

Background notes on globalization

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Narrow definition of globalization: Economic integration, through increased flows of goods, services, investment and labor, information, and ideas.

Broader definition includes cultural, political, military integration.

Basic disagreement about role of markets

- Debate over merits of globalization have “taken the place” of previous debates over merits of capitalism and imperialism.
- Pro- and anti- have different views of roles of markets and governments.
- Globalization associated with increased role of markets, changing role (“internationalization”) of governments.
- Real policy choice is not either/or, but about the rules under which the market operates

Brief overview of policy, last 60 years

- The “orthodox view” changes over time
- Post WW II orthodox view favored reform of capitalism, heightened government intervention
- Creation of IMF, World Bank, attempt to create International Trade Organization
- Post Soviet (early 1990s) orthodoxy saw markets as pre-eminent.

Changing perception of international institutions

- Role of IMF to avoid financial crises by making short term loans to countries with severe short term balance of payments deficits.
- Today IMF critics see its role as enforcer of “neo-liberal” policies.
- IMF does not want to subsidize policies that contribute to a country’s financial crisis.

The ITO—GATT—WTO

- ITO Charter agreed at UN in 1948
- Objective to promote free trade
- US critics call it “Economic Munich”, claim excessive reliance on government interventions. US refuses to ratify 1950.
- GATT adopted 1948 by 28 of 50 countries negotiating ITO. Seen as forum to enable trade negotiations.
- Several rounds of GATT.

The World Trade Organization (WTO)

- Uruguay round leads to WTO.
- Critics object that WTO is a wealthy nations' club that promotes special interests, e.g. ag, pharmaceuticals.
- Current "Doha round", billed as the "development round" appears to have collapsed, largely over disagreements about rich countries' ag policies, and developing countries' liberalization requirements

Trade and development strategies

- A simple model divides economic activity in “export” and “import” sectors.
- Basic economic fact: When factors of production enter one sector, they leave some other sector. A subsidy on one sector is an implicit tax on other sectors. (Illustrate using production possibility frontier)
- Import substitution policies: promote growth by subsidizing/protecting industries that compete with imports. (Latin America)
- Export promotion policies: promote growth by subsidizing/protecting export sectors. (Southeast Asia)

Effect of policies, debate over their merits

- Import substitution policies decrease trade, export promotion policies increase trade.
- Both involve government intervention in market.
- Rationale for govt. intervention: market failures. Example: (i) infant industry argument (ii) promote foreign direct investment (FDI).
- Skepticism of govt. intervention: informational and institutional problems.

Basic arguments for free trade

- Trade intervention “distorts market signals” leads to inefficient allocation of resources.
- Trade intervention protects domestic monopolies, increases their market power.
- Trade restrictions limit range of products available to consumers (in addition to price effect).
- Trade and investment restrictions impede adoption of new technology.
- For all these reasons trade restrictions reduce economic growth, and welfare.

Graphical illustration of trade restrictions

- Use supply and demand and “surplus” to show efficiency and distributional effects of trade restriction (import tariff or export tax) for “small country.
- Assumptions of model: No “market failures”: there is perfect competition and there are no externalities.
- Market failures makes the study of economics interesting. Market failures are central to this class.
- In order to understand the effect of market failures, it helps to understand how markets work in the absence of those failures.

Lessons from partial equilibrium model

- (i) There are gains to trade for both importers and exporters.
- (ii) Policy changes, e.g. a move from autarky to free trade, or a change in tariff level, have distributional effects. Some people win and others lose.
- (iii) Trade restrictions lower aggregate welfare: the gain to the winner is less than the loss to the loser.
- (iv) The welfare loss is proportional to the square of the trade restriction (e.g. the tariff). Therefore, if the trade restriction is small a further reduction in the restriction (a movement toward free trade) has a very small welfare effect.
- v) The distributional effect of a trade restriction is large relative to the welfare effect. The amount by which a winner gains or a loser loses is large relative to the net losses.

Why do countries pursue “harmful policies”?

- Benefits of trade restriction are concentrated, costs are dispersed.
- Problems of collective action make it easier to lobby for, rather than against trade intervention.
- Difficult for governments to resist political pressure.
- “External rules” (e.g. GATT) limit freedom of government action, can increase welfare

Why does a country want its partners to liberalize?

- Even if all partners are small (so each country has negligible effect on market) their cumulative effect can be large.
- If you *export* food (for example) you want partners to eliminate policies that reduce the price of food (e.g. their production subsidies and import restrictions).
- How should a country that *imports* food feel about policies that reduce the price of food?

Early US experience with protectionism

- US trade embargo 1807-1809 reduced US GDP by 8%, during a period when trade/GDP ratio was 13% (i.e. small).
- Early 1800's US imposed the "tariff of abominations". Reduced trade and promoted development of "infants", many of which subsequently succumbed to international cooperation

Evidence linking trade to growth

- Important difference between statistical analysis and selection of facts (e.g. correlations) to support a view.
- But... developing countries growth rates higher in 60s and 70s than in period of rapid globalization, the 80s and 90s.
- Different views on strength of statistical evidence that trade promotes growth. Trade does not retard growth.
- China very important in statistical analyses.

