The Future of Globalization

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I. Underlying problems

- Globalization has not always been well managed
  - We have a system of global governance without global government
  - Economic globalization has outpaced political globalization
  - In our piecemeal system of global governance special interests dominate
  - We have not been able to adapt our system of global governance to the realities of the 21st century

- We have learned how to "temper" the market economy, so that most individuals benefit
  - But we have not yet learned how to temper globalization
- Globalization has exacerbated problems of inequality
  - But has hampered the ability of the nation state to do anything about it
- Today, global rules threaten the ability of governments to protect the environment, protect the health and safety of their citizens, ensure the stability of the economy

- Globalization has facilitated not only good things moving across borders, but also bad things
  - America’s toxic mortgages
  - Terrorism
- Globalization has created more interdependence
  - What one country does has more effects on others
- But the locus of decision making—and responsibility for addressing social responsibility—remains within the nation state

Central irony

- Citizens are told globalization will bring new prosperity
- But for many, globalization seems to have led to lower wages, incomes
  - Predicted result of standard economic theory (factor price equalization theorem)
- But then they are told: to compete in a globalized world there have to be cutbacks in public services, lower corporate taxes, less progressive taxes
  - Leaving them worse off on both accounts
- Reality is that many modern economies are failing—not delivering for most of their citizens
  - In US, median income lower than it was a quarter century ago
  - Median income of a full time male worker lower than it was four decades ago
  - And poorly managed globalization may be part of the reason why this is so

II. Successes of Globalization

Globalization can be a powerful positive force:

- Globalization of ideas
  - Democracy, human rights
    - Arab Spring
    - Gender rights
- Globalization of knowledge/technology
  - Extending life spans
- Achievements of global civil society:
  - Land mine treaty
  - Debt relief

Successes of Globalization

- East Asian countries took advantage of globalization *in their own way*
  - Took advantage of access to global markets
  - Took advantage of access to global technology
  - But took care in sequencing and pacing
    - China has still not fully liberalized its capital markets
    - And was slow to reduce to reduce trade barriers

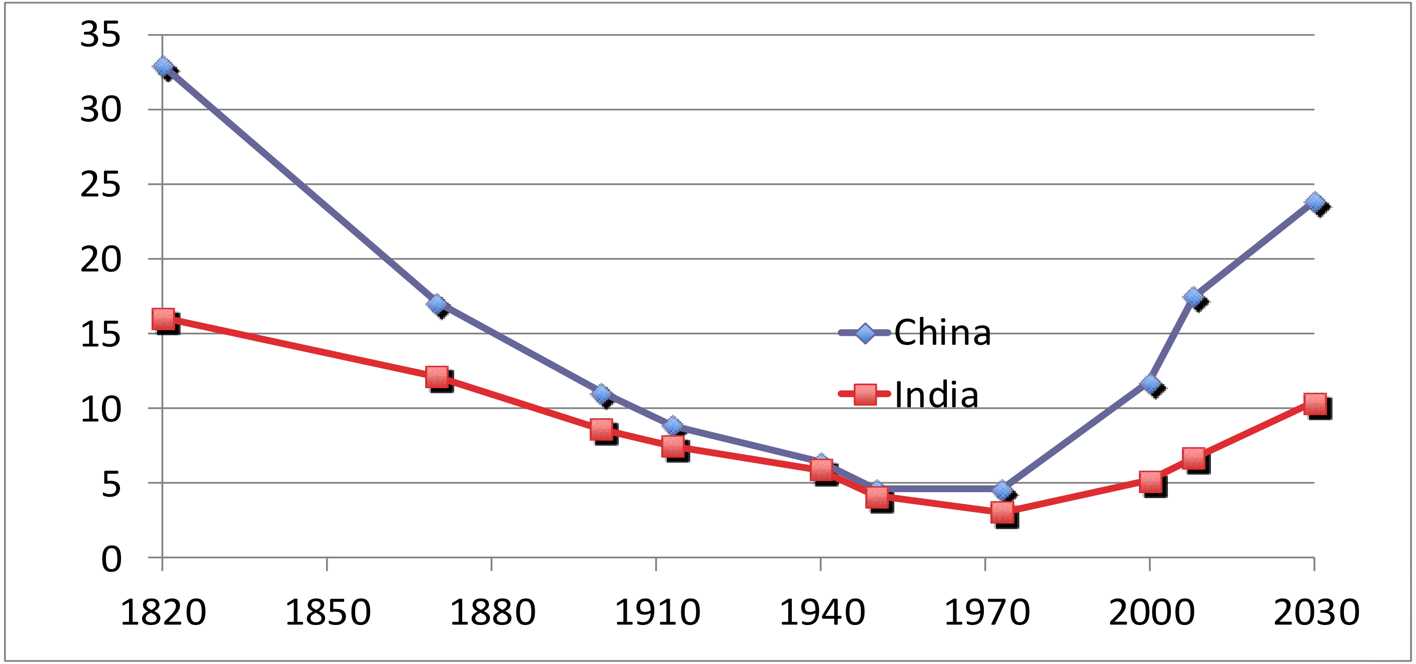
So successful that there is a changing global economic landscape

