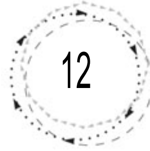

A Sane Globalization

How might the principles proposed in the previous chapter work in practice? Is it possible to devise sensible rules that uphold these principles while preventing descent into international economic anarchy? And how would these rules address the kind of challenges that the world economy currently confronts?

This final chapter provides some answers by focusing on four key areas where the challenges are concentrated. I begin by applying my principles to the world's trade regime and show how they call for rules that differ significantly from those that trade negotiators have been pursuing in recent years. Next I turn to global finance and propose an approach that would allow different national regulations to co-exist side by side without undermining each other. The third area is labor migration, a phenomenon not discussed much in this book, but which can generate significant benefits if properly managed. Finally, I take up a question that is likely to produce the most important headache for the world economy in the years immediately ahead: how to accommodate China in the global economy.

Reforming the International Trade Regime

Our current trade strategy, centered on trade agreements to open markets, wastes a lot of political and negotiating capital for the prospect of meager economic gains. Worse still, it neglects the system's major defect, which is its lack of widespread support among ordinary people.

Today's challenge is no longer to open up the trade regime; that battle was fought in the 1960s and 1970s and has been decisively won. The infamous Smoot-Hawley Tariff of the 1930s has turned into a symbol of everything that can go wrong when nations turn their back on the world economy. "Protectionism" has become a dirty word. Import tariffs and other restrictions that governments impose on international trade have been reduced to the lowest levels the world has ever seen. Even though restrictions and subsidies continue to be important in some areas, especially in certain agricultural products (such as rice, sugar, and dairy products), world trade is remarkably free. As a result, the gains that we stand to reap from removing the remaining vestiges of protectionism are puny—much smaller than what the pundits and the financial press presume. One recent study estimates those benefits to rise to no more than one third of 1 percent of world GDP (and this at the end of a full decade) .[1] Most other credible estimates are also in the same ball park.

Free trade advocates, including some economists, often obfuscate this point by touting the "hundreds of billions of dollars" of trade that would be created by this or that trade agreement. But what generates higher incomes, better jobs, and economic progress is not more trade as such. Shipping a T-shirt or a PC across the border is not what makes us better off. What makes us better off is the ability to consume those goods at lower cost and sell our products at better prices abroad. This is why we want to reduce

man-made barriers to trade. Such gains are small at present, however, because the barriers are so low.[2]

Our challenge today is to render the existing openness sustainable and consistent with broader social goals. This requires a decisive shift in the focus of multilateral negotiations. When trade ministers get together, they should talk about expanding the maneuvering room for individual nations rather than narrowing it further through cuts in tariffs and subsidies. They should create the domestic space needed to protect social programs and regulations, renew domestic social contracts, and pursue locally tailored growth policies. They should be bargaining about policy space rather than market access. Such a reorientation would benefit rich and poor nations alike. Expanding policy space to accomplish domestic objectives does not negate an open, multilateral trade regime; it is a precondition for it.

The world's trade rules already allow nations to resort to "safeguards" in the form of higher import tariffs when a sudden surge in imports puts domestic firms in difficulty.[3] I would like to see the WTO's Agreement on Safeguards (which is a carryover from GATT) rewritten to expand policy space under a broader set of circumstances. A wider interpretation of safeguards would acknowledge that countries may wish to restrict trade or suspend WTO obligations—exercise "opt-outs"—for reasons other than a competitive threat to their industries. Distributional concerns, conflicts with domestic norms and social arrangements, prevention of the erosion of domestic regulations, or developmental priorities would be among such legitimate grounds.

Specifically, countries would be able to "violate" WTO rules when those rules threaten to undermine domestic labor and environmental standards or when they hamper the pursuit of sound development policies.[4] In effect, the agreement would be recast into

an expanded Agreement on *Developmental and Social Safeguards.*

A country that applies such a safeguard would have to satisfy a

key procedural requirement: it would need to demonstrate that it followed democratic procedures in reaching the determination that the safeguard measure is in the public interest. The specific criteria might include transparency, accountability, inclusiveness, and evidence-based deliberation. This hurdle would replace the current agreement's "serious injury" test, which focuses largely on domestic firms' financial profitability.

WTO panels would still have jurisdiction, but on procedural rather than substantive grounds. They would examine the degree to which democratic requirements were fulfilled. Were the views of all relevant parties, including consumer and public interest groups, importers and exporters, civil society organizations, sufficiently represented? Was all relevant evidence, scientific and economic, brought to bear on the final determination? Was there broad enough domestic support in favor of the opt-out or safeguard in question? The panels may rule against a country because the internal deliberations excluded an interested party or relevant scientific evidence. But they would not be able to rule on the substantive claim—whether in fact the safeguard measure serves the public interest at home by furthering a domestic social purpose or promoting economic development at home. This echoes the procedural emphasis in the existing Agreement on Safeguards, although it greatly increases the scope of its application.[5]

The case in favor of economic openness must be made and won at home. A sustainable trade regime ultimately rests not on external constraints but on domestic political support. The proposed procedure would force a deeper and more representative public debate on the legitimacy of trade rules and on the conditions under which it may be appropriate to suspend them. The most reliable guarantee against abuse of opt-outs is informed deliberation at the national level. The requirements that groups whose incomes would be adversely affected by the opt-out—importers and exporters—participate in the deliberations, and that the domestic process balance the competing interests in a transpar-

ent manner, would minimize the risk of protectionist measures benefiting a small segment of industry at large cost to society. A safety valve that allows principled objections to free trade to prevail makes it easier to repress protectionist steam.

