

# Michigan Journal of International Law

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Volume 26 | Issue 1

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2004

## Development, Globalization, and Law

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*The American Prospect*

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### Recommended Citation

Robert L. Kuttner, *Development, Globalization, and Law*, 26 MICH. J. INT'L L. 19 (2004).

Available at: <https://repository.law.umich.edu/mjil/vol26/iss1/2>

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# DEVELOPMENT, GLOBALIZATION, AND LAW

Robert L. Kuttner\*

## I. A DEVELOPMENT PARADOX

Is global commerce under essentially laissez-faire rules optimal for economic development? In this era of liberated and deregulated markets, and after the final collapse of communism, a great many commentators would consider that a self-evident question. Of course free global commerce is good for economic development, because we know that the freest possible markets produce the most efficient use of resources and the highest available rates of economic growth. And growth benefits development. How could it be otherwise?

And what is the role of law in facilitating commerce and in contouring a particular regime of domestic and transnational commerce and capital flows? Isn't the global role of law to define property rights and limit the interference and distortion imposed by states, and thus, again, to optimize outcomes?

In exploring these questions, we have to begin with a paradox. All of the world's leading economies are located in countries that, by various political routes, have evolved into what Paul Samuelson called mixed economies: systems that are basically capitalist, but that limit absolute private property rights and capital flows, not just for the sake of equity or sustainability, but to constrain opportunism, to complement private investment with necessary public goods, to compensate for the market's inaccurate pricing, and to temper the instability of a market system prone to bouts of overshooting. So the modern capitalist economy has central banks, regulatory bodies like the Securities and Exchange Commission (SEC), and extensive programs of public investment and social insurance. Member Countries of the Organisation for Economic Co-operation and Development (OECD) tend to spend between a third and half of their gross domestic product (GDP) socially. We balance between property rights and the rights of workers, tenants, and citizens to breathe the air and drink the water. Despite the claims of laissez-faire theory, each of the wealthy nations has opted for some brand of mixed economy to produce

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more economically efficient outcomes than would be produced by laissez-faire means. We do this, not at some regrettable cost to efficiency, but, because laissez-faire markets make systemic mistakes, to enhance efficiency.

My book, *Everything for Sale: The Virtues and Limits of Markets*,<sup>1</sup> examines what markets do well, and where they fail. I conclude that markets are powerful engines of growth and allocation of scarce resources, but that market failures are not isolated, special cases. They are, rather, systemic problems caused by the fact that markets, by their very nature, are myopic as well as dynamic, and price many things disastrously wrong. I am speaking here not of value preferences, or sentimental social choices made at the expense of economic growth. Rather, I am speaking of the pure free market's failure to optimize economic performance itself.

Among the things that markets fail to price correctly are: education, health, research, technical innovation, public infrastructure, pollution, depletion of natural resources, and even currencies and other financial instruments. Many of the things that markets price wrong, such as education, public infrastructure, health, research, and the quality of public governance, are themselves necessary inputs to economic development. Even those who support more market-like measures in, for example, education or the control of pollution, acknowledge that tax revenues are necessary to support voucher schools, and a publicly created trading market in emissions, under a publicly regulated cap, are necessary to allow these market-like inventions to proceed.

Markets, especially financial markets, tend to overshoot. Their mistakes are not instantly corrected by other market forces. Influential players in financial markets take advantage of their privileged position and steer investors to misallocate capital, sometimes running into the trillions of dollars, as in the case of the recent Wall Street scandals and stock market bubble. Imagine the indignation if governments misallocated that amount of money. Markets yield income distributions that not even the champions of laissez-faire defend. One can have a society in which some people literally have more money than they know what to do with while others starve. That society can be efficient by the lights of the free market because allocative efficiency is said to operate at any given income distribution. One can also have economic equilibrium with twenty percent unemployment.

We have painfully learned this lesson since the mid-nineteenth century. The diverse forms of managed capitalism in our several countries

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1. ROBERT KUTTNER, *EVERYTHING FOR SALE: THE VIRTUES AND LIMITS OF MARKETS* (1997).

do not primarily reflect the insights of economists and lawyers in seminar rooms. Rather, they are the result of political struggles in Nation-States involving citizens, political parties, and economic interest groups. The necessarily messy democracy does not invariably produce optimal policies, but there is no way for markets to exist without rules, and rules are made by governments, democratic or otherwise. And while some utopian theorists argue for pure *laissez-faire*, there is a general consensus that a degree of regulation and of social investment is salutary for economic outcomes.

Curiously, however, when the subject turns to cross border trade and transnational flows of capital, it is as if we have discarded the practical lessons of the past century and a half. The assumption, suddenly, is that *laissez-faire* is optimal after all. This is a doubly dubious premise, as the global economy, because it outruns the writ of national authority, is, if anything, even more prone to instability than nationally governed economies. By what alchemy does the market system, which is not optimal as a *laissez-faire* system within nations, somehow become optimal as a *laissez-faire* system between or among nations?

