

The "Globalization" Challenge
The U.S. Role in Shaping World Trade and Investment
by Robert E. Litan

As the United States enters the 21st century, it stands unchallenged as the world's economic leader, a remarkable turnaround from the 1980s when many Americans had doubts about U.S. "competitiveness." Productivity growth—the engine of improvement in average living standards—has rebounded from a 25-year slump of a little more than 1 percent a year to roughly 2.5 percent since 1995, a gain few had predicted.

Economic engagement with the rest of the world has played a key part in the U.S. economic revival. Our relatively open borders, which permit most foreign goods to come in with a zero or low tariff, have helped keep inflation in check, allowing the Federal Reserve to let the good times roll without hiking up interest rates as quickly as it might otherwise have done. Indeed, the influx of funds from abroad during the Asian financial crisis kept interest rates low and thereby encouraged a continued boom in investment and consumption, which more than offset any decline in American exports to Asia. Even so, during the 1990s, exports accounted for almost a quarter of the growth of output (though just 12 percent of U.S. gross domestic product at the end of the decade).

Yet as the new century dawns, America's increasing economic interdependence with the rest of the world, known loosely as "globalization," has come under attack. Much of the criticism is aimed at two international institutions that the United States helped create and lead: the International Monetary Fund, launched after World War II to provide emergency loans to countries with temporary balance-of-payments problems, and the World Trade Organization, created in 1995 during the last round of world trade negotiations, primarily to help settle trade disputes among countries.

The attacks on both institutions are varied and often inconsistent. But they clearly have taken their toll. For all practical purposes, the IMF is not likely to have its resources augmented any time soon by Congress (and thus by other national governments). Meanwhile, the failure of the WTO meetings in Seattle last December to produce even a roadmap for future trade negotiations—coupled with the protests that soiled the proceedings—has thrown a wrench into plans to reduce remaining barriers to world trade and investment.

For better or worse, it is now up to the United States, as it has been since World War II, to help shape the future of both organizations and arguably the course of the global economy. A broad consensus appears to exist here and elsewhere that governments should strive to improve the stability of the world economy and to advance living standards. But the consensus breaks down over how to do so.

As the United States prepares to pick a new president and a new Congress, citizens and policymakers should be asking how best to promote stability and growth in the years ahead.

Unilateralism

A variety of interests and prominent individuals, many of whom otherwise agree on little else, are pushing the United States to adopt a new economic unilateralism, one that at its extremes would abolish the IMF, the WTO, or both.

Some critics of the IMF, for example, argue that because the system of fixed exchange rates that the Fund was created primarily to support has collapsed, so should the Fund. Indeed, some assert that the Fund's role as emergency lender to all countries has encouraged imprudent behavior by governments, borrowers, and lenders. Abolishing the IMF, they argue, would make all parties behave more carefully, with fewer financial crises as a result.

In fact, the supposed "safety net" of IMF lending is far more porous than critics may acknowledge. IMF loans have not bailed out foreign holders of bonds or equities in emerging markets. Furthermore, governments in those countries have had to submit to increasingly onerous conditions (themselves the targets of other criticisms), making it hard to argue that the Fund's continued presence will encourage future recklessness.

The critics do have a point about one thing: IMF funds often find their way, quite legitimately, into troubled banks, which use them to shelter large depositors (often foreign banks) from losses. But abolishing the Fund to address this problem runs enormous risks. During the 1930s the Federal Reserve effectively did not act as a U.S. lender-of-last-resort, allowing a recession to turn into a great depression. World leaders are right to avoid such a risk on a global scale.

U.S. opponents of the WTO claim that subjecting U.S. regulations and standards to an international trade-oriented dispute resolution process risks watering down or even eliminating them. But WTO dispute resolution panels decide whether a country's rules unfairly discriminate against foreign goods, not whether the rules are unsound. And even when the WTO finds the rules to be discriminatory, it cannot change them—it can only allow other countries to retaliate (in a proportionate fashion). Nonetheless, since 1995 the process generally has worked as the United States expected: most cases in which our country has been involved have been decided or settled in our favor, expanding access for our exports.

One Worlders

At the other extreme from the unilateralists are the "one worlders," who want to give the WTO and the IMF even more authority and responsibility, primarily in the

service of raising environmental and labor standards abroad. Indeed, under recently enacted legislation, the IMF must now report on how well its borrowers are advancing labor and environmental standards. Furthermore, President Clinton suggested during the Seattle meeting that the WTO authorize the use of trade sanctions against countries not conforming to minimum world "core" labor standards (prohibiting child and forced labor, discrimination, and restrictions against unions).

