

# Globalization

Among the ideas that seemed to collapse along with the world's stock markets last week was a view of globalization as a kind of manifest destiny. Unlike the 18th and 19th-century version of manifest destiny, this vision didn't involve expanding the borders of colonizing states. Rather, Western values – principally political and economic liberty – would spread to cover the planet cosily, propelled by the digital age. After all, the world of the internet was making free markets a more essential ingredient in prosperity, and free markets work best with free minds. Some libertarians had gone so far as to suggest that globalization represented an inevitable climax of the human story: all you had to do was end trade barriers and then sit back and enjoy the show.

Some show. The political version of that vision – touted most openly by neoconservative cliques – calls for sledgehammer diplomacy to encourage countries into adopting Western-style democracy. Beyond Iraq and Afghanistan, a whole raft of states are still on the list of most wanted – thankfully, domestic support, logistics and especially resources to pursue them militarily have all but evaporated.

Enter the libertarian version of the same vision. Opting for the passive role model rather than aggressive evangelizer, libertarians leave the coercing up to international economic competition, almost smug in their confidence that the pursuit of maximum profit always comes out on top in a dog fight with any other economic system.

But whether libertarian or neoconservative, the mission remains the same, carrying a deep and moral challenge, whose modern values jar with many societies across diverse regions and countries from the GCC to sub-Saharan Africa to China to Venezuela.

For instance, it's perhaps hardly coincidental that the renewed protectionist streak in Russia comes as the capitalist dream turns sour for the majority of Russians, who, according to some surveys, consider themselves poorer in real, socio-economic terms than in the 1980s.

These grievances have grown partly out of globalization. Far from being a benign culmination of history, globalization as it stands has carried the seeds of its own destruction all along.

From a capitalist perspective, it would have been preferable if the worldwide economic tailspin had been caused by Islamic terrorists, who had devised a way of crashing into the towers of finance and credit by using the tools of globalization – cell-phones, the internet and, especially, international banking.

Of course, Public Enemy No. 1 in this case is a lust for power – linked more intimately to rampant Adam Smith than radical Islam. It is greed that has brought us to this point: billions of dollars spent exploiting real estate and on mergers and takeovers rather than on building and renewing productive capacity.

However, viewed against the backdrop of history, the case for a kind of manifest destiny is actually stronger than ever. Globalization dates back to ancient history, with the expansion of commerce driven by advances in technology – wheels, roads and Phoenician triremes, among others – which were used as much to trade goods as to fight wars. The Phoenicians also invented the Ugaritic script – the mother of all modern alphabets – a shorthand evolving out of a need to record inventories and debts.

As the web of commerce expanded and thickened, the interdependence deepened. The ancient world saw prosperity spread but also saw vast downturns – such as the collapse across the eastern Mediterranean in 1200 BC, which saw the end of Pharaonic prominence, and in fifth century AD, with the fall of the Roman Empire.

The main reason trouble can spread so broadly is that it often uses the economic system's conduits of transportation and communication. In the Middle Ages, for instance, the Bubonic plague spread from city to city along the same routes of commerce.

What makes globalization precarious is that business relationships have an obvious downside: players can lose as well as win. Add an internet revolution to the mix – which allows for more complex games, over longer distances and at the speed of light – and the lose-lose contagion can swiftly become pandemic.

So while globalization is ground in human nature, it cannot be left in the hands of any one group of individuals or nations – no matter how well-meaning their agendas.

Specifically, the expanding interdependence of the financial markets – and of threats to it – requires stronger protection. To be sure, the paradigm exists already in the area of international trade, with the World Trade Organization (WTO) policing agreements through its precise set of rules and regulations. What's needed now is the global governance of financial institutions, perhaps along the lines of WTO, with the mandate for more routine and forceful means of policing the world's banks. This may sound radical, but it's just history marching on and commerce making the world safer for itself.

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## **A Supranational Currency**

Keynesians across the world could be forgiven for rubbing their hands right now with high expectations.

Last week, a United Nations panel formally recommended the creation of a global reserve currency under the leadership of the International Monetary Fund (IMF) – that is, taking over from the role traditionally ceded to the US Federal Reserve. And in July, during the Group of Eight meeting in Italy, the Russian President, Dmitry Medvedev, handed out minted coin samples of a new world currency. To be sure, the gesture was grandiloquent at best: it is not Medvedev's "Unity in Diversity" that will knock the dollar off its exalted position as the world's dominant currency. Quite aside from the convoluted name, a better candidate for a supranational currency may already exist.

When the Bretton Woods system was set up at the end of World War II, John Maynard Keynes proposed the creation of an international currency unit – the "bancor" – in order to head off a dollar-denominated world, which, he argued, would ultimately meet its fate of carrying too much on its shoulders.

However, his motion was defeated. America enjoyed its position as top dog, with the option to run massive trade and current-account deficits without being punished for it. Besides, tying

world currencies to the dollar made economic sense back in 1944, particularly in the light of the Marshall Plan that was waiting to pump dollars into a devastated Western Europe.

