

## **‘Globalisation and National Autonomy’**

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Governments need delicately to balance sovereignty and reaping the benefits of globalization. In theory, surrendering some sovereignty and submitting to global rules will unshackle global commerce from messy national interventions. The result will benefit all countries. Or so economic theory suggests.

Yet at Cancun in 2003 instead of further liberalizing trade, countries split into warring camps accusing one another of bad faith. The result was not a strengthening of global rules but a stalemate. In 1997 countries balked at giving up more sovereignty to the IMF to expand its role into opening up of capital markets. And prior to that attempts to forge a multilateral agreement on investment in the OECD broke down before any global code on investment was agreed. In each case governments sought to replace national policies with global rules. The failure to conclude new multilateral agreements highlights that many governments have doubts about the balance between integrating into the world economy and retaining sovereignty. These are worth exploring.

### **The benefits of giving up national autonomy**

Economists have a very compelling story to tell about the benefits of globalization. Liberalizing trade in agriculture stops governments protecting their own farmers and using subsidies and tariffs to distort the market at the cost of consumers and foreign farmers. The potential gains from liberalization are obvious, particularly for over 40 developing countries, for whom agricultural goods comprise over one third of their exports. Not to mention the citizens of Europe and the United States whose governments spend so heavily on protectionist policies. So too, expanding the agenda of the WTO would further enhance the gains to be made from trade by liberalizing trade in services and investment, and reducing the scope for governments to fashion their own competition law and government procurement rules. If the world were further to liberalize trade, the World Bank estimates that within ten years developing and industrial countries would stand to gain an estimated increase in their additional income of US\$1.5 trillion and US\$1.3 trillion respectively, with the gains lifting an additional 300 million people out of poverty by 2015 (World Bank 2003).

Still greater gains would be made by freeing up flows of money and opening up capital accounts. If governments reduced their controls over capital flowing across their borders, the theoretical promise of globalization begins to look yet more dazzling. Developing countries could tap into escalating quantities of capital. According to the IMF, net flows to developing countries tripled, from roughly \$50 billion a year in 1987–89 to more than \$150 billion in 1995–97, before declining in the wake of the Asian crisis. Gross flows to developing countries and more generally have grown even more dramatically, rising by 1,200 percent between 1984–88 and 1989–94.

But the benefits from trade and financial liberalization are easier to project in theory than to harvest in reality. The evidence of the impact of liberalization in countries across the world economy gives pause for thought to governments considering giving up national autonomy to integrate further into the world economy.

### **The contradictory evidence**

Liberalization in two core areas of economic relations – finance and trade – have had a mixture of effects on countries and not all of them positively go in the direction economic theories posit. Contrary to those who argue that countries should open up their economies to capital markets and reap the benefits of global investment, the evidence suggests caution. The intellectual argument for capital account liberalization was punctured by the highly damaging financial crises of the late 1990s. As a recent IMF study pronounces, although theoretical models identified a number of channels through which international financial integration can promote economic growth ‘there is as yet no clear and robust empirical proof that the effect is quantitatively significant’ (Prasad et al 2003).

As IMF researchers admit, capital account liberalization has increased the vulnerability of countries to crises, with globalization heightening the risks by amplifying the effects of shocks and transmitting them more quickly across national borders. Put simply, global finance brings with it a risk of contagion. Unsurprisingly then, some governments want to retain some degree of control over movements of capital in and out of their country, or at least control over an incentive structure which can influence such movements.

In trade there is an equally vibrant debate about whether the evidence demonstrates that liberalization is good. An important study by the World Bank in 1999 definitively showed that ‘globalizing’ countries enjoy the fastest economic growth (Dollar and Kray 1999). But subsequently critics have taken to task the evidence, pointing to fundamental flaws in the reasoning. For example, China is included in the study as an ‘open to trade’ economy, boosting the results with China’s tremendous growth rates and large population even though China is in many respects one of the least open economies in the world and certainly keeps hold of high degrees of national autonomy (Milanovic 2003). The original World Bank study also fails to distinguish countries enjoying growth because of active government liberalization measures and those who achieved economic growth for other reasons (Rodrik 2000).

Counter-evidence has been adduced to show that liberalization and globalization have been bad for development and developing countries. In one study, the economic performance of developing countries in their more protectionist period 1960-1978 is compared to their performance during the liberalizing phase 1978-1998. The results suggest that most developing countries suffered slower growth and less of a catch up to richer regions of the world in the period of ‘globalization’ (Milanovic 2003). Further to this, within the overall world gains from globalization or trade liberalization, the poorest countries have not fared well. Although liberalization has proceeded apace over the past three decades, low-income countries have not increased their share of world trade and the share of the least-developed countries has actually declined over this time (World Bank 2003).

