KEYNOTE ADDRESS:

WHAT GLOBALIZATION IS REALLY ALL ABOUT

Earl A. Thompson, UCLA

ABSTRACT

Prior characterizations of "globalization" have missed the mark by associating this modern movement with previous free-trade episodes. When understood in its proper social-theoretic context, globalization finds it precursors only in the formation of ancient empires, inegalitarian epochs featuring civilization-wide political centralizations. Our modern world's own political centralization is due to the end of the Cold-War competition of states for people. With the recent end to this last remaining vestige of competition of states for people, the new "globalization" policies have predictably been in the interests of the dominant countries' ruling classes and against the interests of their now-struggling middle classes.

INTRODUCTION

First, I think we should all thank Demetri [Kantarelis] for the great intellectual tolerance he has shown by welcoming such divergent economic views to this conference. (Applause.) However, he's partly to blame for what follows. After obtaining my consent to deliver this address, he requested that I be somewhat entertaining. But then he failed to deliver me the clown suit that I said I'd need in order to accommodate his request.

You see, I'm a very serious guy, even to the point of being patriotic. In fact, before I left on my trip to this center of French culture, I felt compelled to check out what my leader, President Bush, had to say about the French. He said, "The trouble with the French is that they have no word for 'entrepreneur' in their language."

Regarding the title of this presentation, now that you're all here and sedentary while digesting your meals, I can tell you the real title. It's "Globalization and Me." No, I lied again. A more correct title is "Me and Globalization." You can see from my implicit disrespect for ordinary grammar that I'm not about form. Let's hope I'm about substance.

MY EARLY YEARS AS AN ECONOMIST

I began my existence as a fledgling economist believing almost everything I was taught in my undergraduate courses at UCLA in 1958-9. My international trade and development Professor, Robert Baldwin, a distinguished and persuasive scholar in the field, taught me that our major international economic institutions represented a benevolent attempt by the world's most highly developed nations to help out the world's least developed nations. I also believed the other, even more right-wing, theories I was taught at UCLA. What I was afterward taught as a graduate student and Assistant Professor at Harvard and Stanford respectively had no noticeable effect on these early beliefs.

Nevertheless, a rather accidental break-through did occur. While working on preparing my graduate Public Finance lectures at Stanford in 1962, on attempting to understand the rhyme or reason behind the U.S. Federal Income Tax, it hit me that the entire Tax could be understood as an equivalent to a simple, non-discriminatory, capital tax. The double taxation of savings, the progressiveness of the Tax schedule, the corporate profits tax, the depreciation and depletion allowances and numerous other exemptions and deductions; these could all be understood as part of an equivalence of our complex income tax to a single, non-discriminatory, tax on "coveted capital," capital that is relevant to potential military aggressors. Moreover, since the national government provides collective defense, the tax is welfare-justified because it serves to internalize a "defense externality," wherein an investor in coveted capital creates the need for a higher level of national defense in order to maintain the initial level of national security.

This interpretation of our Federal Income Tax Code radically changed my implicit view of political processes. While my previous view, in agreement with my undergraduate education and the profession generally, was that our democratic political process generated highly inefficient domestic economic institutions, my tax analysis indicated that political processes, or at least the U.S. Congress, was somehow able to generate policies whose efficiency was at a level that was so high that economists had not even got around to seeing the market failure that the government was eliminating. I did not quite believe this myself, at first. Nevertheless, well over a dozen subsequent studies, studies of theoretical, institutional, and historical nature (many of which are still not published), have revealed that democratic legislatures have indeed been creatively and efficiently solving problems that economists have not even come to seriously recognize. Although it is obvious that politicians do not understand the underlying market failures either, political institutions have implicitly evolved constraints within which politicians operate in a way that generates remarkably efficient solutions. The constraints thus create a sort of "invisible hand" in government,

Anyway, perhaps because of my initial disbelief, or perhaps because I was involved with other, more theoretically challenging problems, I did not get around to writing up these tax results until the early 1970's. My earlier theoretical writings, several of which have been seminal, made me a quite reputable young economist. So I thought that economists would pay close attention when they saw my paper on the tax structure.

