The Annual Proceedings of

The Wealth and Well-Being of Nations

2018-2019

Volume XI: Globalization and the Wealth and Well-Being of Nations

Dani Rodrik

Diep Phan, Editor

The Miller Upton Program at Beloit College

The Wealth and Well-Being of Nations was established to honor Miller Upton, Beloit College's sixth president. This annual forum provides our students and the wider community the opportunity to engage with some of the leading intellectual figures of our time. The forum is complemented by a suite of programs that enhance student and faculty engagement in the ideas and institutions that lay at the foundation of free and prosperous societies.

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Senior Seminar on The Wealth and Well-Being of Nations:

Each year, seniors in the Department of Economics participate in a semester-long course that is built around the ideas and influence of that year's Upton Scholar. By the time the Upton Scholar arrives in October, students will have read several of his or her books and research by other scholars that has been influenced by these writings. This advanced preparation provides students the rare opportunity to engage with a leading intellectual figure on a substantive and scholarly level.

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A portion of the Miller Upton Memorial Endowments supports exceptional students pursuing high-impact internship experiences. Students are encouraged to pursue internships with for-profit firms and non-profit research organizations dedicated to advancing the wealth and well-being of nations.

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Annual Proceedings of The Wealth and Well-Being of Nations:

The keynote address presented by the Upton Scholar is an important contribution to the public discourse on the nature and causes of wealth and well-being. Further, the annual forum includes presentations by noted scholars who expand upon or challenge the work of the Upton Scholar. These presentations are assembled in the *Annual Proceedings of the Wealth and Well-Being of Nations*, which serves as an important intellectual resource for students, alumni, and leaders within higher education.

The Annual Proceedings of the Wealth and Well-Being of Nations

2018-2019

Volume XI

Diep Phan
Editor

Jennifer Kodl
Managing Editor

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Contents

Introduction
Diep Phan 11

Part I: Globalization Around the World

Globalization and the Wealth and Well-Being of Nations
Dani Rodrik 23

Guarding (Against) Financial Globalization:
International Financial Safety Nets and Sovereign Debt Default
Ted Liu 43

Globalization, Policy Convergence, and Liberal Democracy
Sharun Mukand 61

Part II: Globalization in the Developing World

Global Pan-Ethnics and Other Exotic Imaginaries in Bali, Indonesia
Jennifer Esperanza 75

The Emperor's Law Stops at the Village Gate:
The Evolution of Vietnam's Land Law Reform
Rachel Ellett and Diep Phan 83

Washington Blues, Pink Tides, and Brown Development.
The Political Economies of Neo-Extractivism in the Andes
Pablo Toral 109

The Economic Consequences of Globalization in Africa
Darlington Sabasi and Johnson Gwatipedza 137

Manufacturing in Ethiopia and Tanzania: Challenges and Opportunities
Xinshen Diao and Margaret McMillan 157

Contents

Part III: Globalization in the Developed World

Beloit Wisconsin 1896-1914: Global Integration of a Midwestern Industrial Town
Beatrice McKenzie 177

Roger Douglas and His Legacy
Jonathan Mason 189

Trumping Trump: Why U.S. Tariffs Won't Fix the Trade Balance, and What Will?"
Ivan Gradjansky 221

Contributors

Diep Phan is the Elbert H. Neese, Jr. Professor of Economics, Beloit College.

Dani Rodrik, the 2018 Miller Upton Scholar, is the Ford Foundation Professor of International Political Economy at Harvard University's John F. Kennedy School of Government. He rejoined the Kennedy School in July 2015 after two years at the Institute for Advance Study as the Albert O. Hirschman Professor in the School of Social Science.

Ted Liu is a PhD student in Economics at the University of California, Santa Cruz.

Sharun Mukand is Professor of Economics, Warwick University and Research Scholar, Institute for Advanced Study.

Jennifer Esperanza is Associate Professor of Anthropology, Beloit College.

Rachel Ellett is Associate Professor of Political Science, Beloit College.

Pablo Toral is Professor and Chair of Political Science, Beloit College.

Darlington Sabasi was Assistant Professor of Economics at Beloit College.

Johnson Gwatipedza is Visiting Professor of Economics at Beloit College.

Xinshen Diao is Senior Research Fellow, International Food Policy Research Institute (IFPRI).

Margaret McMillan is Professor of Economics, Tufts University; Research Associate, NBER; Senior Research Fellow, International Food Policy Research Institute (IFPRI).

Beatrice McKenzie is Keefer Professor of Public Humanities, Beloit College.

Jonathan Mason is a member of the Board of Trustees and an alumnus of Beloit College, class of 1980. He is currently an independent director of Vector, Zespri and Air New Zealand.

Ivan Gradjansky graduated from Beloit College in 2019 with a degree in Economics.

Introduction

Diep Phan[1]

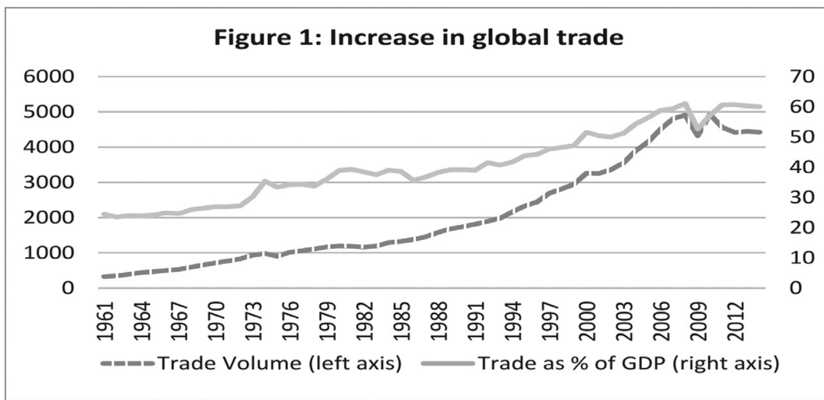
The Miller Upton Forum on the Wealth and Well-Being of Nations is the centerpiece of a suite of programs named in honor of Beloit College's sixth president, Miller Upton, and are inspired by Miller's unflagging dedication to the ideals of a liberal society: political freedom, the rule of law, and peace and prosperity through the voluntary exchange of goods and ideas. The key event of the Miller Upton Forum is the visit and keynote address by the Upton Scholar, whose distinguished work becomes the theme of the forum. In the same week, there are two to three panel discussions with six to ten additional speakers delivering talks on the same theme. All of these talks are published in the Annual Proceedings of the Wealth and Well-Being of Nations.

It was with great pleasure that I directed, for the first time, the 2018 Miller Upton Forum on "Globalization and the Wealth and Well-Being of Nations," featuring the 2018 Miller Upton Scholar Dani Rodrik and nine other speakers. It is now with great honor that I introduce the eleventh Annual Proceedings of the Wealth and Well-Being of Nations, which composes of the ten papers presented at the Forum and one student paper.

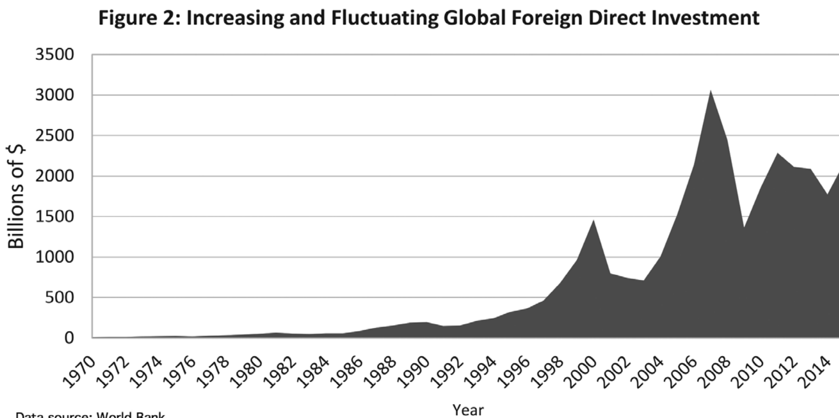
Many of the previous Miller Upton Forums focused on the institutional foundations that support long-run economic growth and development, such as social institutions and the rule of law (2008 Inaugural Forum), property rights (2009 Forum), entrepreneurship (2010 Forum), self-governance (2011 Forum), institutional change (2012 Forum), and economic freedom (2013 Forum). The 2014 and 2016 Forums switched gear to study energy and environmental issues and examined one of the greatest threats to continued improvement in the wealth and wellbeing of nations: anthropogenic climate change. The 2015 Forum returned to an earlier theme--entrepreneurship--but shifted focus away from the West and toward the Chinese Economy, where one-fifth of the world's population resides.

1 Diep Phan is the Elbert H. Neese, Jr. Professor of Economics at Beloit College.

In this eleventh Forum, we turn our attention to a critical and timely topic--globalization. Economic globalization encompasses three main economic processes: the flows of goods and services across economies (international trade), the flows of capital cross economies (international finance), and the flows of labor across economies (international migration). All three of these processes have increased significantly in the last half century, as seen in Figures 1 through 4 below. The increases in international trade and international finance became especially dramatic since the early 1990s, so much that the post-1990 period has been called the period of "hyper-globalization."



Data source: United Nation's COMTRADE data



Data source: World Bank

Figure 3: Increasing and Fluctuating Global Foreign Portfolio Investment

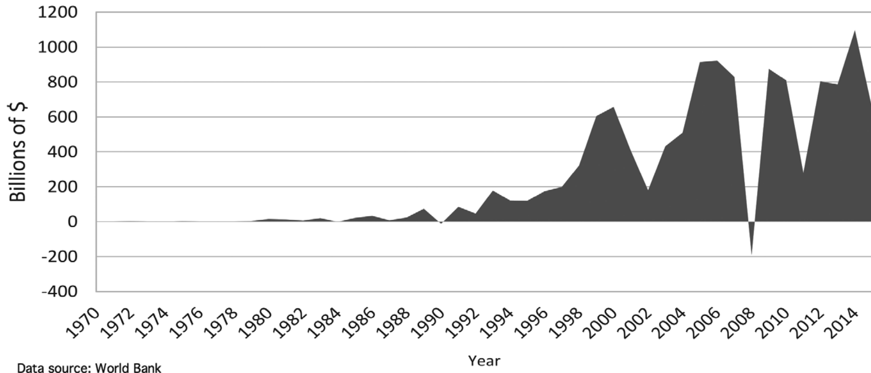
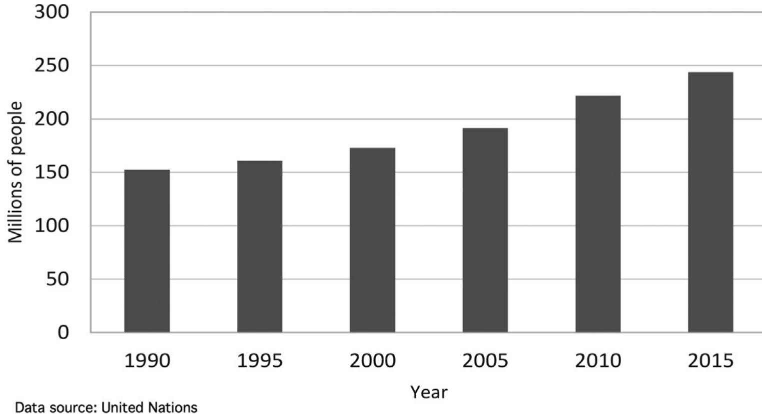


Figure 4: Increasing Global Migrant Population



Since Adam Smith and David Ricardo's time, the theory of comparative advantage has become the most fundamental principle of economics. This theory maintains that differences in opportunity costs lead to the potential for increasing the economic pie and for both countries to gain from international trade. A similar reasoning can be extended to international finance and international migration to show that, similar to international trade, these two processes can also generate mutual national benefits. So in a way, the eleventh Miller Upton Forum, with its theme on globalization, brings us back to one of the oldest and most fundamental topics in economics.

Yet this seemingly old topic is no less relevant today than it was in the 1700s when Adam Smith and David Ricardo published their seminal work on absolute

and comparative advantages. Smith and Ricardo's work argued in favor of free trade and against the mercantilist view that the purpose of international trade is to generate gold or silver, and that imports, which reduces a nation's stock of gold or silver, are bad, while exports, which increases a nation's stock of gold or silver, are good. Since Smith and Ricardo's time, the world has been moving in the direction of freer trade and freer markets, albeit with many ups and downs in between and with variation across space.

It is not a co-incidence that also during these past 200 years, the world has experienced unprecedented economic progress. Not too long ago, many economists thought that mercantilism was dead, and that globalization, or a global economy characterized by free flows of goods, services, capital, and labor, would progress unhinged.

But in recent years, mercantilism has returned. Despite overall economic progress and human development at the global level, there has been a backlash against globalization, which had been simmering and picked up momentum since the global financial crisis in 2008. Accompanying the anti-globalization movement has been the rise of populism and ethno-nationalism. This can be seen in both the developed and the developing world, from Brexit in the United Kingdom and the election of Donald Trump in the United States in 2016, to the election and re-election of Narendra Modi in India in 2014 and 2019.

Against this context, we decided to make globalization the theme of the eleventh Miller Upton Forum. While there are many distinguished economists who can attest the merit of globalization, we feel it appropriate to invite a scholar who can speak to both sides of the debate, who can acknowledge both the tremendous gains and the legitimate grievances that globalization has generated. Professor Dani Rodrik is a natural choice for that reason.

In addition to the keynote essay by the Miller Upton Scholar Dani Rodrik, the eleventh annual proceedings contain ten other papers by two invited speakers who are familiar with Rodrik's work, and by Beloit College's faculty, students, and alumni. Compared to previous annual proceedings of the Upton Forum, the 2018 proceedings are distinctive because of their impressive global coverage. Many countries and regions of the world are covered, including countries from the developed world (the US, New Zealand) and countries from the developing world (Vietnam and Indonesia in Southeast Asia; Chile, Peru, and Bolivia in Latin America; and Ethiopia and Tanzania in Africa). To leverage this distinctiveness, this volume is organized by region, defined by level of economic development.

Part I consists of three papers about globalization in general, including the keynote address by Dani Rodrik. Part II contains four papers about globalization in the developing world. Part III contains three papers about globalization in the developed world.

Part I – Globalization Around The World

Dani Rodrik is the Ford Foundation Professor of International Political Economy at Harvard's John F. Kennedy School of Government. He was previously the Albert O. Hirschman Professor in the School of Social Science at the Institute for Advanced Study in Princeton (2013-2015). Professor Rodrik is currently President-Elect of the International Economic Association. His work encompasses development economics, international economics, and institutional economics. He has published profusely in top journals such as The Economic Journal, American Economic Review, Journal of Economic Perspectives, Journal of Political Economy, Quarterly Journal of Economics, Journal of International Economics, World Development, Journal of Development Economics, and many others. Some of his popular books include *Straight Talk on Trade: Ideas for a Sane World Economy* (2017)*, The Globalization Paradox – Democracy and the Future of the World Economy* (2011)*, One Economics, Many Recipes: Globalization, Institutions and Economic Growth* (2008).

Among economists, Professor Rodrik can be considered one of the earliest globalization skeptics. Following the end of the cold war and the collapse of the communist block at the end of the 1980s, developing and former communist countries around the world adopted market-oriented reform and liberalized international trade and foreign investment, resulting in the dramatic increase in globalization mentioned earlier. The 1990s saw the support for globalization and for pro-market ideology at its height. But even during this period, Dani Rodrik published a book with a very provocative title: *Has Globalization Gone Too Far?* The book gave an early warning that too much of a good idea can be a bad thing. In the next twenty years, he continued to publish work on globalization, documenting both its gains and grievances.

On October 26th 2018, at the eleventh Miller Upton Forum at Beloit College, Professor Rodrik delivered his keynote address titled ***"Globalization and the Wealth and Well-Being of Nations."*** The first essay in this volume draws from this keynote address. In it, he continues to answer the questions that he

first asked more than twenty years ago: can globalization go too far? How much globalization should we have, and what kind of globalization should we seek? In answering the first question, Rodrik summarizes globalization's effects, both good and bad. Globalization, in particular international trade, has generally promoted economic growth, but has also created winners and losers and worsened domestic inequality in many countries. This qualitative statement about the effect of international trade is not surprising at all, because it's precisely what economic theory would predict. But Rodrik's essay goes into the nuances and specifies that "the growth benefits accrue mainly at intermediate levels of globalization: it is those countries that move from near-autarky to more open economic borders that reap most of the benefits. Hyper-globalization, moving into more advanced stages of globalization, produces meager growth benefits." In other words, the gain in increased economic growth induced by hyper-globalization is small compared to its large and negative distributional effect. So Rodrik's answer is: yes, there has been too much globalization.

In answering the second question of what kind of globalization we should seek, Rodrik points out the asymmetry in the treatment of capital and labor in the rules of global trade and investment, which favor investors and capitalists over workers. Rodrik then gives a tale of two globalizations in order to propose that the world economy move away from the 1990s model of hyper-globalization in which globalization trumps domestic needs and objectives. He advocates for the return of the Bretton Woods System, which prioritizes domestic economic and social goals over globalization.

Rodrik's essay also links the debate on globalization to the current political backlash against globalization and the rise of populism and ethno-nationalism. He argues that economic anxiety caused by globalization (and technical progress) takes a cultural form of nativism, racism, anti-immigration sentiment, and a conservative backlash against social liberalism. But since the root causes are economic, "the appropriate remedies are to be found in the realm of economic policy rather than culture wars and identity politics."

As Rodrik noted in his essay, while economists generally support liberalization of trade and labor, the view on financial globalization is more divided. One main reason is that financial globalization can pose new risks, such as a sudden reversal of capital flow, sovereign debt distress, among others. Can measures be taken to reduce the risks associated with financial globalization? An example of such a measure is Global Financial Safety Nets (GFSN) which has received

considerable support from policymakers and scholars. In ***"Guarding (Against) Financial Globalization: International Financial Safety Nets and Sovereign Debt Default,"*** Ted Liu[2] studies the empirical relationship between sovereign debt default (in terms of default probability and value) and GFSN for a group of emerging markets using fixed-effect logistic models, the econometric analyses suggest that GFSN itself does not reduce the probability of default, but it could help mitigate the level of nonpayment. This paper reiterates the concern that although it's possible to manage or alleviate the risks posed by financial globalization, this is a challenging task.

Many of the papers in this volume are about economic globalization, or the exchanges of goods, services, capital and labor across economies. But globalization is also about the exchange of ideas in various forms-technology, culture, policy, institution. Sharun Mukand's[3] paper **"Globalization, Policy Convergence, and Liberal Democracy"** provides a simple yet powerful theoretical framework to examine how ideas regarding policy and institution spread across countries as globalization advances. Applying this framework, the author illustrates how globalization may contribute to an erosion of liberal democracy, which consists of three pillars--political rights, property rights, and civil rights. Civil rights, or the rights of minorities, are especially vulnerable to shocks from globalization, since minorities have neither strength in number (which yields political rights) nor economic strength (which is about property rights). This concern is particularly relevant in today's global context in which ethno-nationalism and racism are on the rise.

Part II – Globalization In The Developing World

In **"Global Pan-Ethnics and Other Exotic Imaginaries in Bali, Indonesia"** Jennifer Esperanza[4] discusses a paradox of globalization through the lens of Bali's ethnic handicrafts and tourism industries. One the one hand, as Bali's tourism industry flourished and as its export of handicrafts boomed, Hindu Balinese have been able to assert themselves economically and culturally in the global market-

2 Ted Liu is an alumnus of Beloit College, class of 2013. He's currently a PhD student in economics at the University of California – Santa Cruz.

3 Sharun Mukand is long-time friend of and co-author with Professor Rodrik. He is Professor of Economics at the *University of Warwick* and is the Research Director on Culture and the Politics of Development at the Center for Competitive Advantage in the Global Economy (aka CAGE).

4 Jennifer Esperanza is Associate Professor of Anthropology at Beloit College.

place. On the other hand, because Balinese enterprises produced and exported not only Balinese cultural products, but also cultural products of indigenous people from many parts of the world, "their engagement in this industry are fraught with the ethical dilemmas of violating others' cultural heritage and intellectual property rights." Foreigners' fascination with Bali has both created and deconstructed notions of cultural authenticity, economic development and cosmopolitanism.

Although Rachel Ellett[5] and Diep Phan's[6] paper **"The Emperor's Law Stops at the Garden Gate: The Evolution of Vietnam's Land Law Reform"** is not directly about globalization, it is tightly linked to the Miller Upton Scholar Dani Rodrik's work on institution and economic growth in the context of a rapidly globalizing world. The paper examines and characterizes the evolution of market-oriented land law reform in Vietnam, a slow and incremental process that has taken forty years and is still in progress. This evolution demonstrates Dani Rodrik's argument that good institutions do not perfectly align with formally legislated rules, and also presents an interesting example of both competing and complementary formal and informal institutions at work. Informal institutions (social cultural norms around land) are both an obstacle and a stabilizing or enabling factor in the implementation of the land reform policy through formal institutions (bureaucracy and the court system).

Pablo Toral[7]'s paper **"Washington Blues, Pink Tides, and Brown Development: The Political Economies of Neo-Extractivism in the Andes"** is an intriguing comparative analysis of economic development models in three Latin American countries—Chile, Bolivia, Peru—and the role of trade, in particular the exportation of natural resources, in these economic models. Some global context is necessary to fully appreciate this paper. In the decades following the end of World War II in 1945, many former colonies gained independence and faced the problem of underdevelopment. The popular economic model during this period for most developing countries was inward-orientation and import substitution industrialization—an industrial strategy which promotes domestic production through raising trade barriers. This anti-trade development model draws its rationale from the dependency theory, which maintains that the capitalist world economy con-

5 Rachel Ellett is Associate Professor of Political Science and Chair of Political Science and African Studies at Beloit College.

6 Diep Phan is Associate Professor of Economics at Beloit College. She is the current Neese Chair who directs the Upton Programs and is the editor of this volume.

7 Pablo Toral is Professor of International Relations and Environmental Studies at Beloit College.

sists of the core and the periphery who are in a dependent and exploitative relationship: the core exploits the periphery, who provides raw materials and labor to the core. During the colonial period, the core was the European colonial powers, and the periphery was the colonies. After colonialism ended, through international trade, poor and underdeveloped nations would continue to export natural resources and labor-intensive goods--their areas of comparative advantage--while relying on advanced industrial economies for high value-added manufactured goods. This extractivist economic model, or extractivism, would effectively continue the dependency relationship between the core and the periphery. According to the dependency theory, globalization, particularly international trade, is just a new form of colonialism, i.e., neo-colonialism, and is thus inherently bad.

Prior to the 1980s, Latin America, like many other developing countries at the time, pursued ISI and inward orientation, in an attempt to deviate from the *extractivist* economic model; that is, to reduce their reliance on exportation of natural resources and to promote domestic industrial production capacity. But since the 1980s, they again shifted toward an export-led model of economic development, also known as neo-extractivism. In his paper, Pablo Toral questions the simplistic view that all Latin American countries followed the same neo-extractivist model. Through three case studies—Chile, Bolivia, and Peru--he successfully argues that there is a wide variety of neo-extractivist capitalism in Latin America. They differ in the sources of political support and governance structures regarding industrial relations, vocational training and education, corporate governance, inter-firm relations, and intra-firm relations. Despite such differences, the economic outcomes of the neo-extractivist model in these economies have been similar: economic growth has been steady; poverty and inequality fell dramatically (with the exception of Chile); and the impact on the environment has been negative. Pablo Toral's paper brings us to an argument repeatedly made by Dani Rodrik in many of his works, that there are multiple paths to successful economic development.

In **"The Economic Consequences of Globalization in AfricA"** Darlington Sabasi[8] and Johnson Gwatipedza's[9] revisit the argument that globalization would induce a rapid economic growth and transformation for Africa. They investigate the relationship between globalization and GDP per capita in sub-Saharan Africa using a panel of 39 countries over the period 1996-2015, and find that although

8 Darlington Sabasi was Assistant Professor of Economics at Beloit College.

9 Johnson Gwatipedza is visiting Professor of Economics at Beloit College.

globalization's impact is positive, the gains have been minimal.

Similar to Sabasi and Gwatipedza's paper, the next paper by Xinshen Diao [10] and Margaret McMillan[11] "Manufacturing in Ethiopia and Tanzania: Challenges and Opportunities" is also about Africa's globalization and economic growth. But Diao and McMillan's paper zooms in and investigates the performance of formal manufacturing sectors in Ethiopia and Tanzania and their potential for entering the global value chains. Their paper shows that in many respects, the formal manufacturing sectors in these two economies are performing well, evidenced by rapid labor productivity growth and export growth. However, employment growth has been limited, and participation in the global value chains is minimal; these are challenges that policymakers of these two African countries and also many other developing countries face.

Part III – Globalization In The Developed World

Beatrice MacKenzie's[12] paper **"Beloit Wisconsin 1896-1914: Global Integration of a Midwestern Industrial Town"** is a fascinating documentation of how global the city of Beloit has always been. It was global integration that drove Beloit to prosperity as the city grew tremendously from 1896 to 1914. All three processes of economic globalization—international trade, international finance, and international migration—were present during this period, making Beloit a characteristic example of global integration. Beloit industries used local capital to produce and export manufactured goods, and several industries opened factories in other countries for international sales. The draw of immigrant labor, first from Germany and Ireland, and later from Southern and Eastern Europe, enabled the expansion of local production and exports.

In **"Roger Douglas and His Legacy,"** Jonathan Mason[13] adds another fascinating case study of globalization to this volume. His paper gives a historical

10 Xinshen Diao is the Deputy Division Director of the Development Strategy and Governance Division at the International Food Policy Research Institute.

11 Margaret McMillan is Professor of Economics at Tufts University and a Research Associate in the National Bureau of Economic Research's program on Int'l Trade and Investment. She is a long-time friend and co-author of Dani Rodrik.

12 Beatrice McKenzie is Keefer Professor of Public Humanities and Professor of History at Beloit College.

13 Jonathan Mason is a member of the Board of Trustees and an alumnus of Beloit College, class of 1980. He is currently an independent director of Vector, Zespri and Air New Zealand.

account of Roger Douglas, New Zealand's Minister of Finance (1984-1988), who played a prominent role in the economic restructuring of New Zealand in the 1980s. Through the story of Roger Douglas, the paper describes how New Zealand embraced globalization and implemented market-oriented reform through successive right- and left-wing governments for the last thirty years. The paper also examines the merit of such reform, focusing on New Zealand's performance on a variety of economic and social indicators.

The final paper **"Trumping Trump: Why U.S. Tariffs Won't Fix the Trade Balance, and What Will?"** is contributed by Ivan Gradjansky, who was a senior economics major at Beloit College in 2018-19. Ivan Gradjansky's paper could not be more timely. At the time of this writing (June 2019), the US-China trade war has been going on for more than a year and has shown no sign of abating. The primary reason that the Trump administration raises tariffs against China (and many other countries such as Canada, Mexico, and even countries in the European Union) is to reduce the US trade deficit. But does such a policy work? In his paper, Ivan Gradjansky uses a fixed effect regression to examine the determinants of exports, imports, and bilateral trade balances of the United States with sixty-one countries for the period 1987-2017. The paper's empirical results show that tariffs imposed by the US have no effect on US bilateral trade balances with other countries, suggesting that raising tariffs is unlikely to improve the US trade balance. This helps explain why the US trade deficit is currently at an all-time high despite escalating tariffs. Additionally, the paper finds that exchange rate fluctuations are not a significant determinant of trade balance, rejecting the claim by many politicians and pundits that foreign countries' manipulation of their currencies (such as the Chinese Renminbi) causes the US trade deficit. Finally, the paper also yields support for the twin deficits hypothesis that fiscal policy and trade policy go together. So if the US wants to improve its trade balance, it needs to readjust its own fiscal policy and improve its fiscal balance. The Trump administration's expansionary fiscal policy, in the form of tax cut, is only worsening, not improving, both fiscal and trade deficits.

Acknowledgement and Thanks

On behalf of the Department of Economics, I would like to acknowledge and thank, Jennifer Kodl, Program Coordinator of the Upton Programs and Managing Editor of this volume. Her excellent work is key to the success of the

Upton Forum. I would also like to thank my colleagues and students at Beloit College, whose enthusiastic participation makes the Upton Forum one of the most well-attended and successful residency programs on campus. I especially thank students in the economics senior seminar, most of who are now alumni, for their eager learning about globalization and their critical reading of Dani Rodrik's work, especially his book *The Globalization Paradox: Democracy and the Future of the World Economy*. I will forever remember the engaging class discussions on various globalization topics that we had in the senior seminar. Finally, continued thanks are due to the many alumni, friends, and charitable foundations who have supported the Miller Upton Programs. Their initial support launched the Upton Programs, and their continued support enables the Department of Economics to invite to campus the world's top scholars and practitioners who are committed to understanding and promoting the sources of the wealth and wellbeing of nations.

Globalization and the Wealth and Well-Being of Nations

Dani Rodrik[1]

The title of this lecture harks back to Adam Smith, the founder of modern economics, and his masterpiece, the Wealth of Nations. It is appropriate to start from Adam Smith, because his ideas – and those that he tried to demolish -- still punctuate the evolution of our contemporary world economy.

Smith's main target were the mercantilists, who believed the government should commandeer the economy and never let it go free. International trade, they thought, was a zero-sum game: what one nation wins, another nation loses. Export were good, and imports were bad. Trade surpluses were a sign of strength; deficits a weakness. These were the dominant ideas at the time Smith wrote.

Smith demonstrated that mercantilists had it backwards. Free markets and free trade would increase the size of the economic pie. State control of the economy not only reduced aggregate prosperity, it also redirected wealth to those who were well connected and politically influential.

We have been living in Adam Smith's world ever since. Freer markets and freer trade have laid the foundation for economic prosperity in the advanced nations, and have enabled, in recent decades, rapid economic catch-up in the poorer nations. But every revolution risks going too far and neglecting some of the wisdom of the ideas it discarded. The market economy worked best when it was embedded in social and political institutions that regulated, stabilized, and legitimized outcomes. When we overlooked that central insight and pursued not just freer trade but hyper-globalization, the market became unmoored from its institutional underpinnings.

Those who had the resources, skills, and networks to benefit from the global

1 Dani Rodrik, the 2018 Miller Upton Scholar, is the Ford Foundation Professor of International Political Economy at Harvard University's John F. Kennedy School of Government. He rejoined the Kennedy School in July 2015 after two years at the Institute for Advance Study as the Albert O. Hirschman Professor in the School of Social Science.

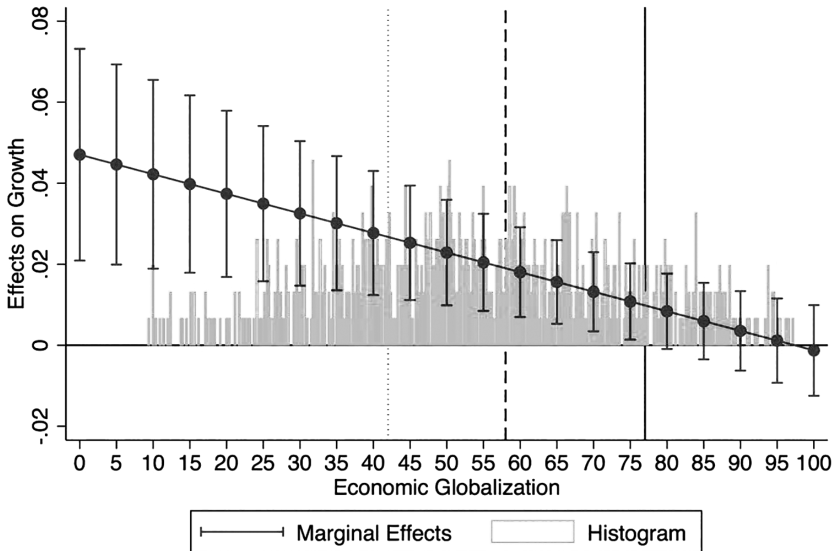
division of labor did very well, for sure. But others have not done as well, and incomes of the working class stagnated in much of the advanced world. Perhaps it is not surprising that mercantilism has returned. President Donald Trump views international trade in much the same way that the mercantilists of the early 18th century did, as a zero-sum game where one country's gains are another's losses. The backlash to hyper-globalization, while rooted in legitimate grievances, threatens to undo many of the gains that an open world economy generated.

Once more, the pendulum swings. Will it swing too far away from the happy median yet again?

Globalization's Balance Sheet

Let me begin by summarizing the economic record of the last few decades. A good overview is provided in a recent paper by two economists at the International Monetary Fund – who certainly cannot be accused of being biased against globalization (Lang and Tavares, 2018). The bottom line is that globalization has produced highly uneven outcomes in terms of well-being across and within nations. (The authors rely on a multidimensional index of globalization that captures both the intensity of trade and financial flows and the restrictiveness of regulatory barriers to such flows.) When we look at overall economic performance, measured by economic growth rates of nations, globalization is generally associated with faster economic growth. But the growth benefits accrue mainly at intermediate levels of globalization: it is those countries that move from near-autarky to more open economic borders that reap most of the benefits. Hyper-globalization, moving into more advanced stages of globalization, produces meager growth benefits (Figure 1).

Figure 1: Diminishing Marginal Returns to Globalization



The figure visualizes the result of the growth regression reported in table 2, column 6. The blue line depicts the marginal effect (and 95%-confidence intervals) of a one-point-increase in economic globalization depending on a given level of economic globalization. A histogram of the distribution of globalization levels across the sample is shown in orange. The three vertical lines indicate the current average globalization score of LICs (dotted), MICs (dashed), and HICs (solid).

Source: Lang and Tavares (2018)

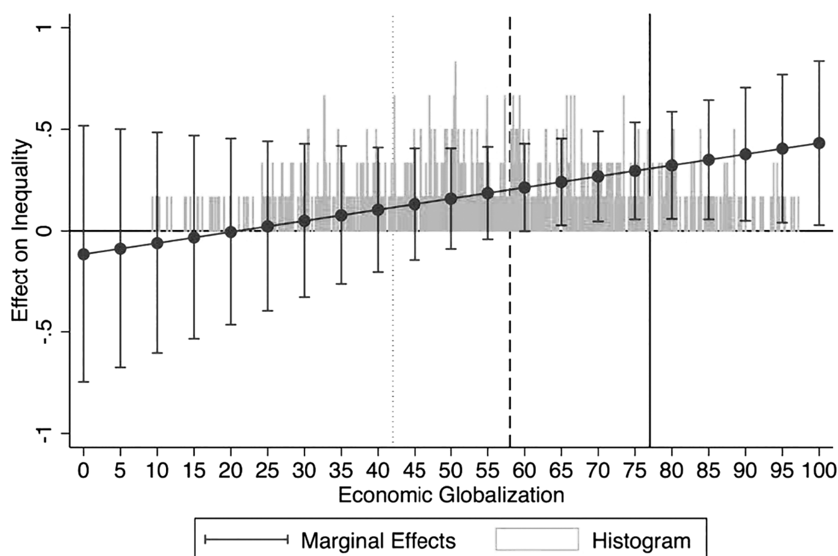
To express this result in concrete terms, think of two countries, China and the United States. When China turned to world markets in the 1980s and especially the 1990s, it was a closed, repressed economy. Globalization enabled it to grow much faster than what it would have been able to do absent globalization. The U.S., by contrast, already had fairly open trade and financial policies in the 1980s. It is hard to argue that the trade agreements it has signed since then (e.g., the North American Free Trade Agreement, NAFTA) or the intensification of financial globalization has had quantitatively significant effects on the U.S. economy's overall growth rate.

Before we chalk up China as a large net gain in globalization's balance sheet, it is worth spending a moment on the actual policies that the country deployed to manufacture its impressive economic record. This was hardly a miracle of free markets. In all major areas of economic policy, Chinese policies diverged from hyper-globalist's preferred remedies. Instead of a free market economy, with exclusively private ownership, China continued to rely on state direction and state-

owned enterprises. Instead of free trade, China kept moderate levels of import protection and extensive export subsidies. Instead of a liberal foreign investment regime, China imposed technology transfer restrictions and domestic content requirements. Instead of protecting intellectual property rights, China violated them right and left. Instead of free capital mobility, China had controls on the capital account. Instead of a freely floating currency, China had a managed exchange rate. In other words, China played globalization very much by its own rules – a point I will return to later.

The global picture with respect to inequality is similarly mixed. The IMF study finds that globalization has had highly asymmetric effects on the distribution of well-being within countries. Once again, the news is worse for those countries in the advanced stages of globalization. Those countries experienced a widening of domestic inequality as they embraced further globalization. Countries in the early stages of globalization generally had more positive distributional consequences

Figure 2:

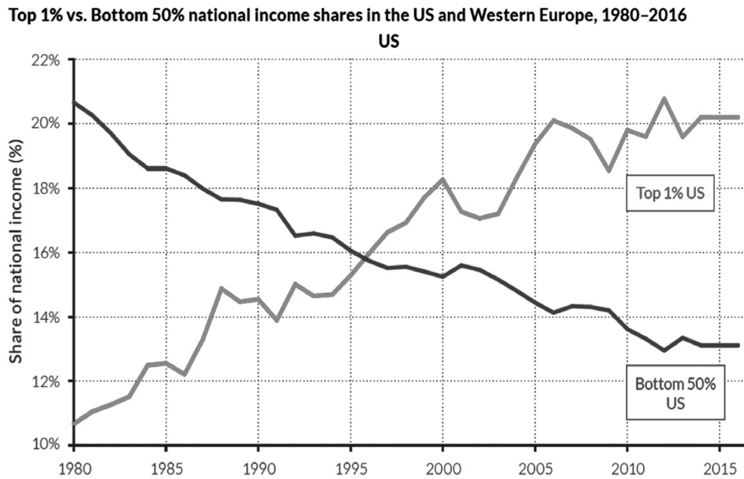


Note: The figure visualizes the result of the inequality regression reported in table 3, column 6. The blue line depicts the marginal effect (and 95%-confidence intervals) of a one-point-increase in economic globalization depending on a given level of economic globalization. A histogram of the distribution of globalization levels across the sample is shown in orange. The three vertical lines indicate the current average globalization score of LICs (dotted), MICs (dashed), and HICs (solid).

Source: Lang and Tavares (2018)

Once again, the experience of the U.S. is instructive. As Figure 3 shows, the U.S. went through what can only be described as an upheaval in terms of income distribution. The income share of the richest 1% doubled, from around 10 percent to more than 20%. Meanwhile, the income share of the poorest 50% tanked, from more than 20 percent to 13 percent. Almost all advanced countries experienced widening income and wealth inequality, though the deterioration was more modest in continental Europe, where generous safety nets and more institutionalized labor markets helped prop up incomes at the bottom. But even in countries such as Germany and Sweden where the rise of income inequality was contained, there were large gaps in perceived social status. Relatively less educated males experienced a significant loss in self-perceived social status (Gidron and Hall, 2017).

Figure 3:



Source: WID.world (2017). See wir2018.wid.world for data series and notes.
In 2016, 12% of national income was received by the top 1% in Western Europe, compared to 20% in the United States. In 1980, 10% of national income was received by the top 1% in Western Europe, compared to 11% in the United States.

Source: World Inequality Report (2018)

Globalization alone is not responsible for the widening income and social gaps in the advanced nations. There were significant technological trends pushing in the same direction: skill-biased technological change, in particular, and the scale and network economies associated with tech and digital platforms distributed their fruits very unevenly. Most of the gains were reaped by highly-skilled professionals, managers, and winner-take-all firms.

Apportioning responsibility between technology and globalization is ultimately a fool's errand; they clearly interacted with each other. And together they produced a cultural chasm within societies as well – a division between globalist, cosmopolitan elites who viewed themselves as citizens of the world with little stake in (or responsibility for) their local communities and communitarian (and sometimes nativist) groups whose fates were still tied up with local economic circumstances.

What economic theory says

Many economists and policy makers were caught unprepared for these results. The scenarios they had sketched during the heyday of globalization were considerably rosier. But should we have been surprised? I'd argue not. The real-world consequences of globalization for economic performance and inequality are in fact quite consistent with the economics of international trade and international finance we teach in the classroom – to graduate students, even if not to undergraduates.

Take the theory of international trade first. The principle of Comparative Advantage suggests that reducing trade barriers at the border generally enlarges the overall economic pie at home, subject to some important caveats. For example, we must assume full employment in the background, or at least that the conduct of monetary and fiscal policies ensure trade liberalization does not cause changes in the level of aggregate employment. We must also rule out technological or other externalities being aggravated by trade openness. But, even if those assumptions are granted, a second critical implication of standard theory is that the gains from trade typically come with sharp alterations in the distribution of income. In the factor-endowment model, it is factors of production that are relatively scarce in the home economy that lose out. In advanced economies, that would be unskilled labor. In other models, it is firms in the import-competing sectors (and the factors of production employed therein).

Such distributional consequences are not purely incidental. They are the immediate result of the reallocation of labor and capital along the lines of comparative advantage. The gains from trade depend on this economic restructuring taking place. Hence, distributional changes are the flip side of the gains from trade. No pain, no gain!

It is important to emphasize that I am talking about absolute losses here,

rather than relative losses. Opening to trade reduces the standard of living of some groups in absolute terms. This result goes back to the famous demonstration by Stolper and Samuelson in 1944 that free trade would make one of the factors of production worse off. Stolper and Samuelson (1941) proved this result in the benchmark factor-endowments model, with two goods, two factors of production, and complete mobility of factors between the two sectors. That is a very specialized model. However, the Stolper-Samuelson logic is quite general and extends to much more complicated and realistic settings – with many factors of production, many goods, and diverse assumptions about factor mobility. We can state this generalization as follows: as long as there remains import-competing domestic production – in other words, ruling out complete specialization – at least one factor of production must suffer a loss in real incomes as a result of opening up to trade (Rodrik 2018). The losers will be those associated with import-competing activities that have to contract. The potentially reduced cost of living due to cheaper imported goods – the "Walmart effect" – will not be enough to compensate them. And these are permanent, not temporary losses. There is no escaping the sharp distributional consequences of trade.

The theory behind the gains from financial globalization is quite similar, and subject to the same kinds of qualifications. Trade in financial assets is just another form of trade, intertemporal trade. In principle borrowing and lending across borders enable the following benefits: (i) the channeling of saving to countries where investment returns are high; (ii) the smoothing of consumption over time (i.e., provision of liquidity in response to temporary shocks); and (iii) international portfolio diversification (and hence achieving a better risk-return profile).

Too Much of a Good Thing?

Economic theory provides additional cautionary notes (in addition to the distributional implications). One of the most important of these is that there are diminishing economic gains to globalization. The bulk of the gains are reaped when the barriers to trade are large. As tariffs and non-tariff barriers get lower, trade agreements end up chasing smaller and smaller gains from trade. Even worse, the redistributive effects of trade agreements loom larger and larger compared to the net benefits. Quantitative simulations with standard trade models suggest that at current levels of tariffs further tariff reductions are tantamount to reshuffling up to $10 of incomes among different income groups for each $1 of efficiency gain

(Rodrik 2018). No wonder trade agreements start to look increasingly like tools for redistribution, rather than means for overall prosperity.

This dismal result on the high ratio of redistribution-to-net gains in the advanced stages of globalization follows from a standard implication of public finance theory. A trade barrier is a tax on international transactions. The efficiency costs of taxes rise with the square of the tax rate. A tax that is twice is large causes four time as much economic harm. Applying the logic in reverse, a tariff that is ten times smaller (3% versus 30%) for example, results in a loss in gains from trade that is 100 percent smaller.

This is all in economic theory. Does it work like that in practice too? We have good empirical evidence for the U.S. on the consequences of NAFTA and of China's entry to the WTO. Studies find that the local labor-market effects in affected communities were indeed sizeable. Hakobyan and McLaren (2016) look at the NAFTA shock in the 1990-2000 period. They find that NAFTA produced modest effects for most U.S. workers, but an "important minority" suffered substantial income losses. Regions that were most affected by tariff reductions experienced significantly slower wage growth than regions that had no tariff protection against Mexico in the first place. The effect was greatest for blue-collar workers: a high-school dropout in heavily NAFTA-impacted locales had 8 percentage points slower wage growth over 1990-2000 compared to a similar worker not affected by NAFTA trade. The industry effect was even larger: wage growth in the most protected industries that lost their protection fell 17 percentage points relative to industries that were unprotected initially.

These are very large redistributive effects, especially when set against the result of other studies that indicate the overall gains from trade generated by NAFTA have been tiny. For example, Caliendo and Parro (2015) estimate that these overall gains amount to a "welfare" gain for the U.S. economy of 0.08% -- eight-hundredth of 1 percent.

China is a much larger country, and its entry into the WTO was a bigger deal for the United States. While U.S. tariffs on imports from China did not change, the uncertainty about the annual renewal of most-favored nation status was removed and, as a result, there was a large increase in the volume of trade. In a well-known paper Autor, Dorn, and Hanson have documented the labor-market disruption caused by the "China trade shock," which was not only massive but also very persistent (Autor et al., 2013; see also Autor et al. 2016). Their baseline result is that a commuting zone in the 75th percentile of exposure to Chinese im-

port growth had a differential fall of 4.5 percent in the number of manufacturing employees and a 0.8 percentage point larger decline in mean log weekly earnings, compared to a commuting zone at the 25th percentile. They also find a significant impact on overall employment and labor force participation rates. These local labor-market effects appear to have been highly persistent. The wage, labor-force participation, and unemployment consequences had not dissipated after a full decade of the China trade shock (Autor et al. 2016). The offsetting employment effects in export-oriented activities, which conventional trade models produce, did not take place.

Uncertain Benefits of Financial Globalization in a Second-best World

While economists almost universally favor free trade, there has been recently more skepticism about the benefits of financial globalization. While recognizing the theoretical case for cross-border finance, as stated previously, they have become more aware that real-world economies present complications that may reduce, or even reverse, the potential benefits. Economists refer to such complications as second-best interactions. The basic argument is as follows: in the presence of inadequate prudential regulation, moral hazard, or proclivity of governments to over-borrow, access to foreign finance can make these problems worse. And the associated losses may outweigh the conventional gains from trade.

The implication of this line of reasoning is that financial globalization cannot be presumed to be beneficial for investment, growth, and financial stability. Financial globalization accentuates the weakness of domestic institutions and debt-enforcement mechanisms. Such accounts also rationalize two sets of empirical findings that pose problems for advocates of financial globalization. First, the association between capital-account convertibility and economic growth is weak at best (Rodrik, 1998; Schularick and Steger 2010; Kose et al., 2011; Ostry, Prati, and Spilimbergo 2009). Typically, positive growth effects are found either for specific periods (e.g., during the late 19th century when capital flowed to the new world), specific sub-samples of countries (e.g., those with strong institutions and macroeconomic management), or particular types of capital (foreign direct investment). Second, there is a strong empirical association between financial globalization and financial crises over time. The canonical chart on this comes from Reinhart and Rogoff (2009), who show that the time trends of financial

globalization and the incidence of banking crises coincidence coincide almost perfectly. Banking crises and financial globalization go together.

The boom-and-bust cycle associated with capital inflows has long been familiar to developing nations. Prior to the global financial crisis, there was a presumption that such problems were largely the province of poorer countries. Advanced economies, with their better institutions and regulation, would be insulated from financial crises induced by financial globalization. It did not quite turn out that way. In the U.S., the housing bubble, excessive risk-taking, and over-leveraging during the years leading up to the financial crisis were amplified by capital inflows from the rest of the world. European banks were major purchasers of U.S. asset-backed securities and the appetite of emerging-market creditors for "low-risk" investments fueled the U.S. credit boom. In the euro zone, financial integration, on a regional scale, played an even larger role. Monetary unification and the introduction of the euro in 1999 drove down risk premia in countries such as Greece, Spain, and Portugal, and led to the convergence of borrowing costs across member states. This enabled borrowers to run large current account deficits and accumulate problematic amounts of external debt. Construction and other non-tradable sectors were boosted in the receiving countries at the expense of tradable activities. Such credit booms would eventually turn into bust and sustained economic collapses in Greece, Spain, Portugal, and Ireland once credit dried up in the immediate aftermath of the crisis in the U.S.

