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Globalization Goes into Reverse?

by Edwin M. Truman | January 30th, 2009 | 11:00 am

One definition of globalization is the integration of economies and financial markets. By that definition, globalization has increased steadily since World War II. International trade has expanded more rapidly than global output, and cross-border financial flows have increased more rapidly than international trade—albeit with larger and deeper reversals. This process of global integration has been supported by the increased openness of national markets for goods, services, and finance and by a set of institutions designed to establish and support rules of the game, including the International Monetary Fund (IMF), the World Bank and other development banks, the World Trade Organization (WTO), the Bank for International Settlements (BIS), the Organization for Economic Cooperation and Development (OECD), and many other global and regional institutions.

Numerous studies have documented the benefits of increased globalization for individual economies and the world as a whole.¹ Nevertheless, globalization has been under attack for more than a decade from those who argue that the benefits are unevenly spread across or within countries and from those who argue that the damage to some countries, for example from international financial crises, has exceeded the benefits of increased financial integration. More recently, in the wake of the September 11, 2001, terrorist attacks on the United States and the associated and unassociated responses, historians have reminded us that the previous era of globalization ended spectacularly with the outbreak of World War I and that the unraveling continued for four decades culminating in the Great Depression and World War II.

In the context of the worst global economic and financial crisis since the end of World War II, is the era of globalization coming to an end? What are the manifestations? Is it too late to do something about them?

Manifestations

Manifestations of a reversal of globalization are everywhere in discourse, finance, trade, and other responses to economic crisis. In the litany of examples that follow, I include negative policy actions. We have also seen positive examples of coordination and cooperation, but my fear is that they have been insufficient in number and effect to preserve an open global economic and financial system.

At the level of discourse, the reversal of globalization can be found in the finger pointing about the cause of the crisis. When a country faces a crisis, it is common for its leaders to point to external actors and forces. In this crisis, the easy target is the United States and its economic, financial, regulatory, and other (largely noneconomic) policies. The United States is far from blameless. Its policies and leadership have let down the world. However, one can question whether the appropriate lesson to be drawn is to retreat into an autarky and whether the principle test of every policy should be to reverse what US domestic and international economic policies generally have stood for over the past five decades.

With respect to the less cosmic area of finance, we have a plethora of policy actions that start from generally well-intentioned responses to domestic consequences of the crisis but that have had negative spillover effects. The US Troubled Asset Relief Program (TARP) was initially targeted exclusively at US domestic financial institutions and has largely been employed that way. One country's action to guarantee 100 percent of the deposit liabilities of its banks forced the hand of many other countries unless they clearly did not have the financial strength to do so, in which case those financial institutions were further weakened. Government guarantees of the nondeposit debt of domestic financial institutions have had similar effects on institutions in emerging-market and developing countries, limiting their capacity to finance domestic investment projects and to provide trade finance. Financial markets around the world have been distorted by the panoply of ad hoc measures to support different segments of national financial markets.

With respect to trade, at least half a dozen countries whose leaders participated in the G-20 summit meeting in Washington on November 15 have violated the spirit, if not the letter, of their pledge to "refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing WTO inconsistent measures to stimulate exports." Moves in the US Congress to impose or strengthen "Buy American" provisions in the economic stimulus legislation may well be WTO-compatible, but will have a chilling demonstration effect on other countries, even though some other countries may have beat the United States to the punch.²

With respect to government actions to rescue private-sector, nonfinancial firms, the story is the same. Actions to benefit firms in the automobile industry, the mining industry, or agriculture often discriminate in favor of domestic firms and against foreign firms whether they operate inside or outside the implementing country. This distorts competition, again to the special detriment of countries that do not have the financial capacity to provide subsidies to their own firms.

Finally, in the area of exchange-rate policy, the temptation is for countries to encourage or tolerate excessive exchange-rate depreciation, as well as to resist current or subsequent exchange rate appreciation. This is a classic "beggar-thy-neighbor" policy drawn from the interwar period and the Great Depression, attempting to support domestic employment by exporting unemployment to other countries. Not all countries can follow such policies because all currencies cannot depreciate against all other

currencies at the same time. The result is a downward spiral fanning the flames of protectionist trade policies.

What Should Be Done?