However, the profession's response to the paper was even more amazing to me than the paper itself.

MY MIDDLE YEARS AS AN ECONOMIST

I first delivered my tax paper to the 1972 Meetings of the American Economic Association. Despite its rather careful, technical, nature, it was panned by its establishment discussant, an economist whom I though was my friend, as "a baby only a father could love." J.K. Galbraith, the organizer of the Meetings, then called and offered to omit the unflattering review if I would withdraw my summary from submission to the May **AEA Proceedings**. Given the lack of substance of the criticisms, I was amazed at the inference that something was terribly wrong with the paper. Of course, I rejected the offer. A summary of my paper and the original comments are public information. Anyway, I then submitted the paper to the **JPE**, who published it in their July/August 1974 issue.

I then discovered that – despite the lack of theoretical or empirical criticism of the paper – my AEA discussant really was a friend. Not only was the paper ignored by the profession, but, from the publication of that paper until 1979, I went through a string of about 35 journal rejections in a row. My invitations to conferences almost immediately all but dried up. I felt black-balled by my profession. Why?

It was fairly clear, even from the beginning, that the content of the paper was unflattering to the economics profession. If economists came to believe the paper, they would have to join me in returning to the drawing board. The old set of policy critiques would have to be abandoned and an entirely new framework for policy analysis devised. There would be a temporary collapse in the demand for economists. Heavy financial losses would have to be sustained by the profession. I thought in my foolish youth that all this would soon happen, that economists are organized as a group of largely independent, individually competing, thinkers who would let the chips fall where they may as regards the effect of their analyses on the demand for economists. I discovered instead that the economics profession was an intellectual cartel. Although socially constrained to admit free entry into the cartel, the cartel could still profit by selecting ideas not for their objective truth value but for their effect on the aggregate demand for economists.

While struggling to be published again in the later half of the 70's, I began to pay some attention to the style and clarity of my writing, finally lifting them to a level that would lead referees to treat my papers reasonably fairly despite my poor reputation. So I published a batch of new papers from 1979 to 1981. One of them was a paper (published in the June,1981, **AER)** on the nature of social organization that I wrote with Roger Faith, then a UCLA graduate student. In this paper, we showed that simple communication between strategy-selectors would convert an ordinary, prisoner's-dilemma-ridden, Nash equilibrium into an efficient social equilibrium. It showed how easy it was for individuals to form an efficient, cartel-like, solution. All people had to do was form a communicating hierarchy in which the strategy appropriate to each slot was rationally selected. This helped explain the efficient-institutions result in my tax paper. Although not explicitly written in the paper, the implication was that economics, which contains fairly well-defined hierarchies, was a cartel. Anyway, I thought that the profession might ignore these "defects" and come to enthusiastically accept the paper as a tool for social analysis the way I have despite its unprofitable implications. This did not happen. I remained a lonely researcher in spite of – and perhaps because of – my ever-increasing supply of studies showing the dramatic efficiency of democratic legislation.

MY MATURE YEARS AS AN ECONOMIST

I found myself sort of "dropping out" in the early '80's. Partially in response to the profession's lack of attention to what I considered my most important work, partially in order to fill in the details of the social theory as well as a theory of underdevelopment that I had developed in the late 70's, and partially because of some changes in my personal life, I found myself intensively reading history. I was also engaged in reading comparative myth and religion because the only way for members of a ruling class to carry out their broadly rational strategies is to escape their narrow rationality by adopting highly exaggerated beliefs about the nature of their worlds.

It was in the process of this reading that I began to work with Charles Hickson, a previously Marxist UCLA graduate student who had a rare understanding and aptitude for economic history. We ended up doing a lengthy project on the rise and fall of European guilds. This gave me an opportunity to see the rise and fall of an economic institution through an evolutionary lens. It had long been apparent to me that the strategies and supporting myths that were responsible for the efficiencies that I had been observing were the result of an evolutionary process. But now I was able to see such a process in action. It was fairly exciting. Not only were we showing how a normal evolutionary process was generating efficient institutions, but we were also showing how the thoughts of economic or social intellectuals were actually destroying entire states. We wrote a long 1991 paper on the subject for **Explorations in Economic History**. Although it has been predictably received in a way that is similar to the earlier papers, seeing the social and developmental theories work through a historical and evolutionary process was extremely encouraging.