Even though domestic interests would presumably dominate the deliberations, the consequences for foreign countries would not be entirely overlooked. When social safeguards pose serious threat to poor countries, for example, non-governmental organizations and other groups may mobilize against the proposed opt-out, and those considerations may well outweigh ultimately the costs of domes tic dislocations. A labor union may win protection when its members are forced to compete against workers abroad who toil in blatantly exploitative conditions. They are much less likely to carry the day against countervailing domestic interests when foreign working conditions reflect poor productivity rather than repression of rights. As the legal scholar Robert Howse notes, enhancing confidence in the ability of domestic deliberations to distinguish between legitimate domestic regulations and protectionist "cheating" should allay concern that domestic measures are purely protectionist. "Requiring that regulations be defensible in a rational, deliberative public process of justification may well enhance such confidence, while at the very same time serving, not frustrating, democracy."[6]

An extension of safeguards to cover environmental, labor, and consumer safety standards or developmental priorities at home—with appropriate procedural restraints against abuse—would increase the legitimacy and resilience of the world trading system and render it more development-friendly. It would breathe life into the principle that countries have the right to uphold national standards when trade undermines broadly popular domestic practices, by withholding market access or suspending WTO obligations if necessary. Advanced countries could seek temporary protection against imports originating from countries with weak enforcement of labor rights when these imports worsen working conditions at

home. Poor nations might be allowed to subsidize industrial activities (and indirectly their exports) when those subsidies contribute to a broadly supported development strategy aimed at stimulating technological capabilities.

Current safeguard procedures require most-favored-nation treatment of exports, permit only temporary measures, and demand compensation from the country applying the safeguard. These need to be rethought in the context of the broader arrangement I am proposing. MFN treatment will often not make sense. If the safeguard is a reaction to labor abuses in a particular country, it is appropriate to direct the measure solely against imports from that country. Similarly, an ongoing abuse will require ongoing use of the safeguard. Instead of imposing temporary relief, it would be better to require periodic review or a sunset clause that could be revoked in case the problem continues. This way, trade restrictions or regulations that hamper other countries' interests are less likely to become ossified.

The issue of compensation is trickier. When a country adopts a safeguard measure, the logic goes, it revokes a "trade concession" it had previously granted to other countries in an internationally binding agreement. Those other countries are entitled to receive equivalent concessions or to revoke some of their own concessions in return. In a dynamic world with near-constant change, the nature of the concessions that a country grants to others cannot be predicted perfectly. This uncertainty turns international trade agreements into "incomplete contracts." When unforeseen developments change the value or cost of trade flows—because of new technologies on genetic engineering, say, or new values on the environment, or new understandings on desirable development strategy—who controls rights over those flows? The requirement of compensation places those rights squarely with the international trade regime; the exporter can continue to demand market access on the original terms. But we might just as legitimately argue that the value of the original concessions depends on the

circumstances under which they were provided. Under this interpretation, an exporter could not claim a benefit that did not exist, nor the importer be forced to suffer a loss that was not originally contemplated, when the agreement was signed. This would bring control rights closer to nation states and sharply limit the amount of compensation that exporters could expect.

Authoritarian regimes would be subject to additional substantive requirements when resorting to opt-outs. Such countries may need to make an explicit social or developmental case to justify safeguard measures. They may need to demonstrate that the safeguard would effectively achieve a specified public purpose.

Authoritarian regimes likely will become easier targets for safeguard action by democratic nations when their exports cause problems in those nations. Even though some of their labor practices, for example, will be easy to justify, others may not be. Minimum wages that are significantly lower than in rich countries can be rationalized in the domestic debate by pointing to lower labor productivity and living standards. Lax child-labor regulations are often justified by the argument that it is not feasible or desirable to withdraw young workers from the labor force in a country with widespread poverty. In other cases, arguments like these carry less weight. Basic labor rights such as non-discrimination, freedom of association, collective bargaining, and prohibition of forced labor do not cost anything. Compliance with these rights does not harm, and indeed possibly benefits, economic development. Gross violations constitute exploitation of labor, and will open the door for safeguards in importing countries on the ground that they generate unfair distributional costs.

Generalizing the safeguards agreement in this fashion would have its risks. Critics will worry that the reduced scope for compensation will lower the value of trade agreements. They will be concerned that the new procedures put us on a “slippery slope” of protectionism. Such qualms have to be tempered by considering the abuse that occurs under the existing rules without great det-

riment to the system. If mechanisms explicitly designed to facilitate protectionist barriers, such as the anti-dumping rules of the GATT, have not destroyed the multilateral trade regime thus far, it is not clear why well-designed exit clauses would have consequences that are worse.

Less flexible rules do not necessarily make better ones. They increase the risk that governments will find their hands tied in circumstances where it would have been desirable for them to act. They may therefore reduce, rather than increase, the value of trade agreements and diminish the incentive to sign on to them.

Consider what happens if we continue on our current path. The Doha Round of trade negotiations, with which the world's trade officialdom remains preoccupied, focuses on reducing the remaining barriers at the borders, especially in agriculture. The round was launched in 2001 and has experienced one collapse after another. Despite all the hoopla that accompanies these negotiations, it is safe to say that the prospective gains from a successful completion of the Doha Round are quite small—even paltrier than the one third of 1 percent of world income that a movement to full liberalization would entail.

