

**Globalization of the World Economy:
Potential Benefits and Costs and a Net Assessment**

by

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Introduction and Purpose

Globalization is a powerful real aspect of the new world system, and it represents one of the most influential forces in determining the future course of the planet. It has manifold dimensions: economic, political, security, environmental, health, social, cultural, and others. The focus here will be on the concept of "globalization" as applied to the world economy. The term was coined in the 1980's, but the concept is an old one that has different interpretations to different people. Partly as a result of these different interpretations, there are very different reactions to "globalization," with some policymakers, scholars, and activists seeing it as a force for advancing the world economy while others, again all three, seeing it as a serious danger to the world economic system. (For the former, supporting globalization, see International Monetary Fund, 1997; Ohmae, 1990; International Monetary Fund Staff, 2000; Friedman, 2000; Micklethwait and Wooldridge, 2000; World Bank, 2002. For the latter, opposing globalization, see Greider, 1997; Rodrik, 1997; Bauman, 2000; Gray, 2000; Giddens, 2000; Hutton and Giddens, 2000; Hertz, 2001; Bhagwati, 2001; Stiglitz, 2002; and Sullivan, 2002)

There are three purposes of this paper. First, it will clarify the notion of "globalization" as applied to the world economy. Second, it will evaluate both

the potential benefits and the potential costs stemming from globalization. Third, it will consider how the costs or dangers stemming from globalization could be offset through wider international cooperation and the development of new global institutions. (For a related perspective, see Soros, 2002; Bourguignon et. al., 2002; and Fischer, 2003)

The view taken here, representing the thesis of this paper, is that there are both positive and negative aspects to globalization, that some of its positive features stem from the effects of competition that it entails, and that some of the negative aspects that could potentially lead to conflicts could be offset by international or global cooperation through agreements on policy or through the development of new international institutions. Thus, while globalization can cause international conflicts, it can also contribute to their containment through the beneficial effects of competition and the potential of global cooperation to treat economic and other threats facing the planet.

I. Globalization of the World Economy: An Interpretation

"Globalization" will be understood here to mean major increases in worldwide trade and exchanges in an increasingly open, integrated, and borderless international economy. There has been remarkable growth in such trade and exchanges, not only in traditional international trade in goods and services, but also in exchanges of currencies; in capital movements; in technology transfer; in people moving through international travel and migration; and in international flows of information and ideas. One measure of the extent of globalization is the volume of international financial transactions, with over \$1.2 trillion flowing through New York currency

markets each day, and with the volume of daily international stock market transactions exceeding this enormous amount.

Globalization has involved greater openness in the international economy, an integration of markets on a worldwide basis, and a movement toward a borderless world, all of which have led to increases in global flows. There are several sources of globalization over the last several decades. One such source has been technological advances that have significantly lowered the costs of transportation and communication and dramatically lowered the costs of data processing and information storage and retrieval. The latter stems from developments over the last few decades in electronics, especially the microchip and computer revolutions. Electronic mail, the Internet, and the World Wide Web are some of the manifestations of this new technology, where today's \$2,000 laptop computer is many times more powerful than a \$10 million mainframe computer of a generation ago.

A second source of globalization has been trade liberalization and other forms of economic liberalization that have led to reductions in trade protection and to a more liberal world trading system. This process of wider liberalization started in the last century, but the two World Wars and the Great Depression interrupted it. It resumed after World War II through the most-favored-nation approach to trade liberalization, as embodied in the 1946 General Agreement on Tariffs and Trade (GATT) that evolved into the World Trade Organization (WTO). As a result, there have been significant reductions in tariffs and other barriers to trade in goods and services. Other aspects of liberalization have led to increases in the movement of capital and

other factors of production. Some economists and historians have suggested that globalization is little more than a return to the world economy of the late nineteenth century and early twentieth century, of the century from the Congress of Vienna in 1815 to the outbreak of World War I in 1914. At that time borders were relatively open and there were substantial international capital flows and migrations of people, when the major nations of Europe depended critically on international trade as part of the colonial system. This is particularly the view of some British scholars, looking back to that period of British imperial dominance of the world economy. While there are some similarities in terms of trade and capital movements, the period of a century ago did not have some of the major technological innovations that have led to a globalized world economy today that is qualitatively different from the international economy of the last century.