Our research was then hit by a stroke of good luck when Jorgen Weibull, in Chapter 5 of his Evolutionary Game Theory, was able to prove that any ordinary evolutionary process, whether generated by objective learning, natural selection, or a combination of the two, would uniformly converge to a Thompson-Faith social equilibrium as long as a stable social hierarchy is present. This theoretically confirmed our empirical study and allowed us to fit other studies into an explicit evolutionary framework. Morever, since objective learning was required for this felicitous convergence, we could show how the non-objectivities generated by an an "ideologized" ruling class, one whose thoughts are captured by an intellectual cartel, would evolve to an inefficient equilibrium. Intellectual cartels have not only been the bane of my little existence. They have also been the bane of society at large. The corresponding evolutionary theory and the new, anti-ideology, policy framework generated by this theory is the basis of the recent, 2001, Kluwer book by myself and Hickson, entitled, **Ideology and the Evolution of Vital Institutions: Guilds, the Gold Standard, and Modern International Cooperation.**

Before turning to globalization, a subject discussed at length in the book, I should point out that much of the book's theory of globalization is based on its theory of tariffs and international cooperation.

TARIFFS AND INTERNATIONAL COOPERATION

As elaborated in Chapter 3 of the book, the efficiency of tariffs is found in their ability to internalize the defense externality arising from the importation of durable consumer goods. Since taxing the importation of capital inputs is readily achieved by applying an ordinary domestic income tax to these capital imports, the defense externality does not justify a tariff on these capital imports. In fact, imports of capital inputs are rarely subject to tariffs. However, imports of durable consumer goods (which should not be taxed at the retail level for reasons having to do with domestic monopolization) cannot practically be taxed anywhere but at their port of entry. So, by ignoring defense externalities, modern economists have generally ignored the primary rationalization for historically observed tariffs.

This error is practically very important because of the effect economists have had on our international agencies. The GATT and its successor, the World Trade Organization, have worked to impose artificially low tariffs on third-world countries under the threat of imposing exceptionally high tariffs on their exports to the developed countries. The International Monetary Fund (IMF), has lent its powerful support to these policies by making the vital lines of credit that it supplies to these financially dependent countries conditional upon their acceptance of low-tariff policies.

Such ideologically inspired policy impositions are especially unjustified in that third-world countries seldom have sufficient effect on the terms-of-trade to justify our concern for their attempting to use tariffs to monopolize or monopsonize their international markets. Nevertheless, despite the corresponding absence of any clear welfare justification, our international agencies persist in imposing free trade policies on third world countries.

These ideologically inspired free-trade policies are exceptionally highly costly to third-world countries because such countries have exceptionally high defense externalities. This is because such countries are typically threatened from within as well as from without. Indeed, these domestic military threats are what keep these countries poor. Excessive imports exacerbate the problem and threaten these countries with excessive political instability. The U.S. thus further benefits from these inefficient policy-impositions through the higher third-world demand for military goods that the policies induce.

As elaborated in Chapter 5 of the book, each of these third-world countries has adopted domestically efficient, but of course globally inefficient, responses to the persistent policy impositions of the international agencies. Depending on the degree of dependency of the third-world country, these domestically efficient policies are, respectively: Hyper-repression, hyper-savings, hyperinflation, and costly social revolution. An ancillary, quite predictable, effect of all the painful adjustments is that the U.S., the developed country pushing hardest for these costly accommodations, is rationally regarded by third-world countries with the same hatred that mistreated children have for their possibly well-meaning parents.

Since the end of the Cold War and resulting increased dependency of the third-world countries on the U.S., these ameliorative adjustments have become more costly, meaning that free trade has become more prevalent. However, some additional IMF loan conditions have also been imposed on the third-world countries. Coupling these new loan conditions with the externally imposed free-trade conditions constitutes the "globalization" policies that we promised to discuss.

