Center for American Progress

Transitioning to a New U.S. International Economic Policy

Toward a "Global Deal" to Revive and Broaden the Benefits of Growth

Richard Samans December 2008

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Executive summary

There is a great deal riding, both economically and politically, on the international community's ability to find the common ground necessary to reverse the current vicious circle in the world economy and turn it into a stronger virtuous circle of synergistic advances of living standards in rich and poor countries as they integrate.

The recent economic crisis, as well as the combination of rising inequality in many newly industrializing countries and stagnating real wages in the United States and other advanced industrialized countries, has sown doubts about whether global integration can live up to its billing as a force for shared progress. As a result, the social consensus behind free trade has frayed noticeably in recent years, particularly in developed countries.

U.S. international economic policy needs fundamental realignment to meet these challenges. Instead of expending scarce political capital on economically marginal free trade agreements, the new administration should focus on retooling and realigning the full spectrum of international aid, trade, and monetary policies so that they collectively serve to strengthen aggregate demand worldwide by building a larger, more prosperous global middle class.

Virtually every political leader around the world today perceives a vital national interest in the following:

1) Averting the worst-case scenario of a spiraling negative feedback loop of falling economic activity and deflation around the world.
2) Creating a stronger positive feedback loop of more broadly shared participation in the benefits of global economic integration among and within countries—what World Bank President Robert Zoellick calls "a more inclusive and sustainable globalization."

This common political imperative has created the conditions for an unprecedented exercise in international economic cooperation aimed at stabilizing the world economy and placing it on a stronger and more sustainable footing through a series of structural reforms. This is precisely the approach the creators of the New Deal took to our national economic crisis in the 1930s. The Roosevelt administration instituted a series of measures aimed at stabilizing the economy in the near term, including fiscal stimulus, public works, and bank restructurings. At the same time it pursued fundamental reforms intended to rebalance the country's underlying economic development model, including securities, banking and investment advisor reforms, the creation of Social Security and unemployment insurance, and labor law reform.

The Obama administration should rally the international community around a shared strategy to revive, sustain, and broaden the benefits of economic growth. This Global Deal should mobilize advanced and emerging economies to take coordinated, mutually reinforcing actions in two respects: measures to stabilize the world economy; and structural reforms that diversify the foundations of global growth and broaden its benefits by establishing a new paradigm of global economic integration—a Roosevelt Consensus—that places parallel and equal emphasis on liberalization and institution building.

Over the past generation, U.S. international, as well as domestic, economic policy has placed overriding emphasis on top-line growth—promoting economic efficiency through deregulation, privatization, trade liberalization, and fiscal balance. In the process, it has paid comparatively little attention to the importance of economic institutions to the fulfillment of the basic objectives of markets (resource allocation efficiency) and economies (broad-based progress in living standards).

Institutions matter to progress in rich and poor economies alike. They profoundly, albeit indirectly, influence the productivity of private investment—its contribution to sustainable labor productivity and economic growth—by shaping the incentives that investors face. Just as consequentially, but also indirectly, institutions affect the relative shares of labor and capital in national income. Arguably, the more the state retreats from the economy, the more important it is to have an effective enabling environment of investor rules and incentives such as financial supervision, corporate governance, transparency, property rights, judicial and exchange rate institutions, as well as other economic rules and incentives, such as labor, consumer, environmental, and social insurance institutions.

The fundamental political economy choice faced by modern market economies is not, as conservatives have been saying for the past generation, between big and small government. It is between functional and negligent government with respect to government's role in maintaining an enabling environment conducive to productive private investment and broadly shared prosperity. After the mortgage and derivatives market meltdowns, toy import scares, food safety disruptions, exchange rate misalignments, and energy regulatory uncertainties of recent years, this ideological blind spot of American policymakers has become glaringly obvious to people the world over, almost irrespective of political philosophy.

The world economy needs short-term stabilization. Yet it also needs structural rebalancing through institutional reforms to allocate capital stably and productively as well as translate the growth created by integration into the broadest possible gains in living standards. This will require the international community to go beyond the roadmap of macro-prudential institution building that was the focus of the G20 leaders' recent summit.

Policymakers in the United States and elsewhere are facing a growing output gap, falling prices, and monetary policy that is rendered increasingly ineffective by the kind of liquidity trap Japan experienced in the 1990s. They should therefore be looking to exploit significant additional potential sources of aggregate demand. Helping countries with high saving rates or current account surpluses make the structural transition to greater reliance on growth in domestic demand represents such an opportunity.

The new administration should place G20 leaders on notice that, after their April 2009 summit, it will seek to focus the group on a comprehensive, well-funded initiative to strengthen and redeploy the International Labor Organization, Development Finance Institutions, or DFIs, International Monetary Fund, World Trade Organization, in particular, to help developing countries to build better labor, social insurance, investor, consumer, environmental, and anti-corruption institutions to help them shift to greater reliance on domestic demand and diffuse the benefits of their integration into the world economy among larger shares of their populations. A central part of this effort should be to provide the mandate and resources necessary for the ILO and multilateral development banks, or MDBs, to scale implementation of the Decent Work agenda, and the IMF must also be given the mandate and resources necessary for it to be a more effective bulwark against exchange rate misalignments and massive, persistent current account imbalances.

This Global Deal should have a domestic component that includes not only a major additional stimulus package, but also enactment of a set of structural reforms that expand labor's share of national income by strengthening our domestic social contract in four areas: a universal, second tier pension program similar to that which exists in other countries; universal health insurance; major support for basic and tertiary education in less advantaged communities; and an upgraded, universal set of adjustment assistance benefits.

As we learned at an earlier stage of our own economic development, a strategy to place institution building on an equal par with integration and efficiency is a strategy to increase both equity and growth. Far from being mutually exclusive policy objectives, these can be mutually reinforcing. A Global Deal along these lines amounts to a populist approach to globalization in the best sense of the term, a concrete plan to make it work for more people.

By refocusing U.S. international economic policy on the goal of improving the quality of global economic integration and not simply its quantity, the new administration could help to avert the worst case scenario of a spiraling global recession and deflation as well as break the Gordian knot of politics on trade and globalization that has polarized Washington for far too long.

"Global Deal" Policy Overview

The new administration should place G20 leaders on notice that, after agreeing on a set of strong stimulus measures and financial supervision reforms at their April 2009 summit, it will seek to focus the group on a comprehensive, well-funded initiative to strengthen and redeploy the ILO, World Bank, and other development finance institutions, as well as the IMF and WTO.

This additional structural component of the international community's response to the economic crisis should consist of institution building in three areas of international economic policy: 1) helping developing countries institute the labor, investor, environmental, and consumer protections and basic social insurance programs that can help them to diffuse the benefits of trade and growth more broadly among their populations; 2) updating international financial institutions to enhance the stability and contribution to real economic activity of financial markets; and 3) improving the management coherence of the international economic system as a whole.

A central part of this effort should be to provide the mandate and resources necessary for the ILO and MDBs to scale implementation of the Decent Work agenda and for the IMF to be a more effective bulwark against exchange rate misalignments and massive, persistent current account imbalances.

1) Widen the gains from trade and integration.

Strengthen and focus the ILO on national labor and social insurance institution building.

- Establish system for measuring country progress and institutional capacity gaps on the main parameters of Decent Work and provide funding to countries requiring improvement in their labor statistical services ($50 million).

- Greatly expand financing of institutional capacity-building assistance to countries wishing to strengthen their key labor ministry functions, including inspection and administration of labor standards ($130 million), improve their ability to respond to specific problems identified by ILO Supervisory Body reports ($40 million).

- Greatly expand assistance to countries wishing to design and implement basic pension and unemployment insurance systems ($30 million).

Refocus development finance institutions on national economic institution building.

