The Global Economy—MALS

Unit 1: Historical and Contemporary Overview of Globalization

Introduction

Although “globalization” became the *mot du jour* to explain changes in the world economy in the late 1990s, today its meaning is still not very clear. People associate globalization with increased trade, financial volatility, business growth, lower commodity prices, cross-cultural conflict, multinational outsourcing, developing-world poverty (or progress), environmental degradation, speed-up in all aspects of life, and terrorism, among other things. Some of these associations make more immediate sense than others, but all of them point in one way or another to the integration of the world economy. This integration has been more pronounced in the last thirty years than in the previous thirty, but, as we will see, globalization is actually more the rule than the exception over the long-historical haul.

Globalization might have little clear meaning because of its association with freer trade and the fact that Americans hold notably changeable and somewhat contradictory views about free trade. A recent poll conducted by *Newsweek* suggested that a clear majority of Americans disagreed with the chair of the President’s Council of Economic Advisers’ claim that outsourcing is good for the American economy. At the same time, respondents were roughly evenly divided about whether trade agreements like NAFTA, which enshrine the principles that enable such outsourcing, were good for the economy. Likewise, an *Investor’s Business Daily/Christian Science Monitor* Poll in 2002 found that a large majority of Americans believed that the foremost goal of trade policy should be to increase exports (rather than restrict imports); at the same time, a similarly large majority said that American trade policy should include restrictions on imports to protect American jobs. As far as the theory of international trade goes, these two views are diametrically opposed. That a majority of polled Americans could claim to hold them at the same time perhaps speaks to the work that needs to be done to clarify the implications of free international trade and globalization.

WEBSITE: For more polls on the opinions of Americans on globalization, see The Polling Report’s international trade website:

Polling Report
http://www.pollingreport.com/trade.htm

So what does globalization mean? When did it begin?

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WEBLINK: What is globalization? Click here to find out.

International thinking at its best!

Question: What is the truest definition of “globalization”?

Answer: Princess Diana's death.

Question: How come?

Answer: An English princess
with an Egyptian boyfriend
crashes in a French tunnel,
driving a German car
with a Dutch engine,
driven by a Belgian
who was drunk on Scottish whisky (check the bottle before you change the spelling),
followed closely by Italian paparazzi,
on Japanese motorcycles;
treated by an American doctor,
using Brazilian medicines.
This is sent to you by
an American, using Bill Gates' technology,
and you're probably reading this on your computer
that uses Taiwanese chips
and a Korean monitor,
assembled by Bangladeshi workers
in a Singapore plant,
transported by Indian lorry-drivers,
hijacked by Indonesians,
unloaded by Sicilian longshoremen,
and trucked to you by Mexican illegals.
That, my friends, is globalization!

Part 1: Before the World Wars

We can begin with a descriptive definition: globalization means economic integration. It means that nominally independent people, places, and institutions become economically important to each other. Japan's banking sector depends upon the value of US Treasury Securities, which in turn depends upon the competitiveness of US manufacturers, which in turn depends upon the costs of intermediate goods imported from Mexico, and so on. It also means change outside of the strictly economic realm—in the political and cultural realms, for example. (Think: the European Union, animé on the Cartoon Network, anti-war protesters also collaborating to stop human rights abuses in China.) Moreover, globalization is not a new process; it has been fundamental to the modern world economy since at least the late 16th century, when the age of mercantile colonialism began. The founding the Americas and the development of the slave trade, upon which much of early modern European development was based, were fundamentally global in the sense we use the term today. Cross-border trade and fancy financial instruments to avoid the authority of the Roman Emperor were common during the Roman Empire. So globalization is not new: whenever we are talking about freer flows of capital, goods, and labor, about closer interdependence between geographically and culturally distant people, we are talking about globalization.

WEBSITE: For more information about trade during the Roman Empire, click on to:

Roman Empire
http://www.unrv.com/economy.php

Many understand globalization from the perspective of the last thirty or so years, an era marked by consistent efforts by many industrialized countries to deregulate national and international commerce. This period does stand in contrast to the previous forty years, during which time governments were somewhat reluctant to leave the market to take care of itself in any fundamental way. But that period—from the Great Depression until the 1970s—should be understood as the exception, not the rule. Indeed, the present period of globalization has more in common with the period before the First World War (1870–1914) than the period after the Second World War.

