Globalization and Democracy-Enhancing Multilateralism: A Structuralist Interpretation

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ABSTRACT

International cooperation, especially on a multilateral basis, has lost ground in recent years. This process has been accompanied by the devaluation of core democratic values in many developing and developed countries. The specific form adopted by globalization since the late eighties and early nineties (Rodrik's "hyper-globalization") is central for understanding why this has occurred. Keohane et al (2009) define a set of conditions required for a "democracy-enhancing multilateralism", which would allow multilateralism and constitutional democracy to go hand in hand. Drawing from the Structuralist tradition in the theory of economic development and trade, we argue that these conditions are necessary but not sufficient. A viable form of multilateralism requires an additional condition, namely the provision of global public goods to curb the negative economic and political externalities that inevitably emerge in an international system marked by strong asymmetries in specialization and technological capabilities.

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1. Introduction

Two interrelated puzzles have become particularly apparent in the international political economy in recent years. The first puzzle is that international cooperation is declining precisely at a moment in which its importance for curbing global negative externalities has increased. Climate change is the canonical example of such externalities, but also economic and political instability in one country being transmitted to the rest of the world in an amplified scale. Instead of furthering cooperation, the response of key players in the international system has been moving towards conflict, rivalry, nationalism and the weakening or abandonment of international agreements, especially those of a multilateral nature[1]. The second puzzle is that core values and contents of democracy are being devalued precisely at a moment in which the number of countries considered democracies is at an historical high. Racial and gender discrimination, threats to minorities and civil rights, along with the loss of confidence on democratic institutions and the political establishment, have spread both in developed and developing countries[2].

This paper argues that understanding these puzzles requires rethinking the importance of global public goods in a world marked by international asymmetries. We take as a point of departure two important contributions in the tradition of liberal institutionalism. On the one hand, Rodrik's trilemma states that deep global economic integration ("hyperglobalization") cannot coexist with a world of democratic national states because democratic governments inevitably interfere with the free mobility of goods, capital and labor (Rodrik, 2011, p172-177). On the other hand, Keohane, Macedo and Moravcsik (2009, pp. 6-8, henceforth KMM) lay down the conditions that would allow multilateralism and democracy to reinforce each other. KMM, however, do not discuss whether the combination of multilateralism and democracy is compatible with increasing

[1] See Hu and Spence (2017).
[2] See Diamond (2015), Rodrik (2018) and Galston (2019). See also The Economist, "What's gone wrong with democracy", http://www.economist.com/news/essays/21596796-democracy-was-most-successful-political-idea-20th-century-why-has-it-run-trouble-and-what-can-be-do, on December 18th 2017.

levels of globalization or (as the trilemma argues) one would necessarily compromise the other. We claim in this article that, rather than being a hindrance to economic integration, the KMM conditions are important to keep the momentum of globalization, albeit upon new bases adressing the specific problems of economic backwardness and inequality.

Based on the distinction between "harmony" and "cooperation" (Keohane, 1984, p. 51-52), we use the Structuralist tradition in economic development as the theoretical basis for discussing how openness, democracy and multilateralism may reinforce each other and offer a way out of the trilemma[3]. Structuralists argue that technological and productive asymmetries between countries and regions are persistent features of the international system. These asymmetries tend to persist, or even increase, in the absence of industrial and technological policies that allow laggard economies to escape from slow-growth, slow-learning specialization traps. The Structuralist school claims that the result is a center-periphery dynamic that entail negative political and economic impacts for *both center and periphery*. More specifically, polarization generates negative externalities to global growth and equality which at the end of the day erode the basis of both democracy and global economic integration. To overcome these negative effects and sustain openness in the long run in a way which is compatible with democracy, the KMM framework should be expanded to include the provision of public goods aimed at reducing international asymmetries that boost (domestic and international) inequality.

The paper is organized in 5 sections. Section 2 presents the trilemma and identifies trends in economic growth and trade in the postwar period that contradict the predictions of the trilemma. Section 3 presents the Structuralist School and argues that this school provides analytical tools that help explain these contradictions. Section 4 discusses the KMM conditions for democracy-enhancing multilateralism and (based on the theoretical arguments of the previous section) argues that they have as a necessary counterpart the provision of public goods to curb global negative externalities. Theoretical arguments are supported with evidence from the historical experience in convergence in Asia and Latin America. The focus is on externalities related to growth and income distribution. Other crucial externalities in the global system, like climate change and environmental degradation, are beyond the scope of this paper. However, some interrelations

[3] Although the core ideas of Structuralism originally emerged from the analysis of the specific insertion of Latin America in the world economy, they had been very influential in the debate on international political economy. On the influence of Prebisch and the center-periphery theory in international relations, see Rivarola Pontigliano (2017)

between sustainability, equality and convergence will be briefly mentioned in the concluding section. A simple formal model is presented in a mathematical appendix at the end of the paper.

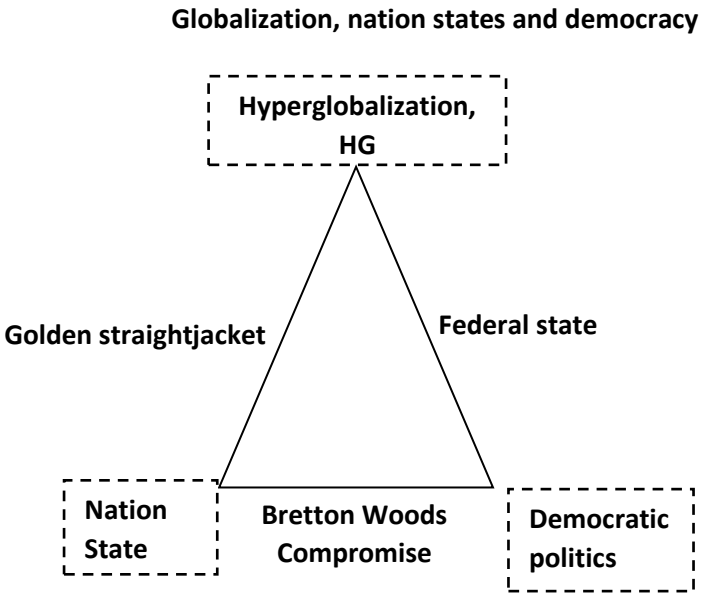
2. Globalization and Democracy: Rodrik's Trilemma Revisited

The trilemma revisited

A central theme in international relations is the tension that exists between national sovereignty and the constraints placed on sovereignty by the international system. Two influential views of how these forces interact (in the tradition of liberal institutionalism) are Rodrik's trilemma and the "democracy-enhancing multilateralism" of KMM.

A trilemma is a situation in which there are three elements that can be combined in pairs but cannot be present at the same time. The three elements of Rodrik's trilemma in international political economy are deep economic integration (hyperglobalization, HG), nation states and democracy (Rodrik, 2011, chapter 9). HG requires minimizing the transaction costs of capital, labor and goods across national borders. Rodrik observes that most transaction costs arise from legislation and norms issued by different governments, and therefore they are by large the creation of the nation states. As a result, nation states conflict with HG unless they fully adhere to free-market rules and only legislate to make the flow of goods and factors of production freer. So stringent constraints on public policy are incompatible with democracy. From standard economic theory, trade, labor and capital flows create winners and losers. In a democracy, losers will vote for policies that compensate for (or at least moderate) the impacts of external shocks on jobs and welfare. If governments are responsive to voters, they will raise trade barriers, offer subsidies or impose taxes to redistribute income. These measures heighten transaction costs and eventually weaken HG.

Figure 1. The political trilemma of the world economy



Source: Rodrik (2016), p. 182.

Figure 1 shows that the combination of HG and nation states is associated with the "golden straightjacket" of the gold standard era, whose heydays corresponded to the first globalization wave (1870-1914). Increasing openness coexisted with nation states, of which very few were democracies or had effective representation of workers' interests[4]. On the other hand, the "glorious thirties" of the Bretton Woods years (1946-1976) combined nation states and democracies in the developed world. But instead of HG, what emerged was a system of "embedded liberalism" (Ruggie, 1982), defined as an implicit compact between governments and citizens by which the latter gave political support to liberalizing international trade, while governments offered a safety net cushioning the impacts of external shocks. The Bretton Woods agreement restricted capital mobility to give more policy space for democratic governments to pursue employment and welfare objectives along with freer trade (Gosh and Quresh, 2016; Dooley et al, 2004; Eichengreen and Leblanc, 2008). Developing economies did not follow the same path: most of these economies were not democracies and many were relatively closed to trade[5]. The reasons why the periphery

[4] In the words of Eichengreen (2008, p.30): "*The credibility of the government's commitment to convertibility was enhanced by the fact that the workers who suffered most from hard times were ill positioned to make their objections felt. In most countries, the right to vote was still limited to men of property*".
[5] Li and Reuveni (2003) and Rudra (2005).

followed a different path—and why such path differed so widely across different periphery countries—will be addressed in the next section.

