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The Debate Over Globalization: How to Move Forward by Looking Backward

DANI RODRIK

In 1919, a disillusioned and pessimistic John Maynard Keynes penned his famous indictment of the Treaty of Versailles, *The Economic Consequences of the Peace*. This work is best known for its incisive analysis condemning French and British shortsightedness in imposing a draconian settlement on Germany. But in an early chapter, Keynes also provided a masterful survey of the economic landscape of the world as it stood before the war. These pages merit close reading today, as Keynes described realities and dilemmas remarkably similar to those we currently face.

Keynes (1920, 11-12) wrote nostalgically:

> What an extraordinary episode in the economic progress of man that age was which came to an end in August, 1914. . . . The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or trouble, in their prospective fruits and advantages; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend. He could secure, forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could dispatch his servant to the neighboring office of a bank for such supply of the

Dani Rodrik is Rafiq Hariri Professor of International Political Economy at the John F. Kennedy School of Government, Harvard University. *Thanks to Joanna Veltri for editorial help and Jeffrey J. Schott for helpful comments.*

precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference.

Keynes was aware that the situation he was describing did not apply to the majority of the working people. But he argued that the advantages offered by the global economy could be reaped by "any man of capacity or character at all exceeding the average."[1]

As Keynes's description makes abundantly clear, globalization has existed before. In fact, in many ways, today's world falls far short of the economic integration reached at the height of the gold standard (around the turn of the 20th century), as described so vividly by Keynes. To be sure, the revolutions in transportation, communications, and information technologies have considerably increased the speed with which global markets react to changing realities and perceptions. But the flows of goods, services, and capital across national boundaries are not significantly larger today—in relation to national product—than they were during the time of the classical gold standard.

Furthermore, economics literature is replete with findings that suggest national markets for goods and capital remain remarkably isolated from each other today: Canadian provinces trade 20 times more with each other than they do with US states just across the national border; tradable goods prices in different countries converge to a common level very slowly; domestic investments in the advanced industrial countries tend to be correlated almost one-for-one with *domestic* savings; asset portfolios held by households and institutional investors tend *not* to be diversified internationally; and so on.

How do we reconcile these facts with the conventional wisdom of pervasive globalization? It helps to distinguish clearly between two questions:

- Has the international integration of markets increased over the last few decades?
- Currently, how integrated are national markets with each other?

The answer to the first question is unambiguously and emphatically "yes." The answer to the second question is "less integrated than one

1. Keynes (1920, 12) elaborates:

> The greater part of the population, it is true, worked hard and lived at a low standard of comfort, yet were, to all appearances, reasonably contented with this lot. But escape was possible, for any man of capacity or character at all exceeding the average, into the middle and upper classes, for whom life offered, at a low cost and with the least trouble, conveniences, comforts, and amenities beyond the compass of the richest and most powerful monarchs of other ages.

might think." Making this distinction is important because it helps us avoid the two most common pitfalls in the globalization debate: the view that the international spread of markets has left governments virtually powerless to regulate their economies and societies, and, at the other extreme, the belief that globalization amounts to very little and is therefore of no consequence. Further, this distinction forces us to be sensitive to the tensions created by globalization, while recognizing that national policymakers still have considerable leeway to manage these tensions.

The Tensions

In a recent monograph, I argued that there are three potential sources of tension between global markets and social stability (Rodrik 1997). First, globalization makes large segments of the working population more easily substitutable across national boundaries, and, therefore, it fundamentally transforms the employment relationship. The post-World War II social bargain between workers and employers, under which the former received a steady increase in wages and benefits and a degree of job security (in return for labor complacency), is thereby undermined. The result is a widening rift between groups that have the skills and mobility to flourish in global markets and those that do not have these advantages.

Second, globalization creates strains—both within and among countries—by engendering conflicts over domestic norms and the social institutions that embody them. Trade becomes contentious when it unleashes forces that undermine the norms implicit in domestic practices. Few residents of advanced industrial countries are comfortable with the weakening of domestic institutions through the forces of trade, as when child labor in Honduras replaces workers in South Carolina or when cuts in French pension benefits are called in response to the requirements of the Maastricht Treaty. This sense of unease is one way of interpreting the demands for "fair trade." Most of the discussion surrounding the new issues in trade policy—i.e., labor standards, environment, competition policy, and corruption—can be cast in this light of procedural fairness.

