Will Globalization Survive?

Martin Wolf

> "[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."
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> Niall Fergusson, "Sinking Globalization".[1]

The decades before the First World War were remarkably similar to our own era. Under the aegis of the UK and stimulated by a host of technological advances, the world enjoyed liberal trade, free movement of people and almost entirely free movement of capital. It also enjoyed an unprecedented rise in prosperity. According to the economic historian, Angus Maddison, real gross domestic product per head rose at a rate of 1.3 per cent a year in the world as a whole between 1870 and 1913.[2] This is not far short of the improvement of the past three decades. As Table 1 overleaf shows, only Asia and Africa failed to share in the rising prosperity.

Then came the war. Norman Angell, in his famous book, *The Great Illusion*, published in 1909 argued persuasively that war was a ruinous folly. 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. As is their wont, people disappointed him.

That war began the ruin of the first globalization. The economic disarray of the interwar years, the failure of the US to assume the responsibilities of its power, the weariness and weakness of the UK 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 nineteenth century—led to thirty years of catastrophe. "Never again" was the motto under which

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[1]Niall Ferguson, "Sinking Globalization", *Foreign Affairs*, March/April 2005, pp.64–77.
[2] Angus Maddison, *The World Economy: Historical Statistics* (Paris: Organisation for Economic Co-operation and Development, 2003).

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
Former 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.

I wrote my recent book, *Why Globalization Works*.[3]

But will it really be never again? In the remarks that follow, I will start by analysing the driving forces behind globalization. I will then look at its impact, before examining the risks that lie ahead. I conclude with a few ways to minimise those risks.

What drives globalisation

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

Falling costs of transport and communications

Changes in technology of transport and communications create opportunities for greater commerce and are, in turn, created by them. This is *not* a new phenomenon.[4] The railway, the steamship, the refrigerator and the telegraph created the opportunities for the integration of the nineteenth and early twentieth 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

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

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

1866. This, argues professor Kevin O'Rourke was "the most important breakthrough of the last 200 years for the capital markets".[5]

The twentieth 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 multi-national corporations of today.

Economic liberalisation

In the long run then, the world seems bound to become more globalized, because underlying opportunities have grown so much. But history tells us that this does not mean a never-ending increase in integration. In the nineteenth century, a rising ride of liberalism reached its highest point in the last one or two decades of the century. Thereupon that tide reversed.

After World War II liberalisation began anew, though haltingly, within Western Europe and across the Atlantic under the leadership of the US. By the late-1960s, the success of a small number or relatively outward-looking East Asian economies was also becoming more visible. By the late-1970s, the failures of state planning and nationalisation were also becoming evident. This set the stage for what must be the most dramatic period of economic liberalisation there has ever been. Think of the headlines alone: the transformation of China; the peaceful collapse of the Soviet empire; and the end of India's "license raj". These events alone transformed the economic lives of about 2.8bn people.

It is impossible to examine this liberalisation here in detail. But let us take one example. Between 1992 and 2002, the weighted average tariff on Chinese imports fell from 40.6 per cent to 6.4 per cent. In effect, China moved from having barriers to imports comparable to those of today's high-income countries in the early 1950s to close to the current levels of the high-income countries within just ten years. And, since a tax on imports is also a tax on exports, China's exports exploded: between 1999 and 2004, they rose from $200bn to $600bn.

