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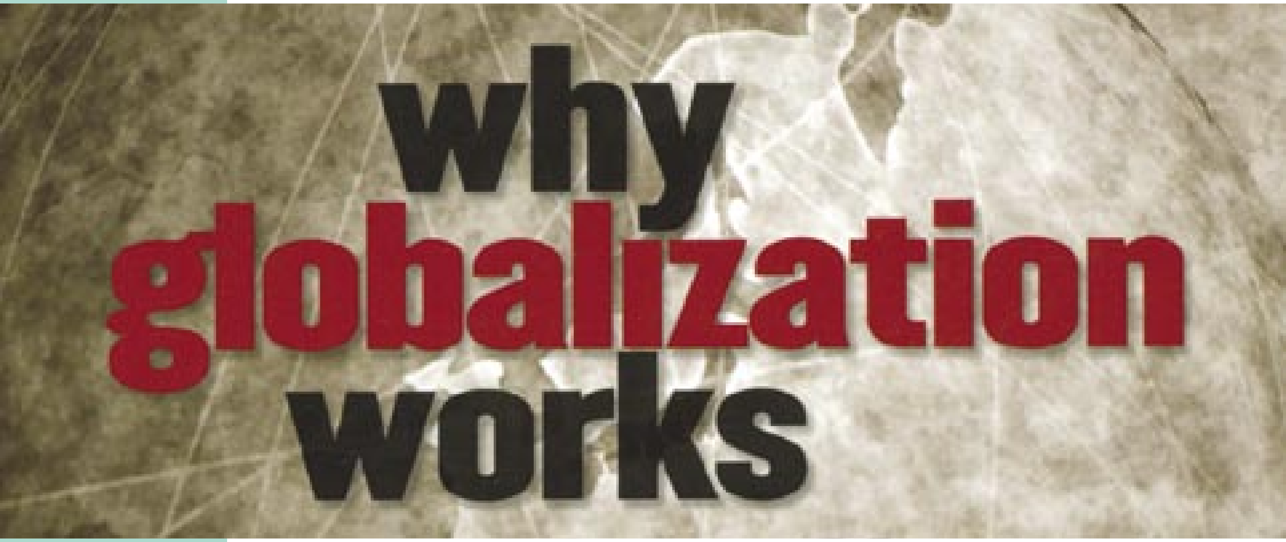

In a ground-breaking work, Martin Wolf refutes the criticism levelled at economic globalisation, and demonstrates why this is the only path to greater prosperity and freedom for developing countries

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It has been written by Stefan Schirmer, consultant to CDE, and Ann Bernstein.

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WHY GLOBALIZATION WORKS

CDE reviews a ground-breaking work by Martin Wolf in which he refutes the criticism levelled at economic globalisation, and demonstrates why this is the only path to greater prosperity and freedom for developing countries

The Centre for Development and Enterprise
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CONTENTS

INTRODUCTION

> The failure of our world is not that there is too much globalization, but that there is too little. The potential for greater economic integration is barely tapped. We need more global partners, not fewer, if we want to raise the living standards of the poor of the world. Social democrats, classical liberals and democratic conservatives should unite to preserve and improve the liberal global economy against the enemies mustering both outside and inside the gates.

This quote from Martin Wolf's impressive book *Why Globalization Works* captures much of its essence. The book demonstrates that globalisation promotes desirable objectives such as economic growth, reductions in poverty and inequality, good governance, and personal freedom. It should therefore be supported by those who value these goals. By contrast, the opponents of globalisation mostly have their facts wrong, and their 'solutions' can only reduce both the welfare and freedom of people throughout the world.

There are many reasons why globalisation is good, and why the forces working against it are bad. Wolf's book demonstrates that globalisation has been a progressive force throughout history, that the expansion of markets across borders is both morally and materially superior to placing restrictions on this process, and that the criticisms which have been levelled against various aspects of globalisation are either misinformed or misconceived, or both. Against the often extreme rejections of the market espoused by the opponents of globalisation, Wolf does not offer a radical counterargument in favour of the miracle of free markets. Nor does he provide a dogmatic defence of institutions such as the World Bank and the IMF (see box: *Wolf's criticism of the World Bank and IMF*, page 4). He acknowledges that these institutions have erred, and that it is often difficult for less developed countries to gain access to all the benefits of globalisation.