A third source of globalization has been changes in institutions, where organizations have a wider reach, due, in part, to technological changes and to the more wide-ranging horizons of their managers, who have been empowered by advances in communications. Thus, corporations that had been mainly focused on a local market have extended their range in terms of markets and production facilities to a national, multinational, international, or even global reach. These changes in industrial structure have led to increases in the power, profits, and productivity of those firms that can choose among many nations for their sources of materials, production facilities, and markets, quickly adjusting to changing market conditions. Virtually every major national or international enterprise has such a structure

or relies on subsidiaries or strategic alliances to obtain a comparable degree of influence and flexibility. As one measure of their scale, almost a third of total international trade now occurs solely within these multinational enterprises. With the advent of such global firms, international conflict has, to some extent, moved from nations to these firms, with the battle no longer among nations over territory but rather among firms over their share of world markets. These global firms are seen by some as a threat to the scope and autonomy of the state, but, while these firms are powerful, the nation state still retains its traditional and dominant role in the world economic and political system and is likely to remain in this role. (Waltz, 1999)

Non-government organizations, the NGO's, have also taken a much broader perspective that, as in the case of the global firms, is often multinational or global. Even international organizations, such as the United Nations, the International Monetary Fund and World Bank, and the World Trade Organization have new global roles. Overall, multinational enterprises and other such organizations, both private and public, have become the central agents of the new international globalized economy.

A fourth reason for globalization has been the global agreement on ideology, with a convergence of beliefs in the value of a market economy and a free trading system. This process began with the political and economic changes that started in the 1978 reforms in China and then involved a “falling dominoes” series of revolutions in Eastern and Central Europe starting in 1989 and ending with the dissolution of the Soviet Union in December 1991. This process led to a convergence of ideology, with the former division

between market economies in the West and socialist economies in the East having been replaced by a near-universal reliance on the market system. This convergence of beliefs in the value of a market economy has led to a world that is no longer divided into market-oriented and socialist economies. A major aspect of this convergence of beliefs is the attempt of the former socialist states to make a transition to a market economy. These attempted transitions, especially those in the former Soviet Union and in Eastern and Central Europe have, however, been only partially successful. The nations involved and their supporters in international organizations and advanced western market economies have tended to focus on a three-part agenda for transition, involving: 1) stabilization of the macroeconomy, 2) liberalization of prices, and 3) privatization of state-owned enterprise. Unfortunately, this three-part agenda, sometimes referred to as the “Washington Consensus” and that I refer to elsewhere as the “SLP” approach to transition fails to appreciate the importance of 1) building market institutions, 2) establishing competition, and 3) providing for an appropriate role for the government in a modern mixed economy. I have referred to this alternative three-part agenda in other publications as the “ICG” approach to transition. (Intriligator, 1993a, b; 1996a, b; 1997; 1999)

A fifth reason for globalization has been cultural developments, with a move to a globalized and homogenized media, the arts, and popular culture and with the widespread use of the English language for global communication. Partly as a result of these cultural developments, some, especially the French and some other continental Europeans, see

globalization as an attempt at U.S. cultural as well as economic and political hegemony. In effect, they see globalization as a new form of imperialism or as a new stage of capitalism in the age of electronics. Some have even interpreted globalization as a new form of colonialism, seeing the U.S. as the new metropole power and most of the rest of the world as its colonies. In this view, the rest of the world supplies the U.S. not only with raw materials and markets on a global basis, as in earlier forms of European colonialization, but also with production facilities and labor, capital, and other inputs to the production process.

