WILL GLOBALIZATION SURVIVE?

Martin Wolf [1]
Associate Editor & Chief Economics Commentator,
Financial Times

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> *[I]t is worth bearing in mind that, despite numerous warnings issued in the early twentieth century about the catastrophic consequences of a war among the European great powers, many people—not least investors, a generally well-informed class—were taken completely by surprise by the outbreak of World War I. The possibility is as real today as it was in 1915 that globalization, like the Lusitania, could be sunk.*
>
> —Niall Ferguson, "Sinking Globalization," *Foreign Affairs*[2]

Ours is not the first age of globalization. The decades before the First World War were remarkably similar to our own era. Under the aegis of the United Kingdom and stimulated by a host of technological advances, the world enjoyed an era of liberal trade, remarkably free movement of people, and almost entirely free movement of capital. The world also enjoyed an unprecedented rise in prosperity. According to the economic historian, Angus Maddison, real GDP per head rose at a rate of 1.3 percent a year in the world as a whole between 1870 and 1913.[3] This is not far short of the improvement of the past three decades. As table 1 shows, only Asia and Africa, both victims of colonialism, failed to share in the rising prosperity.

Then came the war. Norman Angell, in his notorious book, *The Great Illusion*, published in 1910, argued persuasively that war was a ruinous folly. He hoped to persuade people that nothing could come from a European war but mutual ruin. His hopes failed. Many have since condemned him for his innocence. But if one reads his book, one will find not that he thought war impossible, but that he thought it insane. He hoped people would prove rational. People, as is their wont, disappointed him.

That war began the ruin of the first globalization. The economic disarray of the interwar years, the failure of the United States to assume the responsibilities of power, the weariness and weakness of the United Kingdom and France, the bitterness of the Germans, and the Bolshevik triumph in Russia completed the job. The failure of the first liberal order—that of the 19th century—led to 30 years of catastrophe. "Never again" was the motto under which I wrote my book, *Why Globalization Works*.[4]

Since then, we have recreated a better liberal international order—one that extends opportunities to the world as a whole. It is our duty to our descendants not to throw away this golden opportunity once again. Yet the fact that we should not do something does not mean that we will not do so. Globalization is fragile, for a simple reason: A global market economy depends on the support of states. States provide the security of property and person on which all complex exchange depends. But states are necessarily territorial. The loyalties they create, evoke, or reflect are steeped in humanity's characteristic tribalism.

In the remarks that follow, I wish to extend this argument by first analysing the driving forces of globalization and then looking at its achievements and failures before examining the risks that lie ahead. I conclude with what we can do to minimize those risks. But when I say "we", I really mean you: the United States.

What Drives Globalization

I define globalization as the integration of economies through markets across frontiers. It is driven, in turn, by two forces: the reduction in the costs of transportation and communications and economic liberaliation. The reduction in the costs of transportation and communications is a consistent tendency in human history, though one that has accelerated over the past two centuries. Economic liberalization, however, is far from consistent. On the contrary, the last two centuries have seen two upswings and one huge downswing.

Falling Costs of Transportation and Communications

Changes in transportation and communications technology create opportunities for increased commerce and are, in turn, created by them. This is *not* a new phenomenon.[5] The railway, the steamship, the refrigerator, and the telegraph created the opportunities for the integration of the 19th and early 20th centuries. The railway made the shipping of commodities in bulk over land feasible for the first time in history. With the steamship, tens of millions of people could cross the oceans with ease—and did so.

The first transatlantic cable was laid in 1866. This, argues professor Kevin O'Rourke, was "the most important breakthrough of the last 200 years" for the capital markets. "No other innovation," he writes, "including the late nineteenth-century invention, the telephone, or its late twentieth-century equivalent, the Internet, has had comparable impact on the speed of information flows and capital market integration."[6]

The 20th century added the container ship, the giant tanker, and the airliner. It also added radio, television, transcontinental telephony, the satellite, the computer, and the Internet. New opportunities have been created and, again, they have been exploited. They are to be seen in 24-hour financial markets, mass tourism, and the global interconnection of production that has spawned the multinational corporations of today.

