



# WHAT IS THE PHENOMENON OF GLOBALIZATION?



- Closer integration of countries & peoples of the world that has been brought about by the enormous reduction of costs of transportation and communication, and the breaking down of artificial barriers to the flow of goods, services, knowledge and people across borders
- Creation of new institutions working across borders
- Three main institutions govern globalization: IMF, World Bank and WTO

# THE PROMISE OF GLOBAL INSTITUTIONS



Globalization has helped:

- Countries grow faster by opening up to international trade
- Reduce the sense of isolation
- Millions by bringing them foreign aid benefits



*Then, why has globalization become so controversial?*

# THE PROMISE OF GLOBAL INSTITUTIONS



- Growing divide between haves and have-nots has left increasing numbers in the third world in dire poverty
- Neither has globalization succeeded in ensuring stability
- Western countries have pushed poorer countries to eliminate trade barriers
- Environment has been destroyed

# THE PROMISE OF GLOBAL INSTITUTIONS



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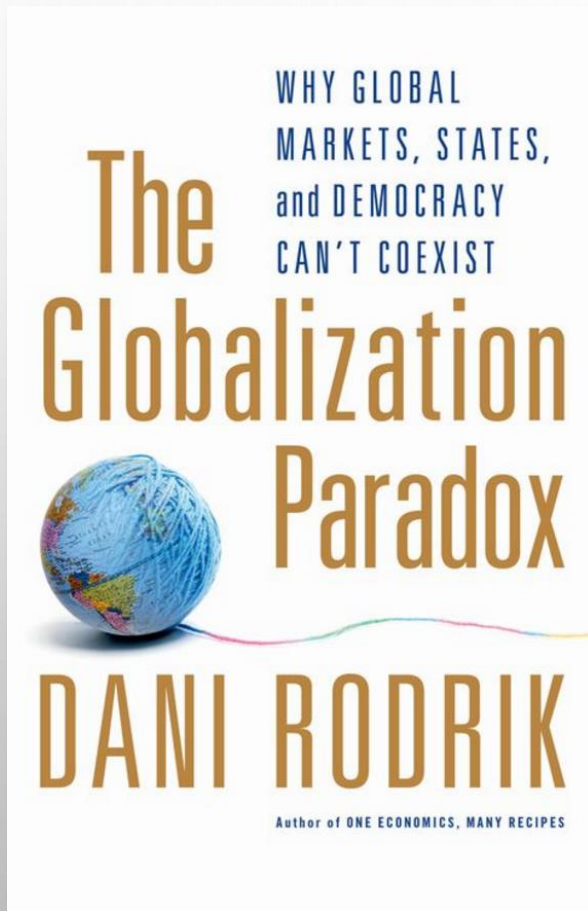
- These institutions could have provided alternative perspectives on challenges to development and transition *but* were driven by the will of G-7
- The IMF has **failed** in its mission of promoting global instability; has also been unsuccessful in guiding transition of countries from communism to a market economy
- Jobs have been systematically destroyed before countries' industrial & agricultural sectors were able to grow strong and create new jobs
- Maintaining tight monetary policies has led to interest rates that would make job creation impossible
- Those who lost jobs were forced into poverty

# THE PROMISE OF GLOBAL INSTITUTIONS



- Globalization is neither good or bad. It has the *power* to do enormous good
- Process of 'globalization' analogous to the earlier processes in which national economies were formed
- Unfortunately, no world government, accountable to all the people of the world
- Current system is that of *global governance without global government*

# THE GLOBALIZATION PARADOX



- Lessons are learnt crisis after crisis ; Asian crisis, the U.S. Crisis , they are resulted from the free mobility of financial capital
- However, no economist is against globalization, but new institutions and compensation mechanism needed to be created in order to render globalization more effective, fair and sustainable.
- Globalization brings about prosperity to advanced countries down to poor workers in developing country, yet it rests on shaky pillar, says, global market suffers from weak governance,
  - e.g. There is no global authority, no global lender of last resort/regulator/safety net/democracy as a result is prone to instability and weak legitimacy.

