Globalization

based on Stiglitz: "Making Globalization Work"

Great hope:

"Globalization will ultimately make everybody better off"

World Social Forum 2004: "Another world is possible"

Contents:

Pressing issues: Why is there so much opposition (Seattle protests etc.)?

- jobs threatened by competition from China etc.

- unemployment rates increased between 1990 and 2002 all over the world

except in South Asia, USA and the EU

Source: World Commission on the Social Dimensions of Globalization

- developing countries: large international banks move in → losers: local banks

small local businesses depend on them

- farmers in DCs can't compete with subsidized crops

- job protection laws in Europe etc. under threat

- AIDS: drugs becoming unaffordable in DCs

- environmental standards are threatened

- threat to cultural heritage

- growing inequality (not only in DCs)

<u>5 underlying general concerns</u>:

- unfair rules favour advanced industrial countries ("democratic deficit")

  → *structure of World Bank and IMF*

- material values dominate over other values

  → *e.g. concern for the environment or for life itself*

- too many losers

- economic system and culture pressed on DCs is often damaging

  → *resentment*

- DCs' sovereignty is undermined

  → *conditionality undermines democracy*

Conditionality:

Countries seeking foreign aid are typically required to meet a large number of conditions:

e.g.:

- downscaling of government interventions
- deregulation
- rapid liberalization of markets (including capital markets)
- rapid privatization
- main focus of economic policies: price stability (tight monetary policy + fiscal austerity)
- strengthening of property rights

"Washington Consensus"

= set of policies agreed upon by

IMF

World Bank

US treasury

IMF and World Bank now admit that conditionality has gone too far!

Global governance

Problems:

- economic globalization has outpaced political globalization

  → chaos of institutions and agreements

- "democratic deficit" in the international economic institutions

- people are still very loyal to their nation-state

Still far away: single legitimate global government!

Development Problems and examples

"There is no magic solution!"

Problems:

- uneven distribution of new wealth
- education
- no jobs □ no development
- no roads/ports □ no transport of goods
- low productivity
- Washington consensus:

    □ puts little emphasis on:

    - increasing output
    - equity □ widespread assumptions:
        - trickle-down economics (little evidence that it worked)
        - province of politics, not economics

<u>Consequence</u>: Policies must change!

The government must play a more active role!

must promote development and protect the poor

<u>but</u>: Markets must remain to be the center of any successful economy!

- "governments have to create a climate that allows business to thrive and create jobs"
  - basic necessity: institutional infrastructure
    - legal system, banking system, securities markets etc.
  - Markets do not always work well by themselves ("market failures")
    - state must provide:
      - strong competition policies
      - environmental standards
      - investments in education in technology
        - closing the "knowledge gap" is an important precondition for development

Washington Consensus

 based on a **market theory of perfect competition**

but: **Markets are always more or less imperfect, especially in DCs!**

 theory is of little relevance to DCs

"If private banks don't set up branches in rural areas: government must step in!"

"If private banks don't provide long-term credits: government must step in!"

"If private investors don't set up basic industries: government must step in!"

<u>Once everything is set up, governments can retreat slowly</u>!

<u>most successful</u>: Asian countries with active role of government

 export-led growth

 high savings-rate: no need for volatile capital flows from abroad

<u>negative example</u>: Russia (shock therapy)

 first decade of transition period: drop of per capita income: 40%

Model country China:

growth, based on exports → *lifted hundreds of millions of people out of poverty*

Careful reforms:

- slow opening of markets for imports and capital flows
- even today: no entry of hot speculation money

"money that seeks high returns in the short run only to rush out again at the first hint of trouble"

- no private property of ground → state grants ground lease rights/ hereditary lease

Conditions by some countries for FDI(**F**oreign **D**irect **I**nvestment):

- training for local staff
- transfer of technology
- restriction of short-term capital flow

□ Asian crisis: too much money came in (liberalization through IMF pressure), but at some stage lenders suddenly wanted their money back

