



# **Post-Neoliberal Globalization**

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## **Neoliberal Globalization Based on Premises of Well-Functioning Neoclassical Economy**

- Adam Smith—take advantage of economies of scale
- David Ricardo—take advantage of comparative advantage
- Free flow of factors—factors go to where they are most productive
- All of this leads to maximization of global GDP
- With maximization of global GDP, everyone could be made better off

## Multiple Flaws in Analysis

- Assumed away market imperfections—some inherent (like imperfections in information and imperfect risk markets)
- Ignored externalities
- Ignored technological change (including learning by doing)
- Much of policy ignored second-best economics—with multiple market failures, eliminating or reducing one may actually be welfare-reducing
- While analysis said everyone could be made better off, political economy was otherwise: large distributive effects

## Key Theorems Explaining Why Neoliberal Globalization Might Not Work

- Competitive equilibrium are not in general even constrained Pareto efficient, in the presence of incomplete risk markets and imperfect, asymmetric information (Greenwald-Stiglitz, 1986)
- With imperfect risk markets, trade liberalization could make everyone in every country worse off (Newbery-Stiglitz, 1984)
- With imperfect capital markets, capital market liberalization may be welfare decreasing (Stiglitz, 2008)
- With learning by doing, market equilibrium is essentially never efficient (Greenwald-Stiglitz, 2014, Dasgupta-Stiglitz, 1988)

## In Practice, Things Were Worse

- Efficiency gains were smaller than predicted
- Distributive effects were larger—large groups became worse off
- Free trade agreements were never about free trade—about managed trade, managed for benefits of large corporations in powerful countries
- International institutions (including WTO) reflected same power dynamics
  - TRIPS (intellectual property) agreement reflected interests of Big Pharma
  - IMF reflected interests of larger creditor countries

## Undermining Neoliberal Globalization

- 2008 showed that financial globalization and integration meant that mismanaged financial markets in one country could lead to a global crisis
- 2017—Trump showed that powerful countries could rip up rules at will
- Perspective reinforced by Biden's IRA ignoring subsidy restrictions—even if in a good cause
  - Made it clear that if rules that the US had largely written proved inconvenient, they would be ignored
  - No pretense of a level playing field
- US refused to allow appointment of appellate judges—no way of addressing breaches in global agreement

## Undermining Neoliberal Globalization: The Pandemic and Its Aftermath

- Global IPR rules lead to vaccine apartheid, lack of access to tests and therapeutics
  - Leading to unnecessary disease, hospitalizations, and death
- Hoarding of covid-19 products showed that ***borders do matter***
  - As Trump had shown earlier
- Advanced countries put Big Pharma profits over lives
  - Even though government had paid for most of the research
- International institutions failed to provide balanced economic support
  - US spent 25% of GDP maintaining its economy, others couldn't
  - Leading to deeper downturns in some developing countries and emerging markets
- Market economies showed lack of resilience
  - Supply chain interruptions, in some areas massive shortages

## **Undermining Neoliberal Globalization: the New Geopolitics/Geoeconomics**

- New Cold War
- Russian invasion of Ukraine
- The growing split with China
  - Only thing Democrats and Republicans agree on
- Old vocabulary: friendshoring—but how to define?
- New vocabulary: de-risking



## Undermining Neoliberal Globalization: Climate Change

- Massive externality
- Pricing emissions at zero is like a major subsidy to cost
- But no country charges true cost, and complex regulatory system makes it difficult to assess “shadow price”
- Europe’s responses (restricting imports from countries that can’t show that land was not deforested) greatly resented
  - Privileges old deforestations over recent deforestations
  - Proof hard to come by
  - Likely to have little effect on carbon emissions
- At the same time, emerging markets are beginning to use industrial policies to enhance “value added” of their natural resources
  - Indonesia forbidding export of nickel
  - Europe objecting: wants to maintain neocolonial model—old power relationships

## Still Other Drivers of Change in Globalization

- Changing structure of economy towards services
- Trade is less important in services
- Services more local, smaller production units
- One of explanations of growth in market power—departure from competitive model

## II. Global Trade with Learning by Doing and Climate Change

- Historical patterns raise the question of whether there can really be an international rule of law
  - Powerful countries obey law only when it is “convenient”
  - But rule of law still important for less powerful countries
- In next few minutes, will discuss special case of trade systems in presence of learning by doing
  - Equilibrium outcomes likely to differ markedly from output or welfare maximizing outcome

## How Should Global Trade Rules be Designed to Promote the Development of Sovereign Nations?

- **Case I:** first-best global solution
- *Environment:*
  - Well-defined global welfare function
  - Global political system that enables redistribution
- *First-best:*
  - Innovation happens in region with comparative advantage to innovate, it is globally funded, and benefits of innovation are shared
- Incompatible with world composed by multiple sovereign nations with large disparities in economic and political power

## “Just” Trading System

- Set of rules based on how they might have been written behind a veil of ignorance, before each individual in each country knew where he was to be born—thinking about the matters partially at least through the lens of Rawls
- A “fair” agreement might allocate the surplus generated by global cooperation equally. A compassionate solution might allocate a larger amount to those whose initial conditions were worse off
- *A first constituent of a fair and compassionate trade agreement with endogenous technology is that if the developed countries provide industrial subsidies, they must provide incremental assistance for similar purposes for developing countries*

