

DYNAMICS OF THE “ECONOMY-SECURITY” NEXUS IN TRANSITION STATES

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This year's Colloquium takes place under special auspices. Firstly, we celebrate a decade since the fall of the Berlin Wall, which symbolises the demise of communism. Consequently, there is more than a need to take stock of events, of achievements and failures, as a way to scrutinise what lies ahead. Secondly, Europe witnessed another major military conflict this year, within Yugoslavia. This conflict reminded us vividly how much remains unfinished on the Continent in order to have lasting peace and realise economic prosperity for all. Thirdly, against the background of globalisation one can detect a mounting pressure to rethink the architecture of the international financial system, although some of the efforts subsided lately. The Bretton Woods arrangements are seen by many as inadequate for dealing with increasing volatility and spreading financial crises in the world economy.¹ Last but not least, this year signalled the official entry of two other big (populous) countries - India and Pakistan - into the “select” club of nuclear powers. This event indicates that the end of the Cold War is far away from taking the steam out of the arms race. I would even dare to say that the very special status of the USA now - as the only superpower left in the world - prompts other major countries to search for new vectors of power. This status has triggered a peculiar dynamic which, in my view, is going to reinforce tendencies for the creation of a multipolar world.

I have structured my brief intervention along three lines. On one hand, I try to deal with the nexus “economy-security” by originating the roots of crises in the economic field. An alternative perspective is to seek the origin of economic difficulties in the realm of security concerns of countries. And this approach will be used as well. At the end I try to sketch what I see as major features of the world context, which bear on the dynamic of this nexus. I should say from the beginning that my focus is on transition societies which try to construct market-based economies and pluralistic polities.

Economy and Security

That economic health conditions security is a trivial statement and one could question the suitability of mentioning it in front of knowledgeable persons.

What motivates me, however, to remind you of this obvious fact is the balance-sheet of post-communist transition in Europe and the CIS. After a decade of reforms the results are significantly different as compared to early expectations. Transformation has proved to be much more complicated and complex than initially thought. Institutional change, in particular, disproved the tenets of those who espoused a sort of hocus-pocus social science and practice. As against the euphoria at the start, nowadays, sobriety, cautiousness and more open-mindedness mark the conduct of research. Those who stressed the importance of initial conditions, of geography, of institutional change are vindicated by the sequence of events, and they can claim an intellectual victory.² There has been no major conference in the last few years which has not emphasised the importance of proper institutions for the success of transition. Policy is important, but policy itself depends on a propitious context, on preconditions. This is probably the most glaring lesson of transition, which explains why Slovenia and Hungary - which practiced gradualism - stay at the top of the league (of frontrunners) together with Poland, which championed fast reforms.

Let me get back to the nexus we are dealing with. The geography of transition results should give us plenty of food for thought and concern. This is because most of the transition economies are far away from what one considers to be a benchmark workable market economy (as exemplified in the Western world). There is a cluster of economies, in the vicinity of the EU, which score quite highly in many respects of transformation. At the same time, however, South East Europe and the CIS countries remain extremely shaky institutionally, with very depressed levels of output (even if correction is made for redundant output), low saving and investment ratios, and are crisis prone. In addition, most of these countries reveal steadily worsening social indicators (life expectancy, death rates, infant mortality, spread of new diseases, income inequality³, etc.), which is a bad omen for their ability to cope with future pressures. Moreover, weak public governance and a weak state is a constant trait of transition, which reinforces the thinking about unfavourable prospects for these countries.⁴

From this bleak description of transition there emerges an interesting question: is not this state of affairs unsurprising in view of the challenges of transformation, which had remained largely unheeded for many years? And if this is the case, what should be the nature and the order of concerns to policy-makers and analysts? In order to suggest an answer, I would side with those who stressed the unjustified high expectations at the start of transition. I would go further and submit that most transition economies reveal a striking combination of features pertaining to rich and poor countries. For example, the level of education (literacy) and skills, in general, vs. the degree of competitiveness of most of their industries. What is worrying for these countries is, in my view, the steady worsening of the “good” indicators, which may undermine what appear now as factors of strength. In this respect I submit that the experience of transition may lead to a resurrection of development economics along “classical” lines,

seen as a vehicle for helping countries escape the traps of poverty and underdevelopment. The intensity of debate on globalisation and the controversies surrounding the “Washington Consensus”⁵ provide a further argument to this end.