# THE GLOBALIZATION PARADOX



- The result of **hyperglobalization** was that it promoted instability, inequality and insecurity instead of lifting all boats.
- Some country like China, instead, chose to pursue a mixed strategy with heavy state intervention .
- 2 ideas are learned
  1. Market and government are complements, not substitutes.
  2. Capitalism does not come with a unique model.

# GLOBALIZATION IN HISTORY'S MIRROR

- During the British colonizing period, mercantilist idea was predominant (high import tariff, reservation of raw material to domestic producer)
- But they also believed in the capitalism and export, says, the state and commercial enterprise are to serve needs of each other (economics and politics are tool for each other)
- **Adam Smith** (economic liberals), against the mercantilist idea, he thought the state-business collaboration is another name for corruption. He proposed that the market should be free of state control and roles of government are limited.
- Rodrik: “Smith was wrong!” **Market necessarily requires non-market institutions in order to function**, not necessarily in the state, e.g. The chartered trading company functioned like the state at that time (as those functions were needed to conduct trade, enforce contract)

# GLOBALIZATION IN HISTORY'S MIRROR

- **Chartered trading company's** role was to reduce transaction cost in international trade to enable some degree of economic globalization.
- To reduce/overcome **transaction costs** could be done through 3 forms :
  - **Trust-reciprocal approach** (Predominate in developing nations where formal legal structure is not strong)
  - **Belief system approach** (Work best in small community/market) or
  - **Third-party enforcement approach** (Countries that become rich under capitalism are those that use this approach to govern market) through institutions like marketplace, security, common language, currency, contract, property rights.

# GLOBALIZATION IN HISTORY'S MIRROR

- In 1914, the previous transaction costs : transportation cost, tariffs, currency-stability declined precipitously by communication technology, idea of free trade, adoption of gold standard.
- Supported by the convergence in **belief system** (economic liberalization and gold standard) of economic decision makers
- World economy had outgrown classical liberal economic order , says, international economy requires better balance between demand of international economy and domestic social group

# GLOBALIZATION IN HISTORY'S MIRROR

- So, basically, the rule of the game are enforced by formal **government** apparatus.
- Government consumes greater share of resources, its expenditure goes up with the bigger/ stronger the government in advanced countries. The correlation between government size and per capita income is tight.
- Moreover, the government had grown the largest in those economy that most exposed to international market since people demand compensation against that risk.
- Government so has to provide social insurance, public employment, assistance programs.
- *"If you want market to expand, you need government to do the same"*
- In conclusion, transaction cost and unequal benefit shared by all participants are inherent to international trade.

# WHY DOESN'T EVERYONE GET THE CASE FOR FREE TRADE?

- Trade benefits all sides in the long run (it has income redistribution effect), it is **not** *zero-sum* because it would economize the use of resources at home which we did not specialize, says, what creates comparative advantage is differences cross nations in comparative costs.
- **However**, it is not totally true to associate free trade with economic and political progress, it depends on context.
- Apart from understanding economics of Free Trade, implications for distributive justice and social norms are important too.
- Free Trade is supported or not depends on individual's value, identities, patriotism.
- Resources used in international exchange must be values at true social opportunity cost rather than at prevailing market price.

# BRETTON WOODS, GATT AND THE WTO

- The creation of **IMF** and **World Bank** wanted to allow enough international discipline and progress towards trade liberalization but also give space for domestic government to achieve their objective, says, we want ***moderate globalization***, not a hyper one.
- Multilateralism was created, **GATT**, it was successful in eliminating import restrictions, world trade volume grew.
- WTO aimed for ***hyperglobalization*** (opposed to Bretton Woods, shallow integration); deeper integration of goods and capitals as multinational companies need more extensive global rule to expand and that global rule become domestic rule, in effect. e.g. China still used the shallow regime.
- Some argue income gap was result of technological advances not increased globalization, some argue the other way but evidence is not yet clear.

