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

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

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.

About the author

Richard Samans is a Senior Fellow at the Center for American Progress and managing director of the World Economic Forum, responsible for the forum's multistakeholder partnership initiatives and its relations with the intergovernmental community. A member of the forum's managing board, Richard has developed the organization's portfolio of multistakeholder projects, which currently engage over 300 forum member companies in action-or policy-oriented work in collaboration with experts from official, civil society, academic, and other institutions, while helping to structure the global issues program content of the forum's meetings.

Before joining the forum in 2001, Rick served as special assistant to the president for international economic policy in the U.S. White House. As senior director of the National Security Council's International Economic Affairs directorate and a senior staff member of the National Economic Council, he assisted President Bill Clinton on a broad range of international trade and financial policy matters. From 1996 to 1998, Richard served as economic policy advisor to U.S. Senate Democratic Leader Tom Daschle (D-SD). He assisted Senator Daschle and the Senate Democratic Caucus on international trade and monetary, tax, and broad economic policy issues. He served previously in a variety of roles in government, the private sector, and research institutions.

Acknowledgments

The author wishes to thank Sarah Rosen Wartell, Will Straw, Sabina Dewan, Michael Ettlinger, and other colleagues of the Center for American Progress, as well as Juan Somavia, Stephen Pursey, and other colleagues at the International Labor Organization for their invaluable feedback and suggestions. The views expressed are the author's alone.

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is "of the people, by the people, and for the people."

Center for American Progress

1333 H STREET, NW, 10TH FLOOR, WASHINGTON, DC 20005 • TEL: 202-682-1611 • FAX: 202-682-1867 • WWW.AMERICANPROGRESS.ORG