Economic Liberalization

In the long run, then, the world seems bound to become more globalized because opportunities have grown enormously. But history tells us that this does not mean a never-ending rise in integration. In the 19th century, a rising ride of liberalism reached its highest point in the last one or two decades of the century. Thereupon a combination of powerful forces reversed the tide. I define those forces as the four "I's": geopolitical insecurity—the rivalry among the great powers that culminated in two world wars; macroeconomic instability—above all the Great Depression; protectionist interests—particularly important in the United States in 1930, when the Smoot-Hawley tariff was enacted; and collectivist ideas—nationalism, imperialism, socialism, and communism. By 1945, the integrated world economy had disappeared.

After World War II, liberalization began anew, though haltingly, in Western Europe and across the Atlantic under the wise leadership of the United States. By the late 1960s, the success

of a small number of relatively outward-looking east Asian economies was becoming more visible. By the late 1970s, the failures of state planning and nationalization were also becoming evident. This set the stage for what must be the most dramatic period of economic liberalization there has ever been—a process that has, in a quarter of a century, brought something like 4 billion additional people within the purview of the global market.

Think of the headlines alone: the transformation of Mao Zedong's China into what is, almost certainly, the most internationally open large country in history; the collapse of the Soviet empire; and the end of India's "license raj." These events alone transformed the economic lives of about 2.8 billion people. But this was not all. Economic liberalization also swept across much of Latin America.

In all these cases, moreover, what happened was not just liberalization at the border. As has usually been the case, the move towards the market has been simultaneously internal and external. There have been exceptions: The United States was one in the 19th century, when it combined high protection against imports with laissez-faire at home. But when countries decide to adopt the logic of the market, they normally do so both domestically and internationally. Once one has accepted that market relations make sense among domestic residents, it is hard to argue that foreigners must be excluded. A country's international transactions are, after all, just the aggregate of the individual transactions by its residents. Moreover, because the motivation for such transactions is the same as for transactions with fellow residents, they are just as likely to contribute to the welfare of those who undertake them. This is the logic of international integration.

It is impossible in a short space to examine this liberalization in detail. But let us take one example: China. Between 1992 and 2002, the weighted average tariff on Chinese imports fell from 40.6 percent to 6.4 percent. In effect, China, within just ten years, moved from having import barriers comparable to those of today's high income countries in the early 1950s to levels close to the current ones of the high-income countries. And, since a tax on imports is also a tax on exports, China's exports exploded: Between 1999 and last year, exports rose from $200 billion to not much short of $600 billion. What we are seeing here is nothing short of a global market revolution.

Globalization's Record

What has been the result of the interaction of these twin forces, the declining costs of communications and the move to the market? Summarized briefly, two big things have happened over the past two and a half decades: The first is a huge rise in the integration of the goods-producing sectors of economies, and the second is a still bigger increase in foreign direct investment (see figures). These are two aspects of one thing: the integration of production across frontiers by transnational companies. They have, in the process, created something quite new: specialization of production within manufacturing on the basis of specific sources of comparative advantage.

Yet it is also important to be clear about what has not happened. Two things, in particular, are almost certainly less globalized than a century ago: labor markets and long-term capital markets.

The former is shown by the fact that the proportion of the world's population living in countries other than the country of birth is about 3 percent now, against about 10 percent in the

late 19th century. It is also shown by the historically unprecedented gaps in real wages across the planet for people with much the same skills.

The latter is shown by the failure to generate consistent large net capital flows from rich countries to poorer ones. In fact, over the past seven years, the net flows have gone in the opposite direction, from the developing world to the world's richest country. The failure to create the basis for stable net flows of capital from the rich world to the poor one is, I would argue, the greatest single failure of the second age of globalization.

If we turn to human welfare, what is our assessment?

