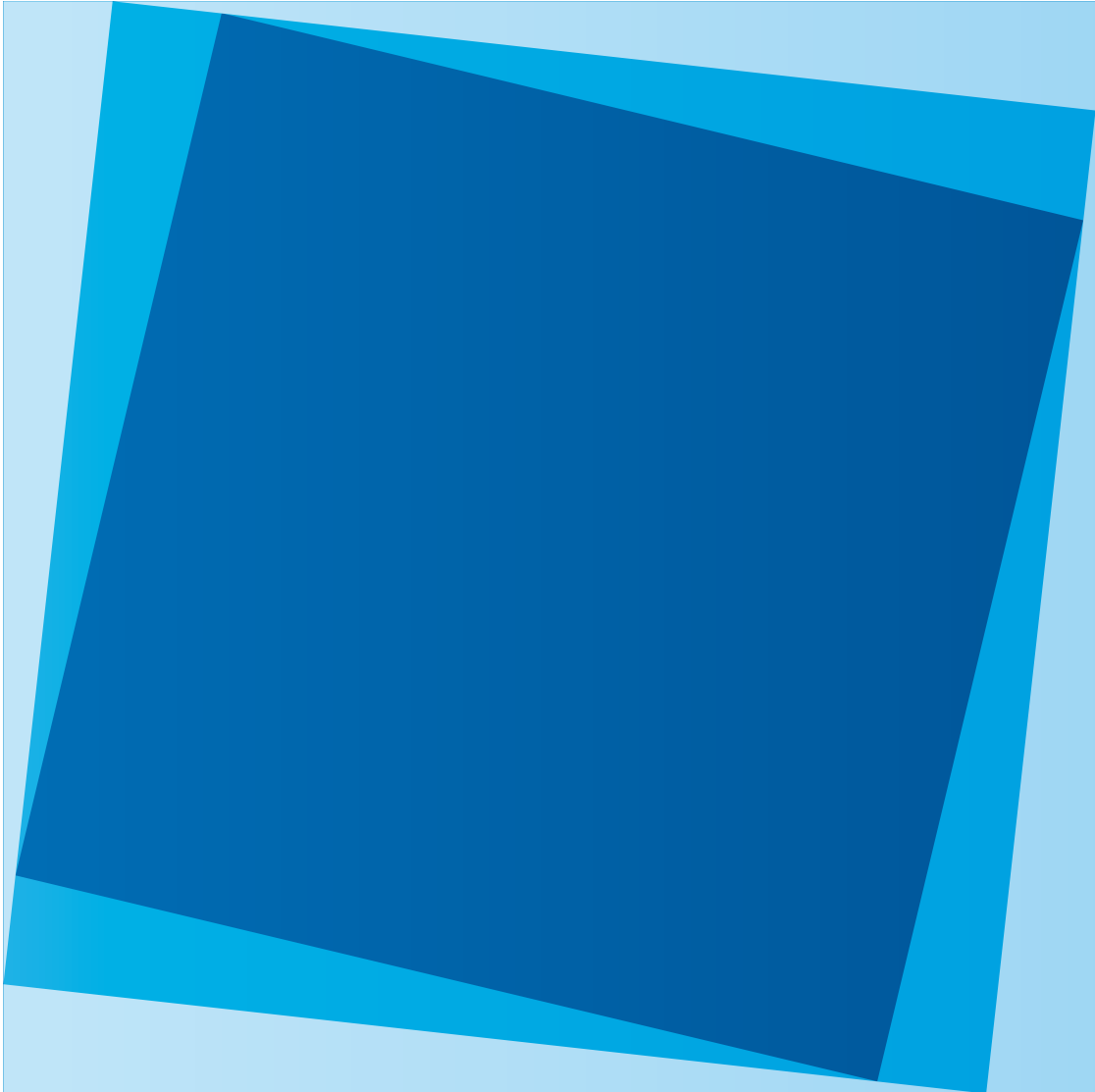


# **Towards a New Enlightenment? A Transcendent Decade**



## **The Past Decade and the Future of Globalization**

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Recommended Book: *Why Globalization Works*, Martin Wolf, Yale University Press, 2004.

**For globalization to deliver to its full potential, all governments should take more seriously the essential insight provided by economics that open markets need to be accompanied by policies that make their impact less disruptive and more beneficially inclusive for the population at large. The real dilemmas must be acknowledged and acted upon, and not evaded as is done when tweaking trade policy is wrongly alleged to be the instrument to address unacceptable social ills.**



This article was written ten years after the outbreak of the worst crisis that the global economy had known in more than seventy-five years. The meltdown of the subprime market that had happened in the summer of 2007 in the United States became a full-blown crisis as Lehman Brothers collapsed in the early hours of the morning on September 15, 2008. The financial panic lived during those days not only marked the end of the so-called Great Moderation, but also the beginning of a period if not of twilight, at least of seriously deflated expectations, about modern globalization.

