MARTIN WOLF:

Why Globalisation Works

BERTIL OHLIN-INSTITUTET är en liberal tankesmedja grundad 1993. Institutets uppgift är att genom forskning och kvalificerad debatt i svensk liberal tradition bana väg för nya tankar och nya frågor.

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FÖRORD

För ungefär ett halvt decennium sedan fylldes gatorna med anti-globaliseringsdemonstranter och tidningsspalterna med globaliseringskritiska texter. I dag är läget på många sätt annorlunda.

Martin Wolf tog sig an uppgiften att granska anti-globaliseringsrörelsens argument, vilket resulterade i boken Why Globalization Works, som utkom första gången 2004. På initiativ av Bertil Ohlin-institutet utkom två år senare en svensk översättning, Så fungerar globaliseringen, på SNS Förlag.

Huvudpunkterna i sin bok presenterade Martin Wolf i Stockholm den 30 november vid 2006 års Bertil Ohlinföreläsning. Hans engelska anförande ges nu ut i skriftform och erbjuder en snabb introduktion till bokens budskap.

Martin Wolf är biträdande chefredaktör och kolumnist på Financial Times.

Uppsala 31 januari 2007

HÅKAN JACOBSON
Redaktör för Bertil Ohlinistitutets skriftserie

BERTIL OHLININSTITUTET

TORSDAG DEN 30 NOVEMBER 2006

Why Globalisation Works

Bertil Ohlin-föreläsningen år 2006
av Martin Wolf

The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often incumbers its operations; though the effect of these obstructions is always more or less either to encroach upon its freedom, or to diminish its security. In Great Britain industry is perfectly secure; and though it is far from perfectly free, it is free or freer than in any other part of Europe.

Adam Smith, *Wealth of Nations,* Book IV, chapter 5.

Who imagines that the welfare of Americans would be higher if their economy were fragmented among its fifty states, each with prohibitive barriers to movement of goods, services, capital and people from the others? Who supposes that Americans would be better off if every state had its own capital market or GE, Microsoft and IBM could operate in only one of these states? In such a Disunited States, without inter-state direct investment, capital markets or trade, the decline in standards of living would be precipitous. Some states would become prisons, with desperately unhappy populations locked inside. A similar disaster would befall Europe if policymakers once again fragmented the European economy into the isolated national economies of 1945.

Yet this is precisely the current fate of large swathes of the world. If some critics of globalisation had their way, still more would be in the same state. Why, however, would humanity be better off for having its economy broken up into more than 200 entirely self-sufficient pieces? Maybe, continental economies, such as the United States, would remain reasonably prosperous. But what would happen to small economies, such as Hong Kong, Ireland, Taiwan or South Korea?

It is to answer those people who believe in limiting the integration of economies across frontiers that my book – Why Globalization Works (Yale University Press 2004) – was written. This protest movement is fractured into many different and often discordant communities of ideas. What they share is only what they are against. Most critics of globalisation are opponents of a market economy that embraces the world as a whole. Some of them are against any sort of market economy.

When the ideologically impassioned left last took full command, it produced the monstrosities of communism. If anything, its grasp on reality has worsened since then. The mood was captured in a banner seen at an anti-capitalist protest in London: 'replace capitalism with something nicer', it said. It is easy to indulge in such fantasies. But fantasies are not the route to a tolerable future.

The reason for rejecting most, though not all, of the charges of the critics is not that the world is perfect, but that it would be worse if they had their way.

HOW THE BOOK ASSESSES THE CRITIQUE

If the critics were right, supporters of the global market economy would be in favour of mass poverty, grotesque inequality, destruction of state-provided welfare, infringement of national sovereignty, subversion of democracy, unbridled corporate power, environmental degradation, human rights abuses and much more. Naturally, they are not. To demonstrate this, such criticisms need to be confronted. In each case, I have tried to identify a number of propositions that can be assessed both in terms of their logic and their consistency with the facts. I will now turn to the conclusions.

Inequality and poverty

Critics of globalisation have made a large number of specific propositions about what has happened to global inequality and poverty. Here I consider each in turn.

The first proposition is that the ratio of average incomes in the richest countries to those in the very poorest has continued to rise in the age of globalisation. This is correct. The explanation is the failure of some poor countries to grow. Failure to grow is the problem and growth is the solution.