- Globalization has brought large economic gains to many parts of the world, above all to Asia, which has successfully exploited the ladder of development created by labor-intensive manufactures.
- Globalization has brought about huge reductions in the number of people in extreme poverty. According to the latest World Bank data, the proportion of the east Asian population living on less than a dollar a day at purchasing power parity fell from 56 percent in 1981 to 16 percent in 2001. This is the biggest and fastest reduction in extreme poverty in world history.
- The relatively rapid growth of Asian developing countries has almost certainly reduced global inequality among households for the first time since the 1820s.
- Globalization has brought big gains to the developed countries as well. Recent work by the Institute for International Economics suggests that the gains to the United States alone amount to $1,000 billion—almost 10 percent of GDP. For the United Kingdom, the gains must be far greater.[7]
- Globalization has not worked well for Africa or much of Latin America. For this there are three reasons: the resource curse, persistent protectionism in agriculture, and the weak supply conditions in these countries. In addition, for these countries, the entry of China into the world economy is a massive shock, both positive and, in some cases, negative.

My conclusion then is that we have done quite well, but we must do better. For this reason, I strongly support the idea of a big push on Africa. It is also why we must do what we can to encourage the rest of Latin America to learn from Chile's success, not Argentina's failure.

Threats to Globalization

Doing better would be excellent. But we can also do far worse. The international economic integration of the late 19th century went into reverse. Is the present move towards integration likely to suffer the same fate? To answer this question, one needs to take account of the differences and similarities between these two epochs. The breakdown last time was the consequence of the combined force of protectionist interests, antiliberal ideas, economic instability, and international rivalry. How likely are the same four horsemen of the apocalypse to return?

Protectionist Interests

The first force underlying the disintegration of the earlier form of globalization was protectionist interests, shown most decisively in the United States in the interwar years. The highly protectionist policies of the world's biggest and most successful economy undermined liberalism elsewhere.

Yet these forces have happily been significantly modified and ameliorated by contemporary economic developments.

The rise of the internationally integrated transnational company has reduced the ability (and willingness) of producers to wrap themselves in national flags. It is no accident that protectionist interests are strongest in predominantly nationally owned and operated industries—such as steel and agriculture. Is a Toyota factory in the United States less or more American than a General Motors factory in China? Is Goldman Sachs in Frankfurt less or more American than HSBC in New York? The answer to such questions is: Who knows? Modern companies have global interests. The same is true for many of their most valued employees. Nationalists find the cosmopolitan attitudes of companies and many top-level employees objectionable. A significant consequence, however, is the breakdown in the ability and willingness of companies to collaborate with trades unions on their demand for protection. Developing countries have been affected by the same trends. Inward foreign direct investment and intraindustry trade diffuse traditional protectionist interests. The concept of a purely national business sector has become increasingly irrelevant and, just as in industrial countries, this diffuses protectionist lobbying.

The increase in service sector employment and the decline in employment in manufacturing has, along with the rise in the portion of the population in retirement, reduced the share of the voters whose jobs are directly vulnerable to import competition. Consumers have also become accustomed to foreign products. They may, as workers, complain about imports. But they still like the products foreign companies provide. Many in high-income countries express concern about the decline in relative wages and employment opportunities of the unskilled. But the political power of unskilled workers has diminished. Moreover, the consensus of economists, disputed by only a minority of politicians, is that this decline in opportunities reflects changes in technology, not in trade.

In addition, the existence of multilateral institutions and a web of strong international commitments makes it far more difficult for protectionist interests to capture legislatures, as they once did. There is too much at stake for countries to reverse the commitments they have made. Even the Bush administration, wedded though it is to unilateralism, has never said that it should ignore its obligations under the World Trade Organization (WTO), even though it is the most binding multilateral economic commitment the United States has.