Is it too late to halt this stampede away from globalization? I hope not, but time is running out. The world needs a strong program to resist and monitor the temptation for one country to improve its position at the expense of other countries. We need a comprehensive, internationally coordinated strategy if the global economy is to recover from this crisis with a minimum of damage to the fabric of international cooperation that has been constructed since 1945. The G-20 summit meeting last November made an effort, but a great deal more needs to be put in place at the London summit on April 2.

The strategy should start with the G-20 leaders signing a declaration committing themselves and officials of their governments to eschew finger pointing with respect to the causes of the crisis. Blame is appropriately widespread, but little can be achieved by spreading it. The effort now should be to learn and apply the collective lessons to limit the probability of future crises and to preserve the benefits of globalization achieved over the past half century.

More concretely in the area of financial-market and financial-sector policies, policymakers should commit to limiting the negative, external effects of their actions. The IMF, the Financial Stability Forum (FSF), and the BIS through the FSF should be tasked with reviewing the potential for such effects, preferably before such policies are adopted, but contemporaneously and ex post as well. To the extent that policies are found to have significant, negative spillover effects, and they cannot be reversed, governments should provide the IMF, the World Bank, and other multilateral development banks with the financial resources to lend to other countries to implement parallel or compensating policies to recapitalize financial institutions, finance trade, etc.

With respect to trade policies, the G-20 countries should strengthen their commitment to not implement protectionist policies on investment and trade in goods and services, regardless of whether or not they are WTO compatible. The WTO and OECD should be empowered to monitor, catalogue, and publicly chastise countries that are not living up to both the letter and spirit of such an enhanced standstill agreement.

Along the same lines, the IMF should be called upon to monitor the impacts of fiscal stimulus programs and publicize antisocial features in them. The Fund's surveillance should be comprehensive and instantaneous. At the G-20 summit on April 2, the IMF should lay out, and the G-20 should endorse, a coordinated program of fiscal stimulus including outlining the minimum contributions by each internationally significant country that has the fiscal room to maneuver and participate. The Fund should also keep a real-time, public scorecard on countries that fall short of international expectations and, thereby, free ride on the stimulus programs of other countries and incite the incorporation of protectionist provisions into such programs. The OECD should use its expertise in the fiscal area to keep the Fund and the countries honest.

The WTO and OECD should develop a similar scorecard with respect to the design and implementation of rescue or support operations for domestic nonfinancial enterprises. That scorecard not only should flag potential violations of WTO commitments and undertakings under OECD investment codes but also publicly identify potential or actual actions that undermine the spirit of those obligations.

Finally, the IMF should not abandon its responsibility to monitor the evolution of global imbalances and police the exchange-rate obligations of members. The global economy was not in overall balance when the financial crisis hit in the middle of 2007; nor were exchange-rate relationships. The Fund should lay out a desirable path for external adjustment for the systemically important countries. The Fund should use that framework to assess the appropriateness of the movements of each member's real, effective exchange rate (average nominal exchange rates adjusted for changes in price levels) with a view to calling upon individual countries to resist movements in the inappropriate direction and not to resist movements in the appropriate direction.

The global financial crisis has been with us for 18 months. It promises to be the mother of all financial crises. The worst global recession since the Great Depression has been in evidence for about six months and is worsening. It may be too late to put in place a framework that serves to preserve the increased globalization of the past 50 years, but the potential benefits to the citizens of all countries are worth the effort. We should expect nothing less from our leaders.

Notes

1. A leading example for the United States is Scott C. Bradford, Paul L. E. Grieco, and Gary Clyde Hufbauer, 2005, *The Payoff to America from Global Integration*, in *The United States and the World Economy: Foreign Economic Policy for the Next Decade*, C. Fred Bergsten and the Peterson Institute for International Economics. This study documents US gains from globalization in trade, aided by globalization in finance, equal to about \$1 trillion as of 2003.

2. The rationale for such provisions, which is that purchases should be targeted at domestically produced goods and services, is also flawed. The issue is not the first-round expenditures, but expenditures out of the income generated by them. US imports of goods and services are only about 18 percent of GDP, substantially less than for most other countries, implying that the simple multiplier associated with US government expenditures is much higher than for other countries.

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