This brings me to the question of the role of law in the international trading system. Domestically, law defines the citizen's relationship to the government—including property rights; thus, law allows commerce to proceed. Law also defines other rights that complement and sometimes constrain property rights for the sake of efficiency or equity, for example in asserting the collectivity's right to tax and invest socially, or limiting the absolute right of an employer to fire an employee, or the absolute right of a property owner to dispose of sewage.

But in the context of a trade regime, the function of law is more complex and ambiguous. It can serve to create rough balance and fairness in the rules of trade among nations that have different domestic economic systems. Some States, for instance, may choose to have a greater or lesser role for the State in economic development. Some may place higher value on social goods. A trade regime can devise rules that allow commerce nonetheless to proceed equitably among nations with different systems. Alternatively, law can try to impose a single regime on diverse, nominally sovereign States, using the leverage of the strong on the weak. This is invariably said to be for their own good because it shakes loose the cobwebs of statism, exports transparency, makes emerging economies attractive to investors, and imposes the discipline of the global financial community on budgets that are sometimes profligate. Or so some advocates like to believe.

It is very important to disentangle these different functions of law in creating a global trade regime and to see what is at work in any given

case. It is a mistake to assume, with some of our law-and-economics colleagues, that the purpose of law is simply to maximize the conditions in which free-market economics can flourish. Normatively, history shows that laissez-faire treatment does not in fact optimize welfare outcomes, much less distributive goals. Descriptively, this view is touchingly or disingenuously naïve about the realities of geopolitical power.

The neoliberal model reflects the self-interests, not of “countries,” but of the most politically powerful actors within those countries. A cynic might be forgiven for concluding that bankers, corporate elites, and their allies in government are using globalization and the so-called Washington Consensus<sup>2</sup> to return to the regime of property rights that obtained domestically in about 1890—nearly absolute rights for property, with scant countervailing rights for workers or citizens.

This enterprise is less about optimizing outcomes and more about who benefits. If laissez-faire government can be imposed as the principle of global commerce, it very usefully feeds back into domestic politics and law. The nation with high taxes and costly social investment, or regulatory constraints on industry and finance, or industrial policies, finds itself priced out of the game or in violation of the international laissez-faire rules. As the Church Lady on “Saturday Night Live” used to say, “how convenient.”

Therefore, there are really several interrelated challenges. First, how shall we make sure necessary functions of national government, to stabilize and temper brute market forces, are not hopelessly eroded by global commerce and the ease with which globalized corporations and investors can outrun the writ of governments and play off governments with costly social overhead against each other?

Second, how can the advanced countries protect their mixed economies without retarding the capacity of poorer countries to develop?

Third, what are the appropriate institutions and rules for the global economic system to reconcile both goals? To believe that the global economy needs to be a mixed economy is not to know how to construct it, because of course there is no global sovereign, and the issue of how to delegate or pool sovereignty is necessarily a delicate one.

Sixty-one years ago at Bretton Woods, New Hampshire, in June 1944, the world’s leaders attempted to create the global preconditions for domestic mixed economies. Having rejected both the laissez-faire approach and socialism, they endeavored to reconcile their desire for a

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2. The phrase “Washington Consensus” is today a very popular term in debates about trade and development. It is often seen as synonymous with “neoliberalism.” The phrase’s originator is John Williamson of the Institute for International Economics. Additional information is available at <http://www.cid.harvard.edu/cidtrade/issues/washington.html>.

mixed economy at home with a restoration of trade and financial flows globally. These architects of the postwar economic system, having learned from the man-made disasters of the recent past, endeavored to rebuild global commerce, not as *laissez-faire*, but on a foundation of broadly distributed prosperity, full employment, and economic management, as well as political democracy. They understood that the instability and excess of a speculative market economy in the 1920s had led to the economic collapse and political nightmare of the 1930s, and to a second world war. They understood that *laissez-faire*, taken to an extreme, was no friend of human development, economic prosperity, or liberal democracy. They were determined that the postwar institutions create a framework in which national governments could manage the private economy for the sake of collective human betterment, even as they promoted the revival of private commerce and expanded trade.<sup>3</sup>

So, while the World Bank and the International Monetary Fund (IMF) helped restore transnational financial and commercial flows, they did so in a context of fixed exchanged rates, temporary capital controls, substantially state-run sectors, tight domestic regulation of financial institutions, and relatively high tariffs. As the postwar boom matured, all of these strictures were gradually relaxed, and we have now gone to the opposite extreme.

The contrast between the vision of the founders of the Bretton Woods institutions and those who operate them today is striking. In 1944, the architects of Bretton Woods understood the risks of competitive devaluation. They understood that private global financial flows, left on their own, would cumulatively lead to collective deflation. The purpose of the IMF was to allow nations to stabilize their currencies without contracting their economies. The idea was to inject an expansionary bias into the system rather than a contractionary one, so that each member nation could pursue full employment at home. This, the founders thought, would allow nations to accept freer trade. But free trade and free movement of capital, per se, were not the *summum bonum* of the system. They were means, not ends.