> *The opponents of globalisation mostly have their facts wrong, and their 'solutions' can only reduce both the welfare and freedom of people throughout the world*

What he demonstrates unambiguously, however, is that those policies, institutions, and processes which allow people across the world to access markets will lead only to positive results. He therefore presents a powerful and sensible point of view that should be supported by all those who care about liberty and the welfare of the poor in less developed countries (see box: *Liberalism – its meaning and virtue*, page 8).

WOLF'S CRITICISM OF THE WORLD BANK AND IMF

'By the late 1970s I had concluded that, for all the good intentions and abilities of its staff, the World Bank was a fatally flawed institution.

'The most important source of its failures was its commitment to lending, almost regardless of what was happening in the country it was lending to. … During my time in India as senior divisional economist, my chief function, so far as the Bank was concerned, was to justify the provision of significant quantities of aid, even though this money was helping the government of India avoid desperately needed policy changes.

'Unfortunately, lending too much was not the banks' only fault. It also had to lend to governments. This had two undesirable consequences: it had to assume that the government represented the interests of the country; and it reinforced an unjustifiably collectivist view of that national interest. Bank lending made it easier for corrupt and occasionally vicious governments to ignore the interests and wishes of their peoples.

'The IMF has been a secretive and arrogant organisation, though both charges are far less applicable today than they were a few years ago.

'Its technical approach to both monetary and fiscal policies has often been questionable. It has also frequently made debatable assumptions about the availability of finance, particularly aid, in the long run. It has interfered too heavily in the details of revenue and spending decisions, quite apart from a vast range of macro economic policies. Its conditionality has, consequently, been too complex and intrusive. It has lent again and again to the same incompetent countries. It has, in effect, assumed responsibility for running many developing countries, particularly small and poor ones, as though it were proconsular agent for the finance ministries of the G7. This has created many difficulties, but the most important by far is confusion of political responsibility. Policies mandated by a mixture of adverse circumstances and incompetence are too frequently blamed on the IMF instead. While that may be politically convenient for the government, and especially for the finance ministry, which often needs all the excuses (and backing) it can obtain, such use of the IMF as the scapegoat conceals from the population both the responsibility for a crisis and the inevitability of the means of escaping from it.

'The realization that the institutions designed to oversee aspects of the global economy might fail, even though integration was an important element in successful development, is important. To defend a liberal world economy is not to defend the IMF, the World Bank, the World Trade Organization or any specific institution. These must be judged – and reformed or discarded – on their merits.'

This review presents Wolf's case for globalisation in three sections. The first concentrates on some of the more general reasons why globalisation and markets are good, as well as how they work to generate positive results. The second looks in detail at the anti-globalisation critics, and shows why their various criticisms are invalid. The third analyses the implications of Wolf's findings for South Africa.

THE POSITIVE RESULTS OF GLOBALISATION

What is globalisation?

To understand how globalisation works, we must have a clear sense of what it actually is. Wolf addresses this by focusing on the economic aspects of globalisation, and by placing recent trends in historical context. In this way he achieves the important objectives of clarity and perspective. To avoid engaging extensively with the more esoteric, culture-based objections to globalisation, Wolf employs a trade-based definition. As he puts it:

> Globalization is defined … as integration of economic activities, via markets. The driving forces are technological and policy changes – falling costs of transport and communication and greater reliance on market forces. … Economic globalization has cultural, social and political consequences (and preconditions). But those consequences and preconditions are neither part of its definition nor a focus of our attention.

> *What he demonstrates unambiguously is that those policies, institutions, and processes which allow people across the world to access markets will lead only to positive results*

Defined in this manner, the process of globalisation has been under way for a very long time. Markets have always had a tendency to expand, and, by doing so, have facilitated the exchange not just of goods but of ideas as well. The expansion of markets brings people closer together, and thus facilitates cultural, political, and technological exchanges. The same process also puts people in previously separate societies into competition with one another, which then pushes entities in both those societies into adopting those methods and systems that produce the best economic results. Of course, this has not been the only way in which societies have interacted. They have also responded to neighbourly encroachments by isolating themselves, or by restricting and controlling contact. Just as often, they have decided that force is preferable to trade. In such cases, conquest has been used by one society to acquire goods, services, and factors of production from another. Throughout history, those societies that were more prepared to allow competition with other countries fared much better than those which restricted trade or relied on force (see box: *Adam Smith on free trade and 'globalisation'*, page 13).