Asymmetries in the Treatment of Capital and Labor

I have talked so far about the redistributive effects generated by trade agreements that operate through reductions in trade barriers and the consequent changes in relative prices. But increasingly, the trade regime became more redistributive in other ways as well. In particular, trade agreements incorporated rules that were highly asymmetric, greatly benefiting investors and corporations, but not doing much for workers. Pharmaceutical and tech companies managed to extend restrictive patent rules to other nations, increasing their stream of monopoly profits. Investors obtained special arbitration tribunals that allowed them to sue foreign governments for changes in domestic regulations that reduced their profits. Corporations also pushed for regulatory harmonization in diverse areas such as health and safety, banking rules, and product standards, essentially treating regulatory differences across nations as barriers to trade.

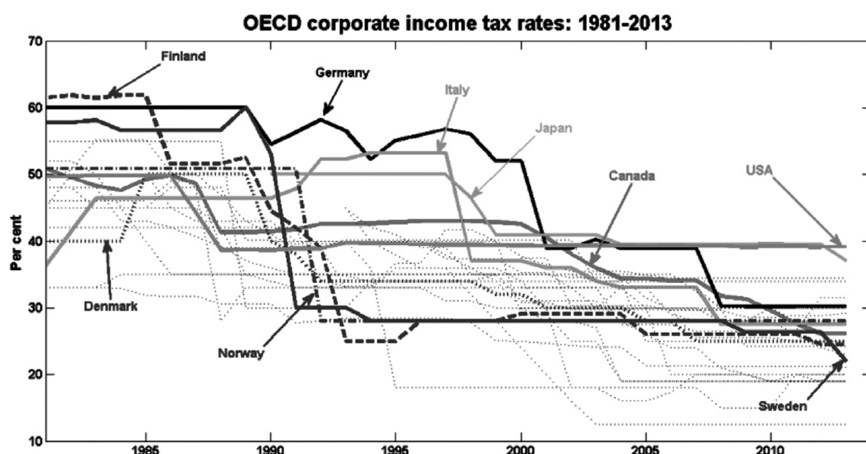
While lip service was paid to labor rights, trade agreements rarely contained enforceable provisions enhancing labor standards and guarding against a race to the bottom. In the original NAFTA, signed in 1992, labor standards were shunted to a side agreement. Since then U.S. trade agreements have typically included a labor chapter in the body of the agreement. The Trans-Pacific Partnership (TPP) would have required Vietnam, Malaysia, and Brunei to significantly improve their labor practices – and Vietnam to recognize independent trade unions. In all these agreements, charges of labor-rights violation can be brought up only by governments -- not by trade unions or human rights organizations. This is in stark contrast with disputes over investment, which can be launched by corporations themselves. To date there has been only a single instance of labor rights being pursued under a trade agreement's dispute settlement procedures. Following two years of complaints by U.S. and Guatemalan trade unions, the U.S. formally launched a case against Guatemala in 2010. It took nearly a decade for the ruling to be issued and the decision went against labor. Interestingly, the panel did find violations of Guatemalan labor laws. But it ruled that such violations did not have an effect on Guatemala's competitive advantage and exports, and therefore were not covered by the trade agreement!

There is a deeper asymmetry in the treatments of capital and labor under present-day hyper-globalization: the global economy is built on the presumption that capital should be as mobile as possible across national boundaries, while the movement of labor is tight regulated and prescribed. Direct foreign investment is actively encouraged and often subsidized. Countries are expected to maintain open borders to financial transactions -- bonds, equities, bank lending, and other financial instruments. Workers who want to sell their labor services across national borders typically encounter a wall. The asymmetry is not grounded in any economic reasoning; in fact, the gains from trade from loosening labor mobility restrictions are orders of magnitude larger than in the case of furthering financial globalization. It is the result of politics, and the fact that corporations and banks have the upper hand in designing the rules of the system.

The asymmetry in mobility produces a number of adverse effects for labor. First, it shifts the distribution of value within firms towards capital and against labor. Capital mobility gives employers a credible threat: accept lower wages, or else we move abroad. Furceri et al. (2017) provide some evidence that the decline in the labor share is related to the threat of relocating production abroad. A second consequence is that differential mobility increases the volatility of labor earnings

and, in particular, shifts the burden of economic shocks to labor. The factor that is stuck within borders has to absorb the costs of idiosyncratic shocks. Workers with the lowest skills and qualification, those least able to move across borders, are typically the most affected by this risk shifting. Third, as capital becomes globally mobile, it becomes harder to tax. Governments increasingly have to fund themselves by taxing things that are less footloose – consumption or labor. Indeed, corporate tax rates have come down sharply in virtually all advanced economies since the late 1980s, sometimes by half or more (Figure 4). Meanwhile the tax burden on wages (social security charges, etc.) has remained roughly constant and value added tax (VAT) rates have generally increased. In a remarkable series of papers, researchers at the IMF have documented the adverse effects financial openness has had on inequality within countries (Jaumotte et al. 2013; Furceri and Loungani 2015; Furceri et al. 2017).

Figure 4:



(Source: OECD)

What About Compensation?

Economists have long known about the distributive effects of globalization, but they have not been overly concerned by those. Typically, they take refuge behind the argument that such consequences are better treated separately, by compensating the losers. We should not slow down on our path to hyper-globalization; we should do a better job of redistribution. The logic here is superficially impec-

cable. But a closer look at the economics and politics of compensation suggests that economists have been too optimistic about the prospects of compensation.

Consider the economics first. Unlike in economics textbooks, lump sum transfers from the winners of globalization to the losers is not possible. So any compensatory transfer must include its own efficiency costs, at both ends: distortionary taxes must raise the needed revenue, and distortionary transfers must be put in place. In the process, at least some of the gains from trade are dissipated. How much depends on where we are in globalization. Recall my previous discussion about the magnitude of redistribution relative to efficiency gains. This ratio is highest when an economy is already highly globalized – when barriers to trade are small to begin with. Back-of-the-envelope calculations suggest that under those conditions the economic costs of compensation would eat up the bulk (if not all) of the gains from trade. Moreover, as capital become more mobile internationally, burden of taxation shifts to labor, as I discussed previously. This defeats the purpose of compensatory taxation.

The simple political economy of compensation raises further difficulties. The central problem here is what economists call time inconsistency. Promises to redistribute ex-post are time-inconsistent when a trade deal undermines the power of veto players. In the U.S., promises to compensate labor through Trade Adjustment Assistance (TAA) usually accompany any new trade agreement. But once the agreement is signed and comes into force, there are few political incentives to ensure that the compensation takes place as promised. After all, proponents have got the agreement they wanted and it is unlikely to be revoked even in the absence of compensation. This is exactly how TAA has worked in the U.S. Congress has typically not funded it to the extent needed, and the program has remained very ineffective.

A Tale of Two Globalizations

The hyper-globalization model we pursued after the 1990s is not the only model of globalization we could have had. It is useful to contrast this model with the earlier Bretton Woods model. The comparison highlights the choices that we made deliberately in taking a good thing a bit too far. It also clarifies why globalization's newest winners, such as China, have succeeded.

The Bretton Woods model was founded on a central insight John Maynard Keynes developed after observing the ruptures and eventual collapse of globalization during the interwar period. A modern democratic society, in which the

government is viewed as responsible for pursuing broad prosperity and managing business cycles, employment levels, and social safety nets, cannot be reined in by tight external constraints. The government needs policy space to carry out those objectives. When domestic economic and social objectives collide with globalization's demands, it is the latter that must give way. In other words, globalization must serve domestic needs, not the other way around.

In the macroeconomic sphere, this meant governments needed to shield the conduct of their monetary and fiscal policies from the whiplash of international capital flows. Hence capital controls were to be the norm, rather than the exception. Currency rates were to remain fixed, not to create too much uncertainty, but were adjustable by government fiat when domestic conditions required it. Those were the principles that were enshrined in the original articles of agreement of the IMF.

In trade, Keynes did not have a direct hand at shaping the GATT and its evolution. But the trade regime internalized the same approach: eliminate or reduce the most egregious barriers at the border, especially quantitative restrictions, but do not touch behind-the-border regulations and leave governments plenty of room to devise their own regulations and industrial policies. Developing countries were left essentially completely free to pursue the policies they wanted, and advanced countries got plenty of room to safeguard domestic social bargains. When garment imports from low-wage countries surged, for example, threatening jobs at the low end of the skill distribution, a separate regime was carved out restricting imports (while compensating developing country exporters with quota rents).

From the hyper-globalist perspective, such safeguards were a derogation from free-trade rules that should be abolished. Hence the WTO regimes, established in the 1990s, prohibited these arrangements and greatly expanded the scope of international disciplines in the area of investment rules, intellectual property, subsidies, and sanitary standards. Subsequent bilateral and regional trade agreements pushed even harder in this direction, and reached increasingly beyond borders to domestic regulations. In finance, free capital mobility was transformed into a norm, the ultimate objective to which all countries should aspire, rather than the exception.

The hyper-globalist model effectively turned globalization into an end rather than a means. The political right and left converged on the necessity of global economic integration, differing only in their preferred set of complementary policies. The right argued countries needed to cut taxes, regulations, red tape, and government spending to compete better in the world economy. The left argued for increased expenditures on education, infrastructure, and social transfers – again

for the same purpose of positioning their countries for global competition.

The hyper-globalist approach was predicated on the implicit understanding that countries would converge in their economic and social models. This was adverse spillovers would be minimized and a race to the bottom in regulation would be avoided. Current trade tensions with China show how misguided this presumption was. China has greatly benefited from its unorthodox approach to economic management – in industrial policies and technology promotion, in particular -- and does not look keen to adopt Western style recommendations.

The Chinese experience reveals another important truth about the possibilities of prosperity under globalization. I discussed earlier how China marched to its own drummer and violated many of the hyper-globalist rules. In light of the distinction I have just drawn between the Bretton Woods and hyper-globalist models, we can now see that China in fact played globalization by the first set of rules rather than the second. It safeguarded its policy space to pursue its own, divergent policies in industry and finance. Its trade protection, subsidies, financial controls, and exchange-rate management are reminiscent of Bretton Woods practices.

In short, China's superlative economic performance is hardly an endorsement of post-1990 rules of globalization. If anything, it demonstrates the continuing relevance of an earlier, more relaxed approach to globalization – one that is more permissive of every nation's own path to its economic and social model.

The Politics of the Backlash

In view of the damage that these developments did to the social fabric, it is not entirely surprising that a political reaction has developed against domestic manifestations of globalization. In the U.S., the main drivers were trade agreements (and imports from China and Mexico, in particular) and the lingering effects of the financial crisis. In Europe, it was the Eurozone crisis and the consequent austerity policies associated with E.U. rule from Brussels (and Frankfurt). Policy elites, wealthy professionals and large corporations that supported globalist, technocratic arrangements appeared increasingly distant from local populations and their concerns. This bred distrust of elites and sense of political disenfranchisement. The ground was cleared for non-establishment political leaders and parties to take advantage of the grievances against the established economic order.

There are two main explanations for the populist backlash. One group of analysts stress the economic dislocations I have discussed in this lecture: the loss

of middle-class jobs, the rise in inequality, increased economic insecurity (Guiso et al., 2017). A second group emphasizes cultural factors instead: nativism, anti-immigrant sentiment, lingering racism, and a conservative backlash against social liberalism (Inglehart and Norris, 2016). Adherents of these two perspectives have had a largely unproductive back-and-forth to date.

My preferred take on this debate is to distinguish between the demand and supply sides of populism (Rodrik 2018). On the demand side, we have a list of economic grievances that generate a search for new leaders and new solutions. On the supply side, we have political leaders and parties that provide an overall narrative that explains to electorates the sources of their predicament and advance specific remedies. This distinction implies that there can be a disconnect between the underlying causes of populist sentiment (on the demand side) and the form that populism takes in practice (the supply side). In particular, economic anxiety can take a cultural/nativist form.

I believe this is why Donald Trump in the U.S. and right-wing populist parties in Europe get most of their support from economically distressed regions rather than places with a lot of immigrants. Even though they focus on fanning the flames of anti-immigrant sentiment and other forms of xenophobia, nativism is not the root cause of their electoral success. Immigrants are convenient culprits.

Distinguishing between the demand and supply sides of populism also allows us to see that there could be a different, more constructive response. The problem with ethno-nationalism populism is neither its claim to speak for "the people" nor its focus on national interest. The problem is the exclusionary definition of who the people are – excluding racial, ethnic, or religious minorities – and the ineffective nature of its remedies. There is nothing wrong with patriotism and the advancement of national interest as long as it is inclusionary, and takes aim at reducing the social and economic gaps that have opened up in recent decades. The appropriate remedies are to be found in the realm of economic policy rather than culture wars and identity politics.

What kind of a future?

The last three decades were a time of rapid global economic integration. If the fissures they have created are to be healed, the next decade will have to be one of domestic re-integration. This will require major shifts in our economic policy orientation, from a focus on finance and international competitiveness to

a focus on creating middle-class jobs. We will need increased public investment in infrastructure and skills, new regional policies, industrial policies connecting technologically frontier firms with rest of economy, and egalitarian tax policies. A less-ambitious, more balanced globalization, framed around such policies, can indeed produce increased wealth and well-being of nations – one that Adam Smith would be proud of.

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Guarding (Against) Financial Globalization: International Financial Safety Nets and Sovereign Debt Default

Ted Liu[1]

Introduction

Financial globalization, often indicated by increasing cross-border capital flows, has evolved and exhibited new characteristics since the Great Recession. The global stock of foreign investment has remained stable since 2007, largely driven by the retrenchment of bank lending in Europe[2]. Nevertheless, the process of globalizing capital continues. For example, non-resident investors owned 31% of bonds in the global securities market in 2016, up from 18% in 2000[3]. In particular, many emerging markets are more connected to the global financial system by simultaneously allowing more capital inflows and increasing investment abroad.

The current form of financial globalization offers growth opportunities for developing countries, but also poses challenges in maintaining financial stability. Many scholars have examined the benefits as well as the risks of accelerating financial globalization. Most notably, Rodrik and Subramanian (2009) argue that for some developing countries, increasing capital inflows could exacerbate the problem of investment constraints in these countries by pushing real exchange rate appreciation, therefore reducing investment profitability (particularly for producers of tradables), and subsequently exerting little or even negative effects on growth[4].

To be sure, deeper financial globalization itself does not necessarily lead to

1 Ted Liu is a PhD student in Economics at the University of California, Santa Cruz.
2 Lund et al (2017)
3 Ibid.
4 Rodrik and Subramanian (2009)

crisis. But for some economies, it "amplifies the costs of policy and regulatory failures, both in terms of crisis prevention and crisis management."[5] Such incidents could be a balance of payments crisis, a liquidity crisis of foreign currency, a sovereign debt crisis, or a combination of any of the three[6]. While most economies are not immune from the risks of such crises, developing countries may be especially susceptible as many of them lack liquid and deep domestic financial markets.

Partially as a proposal for managing these risks, policymakers and scholars who are engaged in international financial governance have developed a concept called "global financial safety nets," also known as GFSN. This system consists of four components: foreign exchange reserves, currency swap networks among central banks, the International Monetary Fund (IMF) financing, and regional financial arrangements (e.g., the Chiang Mai Initiative). Many of these scholars and policymakers argue for a stronger GFSN system to maintain global financial stability[7]. While the policy support for strengthening the GFSN as an integrated system is abundant, empirical and quantitative analyses on the efficacy of this system are limited.

This paper provides econometric analyses that use GFSN as a uniform concept in order to empirically illustrate its relationship with sovereign debt default. Section II provides a review of literature that examines GFSN and its components, in relation to financial crises and sovereign debt distress. The next section describes the data sources and main variables involved in the empirical estimation. Section IV discusses the econometric models and estimation strategy being used, in the context of existing theoretical literature on sovereign default. Section V examines the results from the estimates, and its following section concludes.

Related Literature

Though each of its components is well-studied, global financial safety nets (GFSN) as a unified concept is relatively new. Much of the literature on this notion is intended for a policy audience, and more specifically on what an ideal system of GFSN should be. For instance, citing experiences from the European debt crisis, Henning (2017)[8] argues that the proliferation and heterogeneity of regional

5 Lane (2012)
6 Denbee, Jung, and Games Paternò (2016)
7 Lagarde (2018)
8 Henning (2017)

financial arrangements (RFA) pose challenges for a coherent GFSN, as such an incoherent framework could lead to contention between the IMF and RFAs on program design, sequencing of financial assistance, and debt restructuring. Similarly Weder di Mauro and Zettelmeyer (2017) have raised concerns about the "patchy coverage" of RFAs, and about the effectiveness of crisis prevention of the existing GFSN given its ad hoc governance[9].

Some other articles such as Rhee et al (2013)[10] trace the evolution of GFSN with particular attention on the development of regional financing arrangements. Other studies examine in-depth the relationship among the various instruments of GFSN. Aizenman et al (2010)[11] find that the proliferation of currency swap agreements may reduce central banks' incentives to accumulate reserves, but such agreements only have limited substitution effects on reserve accumulation. Eichengreen (2012)[12] takes a historical perspective, and shows that the gap of understandings between the IMF and regional arrangements dates back to as early as the 1950s with the establishment of the European Payment Union.

Indeed, unifying and integrating all the instruments available against financial instability have received backing from key economic policymakers. For example in 2011, G20 finance ministers and central bank governors declared the principles through which the IMF and regional financial arrangements should cooperate with each other[13]. The IMF has also produced several reports[14] that discuss the adequacy and unevenness of the GFSN, with the goal of providing empirical evidence that the safety networks need to become more systematic.

Despite the enthusiasm about GFSN as a unified, clear-cut concept from the policy community, it is important to take a step back and examine whether such instruments are empirically useful or efficient for either preventing or mitigating financial instability. The existing literature includes abundant studies that examine components of GFSN, and their relationships with financial stability and with economic growth. But these studies typically analyze GFSN instruments in isolation from each other. In particular, optimal foreign exchange reserves and their implications for the probability of a "sudden stop" have received extensive attention.

9 Weder di Mauro and Zettlemeyer (2017)
10 Rhee, Sumulong, and Vallée (2013)
11 Aizenman, Park, and Jinjarak (2010)
12 Eichengreen (2012)
13 G20 Finance Ministers and Central Bank Governors (2011)
14 IMF Strategy, Policy, and Review Department (2016) and (2017)

In this strand of literature[15], for instance, some studies try to understand the theoretical optimal reserves and their deviation from the reality. Jeanne (2007)[16] focuses on optimal level of reserves in emerging markets, and finds that the motive of self-insurance against capital account crisis does not explain the large reserves observed in Asian countries. Similarly, Calvo, Izquierdo, and Loo-Kung (2012)[17] estimate the optimal levels of reserves using a model on the probability of sudden stop, and compare the results to actual levels. They argue that the discrepancies can be attributed to some economies' perception that they could receive help from lenders of last resort (such as the IMF). Sudden stop, however, is usually only a symptom of a deeper financial crisis that includes sovereign debt distress. In other words, to understand the efficacy of GFSN, we need to look at not only capital flows, but also sovereign debt dynamics.

There exist additional studies that look at the connection between the risks of sovereign debt crises and reserve accumulation. For instance, in an empirical paper, Gourinchas and Obstfeld (2011)[18] find that the probability of a financial crisis (of banking, currency, or sovereign debt) is reduced given higher foreign exchange reserves. Corneli and Tarantino (2015) have constructed a theoretical model of the relationship between reserves accumulation and debt issuance, and they find a complementary relationship between the two[19]. Moreover, Hur and Kondo (2013)[20] argue that countries use reserves to remain solvent in the event that investors refuse to rollover debt, thus avoiding a sudden stop and default. They also find that emerging markets (EMs) with access to "international mutual insurance" may reduce their reserves. There are papers that study GFSN instruments other than reserves. For example, one study by Maurini (2017)[21] examines how well IMF financing capacity and its precautionary lending facilities explain sovereign bond spreads in emerging markets. The main finding is that IMF resources may have negative effects on the bond spreads (i.e., the perceived riskiness of such sovereign debt), but the role of precautionary facilities is not statistically significant.

15 In the literature, a "sudden stop" is typically defined as "a fall in capital flows exceeding two standard deviations below the mean that coincides with a spike in regional spreads." See Calvo, Izquierdo, and Loo-Kung (2012)
16 Jeanne (2007)
17 Calvo, Izquierdo, and Loo-Kung (2012)
18 Gourinchas and Obstfeld (2011)
19 Corneli and Tarantino (2015)
20 Hur and Kondo (2013)
21 Maurini (2017)

Nevertheless, the majority of these studies focus on the countries' motives of accumulating precautionary reserves (and other GFSN funding). In other words, they focus on how GFSN may prevent crises, instead of how GFSN mitigates debt crises ex post, or at least when a significant economic shock has occurred. However, not all GFSN instruments can become available ex ante, notably some IMF programs such as the Extended Fund Facility. In other words, more research is needed on how well GFSN works during or after a crisis.

In the meantime, studies that examine all the components of GFSN using methods beyond descriptive statistics are still limited. Denbee, Jung, and Paternò (2016)[22] conduct simulation of different scenarios in which economies could use GFSN during crises, or when economic shocks occur. They look at three specific types of shocks: banking sector liquidity shock, balance of payment shock, and sovereign debt shock. For the debt shock scenario, they focus on 14 advanced economies that encounter refinancing difficulty, loss of market access, and widening fiscal deficits. The main GFSN instruments these countries draw on are IMF financing, RFAs, and/or foreign exchange reserves. They find that the current GFSN could be sufficient in most of the stress scenarios: the IMF resources would be adequate to deal with three major sovereign debt crises, and RFAs would play an active role. However, simultaneous sovereign events in a multitude of these 14 economies would overwhelm these resources.

In summary, existing literature offers evidence that individual GFSN instruments could be useful in preventing crises, usually by reducing the likelihood of sudden stops. However, it would be interesting to illustrate the direct relationship between debt default and GFSN. Moreover, the instruments of GFSN are not necessarily complementary to each other. For example, the study by Hur and Kondo (2013) suggests that reserves and international financial arrangements can be substitutes. Such a substituting relationship is applicable to regional financial arrangements and the IMF as well. Thus before fully embracing GFSN as a concept and as a policy tool, we need to better understand how well it, as a unified/aggregate variable of all the financing instruments, explains sovereign debt crises.

This paper illustrates the relationship between global financial safety nets and sovereign debt default. More specifically, the paper tries to answer whether GFSN access reduces the likelihood of default, and how the amount of GFSN access is related to the value of debt default. The paper differs from other studies in that

22 Denbee, Jung, and Paternò (2016)

GFSN instruments in this case are not examined in isolation from each other. Grouping these into one variable, consequently, can shed light on the usefulness of GFSN as a unified idea, which has important implications for scholars and policymakers who want to understand what factors mitigate sovereign debt crises.

Data and Variables

In order to better empirically assess the relationship between global financial safety nets and sovereign debt default, this paper uses two datasets: one focusing on GFSN by Scheubel and Stracca (2016) at the European Central Bank, and the other on default by Beers and Mavalwalla (2017) at the Bank of Canada. Both datasets are based on yearly observations. The first database contains information of 198 economies for years 1960 through 2014. It incorporates key data about all four components of GFSN, including whether an economy has access to a particular instrument, and how much funding this economy can obtain.

This paper thus uses one variable that sums up all available GFSN resources in a given year: level of foreign exchange reserves, disbursement amounts agreed with the IMF, central bank swap line limit, and size of regional financial agreement loans. We refer to this variable simply as "GFSN" in this paper and analyze it as a percentage of GDP. The GFSN variable serves as an independent variable in the analyses.

The panel dataset by Beers and Mavalwalla (2017) compiles the information of countries' bonds and other securities, bank loans, and official loans that are in default for years 1960-2016. Their definition of sovereign "default" is broad: besides outright debt moratorium or nonpayment, a default also occurs when governments and creditors agree to reduce interest rate or extend maturity, governments buy back the debt at a substantial discount, and other circumstances in which creditors incur tangible losses on their debt holding. Though the dataset contains figures of both official and private sector debt on which governments have defaulted, we examine only the private debt figures (normalized by being calculated as a share of GDP) in this paper. Moreover, we use a set of two dependent variables calculated based on the dataset: a binary variable of whether an economy has defaulted on debt owed to the private sector in a given year (a value of 1 means default has occurred), and a variable illustrating the amount of default as a percentage of GDP.

The coverage of these two datasets is comprehensive. This paper, however, only uses a subset consisting of 26 emerging markets. A primary reason for this

selection is that compared with less developed economies, EMs are generally more integrated into the global economy and may have relatively adequate access to GFSN. Nevertheless, EMs are susceptible to the vicissitude of financial globalization: for example, drastic capital movement induced by changes in advanced economies' monetary policies. At the same time, EMs in general have less comprehensive GFSN access (e.g., central bank liquidity swap) than advanced economies. Many of these EMs, such as Argentina and Mexico, have had episodes of default. A combination of these factors renders this group of EMs as interesting examples of how GFSN access relates to sovereign debt default. Table 1 provides summary statistics of the data used in the paper. Table 2 presents a correlation matrix of the independent variables including GFSN and control variables.

Empirical Estimation

This paper draws insights from theories in the sovereign default literature. Most notably, works such as Eaton and Gersovitz (1981), Arellano (2008), and Roch and Uhlig (2018) provide guidance on how to estimate sovereign debt default, and incorporate considerations of external funding/bailout. In general, a country decides to default on its sovereign debt when the net gain from this exceeds the net gain from repayment. A simplified version of the government's decision process could be described as[23]: at each time period, a government needs to maximize its value function subject to resource constraint. With certain amount of initial assets, the country considers the income shock or income state. The choice is discrete: either to default or not. If the government defaults, the debt would be erased from the country's resource constraint, but would incur costs that typically include output loss and the country's exclusion from the international capital market. If the country chooses to repay, it needs to follow the prices and repayment schedule as set by the market. Under the assumption that the asset market is incomplete, when countries are in low income states or in recessions, the incentive for defaults is higher than in other scenarios[24].

In this paper, we consider GFSN instruments as an income shock that can be incorporated into the government's value function. However, the relationship between debt default incentive and external financial assistance is ambiguous a priori.

23 Arellano (2008) p.8
24 Ibid.

Being able to receive financial assistance from official creditors has two counteracting outcomes on a country's default incentive[25]: such financing could help reduce investors' run on the country's assets, cover deficits, and therefore avoid a default. On the other hand, the ability to access such instruments (with the exception of reserves) provides insurance, and signals that countries would overall decrease borrowing costs and incur higher level of debt for the future. Moreover, the actual accumulation of official debt also has two opposite effects: the probability of defaulting on commercial debt could increase (as organizations such as the IMF have the senior creditor status); the conditionality attached to the official loans could force the government to act more prudently, thus avoiding default[26].

The study by Roch and Uhlig (2018) simulates a bailout agency (for instance, the European Central Bank) that is willing to purchase the debt of the government in distress, but they argue that such support does not necessarily prevent defaults that are due to economic fundamentals. Another study by Fink and Scholl (2016)[27] finds that bailout programs could prevent default in the short term, but could increase default probability in the long term as the government's incentive for debt accumulation would also increase. Similarly, Kirsch and Ruhmkorf (2017) argue that while official lending can reduce the frequencies of debt default due to investor runs, it does not necessarily decrease the probability of default overall or in the long term.

Therefore, the theoretical predictions based on such studies do not show that external official financing necessarily reduces default probability or default incentive. At the same time, foreign exchange reserves are not part of the models of the aforementioned studies. Thus based on empirical data of a group of countries over years, it would be interesting to see how GFSN, combining reserves and external financing, relates to default likelihood and incentive.

In order to examine this relationship, we will conduct two econometric tests: fixed effect logistic model, and fixed effect regression model using the ordinary least squares (OLS) method. The first model estimates the likelihood of default as related to GFSN, and the second model illustrates the relationship between the amount of default and the amount of GFSN financing.

The mechanism through which this relationship takes shape is that GFSN

25 Kirsch and Ruhmkorf (2017)
26 Boz (2011)
27 Fink and Scholl (2016)

instruments provide financing and incomes for countries in distress to potentially avoid default. We assume that the default incentive is also endogenous to the cost of financing (measured by bond spread), economic growth rate, external debt level, and current account balance. The country's optimization of utility is also subject to its budget constraint, measured by fiscal balance. The government's ability to roll over debt can be indirectly measured by capital outflows. However, the paper does not fully account for creditors' role in debt default, or the process of debt negotiation and restructuring (which in many cases also count as default). The decision process of the government is neither dynamic nor inter-temporal in the approach of this paper. Thus the econometric model in the paper is a simple linearization of the aforementioned assumptions and factors.

The basic linear fixed-effect model is the following,

$$y_{it} = \boldsymbol{\beta x}_{it} + \alpha_i + \varepsilon_{it}$$

where

$i = 1, \dots\dots, N$ and $t = 1, \dots\dots, T$

y_{it} is the dependent variable which represents

1 A dummy variable (1 = default) in the logistic model
2 The value of defaulted debt in the case of the OLS regression,

$\boldsymbol{x}_{it}$ is a vector of independent variables including the GFSN variable and control variables,

$\boldsymbol{\beta}$ is a vector of parameters we want to estimate,

α_i is the unobserved time-invariant individual effect, and

ε_{it} is the error term.

For the logistic model, we use the maximum likelihood estimation (MLE) and need the following specification for the conditional probability of default

$$\Pr(y_{it} = 1 | \boldsymbol{x}_{it}, \alpha_i, \boldsymbol{\beta}) = \frac{1}{1+e^{-\alpha_i - \beta x_{it}}}$$

For the OLS regression, we calculate the average of the variables over time,

demean the variables, and as a result eliminate α_i, the unobserved individual effects that are time-invariant:

$$y_{it} - \bar{y}_i = \boldsymbol{\beta}(\boldsymbol{x}_{it} - \bar{\boldsymbol{x}}_i) + (\varepsilon_{it} - \bar{\varepsilon}_i)$$

In both cases of the logit model and the OLS regression, the parameter of interest is the vector $\boldsymbol{\beta}$. The models also include a group of control variables of the country's economic and financial fundamentals: GDP growth, fiscal balance, capital outflow, bond spread, external debt, and balance of payments.

Estimation Results

Table 4 presents the results from the logistic model, which estimates the probability of default based on variables including GFSN and control variables. Overall, the results do not suggest that GFSN reduces the likelihood of default in a statistically significant way. Column 1 presents the model with only GFSN as the independent variable. With one unit of increase in GFSN, there is 0.042 increase in the log-odds of default. This positive relationship between GFSN and default probability also holds when the model incorporates capital outflow, GDP growth, and bond spread (as shown in Column 5). Otherwise, while some other columns present negative relationship between GFSN and default probability, such results are not statistically significant. In contrast, capital outflows and external debt have consistently significant effects on the default probability.

In short, GFSN financing does not prevent default, and in fact has a small and positive relationship with default probability. This result echoes the theoretical predictions in the debt default literature, as described in the previous section: receiving bailout and external financing have counteracting effects, and some theories suggest that such aid does not prevent default resulting from economic fundamentals, and at most it could only reduce the probability of default in the short term. The specification in our model only produces estimation for the short term, and some of the default-inducing impact (for example, incurring higher debt for the future) of financial assistance occurs in longer time horizons. Thus it is difficult to say that the results are fully consistent with the literature. Nevertheless, at least for the countries sampled, GFSN does not tangibly help reduce default probability.

Table 5 presents the results from the fixed effect OLS model, which estimates

the relationship between default value and GFSN value (both in natural logarithm form) along with control variables. In other words, this model assumes that default has occurred, and estimates how much default value changes in relation to GFSN value. All the seven regression models present that GFSN and default value have a negative relationship in a statistically significant way. For instance, as shown in Column 7, the coefficient of the estimator for GFSN is -3.418. It means that if for instance GFSN funding increases by 10%, the value of debt default would decrease by over 28%. Similar to the results from the logistic model, external debt has a positive relationship with the dependent variable. Overall, the results of the OLS estimation suggest that GFSN financing may have material impact on reducing how much debt on which a government defaults.

Interpreting the results from both Tables 4 and 5, we can infer that global financial safety nets by themselves do not prevent emerging economies from defaulting on their sovereign debt to the private sector. In some cases, using GFSN could slightly increase the default likelihood. However, it is very likely that GFSN financing does help reduce the amount a government defaults on its debt.

Conclusion

In this paper, we have examined the connection between global financial safety nets and sovereign debt default, both in terms of default probability and value. The results from the fixed effect logistic model do not corroborate the claim that GFSN effectively prevents sovereign default. Moreover, GFSN financing could exacerbate default probability in the short term. The results from the fixed effect OLS regression, however, suggest that while GFSN does not avoid default per se, it may help mitigate the level of nonpayment. This evidence means that the opinions that GFSN necessarily maintains financial stability are at best partially correct.

The results and conclusion have several limitations. While the ways in which external assistance/bailout (e.g., IMF programs) affect debt default have solid theoretical underpinnings, it is unclear what happens when such external financing is combined with foreign exchange reserves.

Further, the individual components of GFSN and how they interact in the context of sovereign debt distress are not tested. The individual components have very different mechanisms through which they affect the financial sector and the real economy. They also have different levels of versatility and costs. This means

that there is a potential problem in amalgamating these components into one variable, which is a key limitation of the study.

At the same time, part of my goal (in many ways an epistemological one) is trying to test whether "global financial safety nets" as a unified concept can generate empirically meaningful results, as economists have long been studying the individual components of GFSN as though they were isolated from one another. While this paper does not truly answer whether GFSN as a uniform concept is empirically useful or efficient, it does illustrate the potential for future studies to examine this idea in more depth and with more theoretical rigor. Deeper and more systematic exploration of GFSN will help scholars and policymakers better understand financial globalization as well as develop strategies to manage its benefits and risks.

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Default Value (% of GDP)	1,282	1.77	7.26	0.00	102.40
GFSN (% of GDP)	1,408	10.27	9.53	0.00	54.39
Capital Outflow (% of GDP)	764	1.93	3.85	-10.25	20.63
Real GDP growth	1,238	4.72	5.92	-27.30	81.89
Fiscal balance (% of GDP)	637	-1.59	4.64	-16.48	22.73
Bond spread	238	4.11	4.98	-6.76	33.90
External debt (% of GNI)	711	40.38	33.01	0.75	384.01
Current account (% of GDP)	871	-0.40	5.96	-22.46	32.58

Table 2. Pairwise correlation matrix

	GFSN	Capital Outflow	GDP growth	Fiscal balance	Bond spread	External debt	Current account
GFSN	1						
Capital Outflow	0.2704	1					
GDP growth	0.0469	-0.0605	1				
Fiscal balance	0.1257	0.1532	0.266	1			
Bond spread	-0.2193	0.2043	-0.3681	-0.2307	1		
External debt	0.0042	0.0869	-0.1421	-0.0023	0.02	1	
Current account	0.332	0.5439	0.0821	0.4217	0.0232	-0.0353	1

Table 3. Countries in the sample

Argentina, Bangladesh, Brazil, Chile, China, Colombia, India, Indonesia, Israel, Malaysia, Mexico, Nigeria, Oman, Pakistan, Peru, Philippines, Qatar, Romania, Russia, South Africa, Thailand, Turkey, Ukraine, United Arab Emirates, Venezuela, Vietnam

Table 4. Logistic estimation

	(1) Default	(2) Default	(3) Default	(4) Default	(5) Default	(6) Default	(7) Default	(8) Default
GFSN	0.042*** (0.012)	-0.002 (0.017)	-0.002 (0.017)	0.033 (0.023)	0.151*** (0.059)	0.004 (0.020)	-0.028 (0.019)	-0.018 (0.023)
Capital Outflow		-0.111*** (0.037)	-0.117*** (0.037)	-0.209*** (0.058)	-0.246** (0.110)	-0.069 (0.046)	-0.180*** (0.046)	-0.115** (0.059)
GDP growth			-0.055** (0.023)	-0.038 (0.036)	-0.171 (0.144)	-0.027 (0.030)	-0.048** (0.024)	-0.013 (0.032)
Fiscal balance				-0.004 (0.071)				
Bond spread					0.394** (0.182)			
External debt						0.043*** (0.007)		0.039*** (0.008)
Current account							0 .082*** (0.032)	0.046 (0.039)
Prob > chi2	0.0002	0.0067	0.0014	0.0024	0.0008	0.000	0.0002	0.000
N	923	546	542	284	103	420	498	376

Fixed effect. Standard errors in parentheses.
*p -value < 0.1, **p - value < 0.05, *** p - value < 0.01
Dependent variable: whether the country defaults (1=yes)

Table 5. Fixed effect OLS regression

	(1) Default	(2) Default	(3) Default	(4) Default	(5) Default	(6) Default	(7) Default
GFSN (log)	-1.923*** (0.337)	-2.869*** (0.516)	-2.635*** (0.528)	-3.956*** (0.851)	-2.534*** (0.500)	-3.110*** (0.553)	-3.418*** (0.433)
Capital Outflow (log)		0.050 (0.237)	-0.039 (0.240)	-0.475 (0.334)	-0.388* (0.229)	-0.567** (0.265)	
GDP growth			-0.096* (0.053)	-0.117 (0.071)	-0.052 (0.055)	-0.094 (0.060)	-0.028 (0.045)
Fiscal balance				0.156 (0.134)			
Bond spread							
External debt (log)					4.553*** (0.669)	4.758*** (0.703)	4.428*** (0.540)
Current account						0.158*** (0.059)	0.088* (0.046)
Constant term	2.708*** (0.743)	4.775*** (1.132)	4.574*** (1.129)	8.366*** (2.203)	-13.737*** (2.933)	-12.894 (3.092)	-11.165*** (2.441)
Prob > F	0.000	0.000	0.000	0.0001	0.000	0.000	0.000
N	269	157	157	89	132	111	182

Fixed effect regression. Standard errors in parentheses.
*p -value < 0.1, **p - value < 0.05, *** p - value < 0.01
Dependent variable: natural log of default value

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Globalization, Policy Convergence & Liberal Democracy

Sharun W. Mukand[1]

Introduction

The twenty-first century has not been kind to the process of globalization. A process that seemed to be driven by the inexorable march of technology and competition seems to be questioned in countries across the globe. In this paper we examine the process of policy diffusion and convergence that has accompanied globalization. In doing so we also throw light on how policy convergence that has accompanied hyper-globalization may catalyze a political backlash. We further examine whether this political backlash has economic or cultural roots. We also examine the prospect of liberal democratic institutions surviving in such a hyper-globalized world.

The late twentieth century saw the worldwide diffusion of economic and political liberalism. The advent of Margaret Thatcher in the United Kingdom resulted in the adoption of neo-liberal policies such as privatization of state-owned enterprises and deregulation of the financial sector. However, this neo-liberal revolution soon spread to the United States and then gradually diffused across the globe. This process of diffusion of liberal policies and institutions across the globe can be observed from Figure 1 taken from Dobbins, Garrett and Simmons (2008).

Of course, the late twentieth century coincided with integration of product and capital markets as well as a surge in immigration, i.e. with the globalization of trade, capital and people. This was complemented with the ongoing immigration from the developing countries that was reaching the worldwide spread of liberalism. However, it is far from clear whether the globalization caused the spread of economic and political liberalism or whether it was merely correlated with it.

1 Sharun Mukand is Professor of Economics, Warwick University and Research Scholar, Institute for Advanced Study.

Several factors have been argued to be behind this correlation between the spread of globalization and global policy diffusion. Some commentators have pointed to the importance of the role of the United States as global hegemon. This argument had special bite in the aftermath of the collapse of the Soviet Union, when we had the high-water mark of American hegemonic power. However, the importance of 'carrots' and 'sticks' (be it preferential access to American markets, military support and coercion) is argued to have played a direct role in this process. Of course the hegemonic power of "Pax Americana" was also profoundly ideological and helped shaped the prism through which policymaking, institutional reform and globalization were viewed.

Similarly, others have argued that technological changes have made it very difficult to constrain cross border capital, trade and (most importantly) information flows. For example, the lower costs of trade and capital have made it more attractive to governments to attract foreign investment by enacting investor friendly policies. Therefore, it is possible that these technological changes underlie both the process of globalization as well as policy convergence seen across the world in the late twentieth century.

In this review we take a second look at some of the factors that underlie this policy and institutional convergence. In doing so we also re-examine some of the key elements behind the backlash against globalization – seen across the world. In doing so, we pay special attention to the arguments put forward by Dani Rodrik on the fundamental tension between globalization and the erosion of national autonomy.

Globalization and Policy Diffusion

We first illustrate in Figure 1 that the late 20th century saw the global diffusion of liberal political and economic policies. We further observe that this diffusion took place across all regions of the developing world – but was especially sharp in Latin America, the former Soviet Union and parts of Asia. Scholars of international political economy have argued that a number of possible mechanisms may be at work.[2]

The first important mechanism that caused this diffusion (and in many instances convergence) of liberal policies and institutions is the economic com-

2 See Dobbins, Simmons and Garrett (2006) for an excellent overview of many of the issues involved.

petition for resources such as investment, capital and foreign aid. At one level the economic competition for investment and capital can improve the economic climate in a country. This is especially the case in developing countries where governments find it politically difficult to undertake reform. The competition to attract (and retain) capital can undoubtedly provide governments with an incentive to reform their policies and institutions in an investor-friendly direction. This mechanism is particularly applicable to the diffusion of economic policies. For instance, foreign investment and capital are likely to go to countries where the investment climate is perceived to be more "investor-friendly". The set of such policies are likely to include lower taxes and possibly lower labor standards as well as investor safeguards such as easing of capital controls.

There are two reasons for policymakers to be cautious of any policy convergence that is driven by this mechanism. First, is the fact that this competition for investment has led many commentators to argue that the competition for capital may result in the easing of regulatory standards across the board and result in a "race to the bottom". The second factor is that a government's incentives to undertake policy response are in order to shift investor *perceptions*. While this desire to earn the confidence of the market may well result in efficient policy convergence, it also may not. As Mukand (2007) has pointed out, it may result in governments making inefficient policy choices.

A second mechanism may well be the coercive impact on small countries of the preferences and world-view articulated by influential countries such as the United States, China or the diktats of international institutions such as the IMF or the European Union. These dominant countries use their power and influence to impose their policy preferences on lesser (often developing) countries. Indeed, requirements of conditionality imposed by the World Bank and the IMF also have similar effects in terms of increasing economic convergence across countries. Of course, this coercion need not be due to the explicit brandishing of carrots and sticks by a country. Rather, it could be the unintended by-product impact of policy leadership by a country that forces another country to liberalize, even if it is not their intention to do so. For instance, Gruber (2000) argues that Mexico felt coerced into liberalizing much earlier than it would have, due to the trade agreement between the United States and Canada.

The third channel, through which policy diffusion takes place, occurs through the process of learning. Policymakers observe the success and failure of policy choices made by countries elsewhere. This learning can be restricted to the

policymaking elite or more broadly across society. In either case, governments learn from the accumulation of knowledge that takes place with the success and failure of policy experiments elsewhere. This learning results in an accumulation of knowledge that results in changed beliefs and gradual policy convergence.

Specificity and Policy Convergence

This diffusion and convergence of policies and institutions can be captured in a simple framework (Mukand and Rodrik, 2005).[3] The framework encapsulates all three motivations described above (competition, coercion and learning) in a simple framework. To see this we describe the basic elements below and relegate details to an appendix.

We consider a scenario where governments in all countries are divided into two cohorts—a “leader” and a “follower” cohort. The developed, successful countries that have high levels of national income constitute the “leader” cohort, while the lower income (mostly developing) countries comprise the “follower” cohort. Each country in the “follower” cohort can choose to “imitate” or mimic the policy chosen by a leader country, or it may prefer to “experiment” with its choice of policy. This decision is a function of several factors, which we describe below.

Each country differs from the other in terms of their geography, historical trajectory, culture and other local conditions, which make any given institution or policy more *or* less appropriate across countries. We capture these country specific local conditions by assuming that each country has a unique “state of the world” that is represented by a location on the real line that captures the underlying country-specific state of the world. This location is a proxy for all geographical, cultural and historical factors that makes a country distinct and unique. This allows a major simplification. In particular, we can reduce all differences in underlying characteristics across any two countries to a single dimension (i.e. location on the real line). So the distance between the location (i.e. state of the world) of any two countries helps us capture the notion of whether countries are proximate or distant from each other in terms of their historical trajectory, cultural and institutional structure.

The government in any given country gets to choose a policy that affects national income. The important feature of a policy that we emphasize is its “spec-

3 The model sketched out here draws heavily on Mukand and Rodrik (2005).

ificity" or state-contingent nature, with the impact of a policy on national output depending on the country's location. If a country chooses a policy that is not appropriate for its particular location, then output is lower than the maximum of what it could achieve if the institutional and policy location were appropriately mapped.

We are interested in capturing the process of policy diffusion and convergence across countries in the "leader" and "follower" cohort of countries. Accordingly, we allow all countries to choose between one of two alternatives – either "experimentation" of "imitation".

A country that chooses to try new policies that may (or may not) be adapted to its local conditions engages in "experimentation". Of course, as is the case with any process that involves trial and error, a policy of experimentation will be rife with uncertainty. If a country serendipitously discovers a policy/institution that is well adapted to its underlying state of the world (i.e. location), then output will be very high. However, there is uncertainty in any such process of discovery. This uncertainty is likely to lower the expected returns to any government from experimentation in the first place.

In contrast, a policy that involves "imitation" involves much lower uncertainty. Some of the countries in the "leader" cohort have successfully tried and tested policies and institutions that are adapted to their own respective locations.[4] A country in the follower cohort has the option to imitate these tried and tested policies for which at least some kind of road map and blueprint is available. Adopting such a policy has the advantage that uncertainty is lower. On the other hand, a follower country's blind imitation of institutions of the leader cohort comes at a cost. In particular, due to the "specificity" of policies, a policy that has been adapted to a leader country, may not be as well adapted to a follower country.

Given our assumptions so far, and assuming that the follower government maximizes (expected) national income, the choice of experimentation versus imitation is a simple function of two factors: the distance between the follower country and the successful leader and the uncertainty associated with policy experimentation. If the distance is large relative to the uncertainty, then the government will prefer to experiment.

4 There are two ways of modeling this: either we assume that the government is imperfectly informed or we can assume (as we do in this paper) that the government has imperfect control over the policy implementation process.

We now introduce an additional complication, which drives a wedge between the government's utility function and overall social welfare. We assume that the government's preferences are such that it incurs this private cost only when it chooses to experiment. For simplicity, we simply take as given the existence of this private cost. The existence of this fixed cost can arise for a variety of political economy reasons (see Mukand, 2007 and Mukand and Rodrik, 2005 for a discussion). For instance, governments may fear capital flight (and its economic and political consequences) if they are perceived by international financial markets to deviate from policy orthodoxy. In that sense, the competitive and coercive mechanisms driving policy diffusion are encapsulated in this variable.

So under what conditions will a policy diffuse from the leader to the follower cohort? The answer to this is best understood by considering the precise tradeoffs facing a follower country. The "distance" of a follower country from that of the leader determines the size of the direct economic gain from imitating the policy of the leader. In contrast, if it chooses to experiment and follow a policy in accordance with its own private signal, the payoff to the government is given by both the cost of an uncertain technology as well as the private fixed cost of experimenting. Therefore, the follower country will prefer to imitate the successful leader rather than experiment if the "distance" is relatively small and the private fixed cost from experimenting is relatively large. In Mukand and Rodrik (2005) we show that this implies that a follower country will choose to imitate if it is located in an interval, where the size of the interval is a function of the private fixed cost. In the absence of the private fixed cost, the interval of imitation would have been much smaller. Clearly, the larger the government's private fixed cost, the larger the zone of "inefficient imitation"—the zone within which a country ends up imitating even though it would have been better off experimenting.

Despite the very simple structure of our model, we are able to generate some fairly striking implications. The pattern of economic performance that results can be summarized with the help of Figure 3, which we will refer to again when we lay out the full model in the next section. In particular, our framework yields a U-shaped relationship between economic performance and "distance" from the leader. Specifically:

(1) In the immediate neighborhood of the successful leading country, countries prefer to imitate the leader's policies, and achieve high economic performance. There is a "growth pole" around the successful leader.

