The truth about globalization

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To keep my economist union card, I am required every morning when I arise to place my hand on the leather-bound family heirloom copy of Adam Smith's *The Wealth of Nations* and swear a mighty oath of allegiance to globalization. I hereby do asseverate my solemn belief that globalization, taken as a whole, is a positive economic force and well worth defending. I also believe that the economic and social effects of globalization are exaggerated by both its detractors and supporters.

In media coverage of anti-globalization protests, "globalization" often becomes a catch-all term for capitalism and injustice. (Indeed, for some protestors, referring to capitalism *and* injustice would be redundant.) But economic globalization in fact describes a specific phenomenon: the growth in flows of trade and financial capital across national borders. The trend has consequences in many areas, including sovereignty, prosperity, jobs, wages, and social legislation. Globalization is too important to be consigned to buzzword status.

One world?

The degree to which national economies are integrated is not at all obvious. It depends on your choice of perspective. During the last few decades, international flows of goods and financial capital have certainly increased dramatically. One snap measure of globalization is the share of economic production destined for sale in other countries. In the U.S. economy, exports of goods and services were 4.9 percent of the gross domestic product (GDP) in 1965, but 10.8 percent of GDP in 2000. From a global perspective, exports rose from 12 percent of world GDP in 1965 to 22 percent of world GDP in 2000. In round numbers, international trade of goods and services has doubled in about four decades.

International financial markets are not tracked as easily as cross-border flows of goods and services. But by a variety of measures, they have also expanded considerably, especially in the last decade. Total assets held by U.S. investors in other nations nearly tripled from $2.3 trillion in 1991 to $6.2 trillion in 2000. Conversely, total foreign-owned assets in the U.S. economy quadrupled from $2 trillion in 1991 to $8 trillion in 2000. Annual global flows of "foreign direct investment"—that is, investment that creates a lasting management interest, often defined as more than 10 percent of voting stock in a company—rose from $200 billion in 1990 to nearly $900 billion in 1999. A 1998 survey by the Bank of International Settlements found that $1.5 trillion *per day* was traded on foreign-exchange markets. Since foreign-exchange trading has been growing at double-digit rates, its volume now must exceed $2 trillion per day.

For many countries, international financial markets feel more like an anvil on their toes than a parade of dry statistics. Argentina in 2002 has no remaining doubts about the size and power of international capital movements. A number of countries and regions have recently suffered through economic instability and recessions caused by rapid outflows of international capital: Russia in 1998, East Asia in 1997 and 1998, Mexico in 1995, and European countries in 1993, when international financial speculators blew down the mechanism for coordinating their exchange rates.

But while international flows of goods, services, and finan-

cial capital have increased dramatically in the last few decades, the term "globalization" implies more. It implies that the world is a single market—or nearly so. In a fully globalized economy, goods and investments would flow across national borders with no more difficulty than that encountered by a company from California selling its products or taking out a loan in New York. But studies testing the importance of national borders in determining the flows of goods and services have shown that we are still a long way from a single world market.

Indeed, national borders continue to play a significant role. For example, the Canadian province of Ontario is an equal distance from Washington state and the province of British Columbia. In a borderless world, one might expect Ontario's level of trade with Washington state and with British Columbia to be about the same, at least after adjusting for the size of the local economies. Yet this is not the case. The levels of trade have been measured between pairs of Canadian regions, pairs of U.S. regions, and pairs of U.S.-Canadian regions, and it turns out that trade between regions of Canada, and between regions of the United States, is commonly 12 times higher than trade between equivalent regions across the U.S.-Canadian border. In Europe, similar studies have found that trade between regions within countries is three to ten times higher than trade that crosses national borders, even after adjusting for factors like size of local economies and geographic distance.

A second convincing piece of evidence that the world economy is far from borderless comes from price comparisons across countries. When goods are sold within a single, borderless market, their prices tend to adjust together. For instance, when gasoline prices rise in the United States, they tend to rise across the country, although the exact amount and timing of the rise depend on local circumstances. But many studies have found that prices of internationally traded goods like gasoline, computers, cars, and televisions do not rise and fall together across national borders. One study of this type examines how movements in exchange rates affect relative prices of goods. When the exchange rate between two countries changes by, say, 10 percent, then prices of goods in those countries

must also adjust by 10 percent if the prices in the two countries are to stay in the same relationship. Instead, when the exchange rate moves, it often takes three to five years for just half of that change to "pass through" into the relative prices of goods. Thus relative prices of goods across national boundaries do not behave as if there were a single, borderless market.

