

## Globalization Trends and Economic Policy

**Antonín Slaný, CSc.**

*Masaryk University in Brno,  
Lipová 41a), 628 00 Brno, Czech Republic*

**Aleš Franc**

*Masaryk University in Brno,  
Lipová 41a), 628 00 Brno, Czech Republic*

*The paper deals with the role of economic policy and the role of the state in economy on the background of historic experience. It is particularly focused on the changing role of the state in the globalization process and the impact of recent globalization trends on economic and political decision-making.*

*Keywords: globalization, economic policy, role of the government, economic policy autonomy, interventionism, interests.*

*Pagrindinės sąvokos: globalizacija, ekonominė politika, valstybės vaidmuo, ekonominės politikos autonomija, intervencionizmas, interesai.*

### Introduction

Society, recognizing the need for coordination of economic activities, tries to find some principles of state activities in economic domain – first at the theoretical level and then at the level of economic practice. The purpose of this paper is to discover such mechanisms that could coordinate individual interests and needs of anonymous people not knowing each other.

### The background of the problem

The 20<sup>th</sup> century witnessed a gradual expansion of the economic and political role of the state that aspired at the coordinating role, which, in some cases, grew considerably large and sometimes even all-embracing. Particularly the first half of the century, a host of reasons were formulated that consequently prepared a favourable climate for the growth of governmental interventions and governmental expenditure. The advent of communism in the former Soviet Union and later in other East-European countries together with attractiveness of the central planning for numerous intellectuals in the rest of the world caused many countries were linked to adopt mixed economy. The mixed economy

was characterized by the extensive role of the government.

Marxist and socialist reasoning exerted a strong pressure on the government in market economies to devote their economic policy more to the issues of income inequality among individuals. The income redistribution started to be considered and important and legitimated the political objectives that required adopt some measures diminishing revenues of the rich and increasing the revenues of the poor. So it became common for the economic policy of government to introduce the income tax with very progressive rates, to subsidize the fundamental commodities of the population and to provide welfare payments.

### The growing role of the government

The objective of economic policy in the Keynesian concept should have been to eliminate cyclic fluctuations with the purpose of stabilizing economy. Economic-political measures were focused on demand management, which ensued from the Keynesian idea that the driving force of economy is effective demand and its stability or growth can be reached by measures that are rather demand-oriented than supply-ori-

ented. This concept justified the programmes of public work, unemployment benefits and expansion of activities of the public sector as a whole. Strongly redistributive pension systems were introduced as well as various forms of aid designed to help those whose pensions dropped under a certain limit. Public enterprises attempted at maximizing employment. The countries having a vast public sector were considered less prone to economic cycles. So the Keynesian thinking justified the necessity of expanding the economic-political role of the state.

However, the interventionist character of economic policy also promoted the development of the technical means in the economy, the concept of public good made popular by Paul Samuelson and Richard Musgrave, who justified provision of certain goods by the government, because if the state does not intervene, the market does not create sufficient supply of these goods. The private sector would not be motivated to produce public goods because it would not be viable to eliminate from the consumption the individuals who would not contribute to payment for the high costs of the production some goods (fare dodger problem).

Public goods were closely linked with the concept of externalities. The notion consuming of production of some goods can generate positive or negative externalities that are not reflected in the price of the goods. That gave rise to another case of market failure requiring governmental intervention. These concepts were often used vindicate expansion of the public sector to the health care, education, science, transport and many other sectors.

No longer is the opinion that governmental intervention could solve many current problems so widely accepted as it used to be two or three decades ago. We have had the experience of several decades in which governmental interventions have been increasing so that now the expectations can be compared with results. Appraisal of this experience in many countries caused certain disappointment since it has not been proved that the economic policy of government intervention improves allocation of resources, brings more equitable distribution of the incomes or jointly more stable economic environment.