(2) Countries that are very far from the leader—located in the zone we call

the "far-periphery"—choose to experiment, rather than imitate. Their economic performance is on average worse than that of countries in the close neighborhood of the leader. But these also exhibit much greater variance in performance (due to the uncertainty in the policy implementation process). So some experimenters could achieve better performance than imitators in the neighborhood of the leader.

(3) Countries located in the intermediate zone between these groups—countries in the "near- periphery"—are strictly worse off than both of those groups (compared to a situation where there was no successful leader). These are countries whose governments choose to mimic, even though they are too distant from the leader to benefit.

(4) Extending the model dynamically (if informally), we can see that growth poles are likely to develop sometime down the line in the far periphery, but not in the center or the near-periphery. That is because experimentation takes place only in the far periphery.

While the above analysis is somewhat heuristic, it has the merit of delineating most of the key results of the full model in a transparent manner. The key to the U-shaped pattern is the inefficiency that arises from the government's private cost from choosing a different policy choice than one made by the leader.

Globalization and Policy Convergence

Globalization can affect the above process of policy diffusion and convergence through several channels. In this essay, we emphasize the three that are the most directly relevant for the issues that are of interest to us.

First, the process of globalization may also involve the diffusion of information, i.e. informational globalization. Voters (and not just policymakers) may learn about alternative policy choices (and their success or failure) that other countries have adopted. This diffusion of information about policy choices and economic outcomes increases the likelihood that a low-income status-quo is politically viable.

Second, the process of global economic integration itself may catalyze structural changes. For instance, it may increase structural homogenization as interdependent economies become(?) more similar. For instance, as countries get more globally integrated and economic interdependence increases, this may increase

the degree of homogenization of financial systems, accounting systems, labor and environmental standards. In as much as this process of structural homogenization takes place, it lowers the importance of country-specificity of a policy that is imported from a "leader" country. In other words, if country-specificity becomes less important, then policy diffusion becomes more likely and countries further away are more likely to adopt policies and institutions of the leader. Of course, this expanded zone of imitation need not eliminate the zone of inefficient imitation in the "near-periphery" – it may just shift it to countries further afield from the leader.

Similarly, globalization may increase the degree of within-country inequality. This may be due to some combination of greater trade (Autor et al) or the diffusion of (often labor-saving) technology. Together this increase in inequality can destabilize the domestic political equilibrium. However, how a country's domestic political economy is affected by inequality is best understood in the context of our discussion on the role of politics of ideas. Accordingly, we now turn to our discussion of the political economy of ideas.

Globalization, Inequality and the Political Economy of Ideas

We first summarize the argument from Mukand and Rodrik (2018). This paper takes a first step in providing a minimal conceptual framework to think about ideas as a distinct vehicle from interests. In our framework, political entrepreneurs use ideas to catalyze political (and policy) change. The framework highlights two different channels through which "ideational politics" can alter the political status-quo.

First, ideas shape the electorate's understanding of how the world works, which in turn alter its perceptions of the mapping from proposed policies to outcomes. We call political entrepreneurship geared at altering public perceptions about the underlying state of the world "worldview politics". Among many examples of worldview politics are the investments made by the Koch brothers in libertarian think tanks and research institutes and the role of the financial sector in convincing not just regulators, but also broader segments of the public that "what is good for Wall Street is good for America". This brand of ideas is perhaps closest to what Keynes and Hayek had in mind when talking about the importance of ideas in driving policy.

Second, by sending messages about who is a native or an outsider, disseminat-

ing stereotypes about racial and religious minorities, harping on patriotism and national identity, or framing policy issues in such terms, a political actor can make a particular identity more or less salient. In other words, not only is the salience of these identities changeable, but they can also be constructed by the deployment of ideas by political actors. This can help alter voter behavior and either catalyse or block policy and institutional change. This is our second type of ideational politics, which we call "identity politics".

Mukand and Rodrik (2018) incorporate both these forms of politics in a standard political economy framework. In the benchmark model, the prevailing interests of the median voter (who is low-income) drive policy choice. In this context, a high-income political challenger faces a difficult task: how to push through a new policy that has distributional effects that hurt the low-income majority? With the (lower income) majority on his side, the political incumbent cannot be easily dislodged and the new policy will *not* get adopted. Under these conditions, one of the few options that a political entrepreneur (or an allied "political-ideational complex" of think tanks, pundits and partisan media) has is to try and disseminate ideas that alter either the worldview or the identity of the voters (or both). Therefore with the aim of unseating the incumbent, a political entrepreneur allocates resources towards the search and discovery of memes that catalyze ideational politics.[5]

Now in the context of this framework, consider the impact of a rise in inequality (say due to globalization). A rise in inequality increases the reward to the rich from successful ideational politics. The returns from discovering a policy meme that persuades the median voter, for example, that lower taxes are in the interest of not only the rich, but also the low-income median voter are higher. Similarly, an effective identity meme that catalyzes identity around issues such as gay marriage, women's rights and immigration can also serve as a "wedge" that gives low-income voters a reason to vote for the political party that represents higher-income interests.

Therefore, Mukand and Rodrik suggest that the rise in inequality increases the likelihood of memes being generated that push governments to move away from the status-quo. In other words, the rise in inequality provided political en-

5 A meme can be considered to be some combination of cues, narratives, symbols that is deployed by the political entrepreneur such that exposure to it either shifts views about how the world works or makes an identity salient.

trepreneurs representing the rich (along with an allied political-ideational complex) greater incentives to disseminate memes that may increase the degree of policy convergence. To see this, consider the set of countries that are sufficiently far away from the "leader" cohort that it does not make sense for them to imitate the policy blueprint that has worked. The polity in these countries becomes vulnerable to the generation of inappropriate memes. These policy memes may arise directly because of higher inequality in these countries. Or these policy memes may migrate from a neighboring country. For example, an austerity meme that seems to have political legs in the U.K. may find it easy to infect the polity in neighboring Germany. This migration of memes may further reinforce the process of policy convergence – as entire regions adopt policies such as financial deregulation, low capital income taxes and embrace hyper-globalization. Taken together, this ideational politics is likely to reinforce the diffusion of policies from the center to the periphery.

Globalization and Liberal Democracy

We are now in a position to see how globalization can trigger political forces that exacerbate not just policy convergence, but also unleash forces that have the potential to undermine liberal democracy.

A liberal democracy guarantees political rights, property rights and civil rights. We take the main distinctive feature of a liberal democracy (as against electoral democracies) to be the restraints placed on those in power that prevent discrimination against minorities and ensure equal treatment. The restraints can be legal or administrative; they can be maintained by constitutional strictures or self-enforcing agreements. What matters is that whether in practice, these checks, which we label "civil rights" for short, are effective.

The key thing to observe is that all institutions (democratic or otherwise) are vulnerable to shifts in underlying structural changes. However, the sustainability of political and property rights is on firmer footing than that of civil rights. This is because the masses are willing to defend political rights and the elite have a vested interest in the perpetuation of property rights. However, in the case of civil rights, there is no such automatic constituency. Minorities neither have the money nor the numbers. Therefore, absent other considerations, civil rights are uniquely vulnerable to shocks from globalization.

We now elaborate on how globalization has the potential to unleash forces

that may result in an erosion of liberal democracy. To see this, consider a set of N countries. Suppose that globalization has adverse distributional effects on one country – say country 1. So this gives rise to two questions. First, how does the shock of globalization directly erode liberal democracy? Second, can this erosion of liberal democracy become contagious across countries?

Let us first examine how the erosion of liberal democracy may occur. First, as pointed out by Rodrik (2018) globalization is accompanied not just by distributional effects, but also by "economic anxiety, discontent, (and a) loss of legitimacy" that this entails. This potential discontent provides political entrepreneurs an opportunity to overturn the political status quo. Indeed under these conditions, political entrepreneurs are likely to discover memes (or import memes from culturally similar neighbors) that make identity salient (identity politics) or shift views about how the world works (worldview politics). Not surprisingly, when economic anxiety is high and unemployment is a real fear – individuals will be susceptible to memes that make identity salient in a way that distinguishes between natives and immigrants (or ethnic and racial groups). By its very nature, identity politics has the ability to increase the cleavage between the minority and majority group. An increase in this identity cleavage makes the group vulnerable to an absence to equal treatment by the state and a corresponding weakening of civil rights. Ipso facto, an erosion of liberal democracy follows.

However, this erosion of liberal democracy may diffuse across countries. This is due to several reasons. First, is the possibility that memes may migrate across a culturally similar neighboring country. So political narratives that capture the voter's imagination in the United Kingdom may find it relatively easy to migrate to a somewhat culturally similar country such as the United States. Second, the cost of being illiberal comes down as the size of illiberal club increases. Victor Orban of Hungary finds it much easier to engage in illiberal policies towards immigrants at home, when similar sentiments are being voiced in supposedly liberal countries such as the United States and Great Britain. Third, globalization may have catalyzed structural changes (i.e. higher inequality), that increase the possibility of illiberal politics – as outlined in a previous section. On the margin, all of these factors will reinforce each other and illiberalism may spread to countries that were not even directly affected by globalization.

Conclusion

In this paper we have examined the factors underlying the convergence of policies and institutions across the globe. We observed that the process of globalization constrained national governments from pursuing independent policies. However, we have shown that at least some of this disciplining is likely to be inefficient. We further showed how the rise in inequality is likely to have resulted in an exacerbation of this inefficient policy convergence. Finally, we illustrated the various mechanisms through which the process of globalization may have helped catalyze the erosion of liberal democratic norms.

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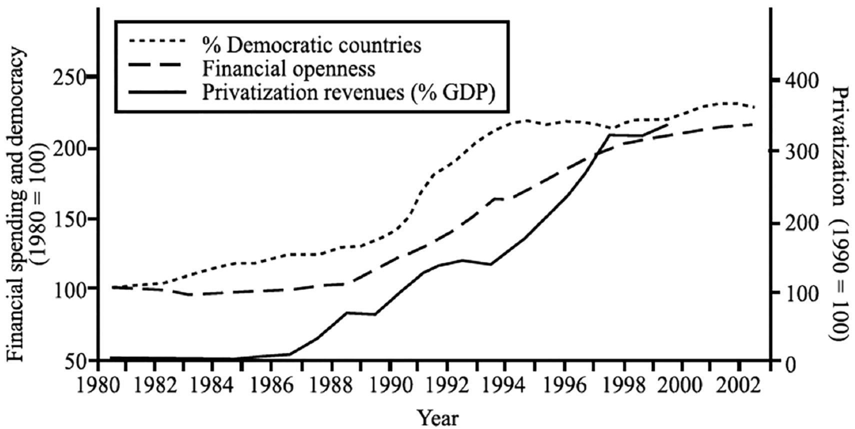

Figure 1: Political and Economic Liberalization across the World (from Figure 1 of Dobbins et al, 2006)

Global Pan-Ethnics and Other Exotic Imaginaries in Bali, Indonesia

Jennifer Esperanza[1]

On October 12, 2002, a bomb detonated inside the Sari Club, a popular bar in Kuta, a town in southern Bali (Indonesia). Over 200 people died, which included local Balinese and Indonesian nationals as well as Australians, Americans and a small number of other foreigners. The bombing was attributed to the extremist Islamic group, Jemaah Islamiyah, and the international media characterized it as a heinous act of domestic terrorism upon a peaceful island paradise. With the world's attention temporarily focused on Bali, the Asia edition of Time Magazine chose an image of a young, blonde, blue-eyed tourist for its cover shortly after the tragedy.

The woman's hands are clasped in solemn prayer with two other foreigners standing in close proximity during a Hindu ceremony to honor the victims. The photo is cropped to highlight the *menhdi* tattoos that adorn the woman's hands. Yet, *mehndi*—temporary henna dyes painted in elaborate designs on the hands and feet—are not part of Bali's cultural heritage. Mendhi are usually found among South Asian and Middle Eastern cultures and has only made its way to Indonesia in the last fifteen years -- as a cosmetic service offered for tourists. In short, what came to represent Bali during this tragic moment was a photo of a foreigner and of an aesthetic practice that have no correlations to Balinese people—who were the majority of the bombing victims—nor of their cultural heritage or traditions.

In this paper, I will discuss how the fetishization, and misuse of foreign cultural symbols are not new to Bali—a province populated largely by Hindus within in the world's largest Muslim country. As a site for cultural tourism, the photo example I illustrate here underscores the long-standing history of how Bali

1 Jennifer Esperanza is Associate Professor of Anthropology, Beloit College.

attracts global audiences by engaging in the economy of both real and invented traditions (Hobsbawm and Ranger 1983). A situation that can be simultaneously profitable, culturally detrimental, and also a savvy form of resistance politics, I will discuss how the island's handicrafts and tourism industries complicate our understandings of identity politics in increasingly globalized economies.

Mendhi are just one of many "pan-ethnic" aesthetics and practices that foreigners encounter in popular tourist destinations such as Bali. In this paper, *pan-ethnic* aesthetics and practices refer to the collection of symbols, objects and activities – often associated with indigenous cultures—that have been decontextualized, relocated and appropriated such that their origins are ambiguous, viewed as irrelevant. Pan-ethnic aesthetics are also the result of hybrid combinations of two or more aesthetics, that often blended together, often because their common origins from indigenous/culturally marginalized traditions assumes that the aesthetics can be blended (and assumed without problems). Other examples of pan-ethnic traditions include having one's hair twisted into dreadlocks on the beaches of Thailand, *reiki* retreats in Italy, Native American dream catchers in Cancun, Mexico or reggae music in Goa, India.

Such examples immediately elicit debates around cultural authenticity, exploitation, and appropriation—and rightly so. But to reduce discourse around notions of authenticity and cultural appropriation, however, avoids a more nuanced and productive discussion the around the role of cultural symbols and traditions serving as a form of political resistance. In this paper, I will examine the (mis)use of appropriated symbols and traditions as an assertion of global belonging, especially among ethnic minority groups who wield little, if any, political representation and rights to economic self-determination.

Bali has experienced a long-standing history with cultural appropriation and commodification. During the 1920s, the Dutch colonial government invested in a campaign called *Baliseering* (Balinization), in which schools were established to encourage the Balinese to learn and participate in the material and performing arts. The idea was to shift local Balinese's focus away from the anticolonial movements that were brewing in neighboring provinces such as Java. Separating politics from culture, these schools encouraged Balinese youths to perform their traditional dances away from sacred temples, how to make paintings using brushes on canvas, how to carve masks for foreign consumers and in essence, how to become artists—in the European tradition (Picard 1996: 20-23). Part pacification program, part feeder-school, *Baliseering* trained the first wave of dancers, painters and

carvers who would eventually establish the island's tourism industry. Dutch-authored narratives of the island where "everyone is an artist" emerged at the time of the *Baliseering* schools as well; further adding to the exoticization of Bali during the last decades of colonial rule, and enduring well into the present day.

The success of the *Baliseering* program paved the way for foreign travelers, and expatriate artists to travel to the island in pursuit of examining a culture in which everyone was perceived to be a natural born artist. Another large draw has also involved the myth that the Balinese are guided in their everyday lives by unique beliefs about their natural environment and their localized version of Hinduism—amidst being minorities within the dominant Muslim population. To this day, foreigners flock to Bali more so than in any province in the Indonesian archipelago—making the island the primary source for Indonesia's tourism industry.

Similar to the touristic fascination with Bali, much of the anthropological scholarship has also focused on images of the Balinese informed by ancient Hinduist worldviews and their natural environment (Covarrubias 1936; Eisman 2009; Geertz 1973; Lansing 1983; Picard 1998; Vickers 1986). Yet this scholarship often falls short of centering the notion that the Balinese have always adapted their political, cultural and economic destinies as a response to external (national and foreign stimuli). For example, the island's rulers maintained kinship ties with other rulers scattered throughout the archipelago; they sustained partnerships with Malay, Indic, Arab and Chinese traders long before the arrival of the Dutch, and furthermore, their cultural/religious practices are no strangers to religious change and adaptation. In other words, *Bali has always been global.*

While Bali's provincial economy has grown over the last forty years to reflect its wider (global) reach, the paradox is that the romanticized narrative of its cultural isolation and tradition is precisely what brings travelers here. A *New York Times* article profiled the so-called *dilemma* of modernization in Bali, with journalist John Bowe asking "*when you sell your culture for profit… can you remain true to yourself?*" (March 19, 2009). This supposed tenuousness of Bali's cultural integrity against a global capitalist backdrop looms large and is continually framed as problematic… but for whom? Bali, like many places in the global South, is no stranger to the effects of colonial occupation, nation-state building projects, and international development schemes (Lansing 1991). So why is Bali's paradisiacal image still framed under these perilous terms, especially as the tourist industry continues to adopt aesthetic markers (mendhi tattoos), and cultural practices (reiki retreats and Rastafarian music in local bars)?

In my previous research, I have argued that despite the ubiquitous evidence that Bali has indeed "gone global," foreigners actively resist portrayals of the Balinese as active, deliberate agents of their own political, cultural and economic destinies (Esperanza, 2011; 2014). Whatever public discourse endures about Bali, is that it has managed to endure *despite* globalization— still implying a sense of cultural endangerment, and still enforcing the stark dichotomy between traditional and modern.

The bulk of my ethnographic research took place in central Bali, where I studied one community's "primitive" or "tribal" cultures. Native American dream-catchers, Australian Aboriginal *dijereedoo*, and African-style masks are just a few of the items the local woodcarvers successfully mass produce for the world market.

Balinese have long been agents of economic, cultural and political change, and that the handicrafts industry is one window from which we can see this in practice. For example, Balinese have long been privy to Orientalist tropes of the ethnic Other, and while they have been subjected to its cultural and racist stereotypes, they have also played it to their own advantage. Aesthetic terms such as *antik*, *rustik*, *primtif* and *etnik* are used regularly among woodcarvers and vendors so that they are able to offer foreign buyers a way range of goods and to also assert their own savviness for the changing desires among overseas consumers.

Yet in an age of global commerce, expanded tourism and transnational media, a different kind of imaginative process has taken hold of the island, especially after the Asian financial crisis of 1997-1998. Beginning with export handicrafts market, Bali found new forms and practices of cultural reproduction. Hotel gift shops and beach stalls continued selling Bali-Hindu wood carvings, handmade batiks and basketry, but vendors soon found that tourists were also interested in purchasing items such as Native-American dream catchers, Australian Aboriginal *dijeridu* or African-style masks. Designs from these various cultures have made their way into local artifacts and products; Hindu offering baskets are now popularly adorned with Australian Aboriginal-style dot paintings.

By the early 2000s, cultural products were reconfigured to meet the needs of a global economy and consumers became increasingly interested in integrating "indigenous" experiences to their tourism, while authenticity took a back seat. The mélange of Balinese, Indonesian, African, Caribbean, South Asian and other cultural aesthetics in tourist sites such as Bali serves as a commentary on how various groups (Balinese, Indonesians, foreigners) attempt to resolve definitions of culture, especially as economies become increasingly

multinational and nations become more multicultural.

How does the generic aesthetic liberate Balinese from the Orientalist discourses of the past or does it simply reemphasize notions of cultural difference (Otherness) in new and more profitable ways? In *Expectations of Modernity*, anthropologist James Ferguson reworks the idea of "cosmopolitanism" to imply not so much about one feeling at home in the world than it is about seeking worldliness at home (1999: 212). In my ethnographic research, I found that the Balinese involved in reproducing cultural objects for clientele in North America, Europe, Australia and Asia signified a type of identity that challenges stereotypes that pervade the tourism industry. The ethnic handicrafts market offers Balinese the opportunity to renegotiate their identities to become cosmopolitan citizens of the world: in this business, there is less compunction to adhere to the tropes of ancient, ahistorical tradition and instead, there is more flexibility to envision oneself as modern, transnational entrepreneurs connected to social networks across the globe. For example, the handicrafts artisans and purveyors I spoke to take great pride in the fact that they must be well versed in the aesthetic traditions of other cultures, and keep abreast of art trends outside of their nation-state boundaries.

The artisans whom I interviewed seemed to assert that travel was not necessary in order to be an active player in the global economy. The constant and rapid flow of resources and information via cell phones, the Internet, and their daily business transactions with foreigners are enough to keep them part of this new system of global cultural production. The ability to reproduce ethnic Others, to profit from the mass production of cultural objects not their own and to maintain a clientele from North America, Europe, Australia and Asia are the new signifiers of power in Bali. These have become sources of pride and status, as a new middle class has emerged over the last two decades. No longer tied to the romanticizations of the Barong dance, *wayang kulit* puppet theatre or the *kecak* dance, the commercial handicrafts and souvenir industry serves as a platform from which to assert and affirm their cosmopolitan subjectivities. The men and women whom I interviewed regularly took part in innovative production methods and were quick to showcase the broad sets of knowledge required to successfully take part in the export handicrafts market. Not only do they use modern methods to produce their crafts, but they acquired new vocabularies in art and furniture design that are necessary for staying competitive in the global marketplace.

And yet, one cannot ignore the fact that—as liberating as this industry may be for Balinese who do not take part in the conventional tourism industry—their

engagement in this industry are fraught with the ethical dilemmas of violating others' cultural heritage and intellectual property rights. The global trade in commercially produced ethnic arts and handicrafts engenders a type of symbolic violence over ethnic minority groups who already wield little economic and political power within their own nation states. By reproducing their aesthetics without proper consent and by decontextualizing symbols from their appropriate religious and cultural origins, Balinese artisans have inadvertently subjected communities such as the Native American Haida, and Australian Aboriginal Pintupi to a type of violence that further prevents them from gaining economic profit, cultural representation or voicing their political opinions.

Furthermore, my interviews with Balinese artisans revealed that while the pan-ethnic arts market served as a form of resistance against being stereotyped as ahistorical and locked into traditional practices, they are still ultimately tied to an enterprise that largely reinforces the binaries of "Us" versus "Other" and "modern" versus "traditional." Taking cue from Pierre Bourdieu's work on class distinction in France (1984), I found that Balinese artisans, similar to their French working class counterparts, are still obliged to defer to the aesthetic standards that have long been determined by the dominant class (Bourdieu 1984: 41). There has certainly been room for Balinese handicrafts artisans and purveyors to play with aesthetics, but they are ultimately dependent upon consumer trends in North America and Europe to dictate which trends they must mass produce and export.

Similar to the mendhi-tatooed woman on the cover of Time Magazine, we must ask what sorts of aesthetics and practices are being used to represent a particular place and people. More importantly, however, we must first critique the very enterprises that assert the commodification of ethnic aesthetics in the first place. By being reflexive of our own practices and intentions behind consuming ethnic and pan-ethnic commodities, we can begin to challenge the ways in which the tourism and handicrafts industries continue to depoliticize and disempower socially marginalized peoples.

The Time Magazine cover photo immediately comes to mind: while mendhi is not traditional to Balinese culture, the Balinese have resourcefully adopted the latest offering for tourists, with its economic potential in mind. The real problem, however, perhaps can be found on the cover of the Time Magazine itself: as a terrorist bombing tore through the Sari Club, why weren't Balinese portrayed as the primary victims? Like the ethnic aesthetics, Balinese interests only go so far. The central audience, and the central subjects will always be white Western tourists.

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The Emperor's Law Stops at the Village Gate: The Evolution of Vietnam's Land Law Reform

Rachel Ellett[1] and Diep Phan[2, 3]

Quality institutions are a critical determinant of long-run economic growth (North 1991, Acemoglu and Robinson 2008, Rodrik 2003). In the post-Washington consensus era, without good governance, development is not possible (World Bank 2000). North (1991) defines institutions as "humanly devised constraints that structure political, economic or social interaction." In other words, institutions are a set of formal and informal rules, which shape the incentives and behaviors of economic agents. While good institutions conducive to long-run economic growth such as entrepreneurial activities, productive investments and innovation are desirable, institutions may instead promote corruption, piracy, rent seeking, and other deleterious behaviors that undermine potential economic growth.

Both policymakers and academics alike collapse institutional reform under the broad umbrella of good governance. But is 'good governance' as an overarching blueprint for economic reform helpful in terms of policy prescriptions? As Rodrik (2008) notes, there are plenty of countries - from Vietnam to Ethiopia to China - where there is overall poor governance and yet high rates of economic growth. For Rodrik (2008:20), "[a] broad governance agenda rarely deserves priority as part of a growth strategy—except for in those rare instances where weak governance is specifically identified as a generic area of binding constraints." One potential distinction Rodrik (2004) makes is to parse out 'stimulating' economic growth from 'sustaining' it.

1 Rachel Ellett is Associate Professor of Political Science, Beloit College.
2 Diep Phan is the Elbert H. Neese, Jr. Professor of Economics, Beloit College.
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Economic growth without robust institutional property rights protections is particularly challenging. Strong property rights are often interpreted as secure private property rights for a broad cross section of society (Acemoglu, Johnson, and Robinson 2001). For policymakers, this view has been distilled down to the formalization property rights (de Soto 2000). Yet Vietnam and China are two countries where we see, in Rodrik's words, unorthodox institutions working "[p]recisely because they produced orthodox results" (Rodrik 2007:24). China did not privatize individual property rights but rather vested formal ownership rights in local communities. This community based approach worked, because it created a more secure property rights regime than standard western prescriptions (Qian (2003), cited in Rodrik 2007). In short, liberal individualistic land rights regimes are not always the most effective institutional approach.

In transitioning economies such as Vietnam, land law is a critical area of institutional reform. It is estimated that seventy percent of complaints filed nationwide against the government and public officials are related to land (Hiebert 2012). The government has been reluctant to pursue full privatization and there are major conflicts over land appropriation, clearance and compensation. While some form of land privatization is necessary and inevitable, land disputes are highly charged and have the potential to weaken the legitimacy of the Vietnam Communist Party (VCP), which in turn hinders institutional development. It is therefore not surprising that like China, Vietnam has taken a piecemeal, heterodox approach to institutional reform and economic reform since the 1980s. And nowhere is it more apparent than the painfully slow and uneven approach to land reform. As Vietnam's economy has rapidly grown, the pace of farming land lost to industrial and urban development has accelerated. In its wake we observe a seemingly endless cycle of conflict between the government and the people. As *The Economist* reported in 2017:

> Transformation on this scale would provoke ire anywhere, but it is especially problematic in Vietnam, a one-party state where the government grants usage-rights but insists all land belongs to the state. Compensation for forcible acquisitions is far below market rates. Consultations can be superficial, and courts rarely entertain appeals. Evicted residents sometimes complain of collusion between local officials and developers. Spotty registries make it hard to adjudicate competing claims [. . .] *(The Economist,* June 15, 2017*)*

Vietnam is a particularly interesting case study because its land law reform

has taken place within the context of a capricious single-party police state interacting with resilient informal institutions. What does partial formal institutional reform of a narrow sector look like in the ongoing context of an authoritarian police state and strong informal institutions? For the Vietnamese government land reform represents an instrumental approach to good governance reform, rather than good governance as an end unto itself (Rodrik 2008).

This paper examines land conflict in Vietnam, mapping the evolution of market-oriented land law reform, a state that is categorized by poor governance[4] and weak rule of law.[5] The paper explores the reasons for slow, incremental, and partial land law reform, analyzes the complex interaction between formal and informal institutions, and asks whether engaging in partial 'good governance reform' within one sector is enough for sustainable economic growth? Using Vietnam as a case study, the paper offers empirical evidence to support Dani Rodrik's (2008) arguments that good institutions do not perfectly align with formally legislated rules, and that desired institutional outcomes do not map onto unique institutional designs. In short, broad calls for 'good governance' reform (Rodrik 2008) or for 'strengthening the rule of law' (Economist, March 13, 2008) is unhelpful and unrealistic.

Below we review the literature on institutions and property rights reform in section 2. We then provide in section 3 background information on the Vietnamese economy and political institutions, and an overview of the history of land reform and land conflict resolution in Vietnam, followed by a discussion of our data collection in section 4. Section 5 summarizes and analyzes key characteristics of the evolution of Vietnam's land laws, and section 6 outlines the central argument about the complex interaction of informal and formal institutions in Vietnam's land law reform and conflict resolution. Section 7 concludes with some lessons on development policy.

4 Although politically stable, Vietnam ranks poorly in terms of regulatory quality, corruption and extremely poorly in terms of political and civil liberties. See for example the World Bank Governance Indicators (World Bank).

5 According to the latest World Justice Project 2017-18 Rule of law Index Vietnam ranks poorly overall: 74th out of a 113 countries surveyed. And more specifically, Vietnam is particularly weak in the areas of 'Constraint on Government Power' and 'Civil Justice' (World Justice Project).

Land Reform and Good Governance: One Path or Many? Complete or partial?

While economists acknowledge the importance and difficulty of building good institutions, economics yields little insight into what preconditions are necessary, how institutions form, evolve, persist or change. Political scientists have delved deeper into these questions and understand that institutional reform is not merely a technical process, but rather an intensely political process with winners and losers. Yet while successful in identifying the problems or pathologies of weak states and poor performing institutions, they are less successful in identifying the formula for building strong, adaptable and coherent institutions. Moreover, while acknowledging the importance of informal institutions - from moral economies (Scott 1977) to the iron triangle of business and politics in Japan - the specificities of each unique setting has generated weak theorizing and few policy prescriptions.

Formalized private property rights took center stage as part of the free market centric checklist of governance reform in the 1990s. Some notable examples from the 1990s, a period of hyper-globalization and market liberalization, include: the wave of privatization of state-owned assets in former communist countries in Eastern Europe; various massive land-titling programs across Latin America (see Field 2007 and 2005 on titling program in Peru); and the de-collectivization of agriculture and land-titling programs in formerly centralized command economies such as China and Vietnam.

Yet we see many examples of countries today who have not followed these institutional prescriptions; countries who have experienced rapid economic growth with only partial land privatization, thus questioning the one size fits all narrative and the naive view that rule formalism and privatization constitute the ideal approach to institutional development. Rodrik (2006) stresses the importance of developing institutions that fit local conditions--a kind of bottom up approach - and has highlighted the importance of local ownership over policy change and institutional reform. In particular, Rodrik (2004) challenges the approach of "identifying institutions solely with the formal legislated rules in existence" and argues that desired institutional outcomes do not neatly map onto unique institutional designs. For example, a system of private property rights enforced by an independent judiciary does not necessarily give investors the confidence to invest. To illustrate this point, Rodrik uses the example of Russia vs. China during their market transition in the 1990s. Despite the fact that Russia had a system of com-

plete private property rights enforced by an independent judiciary, while China did not, yet investors consistently gave China higher marks on rule of law, because they "felt" safer when making investments in China. Rodrik, et al. (2002:24) find that "credibly signaling that property rights will be protected is apparently more important than enacting them into law as a formal private property rights regime." Or as Sturgeon and Sikor (2004) and Sikor (2004) argue in the case of China and Vietnam, formal property rights might complicate or worsen land disputes as they violate local practices and norms regarding just access to land.

Although Rodrik argues that small changes can spark growth, over the long term stronger governance reform is needed - countries need to acquire "high quality institutions (Rodrik 2007:51). But for Rodrik institutional reform can be uniquely situated. Merilee Grindle (2004, 2007) has argued elsewhere that reform can be partial or piecemeal, rather than total reform. Grindle terms this "good enough governance" which she defines as the "minimal conditions of governance necessary to allow political and economic development to occur" (Grindle 2007:554).

We define informal institutions as socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels (Helmke and Levitsky 2004: 747). By contrast, formal institutions are rules and procedures that are created, communicated, and enforced through channels widely accepted as official. This includes state institutions (courts, legislatures, bureaucracies) and state-enforced rules (constitutions, laws, regulations), but also what Robert C. Ellickson calls "organization rules," or the official rules that govern organizations. Rodrik's (2006) bottom up approach may or may not imply a kind of 'cultural fit'. But either way, the major conclusion is that people have to believe in the rule of law - both the people and the elites. Brooks (2003: 2285, cited in Hadfield & Weingast 2014) argues, "[T]he rule of law is not something that exists 'beyond culture' and that can be somehow added to an existing culture by the simple expedient of creating formal structure and rewriting constitutions and statutes."

Below we review the history of the development of Vietnamese land law and analyze the political decision-making and interaction between formal and informal institutions along the way.

Background: Vietnam's economy, political institutions, and the role of land

Until 1986, the Vietnamese economy was centrally planned, its agriculture collectivized, and its state firms and industries subsidized. This system produced disastrous results. Economic growth was slow and could not keep up with population growth, leading to a decline in per capita income. The country was heavily dependent on the former Soviet Union for external aid. Agricultural growth barely kept up with population growth, causing food shortage and famine. By 1986, the country was in a severe economic crisis characterized by a deep trade deficit, a large budget deficit, and hyperinflation.

The economic crisis created pressure for reform, especially after Vietnam's leaders observed successful reform policies in China after 1978. The reform package, known as *doi moi* or renovation, was launched in 1986. The package included three main components: (i) Macroeconomic adjustment and stabilization, which included monetary and fiscal tightening measures, tax reforms, elimination of production and consumption subsidies; (ii) Transition from a centrally-planned to a market-oriented economy, including legalization of the private sector and removal of most price controls, and (iii) Transition from a closed to an open economy by opening the economy to foreign trade and foreign direct investment.

The results of *doi moi* were miraculous. The economy stabilized, and inflation was tamed by 1992. GDP growth picked up, averaging 6-7% per year ever since, with some slowdown during the Asian Financial Crisis in the late 1990s. In addition, growth during this period was especially pro-poor. Overall poverty decreased dramatically, for example, a 49% poverty headcount in 1993, dropped to 3% in 2014 (author's calculations using data from Vietnam Households Living Standard Survey 1993, 2004 and 2014). Other human welfare indicators such as school enrollment, child mortality, access to clean water also showed significant improvement. All while overall income inequality, as measured by the Gini coefficient, showed little or no increase. Despite impressive progress, the state sector continued to be large and inefficient, and institutional reform, especially land law reform has been partial and controversial. Before turning to the land law reform, it is important to understand the political context in Vietnam.

There are two approaches to analyzing Vietnamese politics. One is to highlight the pragmatism and success of the VCP – both in terms of regime longevity and sustaining economic growth. For Gainsborough (2010:4) "[P]olitics is much

less about disputes over rival policy positions — elites in Vietnam hang loose to policy — than about money, patronage and loose political groupings linked to personalities." To be sure, there is a certain level of disorder as high level corruption scandals rock the party and dissenters and human rights activists are faced with an increasingly restrictive environment. Yet the VCP maintains a vice-like grip on power and this is in large part due to their historical roots in Vietnam's agrarian society and their ability to mobilize the social base. Furthermore, Kuhonta (2011:218) articulates the importance of maintaining a 'rootedness' in socialist ideology: "The VCP's coherence and rootedness in socialist ideology has kept the party on track with its policy agenda [. . .] Compared with other similar communist regimes the VCP has been willing and able to shift policy direction when it realized that its policy choice had not worked or when it had incited considerable opposition. This flexibility has enabled it to weather crises and maintain legitimacy among its social base." The needs for flexibility in the dominant VCP police state explains the need to maintain space and leverage for informal institutions. Chand, Duncan and Quang (2001) claim that Vietnam has well-established institutions, but many of these are not yet formalized which would make transactions impersonal and lower transaction costs.

To understand Vietnam's land law reform, it is important to recognize that land has always been center stage in Vietnam's modern history, and that land is at the root of the VCP's power and legitimacy. During the war for independence from France (1945-1954), the anti-colonial resistance movement, the Viet Minh, gained peasants' support by promising land redistribution. Transference of land controlled by the French or large Vietnamese landlords to poor peasants started during the war; and after the victory against the French in 1954, Vietnam was divided into North Vietnam and South Vietnam. In the North, family farming did not last long and by 1957 agriculture was fully collectivized.

In South Vietnam, consecutive US-supported governments pursued land policies that aligned with the interests of large landowners, and as a result lost the support of the rural population. The resistance movement, known as Viet Cong, continued to use its strategy of land redistribution to gather farmers' support and loyalty. In 1975, after unification, large tracts of land were redistributed in the South, helping to reduce landlessness. Efforts to collectivize agriculture in the South soon followed, but were largely unsuccessful because of resistance from farmers.

By the early 1980s, collectivization had lost popularity throughout unified Vietnam. Farmers had utilized informal arrangements to assign plots of land to

each other and the Vietnamese government became increasingly aware of these grassroots movements to revert back to family farming, but turned a blind eye. The momentum was set for de-collectivization, which informally started in the early 1980s in various parts of the country, and was officially recognized and legalized by the Vietnamese government with the 1987 Land Law. Between 1991 and 2017 the percentage of Vietnamese working in agriculture almost halved, from 75% to 41% (International Labour Organization). The story of Vietnam's incremental land reform since 1987 has to be told within the context of this major economic transformation.

Data Collection

Interview data was collected during two weeks of field work in Hanoi, Vietnam in May 2013, when ten informants were interviewed. Two follow-up interviews were done in July 2018. Informants included government officials, lawyers, farmers, NGO experts, researchers and academics. All interview data is anonymous to protect the identities of informants. Interviewees are coded and are identified by a letter designation. The interviews were conducted in both English and in Vietnamese and were digitally recorded. Select interviews were transcribed into both Vietnamese and English by a student researcher. The interviews were semi-structured and ranged in length from one hour to more than two hours.

General information on land issues and land conflicts were gathered from various newspaper sources in both Vietnamese and English. Data on land conflicts was collected from government ministry sites and from PAPI or The Viet Nam Provincial Governance and Public Administration Performance Index (CEm CODES, VFF-CRT, RTA & UNDP 2018).

In addition, in examining the evolution of the land law, we closely analyzed the 1993, 2003 and 2013 land laws and generated comparative data on mentions of individual vs. state land rights and data on concentration of state power between the 2003 and 2013 land laws.

Creating formal institutions: the evolution of Vietnam's land law

In the case of Vietnam, challenges around land reform have spread across all aspects of rule of law.[6] The evolution of Vietnam's land law exhibits two main characteristics: (i) it evolves very slowly and incrementally with no clear "end point" and, (ii) it waxes and wanes in terms of market orientation, i.e., it does not always move in the direction of increasing security of property rights.

The 1987 Land Law dismantled farm cooperatives and started the household responsibility system. The law (and the constitution) only partially privatized land; that is, land belongs to the people, the government represents the people to manage the land in trust, and households have the right to use the land.[7] This reform was a win-win situation because it solved the problem of inefficiency under collective ownership, while still maintaining communist ideology. But a land market was missing.

In theory, a land market should increase efficiency as it reduces land fragmentation caused by the de-collectivization process in the late 1980s.[8] One primary goal of the 1993 Land Law was to create a market for land-use rights and to bring Vietnam's land tenure system closer to a system of private property rights, through the issuance of land use rights certificates (LURC), otherwise known as "Red Books". LURCs represent a form of title that farmers could transfer, exchange, lease, mortgage, or give as inheritance. LURCs were initially granted for a period of 20 years in the case of annual crops and for 50 years for perennial crops.

Toward the end of the 1990s, rapid industrialization generated a strong need to convert rural, agricultural land to industrial, urban land. The 2003 Land Law was enacted to address issues arising from that conversion, and it exhibited both progress and regression. On one hand, it created a legal framework for developers to negotiate compensation directly with farmers, so that the compensation price would

6 Here it is helpful to delineate three components of rule of law: the first is the law itself, second, a judiciary that is efficient and knowledgeable and independent and thirdly, a body of law enforcement units able to enforce the law (see Kleinfeld 2006).

7 Across both the policy and academic literature there is inconsistent use of the term "state ownership of land" versus "state management." Under Art. 4 of the 2013 land law: "Land belongs to the entire people with the State acting as the owner's representative and uniformly managing land. The State shall hand over land use rights to land users in accordance with this Law."(LAW NO. 45/2013/QH13)

8 During decollectivization in the late 1980s, each farming household was given several small plots of land in various locations. Consolidation of these plots into larger plots is economically desirable. And as the economy industrializes, some farmers would stop farming and migrate to the cities, so it would be efficient to have a market in which they could sell their land use rights.

be as close to market price as possible. On the other hand, it increased the power of local authorities by allowing the state to represent developers to withdraw land for the purpose of "socio-economic development." This socio-economic development clause actually violated the 1992 constitution, which allowed the withdrawal of land only for the purpose of national security and public goods. In this aspect, the 2003 Land Law was a step backward as it undermined property rights over land. Furthermore, the compensation guidelines provided by the central government always resulted in below market prices. The 2003 law also allowed for joint registration of land, yet while there was a short term increase in titling, over time actually the opposite has occurred. According to Newman, et al. (2015) the proportion of LURC's declined from 90% in 2006 to only 67% in 2010. Land disputes continued to intensify after the 2003 Land Law. Rural landlessness increased, particularly for those at the bottom of the economic ladder (Ravallion and van de Walle 2008). Furthermore, Ravallion and van de Walle (2008) have confirmed that most Vietnamese households become landless as part of a government strategy aimed at exploiting new economic opportunities beyond the agricultural sector.

In preparing for the 2013 Land Law the Vietnamese government consulted the people and solicited input from the World Bank and international NGOs such as Oxfam. The public also offered feedback on the drafting of the new law and 7 million public comments were reported on a website ("Gần 7 triệu ý kiến"). Despite the high anticipation, the changes in land law turned out to be limited and again exhibited both progress and regression. Evidence of progress could be found in further embrace of market mechanisms by limiting the use of state-determined land price tables for tax purposes only, so that land compensation price could be closer to market price. The governance over land compensation was theoretically improved to allow for more independence and transparency. The law also relaxed several controls, for example allowing private developers to transfer project land to other investors, and putting foreign investors on the same playing field as domestic investors. In addition, the law attempted to reduce cases of land seizure, by making payment due before the land is cleared.

According to one land expert, the major difference between the 2003 and 2013 land laws is that the "2003 law's approach is to bring land into the market while the 2013 law's approach is to make assurances of state power [...] That's why the 2013 law really focuses on what the state is doing instead of focusing on

how to manage land in a market economy."[9] The evidence to support this claim can be found in the articles in the 2013 law regulating state power. The new law strengthened state rights over land and tightened state control in several areas. Table 1 outlines the changes in state's rights versus individual rights in the 1993, 2003 and 2013 laws.

TABLE 1: Total number of clauses in land laws on state vs. individual rights[10]

LAND LAW YEAR	State's Rights	Individual Rights	Ratio
1993	19	9	2:1
2003	51	31	1.6:1
2013	58	45	1.3:1

Source: Author data collected from 1993, 2003 and 2013 Vietnam Land Laws[11]

Although we see an increase in the number of mentions of state's rights, we also see an increase in the number of mentions of individual rights. The gap appears to be decreasing. But if we adjust our frame of analysis to the content of the laws, we can see more clearly why there are perceptions of enhanced state rights. For example, the 2013 Land Law is less clear compared to the 2003 Land Law regarding what constitutes "national interests" for the purpose of land seizure. Another example is that under the 2013 Land Law all investors, domestic and foreign, face harsher requirements and more state control when leasing and obtaining land allocation by the state.[12] However, it's noteworthy that some of the re-centralization of decision-making over land is to constrain corruption by local officials, and it's unclear whether such reform increases or decreases security of land rights.

Because the 2013 Land Law exhibited both progress and regression, it's not

9 Author interview with an informant, Hanoi, Vietnam, July 2018
10 We counted all instances of "state power" or "state rights" "rights of the ministry" "state responsibilities" and "state's jurisdiction", including provincial and lower levels of government. Under household-individual rights: we include domestic organizations, domestic households, individuals, community, religious establishments, overseas Vietnamese, foreign-invested enterprises, foreign organization with diplomat function
11 http://vietnamlawenglish.blogspot.com/2013/11/vietnam-land-law-2013-law-no-452013qh13.html
12 For instance, the 2013 Land Law limited the term for land-use right for rental or investment purposes. More specifically, if one builds houses on a plot of residential land for the rental market, then his/her land use right is only 50 years, as opposed to an indefinite term if the house is for his own residential purpose.

surprising that its impact has been mixed. According to data from the Ministry of Natural Resources and the Environment, before 2013 the ministry received 6,000-10,000 letters of complaint each year ("Năm 2017 Có Trên" and "Hà Nội, TPHCM,Đà Nẵng Dẫn Đầu"). After 2013, the number of complaint letters received gradually declined to less than 5,000 per year. This positive development is confirmed by data from PAPI, or the Viet Nam Provincial Governance and Public Administration Performance Index (CECODES, VFF-CRT, RTA & UNDP 2018). The PAPI 2017 data shows an overall decline in the percentage of citizens reporting land seizures. Yet, there was also declining satisfaction with the level of compensation for land seized after 2013. As the *NY Time*s recently reported, citizens are dissatisfied when they feel that eminent domain laws are being activated for private business interests rather than the public good (*NY Times* April 21, 2017). Finally, it should be noted that land markets remain thin. As Markusson, et al (2014:293) found in their farmer surveys: "[m]ore than 70% of the plots in our sample, farmers declared themselves unable to estimate the sales value of the land and less than 15% of the plots have been acquired through purchase."

Why were changes in Vietnam's land laws so slow, incremental, and non-linear? There are several reasons. First, the government must constantly revise the land law to respond to changing economic conditions, albeit in a reactive manner. For example, withdrawing agricultural land for industrial development only started in the late 1990s and became a serious issue and source of conflict in the early 2000s, hence the development of the 2003 Land Law. In recent years, land conflict became less about land conversion, and more about the management of high-rise buildings in urban areas, and Vietnamese lawmakers are again having to revise the land law to take into account new issues.

In addition to the changing dynamics of the economy, political change and dysfunction can necessitate changes in the law. As Murkasson, et al (2014) note, issuance of LURCs proceeded efficiently in the 1990s, but later became polluted by local government corruption. We therefore see in response an effort to reassert more centralized, top-down political control. In a personalistic, patronage based political system, high levels of political discretion, without transparency, will naturally lead to higher corruption. This increases farmers' dissatisfaction and, in turn, impacts the legitimacy of the VCP. That the economy is changing fast and new issues are always arising explains why lawmaking in Vietnam in general (not just land law) is an ongoing, evolving process. According to an informant who was involved in the land law revision process in 2013: "The moment a new law

is passed, people start thinking about amending it already […] from 1993 until now, they have amended the land law quite frequently […] every single 2 or 3 years."[13] This challenges the conventional thinking that established institutions are pre-conditions for economic growth.

A second reason for the slow and incremental change is due to ongoing disagreement and in-fighting among government ministries, and between the National Assembly and the Communist Party, which slows down the drafting of a law. For example, according to a land expert,[14] in the process leading to the 2013 Land Law: "The ministries themselves fight against each other. […] it's very difficult to unify all the interests of the ministries to make a single legal code on the land. The reason why they wait until now, the final year to amend this law because before any single law to be discussed by government or by the National Assembly, The Party, the Central Committee have to consider and approve it first […] the National Assembly MPs keep asking for private ownership. So it's a big question whether the National Assembly can surpass the party or not."

A third reason is that in Vietnam, there is rule by group consensus, which tends to slow down reform. During our fieldwork, we learned that more comprehensive privatization, i.e., a model of multi-ownership including private ownership of land, was always a topic of discussion during the drafting of all of the land laws. Over time, the proposal for private ownership gained more and more support, but it was never enough to make it a reality. According to one informant[15], a private ownership proposal had about 40% support among top leadership when the 2003 Land Law was debated and drafted, and by the time the 2013 Land Law was debated and drafted, it gathered well over 50% support. During our second round of interviews in 2018, we learned that the majority of policy makers and communist party members "privately" advocated for private ownership, yet publicly no one spoke of it.

On one hand, most Vietnamese policymakers seem to understand that at a foundational level, land conflicts originate from unclear property rights, or the unclear relationship between land owner and land right holder. As the number of land disputes skyrockets and floods the court system, and as land protests become more common and intense, many members of the National Assembly advocate

13 Interview with Informant, Hanoi, Vietnam, May 2013
14 Interview with informant, Hanoi, Vietnam, May 2013
15 Author interview with an informant, Hanoi, Vietnam, May 2013

private ownership, albeit privately. In talking about how the Vietnamese Prime Ministers had to personally deal with some of the most famous and controversial land cases, one of our informants joked that "if the Prime Minister is needed to resolve each land conflict, then Vietnam needs several thousand Prime Ministers."[16]

On the other hand, "if we return to private ownership, we will betray our revolution 60 years ago,"[17] referring to how the VCP gained legitimacy 60 years ago by promising and ensuring that each farmer would have his own land. Legitimacy and trust continue to be an issue: "poor people now sell their land to very rich people. Some rich people have thousands of hectares … poor farmers have no land. They only work for the landlord and have very low wages." In the developing world, states are always seen as beneficial to rural citizens (see Scott 1979). In the context of Vietnam there is an ongoing tension between the high levels of corruption encountered during the process of registering land or disputing land seizures, but still an enduring faith that the VCP is rooted in a sense of equality and fairness based on the history of land and politics in Vietnam.

