- the rules-setter and system designer;
• the Second World of centrally planned communist nations -- isolated from the
  so-called global economic system for ideological, cold war reasons as well as
  the contradiction between state planning and competitive market systems; and

• the Third World of poor, less developed economies, many states newly
  emerging from colonialism.

The Third World countries were rather paternalistically given special treatment and
exemption from trade and foreign exchange control rules of the First World game.

I don’t need to discuss the profound changes that have taken place over the last 35
years, in the economic sphere nowhere more profoundly than in the Asia-Pacific region
where, by and large, economic performance has been driven by private, decentralized
business decisions -- though in many environments helped by supportive government policy.

All too often we take markets and their efficient operation for granted until we see
the collapse of the planned economies of Eastern Europe and the USSR, and the
contradictions between the state and local enterprise systems within China.

International trade markets have worked so well because of the global system of open
multilateral trade based on GATT, its rules, and its success in reducing the most important
tariffs and quotas on manufactured goods, though now leaving exposed the remaining
deficiencies of the system -- namely, trade barriers in agriculture, services, and textiles, much less problems of ensuring intellectual property rights.

Add to this, of course, the profound and in some respects frightening as well as exhilarating implications of the ending of the cold war and the collapse of communism in Eastern Europe and what used to be the Soviet Union.

Thus, today when I use the phrase "One World, Two Worlds or Three", it is in a different world frame of reference. We face a different mix of problems -- some old, some new -- and we need to create a new architecture for the international system.

**The New International Economic Order**

The scenarios of alternative world systems today have as their primary architectural units **world regions** -- not level of development or type of economic system, which were the keystones of the post-World War II system.

The key issue we face in our new international economic order is whether we will:

(a) maintain, strengthen, and expand the membership in a multilateral, global system of open markets and economic transactions symbolized, all too weakly, by GATT and perhaps more strongly by the Euro-currency, Hong Kong, Singapore, and other international capital markets, or
(b) break down into a discriminatory system of regional trading and currency blocs which raise substantial barriers against outsiders, non-members.

Most fundamentally, such regionalist trends invoke either two worlds, Europe on the one hand, and the rest of the world, notably the Western Hemisphere, led by the U.S. and the Asian Pacific; or three worlds of blocs discriminating against each other: Europe; the Western Hemisphere, led by the U.S.; and the Asia-Pacific region, led -- though less strongly -- by Japan.

It is profoundly clear that in terms of our overarching economic and political interests, one world is better than two, and two is better than three. Market economics is a win-win game, not a zero-sum game.

However, as we all know, there is a real danger that we will move backward rather than forward.

Essentially the rules-makers -- the main architects -- of the new system are the European Community, the United States, and Japan. Each has its own narrownesses, parochialisms, and short-term domestic political objectives which have the potential to sabotage the creation of a new, global economic order, as the difficult Uruguay Round negotiations well demonstrate.
I might note parenthetically there are big differences between an economic region, where geographic and economic complementarities create more intense relations with each other as exemplified by the Asia-Pacific region; and an economic bloc, which is based on government arrangements to give preferences to each other in economic transactions, and indirectly or directly to discriminate against non-members, as exemplified by the European Community.

The basic issue is whether such an economic bloc is beneficial or pernicious -- whether it reduces external as well as internal barriers and expands trade, or instead raises external barriers. The European Community is beneficial in manufacturing trade, pernicious in agriculture, and the story on foreign direct investment is mixed but beneficial on net balance.

The danger we face is of pernicious blocs. The most dangerous is the possibility of a three-world situation in which the U.S. retreats to the Western Hemisphere, though I do not think that will occur. The U.S. has too much to lose from raising major barriers in its trade with Japan and the other Asia-Pacific economies.

So too does the Asia-Pacific region. I don't have to tell you of the vital importance of the U.S. as both a market and player in the Pacific Basin region and even more importantly as the leader, the first among equals, in pressing to maintain and strengthen the global system -- albeit with a certain amount of protectionist backsliding or aggressively
unilateral pressure on other countries to open their markets under threat of retaliation.

Indeed, the U.S. unilateral actions of recent years make all the more important the revamping and strengthening of a GATT-type organization.

The Role of the United States

Let me say a few words about the United States.

I know it's popular to talk of the United States as being in decline, as no longer having the power it once did. Power is a relative concept of winners and losers, while economic well-being is essentially a positive sum concept. Certainly the U.S. no longer has the power it once did. Part of that is desirable and part of it is bad, mainly because it is a reflection of American unwillingness to address adequately its very real domestic problems, economic and social.

But the issue is more complex.

The United States emerged from World War II with a degree of economic power that, in global and even U.S. perspective, was unnatural, unsustainable, and not in long-run U.S. interests. Indeed, U.S. foreign policy was designed to reconstruct Europe and Japan and to encourage the rapid economic development of the Third World. And it succeeded. The implication, of course, was that the U.S. share of world GNP would decrease as other
economies performed even better than the United States. In reality, over the past 35 years the world and the U.S. have prospered; absolute improvement has been exceptional, even as the relative position of the U.S. economy has declined. This has been healthy. Better for the U.S. to have rich trading partners than poor.