Let me pass to a special category of transition economies, those which I call *distress economies*. The latter can be found in the Balkans, where a decade of massive destruction and human suffering (caused by wars and inter-ethnic strife) complicated exceedingly the tasks of reforms, of transformation. Most of the Balkans is made up of disaster areas, which suffer from huge unemployment, aid-addiction, very depressed levels of output, export stagnation, and rising criminal activity. I should say that disaster areas can be found elsewhere as well; let us think about the Caucasian space of the former Soviet Union, which is also ravaged by military conflicts and very precarious public governance. Nonetheless, nowhere else there does seem to be so much destruction linked with the process of one entity dissolution. The bad news is that the political map of the Balkans is still fuzzy and the current “silence” of the arms is due, to a large extent, to the presence of outsiders, to the functioning of hard and soft protectorates. It goes without saying that sensible economic policies are very difficult to pursue under such circumstances and that economic fragility will continue to mark the life of these countries.

On this line of reasoning, I would highlight the *high vulnerability* of most transition economies. It is noteworthy that this vulnerability is not linked necessarily with financial markets;⁶ it derives from large disequilibria, from very intense strain, which sooner or later comes into the open as high inflation or banking crises, etc. Vulnerability should be judged in a narrow and a broad sense. In a narrow sense it refers to its economic dimension, to the inability to cope with domestic and external shocks. In a broad sense, it points to failures of society (state) to deliver public goods and provide a liveable and empowering environment to its citizens; it signals a high probability for the existence of considerable internal strife, for fragmentation and the upper-hand of centrifugal forces, which can be viewed as real threats to national security. Thence arise temptations to impose authoritarian political solutions as a substitutes for weak state structures.

Security and Economy

One can go the other way around and see how security failures and concerns interfere with and strangle economic advance.

When borders are questioned, or when the process of state-formation is the overriding task of policy-makers, the economy serves an ancillary function. Consequently, and as I mentioned above, sensible economic policies - evaluated from the rationality of market-oriented institutional reforms - are hard to formulate and implement. This combines with the intrinsic pains of implementing reforms when *strain* is overwhelming. For this can be propounded the rationale for and

emergence of the policy propensity to apply *kriegswirtschaft* (*war economy*) - specific means - such as a wide range of direct controls in the economy. Sometimes such controls function in conjunction with quasi- or simulated democratic procedures. Can the economy progress under such circumstances? This is highly unlikely.⁷ For it is one thing to apply public policy (state intervention) as a means to forward reforms and a development agenda⁸, and it is a different thing if controls become ubiquitous and entrenched, and are a means to exert centralised and abusing power.

Very shaky institutional foundations and a weak state are fertile ground for the expansion of underground, parallel, structures. As a matter of fact, in many transition economies parallel structures are so powerful that they determine social and economic dynamics. What has been happening in several Balkan countries, in Russia, Ukraine, etc., is quite relevant in this respect. A big threat to society is that parallel structures, which are non-transparent by definition, are driven frequently and mainly by criminal organisations (networks). Would such organisations (networks) become transparent and submit themselves to the rules of well functioning market economy and democratic polity? I would argue that the victory of the good over the evil cannot be taken for granted, even in the very long run. *Path-dependency* plays a critical role in history. For historical breakthroughs to occur there is a need to combine the action of domestic factors with external anchors, with the “gravitational power” of clubs like the EU and NATO. However, for big countries, like Russia and Ukraine, the efficacy of such clubs can be questioned. In their case internal factors are of paramount importance.

Let me end this section by referring to an issue which was touched upon by Martin Spechler as well. It is about the allocation of resources between different purposes. Transformation is supposed to raise both productive and allocative efficiency, and arguably, to alleviate an old policy dilemma: guns vs. butter (security vs. consumption). However this reasoning may not hold when time is neglected, or when the provision of public goods is impaired by the pains of transformation and the “Big Trade-Off” (between efficiency and equity)⁹ shows its limits.