The decade that preceded the great crisis of 2008–09 was by several measures a golden period for globalization, which had been painstakingly rebuilt over the previous fifty years after its destruction during the Great Depression and World War II. Despite the Asian crisis of 1997–98, and other financial crises in other emerging economies, globalization intensified markedly in the 1990s to the point that already by the end of the twentieth century it had surpassed, at least on the trade and financial fronts, that phenomenon's previous golden era of a century earlier.

During the mini golden era of contemporary globalization, it was not only that trade in goods and services as well as capital flows across borders grew to unprecedented levels, but also that a process of economic convergence between the developed and the emerging and developing economies took place at last.

For over one hundred years, the group of countries known in recent history as the advanced ones—chief among them the United States, and those in western Europe and Japan—consistently generated sixty percent or more of global output. This group's large share of world production seemed to be perpetual. That economic predominance was not challenged even by the industrialization of the Soviet Union nor by the take off in the 1960s of some previously underdeveloped countries.

In 1950 the share of the advanced countries was sixty-two percent of global GDP, in purchasing power parity (PPP) terms, and twenty-two percent of world population. Two decades later that share of world output was the same and was still similar by 1990, notwithstanding that those countries' population had fallen to fifteen percent of the world's total (Maddison, 2001). Indeed, economic convergence of developing countries with industrialized ones appeared unachievable throughout most of the twentieth century. Countries accounting for most of the world's population seemed to be perennially condemned to only a small share of global GDP.

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That seemingly historical regularity ended during the precrisis decade. Now, since the middle of the first decade of this century, the group of emerging or developing countries produces more than half of world output (Buiter and Rahbari, 2011). Needless to say, the richest countries' per capita income still surpasses every one of today's fastest growing emerging countries by a substantial margin. But the historical gap has closed significantly.

Part of this story of economic convergence is that during the last few decades the group of rich countries registered slower growth than before. However, convergence has been much more about the faster growth of developing countries, and this growth has been driven by



precisely those countries that, having been relatively closed a few decades ago, took the crucial step around the 1980s to integrate into the global economy. Thus, in less than a quarter of a century, a group of developing countries—home to more than fifty-five percent of the world's population—while doubling their ratio of trade to GDP and becoming more open to Foreign Direct Investment (FDI), were able to raise their per capita GDP at more than twice the rate of rich countries. Significantly, they also reduced both the number and proportion of their people living in extreme poverty—despite their substantial population increases.

Those countries are typically the ones that have been able to fast-track their industrialization by inserting their productive capacities into the global supply chains made possible by the information technology (IT) revolution (Baldwin, 2014).

Prior to this revolution, industrialization was about economies of scale as well as vertical integration and clustering of production processes. Consequently, building a competitive industry required a deep industrial base, a condition historically achieved by a rather small number of countries.

In turn, international trade was about specialization in the production of goods or commodities and essentially consisted of selling the merchandise produced in one country to customers in another; in other words, practically a two-way trade.

As computing and telecommunication capabilities became cheaper and enormously potent, in the presence of already inexpensive transportation costs and lower impediments to cross-border trade, it became economically attractive to separate the previously integrated and concentrated production processes. Production dispersion in internationalized supply chains now became cost effective and eventually, in many cases, the only way to remain competitive.

Increasingly, the old manufacturing clusters have given way to geographical fragmentation of production supported by incessant flows of investment, technology, personnel expertise, information, finance, and highly efficient transportation and logistics services, none of which would be attainable at the speed and with the certitude required without modern IT. This revolution has made it relatively inexpensive to coordinate complex activities situated in locations all over the world, making international supply chains feasible and profitable.

The implications of this transformation for the international division of labor are far reaching. On the one hand, by off-shoring fragments of their productive activities, the developed countries' firms can now put their more advanced technologies together with the low-cost labor of developing countries to augment their competitiveness. On the other, developing countries, by virtue of assimilating off-shored links of the supply chain, can now industrialize more rapidly without waiting to build the deep industrial base formerly required. Thanks to this unbundling and off-shoring, nations can industrialize, not by building, but by joining a supply chain, making industrialization faster and easier.

The new organization of production, driven by the Internet and the other tools of IT, does not pertain only to large corporations as commonly believed. The Internet is fueling transformations covering the entire value chain in practically all sectors and types of companies. In fact, its impact has been most significant in small- and medium-sized enterprises and start-ups. Remarkably, it is now possible for a small firm to be a global company practically as soon as it is born.

On the international trade front, increasingly, countries' comparative advantage is no longer about finished goods or commodities; it is about the finer tasks that make up the manufacturing, commercial, and financial processes necessary to ultimately produce and deliver the goods demanded by consumers. Interestingly, the services or tasks that go before and after the fabrication itself of each final good have become a larger proportion of its definitive value—this determines the so-called smile curve.