In my view, the U.S. has moved from its historically temporary phase as economic hegemon -- with all its pluses and minuses -- to the more natural position of first among equals. While this causes lots of psychological problems, both for Americans and for others living off U.S. benevolent-patron patterns of thinking and behavior, in the long run it is healthier all around.

With some redistribution of economic power has gone redistribution in political power. On the other hand, the U.S. remains the supreme military power. Ideologically, communism as a value system has imploded upon itself; however democracy, freedom, and civil and human rights have yet to win the day in what is still a world of many authoritarian states. Nonetheless, the U.S. continues to serve as a democratic model for many in Asia and elsewhere.

While U.S. economic decline in any absolute sense certainly is not inevitable, I am concerned about the U.S. political inability to tackle its fundamental economic problems. They are real, they are domestic, and there are no quick fixes.
• The U.S. must raise its saving rate, both governmental and private.

• While university education is outstanding, we must improve basic education and vocational training. We need to produce computer programmers, as well as training up steel workers, and auto workers, in new technologies and ways of managing and handling production.

• American firms have become more competitive and more export oriented, but they have considerably more to accomplish.

• We need to reduce the de facto trade barriers we have raised over the past decade -- textile quotas, steel, auto, machine tool quotas, and the like.

But the U.S. does have a lot in its favor. I won’t recite a litany of U.S. strengths. Let me simply note that:

First, a technological innovation is the key to future economic growth. We are in the midst of the microelectronic revolution, perhaps as profound as the steam engine, or electricity. Moreover, there are new revolutions ahead, perhaps equally profound: biotech and genetic engineering, and new forms of harnessing energy, in addition to composite materials and other innovations.
Second, the U.S. savings rate, now at an all-time low, will increase for demographic reasons, if no other. All workers save. But younger families spend even more, for housing, furniture, children’s education. As the baby boom generation becomes older, they will inevitably not spend as much as they have in recent years. This is a major demographic transition we have not yet adequately incorporated into our analysis of saving behavior.

Third, while the share of the U.S. economy in world production has decreased, the share of U.S. multinational corporations in world production has not decreased at all. It simply has shifted its locale in response to changing market and cost conditions. For better or worse, multinationals -- U.S., Japanese, other Asian, and European -- will be the carriers of economic progress into the 21st century.

Some incorrectly see the United States as in economic retreat from the Asia-Pacific region. In reality, in an absolute sense the American economic and business presence is increasing. It is only in the relative sense that the U.S. presence is less overwhelming than before. Indeed, I take as inevitable a rising absolute and relative Japanese business and economic presence in the region, as it continues to become more and more open in practice, and as its economic performance continues to be very good relative to the other OECD countries. But the story is complicated, and made better, by increasing trade and foreign direct investment among the other economies of the region, such as Taiwan and South Korea, much less Hong Kong.
Let me note some basic facts.

Between 1985 and 1990, U.S. exports grew faster than its GNP, and they grew particularly rapidly to the Western Pacific economies.

Between 1970 and 1990, the share of U.S. exports to the APEC member economies rose from 40.6% to 52.8%, and the import share was higher but increased less, from 52.0% to 58.2%.

Between 1985-1990, U.S. business foreign direct investment in Japan and the Asia-Pacific increased by $29 billion to $62 billion, not large relative to U.S. total FDI, but a slightly rising share.

Perhaps more important, more U.S. multinationals are active in the Pacific Rim, and their Pacific share of total sales is rising.

The U.S. political and security commitment to the Asia-Pacific region is strong and will remain so. Indeed that was the main purpose and message of President Bush's recent trip through the region, even though the strength of those signals were weakened by his lip-service to American domestic politics in an election year ("jobs, jobs, jobs").

Asia-Pacific regionalism is now seen by American policy makers as congruent with
and supportive of a new global international economic order.

The U.S. government at the fundamental systemic level is committed to the revamping and building of an open, multilateral, relatively free system of flows of trade in goods and services, finance, and business direct investment. Ideally this will be under a set of rules commonly agreed upon through GATT-type international negotiation, and including countries and economies which share an overarching vision of and commitment to the role of markets and of competitiveness.

I admit, but certainly do not condone, the domestic political pressures which constrain the U.S. from living up fully to this basic goal.

- the ability of producer interest groups to obtain protection at the expense of consumers;

- Reagan's budget policy, perhaps the most important economic policy mistake in decades, especially the final round of tax cuts, which led to the government eating up not only private savings but having to borrow from abroad;

- the U.S. huge, though now declining, trade deficit, which in turn brought on the 1988 Trade Act and Super 301; and
perhaps worst of all, a growing sense that the U.S., the richest country in the world, is a poor country which cannot afford to solve its economic problems.

The U.S. problem is not one of lack of resources, but lack of political will.

