Globalization and Marginalization

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1. No one knows with any precision what the benefits and costs of globalization and of liberalization will be. My own guess for Canada is that the net impact of freer trade with the U.S. on Canadian standards of living has been small; although trade has grown quickly, it is not clear that the Canadian economy has grown any faster, and if so the effect has probably been quite small; the fact that we cannot be sure there has been an effect on growth at all means that if there has it has been small. If this is the case, then we have probably lost about as much through imports displacing domestic production as we have gained from new exports to the U.S.
This is consistent with most of the predictions of economists before the free trade accord was signed, i.e. that the net one-shot gain to Canada would be on the order of a couple of percent of GDP, which in our case amounts to about eight month's normal economic growth. Possibly there will be no net growth gain at all, since one of the things that was hard to predict in advance, and is still hard to measure, is the number of firms, both Canadian-owned and American-owned which have moved to the U.S. now that they do not have to be here in order to sell here without jumping a tariff barrier. It makes sense for many to be closer to the big market, so we have seen some firms migrate, and we have become more of a branch-plant economy. Still, there is no evidence that growth of our economy has been harmed. In fairness to the economists, most of them thought that the impact on GDP would be small, but many thought the treaty worth while in order to be less vulnerable to unilaterally imposed barriers to our exports to the U.S. The tribunals set up to decide on trade disputes have representation from both countries, which is supposed to get us a better deal, on average.

2. Economics is a very rough science (when a science at all, and that depends on who is wielding the tools) but substantially also an art. The economic world is much too complicated for us to understand more than a part of it. Economists who claim to "know" the answer to any but the simplest questions are either incompetent (don't know what they don't know) or dishonest or both. All one can usually do is to take one's best guess on any given issue. Still, some people's guesses will be right much more often than others.

3. Trade policy, financial policy and all other economic policies need to be thought through in light of a country's development goals. Economists tend to focus on growth (making the total economic pie bigger) and income distribution--how that pie is distributed among the population. Economic performance could not be considered unequivocally good unless a country was doing well on both counts. Where something has to be given up on one of these fronts to get a good outcome on the other, a delicate social and/or moral decision is needed. In fact a country needs to judge its policies by other criteria than these two, e.g. how dependent does it want to be on other countries, how important is economic stability, etc.

4. We have talked of neo-liberal economists, Keynesian ones, and perhaps a few other terms. For me, a neo-liberal is someone who believes strongly that free markets almost always provide the

best economic outcome, which implies that he/she mistrusts interventions in the markets. Almost all economists believe markets work well under some circumstances; the differences among them relate to how many circumstances we feel the market is the best solution to. Keynesians believe that markets malfunction periodically due to lack of aggregate (total) demand for goods and services, and if the government does not intervene to keep demand up the country will suffer a recession or a depression. Other economists are worried about other sorts of market malfunctioning.

5. There has been a paradigm shift in favour of free market economics over the last quarter century, both in developed and in developing countries. It owes something to the perception that interventionist economics was not working well, from the USSR to Argentina to Ghana. The election of Reagan and Thatcher partly reflected this shift and partly contributed to it. Personally I think the shift has gone quite a bit too far and a reversal is probably already under way, though how far it will go is hard to say. The paradigm shift has been reflected in the official views and in the policies of the World Bank and other international financial institutions (IFIs). When a paradigm shift occurs, and major policy changes accompany it, past experience becomes less valuable as a guide to what will happen in the future. At such times the brazen and the incompetent are much quicker to provide predictions and solutions than the careful and the competent. As a result, we saw some pretty wild ideas under the name of "supply side economics" a decade or so ago. Few serious economists paid much attention to such ideas, but they get a lot of press.

6. By the early 1980s when the debt crisis hit Latin America, this shift was in evidence. As Latin countries become deeply indebted they lost bargaining power vis a vis the IFIs and the countries of the North, and this was an important factor, in some cases, in their decision to go for more market-friendly policies. By the early 1980s World Bank spokespeople, perhaps most notoriously Anne Krueger, the chief economist at the time, were pushing hard for more open trade policy, financial policy etc. The argument was that this would raise growth; not only that, it would also improve income distribution because it would allow the countries to produce more labour intensive goods (goods whose production requires a lot of labour) since that's what these countries had a "comparative advantage" in. There was certainly some serious evidence to support the former expectation, but the distribution question is a much more complicated one, one on which only the daredevils gave very strong predictions. Some of the countries of the region adopted the new trade and other policies voluntarily (Chile under Pinochet and Colombia in the early 1990s) but most did so under the pressure of circumstances--they were severely indebted and had to promise to move policies in this direction in order to secure funds from the IMF, the World Bank and others. In each country by this time there were economists and others who favoured the new policies (e.g. Salinas in Mexico), a fact which reflected the changing views in academia, etc.