Three workers walking inside Piaggio Vietnam in April 2015. This factory on the outskirts of Hanoi produces the iconic Vespa, and has made over half-a-million scooters since the company moved its Asian headquarters from Singapore to Vietnam in 2009





Each good sold at the end of its supply chain is a conjunction of many countries' capital, labor, technology, infrastructure, finance, and business environments. This is leading to a profound change in the way we look at, study, and measure the evolution of the global economy.

Of course, the fact that technological progress is leading to a fundamental change in the pattern of production and trade—and with it a redistribution of economic might—across the world is not unprecedented in human history. It happened before with the Industrial Revolution. A profound shift and concentration of economic power among the nations of the world took place over the course of just a few decades, and those countries that played the new game best became the advanced ones, not only of the late nineteenth century but also of the twentieth.

In the economic rebalancing occurring during our time, although there have been many developing countries achieving rates of economic growth above those of rich countries, the case of China stands out among all of them. Thanks to its high average GDP growth for over two decades, ten years or so ago China had already become the second largest economy in the world, whereas as recently as 1990, it was only the tenth largest with a GDP even smaller than that of Spain that year.

By the eve of the financial crisis, it had also passed from being a marginal participant in global trade flows to be the largest exporter and the second largest importer of goods in the world, as well as the fastest growing importer of commercial services, ranking the third largest in the world. It also became the recipient of the largest flows of FDI, even surpassing the net flows going into the United States.

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China's growth has been an accelerator of the new pattern of international production and trade that created unprecedented opportunities for other developing countries while allowing developed ones to have new fast-growing outlets for their own products, investments, and technologies. That growth also enlarged the pool of global savings, thus helping to loosen financial constraints, not least for the United States. Ironically, the latter aspect of China's success was also part of the story that led to the financial crisis that interrupted the mini golden era of globalization. It is now commonly believed that the crisis was caused by recklessness alone on the part of private financial institutions, mainly US but also European ones, and it seems to be forgotten that, in truth, the turmoil had some deep macroeconomic policy mismanagements and imbalances as its primary causes.

Lax fiscal and monetary policies played into the US economy's seemingly insatiable absorption of the vast pool of foreign savings, which, in turn, was made possible by key rigidities in the other major countries' economic policies, certainly China's, but others such as Germany and Japan as well. The underpricing of highly risky assets was the end result not only of faulty financial engineering but, more fundamentally, of too much liquidity chasing too few sound investment opportunities. Quite aside from the well-documented incompetent and foolhardy behavior of a number of financial institutions, without the massive borrowing by some countries and the massive lending by others, and of course the policies and structural factors underlying such imbalances, it would have been impossible to create such a tremendous economic disaster.



As warned repeatedly by some observers, the global macroeconomic imbalances were bound to cause trouble, and they did. Although the crisis originated and spread from the US financial markets, it soon became apparent that no significant economy would be spared the pain, and actually the guilt, from having allowed the roots of the crisis to grow so strong. For a while, the members of the Eurozone proclaimed themselves as victims and not culprits for the disaster on the basis that they had managed to keep a nearly balanced current account for the Union as a whole. They were failing to acknowledge that serious macroeconomic imbalances did exist within the European Monetary Union (EMU)—those between its northern members, chiefly Germany, and their southern partners. The truth is that Germany's current account surpluses were, among other things, feeding consumption binges in Greece, supporting exuberant construction booms in Spain and Ireland, funding unsustainable fiscal deficits in Portugal, and even helping to inflate the real-estate bubble in the US—as more than a few of the German banks' balance sheets painfully revealed in due time. Japan was another country that failed to take into account the effect of its large surpluses on its trading partners.

Extravagant claims about being decoupled from the US travails were also foolishly entertained in some important countries of Latin America. The commodities super-cycle that more or less survived until 2014 was the opioid that caused the leaders of those countries to rest on their laurels and fail to recognize the illnesses that had infected our economies well before the crisis. The chief consequence of the Latin American complacency of a few years ago is that, as the global economy gained enough momentum to leave the great crisis behind, the opposite happened in our region.

Sensibly, if only after the fact, the G20 leaders were right on target when, at their first Washington Summit of November 15, 2008, they identified insufficiently coordinated macroeconomic policies at the root of the crisis that had erupted with great force that fall. They recognized that as their national economies had become more interdependent, which had been positive for growth, this interdependence had also exacerbated policy challenges, including the need for more, not less, macroeconomic policy coordination. Unfortunately, that admission and the pledge to fix it, were made too late and were short lived.

The world has not and will not be the same after the other Black Monday, the one of September 15, 2008. For one thing, not only did the great crisis cause a meaningful loss of output throughout the years of its acute phase, it also brought about a negative effect on the trajectory of world output that has proved permanent. A secular dampening on global growth is part of our new normal. We are living through a period—one that will probably last a long time—of deflated or diminished expectations.

It is evident that the prospects for most economies, even in the presence of the relatively benign world output growth figures of 2017 and 2018, are very different from the ones entertained only a bit longer than a decade or so ago.