Collectivist Ideas

A second element in the 20th century collapse of the liberal international order began, at home, with the rise of antiliberal ideas. There are parallels today between groups then and now, particularly with what the former chief economist of the OECD, David Henderson, has called 'new millennium collectivists'—the groups who unite to protest against global capitalism.[8] But this group of protesters is very different—and much less intellectually coherent—than the opponents of liberalism of a century ago. The antagonists of liberalism then converged around two ideas: radical socialism and racially-defined nationalism. Both groups called for control of

the state over the economy and primacy of the collective over the self-seeking individual. Both sought power—and knew what they wanted to do with it. That made them extraordinarily dangerous.

The intellectual origins of today's antiliberal movement are far more diverse. They include environmentalists, development lobbies, populists, socialists, communists, and anarchists. These groups are united only in what they oppose. They are rooted in no cohesive social force, such as the organized working class. They largely reject party politics. They offer no alternative way of running an economy. They are split in their objectives. Part of what some protesters say—notably on the hypocrisy of the advanced countries and the plight of the poor—is valid. But a political movement cannot beat something with nothing. A movement that offers only protest is unlikely to triumph.

Economic Instability

The decisive event in the collapse of the integrated economy of the late 19th and early 20th centuries was the Great Depression in the United States and the financial and exchange rate crises that rolled across the world in the 1930s.[9] In developing countries, financial and exchange rate crises have come with depressing frequency over the past two decades. Substantial financial and exchange rate crises also erupted among the other advanced economies in the 1980s and early 1990s. Japan is still struggling with the aftermath of its bubble economy, while the United States has also suffered a huge stock market bubble, which reached its maximum extent in 2000.[10]

All these are signs of significant financial instability. Yet it is almost impossible to believe that the outcome will be another 1930s. The move to floating rates has, as Max Corden foresaw, significantly reduced the risk of such crises.[11] The woes inflicted upon Argentina by the collapse of its currency board at the end of 2001 should, therefore, be viewed as the end of an era rather than as the beginning of a new one. Its crisis has also had remarkably little effect on other emerging-market economies. Much of the transfer of resources to developing countries is now taking place in the longer-term, more sustainable form of foreign direct investment. For all these reasons, the likelihood of massive waves of financial crises in emerging-market economies has declined. It is also striking that, despite these crises, no significant country has reversed its commitment to liberal trade or even to freedom from exchange controls. That even includes Argentina. Today, such policies are seen as a dead end—the quickest way to join Castro's Cuba or Kim Jong-il's North Korea in far from splendid isolation.

Yet I cannot leave the question of global economic instability without touching upon what is both the strangest and most disturbing feature of the world economy—its dependence for macroeconomic stability on explosive rises in US current account deficits. The United States has, in essence, become the world's borrower of last resort. Since it is the world's most creditworthy debtor and the issuer of the world's most trusted currency, it is better placed to play this role than any other country. In the process, the United States is making it possible for the world to run at tolerably high levels of economic activity, by absorbing the excess savings of Japan and continental Europe and accommodating the mercantilism of emerging Asia. In addition, it has been substituting its own excellent credit for the poor credit of weak emerging-market economies, which would otherwise have surely been the world's principal borrowers. That has eliminated the big financial crises of the 1990s.

Yet this "solution" to the adding-up problem for the world economy itself carries two big risks: rising protectionist sentiment in the United States, and, at some point, a brutal and sudden

correction, as the rest of the world decides that its holdings of dollar claims are excessive and, not least, too vulnerable to the depreciation that must occur if the US current account deficit is to fall sharply as a share of GDP. The chance of a hard landing, with unpredictable political consequences in the United States and among the creditors, though not 100 percent, is not zero either, and, as I have frequently argued, the odds increase with each passing year.

International Rivalry

Yet the most important cause of the 20th century breakdown was the collapse of harmonious international relations, as rivalries among the great powers and the rise of communism and fascism fragmented the globe.