Whether one sees globalization as a negative or as a positive development, it must be understood that it has clearly changed the world system and that it poses both opportunities and challenges. It is also clear that the technological, policy, institutional, ideological, and cultural developments that have led to globalization are still very active. Thus, barring a radical move in a different direction stemming from major changes in the current world system, as happened earlier with two World Wars and a Great Depression, these trends toward greater globalization will likely continue or even accelerate in the future. One important aspect of these trends will be the growth in international trade in services that has already increased substantially but promises even greater growth in the future, especially in such areas as telecommunications, financial, and computer services. The result of these trends will be continued moves toward a more open and a more integrated world as it moves closer and closer to a planet without borders and to a more integrated, open, and interdependent world economy.

The result will be even greater worldwide flows of goods, services, money, capital, technology, people, information, and ideas.

II. Impacts of Globalization on National Economies

Globalization has had significant impacts on all economies of the world, with manifold effects. It affects their production of goods and services. It also affects the employment of labor and other inputs into the production process. In addition, it affects investment, both in physical capital and in human capital. It affects technology and results in the diffusion of technology from initiating nations to other nations. It also has major effects on efficiency, productivity, and competitiveness.

Several impacts of globalization on national economies deserve particular mention. One is the growth of foreign direct investment (FDI) at a prodigious rate, one that is much greater than the growth in world trade. Such investment plays a key role in technology transfer, in industrial restructuring, and in the formation of global enterprises, all of which have major impacts at the national level. They have been especially significant in China. A second is the impact of globalization on technological innovation. New technologies, as already noted, have been a factor in globalization, but globalization and the spur of competition that it entails have also stimulated further advances in technology and sped up its diffusion within nations through FDI. A third is the growth of trade in services, including financial, legal, managerial, and information services and intangibles of all types that have become mainstays of international commerce. In 1970, less than a third of foreign direct investment related to the export of services, but today that

has risen to more than half and it is expected to rise even further, making intellectual capital the most important commodity on world markets. As a result of the growth of services both nationally and internationally, some have called the current age as one of *competence*, underscoring the importance of lifelong education and training and the investment in human capital in every national economy.

III. The Benefits of Globalization Stemming from Competition

It has already been noted that globalization has both positive and negative effects. This section will focus on its positive effects of globalization, stemming from competition, while the next will focus on its negative effects, which could lead to potential instabilities and conflicts. Finally, the last section will consider the potential for international cooperation to diminish or to offset these negative effects of globalization.

Globalization has led to growing competition on a global basis. While some individuals and organizations fear competition, there are many beneficial effects of competition that can increase production or efficiency. Competition and the widening of markets can lead to specialization and the division of labor, as discussed by Adam Smith and other classical economists writing in the eighteenth century on the benefits of a market system at the beginning of the industrial age. Specialization and the division of labor, with their implications for increases in production, now exist not just at the national level but also on a worldwide basis. Other beneficial effects include the economies of scale and scope that can potentially lead to reductions in costs and prices and could result in continuing economic

growth. Other benefits from globalization include the gains from trade in which both parties gain in a mutually beneficial exchange, where the "parties" can be individuals, firms and other organizations, nations, continents, trading blocs, or other entities. Globalization can also result in increased productivity as a result of the rationalization of production on a global scale and the spread of technology and competitive pressures for continual innovation on a worldwide basis.

Overall, these beneficial effects of competition stemming from globalization show its potential value in improving the position of all parties, with the potential for increased output and higher real wage levels and living standards. The result is a potential for greater human well being throughout the world. Of course, there is the distributional or equity issue of who does, in fact, gain from these potential benefits of globalization. As one important case in point, however, China has benefited enormously from globalization as a result of which hundreds of its people have been lifted from poverty, with China becoming the factory for most of the world.