Fortunately successive Presidents, Republican and Democratic, have been able to transform domestic political pressure for protection into pressure to open foreign markets, through GATT, and especially through the Uruguay Round. But unfortunately the U.S. has taken an aggressively unilateralist approach in insisting trading partners open their markets more, and adhere more to internationally accepted rules, as with intellectual property rights and the ongoing negotiations with China as well as other Asian countries.

This American bullying is one reaction to the inability of GATT to solve such problems. It is a major reason why the world needs a strengthened GATT instead of American aggressive unilateralism.

In its longstanding commitment to a global multilateral system, up until 1985 the U.S. government tended to reject Asia-Pacific regionalism as undermining the global system. In 1985, President Reagan and Secretary of State Schultz made a dramatic policy change, supporting the private tripartite Pacific Economic Cooperation Conferences (PECC) and later the formation of APEC, the ministerial level government organization for Asia-Pacific Economic Cooperation.
The U.S. recognizes that this commitment to the Asia-Pacific region is supportive of the global system, offering a mechanism whereby liberalizing regional efforts can be a practical road toward global liberalization without being the genesis of a restrictive regional bloc.

APEC is also a tactical instrument, a counter threat to the European Community should it become too inward looking and discriminatory, a fallback if the European Community does become a pernicious bloc, as well as a counterbalance to Asian regionalism as epitomized by the EAEG proposal, now the EAEC.

I do not regard the proposed three nation North America Free Trade Area involving the U.S., Canada, and Mexico as inherently inimical to Asia-Pacific interests. Given U.S. porous borders, and extensive economic relations with Mexico, it is natural. What would be inimical and against Asian-Pacific and indeed American interests would be for the U.S. to expand the free trade area to all of Latin America without at the same time including the Asian-Pacific economies. This is the three world scenario -- the worst of all -- and ultimately unlikely, I believe.

Three Problems for the New System

A great deal depends on how the three major players behave. Let me briefly raise three problems the new system faces.
One is the successful conclusion of the Uruguay Round. The European Community can prevent that. Even if a success, it will leave many problems yet to be resolved. And if it fails, the drift toward regionalism will become a movement, and regions may well become discriminatory blocs.

A second, and in my judgment the deepest, threat to the new international economic order, and indeed to the stability of Asia, is the possible breakdown of the U.S.-Japan alliance through its mismanagement, especially by the U.S. but also by Japan.

The U.S.-Japan alliance in the post cold war era continues to be essential, but for new reasons. This bilateral alliance is essential economically in order to determine how to manage constructively and cooperatively the great competitive economic challenge of Japanese business, and how to create the conditions whereby Japan can play a mature constructive leadership role in world affairs.

The danger on the American side lies in our paranoia over the Japanese challenge, our unwillingness to recognize that our problems are of our own creation and require our own solution; and in the temptation of some to engage not simply in Japan-bashing but to suggest that somehow the U.S. might contain or isolate Japan. It is impossible to contain Japan, and it would be very unwise to attempt to isolate it rather than to integrate into the leadership system.
The problem on the Japanese side is that it remains a parochial, insular, outsider-unfriendly society, even when the outsiders are other Japanese. The central Japanese problem as the world’s second largest and most vibrant economy, is that it has no vision for the international economic order, no vision of Japan’s role in that order, and no strategic sense of what Japan must do to build the new structures that are required. The earlier low-risk, bystander, free rider’s game is becoming increasingly expensive, and indeed perhaps can no longer be played at any price. Symbolic gifts and bandaids will no longer suffice; fundamental reforms in policy are essential.

The United States and Japan need to create a new, balanced, and mature relationship. I suspect it may get worse before American leaders come to their senses, and start to improve the relationship.

The United States-Japan alliance is even more important for Asian stability. I don’t need to raise the spectre of a Japan bereft of the United States military umbrella, seeking its own military strength.

What the United States has in its favor in Asia is that Japan has no ideology and no message to export; and that its military potentialities are feared, even by the Japanese themselves.

Finally, one of the most difficult challenges facing the new international order will be
to deal with the differences among economies and nations in economic institutions, behavior, and values in an increasingly intertwined, and indeed interpenetrated, set of economic relationships.

It used to be that the exchange rate was the standard adjuster for national differences in market-based economies. Harmonization is a current buzzword, and indeed market and government pressures will bring about greater congruence and harmonization of institutional arrangements. However, the world certainly will not become homogeneous. Many national differences will persist, and validly so in reflecting differences in values, types of democratic political systems, as well as the realities of the historical process of institutional development. As the United States-Japan SII talks and the European Community 1992 talks demonstrate, many institutional differences will be raised (and even more so as the major barriers to trade are reduced); and while some will be harmonized, others will be accepted.

Pressures for harmonization must deal with two fundamental problems. One is how does the market economy world deal with the transforming socialist economies, most notably China which after all has not collapsed, but also the former Soviet Union states and the East European nations. Second, how do we deal with differences within the general framework of capitalism. We now have three models of capitalism: Anglo-American, continental European, and Asian. The great challenge will be to successfully incorporate all three into an effective one world system. It is on this challenging note that I end.