Today's statesmen have a very different view; and the Bretton Woods institutions, particularly the IMF, have become instruments for the imposition of a single model. It is not at all clear that this approach optimizes economic development, though it certainly benefits commercial and financial elites.

As the economy globalizes, and as private capital liberates itself from the reach of the Nation-State and the stabilization and management

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3. See RICHARD N. GARDNER, *STERLING DOLLAR DIPLOMACY* (1969); see also KARL POLANYI, *THE GREAT TRANSFORMATION* (1944).

of national governments, we are reverting to a laissez-faire system that has been historically proven to be unstable, unreliable, and often unbearable in human terms. Therefore, the task today is to reinvent a mixed economy, under circumstances that are institutionally much more difficult than those of the postwar reconstruction. That institutional challenge is compounded by the ideological triumphalism of the market.

The current U.S. administration is using its very substantial diplomatic leverage to devise international agreements that reduce the power of the state to regulate commerce, both in the United States and in other nations. Many perfectly legitimate state interventions for purposes of development, stabilization, or social investment are defined as contrary to the World Trade Organization (WTO) or the North American Free Trade Association (NAFTA). Under the NAFTA Chapter 11 mechanism, whose dynamics were little appreciated at the time of its ratification, a corporation domiciled in any of the three NAFTA member countries may challenge a piece of lawfully enacted environmental regulation that treats domestic and foreign companies exactly alike as an interference with trade. These challenges may be brought in a special NAFTA tribunal, bypassing both domestic legislatures and courts. A similar initiative, the now defunct Multilateral Agreement on Investment, was attempted under the auspices of the OECD, but was withdrawn in the face of broad popular opposition. What is ironic is that the U.S. government is particularly resistant to multilateral agreements on social standards, which it rejects as constraints on sovereignty, but the United States is leading efforts to subordinate its own sovereign authority and that of other nations when the results serve private commercial purposes.

During the height of the Cold War, President John F. Kennedy invoked the words of his predecessor Woodrow Wilson, who brought the United States into World War I pledging to make the world safe for democracy. Half a century later, in an address launching the Alliance for Progress, Kennedy declared that the task of his generation was to make the world safe for diversity. Kennedy of course meant that the United States would not allow the Soviet Union to impose a single model of political philosophy or economic development upon the dozens of newly independent nations. Now, however, with the Cold War ended in favor of liberal capitalism, making the world safe for diversity has a different and ironic meaning. Liberal democracy is said to be pluralist, yet today there is a risk that the triumphant ideologues of laissez-faire economics will impose a single economic model on a diverse world—a model that makes the world safe for investors but ignores the needs of human development. The United States may have a chronic trade deficit in goods and services, but it is superb at exporting economic dogmas.

If this model of economic neoliberalism reliably produced prosperity, one might argue that the loss of national sovereignty to global market forces, and even the widening inequality, might be worth it. But the turning away from the mixed economy in favor of laissez-faire economics has produced widening instability and rising inequality both between and within nations. We have had two lost decades of development for some of the South, rising financial volatility, and worsening environmental calamity. And some of the most successful nations, such as North Korea and China, have radically departed from the neoliberal recipe. Yet, despite this record, it has also produced a new certitude that the standard model of economic stabilization and market liberalization is the best approach, indeed, the only approach, for rich and poor nations alike.<sup>4</sup>

Let us never forget that the appropriate blend of market development and human development is a political choice and not an economic imperative. My earlier book, *The Economic Illusion: False Choices Between Prosperity and Social Justice*,<sup>5</sup> challenged the idea that there was a necessary trade-off between equality and efficiency. In free market theory, markets, by definition, optimize the allocation of resources. By altering that allocation, through taxes, income transfers, state regulations, or public investments, you may improve income distribution. By distorting allocation, however, you worsen economic performance. If in fact markets price many inputs and outputs incorrectly, and if the market itself is sometimes a source of instability and irrationality, then judicious intervention can improve performance as well as distribution.

Looking at the actual economies of the world, one can find societies with relatively high growth that are more egalitarian, and ones that are less egalitarian. One finds unequal societies that are good economic performers, and bad ones. Looking at actual institutions, one can identify public infrastructure programs that compensated for private market myopia and stimulated development; and one can find pension schemes that simultaneously increased the self-reliance of the non-rich, even as they raised the national rate of saving and investment. One can find labor market programs that raised the earning power of ordinary people, while they improved productive output and macro-economic efficiency by allowing economies to run closer to full employment without triggering inflation. One can identify health, safety, and environmental regulations that improved economic performance by prohibiting companies from taking the low road, and forcing them to invest in technical innovation

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4. See JOSEPH STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* (2002).

5. See ROBERT KUTTNER, *THE ECONOMIC ILLUSION: FALSE CHOICES BETWEEN PROSPERITY AND SOCIAL JUSTICE* (1984).



rather than treating people and the natural environment as disposable assets. Efficiency and equality come packaged in multiple ways.