- Create Social Insurance System Catalytic Revolving Fund to help developing countries finance the creation or expansion of basic social insurance systems ($3 billion per year for five years).

- Greatly expand financial and technical assistance to developing countries that wish to create or improve investor, environmental, consumer and anti-bribery legal protections and public agencies responsible for administering them ($800 million).

Restructure trade policy priorities to reflect parallel emphasis on institution building.

- Frame the multilateral institution-building initiative described above as an equal and related companion to the international community's top trade liberalization priorities, including the multilateral Doha Development Round.

- Include major weaknesses in law or institutional capacity within the scope of FTA negotiations with developing countries for the purpose of developing a mutually agreed and adequately funded plan of development assistance to help reduce them over time.

- After a successful conclusion of the Doha Round, seek willing partners among Europe, Japan, and other industrialized countries to pursue under WTO auspices deeper economic integration through free trade, basic consistency of structural, regulatory, and exchange rate policies and institutions, and harmonization of FTA and trade preference programs.

2) Strengthen international financial stability and investment in the real economy.

- Provide the IMF greater independent authority to conduct exchange rate surveillance and facilitate macroeconomic coordination.

- Support a significant increase in the IMF's resources for the purpose of insuring member countries against the risk of currency crises, thereby reducing a corresponding incentive in the international monetary system for emerging economies to run large current account surpluses.

- Encourage greater investment in the real economy of emerging economies and boost their levels of domestic demand by shifting the focus of multilateral development bank operations from direct lending to risk mitigation and institution building related to private investment in the real economy, particularly with respect to infrastructure and clean energy systems.

3) Strengthen systemic coordination and oversight.

- Return the G8 process to its original mission of economic policy cooperation—allowing discussions on foreign policy only on the side—and indicate willingness to expand its membership to all G20 countries so that it can serve this purpose effectively.

- Expand the G8 to the G20 in conjunction with steps by emerging economies to share responsibility for reviving, sustaining, and broadening the benefits of global growth by shifting progressively to a greater reliance on domestic demand for growth through institution building and other reforms.

- Cultivate a culture of systemic oversight and collective responsibility among G20 leaders by requiring a joint report on the performance of the world economy each year from the IMF, World Bank, ILO, and WTO, signed and presented as a standing item on the G20 summit agenda by the heads of the organizations.

In addition, a Global Deal should include a domestic U.S. component of structural reforms aimed at supporting growth of median compensation and reversing the trend toward greater inequality. Our domestic social contract should be adapted to the circumstances of the global economy in four primary respects by establishing a universal, second tier pension program similar to that which exists in other countries; universal health insurance; major support for basic and tertiary education in less advantaged communities; an upgraded, universal set of adjustment assistance benefits; and a rebalancing of collective bargaining rules.

Introduction

The international economic challenges facing the new administration are numerous and daunting. Global economic growth is decelerating rapidly in the wake of the collapse of confidence in financial markets around the world. Global stock market capitalization is down more than a third since the summer, and the corresponding adverse wealth effect on households is only beginning to be felt in consumer behavior. U.S. export growth has cooled, after buoying the economy for most of 2008. The United States, European Union, and Japan have all experienced negative growth in the past quarter, and some economists have begun predicting not just a major U.S. recession, but also an outright global recession in 2009.[1]

As difficult as the macroeconomic environment may be, prospects for other longstanding U.S. foreign economic policy priorities are hardly rosier. The Doha round of multilateral trade negotiations remains stymied after collapsing in July, and many governments have all but given up on the negotations. Bilateral and regional trade liberalization efforts are faring no better. The South Korean and Colombian Free Trade Agreements are stalled in the U.S. Congress. Grand, U.S.-inspired plans for a Free Trade Area of the Americas and a comparable arrangement among Asia-Pacific Economic Cooperation countries have been quietly shelved over the past decade.

As for development assistance, the Bush administration's promises at the 2005 G8 summit to boost U.S. foreign aid have not been met, and this task has been made even more difficult by a skyrocketing U.S. fiscal deficit that is projected to approach $1 trillion or more in the coming year. Last, but certainly not least, the most fundamental challenge for international economic policy over the next generation—the need to place the world on a trajectory to stabilize atmospheric concentrations of greenhouse gases by mid-century—has gotten off to a very slow start despite a target of December 2009 for an agreement to succeed the Kyoto Accord. Indeed, the Chinese government recently appeared to have raised the stakes of these negotiations by publicly calling for developed countries to allocate at least 1 percent of GDP—about $140 billion for the United States—to help poor countries cut greenhouse gas emissions.[2]

The political context that the new administration's international economic policy team will operate in is at least as challenging as the economic one. Public confidence in globalization had reached a low ebb even before the financial crisis, as illustrated by the boisterous public debates over the North American Free Trade Agreement and outsourcing to Asia in recent years, as well as polling data showing that Americans' support for free trade had fallen to an all-time low. According to a CNN/Opinion Research Corporation poll from July, 51 percent of Americans view foreign trade as a threat to the economy—the first time that a CNN poll has shown a majority of Americans holding negative views on free trade. That compares with 35 percent of Americans who believed that free trade posed a threat to the economy in 2000.[3] Other polls have registered a similar shift in sentiment.[4]

Americans' increased skepticism of the benefits of globalization is far from unique. Many European countries are embroiled in at least as heated a debate about how to reconcile greater integration with emerging economies, their high standard of living, and a tradition of social equity. And several of the developing countries that are the biggest beneficiaries of globalization, such as India, South Africa, and China, are contending with related domestic political backlashes of their own as years of rapid but uneven growth have exacerbated inequality and marginalization in their societies.

In the United States and elsewhere, the intrinsic win-win nature of global economic integration—namely the notion that a rising tide of economic growth propelled by greater resource allocation efficiency will ultimately lift all boats—is being challenged as never before.

And that was before various governments committed an estimated $4 trillion of scarce public resources to backstop and restructure financial institutions caught up in a worldwide financial panic.[5] Now, with the enormous privatization of gains and socialization of losses represented by these taxpayer bailouts, there are rising demands around the world for major changes to be made in not only international financial supervision, but also the very model of global economic integration that has been pursued over the past generation—a model that has been closely associated with the United States through Republican and Democratic administrations alike.

The damage caused by the financial crisis to public finances and the real economy has given new moral and political urgency to the abstruse, long-running discussion among economists about what should succeed the so-called Washington Consensus of standard economic policy reforms traditionally recommended to developing countries by the International Monetary Fund, World Bank, and U.S. Treasury, which includes fiscal discipline, deregulation, privatization, and lower trade barriers.[6] As if the macroeconomic, macro-prudential, trade, and aid policy challenges it faces were not daunting enough, the new administration's international economic policy team will also find itself under pressure to shape this larger debate in a way that enables political leaders to demonstrate to their publics that they have drawn the appropriate lessons from the crisis and have a credible plan to shift the paradigm of globalization accordingly.[7]

Reassessing the pre-crisis paradigm of global economic integration

If the new administration wishes to avert a simplistic, ideological overreaction by the world to economic integration, then it should be prepared to reflect candidly about the relative merits and shortcomings of the policy mix that has been pursued and pattern of global economic integration that has ensued over the past generation.