Although international financial transactions have clearly increased over time, global financial markets also appear far from borderless. One test of this question relies on the idea of diversification. A well-diversified investor in the U.S. market will hold a broad range of stocks. It would be peculiar for an investor from Chicago to hold stock only in companies from Chicago or only from Illinois. By similar logic, a well-diversified investor in a single global market would hold stocks in companies located around the world. Instead, investors all over the world tend to stick to their home market. In the late 1990s, for example, U.S. investors held 90 percent of their equity portfolios in U.S. stocks. Canadian investors held 88 percent of their equity portfolios in Canadian stocks. Ninety-four percent of stock held by Japanese investors was in Japanese stocks. Even German and U.K. investors, despite all the movement toward the European Union, held about 80 percent of their equity portfolios in German and British stocks, respectively. Investors are not diversifying their holdings as if they perceived the global financial market to be borderless.

Another test for whether national borders affect investment patterns is the extent to which national savings provide the funds for domestic investment. Within the borders of the U.S. economy, capital sloshes back and forth between individual states, so that little correlation exists for any given year between the amount of saving in a particular state and the amount of investment in that state. The same pattern of free-flowing capital holds across the provinces of Canada and within areas of other industrialized countries. But for nations as a whole, national saving is generally quite close to national investment, and the net amount of financial capital flowing in or out of an economy is relatively small—rarely more than a few percentage points of GDP, and typically less. Financial capital moves easily across regions within countries but more hesitantly across national borders.

It's easy to identify reasons why national borders play such a substantial role in limiting international movements of goods and capital. Transportation and communications networks are often built by national governments and focus more on connections within a country than across national borders. Economic transactions across a border must face additional costs associated with different legal systems, regulations, institutions, cultures, and languages. Movements in exchange rates add a degree of risk to economic transactions across borders. Moreover, many countries retain tariff and nontariff barriers to trade.

Many discussions of globalization often begin with the assumption, buttressed by a few lively anecdotes, that international flows of goods and services have become so powerful that national borders are economically obsolete, or nearly so.

Don't believe it.

The benefits of trade

The circumstantial evidence that international trade provides economic benefits is overwhelming. Eras of expanding global trade, like recent decades, have generally been times of economic growth. Periods of contracting trade have often involved recession or worse. When a country's economy expands, its level of international trade typically increases. International trade and investment played an important role in the great economic success stories of the last four decades: Japan, East Asia, and now China.

A recent study by the World Bank grouped developing economies into two categories according to their participation in the global economy. In one group of two dozen countries that includes China, Mexico, and India—and a total population of 3 billion people—the ratio of exports to total GDP has doubled in the last two decades. In these countries, the level of per capita GDP rose 5 percent per year in the 1990s. In the second group of countries, which includes much of Africa, Russia, and the Middle East—and a population of 2 billion people—the average share of exports to GDP has fallen over the last two decades. In these countries, per capita GDP fell an average of 1 percent per year in the 1990s.

The fundamentals of economic theory explain how trade

should benefit all parties. Trade allows countries to specialize in the products they have the greatest advantage in producing. Specialization encourages learning and innovation about these products and allows nations to take advantage of economies of scale. When countries specialize and trade, the world's productive resources of labor, physical resources, and time are used more efficiently. Trade allows consumers and businesses to seek out the best deal in a global market, giving producers an incentive to compete in this market. International flows of financial capital allow the world's savings to flow toward the most productive investment opportunities—even if those opportunities are halfway around the world. National economies can draw on international capital markets when they need funding and diversify their risks by investing their savings outside their own borders.

These textbook reasons as to how trade benefits an economy are fine, as far as they go, but I suspect they don't go far enough. Many of the benefits of globalization are not from the products that are shipped but from other ways in which trade shapes the economic environment.