The third globalization era came about after the collapse of the Bretton Woods system, and gained momentum from the late eighties / early nineties. It resembled the gold standard period in the focus on removing barriers to trade and capital mobility (and to a much lesser degree to labor mobility). In particular, the new globalization drive sought to open up the capital account, which had remained relatively closed under Bretton Woods rules. The change in the rules for capital mobility gave rise to what some authors call "financialization" of the world economy, given the importance that the financial sector acquired in economic dynamics in the last three decades (Storm, 2018). Domestic credit provided by the financial sector as a percentage of GDP at the world level jumped from about 91% in 1980 to 181% in 2016 (this percentage had increased just from 75% to 91% between 1960 and 1980)[6]. In addition, open capital accounts implied that large trade unbalances could be more easily financed, and many economies were able to continue growing in spite of a rising external debt to GDP ratio. The share of exports and imports as a percentage of world GDP, which was approximately 12% in 1960, reached about 28 % in 2015 with a peak of 36% in 2016.

The previous figures explain the sense of economic insecurity—and the intensity of the competitive pressure—that most countries experienced in the third globalization era. Such insecurity has been made still more acute by price volatility in the world markets, reflected in large fluctuations in the exchange rates (especially in developing economies[7]) and speculative bubbles in real estate and commodities markets. Although several exchange crises took place in different parts of the world between the mid- to the late-nineties (the "tequila" 1994-95 Mexican crisis, the 1997-98 Asian crisis, the 1999 Russian crisis, and the 1999 Brazilian crisis), it was the 2008 Great Recession that marked a turning point in the perception of the costs implied by unregulated financial markets for growth and equality[8]. The confidence on the ability of the markets to deliver growth and political legitimacy to HG collapsed after the 2008 crisis (Posner, 2010, chapter 10).

[6] World Bank, https://data.worldbank.org/indicator/FS.AST.DOMS.GD.ZS.
[7] Financial openness tends to exacerbate real exchange rate volatility in countries that have a low participation of manufactures in total exports and a high share of debt in foreign liabilities (Calderón and Kubota, 2017).
[8] Stiglitz (2013) and Tooze (2008).

The weakening of democracy and multilateralism gives empirical support to the key prediction of the trilemma, namely that HG and democracy conflict. Political actors see globalization as a force that harms their constituency; many of them have been elected on nationalist agendas that challenge multilateralism and seek to reduce openness to trade, technology and / or migration. Given that a Federal (global) democratic state is not in the horizon, from Rodrik's trilemma one should expect an unease convivence between democracy and globalization—one in which nation sates either compromise democracy to attain deeper global economic integration or compromise globalization to respond to citizens' demands in democracy. However, there are trends in the international political economy which are at odds with the predictions of the trilemma. They are paradoxes whose explanation demands broadening the theoretical approach.

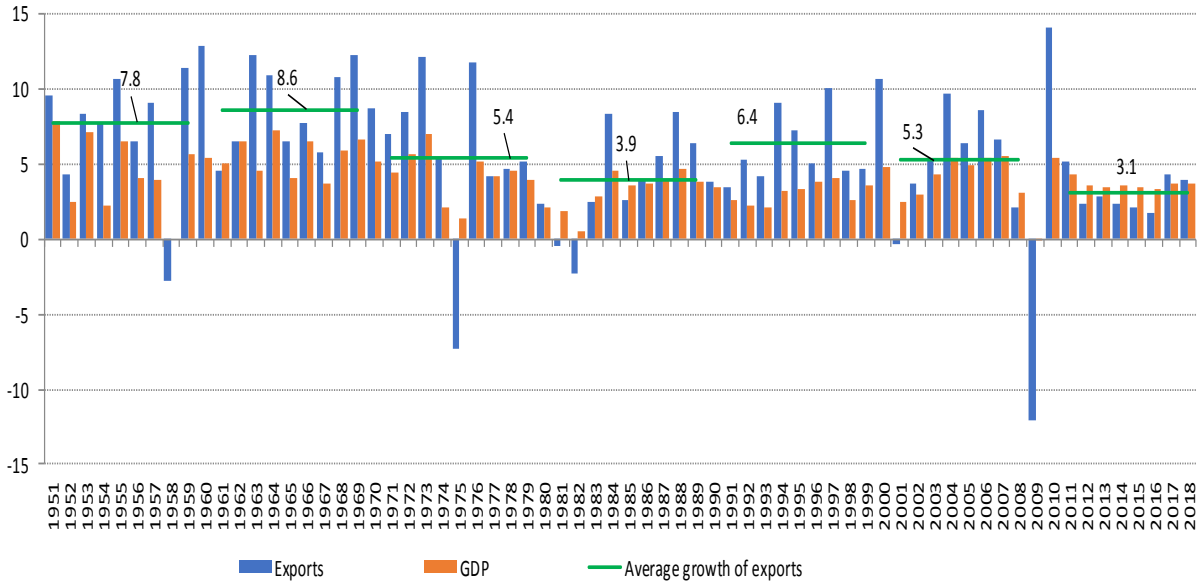
Paradoxes of the trilemma: trade, growth and industrial policy

A first paradox is that HG has been *less effective to encourage global trade and growth than the (apparently more restrictive) era of embedded liberalism*. The coalition that pushed forward the HG agenda (which for a shortcut we will call the "neoliberal coalition", see Rodrik 2019) assumed that (a) HG would boost growth and (b) economic success would suffice to ensure political support to HG. In other words, concerns with how to compensate losers from trade and financial liberalization, and how to facilitate adaptation to external shocks—which were at the core of the embedded liberalism era—would be a marginal problem in a rapidly expanding world economy. The prevailing view was that the Bretton Woods rules of fixed exchange rates and constraints on capital mobility had hindered growth, and their removal would make the economies more flexible and adjustments less costly.

The empirical evidence, however, challenged both assumptions. To begin with, the economy did not perform as predicted by the neoliberal coalition. Both international trade and GDP per capita grew at a faster rate during the Bretton Woods years than during the HG years (see figure 2). While openness increased with HG (measured in terms the ratio between world exports and world GDP), this happened because the fall in the growth of exports was lower than the fall in GDP growth since the 1980s. Still more puzzling, the "big bang" of the 1990s in terms of

liberalization of the financial markets and openness of capital accounts in Latin America came hand in hand with a marked *decline* rather than a boost of the investment (figure 3).

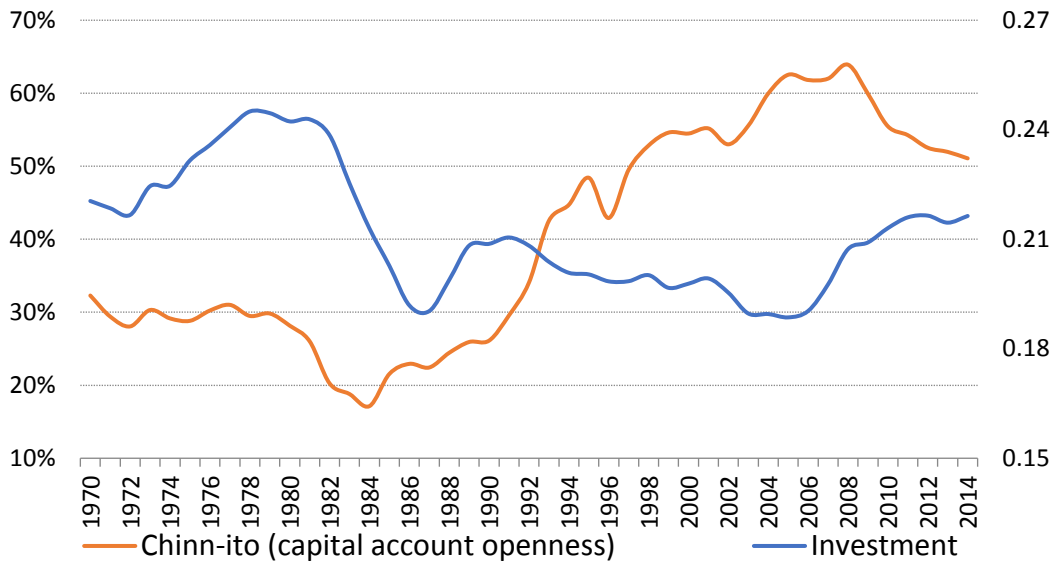
Figure 2. Trade and GDP growth rates in the world economy: from Bretton Woods to hyperglobalization (in percentage)



Source: WTO, *World Trade Statistical Review*, https://www.wto.org/english/news_e/pres17_e/pr800_e.htm

Figure 3. Investment rate and capital account openness in Latin America

(in percentage)



Source: ECLAC, based on the Chinn-Ito Index and Penn World Tables, ECLAC (2018), p. 102.