The interaction between formal and informal institutions in Vietnam's land law

In the context of land rights, formal institutions refer to land laws that are drafted by the ministries in the capital city Hanoi, passed by the National Assembly, then implemented and enforced by bureaucracies and courts, often at the local level. Informal institutions refer to local norms and practices regarding land ownership, transactions and conflict resolution, and also local and central governments' practice of interpreting and implementing the laws to serve certain political imperatives. Although the formal and informal land use rights of smallholder farmers have expanded over time, limitations and restrictions on conversion of land use combined with perceived unfair land seizures create a perception of high levels of land insecurity in Vietnam. In Vietnam, formal and informal institutions delineating property rights coexist but not in separate spaces. Rather, they coexist and are intertwined in the same space, sometimes aiding each other, other times undermining each other, with mixed effects on land security and economic efficiency.

In understanding informal institutions, theorists tend to examine the diver-

16 Author interview with an informant, Hanoi, Vietnam. May 2013
17 Author interview with an informant, Hanoi, Vietnam. May 2013

gence between law formation and law implementation, a phenomenon often observed in countries with underdeveloped institutions and weak governance such as Vietnam. This gap is said to be a function of corruption and weak state capacity in law enforcement. A 2011 World Bank report presents strong evidence that land administration is one of the most persistent and prevalent sources of corruption in Vietnam (Alcaide Garrido et al 2011). The report cites numerous obstacles towards securing land use certificates, and notes that the law allows for significant discretionary decision making at various stages in the process. At the outset the procedures are complex and this may lead farmers to seek the support of 'middle men' to aid with the process. Once the process is started then it is common for officials to ask for supplementary documents or to solicit bribes and extra payments. The report further notes that the process is slow and this increases the chances of individuals trying to speed up the process through bribes. In cases of compulsory land acquisition there is high risk for corruption in delaying compensation, avoiding compensation or paying below market value for the land. Full discretion plus a monopoly on decision making generates a high probability of corruption. However, the divergence between law formation and law implementation in Vietnam is caused not only by weak state capacity, but also by the necessity of making the law flexible and context-specific in order to accommodate local social norms and practices as well as to serve political imperatives. There is a blurry line and a close and complex interaction between formal and informal institutions. How can we further understand the causes and implications of this dynamic?

A close examination of the 2013 Land Law reveals that informal institutions have been brought into the formal law. In particular, there is an elaborate process in the 2013 Land Law detailing how land conflict should be resolved through conciliation: "The State shall encourage the disputing parties to conciliate themselves or have their land disputes settled through grassroots conciliation" (Article 202.1. 2013 Land Law). However, the law further states that if "self-reconciliation" fails, then parties can petition for the Fatherland Front Committee to help the process of conciliation. At this point, we can no longer refer to this as an informal institution, because the conciliation must be in the form of a written record and registered with MoNRE (Article .202.5 2013 Land Law). If this process fails then the complainant goes on to the People's Court. The law then explicitly states that the people have the right to "lodge complaints"(Article 204.1 Land Law) and to "denounce violations of the law on land management and use" (Article 205.1 Land Law). It is clear here that the

VCP is attempting to push disgruntled citizens back towards the party, albeit through less formal mechanisms, and away from the media - particularly the foreign media and foreign NGOs. It is unlikely that this is a genuine attempt to harmonize local informal practices with formal institutions.

The complex, hierarchical reach of the VCP suggests the Vietnamese state is strong. Yet, party-state reach does not necessarily equate to strength in terms of governance (Koh 2001). While the state is present in the daily lives of all Vietnamese, local officials are stymied by low-wages (encouraging corruption) and their kinship ties in the local community. Thus, when the 2013 Land Law explicitly directs individuals to resolve land disputes through conciliation before approaching the courts, they are entering into a messy tangle of informal and formal institutions--an arena where due process, individual rights and transparency are subsumed or violated altogether. According to Besley and Ghatak (2010:4559) there are three types of states: predatory state, anarchic state, ineffective states. Vietnam has concomitant strains of the predatory state and the ineffective state. Weak rule of law in Vietnam does not effectively check the predatory strains of the state and neither does it offer full institutional support to buttress a vibrant land market. Authoritarian regimes are nervous about strengthening rule of law, because rule of law "not only serves as a credible commitment to asset holders [. . .] but also provides ways for discontented citizens to challenge the state" (Wang 2015:154). Therefore, it makes sense that authoritarian states will engage in partial reform, or to borrow from Merilee Grindle, 'good enough governance'.

According to MacLean (2013) historically, policies formulated in Hanoi often had relatively little to do with how low-level officials and villagers implemented them. There is a saying in Vietnamese "*phep vua thua le lang*" meaning the emperor's law stops at the village gate. Kerkvliet (2014) provides evidence that Vietnamese villagers frequently challenge existing laws pertinent to their grievances and assert rights that go beyond officially recognized. Gillespie (2014) asserts that land law is only one of the many mechanisms for resolving land disputes. Gillespie (2011) explains how judges in Vietnam struggle to use the law to resolve land disputes, and they have to use "reason and sentiment in applying the law." In short, party and political imperatives and community sentiment and morality can and do displace legal thinking.

Below we provide an interesting land conflict case study to show that formal and informal institutions in Vietnam co-exist and are strongly intertwined in the same space, and that people (both local/central government officials and citizens)

frequently want to bend the law based on their own sense of morality and justice or on political objectives.

Doan Van Vuon Case Study

In 1993, Tien Lang District allocated to Mr. Doan 21 hectares of fallow land around the tidal flats on a 14-year lease. He and his family improved the land and used it for a successful aquaculture business. In 1997, Mr. Doan applied for additional land allocation and was given 19.3 hectares, also on a 14-year lease (but counting from 1993 when all the land distribution was supposed to have happened). Several provisions of the land law were violated regarding this allocation. First, Mr. Doan was not a resident of Tien Lang district, and therefore was not supposed to be given land from the district. Second, the land law required a cap of 20 hectares per family, so Mr. Doan's total allocation of 40.3 hectares was too high. Third, the law mandated that the lease be 20 years, counting from 1993, yet Mr. Doan got only 14-year leases. It was unclear how and why Mr. Doan was allocated so much land in a district that he was not a resident of. It was possible that corruption was the underlying reason. But it was also possible that the officials of Tien Lang district did not see much value in the fallow land that they gave to Mr. Doan, so they did not mind bending the law to favor him. In fact, the bending of the law in this instance enhanced efficiency, because Mr. Doan turned out to be very entrepreneurial and enterprising, and he made good use of the land. His carp farm was so prosperous he was seen as an economic hero in the region and a shining example of the triumph of *doi moi*. Others followed his lead and soon many families in Tien Lang district were developing fish farms over an area of several hundred hectares.

In 2009, Tien Lang district arbitrarily wanted to recover all of Mr Doan's 40.3 hectares, taking advantage of the fact that the land allocation to Mr. Doan was a violation of the land law, and that the 14-year leases were over. But clearly, the land that they wanted to recover in 2009 was no longer the unprofitable fallow land that they gave him in the 1990s, so they were essentially trying to rob Mr. Doan and his family of the fruits of all their hard work and investment in the land. "They saw a very good profit from this farm and they wanted to take it. They said they seized the land in planning for a new airport but that was not the case. Actually, the district chairman has a younger brother who is the Tien Lang commune chairman. So he wanted to take back Mr. Vuon's land to give it to his

younger brother. That's the real reason behind all of these."[18]

Mr. Vuon tried to appeal many times and at many court levels, but his appeals were either denied, or the court would recommend a mediation process with no resolution. Still, he and his family refused to vacate the land. In the morning of Jan. 5, 2012, Tien Lang district mobilized a force of more than 100 policemen and soldiers to revoke Mr. Doan's land. Using improvised weapons, including muskets bought on the black market, he and his family members fought against the squad of armed policemen and soldiers. When the shooting was over, two soldiers and four policemen were injured. Mr. Doan was taken into custody. His farm was ransacked: three houses bulldozed and his impressive carp stock looted. Afterwards, Mr. Vuon and his brother Mr. Quy were charged with attempted murder and eventually sentenced to five years in prison. Mr. Doan's wife and another female relative were convicted of obstruction charges but were paroled. Local officials involved in the case were convicted of multiple charges, including "irresponsibility" and "destroying citizens' property." They were also paroled.

Mr. Doan's case is a clear example of the divergence between law formation and law implementation, of the intertwining of formal and informal institutions, and also of how party and political imperatives and community sentiment and morality trump legal thinking. From the perspective of promoting economic efficiency and growth, it was probably good that in the 1990s Tien Lang district's officials violated the law to give the fallow land to Mr. Doan, which he put to good use. But because Mr. Doan lacked secured property rights, all the investments he made in the land were subject to expropriation, which eventually did happen. Furthermore, how Hanoi handled the case demonstrated the central government's practice of bending the law to align with political imperatives. The government and the party cannot tolerate dissent, and certainly not its citizens using homemade weapons to fight against the police and the military. So the court gave Mr. Doan and his male relative an unfair charge--attempted murder--even though they were really just trying to defend their property. At the same time, despite the serious charge and the guilty verdict, the judge gave them a very light sentence--five years in prison. After Mr. Doan and his brother had served two thirds of that sentence, they were released on parole. He returned to his farm, started to raise ducks and again has become successful.

18 Author interview with an informant, Hanoi, Vietnam, May 2013

Analyzing the role of informal institutions: advantages and disadvantages

There are advantages and disadvantages to Vietnam's reliance on informal institutions for recognizing land rights and resolving land disputes. The main advantage is that informal institutions are based on community norms and self-regulatory practices, so they can help resolve land conflicts when the formal law is under-developed and lacks clarity and transparency. Informal protections can temporarily provide enough security for villagers to invest in their farms. Even when the formal law is well-developed, informal institutions still have the advantage of being flexible and situational, since they allow for social and cultural variation across space. Through an analysis of four case studies, Gillespie (2011:241) demonstrates that informal institutions, not the court system better resolve land disputes. He also cautions that "reforms designed to increase rule formalism in the courts may have the unintended consequence of reducing the capacity for judges to find lasting solutions to land disputes." Yet there is a strong case to be made that strengthening informal institutions, as we see in the 2013 Land Law, is also a means to empower local elites, who in turn can engage in enhanced rent seeking when they are incentivized to do so (Mattingly 2016).

As Markusson, et al. (2014) further note, in countries with underdeveloped land rights and land markets, the most salient institutions become the informal ones. Yet using informal institutions as a tool of social control or compliance only works if it is clearly in the interests of local villagers. Moving beyond local government, Gillespie (2011) demonstrates how party and political imperatives combined with community sentiment and morality can displace legal thinking. Our example earlier supports Gillespie's argument.

Thus, local bureaucracies and courts are shown to be ineffective in resolving land disputes, and both officials and the people tend to bend the law to their favor using informal norms and mechanisms. For economists, informal institutions lack predictability, efficiency and transparency and this undermines growth. A formal legal system creates a common basis for trade in large markets, promoting greater efficiency and productivity. But informal institutions, or the tendency to bend the law to local norms and practices, makes rule formalism a more challenging task. In sum, it is naïve to think that given Vietnam's current economic and political developmental stage, clearer and more transparent laws on property rights will solve land issues and conflicts. Informal mechanisms for conflict reso-

lution play a crucial role alongside formal ones. But as the Vietnamese economy develops, can this situation continue? Rodrik (2004) asserts that although large-scale institutional transformation is not necessary for catalyzing growth, sustained economic convergence eventually requires high quality institutions. Applying this to Vietnam, incomplete land privatization and lack of rule formalism, or the reliance on informal institutions have so far not prevented the country from jump starting economic growth and escaping poverty. It became a lower middle-income country in 2011, a little more than 20 years after its transition to a market-oriented economy began. In fact, it can be said that informal institutions have helped promote industrialization and economic growth during a period of rapid change and volatility. But it's likely that the country will need to develop and rely more on formal institutions, if it wants to avoid the middle-income trap that has plagued many Asian countries, such as Indonesia, the Philippines, or Thailand.

Summary and Policy Lessons

The evolution of Vietnam's land reform illustrates Dani Rodrik's argument that good institutions do not perfectly align with formally legislated rules, and also presents an interesting example of both competing and complementary formal and informal institutions at work. Informal institutions (i.e. social cultural norms around land) are both an obstacle and a stabilizing or enabling factor in the implementation of the land reform policy through formal institutions (bureaucracy and the court system).

Several policy lessons can be drawn from the example of Vietnam's land law reform. First, changing institutions and economic development are intertwined; it's not that institutions are pre-conditions for economic growth. This paper demonstrates how Vietnam's land law reform is ongoing and concomitant with economic growth and development. However, the long-term sustainability of this approach is questionable - both in terms of economic growth and political stability.

Second, institutional development is country- or context-specific. There are various paths to institutional development, and various institutional forms might serve the same purpose (Rodrik 2007). Standard Western style institutions often don't fit. In Vietnam's case this means gradual and partial rather than rapid and complete privatization of land. It is looking increasingly likely that Vietnam will never adopt private property rights, yet for now this does not seem to constrain its economic growth and development.

Third, informal institutions can be paradoxically, positive and negative forces. Informal institutions are a positive force in helping to resolve conflicts and facilitate market processes, when formal laws and regulations lack clarity and transparency. But informal institutions may just be a mechanism by which the state increases its reach, enhancing corruption by allowing for private business interests and politics to enter the marketplace. Changes in the 2013 Land Law in Vietnam to encourage dispute resolution at the grassroots level demonstrate a superficial effort towards to the harmonization of informal and formal institutions. These efforts are more likely intended to enact greater control on possible complainants, rather than a relaxation of control. The salience of informal institutions may continue to hinder the land reform, by narrowing the segment of the population who are able to obtain strong property rights.

Research on Vietnam tends to bifurcate institutional analysis/reform and economic growth. Future research should combine these two strands of literature, because we cannot simply focus on institutions and governance as an end unto itself, but should rather consider an instrumental approach to governance and institutional reform (Rodrik 2008). In addition, further research is needed to understand the complex interaction between formal and informal institutions that delineate and protect property rights. We cannot simply dismiss informal institutions as 'corruption' that is bad for development, nor as a panacea in the face of weak formal institutions. As this paper has demonstrated, the record of informal institutions in land reform in Vietnam is one of mixed effects and is perhaps, in part, stabilizing a traumatic phase in Vietnam's development.

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Washington Blues, Pink Tides, and Brown Development. The Political Economies of Neo-Extractivism in the Andes

Pablo Toral [1]

Introduction

Dani Rodrik offers two tales of globalization in his presentation. The first one is the "hyper-globalization model" pursued in the 1990s. In this model, disseminated by the large international financial institutions (I.F.I.s) such as the International Monetary Fund (I.M.F.) and the U.S. government, governments are to implement pro-market reforms that facilitate the free movement of capital, trade, and production, while reining in the state's ability to intervene in light of changing conditions in global markets. The second model, "the Bretton Woods model," accords governments policy spaces to prioritize domestic economic and social goals over globalization. Latin America has oscillated between these two different models since the second half of the nineteenth century. The consolidation of the so-called "liberal period" in the 1880s relied on a free-trade strategy that resulted in the insertion of the Latin American republics in international markets through the export of their natural resources. In the 1930s, Latin American governments responded to growing protectionism in Europe and the United States by adopting an "import substitution industrialization" (I.S.I.) model that relied on a developmental state to promote industrialization. This model was in place until the 1980s.

After the debt crisis of the 1980s, Latin American governments adopted the "Washington consensus," often under pressure from the U.S. government and

1 Pablo Toral is Professor and Chair of Political Science, Beloit College.

I.F.Is such as the I.M.F. and returned to the export-led strategy of the late nineteenth century that relied, once again, on globalization and the exportation of natural resources. Dani Rodrik has been very critical of the "Washington consensus" in Latin America, advocating instead for a model that allows governments policy spaces to pursue national development agendas.[2] A so-called "pink tide" of left-wing politicians were voted into power in the 2000s across Latin America on the promise to deliver economic growth with equity.[3] Do labels such as the "Washington consensus" and the "pink tide" capture the diversity of development models in Latin America since the implementation of structural reforms in the 1980s? This paper seeks to answer this question by reviewing the economic models of three different Andean countries, Bolivia, Chile, and Peru since the turn of the twenty-first century. This paper takes a comparative environmental political economy approach by reviewing the governance structure that sustains different models of economic development, as well as the role these models accord to the environment. In all three case studies, the economic record has been generally positive. Economic growth was steady over a quarter century. Poverty and inequality failed considerably. However, the environmental impact is negative. An export-led model that relied on the exportation of natural resources was once again the great pillar of the new development agendas since the 1980s. However, unlike the liberal period of export-led development in the turn of the twentieth century, the state grew considerably, as it played a more prominent role both facilitating the exploitation of natural resources while capturing some of the revenue generated from extractivism to advance national development goals. The neo-extractivist developmentalist state of the twenty-first century is different from the one that led Latin America through the I.S.I. period, which sought inward-looking economic development by developing national manufacturing industries and a domestic market.

Theoretical background

This paper builds on two theoretical approaches to frame the analysis of development models in Latin America, the varieties of capitalism approach (VoC),

2 Dani Rodrik, *Straight Talk on Trade. Ideas for a Sane World Economy*. Princeton, NJ: Princeton University Press, 2018; Dani Rodrik, *The Globalization Paradox. Democracy and the Future of the World Economy*. New York, NY: W.W. Norton, 2011.

3 Gavin O'Toole, *Politics Latin America*. New York, NY: Routledge, 2018.

as developed by Peter Hall and David Soskice[4]; and neo-extractivism by Eduardo Gudynas.[5] Hall and Soskice draw from game theory and new institutional economics. Their analysis looks at five key governance structures: industrial relations, vocational training and education, corporate governance, inter-firm relations, and intra-firm relations. The type of governance within each structure determines a variety of capitalism. Hall and Soskice provide a two-cell typology. In one cell, they place "liberal market economies," in which firms coordinate their activities primarily via hierarchies and competitive market arrangements. This model includes the United Kingdom and some of its former colonies, namely the United States (U.S.,) Canada, Australia, and New Zealand. In the other cell, they place "coordinated market economies," in which firms engage more heavily in non-market relationships to develop their core competencies. This is the model of central and northern European countries such as Germany, Switzerland, Austria, The Netherlands, Belgium, Sweden, Norway, Denmark, Finland, and Japan.[6]

Since the publication of this book, scholars have sought to understand alternative varieties of capitalism to these two, such as those of Eastern and Southern Europe as well as East Asia.[7] However, Latin America and the Caribbean have received less attention. Ben Ross Schneider argues that Latin America constitutes a variety of capitalism in its own right that he calls "hierarchical market economies". He identifies four key characteristics. The first one is the prominent role of diversified business groups, dominated by families, which account for a large share of the economy and exercise hierarchical control over a wider variety of subsidiaries that have little relation to one another. The second characteristic is that multinational enterprises (M.N.E.s) play a dominant role in key industries where there is a premium on technological knowhow. M.N.E.s adopt hierarchical managerial structures and engage in hierarchical transfers of technology from the

4 Peter A. Hall and David Soskice (eds.), *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*. New York, NY: Oxford University Press, 2001.

5 Eduardo Gudynas, "Diez tesis urgentes sobre el nuevo extractivismo". In Jürgen Schuldt, Alberto Acosta, Alberto Barandiarán, Mauricio Folchi, CEDLA-Bolivia, Anthony Bebbington, Alejandra Alayza y Eduardo Gudynas (eds.), *Extractivismo, política y sociedad*. Quito (Ecuador): Centro Andino de Acción Popular (CAAP) and Centro Latinoamericano de Ecología Social (CLAES), 2009: pp. 187-225.

6 Peter A. Hall and David Soskice, *Varieties of Capitalism*, 2001.

7 Bruno Amable, *The Diversity of Modern Capitalism*. Oxford, UK: Oxford University Press, 2004; Bob Hancké, Martin Rhodes, and Mark Thatcher (eds.), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy*. Oxford, UK: Oxford University Press, 2007; David Lane and Martin Lyant (eds.), *Varieties of Capitalism in Post-Communist Countries*. New York: Palgrave, 2006; Andres Nölke and Arjan Vljegenthart, "Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe", *World Politics*, 61 (4), 2009: 670-702.

parent to the subsidiary. The third characteristic is the atomistic, and often anomic, nature of labor markets. Labor relations are individualized, disintermediated, and hierarchical. The fourth characteristic is the low level of education of the population compared to Europe and North America.[8]

Latin American economies have relied very heavily since the 1990s on an export-led model of development that prioritizes the exploitation and exportation of natural resources. A framework for understanding this model provides a useful complement to VoC. Gudynas defines the 1990s model as "extractivist" and claims it was similar to the model of the liberal period of the turn of the twentieth century. He defines "extractivism" in the Latin American context as the exploitation of subsoil resources through mining and hydrocarbons. "Extractivist development" lacks diversification and is highly dependent on the insertion of Latin America in the world economy as producer of raw materials. Gudynas pays special attention to the role accorded to the state in each development model and appreciates significant differences between the 1990s and the 2000s. The governments that embraced the "Washington consensus" in the 1990s saw the role of the state limited mostly to the granting of permits over natural resources to large firms (M.N.E.s or domestic groups) and enforcement of (property) rights. The "pink tide" governments of the 2000s embraced a new model of extractivism that Gudynas calls "neo-extractivism" or "progressive neo-extractivism." This "pink-tide" version of extractivism relies on a heavier involvement of the state in the economy. The neo-extractivist "developmental state" promotes extractivism through export-led monocrop agriculture as well. The state seeks to distribute some of the profits generated from the extractive industries geographically through infrastructure projects and across income groups through welfare programs.[9] The developmental state raises revenue from the extractive industries either by increasing royalty payments on the private sector or by expanding production through state-owned enterprises, which adopt the business practices of large M.N.E.s and large domestic extractive firms. The pink-tide governments accept the international governance rules set under the auspices of the World Trade Organization (W.T.O.)

8 Ben Ross Schneider, "Hierarchical Market Economies and Varieties of Capitalism in Latin America". *Journal of Latin American Studies*. Vol. 41, No. 3, August, 2009, 553-575; Ben Ross Schneider, *Hierarchical Capitalism in Latin America. Business, Labor, and the Challenges of Equitable Development*. New York, NY: Cambridge University Press, 2013.

9 Eduardo Gudynas, "Diez tesis urgentes," 2009, 187-188.

The neo-extractivist developmental state has reproduced some of the negative externalities of the old extractivist models such as the creation of "enclave economies," where the wealth generated from extractive industries is syphoned out of the country through export networks and does not develop linkages to other national industrial sectors, particularly in related processing industries. The neo-extractivist model also exacts a high environmental and social toll on the communities living in the proximity of the sites of extraction. When faced with anti-extractive activism, pink-tide governments legitimize neo-extractivism as the sole legitimate development strategy of the state, denounce its critics, and pit the victims of neo-extractivism against the beneficiaries of popular social welfare programs.[10]

In the remainder of the paper I elaborate on three different case studies of (neo-)extractivist development, Chile, Bolivia, and Peru. The goal is to highlight the key pillars of the post-1980s development strategies in each country and point out similarities and differences. All three countries first adopted the Washington consensus package and later modified it as the pink tide rose to power to address equity concerns. In Chile, an agreement between the political right and the political left (*concertación*) allowed for the continuation of the export-led extractivist model introduced by the authoritarian regime of Augusto Pinochet in the 1970s and 1980s, while empowering the state to develop policies to reduce poverty and inequality. I call Chile's model "*neo-extractivismo concertado*." Both Bolivia and Peru experienced a serious debt crisis in the 1980s and went through shock therapy in the 1990s, adopting pro-market structural adjustment plans under the auspices of the Washington consensus that introduced a new phase of extractivist development. The pink-tide governments of the 2000s tried to legitimize the extractivist model by implementing wealth-distribution and poverty-alleviation policies. Bolivia developed a version of "*grassroots extractivismo,*" as Evo Morales, who came to power following street protests and grassroots mobilization, returned ownership of natural resources to the state in the name of the Bolivian people and used legal guarantees to extract concessions from firms to finance welfare programs that benefited his constituents. In Peru, a group of technocratic politicians and civil servants decentralized the state to empower regional and local governments to capture part of the revenues generated by the extractive industries, in exchange for protecting the neo-extractivist model. I call Peru's model "*technocratic neo-extractivism*."

10 Ibid., 187-225.

Chile: neo-extractivismo concertado

Chile was a pioneer in the implementation of pro-market reforms in the 1970s and 1980s, the peak years of the neoliberal extractivist model in Chile. The government of General Augusto Pinochet (1973-1990) adopted the first wave of reforms in the 1970s to regain macroeconomic stability and establish a business-friendly legal framework. Key to his reforms were the reduction of trade barriers as a strategy to increase productivity and promote exports, deregulation of capital markets to facilitate efficient allocation of credit, and privatization of state-owned enterprises, such as banks and utilities, to generate revenue for the state, reduce deficits, and attract foreign direct investment, technology, and knowhow. By the early 1990s, the Chilean economy had become a major exporter of mining, agricultural, forestry, and fishing goods.[11]

Chile's democratically elected politicians highlighted the "grave social debt" left by Augusto Pinochet and committed their efforts to increase expenditures in health and education. However, they followed a gradualist approach that would not compromise macroeconomic stability so as not to generate capital flight. The leading political parties of the moderate left and the moderate right sealed a compromise ("*concertación*") along these lines and encouraged civil society actors to go along. The success of *concertación*, which ruled Chile between 1990 and 2010, relied on the strength and discipline of the leading political coalitions, committed to the consolidation of democracy, and their strong ties to civil society actors, especially the right's ties to the business sector and the left's credentials with the unions and human rights groups. Chile's strong technocratic state provided the institutional capacity to enforce the policies that came out of the pact.[12]

The macroeconomic policies of the democratic governments did not challenge the pillars of Pinochet's model: fiscal responsibility, trade liberalization, capital account liberalization, and continued privatization of state-owned enterprises. The *concertación* governments focused on keeping inflation low to prevent an erosion of purchasing power among the low-income sectors. Currency undervaluation sought, unsuccessfully, to prevent Dutch disease and facilitate a gradual process of economic diversification. The task of meeting Chile's inflation targets

11 Sebastian Edwards, *Crisis and Reform in Latin America. From Despair to Hope*. Washington, D.C.: Oxford University Press for the World Bank, 1996, 119-124, 135, 186-191, 214-218.

12 Kurt Weyland, "Economic Policy in Chile's New Democracy," *Journal of Inter-American Studies and World Affairs*, Vol. 41, No. 3 (Autumn, 1999), pp. 67-96.

was entrusted to an independent central bank, which adjusted interest rates as needed. To prevent financial volatility, the government adopted a "hidden" Tobin tax on capital imports by gradually increasing reserve requirements. Foreign direct investments were exempt from this tax so as not to discourage investment in productive activities.[13]

Critical to the success of economic policies for the *concertación* governments was the consolidation of a technocratic developmental state. The new developmental state focused on subsidizing exports through a set of policies that included construction of infrastructure, technology, investment capital, worker training, export promotion in international markets, and subsidies. CORFO was the state agency that funneled subsidies to firms. PROCHILE prepared firms to meet international quality standards.[14] One of the consequences of Chile's neo-extractive model is the decline of some industries that grew since the 1930s and the concentration of capital into commodity-export sectors under the control of large financial groups. The leading firms in the export-sector are large M.N.E.s as well as large national business groups that command capital and technology resources. The state increased social expenditures, especially in areas the targeted the most marginalized groups, to achieve what the *concertación* leaders called "growth with equity." The conservative administrations of Sebastián Piñera (2010-14, 2018-) and Michelle Bachellet's second term (2014-18) did not challenge the neo-extractivist model.[15]

Concertación's neo-extractivist economic agenda deepened the economy's reliance on the exportation of natural resources, primarily minerals, while weakening other sectors, especially manufacturing and commerce (table 1.) Mining remained the main source of export revenue, growing its overall share from 49 percent to 53 (table 2.) The size of the state grew considerably under the democratic administrations, from ten percent of G.D.P. in 1990 to eighteen percent in 2017 (table 1.) From the three countries included in this studied, Chile's neo-extractivist coalition has achieved the greatest successes in terms of increases in living standards (143 percent growth of G.D.P. per head between 1990 and 2017,

13 Ricardo Ffrench-Davis, *Economic Reforms in Chile: from Dictatorship to Democracy*. Ann Arbor, MI: Michigan University Press, 2002; Marcus Taylor, *From Pinochet to the 'Third Way': Neoliberalism and Social Transformation in Chile*. London, UK: Pluto Press, 2006, 123; Kurt Weyland, "Economic Policy in Chile's New Democracy," 67-96.

14 Marcus Taylor, *From Pinochet to the 'Third Way'*, 129-130; Kurt Weyland, "Economic Policy in Chile's New Democracy".

15 Marcus Taylor, *From Pinochet to the 'Third Way'*, 132-133.

table 7 and graph 1) and decrease in poverty rate, which fell from 39 percent in 1990 to 12 percent in 2015 (table 9.) However, Chile has become one of the most unequal countries in Latin America and its efforts to lower inequality have been less successful than Bolivia's and Peru's (table 8.)

Bolivia: Grassroots Neo-Extractivism

Three key domestic economic actors have played a critical role in the development of Bolivia's extractivist development strategy since the mid-twentieth century, mining barons, oil barons, and landed elites. Their rise took place in a context of adversarial relationships between the private sector and the state that dates back to the early twentieth century in some cases. The oil industry was nationalized in 1937 following the Chaco War. The state took over the assets of Standard Oil to establish a new state-owned oil monopoly called Yacimientos Petrolíferos Fiscales Bolivianos (Y.P.F.B.) The Nationalist Revolutionary Movement (N.R.M.) that ruled between 1952 and 1964 decreed state ownership of natural resources and nationalized the tin industry in 1952, turning its assets to a state monopoly called Corporación Minera de Bolivia (Comibol.) Until then, the tin mines were controlled by three "tin barons." Ironically, the N.R.M. became a major recipient of U.S. aid. As a result, N.R.M. granted hydrocarbon contracts to foreign firms and Gulf Oil became the major player in Bolivia until its assets were nationalized in 1969.[16] N.R.M. also tried to implement a land reform agenda, but it was much less successful. By the end of the revolutionary period, seventy percent of the arable land remained in the hands of large *hacendados* (landowners.) [17]

The end of N.R.M. rule in the mid-1960s gave way to a turbulent period in which democratic rule was regularly interrupted by military dictatorship until democracy was restored in 1982. The alternation of short periods of democratic rule and military dictatorships in the 1960s and 1970s prevented the consolida-

16 Fernanda Wanderley, "Beyond Gas: Between the Narrow-Based and Broad-Based Economy." In John Crabtree and Laurence Whitehead (eds.) *Unresolved Tensions: Bolivia, Past and Present*. Pittsburgh, PA: Pittsburgh University Press, 2008, 195-196; John Crabtree and Ann Chaplin, *Bolivia: Processes of Change*. London, UK: Zed Books, 2013, 76-77; Tom Perreault, "Nature and Nation: Hydrocarbons, Governance, and the Territorial Logics of "Resource Nationalism" in Bolivia." In *Subterranean Struggles. New Dynamics of Mining, Oil, and Gas in Latin America*, ed. by Anthony Bebbington and Jeffrey Bury. Austin, TX: University of Texas Press, 2011, 66-67.

17 Brent Kaup, *Market Justice. Political Economic* Struggles *in Bolivia*. Cambridge, MA: Cambridge University Press, 2012, 31-53.

tion of a long-term model of economic development. Mining and hydrocarbon production languished, as the state syphoned revenue generated from both industries into the development of large-scale cash crops in the eastern part of the country via subsidies and tax exemptions.[18] The state monopoly over the export of minerals was gradually lifted and a few local mining groups began to thrive from the export of tin, copper, and other minerals. The east became the most dynamic economic region in Bolivia, as oil exports began to grow in the 1960s and subsidized cash-crop agricultural commodity exports took off in the 1970s. By the 1970s, three elite groups had emerged, the mining barons, the oil barons, and the landed elites. The interests of the last two often overlapped, as the landed elites extracted rents from oil concessions as well.[19]

Democracy returned in 1982 in the midst of a severe crisis caused by drastic fluctuations in commodity prices and mounting debt. Under the leadership of one of the mining barons, Gonzalo Sánchez de Lozada, who served as minister, Bolivia embarked in a wave of pro-market structural reforms in the 1980s to regain macroeconomic stability. Sánchez de Lozada, who introduced the Washington consensus in Bolivia, went on to serve two terms as president in the 1990s and early 2000s. While president, he opened up mining and hydrocarbons to the private sector to attract investment and regain economic growth but allowed state-owned enterprises in these sectors because they were the state's main source of revenue. His "privatization and capitalization" program intended to build popular support for his policies by granting stock in the privatized firms to individuals and workers' cooperatives, especially in the mining industry.[20]

Peasants, indigenous peoples, and workers groups took to the streets in opposition to the neoliberal reforms, particularly the privatization process. The demonstrations, which cost the lives of hundreds of people, led to a referendum in 2004 in which Bolivians expressed support for a greater role of the state in the hydrocarbon sector. The referendum marked the transition to the new phase of neo-extractivist development. Evo Morales became president in 2006 and moved to implement the new hydrocarbon law of 2005 (which his *Movimiento al Socialismo* party introduced while he served as a legislator) by issuing a nationalization decree that required all hydrocarbons companies to surrender production to Y.P.F.B.,

18 Jeffery Webber, *From Rebellion to Reform in Bolivia: Class Struggle, Indigenous Liberation, and the Politics of Evo Morales*. Chicago, IL: Haymarket Books, 2011, 18.
19 Brent Kaup, *Market Justice*.
20 Ibid., 95.

now Bolivia's sole exporter; increased gas royalties from 18 percent to 50 percent; and asked Y.P.F.B. to take back ownership of the five hydrocarbons companies privatized in the 1990s. Morales also introduced a reform of the mining sector that granted exclusive rights to exploit all future mines to state-owned Comibol and raised the state surtax on exports during periods of commodity booms. The state did not displace M.N.E.s and large domestic firms from the hydrocarbon and mining sectors. They remained in Bolivia after the implementation of Morales' reforms but sought accommodation with the state.[21]

Morales' neo-extractivist policies strengthened the role of the state in the economy, as seen by the growth of the public sector from 20 percent to 23 percent (table 3.) The commodities boom and the rising revenue resulting from royalties allowed the government to redirect resources to welfare programs, which managed to reduce inequality (table 8) and poverty (table 9.)[22] G.D.P. per capita grew by 38 percent between 2005 and 2015 (table 7 and graph 1.) These reforms, however, did not overcome some of the key challenges of past development models, such as the growth of enclave economies, as Gudynas remarked. Table 3 shows that mining as a share of G.D.P. grew by eighteen percent between 1990 and 2017. Table 4 shows that the share of mining and hydrocarbons over exports increased from 64 percent in 1990 to 78.2 percent in 2017. However, the hydrocarbon industry employed only 0.04 percent of the population in 2008 and capital movement between sectors was insignificant, as most capital was sector-specific and financed via foreign direct investments.[23] The Morales administration justified this model as necessary for the elimination of poverty and denounced his critics as "neoliberals" manipulated by N.G.O.s that want to deny oil to the Bolivians. The Bolivian constitution even calls for the "industrialization of natural resources".[24]

Peru: Technocratic Neo-Extractivism

21 Ibid., 118-121, 132-133, 145-146; Eugeni Cerutti and Mario Mansilla, *Bolivia: The Hydrocarbons Boom and the Risk of Dutch Disease*. Whashington, D.C.: International Monetary Fund, Working Paper 08/154, June 6, 2008, 7-8.

22 José Vargas and Santiago Garriga, ¨Explaining Inequality and Poverty Reduction in Bolivia." IMF Working Papper No. 15/265. 2016, February; Nora Lustig, "Fiscal Policy, Income Redistribution and Poverty Reduction in Latin America: Bolivia, Brazil, Chile, Costa Rica, El Salvador, Guatemala, Mexico, Peru and Uruguay." In: Timothy Besley (ed.), *Contemporary Issues in Development Economics.* International Economic Association Series. London, UK: Palgrave Macmillan, 2016, pp. 11-18.

23 Eugeni Cerutti and Mario Mansilla, *Bolivia*, 9.

24 Eduardo Gudynas, "Diez tesis urgentes," 214, 216-217.

Peru was the laggard among the three countries included in this study in terms of implementation of the Washington consensus neoliberal export-led extractivist model. The administration of Alberto Fujimori adopted drastic economic reforms that he branded as "shock therapy" between 1990 and 2000 as a response to serious political, economic, and security crises. His first efforts sought to contain hyperinflation, which reached almost 7,500 percent in 1990. He eliminated price controls and most subsidies, reduced monetary expansion, and allowed the currency to free float. To attract foreign direct investment, he privatized state-owned enterprises such as the national telephone operator, and created independent agencies to enforce the rules of the game in each industry. A critical agency created in 1993 was INDECOPI, staffed by uninstructed experts, and tasked to enforce competition law. He also lowered tariffs on trade to increase competition and the competitiveness of domestic firms. The rate fell from an average of 66 percent in 1990 to 26 percent by decade's end, and to ten percent in 2005. Fujimori's development strategy relied on a liberal approach to trade and financial flows. He conceived of a very small state whose sole role as an engine of economic development was the creation of independent regulatory agencies such as INDECOPI, enforcement of the rule of law, property rights, a system of justice, and security. He believed the private sector had to be the key decision-making actor regarding allocation of productive resources.[25]

The transition to the neo-extractivist phase in Peru came after Alberto Fujimori. The administrations of Fernando Toledo (2000-2006) and Alan García (2006-2011) tried to redefine the role of the state, in part to empower the state's agencies to play a more active role in decisions over the allocation of productive resources and social policy. Having achieved macroeconomic stability, both presidents entrusted an elite of technocratic ministers and civil servants representing different ministries and state agencies to craft a long-term vision of economic development. The central bank, independent since its creation in the 1920s, focused on inflation-targeting and exchange-rate volatility while maintaining a devalued currency to favor exports.[26]

Peru, along with Colombia and Ecuador, began to negotiate a free-trade

25 Elías Baracat, Joseph Michael Finger, Julio Nogues, and Raúl Matías León Thorne, *Sustaining Trade Reform: Institutional Lessons from Argentina and Peru*. Directions in Development. Trade series. Washington, D.C.: World Bank, 2013, 26-71.

26 Gabriela Mundaca, "Central Bank Interventions in a Dollarized Economy: Managed Floating Versus Inflation Targeting." *Empirical Economics* 3, no. 3 (2017), doi:10.1007/s00181-017-1331-5.

agreement (F.T.A.) with the U.S. in 2003. To get the U.S. government interested, Peruvian negotiators related a F.T.A. to the U.S.'s drug policy by highlighting Peru's role as the world's top producer of cocaine. Once the U.S. government engaged, the Ministry of Foreign Commerce and Tourism (MINCETUR) became the key negotiator for Peru. MINCETUR invited a group of Peruvian business leaders to help craft Peru's strategy and, with that goal in mind, the business sector created an association called Business Council for International Negotiations, which represented a network of national and regional chambers of commerce and business associations. The government also invited civil society groups such as labor and trade unions, professional organizations, universities, farmers' associations, etc., to participate in the negotiations to render the trade agreement legitimate. The Peruvian team used sections of Chile's F.T.A. with the U.S. to inform their draft of the new agreement, such as the chapter on F.D.I. This strategy eased the talks along, as U.S. negotiators looked favorably at the U.S.-Chile F.T.A. The agreement was signed in 2005 and came into effect in 2007. President García built on the interest of small- and medium-sized firms to export and went on to sign F.T.A.s with China, the European Union, Japan, and several countries in Latin America.[27]

In 2008, the new U.S. administration led by Barack Obama asked Peru to introduce some changes to the F.T.A. García's administration took this opportunity to push a new wave of reforms and wrote them into the F.T.A. with the U.S. to make it harder for future Peruvian administrations to significantly alter economic policy. The executive persuaded congress to grant the president and his cabinet of ministers the authority to issue a series of decrees to secure this trade agreement. The executive then went on to issue over a hundred decrees, many of which had not been required by the U.S. for the passing of the F.T.A. These decrees addressed customs administration and trade facilitation, public hiring, investment, competition policies, property rights, labor, environment, and transparency. There were several goals behind these reforms. First, the government wanted to secure a stable long-term market-friendly legal framework. Secondly, Peru's economic legislation embraced W.T.O. standards. Thirdly, the reforms introduced some guarantees to protect sectors of the local economy, such as small producers in trade-sensitive

27 Mónica Patricia Lombana, *Free Trade Agreements between Peru, Colombia and the United States: Effects of Negotiations and Implementation on FDI and Non-Traditional Exports*. College Park, MD: University of Maryland, dissertation, 2018, 89-92; Elías Baracat et al, *Sustaining Trade Reform*, 26-71.

industries, and granted the state some room to maneuver in terms of economic policy.[28] After completion of the F.T.A. with the U.S., Peru's negotiators moved fast to sign a F.T.A. with China. Negotiated in 2008 and signed in 2009, the Peru-China F.T.A. was facilitated by China's eagerness to be recognized by Peru as a market economy. Peru took this opportunity to introduce clauses into the agreement to open up the Chinese economy to Peru's exports and investment and added anti-dumping safeguards to protect Peruvian producers from unfair trade practices by China.[29]

The F.T.A.s that Peru signed with the U.S. and China had significant impact on the Peruvian economy. First, there was a great increase in F.D.I. into Peru's extractive industries, peaking at $12 billion in 2012 but remaining consistently above $6 billion thereafter. In 2016, Peru was the world's fifth main host to F.D.I. for exploration in non-ferrous metals.[30] Along with rising F.D.I., there was a reorientation of Peru's external trade. The U.S. share of Peru's external trade fell as China's grew exponentially. By 2017, China had become Peru's main trading partner, with exports going to China worth $11.6 billion and imports from China worth $8.8. Most of Peru's exports were minerals and agricultural goods.[31]

The data for Peru also supports the thesis that pink-tide governments in Peru embraced a neo-extractivist model of development. Mining grew by almost thirty percent since the turn of century, fueling significant growth in finance and construction as well (table 5.) The share of exports generated by mining grew from 29 percent in 2000 to 49 percent in 2017 (table 6.) The size of the state as a share of G.D.P. did not grow as much under the pink-tide governments in Peru as it did in Bolivia and Chile. On the contrary, its share of G.D.P. fell slightly from 23 percent in 2000 to 22 percent in 2017 after growing during the Fujimori administration from 19 percent in 1990 to 23 percent in 2000 (table 5.) However, the amount of resources going into the state grew considerably in absolute terms, but this growth was obscured by the fact that Peru sustained phenomenal rates of economic growth in this period, so that relative to the overall economy, the state grew less (table 7 and graph 1.) Peru's model delivered significant reduction in poverty rates, from 59 percent in 2006 to 21 percent in 2016 (table 9,) and inequality (table 8.) In spite of his fiery anti-market rhetoric, President Ollanta

28 Elías Baracat et al*, Sustaining Trade* Reform, 26-71.
29 Ibid., 26-71.
30 Mónica Patricia Lombana, *Free Trade Agreements*, 112-113.
31 Ibid., 21-22, 124.

Humala (2011-2016) did not change course. Presidents Pedro Pablo Kuczynski (2016-2018) and Martín Vizcarra (2018-) also found themselves comfortable with the neo-extractivist agenda and the institutional arrangements developed by their predecessors.

Conclusions

The VoC framework developed by Hall and Soskice provides useful guidance to analyze economic governance in Latin America, especially when focusing on the interaction of the state and civil society. The role of the state as an agent of development has received much attention in Latin American studies. During the liberal period of the late nineteenth century and early twentieth century, a small state enabled an export-led strategy that relied on the exportation of natural resources by granting permits to the private sector, mainly M.N.E.s. The state grew during the I.S.I. period (early twentieth century to early 1980s) to become an active agent of industrialization, as it funneled resources into state-owned or mixed ownership firms that intended to transform raw materials into consumer goods. The debt crisis of the 1980s forced governments across Latin America to implement structural adjustment programs, often under the auspices of the U.S. government and I.F.I.s. The so-called "Washington consensus" called for the implementation of pro-market reforms, including trade and investment liberalization and privatization of state-owned firms that significantly streamlined the size of the state. F.D.I. poured in and commodities exports began to ship out. It was a "return" to the liberal model of the late nineteenth century (small state, export-led development,) leading scholars to call this model "neo-liberal." This model seemed to fit the Latin American VoC described by Schneider, which accorded great control over economic governance to large domestic diversified groups and M.N.Es.

The social cost of the "neo-liberal" reforms, often introduced hastily and justified as necessary "shock therapy," brought to power left-wing leaders across Latin America in the 2000s who called for "growth with equity," in a wave that scholars named "pink tide." Pink-tide governments beefed up the state as an agent of development to capture a larger share of the revenue generated from the export of natural resources, either through taxation or through the development of mining and hydrocarbon projects by state-owned firms. While scholars brand both the neoliberal and the pink-tide models as extractivist, a significant difference

exists in the role accorded to the state between the early neoliberal models of the 1980s-1990s and the progressive pink-tide model of the twenty-first century. The neo-liberal state accorded the private sector the primary role in extractive industries and kept taxation low so as not to discourage private investment. Pink-tide governments sought to capture a higher share of extractive revenue to invest in poverty-alleviating policies. For this reason, it is fair to speak about two different types of extractive development in the turn of the twenty-first century, the "extractivist neoliberal" model of the Washington consensus in the 1980s and 1990s, and the progressive "neo-extractivist" model of the 2000s and 2010s developed by the pink-tide leaders. The neo-extractivist model, as defined by Gudynas, accords a stronger role to the state as an agent of economic governance, thus challenging the definition of the Latin American VoC described by Schneider, according to which large diversified domestic groups and M.N.E.s were the main actors of economic governance.

Neo-extractivist models across Latin America bear significant similarities, such as insertion of Latin American economies in global markets via the provision of commodities (agricultural, mineral, and hydrocarbons) and the redistributive capacity of the developmental state. However, there are also important differences, such as those offered by the three models discussed in this presentation. Chile's neo-extractivist model was the result of a pact between the moderate right and the moderate left. They integrated the *Concertación* coalition that succeeded Pinochet's dictatorship. Their political platform called for "growth with equity." The right wing of *Concertación*, with strong ties to business associations, demanded a continuation of liberal trade and investment regimes. The left-wing partners of the coalition expected the state to engage in welfare transfers to address extreme poverty and growing income inequality. This compromise, which has survived to date, instituted Chile's variety of neo-extractivism.

Bolivia's grassroots neo-extractivism was implemented by President Evo Morales. Indigenous groups, workers unions, coca growers associations, and other grassroots organizations catapulted him to the presidency as he capitalized on social unrest and street protests against the neoliberal policies of his predecessors, particularly the privatization of public services. Morales, who claimed that his broad base of support offered legitimacy to his neo-extractivist agenda, built a developmentalist state to transfer revenue generated from commodities exports to an ambitious social agenda through a combination of higher taxes on exports and by directly involving state-owned enterprises in extractive operations in min-

ing and hydrocarbons. Peru's technocratic neo-extractivist agenda was crafted by a group of technocrats, both ministers and civil servants, under the Toledo and García administrations. These technocrats organized civil society for input and legitimacy and sealed the model into two F.T.A.s, one with the U.S., and the second one with China, to protect economic policy from domestic politics.

