Mid-Term Examination #1
GEOG 2064

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Question #1: Examine the relationship markets and institutions.

Simply, Dani Rodrik (2011) states very clearly "…Markets and states are complements, not substitutes…" (p. 16). Throughout the beginning chapters of his book, Rodrik takes a very strong position against the notion that an institution, such as government, and markets should be kept separate, as laissez-faire advocates would prefer. He claims, "…markets are not self-creating, self-regulating, self-stabilizing, or self legitimizing…" (p. 22) implying that markets need another entity to create, regulate, stabilize, and legitimize them. The question of the relationship between markets and institutions is answered throughout the beginning of the book as Rodrik moves from early trade at the Hudson Bay Company through the establishment and dissolution of the Bretton Woods Agreement to the recent Asian financial crisis, among others.

In the chapter, "Of Markets and States" (p. 3), Rodrik begins with the example of trading in North America by what would become the Hudson Bay Company. He states that "… 'merchant-traders' had to carry out statelike functions, because trade would have been impossible in their absence." (p. 11), essentially arguing that without an institution, a governing body, that would provide the necessary infrastructure–listed as transport, logistics, communications, trust, law and order, contract enforcement (p. 11)–trade would not be possible. Rodrik also provides more seemingly trivial but practical reasons that are essential for trade when he lists such things as a medium of location, common language, belief system, medium of exchange, peace, and protection (p. 13-4). Gaining from this trade means lowering the transaction costs (p. 13) and making goods more accessible to more markets and populations.

One of Rodrik's most fervent dislikes is the dislike for the ineptitude and, downright, inefficiency of free trade. Free trade is the scenario where a country will remove certain restrictions or certain exports and imports in order to facilitate the trading between countries.

Rodrik describes a lesson which he states is “clear”: “…depending on where a country stands in the world economy and how trade policies align with its social and political cleavages, free trade can be a progressive or a regressive force…” (p. 30). Clearly, whether or not free trade should be implemented depends really on the specific country at hand. Rodrik also states that much of the growth in trade and globalization that occurred during the twentieth century was not due so much in part to free trade, a statement that is frequently stated (p. 33).

Rodrik makes his stand against free trade much more apparent later on when he states that free trade is unnatural (p. 47). He also states that advocates are incorrect to associate free trade with economic and political progress while downplaying the role of protectionism as a “backwardness” and “declin[ing]” policy (p. 47). His reasoning against free trade is that absolute costs do not create comparative advantage, comparative costs do (p. 50). Money is not the only cost that is encountered when consuming a good, as the labour and scarce material used to obtain it must be considered as well (p. 51), a point emulated by Adam Smith. Adam Gopnik (2010) writes in his New Yorker article that the true cost of producing a good is the time that worker uses to make that good, “…Workers make wealth; prosperity is productivity. The wealth of a nation is all owed to the labour of its people and technology they possess. Make more and you make more.” (Gopnik, p. 85). Free trade essentially takes away the comparative advantage that nations have by sending the manufacturing labour and productivity elsewhere, and Rodrik states that this will not be beneficial in the long run (Rodrik, p. 56).

The Bretton Woods Model was an attempt to “…allow enough international discipline and progress toward trade liberalization to ensure vibrant world commerce, but give plenty of space for governments to respond to social and economic needs at home…” (p. 69). Essentially, Rodrik states, the model would help guide globalization into a manageable and workable form that would be efficient and beneficial to all. From Bretton Woods sprang several institutions that aimed to deal with respective areas that were believed to be new focus points in the changing world. First, the General Agreements on Tariffs and Trade (GATT), which was an "ambitious" program and acted as the "multilateral forum for overseeing global trade liberalization…" (p. 71) and to maximize the amount of trade compatible with different nations (p. 75). The GATT ensured that all signatories would benefit from the relaxing of restrictions, whether or not they had a large role in the decision making process (p. 71). However, the GATT did omit certain areas in its protection policies, showcasing a grave inefficiency (p. 72). Second, the World Trade Organization (WTO) was an "instrument for attacking the full range of transaction costs that impeded international commerce…" (p. 79) and essentially acted as a court where plaintiffs could plead their case against a defendant. And lastly, the International Monetary Fund (IMF) acted as an institution, which would free up capital and allowed for longer investment in nations though, technically, the "IMF had no legal authority over capital flow…" (p. 90).