The second proposition is that the absolute gap in living standards between today's high-income countries and the vast proportion of developing countries has continued to rise. This is also correct and inevitably so, given the starting point of two decades, or so, ago. When one country is 30 times as rich as another, the absolute gap in living standards must rise, unless the poor country grows 30 times as fast.

The third proposition is that inequality among individuals has risen. My response is that that this is almost certainly false. Global inequality among individuals has fallen since the 1970s, largely because of the rapid growth of China, India and a number of other, predominantly Asian, developing countries.

The fourth proposition is that the number of people in extreme income poverty has also risen. This is false. The number of people in extreme poverty has fallen since 1980, for the first time in almost two centuries, again because of the rapid growth of the Asian giants.

The fifth proposition is that the proportion of people in extreme poverty in the world's population has risen. This is certainly false. The proportion of the world's population in extreme poverty has certainly fallen, as it has since the early 1800s. Remember also that one of the reasons it does not fall still faster is that the poorest countries tend to have the fastest population growth.

The sixth proposition is that the poor of the world are worse off not just in terms of incomes, but in terms of a wide range of indicators of human welfare and capability. This is unambiguously false. The welfare of humanity, judged by life expectancies, infant mortality, literacy, hunger, fertility and the incidence of child labour has improved enormously. It has improved least in sub-Saharan Africa, partly because of disease (predominantly AIDS), and partly because of the continent's failure to grow.

We can also make some propositions of our own. Human welfare, broadly defined, has risen. The proportion of humanity living in desperate misery is declining. The problem of the poorest is not that they are exploited, but that they are almost entirely unexploited: they live outside the world economy. The soaring growth of the rapidly integrating developing economies has transformed the world for the better.

Trade

The second big area I examine is trade. If we look at the charges here we see that they fall into a few big categories.

The first group contains charges brought by people who believe the rise of the developing countries threatens the livelihoods of the privileged citizens of high-income countries. Their complaints are largely, though not entirely, groundless. I stress, in particular, that differences in wages across countries accurately reflect differences in average productivity. The fact that these differences do not exist in some sectors is a basis for the comparative advantage of developing countries. If they have relatively high productivity in some areas, they have relatively low productivity in others.

The second group contains charges brought by people who wish to stop trade everywhere. Their ideas – above all localisation – are both foolish and dangerous, above all to the people of the developing countries whom they pretend to help. I point out that if, as they suggest, countries ceased to import products they could make themselves, the exports of developing countries would collapse. They would then be unable to import the capital goods and technology they need if they are to develop.

The third group contains charges brought by people who fear that the freedom of action of developing countries is improperly circumscribed, particularly over infant industry promotion. These arguments are not worthless, though exaggerated. It is an issue that needs to be re-examined.

The fourth group contains charges that globalisation harms the environment. This argument confuses the connection between growth and the environment and that between liberalisation and the environment. Liberalisation promotes growth, but does not necessarily harm the environment. Often it will help it. What harms the environment is the failure to internalize environmental costs. Protectionism is never a good way of doing so. Experience of the closed economies of the Soviet bloc demonstrates the lack of any connection between self-sufficiency and limited environmental damage. Again, I note that in the case of agriculture, protection tends to increase environmental damage, by encouraging more intensive technologies.

The fifth group of charges concerns the WTO as an institution. These complaints are generally wrong and, where not wrong, exaggerated. It is ludicrous, for example, to argue that the WTO is undemocratic, since there exists no global polity that could be democratic. It is an agreement among states, which is the only basis for order in the global trading system. It is quite unacceptable to argue that non-governmental organizations – so-called "civil society" – are entitled to displace elected governments as representatives of their societies. But the WTO does need to be made more transparent.

The last and much the most persuasive group of charges are complaints about the handicaps now imposed upon poor countries by the dreadful state of commodity markets and the hypocrisy of the high-income countries on trade barriers against developing countries.

But I emphasise that developing countries also hurt themselves (and one another) by their own, generally high protection.

Corporations

Perhaps the core faith of globalisation's critics is in the power and the malevolence of the corporation. This is their Satan. When one looks closely, however, at the evidence and the arguments one finds that corporations are not more powerful than countries and do not dominate the world through their brands.