IV. The Costs of Globalization and Potential Conflicts

Globalization involves not only benefits, but also has costs or potential problems that some critics see as great perils. These costs could lead to conflicts of various types, whether at the regional, national, or international level. One such cost or problem is that of who gains from its potential benefits. There can be substantial equity problems in the distribution of the gains from globalization among individuals, organizations, nations, and regions. Indeed, many of the gains have been going to the rich nations or

individuals, creating greater inequalities and leading to potential conflicts nationally and internationally. Some have suggested the possibility of convergence of incomes globally based on the observation that the poor nations are growing at a faster rate than the rich nations. (Barro, 1997) The reality, however, is that a small group of nations, the "tiger economies" of East Asia, especially China, South Korea, Taiwan, and Malaysia have been growing at rapid rates, while the least developed nations of Africa, Asia, and South and Central America have been growing at a slower rate than the rich nations, leading to a bimodal "twin peaks" distribution of incomes. (Quah, 1996) The poor nations are thus becoming increasingly marginalized. The result has been not a *convergence* but rather, with the important exception of East Asia, a *divergence* or polarization of incomes worldwide. The rapid-growth economies of East Asia are joining the rich nations, but the poor nations are slipping even further behind. This growing disparity leads to disaffection and possibly even international conflicts as nations seek to join the club of rich nations and the have-not nations struggle with the have nations for their share of world output. This issue of distribution is a major challenge in the process of the globalization of the world economy.

A second cost or problem stemming from globalization is that of major potential regional or global instabilities stemming from the interdependencies of economies on a worldwide basis. There is the possibility that local economic fluctuations or crises in one nation could have regional or even global impacts. This is not just a theoretical possibility as seen in the financial crisis in Asia, starting in Thailand in 1997 and then spreading to other

Southeast Asian economies and even to South Korea, with delayed effects in Russia in its economic collapse of August 1998. These linkages and potential instabilities imply great potential mutual vulnerability of the interconnected nations of the global economy. A worldwide recession or depression could lead to calls to break the interdependencies that have been realized through the globalization process, as happened in the Great Depression of the 1930's, with competitive devaluations, beggar-my-neighbor policies, escalating tariffs, other forms of protectionism, etc. The result could be economic conflict, gravitating to economic warfare and possibly even to military conflict, repeating the history of the interwar period of the 1930's that led to the largest war in human history. Such a scenario is not impossible, and glimpses of it were seen in the 1997-98 Asian financial crisis.

A third type of problem stemming from globalization is that the control of national economies is seen by some as shifting, in part, from sovereign governments to other entities, including the most powerful nation states, multinational or global firms, and international organizations. The result is that some perceive national sovereignty as being undermined by the forces of globalization. Thus, globalization could lead to a belief among national leaders that they are helplessly in the grip of global forces and an attitude of disaffection among the electorate. The result could be extreme nationalism and xenophobia, along with calls for protectionism and the possible growth of extremist or fundamentalist political movements, ultimately leading to potential conflicts.

It is sometimes alleged that a cost of globalization is unemployment in the high wage industrialized economies. The relatively low unemployment rates in many high wage nations and their high rates in many low wage nations appear to disprove this allegation. National policy and technological trends are much more important determinants of employment than global factors. A related myth is that globalization is threatening the social welfare provisions of some states, but other factors are much more important, including domestic fiscal policy and demographic trends. In both cases, globalization is a convenient scapegoat for failures of national policy.

It is important also to appreciate that the economic aspects of globalization are but one component of its effects. There are potentially very important noneconomic impacts of globalization involving great risks and potential costs, even the possibility for catastrophe. One is that of security, where the negative effects of globalization could lead to conflicts, as suggested above, and even possibly another world war. Indeed, the very process of globalization leading to integration of markets could make conflicts escalate beyond a particular region or raise the stakes of conflict, for example, from conventional weapons to weapons of mass destruction. A second noneconomic area in which globalization could lead to catastrophic outcomes is that of political crises, that could escalate from local to large-scale challenges. A third such area is that of the environment and health, where the greater interconnectedness stemming from globalization could lead again to catastrophic outcomes, such as global warming and pandemics, repeating the great influenza pandemic of 1918.