A powerful way in which Wolf demonstrates the negative consequences of limiting globalisation is by revealing the link between the rise of fascism and international trade restrictions. After identifying the 19th century as the heyday of liberalism and growing globalisation – a time when people, capital, goods and ideas, moved increasingly freely across borders – he points to an inevitable anti-liberal backlash. This was rooted in both ideological trends and political realities and led, eventually, to World War 1.

This war, which Wolf describes as 'a crime and a blunder', resulted in a world in which trade was increasingly difficult, and monetary stability vanished into a series of hyper-inflations as governments printed money to settle their wartime debts. Any notion of returning to freer international trade was then destroyed by the Great Depression, which inspired the United States to impose the Smoot-Hawley tariff, which raised import tariffs on manufactured goods to an average of 48 per cent. It also led Britain and other European countries to abandon free trade and the gold standard, which then acted as 'a huge spur to the search for autarky and Lebensraum, most of all for Germany and Japan'.

Wolf demonstrates the negative consequences of limiting globalisation by revealing the link between the rise of fascism and international trade restrictions

The point which Wolf stresses here is that the aggressive aspects of fascism and nationalism were immeasurably strengthened by a diminution of free trade. In such a context, countries that hoped to become richer and more powerful, such as Japan and Germany, saw little alternative but to forcibly create the factors of production which their economies needed to grow. This led to a situation in which most internal freedoms were destroyed, huge territories containing millions of people were forcibly and violently annexed, and a massive and hugely destructive conflict with the great powers became inevitable. After World War 2, when Germany and Japan had no option but to rely on trade to expand, they grew far more extensively and effectively than they had before the war, and did not have to destroy freedoms and lives to do so. This is surely the most powerful historical lesson on why global economic integration is preferable to the alternative.

Any engagement with the debates about globalisation must be based on a clear understanding of how markets work

Wolf also demonstrates that there is nothing fundamentally new or novel about the current process of globalisation. None of the phenomena connected to the technology of the Internet or to breaking down barriers to trade, which commentators have claimed make our era unique, is without precedent. Wolf sums this up as follows:

> Compared to what was available in, say, 1 000 BCE, the naval technology of 1 500 had killed distance: it made the world one. Again, long-distance trade has always concentrated on high-value-to-weight items: think of silk and cloves. The book had a revolutionary impact: neither the Reformation nor the scientific revolution of the 16th and 17th centuries would have been feasible without it.
>
> Let us see whether the Internet proves as important. Again, printing made possible a strong sense both of the world as a whole and of nationalism as an intellectual enterprise … Financial crises have spread across borders ever since lending has. Nor is the impact of faraway events a new phenomenon either.

There is, therefore, nothing really distinctive about today's globalisation. This means that we do not require radically new approaches to deal with this phenomenon. Instead, we can expect the future benefits of and reactions to ongoing integration to be broadly similar to those of the past. Increased trade in goods and ideas will continue to produce long-term benefits, whereas movements in the opposite direction will mostly destroy both freedom and growth.

Markets require a sophisticated institutional framework

Any engagement with the debates about globalisation must be based on a clear understanding of how markets work. As Wolf points out, this is frequently not the case among the critics of globalisation. One misperception that Wolf dispels – one that is also held by some of the more radical supporters of globalisation – is that markets are somehow associated with a natural competitive state. The idea that the laws governing markets are the same as the 'law of the jungle' is wrong because it fails to appreciate the sophisticated institutional framework that is required if markets are to allocate resources and goods effectively.

Further, such an institutional environment will not suddenly

LIBERALISM – ITS MEANING AND VIRTUE

Anti-globalisers, especially those in South Africa, like to disparage liberalism. They often do so by adding the derogatory prefix 'neo' to the term. Wolf sees this as nothing more than baseless mud-slinging. He quotes Mario Vargas Llosa, Peruvian novelist and former presidential candidate to argue against the validity of this approach:

'A "neo" is someone who pretends to be something, someone who is at the same time inside and outside of something; it is an elusive hybrid, a straw man set up without ever identifying a specific value, idea, regime, or doctrine. To say "neoliberal" is the same as saying "semiliberal" or "pseudoliberal". It is pure nonsense. Either one is in favour of liberty or against it, but one cannot be semi-in-favour or pseudo-in-favour of liberty, just as one cannot be semipregnant, semiliving or semidead.'