The most valuable Japanese export to the United States over the last few decades may not have been cars or computers. Instead, it may have been the competitive push that Japanese firms gave U.S. automakers and high-tech firms to make better products in more efficient ways. Or it may be the idea of "just-in-time" inventory procedures that U.S. firms learned from Japanese producers, which has made manufacturing across many industries leaner and more efficient. Or it may be Japanese quality-control procedures. Trade often carries with it a wealth of skills and institutions: technology, training, management, accounting, outside monitoring of businesses, and even exposure to expertise in such areas as bank regulation, antitrust policies, and environmental protection.

These indirect benefits of trade are especially important for smaller and poorer economies. The United States has an enormous internal market, a remarkable capacity for innovation, and advanced capitalist institutions. It could limp along with a reduced level of external trade if it needed to do so. But if small economies like Belgium or Chile or Ivory Coast were forced to consume only what they produce domestically,

their standards of living would fall dramatically. Without trade, small economies cannot sustain a high degree of specialization. Furthermore, they would have a difficult time generating a broad array of expertise in science, technology, management, and financial regulation. If small economies were forced to rely only on their domestic production, they would end up consuming a far smaller variety of products at far higher prices.

The idea that the benefits of trade may flow through ideas and institutions, rather than inhering in the physical goods that are traded, is an old one. One legend attributes the creation of Italy's pasta industry to the voyages of Marco Polo, who didn't need to bring actual noodles back from his trip to China in the thirteenth century—only the idea of noodles.

Nonetheless, despite these broader benefits, globalization is not the single, or even most important, ingredient of economic growth. If one compiled a list of factors that stimulate a nation's economic growth, the list would include (in no particular order): better education; better health; available investment capital; infrastructure for transportation, communications, and energy; transparent administration of government and law; a legal and institutional framework that supports competitive markets; a well-regulated financial sector; a stable macroeconomic environment; sensible monetary, fiscal, and exchange-rate policies; intellectual property protection; flows of information about technology and products; and widespread expertise in management, accounting, and law. Openness to international flows of goods and capital would also appear on the list but probably not at the top. If a national economy reduces its trade barriers but is otherwise a hostile environment for economic growth, globalization will accomplish little or may even be economically harmful. On the other hand, a nation that aggressively pursues other elements of growth, but practices benign neglect of its trade policy, might do just fine.

Indeed, one might argue that globalization accompanies economic growth in large part because it is often a proxy for a nation's openness to the production methods, management, and social institutions that lead to economic growth. Opponents of globalization often like to blame it for a nation's economic woes, as it is easier to point the finger at unpopular targets like multinational firms than to take on the tough

spadework of institutional and economic reform in low-income or low-growth economies. While the poorest people in the world suffer grievously from many ills, an excessive connectedness to global markets is not one of them. As Kofi Annan, Secretary-General of the United Nations and certainly no free-market fanatic, said in his acceptance speech for the Nobel Peace Prize: "The main losers in today's very unequal world are not those who are too exposed to globalization, but those who have been left out."

Unemployment in the global village

During the debate over the North American Free Trade Agreement (NAFTA), Ross Perot infamously predicted that free trade with Mexico would cause a "giant sucking sound" as U.S. jobs fled south over the border. In fact, NAFTA passed into law in 1994 and was immediately followed by seven years of the lowest unemployment in the history of the U.S. economy. It is worth savoring the occasions when ignorance is so quickly and decisively revealed by events. There is no evidence at all that globalization increases overall unemployment rates. As globalization increased over the last few decades, global unemployment levels did not rise. Moreover, countries with higher levels of international trade do not typically have higher unemployment.

However, international competition can cause reallocations of jobs from one industry to another. For example, the number of unionized steelworkers in the U.S. economy fell from just over 1 million in 1975 to 572,000 in 1985, and the number of unionized autoworkers declined from 974,000 in 1985 to 751,000 by 1995. Increased competition from steel and auto imports surely played a role in these declines. This problem is not best described as unemployment, since total unemployment isn't rising, but rather as an increase in what economists call "displaced workers," workers who are pushed out of one job and thus forced to find another. For an economy as a whole, a flexible workforce that moves between different employers, different geographic areas, and even different occupations is an enormous strength. However, the individual workers involved in these labor-market movements can suffer high costs: lost wages due to unemployment or new employment

with lower wages, costs of moving and retraining, and the psychological costs of uncertainty and a disrupted life. For present purposes, the question is how much globalization contributes to the churning of the labor market as people move in and out of jobs.