7. In fact neither of these "optimistic" expectations has been borne out. Growth in Latin America as a whole averaged 5.55 over the three decades 1950-80, when nearly all the countries were following an Import Substituting Industrialization (ISI) strategy, whereby they protected infant industries in order to give them a chance to "mature" before being fully subjected to international competition. Parenthetically, the countries of East Asian were following similar protectionist

policies for their own industries, but with the difference that they were pushing their manufactured exports more vigorously than were most of the Latin American countries. Then came the "lost decade" of the 1980s, with the debt crisis. When it was more or less past and the new "outward-looking" free trade policies were being followed in the 1990s, growth averaged a little under 3.5%, markedly less than under the old ISI strategy. This does not prove that ISI was better, since other things may have changed between these two periods, which make it harder to grow now than it was then. But, obviously, the record so far is quite disappointing for the free trade advocates. Several things seem to have been missed or exaggerated in their optimistic diagnosis. As far as growth is concerned, I think there are two main ones. First, this group of economists exaggerated the weaknesses of the former ISI policy (they seemed to forget how fast the region was growing then) and fantasized a bit about the beauties of the new regime; a general failing in economics and other disciplines is to be unable to see the weaknesses of new models until those weaknesses show up "on the ground". Second, almost no one predicted the severity of the financial instability and crises which would follow on the freeing of international capital markets, and this has slowed growth in most countries of the region, especially Mexico.

8. Whatever its weaknesses on the growth front, the new model has preformed worse on the distributional front. In the majority of countries the evidence suggests that around the time of the introduction of the market-friendly package of policies (freer trade, freer capital movements, privatization and labour market reforms) the level of inequality has gone up. This is a serious matter in a part of the world where the level of inequality was already quite high. There are a few exceptions, it seems, including Uruguay, Costa Rica and perhaps Peru and Jamaica. Again there seem to be a couple of reasons why the optimists were wrong in their income-distribution expectations for the new model. First, the belief that Latin America's wages are low enough to make the region dominant in very labour intensive products like garments was wrong; wages are considerably lower in many Asian countries, so as trade has become freer around the world it is those countries which have conquered this particular market. Second, there was inadequate recognition that if exports are to create a lot of jobs small and medium firms (and/or farms) must somehow be involved. As the East Asian countries rode their export booms to get higher employment, rapidly rising wages, etc. these firms played an important role, either exporting directly themselves (frequent in Taiwan) or as subcontractors for the larger firms which did the exporting (Japan and Korea). The East Asian export experience was thus successful partly because protection was retained to foster the industries still needing it and because there were lots of linkages between the export activity and the small and medium firms. Why this model worked so well has not been well understood by many of the decision-makers in Latin America or the IFI people who have pressured them towards totally open markets.

9. I have not commented in the above on what the true objectives of all of the players in the Latin american drama have been, but rather limited myself to the views of economists whom I would expect to have the interests of the countries in question at heart. But it can also be argued that the opening up of those countries was a power play pushed by international capital, financial and other. There is certainly something to this. My impression is that most of these actors do believe that open markets help everyone, a convenient belief, and one which reflects the fact that they are amateurs when it comes to economic analysis. Undoubtedly there are some who welcome the higher degree of dependence which the Latin American countries now live under. With a higher

degree of integration, more of the administrators in a given Latin country are likely in future to work for a large MNC or an IFI, so their attitudes to those institutions are less likely to be negative.

10. It is impossible to know at this time just how much of the blame for the increased levels of inequality in most latin American countries should be assigned to freer trade and financial movements. The analytical problem for the research is that usually all the elements of the market-friendly package of policies are implemented at the same time, which makes it very hard to figure out which ones have done the damage. In another 10 years we should have a better idea; at this point nobody knows much. My own guess is that freer trade has played a negative role, given the other circumstances of these countries--failure to link smaller enterprises sufficiently into international trade, and the very unequal levels of education to which different social groups have access. If those two conditions could be changed, the impacts of freer trade might be positive. But they will not be easy to change. (Note that I am generalizing across the region here and some of the points do not apply to some countries, e.g. unequal access to education is not a failing of all.)

There is a major debate occurring at a world level now as to sources of increased inequality generally, especially in the U.S. where distribution has worsened markedly since the 1970s. Many people attribute a lot of it to the nature of technological change- -robotization, the replacement of secretaries by the personal computer, replacement of retail workers by the internet or TV sales, etc. To the extent that this technological change is the dominant factor worldwide in increasing inequality, current policy will have a difficult time in preventing the negative effects and will instead have to search for palliatives and for policies which work the other way enough to at least partially offset these effects.

11. We do not know how freer trade and the other policy changes of recent times have affected gender equity. Female labour market participation has generally continued to rise in Latin America, partly as families get smaller and the population becomes more urbanized. Earnings differentials against women tend to be on the order of 20-40%, for people of comparable education and experience, which is not unusual as one looks around the world. Colombia (1975-90) is the only case I know of where there was a large reduction in this differential, to almost zero. Nobody knows why it happened in Colombia but not elsewhere, as far as I am aware. Various forms of discrimination against women exist and its hard to measure whether they have changed significantly or not; many people believe that rising levels of education do have a positive effect. It is striking that in many countries there are now more females in tertiary education than males. There is still serious occupational streaming, and the experience of now-industrialized countries is that these things seldom change really fast. As the extended family loses prominence and the female-headed household becomes more prevalent, a new version of female poverty has arisen over the last few decades. Social policy will be necessary to address it effectively, but advances are not easy when the fiscal situation is tight and more emphasis is given to economic growth.

