

The Globalization Paradox

Dani Rodrik

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The magic of markets?

Milton Friedman's
pencil story, retold



MADE IN THE PEOPLE'S REPUBLIC OF CHINA



China as an instance of the “globalization paradox”

- China’s was a managed globalization: “open the window, but don’t forget the screen”
 - leveraging globalization requires active government policies to restructure economy
 - state enterprises, local-content requirements, subsidies, technology transfer requirements, managed currencies and capital flows, ...
- Globalization works best when it is not pushed too far
 - when domestic policy authorities retain adequate policy space

The “globalization paradox” in the advanced countries

- Legitimacy and efficiency both require effective regulatory state
 - hyper-globalization undermines:
 - regulations (e.g., financial regulations, product safety rules)
 - tax regime (e.g., income and capital taxes)
 - domestic norms (“what’s an acceptable redistribution?”)
 - institutional practices (e.g., employer-employee bargaining)
- Once again, globalization works best when it is not pushed too far
 - when domestic policy authorities retain adequate policy space

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

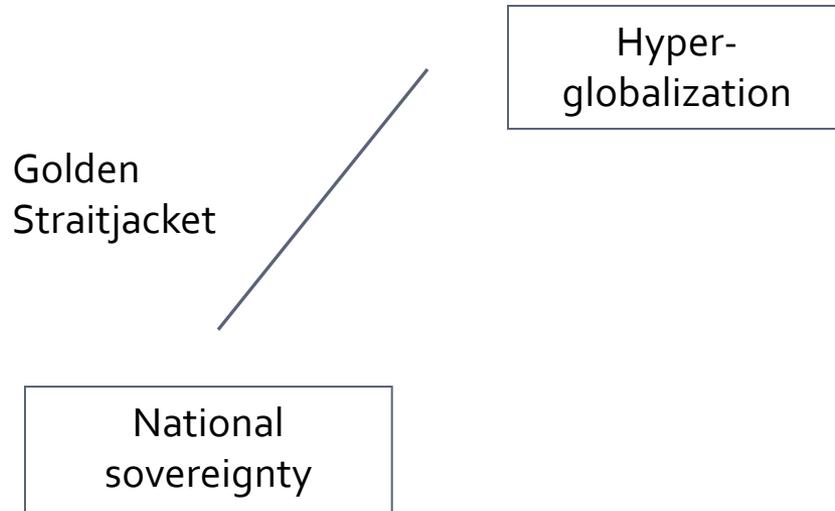
... at the cost of imposing ill-fitting rules on all

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 history of globalization viewed through the prism of a trilemma



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

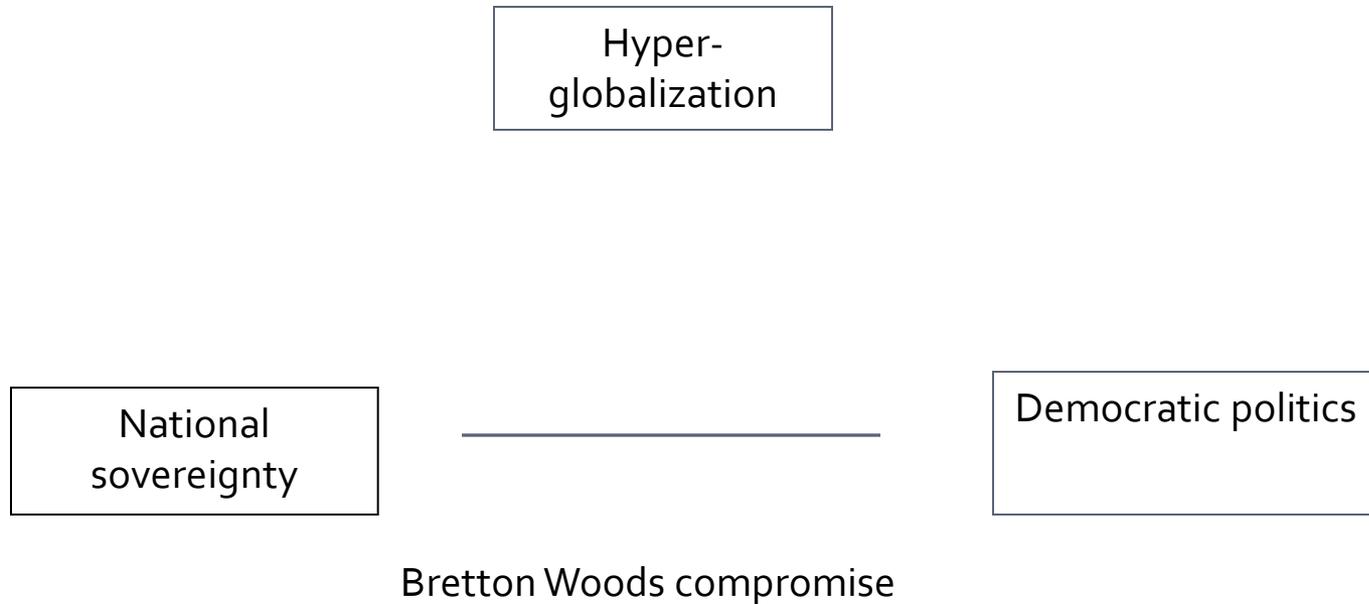
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Problem: historically, this model has not been compatible with democracy (Great Britain 1931, Argentina 2001, Greece today?)