# FINANCIAL GLOBALIZATION

- Since 1980s, IMF supported for freeing up capital market, it was an inevitable step on the path o development (global savings to be allocated more efficiently),yet had no legal authority over capital flows was there.
- Capital will flow out automatically as a punishment if that financial market does not do their job right. The uncontrolled capital flow undermined not only financial stability but macroeconomic equilibrium; employment and price stability, monetary and fiscal policy (exposed to greater risk).
- Question was raised again after U.S. Crisis in 2008. Alternative of capital control is floating currency but it is fluctuated and is source of bubbles, irrationality, chaos.
- Global finance requires **institutions** like global regulations, standards, supervision, lender-of-last-resort

# FINANCIAL GLOBALIZATION

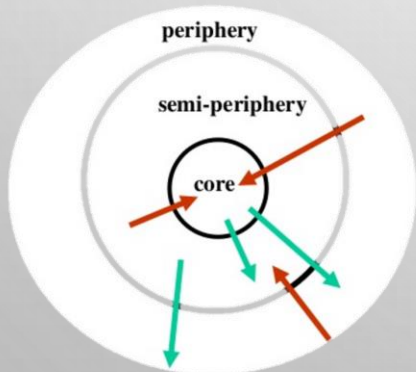


- "a fox knows many things, but a hedgehog one important thing"
- The **hedgehogs** are those who think freeing up market is always a right solution (max. efficiency, the freer the better)
- The **foxes** also focus on details and real world implication.
- Their differences are how they respond to market failure,
  - Hedgehog would make market work better by itself (liberalizing everything, Govt intervention are worse, bureaucrats do not have information to do the right thing),
  - Foxes fix the incentive to rein in risky behaviour ( "principle of policy targeting", use regulations e.g. Tobin tax to limit excessive risk in international financial market/set up domestic-international compensation mechanism)

# POOR COUNTRIES IN A RICH WORLD

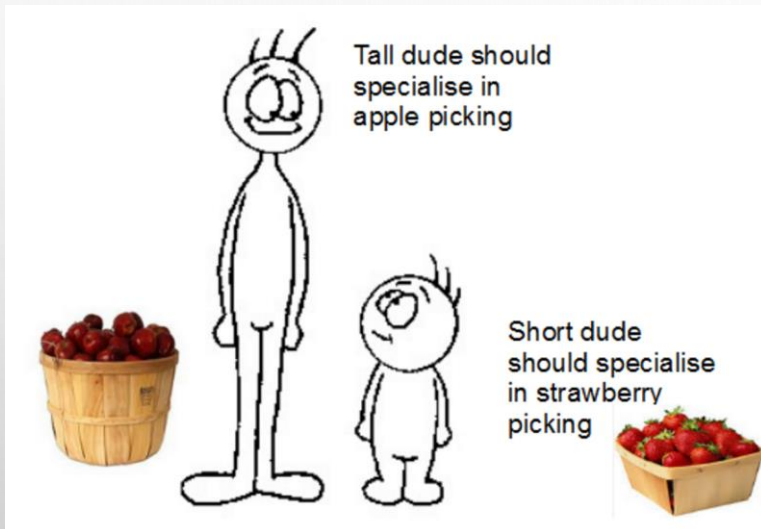


- Globalization promises to give everyone access to market and a potential to remove all deficiency that sustain poverty.
- *Why that is not true?*
- Some blames for too much globalization, some blames it is too less. We need the middle one like Bretton Woods where all transaction costs are not removed.
- The division between the core ( industrializing) and peripheral (raw material producing) countries, from colonization, are strengthened due to the international division of labor ( comparative advantage)



# POOR COUNTRIES IN A RICH WORLD

- Having comparative advantage in primary commodity did not encourage skill accumulation, they deindustrialized!
- And wealth only falls on small group of elite in these countries.
- In labor intensive country with domestic investment limited by small scale of savings, government need to play an active role to stimulate the creation of new industries with incentive, e.g. Tax holidays, adequate infrastructure to create job employment and export, yet high import tariffs would be recommended to protect infant industries, says, industrial policy had to be part of development strategy.
- All advanced countries nowadays had its origins in proactive government intervention.