But if the trade-off between equality and efficiency is a myth, it is all too true that pure markets are more likely to produce extreme inequality. The more that society is operated as nothing but a marketplace, the more it tends to produce extremes. In a world of mobile capital, relatively immobile labor, and high unemployment, people with routine skills have little bargaining power. There are untold riches for a relatively small number of entrepreneurial winners and financial engineers. As the recent stock market scandals demonstrated, deregulation also creates opportunities for insider opportunism that “self-regulating” market forces do not limit or correct until after substantial damage has been done. This also widens income inequalities. The more the social constraints on the market are weakened, the more inequality we see. If the market is the entire world, the extremes only widen. As Robert Frank observed,<sup>6</sup> the bigger the economic stage, the more extreme the winnings of the biggest winner. So on both grounds—equality and efficiency—we need to reinvent a mixed economy—one that maximizes both sustainable economic growth and equitable human development.

Nor is there a simple correlation between a *laissez-faire* economy and political democracy. A command economy, certainly, tends to require a command state. Capitalism, by contrast, has coexisted nicely with the stable parliamentary democracies of the North, but it has also dwelt all too easily with Nazis, fascists, mafias, and traditional despots. Racialist South Africa was very hospitable to private capital. So were countless military dictators in primary-producing countries. Multinational corporations like the enforced social peace and the low labor costs of dictatorship. Indeed, early capitalism coexisted easily with slavery and with the extermination of native peoples. Markets, by themselves, do not spontaneously produce the combination of order and accountability on which efficient capitalism depends. The latest case in point is gangster capitalism in post-Soviet Russia.

So let us not make the mistake of assuming that the greatest degree of free market equals the greatest degree of political freedom, any more than we should assume that *laissez-faire* economics maximizes growth. The case for political democracy must be made on its own merits. Often the nations with the most successful expansion of political democracy to working people have been those that also succeeded at tempering the extremes of markets, to make that democracy real.

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6. See ROBERT H. FRANK & PHILIP J. COOK, *THE WINNER-TAKE-ALL SOCIETY* (1995).

## II. RESTATING THE PRACTICAL CHOICES

In *Everything for Sale*, I suggest that there are really three entirely different kinds of efficiency, and that standard economics has trouble integrating them into a common analytical framework.<sup>7</sup> There is, first, the usual efficiency of the price system—the efficiency of allocation. That is the efficiency of Adam Smith, and the kind cherished by laissez-faire economists. However, there is also the macroeconomic efficiency of John Maynard Keynes. If an economy has twenty percent unemployment, the price system may be operating normally, but it is producing an outcome that is collectively inefficient since it leaves twenty percent of the human resources needlessly idle. In these circumstances, the price system is not capable of correcting the inefficiency, since price reductions in the face of slack demand will only deepen the recession. Governments can violate the price system by using public investments to stimulate the economy and put idle people back to work, and the outcome will be more efficient, despite the interference with the price system. World War II was an assault on market pricing, but it ended the Great Depression. The third sort of efficiency is innovative. One of the market's greatest failures is its failure to invest adequately in research. Studies by the economist Edwin Mansfield and others have carefully investigated the gap between the return to society from investment in innovation and the private return captured by the entrepreneur. The social return is at least double the private return—which means that private investors do not, indeed cannot, invest optimally in research, technical innovation, or human capital, because they will not capture all of the returns. This is the third efficiency—the efficiency of technical progress, an efficiency associated with the economist Joseph Schumpeter. The efficiency of Smith relies on the price system, but the efficiencies of Keynes and Schumpeter suggest that the price system often gets things wrong. If that is so, state intervention or criteria other than profit-maximizing ones can improve outcomes. The emerging laissez-faire rules of the trading system, however, condemn state investments as illegitimate distortions.

In an earlier time, virtually all of the currently wealthy nations intuitively understood that a laissez-faire approach was not the optimal path for economic development. The United States, long before Franklin Roosevelt's New Deal, had interventionist policies for land tenure, development of agriculture, railroads and canals, the creation of the aircraft, and radio industries. During its first century, the United States had high tariffs. With World War II and the Cold War, it devised the world's

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7. See KUTTNER, *supra* note 1.

most extensive science and technology policy; this was deemed compatible with a laissez-faire ideology, because it was for national security purposes, and, therefore, deemed not to really count. The technological spillovers were accidental and incidental.

Germany, France, and Japan, are of course famous for state led economic growth. Germany, the most liberal of the three, uses banks rather than equities markets, has an indulgent view of cartels, and employs a variety of more subtle mechanisms of economic nationalism. Even Britain, the historical champion of free commerce, combined its support for laissez-faire government with its operation of an empire. It is hard to reconcile imperial preference with liberal trade.

My point is not to criticize retroactively the policies that the developed nations used decades and centuries ago. On the contrary, I suggest that the world's richest and most powerful countries understood in their own earlier stages of economic growth that private markets were capricious and that States had a role to play in economic development. They understood that their own sovereignty required that while they might welcome a partial role for foreign capital and for trade, they could not leave their fates entirely dependent on a global market and the whims and fashions of private investors. It is of course ironic that today's most powerful nations would deny the mixed development strategy that they themselves pursued to today's newly emergent economies. It is also the case that the most successful economies of the post war era have been precisely those, mainly in Asia, that combined a fierce entrepreneurial skill with a strong developmental role for the state; a combination of capitalism and neo-mercantilism. It is bizarre that champions of laissez-faire economics claim China's ten percent annual growth rate as evidence for their side of the argument. This is a nation, after all, that pegs its currency, has neither transparent capital markets nor western style human rights, whose industry and banking system is still dominated by the state, and who allows in foreign investment only on carefully negotiated terms.