To be a liberal is not necessarily to be conservative, or to favour the rich over the poor. Liberals are simply people who agree with John Stuart Mill in their commitment to freedom. This covers civil, personal, and economic freedoms, and is based on Mill's assertion that 'the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of any of their number is self protection. ... His own good, either physical or moral, is not sufficient warrant.'

This statement is open to wide interpretation about what can be justified and what cannot, but Wolf prefers to move beyond the debates within liberalism and to focus on those issues that bind liberals together and unite them in opposition to anti-liberal, anti-globalisation forces. As he puts it, the differences between liberals are generally small because they are united in their opposition to state ownership and communist-style planned economies. They are, furthermore, on the same side in current battles against 'religious fanatics, obscurantists, extreme environmentalists, fascists, Marxists, and contemporary anti-globalisers'.

or automatically emerge; it has to be created over time via a combination of benevolent state regulations, self-interested private initiatives that focus on long-term benefits, and other processes such as the spread of ideologies and technologies. As market transactions start to grow they will often encourage the development of a more conducive institutional environment. This happens as private individuals and states begin to see the advantage of developing information flows; trusting others, and acting in a trustworthy fashion; allowing and encouraging competition; providing and enforcing property rights; and regulating externalities. However, it is very difficult to initiate this evolutionary process at a time when markets are not extensive, and there is no guarantee that, once under way, the process will not be reversed.

> *Corporations facilitate a far higher level of economic activity than would be possible if everything was left to the market*

Two important points about the nature of global market interactions emerge from this insight. First, becoming integrated with and benefiting from the global market economy will not be easy for those societies that lack an appropriate institutional framework. Second, many of the central features of the dominant economic systems within the global economy have to be understood and appreciated as part of the institutional framework that has evolved to allow markets to work. These include corporations, intellectual property, and financial markets.

The opponents of globalisation have criticised all three of these features, and it is true that none of them is perfect. However, those who argue that they should somehow be replaced are failing to recognise their key role in generating the continuing expansion of market-based social systems.

Corporations emerged in the course of the 19th century as a way of reducing the transaction costs inherent in market-based economic systems. In developed countries such as the United States, corporations coordinate most of the economic decisions and interactions necessary to produce goods and services. They therefore facilitate a far higher level of economic activity than would be possible if everything was left to the market. At the same time, however, they concentrate knowledge and control in the hands of managers whose interests do not necessarily converge with those of society as a whole. Corporations are therefore sources of power that, in a similar way to states, allow an elite group of people to divert resources in favour of the narrow interests of managers. What distinguishes corporations from the state, however, is that the former are subject to the discipline of the market. In the words of Wolf:

> The corporation is not above or outside the market. Shifts in market conditions, including technology or trade, will alter the boundaries of corporations, force them to merge, impose fundamental changes in strategy or maybe bankrupt them. Companies are servants of market forces, not their overlords. If they do not meet the terms of market competition, they will disappear.

However, in order to ensure that corporations do not spend significant and damaging amounts of time defying the logic of the market, other forms of regulation should ideally be enacted. These include government laws that prohibit anti-competitive behaviour, internal checks that give independent directors and shareholders control over managers, and requirements for regular, transparent accounting and auditing.

The second important institution that underpins successful modern market economies is intellectual property. Innovation is normally endemic within competitive market systems, but intellectual property rights are required for it to be generated at optimal levels. These rights create the rewards that act as incentives for people to produce new, economically useful ideas. Again there is a danger here as patents, trademarks, and copyrights are also legally sanctioned restraints of trade that can protect undeserving interest groups. According to Wolf, the protection of intellectual property must therefore strike a delicate balance; it is essential for the maximum performance of the market system, but can easily go too far. The pressure from powerful and self-interested lobbies for the excessively close protection of intellectual property must be resisted.

Without financial markets, savings and investments would be at a much lower level, and would be linked together far less effectively

A third major feature of effective market systems is the financial market. Financial markets perform four essential services, namely:

- mobilising savings that would otherwise be unavailable for productive use, or would be spent on consumption items;
- allocating capital to productive projects;
- monitoring the performance of the managers of projects financed with borrowed capital; and
- pooling risks, and distributing them among those best able to bear them.

