**Globalization: The Concept, Causes, and Consequences**

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Ethics and Globalization

The Tradeoffs Underlying Our Policy Choices

The Peterson Institute held a significant and path-breaking all-day conference on ethics and globalization featuring the Honorable Barney Frank as the keynote speaker. Economists, philosophers, political scientists, and policymakers engaged in an interdisciplinary discussion of fundamental issues underlying economic policy decisions.

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This speech was given while Mr. Williamson was the Chief Economist for the South Asia Region at the World Bank.

Globalization has become a familiar enough word, the meaning of which has been discussed by others before me during this conference. Let me nonetheless outline briefly what I understand by the term. I shall then go on to consider what has caused it. The bulk of my paper is devoted to discussing what we know, and what we do not know, about its consequences. I will conclude by considering what policy reactions seem to be called for.

The Concept

It is the world economy which we think of as being globalized. We mean that the whole of the world is increasingly behaving as though it were a part of a single market, with interdependent production, consuming similar goods, and responding to the same impulses. Globalization is manifested in the growth of world trade as a proportion of output (the ratio of world imports to gross world product, GWP, has grown from some 7% in 1938 to about 10% in 1970 to over 18% in 1996). It is reflected in the explosion of foreign direct investment (FDI): FDI in developing countries has increased from $2.2 billion in 1970 to $154 billion in 1997. It has resulted also in national capital markets becoming increasingly integrated, to the point where some $1.3 trillion per day crosses the foreign exchange markets of the world, of which less than 2% is directly attributable to trade transactions.

While they cannot be measured with the same ease, some other features of globalization are perhaps even more interesting. An increasing share of consumption consists of goods that are available from the same companies almost anywhere in the world. The technology that is used to produce these goods is increasingly standardized and invariant to the location of production. Above all, ideas have increasingly become the common property of the whole of humanity.

This was brought home to me vividly by a conference that I attended four years ago, where we discussed the evolution of economic thought around the world during the half-century since World War Two (Coats 1997). We debated whether the increasing degree of convergence in economic thinking and technique, and the disappearance of national schools of economic thought, could more aptly be described as the internationalization, the homogenization, or the Americanization of economics. My own bottom line was that economics had indeed been largely internationalized, that it had been substantially homogenized, but only to a limited extent Americanized, for non-American economists continue to make central contributions to economic thought, as the Nobel Committee recognized by its award to Amartya Sen a few weeks before this conference took place. Incidentally, the nicest summary of the change in economic thinking over the period was offered by the Indian participant in that conference, who remarked that his graduate students used to return from Cambridge, England focusing on the inadequacies of the Invisible Hand, while now they return from Cambridge Mass. focusing on the inadequacies of the Visible Hand! In the same vein, one of the more telling criticisms of my phrase "the Washington Consensus" was that the (substantial though certainly incomplete) consensus on economic policy extends far beyond Washington.

However, there are areas where globalization is incomplete, even in the economic sphere. In particular, migration is very far from being free. Highly skilled professionals have a relatively high degree of mobility, but those without skills often face obstacles in migrating to higher-wage countries. Despite the difficulties, substantial proportions of the labour forces of some countries are in fact working abroad: for example, around 10% of the Sri Lankan labour force is now abroad.

Moreover, globalization is much less of a reality in other fields than it is in the economic one. Culture still displays strong national, and even regional and local, variations. While English is clearly in the process of emerging to be a common world language, at least as a second language, minority languages are making something of a comeback, at least in developed countries. Sport is still very different around the world: the Americans have still not learnt to play cricket, and most of the rest of us have still not learned to understand what they see in baseball. Although the nation state is far less dominant than it used to be, with significant powers being devolved both downwards to regional and local authorities and upwards to international and in Europe to supranational institutions (and although "interfering in the internal affairs of another state" is less frowned on than formerly), politics is still organized primarily on the basis of nation-states.