Although the list of factors suspected of contributing to the deflation of global growth expectations is not an insignificant one, not least as it includes both the mystery of reduced growth productivity as well as the aging of the labor force in advanced countries, particular consideration must be given to the question of whether globalization—a significant growth engine—might have peaked already and could even be at risk of significant reversion.

Naturally, most of the attention to the question of possible deglobalization has centered on trade (Hoekman, 2015; and IMF, 2016). The global trade to GDP ratio grew from roughly twenty-five percent in 1960 to sixty percent in 2008. This happened because, from 1960 to



the eve of the crisis in 2007, global trade in goods and services grew at an average real rate of about six percent a year, which was about twice that of real GDP growth during the same period. After a sharp drop during the crisis and a brief rebound in its immediate aftermath, trade growth has been very weak relative to the past; in fact, until 2017 it was not even keeping up with global output growth over several years. If that trend were to prevail, then the trade/GDP ratio of sixty percent would prove to be a peak and would give credence to the presumption that globalization is stalling and even risks reversing.

The confirmation of this presumption should be hugely concerning for those, like myself, who believe that the payoff of trade expansion has been on balance quite favorable not only for global growth—of both developed and emerging economies—but also in particular to increase average per capita income, reduce poverty rates, and accelerate human development in many developing countries. We get some relief regarding this issue from those who submit and empirically support the view that for the most part the trade slowdown has been driven essentially by cyclical factors, such as the weakness in aggregate demand caused in turn by the necessary rebuilding of balance sheets, which certainly has been the case for several years in the Eurozone and more recently even in China and other emerging economies.

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Moreover, there are questions as to whether the process of global integration may also be stalling by virtue of the process of financial deglobalization that has occurred over the last ten years as gross cross-border capital flows decreased sixty-five percent (MGI, 2017). As in the case of trade, we are told that there is no cause for alarm since most of the contraction of international lending can be accounted for by the global retrenchment of European and a few US banks, which, to respond to credit losses, had to cut lending and other assets abroad enormously. From this perspective, the observed financial deglobalization, far from being a broad phenomenon, would reflect for the most part a cyclical deleveraging, by itself a necessary and actually benign evolution.

Be that as it may, even analyses more supportive of the cyclical nature of the trade slowdown acknowledge that there might be other factors at play that should not by any means be overlooked. That noncyclical, structural factors help to explain the trade slowdown is suggested by the fact that it actually started before the crisis—around the mid-2000s.

Among those factors there are some that should not be worrisome as they reflect evolutions that should have been expected, such as the completion of the phase of the fast integration of China and the central and eastern European economies into the global economy, a transition that by definition could not go on forever. Another would be that the international fragmentation of production fostered by the development of global supply chains has reached a plateau consistent with the existent IT and transportation technologies, a circumstance that may change as these technologies continue to make sufficient progress in the years to come.





**The commitments assumed by G20 leaders at their first summit in Washington came too late and were too short-lived**

Then president of the United States, George W. Bush, welcomes chancellor Angela Merkel to the White House before a dinner for G20 participants in November 2008



**Thanks to its high average GDP growth for over two decades, ten years or so ago China had already become the second largest economy in the world, whereas as recently as 1990, it was only the tenth largest**

An online-sales start-up employee in Beijing's Soho Galaxy takes a break during the night shift



But there are other noncyclical circumstances that should be of true concern. One is, of course, that the multilateral efforts to further liberalize trade have failed terribly for many years, not least with the Doha Round, now totally defunct despite the multiple pledges to complete it made by the G20 in the aftermath of the crisis. Another is the increase in protectionism that rather quietly—in a murky way, avoiding large-scale increases in the average level of border protection—took place over several years, again despite the solemn pledges of the G20 (Global Trade Alert).

The failure of further multilateral liberalization and the occurrence of creeping protectionism were bad enough for the prospects of global growth, but a much worse scenario has now emerged as a consequence of the trade wars that are apparently being actively pursued by the government of none other than the major economic power of the world, the United States. This is a scenario that, unthinkable until recently, now seems to be materializing.

The election and the actions of an old-fashioned, nationalistic, and populist government in the United States, the country that has championed and benefited the most from globalization, is the most significant downside risk faced by the world economy, a risk that has been grossly overlooked by financial markets at least until the fall of 2018.

It is not only the trade and investment consequences of the US neo-mercantilism that should raise serious concerns about the future of globalization and global growth. Equally or even more concerning is the country's use of nationalistic and populist postures at the expense of multilateral diplomacy in dealing with serious geopolitical issues, an approach that conceivably could make bellicose situations more likely with dire consequences for the world economy.

The crisis and its economic and political sequels have exacerbated a problem for globalization that has existed throughout: to blame it for any number of things that have gone wrong in the world and to dismiss the benefits that it has helped to bring about. The backlash against contemporary globalization seems to be approaching an all-time high in many places including, the United States.