In his gloomy article, Ferguson, too, emphasizes the geopolitical dangers, pointing to five parallels between the United States today and the United Kingdom a century ago: overstretched, physically and financially; great power rivalry, with China now in Germany's role; an unstable alliance system, with the disintegration of the transatlantic relationship; rogue regimes (then Serbia, now Iran and North Korea); and revolutionary organizations (then the Bolsheviks, now al-Qaeda). I believe he is right: the breakdown in economics starts from a breakdown in global politics.

For the moment, however, the situation is different, in four fundamental respects.

- There is a single undisputed hegemon, the United States, and little chance of a war among the great powers in the near future, except just conceivably between the United States and China over Taiwan. Yet China is not, at present, powerful enough to be a rival of the United States.
- Second, all the great powers have largely abandoned the atavistic notion that prosperity derives from territorial gains and plunder rather than internal economic development and peaceful exchange. One of the striking features of today's war against terrorism is that all the world's great powers are on the same side.
- Third, all the great powers share a commitment to market-led economic development and international economic and political integration.
- Fourth, global institutions and habits of close cooperation reinforce the commitment to cooperation.

All these are powerful differences between the world of nearly a century ago and today's world. Against this, we must note two obvious parallels.

The breakdown of the early 20th century occurred, in part, because of the pressures to accommodate rising powers in the global economic and political order. The rise of China will, in time, create comparable pressures. If the United States remains wedded to notions of global primacy rather than of a shared global order, conflict with a rising China would seem virtually inevitable. Indeed, John Mearsheimer, professor of political science at the University of Chicago, argues that conflict (though not war) is inevitable *tout court*: the United States, he argues, will not tolerate a strategic rival.[12] War would then ensue for exactly the same reason that Thucydides thought it arose between Athens and Sparta: The status quo powers feared the rise of a rival, while the rising power resented the pretensions of the incumbents.

In addition, China's rise will force uncomfortable economic adjustment on the rest of the world. These are already creating protectionist pressures, notably so in the United States. It is

not, alas, impossible to envisage a spiral of mutual hostility that undermines the commitment to a liberal international economic order.

Today, however, instead of such a breakdown in relations among the world's most important powers, we confront an alternative threat: mega-terrorism. Some fear that terrorist outrages on the scale of the attacks on New York and Washington of September 11, 2001—or even bigger ones—will end the commitment to open borders. It is not difficult to envisage the devastating impact the smuggling of a nuclear device into a country on a container ship would have on confidence in open borders. Closely related fears concern the development of weapons of mass destruction by regimes hostile to the liberal world order in general and the United States in particular. At worst, such regimes might collaborate with terrorists to inflict vast, and virtually untraceable, damage on civilized states.

Fear of what might come across borders must act as a tax on globalization. If countries had to be sure of the safety of every shipment and person that crosses their borders, much of today's globalization would become impossible. Yet that would also hand the victory to the terrorists and their sponsors. At present, it does not appear that the world's response to September 11 will be to close borders. That would only exacerbate the desperation in the world's less economically successful countries. Global cooperation to control terrorists and improved security measures seem a more appropriate and effective route. But the danger is a genuine one. It cannot be ignored.

Resource Insufficiency

Power is not the only asset whose availability creates a zero-sum relationship. So does the supply of finite resources. While most countries now understand that wealth is created by production and exchange, not plunder, that is not so obviously true of access to raw materials, particularly fossil fuels. If one accepts that the supply is, indeed, finite, then more demand by new consumers makes other consumers unambiguously worse off. In recent years, incremental demand for oil from Asia has exceeded incremental demand from North America by two to one. This is one of the explanations for today's high prices. If one combines this with the fact that the politically unstable Gulf region seems set to become an ever more important source of this vital fuel, the potential for disruption and even conflict is not small. Why, Americans might reasonably ask, should they bear the price of ensuring oil to China at the same (high) price as the one they pay themselves? The search for vital raw materials was a motivating force behind territorial expansion in the first half of the 20th century. It could easily become so again in the years ahead.

So What Is To Be Done?