The deacceleration of trade and economic growth in this period cannot be explained by domestic political resistance to globalization. At the height of the political and ideological predominance of HG in the nineties, world exports grew at 6.5 % annually, two percentual points below the annual rate of growth of world exports in the sixties. The weak dynamism of the global economy during HG had economic, not political causes.

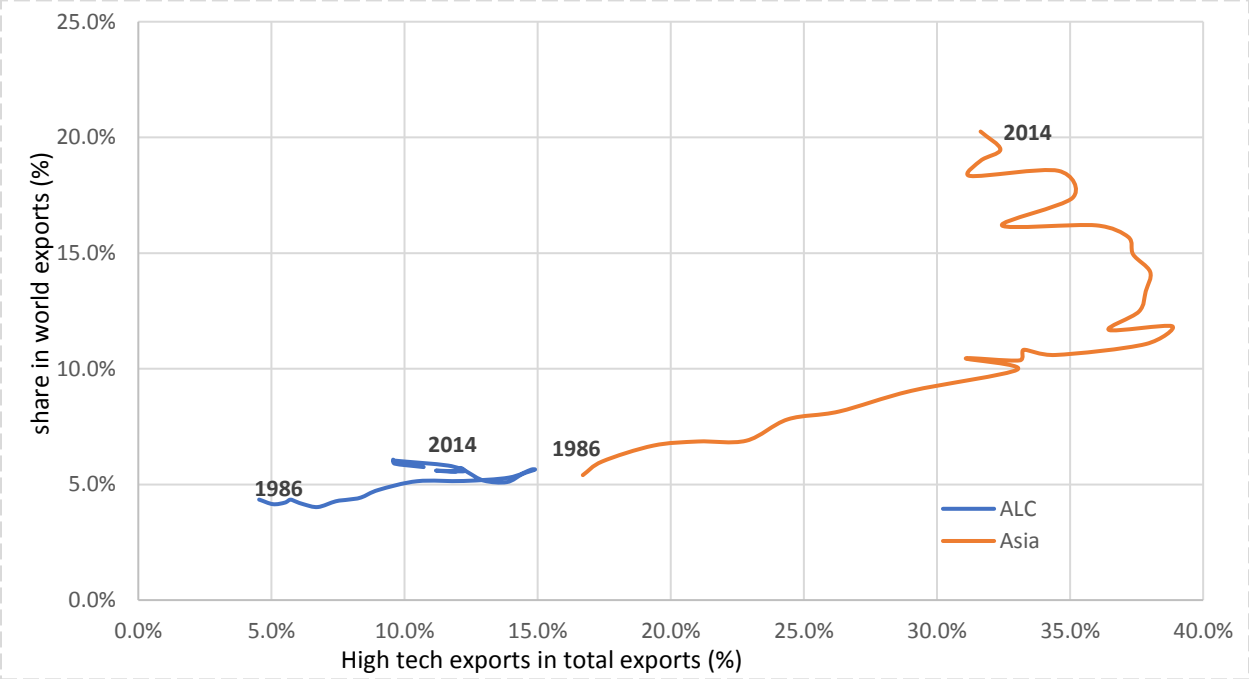
The second paradox is that countries that were not democracies (such as China, and Korea in the 1960s and 1970s) sharply increased their integration to the global economy *while at the same time adopting a strongly interventionist stance* in the markets[9]. Very active industrial and technological policies "distorting" market signals in Korea and China attracted foreign direct investment to targeted industries and spurred the integration of these countries to global trade. The hands-on approach of the state in economic development in the Korean case is abundantly documented in the literature (see the classical work of Amsdem, 1989 and 1993; see also Koo, 2013 and Lee, 2013). In China, the government selectively encouraged foreign direct investment, resorted to the widespread use of state power to ensure the transfer of technology to Chinese firms,

[9] Chang (2002, especially chapter 2) shows that this interventionist stance was prevalent not only in the successful East Asian countries, but also in the "Now Developed Countries" in early stages of industrialization.

and expanded the role of state-owned enterprises in many dynamic sectors (Poo, 2014; Lo and Wu, 2014). These policies did play an important role in both the diversification of the Chinese exports and the construction of indigenous capabilities that placed this country on a new, outstanding position in international trade. They cannot be considered policies aimed at minimizing transaction costs, but at building comparative-advantage defying industries (Chang, 2009).

In other words, a policy toolkit that included a broad array of policy-driven "distortions" in the factor and goods markets enhanced (instead of inhibiting) the economic integration of the Asian countries into the world economy. The Chinese and Korean experience of state-led growth stands in sharp contrast with the experience of the Latin American countries, which adhered more strictly to the HG agenda since the 1990s (Stalling and Peres, 2000; Bértola and Ocampo, 2012, chapter 5). Latin America was unable to transform its pattern of specialization, which limited its ability to compete in the fastest growing markets. Figure 4 shows the co-evolution of structural change and the share in world trade of developing Asia and Latin America between 1986 and 2014 (years for which information is available). The Asian countries changed their pattern of specialization towards high-tech sectors (represented by the share of high-tech exports in the region's total exports in the *y*-axis); this allowed them to capture a larger share of global trade (*x*-axis), while Latin America remained specialized in low-tech sectors, with little change in their participation in international markets. Structural change is related to technological change and productivity growth: Figure 5 shows the evolution of relative productivity (value added per worker) in the two largest Latin American economies (Brazil and Mexico) and Korea. It is very apparent that the Latin American countries lagged behind Korea since the early 1980s.

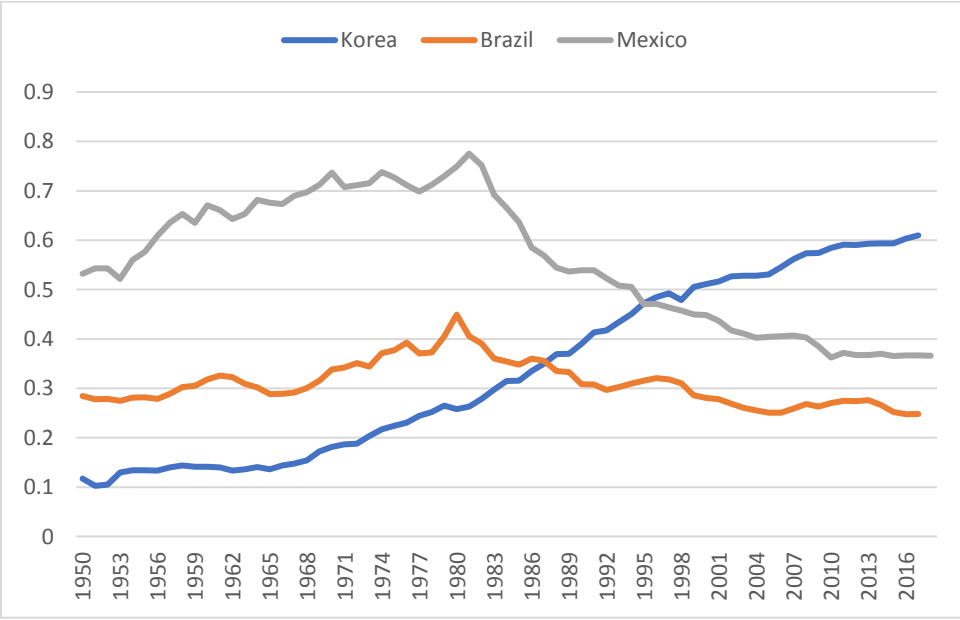
Figure 4. Structural change and shares in world trade: developing Asia and Latin America (in percentage)



Source: ECLAC from CEPALSTAT, World Bank and WTO

Figure 5. Relative Productivity: Brazil, Korea and Mexico, 1950-2017

(with respect to labor productivity in the USA)



Source: ECLAC based on Total Economy Database.