The principle difference between today's global financial system and the international trade regime that was established at Bretton Woods is that, following Rodrik, while there was an attempt to control globalization through institutions under Bretton Woods, today "we lack the domestic and global strategies needed to manage globalization's disruptions…" (p. 88). The result, Rodrik states, is that the risks of social costs of trade outweigh the slim economic gains and severe globalization consequences (p. 88). In the late nineties, there was a push for free capital mobility, the argument being that capital mobility would allow more efficient allocation of savings and productive use (p. 91). Another extreme difference between now and then is the "dollar-exchange standard", where the global economy relied on the fact that the United States dollar, the main currency for transactions, would remain pegged to the price of gold (p. 99). This changed, however, in 1971, when President Richard Nixon and Treasury Secretary John Connolly abandoned the gold standard when foreign nations attempted to exchange dollars for the gold they were backed by (p. 100).

Global trade rules set up by institutions can arguably assist and impeded the development and diversification of poor countries. Through programs under Bretton Woods, such as the IMF, short term lending to smaller countries was possible. However, programs such as free trade create redistribution-to-efficiency ratio that is drastically uneven (p. 57). Rodrik states that a proximate cause for poverty is low productivity, and that "…globalization promises to give everyone access to markets, capital, and technology, and foster good governance… globalization has the potential to remove all the deficiencies that create and sustain poverty…" (p. 137). He also states that "…Globalization… makes it easier for countries to fall into the commodities trap…" (p. 156). To solve this, Rodrik suggests increasing transaction costs rather than lowering them to empower poorer nations (p. 157).

Whether markets today are more efficient is, again, a matter of opinion. Rodrik appears to conclude that governments are inefficient in managing their economies (p. 93), and that though bank runs are a thing of the past thanks to governmental safeguards, the global equivalent does not exist (p. 94). However, he is against totally removing government regulation from international financial markets, as is supported by Keynes, since it would eventually lead to undermining macroeconomic equilibrium (p. 95-6). He concisely concludes by stating financial globalization has failed the global population, "…Countries that have opened themselves up to international capital markets have faced greater risk, without compensating benefits in the form of high economic growth." (p. 111) which implies both that international finance markets are inefficient (unrealized economic growth) and unstable (greater risk).

Question #2: Examine the relationship between globalization and democracy.

Dani Rodrik (2011) summarizes the tensions that exist between “hyperglobalization”, democratic politics, and national self-determination into a concept he calls “the Trilemma” (p. 200). The Trilemma depicts the scenario in which hyperglobalization, the nation state, and democratic politics cannot live in concurrency. Specifically, he states, “we cannot have all at once… We can have at most two out of three.” (p. 200). Hyperglobalization requires that domestic politics be pushed out to the periphery and decisions be left up to more specific entities that encompass the “world’s” interests, and no longer a specific domestic group (p. 202).

However, an alternative exists in the form of “global governance”, institutions endowed with sufficient powers to enforce accountability and legitimacy, which would relocate power to a global level (p. 202). Rodrik proposes a global federalism, much like the way individual states in the United States hold certain powers but are ultimately regulated at the federal (or national) level (p. 203). Again, a compromise must be made. This scenario “[sic] would entail a significant diminution of national sovereignty” (p. 203) and reduce the powers they once held. An example of this scenario is the European Union (p. 203) where European nations have come together to open borders, use one consolidated monetary unit (the euro), and operate under one economic plan. Rodrik explains that the problem with this idea is that “…there is simply too much diversity in the world for nations to be shoehorned into common rules…” (p. 204). Furthermore, he uses the strong language that such global standards and regulations are “undesirable” (p. 204).

The last option, sacrificing hyperglobalization, ultimately leaves out developing countries, as was apparent with the Bretton Woods regime (p. 204). This catch-twenty-two, where a result cannot be achieved without sacrificing certain requirements in such a way that the intended result is unachievable, illustrates the tensions that arise between hyperglobalization, democratic politics, and national self-determination.