# POOR COUNTRIES IN A RICH WORLD



- Japan is an exception because government and private combined their efforts leading to the right kind of globalization. e.g. Government-supported industry policies, interventionist policy –government created investment climate.
- China – gradually open economy, low IP law to imitate foreign technology, state-owned national champion, special economic zone, when China was domestically strong enough, it then joined WTO in 2001, until nowadays , it still controls its exchange rate to shield themselves from globalization

# TRADE FUNDAMENTALISM IN THE TROPICS



- However, by 1980s, idea changed and viewed government as obstacle.
- ‘**Washington consensus**’s then suggested deregulation, liberalization, privatization after that the idea of free trade as engine of growth has become sacred, anyone who question needed to have his motives questions.
- Yet in the end the consensus doomed to failure as proven in Latin America.
- The institution changes were needed and took a century to success like in advanced country - “**governance reform**”, however, every countries have different problem and urgency, so one model could not fit all.

# TRADE FUNDAMENTALISM IN THE TROPICS



- Developing country might not need as much capital flow as it does in advanced country due to low profitability, problem could be aggravated into worsen its competitiveness in global market.
- Success of East Asian (rapid productivity growth) partly came from import substitution policy which needs government interventions (import protection, credit subsidy, tax incentive, public investment)
- Globalization on its own does not generate development and economic growth
- It only allows nations to leverage better those that they already possess.

# THE COUNTRY PERSPECTIVE

- Trade is both similar and dissimilar to domestic competition
- Similar insofar as it can create losers as well as gainers in the process of generating wider economic opportunities
- Dissimilar insofar as it forces competition under ground rules that have been prohibited at home

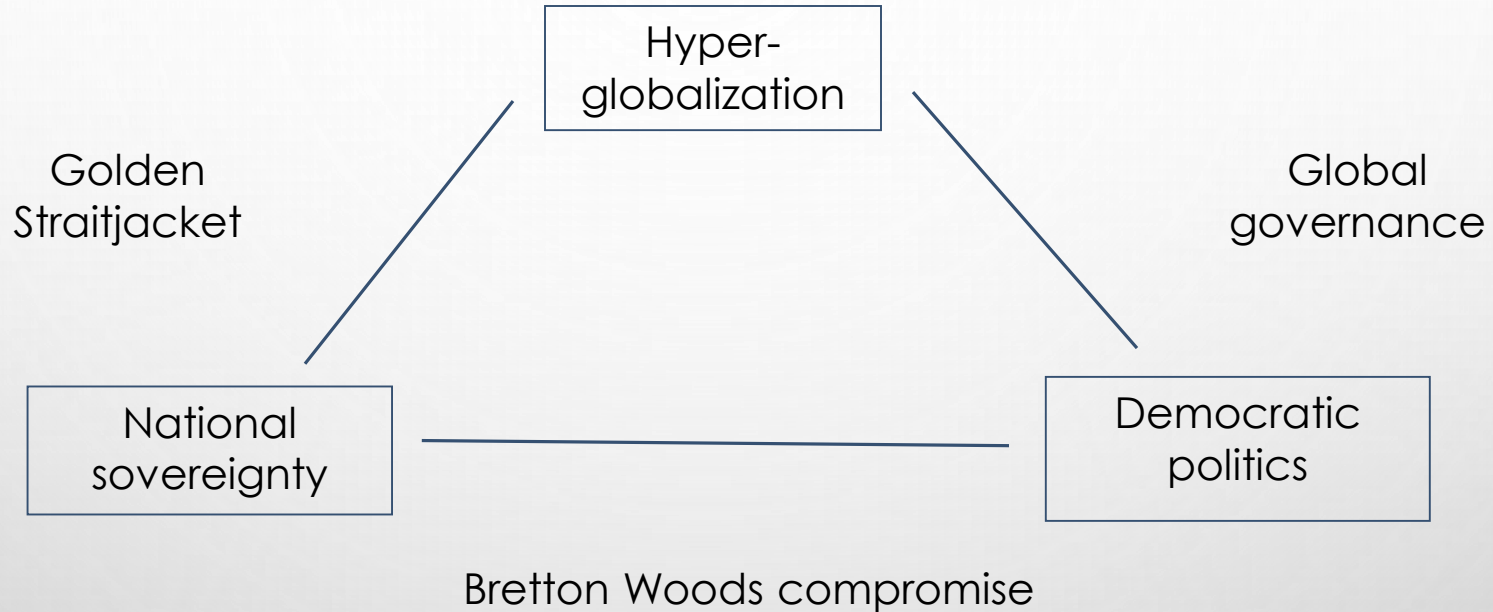
(e.g., Unfair labor practices, tax havens, subsidized goods, ...)