Globalisation's record

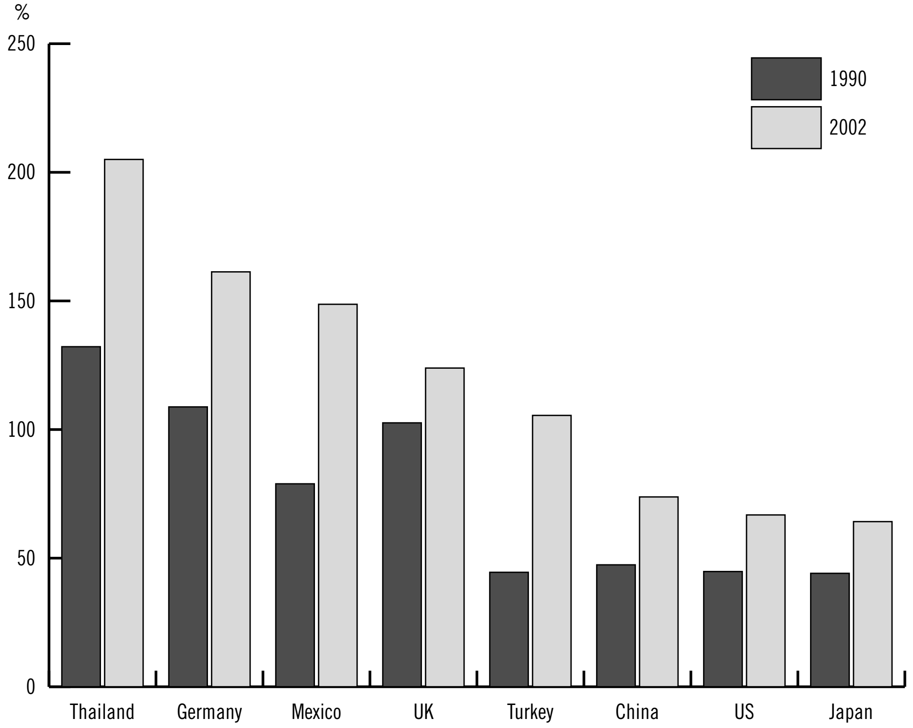
What has been the result of the interaction of these twin forces—the declining costs of communications and the move to the market? Two big things have happened over the past two and a half decades: the first is a huge rise in the integration of the goods-producing sectors of economies; and the second is a still bigger increase in foreign direct investment (see Figures 1 and 2).

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

The former is shown by the fact that the proportion of the world's population

[5] *Ibid*. p. 76.

Figure 1: Ratio of trade in goods to goods GDP (%)



living in countries other than the country of birth is about 3 per cent now, against about 10 per cent in the late nineteenth century. It is also shown by the historically unprecedented gaps in real wages across the planet.

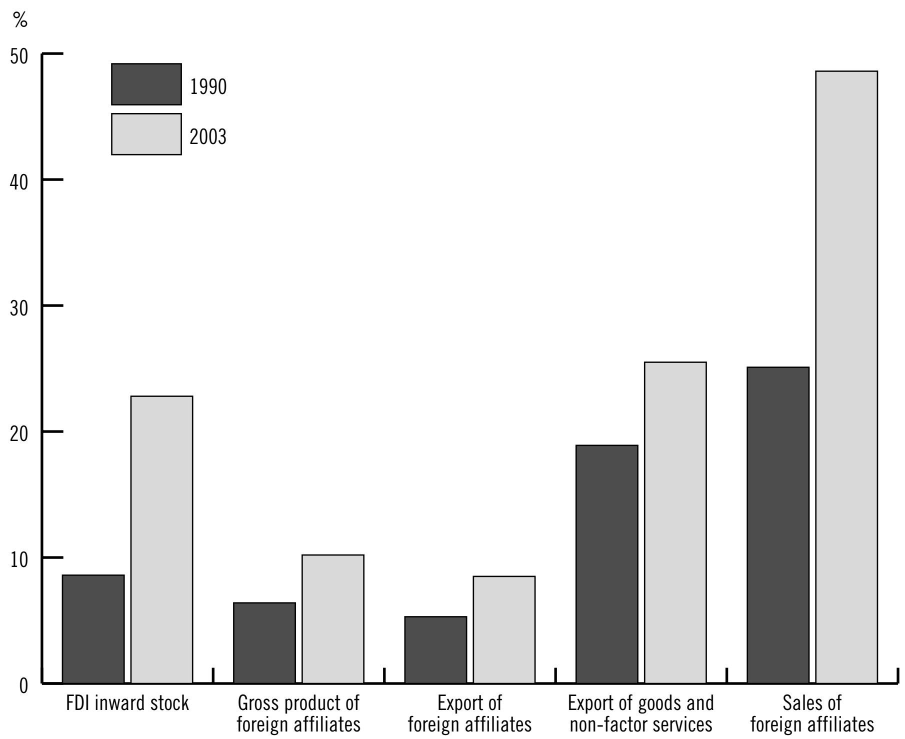
The latter is shown by the failure to generate consistent large net capital flows from rich countries to poorer ones. Over the past seven years net flows have gone in the opposite direction, from the developing world to the world's richest country. The failure to create stable net flows of capital from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