The U.S. labor market has more turnover than many people realize. Early in 2002, about 8 million Americans were unemployed. Based on historical experience, we can estimate that more than half of these workers will find another job within a couple of months, even in a slow economy. But the number of unemployed will not fall by half in the next two months, because the churning of the labor market will cause millions of other workers to become unemployed over that same period. Even in the strong U.S. economy of the late 1990s, when overall unemployment was very low, mass layoffs totaled about 1.1 million per year. Longer-term studies of U.S. labor markets found that in a given year in the 1990s, about 10 percent of all jobs disappeared during the year. But the unemployment rate did not rise, because an even larger number of new jobs were being created. Indeed, workers often moved fairly seamlessly from old jobs to new ones without a period of unemployment in between.

The reasons why workers are pushed out of jobs are many and varied. Tough domestic competition may drive a firm to reduce employment. Consumer tastes may shift so that demand for a product falls. A key customer of the firm may reduce purchases or go bankrupt. A firm's technology may become outdated. Employees as a group may not have worked hard or well. Competition from international trade plays a role, too. Magazines like *Business Week*, *Fortune*, and *Forbes* are a chronicle of all that can go wrong for businesses.

The United States could stand to rethink its policies regarding workers who are forced or pressured to move between jobs. Unemployment insurance is one useful mechanism for softening the transition. But there is a range of additional assistance that might be offered to those between jobs, including health insurance, "wage insurance," and retraining. Government programs that aid job seekers have been effective in western Europe, and welfare reform in the United States has in recent years helped many of the unemployed to find

jobs. I favor expanded efforts in all of these directions to reduce the costs that workers must bear during labor-market transitions. Since labor mobility benefits the economy as a whole, it makes sense for society to share the costs involved, rather than to impose the burden solely on the individuals who are forced to make a job change.

But I see no reason why efforts to reduce the cost of job mobility for individuals should focus on globalization. It's hard to estimate how much of the churning in America's labor market is due to increased foreign trade, but compared to all the other factors of a dynamic market economy, globalization is a minor contributor. Moreover, from the view of public policy, it doesn't matter why a worker lost a job. A worker who is out of a job because of tough domestic competition or poor management is no less deserving of support in the transition to a new job than one laid off because of foreign competition. Public policy should neither demonize globalization as the primary cause of job loss, nor pretend that job dislocation won't happen in a dynamic market-oriented economy. Rather, it should build institutions and programs to help workers make the transition to new employment.

The wages of globalization

The most important factor determining the average level of wages in an economy is the average productivity of its workers. Since globalization contributes to productivity, it also increases the average wage level. However, even as globalization increases the overall level of wages, it may also increase inequality. The gap between high and low incomes might expand within a developed economy like the United States, or within a developing economy like Mexico. Also, the gap between average incomes in high-income and low-income economies around the world can expand. Let's take each of these cases in turn.

It is conceivable that low-wage workers in high-income economies like that of the United States suffer from increased competition with low-wage workers in other countries. But most studies have attributed the growth in inequality in high-income economies to the remarkable advances in information

and communication technology over recent decades. These advances have meant that the labor market pays a higher premium for skilled workers who are better equipped to use the new technologies. The share of income going to the top fifth of U.S. households rose from 40.7 percent in 1975 to 46.5 percent in 1995. Most of that increase was accounted for by the income share of the top 5 percent of households, which rose from 14.9 percent in 1975 to 20 percent in 1995. Since then, inequality in the U.S. income distribution has not risen further, but neither has it receded.