The response of globalizers is that even if trade and financial liberalization do not enhance a country's growth or access to capital, it is nevertheless good for a country because it locks the government into more market-oriented policies in the home economy, making it difficult for special interests to distort policy. Hence the World Bank writes that 'developing countries should implement trade and other policy reforms unilaterally because it is to their benefit' (World Bank 2003). Similarly in finance, researchers in the IMF refer to the 'disciplining effect of liberalization' which ideally reduces distortions in domestic capital markets and locks in the right policies (Gourinchas and Jeanne 2002). These arguments require concrete country-specific evidence in order to stand or fall. For our purpose what is significant about them is the shift they reflect in the argument as to why a government should give up national autonomy and liberalize its policies. Until recently the dominant rationale has been that liberalization is necessary to reap the benefits of globalization. In the face of ambiguous evidence, the argument has shifted to one of 'locking-in' sound domestic economic policies. The result is a shift away from the debate about how to reap the benefits of globalization.

The evidence on trade and financial liberalization does not suggest that globalization *per se* has negative effects on a large number of countries. Rather it emphasizes that globalization must be managed differently if it is to benefit all countries. Before governments give up national autonomy, they need to ensure that the global rules and institutions which replace national policies are effective and work in practice to distribute fairly the benefits of globalization and the costs of dealing with new vulnerabilities. This adds little to what G-7 governments have been saying over the past five years. But their actions have not echoed their rhetoric.

### **The role of global institutions and rules**

In global finance, the crises of the 1990s made clear that governments must act together to avert catastrophic consequences. Left to market forces a financial crisis can bring down a government, spread rapidly to other countries, and create highly damaging systemic or regional instability. In brief, collectively countries must act together to manage financial crises because individually many have given up instruments of national control.

But managing crises is difficult. There is little appetite for channelling public money into the IMF to bail-out reckless investors to stabilize a financial crisis or to fund inadequate borrower government policies. But doing nothing is worse. The situation has a counterpart within countries. Large banks are usually too important to let fail in developed economies. A banking failure imposes high costs not just on shareholders but on depositors, businesses, and the government. For this reason banks and large investment funds are normally heavily regulated. This is not an anti-market policy. Rather, it is a recognition that market discipline is simply too costly and too messy to rely upon in the financial system.

In the global economy there is a stark difference in the way banks and investors are regulated. In essence, they are virtually unregulated. This is not for economic reasons. It reflects a failure by governments to keep up with the globalization of finance (witness the glacial pace of Basle negotiations). It also reflects the political skill of the financial sector in lobbying and subverting attempts at regulation - starkly

demonstrated in their role in framing and then postponing the implementation of current international banking requirements (the Basle II accords), and in stopping efforts to negotiate a statutory standstill mechanism in the IMF which would require the private sector to participate and to shoulder some of the burden of financial crises.

A similar story can be told about the politics of trade. Effective liberalization requires inter-governmental rules requiring countries to keep their borders open and the effective enforcement of these rules. The reality of world trade reflects differences in bargaining power among countries and powerful vested interests within countries.

In negotiating trade rules, state power depends upon market size. The bigger the market a government can offer access to, the greater that government's bargaining power. For this reason the United States, the European Union, Japan and Canada have long been the rule-setters. But in each there is a further complication – highly organized small groups of vested interests. At Cancun in 2003 much was made of the reported US 'brush-off' of a request for greater market access made by four cotton-producing African states. Continued US protectionism in this sector highlights the power of a lobby which benefited from US\$2065million of subsidies in the year 1999-2000 alone. To quote an IMF official after Cancun: how is it that 25,000 US cotton farmers have so much power? One might equally ask the same of farmers in France or agricultural interests across the European Union. The result is trade rules which liberalize in some areas and permit rampant protectionism in others.

The enforcement of trade rules is also biased in favour of countries with large market size. This is not due to the WTO dispute resolution process which is widely regarded as fair. The problem lies in the unequal power of member states to implement a ruling. The WTO does not enforce rulings. Rather a winning country is given the right to impose 'retaliatory measures' on its rule-breaking trade partner. In the David and Goliath situation of many trade relationships, an erring Goliath may comply because it costs very little and bolsters the rule-abiding image of the government. However, the small aggrieved (David) state has no way to force such compliance if Goliath is not so inclined. For these reasons international trade falls far short of being governed by a rule-based regime. Rather, in the absence of a special prosecutor or capacity to enforce breaches of rules (such as those revealed in regular WTO trade reviews) the WTO is little more than a reciprocity-based framework for trade relations.

### **Who should be giving up more national autonomy?**

Globalization can deliver benefits across the world economy. This requires governments to give up some areas of national autonomy and to play by international rules. But the evidence of the impact of globalization so far makes it difficult to argue that developing countries should give up more national autonomy and submit to global rules. In international trade and finance the rules too heavily reflect special and vested interest pleading in the industrialized countries. Paradoxically, the current argument for liberalization in the developing world is that it would insulate developing country governments against special pleading. This is precisely what industrialized countries need in order to frame rules for international trade and finance which benefit their societies at large as well as those in developing countries.

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