WEBSITE: For a view of the Great Depression by economist Robert Samuelson, log onto:

Great Depression
http://www.econlib.org/library/Enc/GreatDepression.html

Of course, the late 19th-century experience of an expanding market was very different from our own. At that point, the economy was not wholly coextensive with the market, even in developed countries. Many commodities we take for granted were not even commodified then: many kinds of food, finished clothing, water, child and elderly care, and medical services (such as childbirth) were handled with the unpaid labor of family members or friends, or they were paid for in kind, rather than cash. This is to say nothing of the experience of the subjects of colonialism, with whose unpaid labor and seized

natural resources European progress continued apace. So when we talk about late 19th century liberalization, we should keep that in mind.

Nonetheless, railroads had really made internal markets national in the late 19th century. And the steam engine made international shipping much more feasible and profitable—it made the world smaller for commercial purposes by facilitating migration and trade. Finally, the telegraph fundamentally changed communication, inaugurating an era of (relatively) high-speed information exchange and encoding.

But the relative freedom of the economic world at that moment depended on two other related things: a (once again, relatively) stable international payments system and a leading military power. The payments system at that point was anchored by gold, and the British served as military leader. Both of these conditions unraveled after World War I. By the beginning of the Second World War, the US had overtaken Great Britain as the world's military and financial leader, and the gold standard had been abandoned. In the period between the wars, and for various reasons, much of the world became skeptical about the virtues of untrammeled market forces and the liberalizing impetus was temporarily put on hold. We should keep in mind, however, that even "free markets"—like those of today or of the late 19th century—rely on the power of economic, political, and military institutions.

Part 2: Between the World Wars

The period between the two world wars was punctuated by political and economic upheaval, the rise of Stalin and the Soviet Union, the Spanish Civil War, the emergence of European fascism, and the Great Depression. The US's Smoot-Hawley tariffs of 1930 were emblematic of the changes in the world economy. European overproduction in the agricultural sector (an after-effect of agricultural build-up during the first world war) drove world grain and corn prices down, and thus drastically depressed the value of farm land in the US. The Smoot-Hawley tariffs drew up agricultural import restrictions and provoked other industries to seek relief from international competition. The US government complied. By 1933, the US had the highest levels of tariff protection it had ever had. These drew retaliatory measures from all of the US's trading partners. In general, the world's largest economies increasingly relied on "beggar-thy-neighbor" policies which, like Smoot-Hawley, benefited one country at the expense of others. World trade collapsed. During this period, U.S. imports from Europe declined from $1,334 million in 1929 to $390 million in 1932; U.S. exports to Europe fell from $2,341 million in 1929 to $784 million in 1932. World trade declined by roughly 66% between 1929 and 1934.

Between the wars, suspicion grew about how well the market could achieve just or efficient outcomes on its own. The market economist who enunciated skepticism most clearly was John Maynard Keynes, whose *Treatise on Money* was a flashpoint for debate. Although the *Treatise* is fairly technical, covering topics ranging from the theory of monetary fluctuations to the diffusion of price levels, its basic premises are pretty simple. Keynes argued, quite contrary to the traditional liberal, "free-market" view, that money was not neutral in economic transactions—it wasn't simply a veil for the real value of goods being traded. This implied that prices did not always adjust immediately to supply or demand shocks so as to equilibrate the market at full employment—especially in an international context: since prices were "sticky," we might expect there to be perhaps prolonged periods of unemployment of labor or capital. This view, rearticulated in *The General Theory of Employment, Interest and Money*, was widely accepted as the basis for national economic policy especially during and after the Great Depression, when the inability of the markets to clear at full employment was on glaringly on display in the US and the Europe.