Mainstream studies of the rise in U.S. inequality have attributed relatively little of it—perhaps one-fifth or so—to higher levels of trade. Why does trade play a relatively small role in shaping the wage distribution? One reason is that more than half of America's imports come from other industrialized countries—Canada, Japan, the European Union—and there is no reason why trade with these other high-wage economies should much affect U.S. income inequality. Only about one-quarter of America's imports come from the truly low-wage economies of the world such as China. So the argument that trade with low-income countries increases domestic wage inequality supposes that a relatively small tail of overall U.S. trade wags the entire U.S. wage distribution.

In addition, most U.S. workers, including low-wage workers, are in service industries. Traditionally, imports have not competed much with services. Imported goods like textiles can directly affect the jobs and wages of U.S. textile workers. But the U.S. economy cannot import hotel cleaning services, restaurant labor, yard work, or many of the other services provided by low-wage workers, so the impact of inexpensive imported products on the wages of low-income workers in these industries is muted and indirect.

There are other reasons to doubt that global trade is a primary shaper of the income distribution. The time frame of the rise in income inequality, the mid 1970s to the mid 1990s, doesn't match the time frame of rising globalization, which started in the 1950s and has continued since 1995. Moreover, the rise in globalization has been worldwide, but the U.S. economy saw a larger rise in inequality than other high-income countries. Patterns of education, unionization, minimum

wages, taxation, and executive stock options appear to have a more powerful effect in shaping income distributions than other economic influences such as new technologies and globalization.

The situation with regard to inequality is rather different in developing nations like Mexico, because the issue there is not whether globalization holds down the poor—since the truly poor in such countries typically live in rural areas that are disconnected from the global economy—but whether it creates inequality by offering opportunities to a limited segment of the population. This sort of rise in inequality should be unobjectionable. After all, the middle-income workers who benefit from such opportunities often still earn less than the minimum wage in the United States or the European Union. It would be peculiar and perverse to oppose economic policies that can benefit substantial numbers of people in low-income countries on the grounds that other people in those countries are not also benefiting. Yes, the benefits of globalization arrive unevenly. But a nation's economic progress should not be hindered for that reason alone. No one would dream of opposing a foreign-aid project for one village on the grounds that it wouldn't help people in other villages. To be sure, globalization will only address part of the overall puzzle of economic growth in low-income countries. But this is an argument for seeking other pieces to complete the growth puzzle, not for blocking a policy that works.

The degree of inequality among nations has risen substantially over the last century. One set of calculations found that the ratio of per capita GDP of the highest-income and lowest-income countries rose from 8.7 in 1870 to 38.5 in 1960 and to 45.5 by 1990. This rise in global inequality occurred because countries that have caught the economic growth train have moved steadily ahead of countries that have been left at the station. For example, per capita GDP in the U.S. economy rose by a factor of nine from 1870 to 1990, while per capita income in the poorest countries of the world, like Ethiopia or Chad, rose barely at all over those 120 years.

It is sometimes popular to assert that the high-income levels in the United States and Europe are achieved through the exploitation of Africa, Latin America, and other low-income areas of the world. There have been enough episodes of ma-

lign behavior by colonial powers and multinational corporations to give surface plausibility to such a claim. Nonetheless, the idea that global trade is a primary source of the gap between high-income and low-income nations is based on an outdated view of the wealth of nations. The model of economic growth that prevailed in much of the world up to the twentieth century was based on conquest: A nation became richer by controlling a greater quantity of land, people, or resources. Yet in the modern world, economic welfare is based not on far-flung political control but on skilled workers taking advantage of recent technology in a market-oriented environment. Global trade is part of this environment but not the most important part. Certainly, Belgium once benefited from its colonial control over rubber, timber, and other resources from the Congo. But Belgium's current economic performance as a country with income levels above the European Union average is based on the capacities of its citizens to produce goods and services inside Belgium. Modern economic growth is fundamentally built upon voluntary transactions made for mutual benefit, not upon coercion.

The global tide of economic growth over the last century has not raised all economic ships. But globalization is an avenue through which high-income nations can reach out to low-income ones. Expecting the poorest people in the world to pull themselves up by their bootstraps, without access to foreign investment, training, technical skills, or markets, verges on indifference or cruelty. Foreign aid has its place, but as a matter of practical politics, it will never arrive in sufficient quantities, nor be spent with sufficient wisdom, to raise overall standards of living dramatically in low-income countries. Only a combination of institutional reforms within low-income countries, coupled with much closer connections to the extraordinary resources and buying power of international markets, offers a realistic chance of substantially improving the plight of the poorest people in the world.