Globalization in the image of the Washington Consensus has created a solid legacy of economic growth. The world economy has expanded at a strong pace in recent decades, growing at an average rate of 3.3 percent per year from1980 to 2007. World trade has grown by over 6 percent per year. Strong growth has contributed to rapid poverty alleviation, particularly in East and South Asia where it was strongest and average annual rates have been 8.6 percent and 6 percent, respectively.[8] More than 60 percent of people in China lived on less than a dollar day in 1980, but less than 20 percent do today. Excluding China, the poverty rate in developing countries has been falling by about half a percentage point per year.[9]

This "model" has performed well in terms of the top-line growth, or GDP per capita, but its track record on a crucial bottom-line measurement of economic performance—median living standards—has been far less favorable. Median wages and household incomes have been stagnant in the United States for the past quarter-century,[10] and other developed and developing countries have experienced a similar divergence between top-line and bottom-line performance. The Organisation for Economic Co-operation and Development reports that both income inequality and relative poverty have risen significantly over the past 20 years in more than three-quarters of member countries due to a combination of factors.[11] In the world as a whole, 51 out of 73 countries for which data are available have seen the share of wages as a portion total national income decline over the past two decades. The largest decline in the share of wages in GDP took place in Latin America and the Caribbean (-13 points), followed by Asia and the Pacific (-10 points), and the advanced economies (-9 points).[12]

The current model has also promoted a massive misallocation of financial resources in two primary respects, in addition to underperforming in the delivery of broad-based progress in living standards. First, particularly in the United States and United Kingdom, the financial sector's share in GDP has risen sharply. In the United States, it has doubled since the 1970s and risen by half since the early 1990s.[13] With losses in the U.S. financial system projected to exceed $1 trillion, it is now clear that this was an unsustainable reallocation of investment on a colossal scale. The related financial sector and real estate bubbles have imposed major costs on society. These include not only the wealth and jobs currently being destroyed by the sharpest downturn in 25 years, but also the opportunity cost of higher non-residential fixed investment and sustainable employment in the real economy that might have resulted if so much capital was not diverted to the financial and real estate sectors.

Second, the enormous capital account surpluses of several major emerging market countries since the Asian financial crisis represent a massive misallocation of capital in their own right. Since 2000, many developing countries have perversely served as bankers to the governments of the richest nations running large domestic savings and current account surpluses. If the goal of economic policy is to maximize human welfare, then there is little justification for poor countries to accumulate gargantuan stocks of foreign exchange reserves and lend them to rich country governments at extremely low rates of interest, when there should be much more profitable and socially useful ways to use that money in the real economy at home. Yet this is precisely the pattern that has characterized the international monetary system for the past decade, and it has restrained the pace of poverty alleviation and domestic consumption in developing countries.

These distortions in domestic and international capital allocation have contributed to the underperformance of median living standards. Diverting capital from investments in the real economy of rich and poor countries alike has undermined sustainable growth in global employment, wage income, consumer purchasing power, and aggregate demand. This is part of the reason why globalization has had trouble living up to its potential to lift all boats.

Toward a new paradigm for global economic integration

The conclusion that emerges from this stylized assessment of the Washington Consensus model of economic integration and development is not that its principal components are intrinsically flawed, but that they are incomplete and therefore overemphasized. Underperformance of median living standards, widening inequality, and misallocation of capital—the principal shortcomings of globalization—have their roots in policymakers' insufficient attention to institutional enabling environments. These include legal and regulatory frameworks as well as the institutional capacities necessary for them to be administered effectively, at both the national and global levels.

U.S. international and domestic economic policy has over the past generation placed overriding emphasis on top-line growth—promoting economic efficiency through deregulation, privatization, trade liberalization, and fiscal balance. It has, in the process, neglected the importance of economic institutions to fulfilling the basic objectives of markets (resource allocation efficiency) and economies (broad-based progress in living standards).

Institutions matter to progress in rich and poor economies alike. They profoundly, albeit indirectly, influence the productivity of private investment—its contribution to sustainable labor productivity and economic growth—by shaping the incentives investors face. Just as consequentially, but also indirectly, institutions affect the relative shares of labor and capital in national income. Arguably, the more the state retreats from the economy, the more important it is to have an effective enabling environment of investor rules and incentives such as financial supervision, corporate governance, transparency, property rights, judicial system, and exchange rate institutions, as well as other economic rules and incentives, such as labor, consumer, environmental, and social insurance institutions.

The recent blue-ribbon Commission on Growth and Development chaired by Nobel laureate economist Michael Spence reached a similar conclusion:

> In recent decades governments were advised to 'stabilize, privatize and liberalize.' There is merit in what lies behind this injunction—governments should not try to do too much, replacing markets or closing the economy off from the rest of the world. But we believe this prescription defines the role of government too narrowly. ... On the contrary, as the economy grows and develops, active, pragmatic governments have crucial roles to play ... Mature markets rely on deep institutional underpinnings, institutions

> that define property rights, enforce contracts, convey prices, and bridge informational gaps between buyers and sellers. Developing countries often lack these market and regulatory institutions. Indeed, an important part of development is precisely the creation of these institutionalized capabilities.[14]

America learned this lesson during its own industrial development, but seems to have forgotten it over the past generation in its conduct of both domestic and international economic policy. During the first several decades of the 20th century, we implemented several waves of policy reforms aimed precisely at achieving more balanced and sustainable economic growth by stimulating broader progress in living standards and correcting distortions in investor behavior. This was a response to the glaring inequality and economic imbalances accompanying our own rapid industrialization and national economic integration.

We constructed a national infrastructure of economic institutions that successfully broadened the base of our economic growth, from the landmark environmental, labor, investor and consumer protections enacted as part of Theodore Roosevelt's Square Deal; to the retirement and additional labor and investor protections of Franklin Roosevelt's New Deal; to the health, labor, consumer, and environmental protections of Harry Truman's Fair Deal and Lyndon Johnson's Great Society.[15] These institutions deliberately increased incentives to invest in industry as opposed to speculation in financial assets, and they diffused the benefits of the country's rapidly rising national income more widely among the population.

In the middle decades of the 20th century, these progressive reforms played a crucial role in making the American Dream of a middle-class lifestyle—rising incomes in line with growth in labor productivity, home and small business ownership, retirement and health security—accessible to millions upon millions of American families that had little accumulated wealth and relied entirely on wage income. In the process, they helped turn the United States into a middle-class society and mass-consumption locomotive of the world economy.

The fundamental political economy choice faced by modern market economies is not, as conservatives have been saying for the past generation, between big and small government. It is between functional and negligent government with respect to government's role in maintaining an enabling environment conducive to productive private investment and broadly shared prosperity. After the mortgage and derivatives market meltdowns, toy import scares, food safety disruptions, exchange rate misalignments, and energy regulatory uncertainties of recent years, this ideological blind spot of American policymakers has become glaringly obvious to people the world over, almost irrespective of political philosophy.

The principal lesson to be drawn from the recent financial crisis and broader legacy of globalization is that the conservative American economic model—including the Washington Consensus—was incomplete and unstable. It placed almost exclusive emphasis on measures to enhance top-line growth and neglected the need to strengthen investor and other economic institutions that help translate such top-line performance into the bottom-line measure of a country's economic success: strong, broad-based gains in living standards. Going forward, U.S. international economic policy must be rebalanced so that it places parallel emphasis on measures that advance efficiency and top-line growth, on the one hand, and measures that strengthen the institutional enabling environment for productive capital allocation and broadly shared prosperity on the other. Indeed, U.S. policymakers must regain their historical appreciation of how diversifying the foundations of economic growth in this fashion can accelerate economic growth further and make it more resilient.

A "Global Deal": Establishing a new consensus among advanced and emerging economies to revive and broaden the benefits of growth

The new administration's challenge will be to absorb this lesson regarding the importance of institutions in market economies, and, like its progressive, 20th century predecessors, translate it into an economically effective and politically compelling reform agenda. The key difference today is that the challenge is an international, rather than national, one. No country is an island in an interdependent global economy when it comes to pursuing strong growth, financial stability, and progress in median living standards. For this reason, the next "Deal" must evoke a global, rather than just national, sense of shared economic destiny. What is needed is a Global Deal that combines advanced and emerging economies in a coordinated strategy to revive economic growth and broaden its benefits.

Virtually every political leader around the world today perceives a vital national interest in the following:

- Averting the worst-case scenario of a spiraling negative feedback loop of falling economic activity and deflation around the world.