The World Context

My subsequent glossing over the world context may be viewed by some as unbalanced, and I would not dispute such a judgement. As a matter of fact it is not my intention to deal herein with the “new economy” or as it is said by some pundits, the “new paradigm”. It is not my purpose to analyse the impact of the new information technologies which, some claim, seem to have revolutionised the American economy and ushered in the longest business cycle growth phase after the Second World War. Neither is my intention to look at the process of EU integration, at mega-mergers which seem to have gripped Western economies

in the last two years. All these processes have consequences for the relationship between economy and security, for they mean new technological and economic edges for some, growing divides, and intensified non-co-operative behaviour as well.

Instead I will highlight what I view as security challenges which are rooted in world-wide dynamics.

Globalisation was mentioned several times in my intervention. Usually this process is meant to cover financial and trade-related matters. But there is another space of globalisation, less visible but highly threatening. Let us think of arms and drug trafficking, money-laundering, illegal immigration, etc. Criminal activity is getting a global thrust and it uses increasingly sophisticated means in order to outsmart state authorities. Many transition economies have become “congenial” environments for such activities.

Globalisation is linked also with growing gaps both inside countries and among them. A recent UNDP report speaks eloquently about the dangers posed by a rapidly rising income inequality which, arguably, is enhanced by the new information technologies. Increasing discrepancies between so called knowledge have and have-nots are very likely to strain social structures and create tensions; high inequalities would also impede economic growth, as World Bank studies emphasise.¹⁰ The late backlash against globalisation, which can be detected both in rich and poor countries, mirrors intense social strain which could lead to policy reversals and serious clashes.¹¹ Let us not forget that the period preceding the First World War was one of extreme openness of trade relations and labour movement, but was followed by rising protectionism.¹²

Globalisation can lead to major trade clashes, which, sometimes, can be viewed through the lenses of Huntington’s “Clash of Civilisations”. For example, one should not underestimate the feelings of Asians following the financial crisis which engulfed South East Asia in late 1997 and 1998. Mahathir Mohamad, the Prime Minister of Malaysia, expressed publicly in a very blunt way what other Asian statesmen voiced very softly (diplomatically), or behind closed doors. One strongly held perception was that Westerners use the plight of Asian countries to “colonise” them again economically, that the pressure put by USA and the IMF for financial liberalisation serves only the interests of the American (Western) financial industry.¹³ It can be said that the refusal of major South Korean chaebols to submit to the requirements of Western creditors indicates such a thinking. And the economic recovery in Malaysia and the remarkable rebound of industrial output in South Korea strengthened their leaders’ determination to find a way out of difficulties by not giving in to pressure.

Globalisation effects social psychology, and it can increase fears of and resentment towards neighbours or “those who are not like us”; xenophobia is rising in many parts of the world, including Western Europe. The rise of right wing extremist parties in Austria, Switzerland and Denmark is very telling in this respect.

The comments made above lead us to the issue of fragmentation, be it social or among ethnic groups. There are many revealing examples in today's world about economic strain leading to fragmentation, social and inter-ethnic upheavals. Indonesia is a conspicuous example in South East Asia. But one can argue that in the Balkans, too, economic strains have fuelled the dynamics of fragmentation.¹⁴ Russia, too, feels the heat of this tension; other examples can easily be provided.

If one combines the social tensions and upheavals, which are induced by economic strains, with moral and value-related uncertainties the result can be pretty disturbing. Fukuyama, in a recent book in which he looks at the Western world in the main, talks about the "Great Disruption"¹⁵; he is confident nonetheless that, in the end, human society will reorder itself owing to intrinsic virtues and a natural proclivity for order and self-organisation. I would espouse this optimism were I not so worried about possible long detours and bad path-dependencies. In addition, I would say that the world is so multicoloured and diverse that opinions need to be differentiated according to local circumstances.