It is not possibly to discuss in this paper why industrial policies failed in Latin America while they succeeded in Asia[10]. However, it is important to mention that one key difference was precisely the fact that catching-up economies like Korea and China kept their economies relatively isolated from the cycles of international liquidity, while Latin America advanced more rapidly in terms of financial globalization[11]. In Latin America open capital accounts meant periods of sharp appreciation of the real exchange rate which heightened external unbalances and reduced competitiveness and the ability to diversify exports. Uncertainty and real exchange rate volatility had such a strong impact on competitiveness in Latin America that the industrial and technological policies were ineffectual for reshaping the export structure.

Explaining the two paradoxes of the trilemma—the paradox of higher growth and trade in Bretton Woods than in HG, and the paradox of state-led integration (riddled with market distortions) to the world economy—requires looking at international trade from a different theoretical perspective, one that that takes into account the various sources of and barriers to technical and structural change in an interdependent but asymmetric world. This point is addressed in the next section.

3. A Structuralist Interpretation of the limits of HG: Rethinking Cooperation in an Asymmetric International Economy

Harmony and Cooperation

In his classical work, Keohane (1984, pp. 51-52) argues that there is harmony in international relations when one actor, acting unilaterally in the pursuit of its own interests, produce outcomes that benefit (and is benefited from the actions of) other actors that are also acting unilaterally in accordance with their own interests[12]. The implicit assumption in HG is that harmony prevails in trade and finance: each country will be better-off with freer trade and more open capital accounts than with any other form of international governance implying higher

[10] Political economy variables played a key role in the effectiveness of the industrial policy; see Khan and Blankenburg (2009). See also Chang (2006) and Nassif et al (2016).

[11] See Ffrench-Davis (2001, 2012), Frieden (2015) and Ocampo (2016).

[12] "*When harmony reigns, cooperation is unnecessary*" (Keohane, 1984, p. 51).

barriers or transaction costs[13]. However, when unilateral actions do not spontaneously[14] bring about the most desirable outcomes, cooperation is necessary to coordinate decisions, encourage certain strategies and penalize others (like free-riding in the prisoners' dilemma). Openness and Pareto-efficient outcomes in the real world frequently are he result of cooperation, not of harmony. HG accepts that in some cases coordination is necessary—when governments are myopic or susceptible to the pressure of vested interest. But even in this case the only public goods that the international system would require for working efficiently are agreements that prevent domestic interests from standing in the way of free trade and unimpeded capital flows.

The Structuralist school, on the other hand, challenges the underlying assumptions on trade and growth of HG. It sees international trade and investment as a powerful force in favor of development. Still, these positive effects only arise under certain conditions, namely when there are in place policies that reshape incentives away of static comparative advantages (see Amable, 2016). The central point of structuralism is that, when these conditions are not fulfilled, market forces reproduce technological and income asymmetries—between regions within a certain country, and between countries in the world economy—leading to a center-periphery dynamic. Such dynamic produces *negative economic and political externalities that affect both center and periphery*, setting in motion forces that challenge the globalization process and destabilize democratic regimes (see next section). In explaining why convergence persist and negative externalities emerge, New Structuralists combine classical Structuralism with Schumpeterian and Keynesian insights in economic theory, as discussed below.

Why there is no spontaneous convergence in technological capabilities

A key tenet of Structuralism is that international specialization and technology co-evolve driven by lock-in and hysteresis phenomena. On the one hand, differences in technological capabilities affect the pattern of specialization—countries which are more technologically advanced are specialized in technology-intensive sectors. On the other hand, specialization affects

[13] The only exception is the case of an optimal tariff, aimed at improving the terms of trade of a big country which has market power in the international economy.

[14] The word "spontaneous" is misleading in this context. There are crucial institutional and political assumptions behind perfect markets leading to a Pareto optimum.

the rate and direction of technical change (Dosi et al, 2015). Technological opportunities (the potential for innovation and productivity growth) are higher in high-tech activities than in traditional activities. This means that a country specialized in advanced technologies will experience higher rates of innovation and productivity growth (as suggested by the combination of figures 4 and 5 above)[15].

The reason why there is no spontaneous trend towards convergence in technological capabilities between center and periphery is captured in the literature through the concepts of localized technical change (Atkinson and Stiglitz, 1969), tacitness (Nelson and Winter, 1982), learning by doing (recently revisited by Arrow, 2004) and learning by interacting (Lundvall, 2016, pp. 143-144). All these concepts stress the importance of experience in production and innovation within a certain "technological region" or technological domain as a source of learning. The concept of localized technical change underlines that firms can only adopt or improve a technology when it is related to technologies they are already using. Tacitness refers to the limits of learning from codified sources. A manual or a handbook contribute to learning, but capabilities only become effective when they are incorporated to the routines of firms and the skills of workers. Samuelson (1948) provides an early statement of this property of technical change: "Knowledge is *not* an input such as the more you use it, the less is left. Effective knowledge is even more important than knowledge, and unfortunately cannot be acquired by reading a book or by editorial exhortation" (italics in the original). Learning by doing describes the fall in average cost of production that comes from the accumulated experience in production. Learning by interacting, in turn, refers to the role that the exchange of information between users and producers play in fostering learning and innovation. In all cases, in the absence of specific policies for catching up and the absorption of foreign technology, increasing returns widen the technology gap between innovators and followers[16].

The intensity of the various forms of learning depends on the existence of institutions that (explicitly or implicitly) coordinate interactions and enhance cooperation in innovation and diffusion of technology among the different actors involved in technical change. The literature has coined the concept of "National System of Innovation" (see Alcorta and Peres, 1998) to stress the

[15] A pioneer work relating the sectoral composition of production to the dynamism of technical changes is Pavitt (1984). Recent empirical advances using this typology can be found in Bogliacino and Pianta (2016).
[16] See Fagerberg and Verspagen (2002).

systemic nature of learning and the importance of domestic policies for catching-up. The concept of NSI considers the heterogeneity of the agents involved, the importance of their interactions, and the specificities (historical and institutional) of their learning paths[17]. In the words of Lall (1992, p.169): "*(N)ational capabilities are not simply the sum of thousands of individual firm-level capabilities developed in isolation. Because of externalities and interlinkages, there is likely to be synergy between individual FTCs*", where FTCs stands for firm-level technological capabilities. This systemic dimension implies that patterns of specialization and technological trajectories become more rigid, giving rise to lock-in in the existing trajectory (Arthur 1994). Increasing returns and self-reinforcing mechanism in technical change underline the crucial role of policies "distorting" the structure of incentives in allowing countries to escape from lock-in (ECLAC, 2012).

Why there is no spontaneous convergence in GDP per capita

Technological backwardness does not only affect learning and productivity growth; it also affects demand growth. Differentiated goods from technology-intensive sectors usually command higher rates of demand growth in the international and domestic markets than commodities and homogeneous (less sophisticated) goods[18]. This is formalized in the Structuralist tradition in the form of a higher income elasticity of the demand for exports than the income elasticity of its demand for imports in the periphery[19]. To the extent that the ratio between the income elasticity of the demand for exports and imports is lower than the unity, the periphery will experience a deficit in the trade balance if it grows above the rate of growth of the world economy (Moreno-Brid, 2003). Although for a short period of time current account deficits can be financed through foreign loans, a growing debt to GDP ratio is not sustainable in the long run. As a result, the

[17] For a discussion of the specificities of learning in a developing economy, see Cimoli and Katz (2003) and Bell (2006).

[18] For a discussion of the links between changes in the production structure and growth in the long run, see Peneder (2002), Felipe et al (2012), Aldrighi and Colistete (2013) and Storm and Naastepad (2015). There are exceptions to this empirical regularity, such as good luck in the "commodity lottery" (Díaz-Alejandro, 1983). However, the commodity lottery provides a less stable basis for growth than technological capabilities.

[19] The simplest expression of the BOP-constrained rate of growth is Thirwall's Law, that states the relative rate of growth of the periphery with respect to the center equals the ratio between the income elasticity of exports (ε) and imports (π) of the periphery $(y^P/y^C) = \varepsilon/\pi$. An assessment of the literature can be found Thirlwall (2011). For an early structuralist formulation, see Rodríguez (1977). See also the formal appendix.

periphery will have to reduce its rate of economic growth to what is compatible with current account equilibrium.