- Creating a stronger positive feedback loop of more broadly shared participation in the benefits of global economic integration among and within countries, or what World Bank President Robert Zoellick calls "a more inclusive and sustainable globalization."

This common political imperative has created the conditions for an unprecedented exercise in international economic cooperation aimed at stabilizing the world economy and placing it on a stronger and more sustainable footing through a series of structural reforms. This is precisely the approach the creators of the New Deal took to our national economic crisis in the 1930s. The Roosevelt administration instituted a series of measures aimed at stabilizing the economy in the near term, including fiscal stimulus, public works, and bank restructurings, at the same time that it pursued fundamental reforms intended to rebalance the country's underlying economic development model, including securities, banking and investment advisor reforms, the creation of Social Security and unemployment insurance, and labor law reform.

In their November 15 communiqué, G20 leaders committed their governments to a coordinated series of monetary and fiscal stimulus measures intended to stabilize the world economy in the short term. Major developed and emerging-market economies that have the necessary policy space, but have not yet adjusted monetary policy to an accommodative stance or instituted a temporary fiscal stimulus equivalent to at least 1 percent to 2 percent of GDP, should do so in the coming months.[16] As part of this effort, the new administration and Congress should enact a major second stimulus measure in the first quarter of 2009. And countries with large external surpluses or adequate fiscal headroom should follow suit with additional fiscal outlays, including China, whose budget is slightly in surplus; oil exporters; and other countries, including possibly South Korea, Mexico, and Taiwan.

As for structural reform, G20 leaders also instructed finance ministers to develop international financial architecture recommendations by spring 2009 primarily in the area of financial supervision. A strong package of reforms must be adopted as a result of this process. But it would be a mistake if the world's structural response to the crisis stopped there. Now is the time to undertake a broader set of coordinated institutional reforms at the global and national levels in order to turn a vicious circle into the sustained virtuous one promised by the theory of economic integration.

A Global Deal to revive, sustain, and broaden the benefits of growth would also engage advanced and emerging economies in a collective effort to strengthen international and national institutions so that they are better equipped to promote stable and productive allocation of capital within the international financial system as well as provide tangible support for developing economies wishing to construct stronger social insurance systems, and labor, environmental, consumer, and investor protections.

Domestic economic institution building along these lines has the potential to help these countries diffuse the benefits of the growth created by their integration into the world economy more widely within their societies. This would have the added benefit of making an ongoing structural contribution to growth in global aggregate demand, which would complement the one-off, short-term stimulus packages that some governments have begun to implement.

Economists have warned for years that huge global economic imbalances were unsustainable and that the world economy would inevitably require rebalancing. Temporary fiscal stimulus packages will help brake the current fall. But the hardness of the world economy's landing—the extent to which global aggregate demand holds up during and after a deep U.S. recession—will be strongly influenced by whether internationally coordinated steps are taken to structurally rebalance it. The world cannot expect to return to its traditional reliance on U.S. consumer spending for growth any time soon.

Policymakers in the United States and elsewhere are facing a growing output gap, falling prices, and monetary policy that is rendered increasingly ineffective by the kind of liquidity trap Japan experienced in the 1990s. They should therefore be looking to exploit significant additional potential sources of aggregate demand. Helping countries with high saving rates or current account surpluses make the structural transition to greater reliance on growth in domestic demand represents such an opportunity.

High saving rates are not principally a cultural phenomenon, and rapidly rising inequality is not an inevitable byproduct of economic development. These reflect acts or omissions of policy, including underdeveloped institutional frameworks. Stronger labor, consumer, investor, pension, unemployment, and health institutions tend to reduce incentives for households to save, and boost median incomes, which leads to structural improvement in domestic consumption, other things being equal.

As it happens, broadening social participation in the benefits of national income growth is already a top domestic political priority in many emerging market countries. The governments of India, South Africa, China, and Brazil, among others, openly describe themselves as being in a race against political time in this respect and should therefore be receptive to a win-win exercise in international economic cooperation to help them broaden the base of their economic growth in this fashion.

A cooperative effort to structurally rebalance the world economy along these lines could usefully be characterized as a new Roosevelt Consensus[17] on global economic integration and development in which advanced and emerging countries recognize that global and national economic institution building has to be elevated to a top priority of economic policy and integrated deeply into trade, development, and monetary strategies.

A Global Deal to more fully activate the world economy's virtuous circle based on the progressive (and originally bipartisan) Roosevelt model of industrial development would be based on a few shared principles:

- As emerging economies become more systemically significant through their industrialization and integration into global product and services markets, they have an obligation to assume a commensurate degree of responsibility for sustaining global growth and nourishing the world economy's virtuous circle of rising global living standards by rebalancing dependence on exports and domestic consumption for growth.

- Deeper integration between advanced and emerging economies should be accompanied by cooperative efforts to strengthen institutional environments in emerging economies to help ensure that the added growth stimulated by integration is translated to the greatest extent possible into broadly shared improvement in incomes, consumer purchasing power, and import demand. Developed countries have an obligation to strengthen relevant multilateral and regional institutions' capacity to deliver such institution building assistance, and emerging economies have an obligation to accept it, albeit in ways that they determine suit their national and developmental circumstances.

- Developed countries must do their part by keeping their markets open and taking parallel measures in their own institutional-enabling environments to assure financial stability and widen social participation in the benefits of growth and integration. In the United States, this points particularly to the need to adapt the domestic social contract to the global economy by improving Americans' access to adequate pensions, health insurance, basic and tertiary education, and adjustment assistance, as many progressives have argued, including former Representative and incoming White House Chief of Staff Rahm Emanuel.[18] It also argues for rebalancing collective bargaining rules in order to provide workers with a fairer opportunity to form unions. Such domestic structural reforms would help to reverse the erosion of labor's share in U.S. national income, raise domestic consumption, and thereby stimulate U.S. and global aggregate demand.

- Developed economies must afford emerging economies a greater role in decision making within multilateral economic institutions and arrangements as those emerging economies come to share responsibility for the vibrancy of the world economy by strengthening domestic economic institutions and relying to a greater extent on domestic demand.

- Reductions in trade barriers by developed and emerging economies should disproportionately benefit the least developed countries, and development assistance efforts should be increased to support achievement of the Millennium Development Goals.

Transitioning to a new U.S. international economic policy

The essential lesson of the global economic crisis is that deeper international economic integration and stronger institutional-enabling environments must be pursued in parallel and with equal emphasis. This new paradigm of globalization will need to be embedded in U.S. trade, aid, and monetary policies, and supported by a major renovation and coordinated redeployment of the major multilateral institutions relevant to the task: the International Monetary Fund, the World Bank and regional multilateral development banks, the International Labor Organization, and the World Trade Organization.

The structural component of the international community's response to the crisis should consist of institution building in three areas of international economic policy: 1) helping developing countries institute the labor, investor, environmental, and consumer protections and basic social insurance programs that can help them diffuse the benefits of trade and growth more broadly among their populations; 2) strengthening international monetary and macro-prudential arrangements to enhance financial markets' stability and contribution to real economic activity; and 3) improving the international economic system's management coherence as a whole.

The good news is that political circumstances have set the stage for progress on all three fronts. By virtue of the unanimous support for the International Labor Organization's Decent Work agenda, and the international financial architecture reform objectives set by G20 leaders at their November 15, 2008 summit, the new administration would be pushing on an open door if it chose to lead.

1. Institution building to widen gains from trade

The new administration need not start from scratch in gathering international support for an economic institution-building agenda that will widen social participation in the gains from trade and integration. There already exists a diplomatic consensus on a major part of this agenda that only awaits implementation: the International Labor Organization's Decent Work agenda.