This presentation offered solely a preliminary look into three different varieties of Latin American neo-extractivist capitalism, Chile, Bolivia, and Peru. Further country-level research is necessary to assess the institutional strength of these three neo-extractivist models, as well as competing ones. Latin America offers many more varieties of neo-extractivism that merit study. Colombia has strengthened the role of state-owned enterprises in extraction, like Bolivia, while implementing institutional protections to prevent changes of the model, like Peru. Brazil's variety of extractivism accords a much stronger role to the developmental state through a combination of subsidies to the private sector as well as via significant investments in extraction by state-owned enterprises. Venezuela validates many of the claims raised by the resource curse literature. Argentina lacks a coherent model, as society and the main political parties have not been able to reach consensus. Mexico downplayed extractivism as it deepened its economic ties with the U.S. under N.A.F.T.A. and now looks at extractivism again as China has limited the competitiveness of its exports. All of these are important case studies that warrant inclusion in a comparative research agenda into the varieties of Latin American extractivism.

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Appendix.

Table 1. Chile, aggregate value of G.D.P. by economic activity, current prices.

Sector	**1990**	**1995**	**2000**	**2005**	**2010**	**2015**	**2017**	**1990-2017, % change**
Finance	25	24	25	23	22	25	24	-4
Public administration	10	13	16	14	16	17	18	80
Commerce	15	15	13	11	11	12	12	-20
Manufacturing	15	16	16	15	12	13	11	-7
Mining	10	7	6	13	17	10	11	10
Transport and communications	10	10	11	11	9	9	9	-10
Construction	5	7	5	5	6	7	7	40
Agriculture	7	6	6	5	4	4	4	-43
Electricity, Gas and Water	2	2	2	3	3	3	4	100

Source: CEPAL

Table 2. Chile's main exports, 1990-2017.

Product	***Share of exports***			
	1990	***2000***	***2010***	***2017***
(Mining)	*(49.5)*	*(41)*	*(62)*	*(53.2)*
Ores and concentrates of copper	6.3	13.4	19.6	25.4
Refined copper	37.7	26	34.1	25
Fish	3.9	6.6	3.3	7.1
Sulfate wood pulp	2.7	5.3	3.1	3.4
Grapes	4.3	2.9	1.9	1.8
Metal ores and concentrate			1.8	1.4
Iron ores and concentrate	1.7		1.7	1.4
Lumber				1.2
Fresh fruit				1.1
Other carbonates				1
Blister copper and other unrefined copper	3.8	1.6	3.5	
Wine		3.2	2.2	
Copper waste and scrap			1.3	
Lumber	1.8	1.8		
Methyl alcohol/methanol		1.7		
Meat and fishmeal (not for human consumption)	4.6	1.3		
Apples	1.3			

Source: CEPAL

Table 3. Bolivia, aggregate value of G.D.P. by economic activity, current prices.

Sector	***1990***	***1995***	***2000***	***2005***	***2010***	***2015***	***2017***	***1990-2017, % change***
Public administration	16	17	19	20	19	23	23	44
Agriculture	17	16	15	14	12	13	14	-18
Mining	11	7	7	12	17	12	13	18
Manufacturing	18	19	15	14	14	13	12	-33
Finance	11	11	15	11	10	12	12	9
Commerce	13	12	11	11	12	11	11	-15
Transport and communications	10	11	12	13	11	11	10	0
Construction	3	3	3	2	3	3	3	0
Electricity, Gas and Water	2	4	3	3	2	2	2	0

Source: CEPAL.

Table 4. Bolivia's main exports, 1990-2017

Product	***Share of exports***			
	1990	***2000***	***2010***	***2017***
(Mining)	*(39.4)*	*(25.5)*	*(31.2)*	*(39.6)*
Natural gas	24.6	9.3	40.7	38.5
Ores and concentrates of zinc	15.9	12.5	13	19.8
Ores and concentrates of silver, platinum, etc.	6.7	4.8	10	8.3
Oil seed and other vegetable oils		10.8	5	5.3
Tin and tin alloys	2.6	4.8	4.2	4.8
Ores and concentrates of lead			2.3	3.6
Coconuts and nuts				2.5
Soybean oil		5	2.8	2.3
Jewelry and precious metals		3.4		1.9
Silver, processed	5.1		1.7	1.2
Soy beans		3.4		
Flour and vegetable oils		3		
Aircraft		10.5		
Crude petroleum			2.7	
Sunflower seed oil			1.4	
Tin, processed	9.1			
Bovine cattle	5.4			
Lumber	3.9			
Refined sugar	3.4			
Leather	1.8			

Source: CEPAL.

Table 5. Peru, aggregate value of G.D.P. by economic activity, current prices.

Sector	***1990***	***1995***	***2000***	***2005***	***2010***	***2015***	***2016***	***1990-2016, % change***
Public administration	19	22	23	24	20	22	22	16
Commerce	23	21	19	15	15	16	16	-30
Manufacturing	20	17	17	18	17	15	14	-30
Finance	8	7	8	8	9	11	11	37
Transport and communications	9	9	9	8	9	10	10	11
Mining	7	6	7	12	13	8	9	29
Agriculture	8	9	9	8	8	8	8	0
Construction	4	7	5	5	7	8	7	75
Electricity, Gas and Water	1	2	3	2	2	2	3	300

Source: CEPAL.

Table 6. Peru's main exports, 1990-2017.

Product	***Share of exports***			
	1990	***2000***	***2010***	***2017***
(Mining)	*(39.7)*	*(29.7)*	*(45.6)*	*(49.2)*
Ores and concentrates of copper	2.5	2.7	21.9	32.3
Ores and concentrates of zinc	9.8	6.7	5.3	5.4
Refined copper	13.5	14.3	9	4.9
Meat and fishmeal (not for human consumption)	11	16.9	5.8	4
Ores and concentrates of lead	4.5		4.5	2.9
Natural gas			1.9	2.2
Tropical fruit other than bananas				2.1
Zinc and zinc alloys	3.7	3.7		1.9
Coffee, green and roasted	3		3.2	1.9
Ores and concentrates of silver, platinum, etc.				1.8
Iron ore and concentrates			1.9	
Tin and tin alloys		2.3	3	
Textiles		9	2.4	
Crude petroleum		2.5		
Silver		3.5		
Residual fuel oil	6.3			
Blister copper and other unrefined copper	5.7			
Cotton	2.4			

Source: CEPAL.

Table 7. G.D.P./capita, U.S.$

Country	**1990**	**1995**	**2000**	**2005**	**2010**	**2015**	**2017**	**1990-2017**
Bolivia	1,370	1,516	1,626	1,726	1,983	2,390	2,518	84%
Chile	6,073	8,515	9,764	11,332	12,770	14,739	14,906	145%
Peru	2,661	3,140	3,310	3,831	5,021	5,936	6,172	132%
Latin America	6,193	6,657	7,131	7,584	8,578	9,049	8,874	43%

Source: CEPAL.

Table 8. Gini coefficient (1, greatest inequality; 0, greatest equality)

Country	***Year***										
	1989	***1990***	***1994***	***1997***	***2000***	***2001***	***2004***	***2006***	***2007***	***2009***	***2013***
Bolivia	0.537		0.514		0.643		0.565		0.565	0.508	0.491
Chile		0.554	0.552		0.564			0.522		0.524	0.509
Peru				0.532		0.525			0.500	0.469	0.444
USA											0.39

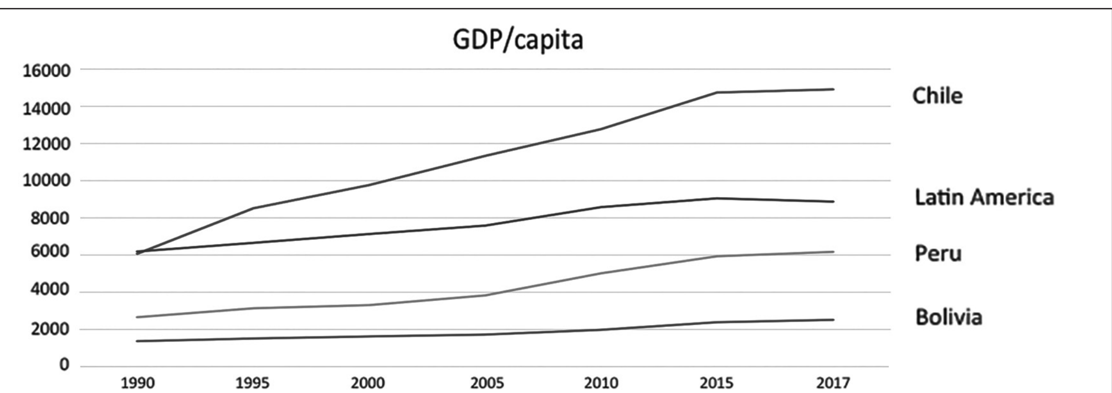
Source: CEPAL, OECD.

Table 9. Share of population below the poverty line, 1990-2016.

Country	***Year***									
	1990	***1996***	***2000***	***2001***	***2003***	***2004***	***2005***	***2011***	***2015***	***2016***
Bolivia				66.4			59.6	45.1	38.6	39.5
Chile	38.6	23.2	20.2		18.7			22.2	11.7	
Peru						58.7		27.8		20.7

Source: World Bank.

Graph 1. G.D.P./capita, 1990-2017, U.S.$



Source: CEPAL

The Economic Consequences of Globalization in sub Saharan Africa[1]

Darlington Sabasi[2] and Johnson Gwatipedza[3]

Introduction

In the past fifty years, globalization has brought countries closer together, immensely shaped a new economic order with numerous and varying consequences. From increased trade, financial openness, movement of people and capital, globalization has offered economic opportunities to peoples of the world and helped take millions of people out of poverty in some regions. While, in other regions, globalization increased imports of cheap foreign goods, increased competition against local firms which led to closure of industries, loss of jobs, and increased poverty.

Globalization has bestowed enormous benefits to some developing economies in East Asia and China. Labor intensive goods manufacturing firms from developed economies relocated into their regions, thus created jobs for the local people, increased exports, and incomes, helped drive the local people out of poverty and destitution. However, in comparison it has also produced dismal results to other developing economies in the sub-Saharan Africa (SSA) region. Inefficient local industries faced increased competition from products produced in other emerging economies, which led to a collapse of the primary and intermediate manufacturing sectors and decimation of the manufacturing base, retrenchment of workers, increased unemployment, , economic decline and increased poverty

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2 Darlington Sabasi was Assistant Professor of Economics at Beloit College.

3 Johnson Gwatipedza is Visiting Professor of Economics at Beloit College.

level. As Rodrik (2017) highlights,

"Elites now concede that globalization produces losers as well as winners. But the correct response, they argue, is not to change course of globalization; it is to ensure that the losers are compensated."

Globalization in the SSA region produced a few winners and many losers. Unfortunately, the losers are not well represented, and there has not been serious discussion about compensating the losers in SSA. Further, the expansion of the economic pie in SSA is being constrained by multifaceted factors which are both internal and external. We discuss some of these issues in this paper and provide some recommendations on the way forward.

The literature argues that the poorly structured SSA economies, with the majority of its workforce in the informal sector, were unable to take advantage of increased integration. During the globalization period, the economic growth in SSA was stagnant or morbid at best. As Stiglitz (2007) points out,

"*In Africa, economic prospects were even bleaker*."

Therefore, we seek to answer the following questions: What were the effects of globalization on SSA? Why were the positive effects limited? Are there any lessons that can be drawn? As we attempt to answer these questions, we hope to come up with some policy implications. SSA is home to over a billion people, most of whom are young people under the age of thirty. Its growth is important to improving the livelihood of its citizens and for the welfare of the global economy at large. While the "…standard argument has been that Africa's economic prospects are not bright because its long-standing problems are hard to fix," as noted by Johnson, Ostry, and Subramanian (2007), we hope that this critical empirical analysis unmasks this smokescreen and "hard to fix" argument by providing examples which show that the problems are not "hard to fix". Thus, a critical analysis is important to inform policy on mechanisms that can be effective for the region to effectively benefit from opportunities provided by the integrated global environment.

Our research objective is to empirically examine the relationship between globalization and the wealth and wellbeing of the citizens of SSA (measured by GDP per capita) in a panel of 39 SSA countries over the period 1996-2015. We closely follow an approach by Dreher (2006), while focusing on SSA and using a different data set and time-period. Other studies that also examined the relationship between globalization and growth includes Dollar and Kraay (2001) and Edison et al. (2002) who provide a review of studies examining the relationship between

indicators of financial integration and growth. Studies that focus on globalization and growth in Africa include Ajayi (2013). However, they lack a detailed empirical analysis.

It is important to examine the globalization economic system so as to ensure that this international integration framework does not leave the poor countries behind. Because of the limited effects of globalization on SSA, it can pose significant risk and threaten the growth in other countries as well. In order for globalization to gain widespread acceptance in developing economies, there is need to structure it so that its systems can create opportunities for the marginalized people in society and also create an environment in which the gains from economic growth are widely shared between the income groups.

The empirical results suggest that there is a positive and statistically significant relationship between GDP per capita and globalization. This suggests that globalization can be a powerful-force that promotes growth not just in developed countries but also in developing countries as well. However, the magnitude of growth is very small. As Rodrik (2017) highlights, globalization should not be rejected but rather there is need to rebalance it to cater for excluded groups. Thus for SSA, there is need to focus on increasing the gains from globalization and explore areas in which the gains can be widely shared.

The remainder of this paper is organized as follows. In section 2 we review some basic conceptual issues of globalization in SSA. In section 3 we present the simple empirical model. In section 4 we present empirical results, a brief discussion of results and identify the main facts and trends. In section 5 we provide some thoughts on the way forward on globalization for SSA and in section 6 we conclude.

Globalization and growth in SSA

This paper contributes to the literature on growth and globalization in SSA (Baliamoune 2002; Freeman 2006; Dreher 2006; Stiglitz 2007; Berman and Martin 2012; Bratton 2013; Rodrik 2017; and Lang and Tavares 2018).

Dreher (2006) considers the effect of globalization on economic growth. Our paper conducts a similar empirical analysis by focusing exclusively on the SSA region. We use an updated dataset on economic, political and social variables from 1996 to 2012. This study does not consider the Northern Africa region, as it is heavily dependent on the exports of the petroleum products and is not subject to

the same shocks as the rest of the continent. Its economic shocks and growth patterns are similar to other Arab economies that are heavily depended on the export of basic petroleum products.

Since the period of international integration in the 1970s, the SSA region's economic growth has lagged that of other comparable developing economies. According to Baliamoune (2002), the growth rate for SSA was much lower compared to the other East Asian Countries including China. Baliamoune (2002) highlights that in 1975, the ratio of per capita income in the richest developed countries (high-income OECD countries) to income in China was 24 to 1. In 1995 the ratio was brought down to 8 to 7. During the period 1975-95, China's income increased almost 10 fold, while in high-income countries per capita income increased 3.5 times. On the one hand, SSA's income in 1995 was less than double its level in 1975, leading to a widening in the gap vis-à-vis industrial countries. In fact, this gap rose significantly (almost doubled) in the 20 years since 1975. There was no convergence that occurred, in contrast the gap between the SSA countries and the emerging Asian and the developed European countries actually increased during this period.

Globalization affected the economic, social and the political environment in SSA. Bratton (2013) points out that the adoption of the cellular telephone network technology has enabled the smooth flow of the remittances, exchange of information for agricultural activities, access to financial services and the development of markets. However, the high transaction fees may discourage the poor citizens from using the information technology in a meaningful way.

The SSA region is rich in mineral resources (Huff, 2007). Huff (2007) argues that globalization increased the demand for primary mineral resources, and increased investments in their extraction. The capital intensive extraction industry provided vital sources of investment capital, tax revenues, infrastructure development and foreign currency reserves. However, Stiglitz (2007) argues that the export of the raw mineral products from SSA without value addition deprives the region of vital rents. In addition, according to Stiglitz (2007), most of the international corporations extract as much wealth from the region and externalize it back to their shareholders in the developed economies. They rarely invest the proceeds of their operations in improving productivity of countries they operate in.

Globalization reformed the international trade regime and opened the international markets by reducing the international tariffs. Allen and Giovanetti (2001) argue that this increased SSA's access to markets for the primary agricul-

tural, raw materials and semi processed manufactured goods that included footwear, glass and metal. However, Berman and Martin (2012) state that exports of the primary raw materials fluctuated massively on the international markets leading to price shocks being transmitted into the SSA economies. They point to the fact that part of the vulnerability of the African exports in the short run comes from the composition effect, because the primary exports prices are disrupted more regularly than manufactured exports. Further, the dependence of African countries from trade finance also explains the vulnerability of SSA exporters to banking crisis in partner countries (Berman and Martin 2012). The SSA's dependency on the primary raw mineral exports and the agricultural sectors meant the growth in these sectors was volatile. There was hardly any value addition, growth in these sectors wasn't enough to generate the growth and revenues to kick start overall economic growth, which implied that it failed to absorb the labor, increase the incomes and put a lot of people out of poverty.

Stiglitz (2007) argues that globalization also meant a surge in the importation of cheap material such as clothing and textiles from other labor surplus economies such as China. Most of the economies in SSA, were structured mostly under the state structured controls, exchange controls and import substitution policies. These public enterprises were inefficient, badly managed through rewarding political patronage with posts, and also corrupt practices of rewarding the politically connected with favorable public tenders and contracts. The public enterprises were a drain on the economies and they focused on the primary and intermediate manufacturing goods sectors. During the international economic integration period, these firms could not compete, failed to take advantages of the opportunities from global integration. They could not compete with the cheap and low quality imports, many firms closed, retrenched workers many of whom were absorbed in the overcrowded informal sector space.

The integration of the financial markets has allowed countries and firms in SSA to access capital for inventory purchases, trade credit, public investments, provision of public goods and growth. However, the international capital markets have exposed SSA to external shocks that originate in the developed economies (Mendoza 2010). This has created, in some cases, a sudden flight of capital from the SSA region, leading to the drying of the credit markets, exchange rates volatility, increased foreign denominated debts, and firms being driven into solvency, sale of assets at a bargain in order to meet the debt obligations, retrenchments, job losses and economic recessions.

Tang and Tavares (2018) state that within countries, the gains from globalization are concentrated at the top of the income distribution. The politically connected families have benefited through engagement in joint ventures with the foreign investors in the extractive industries and this has increased inequality. Poor growth rates can be attributed to the fact that globalization occurred when SSA countries had gained independence and still suffering from the effects of colonial discrimination, in which the native people where denied access to education, land, and means of production. Therefore, these newly independent countries did not have a majority well skilled citizens and entrepreneurs to take advantage of the opportunities created by the international integration.

Stiglitz (2007) argues that a number of the multinational companies bribed the politicians to access the minerals concessions, instead of paying a fair market value for the mining concessions involved, which deprived the countries of the much needed funds for investment and development in order to take advantage of globalization. For example, in Wyoming in the United States, state mineral royalties for oil and gas on production were increased from 18.5% to 20% in 2017 whereas in the Democratic Republic of Congo the mineral royalties for cobalt and other materials was increased from a mere 2 to 3.5% in 2018. This is just one example of many other similar cases. This implies that SSA is losing billions of dollars in extractive and mining industries. With very low royalty rates, the rents are repatriated oversees. The officials with political power enjoy the windfalls of the corrupt activities, while the rest of the citizens lose on potential royalties and taxes from the leases for public investments, thus further increasing the wage gap.

The movement of people has been affected by globalization. Freeman (2006) argues that the migration of labor from developing countries including SSA help these countries with a critical source of remittances from emigrants. These remittances account for a large share of foreign currency for the importation of critical inputs and goods such as medicines. However, Freeman (2006) argues that the emigration of highly skilled workers causes a brain drain in critical areas such as the health sector that might be harmful to the region. The emigration might be harmful to SSA which heavily invested in the schooling of the emigrants but do not gain from such investments.

Obi (1999) argues that some of the SSA countries lacked strong environmental protections, which led to extraction practices that compromised and destroyed the natural environment such as the oil spills in Delta region of Nigeria, and lead contamination of water sources from copper extraction in Zambia. The unsus-

tainable extraction of resources led to the contamination of the river systems, land, forests, and cultivation fields thus negatively threatened the livelihoods of local people.

Konig et al. (2017) state that globalization led to the world powers to seek control and access to resources in other regions such as the conflict in Libya over the control of the rich oil fields. Konig et al. (2017) argue that the external pressure groups sometimes want to maintain the *status quo*, exploit mine resources and therefore might sponsor the proxy war. They highlight that in SSA the demand for the control of mining resources witnessed countries involved in a regional conflict in the Democratic Republic of Congo that involved, Rwanda, Uganda and other Southern African Development Countries (SADC) such as Zimbabwe and Angola. The conflict led to increased instability in the region, human abuse and suffering, loss of lives, and the destruction of property. The recent conflict in Southern Sudan has been enabled by funding from foreign actors who are supporting the factions in order to share in the control of the oil fields. The global financial system has also made it easier for foreign groups to provide support and financial resources to support insurgent and terrorist groups in SSA.

Therefore, our paper seeks to empirically analyze the overall effect of globalization on SSA Africa outlined in the literature. In the empirical analysis we add a globalization index that includes both political, social and economic variables, and determine its effect on growth in SSA.

Empirical model and estimation procedure

The empirical model we estimate is:

$$GDP\ per\ capita_{it} = \beta_0 + \beta_1 glob_{it} + \gamma' \boldsymbol{X}_{it} + \delta_i + \varepsilon_{it},$$

where *glob* is globalization index for country *i* in year *t*, **X** is a set of control variables which includes natural logarithm of lag of GDP per capita; fertility rate and life expectancy; natural resources as a percentage of GDP; government consumption as a percent of GDP; worldwide governance indicators measured as percentile rank for rule of law, voice of accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, and control of corruption; and time trend as a technology measure; δ_i are time-invariant country fixed effects and ε_{it} is the error term. The parameter of interest is β_1 which shows the association between globalization and GDP per capita.

The globalization measure is the KOF index which captures economic, po-

litical and social integration. We anticipate a positive sign for the globalization index – the more integrated a country is the higher the expected GDP per capita. The control variables are included based on prior studies by Dreher (2006) and Ezcurra and Rodríguez-Pose (2013). The variables, their descriptions, unit of measurement and source are presented in Table 1.

Table 1. Summary Statistics

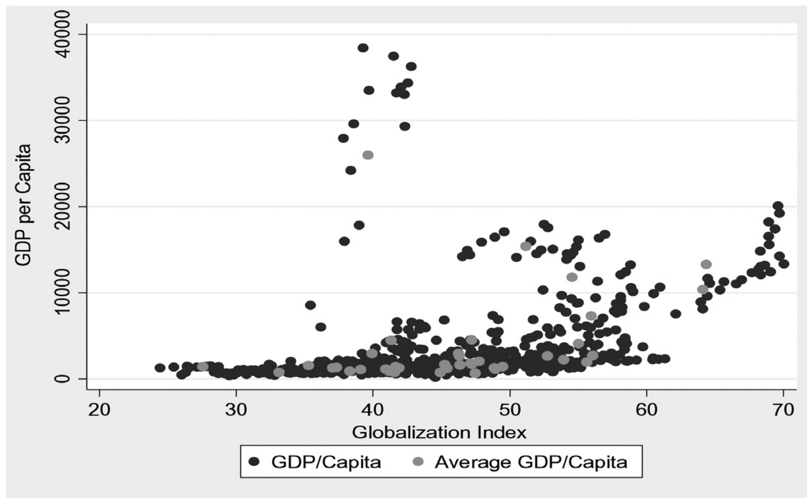
Variable	**Mean**	**Standard Deviation**	**Minimum Value**	**Maximum Value**
GDP per capita	3716.300	5500.599	194.903	38441.350
Globalization index	46.099	8.851	24.406	70.025
Fertility rate	5.123	1.159	1.360	7.716
Life expectancy	56.038	6.222	35.923	74.353
Natural resources	14.334	13.348	0.001	68.815
Government consumption	15.403	9.185	2.047	88.983
Rule of law	29.717	20.311	0.474	83.663
Voice of accountability	32.017	19.251	0	77.612
Political stability and absence of violence/terrorism	34.331	21.731	0.476	93.750
Government effectiveness	27.705	20.286	0.957	83.060
Regulatory quality	30.158	19.146	0.474	83.654
Control of corruption	30.423	21.130	0	84.848

Summary statistics are presented in Table 2. Figure 1 presents a scatter plot of globalization and GDP per capita. The scatter plot suggest that, generally, the higher the globalization level the higher the GDP per capita. However, the GDP per capita for developing economies with a high level of globalization are very low when compared with those in the developed economies with also higher and comparable globalization levels.

Table 2. Variables, Descriptions, Units, and Sources

Variable	Description	Measurement	Source
GDP per capita	Gross domestic product divided by the country's population	Current international $	World Development Indicators (WDI)
Globalization index	Overall index - weighted economic, social, and political	Index	KOF
Fertility rate	Birth per woman	Number	WDI
Life expectancy	Life expectancy at birth	Years	WDI
Natural resources	Sum of rents for oil, gas, coal, minerals, and forest	Percent	WDI
Government consumption	All consumption of goods and services	Percent	WDI
Rule of law	Perceptions of the extent to which agents have confidence in and abide by the rules of society - the quality of contract enforcement, property rights, the police, and the courts, and the likelihood of crime and violence.	Percentile Rank	Worldwide Governance Indicators (WGI)
Voice of accountability	Perceptions of the extent to which a country's citizens are able to participate in selecting their government, freedom of expression and association, and a free media.	Percentile Rank	WGI
Political stability and absence of violence/ terrorism	Perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.	Percentile Rank	WGI
Government effectiveness	Perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.	Percentile Rank	WGI
Regulatory quality	Perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.	Percentile Rank	WGI
Control of corruption	Perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, and "capture" of the state by elites and private interests.	Percentile Rank	WGI

Figure 1. Scatter Plot: GDP per capita and globalization index



Results and discussion

Before estimating, we use the Modified Wald and Wooldridge tests for heteroskedasticity and autocorrelation, respectively. The results, presented in Table 3, show that we cannot reject the presence of these problems in our dataset.

Table 3. Diagnostic Tests Results

Diagnostic Test	**Test Statistic**	**Null Hypothesis**	**Test Statistic (P-Value)**
Wooldridge (autocorrelation test)	F(1, 38)	No first-order autocorrelation	36.15 (0.000)
Modified Wald (heteroscedasticity test)	χ^2 (39)	$\sigma_i^2 = \sigma^2, \forall i$	16,114.77 (0.000)
Hausman (test for regional FE vs RE)	χ^2 (11)	Difference in coefficients not systematic	530.05 (0.000)

In addition, we performed the Hausman specification test (Hausman 1978), to determine whether to use a random or fixed effects panel data estimator. The test results support using a fixed-effects estimator. In columns 1-4 in Table 4 and in column 4 we present the robustness check estimates where we use fixed effects estimator and drop all worldwide governance indicators except the rule of law measure to circumvent potential multicollinearity problem.

Table 4. GDP per Capita and Globalization (1996-2015)

	(1)	(2)	(3)	(4)	(5)
	FE	**RE**	**FE**	**FE**	**Robustness Check**
ln(GDP per capita) t-1		0.523***	0.146***	0.120**	0.147***
		(0.093)	(0.054)	(0.053)	(0.056)
Globalization index	0.018***	0.015**	0.019***	0.012***	0.021***
	(0.003)	(0.006)	(0.004)	(0.004)	(0.004)
ln(fertility rate)	-1.305***	-0.716***	-0.851***	0.044	-0.853***
	(0.351)	(0.236)	(0.288)	(0.358)	(0.296)
ln(life expectancy)	1.030***	0.726***	1.101***	0.181	1.104***
	(0.324)	(0.222)	(0.285)	(0.310)	(0.287)
Natural resources (rents in percentage of GDP)	-0.004	0.007**	-0.004	-0.003	-0.004
	(0.004)	(0.003)	(0.003)	(0.003)	(0.003)
Government consumption (in percentage of GDP)	-0.003	0.001	-0.002	-0.001	-0.002
	(0.002)	(0.003)	(0.002)	(0.002)	(0.002)
Rule of law (percentile rank)	0.003	-0.005	0.001	0.003*	0.001
	(0.002)	(0.004)	(0.002)	(0.002)	(0.002)
Voice of accountability (percentile rank)	0.001	-0.002	0.002	0.001	
	(0.002)	(0.003)	(0.002)	(0.002)	
Political stability and absence of violence/ terrorism (percentile rank)	0.0004	0.005**	0.0001	0.001	
	(0.001)	(0.002)	(0.001)	(0.0009)	
Government effectiveness (percentile rank)	-0.006*	0.005	-0.004	-0.001	
	(0.003)	(0.003)	(0.003)	(0.003)	
Regulatory quality (percentile rank)	0.003	0.004	0.003	0.004**	
	(0.002)	(0.003)	(0.002)	(0.002)	
Control of corruption (percentile rank)	0.001	-0.006**	-0.001	-0.001	
	(0.002)	(0.003)	(0.002)	(0.002)	
Time				0.031***	
				(0.006)	
Intercept	4.828***	1.063	2.609*	4.933***	2.559
	(1.650)	(1.064)	(1.492)	(1.504)	(1.532)
R-Squared (within)	0.67	0.50	0.72	0.75	0.71
Number of observations	617	617	617	617	617

Notes: robust standard errors in parentheses; * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$; parameter estimates for country fixed effects suppressed. RE – random effects model; FE – fixed effects model.

Estimation results presented in Table 5, show that the globalization index is positive and statistically significant across all the five models. However, the magnitude of the coefficient estimates is very small indicating that although the impact of globalization on growth in SSA has been positive in the period under consideration, the gains have been minimal. The estimates also have expected signs in all the models with the worldwide governance indicators largely insignificant.

Our results suggest that globalization brought positive contribution to economic growth in SSA. However, the growth was not large enough to bestow meaningful contribution to a majority of its citizens. Further, these results might also suggest that the positive incentive effects of globalization were not large enough to significantly overpower the negative effects that it also created.

Plausible contributors to minimal gains from globalization are the local political economy failures and international corruption. Most countries in SSA were heavily involved in the economies through the state owned companies and also the defense industries. These companies formed a major component of the government expenditures. They were involved in billions of dollars in procurement of equipment and services. The developed world governments, emerging economies such as China and international multi-corporations have been involved in massive bidding contracts to supplying capital equipment such as defense equipment, combat war planes, building nuclear facilities, supply of trains, construction of roads and rail. These organizations have helped in ensuring that technology and capital is available to the SSA economies for their growth.

However, in most cases these organizations have bribed politicians in SSA in the magnitude of billions in order to win the contracts. In some cases, they have colluded with the politicians and charged exorbitant prices for the supply of the materials outlined in the tenders, and shared the loot with the corrupt politicians. They have also helped the politicians to hide the looted money in international tax havens such as Hong-Kong and Dubai so that it's beyond the reach of the local law enforcement officials, thus denying the developing countries the much needed resources for the building of their countries. In addition, most of these organizations also employ the services of international auditing firms operating in SSA, who have helped them hide their unscrupulous corrupt and unethical behavior in both the international organizations and the state owned companies. In some instances, these audit firms have also been involved in lobbying corrupt officials in the state owned enterprises for auditing

business, such that they encounter conflict of interest that prevents them from exposing wrongdoing in the fear of losing business clients.

In SSA, some of the international organizations and individuals collude with the politicians and capture the state, in which the organization receive favorable deals from the government owned enterprises, siphon public funds from bogus consultancy, extract rents by acting as middlemen between international suppliers and state owned enterprises, transfer government assets to them on favorable terms, use government resources and guarantees to buy private assets, and use political connections to force a transfer of private firms to their ownership on favorable terms. The McKinsey and Eskom 2018 scandal in South Africa are two examples.

When the international organizations have been involved in wrong doing in SSA, the home governments have been reluctant to investigate and pursue criminal charges against the violators. Instead the developed economies leaders have often bullied, threatened and pressured the SSA governments to drop cases of wrong doing on the part of these international organizations. Due to this undue pressure, international corporations who engage in wrong doing have rarely been held to account and sometimes in the process, they impose billions of dollars in losses to developing country economies.

The international organizations that win the bidding process, have refused to assemble some of the equipment in SSA and use some of the locally produced intermediate manufactured goods, thus keeping away demand for the manufacturing industries products in SSA and denying them learning process by doing process opportunities and also not building local capacity that can repair the assets when the international organizations have left. In many instances, the international organizations have insisted on importing labor from their home countries to work on the projects in SSA, yet these countries enjoy abundant and excess labor. These practices have led to the displacement, further depressed employment opportunities for the local people, and the deprivation of their own livelihoods. Some of the projects such as building of roads are of poor quality due to poor workmanship. They often do not reflect a true value for money. They require huge maintenance costs, and have given the public financial constraints. Further, these assets deteriorate fast while the debt burden balloons.

The way forward: Making globalization work for SSA

The SSA region offers a great potential for driving the world economy. While other regions are witnessing a decline in population growth, its population is growing and just over a billion people with a majority below 35 years of age, and thus can be an important source of labor in the foreseeable future. The SSA economies generate more than a trillion dollars in GDP every year with a great potential for accelerated growth, which can act as an important market and source of goods for the global economies. In order for globalization to work in SSA we propose a number of initiatives.

The presence of a young and educated labor-force can provide an incentive to international companies to relocate some of their manufacturing processes and activities to SSA to take advantage of the abundance of labor, and the rapidly increasing skilled workforce. Its geographic proximity to most developed countries makes it ideal for western companies to locate in Africa. The presence of a well-developed public and transport infrastructure can enhance the productivity of the region. Public and private programs that can help SSA improve access to public goods and critical production inputs by investing in electricity generation through solar and wind energy potential, will ensure that the region undergoes a strategic growth path that is less dependent on the fossil fuels, and that can fully capture the opportunities from global integration.

The opening up and conclusion of the agricultural trade negotiations round within the International Trade Organization, will help the SSA countries to thrive, by opening of developed countries' markets to their markets to agricultural products, and also a reduction in the farm subsidies that harm the producers in SSA. The elimination of tariffs and trade restrictions by developed economies on semi-processed agricultural products such as coffee and tea, will encourage the development and growth of agro-processing firms that can create jobs for the local people, while adding value to the production chain. Incentives that encourage international agro-processing firms to locate in the SSA region would help with the development of the manufacturing industry close to the source of inputs, improve the export value of the agricultural sector.

The modern consumers in addition to purchasing a product, care about the social responsibility of the companies. By enacting legislation to promote social responsibility in the principle of African humanism or *ubuntu* which strongly emphasis the traditional communitarian values, the SSA region can engage and

encourage firms to build strong social responsibilities that benefit and help improve the livelihoods of the local people.

The continent is rich in mineral and other natural resources, in which they do not capture the maximum value along the chain as they only export the resources in their raw and natural form. Legislation that give priority to processing the resources before exporting, and the establishment of joint ventures across SSA countries would encourage value addition that increases rents for the region. For example, the government of Botswana passed a law that required diamonds mined to be processed and cut locally before exporting. This initiative has the potential to be expanded to other minerals such as cobalt in which governments such as the Congo can enter into a joint venture with an international company to process cobalt and have goods such as batteries for cars and cellphone be produce locally. Such firms will provide the much needed jobs for the locals, and also support downstream firms. Each country in SSA could then have a manufacturing hub for the continent specializing in a resource(s) it has a comparative advantage in.

The region lacks adequate institutions to deal with economic and financial shocks. The creation of a regional development bank, established with member contributions will help the region pull their resources together for a stabilization fund along the lines of the Brazil Social and Development Bank and provide locally based risk insurance against financial, foreign exchange, foreign debt, and external shocks. The bank would act as a lender of last resort, provide credit and also as a development bank that can provide loans to big business as well as small and medium enterprises that are engaged in entrepreneurial activities such as textiles and shoe manufacturing. This would enable the region to craft homegrown solutions to problems without undue external interference. This would reduce the reliance of the region on international development institutions, that may not serve their interests well and who also bring adverse strings attached to the loans.

To ensure the smooth flow of goods and capital between regions, this requires cooperation in the international community. The global economy is changing, policy makers need to adapt and keep up. Information sharing and transparency between the different tax authority jurisdiction, should help combat illicit financial flows, externalization of funds, money laundering and the evasion of taxes by individuals and firms. A mechanism that makes it easy for the full return of externalized funds from corruption back to their countries of origin, would help bring justice - and justice, equality, and liberty are the premise of growth. If the developed countries step up prosecutions of corruption that occurred in SSA in

their jurisdictions, that should serve to deter the looting of public funds. A new framework on rules that govern the taxation of value created along the production chains in different jurisdictions need to be pursued within the Nations, the Committee of Experts on International Cooperation in Tax Matters in which all the interested parties' views are considered.

An educated population is an important primer for growth. Investments in teacher training, vocational and university education, can improve the skills of the young people of SSA and contribute to production and growth of the economy. Partnerships with international education institutions that encourage them to open up satellite campuses and provide online classes to cater for some of the SSA populations that can pay for the education, will help provide quality international education to the region.

The royalties paid by international companies extracting natural resources in developing countries is about 20% lower than the rates they pay to extract the same resources in developed economies (Alt et al., 1983). The development of legislation that increases mineral and natural resources royalties in line with current international averages, and building the capacity for the states to collect the funds will enable governments to easily fund public expenditures and growth. Establishment of funds from royalty payments along the lines of the Alaska Permanent Fund, or the Wyoming Endowment fund, to build savings for the benefit of the local people for use to support education, infrastructure, health and also remittances to the populations would be important to development. The governments can create Sovereign Wealth funds along the lines of Denmark, so that they can take advantage of high returns and ensure that future generations continue to benefit long after the natural resources have been exhausted.

A majority of people in SSA lack access to resources and means of production such as land. Major reforms that ensures that land is equitably shared and is not only in the hands of the few politically connected elite, the distribution of mineral rights to local people, will give people the opportunity to work the land, improve productivity, increase output and incomes.

The SSA region is likely to be one of the areas most impacted by climatic change. A creation of an international fund for the SSA countries to access loans that can be used in the mitigation and adaptation to climatic change would help reduce the negative impacts. The developing countries can also get some financial incentives for implementing measures to reduce emissions of GHGs. The international community and the East Asian countries in particular working with SSA,

can help combat illegal hunting of wildlife and selling of animal products such as rhino horns or elephant tasks. This will help reduce pressures on poaching and promote the existence of biodiversity and natural beauty in SSA.

Conflict has been a major setback for development in the region. Closer economic integration, development of infrastructure, inclusive and equitable distribution of resources and power may help raise the costs of conflict and reduce their occurrence. Efforts should be doubled by the international community to ensure that conflicts are resolved, and those who finance proxy wars are punished. The international community working with SSA governments have capacity to peaceful conflict resolution and put an end to conflicts that have been going on for years. The international community, needs not to be quick in slapping economic sanctions on some of the repressive dictatorships in SSA, but they should engage with them, use diplomacy, soft power, pressure regional allies so that tensions are resolved without penalizing the general population.

Within SSA much progress in terms of formulation has been made and there is a growing awareness and realization that its growth prospect can only be truly achieved if its driven internally rather than to always be relying on other countries outside the region. The recent African Free Trade Continental Area (AfCFTA); the recently developed African passport; efforts being made for a common African language devoid of any colonial inheritance; a universal currency similar to the Euro; and eventual integration of the region back to one unit by demolishing the demarcations from the 1884-85 Berlin conference is commendable. Speedy progress in these areas offer an opportune growth avenue. Recent resurgent in engagement between Ethiopia and Eritrea after over two decades, as one example, should be the torch bearer and other hostilities between SSA countries should be diffused to enable increased economic, political, and social integration. Given developments in other parts of the world such as Brexit and the U.S., a great opportunity exists for Africa to unite and capitalize.

Concluding remarks

This paper revisits the argument that globalization would induce a rapid economic growth and transformation for Africa. Our research objective is to empirically examine the relationship between globalization and the wealth and wellbeing of the citizens of SSA.

The results show that the globalization index has a positive and statistically

significant association with GDP per capita. However, the institutional quality indicators such as rule of law and regulatory quality are largely insignificant. This finding supports results from prior studies which find that globalization has had a positive impact on SSA's economic growth. However, the magnitude is very small indicating that though the impact has been positive, gains have been minimal.

While SSA's economic growth and well-being of its populations have benefited from globalization, there is still great room for improvement if globalization's full potential is to be unlocked. The region can learn from the experiences of other regions and implement their own reforms to make globalization work and deliver sustainable growth. That a region with an abundance of natural resources, an educated, young and hardworking labor force still has a huge population in dire poverty and living on less than a dollar a day is quite mind-boggling.

We applaud efforts being made to further integrate the region internally and to start shifting focus on sources of economic growth to its citizens both internally and externally. A lot more still remains to be done that could help fast-track SSA's realization of the globalization benefits. Increased investment in young people, setting up of manufacturing hubs that cater for the region; increase access to agricultural land, input, output and credit markets; a framework for helping the region adapt to climate change; speedy conflict resolutions; change in approach by the international community on how to handle some of complex political issues e.g. a restrain in imposition of sanctions; and reevaluation of how rents from extraction of natural resources are shared with international corporations are all examples of strategies that might help increase SSA's gains from globalization. We remain cautiously optimistic!

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Manufacturing in Ethiopia and Tanzania: Challenges and Opportunities

Xinshen Diao[1] **and Margaret McMillan**[2]

There is no doubt that a healthy manufacturing sector can help to bridge the gap in income levels between rich and poor countries (Rodrik 2013). The historical importance of manufacturing in economic growth has not gone unnoticed by African policymakers. For example, the President of the African Development Bank, Akinwumi Adesina notes that "Africa must quit being at the bottom of the global value chain and move to rapidly industrialize with value addition to everything that it produces." (AFDB, 2017). Indeed, the expansion of modern manufacturing, is at the core of African countries' growth strategies.

In some African countries, manufacturing appears to be performing well. For example, in Ethiopia and Tanzania – two of the most rapidly growing African economies – value added in manufacturing grew more rapidly than GDP (Figure 1). In fact, manufacturing value added grew more rapidly in these two countries than it did in Vietnam over the period 2000-2016 – albeit from a lower base. Manufacturing employment also grew rapidly in Ethiopia and Tanzania (Figure 2). A good deal of the expansion in the manufacturing sector occurred in the informal sector (Diao et al, 2018). This is not surprising since Ethiopia and Tanzania are still two of the poorest countries in the world. Growth in these countries has been accompanied by a significant increase in the demand for locally produced services and goods – a natural part of the development process (Lewis, 1979).

But while growth in informal manufacturing is not a problem per se, it will

1 Xinshen Diao is Senior Research Fellow, International Food Policy Research Institute (IFPRI).
2 Margaret McMillan is Professor of Economics, Tufts University; Research Associate, NBER; Senior Research Fellow, International Food Policy Research Institute (IFPRI).

not be a driver of economywide productivity growth. In fact, the growth in informal manufacturing may be one of the explanations for the poor within-sector productivity growth in manufacturing documented by Diao et al 2017. But there are at least two other plausible explanations. The first is the difficulty of measuring output in the informal sector.[3] A more worrying explanation would be poor performance in the formal manufacturing sector.

To disentangle these explanations, this paper examines the performance of formal manufacturing firms in Ethiopia and Tanzania using firm level census data for the periods 2001-2013 (Ethiopia) and 2008-2013 (Tanzania). The comparison between Ethiopia and Tanzania is instructive for a number of reasons. First, Ethiopia is often held up as exemplary when it comes to promoting manufacturing in Africa. The government's policies have been designed to promote labor-intensive garments and footwear for overseas export and participation in global value chains (GVCs). It is often referred to in the popular press as the new China. However, Ethiopia's manufacturing export performance has been disappointing. The share of manufactured exports in GDP has declined from 1.8% of GDP in 2001 to 0.8% of GDP in 2016. Tanzania has performed well by comparison. Its share of manufacturing exports in GDP rose from 1% in 2001 to around 3% in 2016. In stark contrast to Ethiopia, Tanzania exports mostly resource-intensive manufactured products to other African countries.

We set the stage for this essay by describing Africa's recent growth boom and comparing it with growth in low income Asian countries; this section draws heavily on work by Diao et al 2017. Next, we turn to an examination of firm performance in the formal manufacturing sectors of Ethiopia and Tanzania. We then relate these patterns to the patterns observed by Chinese investors in African manufacturing. In the next section, we examine the performance of the informal manufacturing sector in both countries. We conclude this essay by laying out key challenges to and opportunities for manufacturing in these two countries touching on their relevance to the rest of Africa.

3 This is because the employment numbers used for the productivity calculations often come from population censuses while the value added numbers are based on national accounts. Estimating the output of the informal sector is notoriously difficult since these businesses typically do not pay taxes and and are often run out of the household; by contrast employment is easier to count.

Africa's Recent Growth Boom

Average growth rates in most African countries have been positive for the past two decades and, in some of the fastest-growing economies, have exceeded six percent per annum. In many countries, this growth persists in spite of the decline in commodity prices. A good deal of this growth is a result of structural changes in the economies of Africa. As in other developing regions, structural change in Africa has been characterized by a significant decline in the share of the labor force engaged in agriculture. This is a positive development, because agriculture has been, *on average,* the least productive sector in the economies of Africa. However, unlike in East Asia, structural change in Africa has not been accompanied by rapid industrialization (Diao et al, 2017a).

In more recent work, Diao et al 2017b decompose episodes of rapid labor productivity growth in developing countries into three components: (i) the part due to agriculture; (ii) the part due to within sector labor productivity growth in sectors other than agriculture and; (iii) the part due to structural change or the movement of labor out of low productivity sectors (agriculture) and into higher productivity sectors (manufacturing and services). Figure 3 summarizes the growth decompositions by region. Labor productivity growth is reported along the horizontal axis and ranges from around minus 1 percent to close to 5 percent when East Asia is included. The bars are coded according to how much of labor productivity growth comes from structural change (in Gantt chart) and how much comes from within-sector labor productivity growth in agriculture (in diagonal lines) and in nonagricultural activities (in black).

After the growth acceleration, structural change contributes significantly to growth in Africa. This is not surprising since we expect the payoff to structural change to be greatest in poor countries. However, the contribution of within-sector labor productivity growth in the nonagricultural sector is smaller than labor productivity growth in agriculture in Africa during this period. Moreover, Figure 4 reveals that the relationship between within-sector productivity growth (in the nonagricultural sector only, horizontal axis) and the labor productivity growth that arises as a result of structural change (vertical axis) is negative for Africa. This implies that changes in the output structure are slower than changes in the employment structure across most African countries during the period of growth accelerations.

This pattern holds for manufacturing (red dots) and implies that annual labor

productivity growth in the manufacturing sector has been negative (Ethiopia) or close to zero (Tanzania). This is troubling. As we noted in the introduction, most African policymakers see industrialization as a sine qua non for development. These patterns reveal that in spite of rapid growth in value added, manufacturing has not been contributing to growth in output per worker. To better understand the reasons that manufacturing has not been contributing to growth in output per worker, we turn to the cases of Ethiopia and Tanzania, two countries with very high growth rates in manufacturing value added.

Formal Sector Manufacturing in Ethiopia and Tanzania

Our analysis of the performance of the manufacturing sector is based on firm level census data for Ethiopia for the period 2001-2013 and for the period 2008-2013 for Tanzania. We restrict our analysis to firms with 10 or more employees or manufacturing firms in the formal sector. Using these data, we examine trends in value added, employment, capital intensity and labor productivity by firm type (foreign vs domestic and exporters vs non-exporters). Importantly, things are still evolving rapidly in these two countries and 2017 censuses will soon become available. However, based on our knowledge of the situation in both countries, the trends we uncover here are unlikely to change. We complement the firm data with international trade data to explore the composition and destination of exports.

Value Added and Exports

We begin by comparing growth in value added and exports in formal manufacturing to the results obtained using the national accounts data. Annualized growth rates are reported in Figure 5 for the period 2001 to 2013 with the exception of the firm level results for Tanzania where firm level data are only available beginning in 2008. The results reveal a remarkable similarity between the firm level statistics and the national accounts and trade data for both countries. The implication is that all of the growth in manufacturing value added is coming from the formal sector – a point to which we shall return. They also reveal that the value of Tanzania's manufacturing exports grew twice as rapidly as manufacturing exports from Ethiopia. This is surprising given the Ethiopian governments' single- minded focus on promoting manufacturing exports. To exclude re-exports, we went through the products item at the HS 6-digit code and removed all items

that are not produced domestically based on the firm surveys. Thus, our export numbers are smaller than those reported in UN comtrade.