12. I believe that there is an important difference between freer trade in a bloc like the European Union where most of the countries are of roughly equal size and economic weight, and that in a union with one big player, i.e. NAFTA. In the latter case neither Canada nor Mexico can expect to have much power in determining conditions or outcomes. American business pretty much

wrote the details of the NAFTA arrangements. The U.S. is an especially dangerous partner because its people tend to genuinely believe that the American way in everything is better, which makes them give little credence to other views, as Canada has found out in its attempts to protect its cultural industries. They tend to believe that everyone else really wants to be an American anyway. And they are hard and organized bargainers. Finally their deep strain of isolationism makes it very hard even for an American administration which would be willing to pass some power to an international body to be able in fact to do so. The dispute resolution panels in the Canada-U.S. free trade treaty provide some evidence on how far the U.S. may be willing to go; the evidence is not easy to interpret yet.

13. To sum up, I believe that trade provides many benefits to most of the countries that participate, but the most beneficial part of it is already occurring. As we move toward ever freer trade we are adding the less beneficial types. That is why the figures seems to tell us that Canada, for example, has not gained in growth due to its membership in the free trade area with the U.S. and now Mexico. Capital movements are of even more doubtful value at present, since the uncontrolled movement of capital leads both to crises like the Mexican one in 1994 and more recently the Asian one, but much more frequently capital inflows lead to overvaluation of a country's currency which stifles its exports and can lead to recession. This ironic outcome--just when a country has access to lots of capital nobody wants to invest it in productive uses, is another of the problems which was not predicted by the optimists who supported free markets. The debate around the "Tobin tax" or some other way to control the excessive mobility of short-term capital between countries reflects these problems, and until a better arrangement than the present one is achieved, the flow of capital will not necessarily be an advantage at all for Latin countries. Though many economists see some controls on capital movements as essential, the big financial powers in the industrial countries, especially the U.S., are opposing this vigorously. Some countries of Latin America do control capital movements into and out of their economies to some degree (Chile and Colombia) and they seem to have benefited from exercising this control. But they have been criticized for doing so.

14. Was the replacement of ISI by the market-friendly policy package ideological? I would say that the choice of the new approach was definitely ideological on the part of the economists who supported it, in the sense that it flowed from a simple (simple-minded?) economic theory, what I would call "primary-school economics". All well-trained economists see merits in markets but also study their failings. The supporters of this shift did not give much weight to the failings. In their defence some of them thought that the growth slowdown as the debt crisis approached was due to the "exhaustion of the ISI model". I would certainly agree that if a country pursues that model to the ridiculous extreme of trying to produce everything it possibly can at home and keeping imports to a bare minimum, then unless it is a big country with a wide range of natural resources, this policy will be costly in terms of lost growth. And it is true that some of the smaller Latin countries were going away too far in this direction (Chile, for example, was one). But one can have a considerable dose of ISI policy without going to the ridiculous extreme; by the late 1960s both Brazil and Colombia were modifying their policy in order to encourage new types of exports, which means that they were doing something pretty similar to what the East Asian success stories were doing. And they grew as a result. What, for me, was ideological rather than careful and pragmatic, was to go so far in the other direction towards free trade, when (a) there

was no need to go that far, (b) the empirical record from East Asia suggested that it was the combination of carefully planned protection of domestic markets with inducement to export new items which underlay their great successes and (c) there was at the time no record of success under free trade policies in anything but city states like Hong Kong, so it was quite a brash thing to jump into such untested waters, the sort of thing which theoreticians might be willing to do, since they tend to have an idealized and partial picture of reality.

15. Is globalization and increasing interdependency among countries inevitable? Part of the increase in trade and financial flows which we have seen result from technological change which lowers the costs and makes us more like a global village. These aspects are not reversible. Another part, however, is due to the policy decisions taken, and this is a big part. In principle it can be reversed. The high level of economic integration achieved after the previous great wave of globalization (late 19th and early 20th century) was reversed by World War 1 and the Great Depression of the 1930s. But integration is hard to reverse since it is costly for a single country to take itself out of the arrangements it has moved into; other countries will penalize it for not "playing by the rules of the game." So, although I think these processes have gone undesirably far, I think it will be hard to reverse them. It would require quite a bit of pressure from quite a few different quarters. The widespread suspicion on the part of many people in both industrial and developing countries about the current governance of the world economic system is very healthy, I believe, even though many people are naturally not well informed on the details. They are right in suspecting that the world economy is powerfully controlled by large private sector interests--MNCs, large financial institutions, and others and that these exercise their power largely through the Group of 7 (dominated substantially by the U.S.A.) which makes the big decisions, generally without much informed concern for the poorer countries. They may well be wrong in putting too much of the blame on the World Bank and the IMF, especially on the Bank which, while having lots of weaknesses, also has lots of informed expertise on some issues. If the Bank's influence in the world is bad, that of the big private bankers is atrocious. If we scuttle the easier target, will we be left with only the really bad players on the stage?