"Free trade" versus "protectionism" misstates the practical choices. This is not a two-way debate between free traders and protectionists, but a rather richer and more complex four-way argument. One view is the laissez-faire recipe advocated by proponents of the Washington Consensus, as an architecture of global commerce that is good for the global system, and by extension, good for the United States. Second, there are domestic critics of the Washington Consensus who feel that it places geopolitical U.S. goals and gains for certain sectors, such as finance, ahead of U.S. economic goals, to the disadvantage of other domestic sectors such as industrial workers. This critique is sometimes self-interested, sometimes

principled. Third, there are non-U.S. critics of the Washington Consensus who resent the imposition of a one-size-fits-all model, and who accuse the United States, with some justice, of practicing a double standard. These critics are very skeptical of labor and environmental standards, which they see as just another variant of protection for the rich North, but also want to be able to use domestic development policies that neoliberals consider mercantilist. Finally, there are principled advocates of a mixed economy, who believe that the neoliberal recipe is neither optimal for most actors in the U.S. economy, nor for human development objectives, nor for the stability, sustainability, and performance of the system as a whole. I would put myself in this fourth group.

The quarter century after World War II was a golden age, in both the North and South, of managed capitalism and the mixed economy and of tolerable distribution and security. The developed nations grew smartly, and the third world grew even faster. This was supremely the era of economic management. The financial underpinnings of the first Bretton Woods system were probably unsustainable because of the special role of the U.S. dollar, which had to diminish as other countries developed. But the collapse of Bretton Woods, combined with the oil price increases, the resultant heavy borrowing of non petroleum exporting developing countries, followed by the abrupt increase in interest rates, created a new geo-economic reality which in turn produced new political leverage for the advocates of neoliberalism, at a time when prevailing ideology was shifting to *laissez-faire*. The IMF, in concert with commercial banks and national leaders newly committed to a *laissez-faire* approach, devised a new set of stabilization policies and enjoyed a new capacity to enforce them.

Instead of providing countervailing public financial institutions to counter-balance the global financial tendencies to austerity and contraction, the Bretton Woods institutions became the agents of austerity and contraction. Instead of serving to facilitate the management of a mixed economy, they became instruments of *laissez-faire* economics, conditioning financial assistance upon an economic program that would have been unrecognizable to the 1944 architects.

The Washington Consensus reflects a reversion to the pre-Roosevelt view that markets are, by definition, efficient, and that interferences with markets are, by definition, unwise. The approved recipe has called for "getting prices right" by reducing public sector outlays, frequently by devaluing, deregulating and privatizing, opening national capital markets, and making the domestic economy friendly to foreign private investment. All of these measures are supposed to increase allocative efficiency. Foreign capital is supposed to pour into nations that offer above-average

returns; investment then yields higher growth. This formula has been applied to nations as diverse as the formerly communist countries of central and eastern Europe, the nations of Latin America suffering from excess debt, and the extremely poor countries of sub-Saharan Africa. These economic stabilization policies have been a rousing success at opening markets and collecting debts. They have not been so successful for poor countries and poor people. Sometimes, they have produced merely “hot” financial flows and speculative volatility rather than patient capital for long-term development, as in the case of the East Asian induced depression of the late 1990s.

The record of this approach is mixed at best. Many of the most successful developing economies are precisely those that violated the recipe of the Washington Consensus—those that “got prices wrong,” as it were, in order to get cheap capital to domestic industry. These were the nations that remained largely closed to foreign capital or that admitted foreign investment only on carefully negotiated and managed terms, and, therefore, relied heavily on domestic savings.

Elsewhere, the sacrifices were great, but the rewards were far lower than predicted. In this neoliberal era, the global rate of growth has remained well under three percent. The pursuit of allocative efficiency, because it represents only one form of efficiency, has created many sacrifices but only mediocre benefits. The loss of the efficiencies of technical innovation and high employment economies has generated offsetting costs. Standard neoliberal theory predicts that marketization will lead to convergence. Investors in capital-rich countries will perceive opportunities for supernormal growth in poor countries. They will send them their capital, growth and high profits will ensue, and all will be well. But as Angus Maddison has shown, in an OECD study,<sup>8</sup> the story of recent decades has been divergence, not convergence. With the exception of a few Asian countries, all of which violated the *laissez-faire* formula, per capita incomes in the South have been declining relative to northern incomes.