V. The Role of Global Cooperation in Dealing with Global Threats and in Creating a New Post Cold War System

The last two sections have highlighted both the benefits and the costs stemming from globalization. Some could see globalization as a very dangerous negative development by focusing on its costs and the potential for conflict. Others, on the other hand, could see it as a positive development, one offering unprecedented opportunities. Both of these views contain some elements of truth, but each should be offset by the other in order to gain a full understanding of the impacts of globalization. There are twin myths here, the optimistic one that globalization leads to only positive outcomes and the pessimistic one that globalization leads only to negative outcomes, and as noted already the literature on this subject is polarized into these two extreme viewpoints. Any objective treatment or net assessment, however, would have to recognize both the benefits and costs of globalization.

What is the net result of globalization, when taking both benefits and costs into account? The answer depends crucially on the nature of the world system. In a world beset by conflicts, globalization would probably have a net negative impact. Conversely, in a cooperative world, globalization would probably have a net positive impact. Thus, globalization represents a major challenge and at the same time an unprecedented opportunity in terms of the possibilities for conflict or cooperation. The challenge is to create a new world system in the aftermath of the cold war and the movements toward globalization that would enhance its generally beneficial effects and that

would minimize its actual or potential costs. The key to such a world system will be cooperation among the nations of the world and dynamic innovation, including the establishment of new institutions.

The challenge of the present globalized and post cold war economy is comparable to the challenge facing the allied nation victors in World War II. The old world had been destroyed and a new world had to be created. Not one, but two world systems were created, in fact, one in the West and the other in the East. Both involved the creation of new institutions that would replace the ones that had been destroyed in the war. Each side had its own ideology and organization, that in the West being market oriented and that in the East being socialist. Now, of course, the ideological divide has dissolved, and there is a convergence of ideology on the value of a market economy.

A small group of Americans helped create a new world system for the West during the period from 1945 to 1955. One of the major participants was Dean Acheson, the U.S. Secretary of State during part of this period. His memoirs are aptly named *Present at the Creation*, given his role in creating this new world system. Another was Will Clayton, who developed the blueprints for two of the basic institutions of the new world system. One was the Marshall Plan that was announced by General George C. Marshall at the Harvard commencement in 1947 and became the most successful aid program in history. The other was the General Agreement on Tariffs and Trade (GATT) that evolved into the present World Trade Organization. These Americans, together with President Truman, George Marshall, and others created the institutions that brought the devastated nations of Europe

into the world community. These institutions included the United Nations; the World Bank and the IMF; the Marshall Plan and OEEC (later to evolve into the OECD); GATT; NATO; and others. These institutions and the new world system that they helped create was most successful in bringing the nations of Europe, including both former enemies and devastated allies, into this new system and in promoting reconstruction and growth.

The present post Cold War period has some similarities to the one after World War II in that a new world system must be created. Such a system that would have to take account of the new situation - that of a world not divided by ideology and one becoming increasingly integrated. The sequence of revolutions that began in Eastern Europe in 1989 led directly or indirectly to the end of the Cold War, the demise of the Warsaw Pact, the unification of Germany, the dissolution of the Soviet Union, and the attempted transition of the former socialist states to democracy and a market economy, with only mixed success. The West for its part has been only partially successful in establishing structures such as those developed after World War II to bring Russia, other former Soviet states, and Central and Eastern Europe into the world economic and political system. In some respects the treatment of the former Soviet Union and its former allies in the current period is unfortunately similar to the treatment of Germany after World War I rather than its more enlightened treatment after World War II when it was one of the recipients of Marshall Plan assistance and joined various European and international institutions. (Keynes, 1919, foresaw the disastrous consequences of the treatment of Germany after World War I)

Overall, the challenge of globalization will require truly cooperative efforts of the great nations, especially among the new great powers of the European Union, the United States, Canada, Japan, Russia, China, India, Brazil, and others. Their joint activity in establishing new political arrangements and institutions could go a long way to solving global problems, including the economic and other challenges stemming from globalization. As was true in the earlier period of the creation of a new world, it will be necessary to reinvent existing institutions and/or to create new ones so as to deal with economic challenges, such as the problems of distribution and mutual vulnerability stemming from globalization. These institutions must have global perspectives and responses and they will require substantial resources and enforcement mechanisms, including some elements of supranational decision-making and authority, along with appropriate transparency and accountability.