In June 2008, government, business, and labor representatives at the ILO, which has 182 member countries, unanimously approved an ambitious agenda of institution building to widen social participation in the benefits of globalization through the Decent Work agenda. The strategic objectives of this effort are:

- Promoting employment by creating a sustainable institutional and economic environment.

- Developing and enhancing measures of social protection—social security and labor protection—that are sustainable and adapted to national circumstances.

- Promoting social dialogue and tripartite collaboration between workers, employers, and governments as the most appropriate method for, inter alia, making labor law and institutions effective. This includes promoting good industrial relations and building effective labor inspection systems while respecting and recognizing the employment relationship.

- Respecting, promoting, and realizing the fundamental principles and rights at work.[19]

This ILO Declaration on Social Justice for a Fair Globalization can be read as a multilateral commitment to apply the Roosevelt model of economic development to the process of globalization. This entails helping countries build labor, investor, and social insurance institutions as they industrialize and integrate into the world economy. But what this Declaration lacks in comparison to the Square and New Deals is a concrete implementation agenda, and that is where leadership by the new U.S. administration could make a crucial difference.

The next administration should build on the universal political support for the Decent Work agenda by mobilizing the international community to implement it through a set of concrete steps to:[20]

1. Strengthen the ILO in order to provide greatly enhanced support to developing countries that wish to build:

- Effective labor ministries to support improvement in wages and working conditions in line with labor productivity growth.
- Basic pension and unemployment insurance systems.

2. Refocus multilateral development banks and bilateral development assistance ministries on providing greatly enhanced support to developing countries that wish to build:

- Social security systems to support the living standards of the poor, elderly, and infirm, thereby reducing the incentive for households to forego consumption and save large proportions of their income.

- Investor protections to mitigate the risk of private investment in small businesses, infrastructure, and homeownership, thereby stimulating substantial additional employment creation.
- Ethical business cultures to reduce the large, deadweight cost to investment and employment creation from corruption.
- Consumer and environmental protection agencies to reduce health, environmental, and other costs accompanying industrialization.

3. Link multilateral and bilateral trade liberalization efforts to this economic institution-building agenda, framing the two as complementary parts of a larger strategy to translate expanded trade and investment into wider progress in living standards in developed and developing countries.

A well-funded multilateral institution-building initiative along these lines, framed as a plan to implement the Decent Work agenda in tandem with trade liberalization, would be a major step forward for both the economics and politics of globalization.

Strengthening the ILO and focusing it on national labor and social insurance institution building

Broad international support for the first part of this agenda—strengthening the ILO—already exists. The unanimous June 2008 ILO Declaration explicitly directs the organization's secretariat to develop a plan to strengthen its capacity to help countries improve information about their progress on the main parameters of Decent Work, including implementation of core labor standards; construct effective labor ministries, including labor law inspection and enforcement capacity as well the ability to remedy problems identified by the ILO's supervisory bodies; and establish basic social insurance systems.[21] The new administration should work closely with developing and developed country ILO delegations to help the secretariat design, fund, and implement a major expansion of the organization's activities in these three crucial areas of the Decent Work agenda. The new administration should also offer to fund a significant proportion of the necessary resources.

Measuring countries' progress on Decent Work and institutional capacity gaps

A tripartite international experts meeting in September 2008 on Measuring Decent Work developed the main elements of a global template for Decent Work Country Profiles. These profiles would draw together statistical information and descriptions of the legal and institutional framework under 10 dimensions of Decent Work. They aim to provide a way of comparing a country's current (or recent) position with a point in the past—say, 10 years ago. The profiles would thus have sufficient nation-specific information to be of use to constituents in assessing progress, and follow a standard framework, which would facilitate comparisons with other countries.

The profiles would be available on the web and therefore also act as a "portal" to connect to sources of data and information on employment and enterprise development, social protection, social dialogue, labor law, standards, and other relevant economic, social, and legal matters. The profiles would provide key information for the ILO's constituents and allow the organization as a whole to identify institutional gaps and improve the design of programs to remedy weaknesses, including through country-specific studies.

There are two pressing priorities for implementing a system to improve the transparency and benchmarking of country progress on key aspects of Decent Work. The first is to establish a system in the ILO to generate country profiles at the rate of 30 per year over the next six years in order to have full coverage by 2015. The second is to strengthen the technical assistance to build in-country capacity for the collection, compilation, and analysis of the labor statistics that will be included in such profiles. Least-developed countries in particular, but also several mid-income developing countries, are not currently able to pull together all the labor market information they need for good policymaking and evaluation. The core of such services is a reasonably frequent labor force survey. The ILO is currently offering advice in this field, but is able to meet only a small number of the many requests received. The estimated annual cost of these reforms would be $10 million to establish a comprehensive set of country Decent Work profiles within the ILO and $40 million in direct assistance to country labor ministries to improve their statistical services.

Providing institutional capacity building assistance to labor ministries

Over the last 10 years, good governance has become a watchword in many areas of public life. At the heart of good governance is the issue of regulatory compliance and how to implement good practice. In the labor field, this is focused on implementing international labor standards, in particular the five core labor standards: freedom of association, right to collective bargaining, elimination of all forms of forced or compulsory labor, effective abolition of child labor, and equality of opportunity and treatment. National labor administration and labor inspections services hold the primary responsibility for implementing international labor standards taken into national laws. The new ILO Declaration on Social Justice specifically mentions the need for "effective labor inspection."

Private enterprises and non-governmental organizations are increasingly taking on these responsibilities in developing countries because of the lack of capacity in such labor inspectorates. However welcome such private initiatives may be, they are no substitute for good laws that are broadly applied and therefore influence the behavior of all employers and not just those which espouse corporate social responsibility.

Advisory and capacity-building services in the two closely related fields of labor administration and labor inspection have been part of the ILO's work since its foundation. Yet there is an urgent need to integrate and greatly expand the limited and scattered resources in the ILO into a more effective service. Similar to the approach recommended above for measuring country progress on Decent Work, the ILO should help countries strengthen labor administration and inspection in a two-track approach of developing country capacity-building plans based on identified gaps and providing direct support to their labor ministries to remedy them. The estimated annual cost of these reforms is $10 million to work with countries to assess gaps and develop plans, and $120 million in direct assistance to country labor ministries to strengthen the administration and inspection of their labor standards.

Helping countries address ILO supervisory body findings

Each year the ILO undertakes an extensive examination of countries' actions to implement international labor standards. This leads to often-detailed recommendations on how countries could adapt their laws or the way they are enforced. In most cases countries are ready to cooperate with the ILO to make the necessary reforms and strengthen their enforcement mechanisms. A few are not, and this can lead the ILO to escalate pressure on them to respect the standards. Attention needs to be focused not just on the few cases where there is a failure to cooperate, but also on the ILO's capacity to systematically help those who state that they are willing to follow up on the recommendations of the ILO's supervisory bodies.

The ILO Committee of Experts on the Application of Conventions and Recommendations has called for an increase in the ILO's technical assistance to countries in order to help them meet their obligations under ratified conventions. In its 2008 report, the committee identified 39 countries that it was concerned enough about to invite them to use ILO technical assistance to remedy weaknesses in their law and practice. Several countries each year call for such assistance, but the ILO is not at present able to meet all the requests.

A reinforced ILO program to follow up on the findings of its supervisory bodies would cover a variety of situations. In some cases, this involves technical redrafting of laws; in others, it requires more in-depth dialogue and analysis of ways in which international principles can be integrated into national systems for labor market governance. They range from the small-scale technical assistance, advisory, and training services to public authorities, trade unions, and employer associations, to large-scale technical cooperation projects aimed at creating new public institutions and assisting voluntary associations of employers and workers. Rapid reaction capacity is needed to address particularly troubling and serious cases of non-observance of labor standards. The estimated cost of boosting the ILO's own capacity to systematically follow up on the findings of its supervisory bodies is $10 million per year with a further $30 million per year for technical assistance to countries implementing the measures required to come into conformity with their obligations under international labor standards.