Now turn to the impact on human welfare:

- Globalization has brought big economic gains to many parts of the world, above all to Asia, which has successfully exploited the ladder of development created by labour-intensive manufactures

- Globalization has brought about huge reductions in numbers 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

Figure 2: Rising integration of the world economy (per cent of global GDP)



Source: UN, World Investment

56 per cent in 1981, to 16 per cent 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 also brought big gains to the developed countries. Recent work by the Institute for International Economics suggests that the gains to the US alone amount to $1,000bn—almost 10 per cent of GDP.[6] For the UK, they must be far greater.

- Yet the era of globalization has not worked well for Africa or much of Latin America. For this there are three reasons: what development economists now call the "resource curse"; the developed world's persistent protectionism in agriculture; and weak underlying supply

[6] "A New Foreign Economic Policy for the United States", February 9th 2005, Institute for International Economics, www.iie.com.

conditions (economic, ecological, institutional and political) in these countries.

We have done quite well, but must do better. It is for this reason that I strongly support the idea of a big push in assistance for Africa. It is also why we must encourage the rest of Latin America to learn from Chile's success, not Argentina's failure. Here is a task for Paul Wolfowitz at the World Bank.

Threats to globalization

Doing better would be excellent. But we can also, alas, do worse. The international economic integration of the late nineteenth 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, anti-liberal ideas, economic instability and international rivalry. How likely are the same four horsemen of the apocalypse to return? And below I add a fifth: resource insufficiency, particularly energy.

Protectionist interests

The first force underlying the disintegration of the earlier form of globalisation was protectionist interests, shown most decisively in the US in the inter-war years. The highly protectionist policies of the world's biggest and most successful economy undermined liberalism elsewhere.

Yet 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 US less or more American than a General Motors factory in China? The answer to such questions is: who knows? Modern companies have global interests. The same is true of 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 in the demand for protection. Developing countries have been affected by the same trends.

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 complain, as workers, 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 this group of people has diminished. Moreover, the consensus of economists is that this decline in opportunities has reflected changes in technology more than in trade.

In addition, the existence of multilateral institutions and a web of strong international commitments make it far more difficult for protectionist interests to capture legislatures, as they once did. Even the Bush administration has never said that it should ignore its obligations under the WTO, even though it is the most binding multilateral economic commitment of the US.

Yet I would not ignore protectionist interests altogether. Perhaps the most important risk is the concern about the "outsourcing" of relatively skilled jobs as information-based services have become unprecedentedly tradeable. At times of macroeconomic instability and high unemployment, such outbursts of protectionist sentiment will happen. They should, however, be containable.

Collectivist ideas

A second element in the twentieth century collapse of the liberal international order began was the rise of anti-liberal ideas. There are parallels today, particularly in what the former chief economist of the OECD, David Henderson, has called "new millennium collectivists"—the groups who unite to protest against global capitalism.[7] But this group of protesters is very different—and much less intellectually coherent—than the opponents of liberalism of a century ago.

Then the antagonists of liberalism converged around two ideas: radical socialism and racially defined nationalism and imperialism. Both groups called for control of the state over the economy and primacy of the collective over the self-seeking individual. Both sought, and knew what they wanted to do with, power.