Race to the bottom?

The "race to the bottom" is the darkly logical scenario of environmental destruction and worker exploitation. In this story, political jurisdictions are pressured by profit-seeking businesses

to reduce their costly environmental rules and labor standards—or else lose jobs and economic clout as businesses relocate to jurisdictions that lack such protections. The result is a race to the bottom in which the selfish, soulless forces of capitalism run roughshod over the social good.

This is a forbidding scenario, but one that does not appear to be happening. Consider trade across the United States. States and localities vary widely in their taxes, welfare benefits, school expenditures, environmental rules, workmen's compensation policies, and much else. Tax rates and social benefits in the highest states are often double those in the lowest states. But these differences have existed for a long time, and free trade across the United States has not forced a race to the bottom. Businesses in the United States have not fled en masse to low-regulation, low-tax states like North Dakota or Mississippi. State and local taxes and regulations have on average been rising, not dropping, over recent decades.

A similar lesson applies at the international level. As globalization has increased in recent decades, the bulk of world economic activity has not in fact departed from the United States, the European Union, and Japan to take up residence in countries with low social standards. Average standards of environmental and worker protection have increased around the world in the age of globalization, not declined. European countries continue to combine high tax rates, strict environmental standards, and generous worker protections, as they have for decades. Developing economies around the world, like Mexico and China, are also enacting tighter environmental standards and worker protection policies.

Why was the race to the bottom called off? When a business makes decisions about where to locate, the costs of government social regulations are usually not the most important factor. Instead, businesses look at issues such as the capabilities of the local work force; proximity to suppliers and customers; infrastructure for communications, transportation, and energy; and predictability in contractual terms and institutions. The costs of environmental and labor regulations matter, but they are typically well down the list of business concerns.

Moreover, large multinational companies typically do not perceive it to be in their self-interest to seek out locations

where they can pollute most heavily. In many cases, they have already designed manufacturing plants with the pollution-control mechanisms to meet the standards of countries with strict environmental laws. It would be costly and inefficient to redesign the entire plant for the sake of stripping out the pollution-control technology. Moreover, multinational firms have no wish to have their emissions immortalized on the front pages of the *Financial Times* or the *Wall Street Journal.* In many low-income countries, the multinational firms are among the lowest polluters, both because they have the best anti-pollution technology and because they have powerful political incentives to use it. Similarly, multinational firms do not find it advantageous to seek out the most easily oppressed labor force. High-profile foreign multinationals in low-income countries typically offer pay, working conditions, and possibilities for worker participation and union membership that exceed most domestically owned plants.

Economic markets don't bring environmental and labor protections automatically, but they are still the uneasy ally, not the enemy, of social protections. Indeed, the remarkable achievement of democratic capitalism, in its many manifestations around the world, is its ability to combine market-oriented economic institutions with public protections for the environment and for workers.

It is impossible to disprove the thesis that environmental and worker protections might have increased even further and faster in recent decades in the absence of globalization. But it seems more plausible that the rise in globalization is helping to improve environmental and labor standards in low-income countries, rather than hindering them. Globalization spreads knowledge about the rest of the world, including the fact that air and water need not become ever dirtier as a country develops its economy. Globalization illustrates that improving the skills of workers, and treating them as if their morale and motivation matter, is a more effective route to economic success than treating them as dumb muscle-power. Globalization also brings with it international public pressure for implementing basic standards and tourists who will not tolerate a filthy environment or a surly workforce. But the ultimate protection for the environment and for workers in low-income

countries is an involved citizenry with an income level high enough to lift its sights above basic needs and allow other social values to take their rightful place.

Perpetual peace?

Before September 11, 2001, it was common to hear blithe predictions that as countries became intertwined with one another through global trade, they would move toward domestic tranquility and peaceful international relations. The world now seems a more dangerous and unstable place.