Part of the backlash may be attributable to the simple fact that world GDP growth and nominal wage growth—even accounting for the healthier rates of 2017 and 2018—are still below what they were in most advanced and emerging market countries in the five years prior to the 2008–09 crisis. It is also nurtured by the increase in income inequality and the so-called middle-class squeeze in the rich countries, along with the anxiety caused by automation, which is bound to affect the structure of their labor markets.

Since the Stolper-Samuelson formulation of the Heckscher-Ohlin theory, the alteration of factor prices and therefore income distribution as a consequence of international trade and of labor and capital mobility has been an indispensable qualification acknowledged even by the most recalcitrant proponents of open markets. Recommendations of trade liberalization must always be accompanied by other policy prescriptions if the distributional effects of open markets deemed undesirable are to be mitigated or even fully compensated. This is the usual posture in the economics profession. Curiously, however, those members of the profession who happen to be skeptics or even outright opponents of free trade, and in general of globalization, persistently “rediscover” Stolper-Samuelson and its variants as if this body of knowledge had never been part of the toolkit provided by economics.

It has not helped that sometimes, obviously unwarrantedly, trade is proposed as an all-powerful instrument for growth and development irrespective of other conditions in the economy and politics of countries. Indeed, global trade can promote, and actually has greatly fostered, global growth. But global trade cannot promote growth for all in the absence of other policies.



The simultaneous exaggeration of the consequences of free trade and the understatement—or even total absence of consideration—of the critical importance of other policies that need to be in place to prevent abominable economic and social outcomes, constitute a double-edged sword. It has been an expedient used by politicians to pursue the opening of markets when this has fit their convenience or even their convictions. But it reverts, sometimes dramatically, against the case for open markets when those abominable outcomes—caused or not by globalization—become intolerable for societies. When this happens, strong supporters of free trade, conducted in a rules-based system, are charged unduly with the burden of proof about the advantages of open trade in the face of economic and social outcomes that all of us profoundly dislike, such as worsening income distribution, wage stagnation, and the marginalization of significant sectors of the populations from the benefits of globalization, all of which has certainly happened in some parts of the world, although not necessarily as a consequence of trade liberalization.

Open markets, sold in good times as a silver bullet of prosperity, become the culprit of all ills when things go sour economically and politically. Politicians of all persuasions hurry to point fingers toward external forces, first and foremost to open trade, to explain the causes of adversity, rather than engaging in contrition about the domestic policy mistakes or omissions underlying those unwanted ills. Blaming the various dimensions of globalization—trade, finance, and migration—for phenomena such as insufficient GDP growth, stagnant wages, inequality, and unemployment always seems to be preferable for governments, rather than admitting their failure to deliver on their own responsibilities.

## **Governments prefer to blame different aspects of globalization—trade, finances, and immigration—for phenomena such as insufficient GDP growth, stagnant wages, inequality, and unemployment rather than admitting their failure to deliver on their own responsibilities**

Unfortunately, even otherwise reasonable political leaders sometimes fall into the temptation of playing with the double-edged sword, a trick that may pay off politically short term but also risks having disastrous consequences. Overselling trade and understating other challenges that convey tough political choices is not only deceitful to citizens but also politically risky as it is a posture that can easily backfire against those using it.

The most extreme cases of such a deflection of responsibility are found among populist politicians. More than any other kind, the populist politician has a marked tendency to blame others for his or her country's problems and failings. Foreigners, who invest in, export to, or migrate to their country, are the populist's favorite targets to explain almost every domestic problem. That is why restrictions, including draconian ones, on trade, investment, and migration are an essential part of the populist's policy arsenal. The populist praises isolationism and avoids international engagement. The "full package" of populism frequently includes anti-market economics, xenophobic and autarkic nationalism, contempt for multilateral rules and institutions, and authoritarian politics.

Admittedly, only exceptionally, individual cases of populist experiments may become a serious threat to the process of global interdependence. When countries have toyed, democratically or not, with populist leadership, the damage has been largely self-inflicted, with any spillover effects limited to their immediate neighbors.



For example, Latin America is a place where populism has been pervasive at times. Yet, most of the hardship populism caused has been contained within the countries suffering the populist maladies. Unfortunately, a major exception to the rule of contained spillovers may be the current case of the United States, where the negative consequences of its leadership's neo-mercantilist stance could be enormously consequential for globalization, economic growth—including its own—and international peace and security.

As this paper was being written, the current US government has provided ample evidence, rather aggressively, of its protectionist and anti-globalization instincts. There was, of course, the very early decision by the Trump administration to withdraw from the Trans-Pacific Partnership (TPP), an action never really satisfactorily justified by the US president or any member of his cabinet. The decision proved rather ironic given that the TPP was an agreement molded to a great extent to favor American interests, not only on trade but also on matters such as intellectual property rights, investor-state arbitration, and labor standards.