The intellectual origins of today's anti-liberal movement are far more diverse. They are rooted in no cohesive social force, such as the organised 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 over the hypocrisy of the advanced countries and the plight of the poor—is valid. But 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 nineteenth and early twentieth century was the Great Depression in the US and the financial and exchange rate crises that rolled across the world in the 1930s.[8] In developing countries, financial and exchange rate crises have also 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 US has also suffered a huge stock-market bubble,

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

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

which reached its maximum extent in 2000.[9]

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, reduced the risk of such crises. Much of the transfer of resources to developing countries is now taking place in the longer-term and 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 includes even 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 the world's apparent dependence on vast and rising US current account deficits for macroeconomic stability. The US has become the world's borrower of last resort. In the process, it is making it possible for the world to run at tolerably high levels of economic activity, by both absorbing the excess savings of Japan and continental Europe and accommodating the mercantilism of emerging Asia.

Yet this "solution" to the "adding up problem" for the world economy carries two big risks: of rising protectionist sentiment in the US; and, at some point, of a brutal current account and exchange rate correction. The chances of a hard landing, with unpredictable political consequences both in the US and in the rest of the world, though far from 100 per cent, is far from zero either and gets bigger with each passing year.

International rivalry

The most important cause of the twentieth 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.

The situation today is different from that of the early twentieth century in several fundamental respects:

- There is a single undisputed hegemon, the US and little chance of a war among great powers in the near future, except conceivably between the US and China over Taiwan. China is not, at present, powerful enough to be a rival of the US
- Second, nuclear weapons should make war unthinkable
- Third, the great powers have largely abandoned the notion that prosperity derives from territorial gains and plunder rather than internal economic development and peaceful exchange
- Fourth, the world's great powers are on the same side in the war against terrorism by non-state actors
- Fifth, the great powers share a commitment to market-led economic

[9] 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).

development and international economic and political integration
- Finally, global institutions and habits of close co-operation reinforce the commitment to co-operation.

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

- The breakdown of the early twentieth century occurred, in large part, because of the pressures to accommodate rising powers in the global economic and political order. John Mearsheimer, the Chicago University historian, argues that conflict between the US and China (though not war) is inevitable *tout court*. The US, he argues, will not tolerate a strategic rival.[10] But China is bound to become one. The pursuit of power, unlike wealth, is a zero-sum game.
- 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 US.
- Finally, nationalism is the natural way for a rising power, particularly an authoritarian one, to cement domestic loyalty at a time of unprecedented social and economic upheaval. The German empire used it. The Chinese regime is doing the same thing.

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 11 September 2001—or even bigger ones—will end the commitment to open borders.

It is not difficult to envisage the devastating impact on confidence in open borders of a nuclear device smuggled into a country and then let off in a container. Fear of what might come across borders must act as a tax on globalisation. If countries had to be sure of the safety of every shipment and person that crosses their borders, much of today's globalisation 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 11 September will be to close borders. Global co-operation 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

Finally, power is not the only asset that creates zero-sum relationships among states. So does the supply of finite resources. Between 2002 and 2004, Asia's incremental demand for oil has exceeded the incremental demand from North America by a ratio of two to one. 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 resource, the potential for disruption and conflict is not small. Why, Americans might reasonably ask,

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

should they bear the price of ensuring oil to China at the same (high) price as they pay themselves? The search for valuable raw materials was a motivating force for territorial expansion in the first half of the twentieth century. It could easily become so again.

So what is to be done?

Globalization is not inevitable. It depends on politics. Today, it depends above all on US politics. Without successful US leadership, the present globalization may founder, just as the last one did.

I suggest three priorities:

- A big effort must be made to ensure that the weakest and poorest countries are in a position to share in at least some of the benefits of the global economy and advancing technologies. Otherwise, by the middle of this century, as many as 1.5bn–2bn people, many of them young, could be living in countries whose real incomes per head are less than a hundredth of those in the richest. Such a world is unlikely to be stable, let alone morally tolerable

- An equally big effort must be made to fix the underlying 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 immediately, China must be told that the Asian mercantilist strategy will not work for a country of its scale. At the very least, China should run a current account deficit equal to the net inflow of foreign direct investment

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

Progress or relapse—which will it be? Peace, rising prosperity and harmonious international relations are neither normal nor natural. They are certainly, as we now know and the nineteenth century did not, far from inevitable. But we do know they are possible. They must be sustained in every generation. Ours is no exception.