Globalization is not inevitable. It depends on politics. In today's world, it depends above all on US politics. Without successful US leadership at a time of huge upheavals, the present globalization may founder, just as the last one did. I suggest three priorities:

First, a big effort must be made to ensure that the weakest and poorest countries are in a position to share at least some of the benefits of the global economy and advancing technologies. It is too easy to imagine that, by the middle of this century, as many as 1.5 billion to 2 billion people will live in countries whose real incomes per head are less than a hundredth of those in the richest. Such a world cannot possible be stable.

Second, an equally big effort must be made to fix the sources of global macroeconomic instability. In the long run, it will be important for emerging-market economies to pursue policies that allow them to borrow in their own currencies. More importantly, China must be told firmly that the Asian mercantilist strategy will not work for a country of its scale. At the very least, it should run a current account deficit equal to the net inflow of foreign direct investment.

Third and most important, the United States must find a way to deal with the three principal long-term sources of geopolitical instability: dependency on oil from the Gulf region; Islamic fundamentalism; and a rising China. In none of these cases will the United States be able to achieve what it wants on its own. In all cases, however, the outcome will depend on US leadership.

Progress or relapse—the choice is largely, but not entirely, the United States'. History will judge. We can only warn. Peace, prosperity, and harmonious international relations are neither normal nor natural. They must be worked for by every generation. Ours is no exception.

TABLE 1 GROWTH IN GDP PER HEAD 1820-2001 (annual average compound growth rates, per cent)					
Region	**1820-1870**	**1870-1913**	**1913-50**	**1950-73**	**1973-2001**
Western Europe	0.95	1.32	0.76	4.05	1.88
Western Offshoots	1.42	1.81	1.55	2.45	1.84
Japan	0.19	1.48	0.89	8.06	2.14
Eastern Europe	0.63	1.39	0.6	3.81	0.68
Fomer USSR	0.63	1.06	1.76	3.35	-0.96
Latin America	0.1	1.81	1.42	2.52	0.91
Asia (excluding Japan)	-0.11	0.38	-0.02	2.92	3.55
Africa	0.12	0.64	1.02	2.07	0.19
World	**0.53**	**1.3**	**0.91**	**2.92**	**1.41**

Source: Angus Maddison, *The World Economy: Historical Statistics* (Paris, Development Centre of the Organisation for Economic Co-operation and Development, 2003), Table 8b.

FIGURE 1
RATIO OF TRADE IN GOODS TO GOODS GDP (per cent)