## Case II: the Decentralized Solution with “Constrained” Power

- *Environment:*
  - Each country has its own welfare function
  - No internalization of spillovers
  - No global political system for redistribution
  - Countries with different power:
    - The most powerful shape the international rules, no perfect competition of nations
    - But once set, international rules are respected (“constrained” power)
- *Equilibrium:*
  - Powerful countries set international rules that maximize their expected welfare
  - Investment in innovation will be suboptimal
  - Innovation at the country-level will not add proportionally to the global pool of knowledge
  - Inequalities will be perpetuated and magnified

## Case III: the Decentralized Solution with International Voting

- *Environment:*
  - Each country has its own welfare function, no internalization of spillovers
  - No global political system for redistribution
  - Countries may have different *economic* and *financing* power
  - There is a voting system for international trade rules
  - Once set, rules are respected by all
- *Equilibrium:*
  - It will depend on the probability density function of countries' power
  - The poorer will want a more distributive global policy and the wealthier a less distributive
  - Meaning that the poorer (further ahead from the knowledge frontier) will vote for global policies that maximize the diffusion of knowledge across borders (no IPR/patents) while the wealthier will vote for the opposite (more stringent IPR/patents)

## Case IV: the Decentralized Solution with International Rules (and its Enforcement) Determined by Power – Power Abuse

- *Environment:*
  - Each country has its own welfare function
  - No internalization of spillovers
  - No global political system for redistribution
  - Countries with different power
    - The most powerful shape the international rules
    - Power determines enforcement of international rules, a country that is “too powerful” may not respect the rules if it’s no longer convenient but enforces other countries’ fulfillment of the rules
- *Equilibrium:*
  - Abuse of power (like current international architecture, WTO)
  - Powerful countries set international rules ex-ante that maximize their expected welfare, powerless countries obey the rules, powerful countries may not enforce the rules ex-post if they are no longer welfare-enhancing
- Rules increase global inequality



## Moving to a Multi-Polar World with Diffuse Power

- Marked by strong polarization
- New Cold War, but divisions markedly different
  - Not centering around ideology—though that was partially a façade
  - Many leaders of emerging markets today educated in West, pro-market—but anti-hypocrisy, against abuses of power, concerned about wellbeing of citizens
  - Don't want to pick sides—even if there is a clear “right” and “wrong,” as with Russia's invasion of Ukraine
- Opening up the potential for large changes in the global economic architecture
- Still—need for global cooperation (climate change, pandemics)

## Multinational Corporate Tax Reform

- Transfer pricing system has long been broken
- Developing countries in desperate need of funds; all countries felt need after 2008 crisis
- OECD Base Erosion and Profit Shifting initiative began with best of intentions
  - Avoid tax shifting, making companies pay fair share of taxes
  - Based on principle of taxing rights being allocated on basis of where economic activity occurs
  - G-24 put forward concrete proposals
- What emerged?
  - Global minimum tax—set at too low a level and with large “carveouts”
  - An allocation of taxing rights of little benefit to developing countries and emerging markets
  - These countries would have to give right to impose digital and other taxes, likely to be of increasing importance in future—for some countries “reform” might lead to loss of revenues
  - Voice of developing countries and emerging markets had not been heard
  - Voice of economists had not been heard: BEPS reflected corporate interests and political power, not good economic principles
- So badly designed that not even US is likely to sign: a lot of effort for nothing
  - Fresh start in UN
  - Called for by AU, should be supported by Latin America, should be pushed in G20

## Global Financial System

- Legacy of long era of low interest rates and absence of capital account regulations
  - Many developing countries now over-indebted
  - Problems compounded by covid-19 and oil and food price shocks
  - Risk of debt crisis in many countries
- But still no framework for resolving sovereign debt
- In spite of UN resolutions with overwhelming support in 2014 and 2015, endorsing recommendations of Stiglitz Commission
- Private contracting (collective action clauses) shown not to be sufficient

## Further Difficulties of Debt Resolution

- Borrowing from IMF has become very expensive and insufficient given the disproportionate growth of private liquidity
  - Interest rate linked to SDRs rate has gone up with Fed, ECB and BoE's rate hikes
  - Surcharges added on
- IMF has become pro-cyclical, contrary to its mandate of being countercyclical

## SDR Interest Rate



## Further Difficulties for Development Financing

- High interest rate also problem for countries turning to MDBs for financing green transition
  - Many economically viable projects to accelerate green transition if cost of capital can be kept at reasonable level
  - MDBs need to be recapitalized and new green industrial banks need to be established
    - Including financing for green technology, to “correct” new imbalances in the global economic order presented by IRA and green subsidies

## Broader Issues

- There is a new balance of economic and political power emerging—markedly different from that of 1944, or even 1990 (the end of the Cold War)
- The advanced countries are loathe to take on board the full implications
- Democracy is in retreat—but democracy is the only way forward that will lead to broad and inclusive societal wellbeing
- Democratic institutions have to be strengthened to withstand the assault from demagogues, populists, and authoritarians
- Overlapping but distinct alliances
  - Democracies
  - Emerging markets and developing countries
- Brazil and Indonesia, as the two largest functioning democracies in the emerging markets, need to take a leadership role in shaping agenda, norms, and institutions in the new global economic order