The fall of the rate of growth in response to external unbalances may come out of a fall in public and private investment caused by pessimistic expectations about future growth, a reduction in public expenditures when the government seeks to avoid an explosive path for the external debt, or a combination of the previous two mechanisms (Blecker, 2011)[20]. The critical role of external disequilibria in leading to a contraction of aggregate demand in a country that experiences deficits in current account is highlighted in an early work by Joan Robinson (1967):

"*the most important benefit of a surplus on income account, which affects the whole economy, is that, provided that there are energetic enterprises and thrifty capitalist to take advantage of it, it permits home investments to go full steam while a deficit country is nervously pulling on the brake for fear of excessive imports*".

Still, center-periphery divergence is not destiny. While it is true that technological and market forces tend to reproduce the center-periphery divide, there are experiences of convergence in the global economy which show that policies for structural change in the periphery could be effective in changing the patterns of specialization. As mentioned, Korea and China redefined their insertion in the global system by challenging orthodox prescriptions in economic policy. By doing so they contributed to enhance global aggregate demand. The commodity boom in Latin America is to a significant extent a reflection of structural change in the Chinese economy. However, in a world in which there are no global public goods to correct unbalances in trade or protect workers' rights from international competition, the rise of China heightened tensions in domestic politics and geopolitical rivalry. The question that presents itself is the following: can paths of convergence be recreated in a way that complies with multilateral rules in the international system, strengthens democracy and do not enhance inequality in the advanced world?

Our response is a cautious 'yes', which we will elaborate in the next section, drawing from KMM. For the objectives of this paper, the central concern is that the center-periphery dynamic described by the Structuralists approach entails two negative global externalities: a contractionary

[20] See also Blecker and Setterfield (2019).

bias in global aggregate demand and higher economic instability; and higher political instability due to a downward pressure on wages and workers' welfare[21].

4. Global Public Goods, Inequality and Democracy-Enhancing Multilateralism

The paper by KMM allows for rethinking democracy and development in a context of multilateralism and openness. To advance in this direction, these authors lay down a set of conditions that international institutions should observe for encouraging a democracy-enhancing multilateralism. It will be argued in this section that these conditions should include the provision of global public goods aimed at correcting external unbalances (and hence promoting a stable growth of global aggregate demand) and reducing inequality between and within countries.

Democracy-enhancing multilateralism

According to KMM, democracy-enhancing multilateralism should comply with three conditions. *The first* is encouraging policies that benefits the majority of the population as opposed to policies that benefits mostly powerful groups that can mobilize substantial resources to make their preferences prevail. In other words, it should help the citizens solve the collective action problem that emerges when the gains of any individual actor are too small to justify her paying the cost of engaging in the policy arena. *The second* condition is strengthening the protection of civil rights, especially in the case of vulnerable groups and minorities. Constitutional democracy entails that the majority cannot overrule the civil rights of minorities and/or groups that do not hold enough political or economic power to defend their rights. *The third* condition is strengthening the deliberative capabilities of the society by opening the policy debate to a variety of actors (from both the public and private sectors) and perspectives, making it more transparent and allowing these actors to contribute with structured, informed arguments to the analysis. The quest for an

[21] As mentioned, there is a third critical externality that will not be addressed in this paper, namely climate change and environmental degradation.

open public debate makes it easier to protect the diffuse interests of the majority, since prevents the most powerful actors from having privileged access to information and policy-makers[22].

KMM explicitly acknowledge that they do not discusses political and economic asymmetries between states. Their focus is on the "vertical" relation between states and citizens, not on the "horizontal" relation between states. However, it is possible to extend their discussion to identify some key issues in the international system that may challenge the viability of a regime based on constitutional democracies and multilateralism[23]. HG resembles the gold standard in placing on labor most of the adjustment costs to external shock, either by rising unemployment, falling real wages, or both. At variance with HG, the conditions for a democracy-enhancing multilateralism imply a renewed call for broadening the policy space at home and curbing negative externalities in the international system (see the technical appendix for a formal analysis of global equilibrium with negative externalities).

Slow growth and instability in global aggregate demand

The periphery is always prone to experience external deficits or real exchange crisis, which compromise sustaining a stable rate of growth of aggregate demand. The specialization of the periphery in a few commodities whose demand is sluggish in the global economy reduces its capacity to import and hence the rate of growth of international trade. Not only will growth be slower, but also more instable. Debt and real exchange crisis are usually preceded by short spurs of growth, but GDP contractions after the crisis are deeper and tend to persist for many years (Guzman et al, 2018; Missio et al, 2015; Freench-Davis, 2012). Instability and the contractionary bias in adjusting to external disequilibria have been observed both in developing economies and in the European periphery—as happened during the debt crisis of Spain and especially Greece

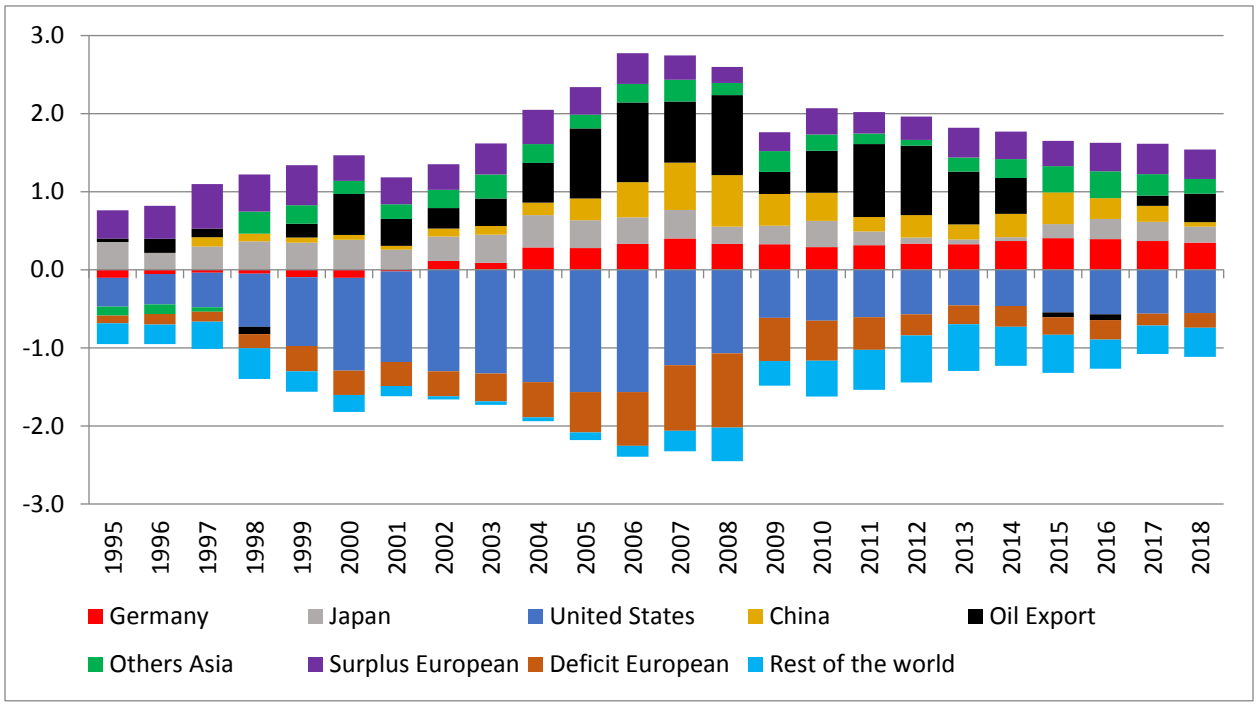
The Trans-Pacific Agreement is an example of a trade agreement of the HG era where a secretive outlook predominated. It has been observed that "(s)ecrecy has real costs. Because the negotiating process combines a general shield from the public with privileged access for industry advisers, the substance of American free trade agreements does not represent truly national interests. It represents the interests of those members of industry who sit on the office's Industry Trade Advisory Committees, which have regular access to negotiating information", Margot Kaminsky, "Don't Keep the Trans-Pacific Partnership Talks Secret", op-ed, *The New York Times*, April 14 2015, https://www.nytimes.com/2015/04/14/opinion/dont-keep-trade-talks-secret.html.

[23] The problem of the quality of democracy—as different from defining democracy in a more restrictive way, namely having elections and electoral competition—is addressed in Przeworski (2009) and Galston (2018)

(Storm and Naastepad, 2015). Austerity policies are the expression of this contractionary bias that represents a negative global externality restraining growth and employment.