Third, globalization makes it more difficult for governments to accomplish one of their central functions: the provision of social insurance that served throughout the postwar period to maintain social cohesion and domestic political support for ongoing liberalization. Since World War II, governments have used their fiscal powers to insulate domestic groups from excessive market risks, particularly those with an external origin. It is in countries like Sweden, Denmark, and the Netherlands, which are the most open, that spending on income transfers has expanded the most. At present, however, the process of international economic integration occurs against a background of receding governments and diminished social obligations. Therefore, the dilemma is how to ease the tension between globalization and the pressures for socialization of risk.

Although widely unappreciated, it is important to note that if one believes that international trade is a major contributor to the prosperity of the advanced industrial countries, one must also believe that trade is responsible for some of the social and distributional costs that trade's opponents have charged it with. Why? Because trade can generate sizable economic benefits only by restructuring economies—that is, the essence of specialization according to comparative advantage—and in the real world restructuring does not happen without someone bearing costs. Therefore, as economists recognize, the flip side of the gains from trade is the losses that have to be incurred by adversely affected workers and enterprises. Simply put: no pain, no gain! It makes little sense to pretend otherwise.

Methodological Blinders

There are three unhelpful methodological choices that are made pervasively in current academic literature on "trade and wages." These choices are constraining and create blind spots in the way that economists approach the impact of globalization.[2]

The type of trade that matters most in this context is trade with developing countries (i.e., North-South trade). Virtually all of the empirical studies in the literature looking at the labor-market consequences of trade have focused on trade with developing countries. This is a natural consequence of adopting the Heckscher-Ohlin (factor-endowments) perspective. Trade has significant wage effects, according to this framework, only to the extent that we trade with countries with relative factor endowments that are appreciably different from ours. But even studies that do not adopt the factor-endowment perspective (such as the Feenstra-Hanson papers on outsourcing in Mexico) typically only look at trade with developing countries.

In practice, this means that the available studies look only at about a third of the trade that occurs. The other two-thirds are of no consequence, because of the maintained assumption that trade has an effect on labor markets only if it occurs between two countries with differing factor endowments. Therefore, it should be unsurprising that the quantitative findings are almost uniformly small: today, trade with developing countries is only about 4 percent of GDP in the United States.

2. A recent collection of papers on the topic is Susan Collins (1998). See also the Symposium on Globalization in Perspective (forthcoming).

But how realistic is it to say that trade with developed countries does not matter? Consider the following thought experiment, with two scenarios. In the first scenario, the United States is completely closed to trade. In the second, the United States is completely open, and, in particular, employers are free to move around the globe and to outsource as they please, but the 150 plus countries of the world are miniature replicas of the United States in terms of their relative factor endowments. So there would be no trade based on comparative advantage à la Heckscher-Ohlin. Imagine how US labor markets would operate under these two scenarios.

Would you rather be a worker in the first scenario or in the second? I doubt that an employee would be indifferent. After all, in the second scenario, one would have less bargaining power than in the first: employers can pack up and leave, but workers cannot. The second scenario differs from the first in one fundamental respect: the elasticity of demand for labor increases in *all* of the countries that are now free to trade with each other. For workers, that is harmful on at least three counts: they would now pay a larger share of the cost of improvements in work conditions and benefits (that is, they bear a greater *incidence* of nonwage costs); they would incur greater salary and work hour instability in response to shocks to labor demand or labor productivity (that is, volatility and insecurity increase); and they would receive lower wages and benefits whenever they bargain for terms of employment (that is, their bargaining power erodes).

Moreover, these changes can happen despite the absence of trade. The reduction in workers' earnings in each country preempts the trade (in goods or capital) that would have otherwise occurred. Hence, two conclusions can be drawn: (1) trade among advanced countries matters to labor markets; however, empirical studies are silent about this kind of trade; and (2) the argument that trade cannot account for important labor-market changes because it is a small share of GDP is generally incorrect; indeed, preemptive changes in the domestic economy (whether in the labor market or in technology adoption) may be the reason that trade is less than what it would have been otherwise.

The deterioration in income distribution (or increase in unemployment in continental Europe) can be separated into independent sources, such as trade, technological change, deunionization, etc. The academic literature on trade and wages has tried to apportion blame between trade and technology. An alternative perspective is that a broader underlying process of "marketization" is occurring, which is transforming the employment relationship in the United States and in other advanced countries. Globalization, technological change, deunionization, deregulation, and weakening safety nets are all different facets of the same phenomenon. Disentangling the interactive workings of these changes may be impossible.