Thomas Friedman's Coke and Pepsi analogy

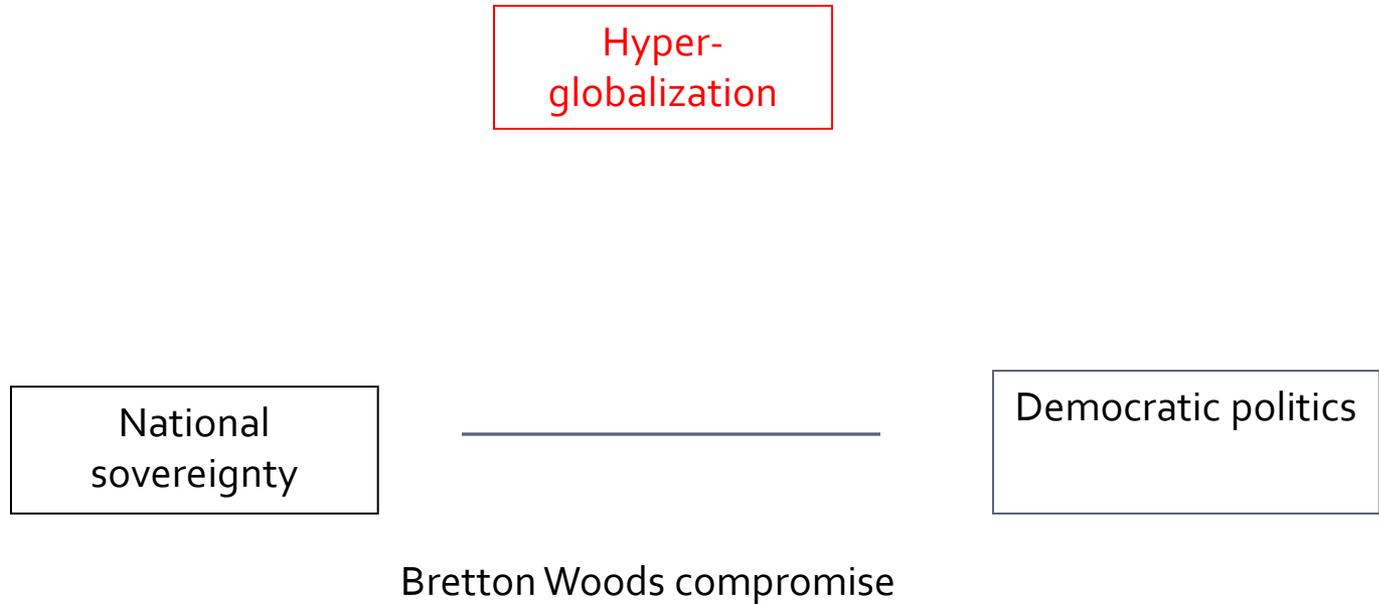
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The Bretton Woods compromise: maximize democratic legitimacy at home