Figure 6 – based on trade data - reveals the steady upward trend in the value of exports from both countries. It also reveals a striking difference in the destination of exports from the two countries. Ethiopia's exports go almost exclusively to countries outside of Africa. This is consistent with what we know about the Ethiopian governments push to include Ethiopia in global value chains. By contrast, a large majority of Tanzania's exports go to other countries in Africa. Note that we are confident that the patterns observed in Tanzania do not include re-exports.

Next, we dig into the product composition of exports from each of these countries. To do this, we examine the top 50 export products in each country and classify them by industry. The top 50 exports from Ethiopia account for 65% of Ethiopia's manufacturing exports; 84% of the top 50 products are classified as textiles including leather and footwear (Figure 7). We group textiles, leather and footwear together because these are typical labor-intensive exports that form part of global value chains (GVCs), the process of the geographic fragmentation of distinct parts of the processes of production whereby labor-intensive aspects of the process are often located in low wage countries (Sturgeon, 2010). The product mix revealed by this analysis is consistent with the results showing that almost all of Ethiopia's exports go to destinations outside of Africa. Other non-textile manufacturing consists of agri-processed goods and other material intensive products.

A similar analysis for Tanzania reveals a very different pattern (Figure 8). 85% of Tanzania's export products are resource intensive with 50% classified as agri-processed goods and another 35% classified as material intensive products. The agri-processed goods consist of items like bottled juices, cooking oils and packaged flour while the resource intensive products consist of items such as wood products and furniture, household articles made from plastic materials such as buckets, washbasins, chairs and clothing hangers, and construction materials such as cement, glass, and ceramic products. In sum, agri-processed goods and resource intensive goods account for 68% of total manufacturing exports. While Tanzania does export some textile products, its' share in total manufacturing exports is tiny at less than 10%.

Labor Productivity, Capital Intensity and Employment

As we noted in Section 2 of this paper, economywide labor productivity growth within manufacturing has been dismal in both Ethiopia and Tanzania. Can any of this be a result of poor performance in the formal manufacturing sector in these two countries? To answer this question, we examine labor productivity, capital intensity and employment generation in each of these two countries using Tanzania's Annual Survey of Industrial Production (2008), Tanzania's Census of Industrial Production (2013), and Ethiopia's annual Large and Medium Scale Manufacturing Establishment Census (LMSM) for the years 2001-2013.

For Ethiopia, we report two periods: 2001-2013 and 2008-2013. We do this for two reasons. First, Ethiopia went through a rough period in the early 2000s that included political turmoil and drought. Thus, we expect that the latter period will be more informative of future prospects for manufacturing in Ethiopia. Second, we currently only have firm level data for Tanzania for the years 2008 and 2013. But unlike Ethiopia, Tanzania is one of the most politically stable countries in all of Africa and did not experience any serious droughts. [4]

The set of bars to the far right of Figure 9 show that labor productivity growth in Tanzania's formal manufacturing sector was 9% per annum between 2008 and 2013. Ethiopia's labor productivity growth was 3% per annum over the 13 years period beginning in 2001 but jumped to 9% over the period 2008 to 2013. These are very high growth rates of labor productivity in manufacturing. To put this in perspective, consider that average annual labor productivity growth in the US manufacturing sector between 1947 and 2017 was only 2.1% (U.S. Bureau of Labor Statistics). These numbers reveal that the low to negative economywide labor productivity growth in manufacturing reported in Diao et al 2017 are not the result of the productivity performance of formal manufacturing.

Breaking down the labor productivity growth by firm type is revealing. The fastest labor productivity growth – almost 19 percent per annum – occurred in Tanzania in the group of foreign firms that produce for local markets. By contrast, labor productivity growth in foreign firms that export was only 7% in Tanzania and 3% in Ethiopia and only over the most recent period 2008-2013. This may

4 We expect to have data for 2017 by the end of 2018 for both Ethiopia and Tanzania. We are working with the National Bureau of Statistics in Tanzania on the years 2009-2012 and hope to be able to include them in the analysis also by the end of 2018.

be due to the fact that foreign firms only entered these countries recently – an examination of the 2017 data will help to refute or bolster this supposition. However, productivity growth in local firms that do not export from Ethiopia was 3.8% from 2001-2018 and 11.3% from 2008-2013.

Figure 10 reveals that the productivity performance of manufacturing firms in Ethiopia and Tanzania was associated with capital deepening. Like productivity growth, capital deepening in Tanzania was most pronounced among foreign firms that produce for local markets at 19%. Somewhat surprisingly, capital deepening was significantly higher (19%) than labor productivity growth (3%) in foreign firms than manufacture for export in Ethiopia. But this is true only for the period 2008-2013.

Figure 11 reveals that in total, employment growth in the formal manufacturing sector was modest. Annual employment growth in Tanzania was close to 0% for the period 2008-2013 while in Ethiopia it was roughly 7% for the period 2001-2013 and 5% for the period 2008-2013. However, when we break employment out by firm type, we see that employment growth in foreign firms in Ethiopia was relatively rapid at 10% in the period 2001-2013 and 15% in foreign firms that export and 26% in foreign firms that serve local markets in the period 2008-2013. Employment growth in local firms that export was negative in both Ethiopia and Tanzania over the period 2008-2013. The only significant employment growth in Tanzania occurred in local firms that produce for local markets and was a little over 10%.

In Figure 12, we report the share in formal sector manufacturing employment changes by firm type. In Ethiopia, 80% of the jobs created in the formal manufacturing sector were created by firms that produce for local markets; 61% of these jobs were created by foreign firms. By contrast, on net only 20% of the new jobs in formal sector manufacturing were created by firms that export with all of this net job growth coming from foreign firms. By contrast, in Tanzania local firms producing for local markets were responsible for almost all of the employment growth. The combined employment in foreign and local firms that export contracted as did employment in local firms that export.

The patterns of employment growth in the export sectors of both countries are consistent with the trade patterns. Textiles and leather products which comprise the bulk of Ethiopia's exports are labor intensive. By contrast, agri-processing and the manufacturing of other resource intensive products like cement and ceramic tiles are capital intensive.

Summarizing, the bulk of employment and productivity growth in formal manufacturing in both Ethiopia and Tanzania occurred among firms producing for local markets. Even in Ethiopia where foreign export firms contributed significantly to employment growth, the bulk of the employment growth came from foreign and local firms producing for local markets. And in Tanzania where employment growth was close to zero, local firms producing for local markets are the only firms in which employment grew.

Chinese Manufacturing Investment in Ethiopia and Tanzania

That much of the foreign investment in Ethiopia is by firms targeting local markets seems at odds with what has been reported in the popular press about Chinese investment in the country. Figuring out exactly how much and what type of Chinese investment there is in African manufacturing is, however, quite difficult. As Brautigam et al (2018) note, Chinese official statistics are at odds with the official statistics produced by African investment agencies and neither appear to be completely accurate. At least part of the confusion has to do with the fact that firms that get licenses often do not follow through on investments.

To get a better sense for what is happening on the ground, Brautigam and her colleagues conducted scoping studies of Chinese industrialists in Africa between 2014 and 2016. To identify countries and firms, they used the Ministry of Commerce Overseas Investment Database (MOFCOM OFDI) along with lists of Chinese investments that were registered with local investment authorities. From this database, they selected the four low- and lower middle-income African countries with the largest number of manufacturing investment registrations for further investigation: Ethiopia, Ghana, Nigeria, and Tanzania. Our focus here is on Ethiopia and Tanzania.

Brautigam et al (2018) confirm that Chinese investment in Ethiopian manufacturing really only took off in 2009 when a Chinese steel company developed the Eastern Industrial Zone, the first industrial zone in Ethiopia. As of January 2015, they found 22 firms doing business in this zone although many were providing business and real estate services and not engaged in manufacturing. During several visits between 2014 and 2016, they confirmed the presence of Chinese manufacturers in a wide variety of sectors including: leather, textiles, cement, plastics, plate glass, gypsum board, recycled steel, air filters and wigs. They also confirmed the presence of a number of foreign owned non-Chinese firms that had

relocated from China to Ethiopia all of which had Chinese trainers and technical experts on staff.

Unlike Ethiopia, China has a longstanding presence in Tanzania one of the most politically stable countries on the African continent. During the 60s and 70s, China built several state-owned factories for the Tanzanian government as part of its' aid program (Brautigam et al, 2018). But with the exception of the Friendship Textile Mill, these companies are no longer in operation.

According to Brautigam et al (2018) because of China's historic friendship with Tanzania and because of Tanzania's stable environment, Chinese businessmen came to Tanzania early primarily as traders. A number of these traders eventually set up factories. Brautigam el al (2018) confirmed the presence of 33 Chinese manufacturing firms in Tanzania in the following areas: textiles and apparel; plastics (shoes, utensils, recycling, bags); construction materials (steel, glass, gypsum and aluminum tiles) and agri-processing (tanneries, cashew, honey and sisal), furniture, paint and bottled oxygen. The agri-processing and garment firms exported all of their products. The rest was sold entirely in the domestic market.

Figure 13 adapted from Brautigam et al (2018) shows the breakdown of manufacturing investments in the four countries categorized by type of investment: raw material seeking; global value chain participation and; local market seeking. Somewhat surprisingly (but consistent with our analysis of the firm level data) half of Chinese investment in Ethiopian manufacturing is local market seeking. Roughly 15% of manufacturing investment is associated with global value chains while the remaining 35% is natural resource seeking. In Tanzania, 85% of Chinese manufacturing investments are local market seeking, 10% are natural resource seeking and only 5% are focused on participation in global value chains.

Informal Sector Manufacturing

To close the circle, we come back now to performance in the informal manufacturing sectors of Ethiopia and Tanzania. Rapid productivity growth in formal sector manufacturing indicates that the poor economywide performance of manufacturing in both countries is a result of more rapid employment expansion in informal sector manufacturing with little increase in value added. Activity in the informal sector is notoriously difficult to measure. We measure informal activity as the residual between total manufacturing output and employment and that in the formal sector. Employment counts are based on population censuses and

labor force surveys. Although the outcome of this exercise seems obvious, for policy purposes it is helpful to understand the magnitude of the outcomes in the informal sector and compare them to the outcomes in the formal sector.

Figure 14 shows growth in value added, employment and labor productivity for total, formal and informal sector manufacturing for both countries for the period. The first two sets of bars show economywide performance in total manufacturing and correspond to the results highlighted by Diao et al. (2017). In Ethiopia, economywide value added grew by around 8% but employment grew more rapidly at a little over 11% leading to negative growth in labor productivity of a little under 2%. Economywide value added and employment both grew at around 7% in Tanzania leading to no growth in total manufacturing labor productivity.

The second set of bars summarize performance in the formal manufacturing sector, something we have already described in detail. Formal sector labor productivity growth in Ethiopia has been positive but low at 3% per annum for the period 2001-2013. By contrast, formal sector labor productivity growth in Tanzania has been more rapid at around 9% per annum for the period 2008-2013. The last two sets of bars show large and negative per annum labor productivity growth in the informal manufacturing sectors of both countries; in Ethiopia it is -5% and in Tanzania it is a little under -9%. Although informal sector value added in Ethiopia grew at a healthy 6% per annum, it was outpaced by close to 12% employment growth. Value added in Tanzania's informal sector grew at around 1% while employment grew at close to 10%.

Figure 15 makes it clear why these trends are alarming. The top four bars of the chart show the results of more rapid employment in the informal sector than in the formal sector. The share of formal sector employment in Tanzanian manufacturing fell from around 22% in 2008 to around 18% in 2013. The share of formal sector employment in Ethiopian manufacturing fell from a little over 10% in 2001 to around 5% in 2013. By contrast, the share of formal sector value added in both countries increased to 85% in Tanzania and 75% in Ethiopia. If these trends continue, economywide manufacturing will become an even bigger drag on economywide growth in output per worker in the years to come. Moreover, even if output in the informal sector is underreported, the magnitude of the underreporting would have to be severe in order to reverse these trends.

Conclusion

We have shown that in many respects, the formal manufacturing sectors in Ethiopia and Tanzania are performing well. Labor productivity growth and export growth is rapid. This productivity growth is primarily fueled by formal firms serving local and regional markets. Moreover, participation in global value chains is minimal and the results for these firms are mixed. This may be good news given the prospects for entering global value chains. However, employment growth in modern manufacturing has been anemic. Instead, capital deepening appears to be fueling much of the rapid labor productivity growth in both countries.

At the same time, employment growth in both countries informal manufacturing sectors has been much more rapid than output growth in informal manufacturing acting as a drag on manufacturing's contribution to economywide productivity growth. This dilemma is perhaps the biggest challenge facing not only policymakers in Africa but also policymakers in other low-income countries.

One bright spot on this horizon is the growth in firms producing for local and regional markets using locally produced inputs. It is likely that these firms have more linkages with the local economy than firms producing for global value chains but more research is needed to determine the extent to which these linkages can generate productivity and employment growth. Public investments in infrastructure and human capital along with pan-African trade agreements present opportunities to foster growth in firms that serve local and regional markets.

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Figure 1

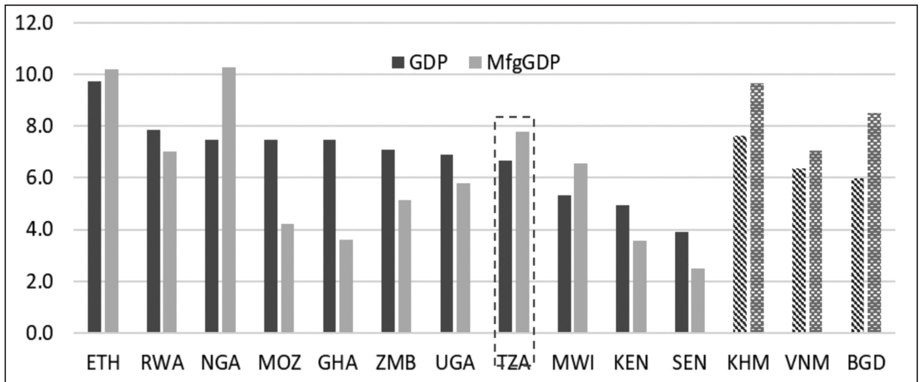
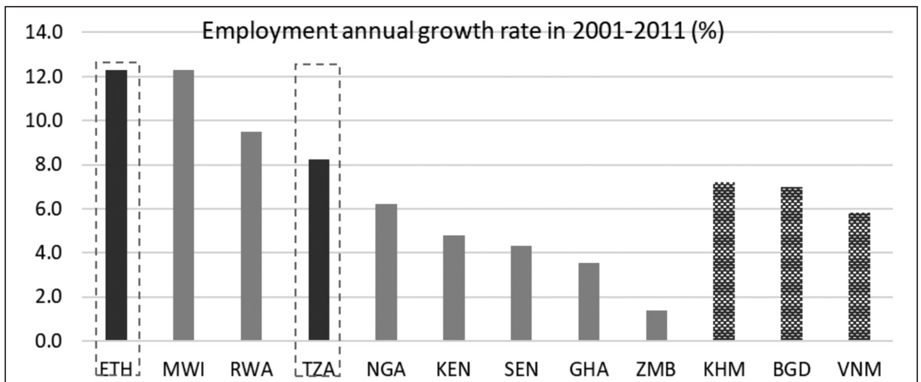


Figure 2



Notes: Data for most African countries, except for RWA, is from GGDC for 2001-2011 (and the data for MWI, SEN and ZMB is for 2001-2010). RWA data is from the country's two rounds of population census in 2002 and 2012. Data for the three Asian countries is from ILO. KHM data is for industrial sector employment in 2003-2014, and BGD and VNM data are for manufacturing employment in 2001-2011.

Source: calculated from various data sources.

Figure 3

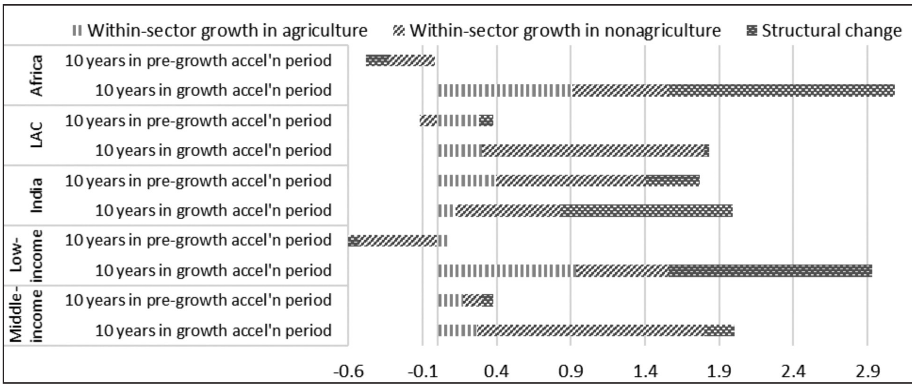


Figure 4

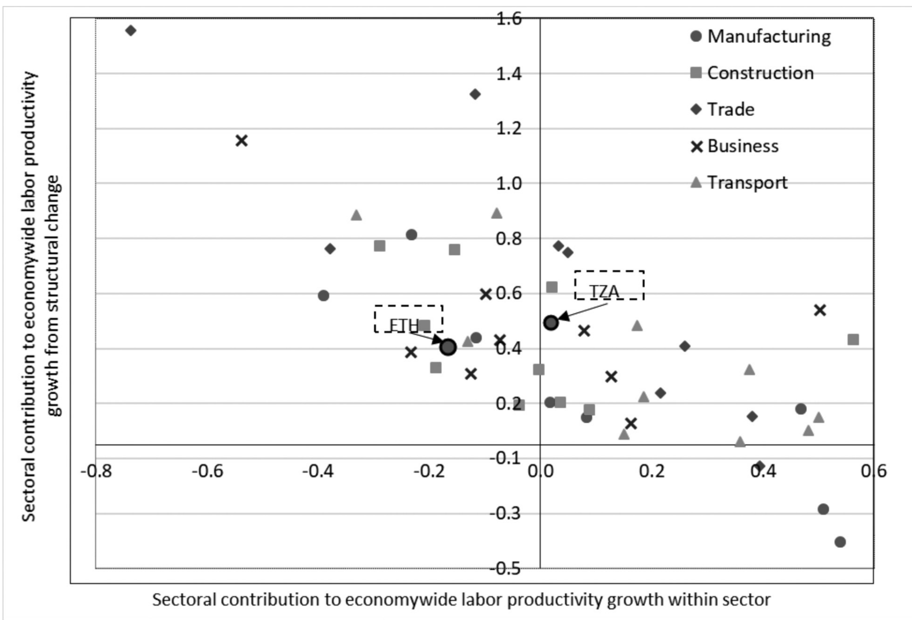
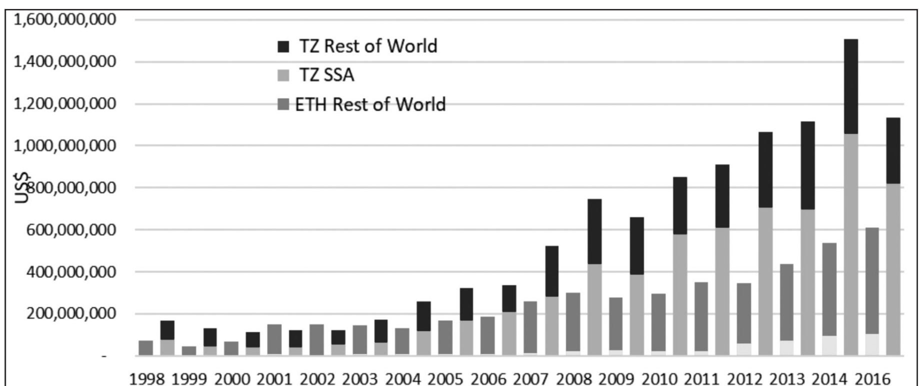


Figure 5

Notes: The annual growth rate for TZA 2008-2013 is calculated from two years' data, while the compound annual growth rate for ETH 2001-2013 is calculated using data 2001-2013. TZA firm data is aggregate from Annual Survey of Industrial Production (ASIP) for 2008 and Census of Industrial Production (CIP) for 2013, obtained from NBS Tanzania. ETH firm data is aggregated from Large and Medium Scale Manufacturing and Electricity Industries Survey (LMMIS) for 2001-2013, obtained from CSA Ethiopia. Manufacturing value-added macro data is from WDI and manufacturing export data is from the BACI International Trade database.

Source: calculated from various data sources.

Figure 6

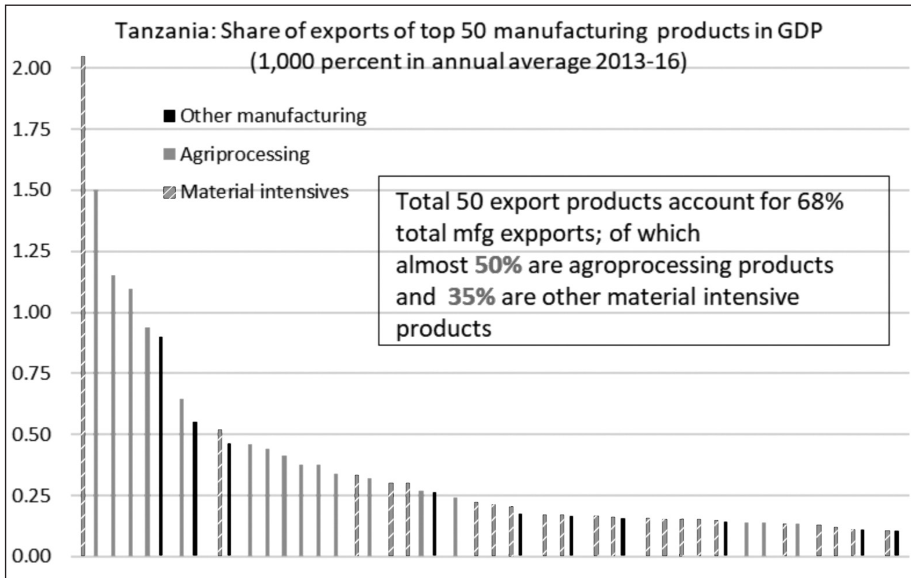


Note: 'Manufactures' defined as SITC sections 5-8, minus 667 (precious/ semi-precious stones) and 68 (non-ferrous metals).

Figure 7

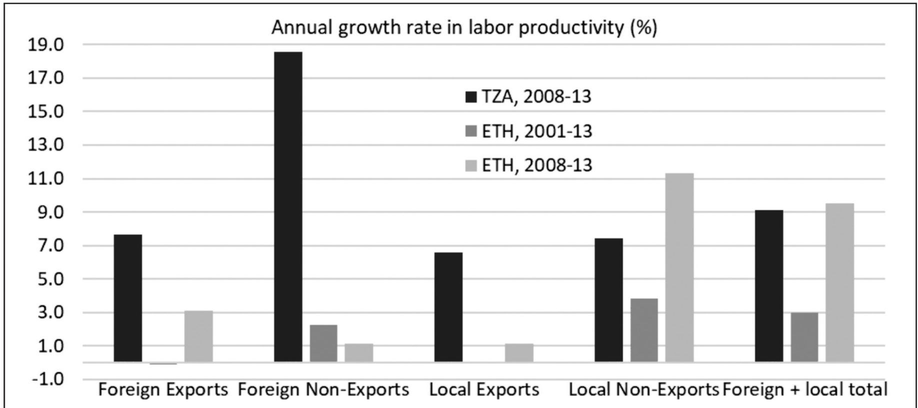
Source: Own calculations using data from the BACI International Trade database

Figure 8



Source: Own calculations using data from the BACI International Trade database.

Figure 9



Source: calculated from firm data.

Figure 10

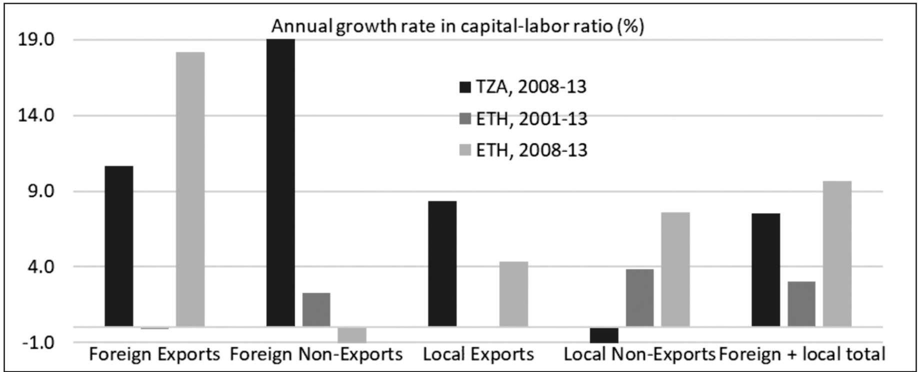


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Figure 11

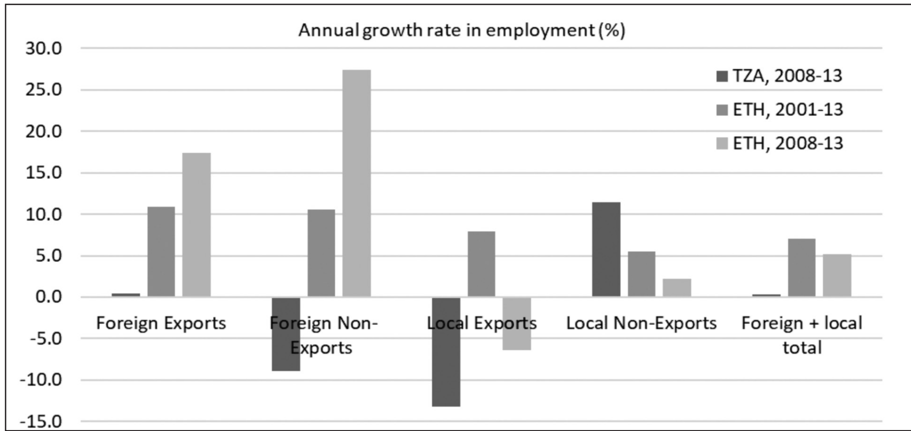

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Figure 12

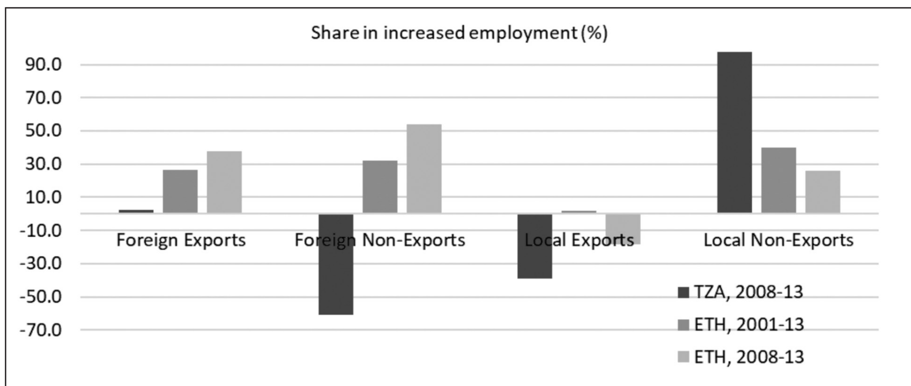

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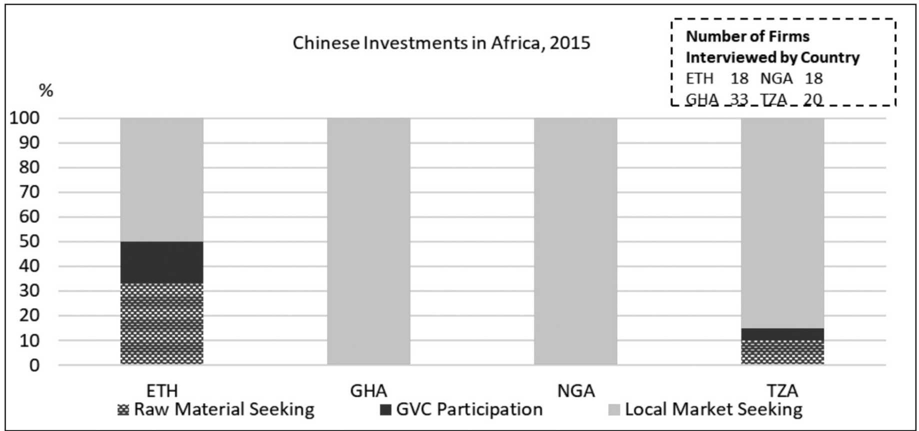
Figure 13



Source: Deborah Brautigam, Tang Xiaoyang, Ying Xia; What Kinds of Chinese 'Geese' Are Flying to Africa? Evidence from Chinese Manufacturing Firms, Journal of African Economies, Volume 27, Issue suppl_1, 1 August 2018, Pages 29–51.

Figure 14

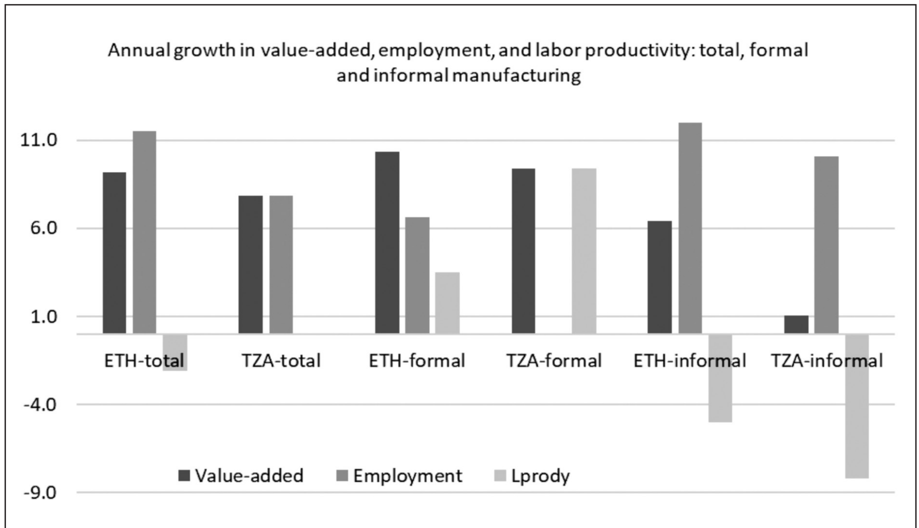


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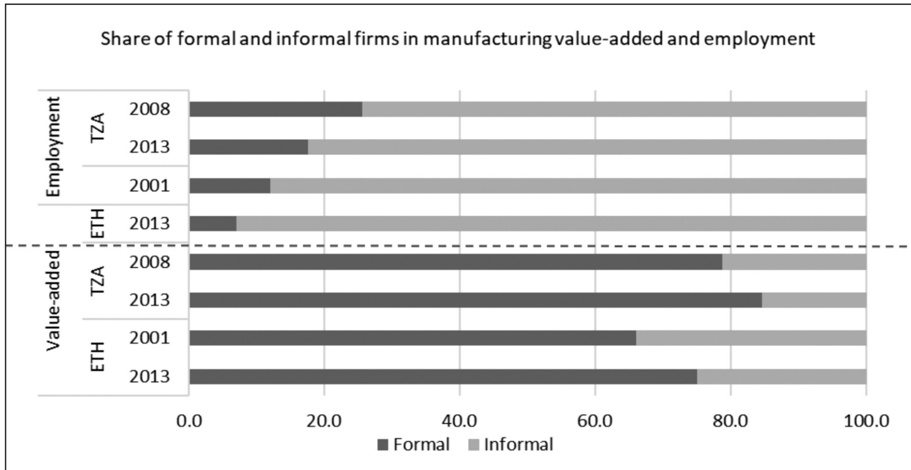
Figure 15



Source: Deborah Brautigam, Tang Xiaoyang, Ying Xia; What Kinds of Chinese 'Geese' Are Flying to Africa? Evidence from Chinese Manufacturing Firms, Journal of African Economies, Volume 27, Issue suppl_1, 1 August 2018, Pages 29–51.

Beloit WI 1896-1914: Global Integration of a Midwestern Industrial Town

Beatrice McKenzie[1]

In this paper I wish to examine Beloit, Wisconsin as a ground-level case for Midwestern industrial integration in the global economy of the late 19th and early 20th centuries. The Beloit economy developed during the era of British-sponsored globalization, an era that Jeffry Frieden says was "the culmination of a world economy…open to the movement of people, money, capital, and goods."[2] As is true of other Midwestern industrial cities, Beloit's ability to prosper during and after World War II rests on the foundation it built during this earlier period of international globalization.

Globalization had little to do with Beloit's founding, which depended on easterners' desire for opportunities for land and wealth and on the removal of Native Americans. The city is located at the confluence of the Rock River and Turtle Creek, near the site of an Indian village called Ke-Chunk, or Turtle, established by the Ho-Chunk people in the 1820s and 1830s.[3] The Ho-Chunk abandoned Ke-Chunk in 1832 as a result of the Black Hawk War, a U.S. government operation to remove Native Americans from Illinois and Wisconsin during a protracted treaty dispute. Thus the Black Hawk War led directly to removal of Indians from

1 Beatrice McKenzie is Keefer Professor of Public Humanities, Beloit College.

2 Jeffry Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (New York: Norton, 2006), 29.

3 In 1829, US Indian agent John Kinzie reported the Ke-Chunk village, with 35 lodges with nearly 700 people, was the largest in a census of 36 Ho-Chunk People's villages in Northern Illinois and Southern Wisconsin. 1834 US Government Land Survey report noted in Bill Green, "The Search for Ke-Chunk: 2012 Investigations in South Beloit, Winnebago County, Illinois," 1-67. Paper delivered to Illinois Historic Preservation Agency, Springfield, IL, April 2013. Historian Patty Loew states that the Ho-Chunk people had inhabited lands in the western Great Lakes region for thousands of years. See *Indian Nations of Wisconsin: Histories of Endurance and Renewal*, 2nd edition (Wisconsin Historical Society Press, 2013), 44-49.

what would become Beloit. But the war also brought the area to the attention of American soldiers, who spread the word about its economic potential. In 1836 an easterner named Caleb Blodgett purchased land on the site from one of its last residents from the Indian era. He sold some of the land to the New England Emigrating Company the following year, and that group, with other newcomers, started the town and college. They built a saw mill first to ready wood for construction of homes and businesses.

Beloit's history ever since is an industrial history.[4] Its location on the Rock River, with access to the Mississippi River, and a steady supply of fresh water and wood, made it attractive as a manufacturing center.[5] The construction of railroads across the region from the 1850s to the 1880s facilitated the growth of Midwestern cities and their hinterlands.[6] By 1856, two major passenger and freight railway lines, the lines that would become the Chicago & Northwestern and the Racine & Southwestern, connected Beloit and its industries to Midwestern and national markets.[7]

Histories of the larger Midwestern cities, Chicago, Detroit, and Cleveland, are known. But histories of smaller cities like Beloit WI and Dubuque IA, which also have a place in Midwestern industrial history, are not. Key elements of small city growth are the existence of a few elite manufacturers and predominantly

4 In his memoir, Sereno Taylor Merrill notes his and his wife's attraction to settlement in Beloit by two of the earliest establishments, a seminary in 1837 and a manufacturing company in 1839. They took a steamer to Southport and then two day horse and buggy ride to Beloit in 1846. Merrill became first principal of the Beloit Seminary with 55 men and 51 women students. Professors Bushnell and Emerson arrived and began teaching the college freshman class in May 1848. Merrill declined to become the permanent principal and started a paper company in nearby Rockton in 1851. There was no bank and the nearest railroad was at Elgin, IL. In 1846 he paid $600 for first house, barn, and lot at 527 Broad Street. In 1855 he purchased the old flax mill and replaced it with a west side paper mill. Sold interest in that and built paper mill on east side of river in 1857, starting operation in 1858. Made paper for Chicago Tribune during the Civil War. Made strawboard, a paper that lined walls inside a building, in 1860s. Merrill was a friend of L.H. Wheeler, whose patent on a windmill was issued in 1867. Merrill helped Wheeler organize a company to produce windmills in 1867, and Merrill was part owner in the Eclipse Windmill Company that Wheeler's son established in 1873. Merrill also founded the Beloit Savings Bank in 1881 and was elected to the Wisconsin State Legislature, 1876-77. Sereno Taylor Merrill, "Narrative of Experiences" (n.p. 1900), 20-36, 40-44.

5 Merrill & Houston Iron Works started as a foundry in 1858. The town was a small manufacturing center by 1889. With a population of 15,125 people in 1910, the Beloit Commercial Club announced that "Beloit is essentially a manufacturing city, containing about 35 large concerns, employing in excess of 4000 people." "Beloit in 1911: Published by the *Beloit Daily News*," Paid for by Beloit Commercial Club, College Archives, 9.

6 William Cronon, *Nature's Metropolis: Chicago and the Great West* (WW Norton & Co., 1991), 63-69.

7 The railroads that reached Beloit were the Galena & Chicago Union Railway (later the Chicago & Northwestern) in 1853, and the Racine & Mississippi (later the Racine & Southwestern), in 1856. *Book of Beloit*, 1936, pp. 98-103.

American-born middle class elite who, together, promoted a local boosterism and wielded significant social control through institutions that were designed to keep the working class and transient residents of the town in check.[8] Whereas the industrial development of the biggest cities peaked by about 1890, smaller cities did so in the following decades, from the 1890s to the 1950s. Small industrial cities are, moreover, vulnerable to cycles of growth and decline. Their histories are marked by a pattern in which a few industries arrive and depart in waves, based upon the availability of resources, movements of capital and populations, and national economic trends.[9] As one of these small cities, the Beloit economy grew tremendously from 1896-1914; global integration drove the town's prosperity.

Capital growth in Beloit was mainly local until industries started to market their products internationally at the end of the 19th century. Manufacturers overcame business failure and a bankruptcy panic in the 1880s. A new firm, Beloit Iron Works, picked up property and assets from Merrill & Houston, after a flood in 1881 and tornado in 1882 drove that firm into bankruptcy.[10] Using entirely local investment, Orson E. Merrill joined several others to form Beloit Iron Works in 1885.[11] Beloit Iron Works prospered through the 20th century, reaching its peak between 1941 and 1955.

Eight years after the founding of Beloit Iron Works, Charles Hosmer Morse bought out and consolidated a different firm, Eclipse Wind Engine Company, under the name Fairbanks Morse & Company. In 1885 the company moved its factory in Beloit to the bluff next to the river and it bought adjacent land in 1890. The new corporation expanded its operations in 1906 to Three Rivers, Michigan and Indianapolis, adding diesel engines to its product line of steam engines, pumps, and clutches for private industry, homes, and militaries. Making engines for trains, ships, and submarines as World War I started, Fairbanks Morse added military contracts at home and abroad to its private sales.

Between 1886 and 1906, local industrialists and investors earned tidy profits and reinvested them in Beloit. Proud of their accomplishments, an investment

8 John Jakle, "America's Small Town/Big City Dialectic," *Journal of Cultural Geography* (1999), 1-27.
9 Timothy Mahoney, "The Small City in American History," (Indiana Magazine of History, 2003), 311-330.
10 H.F. Tower, "Pioneers Paper Machines," Beloit Iron Works History, Beloit College Archives, 29-32.
11 Investors Fred Messer (first president), Alonzo Aldrich, WH Grinnell (20 shares each), NJ Ross (11 shares), joined by Merrill and Burdge (10 shares each) for a total of 91 shares of 1000 each by July 1889. Folder "Record Book Beloit Iron Works," July 21 1885-Sept. 6, 1927, in Box "From Bob Hodge—Beloit Iron Works-related" in Beloit College Archives.

corporation sponsored an ad in a "Prosperity Edition" of the local newspaper that crowed that the number of new homes in the city could double without calling on any capital from outside the city.[12] Boosters claimed that the value of business property in Beloit more than doubled in the year between 1905 and 1906.[13] Underscoring the significance of local capital, most of the three million dollars held in the town's four banks was held by small, local depositors.

Around the turn of the 20th century, Beloit's major firms began selling products in the expanding global market. In 1897 Beloit Iron Works made its first international sale of a paper-making machine to Japan.[14] The company had been invited to show off their novel machine, the Fourdrinier, at the World's Columbian Exposition in Chicago in 1893. That exhibit led to the sale in Japan and also the sales of two apparatuses to China.[15] Other Beloit Iron Works sales were to countries that were part of the British empire, including England, Canada, and Australia. Four of nine of the huge paper-making machines manufactured in 1900 were international sales, two to Canada and two more to China. In October 1903, Beloit Iron Works shipped a complete boxboard mill--25 train carloads of machinery--to be set up on the Thames River in England. That same operation ordered additional machinery in 1906. Additional international sales followed between 1904 and 1907, to Canada, China, and Japan. In the early 20th century, Beloit called itself "the paper-making machine capital of the world," but a greater testament to its significance in the market was that in 1920 Beloit Iron Works had produced 15 percent of the Fourdrinier machines worldwide.[16] Even when sales to Europe fell off during the war, eight machines built in 1917 and 1918 were sold abroad, seven to Japan and one to Australia.[17] Beloit Iron Works was the

12 "Prosperity Edition", *The Beloit Daily Free Press (BDFP)*, October 29, 1906, Beloit College Archives.

13 *BDFP.* Mahoney, 323. In small cities, heads of local industry acquired a disproportionate amount of wealth and thus power and control over the local society. They also participated in the regional or national elite society. See Sereno Taylor Merrill's *Narrative of Experiences*. Mahoney points out that nature of interactions between old mercantilist middle class and local industrial elite, who occupied different social realms, is understudied. 325.

14 H.F. Tower, "Pioneers Paper Machines," Beloit Iron Works History, in Beloit College Archives.

15 *BDFP*, p. 8. See *Rand McNally Hand Book of the World Columbian Exposition,* Vol. 3., p. 218. See also Chronology of O.E. Merrill Company" (etc.) E.H. Neese, Sr., Editor; M.W. Dundore, Associate Editor, Beloit Corp Records, Box 16, Beloit Historical Society.

16 The Fourdrinier paper machine is named for its inventor Henry Fourdrinier, who invented the machine early in the 19th century. It is a process where slurry is pressed on a series of rollers while it dries, making a long continuous roll of paper. H.F. Tower, "Pioneers Paper Machines," Beloit Iron Works History in Beloit, Beloit College Archives.

17 "Chronology of O.E. Merrill Company" (etc.) E.H. Neese, Sr., Editor; M.W. Dundore, Associate Editor, Beloit Corp Records, Box 16, Beloit Historical Society, pp. 65-68.

largest, but not the sole, Beloit manufacturer exporting to a global market.

One of the most successful local businesses in the first decade of the 20th century, Warner Instrument had sales all over the world. In 1902, local inventor and entrepreneur Arthur P. Warner patented a magnetic-based speedometer that also measured distance, for use on automobiles. This and other Warner inventions were of great interest to militaries. One instrument, for example, was used to test the effect of wind and resistance on projectiles from guns and tanks. Just three years after they opened shop, Warner sold instruments to Japan, Russia, England, Germany, France, Mexico, Sweden, Belgium, South Africa, Italy, and Canada. Warner representatives had offices in Canada, England, Germany, and France.[18] Like Fairbanks-Morse, Warner Instrument sales rocketed during the Great War and subsequent wars.

The shift from the use of capital locally to its use globally happened well before the better-known global period following World War II. Like the other large manufacturers, local capital drew and grew Berlin Machine Works until it integrated globally at the turn of the twentieth century. Berlin made sand-papering machines used for wood-working and later for metals.[19] Its founder had started the corporation in Berlin, WI, some 120 miles north of Beloit and a bit remote from the Chicago, Milwaukee, & Oshkosh railroad line. Following the 1880s panic, favorable terms and access to Beloit's transportation network drew the company here. In 1886, the Beloit Land and Investment Company offered factory sites and railway hookups "gratis" to industries willing to relocate to the city.[20] In 1887 Berlin relocated to Beloit, enlarging its plant to offer a complete line of woodworking machinery in 1896, and renaming itself P.B. Yates Machine Company in 1916.[21]

Berlin offers an example of the link between international trade and global capital integration. By late in the 19th century, Wisconsin was one of the most significant timber states in the U.S., and forest products drove industry. Berlin was thus part of the regional industrial complex of lumber processing.[22] But in 1907, the great owner/exploiter of timberlands, Frederick Weyerhaeuser, liquidat-

18 *Book of Beloit* 1936, 229. *(BDFP).*

19 *American Exporter*, November 1917, 134.

20 *Handbook of Beloit* (Shumake & McCabe, 1891), Beloit Historical Society. See also "Prosperity Edition".

21 *Book of Beloit*, 1936, 213. *American Exporter*, 134.

22 David Meyer, "Midwestern Industrialization and the American Manufacturing Beloit in the Nineteenth Century," *Journal of Economic History* (1989), 921-937.

ed his Midwestern business because most of the woodlands had been cut down and sold.[23] Weyerhaeuser started up other more profitable operations in the U.S. West and in Canada. Berlin Machine Works opened a branch office in Hamilton, Ontario, to take advantage of the new marketplace for wood processing machinery, and that office grew to a large proportion of the company's business. In 1908 Berlin established a branch factory in Hamilton, and began fabricating machines there for the Canadian and global market.[24]

Participation in the international market for industrial goods depended on pulling an adequate supply of labor from other markets, and especially from a global labor market. In the period between 1870 and 1920, 26 million persons immigrated to the United States, a significant part of a global migration that historian Adam McKeown estimates to be nearly 100 million.[25] The population of Beloit shows steady increases from 1850 to 1890. By 1900, Beloit's 65 percent population growth over the population in the previous census compared to 22 percent nationally and 21 percent for the State of Wisconsin.[26] This trend of much greater growth in population for the city than the state or nation continued in 1910 and 1920. Nearly 16 percent of Beloit's population in 1910 was immigrant.[27]

Beloit attracted the same immigrant groups as other towns and cities in the Midwest. In the mid-19th century, like most immigrants to Chicago and Milwaukee, immigrants to Beloit were from Germany and Ireland.[28] Irish and Germans in this period immigrated to urban areas, unlike a majority of "old immigrants" who preferred agricultural land in rural areas.[29] After Germany and Ireland, the largest

23 H.F. Tower, "Pioneers Paper Machines," Beloit Iron Works History in Beloit, Beloit College Archives.

24 A coda to the story is that the Berlin company had to vociferously deny that it was a "foreign company with foreign capital" during World War I. In 1916 it changed its name from Berlin to P.B. Yates Machine Company. *American Exporter*, November 1917, 134.

25 Adam McKeown, "Global Migration, 1846-1940," *Journal of World History* (2004), pp. 155-189.

26 1900 Census.

27 In 1920 Beloit had the 11th largest population in the State of WI, but that fails to include the population of South Beloit, in Illinois, the industries and population of which are integrated with Beloit's in the way that Davenport Iowa and Rock Island Illinois are integrated. When the two populations are combined, as they often were in Beloit promotional literature to corporations, Beloit's 1920 population is fourth after Milwaukee, Racine, and Madison.

28 US Census. Germany was the leading source of immigrants from 1872-1896 but their numbers saw a steady decline after 1890. June Granatis Alexander, *Daily Life in Immigrant America*, Vol. 2, 1870-1920, p. 13. Irish immigration, too, peaked in the 1880s. 14. In a wave that also crested in the 1880s, 1.2 million Scandinavians from Sweden, Norway, and Denmark, more than half Swedes, immigrated to the U.S. between 1870-1900. 15.

29 Alexander, p. 17.

number of Beloiters in 1910 traced their parents' nativity to Norway. Beloit City directories and corporate records show that these trends persisted well into the 20th century.[30] Immigrant patterns changed, however, in the period of "new immigration", with many more young men arriving from southern and eastern Europe. These immigrants sought jobs, primarily, and went directly to industrial cities and towns. By 1910, Italians and Greeks made up the largest number of immigrants arriving in Beloit.[31] Italians worked in large numbers at Fairbanks-Morse, mainly in the foundry. After World War I, Black workers from the South outnumbered most other recent arrivals, but immigrants still made up a significant portion of Beloit's population. At Fairbanks-Morse in 1923, the numbers of workers born in Italy and Greece exceeded those born in Norway, Ireland and Germany.[32] To attract immigrant labor, industrial leaders promoted what they saw as distinctive about Beloit, primarily the jobs but also the lifestyle.