There was also the action to initiate the renegotiation of the North American Free Trade Agreement (NAFTA) on false—or at best wrongheaded—premises. In May 2017, when the formal announcement to start the renegotiation process was made, the United States Trade Representative (USTR) argued that the quarter-century-old agreement no longer reflected the standards warranted by changes in the economy. This may have sounded plausible before noticing that the to-do list to update the agreement had already been addressed in the discarded TPP, of which both Mexico and Canada were a part. If NAFTA had been modernized in practice through the TPP, why call for renegotiation of the former while trashing the latter?

## **Latin America is a place where populism has been pervasive at times. Yet, most of the hardship populism caused has been contained within the countries suffering the populist maladies. Unfortunately, a major exception may be the current case of the United States**

The US government's duplicitous approach in dealing with its allies and trade partners was confirmed when the USTR published—as required by law—the objectives for the renegotiation (USTR, 2017). That document falsely associated NAFTA with the explosion of US trade deficits, the closure of thousands of factories, and the abandonment of millions of American workers. Frankly, the Mexican and Canadian governments should not even have sat down at the negotiating table without first receiving some apologetic explanation from their US counterparts about those unwarranted arguments. Accepting to negotiate on deceptive premises might help to explain why so little progress had been made after almost one year of talks.

Betting in mid-July of 2018 for a conclusion of the renegotiation of NAFTA within the targeted timeframe would have looked like an overwhelmingly losing proposition. After seven rounds of negotiation, the last one having taken place as far back as February 2018 with little or no progress, and then followed by several months of deadlock and even rhetorical confrontation, things started to change positively as August approached.

The deadlock was quite understandable. The US trade representatives had not moved a single inch from their most outlandish demands, giving credence to the idea that what they were seeking was to get a deal that, far from promoting, would have destroyed trade and investment among the NAFTA partners. Fortunately, the Canadian and Mexican governments did not cave to the US government's pretension. Repeatedly those countries' chief negotiators



A mural supporting Hugo Chávez in Caracas. The photo was taken during Venezuela's local elections in November 2008, ten years after that leader of 21st-century socialism came to power





expressed firmly and credibly that they would rather take the unilateral termination of NAFTA by the United States than sign an agreement that would have the same practical consequence.

It is not known what motivated the US government to move away from most of the recalcitrant positions it had held for almost a year (Zedillo, 2018). The important fact is that it did, leading to a deal first with Mexico on August 27 and then with Canada in the last hours of September 30, 2018.

There was the US insistence on a sunset clause that would automatically end the new trade agreement every five years unless the three governments agreed otherwise, a feature that would have precluded the certainty for investors that these deals are supposed to provide. They settled for a rather convoluted formula that avoids the sudden death of the agreement and makes possible—and practically certain—an extended life for it.

The US negotiators had demanded to make the NAFTA Investor State Dispute settlement procedure optional for the United States, with a view to deny such protection to its own companies, thus discouraging them from investing in the NAFTA partners. This demand was rejected all along by Mexico on the correct basis that it is important to give foreign investors every assurance that they would not be subject to discriminatory or arbitrary actions if they decided to invest in the country.

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The USTR was never shy about its dislike for the NAFTA investment rules, sometimes even questioning why it was a good policy of the United States government to encourage investment in Mexico. There are, of course, many good answers to this question, not least that by investing in Mexico, US firms, in order to do some part of their fabrication processes at a lower cost, get to be more competitive not only in the entire region but also globally, allowing them to preserve and enhance job opportunities for their American workers. Consequently, it is good for the two countries that the mechanism to protect American investments in Mexico was preserved despite the US negotiators' originally declared intentions.

By the same token, the US had sought to eliminate the dispute resolution procedure which protects exporters against the unfair application of domestic laws on anti-dumping and countervailing duties. This was a deal breaker for Canada, where there is the justified sentiment that the US has in the past abused the application of such measures against Canadian exporters. Canada's perseverance paid off and its exporters will have recourse to the dispute settlement system as it is in NAFTA.

The US side had also been stubborn about getting the Mexican side to accept in the new deal a special mechanism by which the US could easily apply anti-dumping tariffs on Mexican exports of seasonal fruits and vegetables. Mexico would not assent to the inclusion of this mechanism, and in the end the new agreement will not contain it—to the benefit of both American consumers and Mexican producers. Similarly, it is to the benefit of Canadian



consumers and US exporters of dairy products that Canada ultimately accepted an American request for at least a modest opening of such a market.

The only significant US demand accommodated by Mexico and Canada was in the automotive sector where more restrictive and cumbersome rules of origin are to be adopted. It has been agreed that seventy-five percent of a car or truck should have components from North America to qualify for tariff-free imports, up from the current level of 62.5 percent. Furthermore, seventy percent of the steel and aluminum used in that sector must be produced in North America, and forty percent of a car or truck would have to be made by workers earning at least \$16 per hour, a measure obviously calculated to put a dent in Mexico's comparative advantage. Fortunately, the destructive effects of the new rules of origin for trade and investment could be mitigated, in the case of cars, by the provision that vehicles failing to fulfill those rules would simply pay the low most-favored-nation tariff of 2.5 percent as long as total exports do not exceed an agreed reasonable number of vehicles.