The claims that companies are bigger and more powerful than countries is not just wrong factually. Far more important, it is entirely misconceived. For lurking behind these claims is a fundamental error: a wilful refusal to distinguish power from freedom. Companies differ from countries because they can succeed by obtaining from their customers what they need to pay their suppliers (including their workers and their creditors). Unless they have strong monopoly positions, they cannot force their customers to buy from them. They can only cajole them. The resources they control are the result of free choices made in the marketplace. Countries – or rather governments of countries – are quite different. They have coercive control over territory. Even the weakest states can force people to do things most of them would greatly prefer not to do: pay taxes, for example, or do military service. While a sophisticated modern democracy can rely on a great deal of voluntary compliance with its demands, it always has the coercive option available. Companies do not. They are civilian organisations that must win their resources in the marketplace. They rely for survival not on coercion, but on competitiveness.

It is clear also that inward investment benefits recipient countries, given the right policies, and above all, it benefits the workers the corporations employ. Many of those who protest at the conditions of workers in developing countries do so in comparison to their own happy state, not in comparison to the awful alternatives confronting the world's poor. Difficult though it may be for some to believe, there are worse places to work than those we call "sweatshops". There is also little, if any, evidence of a race to the bottom on regulation, though there is certainly an undesirable race to the top on subsidies. It would be good to reach global agreement on how to curtail this.

Finally, the role of corporations in contemporary democracy makes me uncomfortable, but it cannot be eliminated. Above all, it must not be exaggerated. The notion that the liberal economic policies of the past two decades or more, or the structure and rules of the contemporary WTO, are the result of a single-minded plot by corporate interests is plain wrong. Many corporate interests have opposed – and continue to oppose – trade liberalisation. Ideas mattered far more than interests. The essentially Marxist idea that we live in pseudo-democracies because of the power of money was wrong a century ago and it is wrong now. It is right to be on guard against the power of all special interests. It is wrong to assume that any one group dominates.

The State

Now consider the impact of globalisation on the state. I argue strongly, against conventional wisdom of both left and right, that there is no evidence of the disappearance of a well-managed state's ability to tax and spend at levels it chooses. Nor is there any good reason to expect it. The notion that countries compete directly with one another, as companies do, is false. It is false because the most important source of both wealth and comparative advantage, namely, people, is highly immobile.

True, it is harder to run inflationary policies, with open capital accounts. But this is all to the good. Similarly, predatory taxation is more difficult to impose, because people or money will flee. That also is beneficial. But provided a state does not abuse its powers, it continues to have substantial freedom of manoeuvre. What it must do is convince its people that the taxes it raises are providing them with location-specific services they wish to consume. It must serve its people rather than behave as if it owns them. This rise of the competing service state is an enormous advance. States do not own their people in a globalised world economy. They are forced to provide them with valuable services instead.

Nor, I insist, is the state in any way less necessary than before. The ability of people to take advantage of economic opportunities depends on the quality of their state. True, as the world economy integrates and spillovers across borders become more important, global governance is likely to become still more essential. But that need not come at the expense of the state, but rather as an expression of the interests the state embodies. As the focus of identity, source of order and basis of governance, the state remains as essential in an era of globalisation as it has ever been.

Finance

Now let us turn to the globalisation of finance. Here the story is quite ugly. As Barry Eichengreen of the University of California at Berkeley has remarked in his book *Capital Flows and Crises* (p.46.), 'the crisis problem is back'. Nobody can be satisfied with what has happened as emerging-market economies have tried to integrate into world capital markets. The gains have been questionable and the costs of crises enormous. It would be easy to conclude that the simple lesson is: don't. But, for a host of reasons, emerging-market economies should, I argue, ultimately plan to integrate into the global capital markets, with emphasis on 'ultimately' and 'plan'. This is the way to achieve a more competitive financial system, more efficient allocation of resources and, not least, better discipline over governments. But the big risks of currency mismatches and so forth also need to be managed.

What has happened so far has been a series of blunders, on both sides. Equally, the record of the IMF, though not as dismal as many of its critics believe, is far from a proud one. Its biggest mistake was failing to warn countries adequately of the dangers that confronted them. While countries may have had to learn from painful experience, one would have hoped that the organization charged with advising them could have done a better job of doing so.