Consider, for example, how global cooperation and new international institutions can treat the several problems identified earlier as costs or problems of globalization. The first of these problems was that of the distribution of income and specifically the gains from globalization both within and between nations. A supranational institution based on global cooperation could address this problem. It would, in effect, tax the nations gaining from globalization and use the proceeds to provide financial and technical assistance to those losing from globalization. This is already being done in a somewhat haphazard way through the World Bank and, in particular, its soft lending arm, the International Development Association (IDA) that provides

subsidized loans to poor nations on more favorable terms than the World Bank provides. It should be done, however, on a more systematic basis, which would require either a new international institution or an expansion and change in the nature of the World Bank. The rich nations should be expected to support the establishment of such an institution as an investment in global stability, assuming they recognize the dangers of serious disparities in the worldwide distribution of income.

The second of the problems identified earlier as stemming from globalization was the fragility of the international economic system, leading to mutual vulnerability. Again, international cooperation and the development of new institutions or the expansion of existing institutions could address this problem. The International Monetary Fund could be instrumental in dealing with this problem. The IMF has played a key role in providing support to nations that have experienced instabilities, as in its support for Mexico during the peso crisis and its agreement to support South Korea during the East Asia financial crisis, although in other crises its actions have in fact aggravated rather than ameliorated the underlying problems. A regularized and more credible insurance against these risks would require a substantial augmentation of the resources of the IMF, the assets of which have not grown at the same rate as international financial exchanges. International cooperation could also lead to the implementation of the Tobin tax, a small tax on foreign exchange transactions that could play a valuable role in limiting destabilizing currency speculation and, at the same time, provide important added funding for international organizations.

The third of the problems identified earlier as stemming from globalization was that of the perceived loss of sovereignty of national governments and political leaders. This development could lead to fear of the loss of ability of nations to determine their economic policies, political disaffection, and the rise of extremist politicians and political movements. The process of globalization, however, need not lead to a loss of sovereignty. Once again, international cooperation can play a role in ensuring the sovereignty of national governments and a proper role for political leaders, drawing a firm line between what is in the province of these governments and their leaders on the one side and what is in the province of international organizations and multinational or global enterprise on the other. Participation in the establishment of the needed institutions to deal with these and other problems stemming from globalization will, by itself, help political leaders to regain a sense of control over their futures and positions in the global community. For example, the regulatory regimes of nations and even international organizations have become more porous and more easily overcome through advances in technology. Examples include the lack of regulation of the global integrated capital market, of trade in information services that is widely expected to grow enormously, and of labor and environmental safeguards. Cooperation among nations and international organizations could offset these developments by themselves taking advantage of recent technological advances and using them to reassert control through cooperative activities.

Overall, there are several possible vehicles for cooperation as a way of responding to the serious challenges of globalization. One is the strengthening of existing international institutions. Another is the establishment of new institutions, as in the case of the World Trade Organization, which has a binding dispute settlement mechanism of a supranational character. A third is the establishment of larger entities, such as the expansion of the European Union, or loose combinations of nations to treat certain economic issues, such as the G-8 or the Asian Pacific Economic Cooperation (APEC).

Global cooperation through formal or informal institutions provides an increasingly important mechanism to ensure the proper treatment of global problems, including those stemming from globalization trends. Through such global cooperation it should be possible to ensure equity and stability in a globalized world, leading to economic growth for all, the transition to a market economy for former socialist states, and economic development for the poorer nations. Such cooperation is also the way to treat the noneconomic problems of globalization, including those of environmental and health protection on a worldwide basis, freedom from political crises or instability, and global peace and security for the planet. The challenge will be to develop such new modes of cooperation and new institutions to deal with the challenges of globalization.

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