Other things being equal, however, it is clear that the new regime will reduce both the regional and global competitiveness of the North American automotive industry, a result that will not be good for American, Canadian, or Mexican workers. Of course, other things may not be equal if the US government decides to impose tariffs, as it has threatened to do, on vehicles produced by European or Asian companies. If the US government were to impose those tariffs, the burden of the new regime would fall disproportionately on the American consumer.

As purported from day one, the trade agreement will be subject to an update on a number of topics such as digital trade, intellectual property rights, environmental policies, and labor practices. Interestingly the agreed new provisions really are a "cut-and-paste" of what was contained in the TPP, that was discarded early on by the Trump administration, a decision so damaging to American interests that it will always be a mystery for economic and political historians.

In any case, any careful analyst will find that the US government's claims about the positive attributes of the new agreement are as misguided as were their claims about the ills caused by NAFTA (Krueger, 2018). As a result of the US negotiators' pullback from their original demands, there will be a mechanism, if approved by the respective legislative branches, to keep markets open among the three partners but it will not be a better instrument than NAFTA for any of the three countries.

NAFTA negotiations aside, trade hostilities by the United States generally escalated significantly in 2018. In January, safeguard tariffs on solar panels and washing machines were announced. Next, invoking national-security arguments (section 232 of the Trade Expansion Act of 1962), an implausible argument for commodity metals, the US government imposed high tariffs on imports of steel and aluminum from China (effective in March) as well as the European Union, Japan, Turkey, Canada, and Mexico (effective early July 2018). Predictably, all the affected trade partners responded at once by announcing their own retaliatory trade actions.

The confrontation with China intensified with the announcement (effective in early July 2018) of tariffs on US imports from that country worth \$34 billion. The stated rationale was unfair trade practices (under section 301 of the Trade Act of 1974). By September 2018, the total value of Chinese imports subject to US section 301 tariffs had risen to \$250 billion, with tariffs on a further \$236 billion threatened.

It did not take long, in fact only a few hours, for China to respond in kind to the US action. At the time of writing, the Trump administration is vowing to react with even more tariffs on imports from countries challenging its arbitrary actions.

The trade aggressiveness, rather than an intelligent use of diplomacy, against China is difficult to understand, not only because almost no hard evidence has been provided about the imputed unfairness of China's own trade practices, that if true would warrant a strong





case to be judged by the World Trade Organization (WTO) appellate body, but also because it seems to ignore other aspects of the already significant interdependence between the American and Chinese economies. Among other things, the US government overlooks the effect of China's imports from the US in supporting the latter's economic growth as well as the favorable impact of the lower price of Chinese exports on the real wage of American workers. It equally seems to dismiss that the US trade deficit with China helps to feed the latter's current account surplus which is a simple consequence of the excess savings available in the Chinese economy and that the US has been happy to borrow over many years to compensate for its own very low savings rate.

It is hard to know whether the American administration really believes that sooner rather than later China and the other targeted countries will succumb to the United States' outlandish demands, and thus deliver Mr. Trump a "win" in the still incipient confrontation. If this were the assumption—most likely a wrong one—the trade war could reach epic proportions, with rather irreversible damage. Even worse, however, the US authorities could be envisioning a scenario in which the affected parties implement full recourse to the WTO, and this is taken as an excuse to withdraw from that institution, as President Trump has sometimes threatened to do.

This episode of American neo-mercantilism can hardly have a happy ending, simply because it has been launched on very wrong premises and with questionable objectives. The US government's ongoing policy not only ignores the notion of comparative advantage and its modern incarnation into complex supply chains, but also the essential insight from open-economy macroeconomics that the difference between an economy's national income and its expenditure is what drives its current account and trade balances. Playing with trade policy without looking at the underlying variables of income and expenditure is bound to be futile and counterproductive. Furthermore, focusing on bilateral balances to fix the aggregate one makes the undertaking even more pointless.

The discussion about the NAFTA renegotiation and the other trade actions undertaken by the current American government are highly relevant to a key inquiry of this article: the future of globalization. As claimed above, US neo-mercantilism has the potential to cause enormous damage to the process of increasing global economic interdependence built during almost three quarters of a century. How far and how deep the newly adopted American protectionist stance is taken will determine, more than any other circumstance, whether modern globalization is in its twilight or simply recedes temporarily. Of course, other factors, which must be duly acknowledged, will be at play to determine the ultimate outcome, but the decisive weight of US policies need to be factored properly into any exercise of prognosis about globalization.

If the capricious withdrawal from the TPP, the arbitrary imposition of import tariffs against products of its main trading partners, and the unjustified rhetoric that accompanied the renegotiation of NAFTA were the guide to predict the gravity of US policies, it would be prudent to envision a dramatic compression of globalization in the years to come. This would happen in a scenario where a tit-for-tat vicious cycle of rising trade barriers happens along with the annihilation, formal or de facto, of the WTO and the other cooperative instruments that exist to govern international trade and investment. Obviously, this would be an outcome, economic and otherwise, of practically catastrophic proportions for the US, its main trading partners and all the other participants in the global economy.