Latin American countries

Debt crisis early 1980s:

high interest rates in the USA (up to 20%)

 interest rates for loans to Latin America went up, too

 very bad decade for many countries

1990s: high inflation rates most countries adopted WC policies

 successful at first, but not sustainable   Argentina Crisis

 growth went mainly to the rich

Transition economies

Method: shock therapy capitalism overnight

- instantaneous price liberalization hyperinflation

countermeasures: tight monetary policy + fiscal austerity less inflation but also: **recession, depression**

high interest rates with little credit available

tight budgets

- rapid privatization + liberalization of capital markets

 countries' most valuable assets went to a few oligarchs

 capital flight (e.g. Chelsea - Abramovich) instead of capital inflow

 output fell by one third

agreed now: rapid privatization was a mistake

 done before sound regulations and tax laws were established

 government revenue dropped spending on health and infrastructure collapsed

 high-quality education system collapsed

 old safety nets didn't exist any more grim poverty

India

Decades after independence: "socialist" doctrines prevailed, economy stagnated

- □ bureaucratic restrictions for domestic and foreign companies
  e.g. government permission required for all company activities
- □ no big companies allowed □ protection of small companies
- □ heavy industries and basic industries were/remained nationalised
- □ companies were not allowed to dismiss workers
- □ system protected by heavy import duties, aim: self-reliance

but: foundation of future success was laid

- □ investments in education and research
- □ a number of institutes of science and technology were founded

Green revolution of the 1970s: better farming techniques and new seeds

- □ yields increased enormously

but: not much growth of GDP

Early 1990s: many restrictions for the private sector were removed

still: no short-term capital flows allowed

A vision of development

Goal: sustainable, equitable and democratic development

Focus: increase of living standards

Measurement: GDP

but also important: health and education

 HDI (Human Development Index)

Free Trade = Fair Trade?

Theory: free trade benefits everybody (theory of "comparative advantage")

Problems:

 there is no free trade (in many cases)

e.g. NAFTA: - Mexican corn farmers have to compete with US subsidized corn

- restriction of sugar imports into the US, but US can export corn syrup to Mexico with no restriction

 asymmetric agreements!

 unequal trade partners

- lack of infrastructure in DCs can't bring their goods to market

- high quality standards of industrial countries are hard to meet

 almost no new trade followed when EU opened up its markets for the poorest countries in 2001

 not everyone is a winner:

theory of trade liberalization only promises that the country as a whole will benefit

 the majority of citizens or some groups may well be worse off

 "infant industries": new industries in DCs must be protected until they are strong enough to compete with big MNCs

 tariffs should be allowed

Consequence: Developing countries should be treated differently

 widely accepted view now

developed countries can deviate from the WTO's "most favoured nation principle"

 can allow lower tariffs on imports from DCs (preferential treatment)

shortcoming: voluntary, can be misused as political instrument

Proposal:

- rich countries should open up their markets to poorer ones without reciprocity and conditionality (as the EU did in 2001)
- "middle-income countries" should open their markets to the least developed countries in the same way
- countries on the same level should open up their markets to each other reciprocally

 reciprocity among equals instead of reciprocity among all

Subsidy problem:

Japan: 1/2

2/3 of farm income in Norway and Switzerland come from subsidies

EU: 1/3

 $2 a day for the average European cow

25.000 cotton farmers get $4 billion in subsidies

effect: increased production increased supply on the world market depresses global prices

 increased poverty in DCs

Free movement of labour and capital?

Developed countries' policy:
liberalization of capital markets but no liberalization of labour markets

 but: Widespread opinion:
"Even modest liberalization of labour flows would increase global GDP much more than capital market liberalization"

Trade barriers are still around

e.g. through WTO sanctions:

- safeguards □ in case of a "surge" of imports tariffs are temporarily allowed
- dumping duties □ if a foreign country sells ist products below cost

□ can be permanent

Non-tariff barriers, e.g.:

- technical barriers: specifications on size, shape, functions, performance
- patents, copyrights
- labelling (also: manuals, instructions)
- national regulations on health, safety, employment
- quotas

Patents

TRIPS: Trade-Related Aspects of Intellectual Property Rights

□ WTO agreement that forces countries to recognize patents and copyrights

□ monopoly rights for inventors

argument: higher prices are supposed to spur innovation

<u>Problems</u>:

- higher-priced medicines: people in DCs can't afford it
- patents can slow innovation
  - □ no competition:
    - no need for innovation
    - competitors are discouraged (no research, either)
      □ e.g. Microsoft vs. Netscape
    - no innovation □ slow follow-up innovation
- many inovations are the result of research in universities and government-funded research centers, i.e. should be owned by the public
- attempts to expand the scope of intellectual property e.g.
  - yoga positions
  - genes
  - bio piracy

Proposal:

- medicines at cost to DCs
- compulsory licenses to allow DCs to produce drugs
- reduction of patent protection periods

"The resource curse"

Paradox: many resource-rich countries have high poverty rates

e.g. Nigeria (oil-rich country): - per capita income fell by over 15% from 1975 - 2000
- number of people living on less than $1 per day quadrupled from 19m to 84m

<u>Reasons</u>:

- violent conflicts □ wars eat up much of the revenue
- ruthless dictators/ corrupt regimes steal the countries' wealth □ high levels of inequality
- MNCs:
  - bribery □ undermining of democratic process
  - imbalanced negotiating: e.g. they leave it to governments to clean up environmental damages
  - destruction of other jobs in the country, e.g. dangerous run-offs destroy fishing waters
- IMF: pressure for privatization □ profits go abroad or to a small elite of the country
  dramatic case: Russia (Yeltsin era)
- Dutch disease: high exports □ high exchange rates □ difficult for domestic industries

Alternatives:

- state-owned companies can keep the wealth in the country

  □ successful cases:
  - Malaysia (oil)
  - Chile (copper), with stabilization fund
  - Russia □Putin era
  - Norway (oil), with stabilization fund
  - Botswana (diamonds), with stabilization fund

- stabilization funds: help to stabilize the economy in case of price slumps (volatility of prices of natural resources)

- setting up of independent institutions to fight corruption

- exploiting resources must result in good investments for the future

  otherwise: once the resources are gone, the country will be poorer (not sustainable)

  instrument: accounting framework with depreciation of assets (resources)

  □ Green Net National Product (Green NNP)

  IMF accounting: "countries get good marks if they reduce their deficits by cutting down forests etc. at a fraction of the full value"

  □ also: IMF only accounts debts without regarding investments

- "Extractive Industries Transparency Initiative":
  - □ no tax deduction for payments to foreign governments without disclosure of what was paid and how much the resource was extracted

- reduction of arms sales

- certification:
  - □ diamonds: no uncertified "conflict diamonds" (certificate of origin from the government)
  - □ tropical wood

- limiting of financial assistance to countries that sell their resources below value (why should taxpayers here pay for such bad management?)

- setting norms: some international body (e.g. World Bank) could check/survey contracts of MNCs with DCs to make sure DCs get better value for their resources

- MNCs must guarantee for any environmental damage they cause

- effective enforcement of all these measures

Saving the Planet

The Tragedy of the Commons:

Middle Ages: more and mor sheep on common land □ overgrazing

each farmer looked only at his own benefit!

Parallels today: global fishing industries, greenhouse gases etc.

"Without government intervention
there will always be overgrazing of the sheep on the commons"

□ in the end social costs must be paid by somebody!

Incentives are necessary!

Kyoto Protocol:

- DCs are not obliged to anything, but: by 2025 their emissions will exceed those of the developed world
- reductions of emissions relative to 1990

 those who polluted more in 1990 can continue to pollute more than others

 makes no sense to DCs

Successful: Montreal Protocol on ozone-depleting gases

 employed threat of **trade sanctions**

WTO framework can be used!

 businesses/countries that don't pay for the damage they do to the environment are in fact getting a subsidy

 WTO sanctions, e.g. countervailing duties (compensating tariffs)

 DCs: **compensation for valuable environmental services**

tropical forests: CO_2 reduction + reservoir for biodiversity benefit everybody

e.g. avoided deforestation "negative carbon emissions"

 avoided tons of CO_2 x price per ton = compensation payment

□ **<u>common tax on greenhouse gases</u>** (same rate for all countries)