Of course, there may still be some big winners from the Doha agenda. In particular, cotton growers in West Africa would benefit substantially from the removal of subsidies in the United States, their incomes rising by up to 6 percent—not a small amount for farmers so close to the subsistence level.[7] On the other hand, poor urban consumers who do not grow their food and low-income food-importing countries would be hurt by the increase in the world price of agricultural commodities as rich country subsidies are phased out.[8]

Taken as a whole, Doha should be considered small potatoes. After the kind of progress achieved by export-oriented East Asian economies in recent decades, facing barriers even higher than those of today, no serious economist would argue that the existing restrictions on market access limit seriously the growth pros-

pects of poor countries (or anyone else, for that matter). Indeed, the lack of political momentum behind Doha can be explained at least in part by the weak prospects of significant economic gains.

National borders *do* impose significant transaction costs on trade. However, these costs derive less from protectionism at the border than from differences in standards, currencies, legal systems, social networks, and so on. Squeezing large gains from the world trade regime would require extensive institutional surgery, going beyond conventional trade liberalization and reaching behind borders to harmonize national standards and regulations. Those gains would be quite ephemeral, as they would come at the expense of the benefits of institutional diversity and policy space. Such a strategy is of questionable merit; indeed, there is little appetite for it after the disappointments of the last GATT trade round (the Uruguay Round) —and for understandable reasons.

The Doha Round's troubles are indicative of the impasse in which the trade regime finds itself. They exemplify the problems of the prevailing low-return, high-cost strategy, which leaves the world economy straddling a choice between two unappetizing options. One possibility is that popular pressure will force governments to resort to unilateral protectionism outside existing rules, inviting retaliation from others. Nations will refuse to sign on to substantive trade agreements for fear that the commitments will severely undermine policy space. International cooperation will gradually erode. Another possibility is that the spirit of "deep integration" will ultimately prevail and governments will sign ever-constraining trade agreements. The room for institutional diversity will then shrink and the legitimacy of the trade regime and prospects for economic development will both suffer.

Either way, the "business as usual" approach poses a greater risk to globalization's health than the reforms I have outlined here. It may seem like a paradox, but it isn't: reempowering national democracies is a precondition for an open world economy, not an obstacle to it.

Regulating Global Finance

The subprime mortgage meltdown has laid bare the inadequacies of the prevailing approach to regulation—both nationally and internationally. Loopholes in the rules allowed financial entities to take on risks that endangered not only themselves but society at large. The fallout has unleashed a flurry of efforts to improve the stringency and soundness of financial regulation. The measures under discussion include tighter capital-adequacy standards, restrictions on leverage, caps on executive pay, rules that facilitate bank closures, broader disclosure requirements, greater regulatory oversight, and limits on bank size.

These efforts are marred by a big fudge. Policy makers pay lip service to regulatory diversity and the push and pull of domestic politics that lead major players like the United States and the European Union to design their own regulations. Yet these same policy makers press for regulatory harmonization, fearful that diverse regulations will raise transaction costs and impede financial globalization. As a senior U.S. Treasury official put it to a European audience, "we cannot go our own ways, deviating significantly from international standards or practices, and exposing global markets to the risk of fragmentation." Yet, he added, "[n] or should we impose standards on one another if we are not identical."[9] No one has articulated how to steer a sensible path between these competing objectives. The attempt to have one's cake and eat it too is not just misguided; it leaves the world economy exposed to exactly the kind of mishaps that almost brought it down.

For global governance enthusiasts, international cooperation has produced a few successes since the crisis. These fall far short of a real shift in authority away from national policy makers. A global regulator, say, or a world central bank remains as much a fantasy as ever. The changes are minor and somewhat cosmetic. Most notably, the Group of Seven, the rich country club which

serves as the global economy's talking shop, has been effectively supplanted by the Group of Twenty, which includes in addition a number of major developing nations. The International Monetary Fund has received additional financial resources. The Financial Stability Board (previously Forum), an association of two dozen nations' regulators and central banks, has been given new monitoring responsibilities. The Basel Committee on Banking Supervision has been put to work on a new set of global principles for bank regulation, its third in barely more than two decades.

The real story of financial regulation is one of international discord rather than harmony. Domestic pressure is forcing national politicians to act quickly on financial reforms rather than wait for bankers to come up with globally harmonized rules.[10]

The fault lines among industrial countries fall along expected lines. With some important exceptions, continental Europeans tend to favor a more stringent approach, while the Americans and the British are wary of regulatory overreach that would cripple their financial industries. In 2009, the European Commission, prodded by Socialist parties, proposed extensive regulations on hedge funds and private equity firms that would restrict debt levels, impose capital requirements, require strict disclosure, and cap the pay of managers. These measures, which go well beyond American proposals and would apply also to any American firm that wants to do business in Europe, unleashed a flurry of U.S. lobbying in support of British efforts to water them down.[11] Similarly, the European Parliament approved broad regulations governing credit rating agencies in April 2009, drawing complaints from U.S.-based credit rating agencies about the additional costs the new requirements would impose. The French and Germans, joined this time by the British, have pushed for a global tax on cross-border financial transactions (a variant of the Tobin tax we saw earlier), only to be rebuffed by the American administration. Finally, Europeans have taken a much harder line on bankers' bonuses than Americans.