But well before September 11, economic historians looked skeptically at the notion that globalization assures peace and international stability. The world experienced an extraordinary surge of international trade in the second half of the nineteenth century, but this did not lead to a peaceful twentieth century. During this boom, exports rose from 5 percent of global GDP in 1870 to 8.7 percent by 1913. The speed of communications improved by orders of magnitude as the telegraph, which has been nicknamed the "Victorian Internet," linked information about prices and business conditions around the world. Messages that used to take weeks to cross the Atlantic by ship were now received in minutes by wire. The railroad and the steamship made transportation much faster and cheaper. Waves of immigration reallocated labor across the world. The gold standard provided a reasonably fixed exchange rate that facilitated international movements of financial capital. Indeed, the net sums that national economies borrowed and loaned abroad, expressed as a share of GDP, were often higher in the years around 1900 than they are today.

This earlier wave of globalization was brought to a halt by two world wars and the Great Depression. Clearly, countries that traded with one another were quite willing to fight each other. But even without the disruptions of war and depression, the first phase of globalization faced a severe political backlash in the early decades of the twentieth century. Before the infamous Smoot-Hawley tariffs of the Great Depression (which probably deepened the depression, although they were not a primary cause of it), protectionist barriers were going up on both sides of the Atlantic. European agricultural inter-

ests wanted protection from U.S. farm products, and U.S. manufacturing firms wanted insulation from European competitors. Barriers to immigration arose as well. International finance was shaken by a series of bank runs and panics, and the gold standard began to look very shaky. Both situations discouraged flows of international capital in the same way that financial panics and exchange-rate volatility discourage flows of international capital today.

Violence and war often parade behind grievances that are expressed in economic terminology. But economic grievances alone do not seem either sufficient or necessary to cause war. The vast majority of poor people around the world are not advocates or practitioners of violence. Most wars of recent memory—for example, in the former Yugoslavia or in Rwanda—have not been about unfair trade relations. The terrorist attacks of September 11 were primarily motivated by conflicts over political power, culture, and religion, not by U.S. negotiating positions at the World Trade Organization. Severe civil strife or outright warfare is most often generated by nationalist or ethnic sentiment, fueled and fanned by demagogic leadership. Globalization can make the world a more peaceful place by creating connections between peoples that make it harder to demonize others and by giving powerful political interests a stake in peaceful relations. But economic globalization is far from being an inoculation against international violence.

Three evolutions

The international flow of goods, services, and financial capital will probably continue to increase for both political and economic reasons. Currently, the most visible step toward globalization is the forging of stronger economic ties across the European Union, exemplified by the introduction of the euro. In addition, the global free-trade talks of the World Trade Organization have made some progress at reducing remaining trade barriers, and have sparked a variety of regional free-trade agreements, especially in Asia and the Americas. Continuing improvements in information and communications technologies will drive globalization forward as well, by opening up profitable opportunities to connect and coordinate economic transactions between many distant locations. But as glo-

balization expands, it seems likely to evolve in ways that will change how international trade is publicly perceived.

One trend in globalization, already well underway, has been called "slicing up the value chain." In the traditional version of trade, two countries made final products—for example, cars and computers—and then traded them. But in the future, the production process for that car will be sliced up among several different countries; indeed, bits and pieces of the car may flow in and out of a given country more than once. Measures of globalization, like exports as a share of GDP, will increase as the same plastic, steel, and electronics are shipped back and forth across several national borders until the final products are completed.

Slicing up the value chain internationally may alter how people think about trade because final products will no longer be associated with any one country. For example, when the NAFTA agreement was under negotiation, U.S. autoworkers were concerned that their jobs would move to Mexico. This was traditional trade thinking: Final products like cars will be made either in Mexico or in the United States. But the actual effect of NAFTA has been higher levels of both auto-related imports and exports between Mexico and the United States. Auto parts made in the United States, along with parts and materials made in other countries, are sent to Mexico for assembly and processing, and then returned to the United States to be combined with still other parts. If Mexican labor was building cars from scratch, the political pressures to limit imports of these cars into the United States could become frenzied. But few will rally to oppose expanded Mexican assembly of U.S.-made auto parts which are then combined with other parts and shipped across several other national borders before the car is finally completed and sold.

