Behind Economic Globalization and the Amazing IT Stock Boom

Tsang Shu-ki
Department of Economics
Hong Kong Baptist University

7 February 2000

The roller-coaster of economic globalization

Well, economic globalization has been going on for a long time. A century ago, Lenin and Trotsky were already talking about the danger of imperialism, i.e. globalized capitalism, and hence the need for world revolution.

In fact the world economy in the late 19th century and before the First World War was quite globalized. Some, like William Pfaff (on the *International Herald Tribune*), even argued that the system at that time, dominated by the British Empire and the gold standard, was more stable than the one that we are witnessing. Now the World Bank and the IMF are presumably weaker than the gold standard in imposing economic discipline across nations; and the US as a world leader is not as commanding as Downing Street one hundred years ago, despite the horrendous arrays of high-tech weapons (as a few other countries do have enough, albeit inferior, deterrents). Moreover, the international financial market is enlivened by egoistic hedge fund managers and philosophical investors like Julian Robertson and George Soros, who some would regard, rightly or wrongly, as international anarchists worse than the assassin who killed an Austrian prince and touched off the First World War.

With a little sense of history, we should know that the world has not been moving in a linear or smooth fashion. The two disastrous wars of the past century were accompanied by severe backlash against economic globalization. Paul Krugman, in his debut op-ed piece on the *New York Times* a month ago, pointed out quite rightly that the process was on the retreat after the 1910s. World trade volume did not return to levels reached then until the 1970s.

Of course, from that time onwards, and especially in the recent years, it seems that globalization has been riding on a J curve again. But sometime in the 21st century, who can rule out the possibility of another infamous retreat?

A backlash, if it does occur, may well be a result of politics rather than economics. Fascism, for example, was an exaggerated political reaction to severe economic dislocations. Hence Krugman insightfully warned against inappropriate politics in the new century.

The anti-WTO demonstrations in Seattle last year were the clearest warning signs that it would not be that easy for globalized capitalism to walk over the world, despite all the economic and military might that the IT revolution might bring to the US. If not properly handled, clashes of civilizations, a là Huntington, could well haunt the 21st century, pitting heartless CEOs of MNCs against environmentalists; Muslims against Christians; and the Russians and the Chinese together against the US and Europe. Economic globalization would then be forced to head home.

A cyberspace nirvana?

There has been so much media mythology about the IT revolution and the Cyber Age that it is useful to ask one very basic question: how are human beings supposed to live in the new millennium? Are we all to become electrons, floating in cyberspace, while Microsoft, Linux, Netscape, and all the other "dot-com" companies arrange our daily life. Will i-banking, e-commerce, and net-office ensure that we can live happily thereafter in our own little computer-based nirvana, without ever stepping outside "home", which might just be a "virtual reality"?

Do we have to be clothed, eat food, stay under a physical shelter, and make non-electronic movement through space by tangible vehicles (including our two legs)? These four basic needs are well known to every Chinese, indeed to every living person. Can IT and cyber gadgets displace or even eliminate those needs?

In my university years (way back in the 1970s), I came across Abraham Maslow's theory of the "hierarchy of human needs": ranging from the very primitive to the spiritual. It was quite consistent with the Chinese philosophy of "sublimation", and I did not have any problem with it. But now the cyber-mythology is challenging this conventional wisdom of the orderly hierarchy.

Yes, for many of us, our needs will be increasingly served by the Internet, including our yearnings for entertainment and enrichment. We may spend more time surfing the cyberspace instead of visiting the cinema, the bookshop or reading newspaper. We may also satisfy our material needs by ordering food, sundry items, clothes and cars through i-shopping. But somebody has to shoot the film, edit the book and front-page the virtual newspaper, so that we can view them on our computer or television screen. And there must be people who labour physically to produce food, clothes and machines for us. A cyberstore also has to deliver the goods to us over actual space. We can't just "virtualize" all of them. We are still humans, not electrons, no matter how electronically oriented we may have become.

In other words, the IT revolution is a breakthrough in enhancing efficiency in information propagation and in the circulation sphere. It will no doubt significantly increase the productivity of actual productive activities. But it cannot replace those activities.

Beware of the Internet implosion

Moreover, let us keep a sense of proportion. Out of a world population of 6 billions, only 230 million, i.e. about 4% are reported to have been connected to the Internet by the end of 1998. I don't how many of them are on broad-band circuits. I am, but my experience in surfing the Net has often been frustrating. It is quite obvious that the percentage of Internet "residents" will continue to rise in the future, particularly as browser service becomes available through television. But many are going to waste a lot of time running through the gauntlet of useless stuff, misinformation and disinformation.