Keynesian macro policies + welfare state + economic restructuring

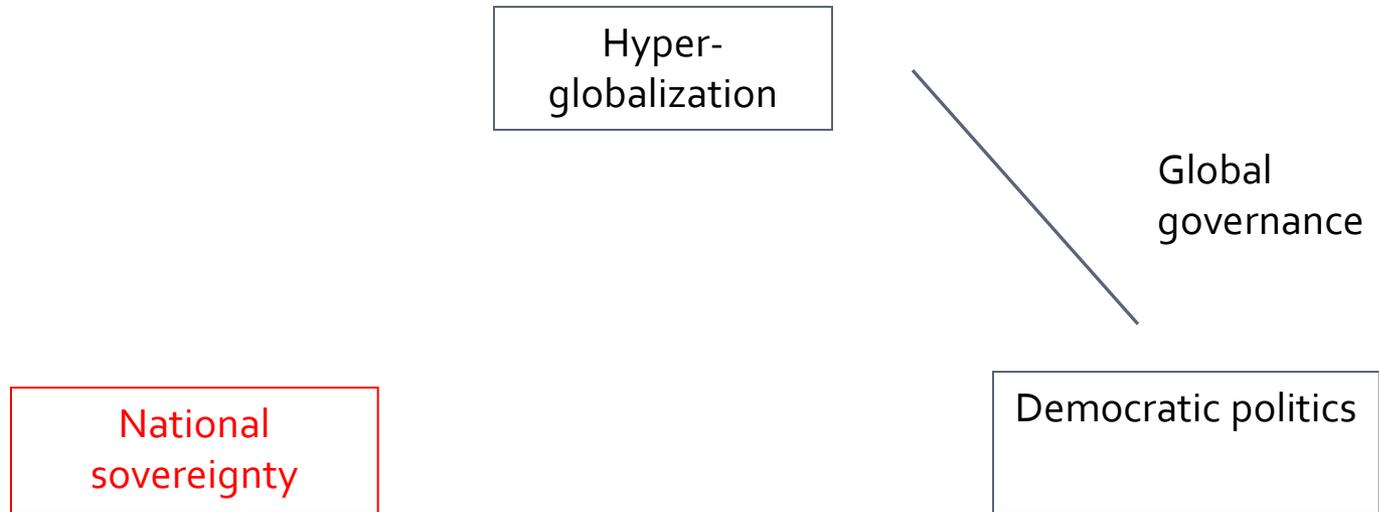
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An explicitly *incomplete* globalization:

Keynes and capital controls; The GATT model in trade

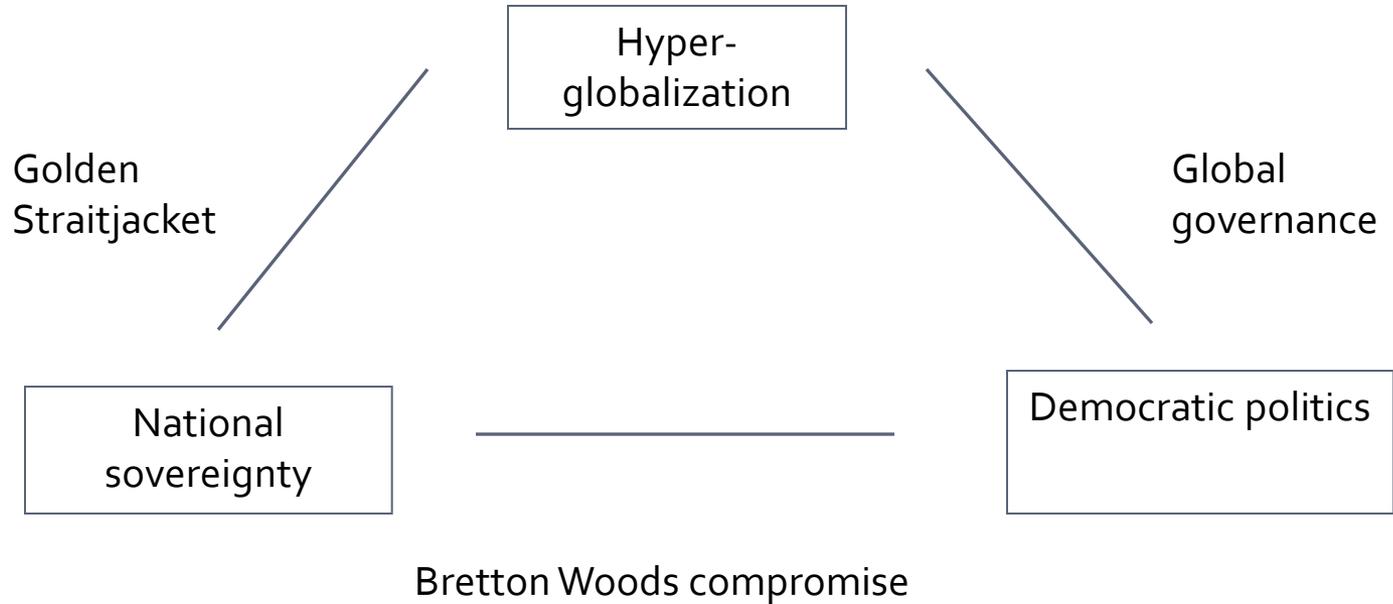
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A third alternative: “global governance”