Making markets work is a process requiring co-ordination between economic, social, and cultural progress. Most importantly, it requires good politics

Without financial markets, savings and investments would be at a much lower level, and would be linked together far less effectively. Financial markets therefore contribute much of the economic growth in market-based societies, but again they contain a number of drawbacks that can be harmful in the short term. The problems surrounding them include the following:

- They suffer from inadequate information about the value and reliability of assets and liabilities. They also contain obstacles to monitoring performance.
- The central institutions of these markets, namely banks, are extremely fragile because their liabilities are short term, and usually payable on demand, while their assets are long term, with values that are vulnerable to interest rate changes and macro economic risks.
- They are liable to wild price swings, both upwards and downwards, because of the difficulty of valuing uncertain income streams.
- They tend towards herd behaviour, because players are frequently ill-informed about the assets they are purchasing and tend to believe that other players know more than they do.
- They generate self-fulfilling expectations, which lead to what economists call multiple equilibria, and lay people call vicious cycles.

As a result of these drawbacks, faltering financial markets have been responsible for much economic upheaval in both the developed and the developing world. However, one should not conclude from this that societies should rather do without financial markets. Market systems simply do not work effectively unless financial institutions are allowed to co-ordinate savings and investments according to market logic. Doing away with these institutions or using strict state control to regulate their behaviour will lead to far greater losses in the long run than markets could ever generate by themselves.

The importance of good government

When markets cross borders, it is vital to understand what makes them work. Those who criticise some of the institutions described above, as if one could do without them and still generate the levels of per capita income and dynamism achieved by the developed world, fail to appreciate fully how markets work. At the same time, some of the optimism of those who think that markets fall from the sky and create easy miracles needs to be curbed.

Making markets work is a process requiring co-ordination between economic, social, and cultural progress. Most importantly, it requires good politics. Wolf feels that politics, even in liberal democracies, necessarily leads to much misallocation of resources and inefficiencies, but he rejects the idea that there is an inevitable dichotomy between the state and the market. In his opinion, what distinguishes the wealthier countries from the poorer ones is primarily their politics. Markets thrive in countries where policies are implemented in a manner that is credible, predictable, transparent, and consistent. Further, the kinds of policies these countries implement help markets to work by sustaining the rule of law and enforcing property rights; providing sound money; providing infrastructure, basic research, and public goods such as education; regulating competition and utilities with monopoly power; and helping to internalise externalities. In those countries where governments provide none of these things and instead act in a way that is predatory, inconsistent, and ineffective, markets will wither. As a result, Wolf concludes, 'bad governments are a huge obstacle to gaining the benefits of economic integration across borders. Indeed, they are the most important obstacle of all.'

There is a strong anti-liberal strain that binds the diverse anti-globalisation groups to one another

WHY THE ANTI-GLOBALISATION CRITICS ARE WRONG

The anti-globalisation movement is made up of a variety of interest groups. Prominent among these are sectional interests that have traditionally opposed free trade in order to protect their members against its harmful short-term effects. Trade union movements and some NGOs are among the representatives of such sectional interests. But leading the current anti-globalisation charge is a motley assortment of mainly idealistic groups which believe that globalisation is inherently harmful, and that a less globalised and less liberal world would be a better place to live in. These groups include left-leaning environmentalists and human rights groups as well as more right-wing nationalists and mercantilists.

Wolf argues that their protests against expanded global interaction are underpinned by 'old preferences for the comforts of community over individual striving, for traditional ways over rapid change, for the beneficence of the state over the cold logic of the market, for collectivism over freedom, for the nation over the global economy'.

In short, there is a strong anti-liberal strain that binds the diverse anti-globalisation groups to one another. For those who value freedom this is a disturbing trend and some, such as Mike Moore former director-general of the World Trade Organisation,

ADAM SMITH ON FREE TRADE AND 'GLOBALISATION'

According to Wolf, one of the most important aspects of Adam Smith's *Wealth of Nations* was the argument against mercantilism in favour of internal development and trade. Mercantilists believed that the well-being of a society should be measured by the extent of the resources it controlled.

They therefore tended to see trade as a zero-sum game and concentrated on obtaining wealth, especially in the form of gold, in the cheapest possible way. The use of force was often deemed necessary and expedient in this ideological context. Adam Smith showed that trade offered benefits to both parties, and that wellbeing could be far more effectively achieved if societies focused on developing their internal capacity.

Although the lesson took a very long time to be fully accepted in Smith's homeland, Britain, it did far better by following aspects of the free trade philosophy than countries that stuck to the mercantilist logic, such as Spain and Portugal.

have drawn explicit links between these and previous, more successful, opponents of freedom. According to him, the current anti-globalisation extremists, 'who lay claim to follow the heritage of Gandhi and Martin Luther King, are really the descendants of strictly reactionary and even more utopian early fascists and Marxists. The last time the far left and the far right held hands in the streets of Europe was to fight against decadent democracies in the 1930s.'