Trade is not *sufficient* for growth

- Example of Haiti
- Increased recognition of importance of institutions.
- Trade is a convenient “policy lever”. It is hard to change institutions.
- Economists broadly agree that “free trade” is better than restricted trade.
- There are exceptions (market failures) – a major emphasis in this class

“Washington Consensus”

- Usually a term of abuse. (See George paper.)
- Favors privatization of public services, reducing or eliminating barriers to trade in commodities and barriers to movements of capital, and floating rather than fixed exchange rates
- International labor mobility not a key part.
- The “end of history” beginning early 90s

Erosion of “Consensus”

- Asian financial crises late 90’s.
- Implosion of Argentine economy early 2000’s.
- Low growth in developing countries.
- Rise in anti-globalization movement.
- Emerging political and military crises (the “war on terror”).
- The end of the “end of history” beginning late 90s, early 2000s

Battle-lines between “pro and anti-globalizers”

- There are pro-market “anti-globalizers” (e.g. environmental groups favoring the use of markets). Skepticism about planned economy.
- Some mainstream economists are critical of features of globalization (e.g. free mobility of international capital, free currency convertibility; specific trade rules such as TRIPs (trade-related intellectual property))

Criticisms of international institutions

- Lack of “democratic accountability”. (Do courts “restrain democracy”? Fast-track authority.)
- Lack of access. (“Friends of the court” briefs)
- Lack of transparency.
- Reform or dismantle international institutions?

What is the source of difference between pro- and anti-globalizers?

- Different objectives (e.g. industry and labor groups interested in profits and jobs, environmental groups interested in environmental protection. Remember the “time dimension”).
- Different emphasis on the different environmental services (e.g. provisioning Vs cultural).
- “Economy vs. environment” is not a good way for environmentalists to frame the debate.

Differing emphases on inequality

- . Should we care about relative as well as absolute levels of consumption? What are the individual and social implications of inequality? Does globalization increase inequality?
- The stock economist's response: use trade to increase size of pie, and other policies to address inequality.

Kanbur's paper: different views about economic development

- Paper was written after two years of consultation on poverty reduction standards, with academic, policy making, and advocacy groups.
- “When an institution (WB) whose self-stated mission is to eradicate poverty can only hold its Annual Meetings under siege from those who believe its mission is to further the cause of the rich and the powerful, there is clearly a gap to be bridged. ”

Question in Kanbur's paper

- "How can people who agree on ends (poverty reduction) disagree so vehemently on means?"
- Seeks to explain different views as a result of difference in perspective, rather than difference in motive or intelligence.

Areas of agreement

- (i) Health and education outcomes are as important as income in assessing poverty. (This area of agreement is relatively recent. Today's debate involves importance of participation and empowerment.)
- (ii) Importance of public intervention to promote international public goods, such as environmental protection, financial stability.
- (iii) Pragmatism regarding role of markets. Agreement about importance of institutions in regulating markets.

Simplified description of debate

- Group A is "Finance Ministry", including economic journalists and many academic economists.
- Group B is "Civil Society", including NGOs, aid and development workers, non-economist academics. Former favors rapid globalization, latter opposes it.

- “...the lack of mutual comprehension is leading to polarization, with Group A often retreating into the formal technical bunker...and Group B dismissing Group A's analysis as either out of touch with reality or ...actively manipulated to get certain answers.”

Kanbur's explanation for division between “A” and “B”

- Different assessments of benefits of rapid globalization are due to different perspectives on Aggregation, Time horizon, and Market Power.
- Group A concerned with higher level of aggregation (and thus less concerned with distribution); more concerned with medium, rather than short and long run; tends to view world through lens of perfectly competitive model.
- Group B places more emphasis on outcomes for poor; both short run and long run perspective; has in mind model of market power.

Example of poverty assessment in Ghana based on income-expenditure data.

- Early 90s estimate showed that the fraction of people living below a poverty level had declined by 3 or 4 percentage points. Few people in Ghana believed this result. Reasons for disbelief:
 - (i) the data does not capture the value of public services, which might have deteriorated.
 - (ii) Regional variation. Rural poverty decreased and urban poverty increased. National poverty had decreased, but some major groups have been made worse off.
 - (iii) Group A focuses on incidence of poverty, group B thinks of absolute numbers. (The International Development Target is to cut in half the incidence of poverty.) In Ghana the population was increasing more rapidly than the incidence of poverty was falling, so absolute number of poor increased.

Difference in time horizon.

- Group A has a 5-10 year time horizon.
- Group B is concerned about short-run vulnerability. Group A recognizes importance of safety nets, but sees these more as an add-on. (Safety nets were "banished" in the 80s after their misuse and inefficiencies during the 60s and 70s.)
- Group B sees safety nets as essential to policies such as trade openness; Group A would recommend trade openness even in the absence of these safety nets.
- Environmental groups have a time horizon of 50 - 100 years. Current levels of consumption are not sustainable, especially if the poor have consumption levels similar to the rich. Increased consumption by the poor requires redistribution.
- Group A are "techno-optimists". They also doubt that massive redistribution from rich to poor is feasible in the middle term.

Disagreements about market power: example 1

- Standard theory (*with competitive markets*): Liberalizing trade benefits the “relatively abundant” factor, harms relatively scarce factor.
- US and Mexico, two factors: “skilled and unskilled” labor. Unskilled labor relatively abundant in Mexico.
- Relaxing trade restrictions benefits unskilled labor in Mexico, harms unskilled labor in US.
- Welfare effects ambiguous with imperfectly competitive markets, or other market failures.

Disagreements about market power: example 2

- Group B thinks that free mobility of investment capital harms workers in both source and host countries.
- This view is “incoherent” if markets are competitive. (Workers in one of the countries must benefit.)
- If wage outcomes determined by bargaining rather than market, capital mobility increases capital’s bargaining power.

- Group A sometimes claims B is anti-growth. B favors growth but disagrees with policy prescription.
- Group A has tried to remain “on message” because “an inch of nuance leads to a mile of protection”.
- Group A wants to avoid “mission creep”.