Causes

What explains this globalization? It is certainly not attributable to conquest, the source of most previous historical episodes where a single economic system has held sway over a vast geographical terrain. The source lies instead in the development of technology. The costs of transport, of travel, and above all the costs of communicating information have fallen dramatically in the postwar period, almost entirely because of the progress of technology. A 3-minute telephone call from the USA to Britain cost $12 in 1946, whereas today it can cost as little as 48 cents, despite the fact that consumer prices have multiplied by over eight times in the intervening period. The first computers were lumbering away with piles of punched cards in the early postwar years, and telegrams provided the only rapid means of written communication. There was no fax or internet or e-mail or world-wide web, no PCs or satellites or cell-phones. Today we witness phenomena that no futurist dreamed of half a century ago, such as Indians with medical degrees residing in Bangalore who earn a living by acting as secretaries to American doctors by transcribing their tapes overnight.

It is clearly the availability of cheap, rapid and reliable communications that permits such phenomena, just as this is the key to the integration of the international capital market. I presume the same factor is important in nurturing the growth of multinational corporations, since it is this which enables them to exploit their intellectual property efficiently in a variety of locations without losing the ability to maintain control from head office. But in this context I would surmise that other factors are also at work, such as the spread of consumer knowledge about what is available that comes from travel and from advertising, itself encouraged by the communications revolution and its children like CNN. The reduction in transport costs is also a key factor underlying the growth in trade.

Of course, it needed a reasonably peaceful world to induce economic agents to exploit the opportunities for globalization presented by technological progress. But the technological basis for the phenomenon of globalization implies that, barring an end to the "Pax Americana" or else extremely vigorous conscious actions to reverse the process, globalization is here to stay.

Consequences

Globalization certainly permits an increase in the level of global output. Whether as a result of the old Heckscher-Ohlin theory of the basis of comparative advantage as lying in different factor abundance in different countries, or as a result of the new trade theories that explain trade by increasing returns to scale, trade will increase world output.2 Likewise FDI brings the best technology, and other forms of intellectual capital, to countries that would otherwise have to make do without it, or else invest substantial resources in reinventing the wheel for themselves. It may also bring products that would otherwise be unavailable to the countries where the investment occurs, which presumably increases the quality, and therefore the value, of world output. And international capital flows can transfer savings from countries where the marginal product of capital is low to those where it is high, which again increases world output.

Globalization must be expected to influence the distribution of income as well as its level. So far as the distribution of income between countries is concerned, standard theory would lead one to expect that all countries will benefit. Economists have long preached that trade is mutually beneficial, and most of us believe that the experience of widespread growth alongside rapidly growing trade in the postwar period serves to substantiate that. Similarly most FDI goes where a multinational has intellectual capital that can contribute something to the local economy, and is therefore likely to be mutually beneficial to investor and recipient. And a flow of capital that finances a real investment is again likely to benefit both parties, since the yield on the investment is expected to be higher than the rate of interest the borrower has to pay, while that rate of interest is also likely to be higher than the lender could expect at home since otherwise there would have been no incentive to send it abroad. Loose talk about free trade making the rich countries richer and poor countries poorer finds no support in economic analysis. Nor is there any reason for supposing that the North benefits itself at the expense of the South by imposing import restrictions like non-tariff barriers or agricultural subsidies: standard theory says that, while this does indeed impoverish the South, the public in the North also suffers, and it loses more than the producers gain. This suggests that a promising strategy for eliminating such barriers is to seek a coalition with Northern consumers, rather than to engage in North-bashing which will simply alienate potential Northern allies.3

The effects on domestic income distribution are less clear. Standard theory says that trade will tend to hurt unskilled labour in rich countries and to help it in poor ones, since the poor countries will be able to export-labour-intensive goods like garments to rich countries, thus increasing the demand for unskilled labour in the poor countries and decreasing it in the rich ones. That is, within rich countries, there is a good analytical reason for arguing that trade will tend to make the rich richer and the poor poorer. There has in recent years been a lively debate among economists in the developed countries as to whether the increase in imports of labour-intensive goods has been a major factor in causing the fall in the relative (and sometimes absolute) wages of the unskilled in these countries: the majority of economists seem to have concluded that it is a contributory factor, but that the major part of the explanation lies instead in the skill-intensive form of technological progress (Cline 1997).