The current anti-globalisers have no alternative model of how the world should be run, and often have contradictory objectives

Wolf has some sympathy with this view, but he also points to essential differences between the old and the new opponents of liberty. He reminds us that the Marxists and fascists of the early 20th century went after power, and knew what do with it when they got it. The current anti-globalisers, by contrast, do not have any clear agenda except to oppose the further spread of global interaction. They have no alternative model of how the world should be run and, because they are so diverse, they often have contradictory objectives.

Some harbour ideas of a world organised along more self-sufficient and localised lines, but they have no sense of how such a world could be created or maintained. Others seem to prefer a world system in which weak regions would be protected from the strong, but again there is no plan on how to bring this about. The anti-globalisers are therefore able to tap into a lot of 'fear and loathing' across the world, but as a movement they do not have much going for them.

Wolf tackles these critics head on by providing detailed evidence that the charges laid against globalisation have no basis in reality. He shows that, contrary to what the critics maintain, globalisation has not increased inequality and poverty, that developing countries have in fact benefited from trade, that corporations have not become all-powerful, that the state is not withering away, and that a liberalised capital account remains a good thing despite the Asian crisis and continuing currency fluctuations. Each of these points is addressed in detail in the following sections.

Has globalisation increased inequality and poverty?

The critics of globalisation believe that it benefits the rich and hurts the poor. They hark back to the old dependency theorists who saw international trade as a means for the rich to 'exploit' the poor.

The critics usually draw on statistics to make their case, but not very carefully, and with a tendency towards sensationalism. Thus they make statements such as the following:

> Taking the planet as a whole, the combined wealth of the 358 richest people (all of them dollar billionaires) is greater than the total income of 45 per cent of the world's poorest inhabitants, that is 2,6 billion people.[1]

Wolf points out that this kind of comparison between the assets of one group of people and the incomes of another is like comparing apples and oranges. Mostly, though, he demonstrates that globalisation has led to economic growth for less developed countries, which has had the effect of reducing both global inequality as well as poverty levels.

China and India loom large in Wolf's analysis, and for good reason. These two countries can readily be seen as the major success stories of globalisation since the 1970s. Both began to grow far more quickly and effectively than they had before they opened themselves up to trade opportunities and international capital flows. Most importantly, at the beginning of the 1980s these countries were among the poorest as well as the largest countries in the world. Once they opened up to markets – both externally and internally – their per capita incomes rose rapidly. Between 1980 and 2000, India's real GDP per head more than doubled, while China experienced a rise in real incomes per head of well over 400 per cent during the same period. As a result, these countries are no longer among the poorest nations in the world, and millions of their poor have experienced a substantial improvement in their standard of living, however this is measured. Even if, as is likely, inequality increased within these two countries during the process of economic liberalisation, global inequality would still have decreased as a result of millions of Chinese and Indians

> *China and India can readily be seen as the major success stories of globalisation since the 1970s*

becoming less poor more quickly than the rich were becoming richer. Thus, despite the absolute gap between Chinese and American incomes between 1980 and 2000 rising from $20 600 to $30 200 a head, the relative gap improved dramatically during the same period: in 1980, Chinese incomes were only 3 per cent of American incomes, while by 2000 they were 12 per cent. China grew substantially faster than the United States during this period (440 per cent to 60 per cent), and if this continues, Chinese incomes will soon start to catch up to those of Americans.

What economically successful countries all share is a move towards a market economy

Many critics of globalisation will find this hard to swallow, especially as inequality remains extreme, across the world as well as within most countries. But, as Wolf points out, 'rapid economic growth in poor countries with half the world's population has powerful effects on the only sort of inequality that matters, that among individuals. It has similarly dramatic effects on world poverty' (see box : *Robert Wade versus Martin Wolf on inequality*, page 20).