Providing institutional capacity-building assistance for the design and administration of basic social insurance systems

Experience in OECD countries over many years has shown that social protection is a powerful instrument to fight poverty and inequality. Positive and encouraging examples in Africa, Latin America, and Asia have also shown how basic social security of a modest scale can be implemented successfully. For example, in Botswana, South Africa, Namibia, and Mauritius, a universal basic pension has had positive effects on poverty reduction. Countries such as Brazil, Mexico, and some parts of India have gained substantial experience in using social transfers in fighting poverty. A package of basic guarantees is the launching platform for a further social security development process that provides more security when governments' "fiscal space" increases as economies continue to develop.

Development planners assumed for a long time that poor countries could not afford social security. But ILO calculations show that a basic package or important parts thereof are affordable in sub-Saharan Africa and Asia.[22] A small universal flat rate pension benefit combined with a universal child benefit—possibly conditional on school attendance—has the potential to lower the number of people living in poverty by 40 percent in some developing countries. The cost for these benefits would amount to no more than 3 to 4 percent of GDP. Expenditure of this size can be manageable—especially if basic schemes are phased in gradually over the course of a decade and perhaps catalyzed with initial financing by the donor community.

A necessary condition for the successful introduction of social security schemes is the availability of sufficiently trained experts that are able to plan, organize, finance, and administer the transfer payments. This requires considerable technical capability, which can only be built up through substantial investments in the technical training of national managers and planners.

The ILO maintains a small team of experts who provide advice and training to countries wishing to establish or expand their social insurance programs. What is needed is a major expansion of capacity-building activities to help developing countries design and estimate the costs of national social security development plans. This could be done by establishing regional competence centers staffed by lawyers, public policy specialists, training specialists, public finance economists, and actuaries who have the capacity to provide sustained technical input into national tripartite dialogue and planning processes, starting from the initial diagnosis of the social and fiscal situation and extending to help with the development of national social budgets, actuarial projections, and national laws. About five such centers would be appropriate—two in Africa, two in Asia, and one in Latin America.

The ILO should also sponsor a system of fellowships for national staff to attend social protection and governance master's programs in a network of universities in Europe and the United States such as the Universities of Maastricht, Lausanne, Sussex, and the Kennedy School. The regional centers of competence could grow over time into Schools of Governance in their own right with the help of this international network. For example, the Maastricht School of Governance grew out of a course initially sponsored by the ILO.

The budget would be about $15 million for five centers of excellence, staffed by 10 to 15 professionals undertaking activities in about 30 to 40 countries and administering 100 fellowships for future social security planners per year. Additional support for the regional schools of governance would bring the annual cost to about $20 million. After a period of five years, there could be functioning national basic social security systems in about 20 countries and a global network of about 8 to 10 Schools of Governance that would train social security managers and planners. National and regional co-financing would be needed to help keep the network alive thereafter.

Focusing development finance institutions on national economic institution building

Development finance institutions, or DFIs, such as multilateral development banks and bilateral aid ministries currently pay scant attention and devote few resources to helping countries implement basic safety nets and adequate investor, antibribery, consumer, and environmental protections. The foreign aid community acknowledges that these institutions are important to broad-based economic progress, but it has yet to translate this recognition into serious action. Aid statistics indicate that less than 6 percent of official development assistance is devoted to social safety nets (2.91 percent) and capacity building (2.80 percent).[23]

Even these modest numbers are an overstatement of the aid community's emphasis on economic institution building, and social insurance systems in particular. For example, World Bank lending for pension systems averaged only $400 million per year between 2002 and 2007, and much of these funds were devoted to helping countries restructure or rationalize their systems in line with demographic challenges, rather than creating or expanding coverage. Two-thirds went to upper-middle income countries.[24]

In addition, most institutional capacity-building assistance provided by DFIs takes the form of technical assistance "pilot" projects that tend to recommend legal frameworks and outline best practice rather than finance the actual institutional capacity necessary to scale implementation of such frameworks and practices. Yet financing public administrative capacity to close the gap between law and practice is precisely what DFIs need to do to help countries achieve a more inclusive pattern of economic growth through robust private sector investment and formal job creation on the one hand, and basic safety nets to support a minimum standard of living for the poor on the other. This shift in focus will be necessary for DFIs to remain relevant in middle-income developing countries that no longer rely on their loans or qualify for their concessional assistance, yet continue to experience substantial poverty and inequality.

Financing basic social insurance systems

The ILO has conducted a number of studies indicating that developing countries can sustain a comprehensive basic social security package starting with benefits such as universal pensions or social assistance at a cost of 1 to 2 percent of GDP, or 5 to 10 percent of national budgets.[25] Implementing this level of benefits would represent a major step toward attacking chronic poverty in these countries. For example, an ILO simulation exercise suggests that even a very modest universal pension, costing about 1 percent of GDP, would reduce the poverty gap in Senegal and the United Republic of Tanzania by more than 20 percent.[26]

As for middle-income countries, a study of five Asian countries suggests that, with reasonable fiscal reform, all should be able to carry a basic benefits package through the allocation of 20 percent of government revenues.[27] A fuller benefits package could be financed in two out of the five countries, and the others would be capable of closing their domestic finance gap over three decades through the phased introduction of benefits, budget support from international donors, or an increase in the resource base of the national social budget.

The case can even be made that the net cost of early investments in a basic set of social security benefits will be zero or negative when secondary productivity growth effects are taken into account. For example, it has been documented that Mexico's basic conditional cash transfer program, Oportunidades, reduces adult sick days on the job by about 19 percent. The cash-for-education program in Bangladesh increased the lifetime earnings of beneficiaries by 25 percent.[28] If GDP increased by 10 percent due to productivity improvements linked to basic social security schemes, then modest schemes would pay for themselves over time. With complementary investment in tax collection mechanisms, tax revenues could be expected to increase in line with growth, creating the additional necessary fiscal space. There are naturally countries in which the fiscal space for social transfers cannot be easily found in the near term. Each country would require its own feasibility analysis.

The ILO is best equipped to help countries design retirement and unemployment security systems and train the public administrators necessary to implement them, per the recommendation above. But DFIs should be given the mandate and resources needed to provide substantial initial co-financing to countries wishing to undertake fiscal reforms to establish or expand coverage of these and other basic social insurance systems, such as those for health and child poverty.

The necessary catalytic financing should be provided through a joint, revolving loan facility in which countries receive medium- to long-term loans, including loans on concessional terms for low- and low-middle-income countries. The ILO should be part of the governance of this facility to ensure that financing decisions on basic pension and unemployment systems are coordinated with the technical assistance provided by the ILO. This Social Insurance System Catalytic Fund might even be constituted as a separate financing vehicle, similar to the Global Environment Facility, in which the World Bank serves as trustee, but other relevant agencies participate fully in disbursement decisions. Given the powerful, direct role of social insurance systems in reducing poverty, the funds provided by donors to this facility would be considered a central part of their official development assistance commitments to achieving Millennium Development Goal 1. The estimated annual cost of these reforms is about $3 billion per year for five years to capitalize the revolving loan facility.

Financing implementation of investor, consumer, environmental, and anticorruption protections

Financing social insurance systems requires far more money than establishing functioning national institutions to administer investor, consumer, environment, and antibribery laws. However, a similar partnership approach is needed with developing countries in which DFIs agree to co-finance the hiring and training of public administrators for an extended, initial period.