A considerably less disruptive scenario could be imagined if the process to devolve NAFTA into a United States-Mexico-Canada agreement (USMCA) were the relevant guide. As argued before, the new deal (if ratified), while not really being a meaningful improvement



over NAFTA, would still be capable of allowing a reasonable degree of mutually convenient integration, not optimal but substantial, among the three partners. Fortunately for all involved, the protectionist rhetoric displayed by the American authorities was not matched at the end by their actions to conclude the deal. In fact, the termination of NAFTA would have been the only outcome matching the aggressive and bombastic positions they held from the beginning to right before the end of the talks. The equally bombastic exaggerations utilized to announce the purported virtues of the new agreement could also be suggestive. Demand unreasonably, negotiate aggressively, make any possible deal, declare victory, and move on, seemed to be the script used by the US government in the NAFTA negotiations. If this were truly the blueprint that the US government intends to follow to restructure the country's trade relations with the rest of the world, then the damage, if not negligible, will be contained. It might even be the case that as trade is disrupted by the US protectionist actions and its partners' retaliation, the damage in terms of jobs, output, and lower real wages could lead to a shift in the American position where rationality prevails over the wrongheaded populist instincts exhibited so far.

## **US neo-mercantilism has the potential to cause enormous damage to the process of increasing global economic interdependence built during almost three quarters of a century**

But even in the least pessimistic scenario, other important issues will have to be addressed in the years to come if a twilight of contemporary globalization is going to be avoided and allowed to continue being, on balance, a powerful force for prosperity and international peace and security. For one thing, all the other major economic powers of the world should deal intelligently with the ongoing American predicament with a view to certainly containing the aggressiveness of the US actions while doing their utmost to protect the rules-based international system. Those powers should commit their collective and coordinated action to compensate for the retrenchment by the US from the multilateral institutions and the provision of global public goods. They will have to be more proactive in their support of institutions and agreements such as the United Nations, the Bretton Woods institutions, the Paris Agreement on Climate Change, and many more. Although it will be very hard, if not impossible, to do it without the concurrence of the United States, the reform and strengthening of the multilateral system, not only in its purely economic aspects but in its entirety, is a necessary condition to deal effectively with the challenges posed by economic interdependence while benefiting the most from it. On the trade front, it is necessary and unavoidable, although unfortunate, that they continue reacting in a targeted fashion to the US trade restrictive moves, but it must be done in a way that complies with the WTO framework. They must also be more forthcoming about their support for that institution, abandoning the passivity or even free-riding attitude that has sometimes prevailed in the past, not least over the failed Doha Round.

Those powers will also have to address more decisively some important domestic challenges. For example, China, whose leadership has come forth to champion globalization in the face of the American retreat, should, in its own interest, move faster in its process of domestic reform. The European Union, nowadays the most benign pole on the map of world powers, should expedite its consolidation, a task that, among many things, implies dealing properly with the march of folly that Brexit is and do what it takes to make the European Monetary Union (EMU) unquestionably viable and resilient.



Crucially, for globalization to deliver to its full potential, all governments should take more seriously the essential insight provided by economics that open markets need to be accompanied by policies that make their impact less disruptive and more beneficially inclusive for the population at large.

Advocates of globalization should also be more effective in contending with the conundrum posed by the fact that it has become pervasive, even for serious academics, to postulate almost mechanically a causal relationship between open markets and many social and economic ills while addressing only lightly at best, or simply ignoring, the determinant influence of domestic policies in such outcomes. This identification problem is adversely consequential for many reasons but mainly because it leads to bad, insufficient, or at best irrelevant policy prescriptions.

Linking abominable inequities to trade and even to technological progress, as has become fashionable, misses the point entirely on two important accounts. First, because it denies that those inequities are much more the consequence of explicit domestic policies unrelated to trade issues. By focusing on the latter, the important fact that those inequities are fundamentally the result of past political choices is overlooked. Second, by committing this omission, it becomes more likely to incur serious policy mistakes with the practical consequence that the inequities purported as undesirable will tend to be further perpetuated.

Trade policy will never be a first-best one to deal with the problems that rightly have increasingly captured the attention of citizens and political leaders in most countries, both developed and emerging, such as poverty, increasing inequality, and marginalization. These ills—less the result of historical initial conditions than of deliberate policy decisions by political leaderships unduly influenced over time by the holders of economic power—if they are to be addressed seriously, it must be done with institutions and policies conformed explicitly for such purposes (Zedillo, 2018). This is a clear-cut political choice that obviously poses a trade-off with other objectives, such as low taxation, that may be considered important by some economic and political constituencies. The real dilemmas must be acknowledged and acted upon, and not evaded as is done when tweaking trade policy is wrongly alleged to be the instrument to address unacceptable social ills.

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