For example, let's examine deunionization. Should one think of it as an independent and exogenous force? Is it not partly related to globalization? Workers who have become more substitutable across national boundaries—in the way that I suggested—are less likely to stand up for their union rights.

Likewise, let's examine technological change. If new machines make it possible for employers to substitute high-school graduates in New England with barely literate workers in Mexico, are the resulting labor-market consequences attributable to trade or to technology?

Then there is the related issue of trade-induced technological change. Many trade economists have discounted this possibility by arguing that technological change would have gone in the opposite direction if it had been really induced by trade: employers should have shifted toward low-skill-intensive technologies, since the price of skill has risen. But there are newer models that suggest other possibilities. Consider a recent model suggested by MIT's Daron Acemoglu, in which there are increasing returns to bringing a technology on-line: the larger the number of users of a particular technology, the larger the base over which the cost can be spread. In this context, increased trade can spur the development of skill-intensive technologies, because trade makes skill-intensive sectors more profitable (in the advanced countries at least) and thus enlarges their size.

The bottom line is that it may be futile to discover how much each of these elements—trade, technology, and deunionization—has contributed to growing income inequality. I view them as part and parcel of a broader phenomenon beginning in the late 1970s that enlarges the role of the market relative to other social institutions.

Anything that is not quantifiable is not worth discussion. There are some subtle (and not so subtle) ways in which trade impinges on the employment relationship and on the role of labor in society more broadly. The key point, once again, is that capital is mobile while labor is not. A parable will illustrate how this results in consequences that, once laid out, should be troubling even to economists.

Consider an American firm that lays off some of its domestic workers and enters into a subcontracting arrangement with a firm in Honduras. Suppose the Honduran plant is a sweatshop where child workers are forced to work in hazardous and unsanitary conditions. Should this be a matter of concern to US trade policy? The trade economist's answer is, by and large, negative. But consider another scenario which is functionally equivalent to this outsourcing scenario. Suppose the US employer brings child workers from Honduras as temporary migrants to California and makes them work in a sweatshop under the same conditions as those that prevail in Honduras. For all practical purposes, the consequences (for the Honduran children, for the US employers, and for the displaced American workers) are identical to those in the first outsourcing parable. The difference is that this second version would break US labor laws.

A widely accepted principle in the United States, reflected in its labor laws, is that it is unfair to erode the wages and working standards of adult American workers by employing child workers. But, as the parable makes clear, trade and outsourcing erode this principle through the back door.

There are many more examples of how trade can undermine the principles that have been enshrined in US labor legislation since the 1930s. US laws prevent its workers from being driven out of their jobs by their fellow *domestic* workers who agree to work 12-hour days, earn below minimum wage, or be fired if they join a union. But these outcomes are now possible through the channel of trade: employers can hire *foreign* workers who agree to do any of those things—work 12-hour days, earn below minimum wages, or be fired if they join a union. If society is unwilling to accept the former situation, why should it condone the latter?

Let me clarify this point. The argument does not imply that trade restrictions are necessarily appropriate in such instances. The point is that trade creates important dilemmas that need to be acknowledged and that require active policy responses.

Evolving Social Bargains

Looking back at the pre-1914 global economy, Keynes noted the inequities of the capitalist system and worried about its ability to maintain itself. He wondered what kept workers reconciled to a system that provided them with such a small share of the aggregate wealth. Keynes thought the answer was an implicit bargain between capital and labor: capitalists were to invest most of their surplus, in return for which labor would not rebel. As long as investment rates were high—and therefore real wages kept increasing—inequality would remain tolerable. Indeed, since Keynes thought that capitalists had higher saving propensities, inequality was necessary for accumulation. He concluded that the continued existence of the capitalist system depended on a "double bluff" (Keynes 1920):

> On the one hand the labouring classes accepted from ignorance or powerlessness, or were compelled, persuaded, or cajoled by custom, convention, authority, and the well-established order of society into accepting, a situation in which they could call their own very little of the cake that they and nature and the capitalists were co-operating to produce. And on the other hand the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice.

Keynes was aware that this was a fragile balance and feared that it might not be recreated after 1918. His fears were well-grounded. The attempt to reinstate the world economy along gold-standard lines was short-lived. After the late 1920s, the world slid into depression, with protectionist tendencies and bilateral trading.

So what changed? The premise of Keynes's bargain no longer held: labor was organized, the franchise was extended, and mass politics had arrived. Keynes's "labouring classes" were no longer "powerless" and could not as easily be "compelled, persuaded, or cajoled by custom, convention, authority, and the well-established order of society" to accept the status quo. When push came to shove, governments went off the gold standard and imposed trade restrictions rather than allow wages to fall or unemployment to rise.