Wynn Quon has also sounded an interesting warning ("The Internet implosion", *National Post*, Canada, 27 January 2000). He pointed out that the Internet population rose from 61 million in 1996 to 230 million in 1998, doubling every year. However, in the top industrialized economies (only where is there sufficient technology and market to sustain the phenomenal growth, which in turn has produced the incredible price-valuations of the Internet stocks), the strict upper limit to the explosion is precariously near. If I may quote him here:

> "Take the U.S. for example. At the end of 1998, about one-third of its population was on the Net. That doesn't sound like too much. But at 100% annual growth, 68% was on the Internet by the end of 1999. By the end of

> 2000, growth will have hit a brick wall because everyone who will have wanted to be on the Net will be there already. ……
>
> The U.S. …… has by far the largest number of Internet users, and the flatlining of its Internet market will have a huge dampening effect. For the Internet to keep doubling, the rest of the world must add 184 million users this year to make up for the U.S. shortfall. That won't happen. Countries with the raw numbers, such as China, India and Brazil, aren't advanced enough in either infrastructure or economic wealth. China had only three million users in 1998. Neither India nor Brazil appears in the list of the top 15 Internet countries. ……… These countries won't be online until far into the 21st century, too late to save today's Internet world from its looming crisis."

I suspect that Quon is too pessimistic. What matters is not just the "size" of the Internet population, but also the "intensity" of their usage of the Net. It is one thing that a surfer shifts aimlessly through the web, settling at nowhere; and another thing that he or she actively uses it to do transactions or conduct business. The latter is what i-shopping and e-commerce are all about. Having said that, though, I fully share Quon's realism. I think that his warning is what anyone sober enough in the present euphoria should bear in mind.

Uneven economic developments

Quon's alarm bell is also instructive if we take our eyes away from the Wall Street and the Silicon Valley. The world remains a place where developments are extremely uneven. For most of the populations in Africa, Latin America and Asia, the cyber-dream remains exactly what it is: a dream. Many have not even heard of the telephone or the fax machine! Paul Kennedy, in his perceptive book, *Preparing for the Twenty-First Century*, published in 1993, highlighted so well the crucial contradictions of the world's economic developments. Silicon valleys are lamentably few in number, and are concentrated in a handful of places in the US and Europe; but population pressure is exactly the strongest in countries where there are no such valleys. In other words, there is a severe mismatch between technology and demographics.

The hope is of course that the process of economic globalization aided by IT revolution would spread quickly around and result in an increase in worldwide purchasing power. People's real income should be raised because goods and services are made much cheaper. However, as I argued in another piece on this website ("Long Wave, Globalization and Technological Salvation"), it all depends on whether the expansion effects of globalization can more than offset its displacement effects, particularly in the context of the labour market.

Optimists will no doubt point to the historical lessons of the Industrial Revolution and accuse sceptics for behaving no differently from the Luddites who broke up machines in the fear of having their jobs replaced by steam-puffing monsters. Eventually, the Industrial Revolution would have created so much demand that the fear turned out to be totally unjustified.

That is a very long historical view. Longer even than a long wave. I am confident that things would get sort out before the end of the 21st century. That would be much quicker that the few centuries required by the Industrial Revolution. But mind you many of Luddites were right: they did lose their own jobs. What happened in historical eventuality was not at all their concern.

As in any technological breakthrough, huge reallocations of economic interests are at stake. A few could become the super-rich. Many others' livelihood would be severely affected. One big difference between the Industrial Revolution and the IT revolution is the speed with which changes are spread. The Industrial Revolution was pushed largely through railways. But the present IT upheaval is pioneered by electronic and air waves. The reallocation of fortunes and the dislocations caused to many who are not ready (the absolute majority) are bound to be much more significant this time round.

At least in the short run, IT-aided economic globalization seems to be reducing costs at a speed higher than that of creating net demands, i.e. the displacement effect dominates the expansion effect. That is going to be bad news for many workers who are within the orbit of the Internet revolution; Wynn Quon's reservations about its short-term worldwide reach notwithstanding.