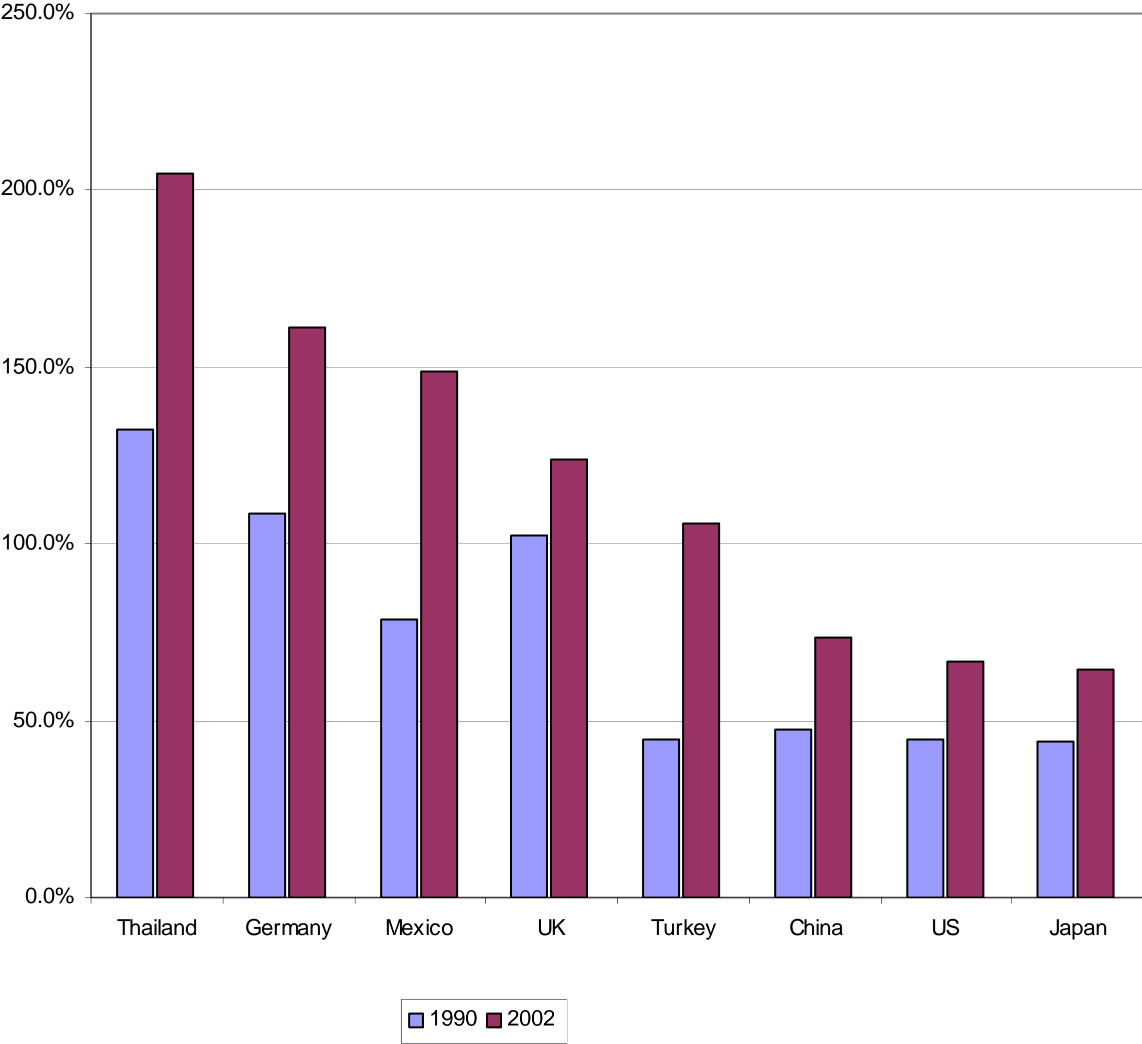
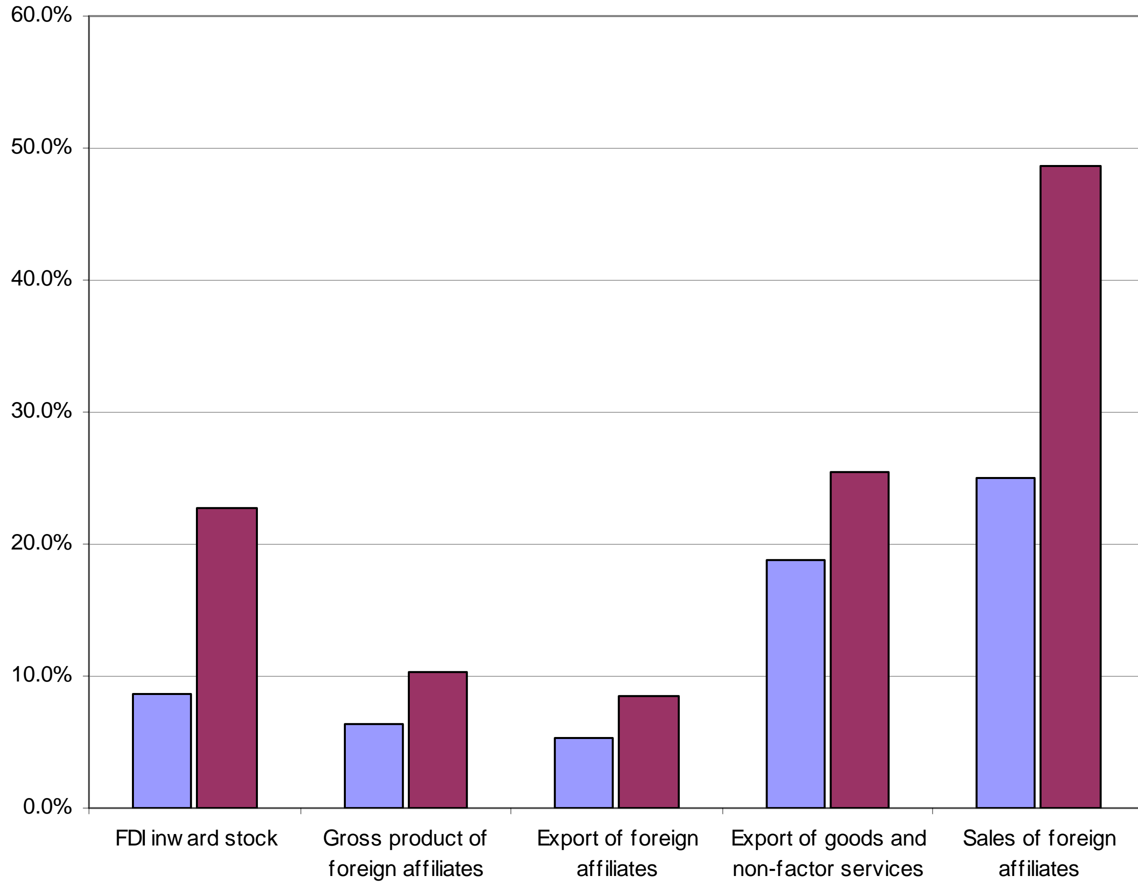