By the standard of the interwar period (1919-38), the decades following World War II have been an unqualified success: world trade and capital flows have expanded at impressive rates. But what is inadequately appreciated is how the resurgence of the world economy after 1945 was upheld by another remarkable social bargain that developed within the advanced capitalist countries. This bargain relied neither on the docility of labor nor on the animal spirits of the capitalist class—which, as Keynes himself demonstrated a few years after his Versailles piece, could not always be counted upon. It relied instead on the government's expanded role, and, in particular, the growth of the welfare state with its network of income supports and safety nets. The function of the welfare state was to take the edge off the risks and inequities inherent in market economies, especially those that were open to trade. Therefore, it is unsurprising that the role of national governments expanded greatly in the post-World War II period as international trade rose. Nor is it surprising to find that the welfare state grew fastest in countries that were most exposed to trade (such as Sweden, Denmark, and the Netherlands).

The broader lesson to be drawn from the experience of the postwar period is that countries that have grown through trade while maintaining social cohesion have managed this feat because of their governments' willingness to tamper with market outcomes. This lesson emerges from both Western Europe and East Asia, the two most successful regions in the world in terms of postwar development experience. The European recovery from the destruction of World War II and its subsequent growth were greatly facilitated by the possibilities offered by international trade. Yet, as European governments took increasing advantage of trade, they also erected an extensive network of social safety nets to ensure that growth through trade became a win-win proposition for their societies. Indeed, it is perhaps only a mild exaggeration to say that in Europe the welfare state was the flip side to the open economy.

Consider the export powerhouses of East Asia. Thanks to their "miraculous" growth performance since the early 1960s, countries such as South Korea and Taiwan have achieved cult status among advocates of outward-oriented growth—at least until the Asian currency crisis of 1997-98.

Yet these are economies where the state has played a critical coordinating role in fostering industrial transformation and diversification. Here is only one quantitative indicator: state enterprises constituted a larger share of the Korean and Taiwanese economies during their take-off in the 1960s than they do in India, an economy commonly thought to be weighed down by such enterprises. In both countries, domestic markets were opened up to international trade gradually—over a period of three decades.[3]

The lesson from both Western Europe and East Asia is that countries that successfully globalize have had market-friendly but proactive governments, and adequate social insurance. They have also integrated into the world economy on their own terms. This lesson contradicts much of today's conventional wisdom—that globalization requires small government, that welfare states have to be cut down to size, and that there is a single (read Anglo-American) model on which all countries will necessarily converge.

The one common factor in all of these paths was the presence of a social bargain: labor and other groups who feared that they would bear the risks of openness and receive few of its rewards were given reason to believe that their interests were included. This legitimized the world economy and enabled its expansion. For the reasons that I enumerated above, this bargain now has been considerably weakened. Putting the world economy on solid footing requires ways of recreating it.

Can National Governments Do Something?

It is sometimes argued that the mobility of enterprises and capital across national boundaries pushes wages and national labor legislation down toward the lowest common denominator. One hears how Germany and France are being "forced" to adopt US-style labor markets (what is euphemistically called flexible labor markets) and discard their generous entitlements, and how the United States, in turn, is being driven toward Mexican living standards (i.e., Mexican wages).

In this extreme form, the arguments about convergence are obviously false. While the tradeoffs facing policymakers have become steeper due to increased trade and capital flows, plenty of room exists for nation-states to maintain their distinctive domestic social arrangements.

3. The 1997-98 Asian crisis has led many observers to conclude that the East Asian "model" was fundamentally flawed and prone to self-destruction. This is an odd verdict for a set of policies and institutions that delivered unprecedented rates of economic growth over almost four decades. The more appropriate conclusion, in my judgment, is that these countries experienced a financial panic due to excessive reliance on short-term inflows–a syndrome that is endemic to the operation of international capital markets.

Consider Germany, whose enterprises face the world's highest domestic unit-labor costs. By one calculation, German unit-labor costs—that is, productivity-adjusted labor wages and other charges—are four times higher than the level prevailing in Singapore. This is why German enterprises have increased their outsourcing—leading to arguments that the European style welfare state is too expensive to maintain in a globalized economy. But the real question is why invest at all in Germany if costs are so high? In reality, German firms choose to allocate only a tenth of their new investments abroad. (This is lower than the corresponding ratio for British firms, although the latter ostensibly face a more investment-friendly domestic environment.) Ultimately, the answer is that the *overall quality* of a society's domestic institutions—respect for the rule of law, good governance, social and political stability, adequate infrastructure, and a skilled labor force—rather than labor costs or taxes determine where the investments go. That leaves plenty of room for policymakers to make their own choices over labor market institutions and their welfare states. The bottom-line is that nation-states remain central, even in a globalized international economy.