- China and India, with 2.5 billion people, have been growing at historically unprecedented rates
- Countries that were marginalized, excluded from global economy are closing the gap with advanced industrial countries
  - China at close to 10% for 30 years; India between 2004 and 2009 at 8.5%
  - With new PPP, China will become largest economy in the world in September
  - Already largest trading economy
  - And largest saver

Historical perspective

- In 1820, China had 1/3 global GDP, India more than 15%
- Between 1814-1828 Industrial Revolution and tariff barrier knocked out Indian exports
  - Indian textile exports to Britain fell by two-thirds
  - British exports of textile to India rose five times

China's and India's shares of world GDP



New Global Landscape

- A half century after end of colonialism new role of emerging markets, especially in aftermath of crisis
  - New sources of economic growth and patterns of trade;
  - Global growth at 5% for years before recent downturn has been almost historically unprecedented;
  - With Europe in recession, and low US growth, emerging markets have become engine of growth;
  - China played major role in growth in Latin America and Africa, especially through impact on commodity prices.
  - Increased demand for commodities has helped developing countries both before and after crisis
- Leading to a new balance of economic and political power

III. Globalization and social sustainability

- Globalization—particularly if it is not well-managed—can lead to growing inequality
- If there is a perception that globalization has significantly contributed to inequality, there will be increasing opposition to globalization

Some reasons that globalization is contributing to inequality

- Failure to create international rule of law—e.g. covering bankruptcy
- Failure to regulate
- Failure to coordinate
- Failures in trade

A. International bankruptcy

- Bankruptcy—and bankruptcy laws—are a fundamental aspect of modern capitalism
  - Both efficiency and equity require giving a “fresh start” to those who become over-indebted
  - Balanced bankruptcy law provides incentives for both lenders and borrowers
- But we have no sovereign debt restructuring mechanism

Argentine case

- In 2001 IMF highlighted need for a Sovereign Debt Restructuring Mechanism (SDRM)
- US vetoed efforts
- Argentina restructured debts—enormously successful—more than 90% accepted, high growth after default
- But vulture funds are trying to making debt restructuring impossible
  - Buying bonds at a deep discount, then suing

- Renegade ruling by American judge requires full payment of vultures if any payment is given to those who have accepted restructuring
    - “Novel” interpretation of pari passu clause
    - Declared Argentina in contempt of court for not repaying
    - Even though Argentina fulfilled contract turning over money to dispersing agent—court ordered dispersing agent not to disperse funds
- Threatens sovereign debt markets going forward
- Argentina has used growth to reduce poverty—but if American judge’s order prevails, Argentines will have to turn over huge amount to money to vultures, and its ability to continue efforts to reduce poverty would be greatly impaired
- On September 9, the UN General Assembly, by a vote of 124 to 11 (with 41 abstentions) voted to create a multilateral negotiating process to create a framework for debt restructuring
    - US led opposition, under the influence of vultures

B. Failure to regulate

- Before crisis, US toxic bonds moved freely across borders
  - America's regulatory failures became global problem
- Since then slow agenda for reregulation
  - With banks having undue influence
  - Problem of too-big-to fail, too-connected-to-fail banks even worse
  - Lack of transparency

Basic economics

- Regulations are necessary to deal with externalities
- With financial globalization, what one country does has large effects on rest of world
- But with globalization and unfettered capital flows, there has been a race to the bottom
- Before the crisis, Iceland and other low-regulated states won the race
- At great cost to themselves and world economy
- Need cross-border regulations

Regulations on cross-border capital flows

- Liberalized capital and financial markets a major source of volatility in the global economy, especially costly to developing countries
  - East Asia crisis
  - Played important role in spreading and amplifying 2008 crisis
  - Contrary to assertions of free market fundamentalists who claimed that they would increase stability and growth, evidence (and theory) is just the opposite
  - Now even the IMF recognizes need for capital controls (capital account management techniques)
  - But it is the poor who always bear the brunt of this instability
    - Unemployment
    - Wage cuts
    - Cuts in public expenditures

C. Failure to coordinate

- Large *macroeconomic* spillovers
- Major success: coordinated response to 2008 crisis, through G-20 London meeting, large Keynesian stimulus
  - Prevented global crisis from being worse
  - Moderated implementation of protectionist measures that might have made downturn worse

QE: A major failure

- Benefits to US were limited, costs to emerging markets large
- With globalization money went to where returns were highest
- In booming emerging markets
- Increasing inflationary pressures, leading to exchange rate appreciation, distorting their economies
- And not to where it was intended and needed—the US
- Partly because the US hadn't (and still hasn't) really fixed its financial markets
- Credit channel blocked—with US government still underwriting most mortgages and small and medium sized loans markedly down from before the crisis

Monetary policy contributing to inequality in US

- A major basis of the limited effect is inflating stock market—boom benefits mostly the very rich
  - Low interest rates hurt prudent elderly who put their wealth into safe government bonds
  - Low interest rates encourage firms that do investment to use very capital-intensive technique
    - Leading to further unemployment, especially of low-skilled workers
- Helps explain why 95% of the gains since the "recovery" have gone to the top 1%.