A further response from critics of globalisation is that India, and especially China, hardly represent the ideal of open economies run according to liberal principles. They therefore deny that globalisation has anything to do with the trends outlined above. Wolf argues that they fail to appreciate the benefits that China and India obtained by embarking on a process of liberalisation. He explains his position as follows:

> The critics are right to argue that economic success in these countries has not required the adoption of the full range of so called 'neoliberal' policies – privatisation, free trade, and capital account liberalisation. But, in insisting upon this point, they are wilfully mistaking policy trees for market-oriented forests. What economically successful countries all share is a move towards a market economy, one in which private property rights, free enterprise, and competition increasingly take the place of state ownership, planning and protection. They choose, however haltingly, the path of economic liberalisation and international integration. This is the heart of the matter. All else is commentary.

These are the core arguments that Wolf presents in refuting the position of globalisation's critics. He also looks more broadly at the statistics relating to poverty and inequality, and their relationship with globalisation. There are often complex measurement issues and a range of subtleties related to these statistical studies, but they overwhelmingly support Wolf's central point: it is not the occurrence of globalisation but the obstacles preventing it from spreading further and incorporating more countries that accounts for the continued existence of poverty and inequality.

Has trade been bad for developing countries?

Some critics of globalisation have maintained that the comparative trade advantages which developing countries once had have been destroyed by the mobility of capital. They argue that because capital can move increasingly easily across borders the differences between countries are being flattened out, and that developing countries no longer have the advantages that came from their distinctiveness. This is belied by the very fact that the differences between rich and poor countries remain large, and that the convergence predicted by the idea that capital should flow away from richer and towards poorer countries is not taking place. Economists have recognised that physical endowments are not a major determinant of growth differences. Instead, the institutional environment and human capital are now seen as far more important. What this means is that, instead of diminishing returns emerging

ON GLOBALISATION'S CRITICS

'The book looks in detail at the arguments of the critics of globalisation. Most of their arguments turn out to be wrong. They are wrong about global impoverishment, corporate dominance, the threat to the sovereignty of the democratic state, and the so-called "race to the bottom" in environmental and social regulation.

'But they are not wrong on all points. Critics are right about the hypocrisy of the developed world on (trade) liberalisation, although some of these critics are trying to make this hypocrisy even worse through increased protectionism. Critics are right too that the institutions set up to manage the global economy do not work as well as they might, particularly in finance.

'The chief obstacle to making the world better is not its limited economic integration, as critics of economic globalisation argue, but its political fragmentation. It is the deep seated differences in the institutional quality of states that determines the persistence of inequality among individuals across the globe.'

earlier in richer than in poorer countries, there are in fact increasing returns in those areas where innovation is high. Human capital resources therefore tend to flow towards the wealthier countries, making it increasingly difficult for poorer countries to catch up. This, of course is not good news for the poorer countries, but it also means that they can still benefit greatly from their comparative advantages. There are, in other words, innumerable trading opportunities available to developing countries, which can only benefit from taking advantage of them.

The solution is not to prohibit globalisation but to develop it more fully

There is, Wolf admits, a harmful aspect of the present trade situation. This is the way in which the developed countries continue to protect many of their more labour-intensive producers from competing with less developed countries while at the same time advocating increased liberalisation in those countries. He agrees that this 'grotesque hypocrisy', and the consequent restrictions on fuller globalisation, is extremely harmful. He cites a World Bank study[2] showing that world income in 2015 would be $355 billion a year more with full trade liberalisation, and that developing countries would gain $184 billion a year. Of this, $121 billion would be the benefits from their own liberalisation, while the rest would come from liberalisation by high-income countries. With dynamic benefits added, the Bank estimates that developing incomes could rise by more than $500 billion a year, with $390 billion of this coming from agriculture, and $120 billion from textiles and clothing. In 2000 the total GDP of developing countries was only $6,300 billion. Of course, the solution to this problem is not to prohibit globalisation but to develop it more fully. If developing countries follow the protectionist lead of the high-income countries, they will only further reduce, not expand, their incomes.

Are corporations taking over the world?

The critics of globalisation maintain that corporations, not democratically elected governments, dominate the globalised world. These corporations are supposedly larger than most developing countries, and therefore wield huge influence. They use brands to capture their customers and are therefore no longer subject to the discipline of the market. They force developing countries to compete for their investments, and therefore promote a 'race to the bottom' and they have an undue influence over governments, thereby undermining democracy.

All of these accusations are, as Wolf convincingly demonstrates, wildly exaggerated. Those who have tried to prove that corporations are bigger than most developing countries have made a major measurement error. What these critics have done is to compare the total revenue of those companies with the GDP of developing countries. This is a serious mistake, as one is now counting the input costs of the companies as part of their output while only counting final goods and services in the case of countries. To obtain more comparable figures for the companies, one has to subtract their costs from their revenue to avoid double counting. It then emerges that in 2000 only two corporations featured in the top 50 economies: Exxon Mobil, at 45th, and General Motors, at 47th.