On other issues, it is the Americans who have led the way while the Europeans have resisted tighter controls. President Barack Obama has endorsed the so-called "Volcker rules," which would impose ceilings on bank size and prohibit banks trading on their own account. A watered-down version of some of these ideas eventually found its way to the financial reform bill that Congress passed in July 2010. The United States has also generally shown much greater appetite for raising banks' capital requirements than Europe.[12] In both instances, Europeans have accused the United States of going it alone and undermining international coordination.

We have to think of these differences not as aberrations from the norm of international harmonization, but as the natural consequences of varying national circumstances. In a world where national interests, perceived or real, differ, the desire to coordinate regulations can do more harm than good. Even when successful, it produces either weak agreements based on the lowest common denominator or tougher standards that may not be appropriate to all. It is far better to recognize these differences than to presume that they can be papered over given sufficient time, negotiation, and political pressure.

The principle we should apply here is the same one that we apply in the case of consumer safety. If another country wants to export us toys, it has to make sure that those toys pass our lead-content and other safety standards. Similarly, when a financial firm does business in our economy, it has to comply with our financial regulations, regardless of where it is based. That means it has to hold the same level of capital reserves as dome stic firms, face the same disclosure requirements, and abide by the same trading rules. It's a simple principle: if you want to be part of our game, you have to play by our rules.

As Simon Johnson rightly asks, why should the United States be left hostage to European resistance when its lawmakers agree that capital requirements need to be increased or banks "too big

to fail" need to be broken up?[13] It is better for the United States to go it alone, he argues, than be slowed down by "the glacial nature of international economic diplomacy, and the self-interest of the Europeans."

Take the example of capital requirements, where the United States wants tougher rules than Europe. Here is what Johnson proposes. If other nations don't raise their capital requirements, then their banks should not be allowed to enter the American market or do business with American banks unless those American banks carry extra cushions of capital reserves. U.S. banks and their executives would face criminal penalties if they violated these regulations. Johnson thinks this approach will bring the Europeans to heel and force them to match America's high standards to gain access to the world's largest and most sophisticated market.

Regardless of whether others follow suit, Johnson has the right idea. As he puts it, the United States should "stop worrying about what other countries might or might not do... [it should] establish high capital requirements in the US, and make this a beacon for safe and productive finance."[14] If the United States feels safer under a certain set of standards, it should be free to implement them—not in order to bring other nations into line, but because national interest demands it.

What is true of the United States is true of other nations as well. Even though other countries may not always have the power to force emulation by others, if they decide they want certain kinds of regulations they should feel empowered to institute them, even if this means imposing restrictions on cross-border finance. Just as in trade, a healthy global regime leaves space for national diversity in standards.

The fly in the ointment is that maintaining regulatory differences when finance can freely cross national boundaries is quite difficult. Banks and investment houses can simply move to jurisdictions with less onerous restrictions. Financial globalization in effect neutralizes differences in national regulations. This is what

is known in the trade as “regulatory arbitrage,” a race to the bottom in finance.[15]

For this reason, a commitment to regulatory diversity has a very important corollary: the need for restrictions on global finance. The rules of the game have to allow for restrictions on cross-border finance designed to counter regulatory arbitrage and protect the integrity of national regulations. Governments should be able to keep banks and financial flows out—not for financial protectionism but to prevent the erosion of national regulations. None of the leading governments has acknowledged this need explicitly to date, yet without such restrictions domestic regulations would have little effect and domestic firms would stand little chance to compete with financial services exported from lax jurisdictions. The domestic economy would remain hostage to the risks emanating from those transactions.

Hence a new global financial order must be constructed on the back of a minimal set of international guidelines and with limited international coordination.[16] The new arrangements would certainly involve an improved IMF with increased resources and a larger voice for developing nations. It might require an international financial charter with limited aims, focused on encouraging financial transparency, promoting consultation and information sharing among national regulators, and placing limits on jurisdictions (such as financial safe havens) that export financial instability. A small global tax on financial transactions (say on the order of one tenth of 1 percent) would generate tens of billions of dollars to address global challenges such as climate change or health pandemics at little economic cost.[17] But the responsibility for regulating leverage, setting capital standards, and supervising financial markets more broadly would rest squarely at the national level. Most important, the rules would explicitly recognize governments’ right to limit cross-border financial transactions, insofar as the intent and effect are to prevent foreign competition from

less strict jurisdictions from undermining domestic regulatory standards.

Deemphasizing international regulatory standards in favor of national ones would shift power away from technocrats to domestic groups, especially legislatures. It would politicize and democratize financial regulation.[18] Technocrats dominate the discussion in international bodies such as the Basel Committee or the Group of Twenty. Stronger democratic accountability to national parliaments would reduce the influence of such technocrats and base regulations on the preferences of a wider group of domestic constituencies. Many economists would consider politicization a big step back. But we might be allowed a measure of skepticism on this in view of the technocrats' dismal recent record. As Professor Nicholas Dorn of the Erasmus School of Law argues, "democratically-fuelled regulatory diversity is a safeguard against the recently experienced frenzy in global financial regulation and markets."[19]

For developing countries, these rules would have additional benefits. They would open up the policy space for them to manage international capital flows and prevent sudden stops and overvalued currencies. Excessive focus on international harmonization has sidelined the specific interests of emerging nations. As we have seen, financial integration can often have unexpected and adverse effects on these countries. Short-term capital flows wreak havoc with domestic macroeconomic management and aggravate adverse currency movements. "Hot money" can make it difficult for financially open economies like Brazil, South Africa, or Turkey to maintain a competitive currency, depriving them of a potent form of industrial policy. Prudent controls, managed in a countercyclical manner so as to deter excessive financial inflows in good times, are part and parcel of good economic policy. Their importance only grows in a world where the mood in global finance can swing from euphoria to gloom in short order. International bodies

such as the IMF and the Group of Twenty must look sympathetically, rather than frown, on such controls.[20]

Of course, groups of like-minded countries that desire deeper financial integration would be free to harmonize their regulations, provided they do not use this as a cover for financial protectionism. One can imagine Europe taking this route and opting for a common regulator. East and Southeast Asian nations may eventually produce a regional zone of deep integration around an Asian monetary fund.