Policy understandable

- Fed had played a central role in creating crisis, now felt it had to do something to address it
- And gridlock in America's political system meant that the more effective fiscal tools couldn't be used
- Monetary policy only game in town
  - Still, should have put more emphasis in fixing credit channel
  - And should have put less focus on saving on the big "global" banks, more on saving the local and regional banks which are responsible for *real* economic activity

D. New trade agreements

- Old trade agreements focused on lowering tariffs, leading to greater overall efficiency based on comparative advantage, with consumers benefiting
- Even then, if the pace of liberalization was wrong, job destruction outpaced job creation, and unemployment increased, growth decreased
  - Especially important in developing countries
- But tariffs now are very low
  - So new trade agreements are about something else

- New trade agreements are an end-run around democratic political processes to reduce environmental, safety, health, and other regulations and to tighten, in an unbalanced way, intellectual property rights
    - With particularly adverse effects on ordinary citizens
- Lack of transparency in negotiating process—with corporations having favored access to information—particularly disturbing

Example 1. Investment agreement

- Supposed to strengthen “property rights”
  - But is there a deficiency in property rights protections in Europe?
  - If there is a deficiency, shouldn’t it be fixed for all citizens, not just foreigners?
- New opium war
  - Using investment agreements to undermine health regulations to reduce smoking
  - Uruguay’s laws praised by WHO
  - But now Uruguay is being sued under investment agreement

- Financial market regulations
  - Crisis showed how important they are
  - Global recognition of dangers of under-regulated derivatives, cross border capital flows
- But USTR wants to inhibit ability of governments to regulate financial markets through trade agreement
  - Example: Chile, and its ability to respond to QE

Example 2: Access to lifesaving medicines

- Critical to have a well-balanced Intellectual Property Regime
  - Even the US Supreme Court has recognized need, denying patents on genes
- But trade agreements have pushed an unbalanced regime
  - Global recognition that TRIPS agreement (in 1994 Uruguay Round) was unbalanced
  - But new agreements being negotiated by US are even *more* unbalanced
  - With especially adverse effects on poor

While globalization has contributed to inequality, it has impaired the ability to address it

- Tax avoidance by corporations has become a global problem
  - Apple and Google have been as ingenious in avoiding taxes as in creating new products
- In many places, response to progressive taxation is for individuals to move elsewhere
  - Maybe an especially important problem within EU

Two solutions

- Redistributive taxation must occur at a “high” level
  - In EU, in Europe-wide progressive taxation
  - Global capital taxation
- Or taxes within each country must be based on global income
  - As in the US, at the individual level
  - Corporation taxes based on real activity occurring within the country

IV. Concluding remarks

- Globalization has brought many benefits
  - Including helping many countries in the emerging markets to close the gap between themselves and advanced countries, moving hundreds of millions out of poverty
- But it has contributed to inequality within developed countries, and inhibited their ability to address these inequalities
  - Results are not inevitable
  - Result as much of the way we have managed globalization—in the absence of an effective system of global governance

Unbalanced globalization has resulted in further problems

- Excesses of financial globalization have contributed to global instability
  - May have contributed to the excessive role of financial markets in most countries
  - And may have hampered the growth of some countries
- Imposed threats to environment
- And especially new trade and investment agreements pose potential threats to the regulations that play an important role in tempering excesses of the market economy

Globalization can be managed better

- In ways in which the adverse effects can be mitigated, while retaining the positive benefits
- But this will require major changes in the governance of globalization

- It has been managed for the special interests of certain sectors within certain countries
- With undue influence of a flawed ideology (“market fundamentalism”) fashionable in the era of rapid expansion of globalization, but since discredited
- Changing governance is difficult
  - US refused to ratify and implement even changes agreed to by G-20

But changes are on their way

- New institutions, to reflect better interests and concerns of developing countries (BRICS bank)
- New awareness of problems
  - Civil society opposition around the world to new trade agreements
- New evidence on the importance of social sustainability
  - IMF studies showing that inequality is bad for economic performance
  - New studies, like *The Price of Inequality,* arguing that we have better economic performance and greater equality.