But Keynes's scheme is being re-examined in the current gelatinous environment of global credit. Indeed, a key attraction of the bancor is its ability to relax the pressure on distressed countries to run budget surpluses during recessions in order to ease the fears of nervous investors.

This reappraisal predates the current financial crisis. The longer-term fate of the US dollar as the supreme reserve currency for foreign-exchange transactions was debated long before the collapse of Lehman Brothers last year. In fact, monetary historians are fond of tracing the two stages in the evolution of the greenback: the first as the currency of a powerful creditor country from the 1920s to the 1960s; and the second as the currency of an empire of debt from the 1970s until today.

Ultimately, the dollar is just another currency that is supported – or tolerated – by a trust that it will be accepted in the future in return for the same sort of goods and services it bought in the past. This is particularly relevant in the Gulf region, where dollar-pegs, currency holdings of national governments, and oil and gas production are all inextricably linked to the destiny of the dollar.

A generous interpretation of all this is that it is wiser for the Gulf region to have its monetary exchanges based on some international spread of currencies rather than on a single one that, if it toppled due to domestic mismanagement, could wreak ruin to many innocent players. We live in a world right now where a single country, representing some 5 per cent of the global population, has roughly 20 per cent of global GDP and freely prints bills that account for about 70 per cent of foreign-currency reserves worldwide.

As developing countries catch up with the west, particularly BRIC – Brazil, Russia, India and China – the American share of things will shrink comparatively. It is only a matter of time before we witness another major shift in the global balances of power. Governments in the Gulf region must prepare themselves for this by formulating plans aimed at shifting national currency pegs and currency holdings away from the dollar.

Given that the long-term dollar trend is indubitably downward, there could well be a push for a more equitable basket of currencies to grease the world's commercial exchanges, with the future arrival of a fully convertible yuan joining the euro, yen and dollar.

But the idea of a world currency is most attractive to those who believe devoutly in multilateral institutions. Within that framework, the existing IMF units of account, which are analogous to a currency and were originally intended to replace gold as an international unit of account, could easily be expanded, particularly if a number of countries band together to hold a large fraction of their reserves in the IMF currency.

Moreover, Keynes's bancor is in the running and growing in popularity, propelled by the host of financial bailouts over the past year that were guided purely by Keynesian theory. In that sense, BRIC countries could well lead the way by divorcing themselves from the dollar and investing heavily in bancors. After the developing world follows suit, even the US could well be compelled to join in, pegging the dollar to the bancor. If such a move were to gather steam, Keynesians would have yet another reason to celebrate the resurgence of their ideas.

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## Monetary Union

The benefits of a single currency were well understood by the Romans. They replaced the plethora of local currencies in the empire with a single coinage system, aware that monetary union served the needs of business. However, once the Romans were no longer able to rely on the riches of the lands they had conquered to support their empire, they began debasing the currency in order to raise revenue. In fact, by the third century, the economy was in such dire straits that Roman coins were dipped in silver rather than made of silver, and the inevitable inflation resulted, which led to the demise of the system.

The modern-day parallels are striking. The current environment of diminishing global credit raises doubts about the status of the US dollar as today's global currency – a status that is certainly not set in cement. Ultimately, the dollar is just another currency that is supported – or tolerated – by a trust that it will be accepted in the future in return for the same sort of goods and services it bought in the past. In other words, if the US Federal Reserve, among other financial institutions, fails to validate that trust, the dollar, too, will go the way of the Roman denarius.

To be sure, with a gelatinous economy, a badly compromised financial system and several US military misadventures, the long-term dollar trend is downward, whichever way the current crisis ends. And if the dollar does fall off its exalted position as the world's dominant currency, the inevitable question is what will replace it? The euro still suffers from a patchwork of national regulators, while the overvalued yen currently disqualifies it from anchoring the global economic system. There is even a danger that the dollar's fall could signal the return to a monetary dark age, with rising protectionism aimed at backing national currencies.

However, in the words of the former Federal Reserve Chairman, Paul Volcker, “a truly globalised world economy needs a global currency”. And a truly global currency comes with a basket of benefits. For a start, national currency crises – of the kind witnessed so calamitously in Zimbabwe over the past few years or in Germany in 1923 – would be eradicated. So too would the foreign-exchange costs on the global trade in currencies, estimated at \$1.4 trillion a day. Moreover, the end of currency fluctuations would stabilise international business.

Of course, a truly global currency to replace the jumble of nearly 200 national currencies is not expected to emerge any day soon. World currency standards possess significant inertia. Take the British pound, for instance, which only forfeited its role to the dollar following two world wars and more than half a century of industrial decline. But contingency plans have already been drawn up by central bankers and finance ministers across the world for the time when it becomes necessary to pull the plug on the dollar.

In the Gulf region, the members of the Gulf Co-operation Council are still debating whether to retain the dollar peg in the run-up to next year's planned launch of a common currency. This comes amid speculation that the monetary union will have to be postponed for economic and political reasons – in a move that is reminiscent of British euroscepticism, Oman is threatening to pull out of the currency agreement altogether.