Hong Kong is an example that I am particularly concerned with, for very obvious reasons. Given transition politics, structural imbalance in the economy, worsening inequality in distribution, and aggravating demographics, the current rush to join the IT bandwagon by the big and small guns alike could in itself lead to a bubble, similar in nature to the pre-1997 property-driven one. It may simply be an indication that people in Hong Kong can't think of much else to do, other than jumping onto the fads of the west. Taken more seriously, for a small open economy that so enthusiastically logs on the Internet, and which professedly serves global capitalism, creating jobs for the labour force that is growing at double the rate of the past poses a huge challenge. A "dual economy" under "one country two systems"; and having to face the onslaught of the Internet Age! I really hope that there are enough smart decision makers around.

The amazing IT stock boom

Despite, or indeed because of, unevenness, it is not surprising that the US, as the leader in IT and economic globalization, could within a certain time limit earn huge profits and bask in prosperity, particularly in an atmosphere of financial euphoria. The inherent problems are simply exported to other economies, which try to emulate the US or are forced to follow suit. Other countries not in a position to join the bandwagon will be under tremendous pressure and have their growth curtailed. Over time, in any case, the global demand constraint would become binding and could result in a drastic consolidation.

It is foolhardy to expect a technological revolution to generate worldwide effects in a smooth manner. Recessions or even depressions are likely on the way. They may turn out to be more far-reaching in an era when contagions are spread electronically.

In this regard, the high-tech stock bubbles in the US and several other regions of the world are both worrying and understandable. Relevant indexes have been defying "common-sense" predictions for a few years now. The thrust has of course been the spectacular surge in the prices of Internet stocks.

The most famous recent example has been provided by the AOL-Time Warner corporate marriage. It was set to produce a conglomerate of US$350 billion, priced at a PE ratio of 300 and ten times the gross revenue of the companies. As Philip Bowring said last month on the *SCMP*, AOL as a provider of browser services could be swept aside by a twist in technological progress, and Time Warner is a mature corporation with relatively limited growth potential. So the valuation is really puzzling.

Nevertheless, more soap operas like this are sure to hit the market in the coming months or even years. The bubble is going to further balloon before it bursts. The unevenness in technological progress, in favour of the US for the time being, is a key reason behind the rise through the stratosphere of the prices of those IT stocks (and their non-US relatives, including those in Hong Kong).

The narrow field of profitability

Another important factor behind the amazing boom has been the recent changes in the international financial scene. As a result of the East Asian crisis, the foreign exchange and the bond markets over a large part of the world have almost become stagnant waters. The Euro has already been a nightmare to many forex dealers. The floating of key Asian currencies, the strengthening of Hong Kong's currency board regime, and the imposition of exchange controls in Malaysia all conspire to force premature retirement on the "whiz-kids" in the region. Moreover, central banks everywhere seem to have learnt a big lesson; and have therefore turned more disciplined. So even interest rates are showing less variability. Predictability, mind you, is poison to fund managers.

I won't put too much of my money on the alleged death of the foreign exchange and bond markets. Remember that under the old gold standard, there was not much to speculate about either. History later more than compensated for the boredom by the competitive devaluations of the 1930s.

What has been happening in the near run, though, is that the huge amount of funds floating around the world, which dwarfs any historical comparison, has lamentably few profitable outlets. Unwittingly, the supply of funds has been electronically facilitated by IT and is so forthcoming. I doubt whether at any other time in history was there a more acute mismatch between the supply of funds and their possible profitable (not to say productive) uses. I am willing to be corrected.

The stock market, relatively unaffected by the rapidly changing financial scene and sensationally boosted by the promises of the "new economy", seems a natural destination for hot money seeking the bets of a life time. After all, companies are where the real sources of spectacular growth should emerge, as any loyal investor in Microsoft in the past years could attest.

The risk is of course that so much has been invested in such an uncertain and volatile field of hopes, glamourously promised and promoted by all those companies with "i" or "e" in front of their names; and/or with ".com" afterwards. The "conventional" wisdom, fast adopted, is that not even one in ten of them is going to survive the market test. But then everybody thinks he or she is the smartest and could make the timeliest exit.

So……..

So I think the saga would go on for some time before the auditor finally turns serious, impatient or even intolerant. We are facing a technological breakthrough that is simultaneously constrained by various economic, demographic, and political factors. Financial euphoria in a world of limited profitable opportunities is a smokescreen that renders the truth elusive and may contribute to a nasty bust. In any case, the IT revolution will take years, not months, to sort out and will take decades to filter through. The ride on the way will be bumpy and drastic reallocations of interests are at stake. The political repercussions have to be handled very carefully.

In textbook terminologies, the supply and the demand curves would be shifting in all directions before eventually settling down. It will not be plain sailing; and the 21st century is as wide open as the 20th century was.