How Can International Institutions Help?

At the global level, the challenge is two-fold. On the one hand, we need a set of rules that encourages greater convergence of policies and standards on a *voluntary* basis. This is one way of reducing tensions arising from differences in national practices. At the same time, sufficient flexibility needs to be incorporated into the rules that govern international trade to allow selective disengagement from multilateral disciplines (in cases where voluntary international harmonization is precluded by divergence in national norms). Currently, the WTO's Agreement on Safeguards allows a member state to impose temporary trade restrictions following an increase in imports, but only under a stringent set of conditions. Might there be an argument for extending such escape-clause action to a broader range of circumstances?

To see the advantages of doing so, it is useful to think conceptually. When will governments relinquish some of their sovereignty and empower intergovernmental organizations? In simple game-theoretic terms, the answer is that some sovereignty will be relinquished when the long-run benefits of "cooperation" outweigh the short-run benefits of "defection" (i.e., unilateral action).

More concretely, consider cooperation between two countries in the context of a repeated game, where the one-shot Nash equilibrium is all-around defection. Both countries would prefer to be in the low-tariff equilibrium, but the one-shot Nash equilibrium entails high tariffs in both countries. (This is the case of a prisoners' dilemma applied to trade policy.) We know that cooperation can be sustained in an infinitely-repeated setting under certain conditions. In particular, cooperation will be the equilibrium strategy for any player at time t if at that time:

$$\textit{short-term benefits of defection} < \textit{(discount term)} \times \textit{(future net benefits of cooperation)}$$

Hence, for cooperation to be sustainable, the short-term benefits of defection must be small, the discount rate low, and the future benefits from cooperation high. One form of such cooperation is the case in which each player employs a trigger-strategy of the form: "start by cooperating, cooperate if the other side cooperated last period, defect for k periods otherwise." In a static environment, that is the end of the story. Either the underlying parameters produce cooperation, or they do not.

But consider what happens when conditions change. Think of the tariff game analyzed by Kyle Bagwell and Robert Staiger (1990, 779-95), where there are exogenous (i.i.d.) shocks to the volume of trade. When the trade volume is (temporarily and unexpectedly) high, the benefits to short-term opportunism (imposing a tariff for terms-of-trade reasons) are also high. The left-hand side of the above expression increases, while the right-hand side remains unchanged. At that point, cooperation may no longer be an equilibrium strategy, even if it had been one previously. Thus, there will be defection by both parties (a trade war) for at least k periods.

It would have been far better to allow for this possibility by altering the strategies to read: "start by cooperating, cooperate if the other side cooperated last period *or if the other side defected when the trade volume exceeded a certain threshold*, and defect for k periods otherwise." Then long periods of trade wars are avoided. Thus, the game now explicitly allows for an "escape clause." A government is not penalized for withdrawing from the rules when there is insufficient incentive for it to have played by the rules. The outcome is better for all parties because unnecessary trade conflicts do not occur.

The point of this example generalizes beyond surges in trade volumes and the use of tariffs for terms-of-trade reasons. Whenever conditions change and free trade becomes incompatible with domestic social/political objectives, the system is better off allowing "defections" than treating the "defections" as instances of rule breaking. Thinking in these terms makes it clear that escape clauses ("safeguards," "opt-outs," etc.) are an integral part of sustainable international agreements.[4]

4. Indeed, as Jeffrey Schott notes, the GATT allows permanent escapes under specific conditions for nontrade and foreign policy reasons. An alternative is to consider revising these provisions.

This is a useful way to think of the multilateral trade system's evolution. As mentioned before, the GATT and the WTO contain explicit safeguard schemes that allow countries to impose temporary tariffs in response to import surges. These safeguard measures have not been used often, because taking advantage of antidumping procedures is considerably easier. In practice, then, it is antidumping duties that have served as the safeguard mechanism of choice. In the past, the GATT has recognized the need to relax or refrain from imposing disciplines in agriculture, textiles (e.g., the Multifiber Arrangement [MFA]), and select industrial products (e.g., voluntary export restraint [VER]). Rather than viewing these as "derogations," one should view them as part and parcel of the broader logic of achieving international cooperation.

