Emerging economies to reap from global crisis

Written by Dani Rodrik

US Trade representative, Susan Schwab (centre), talks to WTO Director-General, Pascal Lamy (left), and Brazilian Foreign minister, Celso Amorim, during the recent G-20 nations Ministerial Meeting. If rich nations want developing nations to co-operate, they will need to let them shape the rules of the game. /Reuters

December 15, 2008: There is a silver lining for developing nations in the present crisis, for they will emerge with a much bigger say in the institutions that govern economic globalisation.

Once the dust settles, China, India, Brazil, South Korea, and a handful of other “emerging” nations will be able to exercise greater influence over the way that multilateral economic institutions are run, and will be in a better position to push for reforms that reflect their interests.

There are two related reasons for this. First, the financial crisis has weakened the United States and Europe. They will be unwilling or unable to provide the kind of leadership that sustained multilateralism in the decades that followed World War II. Developing nations will have to step up to fill the gap.

Second, the relative weight and importance of developing nations in the global economy will have risen even more. Many of the West’s leading financial institutions — those that have not been nationalised — as well some important industrial enterprises, will remain at the mercy of capital from China or the Gulf states.

In trade, the current round of global negotiations has demonstrated that if rich nations want developing nations to cooperate, they will need to let them shape the rules of the game. To make the best of this outcome, developing nations will have to have a good sense of their interests and priorities. So, what should they seek?

First, they should push for new rules that make financial crises less likely and their consequences less severe. Left to their own devices, global financial markets provide too much credit at too cheap a price in good times, and too little credit in bad times.

The only effective response is counter-cyclical capital-account management: discouraging foreign borrowing during economic upswings and preventing capital flight during downswings.

So, instead of frowning on capital controls and pushing for financial openness, the International Monetary Fund should be in the business of actively helping countries implement such policies. It should also enlarge its emergency credit lines to act more as a lender of last resort to developing nations hit by financial whiplash.

The crisis is an opportunity to achieve greater transparency on all fronts, including banking practices in rich countries that facilitate tax evasion in developing nations. Wealthy citizens in the developing world evade more than $100 billion worth of taxes in their home countries each year, thanks to bank accounts in Zurich, Miami, London, and elsewhere. Developing countries’ governments should request and be given information about their nationals’ accounts.

Developing nations should also push for a Tobin tax – a tax on global foreign currency transactions. Set at a low enough level – say, 0.25 per cent – such a tax would have little adverse effect on the global economy while raising considerable revenue. At worst, the efficiency costs would be minor; at best, the tax would discourage excessive short-term speculation.

The revenues collected – easily hundreds of billions of dollars annually – could be spent on global public goods such as development assistance, vaccines for tropical diseases, and the greening of technologies in use in the developing world.

The administrative difficulties in implementing a Tobin tax are not insurmountable, as long as all major advanced countries go along. It would then be possible to get offshore financial centres to cooperate by threatening to isolate them.

Developing nations also need to enshrine the notion of “policy space” in the World Trade Organization. The goal would be to ensure that developing countries can employ the kind of trade and industrial policies needed to restructure and diversify their economies and set the stage for economic growth. All countries that have successfully globalised have used such policies, many of which (e.g., subsidies, domestic-content rules, reverse engineering of patented products) are currently not allowed under WTO rules.

Policy space is also required to ensure that important social and political ends – such as food security – are compatible with international trade rules. Developing nations should argue that recognizing these economic and political realities makes the global trade regime not weaker and more susceptible to protectionism, but healthier and more sustainable.

Increased Power

But with increased power comes increased responsibility. Developing nations will need to be more understanding and responsive to legitimate concerns in rich countries, and be more willing to pay for some global public goods. Capital-exporting developing nations should be willing to accept greater transparency in the operation of sovereign wealth funds and pledge not to use them for political purposes. The largest developing nations – China, India, and Russia – will need to shoulder some of the burden of reducing greenhouse-gas emissions.

Similarly, developing nations must understand that policy space is a two-way street. In countries like the US, where the middle class has reaped few of the benefits of globalisation in the last quarter-century, trade policy will be under severe pressure to provide some redress.

President-elect Barack Obama made the plight of the middle class a central plank of his successful campaign. His chief economic adviser, Larry Summers, has also been vocal of late on globalisation's adverse impact on workers.

It will not do much for good for developing countries to raise the specter of protectionism each time such concerns are voiced. Political and economic reality demands a more nuanced and cooperative approach.

Developing countries should say no to obvious trade protectionism, but they should be willing to negotiate to avoid regulatory races to the bottom in such areas as labour standards or corporate taxation. This is in their long-term self-interest.

Without support from the middle classes of rich nations, it will be difficult to maintain a global trade regime as open as the one we have had in recent years.

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