Figure 6. Global unbalances: current account by countries and regions, 1995-2018

(As % of World GDP)



Source: ECLAC based on IMF, *World Economic Outlook, Cyclical Upswing, Structural Change*, April 2018

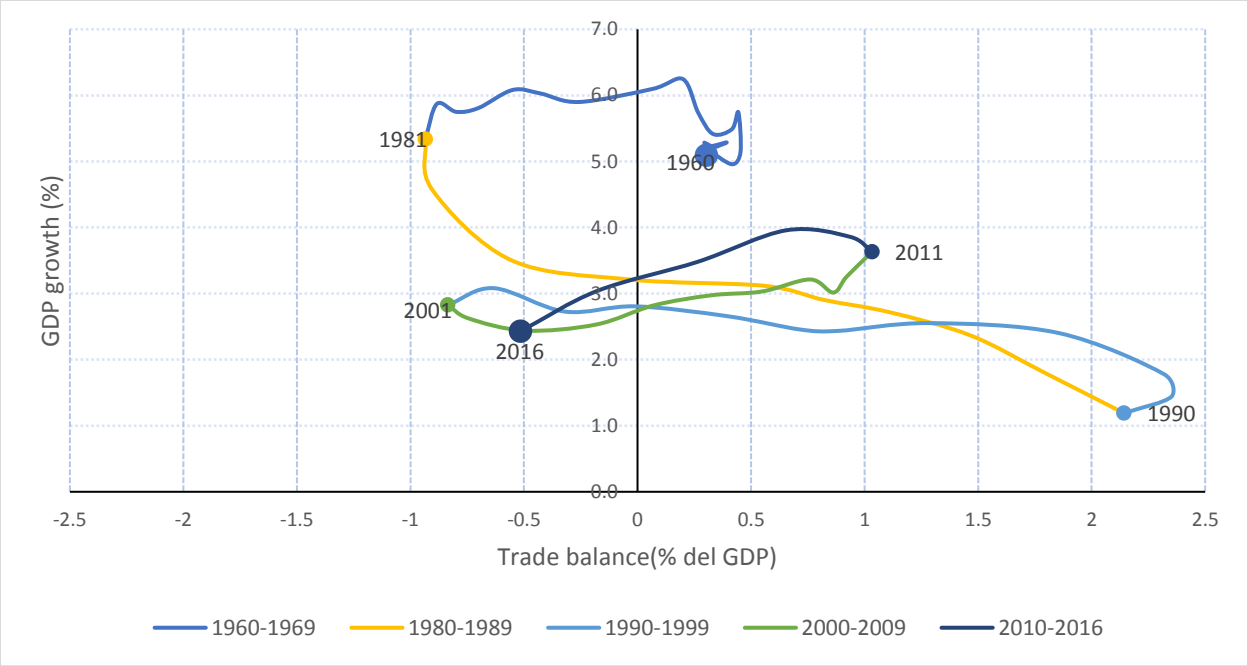
Figure 6 shows the surge of external unbalances in the HG years and especially in the years before the 2008 Great Recession. Two things are especially impressive, the rapid increase in the absolute figure of the unbalances and the persistence of the deficit / surplus positions of countries and regions[24]. The latter reflects the inertia of specialization patterns, the impact of specialization

[24] The US economy showed persistent deficits, which nevertheless could be sustained by the special position of the dollar as the international reserve currency par excellence.

on the external constraint, and the importance of increasing returns in providing an advantage in international trade to the technological leaders (see section 3).

Figure 7. Latin America: economic growth and the external constraint, 1960-2016

(in percentage, 10-year moving average)



Source: ECLAC with data from CEPALSTAT

Figure 7 shows the evolution of the external constraint (measured through the current account deficit or surplus) and the rates of economic growth in Latin America since 1960. The only period in which Latin America was able to grow at a rapid pace with a trade surplus was in the Bretton Woods period (1960s) and during the commodity boom of 2004-2013. In all the other periods, relative rapid growth came hand in hand with a growing external deficit (as for instance in the seventies and nineties), leading in turn to a fall in the rates of growth, which was required for paying the debt and preventing the trade deficit form becoming explosive (first half of the 2000s). This kind of z-curves—alternate periods of faster growth with external deficits and slower growth (or contraction) with a trade surplus—compromises the ability of the periphery to converge and reduces global growth. A hysteresis phenomenon can be identified as well, to the extent that the rate of growth after 1980 has been consistently below the rate of growth of the Bretton Woods years (Cimoli et al, 2010).

Inequality and political instability

There are impacts on income distribution associated with the pattern of specialization in the periphery. The existence of a technology gap with the rest of the world implies that competitiveness in the periphery depends by large on low wages and natural resources. Since ownership of natural resources is usually very concentrated in the periphery, and unskilled labor has little bargaining power in the labor market, this type of economic growth is associated with very inequal patterns of income distribution (high concentration of rents in the hands of land owners or owners of mining industries; low wage share as a percentage of GDP)[25]. In periods of external crisis, the currency of the periphery is forced to depreciate sharply, which also has a negative impact on income distribution. Slow growth in indebted economies implies higher levels of unemployment. In all cases, there is a trend of real wages and wage shares in the periphery to remain at lower levels when compared to more developed economies[26]. In a globalized economy, low wages in the periphery puts a downward pressure on wages and working conditions in the center, boosted by the ability of capital flows to arbitrate between social policies. It was already mentioned that economic insecurity and inequality have been factors eroding the confidence of the citizens on democracy in developed economies. The pressure on the world of labor of a highly inequal periphery is a negative political externality for democracy in the center.

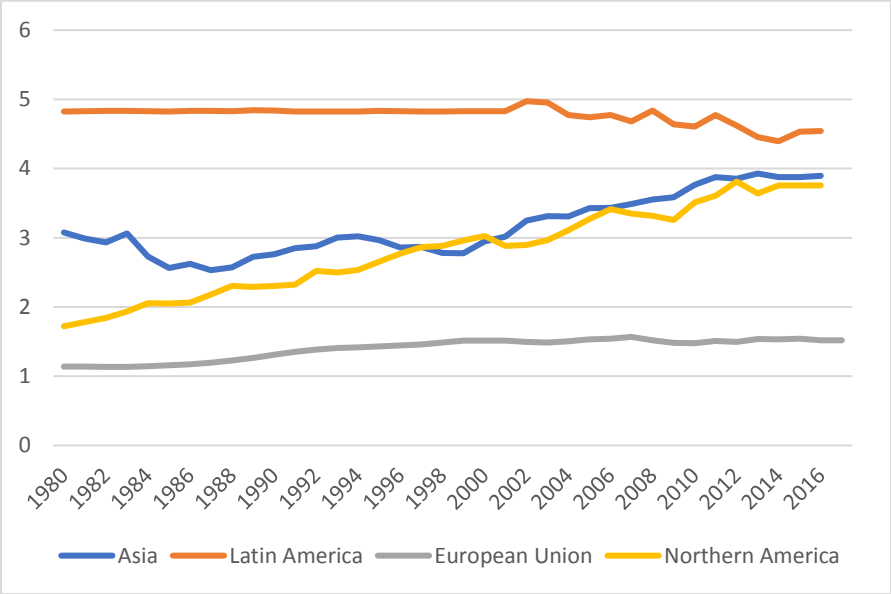
Figure 8 shows trends in inequality in the HG period. All regions have seen a rising trend in the ratio between the pre-tax share of the top 10 % and the bottom 50 %. The only exception is

[25] These patterns of income distribution, in turn, generate a political economy that reinforces the slow-growth, slow-productivity trap; see Doner and Ross-Schneider (2016)

[26] Labor shares have tended to decline since the 1980s in most advanced and developing countries, see Alvaredo et al (2018) and Dao et al (2017).

Latin America, where the 10/50 ratio slightly fell during the commodity boom of the 2004-2013, albeit from a very high initial figure (the highest among the regions in the sample).