But would such well-intentioned initiatives succeed? The history of developed countries suggests that standards will rise as average incomes grow and citizens demand improved labor and environmental protections. Because trade is a well-documented means for countries to improve their living standards, it would be counterproductive to deny emergency financing or market access to countries that may not adhere to some minimum standards.

But, the one worlders will object, what is wrong with trying to hurry things along with some "sticks," such as sanctions? The answer is that many people and businesses in developing countries already operate outside the law. Passing and enforcing more laws that add first-world protections will slow their economic development—and thus improvements in environmental and labor conditions—by driving more business into the underground economy, where even third-world standards are not enforced.

The Sensible Middle

A middle course between the extremes promises both greater economic stability and advances in living standards. But it will require reform of global institutions, coupled with policies at home to ease anxieties about globalization.

For starters, both the IMF and the WTO need to be more tolerant of dissent. To its credit, the IMF has made its operations much more open since the Asian financial crisis. Now it should reach out to nongovernmental organizations to hear their concerns and explain how its policies are (or are not) consistent with their aims. The WTO, meanwhile, should welcome briefs from nongovernmental parties. If Seattle teaches anything, it is that secrecy breeds mistrust.

Substantively, much more progress has been made toward shoring up the international "financial architecture" than is commonly recognized. It is now widely accepted that countries with weak financial systems should be able to restrict short-term borrowings in foreign currency (such as those that helped lay the foundations for the Asian crisis). It is also generally recognized that countries should not maintain pegged, but adjustable, exchange rates because doing so can invite recurrent speculative attacks on currencies and encourage excessive borrowing by firms that erroneously believe rates to be fixed.

As for the IMF's tendency to encourage too much borrowing and lending—by parties who expect to be bailed out by IMF emergency lending—in the past two years the Fund has refused to lend to both Russia and Ecuador because their policies were not sound. These gutsy decisions have changed market expectations about the automaticity of emergency lending. The central issue that now must be resolved is whether to establish more formal criteria for access to and pricing of IMF loans—to encourage countries to pursue sound policies and to put lenders on notice—or leave the current "constructive ambiguity" in place.

The agenda for the WTO, meanwhile, is simple: pick up the pieces from Seattle and move forward. Otherwise countries will be tempted to strike more regional and, possibly, discriminatory arrangements. At worst, without a strong commitment to multilateral trade liberalization, a future economic downturn could sorely tempt nations to raise import barriers, ignoring the WTO as a toothless tiger.

Getting the WTO back on track will require compromise on all sides. To get U.S. priorities—freer trade in agriculture and services, no barriers to e-commerce—on the agenda, we must entertain creative suggestions from other countries. For example, we could accommodate Europe's political difficulties in committing to a total elimination of farm subsidies by discussing an accelerated phaseout schedule that doesn't yet have zero at the end. Meanwhile, we should work with Europeans and others to allow labeling of goods and services to solve such thorny disputes as EU opposition to the sale of genetically modified foods.

The United States should also offer to modify antidumping policy, which hurts both developing countries and American consumers. One approach would ease antidumping rules unless petitioners at home can demonstrate that foreign exporters are taking advantage of cartels or protected markets in their own countries to sell products cheaper abroad.

With such concessions on the table, the United States would be in a stronger position to ask other countries—separately and outside the WTO process—to help create or strengthen organizations to address labor and environmental standards. The WTO might recognize the legitimacy of multinational environmental agreements, even those that may ban imports of harmful products (as long as harmful domestic goods are given similar treatment). The next WTO round can also advance environmental interests by removing subsidies that promote excessive use of natural resources.

At home U.S. leaders need to do a far better job of helping Americans see the benefits of globalization. One way to do that is to emphasize the consumer gains from trade. The office of the Special Trade Representative, for example, estimates that existing WTO agreements add roughly \$3,000 to the purchasing power of the average four-person household every year. Liberalized trade also promotes economic growth and liberty abroad, both in our national interest.

Finally, more must be done to address Americans' continuing anxieties about globalization and, indeed, economic change more broadly. Two possibilities: lifetime loan accounts for workers to use for retraining and wage insurance to compensate for some portion of incomes lost when individuals are laid off. Such measures should be available generally, not just for those who have been displaced because of trade.

In the end, we cannot avoid the challenge of globalization. Meeting it through unilateralism or one worldism is likely both to destabilize the world economy and slow improvements in living standards at home and abroad. Instead we should embrace the opportunities that globalization affords, ease the anxieties it generates, and reform and strengthen the international economic institutions created to promote both global economic stability and growth.

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