As the disciplines of the WTO expand into new areas, there will probably be a parallel need to have an expanded and reinvigorated safeguard mechanism. Sufficient flexibility will need to be incorporated into the rules that govern international trade to allow selective disengagement from multilateral disciplines. One could imagine expanding the scope of the current Agreement on Safeguards to a broader range of circumstances, such as those arising from concern over labor standards, the environment, human rights issues, or, more broadly, ethical norms in the importing country. The purpose of such an expanded "escape clause" mechanism would be to allow countries, under well-specified contingencies and subject to multilaterally approved procedures, greater breathing room to fulfill domestic requirements that conflict with trade. To prevent abuse, the mechanism would have to ensure that domestic proceedings would be transparent, democratic, and open to all interests (including those that benefit from trade). The results would also be subject to periodic reviews. If this could be achieved *in exchange* for a tightening of rules on antidumping action, which have a highly corrosive effect on the world trading system, the benefits could be substantial.

The bottom line is that greater transfer of sovereignty to intergovernmental organizations—in order to reap the benefits of cooperation and coordination—is unlikely to be sustainable unless escape-clause or opt-out mechanisms are incorporated into these arrangements. The outcome is likely to be very different from the twilight of national sovereignty.

Looking Ahead

Back to Keynes (1920, 12). Here is the rest of the paragraph from Keynes that I quoted in the introduction. Remember that Keynes was talking about the pre-1914 inhabitant of London who could easily avail himself of the possibilities of international trade, investments and travel. Keynes went on to note:

> But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable. The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions, and exclusion, which were to play the serpent to this paradise, were little more than the amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice.

Keynes was struck by how irreversible globalization seemed at the time, and yet how fragile its foundations really were. His quote is a reminder of the possibility that the current situation may prove to be as *temporary* as the pre-1913 victory of free markets and globalism over mercantilism and nationalism, and that the "politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions, and exclusion," in Keynes's words (1920), may yet resurface.

I have argued that eras of sustained global integration—the classical gold standard of 1870-1913 as well as the period since 1945—were underpinned by particular social bargains. Presently, our most severe mistake is the tendency to forget that global economic integration needs an infrastructure of popular support and legitimacy in order to survive. Such legitimacy cannot be taken for granted in the absence of complementary social policies. And, for lack of any serious alternative, these policies must still be provided by national governments.

The inherent tension between markets and liberal democracy must be recognized. Democracy follows an egalitarian logic while markets often follow an inegalitarian one. The implication is that global capitalism must be complemented by domestic social policies if we want it to maintain political legitimacy—that means safety nets, social programs, and investments in education and training. In the 30 years or so following World War II, it was the welfare state that allowed this dilemma to be postponed. Now we face the dilemma anew.

Also, we must recognize that there is no single model of capitalism. After World War II, the United States, Western Europe, and Japan (and subsequently other parts of East Asia) each built (or improved upon) their own specific versions of market democracies, and each model was successful in its own way. We do ourselves a great injustice by reading too much into the relatively recent comparative success of the US economy, and by believing that there is a single (that is, an Anglo-Saxon or Anglo-American) model to which all countries will (or should) necessarily converge. After all, it was not long ago that the Japanese model was being touted as the example for others to follow. Instead, the right approach would be to allow each country to experiment with its own model, and to let it adopt a version of the democratic market economy that is more in line with its collective preferences.

Finally, it is necessary to recognize that there is a perception, often based on fact, that the rules of the international economy are being written by business interests, with labor, environmental groups, and nongovernmental organizations (NGOs) largely excluded from the process. Consider some of the anomalies observed. For example, it is difficult to imagine a coherent explanation for why intellectual property rights belong in the WTO but labor and environmental standards do not. Similarly, why should firms be allowed to protect themselves from "unfair competition" via antidumping and countervailing duties imposed on foreign producers, while labor does not have a similar privilege with respect to competition from countries with inadequate enforcement of labor standards? How have business interests been able to control the agenda of successive trade negotiations—in IPRs, information technology, telecoms, and financial services—while labor, environmental, and humanitarian interests have not? As we think of reforming the governance of the global trading system, we would do well to think of ways to redress this imbalance.

The main challenge that global capitalism faces today is maintaining domestic political legitimacy for open economic borders. Without that legitimacy, global capitalism becomes simply unsustainable—a truth that we ignore at our own peril.

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