Unfortunately, the track record of Gulf currency agreements has so far been far from dazzling, including the failed monetary union between Bahrain, Kuwait, Qatar and the United Arab Emirates in 1975; and, in 1977, a ditched proposal by the Arab Monetary Fund to establish a region-wide Arab dinar. But despite all the obstacles, governments need to move beyond the flawed notion that statehood requires them to make and control the money used in their territory.

While the chief determinant for a single currency is invariably political, the economic effects of a monetary union can quickly gain the upper hand, particularly in terms of boosting trade. Historically, money itself in the form of minted coins was invented in 600 BC in ancient Lydia, Asia Minor, in order to replace the inefficient barter system and its coincidence of wants, namely: economic transactions could only occur if the two parties actually wanted what the other possessed.

Even more successful than the Roman denarius was the Athenian tetradrachm, which became the dollar of its day through sheer mercantilism rather than political domination. The tetradrachm, with its distinctive owl on the obverse, remained in circulation for more than four centuries, even when Athens had been relegated to a minor province first in the Macedonian then Roman empires. Its longevity owes to the strictest respect – down to the milligram – for the weight and quality of the silver of each coin. Moreover, the Athenians never debased their coins when the going got tough: the minting simply stopped once the silver ran out. More than the Romans and even many of today's central bankers, these ancient Greeks understood that it is the market that transforms a currency into global tender – and what the market giveth, the market can just as easily take away.

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## **Bubbles and Bulbs**

In 1841, Charles Mackay famously wrote that men “go mad in herds, while they only recover their senses slowly, and one by one”. The dour Scot could almost have been wagging his accusatory finger at Dubai.

In the latest episode of the (ever lingering) global real estate bubble, Dubai World announced last week that it was seeking a six-month moratorium on some of its debt, estimated at \$59 billion. While it may not have the economic punch of the once all-powerful Lehman Brothers, there is real concern that the fall of Dubai World – the government-owned company that has invested so heavily in glistening real estate projects – could deal a blow to the Gulf region and even beyond. For that reason, central bankers and government officials across the world were nervously watching stock markets for signs of a rerun, albeit on a more modest scale, of black September 2008.

To be sure, the folly of popular greed is as old as time: economic bubbles have been around since the dawn of civilization and – contrary to the media frenzy about pandemic economic meltdowns – they do not signal the end of civilization either.

Perhaps the first recorded and certainly most bizarre example of a bubble-and-bust maelstrom occurred in the Netherlands in the early seventeenth century. Tulips, which were a status symbol in the wealthiest of circles, became infected by an unusual plant virus that created

different and highly prized streaks of colour throughout the petals. Almost overnight, the Dutch were swept up by tulipmania, hoping to strike it rich by buying low and selling high. As in all examples of bubbles, a few succeeded: in 1637, for example, a single bulb of a particularly rare colour combination retailed for 10,000 florins, representing approximately the same price as a house along a canal in Amsterdam.

But the vast majority did considerably worse than break even. Just as in modern-day commodity exchanges, speculators were offered riskier option contracts on tulips with the effect that, once sales slowed and prices faltered, a whole segment of Dutch society found itself hopeless in debt or completely bankrupt.

A more recent example of a riches-to-rags story, where substantial paper profits nose-dived into real losses, occurred during the late 1990s. In what became known as the dotcom bubble, no e-idea was too outlandish and as long as you had dot com in your name, you were in a good position to receive funding. But for every Amazon and eBay success story, there were a thousand failed websites and online portals that collectively received hundreds of millions of dollars in venture capital only to lose all of it at a record-setting pace.

Modern speculative bubbles are as bloated with lusty and mindless hope as ever. There will always be winners, of course: those who jump in early, understand the psychology of the herd mentality and get out in time, leaving fools in the rubble. In the case of Dubai World or of Lehman Brothers last year, it is pointless to gloat at those who never fully considered the risk versus reward ratio – or, rather, the risk versus bankruptcy.

Moreover, it is unhelpful at this stage to criticize Dubai for expanding too fast and running up crippling debts. With the power of hindsight, many projects had little financial viability even at the planning stage, including, for example, the Burj Dubai skyscraper and the artificial islands built in the shallow waters along the coast to provide room for miles of luxury villas. These, in particular, should have been questioned by scientists on the payroll to explain how obviously vulnerable they would be in the wake of global warming and rising sea levels.

But unfortunately, the real tragedy is not so much the financial unravelling of a single company or even of one emirate, but rather the deep economic repercussions of such collapses at a regional or global level. In the case of Dubai's current malaise, the main fear is that investors could flee risky markets all at once in search of safer havens for their money.

This is a sobering thought, particularly in the context of the national visions that aim to create centres of modernity, and of education and culture. If the Dubai experiment fails, the reasoning goes, so too might other grand schemes from Abu Dhabi to Doha for spectacular universities and museums, and hubs of high finance.

Plans are already in action to restructure Dubai World's debt in order to pacify the markets. But the damage has already been done. While it remains to be seen whether this financial mess will spread to other sectors and cities in the region, the once vibrant market for Dubai's real estate has – thanks to the madness of herds – lost its lustre as swiftly as tulip bulbs.

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