It seems more difficult to doubt that exports of labour-intensive goods have been a factor that has done something to increase the demand for unskilled labour, and therefore to equalize the income distribution, in the exporting countries like Sri Lanka. Hence I find it betrays a sad lack of concern with the prospects of the poor to hear, as I have during this conference, garment exports being denigrated as likely in some unexplained way to bring negative impacts. On the other hand, some of the effects of the communications revolution must surely have had a disequalizing effect on income distribution in these countries: think of the Indian doctors who are acting as secretaries to American doctors rather than treating Indian patients, thereby earning more for themselves and also tending to pull up the pay of other doctors in India, who are relatively affluent by Indian standards. Similarly, differential mobility of skilled versus unskilled labour tends to pull up the salaries of the skilled in developing countries toward world levels, thereby leaving less for the immobile poor. The same result will occur if the owners of highly-mobile capital are able to evade taxes by investing abroad, and also if governments are induced to avoid imposing high tax rates on internationally mobile capital, or on those who might be prompted to emigrate, in the hope of keeping these factors at home. Thus the net effect of globalization on income distribution within developing countries seems to me distinctly ambiguous.

What impact is globalization likely to have on the long-term possibilities of economic growth in developing countries? My vision of the growth process is that it takes off when the elite in a developing country comes to understand the opportunities of applying world-class technologies within their country, and introduces institutional arrangements that permit individual pursuit of self-interest to serve, in general, the social good. Once that happens the country is able to grow at a rapid rate, unless some political accident obstructs the process, until it catches up with best-practice technology, and therefore attains the living standards of the developed countries. Globalization is tending to make the technologies and the knowledge for this process to occur more readily available, and therefore to enable the process to be telescoped in time. (Singapore may be a small country, but there is no previous case in history of any country that did not enjoy massive resource discoveries going from stark poverty to affluence in under 30 years.)

But it is surely also true that globalization is bringing new dangers. The virulence of the East Asian crisis was primarily a result of countries exposing themselves to the full force of the international capital market before they had built up an unquestioned reputation for being able as well as willing to service their debts come what may, which meant that when investors became concerned about their potential vulnerability as a result of the Thai crisis there were no other investors willing to step in and provide stabilizing speculation even after exchange rates and interest rates had clearly overshot. Of course, one can argue that this increased vulnerability to external shocks has to be weighed against a decreased vulnerability to internal shocks: think how much more Bangladesh would have suffered this year (1998) if the international community had not provided aid to partially offset the cost of the floods, let alone how much more hunger, or even starvation, there would have been had Bangladesh been unable to import additional rice. But this does not justify dismissing the increased dangers from external shocks. Moreover, I might note that Professor Indraratna offered you a much longer and more imaginative list of dangers than I have here identified, which looks beyond narrow economic questions and considers the role of globalization in spreading such unsavoury phenomena as drugs, the sex trade, crime, and terrorism.

Policy Issues

If I am right in arguing that globalization stems from technological developments rather than policy choices, trying to reverse it would be rather like playing at King Canute. It would be more productive to seek to maximize the benefits it offers and minimize the risks it creates. Let me discuss what I see that involving, while restricting myself to the narrow economic questions.