Figure 8: Trends in inequality: the 10/50 ratio in pre-tax income shares

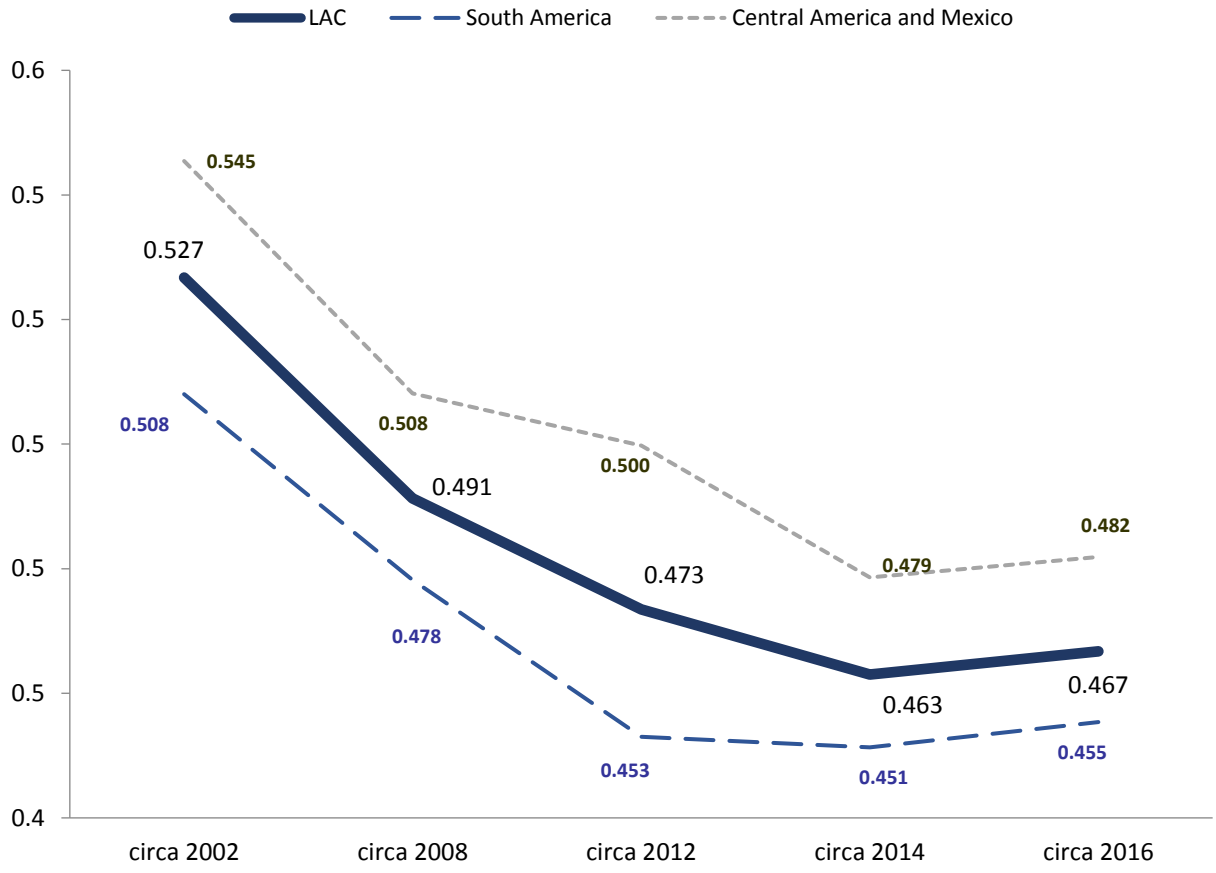


Source: The World Inequality Database, https://wid.world/data/.

Rudra (2015) argues that developing economies expand social expenditure to gain political legitimacy as their economies become more integrated to the world economy. This author observes that globalization and democracy only go together when social expenditure goes hand in hand with higher openness. However, in the case of the periphery, this mechanisms for gaining political support to globalization faces the limit of the external constraint. If the deficit in current account is growing, the fiscal space will be reduced. The recent experience of Latin America illustrates these dynamics. When the external constraint was eased during the commodity boom associated with the demand for natural resources from China, social expenditure increased in Latina America and this helped reduce poverty and inequality. After the commodity boom, positive trends in social expenditure stagnated and income distribution worsened. Figure 9 shows that the Gini index fell until 2014 in Latin America and began to move upwards in 2015, confirming the limits of redistribution as a tool for gaining political support for globalization in economies in which employment and fiscal expenditure are Balance-of-Payments-constrained.

The link between economic diversification and political stability has been highlighted by political scientists. Discussing the conditions for having a stable democracy, Shapiro notes that that "*the diversification of the economy matters more than inequality, and perhaps even as much as PCI* [per capita income]*"*(Dahl and Shapiro, 2015, p. 198; Hartmann et al, 2017). The positive association between diversification and a more stable politics is related to a more stable growth path, with a steady demand of skilled labor and the expansion of the fiscal space.

Figure 9: Inequality in Latin America, 2002-2016
Gini coefficient of income per capita (unweighted average)



Source: ECLAC base on national accounts. Countries included: Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Honduras, Mexico, Panama, Peru, Paraguay, Uruguay and Venezuela (unweighted averages).

Very high levels of liquidity and capital mobility contribute to raise inequality. They allow capital to arbitrate between tax systems, social legislation and levels of labor protection in different

countries. Big financial actors have the "exorbitant privilege"—to paraphrase Valerie Giscard D'Estaing—of being able to veto policies they consider unfavorable to their interests. In addition, to the extent that capital has become not only more mobile but also more intangible, it is increasingly difficult for the governments to enforce taxes and controls. The tendency in the past ten years has been for big corporations to pay less taxes, and such a tendency is especially strong in the case of high-tech firms less dependent on physical assets[27].

The negative externalities associated with HG cast new light on what Krasner (1982) calls "structural conflict" between developed and developing economies. Krasner argued that developing economies, for being much more vulnerable than the developed economies to external shocks, would systematically favor political over market mechanisms in solving the problems of the international system. The North-South conflict was regarded as being a conflict between (developed) economies which were flexible and competitive—and which could rely on markets—versus more rigid (developing) economies—where weak institutions compromised an efficient response to global competition. While this view failed to see that developed economies were imposing trade barriers of their own (and violating liberal rules in sectors in which they were less competitive)[28], it did highlight the vulnerability faced by national states and societies in a rapidly changing world. The rise of China and the flow of refugees and migrants (with its negative political impacts in many developed countries) suggest that the sense of vulnerability should not be confined to the periphery. Negative externalities have a global scope, and this is why rethinking multilateralism (from the KMM-plus-Structuralist perspective) is so important.

5. Concluding remarks

The international system goes through a critical moment. HG heightened global tensions to a point in which a globalization backlash emerged, one that challenges the advances of the post-war period in international cooperation. The Bretton Woods regime provided global public goods

[27] Rochelle Toplensky, "Multinationals Pay less Taxes than a decade ago", *Financial Times*, March 11 of 2018. Constraints on taxation imply that governments are less able to provide the public goods demanded by labor protection and welfare. See ECLAC (2018) and Besley et al (2013) and Furceri and Loungani (2015).

[28] When Krasner formulated his "structural conflict" theory in the early eighties, the developed countries applied restrictions to trade in agricultural goods, textiles and steel, among other sectors, in the form of tariff and non-tariff barriers (whose importance had increased in the 1970s); see Díaz-Alejandro and Helleiner (1982).

(in particular, the reduction of trade barriers and stable exchange rates) that encouraged international trade while keeping a space for domestic policies concerned with building the welfare state and full employment in the center—what was called "embedded liberalism". This kept globalization going hand in hand with democracy. Inversely, "deep integration" advanced on the premise that minimizing transaction costs for moving capital and goods across the borders would bring about rapid growth and, as a corollary, political legitimacy. However, HG produced major negative externalities that compromised both growth and political stability. It was associated with such a redistribution of economic and political power against labor that that the space for pro-welfare policies was drastically curtailed. And so was the confidence on constitutional democracy.

KMM offered a response to the globalization backlash with the concept of democracy-enhancing multilateralism. We argued that the conditions set forth by KMM should also include global public goods to downplay to key negative externalities stemming from a center-periphery system, namely slow and unstable growth and increasing inequality. While it is not the objective of this paper to address the policy implications of a structuralist perspective on KMM, we will highlight two directions that emerge from the previous discussions.

First, the literature has increasingly called for a more coordinated and extensive use of fiscal policy as an instrument for sustaining growth and changing growth patterns towards a low-carbon path (Stiglitz, 2019). There has been demands for reducing trade unbalances by stimulating public spending and real wages in surplus countries, instead of reducing growth and wages in countries running a deficit (Qazizada and Stockhammer, 2015). This would help sustain global aggregated demand as well as employment, reduce the incentives for migration in the periphery and stabilize the political systems. Coordinated fiscal expansion should be related to curbing another global negative externality, namely climate change. The technological revolution offers a broad set of investment opportunities associated with transforming the energy matrix, changing the urban infrastructure in a sustainable direction, and introducing new environmentally friendly technologies in production. The calls for an "environmental big push" for development (ECLAC, 2016), a "global new deal" (UNCTAD, 2016, chapter VI) and a "green new deal" (Stiglitz, 2019), are all initiatives aimed at harnessing technology and public investment for promoting social inclusion and sustainability.