The rest of the world would have to live with a certain amount of financial segmentation—the necessary counterpart to regulatory diversity. That is as it should be. In a diverse world with divided sovereignty, it is the prospect of the deepening of financial globalization that should cause us to lose sleep.

Reaping the Benefits of Global Labor Flows

The problems in international trade and finance arise from too much globalization, not properly managed. By contrast, one large segment of the world economy is not globalized nearly enough. Further economic openness in the world's labor markets could potentially provide huge benefits, especially to the world's poor. Even a minor liberalization of the advanced countries' restrictions on the use of foreign workers would produce a large impact on global incomes. In fact, the gains would outstrip comfortably any other proposal currently on the table, including the entire package of trade measures being considered under the Doha Round of negotiations! Labor markets are the unexploited frontier of globalization.

It may seem surprising to suggest that labor markets are not sufficiently globalized. The news media are full of stories of foreign workers in rich lands, ranging from the inspiring to the terrifying: Indian software engineers in Silicon Valley, illegal Mexicans in

New York sweatshops, poorly treated Filipina maids in the Persian Gulf countries, or disgruntled North Africans in Europe. Human smuggling and trafficking in sex workers represent the especially ugly side of the global trade in labor. But the facts are incontrovertible. The transaction costs associated with crossing national borders are much larger in this segment of the world economy than in any other. Moreover, these costs are created for the most part by explicit government barriers at the border, namely, visa restrictions. They can be lowered at the stroke of a pen.

Consider the numbers. Wages for similarly qualified workers in poor and rich countries can differ by an order of magnitude; a worker could increase his income several-fold just by crossing the border. Straightforward comparisons of wages across nations are fraught with problems because it is difficult to tease out the effects of visa restrictions from other factors such as differences in skills, education, experience, or aptitude. A recent study which makes adjustments for these factors delivers some striking findings. The average Jamaican worker who moves to the United States would increase his earnings by at least twofold, a Bolivian or Indian by at least threefold, and a Nigerian by more than eightfold. To put these numbers in context, we can compare them to the mere 50 percent gain that a Puerto Rican worker can expect to make when she moves to New York City, which she is of course free to do, unlike other foreign counterparts.[21] Or we can compare them to differences across nations in the prices of goods or financial assets, which are again much smaller in magnitude (50 percent or less at most).

Labor markets are much more segmented internationally than any other market. This extreme segmentation, and the huge wage gaps it gives rise to, induces illegal migrants from low-income countries to take serious risks and endure extreme hardships in the hope of improving their incomes and the living standards of their families back home. The reason such large wage gaps persist is not difficult to fathom. The visa policies of rich countries allow

limited numbers of workers from poor countries to move in legally and take up jobs in their economies. Moreover, these restrictions tend to favor, increasingly, the skilled and well-educated workers from abroad.

If the leaders of the advanced nations were serious about boosting incomes around the world and in doing so equitably, they would focus single-mindedly on reforming the rules that govern international labor mobility. Nothing else on their agenda—not Doha, not global financial regulation, not even expanding foreign aid—comes even close in terms of potential impact on enlarging the global pie. I am not talking about total liberalization. A complete, or even significant, reduction in visa restrictions in the advanced countries would be too disruptive. It would set off a mass migration that would throw labor markets and social policies in the advanced nations into disarray. But a small-scale program of expanded labor mobility would be manageable, and still generate very large economic gains for the migrant workers and their home economies.

Here is what I have in mind. Rich nations would commit to a *temporary* work visa scheme that would expand their total labor force by no more than 3 percent. Under the scheme, a mix of skilled and unskilled workers from poor nations would be allowed to fill jobs in the rich countries for a period of up to five years. To ensure that the workers return home at the end of their contracts, the programs would be supported by a range of carrots and sticks applied by both home and host countries. As the original migrants return home, a new wave of workers from the same countries would replace them.[22]

Such a system would produce an estimated gain of $360 billion annually for the world economy, a sum considerably greater than what an agreement to remove *all* remaining tariffs and subsidies in global trade in goods could deliver.[23] The bulk of this increase in income would accrue directly to citizens of developing nations—the poorest workers in the world. We wouldn't have to

wait for the benefits to trickle down to them as is the case for trade and financial liberalization. Equally important, these numbers underestimate the overall gains since they do not account for the additional economic benefits that returnees would generate for their home countries. Workers who have accumulated know-how, skills, networks, and savings in rich countries could be true agents of change for their societies upon return. Their experience and investments would spark positive economic and social dynamics. The powerful contribution that former émigrés have made in getting software and other skill-intensive industries off the ground in India and Taiwan indicates the potential benefits of this plan.[24]

The sizable benefits of a temporary work visa program have to be considered against the backdrop of a series of objections. Many of these objections, arguments that the program would create a new underclass or that it would close the path to full citizenship for hardworking immigrants, are incomplete at best.[25] They ignore the benefits to the migrants' home economies of maintaining a revolving door that would diffuse the gains more widely. They overlook that the likely alternative to a temporary worker program is not greater immigration but sharply curtailed immigration. And they fail to recognize that workers from developing nations would queue up in droves for temporary jobs abroad, given their alternatives. However, two of the objections deserve closer scrutiny.