It will be clear from what was said above that I see little reason to doubt that the citizens of a developing country can expect to benefit from being open to trade and FDI. This gives them the advantages of being able to make relatively good use of their abundant unskilled labour and being able to access world-level technology. However, if they rely simply on exploiting unskilled labour, they will never be able to advance far beyond the living standards of their poorest competitors, who will be exporting similar goods. In order to raise living standards progressively over time, it is at least as important to raise educational standards as it is in a relatively closed economy. To a first approximation, one may summarize the policy advice of how to prosper in a global economy as: give one's citizens a relevant set of skills through education, and then let them get on with the job of producing whatever is useful to the world economy.

However, a second approximation requires one to recognize also the increased risks of full exposure to the world economy. Are there ways of reducing those risks? I am convinced that there is at least one important dimension in which prudence suggests that developing countries are well-advised to limit their integration in the world economy, and that concerns the liberalization of short-term capital flows. If one asks what distinguishes those countries that suffered contagion from the East Asian crisis from those that escaped it, the answer seems to me very clear: that the victims were those that had built up a substantial stock of short-term dollar-denominated debt as a result of having established capital account convertibility, while those who escaped catastrophe were those that had been cautious in liberalizing their capital accounts at the short end. Since there is no persuasive analytical reason or empirical evidence (Rodrik 1998) for believing that freedom of short-term capital flows is a significant factor in contributing to economic growth, let alone distributional equity, I conclude that prudence suggests seeking to postpone rather than accelerate this particular bit of liberalization.

Furthermore, one needs to ask whether there are mechanisms that can protect individuals when risks to the economy actually materialize. The recent experience in East Asia is again instructive: the World Bank has put a lot of effort into a crash course in developing social safety nets in the countries that fell victim to the crisis in the past year. I am sure that many of you will recall that in the past the Bank has been critical of Sri Lanka for having put too many resources into too wide a safety net, but I do not see any contradiction: the Bank was concerned that Sri Lanka was trying to provide a safety net more expensive than the economy could afford, and so indiscriminate that it eroded incentives. Those considerations need to be taken into account, but at the same time, as Dani Rodrik's (1997) work has emphasized, an open economy has a particularly compelling need for an adequate social safety net. I hope that you will find some reassurance that the Bank is not unmindful of the concerns that motivated your generous welfare policies by the fact that we have recently been so active in promoting the cause of social safety nets in East Asia.

Is there any way of ameliorating the potential negative effect on income distribution through increased possibilities of tax evasion and a consequential incentive to limit taxes on mobile factors that I discussed above? One can certainly envisage such measures, although they will require extensive international agreements, in the form of tax-information sharing and potential withholding of taxes on income earned by foreigners. It is my hope that such issues will become a part of the future agenda for international negotiation. A globalized world is going to have to deal with a broader policy agenda than simply liberalization if the outcome is to be reasonably equitable.

Concluding Remarks

I have argued that globalization has a technological base and is therefore here to stay. Sensible policy involves asking how one can get the most out of it while limiting the risks that it brings. The answers on the economic level, I have suggested, involve educating citizens with relevant skills and opening up to trade and FDI while maintaining controls on short-term capital flows, constructing an appropriate social safety net, and seeking international actions to reverse erosion of the tax base.

References

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Notes

1. The author is indebted to Bhaskar Kalimili for research assistance and to Marcus Miller for comments on a previous draft, and to a number of the participants in the conference.

2. Let me register my disagreement with Sir Alan Walters' contention that unilateral free trade is in general to be preferred to the achievement of regional free trade. What his analysis overlooks is that, when trade barriers are already fairly low, something like 80% of the gains from freeing trade come from better access to export markets, and only a relatively small part from undistorted access to imports. This suggests that, if Sri Lanka can gain unimpeded and guaranteed free access to the Indian market through SAARC (or, indeed, through a bilateral free trade arrangement), then it is not only possible, but quite likely, that the regional strategy will dominate unilateral free trade from a Sri Lankan standpoint.

3. There is a much stronger case for arguing that the intellectual property rights provisions of the WTO that were agreed in the Uruguay Round involved an enrichment of the North at the South's expense.

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