The promised flow of both portfolio capital and direct foreign investment into poor countries has also been disappointing, as has the growth of north-south trade. It remains the case that for most countries, capital is primarily generated domestically, from local savings and the profits of national industry. The benefits of foreign investment are often dwarfed by the costs of its volatility. Countries that relied most heavily on foreign investment have generally had lower growth rates than those that relied on domestic savings. As the economist Alice Amsden has calculated from the United Nations Conference on Trade and Development

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8. See ANGUS MADDISON, *MONITORING THE WORLD ECONOMY 1820–1992* (1995).

(UNCTAD) reports, foreign direct investment relative to gross fixed capital formation has been less than five percent in most developing countries, and less than two percent in several of the most successful ones.<sup>9</sup> In other countries, it has gyrated wildly.<sup>10</sup>

Even worse than its effects on individual economies, the current neo-liberal regime of global finance creates a profound contractionary bias, just as the founders of the Bretton Woods institutions understood. A global financial system operated in the interest of bondholders, foreign exchange traders, and private investors, will be inflation-averse to the point of resisting available rates of growth. When world growth is held to the rate of population increase, and that growth is maldistributed, we will never achieve the goals of human development no matter how much sacrifice is extracted in the short run. While some countries undoubtedly need the fiscal discipline that the IMF invariably commends, the cumulative weight of these adjustment programs cuts in the direction of global economic contraction. Is there an offsetting benefit in the form of allocative efficiency and greater investment flows? On balance, there is not.

The developing world emphatically needs flows of capital from the developed North, just as it needs opportunities to export goods and services. But those flows of capital and goods need to be on terms that promote long-term, stable, and sustainable development, and not mere financial speculation. The flow of purely financial foreign exchange is now one and a half trillion U.S. dollars daily—more than seventy times the flow of world trade. As recently as 1980, that ratio was just ten to one.

I am encouraged that the current leadership of the World Bank has begun to tolerate greater divergence from the standard formula, and I hope this is a harbinger of changes to come. There is some renewed acceptance that the public sector can play a constructive role, even that constraints on capital flows and financial regulation are sometimes salutary. We are seeing a slightly less dogmatic and austere form of conditionality, as well as somewhat less project micromanagement. It remains to be seen whether this movement will be complemented by a new era of international institution building.

Of course, even if the Bretton Woods institutions accord greater respect to diverse paths to development, the fundamental problem of the ungovernability of a global economy remains. During the so-called global age after World War II, socially tolerable mixed economies were built by national governments. A decent balance between market and

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9. See ALICE AMSDEN, *THE RISE OF THE REST: CHALLENGES TO THE WEST FROM LATE INDUSTRIALIZING COUNTRIES* (2001).

10. See *id.*

society was obtained. This project is difficult, if not impossible, when the economy is global.

The polity did not decide, gratuitously, to govern the marketplace out of perverse or “special interest” impulses. States intervened precisely because pure markets were neither stable nor reliable, and they rendered decisions that were economically inefficient, morally indefensible, and politically unbearable. The market indeed produces Joseph Schumpeter’s famous “creative destruction.” This is precisely why polities need to broker social compacts to make that turbulence and dislocation socially, economically, and politically tolerable. Karl Polanyi, in his classic work, *The Great Transformation*, recounts how the undermining of traditional societies and their social compromises by the great transformation of nineteenth century capitalism ultimately generated so much insecurity and turmoil that it led to a twentieth century backlash of tribalism, totalitarianism, and war.<sup>11</sup> Another market paradox: taken to an extreme, economic liberalism leads to illiberal politics. Polanyi wrote: “. . . the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and material substance of society. . . .”<sup>12</sup> Polanyi continues “. . . to allow the market mechanism to be the sole director of the fate of human beings and their natural environment, and indeed, of the amount and use of purchasing power, would result in the demolition of society.”<sup>13</sup>

People may be economic actors in a global marketplace, but they are still citizens of Nation-States. They still look to their national governments for economic security, education, health, and political rights. They still blame national leaders when things turn out badly; they do not blame Deutsche Bank, General Motors, or the Director-General of the WTO. Indeed, the more the global market is rampant, the more people look to their national governments to clean up the human damage. I am a voting citizen of the United States. There are no citizens of the Republic of NAFTA. The European Union (EU), a transnational polity with emerging institutions of civic accountability and deliberate efforts to narrow an acknowledged “democratic deficit,” remains the exception.

Several recent books have observed that the more the economy becomes fluid and global, the more anxious people, looking for moorings, become tribal.<sup>14</sup> A vocabulary of facile globalism is for the elite—those people who thrive in a world of computerized currency trades, conferences

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11. See POLANYI, *supra* note 3.

12. *Id.* at 3.

13. *Id.* at 73.

14. See e.g. JOHN NAISBITT, *GLOBAL PARADOX: THE BIGGER THE WORLD ECONOMY, THE MORE POWERFUL ITS SMALLEST PLAYERS* (1994); see also BENJAMIN BARBER, *JIHAD VS. MCWORLD* (2001).

at Davos, and cross-border conglomerate deals. It is a relatively small stratum that personally benefit from global economic integration—those who the U.S. Labor Secretary Robert Reich has called the class of “symbolic analysts.” But for the billions of ordinary people who are tied to their countries and even their villages by the limits of immigration laws, low educations, and the plain, grinding realities of poverty, the global economy often represents merely a loss of what little control they have—a dependency on capricious forces far beyond their reach that seldom act on their best interests. The loss of local sovereignty, and the increasing power of multinational capital, politically accountable to no one, produces a backlash.