- Such competition can undermine:
  - Regulations (e.g., Taxes, financial regulations, product safety rules)
  - Domestic norms (“what’s an acceptable redistribution?”)
  - Institutional practices (e.g., Employer-employee bargaining)

# WE CAN RESPOND BY:

1. Ignoring the problem and pushing for deeper globalization
  - ... At the cost of aggravating the undermining of domestic rules
2. Harmonizing rules across countries
  - ... At the cost of imposing ill-fitting rules on all
3. Restricting the scope of globalization
  - ... At the cost of giving up on some of the gains from trade
  - ... Which brings us to a trilemma

# THE POLITICAL TRILEMMA OF THE WORLD ECONOMY



Pick two, any two

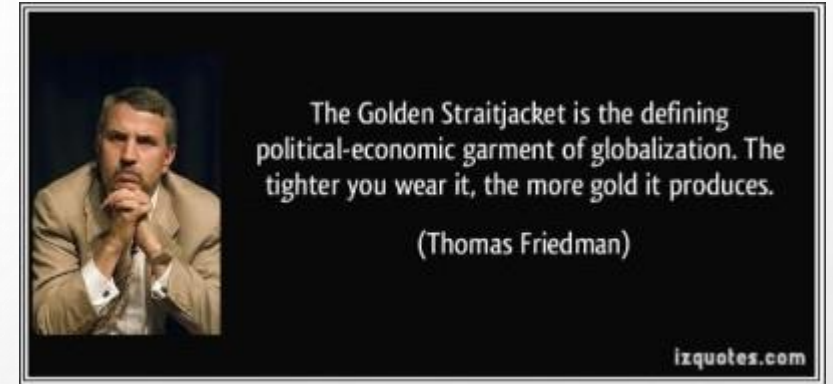
# THE POLITICAL TRILEMMA OF THE WORLD ECONOMY



Golden  
Straitjacket

Hyper-  
globalization

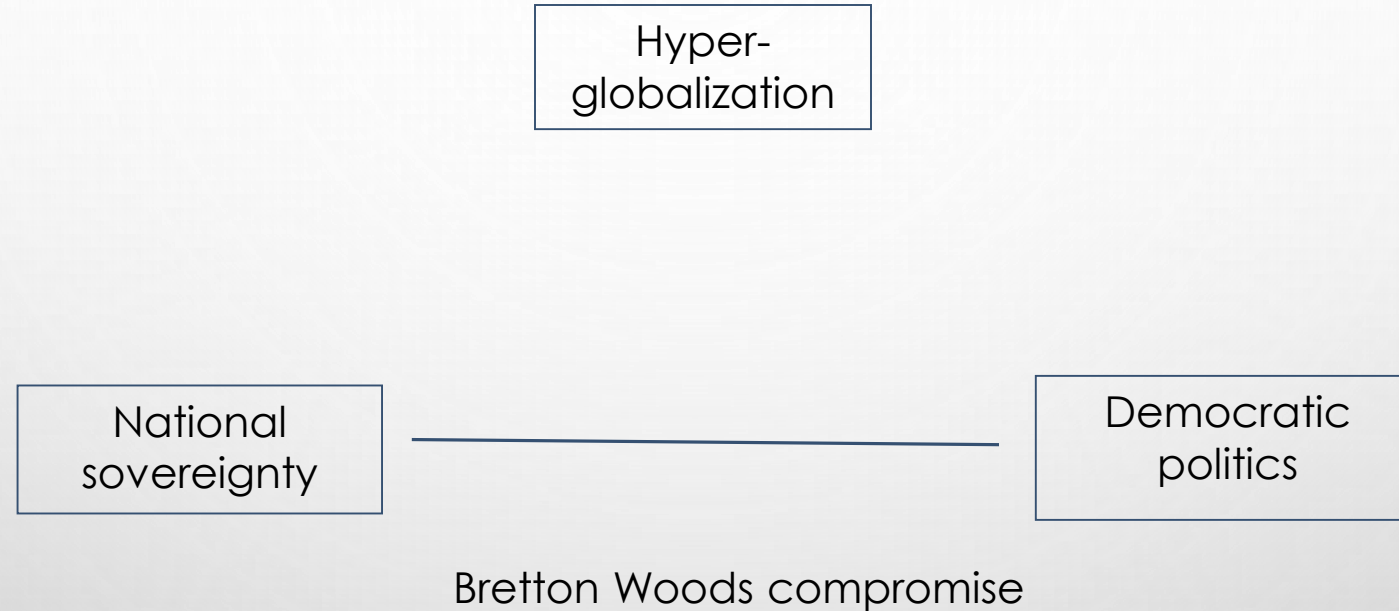
National  
sovereignty



Democratic  
politics

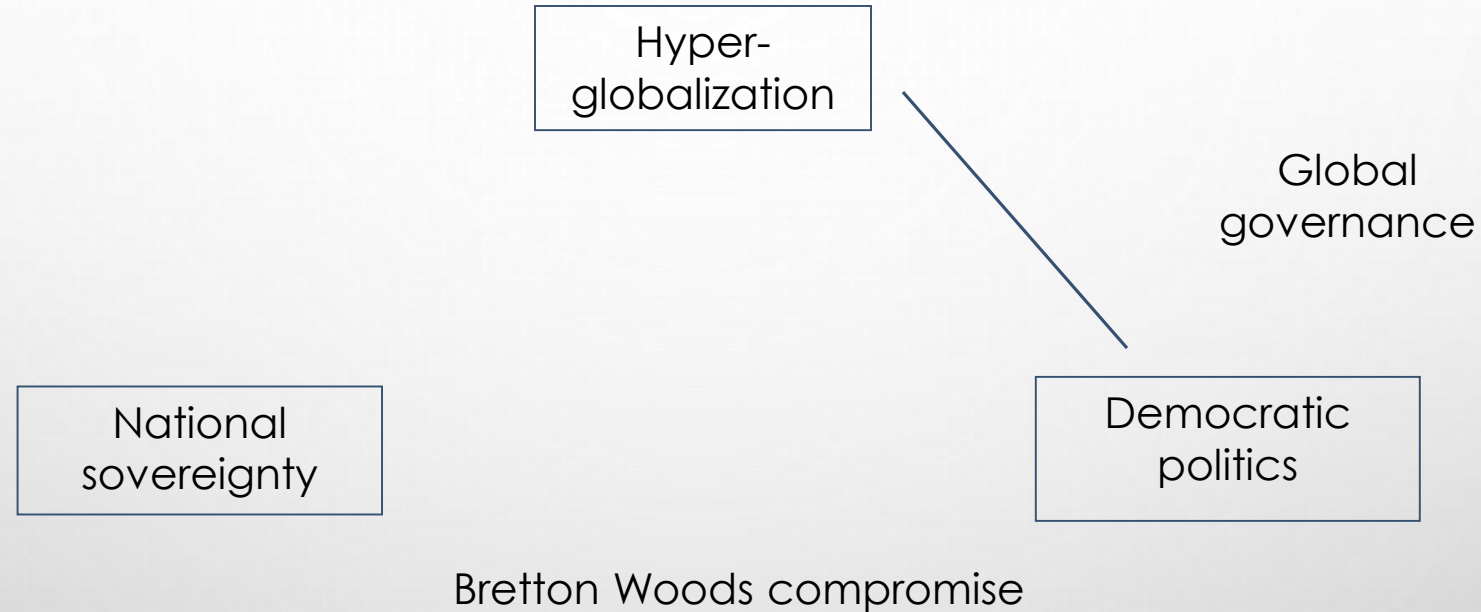
- **The Gold Standard model:** narrow domestic “policy space” in macro, financial, tax, structural and other domains to minimize impediments to free flow of capital and goods
- **Problem:** historically, this model has not been compatible with democracy (Great Britain 1931, Argentina 2001, Greece today?)