Tip Box: According to classical economic theory, when an economy falls out of full employment equilibrium due to an unexpected downturn in demand, as was the case with the 1929 stock market crash, for example, prices (wages) will quickly fall until demand (employment) is restored. This prevailing view of economic order was called into question by Keynes when the economy failed to recover from that crash. Keynes did not hold the classical view of an automatic recovery, believing that there were structural impediments in the system—such as labor unions—which would prevent such an adjustment from naturally occurring. Keynes believed an economy could get "stuck" in prolonged periods of unemployment and that only with the aid of government intervention would an economy return to full employment equilibrium.

WEBLINK: For more information on seminal economist John Maynard Keynes, log onto:

John Maynard Keynes
http://www.econlib.org/library/Enc/bios/Keynes.html

Austrian economist Friedrich A. Hayek articulated the opposite view, arguing that prices were essentially signals about scarcity—money was an impartial and transparent vehicle for such information. In this view, boom-and-bust economic cycles were more or less unavoidable, and Keynesian-style monetary policy would only distort the essentially efficient adjustment process and make everyone worse off. Whatever the theoretical merits of this view, its policy implication in the Great Depression—do nothing; wait for the market to correct itself—was impossible politically. So Keynes won the day.

WEBSITE: A short bio of Friedrich A. Hayek can be found at:

Friedrich A. Hayek
http://www.econlib.org/library/Enc/bios/Hayek.html

Keynesian wisdom became part of conventional economic thinking in industrialized capitalist countries for the next forty years. In a sense, Keynes saved capitalism from itself—that is, he saw that we didn't live in the perfect world of liberal economic theory, and so posited a way of achieving second-best aims with imperfect markets. Although many associate Keynes's name with big government *per se*, Keynesian theory was aimed at building realism into a theory of markets, not at a theory of market governance. On an international level, Keynes' ideas translated into a skepticism about free trade, since the theory of free trade rested on some of the same fundamental principles as the theory of free markets and transparent money. Nonetheless, world merchandise exports grew at a healthy clip in the postwar period—at 7.1% per year on average between 1950 and 1970. While not the 11.1% of the thirty years that followed, this accomplishment was nothing to sneeze at.

Part 3: Following World War II

In addition to providing a theory compatible with the market skepticism between the wars, Keynes, somewhat ironically, helped lay the foundations of the current "global" order. After the Second World War, at a conference in Bretton Woods, New Hampshire, Keynes helped found the World Bank and International Monetary Fund. The Global Agreement on Tariffs and Trade soon followed, and so were born today's three most talked about international financial institutions.

WEBSITES: Click on the following websites for more information about these institutions and agreements:

World Bank
http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTARCHIVES/0,,contentMDK:20053333~menuPK:63762~pagePK:36726~piPK:36092~theSitePK:29506,00.html

International Monetary Fund
http://www.imf.org/external/pubs/ft/exrp/origins

Global Agreement on Tariffs and Trade
http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr01_e.htm

Right after the Second World War the Bretton Woods institutions did not look like they look today. At that point, although the world was off of the gold standard, the dollar was still pegged to gold, and other currencies were pegged to the dollar. This put the US in the unenviable position of being creditor of last resort for the world: in order for the world to grow, the US had to run balance of payments deficits either through lending capital or borrowing in order to consume. The official vision of world growth saw it depending on the health of the West and more specifically, the US.

In the 1970s this picture changed somewhat. The US let its currency float against other world currencies—it was no longer linked in value to other currencies through the price of gold. The IMF and World Bank began to suggest more in the way of neo-liberal, free-market policies to developing economies and the poor. Indeed, the "structural adjustment" policies that the IMF has advocated universally insist on a laundry list of liberal remedies, frequently without regard to country particulars: tight money, less government regulation, privatization of public amenities, government budget surpluses, export-driven development.

Such advice has not always been entirely well-received; especially in the 1960s and '70s, national autonomy for some meant adopting import substitution rather than free trade development policies. Import substitution meant raising barriers to imported goods that could be produced at home in order to protect and foster nascent national industries. As the experience of Latin America has shown, ISI hasn't been terribly successful; there is too much opportunity for corruption, too little incentive to develop efficient, competitive industry. By the late 1970s and early 1980s such policies were generally acknowledged to have failed.