Secondly, a new covenant at a global level is necessary to protect labor rights (Rodrik, 2018). There is resistance in each individual country to strengthen social protection, which is seen as compromising international competitiveness as well as the ability of the country to attract foreign investment. This impasse can only be corrected by adopting international standards for labor protection. Note that these standards might reduce the competitiveness of some peripheral economies, namely those more dependent on low wages to export. However, to the extent that such a global standard will represent a basic floor of labor rights for all countries, relative differences in wage costs will persist and continue to influence the comparative advantage of center and periphery. In addition, it may work as an additional stimulus to raise labor productivity in developing economies.

Appendix: the contractionary bias in a center – periphery system

The negative externalities associated with a center-periphery system can be described by a simple two-country model (center, C, and periphery, P) based on McCombie and Thirwall (1994), Blecker (1998) and Cimoli and Porcile (2010). The model consists of two traditional Keynesian demand functions (equations 1 and 2), the BOP constraint (defined as the condition for equilibrium in trade balance, equation 3) and an adjustment mechanism between the effective and equilibrium rates of growth (equation 4).

(1) $y_P = y\big(a_P, x_P(\hat{q}, y_C)\big)$
(2) $y_C = y\big(a_C, x_C(-\hat{q}, y_P)\big)$
(3) ${y_P}^E = \frac{\varepsilon}{\pi}{y_C}^E$
(4) $\dot{a}_P = \varphi\big({y_P}^E - y_P(a_P)\big), \varphi > 0, \frac{\partial \dot{a}_P}{\partial a_P} < 0$

Where $y = \dot{y}/y$ is the effective rate of growth of GDP (subscripts P and C represent periphery and center, respectively), a is the rate of growth of autonomous expenditure and x the rate of growth of net exports. Autonomous expenditure in this context is the one that does not depend on the rate of growth of the other country. Equation (3) is Thirwall's Law, ε is the income elasticity of exports, π the income elasticity of imports and ${y_P}^E$, ${y_P}^E$ are the Balance-of-Payments-constrained (equilibrium) rates of growth in center and periphery, respectively.

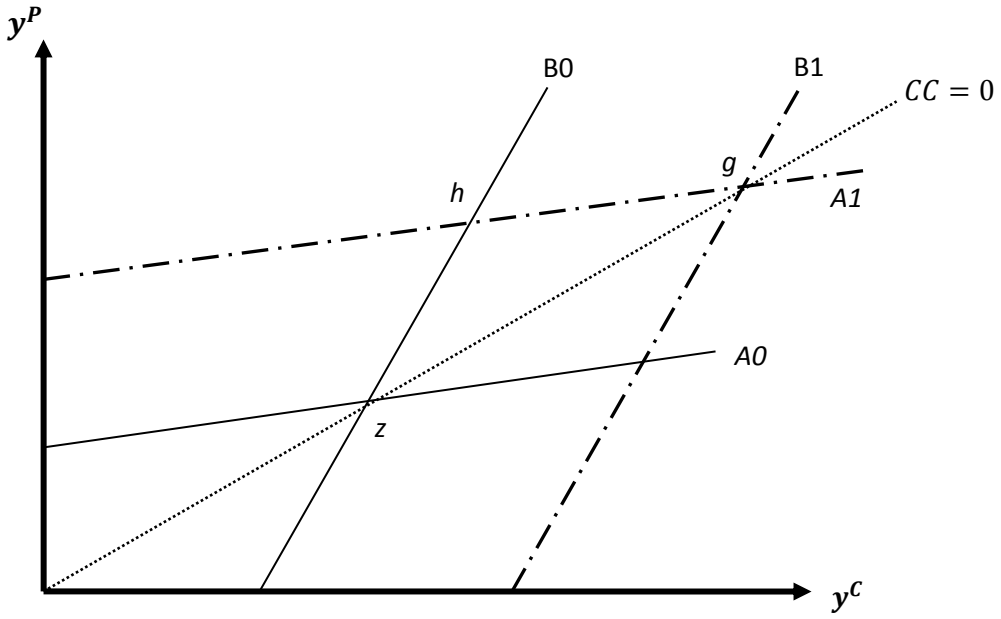
Equation (1) states that the effective growth of the periphery (y_P) depends positively on the growth of autonomous expenditure in the periphery (a_P) and the rate of growth of net exports to the center (x_P). The latter is a positive function of the growth rate of the real exchange rate (defined as $\hat{q} = \hat{P}^C + \hat{E} - \hat{P}^P$, where $P^i, i = C, P$ are price levels and E is the price of the foreign currency in units of the domestic currency) and the rate of growth of the center. Equation (2) is symmetric to equation (1) and gives the effective rate of growth of the center.

The growth of autonomous expenditure in the periphery is endogenous in the long run and adjusts according with the motion equation (4) to make the effective rate of growth equal to the BOP-constrained rate of growth (Robinsonian adjustment). The parameter $\varphi > 0$ is the velocity of adjustment to external equilibrium. As in Thirwlall's Law, in the long run the real exchange rate is stable and hence $\hat{q} = 0$. For simplicity, we will assume that autonomous expenditures in center and periphery are shaped by changes in the rate of growth of fiscal expenditures. We also assume that the periphery and the center have unemployed or underemployed workers that can be employed or transferred from low-productivity to high-productivity activities. In the long run the growth rate of autonomous expenditure is constant ($\dot{a}_P = 0$). The differential equation (4) renders a stable equilibrium for a_P since $\frac{\partial \dot{a}_P}{\partial a_P} < 0$.

Figure AP-1 represents different scenarios of adjustment, beginning at the initial position z, where both center and periphery grows with external equilibrium—z is on the $CC = 0$ schedule that gives all the combinations of effective rate of growth in center and periphery that complies

with the BOP constraint, i.e satisfies ${y_P}^E = (\varepsilon/\pi){y_C}^E$. Assume now that—with a view to improving employment and income distribution—the periphery raises autonomous expenditure and the curve giving the effective rate of growth shifts from A0 to A1. The new (transitory) position of the economy is h, where both center and periphery grow at a higher rate than before. At point h, however, the periphery experiences a trade deficit that raises the debt/GDP ratio. This deficit cannot be sustained in the long run.

Figure AP-1. The contractionary bias: the fall in aggregate demand in the periphery



A0 – effective rate of growth in the periphery as a function of growth in the center
B0 – effective rate of growth in the center as a function of growth in the periphery
A1 – effective rate of growth in the periphery with coordinated fiscal policies
B1 – effective rate of growth in the center with coordinated fiscal policies
z – initial equilibrium position
g – final equilibrium position with coordinated fiscal policies
h – transitory rate of growth
$CC = 0$: BOP-constrained rate of growth

Three alternative paths are possible. First, if there is no coordination of fiscal policies in center and periphery, the periphery will have to slow down fiscal expenditures ($\dot{a}_P < 0$) to reduce the growth of aggregate demand to the level consistent with the BOP constraint. A1 shifts back to A0 and growth falls in center and periphery (from h to z). Second, if center and periphery coordinate fiscal policies, then the center responds to the expansion of fiscal policy in the periphery by increasing its own rate of growth of autonomous expenditure. B0 shifts to B1 and the new

equilibrium position is g. This position implies higher growth with external equilibrium in both center and periphery.

Third, the periphery may change its production structure. By changing its pattern of specialization, the periphery changes the slope of the $CC = 0$ schedule (ε/π increases), which shifts to the left (not represented in figure AP-1). This change implies that the periphery attain external equilibrium in point h, even if the center does not change its fiscal policy. The result of such a shift is to allow both center and periphery to grow at a higher rate with external equilibrium. Enhancing diversification and technological change in the periphery reduces the anti-growth bias implicit in keeping a substantial part of the workforce in the periphery unemployed or underemployed. In this sense, the existence of a large technology gap and marked asymmetries in specialization represent a negative externality for the whole system.

These alternative paths have implications for income distribution. Structural change and the coordination of fiscal policy allow the periphery to reduce underemployment and the share of subsistence workers in total employment. This in turn helps to raise real wages in the periphery. Improving income distribution in the periphery also contributes to reduce downward pressures on wages and welfare in the center and hence cushions political tensions in both poles of the system.

The distance between the equilibrium positions z and g is a measure of the contractionary bias implicit in a system in which there is no coordination of fiscal policies nor structural change in the periphery. It is also proxy for the intensity of the political tensions that may spread in the global system out of a highly unequal income distribution in the periphery.

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