Karl Marx was wrong to imagine the withering away of the State, but so are ultra neoliberals. The State, let us never forget, is not just the instrument of a necessarily mixed economy. It is the necessary locus of political democracy. Too often in our era, the problem has not just been States that are too strong and that trample the rights of their people, but States that are too weak and too lacking in legitimacy to guarantee civil order, to broker social consensus, to protect private property, and to counterbalance the extremes of the market. In Soviet Russia, the problem was that the totalitarian State was too strong. In post-Soviet Russia, the problem is that the democratic State is too weak. You don't just remove the constraints on private capital and expect civil society and mannered markets to appear full blown. Take away a discredited State, liberate market forces, and what fills the vacuum?—private, tribal mafias. The creation of civil society and the domestication of private capital is a gradual, iterative, and consensual process. And at its center is legitimate, democratically accountable government.

In the history of the United States, the early revolutionaries against the British Crown first thought that the best guarantor of the rights of the people was a weak State. After a few years they realized that a weak state was a weak protector of political liberty and a weak promoter of public purpose. And so they went back, scrapped the Articles of Confederation, and wrote a Constitution with a stronger national government—precisely to promote national development, protect liberty, and broker domestic social peace.

The entire history of political democracy is the converting of authoritarian States to democratic purposes, building administrative competence that is popularly accountable, and making the State an effective counterweight to the market, as well as a partner in private development. The State is the realm of citizenship, or political rights, public goods, and minimum social standards. So, to the extent that the



global market is overwhelming the democratic polity, this is a loss, not a gain for human development.

The history of the past century displays an ongoing tug of war between market and polity. But it is not inevitable that this process move one way. Indeed, the more dislocation the market produces, the more there will be pressure for some kind of redress. The danger is precisely that it will be ugly, nationalistic redress, rather than redress consistent with peace, liberty, human development, and democratic order.

How can the state regain some capacity to direct markets to human purposes? There are three basic approaches. The first approach involves attempting to allow Nation-States to reclaim some authority *vis-à-vis* markets. The second alternative looks to new regional groupings such as the EU. Or, the third approach attempts to construct global institutions of governance.

There are problems and possibilities with each of these. In a climate where the trend is towards greater market liberalization and greater globalization, a Nation-State that attempts to reassert authority risks appearing, or even being, merely protectionist. A State with costly social overhead, competent regulation and efficiently enforced taxation risks pricing itself out of the market for global capital seeking cheap labor, weak regulation, and low taxation. Still, the reregulation of areas such as the environment, child labor, banking and accounting standards, aircraft safety, and money laundering by terrorists, suggests that the Nation-State is not entirely helpless in the face of global capital. The Clinton administration was on the verge of negotiating an agreement with Europe under the auspices of the OECD to basically put tax havens out of business, until the Bush administration killed the initiative. So the perceived impotence of the state is more a matter of ideological fashion and the balance of political forces than a case of irreversible change and institutional bankruptcy of the Nation-State.

With respect to regional groupings, the course of least resistance is to devise trading blocs that merely accelerate the move towards *laissez-faire* governance, but on a preferential, regional basis. A case in point is NAFTA. One problem with NAFTA is that it was negotiated on terms far more beneficial to the United States and to investors in the three member nations of the United States, Canada and Mexico, than to Mexico or to ordinary citizens.

A second problem is that NAFTA does almost nothing to devise regional institutions of governance to replace national ones. It is basically a free trade bloc and not a regional polity. Its side agreements on labor and environmental standards are feeble and virtually unenforceable. NAFTA also creates preferential access for the three member nations, at

the expense of third party exporting countries, and this certainly violates the spirit of global nondiscrimination.

A more attractive case, as noted, is the EU, which is, at least, an emergent transnational polity. The ideological import of the EU has reversed at least once, since the Treaty of Rome. At first, it was supported by economic liberals, as an instrument of free commerce. Later, as private commerce overtook the regulatory capacity of European nation-states, labor and social democratic parties looked to Brussels as a transnational emergent government that could maintain social regulation of capital on a continental scale. Now, in another reversal, there is a new struggle over whether the EU will become the province of fiscal austerity and slow growth. But at least, the EU represents an effort to build a supranational institution of governance, to balance market objectives with social ones.

The most difficult task of all, it seems to me, is to replicate institutions of governance at a global level, for the purpose of humanizing the market economy. For one thing, Nation-States are reluctant to cede real sovereignty to institutions of global governance, except when this process serves corporate or geopolitical interests. Even the most modest sharing of authority produces nationalistic backlashes. The United States has been willing to create global institutions, only to the extent that they represent surrogates for U.S. geopolitical or economic goals. Most of the existing global financial institutions accelerate marketization rather than govern and temper it.