# THE POLITICAL TRILEMMA OF THE WORLD ECONOMY



- The Bretton Woods compromise: enlarge space for democratic legitimacy and/or economic management at home
- Keynesian macro policies + welfare state + economic restructuring
- An explicitly *incomplete* globalization

# THE POLITICAL TRILEMMA OF THE WORLD ECONOMY



- A third alternative: “global governance”
- Requires significant restraint on national self-determination and reduction in regulatory, institutional, and policy diversity

# THE POLITICAL TRILEMMA OF THE WORLD ECONOMY

- The deep integration requires domestic economic adjustments which might not fit with politics or what domestic constituencies want.
- The clash between politics (national democracy) and hyperglobalization are inevitable, e.g. Argentine leader chose to cut back pensions (austerity policy) in order to repay foreign debt.
- Globalization doesn't permit nations to deviate from the rules (the labor, health and safety standard, corporate tax competition, regulatory takings, industrial policies in developing nations) , it is your economy grows and your politics shrink.

**The trilemma:** we have 3 options to manage tensions between national democracy and global markets

1. Restrict democracy, accept hyperglobalization
2. Restrict globalization, preserve democracy
3. Globalize democracy at the cost of national sovereignty (global governance)

# IS GLOBAL GOVERNANCE FEASIBLE? DESIRABLE?



- When financial crisis happens, idea of global central bank, international financial regulator occurs.
- Having this supranational organization can relieve the competition that created **“the race to the bottom”** proposing delegates from different nations (while the nature of delegate is to respond to their constituents ) with accountability mechanism sounds nice only in theory.
- The best example is EU which has deep integration, hyperglobalization, however, there is problem of having different goal for different nations according to their nation’s interests, also when crisis occurred, there is no coordination among EU governments.
- Some challenges to concern are global standard ( it is costly e.g. child labor), market-based solution (provide information e.g. Rating agency) and limitation of global governance due to diversity plus citizen needs sense of global citizen more than national citizen

# DESIGNING CAPITALISM 3.0

- Globalization is the worldwide extension of capitalism. The future of capitalism therefore is the future of globalization.
- **First wave of globalization:** government has very limited role (enforce law, keep peace, collect tax)
- **Capitalism 2.0:** government plays more role (welfare assistance, antitrust policy) with new balance with market (mixed economy), shallow international econ integration(Bretton Woods), this was period of cohesion, stability, prosperity in advanced nations until mid 1970s.
- **Capitalism 3.0:** financial globalization and deep trade integration and that globalization should be used for achieving internal goals. Yet we need global coordination on issues like climate change, because the globe has the climate as public goods.

# THREE BUILDING BLOCKS

- The extent of the market is limited by the scope of workable regulation/governance
  - A corollary to: Adam Smith's "the division of labor is limited by the extent of the market."
  - Markets need a wide range of non-market institutions. They are not self-creating, self regulating, self stabilizing, self-legitimizing. Markets cannot work properly and be politically sustained in their absence.
- The main locus of legitimate governance remains the nation state.
  - That is where democratic deliberation resides
  - Transnational forms of "global governance" likely to remain weak at best
- There are legitimate differences across nation states on the shape that regulatory institutions ought to take
  - Differences in history, culture, levels of income result in divergences in needs and preferences

# THE GLOBALIZATION PARADOX

- The fundamental political dilemma of the world economy is introduced :
  - we can **NOT** pursue **democracy**, **national determination** and **economic globalization** simultaneously.
- And the idea of democratic global governance is just hallucination.
- Democracy and national determination should trump hyperglobalization since by empowering national democracy will in fact place the world economy on a safer and healthier footing.
- We need to attain smart globalization instead of maximum one.
- The challenge is how do we compromise an imbalance between the nature scope of governments and the global nature of market, says, if national government has too much power, you have protectionism while giving markets too much freedom and you have unstable world economy with little social and political support.