The ILO is the natural partner of countries wishing to build more effective labor ministries, whereas DFIs are the natural partners of countries wishing to build more effective banking, securities, judicial, auditing, consumer, environmental, and anticorruption agencies. This will require DFIs to recast their role and reengineer their capabilities. In all but the least-developed countries, their central added value lies increasingly in helping countries create the institutional-enabling environment needed for sustained private investment and broader social inclusion in national prosperity. In these settings, they should be principally institution builders rather than bankers—enablers of private sector investment rather than alternatives to it. This will require a major shift in DFIs' skill set and operating style, including the development of extensive partnerships with pools of expertise existing in governmental agencies and the private sector. The estimated annual cost of these reforms is roughly $800 million across the five major multilateral development banks.

Restructuring trade policy priorities

A new approach that places parallel emphasis on institution building and trade liberalization in order to strengthen the payoff to broad living standards from integration would imply important changes in trade policy priorities.[29]

The new administration should first present this multifaceted agenda of economic institution building assistance for developing countries as an equal and related companion to the international community's top trade liberalization priorities, including the multilateral Doha Development Round.

Second, before the new administration enters into a free trade agreement negotiation with a country or region, it should conduct an interagency assessment of the extent to which improvements should be sought in labor, environmental, consumer, or investor laws and institutions in order to strengthen the payoff to broad living standards from such an agreement. Major weaknesses in law or institutional capacity identified by this analysis should be included within the scope of the FTA negotiations for the purpose of developing a mutually agreed and adequately funded plan of development assistance to help the country reduce the weaknesses over time. The scale, design, and timeline of the agreed economic institution building should be adapted to a country's level of economic development as well as its national circumstances.

Third, the administration should resist the temptation to view Europe, Japan, and the Asian tigers as presenting opportunities to extend the prevailing patchwork, narrowly commercial approach to FTAs that has characterized U.S. trade policy. Instead, it should view more advanced countries in various regions as potential partners in a vanguard, global club of advanced economies that agree to pursue deeper economic integration through both free trade and the basic consistency of structural, regulatory, and exchange rate policies and institutions. The objective would be to build an inner multilateral core of countries in the world trading system in which trade and investment flow freely and raise median incomes synergistically without undue distortion from disparate institutional environments. This is a better organizing principle for deep integration than geographical proximity (APEC or a Transatlantic Free Trade Area) or rivalry (the desire to create a counterweight to China).

Some years after a successful conclusion of the Doha Round, the administration should seek willing partners for such negotiations among Europe, Japan, Australia, and other industrialized emerging market countries that have well-developed regulatory regimes in the key areas of labor, environment, consumer safety, and investment, as well as market-determined exchange rates. The idea would be to eliminate tariffs and harmonize the various rules of origin and other miscellaneous features of the group's various and sometimes overlapping free trade agreements that serve to complicate business and divert trade around the world. The talks should also seek to harmonize trade preference regimes with low-income countries. A multilateral process to harmonize FTA and trade preference programs among advanced countries would represent a sensible intermediate step for the WTO to take between the Doha Round and the ultimate 21st-century goal of a worldwide free trade area, which is presumably decades away.

The best hope for transcending the polarization and caricature of the current trade debate is to ground it in this wider, developmental context. Combining trade liberalization with a new focus on providing incentives for countries to build the institutional capacity necessary to help them expand employment, build social safety nets, and support improvement in wages, working conditions, and consumer purchasing power, has the potential to change the chemistry of trade negotiations by framing such agreements more clearly as means to an end rather than ends in themselves. This would also help to turn the increasingly fractious internal U.S. trade debate in a more constructive, outward-looking direction, focusing it on the question of how to use all of the international and domestic policy tools available to make globalization a win-win race to the top rather than a negative sum game race to the bottom.

2. Institution building to strengthen international financial stability and investment in the real economy

Cross-border capital flows and financial innovation have been allowed to outpace global institutional arrangements with respect to both financial supervision and the international monetary system. There is now a general consensus to strengthen the relevant institutions, as evidenced by the reform objectives agreed to at the recent G20 summit in Washington.[30] But there may be a tendency for policymakers in the heat of the crisis to reach agreement on a set of supervisory reforms and gloss over deep-seated problems in the international monetary system that contributed to the crisis. This would represent a major missed opportunity to strengthen the world economy's virtuous circle.

Persistent misalignments and major fluctuations in exchange rates have plagued the international monetary system over the past generation. These have sometimes subjected American workers' livelihoods to extraordinary volatility and dislocation for reasons having little to do with the underlying competitiveness of the industries in which they work. Reforms are needed to reduce the incentive for emerging market countries to undervalue their exchange rates and accumulate large foreign exchange reserves as a hedge against a future financial crises and runs on their currencies. And better mechanisms need to be developed that systematically encourage all governments to think harder about the international implications of their domestic fiscal and monetary policy choices. These objectives can best be achieved by strengthening the IMF's mandate and resources.[31]

It is neither feasible nor desirable to return to a system of fixed exchange rates, but there are less revolutionary steps that could be taken to lessen the likelihood of prolonged misalignments and dramatic swings of currency parities within the current flexible exchange rate system.

First, we should strengthen the IMF's mandate and capacity to publicly and privately assess the appropriateness of exchange rate parities, as well as facilitate macroeconomic policy coordination to prevent or redress persistent misalignments.[32] The fund took an important step in this direction in 2006 when its board approved a process of multilateral surveillance—a series of consultations with key governments to examine the systemic implications of exchange rate relationships and policies. However, this process has been slow to develop, and it suffers from a lack of transparency, independence, and candor in implementation, including individual countries' ability to veto publication of fund analyses of their policies.[33]

These problems have arisen, in part, because country surveillance activities are ultimately the responsibility of the fund's executive board of shareholder governments rather than its professional staff. As such, the fund rarely states directly that countries are pursuing policies that seriously impede the adjustment of economic imbalances or undermine global economic stability, even though that has clearly been the case in recent years with respect to China and a number of other countries. Nor does the fund invoke its authority to require special consultations when member countries fail to respect their longstanding obligation under the fund's articles of agreement to avoid manipulating exchange rates. In fact, this authority has only been exercised twice since its creation in 1979.

The next administration should work with other members of the fund's board to strengthen the institution's independence in the execution of its surveillance and macroeconomic coordination functions. The new administration should not only continue to authorize the public disclosure of its own bilateral and multilateral surveillance discussions with the fund; it should also invite the fund's staff to give greater prominence to its independent estimates of the U.S. dollar's equilibrium range against other important currencies in order to mobilize additional market and political pressure on problem cases.

Second, the new administration should declare itself open to a significant increase in the fund's resources for the purpose of insuring member countries against the risk of currency crises and reducing the corresponding incentive in the international monetary system for emerging economies to run large current account surpluses. U.S. administrations have, over the years, been reluctant to agree to increases in IMF resources in part because these require approval by a traditionally skeptical Congress, which they feared would extract a high price in the form of changes to other aspects of U.S. international economic policy. However, this skepticism has been based largely on a perception by many Democrats and Republicans that the fund takes an unnecessarily contractionary approach to macroeconomic adjustment in developing countries. Since this reform would help to reverse an important bias against global growth in the international monetary system, and it would form part of a broader strategy involving trade, aid, and other policies to improve globalization's contribution to progress in living standards, Congress would be likely to view this initiative in a different light.

Finally, the new administration has an opportunity to encourage greater investment in the real economy of emerging economies and boost their levels of domestic demand by shifting the focus of multilateral development bank operations from direct lending to risk mitigation and institution building related to private investment in the real economy, particularly infrastructure. There are enormous unmet infrastructure needs in these countries, growing pools of domestic capital, and plenty of foreign investors with potential interest in investing in such projects if not for their regulatory, currency, contractual, and other risks. The DFIs could help to mitigate these risks on a much larger scale than they now do, but they by and large retain a direct lending and grant-making culture that remains relevant to the least-developed countries, but is less so for the much larger group of middle-income countries. As a result, as of 2007 they had unused capital representing about $200 billion of potential commitments.[34]

Massive infrastructure investment is a great boon for domestic demand and could contribute greatly to helping countries shift over time from export-oriented to more balanced growth with positive spillover benefits for their middle classes and ours. For example, the World Bank estimates that increasing Latin America's infrastructure investment to the typical level in East Asia would contribute an additional 1.4 to 1.8 percent in annual GDP growth and reduce income inequality by 10 to 20 percent in the region.[35] The global energy and water infrastructure investment gaps in poor countries are estimated to be $80 billion and $50 billion per year, respectively, with another $30 billion plus to make the energy clean energy.