FIGURE 2
RISING INTEGRATION OF THE WORLD ECONOMY
(per cent of global GDP)



Source: UN, World Investment

Notes

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[1] Associate Editor and Chief Economics Commentator, *Financial Times*, London. This lecture is drawn from *Why Globalization Works* (New Haven and Connecticut: Yale University Press, 2004).

[2] Niall Ferguson, "Sinking Globalization," *Foreign Affairs* (March/April 2005), 64-77.

[3] Angus Maddison, *The World Economy: Historical Statistics* (Paris: Organisation for Economic Co-operation and Development, 2003).

[4] Martin Wolf, *Why Globalization Works* (New Haven and London: Yale University Press, 2004), x-xviii.

[5] Kevin O'Rourke, "Europe and the Causes of Globalization, 1790 to 2000" in Henryk Kierzkowski, ed., *Europe and Globalization* (Basingstoke: Palgrave Macmillan, 2002) chap. 3, 74-6.

[6] Ibid., 76.

[7] Institute for International Economics, "A New Foreign Economic Policy for the United States," (Washington: Institute for International Economics, February 9, 2005), http://www.iie.com/publications/newsreleases/feppr.htm.

[8] See David Henderson, *Anti-Liberalism 2000: the Rise of New Millennium Collectivism* (London: The Institute of Economic Affairs, 2001).

[9] See Harold James, *The End of Globalization: Lessons from the Great Depression* (Cambridge, Mass: Harvard University Press), chap. 2.

[10] On the recurrent bouts of financial instability, see Edward Chancellor, *Devil Take the Hindmost: a History of Financial Speculation* (Basingstoke and Oxford: Macmillan, 1999). On the Wall Street bubble, see among other publications, Andrew Smithers and Stephen Wright, *Valuing Wall Street: Protecting Wealth in Turbulent Markets* (New York: McGraw Hill, 2000).

[11] See W. Max Corden, *Economic Policy, Exchange Rates, and the International System* (Oxford: Oxford University Press and Chicago: University of Chicago Press, 1994).

[12] John J. Mearsheimer, "Better to Be Godzilla than Bambi", *Foreign Policy* (January/February 2005).