A second evolution of globalization will involve trade of services. Global trade is still primarily about goods. U.S. exports of goods, for example, are 2.7 times as large as exports of services. This proportion seems out of whack, given that services make up over half of U.S. GDP. Traditionally, trade in services has seemed impractical compared to trade in goods. A solid object like a telephone or a telescope can be boxed and shipped around the world. But how does one ship services

like education, health care, or banking? Now, however, the revolution in information and communications technologies has made it possible for many services to be performed at a distance. In the field of health care, for example, even if a doctor remains in the office to see patients, there is no reason why medical records, billing and insurance, or even telephone questions must be handled in the same physical location—or even within the same country—as long as the information is readily available when needed.

As services enter the age of globalization, political dynamics seem likely to shift. Four-fifths of all Americans work in service-producing industries, while U.S. foreign trade is primarily in goods. As a result, trade issues often affect service employees mainly in their economic role as consumers who benefit from the freedom to purchase imported products. But as trade in services increases, more service workers will perceive global trade as competition for their jobs, and not just as a source of inexpensive products at Wal-Mart or Target. Of course, many service jobs are difficult to send overseas: It is unlikely that city buses will be operated with remote-control drivers from Bangkok or Beijing. But the world economy is just beginning to experience the slicing up of the value chain in service industries.

A third evolution in globalization is the slow, painful adaption of countries and international institutions to the dangers of rapid international flows of capital. When international financial turmoil struck East Asia and Russia in 1997 and 1998, there was considerable fear that the effects might spread to other national economies, even dragging down the global economy. But Argentina's default of 2002, while rotten news for Argentineans, has not rocked global financial markets in any comparable way. The International Monetary Fund is learning, one hard lesson at a time, about when and how to handle international financial panics and countries that default on their debts. Various international bodies are working behind the scenes to build common standards on eye-glazing but essential topics like accounting and bank reserves. Countries are learning about the importance of sensible domestic bank and financial regulation, in order to avoid being crushed in a financial stampede. Central banks have learned to be wary of

making promises—especially about fixed exchange rates—that they cannot keep. Investors are becoming more savvy about international risks and less likely to engage in herd behavior—all racing to invest in a country one year and then scurrying out the next year.

In the last few years, the benefits of international financial transactions have frequently been overshadowed by panics and crashes. But as the risks of international transactions become better understood and managed, the gains will have a greater chance to shine. It will seem quite normal for investors around the world to take greater advantage of the benefits of international diversification. Firms of all sizes will find it increasingly easy to raise investment funds from sources in other countries.

Worth defending

Economic globalization is a powerful trend, driven by a combination of technological developments, profit-seeking businesses, and generally supportive public policy. But globalization is also less pervasive and more fragile than is widely believed by both its supporters and its opponents. The demise of the first wave of globalization in the early decades of the twentieth century vividly demonstrates that it is not an irreversible trend. National borders and policies continue to play a role in limiting and directing international transactions. Discontent with globalization is widespread enough to be troubling. The most extreme and active of globalization's opponents caricature it as the source of all that is wrong in the modern world, including poverty, injustice, inequality, violence, and war.

Those of us who believe in globalization need to defend it. We need to stick up forthrightly for the benefits it has provided and will continue to provide—and to emphasize not just the actual goods, services, and capital that flow across international borders, but the associated trade in ideas, skills, and institutions as well. When accompanied by sensible, market-oriented public policies, globalization can be a great boon to national wealth and social development.

An additional line of defense, perhaps just as important, is to be honest about the meaning and the limits of globaliza-

tion. Globalization is not a magic cure-all for what ails a nation's economy, nor is it a plot by profit-hungry megacorporations to exploit workers and despoil the environment. Globalization is not the return of colonialism, nor is it the arrival of world government. At the most fundamental level, globalization simply means an expansion of the range of possible commercial activities. Acts of buying, selling, producing, borrowing, and lending that used to be ruled out by geographic, technological, or legal barriers have now become practical. Seeking out and sorting through the possibilities opened up by globalization will require a daunting amount of effort, flexibility, and change, precisely because globalization embodies such a vast and marvelous array of new economic opportunities.