Immigrants were drawn first and foremost by high paying jobs in Beloit. Employment opportunities abounded at the largest manufacturing plants, and immigrant workers appeared in every sector of the local economy. In 1906 Fairbanks-Morse employed nearly 2000 workers, but it hoped to expand that number to 5000 within a few years.[33] Jobs were plentiful in the first decade of the 20th century, and the State Statistical Bureau reported in 1902 that per capita wages in Beloit were the highest in Wisconsin.[34]

The largest industries provided services of integration, which drew immigrants. The lead industries sponsored night school classes that went beyond the English language, GED, and civics classes offered to immigrants in Beloit today. Classes aimed at educating the workforce for the major industries in town: pattern making, mechanical or architectural drawing, machine shop work, and wood working.[35] Classes also taught skills to clerks and office personnel. The courses

30 1889 *Handbook of Beloit*. Censuses 1900-1940. Fairbanks-Morse *Hill Folks* Newsletter, 1948-1950, Beloit College Archives.

31 450,000 Greeks arrived in the U.S. between 1900 and 1914. 4.2 million Italians immigrated to the U.S. from 1870-1920; each year between 1900 and 1914, more than 130,000 Italians arrived. Alexander, p. 22.

32 "Americanization" memorandum detailing FM's diverse workforce in July 1923 shows 229 Black workers, 185 Italians, 77 Greeks, 64 Germans, 126 Danish/Swedes/Norwegians, and 64 English/Scotch/Irish. Weaver History, "Fairbanks-Morse" folder, Beloit College Archives.

33 "Prosperity Edition", *The Beloit Daily Free Press*, October 29, 1906, Beloit College Archives.

34 Frederick W. Job, "A Tale of Two Cities," *Public Policy*, April 2, 1904, p. 165.

35 The contemporary equivalent courses are being taught to immigrants and their children at Beloit Memorial High School. For example, see https://www.practicalmachinist.com/cutting-tool-engineering/job-training-programs-see-regal-results/

drew persons from a broad array of Southern and Eastern European nations; one class in basic literacy in 1915 had six Italians, three Austrians, two Greeks, one Russian, and one Lithuanian.[36]

Beloit's integration into the global market for immigrant labor was in tension with its integration in national and global industrial markets. While selling job satisfaction and access to opportunities for oneself or one's children via schooling to immigrants, city leaders also needed to assure industrialists, established and new, that the threat of unionization in the town was minimal. Newspaper articles, editorials, ads, and cartoons in the period between 1896 and 1914 show what immigrant group differences and preferences meant for global labor market integration.

There is evidence of preference toward certain ethnic groups in Beloit in this time. Three separate articles about Lithuanians, who immigrated to Beloit beginning in the 20th century, spoke of the roll of cash usually found in a Lithuanian immigrant's pocket. The articles never said the money was ill-gained, but seemed to suggest this was an endearing Lithuanian custom. Furthermore, during World War I, a city-wide effort raised money for Lithuania, but no parallel effort was made for Italy, Greece, or other affected areas.[37] To speak briefly of women immigrants, they had fewer opportunities in general in smaller industrial towns than in cities, but women from northern European countries were preferred as servants in leading Beloiters' homes.[38] A typical newspaper ad in 1915 read "Competent girl, German or Scandinavian preferred."[39]

Antagonism between immigrants and native-born Americans in this period of globalization is evident. Newspaper articles disfavored Greeks and Italians before the war broke out in Europe. Articles accused Greeks and especially Italians of poor behavior, from "howling and cursing in the street", to gambling, petty

36 *BDN* "Night School Filling Need of Foreigners," 12/10/1915.

37 *BDN* 12/10/1915. "Digs Up $200 'Roll' to Pay $3 and Costs", *BDN*, 6/3/1915. *BDN* "Lithuanian Appeals to Columbia to Aid Stricken People," 10/31/1916. An effort was made to form a group to raise money for Greeks in the Balkan war in 1912, but no group materialized until 1922. Italian efforts were also unsuccessful before the 1930s. *Book of Beloit*, 1936, 179-80; *BDN*.

38 At the homes of William Aldrich (father, windmill manufacturer) and Alonzo Aldrich (son, an owner of Beloit Iron Works) censuses showed a different young Scandinavian woman (Swedish, Danish, and Norwegian) in 1880, 1900, and 1905 living with the family as a servant. *U.S. Censuses*. In smaller cities, there were fewer opportunities for women. They were found in food processing, laundries, and light manufacturing—paper boxes, cigars, garments. But few in heavy industries. Alexander, 106.

39 BDN 1/2/15.

theft, prostitution, and shooting indiscriminately.[40] This behavior reflects, in part, the age and gender of the new immigrants, overwhelmingly young and male, in the first decade of the 20th century.[41] In the workplace, bosses preferred ethnic homogeneity of crews for efficiency, and they assigned immigrants to particular jobs based on stereotyping by cultural or physical attributes. In Fairbanks-Morse, it is easiest to see assignment to the foundry as a job for workers stereotyped as poorly educated, physically strong, dedicated, and uncomplaining.[42] Americans felt antagonism with and superiority over southern and eastern European immigrants. *Beloit Daily News* made sure to emphasize that DF Reynolds, assistant superintendent of the foundry at F-M, has "spent much time and effort training the Italians in the ways of American labor and living."[43] Unemployment and underemployment were the immigrants' own faults. An article claimed that 1200 Italians in Beloit had "accomplished practically nothing for their own betterment in the last several years".[44] Such sentiments nationally led to passage of the Immigration Act of 1924 which severely limited migration from southern and eastern Europe, including Italians. When transatlantic migration recovered after World War I, 210,000 Italians immigrated each year. But the 1924 legislation limited Italian immigration to just 4000 per year, part of a greater U.S. immigration restriction.

As war brought the global era to an end, Beloit's industries turned to Black workers from the South (and other industrial towns in the North) to replace enlistees and immigrant workers in the foundries, factory lines, services, and households in Beloit.[45] International sales slumped in the interwar period, especially during the Great Depression, but military contracts sent Beloit's production volume high again starting in 1941 and peaking in 1955. A second period of global

40 BDN 1913-1915.

41 Ninety percent of Greek and 78 percent of Italian immigrants in this period were men. Alexander, p. 30.

42 This was as true in the period 1900-1914 as it was after 1917. Harry Wong, a high school student who was assigned to the foundry in the 1950s, lost a finger to the work. Oral history Harry Wong, 2018.

43 *BDN* "400 Italians Learn About United Charities and Give Pledge of Co-operation," 2/3/1915.

44 *BDN* 4/30/1915. The shift in tone between 1914 and 1915 is remarkable. Once Italians and then Greeks began to ship out to Europe to meet their home nations' military obligations, the press treated them with greater deference and even reported on the deaths in battle of specific Fairbanks-Morse employees. BDN articles July-October 1915.

45 Beginning in 1917, Fairbanks-Morse especially, recruited workers directly from Pontotoc, Mississippi, many of whom worked in the foundry. An effort to recruit Mexican laborers in a similar fashion in the 1920s was unsuccessful. Oral history of Jim Terrones, March 2018. Sons of the Wong family worked in the foundry in the 1950s alongside an all Black labor force. Oral histories of Mary Wong, 2010, and of Harry Wong, June 2, 2018.

integration followed the end of World War II, marked locally by international marketing and sales, and location of factories abroad. The period of industrial growth, reinvestment of profits, and expansion first into international markets and then into international production allowed the major corporations—Fairbanks-Morse, Beloit Iron Works, Yates American, and Warner Electric, among others—to benefit from military contracts and a second period of globalization immediately following World War II.

Globalization of the United States economy has a history, a history that is evident in one small Midwestern city, Beloit, Wisconsin, at the turn of the 20th century. Local policies enabled Beloit to participate in and benefit from global production, trade, capital, and labor mobility between 1896 and 1914. The draw of immigrant labor completed the industrial integration of Beloit, WI, a small city in the global economy at the turn of the 20th century. In this period, Beloit industries used local capital to produce and export manufactured goods, and several industries opened factories in other countries to supply international sales. Industrial elite and middle class boosters brought global integration of this small city with the region and nation.

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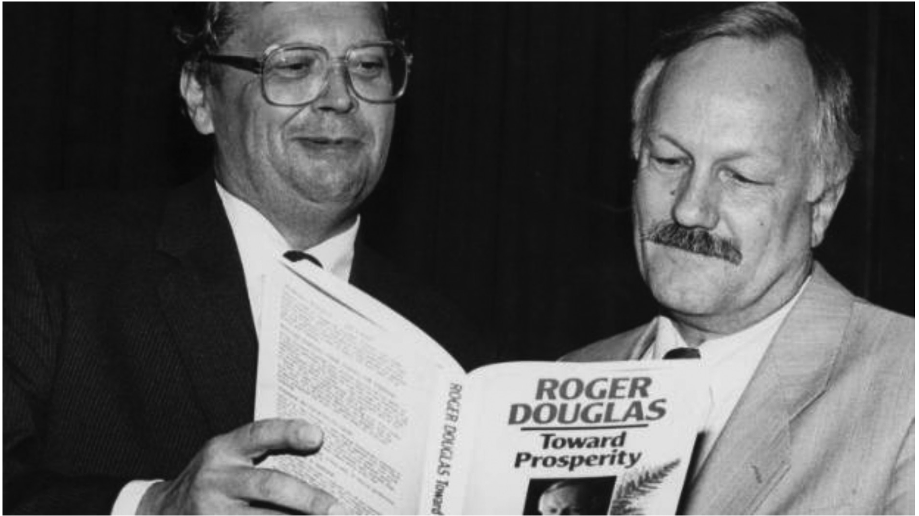
Roger Douglas and His Legacy

Jonathan P. Mason1[1]



David Lange and Roger Douglas looking at Roger Douglas's 1987 book. Source: Stuff.co.nz website

The second half of the 20th century was a time of social change in New Zealand, including the growth of the anti-nuclear and environmental movements, conflict around the Springboks tour, and the rise of women's and Maori rights. But for lasting impact on the economy and society, Rogernomics tops the list. Rogernomics was a programme developed by Roger Douglas, the Minister of Finance under David Lange in the Fourth Labour Government of 1984-90, that reduced the role of government in the economy, eliminating export subsidies and tariffs and privatising or corporatizing many state enterprises. These economic changes had similarities with neoliberal programmes instituted in the United Kingdom and the United States under Margaret Thatcher (UK Prime Minister, 1979-1990) and Ronald Reagan (US President, 1981-89) respectively. Indeed,

1 Jonathan Mason is a member of the Board of Trustees and an alumnus of Beloit College, class of 1980. He is currently an independent director of Vector, Zespri and Air New Zealand.

the term "Rogernomics" came from the US term for the deregulation programme and government spending cuts under Ronald Reagan called Reaganomics. But, unlike the UK and US programmes, Douglas was part of a left-wing government and argued that the changes were needed to support more spending in health care, education, and other social programmes. After he left the Labour government in 1990 and the Labour Party in 1993, Douglas started a new party called Association of Consumers and Taxpayers (ACT), that became a partner of the National Party with a lean government, libertarian model. This paper asks: Was Douglas a right-wing mole in the Labour government or did his thinking evolve into a right-wing libertarian philosophy in the 1980s and 1990s? What is the legacy of Rogernomics in the 21st century New Zealand economy and society?

Given the importance of Roger Douglas and Rogernomics to the New Zealand economy and society, surprisingly few books and essays that focus on Douglas's economic thinking exist. The general histories have very different interpretations of Douglas's contributions. Keith Sinclair describes Rogernomics in reasonable detail but with little discussion on its benefits and drawbacks, concluding that it was primarily a logical response to challenging economics times.[2] Michael King is more critical of Roger Douglas, describing his programme as having been developed by him over many years and then implemented with support from less knowledgeable Labour Party MPs who did not appreciate how the economy and Labour Party would be affected by the changes and how irreversible the changes were once implemented.[3]

The more specific critical analyses from the left on Rogernomics from authors such as Jane Kelsey, Brian Easton, Jonathan Boston and Bruce Jesson emphasise the weaknesses of Rogernomics but minimise Roger Douglas's influence in the programme. These narratives describe the Treasury Department and the Business Roundtable as the real forces behind the neoliberal programme with Douglas not entirely understanding the changes that he led as Minister of Finance.[4] Right-wing narratives interpret Rogernomics differently with "There Is No Alternative" (TINA) argument at the heart of their narrative. Douglas is described as an ef-

2 Keith Sinclair, *A History of New Zealand,* Auckland, 1993, pp.334-48

3 Michael King, *The Penguin History of New Zealand,* Auckland, 2003, pp. 485-90

4 Brian Easton, "The Unmaking of Roger Douglas", *The Making of Rogernomics,* Brian Easton, ed. , Auckland, 1989, pp.171-87 and Jane Kelsey, *The New Zealand Experiment: A Model for Structural Adjustment?,* Auckland, 1997, pp. 28-45 and Jonathan Boston, "The Cabinet and Policy Making in the Fourth Labour Government", *The Fourth Labour Government: Politics and Policy in New Zealand,* Martin Holland and Jonathan Boston eds., Auckland, 1990 pp. 62-82

fective Minister of Finance in his development of an essential programme to raise the New Zealand economy out of bankruptcy and position it for rapid economic growth.[5]

None of the histories and studies focus on the economic philosophy of Roger Douglas and surprisingly there have been no biographies or intellectual histories written on arguably the most important Finance Minister in New Zealand history. The objective of this paper is to begin to correct this oversight by reviewing the evolution of Douglas's economic thinking over the 1970s to 1990s, when he was part of the Labour Party leadership and ending with his break with Labour and the start of the ACT Party in 1993.

Roger Douglas – Early Years and Rise to Labour Party Leadership

Roger Douglas was born on 5 December 1937 into a family with strong ties into the Labour Party and the trade union movement. Douglas's grandfather was William Theophilius Anderton, who emigrated to New Zealand in 1921 and served as Labour MP in two Auckland districts from 1935-60 and Minister of Internal Affairs in the Second Labour Government from 1957-60. Anderton was aligned to the left wing of the Labour Party in the First Labour Government of Michael Joseph Savage in 1935-40, arguing that more aggressive policies were needed to bring New Zealand out of the Great Depression. Douglas's father, Norman Vazey Douglas, worked as a trade union secretary before taking over Anderton's seat in Auckland Central in 1960, serving as Labour MP from 1960-75 and opposition spokesperson for labour, education, and social security from 1967-72. Norman Douglas was considered more moderate than his father-in-law, having an ambivalent view on the Vietnam War and strongly preferring negotiation to strikes in industrial relations.[6]

Roger Douglas was representative of the new professional class that came to leadership positions in the Fourth Labour government in 1984. He grew up in a state house near One Tree Hill/Maungakiekie in Auckland, attended Auckland Grammar School from 1950 to 1955, being elected prefect and showing a talent

5 Example of Business Roundtable see Roger J. Kerr, Executive Editor, *The Old New Zealand and the New.*, New Zealand Business Roundtable. Wellington, N.Z., 1994. pp.3-10. Also see Bryce Wilkinson, "Achieving Reform: The New Zealand Economy", *The Mount Pelerin Society,* Pacific Regional Meeting, 27-30 November 1989

6 Simon Collins, *Rogernomics, Is there a Better Way?* Wellington, 1986 pp.2-18

for mathematics and multiple sports including cricket. He majored in accountancy at the University of Auckland graduating in 1957 and went to work for Bremworth Carpets as Company Secretary. Douglas had a knowledge of Labour Party politics paired with a good understanding of accounting and budgeting. Douglas rose quickly in the Labour Party, working as campaign manager for successful Labour candidate Colin Moyle in 1963, serving on the Manukau City Council from 1967-69, and then elected as Labour MP for Manukau in 1969 at the young age of 32.[7]

The Third Labour Government

Douglas first had an impact on public policy as a back bencher in the Third Labour Government in 1972-75. With his talent for budgets and numbers, Douglas developed a new superannuation programme that he introduced into Parliament as a Private Members' Bill in 1972 and that subsequently became law in 1974 in substantially the same form. The scheme kept in place the basic government superannuation programme from the First Labour Government but supplemented it with a compulsory employer and employee contributory scheme. Employers and employees would each contribute 4% of their annual wages into an individual superannuation account. Upon retirement, each account would make annuity payments adjusted upward for cost of living changes. These payments would be on top of the government superannuation payments. Robert Muldoon used the compulsory superannuation scheme and his alternative proposal of a generous government superannuation benefit funded out of general government revenues to help overturn the Third Labour Government in 1975, subsequently ending the Labour programme. [8]

The compulsory superannuation programme foreshadowed one of the principles that would become fundamental to Douglas's political philosophy. While he believed government was responsible for making support payments so that retirees had a minimum income standard, the core of Douglas's programme focused on "user pays." Rather than having a general supplementary fund for superannuation, each person had their own individual account. The risk in such a system to

7 Collins, pp.10-18

8 Michael Bassett, *The Third Labour Government: A Personal History,* Palmerston North, 1976, pp. 84-91 and 256, 276, 300

traditional Labour Party principles is that the basic benefit would erode over time because much of the electorate would rely more and more on their individual superannuation account with a smaller and poorer portion of the population relying on the basic benefit. The strength of the proposal was that it would sustainably fund the country's retirement liability and not leave the payment to future workers saddled with retirement payments for an increasing number of retirees.

The failure of the compulsory superannuation programme was also ironic because the Labour Government proposed the most conservative funding mechanism but was defeated by the National Government with a more socialist funding mechanism. For public sector programmes, governments have three funding mechanisms available. One is a progressive tax system, in which tax is raised based on the ability to pay. The leading example of such a tax is the progressive income tax, in which tax rates increase on higher income levels. The second type of tax is a based on a flat tax rate, in which the rich, middle income, and poor pay the same rate of tax, but the rich would typically pay an absolutely higher tax amount. The GST is an example of this second tax. All pay 15%, but because the rich typically consume more goods and services, they pay more in absolute dollars. Consumption taxes are nevertheless described as regressive because the poor pay more as a percentage of their income than the rich. The final type of funding for public sector programmes is compulsory payments for services, which could be labelled as "user pays." Public sector economists also call them "lump sum" or "benefit" taxes. The Third Labour Government's programme on compulsory superannuation is an example of this funding structure. Each individual's payments are linked back to individual benefits with minimal income redistribution included in the programme. In overturning this legislation, Muldoon replaced it with a superannuation funded out of general tax revenues that in turn largely depended on progressive income taxes, an ironic twist given the heritage of the National and Labour Parties. A consistent theme in Douglas's thinking that started with compulsory superannuation in the Third Labour Government is a preference for flat tax or user pays tax structures over progressive tax structures.[9]

9 Joseph Stiglitz and Jay Rosengard, Economics *of the Public Sector,* New York, 2015, pp. 506-07, 525-27

Years in Opposition – 1975-84

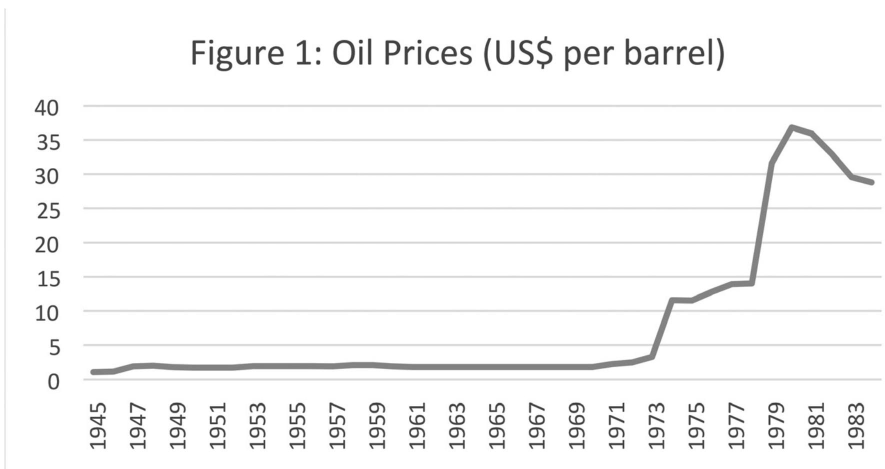
Roger Douglas and the Labour Party went into opposition from 1975 to 1984 for the nine years of the Muldoon National Government. From 1979-84, Douglas developed a comprehensive programme to reform and deregulate the New Zealand economy. To understand why Douglas developed the programme, it is important to review how the New Zealand economy operated in the 1970s and early 1980s, with policies that had been put in place by the First Labour Government in the 1930s and 1940s:

1. In the post-war era, New Zealand protected its manufacturing sector with a set of subsidies and tariffs for industries that were not competitive against larger international competitors. Imports that could not be produced in New Zealand were allowed into the country on a restricted basis under a license regime, which were awarded to a single or few companies. Agriculture was further assisted by government price supports, in which the government stepped in to provide guaranteed price floors for agricultural products such as dairy.
2. The price of the New Zealand dollar was fixed by the government relative to the price of other currencies.
3. Entities owned by the government ran the railroads, some banks, the postal service, telecommunications, and forestry. [10]

The 1970s were particularly challenging for New Zealand primarily due to two events. First, with the UK joining the European Union in 1972, New Zealand's traditional focus on sending exports concentrated in meat, lamb, butter and cheese to the UK which James Belich has called "the protein bridge," was disrupted.[11] Second, as demand for oil continued to increase and the OPEC cartel of oil producers found that they could raise oil prices, the price of oil increased from $5 to $60 per barrel (see Figure 1 below).

10 L. Evan, A. Grime, and B. Wilkinson, "Economic Reform in New Zealand: 1984-95", *Journal of Economic Literature,* December, 1996 pp.1856-1902

11 James Belich, *Paradise Reforged: A History of New Zealanders,* Auckland, 2001



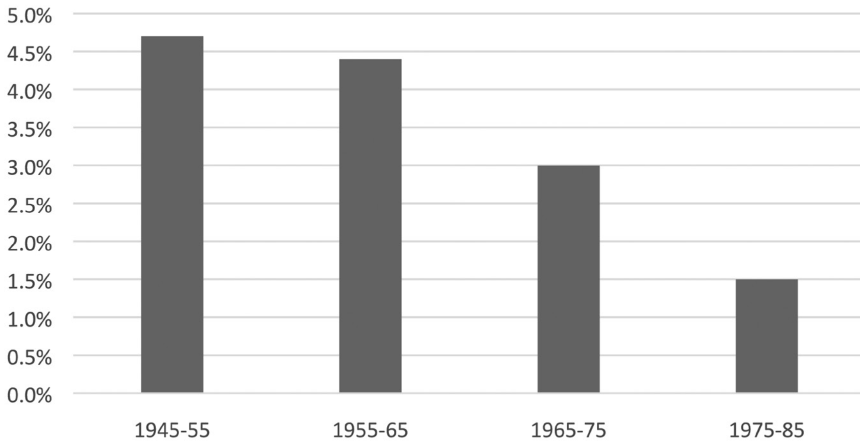
Source: Macrotrends and U.S. Energy Information Administration, Independent Statistics and Analysis Website, October 2017

New Zealand, like other oil importers, suffered unexpected increases in their import costs. The combination of weaker markets for exports and more expensive oil imports meant that New Zealand's terms of trade deteriorated—the price of New Zealand exports dropped relative to the price of imports.

New Zealand fell below the OECD average on real per capita GDP growth in 1974-84, growing only 0.2% per year compared to the OECD average of 1.8% per year.[12] (See Figure 2 for real GDP growth trends). The slower economic growth led to more pressure on government finances and resulted in New Zealand running high government budget deficits. [13]

12 Organization for Economic Cooperation and Development, *Economic Surveys; New Zealand, 1988/89,* Paris, 1989, p. 15. Real per Capita GDP growth is defined as the total increase in goods and services produced after eliminating the effect of inflation divided by the estimated population of New Zealand. In other words, it looks at the growth of goods and services by person in New Zealand.

13 Evan, Grime and Wilkinson, p. 1860



Source: NZ Statistics Office, Cited by Angus Maddison, Monitoring the World Economy 1820-1992, OECD 1995, pp. 150-151

While these economic conditions would have been challenging for any government, and the higher oil prices and consequent pressures on inflation contributed to Labour's electoral defeat in 1975, most historians and economists are also critical of Muldoon's attempts to improve New Zealand's economic performance in his subsequent nine-year tenure as Prime Minister. The list of criticisms includes the replacement of Labour's compulsory superannuation described above with a very generous and unsustainable superannuation scheme funded from general revenues, the "Think Big" projects of government spending on big infrastructure projects with variable returns, and an unwillingness to take firmer action in devaluing the exchange rate in 1982-84.[14]

Meanwhile, Roger Douglas became an increasingly influential member of the opposition. From 1975-81, he was the Shadow Minister for Housing. In 1980, he helped lead a key group of MPs that tried to replace Labour Party head Bill Rowling with David Lange, a move that narrowly failed. Also In 1980, he began his rise to intellectual finance leadership of the Labour Party with his book, *There's Got to Be a Better Way,* and a detailed *Alternative Budget.* The lack of con-

14 Muldoon's government gets criticism from across political spectrum. From centre right see, Michael Bassett, *New Zealand's Prime Ministers: from Dick Seddon to John Key,* Mangawhai, 2017, pp.351-84 From the left, see Tim Hazledine, *Taking New Zealand Seriously: The Economics of Decency*, Auckland, 1997 pp. 19-43

sultation on the *Alternative Budget* with Labour Party leadership led to him being sacked from the Shadow Cabinet. In 1981, he considered retiring from politics, but was talked out of it by a group of his constituents in Manurewa and became the Shadow Minister for Finance later that year. Douglas's position as Shadow Finance Minister was further reinforced when David Lange became the leader of the Labour Party in 1983. [15]

In his two books, Douglas emphasised how private markets would be more efficient and effective in allocating resources than the government. Private market prices allow businesses to respond quickly to changing consumer preferences. Businesses succeed and fail due to their own efforts, taxpayers don't pay for the mistakes of others. Also, Douglas pointed out that government planners often reward the rich and well-connected business people with their programmes in a way that does not happen with independent private market pricing. Import licenses, for example, often result in businesses enjoying a captive market in New Zealand, where consumers overpay for products, while businesses enjoy a guaranteed profit.[16] Subsidies to industry and agriculture distort profit, encourage inefficiency and overinvestment at the expense of consumers.[17]

However, Douglas's discussion of deregulation came with a left-wing twist. While Douglas did not cite leaders of neoliberal thinking in *There's Got to Be a Better Way* or his *Alternative Budget*, he kept Labour Party principles of social spending at the core of his impetus for deregulation by arguing that deregulation would reform New Zealand government spending so that funding was available for education, health care and social welfare programmes.

The *Alternative Budget* is an especially interesting document on tax policy because it shows how consistent Douglas's thinking on tax policy was. In the Budget, Douglas proposes a cut in the income tax by half, the introduction of an asset tax and a sales tax, and simplification of the tax code. These preferences continue in Douglas's intellectual philosophy through his time in the Labour Party and argue for continuity rather than a change of mind on Douglas's approach to tax policy. [18]

Douglas never referenced in these early books a rich set of neoliberal literature

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15 Collins, pp.12-14 and Roger Douglas and Louise Callan, *Toward Prosperity,* Auckland, 1987 pp. 16-29
16 Roger Douglas, *There's Got to Be a Better Way! A Practical Guide to Solving New Zealand's Problems,* Wellington, 1980*,* pp. 39-40
17 Douglas, *Better Way,* pp.63-65
18 Roger Douglas, *Alternative Budget: A Personal View,* June 1980, pp. 8-20

from Europe and North America, generated primarily from right-wing economists and politicians. Neoliberalism thought arose in the 1930s separately in Europe and the USA from economists who objected to fascism, communism and Western government economic intervention during the Great Depression. It further developed academic rigour and created new think tanks in the 1950s and 1960s. Neoliberals objected to an expansion of government activity linked to social welfare programmes, such as Lyndon Johnson's Great Society programme in the USA. Its leading proponents included the Austrian School of Friedrich Hayek and Ludwig von Mises, the Chicago School of Milton Friedman, Henry Simons and George Stigler, and the Rational Choice School concentrated at the University of Virginia of James Buchanan and Gordon Tullock. [19] These Northern Hemisphere arguments for neoliberalism track Douglas's ideas reasonably closely. At the core of neoliberalism is a belief that private sector markets rather than government planners allocate products, services and resources more efficiently. Markets create competition and choices for consumers. Consumers make choices on which products they prefer to buy, which operates as feedback to companies offering goods and services. This feedback, influenced by price and demand, requires successful companies to innovate into better and/or lower cost products. Innovation and economic growth can be further enhanced by cutting back government programmes such as tariffs, import quotas and subsidies that favour selected industries—without these distortions, the most productive and innovative industries also become the most financially successful. Misguided government regulation that was designed to protect labour or encourage competition, but in practice made it difficult for businesses to start up or grow, needed to be eliminated or streamlined. These steps free up government spending to cut tax rates on individuals and business, which increases the incentives of business owners to innovate and become more efficient. Labour unions are at best a necessary evil in neoliberal thinking because they act as a monopolist in raising wages above the market clearing price and often institute inflexible work rules, undermining the ability of

19 There is a vast set of neoliberal literature from 1940-2000 which is outside the scope of this dissertation. Seminal works include Friedrich Hayek, *The Road to Serfdom,* Chicago, 1944 (Reprinted 1969), Ludwig von Mises, *Human Actions: A Treatise on Economics,* New Haven, 1949 (Reprinted 1963), Henry Simons, "Positive Programme for Laissez Faire: Some Policies for a Liberal Economic Policy", *Economic Policy for a Free Society,* Chicago, 1948, pp.40-77, James Buchanan, *Fiscal Theory and Political Economy,* Chapel Hill, North Carolina, 1960, and Gordon Tullock, *The Economy of Income Redistribution,* Boston, 1983

business to cut costs, innovate, and respond to the signals of the market. [20]

Neoliberal ideas became more influential in the 1970s political environment as economic growth slowed and both unemployment and inflation increased. Since Keynesian or classical economics did not predict an economy with high unemployment and inflation, a new economic term called “stagflation” was coined. Neoliberals pointed to the existence of stagflation to undermine dominant Keynesian economic models, offering a return to the higher economic growth of the 1950s and 1960s by cutting the size of government, lowering taxes, and allowing private markets to become more productive. In the UK and the USA, Margaret Thatcher and Ronald Reagan, respectively, came to power on a neoliberal platform of cutting social welfare payments, lowering taxes and decreasing the size of government to spur economic growth.[21]

Given the similarities between the ideas of Northern Hemisphere neoliberals and Rogernomics, it begs the question on why Douglas did not cite Milton Friedman, Friedrich Hayek or other neoliberal Nobel Prize winners in his early writings. There are three possible explanations for the lack of citations. First, it is possible that Douglas was unaware of their writings. I judge this to be highly unlikely—neoliberal ideas were at the heart of intellectual debate around fiscal policy and macroeconomics in the late 1970s, and Douglas knew too many economists and business people both within and outside New Zealand to be unaware of neoliberal thinking. Second, it is possible that Douglas did not want to cite neoliberal economists in the Northern Hemisphere because they were so closely tied to right-wing politicians, such as Margaret Thatcher and Ronald Reagan. Finally, Douglas may also have thought that he was selectively taking neoliberal ideas on economic efficiency but linking them to Labour Party objectives of higher government social spending and support of labour unions so that his programme was truly different. Citing right-wing neoliberals would only cause readers to confuse his unique approach with these more doctrinaire programmes.

20 Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman and the Birth of Neoliberal Politics,* Princeton, New Jersey, 2012, and Milton Friedman and Rose Friedman, *Capitalism and Freedom,* Chicago, 1962, 2nd edition 1982

21 Jones, pp. 329-46

Finance Minister in the Fourth Labour Government

Roger Douglas could not have asked for a hotter burning platform to implement his neoliberal programme for deregulating the economy in 1984, than when David Lange and the Labour Party defeated National in a poorly-thought-through snap election called by Robert Muldoon. In 1983-84, Muldoon had ignored advice from the both the Treasury and Reserve Bank to devalue the New Zealand dollar and instead maintained a fixed exchange rate, and, as a result, hundreds of millions of foreign reserves left the country, leaving New Zealand with no foreign currency to meet its import obligations. (The government could not even meet credit card payments from its overseas embassies). From this mismanagement of foreign exchange, a myth was born, which was that "There Is No Alternative" (TINA) to a radical restructure of government spending and regulation of the economy.[22]

Douglas, with support from Lange and the Labour Party, used the foreign exchange crisis to move New Zealand from the most regulated to the least regulated economy in the OECD under his programme aptly named Rogernomics (after the Reagonomics programme in the USA). In three years, 1984-1987, Douglas pushed through changes that eliminated or phased out all subsidies and tariffs for all industries, all prices supports, and all import licenses. The fixed exchange rate was initially devalued by 20% and then put on a free float in 1985 in which the price of the New Zealand dollar relative to other currencies is set by supply and demand without government intervention. Many entities run by the government were privatised, i.e., sold to private investors, or corporatized which meant they continued to be owned by the government but were expected to run at breakeven or a profit. The tax system was changed as well with the top income tax rate of 66% cut to 33% and a GST of 10% introduced in 1986.[23]

To Lange's and Douglas's credit, the trend in government spending during the Fourth Labour Government supported Douglas's claims that Rogernomics would allow the government to spend more on key Labour Party objectives. Education spending as a percent of GDP increased from 4.6% in 1983-84 to 6.2% in 1990-91, and health care spending increased from 5% to 5.5%. As a whole, social welfare spending increased from 11.6% of GDP to 14.4% in 1990-91.

22 Bassett, *Prime Ministers,* pp. 351-84 and Douglas, *Toward Prosperity,* pp. 51-62
23 For good timeline of Rogernomics, see Evan, Grime, and Wilkinson, pp.1895-1900

Labour also passed legislation to support unionisation.[24] The left wing of the Labour Party worried about the changes but had difficulty gathering arguments to oppose the elimination of subsidies and tariffs, because they were unsure of their effect. They partly conceded Douglas's arguments that these tariffs and subsidies favoured the rich as much as the poor. What they could more easily oppose was Douglas's support for a less progressive system of taxes, underpinned by lower top marginal income tax rates and a new, more regressive taxes on goods and services known as the GST. In a speech to the New Zealand Bankers' Association in November 1984, Douglas argued that the GST was not regressive since most families consumed the same percentage of income:

"All disposable income needs to be spent on something. This means over the long haul an across the board tax cut is broadly proportional to income, rather than regressive. Because the Goods and Services Tax will tax wealth and other non-taxed income it will mean the tax system will be fairer than it currently is. "[25]

Douglas's argument on the tax mix change is not credible. Cutting the progressive income tax by 18 percentage points and replacing it with a GST does not make the tax code fairer. If wealth should be taxed but is not, a capital gains or asset tax would have been a more progressive method of taxing wealth than the GST. But while they had misgivings, the Labour Party Caucus was persuaded that the changes were needed to lower deficits, inflation, and interest rates, and argued that at least the rich would pay more in GST than the poor.[26] However, Douglas subsequently argued that the calculation of progressivity should include both taxes and government spending, i.e., more targeted government spending on the poor would more than offset a less progressive tax system. [27]

But the argument that Douglas was a neoliberal right-wing mole in the Fourth Labour Government is very much alive today, supported by Douglas's shift toward a libertarian philosophy in 1987-1993. This ideological shift meant that Douglas diverged from the left wing of the Labour Party and contributed to the end of his productive partnership with David Lange and even to the end of the

24 Evan, Grime, and Wilkinson, pp. 1877-78

25 Roger Douglas, *Cook Memorial Lecture to New Zealand Banker's Association,* Wellington, 13 November 1984

26 Tim Hassall, *Are the Economic Policies of Rogernomics Consistent with the Basic Principles of the Labour Party?* Research Essay in Political Studies at University of Auckland, September, 1985 pp.37-40 on GST effect

27 Roger Douglas, "The Politics of Successful Structural Reform", The *Mount Pelerin Society: Pacific Regional Meeting,* Christchurch, 27-30 November 1989

Fourth Labour Government in 1990. In 1989, while he was still Finance Minister, Douglas was the keynote speaker at the inaugural New Zealand conference of the Mount Pelerin Society, one of the leading neoliberal groups in the Northern Hemisphere.[28] By 1993, Douglas's most detailed policy book, *Unfinished Business,* offered policy prescriptions that converged with his Northern Hemisphere right-wing neoliberal counterparts and, for the first time in his writings, he cited right-wing neoliberals and noted his membership of the Mount Pelerin Society.[29]

A foreshadowing of the trouble between David Lange and Roger Douglas could be seen in Douglas's second book, *Toward Prosperity,* published in April 1987. Despite having had significant deregulation measures implemented, the last chapter of *Toward Prosperity* was a call to arms for substantial further changes in the government's role in the economy. Douglas called for major changes for public debt, taxation and social service spending. Douglas observed that public debt at 85% of GDP had reached unsustainable levels. Even though it is appealing to think that taxes could be raised to close the government debt gap, Douglas argued that it would be counterproductive to tax the poor because it would lower consumption. In contrast, Douglas found it would be unworkable to tax the rich, both because there were not enough of them to raise meaningful new tax revenues and because there were too many loopholes that the rich could use to avoid paying the tax. Douglas concluded that the only way to control the public sector debt was to cut government spending and make the government operate more efficiently with special attention paid to health, education, and housing spending. [30]

In his biography, *My Life,* David Lange revealed that Douglas presented three budget options to Lange in April 1987, with his preferred option being the sale of most state assets, the reduction of income tax to a flat rate of 15%, and an increase of the GST to 15%. Another budget option focused on consolidating the gains of Rogernomics without further spending and tax changes was also presented, but Douglas was not interested in being Finance Minister under this budget option.[31]

After a general election victory in September 1987, in which Labour lost votes among its base but became more competitive in traditional National dis-

28 Douglas, "The Politics of Successful Structural Reform," pp.1-43

29 Roger Douglas, *Unfinished Business,* Auckland, 1993, Quotes from neoliberal studies on 19, 37, 54, 83, 89,91-92, 107-09, 111, 172, 194

30 Roger Douglas and Louise Callen, *Toward Prosperity,* Auckland, 1987, pp.236-45

31 David Lange, *My Life,* Auckland, 2005, pp.235-37

tricts, Douglas prepared a more moderate programme in October-December that included the following four elements:

1. The introduction of a Guaranteed Minimum Family Income (GMFI) payment to families of $10,000-$20,000/year.
2. The elimination of New Zealand's progressive tax system in which the top rate was 48%, with a single flat tax rate of 23%.
3. An increase in the GST from 10% to 12.5%.
4. $14 billion of public asset sales. [32]

Douglas understood that Lange had some misgivings on the plan, asked whether its announcement should be deferred, but Lange agreed to proceed. The new package was announced with great fanfare on 17 December 1987.[33]

Roger Douglas, Neoliberalism, and the Flat Tax

It took only one to two months for doubts on the programme to arise among both David Lange and outside experts. First, the introduction of such a high GMFI brought challenges on incentives for workers who earned less than the GMFI. Were they going to be taxed on 100% of their earnings up to the GMFI level? If incremental earnings below the GMFI were taxed at high effective rates, it would create huge incentives to pay black-market shadow wages to evade the high tax rate.[34] A second challenge on GMFI programmes is the effective marginal tax rate on incremental earnings above the GMFI level. A rapid phase out is less costly for government spending, but creates high marginal tax rates on these extra earnings, leading to what economists call "the poverty trap." A third challenge would be if they got their projections wrong, there would be pressure to cut government revenues more and keep the income tax cut in place, which would be highly unpopular with many elements of the Labour Party base. Finally, the increase in the GST combined with the flat tax was regressive on the revenue side. [35]

Over time, opposition also built within the Labour Party to the Douglas GMFI/flat tax because they looked like programmes from the American right wing of the neoliberal movement. A variant of the GMFI was first proposed

32 Simon Sheppard, *Broken Circle: The Decline and Fall of the Fourth Labour Government,* Wellington, 1999, p.49

33 Sheppard, pp.35-51

34 Easton, p.180

35 Sheppard, p.53-60

by Milton Friedman in 1962 as a negative income tax that would allow governments to sweep away the welfare state.[36] Payments needed to be low enough to encourage work. The flat tax was similarly encouraged to promote horizontal equity in the tax code by preventing income splitting, evading tax through trusts and/or shell companies, and moving a primary residence off shore.[37] In addition, many economists argued that a flat tax would lead to faster economic growth by creating better incentives for work over leisure.[38] In the USA, flat tax proposals were paired with tax simplification; the Reagan administration's 1986 tax reform package cut the top rate to 28% but also eliminated multiple deductions such as the ability to deduct passive real estate losses. Neoliberals promised that both measures would trigger higher economic growth and pay for themselves. Lange was aware of the UK and USA neoliberal experience and read David Stockman's book on Reaganomics over the holidays in 1987-88.[39] David Stockman, the budget director for Reagan for the first four years of his neoliberal reforms called Reaganomics, was critical of its ability to improve economic growth. Lange also understood that the GMFI benefit could easily be reduced by a future National government even as the flat tax was retained, leaving the country with a more regressive tax and transfer system. [40]

Douglas also faced headwinds on his programme from increasing opposition within the Labour Party, the October 1987 stock market crash, and job dislocation caused by corporatisation programmes. Within the Labour Party, trade unions increasingly viewed Rogernomics as a path to weaker unions. The left wing of the Auckland branch of the Labour Party organised themselves in 1986-87 to unseat Douglas's ally, Richard Prebble, as the local Labour Party candidate.[41] At the same time, Douglas and Prebble formed separate political support groups which promoted their economic programmes and raised money for them from wealthy donors that typically supported the National Party, which further unsettled Lange.[42]

The October 1987 stock market crash in which the New Zealand share mar-

36 Milton Friedman and Rose Friedman, *Capitalism and Freedom,* Chicago, 1962 pp. 190-95

37 Horizontal equity is defined as treating taxpayers with similar gross incomes, with similar tax rates. See Stiglitz and Rosengard, Economics *of the Public Sector,* New York, 2015, p. 523

38 Tension between progressive taxes and economic efficiency is one of important issues in public sector economics, see Stiglitz and Rosengard, pp.503-37 and 606-36

39 Sheppard, p.55 and David Stockman, *The Triumph of Politics, the Crisis in American Government and How It Affects the World,* New York, 1986

40 Sheppard, p.55

41 Sheppard, pp.81-138

42 Lange, pp.239-41

ket dropped in value by 50% was initially viewed as worldwide market correction. Other developed markets started to bounce back in December 1987, but New Zealand did not because the earnings power of many New Zealand companies had been overstated as the New Zealand economy was deregulated. [43]

In 1987-88, the social costs of Rogernomics began to be clearer to Labour Party leaders. Several state entities including Electricity Corporation, Forestry Corporation, NZ Post, and Coal Corporation shed over 20,000 employees in total. In small towns such as Tapawera and Whanganui, the loss of thousands of jobs led to an economic depression with no viable paths for workers to gain employment with similar salaries and benefits without relocation. For those who owned homes, selling them at a reasonable price was impossible, so their assets and wealth along with their wage income were all ravaged. [44]

In reviewing the clash which broke up the Fourth Labour Government and with the benefit of hindsight, Lange's instincts were sound and offer another marker for Douglas's continued migration toward right-wing neoliberalism. What becomes most clear in the Douglas package is the extent to which he had turned away from the progressive income tax as an instrument of redistribution and was willing to accept a society with much higher levels of income inequality.

The progressive income tax arose in developed countries in the late 19th and early 20th centuries as a new source of revenue and a popular measure to lower income inequality by taxing those who could more easily afford to pay. The Liberal government passed the first income tax in New Zealand in 1891. Even conservative classical economists were attracted by the income tax because they reasoned that the marginal utility of the extra dollar earned by a citizen who earned $100,000 was clearly lower than a worker earning $10,000. As a result, a progressive income tax maximised spending utility.[45] In the post-Second World War era, the highest progressive income tax rates approached 90% in multiple economies. Neoliberal economists argued that high tax rates discouraged entrepreneurship and led the rich to set up elaborate tax avoidance structures. As a result, governments collected very little revenue at the highest marginal tax rates. In the 1984-87 term, Douglas used these neoliberal arguments to successfully lower the top marginal tax rate from 66% to 48%.[46]

43 Marcia Russell, *Revolution,* Auckland, 1996 pp. 149-57
44 Russell, pp. 119-27
45 Stiglitz and Rosengard, pp.532-35 for debate around incomes taxes and economic efficiency
46 Stiglitz and Rosengard, pp.503-37 and 606-36. For New Zealand view on income tax history, see

A more extreme right-wing libertarian argument was to abolish the income tax altogether and link government services to user pays. While no Western government has ever followed through on the elimination of the income tax, Douglas made this exact proposal in his next book, *Unfinished Business,* published in 1993.

Unfinished Business and Douglas's Shift to Libertarianism

Unfinished Business offered a more comprehensive plan from Douglas on changing the way the New Zealand government and society operated. Unlike right-wing neoliberals, he still focused on providing comprehensive education, health care, and income support for the poor. But the government's role in providing these services was cut back or eliminated, and all citizens were assumed to be intelligent, rational consumers who made choices to get the best services for their families.

On education, Douglas argued to allow parents to choose schools for their children regardless of where they lived and encouraged the growth of for-profit schools, called charter schools, that would compete for students across private and public schools. Families in the middle class and above would pay for their education, the poor would receive vouchers. Schools would be forced to be much more responsive to families and would have to compete with each other for students just like companies offering services in the private sector. [47]

Douglas offered a similar structure of private competition and consumer choice on health care. All consumers would be required to buy private insurance, other than the poor for whom an insurance policy would be provided. Doctors, insurance companies, and hospitals would be privatised and compete for patients. Retiree health-care savings accounts would be set up with required contributions during every citizen's working life leading to self-financed retiree health care for most New Zealanders. [48]

Not surprisingly, Douglas also resurrected his proposal from the Third Labour Government to phase out superannuation benefits paid from general tax revenues and replace them with individual-based compulsory superannuation accounts paid from wages and salaries.[49]

Paul Goldsmith, We *Won, You Lost, Eat That! A political history of tax in New Zealand since 1840,* Auckland, 2008

47 Roger Douglas, *Unfinished Business,* Auckland, 1993 pp.83-110

48 Douglas, *Unfinished Business,* pp.111-144

49 Douglas, *Unfinished Business,* pp.145-171

Douglas was at his most radical in proposing the mix of new taxes to fund government and transfer payments to the poor. While the GST could be modestly cut in the future, Douglas proposed that the company and personal income tax could be cut to 13% within 11 years and phased out entirely within 20 years. [50]

With the benefit of hindsight from the USA where neoliberal programmes on education vouchers and health care accounts have been implemented, a glaring omission in *Unfinished Business* was how the government was going to protect consumers when they interacted with more powerful private groups such as hospitals, doctors, insurers, and charter schools. In Douglas's world, all consumers act with good information to make better individual decisions for themselves and their families. In practice, consumers don't have the time and knowledge to protect themselves against decisions by these private entities. Providing private options in education, for example, leaves many families worse off. While some families use charter schools to access improved education, other families are left behind in public schools that have become fundamentally weaker because they have fewer students and lower government funding (since vouchers almost always drive funding by number of students). There have also been multiple cases where charter schools overpromised and underdelivered educational results, with families only realising the performance gap when it is too late for their children. [51]

Unlike his previous works, *Unfinished Business* was full of references to American and European neoliberal thinkers and studies, and Douglas's prescriptions on taxes, health care, and education tracked the neoliberal economist, Gordon Tullock, and his 1983 book, *The Economics of Income Redistribution* , surprisingly closely.[52] Douglas had moved away from using the tax system for any progressive redistribution of income and even downgraded the use of flat taxes and onto to a system that most heavily relied on the user pays. In the book, he rejected one of the most fundamental principles of the Labour Party, namely using the income tax to both fund government and redistribute income. On the last page of the book, he gave the address of the new ACT party that he had started with Derek Quigley. [53]

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50 Douglas, *Unfinished Business,* pp.264-89

51 The impact of charter schools on education in the USA is a complex topic, but for respected left-wing critique, see Diane Ravitch, *Reign of error: the hoax of the privatisation movement and the danger to America's public schools,* New York, 2013

52 See Gordon Tullock, *The Economics of Income Redistribution,* Boston 1983. Like Douglas in *Unfinished Business,* Tullock divides his book into chapters on education, health care, and superannuation payments with solutions that are not as specific as Douglas, but structurally similar.