On the contrary the direct consequence of governmental economic policies were frequent wrong allocation of resources. Available evidence shows that Gini coefficients and other measures of income inequality have not been improved and in particular they are not more favourable

in the countries with extensive state interventions than in the countries with a more limited role of the public sector. In fact the countries with more liberal economic policies recorded more positive economic development.

In the course of time there has been a growing awareness that the increasing activism of governmental economic policies has been linked with diverting attention from core activities of the state, i.e. the three fundamental functions of the state in the concept of Adam Smith. Non-productive and problematic use of public resources was justified by efforts to reach equality. It resulted in deterioration of the quality of basic services provided by the state. The state did more and more things but less and less well. The role of state's economic policy was gradually changed from the role which supports functioning of the market to the role where the state competes with the market, or even replaces it.

### **Globalization and the role of the government**

Approximately in the mid-seventies a trend towards downsizing the state began to appear in developed market economies; social and economic environment was changing and was becoming less friendly to extensive governmental activities. It amounted to a universal rediscovery of the market and a better appreciation of the market role in economy from the part of economic policymakers and the public. Economic policy was gradually changing its character from the position, when its measures suppress activities of the market to the measures which strengthen their functioning. One of the reasons must also be (besides the so-called conservative revolution) appearance of a new phenomenon, that step by step started to influence economic activities and economic policies of governments, namely globalization.

Globalization and economic phenomena related to it create progressive revolution in economic activities and economic policies of individual states. Economic activities that were earlier related to some specific locality have gradually become global. The change is more obvious in certain areas (e.g. financial markets), less in others (e.g. labour markets), but to a certain degree it affects all spheres of the national economy. Investment is no longer confined to a given territory, industry becomes global thanks to the increasing role of multinational corporations, whose production capacities are distrib-

uted to several countries; information is more easily available via the internet and can be transferred cheaply and in real time from one part of the globe to the other.

The consequence of this development is a growing divergence among political regions represented by national states and economic regions of individual markets. The two areas have been less and less overlapping. If the companies of the past mostly operated within one country, then economic policy of the country influenced their operation. However, when corporations became multinational and the world market became relevant to them, economic policy of a given country had increasingly less impact on their activities.

Globalization increases the share of foreign trade in the gross national product, exposing the economy to world competition, which has a negative impact on inefficient sectors of national economy. The protective barrier, which provided safety to many companies and their employees in the form of high duties and other protectionist measures, is disassembled by degrees. In this situation economic policy of the government has to prepare favourable conditions for an increase in efficiency. A country that burdens local economic subjects with high taxes and excessive regulatory measures imposes on them competitive disadvantage in the competition with their rivals operating in a more liberal environment.

For that reason globalization will probably paralyse regulatory activities of individual governments. It will include, for instance, existing regulation of labour market, regulations of capital mobility, foreign trade and financial market will be affected as well. At the same time economic policy will have to closely supervise economic activities and formulate and enforce clear rules of the game. It is obvious that the private sector will have to be involved in the areas, which traditionally belonged to the realm of government's responsibilities (such as infrastructure, health care, pensions etc.).

Globalization processes bring along (from economic viewpoint) a whole array of advantages, among which the most important are the following:

- more effective allocation of economic resources leading to the growth in the living standards;
- wider range of goods and services at more affordable prices than in the past;
- better availability of information and dramatic drop in cost of its acquiring.

However, some problems that are caused by

current processes in the world economy should be mentioned as well:

- globalization may decrease relative wages of unskilled workers in industrial countries, which leads to unequal distribution of income in these countries;
- globalization lowers the degree of autonomy of countries in determining their tax burden as well as a desirable tax structure as a result of tax competition;
- Globalization increases the probability of international financial crises (such as Mexican crisis or East Asian crisis).

Economic policy should respond to these problems and particularly in this respect.