The first is that it will be difficult, if not impossible, to enforce the return of foreign workers to their home countries after their permits expire. This is a legitimate concern since many "guest worker" programs have in practice produced permanent immigrants, sometimes creating a large underclass of foreign-born residents left in ambiguous status (as in Germany and many other countries of Europe). On the other hand, past programs typically have offered few incentives for "temporary" workers to return, relying on little more than their willingness to abide by the terms of their visa. It comes as no surprise that many do not go home, given the huge wage gaps between home and host countries.

A workable temporary work visa program will need to offer clear carrots and sticks. To have a chance, these incentives will also need to apply to all parties—workers, employees, and home and host governments. One idea is to withhold a portion of workers' earnings in blocked accounts until the actual repatriation takes place. A migrant worker who overstays his visa would forfeit a large chunk of change. An enforced saving scheme like this would have the added benefit that migrant workers would return home with a sizable pool of resources to invest.

Perhaps more important, there could be penalties for home governments whose nationals failed to comply with the return requirement. For example, sending countries' worker quotas could be reduced in proportion to the numbers that fail to return: the larger the number of workers who overstay their visa, the fewer the number of temporary visas allotted in the next round. Sending countries that can successfully organize themselves to bring their migrant workers back home would benefit from a revolving door. Others would get shut out. That would create a strong incentive for the sending governments to provide a hospitable economic and political climate at home that would encourage their nationals' return. Democratic governments in particular would be under pressure from their voters, many of whom would be in line for future work permits, to ensure that their visa allotments do not shrink.

It is unlikely that any temporary visa program will work perfectly. A fair amount of experimentation will be required to get the details right; but we haven't tried hard or been imaginative enough to give up on the idea yet.

The second objection is that foreign workers would compete with the local workforce and drive wages down in the advanced economies. The degree to which immigrant labor displaces domestic labor remains a hotly contested issue among economists. Many analysts have concluded from the available evidence that

immigration has negligible or even positive effects on wages. I will not enter that debate here, but simply grant the possibility that there may be negative effects. Even so, the kind of limited program I am advocating would depress domestic wages by a very small amount—by no more than 1 percent at most.[26]

Nevertheless, the reader can legitimately ask: How can you support such a program when you appear so concerned about the wage reductions that may arise from regular trade with low-income nations? Recall the argument made earlier in chapter Three when we discussed the ethical questions that trade raises when it generates domestic dislocations. Picking up on the analogy with technological progress, I concluded then that "legitimate" arguments against freer trade must pass one of two tests. First, the overall economic gains must remain small compared to the distributional "costs" that freer trade generates. Second, the trade in question must involve practices that violate prevailing norms and social contracts at home.

The distributional objection against a small temporary work visa program clears neither hurdle. As discussed, a program along the proposed lines would generate large net benefits relative to the redistribution it might cause, given the height of border barriers at present.[27] The foreign workers also would be employed at home, under the same labor standards and regulations that protect dome stic workers. This invalidates any claim of unfair competition on the basis of a non-level playing field. If either of these assertions turns out to be invalid, opponents would then have a stronger case.

Whether a sufficiently broad domestic political consensus on temporary work visas can be reached in the advanced nations remains to be seen. The Comprehensive Immigration Reform Act of 2006 contained provisions that would have expanded a guest worker scheme in the United States, but the bill died an early death in Congress. An enlarged foreign worker presence clearly

garners little enthusiasm in the United States or in Europe. In light of this, it would be easy to write such programs off as politically unrealistic.

That would be a mistake. Trade liberalization has never had a huge amount of domestic political support either. Imports from developing countries create the same downward pressure on rich country wages as immigration. Yet that has not stopped policy makers from bringing trade barriers down. Trade liberalization succeeded through a combination of political leadership, lobbying by exporters and multinational enterprises, and the ideas of economists. Temporary migration, by contrast, has rarely had a well-defined constituency in the advanced countries. The benefits are no smaller, but the beneficiaries are less clearly identifiable. It is only after a Mexican worker enters the United States and lands a job that his employer develops a direct stake in keeping him in the country and the worker himself can add his voice to the domestic debate. For their part, economists have remained excessively tolerant of the political realities that underpin the highly restrictive regime of international labor mobility, even as they decry the protectionist forces that block further liberalization of an already very open trading system.

Today, the global labor regime looks like the international trade regime in 1950—full of high barriers that prevent the world's economies from reaping substantial benefits. The transformation that the trade regime has undergone since that time gives hope that something similar might happen in the area of immigration as well. This will require an honest and clearsighted political debate that allows advocates to make the case for expanded labor mobility. Economists could play an important role in shaping that debate. They can explain the substantial benefits for rich and poor nations alike, and clarify that the gains from worker mobility are low-hanging fruit compared to the mere crumbs from further liberalization in trade and finance.