The single bright spot in the development picture as of the 1980s was South East Asia, which followed neither the neo-liberal IMF-World Bank advice nor import substitution policies. The "Tiger" economies of Japan, Korea, Taiwan, Singapore, and Hong Kong all raised tariff barriers to foreign imports in order to support local industry. But their aim was export-led growth, rather than import substitution. That has proved to be among the important differences between developing economies that succeed and those that fail, and it also helps explain Asian economies' recent positions on trade. (More on this in Unit 2.)

Part 4: After the Fall of the Wall

It's easy to say that the last fifteen years have been especially turbulent ones for the world economy. But it doesn't really mean much. Liberalization—globalization—really means turbulence, because it means speed. For better or worse, the liberal theory of markets—that markets efficiently and instantaneously adjust to changing conditions—implies that those who live their lives in the market must be ready to change quickly also. This idea (to be discussed at much length as the course continues) comes across brilliantly in a recent TV advertisement for IBM. The ad shows a bunch of kids walking through what looks like a museum of natural history with their teacher, looking at the skeletons of dinosaurs and other extinct creatures. They come across a young, contemporary-looking businessman in a suit, frozen behind glass. The children ask their teacher, "What is it?" The teacher says that it's a businessman who couldn't adapt to changing conditions. Obviously, for IBM, the conditions they are talking about are those in the notoriously fast-paced IT industry. But the general lesson is clear: adapt or you're history, a dinosaur.

Among the momentous changes in the past 15 years has been the collapse of the former Soviet Union in 1989, the world counterpoint to US economic, military, and political power since the late 1940s. The USSR finally collapsed under the weight of its own mismanagement and backwardness, succumbing after being drawn into a "second," intensified Cold War in the 1980s. The collapse gave added ideological force to the global neo-liberal thrust begun in the '70s, as it looked like *prima facie* evidence that socialism—or even "managed" capitalism *a la* Keynes—simply wouldn't work. Capitalism was the only game left in town, and neo-liberals—the hard core advocates of free markets for everything—took themselves as capital's representatives.

The newfound interest in markets has increased the visibility of its successes—and failures. Latin American economies that once adhered to ISI principles adopted more open stances to international markets and investment. But, as the experiences of Chile and Argentina have shown, the periods during which such policies succeed are rather liberally mixed with periods of financial, political, and economic crisis. Latin America's "lost decade" (the 1980s) was not followed by one in which it clearly found its way. For that, they are still waiting.

Another of the hallmarks of the last fifteen or so years of economic liberalization has been the continued ascent of financial capital—an ascent which began in 1970s. The liberalization of capital markets has meant increased flows of money across borders. As a result, foreign exchange markets trade an entire year's worth of world GDP many times over in one day. The downside of this freedom to move money across borders has been seen in the rapid development panics and crises. Indeed, the nineties seemed to lurch from financial crisis to financial crisis, from Mexico to Southeast Asia to Russia and Brazil to the US hedge fund Long Term Capital Management. Each of these crises had its own set of special causes but none could have happened without liberalized capital markets.

Although Southeast Asia recovered from the financial crisis of 1997–98, the series of financial catastrophes in the '90s, along with the continued struggle of countries that have

followed the neo-liberal program to achieve stable, lasting growth, has cast globalization in an unfavorable light. In November of 1999, at the World Trade Organization meetings in Seattle, a movement—against globalization—was more or less born. The movement highlighted these failures as endemic to market liberalization itself, and has since drawn together an otherwise unlikely mix of environmentalists, labor activists, anarchists and assorted (mostly) leftists into its orbit. The movement has changed the debate about globalization. At the World Economic Forum in Davos, Switzerland—a meeting for the who's who of the international business, economics, and policy—the agenda has increasingly concerned itself with remedies to market failure since the protests in Seattle.

