Is economic sovereignty an illusion?

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The Greek people, who are making an almost superhuman effort to resuscitate their economy, are wondering if their government has ceded control to international lenders by agreeing to harsh measures as conditions for the country's financial rescue. Taxing Greeks, some of whom make as little as US$6,700 (RM20,000) a year or US$560 (RM1,700) per month, seems harsh and punitive. Greek Finance Minister Evangelos Venizelos claims that his country has been "blackmailed and humiliated" and made a "scapegoat" for the EU's "incompetence".

Economic sovereignty strikes at the core of a nation's ability to manage its economy for the benefit and welfare of its people and at its national pride. Remember the uproar among Indonesians when pictures appeared of former IMF managing director Michel Camdessus, with his arms folded across his chest like a stern school principal, standing over President Suharto as the latter signed the restructuring agreement during the 1997/98 Asian crisis? Some Indonesians viewed it as a humiliation reminiscent of the Dutch colonial era.

The issue of an economy's ability to control its destiny resurfaced during the 2008/09 global financial crisis. The real sector of the East Asian economies was pulled down due to a sharp fall in exports even though their financial sectors were strong and could withstand the global volatility. This resulted in calls, including in Malaysia, for a rebalancing of growth, namely by moving from external to domestic sources of growth.

For this to work, however, it is necessary to have a large domestic economy that can balance external downturns. Past experience shows that countries with large populations such as China and India perform better during crises because their large domestic demand works as a ballast against declining exports.

Naturally, countries want to insulate their economies from the ravages of external crises and to be better able to design and steer recovery measures. But in this age of globalisation, when countries and economic activities are so closely interlinked, do nations really have effective control over their economies?

We could see more crises in the future, in no small part due to the massive capital flows moving around to find high returns, resulting in higher volatility in the prices of financial assets, commodities and exchange rates. We also need to watch for financial contagion effects, whereby the collapse of markets and institutions in financial centres has knock-on effects around the world.

On another front, the 2008 crisis and recent food price hikes demonstrate the eroding autonomy of a country in a central area of responsibility to its people — food security. People expect their governments to ensure enough supply of food at affordable prices. When global rice prices peaked in April 2008, supply was uncertain because exporting countries imposed export bans to ensure self-sufficiency. So, even if the people had the money, there was no supply. The threat of being unable to ensure food security caused governments to seriously rethink their policies.

Looking at the present state of economic interdependence, the immediate conclusion is that countries have very little control over their economies. This is something we should examine closely.

In some ways, the degree of economic sovereignty is determined by the growth path taken by countries. It is useful to remember that economic sovereignty has to be balanced by economic growth and welfare enhancement. At one extreme, there is North Korea, which seems to have near complete control of its economy but which is very poor. Many of its people have died from hunger. Myanmar has, for many years, adopted an isolationist policy but the effectiveness of its economic control is questionable as there is illegal trade, under-the-radar foreign investment and a heavy dependence on China.

At the other end of the spectrum, Singapore and Hong Kong are very open economies, which are highly reliant on the global economy and susceptible to volatility. These countries enjoy high

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rates of economic growth and a good standard of living. In between are countries with varying degrees of openness and economic and development achievements. Over time, some of these countries have taken measures to exert their economic sovereignty, in particular when confronted by a crisis.

Raúl Prebisch pioneered the economic dependence theory in 1950s, which led to Latin American countries embarking on import-substitution industrialisation. This is where a country isolates itself from trade and tries to industrialise using only its domestic market as an engine. This was to overcome their trade deficit problems resulting from the collapse of wheat and beef exports. The strategy failed, however, and Latin American countries were soon trapped on a low-growth path.

In contrast, East Asian countries used the opposite strategy (export promotion), which produced high and sustained economic growth. But their success was largely built on the exports of manufactured goods. Today, services have become an important engine of growth and one with increasingly complex linkages to the economy as a whole. The financial sector, particularly capital flows, is a case in point. Thus, the growth strategy and its relationship with economic sovereignty is not as clear as previously.

Countries that have not adequately understood and managed these interdependencies have often got themselves in debt and have had to go bowl in hand to the IMF. The IMF's structural programmes, however, are deeply resented. Critics claim that these programmes threaten the sovereignty of national economies because an outside organisation is dictating a nation's economic policy. They argue that the creation of good policy is in a sovereign nation's own best interests. But if countries are unable to pay their debt, the loss of sovereignty is inevitable. Supporters of the structural programmes believe that the measures will reduce rent-seeking practices and bring long-term benefits.

Argentina and Malaysia are examples of countries that tried to exert autonomy when faced with a financial crisis. In 2002, Argentina defaulted on public debt worth US$132 billion and abandoned the peso-US dollar peg that had been in place for 10 years. The government ordered banks to convert all US dollar savings to pesos. Recession was very painful, with inflation reaching 80% per annum. However, the devalued peso made Argentine exports cheap and competitive abroad while discouraging imports. Argentina managed to return to growth with surprising strength; its gross domestic product grew at an annual average rate of 8.8% from 2003 to 2007.

The Malaysian capital control story is well known and prompted IMF to be open to the idea of countries adopting such measures under certain conditions.

In many respects, countries surrender their sovereignty willingly. The idea of being competitive, meeting international standards, seeking foreign investment and promoting exports are among the ways in which countries submit to international norms. Subscribing to international governance by being a party to international agreements commits a country to adhere to global values. Financial integration will increase economic activities through expanding access to funds. These steps are taken because countries realise that better links with the global economy will bring higher growth and should not be regarded as a loss of autonomy but an improvement in economic management.

The most serious loss of autonomy is through economic union. The EU requires its members to allow free movement of goods, services, capital and people. Those that are in the eurozone have a single currency and set limits on fiscal deficits and public sector debt. However, the current crisis in the EU is a useful lesson to other regional groupings contemplating closer integration, such as Asean.

The EU crisis highlighted the fact that economic union has to be comprehensive and not selective. Central governance should cover not only exchange rates but monetary and fiscal policies as well. And the central body must have the power to implement these policies at national level, which means yielding almost total economic sovereignty. Partial economic union does not work.

So, is economic sovereignty an illusion?

There are two perspectives to giving up economic sovereignty. The first is to improve economic governance by meeting international norms and adjustments to domestic processes within the control of the government. The second is the imposition of structural changes by international lenders when a country cannot pay its debts.

The first approach should be welcomed but of course we must be careful as to the types of norms that we want to adopt.

The second should be avoided. This can only be done when the economy is well managed, maintains strong fundamentals, ensures low indebtedness, has a deep "war chest" (sufficient financial resources) and is competitive. While the degree of trade openness does not seem to make a difference to performance in the long run, the level of financial openness appears very important.

Equally important are sound policy decisions and institutions that in due time will reduce an economy's vulnerability to an international crisis. If an economy is badly mismanaged, then there is no recourse — a country will lose its economic sovereignty significantly. E

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