- social costs must be paid by those who cause them!
- must be set high enough to reach targets

<u>advantages</u>:

- market-based approach: avoids setting national target levels (e.g. with ETS)

  □ allowing a country high emission levels is the same as giving it money

- each country would keep the revenue from the tax, rather than having to give it to another country (as in an ETS system)

  □ other taxes can be reduced

  it's better to tax things that are bad (e.g. pollution)
  than things that are good (e.g. savings, work)

  □ stimulation of domestic industries: insulation, better use of technology, research

Multinational corporations

 they are rich: richer than most countries in the developing world

 powerful

primary goal: making money, not: providing charity

strong incentive for spreading new technology, creating new jobs etc., also for DCs

but also: often an encouragement to do the wrong things

wrong incentives:

Adam Smith: "The pursuit of self-interest will result in the well-being of society"

but: private incentives are often not aligned with social costs and benefits

 "market failure": externalities = consequences of an individual's or firm's actions for which they do not pay the cost or receive the benefit

e.g. environmental problems:

- it costs more to generate electricity without polluting the air
- it costs more to dispose of waste without polluting the water

 without government regulation companies have no incentive to protect the environment

Other problems:

bribery and corruption:

- "it's much cheaper to pay a government official a large bribe than to pay market price for some natural resource"

limited liability:

companies which are demanded to pay for big damages can declare bankruptcy

e.g. environmental damage:

people suffer doubly: from environmental degradation and from the cost of the cleanup

exertion of economic power:

threat to move somewhere else if certain regulations are enforced

Proposals:

- Limiting the power of corporations:

  reqires a global competition law and a global competition authority to enforce it

- Improving corporate governance:
  - companies should have to take into account all stakeholders (employees and the communities in which they operate, not just their shareholders)
  - executives should be held personally responsible (criminally liable)

    also for environmental damage
    - "It is no less a crime to ruin the environment than to cheat investors by manipulating the books. Environmental damage is longer lasting, and those injured are innocent bystanders who were neither party to any agreement nor stood to gain from any investment."
  - compensation should be made easier to be obtained (also in the HQ's country)

    US history: bandits could cross state lines to seek a safe heaven

- Global laws for a global economy

- Combat bribery:
  - to be outlawed under WTO rules, be subject to sanction
  - high fines and compensation
  - bank secrecy laws must be lifted

The Burden of Debt

Overborrowing or overlending?

Lenders encourage indebtedness because it is profitable

Risks for borrowers:

- variable interest rates
- loans must be paid back in $ or €
- loans are often short-term (sometimes payable simply on demand)

□ foreign banks can pull out money at any sign of a downturn

Argentina:

East Asian crisis 1997 □ global financial crisis □ interest rates soared

□ Argentina's debt service increased from $13b in 1996 to $27b in 2000

□ no immediate exchange rate problem, because peso was chained to the dollar

□ but: peso became overvalued □ flood of imports, exports declined

□ state deficit increased

□ IMF demanded tighter fiscal and monetary policies: inceasing taxes, cutting expenditures, raising domestic interest rates □ lower output and tax revenues

2002: Argentina couldn't pay debts back, let exchange rate float, peso fell by 1/3

IMF also wanted ist debts back   Original intent of IMF: help countries in times of crises!

Proposals:

- debt relief for the poorest (most of them can't pay debts back anyway)

- very little lending to very poor countries
  instead: more aid (grants)

- "odious debts": loans given to dictators/brutal or corrupt regimes
  reasons: buying friendship in the Cold War, securing resources
  - immoral to force the people of these debtor countries to repay these debts later
  - Chileans today are repaying the Pinochet debts
  - South Africans are repaying Apartheid debts

  If these countries didn't have to pay back odious debts, creditors would be unlikely to lend

  necessary: institution that evaluates such debts

- risk reduction: - World Bank could provide insurance against risks of interest rate and exchange rate, even of default
  would make loans more expensive, but: - reliabilty would improve
  - less borrowing good!
  - countries borrow in their own currency

- international bankruptcy laws debts are only paid back partially in certain situations (as companies are allowed to do)