53 Douglas, *Unfinished Business,* p. 306

Roger Douglas's Economic Philosophy – An Appraisal

Returning to a core question of the paper: "Was Roger Douglas a right-wing mole in the Labour government?" we can review his philosophy through his actions and writings and reach some tentative conclusions. First, on the question of using progressive income taxes to redistribute income, Douglas already had a negative view in the 1970s and early 1980s that New Zealand was relying too heavily on the income tax before the start of the Fourth Labour Government. I conclude this from both his actions and writings, including his superannuation plan from the Third Labour Government and the *Alternative Budget* from 1980 and his support for GST in 1985, early in the Fourth Labour Government.

The other related issue was that Douglas preferred a broad, simple tax base with few tax deductions over a narrower tax based with higher rates and more deductions. These ideas had formed by the time that the *Alternative Budget* had been written in 1980.

On an important third strand of Douglas's thinking -- the government's ability to provide key services -- the timing of his shift to libertarian thinking is less clear. While Douglas had by 1987 concluded that the government's role in social welfare, health, and education should be increasingly restricted to funding transfer payments, education vouchers, and guaranteed health insurance, this restricted government scope was not found in his two books from the early 1980s. As a result, I believe that it is most likely that Douglas became convinced in 1984-87 of limiting the government's role in health care and education. In 1989, he described his disappointment in the effectiveness of government spending in his keynote address to the Mount Pelerin Society and was close to the position he described in 1993 in *Unfinished Business*.[54]

On the final strand of Douglas's thinking -- a genuine desire for the poor to have opportunities in society -- my conclusion is that he never changed this commitment from his early days in Labour. In this commitment, he continued to differ from large parts of the more conservative neoliberal movement that emphasised how lower payments to the poor increased incentives to work and in the USA where health care was viewed as a privilege to be paid for rather than a citizen's right. Douglas

54 Douglas, "The Politics of Successful Structural Reform", pp. 35-37, Report of the Hospitals and Related Services Taskforce, *Unshackling the Hospitals,* Hospitals and Related Services Taskforce, Wellington, 1988

disagreed with Labour on how the poor were supported but not his commitment that the poor receive payments and vouchers to ensure they received a basic level of income and a good standard of health care and education for their children. [55]

Rogernomics: The Debate in the 1990s

We're now approaching the 30-year anniversary of the end of Rogernomics so it has arguably become an historical event with enough time to evaluate its impact on the economy and society. But before we evaluate its impact, it's worthwhile to review the debate that Rogernomics triggered in the 1990s. The terms of the debate were finalised when the National Government under Jim Bolger and Minister of Finance Ruth Richardson continued the deregulation of the economy, with key measures being privatisation of the railroads, legislation weakening the unions' bargaining power, lowering of welfare support payments, and an introduction of co-payments for hospital stays.[56] The combination of the changes from both the Lange and Bolger governments appeared to the New Zealand left wing as a version right-wing neoliberalism applied to New Zealand without debate. As noted above, Roger Douglas featured as one of the villains in these left-wing narratives, as a Minister of Finance who allowed right-wing neoliberals at Treasury and the Business Roundtable to drive economic policy against the interests of the Labour Party base.

At the same time, support for neoliberalism in the Northern Hemisphere faded. In 1991-92 the USA turned out the right-wing incumbent, George H. W. Bush, in favour of a centre-left candidate, Bill Clinton, and Margaret Thatcher lost a confidence vote based on her support for a controversial lump sum tax.

A sample of anti-Rogernomics literature from this period includes the following prominent examples. Tim Hazledine, an economist at the University of Auckland, explained in his 1997 book, *Taking New Zealand Seriously,* that the post-war economy before Muldoon was a more equal, healthier economy than after Rogernomics. Hazledine found that most economists made a mistake in assuming that markets for labour and products acted according to the laws of perfect competition. Once the flaws of capitalism were acknowledged, the weak-

55 Douglas's commitment to poor remains clear in his more two more recent books. See Roger Douglas, *Closing the Circle,* Auckland, 1995 and Roger Douglas, *No Second Class Citizens,* Auckland, 2009

56 Basset, *New Zealand's Prime Ministers,* pp. 429-37

nesses of Rogernomics became more apparent. According to Hazledine, Labour made a terrible error in thinking that deregulation and capitalism would fix New Zealand's problems and should have moved back to the pre-Muldoon model of capitalism with active government intervention. [57]

In her 1995 book, *The New Zealand Experiment,* Jane Kelsey built the case that Rogernomics caused New Zealand to become a less productive, underperforming and harsher economy for workers and the least fortunate, and more fundamentally argued for new measures to evaluate economic and societal health. While the economic data looked weak on the top line, Kelsey rejected the traditional emphasis on economic growth and argued for new economic and social measures that tracked income inequality, social cohesion and environmental protection, to move away from the failed dogma of neoliberalism and Rogernomics. [58]

A narrower but powerful indictment of Rogernomics came from Brosnan, Rea and Wilson in their analysis of the effect of Rogernomics deregulation on labour markets. Because the manufacturing sector employed a disproportionate number of low-income New Zealanders, (with a high concentration of Māori and Pasifika workers), when this sector shrunk due to Rogernomics, unemployment in these groups increased rapidly. Rea and Wilson's review is critical of policymakers' lack of understanding of labour markets. With the abrupt end of manufacturing subsidies and import licenses, income inequality increased as lower-income manufacturing workers were laid off. This is also a sign of a new and more serious criticism of Roger Douglas, which indicates that the programme did not improve opportunities for the poor, but instead left them with worse long-term prospects. It's also noteworthy that many of those affected would have worked in South Auckland and lived in or near Douglas's electorate in Manurewa. [59] The difficulty of Rogernomics for the selected groups has even been picked up in health statistics. In a long-term review of New Zealand health care trends, Alistair Woodward and Tony Blakely found that Māori life expectancy improvements stalled from 1985 to 1995 even as improved lifestyles and preventive heart disease medications raised life expectancy among New Zealand's European population. Woodward and Blakely attributed the imple-

57 Tim Hazledine, *Taking New Zealand Seriously: The Economics of Decency*, Auckland, 1997

58 Jane Kelsey, *The New Zealand Experiment: A World Model for Structural Adjustment?* Auckland, 1995

59 Peter Brosnan, David Rea, and Moira Wilson, *Labour Market Segmentation and the State: The New Zealand Experienc*e, Victoria University of Wellington. Industrial Relations Centre, 1991.

mentation of Rogernomics to the widening of life expectancy statistics.[60]

Marcia Russell's *Revolution,* published in 1996, used oral history to review the impact of Rogernomics on New Zealand society without taking a position on the benefits or drawbacks of the programme. Russell includes opinions that present the TINA narrative, but also highlighted the difficult readjustment faced by farmers and workers with special attention to the thousands of workers made redundant by corporatisation in forestry and rail. [61]

The highlight of economic historiography in this period came from two powerful, well-researched articles: one from a pro-Rogernomics group of economists led by Lou Evans, followed by a response from Paul Dalziel, an economist at Lincoln University. The pro-Rogernomic writers argued that the New Zealand economy was clearly in a better position than it had been in the early 1980s. Evans provided econometric modelling to show that the New Zealand economy had grown faster than it would have without Rogernomics, with especially strong GDP growth in the 1991-95 period.[62]

In his response, Dalziel made a subtler and, in my assessment, more persuasive argument, that Evans and his colleagues had used the wrong counterfactual and did not meet the stated goals of the programme to improve economic opportunity among the poor. Rather than looking at pre-1984 economic growth and then comparing Rogernomics in 1984-95 to the weak trends under Muldoon in 1975-84, Dalziel compared New Zealand in 1975-95 to Australia. Australia offered an interesting comparison because it had adopted a milder, less radical deregulation programme in the 1980s. Dalziel used economic data to show that both countries struggled similarly in 1975-84, but then New Zealand fell behind Australia during 1984-95. The relative New Zealand data is especially weak on income inequality, showing, for example, that incomes declined relatively and absolutely in our lowest income decile. Dalziel reminded us that the goals of the Labour programme were not just to increase economic growth, but to also reduce income inequality and provide the poor with better economic opportunities. On this basis, Dalziel maintained that Rogernomics had been a failure and a more modest, gradual and well-thought-through programme of deregulation would have generated better outcomes.[63]

60 Alastair Woodward and Tony Blakely, *The Healthy Country? A History of Life & Death in New Zealand,* Auckland 2014 pp. 179-216

61 Marcia Russell, *Revolution,* Auckland, 1996

62 L. Evan, A. Grime, and B. Wilkinson, pp.1895-1900

63 Paul Dalziel, "New Zealand's Economic Reforms: An Assessment," *Review of Political Economy,* Vol.

The narrative in pro-Rogernomics literature in the 1990s concentrated on preserving the benefit of Rogernomics. This group provided multiple articles from Roger Douglas, Alan Gibbs (an influential businessman and friend of Roger), Simon Upton (a National Party MP), and Roger Kerr (former Treasury Department official and head of the Business Roundtable). While they conceded that selected economic indicators were not as strong as had been hoped, simply more *Rogernomics and its Legacy in the 21st Century*

time was needed to establish Rogernomic's clear successes. In addition, additional deregulation and tax cuts were needed to further spur economic growth and better reach the lower-income workers left out of Rogernomics. This group also emphasised that there was historically no alternative to radical deregulation from the controlled economy of the post-war period to 1984. [64]

In the first 18 years of the 21st Century, as Rogernomics has faded from recent historical memory, there has been less intensity on reviewing its legacy through eight years of Labour-led and nine of National-led coalition governments. Pro-Rogernomic writers have outlined the growing strength of the New Zealand economy and its links to deregulation, while anti-Rogernomic writers have continued the key themes from 1990s' reviews in emphasising that New Zealand has become a less equal society with little focus on our least fortunate citizens. Neither the Helen Clark Labour-led coalition in 2000-2008, nor the John Key National-led coalition in 2008-2017 undid Douglas's reforms that eliminated tariffs and export subsidies. Instead, the Clark government negotiated several new trade agreements, including a landmark deal with China in 2008. There has been an ongoing debate about using taxes to redistribute income, i.e., Labour moved the tax rate to 39%, while National reduced the tax rate back down to 33% and increased the GST to 15%. The Key-led National government continued the privatisation wave started under Douglas with the partial sale of three state-owned power companies.[65] The new Ardern-Labour-led coalition has ratified the Trans Pacific Partnership free trade agreement negotiated under the National government and has continued to embrace the open competitive economy that Douglas introduced despite opposition on its left wing.

If we look at economic and societal wellbeing data over the past thirty years,

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14, No. 10, 2002 pp. 31-46

64 Roger J. Kerr, Executive Editor, *The Old New Zealand and the New.*, New Zealand Business Roundtable. Wellington, N.Z., 1994. pp.3-10

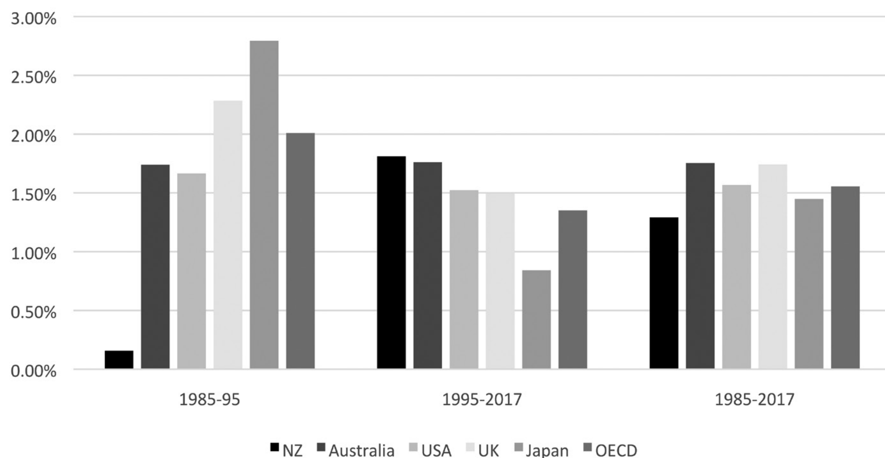
65 Basset, *Prime Ministers,* see chapters on Clark, pp.457-93

the record is mixed. On the positive side, as outlined on Table 3, New Zealand's economic growth since 1995 is among the highest annual growth rates in the OECD, at 1.81% after adjusting for both inflation and population growth, above the UK and USA who both are about at 1.5%/year, Japan at 0.8%/year and the OECD average of 1.35%. And because of strong growth over the past five years, New Zealand has now even overtaken Australia who posts a 1.76% annual growth rate.[66] (See middle bars in chart on Table 3). Neoliberals looking at the relative economic growth rates over the past 20-25 years would see affirmation that the deregulation initiated under Rogernomics has worked.

But before we declare Rogernomics a successful economic and social experiment, using the same measure of real per capita GDP growth indicates that New Zealand economic growth was among the worst in the OECD from 1985-95, with a low growth rate of 0.16%/year for 10 years, which was extraordinarily weak in relative and absolute terms versus our peers (see left set of bars in Figure 3). When we combine 1985-1995 and 1995-2017 into one big data series for 1985-2017 (right set of bars on Figure 3), New Zealand ends up at the bottom of comparative economic performance, driven by weak growth in 1985-95. Unless we further improve our relative strong economic performance in the future over our OECD peers, we will remain at the bottom of the six-country league table for another 10-20 years. So while the data says that we have a strong economy now as measured by Real GDP per capita growth, the ten-year Rogernomics adjustment to get to our new foundation was so economically painful, that it will take 40-50 years to recover that lost income, reminding us of the famous John Maynard Keynes's comment about the time it takes an economy to adjust as "in the long run, we're all dead". [67]

66 "*World Bank. 2017. World Development Indicators 2017.* Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/26447 License: CC BY 3.0 IGO." Data from on-line database, updated on 28 August 2018

67 John Maynard Keynes, *Tract on Monetary Reform,* London, 1923 p.80



Source: "World Bank. 2017. World Development Indicators 2017. Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/26447 License: CC BY 3.0 IGO." Data from online database, updated on 28 August 2018

The second positive legacy from Rogernomics and a key driver in our improved economic performance has been the successful diversification and expansion of the New Zealand primary sector away from the protein bridge to Great Britain to new, rapidly expanding markets in Asia, with China playing an especially significant role. In dairy, New Zealand milk powder facilities are the most efficient in the world, New Zealand has an exceptional reputation for quality, and a 50% increase in milk price driven by Asian demand in the last seven years has resulted in the highest revenue to dairy farmers in post-war history. In horticulture, kiwifruit and apples have built markets in Asia and are receiving a premium for quality and, like dairy, kiwifruit returns are the highest in history for growers due to strong demand from East Asia.[68] New Zealand has built a new competitive industry in agriculture with no government subsidies (unlike its North American, Australian, and European trading partners) and the open economy introduced by Rogernomics acted as a foundation to this economic success.

However, there are also powerful arguments that Rogernomics has left New Zealand with an economy that does not meet the needs of many of its citizens, supported by data on economic well-being.

68 Fonterra and Zespri Annual Reviews, 2010-2017

New Zealand remains in the bottom quartile in productivity improvement within the OECD (25th out of 30), and its Gini coefficient measuring income inequality is in the bottom quartile of the OECD. On environmental measures, largely due to high methane emissions in the expanding agricultural sector, New Zealand is one of the top five per capita carbon emitters in the OECD.[69] Unhappiness about housing affordability and New Zealand income inequality were two issues that were influential in the Labour coalition's success in the 2017 elections, despite strong economic growth.

If we look at trends on mortality for children under the age of five on Table 1, New Zealand shows mixed results. On one hand, New Zealand and the rest of its comparator group has posted dramatic improvements in cutting infant deaths by 75% over the past 45 years. For New Zealand, 20.8 deaths per 1,000 children in 1970 was the leader in the comparator group, and this has been cut to 5.6 deaths per 1,000 children in 2015. However, when we then compare New Zealand's progress to individual countries in the comparator group, New Zealand is arguably the worst performer. The USA is the only country with higher child mortality in 2015, but it has made a larger numerical improvement than New Zealand since 1970. Australia, and the UK moved past New Zealand on this measure in the last 45 years and are now posting child mortality statistics 20%-30% better than New Zealand. Rogernomics and New Zealand's more recent faster economic growth have not led to better relative health outcomes.

Table 1: INTERNATIONAL INFANT AND CHILD MORTALITY TRENDS (Number of Deaths below 5 years old, per 1,000 live births)

	1970	1980	1995	2012	2015
New Zealand	20.8	15.6	8.7	6.0	5.6
Australia	21.4	13.0	7.0	4.3	3.8
USA	23.3	15.0	9.5	8.4	7.1
UK	21.0	14.1	7.2	4.8	4.4
Japan	17.5	9.9	5.7	3.0	3.0
OECD	-	-	16.7	7.9	7.2

Source: "World Bank. 2017. World Development Indicators 2017. Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/26447 License: CC BY 3.0 IGO." Data from online database, updated on 28 August 2018.

69 Jim Stanford, "A View from Afar", David Cooke, Claire Hill, Pat Baskett, and Ruth Irwin, eds., *Beyond the Free Market: Rebuilding a Just Society in New Zealand,* Auckland 2014 pp. 163-72

Conclusion

The narrative on Roger Douglas and Rogernomics will continue to evolve in the coming decades. If the current or a future government is able to convert New Zealand into a society with a higher level of well-being, it is likely historians will become more critical of Roger Douglas's neoliberal philosophy as focusing too much on growing the economy without enough thought on sharing the benefits through society. However, if we are not able to pay for the health care and superannuation payments for the baby boomers over the next 40 years, Douglas's proposals for compulsory superannuation in the Third Labour Government and retiree health care accounts outlined in *Unfinished Business* may re-enter the historical narrative as examples of credible plans that were lost opportunities to fund the demographic bubble. Future historians may also return to the question of how the Fourth Labour Government could have pursued such right-wing neoliberal policies and consider Michael King's hypothesis of whether Douglas was a right-wing mole. In my assessment, Douglas is a complex figure who cannot be easily placed into any ideology, combining right-wing libertarianism with an ongoing commitment to creating better lives for the poor.

The only certainty today is that Roger Douglas remains one of the most ideologically interesting, impactful New Zealand Finance Ministers of the 20th Century, even though he has received little in-depth attention from historians. This paper has attempted to begin to correct that oversight.

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World Bank. 2017. *World Development Indicators 2017.* Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/26447 License: CC BY 3.0 IGO." Data from on-line database, updated on 28 August 2018

Trumping Trump: Why U.S. Tariffs Won't Fix The Trade Balance, and What Will?

Ivan Gradjansky[1]

Introduction

With the advent of Trump's trade war, economic issues such as trade deficits and tariffs have been on the minds of lots of people, and economists worry about the war's effects on the economy. The general public and pundits believe that tariffs will either "Make America Great Again" or that they will plunge the country into a modern day Great Depression, reminiscing the Smoot-Hawley Tariff Act of 1930. Neither side seems to be right. The literature discussing the Great Depression did not confirm that tariffs directly led to a depression, instead agreeing that the tariffs' effect accounted for just 10% of the 1929-1933 drop in GDP (Crucini and Kahn 2006: 23). Trump's tariffs and trade wars have not plunged the U.S. economy into a recession or depression. However, the New York Times has reported on March 6th 2019 that "America's trade deficit in goods with the rest of the world rose to its highest level in history last year as the United States imported a record number of products, including from China, widening the deficit to $891.3 billion and delivering a setback to President Trump's goal of narrowing that gap" (Tankersley and Swanson 2019). This suggests that perhaps Trump's tariffs are ineffective in reducing the trade deficit or even backfiring and leading to an increasing trade deficit.

1 Ivan Gradjansky graduated from Beloit College in 2019 with a degree in Economics.

If "bad trade deals" are not the cause of U.S. trade deficits, what can the U.S. do to reduce the deficit? The literature studying the determinants of trade balance mentions the twin deficits hypothesis, which maintains that fiscal deficit and trade deficit are interrelated. If this is true then reducing the U.S. fiscal deficit might reduce the U.S. trade deficit (Bartolini and Lahiri 2006, 1). Some other explanations focus on a country's exchange rate policy, which is why people argue that the artificially low Chinese Renminbi is unfair to U.S. manufacturers (Bahmani-Oskooee 1992, 85; Pandit and Krishnamurty 1996, 57).

This paper examines the determinants of the trade balance, exports, and imports of the United States with sixty-one countries for the period of 1987-2017. Using a fixed effects model, these three dependent variables are regressed against U.S. tariffs on imports of foreign countries' goods, and foreign countries' tariffs on U.S. exports. Additional independent variables are GDP of foreign countries, population of foreign countries, bilateral exchange rate index, inflation rate of foreign countries, and foreign countries' fiscal balance as a percentage of their GDP. The regression results show that tariffs and exchange rate fluctuations do not matter for trade balances, exports, or imports, while fiscal balances of foreign countries play a role.

The rest of the paper is organized as follows. Section II reviews the literature on the determinants of trade balances. Section III explains the data sources and provides some descriptive statistics. Section IV discusses the econometric model used. Section V discusses the empirical results followed by a short conclusion in section VI.

Literature Review

The literature has recognized two main determinants of a trade balance: trade barriers and exchange rate. In addition, there is the twin deficits hypothesis, which maintains that fiscal deficits and trade deficits go together.

1. The relationship between exchange rate and trade balance

A large number of empirical studies have examined the impact of exchange rate fluctuations and currency revaluations on a country's trade balance. Much of this empirical literature yielded inconclusive results. For instance, Aziz (2012) investigated the long-term and short-term impact of currency devaluation on

Bangladesh's trade balance, and found that there is a positive and statistically significant relationship between the two in the long-run but not in the short run. In addition, he tested the J-curve hypothesis, which states, "following a devaluation in the exchange rate the balance of trade initially deteriorates, but improves eventually" (19). Aziz found evidence supporting the J-Curve hypothesis for the case of Bangladesh: following a real devaluation, Bangladesh's trade balance initially decreases before eventually improving. Studies prior to Aziz's have had conflicting results regarding this J-curve hypothesis. While Bahmani-Oskooee's 1985 paper (cited in Aziz 2012), among others, have argued that the J-curve holds, other authors have reported that it holds only with certain caveats, such as being a delayed reaction (Mead 1988, 20). Others report that the evidence for the J-curve hypothesis is mixed (Hsing 2008, 20).

Michael Burda and Stefan Gerlach's 1992 paper examined how trade of nondurables and durables have been affected by changes in the exchange rate (Burda and Gerlach 1992, 1234). They found that an exchange-rate overvaluation should worsen the trade balance in durables more than non-durables (1234). This is important to a model examining the U.S. trade balance, as the makeup of U.S. goods has changed over time. Thus, the effect of the exchange rate on the trade balance may not be a constant, but rather change with the composition of trade.

Krugman et al (1987) examined the reasons behind the trade deficit, noting that even when the dollar depreciated in the 1980s, the U.S. trade deficit failed to improve (Krugman et al. 1987, 1). This finding goes against what many economists and politicians believe: that both the trade balance and fiscal balance are inversely related to the dollar's strength (1). This paper's results showed that the exchange rate accounts for 45% of the U.S.'s trade deficit, but that the exchange rate's effect is lagged (24). Additionally, the rise in import prices due to the depreciation of the domestic currency was greater than the fall in export prices, so the percentage change in imports was greater than that for exports (24). The income elasticity of demand for U.S. exports was far less than for imports, causing the smaller effect on exports (35). The paper's analysis also suggested that the rising trade deficit resulted from the increases in competition for U.S. production due to productivity gains in other countries (36). The authors claimed that in order to combat this decline in competitiveness the U.S. must accept declining real wages, something that has occurred for much of the U.S. population, to keep the relative price of U.S. goods low (37).

In Krishnamurty and Pandit's 1996 study, the authors created a moderately disaggregative model. They applied this model to India's imports and exports between 1971 and 1991, taking into account variables such as relative prices, import tariffs, export subsidies, and economic activity (Pandit and Krishnamurty 1996, 57). The authors also accounted for adjustments in domestic prices in response to exchange rate adjustments (57). By applying this model to India's imports and exports, they concluded that the exchange rate did not significantly affect export earnings for India (75). However, exchange rate adjustments did have an effect on import volumes. Thus changing the exchange rate can reduce the trade deficit (75). Ultimately, their research showed that although import duties can reduce the trade deficit, the exchange rate also has a similar effect and thus can be used as a substitute (75).

Li (2004, 553) examined how trade liberalization affected the exchange rate. The author found that the real exchange rate depreciated between 27% and 48% if countries opened their economies (570). If liberalization happened in stages, the real exchange rate would initially not depreciate, but in the last episode of trade liberalization the real exchange rate would depreciate within the year of the policy change (577). This suggests that the effect that tariffs and the exchange rate have on the trade balance might be partly confounded.

2. The relationship between protectionist trade policy and trade balance

The literature also yields inconclusive evidence regarding the effect of trade policies such as tariffs on the trade balance. Kim and Shikher (2017) constructed a dynamic general equilibrium model of three countries with two production sectors to analyze dynamic effects on trade balance and international asset positions of trade policies, such as changes in tariff rates. The authors calibrated the model parameters to the U.S., China and the rest of the world, and analyzed the effects of an increase in U.S. tariffs to 10% on (a) Chinese goods and (b) all imported goods. They found that an increase in U.S. tariffs led to a small temporary improvement in the U.S. trade balance and an increase in U.S. foreign asset position. Both savings and investment fell in the U.S., but the initial fall in investment was greater than the fall in savings.

Canto, Laffer, and Turney (1982) examined the impacts of import tariffs and export subsidies on the trade balance of the United States and ten other developed nations (Japan and nine countries that have since become part of the European

Economic Community) for the period 1970-1978, using data from the International Financial Statistics. They found that tariffs were strongly correlated with a reduced volume of imports, but also exports. This suggests that tariffs and other similar protectionist methods were ineffective at improving a country's trade balance: they only decreased a country's trade volume and reduced the overall well-being of the world economy because of both production and consumption losses.

Gardner and Kimbrough (1989) developed an econometric model to explore the intertemporal relationship between tariffs and trade balance, paying attention to the difference between a permanent vs. a temporary increase in tariffs. Their model suggests that only temporary increases in tariffs are likely to improve the trade balance significantly. However, if it is expected that future tariffs will follow, then the trade balance may worsen, because domestic consumers understand that the increase in tariffs raises the relative price of current consumption, encouraging them to import more today.

2. *The Twin Deficits Hypothesis – the relationship between fiscal policy and trade balance*

The twin deficits hypothesis proposes that a government budget or fiscal deficit causes, or at least exacerbates, the trade deficit (Basu & Datta 2005, 3311). The twin deficits hypothesis is derived from the national income accounting identity:

$$Y = C + I + G + (X\text{-}M)$$
$$\Leftrightarrow C + T + S_h = C + I + G + (X\text{-}M)$$
$$\Leftrightarrow X\text{-}M = (T - G) + (S_h - I)$$
$$\Leftrightarrow X\text{-}M = S_g + S_h - I$$

where Y is national income, C household consumption, I domestic investment, G government expenditure, X exports, M imports, X - M trade balance, T taxes, S_h domestic household savings, $S_g = T - G$ is government saving, and $S = S_g + S_h$ is total domestic saving. The expression above shows that a larger government budget deficit (when S_g is very negative) implies a smaller trade balance X-M.

The national accounting identity above indicates that fiscal and trade deficits go together, but it does not tell the direction of causation. One possible mechanism through which fiscal deficits can cause trade deficits is that "an expansionary fiscal policy will raise the aggregate demand and will put upward pressure on domestic interest rates. The high interest rate, in turn, will attract foreign capital in the economy and an appreciation of exchange rate takes place (flexible exchange

rate regime). Exports decline, imports rise and trade balance deteriorates" (Basu & Datta 2005, 3312).

The empirical literature on the twin deficits hypothesis has not reached a consensus. Basu and Datta (2005) tested and rejected the twin deficits hypothesis for the case of India for the time period 1985-2003. The dependent variable trade balance was regressed against explanatory variables of interest such as the fiscal deficit, money supply, national income, exchange rate, and interest rate. Basu and Datta found that fiscal and trade deficits were not twins, regardless of whether they were measured in percentage of GDP or real terms (3314). Additionally, national savings was found to be non-stationary, i.e., unpredictable values that are impossible to forecast (Iordanova 2019; 3314). Therefore, the trade and fiscal deficits as a percentage of GDP, as well as the net savings as a percentage of GDP have moved randomly, without causing a twin deficits phenomenon (3314). In addition, the savings to GDP ratio and the fiscal deficit to GDP ratio have no long run relationship. Savings have not increased because of fiscal deficit and thus have not improved the trade balance (3315).

Using data for sixteen industrialized countries in the post-1970 period, Boileau and Normandin (2012) studied whether tax cuts can trigger the twin deficits. The authors based their empirical investigation on a small open economy model where a tax cut affects the external deficit by two distinct channels. The demographic channel works through the overlapping-generation structure of the model, and the forecasting channel works through the dynamic structure of the model. Their empirical analysis showed that tax shocks generated twin deficits and that both channels played important roles.

Thepthida Sopraseuth's 1999 paper developed a theory to explain why there is no consensus about the twin deficits hypothesis (Sopraseuth 1999, 167). First, stationary data, that is data with statistical properties (mean, median, variance, etc.) that are all constant across time, fails to give evidence that there is a positive link between net exports and the government fiscal balance (Nau 2018, 167). In contrast, data that is in levels, where the statistical properties are not constant across time, lent evidence to the twin deficits hypothesis (167).

3. *Conclusion*

In short, whether it's the relationship between exchange rate and trade balance, or fiscal policy and trade balance, or trade policy and trade balance, the

empirical literature generally yields inconclusive evidence. This is likely because different studies use different data sets and employ different theoretical and/or econometric models. The current paper contributes to the literature on the debate about the determinants of trade balance. It does so through examining U.S. trade balances using an updated data set assembled from forty-seven sources and includes fifty-five countries.

Data and Variables

Table 1 of the appendix shows data sources and variable definitions. Exchange rate data come from multiple datasets from the Federal Reserve in Saint Louis website. The exchange rate index gives the percentage change in the exchange rate from the base year 1987.[2]

Table 2 shows summary statistics of variables used in the regressions. There are a few noteworthy trends in the data. First, U.S. tariffs on foreign goods are generally very low and have small variance (4%-5% tariffs, see Figure 1 in the Appendix), which might impact the regression results, as will be discussed later. Other countries' tariffs on U.S. goods on the other hand have wide variation across countries (see Figure 2 in the Appendix). It ranges from 0.01% for Hong Kong to 80.85% for India. Second, there is a large variance in GDP data because of large countries such as China or India. Third, U.S. trade balances with foreign countries are mostly negative, which is expected. Finally, the exchange rate index has a large variance across time and across countries. For example, Belgium's currency saw an appreciation rate of 200% from its base value in 1987 to 2017. Nicaragua's currency had the largest depreciation in 2010 when its exchange rate, defined as the number of Nicaragua's currency per one USD, ballooned to 1.04 billion percent above the 1987 level (FRED).

Empirical Model

The linear fixed-effect model to be estimated is

$$yit = \beta \quad x_{it} + \alpha i + \varepsilon_{it}$$

where

2 When there was a change in a country's currency, the year that the change happened became the new base year.

$i = 1,...,N$ is country index and $t=1,...,T$ is year index
yit is the dependent variable which represents Trade Balance, Exports, or Imports.
xit is a vector of the independent variables including U.S. tariffs, foreign tariffs, exchange rate index, foreign countries' population, GDP, inflation rate, and fiscal balance as a percentage of GDP (see Table 1 in the appendix).
β is a vector of parameters to be estimated.
αi is the unobserved time-invariant individual effect.
εit is the error term.

The initial expectation is that U.S. tariffs should have an ambiguous effect. On the one hand, higher tariff rates are predicted to reduce imports into the U.S., but this also means that less intermediate goods are coming into the U.S., resulting in fewer exports. On the other hand, foreign tariffs are predicted to reduce the trade balance of the U.S. as discussed in the literature review and in Krishnamurty and Pandit (1996). GDP of foreign countries is predicted to be positively correlated with both imports and exports since bigger economies should have bigger trade volumes. However, since both imports and exports would increase with GDP it would be unclear as to which would have the greater effect and what would be the relationship between foreign countries' GDP and U.S. trade balance.

The exchange rate index is also predicted to have an ambiguous effect on the trade balance based on the literature review earlier. Politicians also believe that exchange rates are of great importance, which influenced the author's hypothesis that tariffs would have a major effect on the trade balance. In a similar vein to the exchange rate index, inflation was predicted to have a large effect on trade balances, imports, and exports. High inflation causes currency depreciation, thus leading to a weak currency which allows countries to sell more.

Estimation Results

Table 4 presents the results from three fixed effects regressions examining three different dependent variables: U.S. imports of foreign countries' goods, U.S. exports to foreign countries, and the U.S. bilateral trade balances with foreign countries. The regressions reveal three striking results with strong policy implications.

First, the U.S. average tariff rate has no statistically significant effect on U.S. imports of other countries' goods, nor does it affect the U.S. bilateral trade

balance. This fits with previous literature that has shown that tariffs do not change the trade balance significantly (Gardner and Kimbrough, 1989). A more careful examination of U.S. tariff data reveals that U.S. tariff rates tend to be small with very little variation across countries (see Figure 2 in the appendix). Of the 1,206 U.S. tariff rates, more than a thousand were below 5%, and there are only a few outliers with rates above 15%. So it's possible that the lack of impact is due to U.S. tariffs being small with low variance. However, note that foreign tariff rates are generally higher with larger variance than U.S. tariff rates, yet they too do not have any statistically significant effect on the bilateral trade balances with the U.S.[3]

Overall, the results from this paper do not support the claim that higher tariffs can help reduce a country's trade deficit. This might explain why Trump's tariffs have failed to reduce the U.S. trade deficit, although it does not explain why it has ballooned under him.

Second, in the third regression (see column IV in Table 4), the coefficient of fiscal balance of foreign countries is negative and statistically significant. When a foreign country's fiscal balance increases by 1% of GDP, this is associated with an increase in their trade balance with the U.S. of 399 million U.S.D. This result indicates that fiscal policy can influence trade balance, confirming the extensively researched twin deficits hypothesis (Bartolini and Lahiri 2006). Although the results in this paper are about foreign countries' fiscal and trade balances, they do lend support to the importance of fiscal policy (relative to trade policy such as tariffs) in determining trade balance. It is hence plausible that Trump's expansionary fiscal policy, particularly the 1.5 trillion dollar tax cut, contributes to the increases in both fiscal and trade deficits, a hypothesis reported in the New York Times (Tankersley and Phillips, 2018; Tankersley and Swanson, 2019).

Third, the exchange rate coefficients are not statistically significant in the regressions, suggesting that exchange rate fluctuations are unimportant in determining the trade balance. This contrasts from what many politicians' claim that countries like China artificially devalue their currency, deepening the U.S. trade deficit. This paper's findings that the exchange rate policy has no effect on the trade balance, imports, or exports confirms Bahamni-Osokooe (1992), but detracts from the results of Krishamurty and Pandit (1996) and Aziz (2012).

3 Although foreign tariff rate has statistically significant and negative effect when the dependent variables are imports and exports, it's not significant when the dependent variable is trade balance, possibly because the two effects cancel each other

In addition to the three main results above, other estimated coefficients make sense intuitively. When the GDP of foreign countries is higher, both U.S. exports to those countries and U.S. imports of goods from those countries are higher; that is, trade volume is higher when economies are bigger. On balance, a higher GDP of a foreign country is associated with a smaller U.S. trade balance with that country. Population size of foreign countries is not statistically significant, possibly because GDP and population are highly correlated (see Table 3 in the appendix), and GDP already captures the impact of economic size. The variable inflation rate (of foreign countries) has a statistically significant and negative coefficient in the first two regressions where the dependent variables are U.S. imports and exports. A one percent increase in inflation rate is associated with a reduction in imports by 259.98 million U.S.D and a reduction in exports by 249.07 million U.S.D. Probably because the effects of inflation rate on imports and exports cancel each other out, this variable is not statistically significant in the third regression where the dependent variable is the U.S. trade balance.

Conclusion

This paper has examined the determinants of U.S. trade balance, imports and exports with a set of sixty one countries for the period 1987-2017 using a fixed effects model. The results from these fixed effects regressions do not corroborate the theories of politicians from either the left or the right about the U.S. trade deficit. Some politicians advocate raising U.S. tariffs on imports of other countries' goods in order to reduce the U.S. trade deficit. But this paper's results show that U.S. tariffs have no effect on U.S. bilateral trade balances with other countries, and perhaps it is the U.S. expansionary fiscal policy that is the culprit. Additionally, worries in regards to currency valuation seem to be misguided. Many politicians claim that undervaluation of foreign currencies, such as the Chinese Renminbi, causes the U.S. trade deficit. This paper's result show that exchange rate fluctuations are not a significant determinant of trade balance, rejecting such claims. Finally, fiscal policy seems to be a major determinant of trade balance, so if the United States wants to improve its trade balance, it needs to improve its fiscal balance.

But a trade deficit may not necessarily be a problem for a country. Only 6% of economists in the U.S. believe "A typical country can increase its citizens' welfare by enacting policies that would increase its trade surplus (or decrease its trade deficit)." 61% of economists do not believe this statement (Chicago Booth School Of Economics, 2014). A New York Times article by Jim Tankersley, *Trump Hates the Trade Deficit. Most Economists Don't*, explained that economists think the U.S. trade deficit is more complicated than simply being good or bad (Tankersley 2018). Most economists realize that the trade deficit depends on many macroeconomic factors, not a measure of whether one country is better than another (Tankersley 2018). Additionally, Lawrence H. Summers argued that because the U.S. is generally at the top of the Global Value Chain, both U.S. tariffs and retaliatory tariffs reduce the competitiveness of U.S. corporations (Tankersley 2018).

This paper has several major limitations, and most of them arise from lack of data. The unemployment rate was left out of the regressions because the number of observations dropped dramatically with the variable in the model. Additionally, the U.S. tariff rates reduced the number of years examined to 26 instead of 30, dropping 244 observations. Another major problem is that U.S. tariffs are small and have low variance, and thus are unlikely to have statistically significant coefficients in a regression. Because of these problems, researchers should look for a larger and more complete panel data set to further test the results of this paper. Finally, another limitation is the problem of endogeneity due to reverse causality between tariff and trade balance. Do tariffs influence trade balance, or is it the other way? This paper has not been able to solve this problem using instrumental variable technique because of a lack of a suitable instrument.

Appendix

Table 1: Variable Definitions and Sources

Variable	Variable Definition	Source
Country	Shows that all 61 countries have 31 observations, the U.S. is not included	
ID	Countries were ID'd with a distinct number, the first country was 1 and the last was 61.	
Year	From 1987 to 2017, 26 years.	
GDP*	Real Gross Domestic Product in millions. Ranges from Equatorial Guinea's $88 million to China's $12.2 trillion GDP	IMF and The World Bank
Trade Balance	From Imports minus exports.	FRED in St. Louis
Imports	U.S. Imports range from $0 Million to $505470 Million	FRED in St. Louis
Exports	U.S. Exports range from $1.1 Million to $312817 Million	FRED in St. Louis
Pop	Population of U.S. trading partners, in million.	IMF
Exchange Rate Index	The Exchange rate is the percentage change in the exchange rate, defined as the number of foreign currency per one USD, from 1987 onwards. The index starts at 1 in 1987 and will change based on how strong the currency is compared to the U.S.D each year. If a country's currency changes then that year is skipped and the index starts at 1 the following year.	Created using FRED data
Inflation Rate	Equatorial Guinea had the -31.566% inflation rate in 1998.	IMF
Foreign tariffs	Average tariff that partner countries put on U.S. exports. Hong Kong had the lowest tariff rate of 0.01% and India's 1990 tariff of 80.85% was the highest.	*World Bank*
U.S. tariffs	The average U.S. tariff on trade partners. The lowest tariff rate is 0% on Equatorial Guinea in 1992. The highest tariff rate is on Equatorial Guinea in 1999	*WITS*
Fiscal Balance	The fiscal balance is measured as a percentage of GDP and is generally negative. The minimum is -557 million dollars for Equatorial Guinea in 1992 and the maximum is 29.8 million dollars for Saudi Arabia in 2008.	IMF

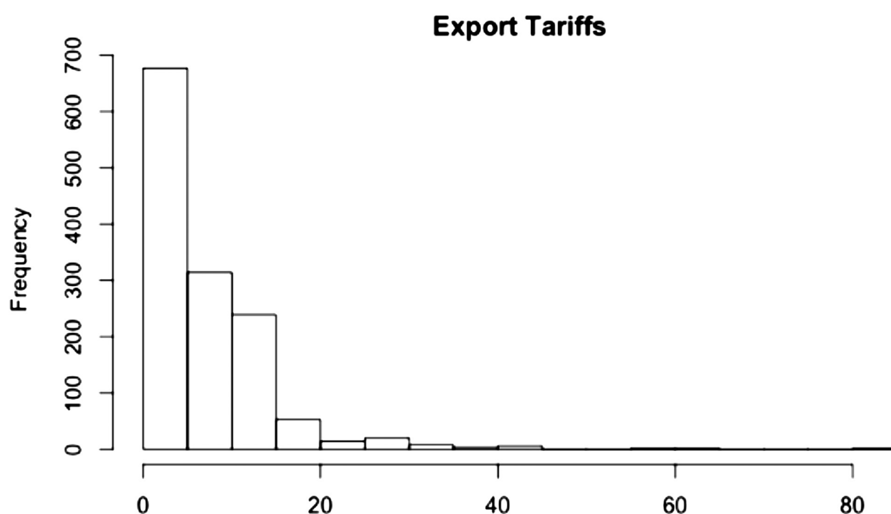
Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max	Missing
GDP (millions U.S.D)	1874	503903	1028000	88.27	12237700	17
Population (millions)	1861	71267.6	211580.4	54.1	1386395.0	30
U.S. tariffs (percentage)	1462	4.463	3.299544	0.0000	39.819	429
Foreign tariffs (percentage)	1337	7.383	6.912456	0.000	80.850	554
Exchange rate index (percentage)	1656	7537319	73412739	-2	1,041,777,984	235
Inflation rate (percentage)	1833	37.914	427.1541	-31.566	13611.635	58
U.S. Fiscal balance (percentage)	1574	-3.265	22.428	-557.500	29.800	317
Imports (millions U.S.D)	1840	20928	52344.72	0	505470	51
Exports (millions U.S.D)	1840	14071.5	32610.94	1.1	312817.0	51
Trade Balance (millions U.S.D)	1891	-6671.4	28696.05	-375576.4	36678.1	0

Table 3: Countries in Sample

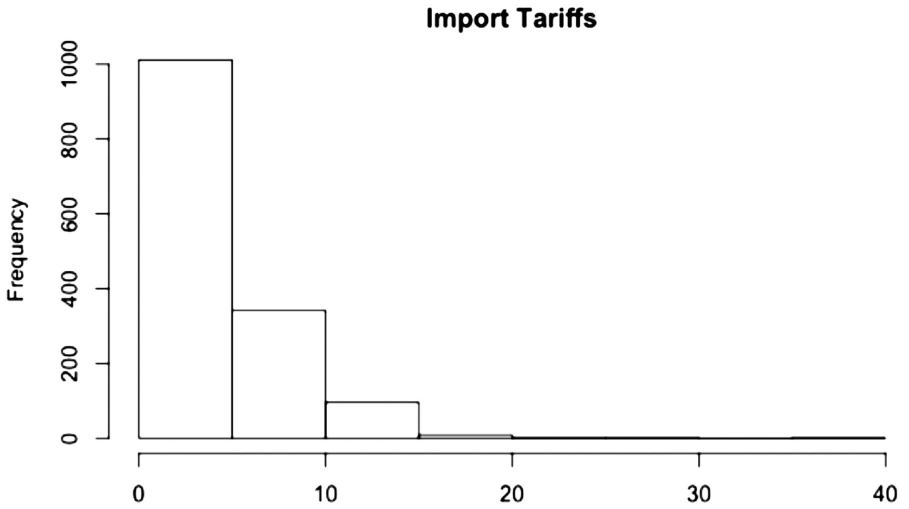
Argentina, Australia, Austria, Bahamas, Belgium, Belieze, Bermuda, Brazil, Canada, Chile, China, Colombia, Costa Rica, Cuba, Denmark, Ecuador, Egypt, El Salvador, Equatorial Guinea, Finland, France, Germany, Greece, Greenland, Guatemala, Honduras, Hong Kong, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Mexico, Morocco, Netherlands, New Zealand, Nicaugra, Norway, Panama, Peru, Philippines, Poland, Portugal, Russia, Saudi Arabia, Senegal, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, United Arab Emirates, United Kingdom, Venezuela, Vietnam

Figure 1



The variable export tariffs (foreign tariffs) has a fairly wide distribution, although it is skewed left. Because tariffs are given as a percentage you cannot take the log in order to improve the distribution.

Figure 2



The variable import tariffs (U.S. tariffs) is skewed left, because of this skew the significance of U.S. tariffs may be understated.

Table 3: Pairwise Correlation matrix

	TB	**Y**	**pop**	**FB**	**Im**	**Ex**	**ER**	**i**	**tU.S.**	**t foreign**
Trade balance	1									
GDP	-0.762	1								
Population	-0.565	0.429	1							
Fiscal Balance	-0.010	0.009	-0.007	1						
U.S. Imports	-0.829	0.711	0.403	0.013	1					
U.S. Exports	-0.441	0.463	0.403	0.017	0.867	1				
Exchange rate index	0.024	-0.053	-0.041	0.009	-0.041	-0.025	1			
Inflation	0.017	-0.033	0.011	0.033	-0.029	-0.031	0.011	1		
U.S. tariffs	0.111	-0.240	0.213	-0.006	-0.068	-0.183	0.213	0.006	1	
Foreign tariffs	-0.003	-0.146	-0.025	-0.117	-0.176	-0.109	-0.025	0.166	0.225	1

Variable Definitions: TB: Trade Balance; Y: GDP; pop: Population; FB: fiscal balance; Im: imports; Ex: exports; ER: normed exchange rate; i: Inflation; tU.S.: U.S. tariffs; t foreign: Foreign tariffs

Table 4: Regression Results

	Dependent Variable Imports (in millions U.S.D)	**Dependent Variable Exports (in millions U.S.D)**	**Dependent Variable Trade Balance (in millions U.S.D)**
GDP of trading partners (In millions)	3.57e-08***	1.32e-08*** (.001)	-2.25e-08*** (.001)
Population of partner country (In millions)	2.02e-07 (.039)	-6.11e-05* (.029)	-6.1e-05*** (.027)
Foreign tariffs (on U.S. export; %)	-818.747*** (193.52)	-673.87*** (141.80)	144.875 (128.94)
U.S. tariffs (on imports of foreign country's goods; %)	-356.49 (400.62)	-487.75* (293.54)	-131.258 (266.91)
Fiscal Balance of partner country (% of GDP)	501.40*** (157.47)	102.14 (715.38)	-399.245*** (104.95)
Exchange Rate Index (base year = 1987)	2.01e-06 (.000)	2.98e-06 (.000)	9.76e-07 (0)
Inflation Rate of partner country (Percentage)	-259.98*** (96.809)	-249.076*** (70.933)	1.089 (64.500)
Country Fixed effect	yes	yes	yes
R2 overall	0.639	0.332	0.633
R2 within groups	0.639	0.332	0.608
R2 between groups	0.437	0.176	0.674
# of observations	1090	1090	1090
# of countries	55	55	55

Fixed Effect. Standard error is in parentheses.

*p-value < 0.1, **p-value, < 0.05, ***p-value < 0.01

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Contributors

Dani Rodrik   Ted Liu   Shatun Mukand   Jennifer Esperanza   Rachel Ellett
Diep Phan   Pablo Toral   Darlington Sabasi   Johnson Gwatipedza   Xinshen Diao
Margaret McMillan   Beatrice McKenzie   Jonathan Mason   Ivan Gradjansky

Department of Economics

Beloit College