## Conclusions

1. The state should pursue economic policy supporting materialization of positive externalities. There is a wide consensus in economic theory that human capital is an important determinant of economic growth. A higher level of education improves labour mobility and its reallocation towards more productive activities. All in all, economic policy stimulating investment in human capital supports adaptation to new conditions created by the globalization process.

2. Globalization and tax competition exert pressure on cutting down the progression in taxation systems, they are reflected in decreasing tax yields which, in turn, results in a drop in overall budget revenues. Revenues of the central government will be decreasing much more than revenues of local governments, since they chiefly rely on resources in the form of property and business taxes – that is the taxes less exposed to tax competition. Thus, contemporary welfare states stand up to a complex situation. Even though they are widely supported by population in some countries, welfare states must face a call for their reform, which has been provoked by the impossibility to maintain tax burden at the level that ensures sufficient revenues to cover social expenditure and regulatory activities enabling the present level of social protection. So the social role of the state will have to be redefined; the present welfare states are in their current form ineffective and not sustainable in the long run.

3. Globalization is often blamed for recent financial crises. Many economists claim that their frequency increased through the impact of globalization on the movement of hot money. That is the reason why a much narrower space is left

in the global world for populist policy and policy which cannot be sustainable in the long term. High fiscal deficits and non-transparent financial policy leading to inflationary pressures, current account deficits and high real interest rates can be sooner or later penalized by international investors. International financial markets are very sensitive to the character of fiscal policy pursued by the given country and it is perceived as an indicator of macroeconomic responsibility of the government. That develops pressure on governments to pursue a rather strict fiscal policy and win the trust of financial markets

4. It must be stated that globalization generates pressures on restricting governmental interventions in economy. Economic policy will have to adapt to these trends as well. The days of segmented markets and relatively independent national economies able to implement their own economic policy, are numbered. As the space for populist policy has been shrinking in the world, which becomes global exerts certain disciplinary pressure on governments.

5. Governments in many countries may even prefer a less important role of the state in

economy. Nevertheless governmental economic policies are confronted with the problem of legacy of past decisions. Economic and political decisions of former governments codetermine, to a large extent, the present economic role of the state and thus limit the activities of present governments. At the same time, economic policy is challenged by special interests of many groups that benefit from past decisions. These interest groups are often sufficiently strong to prevent or at least slow down the implementation of economic policy reforms.

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Antonín Slaný, Aleš Franc

## Globalizacijos tendencijos ir ekonominė politika

Santrauka

Autoriai nagrinėja valstybės vaidmens pokyčius globalizacijos kontekste. Konstatuojama, kad globalizacijos procesai akivaizdžiai apriboja atskirų valstybių ekonominius reguliavimo mechanizmus. Apibrėžiami globalizacijos pranašumai ir trūkumai, ypač akcentuojama investavimo į žmogiškųjų išteklių reikšmė. Atkreipiamas dėmesys, kad visuotinės gerovės valstybės susidurs su naujais iššūkiais. Valstybės kišimasis į ekonominius procesus vis labiau ribojamas, tačiau pereinamuoju laikotarpiu, kai valstybės turi vykdyti savo įsipareigojimus, jos negali nedelsdamos atsakyti ekonomikos reguliavimo funkcijū.

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*Antonín Slaný* – Čekijos Brno Masaryko universiteto Ekonomikos ir administravimo fakulteto Ekonomikos katedros vedėjas

Adresas Masaryk University in Brno, Lipová 41a, 602 00 Brno, Czech Republic

Telefonas +420 549 49 1032

Elektroninis paštas [prorektor\\_soc@muni.cz](mailto:prorektor_soc@muni.cz)

*Aleš Franc* – Čekijos Brno Masaryko universiteto Ekonomikos ir administravimo fakulteto Ekonomikos katedros doktorantas

Adresas Masaryk University in Brno, Lipová 41a, 628 00 Brno, Czech Republic

Telefonas +420 549 49 4213

Elektroninis paštas [66621@mail.muni.cz](mailto:66621@mail.muni.cz)

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