Accommodating China in the World Economy

China was globalization's greatest success story during the last quarter century. Yet it may prove to be the reason for its downfall during the next.

China embodies all the major challenges that the global economy must overcome. How do we reconcile an open economy with the distributional and adjustment difficulties that trade with low-cost countries raises? How do we address the adverse effects that such trade can have on the welfare states, labor markets, tax regimes, and other social arrangements of advanced nations? How do we help developing countries restructure their economies while retaining an open, rules-based world economy? How do we integrate a large authoritarian regime into a global economy where the major players are all democratic?

These difficulties are all rooted in the enormous institutional diversity that exists around the globe. There are few nations whose institutions are as idiosyncratic as China's or leave as large a footprint on the world's marketplace. The appropriate way to respond to these challenges is not through tighter international rules or coordination, as we so often hear. It is possible to provide all countries, *including* China, with greater room to run their economic and social policies, and do so in ways that reduce adverse effects across national borders.

China remains a poor country. Average income has risen very rapidly in recent decades, but still stands at between one seventh and one eighth the level in the United States—lower than in Turkey or Colombia and not much higher than in El Salvador or Egypt. While coastal China and major metropolises such as Shanghai and Guangzhou reflect tremendous wealth, large swathes of western China are mired in poverty. China is not a candidate to take over global economic leadership from the United States or become a global hegemon—at least not anytime soon. But its population of

1.3 billion and rapidly growing wealth ensure that it projects a very large image on the global screen.

China's economic rise has been a boon for the world economy for the most part. The incredible variety of manufactured goods—everything from toys to autos—that its factories churn out has been a veritable gift for consumers in the rest of the world, especially the poor for whom many of these products have become affordable for the first time. China also offers a beacon of hope for developing nations in Africa and elsewhere whose economic difficulties sometimes seem insurmountable. The country stands as the premier example of how the global economy can be leveraged for economic growth and poverty reduction—by combining exports with a domestically tailored strategy of economic diversification and institutional innovation.

But the picture is not all pretty. China and its trade partners have become embroiled in a growing number of trade disputes in recent years on product safety, patent and copyright infringement, government subsidies, dumping, currency manipulation, and market-access restrictions of various kinds. Imports from China have become a leading scapegoat for the stagnant median wages in the United States. China's huge trade surplus has led even sober economists such as Paul Krugman to complain that the country's "mercantilist" policies are costing the U.S. economy more than a million jobs.[28] And China is widely blamed for running roughshod over human rights and good governance in Africa in its quest for natural resources.

The conflict that poses the greatest threat in the near term concerns China's trade imbalance. The country's current account surplus (a broad measure of the excess of export receipts over imports) has risen to great heights in recent years, reaching an astounding 11 percent of GDP on the eve of the financial crisis in 2007 (from low single digits a decade ago). This imbalance increases global demand for goods produced in China at the cost of reducing it elsewhere, greatly complicating the economic recov-

ery in the rest of the world. It has adverse effects on the health of manufacturing sectors everywhere but China. But the problem is not just an economic one. Historically, large trade imbalances have created fertile ground for protectionism. If China's trade surplus does not shrink, the United States likely will resort to trade barriers directed at Chinese exports, inviting retaliation from China and similar tactics from other countries. A major political backlash against China's trade and globalization in general will become a real possibility.

Has China's dependence on exports put the world economy on a collision course? Do we face a fundamental, irremovable conflict between China's development strategy, on the one hand, and economic and social stability in the rest of the world, on the other?

Not necessarily. A trade surplus is only an *incidental* consequence of China's growth strategy, more the result of our present global rules than of the inherent logic of that strategy. To see why, we must return briefly to the story of Chinese growth. The Chinese strategy relies on rapid structural change, which the government accomplishes by promoting industrialization together with continuous upgrading of the country's productive structure. Most of the economic activities that the government encourages are tradable, mainly manufactures. This strategy is perfectly compatible with balance on the external trade accounts as long as the increased supply of electronic products, steel, autos, and other manufactured goods that China's factories turn out is matched by increased demand in China for such goods—not necessarily product by product but in total.

Until very recently, the Chinese model worked this way. Even though the Chinese government has promoted manufacturing heavily since the 1980s, it did so through industrial policies—trade restrictions, investment incentives, subsidies, and domestic-processing requirements—that did not spill over into a trade imbalance.

Things began to change in the second half of the 1990s as the

government prepared for membership in the World Trade Organization. It brought tariffs down sharply and phased out many of the subsidies and domestic-processing requirements to bring policies in line with WTO requirements. But the Chinese government wasn't about to give up on its growth strategy. To compensate for the decline in protection and direct support to manufacturing, it allowed the renminbi to become increasingly undervalued.[29]

A cheap domestic currency has the same economic effects as a subsidy on exports *combined with a tax on imports.* Unlike conventional industrial policy, it necessarily generates a trade surplus.[30] So China's membership in the WTO in December 2001 produced an unwelcome side effect: a precipitous rise in its trade surplus followed at just around the same time.

We can now better understand why the Chinese government resists so vehemently external pressure for the renminbi's appreciation. Such a policy would help reduce global imbalances, but it would also threaten China's economic growth. My own research suggests that China's growth might be reduced by 2 percentage points or more if the renminbi is allowed to appreciate sufficiently to eliminate its undervaluation.[31] A reduction of this magnitude would in turn bring growth below the 8 percent threshold that the Chinese leadership believes is necessary for the economy to generate sufficient employment and avoid social strife. Given the size and geopolitical importance of the country, anything that undermines China's political stability should be of great concern to the rest of the world as well.