Obviously, globalization is not an ideal without imperfections. Of these, the main imperfections are the democratic choices that are infringed upon by unfettered globalization. To illustrate this point, Rodrik provides a succinct list of illustrations that illustrate "…the clashes between globalization and domestic social arrangements" (p. 190). Specifically, he lists that labour standards, corporate tax competition, health and safety standards, "regulatory takings", and industrial policies in developing nations (p. 190-8) as the major illustrations "…of how globalization gets in the way of national democracy" (p. 190).

Labour standards are different across all nations. What right is given to an entity how often one, of any age, is allowed to work if it is there will to do so? Outsourcing has created an interesting loophole through which companies may lower costs by employing workers outside of the country who are willing to work for less than a domestic worker. This creates issues with the domestic populations who are put out of work and must suffer the consequences and unemployment that follows. Related to labour standards are the health and safety standards to which the labour (and consumers) are forced to experience. By being able to choose a favorable tax structure by relocating to another country, companies "…[put] downward pressure on corporate tax rates and [shift] the tax burden from capital… to labour…" (p. 193).

Perhaps the most important point that Rodrik makes is that political power and domestic politics will be replaced by "…more fluid forms of representation that transcend national boundaries" as authority moves from "…domestic rule-makers to transnational networks of regulators…" and ultimately, "multinational companies and faceless international bureaucrats"

(p. 207). The people, the democracies they are represented by, will lose a say in the process and will instead be overshadowed by smaller entities with more power.

In order to curb the growing power or rise of globalization, Rodrik proposes succinctly that what limits us from approaching global governance will ultimately limit globalization. By saying, "…We must acknowledge and accept the restraints on globalization that a divided global polity entails…" (p. 232) Rodrik is implying that a divided global community, one divided by different economic and cultural differences, keeps globalization from reaching its full potential. He further proposes a new globalization, one that must be governed by seven "common sense principles", and lists these principles as: markets and governments interweaved together, empowered nation states, multiple paths to prosperity, social arrangements and regulations protected by independent countries, countries free from imposing regulations on others, traffic rules that manage the communication between national institutions, and the difference between the rights and privileges of democracies and non-democracies (p. 236-47).

As far as global governance is concerned, it appears that Rodrik has two prominent concerns: the rapidly evolving technical challenges of global regulations (p. 212), and the firm democratic decision making of nation states (p. 208). An interesting phrase that Rodrik uses (which he quotes from the ethicist Peter Singer) is "…the development of a new global ethic that follows from globalization" (p. 213). A global ethic seems to imply a global standard that would remedy all the concerns that nations have concerning a particular issue, whether it be labour standards or government regulations, on which different countries have different opinions. He further states that (again quoting, this time the economist and philosopher Amartya Sen) that "…it is quite misleading to think of ourselves as bound by a single, unchanging identity… with which we are born… Many identities cross national boundaries, allowing us to form transnational associations…" (p. 213-4). The fact that many populations group themselves under traditional identities such as race, religion, or gender may be considered archaic in a world focused on establishing working global governance.

Another more apparent hindrance to the success of global governance is that "…the world is too diverse to be shoehorned into a single political community." (p. 228). Rodrik states that countries should be able to set their own standards and safety regulations, for example, and not force other nations to adhere to their own policies. Should other countries wish to export to more restrictive countries, they should not expect to be able to do so unless they meet the importing country's standards (p. 228).

An important realization that Rodrik makes is that "…We need to accept the reality of a divided world polity and make some tough choices. We have to be explicit about where one nation's rights and responsibilities end and another nation's begin… We must acknowledge and accept the restraints on globalization that a divided global polity entails. The scope of workable global regulation limits the scope of desirable globalization…" (p. 232). As stated before, Rodrik acknowledges the importance of sovereignty and a nation's right to establish its own standards. However, because of this sovereignty, global governance is rather difficult to realize given the diversity between nations' wants, desires, and intentions. Rodrik is correct to state that "…Hyperglobalization cannot be achieved, and we should not pretend that it can." (p. 232). Because of an extremely diverse world, consolidating the globe under one policy is most likely an impossible task. He is further correct to establish that countries that wish to cooperate will find compromise between their national ideals and democracies and their wish to interact.

Works Cited

Gopnik, Adam. “Market Man: What did Adam Smith really believe?” *New Yorker* 18 October 2010: 82-87. Print.

Rodrik, Dani. *The Globalization Paradox: Democracy and the Future of the World Economy*. New York: W. W. Norton &, 2011. Print.