I come to the close of my remarks by reiterating nuclear weapons proliferation, for it is one of the new facets of the arms race. The latter is no longer an exclusive affair of governments; groups inside countries can drive it, whether they vie to take over state power, or are engaged in international illegal activities. This dynamic blurs images and hinders the capacity to deal effectively with threats

The plethora of new security threats (including diseases, spreading epidemics)¹⁶ induces governments to seek more co-operation arrangements with partners who share common values and interests. This, too, sounds very much a trivial statement. The big question is what this natural policy reaction means for the dynamic of alliances in the future. Will we see more of the formation of major blocks, whether in trade or going beyond trade. Will the EU develop its own defence capability and what would this mean for the North Atlantic military alliance? If the Euro validates itself as a strong currency, will it join the US dollar as a major reserve currency and how would this affect world financial flows? Will Asian countries reinforce their efforts to develop intra-area trade, or even create an Asian Monetary Authority? These are all questions which imply dealing with the nexus "economy-security".

Notes

- 1 See also Stanley Fischer, "Reforming the international Monetary System", *The Economic Journal*, vol.109, no.459, pp.557-557.
- 2 Since the early 90s the UN/ECE reports have constantly emphasised the time-consuming nature of institutional change and the inherent difficulties of transformation. See also Kozul-Wright, Richard and Paul Rayment, "The institutional hiatus in transition economies and its policy consequences", *Cambridge Journal of Economics*, 1997, 21, pp.641-661.
- 3 Russia, where the Gini coefficient is now above 60%(like in Brazil), underwent this phenomenon in a few years time, which is quite unique in modern history. See in this respect Branko Milanovic, "Income, Inequality and Poverty during the Transition from Planned to Market Economy", *Regional and Sectoral Studies*, The World Bank, Washington DC, 1998.
- 4 I tried to make quite an extensive analysis of transition trends in my keynote speech, "Institutional Change in a Post-Communist Setting", presented at the 1998 NATO Economics Colloquium, in Ljubljana. See the proceedings of the Colloquium.
- 5 See Joseph Stiglitz, "Whither Reform", Speech at the ABCDE Conference, World Bank, Washington DC, 1999. Stiglitz also criticizes sharply traditional aid policies in his "The World Bank at the Millenium", *The Economic Journal*, vol.109, no.459, pp. 577-597.
- 6 Deep financial markets are dangerous whenever macroeconomic policy is not sound and institutions are shaky.
- 7 The case of China merits discussion in this context. In China direct controls are used according to the logic of a functionally dual economy, and they have been used along the trend of gradual economic liberalisation.
- 8 Several Asian states (Japan, and, later, South Korea and Taiwan, Singapore, etc.) are famous for their ability to formulate developmental industrial policies, which proved highly successful.
- 9 Arthur Okun, "The Big Trade-off: Equality vs. Efficiency", The Brookings Institution, Washington DC, 1975.
- 10 The Comprehensive Development Framework (CDF) promoted by the President of the World Bank, Jim Wolfensohn reflects this vision, which contrasts with Simon Kusnets, the economics Nobel Prize laureate's argument, namely that growth assumes and is accompanied by rising income inequality.
- 11 See also Edward Luttwak's book, "Turbo-capitalism. Winners and losers in the world economy", New York, 1999.
- 12 Jeffrey Williamson makes an illuminating analysis of that period and warns that one should not consider globalisation as an inexorable process. See his "Globalisation and the labour market: using history to inform policy" in Ph. Aghion and J.Williamson: "Growth, Inequality and Globalisation", Cambridge, Cambridge University Press, 1998, pp.103-201.
- 13 On this aspect is relevant a New York Times article of 14 February, 1999, which quotes Laura Tyson, the now dean of the Haas School of Business at Berkeley and a former Chairman of the Clinton Administration's Council of Economic Advisers. In her cited remarks she highlights the role of American financial institutions in shaping USA external economic policy, the pressure put on Asian economies to liberalise their financial markets prematurely.
- 14 See Susan Woodward, "Balkan Tragedy. Chaos and Dissolution after the Cold War", Washington DC, The Brookings Institution, 1995.
- 15 Fukuyama asserts that "One of the greatest challenges modern information age democracies face today is whether they can maintain social order in the face of technological and economic change...the tendency of contemporary liberal democracies to fall prey to excessive individualism is perhaps their greatest long-term vulnerability"(Francis Fukuyama, "The Great Disruption.", New York, Free Press, pp.10).
- 16 Think only about AIDS in Africa and elsewhere.