Unlike the picture that the typical commentary in the Western press suggests, this is not a simple morality play, with the Chinese as the "bad guys." China's trade surplus threatens the world economy, but so does a significant slowdown in its growth.

Such is the conundrum that our present rules have produced. Many consider the WTO's ability to constrain the use of subsidies and other industrial policies a great achievement for the world economy. It was a Pyrrhic victory. Restricting industrial policies has

forced China to resort to what is, for the rest of the world, a much inferior tool: currency undervaluation. Since the Chinese government has to buy dollars to prevent its currency from appreciating, it has also required China to accumulate more than $2 trillion in reserves—low-return U.S. Treasury bills and other assets for which the country has no conceivable use.[32] The paradox—more apparent than real—is that tighter global rules have led to worse global problems.

The right approach would be to leave China, and indeed all emerging nations, free to pursue their own growth policies. WTO restrictions on subsidies and other industrial policies should be suspended or subsumed under a general exception for developing nations. It would then be reasonable to expect that China and other emerging nations will pursue currency, financial, and macroeconomic policies that do not generate large trade imbalances. The quid pro quo would be this: you are entitled to your own growth strategy, but you also need to ensure that you do not produce large negative effects for the rest of the world in the form of trade surpluses. This would enable China to employ smart industrial policies in support of its employment and growth objectives without fear of WTO sanction. It would also allow China to let the renminbi appreciate without fear of adverse effects on growth. At the very least, it would eliminate the only sound justification for China's refusal to shrink its trade surplus.

As China moves toward balanced trade, the most significant immediate threat to the world economy will subside. But China's large and growing footprint in global markets will continue to render some of its trade problematic. As China continues its economic transformation and gains market share in ever more sophisticated products, we can be certain that this trade will generate persistent complaints from other countries about the undermining of domestic distributional bargains, labor standards, environmental regulations, or social norms. These complaints would have significantly greater traction in a world where China has a large trade

surplus overall; but they will not disappear in its absence. China and the importing countries must respond appropriately.

In this book I have provided a way to think about these conflicts and separate the legitimate wheat from the "protectionist" chaff. I have also proposed an escape clause mechanism—an expanded safeguard agreement along with domestic procedures—that would be appropriate for handling them. China may think the flexibility that this new apparatus affords importing nations will excessively restrict its exports. Yet the Chinese government (along with the governments of other major emerging nations) must recognize a basic reality of the global economy. If China and other developing nations want their policy space, they will have to allow rich nations to have theirs as well. China has every right to maintain its distinctive institutions; but it cannot expect other nations to alter their own economic and social models under threat from Chinese competition. Furthermore, China's non-democratic political regime requires that its trade receive much greater scrutiny than the trade of other countries like Brazil, Turkey, or India.

Still, provided the proposed safeguard mechanism is designed well, the policies it sanctions will not do much damage to trade overall. Its consequences will be a small price for exporters to pay for preserving an open global economy overall. China will have to take the trade restraints it experiences under this mechanism in stride—not as instances of protectionism that it needs to fight tooth and nail, but as necessary exercises in system maintenance.

Ultimately, the world economy must reconcile the big differences in China's cultural, social, and political system with the Western values and institutions that have dominated it to date. Americans and Europeans might assume that economic growth will make China more Western: liberal, capitalist, and democratic. But as the British scholar and journalist Martin Jacques reminds us, there is little reason to believe in such convergence.[33] China has distinctive views, rooted in its long history, on the organization of the economy, society, and government, and on the proper

relationships among them. As China gains economic power, it will advocate for a world order that better reflects these views.

The resulting tensions will not be easy to manage. But the challenge will be considerably easier to handle under global rules that respect diversity and minimize the need for international fetters than under rules that maximize reliance on coordination and common standards. These rules need not be underpinned by a single hegemon (whether the United States or China) and they will provide for greater stability in the world economy as the U. S role inevitably wanes.[34] That emphasis should suit China as well. The humiliations the country suffered during the nineteenth century at the hands of Britain and other imperialist powers have made the Chinese leaders great believers in national sovereignty and non-interference in domestic affairs. A light global touch would be consistent with those values.

Final Words

Read any book, article, or op-ed on the future of globalization, or listen to any statesman on the subject, and you will quickly feel crushed under the burden of weighty problems. Will we manage to coax enough international cooperation out of the political leaders of major nations? Will we succeed in erecting the structures of global governance that the world economy needs? How do we convince the rank and file of the world economy that economic globalization is good for them, and not a force for inequality and insecurity? What will happen to the global economy as the economic might of the United States recedes? Will China become the new global hegemon, and if so, how will that transform the international order?

These questions are enough to give one a headache. But they derive from faulty premises: that hyperglobalization is desirable (or unavoidable) and that reempowering nation states would

unleash forces that would severely damage the world economy. They make our task needlessly complicated.

We can and should tell a different story about globalization. Instead of viewing it as a system that requires a single set of institutions or one principal economic superpower, we should accept it as a collection of diverse nations whose interactions are regulated by a thin layer of simple, transparent, and commonsense traffic rules. This vision will not construct a path toward a "flat" world—a borderless world economy. Nothing will. What it will do is enable a healthy, sustainable world economy that leaves room for democracies to determine their own futures.