A key foreign aid priority of the next administration should be to transform the general culture, skill set, and capital allocation of MDBs for the purpose of greatly expanding their partial guarantee and regulatory technical assistance activities, particularly with respect to infrastructure. President Zoellick's stated interest in modernizing the World Bank and having it become more innovative and sophisticated in taking and managing risk in the manner of private investment banks presents an important opportunity in this respect.

As part of this general shift away from direct lending and toward risk sharing, the United States should seek to build up MDB support for clean energy infrastructure as an integral component of a post-2012 climate agreement under the UN Framework Convention on Climate Change. This kind of assistance—public capital leveraging larger amounts of private capital by mitigating risk and buying down the incremental cost of clean technology solutions—will be needed to help convince major developing countries to participate in a global response to climate change. Their participation is vital to assuring that reductions agreed to by the United States and other advanced industrialized countries will not be neutralized by rapid emissions growth from their continued economic development.

The G8 requested in 2006 that the MDBs develop a Clean Energy Investment Framework that would help respond to this problem by using MDB and other donor resources to catalyze private sector investment in low-carbon energy systems in developing countries. The new administration could galvanize progress under this emerging framework, as well as improve the prospect of a successful post-Kyoto accord by committing significant sums on a matching basis with other donor governments. The funds would go to a cross-MDB facility that would be authorized to deploy grants, concessional loans, and/or partial risk guarantees as necessary to catalyze private investment in strategically important clean energy investments in developing countries such as clean coal, natural gas, and large-scale renewables.[36]

There is considerable scope for designing such infrastructure investment programs to maximize the creation of decent work opportunities and, where necessary, plan well in advance for transitions out of unsustainable activities. The ILO and the UNEP are pioneering a green jobs initiative with international trade unions and business that would build international employment and social dimensions into strategies to mitigate and adapt to climate change.

3. Institution building to strengthen systemic coordination and oversight

One of the greatest institutional weaknesses of global economic integration is the absence of integrated oversight of the various international economic ministerial processes and multilateral organizations. The original mission of the G6 when it was created in 1975 was international economic cooperation.[37] But the G7 and G8 have never taken this job seriously, and they no longer have the right composition even if they were so inclined. As a result, G8 summit agendas continue to be dominated by a wide range of non-economic issues. And national finance, development, trade, labor, and other ministries, as well as the corresponding multilateral organizations, continue to exhibit a high degree of silo thinking and uncoordinated action.

The next administration should build on the Bush administration's recent convening of G20 leaders by returning the G8 process to its original mission of economic policy cooperation—allowing discussions on foreign policy only on the side—and expanding its membership to include all G20 countries so that it can serve this purpose effectively. By limiting the formal scope of discussions to economic and related aspects of global governance, there would be a clearer logic to institutionalizing the participation of major emerging market economies, including those whose participation is controversial in the context of a general foreign policy summit because they are not democracies.

Indeed, the new administration should hold out the prospect of a formal expansion of the group as an integral part of its proposed Global Deal to galvanize closer cooperation between advanced and emerging market economies to revive, sustain, and broaden the benefits of global growth. If emerging economies demonstrate a willingness to share responsibility for the stewardship of the world economy by delivering on their part of the bargain,[38] then they certainly deserve to be permanent members of this leader-level process to oversee the progress of the world economy and its primary multilateral institutions.

To cultivate a culture of systemic oversight and collective responsibility within the group, G20 leaders should require the IMF, World Bank, ILO, and WTO to prepare a joint report on the performance of the world economy. This report should be signed by the heads of the organizations and presented by them each year as a standing item on the G20 summit agenda. It should analyze trends in growth in economic activity, trade, capital flows, employment, and living standards, and document how the four multilateral institutions are working together to improve these trends. Strengthening the joint accountability of these institutions to heads of government should improve cooperation among them and help ensure that all relevant international economic policy tools are being applied in an integrated fashion to the challenge of maximizing the contribution to global growth and broad living standards of global economic integration.

Conclusion

There is a great deal riding, both economically and politically, on the international community's ability to find the common ground necessary to reverse the current vicious circle in the world economy and turn it into a stronger virtuous circle of synergistic advances of living standards in rich and poor countries as they integrate.

The recent economic crisis, as well as the combination of rising inequality in many newly industrializing countries and stagnating real wages in the United States and other advanced industrialized countries, have sown doubts about whether global integration can live up to its billing as a force for shared progress. As a result, the social consensus behind free trade has frayed noticeably in recent years, particularly in developed countries.

U.S. international economic policy needs fundamental realignment to meet these challenges. Instead of expending scarce political capital on economically marginal free trade agreements, the new administration should focus on retooling and realigning the full spectrum of international aid, trade, and monetary policies so that they collectively serve to strengthen aggregate demand worldwide by building a larger, more prosperous global middle class.

To this end, the Obama administration should rally the international community around a shared strategy to revive, sustain, and broaden the benefits of economic growth. This Global Deal should mobilize advanced and emerging economies to take coordinated, mutually reinforcing actions in two respects: measures to stabilize the world economy; and structural reforms that diversify the foundations of global growth and broaden its benefits by establishing a new paradigm of global economic integration—a Roosevelt Consensus—that places parallel and equal emphasis on liberalization and institution building.

The world economy needs short-term stabilization, but it also needs institutional deepening to allocate capital stably and productively, as well as translate the growth created by integration into the broadest possible gains in living standards. Economic institution building along precisely these lines was crucial to America's success in creating broad-based prosperity and stronger, more stable growth as its economy integrated nationally in the 20th century. It also holds the key to humanizing globalization and making it more sustainable.

But this institution building will require the international community to go beyond the roadmap of macroprudential institution building that was the focus of the G20 leaders' recent summit. The new administration should place G20 leaders on notice that, after their April 2009 summit, it will seek to focus the group on a comprehensive, well-funded initiative to strengthen and redeploy the ILO, DFIs, IMF, and WTO to help developing countries build better labor, social insurance, investor, consumer, environmental, and anticorruption institutions as necessary to diversify the foundations of their economic growth and diffuse the benefits of their integration into the world economy among larger shares of their populations. A central part of this effort should be to provide the mandate and resources necessary for the ILO and MDBs to scale implementation of the Decent Work agenda, and the IMF must also be given the mandate and resources necessary for it to be a more effective bulwark against exchange rate misalignments and massive, persistent current account imbalances.

The Global Deal should also have a domestic component that includes not only a major additional stimulus package, but also enactment of a set of structural reforms that expand labor's share of national income by strengthening our domestic social contract in four areas: a universal, second-tier pension program similar to that which exists in other countries; universal health insurance; major support for basic and tertiary education in less-advantaged communities; and an upgraded, universal set of adjustment assistance benefits.[39]

As we learned at an earlier stage of our own economic development, a strategy to place institution building on an equal par with integration and efficiency is a strategy to increase both equity and growth. Far from being mutually exclusive policy objectives, these can be mutually reinforcing. A Global Deal along these lines amounts to a populist approach to globalization in the best sense of the term—a concrete plan to make it work for more people.

By refocusing U.S. international economic policy on the goal of improving the quality of global economic integration and not simply its quantity, the new administration could help to avert the worst case scenario of a spiralling global recession and deflation as well as break the Gordian knot of politics on trade and globalization that has polarized Washington for far too long.

Endnotes

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