GLOBALIZATION IN PRACTICE

These new IMF loan conditions, "reforms" promoted in the name of relieving domestic poverty and increasing domestic efficiency, insist the third-world countries increase their domestic taxes in order to support expanded education systems, substantially reduce governmental welfare programs, and improve the enforcement of property rights systems by expanding their court and penal systems. Just why these countries are unable to chose optimal educational, welfare, and penal systems is never seriously considered. Taken together, the intent of these "reforms" is fairly clear. It is to make the country more 'investor-friendly," largely through the improvements in the domestic workforce and corresponding reductions in domestic wages.

And, taken together with the harsher free-trade requirements, the effect of the combined, "globalization" policies on the functional distribution of income in the developed countries is clear. The effect is to increase large-company profits and decrease wages and small-company profits despite the reduction in world-wide economic efficiency and despite the further deterioration in the U.S.'s already abysmal reputation among the third-world countries. The U.S.'s persistent support of globalization despite the international events of the past couple of years reveals the high cost our ruling class is willing to incur in order to achieve this distributional goal.

Another revealing policy along these lines is the willingness of the post-Cold-War U.S. to allow ruling class business executives and large investors to escape prosecution for misleading the mass of small U.S. investors, which has recently resulted in the most redistributional market crash in U.S. history.

We are now ready to return to our social theory to gain some perspective on these recent observations.

GLOBALIZATION IN THEORY: POLICY IMPLICATIONS

Let us return again to the social theory that has absorbed so much of my mature years as an economist. Besides social efficiency, a second implication of this simple theory of games with rational strategic communication is that the distribution of wealth is radically skewed to the benefit of the early communicators, the social leaders. In other words, social leaders get almost all of the social surplus. Thus, when we see, as we have in the West during much of the past couple of centuries, a flourishing middle class, it's not because the masses have finally come to assert their "natural rights." We must realize that the only thing responsible for this middle-class revolution is that, following the Napoleonic Wars, the Western ruling classes suddenly had to compete for their populations. The solution distribution has always heavily favored the ruling classes; it's just that the surplus available to the various ruling are much lower once they must compete for their populations,

The end of the Cold War has meant the existence of an entirely new evolutionary direction, one in which the leaders of the world's most powerful country are now, almost inexorably, leading us back to the age of aristocracy, when there was no middle class to speak of. The political economy of such governments imply that wages will always tend to settle at subsistence and stay there – not because of any Mathusian or Ricardian forces but – because this was the explicit intent of the aristocrats, who set tax rates accordingly.

We said "almost" inexorably for a reason. Sufficiently widely held insight can defeat evolutionary forces. In particular, as emphasized in Chapters 2 and 6 of the aforementioned book, we can defeat the emerging distributional disaster by formally acceding to the world's hegemonic leader – say by allowing the hegemon (currently the U.S.) to select the administrative head of the formal world government (the United Nations) in exchange for its commitment to a suitable constitution, one that suitably constrains the policies of international organizations toward the various countries of the world. In particular, the developed nations should commit themselves to allowing third-world countries to set their own economic policies without the interference of international economic agencies. Achieving such a "states-rights," Articles-of-Confederation, type of policy means regulating the international agencies. Under such regulation, the IMF would no longer be able to impose loan conditions on third-world countries that were not demonstrably justified by their effect on the ability of the country to repay the loan. And the WTO would not be able to impose any tariff reduction that could not be demonstrably justified by its salutary effect of the degree of monopoly or monopsony of the tariff-imposing country. Third-world countries would then no longer face the threat of a discriminatory tariff if they did not accede to a tariff reduction. This would represent not only a substantial allocative improvement and a restored international reputation of the hegemon; it would also represent a restoration of competition of independent states for people, a competition that has been recently destroyed by the end of the Cold War through a predictable escalation in the policy dependence of third-world countries on the IMF. A restoration of such competition is required to prevent the imminent disappearance of the world's now-fragile middle-classes.