The United States has not ratified even the core labor standards of the International Labour Organization (ILO) Convention, and there is reluctance to subject environmental goals to international regulation. This process is further complicated by the ambivalence of poor countries. Many of the world's most vulnerable nations, already subject to the dictates of the IMF, the World Bank, the commercial lending banks, and the WTO, are ambivalent about whether to subject themselves to further encroachments upon their sovereignty, even for such worthy goals as labor rights, women's rights, and environmental protection. Sometimes, a high minded concern for labor rights can be used as a pretext for protection. Raising very poor countries to the levels of environmental protection desired by rich countries can deny poor countries the same means of economic development used wantonly by now-rich countries, at an earlier state of development when there was less solicitude for the earth.

### III. SERVING HUMAN SOCIETIES

So, what can we do? As a first principle, we need to acknowledge that human development requires managing markets as well as liberating them. We need to acknowledge that markets, left to their own devices, often produce a race to the bottom—a global search for the locality with the weakest regulatory, environmental, social, and labor standards. A regime of private bankers or their public agents is a regime of deflation and slow growth.

By way of remedy, we should look for more assertive global standards, taking care that these not be instruments of mere protectionism. Raising wages and working conditions in poor countries is good for working people in all countries, because it increases purchasing power, living standards, and precludes a race to the bottom. It is not healthy when multinational corporations play off tax bases and work forces. Through some global body, we need to assure decent social minima.

Some leaders of developing countries see labor standards as an interference with sovereignty. But many of these leaders are all too compliant when the interference with sovereignty comes from the IMF on behalf of private creditors and investors. Many such protestations are nothing but alibis for multinational corporations that could easily do better by their employees. If we can put restraints on sovereignty for the sake of capital, we can surely do it for labor.

The same is true of the environment. But here again, we must take great care that the new concern for sustainable development in the rich countries not be pretext for denying development to poor ones. The wealthy countries are the main culprits because their consumption of nonrenewable energy results in most of the pollutants. It is hard to take seriously the leadership of countries that will not tax themselves to reduce energy pollution. It is even harder to accept that poor countries should reduce living standards already on the edge of destitution, when affluent countries will not take even moderate steps.

The conflict is less between poor and rich countries than between the broad interests of peoples and the narrow interests of extractive industries. We need to find our way towards some kind of global regime that reduces emissions of greenhouse gasses, but well-off nations need to transfer the technology to make this possible, rather than viewing this shift as one more opportunity for private industry to profit.

We also need serious debt relief for poor countries. But debt relief, even if extremely generous, is not satisfactory, as the rest of the Washington Consensus dictates a single universal economic model.

World War II occurred, in part, because the allies of World War I were too slow to give Germany debt relief. Ultimately in the 1930s, there

were countless defaults on World War I debts, but it was too late. In the 1980s, we succeeded in gradually working down the oil-recycling debt over more than a decade, but at far too high a price. Higher growth would more than compensate for the financial losses of greater debt relief. The rich countries have been too stingy with debt relief, and too often have limited it for political purposes.

The same is true of development aid. Just as there are domestic public goods, so there are global ones. A public good, by definition, is something to which the market price system does not accord adequate respect. If we believe this is a single, integrated global economy, we need a global approach to the cultivation of public goods such as education, public health, and public infrastructure. That means investment should not exclusively be private and directed at private goods.

We need to return to something like the spirit of the original Bretton Woods—a commitment to high growth, full employment, and financial management aimed at expansion rather than austerity. This does not mean reverting to the rigid, fixed exchange rate system and the capital controls of Bretton Woods, but it does mean abandoning the cookie-cutter approach to structural adjustment and stabilization defined as austerity. We also need to slow down the dizzy dominance of currency traders, which causes the financial economy to overwhelm the real economy, and, far from helping markets to get prices right, becomes its own source of instability. A Tobin tax on purely financial transactions would be salutary.

If we pursue a grail of letting *laissez-faire* markets dictate all decisions about the allocation of resources and allow markets to lead a race to the social bottom, there will be avoidable human misery. We know that state socialism failed. It deprived hundreds of millions of people of both liberty and prosperity. We also know that market forces, taken to an extreme, yield tepid rates of growth, plunder the natural environment, and create human wreckage.

We need to recognize what economic model truly describes reality, based on what we have learned from economic history, not from abstract modeling. We also need to assess how law is used to maximize human possibilities or to serve those who happen to enjoy political power.

Law, in this context, can serve a more balanced model of development, or one that mainly protects private property rights. This debate has raged for more than a century in the so-called advanced democracies. It is both political and empirical. The argument about what sort of law should govern global commerce can be settled by the presumption—in both senses of the word—that a *laissez-faire* approach is always better.

The nations of the developing world are not just “emerging markets,” as the phrase has it. They are human societies. It is high time to make markets our servant, not our master. We need to appreciate the power of the engine, but recognize that it needs to be steered; and to respect that human ingenuity and social consensus take as many diverse forms as there are diverse cultures. Commerce may be global, but the paths to human development are substantially local. We have not reached the end of history, and those who think so should read some history with more humility.