It's tempting to blame globalization for the upsurge in terrorist activity directed against the secular West. In a certain way, it's true that the spread of Western commercial values and culture have made clashes such as this possible. It's also true that market liberalization by itself doesn't explain much, since terrorism is born of a mix of particular, mostly local political circumstances and the pragmatic concerns of terrorist organizations in general. The advent of large-scale conflict between the secular, commercial West and radical Islam cannot be explained by globalization, but it can't be explained without it either.

For a detailed account of the geopolitical changes that have shaped the global economy over the last century, watch the PBS "Commanding Heights" VHS/DVD (see required course materials) or visit the PBS website "The Commanding Heights Storyline," which provides a complete netcast of the program. (Each of the three two-hour episodes is subdivided into chapters listed in the chapter menu which can be downloaded to a media player of your choice. Links shown below.)

WEBSITE: Visit the PBS website or watch the Commanding Heights VHS/DVD:

Commanding Heights Storyline
http://www.pbs.org/wgbh/commandingheights/lo/story/index.html

Part 5: The Proponents of Globalization

In the present, the difference between the advocates and opponents of globalization can seem very small, or it can seem irreducible. It depends on which advocates and which opponents you're talking about. For example, among professional economists, there is nearly universal agreement that, in theory, free trade increases human welfare. But most economists also recognize that the world does not quite live up to the frictionless dream of theory. The difference is in the remedy. For hard-core proponents of globalization (such as those at the Cato Institute), the answer is more, freer markets, and patience. Boom follows bust as night follows day for such people, and sooner or later we will reap the gains from free trade. For those who support free trade but are nonetheless skeptical about the market left to its own devices, the answer is in prudent governance—in allowing step-by-step liberalization, for example, or building an international payments union that would cushion against wild swings in currency or investment flows.

In general, the proponents of globalization see free trade as bringing with it many benefits: economic growth, higher living standards, better healthcare, environmental protection, lower production costs, increased efficiency, lower prices, better quality, more jobs, technological progress, cultural harmony, less conflict, and so on. How these ends are achieved through the market we will see as we go along.

WEBSITE: For more about the benefits of globalization, see The Cato Institute Center for Trade Policy Studies (CTPS):

Cato Institute
http://www.freetrade.org/

Founded in 1977, the Cato Institute is a nonpartisan public policy research foundation headquartered in Washington, D.C. The Institute is named for *Cato's Letters*, libertarian pamphlets that helped lay the philosophical foundation for the American Revolution. The Cato's Center for Trade Policy Studies (CTPS) seeks to increase public understanding of the benefits of free trade.

WEBSITE: For information on the historical and contemporary impacts of technological change on globalization and arguments favoring the expansion of global markets, go the to the MIT World website and watch "Fortune Favors the Bold,"a one hour lecture by Lester Thurow, Dean of the Sloan School of Business, Massachusetts Institute of Technology.

"Fortune Favors the Bold"
http://mitworld.mit.edu/play/163/

Part 6: The Opponents of Globalization

Those skeptical about or opposed to globalization argue that, although the textbook world of free trade is lovely and perfect, in the real world, globalization has many costs—lost jobs, labor exploitation, human rights abuses, the encroachment of corporate power on the political realm, environmental degradation, and concentration of wealth, to name just a few. Since most of these costs are not measured by corporate balance sheets—or because corporate balance sheets are improved because of them—they don't frequently register in the media. Although in the long run free trade may work, they say, in the long run we are all dead: the answer is prudent policy. (See, for more on this, The Economic Policy Institute's trade and globalization website below.) Or, for some, the answer is another mode of economic organization altogether. (See, for more on this, Infoshop's anti-capitalist activist website, also below.) For the many opponents of globalization the bottom line is that it fails to live up to its grandiose promise of prosperity for all. (For more on this, see The AFL-CIO global economy website).

WEBSITE: For a view supporting prudent policy:

Economic Policy Institute trade and globalization
http://www.epinet.org/subjectpages/trade.cfm?CFID=1573862

WEBSITE: For an anti-capitalist activist view:

Infoshop
http://www.infoshop.org/octo/index.html

WEBSITE: For a critique of globalization's failed promise of prosperity:

AFL-CIO
http://www.afl-cio.org/issuespolitics/globaleconomy/