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 which 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 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 geo-politics/geo-economics

- New cold war
- Russian invasion of Ukraine
- But even more important is growing split with China
  - Only thing Democrats and Republicans agree on
  - Multiple reasons—Thucydides Trap? Chinese support for Russia; Chinese aggression in South China seas; China's *threat* over Taiwan
- Old vocabulary: friendshoring—but how to define?
- New vocabulary: de-risking
  - Real risks of break, e.g. invasion of Taiwan

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 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 oppositive (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 for 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 important 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

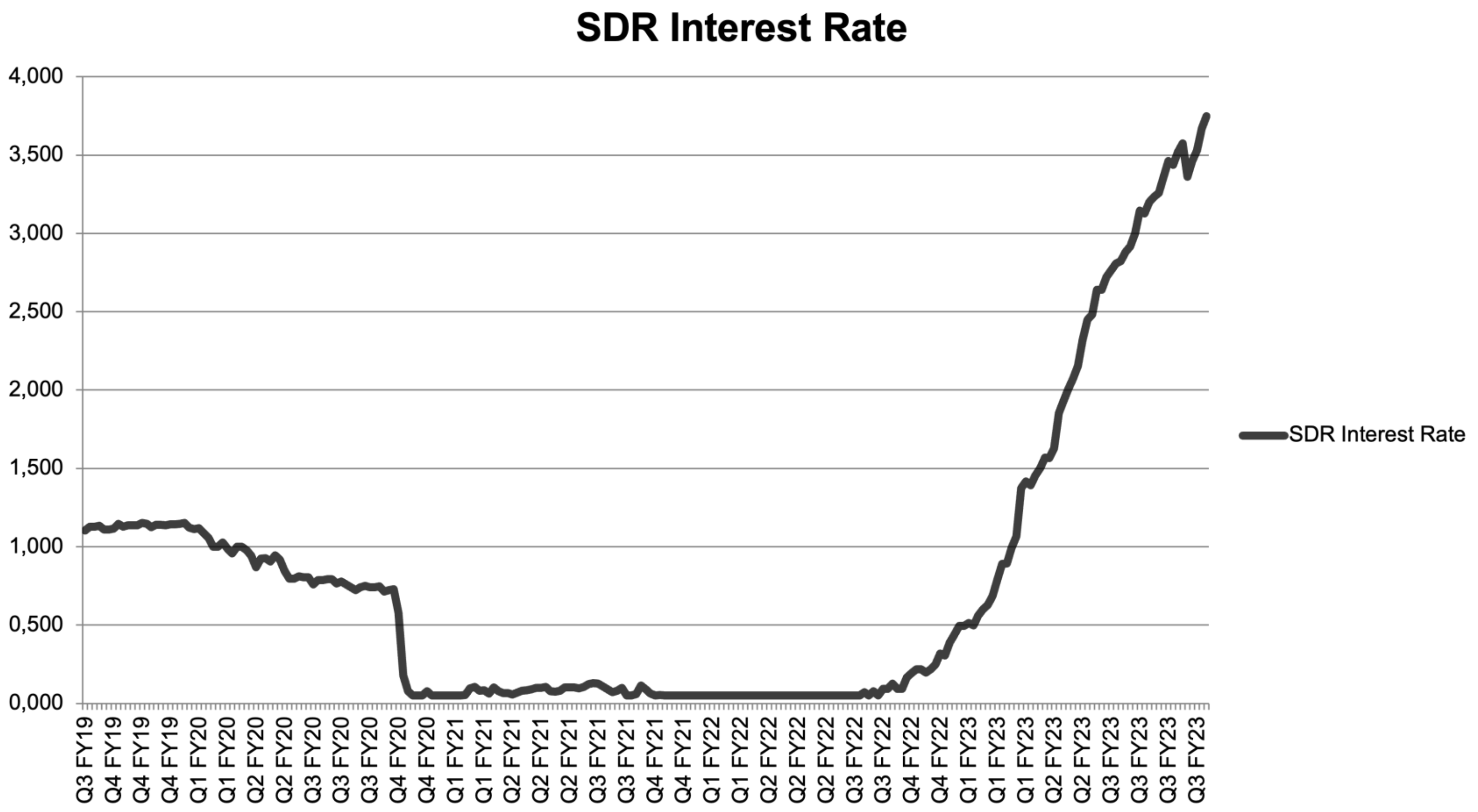
Global financial system

- 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
4,000
3,500
3,000
2,500
2,000
1,500
1,000
0,500
0,000
Q3 FY19
Q4 FY19
Q4 FY19
Q4 FY19
Q1 FY20
Q1 FY20
Q2 FY20
Q2 FY20
Q3 FY20
Q3 FY20
Q3 FY20
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Q1 FY23
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Q3 FY23
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