The challenge now is to help emerging-market economies engage with world capital markets more successfully. It can be done. But big changes are needed. They will have to rethink domestic regulation, laws and behaviour in such areas as the role of banks, the place of foreign financial institutions, deposit insurance, bankruptcy regimes and exchange rate policies. They will also have to be careful about exposing their countries to large-scale foreign currency borrowing. Equity is safer, with foreign direct investment best of all. Factories do not walk. Changes will also have to be needed at the global level, not least in sorting out how the private sector is to be treated during financial crises. The world cannot afford another series of comparable crises. It must act now to prevent them.

WHAT THE BOOK CONCLUDES

Finally, what sort of world should people who understand the power of market forces for human betterment now support? What role should international institutions play? And what are the proper limits of national sovereignty? There is no one set of right answers. My suggestions come – presumptuously, I fear – in 'ten commandments of globalisation'.

First, the market economy is the only arrangement capable of generating sustained increases in prosperity, providing the underpinnings of stable liberal democracies and giving individual human beings the opportunity to seek what they desire in life.

Second, individual states remain the locus of political debate and legitimacy. Supra-national institutions gain their legitimacy and authority from the states that belong to them.

Third, it is in the interest of both states and their citizens to participate in international treaty-based regimes and institutions that deliver global public goods, including open markets, environmental protection, health and international security.

Fourth, such regimes need to be specific, focused and enforceable.

Fifth, the WTO, though enormously successful, has already strayed too far from its primary function of promoting trade liberalisation. The arguments for a single undertaking that binds all members need to be reconsidered, since that brings into the negotiations a large number of small countries with negligible impact on world trade and gives them disproportionate power.

Sixth, the case for regimes covering investment and global competition is strong. It would be best to create regimes that include fewer countries, but contain higher standards.

Seventh, it is in the long run interest of countries to integrate into global financial markets. But they should do so carefully, in full understanding of the risks.

Eighth, in the absence of a global lender of last resort, it is necessary to accept standstills and renegotiation of sovereign debt.

Ninth, official development assistance is far from a guarantee of successful development. But the sums now provided are so small, just over a fifth of a per cent of the gross domestic product of the donor countries, that more would help if given to countries with reasonably sound policy regimes. But aid should never be so large that it frees a government from the need to raise most of its money from its own people.

Tenth, countries should learn from their own mistakes. But the global community also needs the capacity and will to intervene where states have failed altogether.

All these commandments matter. But the first two are the most important. The view that states and markets are in opposition to one another is the obverse of the truth. The world needs more globalisation, not less. But we will only have more and better globalisation, if we have better states. Above all, we must recognise that inequality and persistent poverty are the consequence not of the still limited integration of the world's economy, but of its political fragmentation. If we wish to make our world a better place, we must look not at the failures of the market economy, but at the hypocrisy, greed and stupidity that so often mar our politics, in both developing and developed countries.

CONCLUSION

The 1980s and 1990s witnessed the collapse of the Soviet communist tyranny, an unprecedentedly rapid spread of democracy and nigh on universal economic liberalisation. East and South Asia, home to 55 per cent of humanity, enjoyed an unprecedented leap towards prosperity. Yet critics of globalisation talk of this period of hope and achievement as if it were a catastrophe. Some do so out of a genuine and understandable dismay over the extent of poverty and misery in a world of plenty, but then reach the wrong conclusions on the causes and cures. Others do so because they lament the death of the revolutionary tradition that held sway over the imaginations of so many over two centuries. Most of these critics compare the imperfect world in which we live with a perfect one of their imagining. It is in their way of viewing what has happened in the world, rather than the details of their critique, that those hostile to global economic integration are most in error.

What we must do is build upon what has been achieved, not, as so many critics wish, throw it all away. In the era after 11 September 2001, that co-operative task has certainly become far more difficult. For peoples to sustain openness to one another is far harder at a time of fear than at a time of confidence. But the task has also become more urgent. A collapse of economic integration would be a calamity. Not only would it deprive much of humanity of hope for a better life. It would also, inevitably, exacerbate friction among the countries of the world.

The sight of the affluent young of the west wishing to protect the poor of the world from the processes that delivered their own remarkable prosperity is deeply depressing. So, too, is the return of all the old anti-capitalist clichés. It is as if the collapse of Soviet communism had never happened.

We must, and can, make the world a better place to live in. But we will do so only by ignoring these siren voices. The open society has, as always, its enemies both within and without. Our time is no exception. We owe it to posterity to ensure that they do not triumph.

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