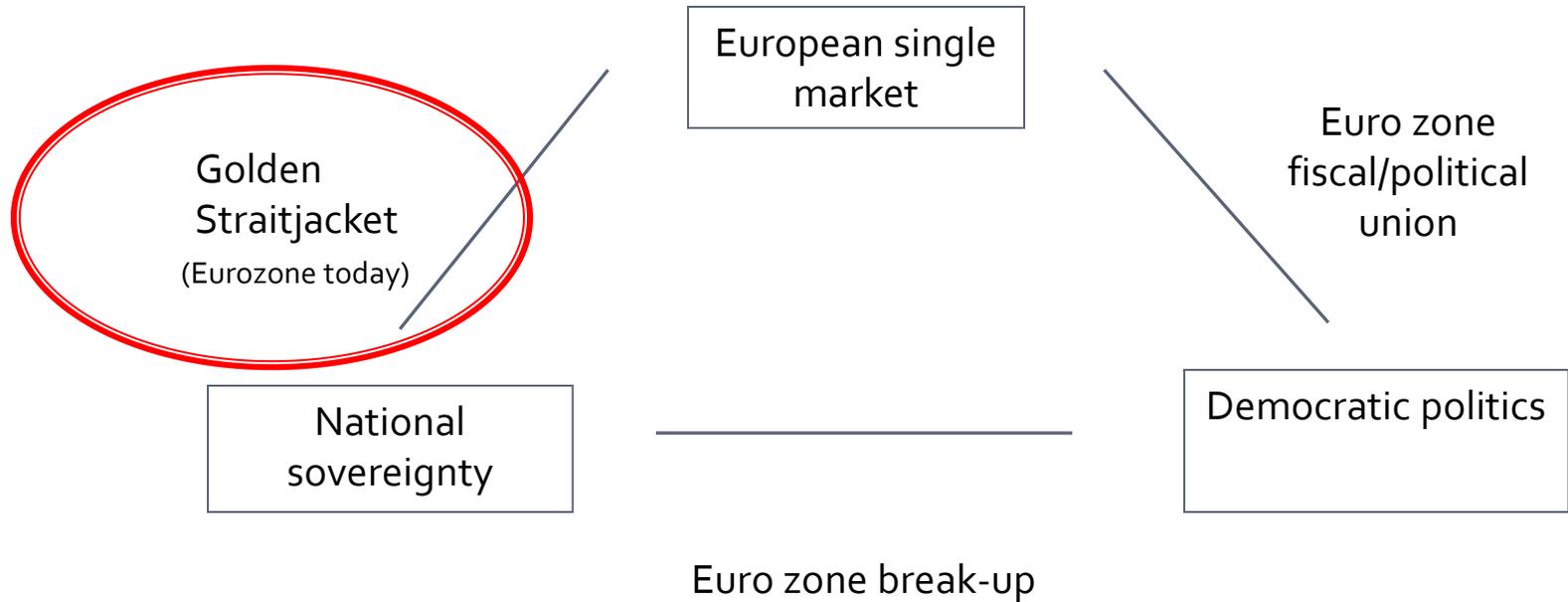
Requires significant restraint on national self-determination and reduction in regulatory, institutional, and policy diversity

The political trilemma of the world economy



Pick two, any two

The political trilemma of the world economy: Euro zone version



Pick two, any two

Where next? The new global economy

- Strong headwinds
 - structural problems of the Euro zone
 - high public debt in Europe and U.S.
 - intensified redistributive struggles due to pressures on middle class and
 - the challenge of climate change
- Potential growth rates reduced for all
- But highly differentiated outcomes across the world
 - Some countries will be less affected than others
- Which countries are the (relative) winners?
 - What characteristics make for (relative) success?

1. Low levels of debt

- High debt reduces growth by
 - intensifying political conflict
 - crowding out productive public investments
 - reducing scope for countercyclical fiscal policies
 - requiring higher (and costly) taxation
 - leaving policy-making hostage to volatile financial market sentiment
 - ...
- Note: private debt matters as much as public debt, as it is ultimately a contingent liability of public sector

2. Reliance on domestic markets and finance as growth engine

- Large trade imbalances a source of instability
 - surpluses will attract hostile reaction
 - deficits will create vulnerability to sudden stops in capital inflows
- Export-led growth less likely than before
- Best positioned countries are those with large internal markets that do not depend on large external imbalances
 - Brazil, India
 - versus China, Turkey

3. Robust democracy

- Democracy provides institutionalized mechanisms of conflict management, which are particularly important in times of stress and turbulence
 - Chinese style quid pro quo (high growth in return for political quiescence) ultimately unstable, and comes apart when growth is depressed
- The winners and losers:
 - Brazil, India, South Korea
 - versus China, Turkey

4. Sound government-business relations

- Challenge of structural transformation
 - Common to advanced countries and emerging markets
- Traditional top-down industrial policies no longer appropriate
- Key is quality of government-business collaboration
 - on-going collaboration to identify opportunities and obstacles to new technologies
 - requires governments that are “embedded” in private sector, but not “in bed” with it

Globalization's future

1. The good: managed globalization
 - Better balance between the prerogative of nation states and international rules
2. The bad: business as usual
 - Continued reliance on (necessarily inadequate) improvements in global governance and coordination
3. The ugly: return to the 1930s
 - Protectionist free-for-all

The paradox of globalization implies that (3) is rendered more likely by (2) than by (1).