Another weak idea is that corporations have cleverly developed brands to capture customers who now have no choice but to purchase the branded products. It fails to account for the ways in which customers influence the process of branding, and the way in which companies with powerful brands have gone out of business when their products have lost their appeal. Evidence derived from UNCTAD and Forbes Magazine on the stability and size of companies in fact shows that the dominance of the biggest companies has diminished. For Wolf, what is remarkable is that big companies have been unable to control their destinies. This shows that the disciplining power of competition is doing the job of keeping big corporations under control.

Those who have tried to prove that corporations are bigger than most developing countries have made a major measurement error

The argument that big corporations are causing a race to the bottom (with respect to social and environmental regulation) in less developed countries is also not supported by the evidence. Rather than big corporations being able to ensure that they pay particularly low wages and low taxes, and are subject to minimal regulations, the opposite is in fact true. A study by Edward Graham has shown that compensation by US-owned corporations in manufacturing is 1,4 times the average compensation in high-income countries, 1,8 times that in middle-income developing countries, and twice that in low-income developing countries.[3] In addition, Moran has provided specific examples of how foreign investors, particularly those involved in more sophisticated operations, encourage or even directly organise improvements in the treatment of labour.[4] This is partly to head off labour unrest, and partly to improve the functioning of the companies' operations.

Further, although this is not necessarily a good thing for developing countries, it is overwhelmingly the case that foreign direct investment does not primarily flow towards the poorest and least regulated countries. Instead, it flows towards the richest and most regulated economies. It is here where returns are higher and, most importantly, more predictable. For the period 1996–2001 least

ROBERT WADE VERSUS MARTIN WOLF

In the March 2002 edition of *Prospect Magazine*, the development economist Robert Wade attacked Wolf for exaggerating the positive consequences of globalisation. Wade maintained that poverty and inequality had probably not diminished significantly during the past two decades; that globalisation would not, in itself, help developing countries; and that it was more likely to prevent countries from implementing the strategies that would best reduce their poverty and backwardness in relation to developed countries.

Wade questioned the way in which the World Bank had collected the figures which show that 'absolute poverty fell sharply from around 28 per cent to 24 per cent in only 11 years'. He concluded that, given these concerns, 'we do not yet know' by how much poverty was reduced, and this should not be the central issue in any case. Instead, he admonished, the focus should be on the magnitude of the inequality between developing and developed countries, which should be overcome as soon as possible. Furthermore, increased trade was not the solution. Instead, one aspect of it would be for developing countries to radically transform the technical capacities of their people, firms, and governments. Globalisation could prevent this by forcing immature local companies to compete with more advanced international firms, and by preventing governments from borrowing sufficiently to make the necessary investments in technology.

Wolf rejects both the validity and the practicality of Wade's claims. He points out that the World Bank researchers calculated the poverty data on a consistent basis and that, despite some problems, the findings are valid. In fact, they show that since 1980 some 200 million people have moved out of the category of extreme poverty. Wolf accuses Wade of taking the view that any data collected by the World Bank developed countries received 0.5 percent of total FDI, whereas the developed countries received 72 percent.

The work practices that exist in some multinational operations in developing countries may be significantly worse than those in developed countries, but this is not an appropriate comparison to make. The people, especially women, who work in these jobs are almost always significantly better off than they would be if they did not have access to those jobs. It is true that corporations are profit maximisers, but this does not necessarily lead to a simple process of slashing costs wherever possible, and there is no evidence that corporations have an impoverishing effect on developing countries. In fact, the opposite is true.

Finally, the idea that big corporations control democratically elected governments, and thereby undermine democracy across

must necessarily be tainted, and of only accepting the findings of those studies which conclude what Wade likes. This, he argued, is clearly unacceptable.

Wolf also accuses Wade of subscribing to a simple-minded technological determinism. Technological development cannot occur in isolation from an environment in which economic growth, social transformation, and political development are also taking place. The Soviet Union and India are two prominent examples of countries that attempted to develop their technological capacity in isolation, and failed. In order to catch up, developing countries need to develop a growth-inducing environment. Participating in the globalised world is part of moving towards such an environment.

Lastly, Wolf rejects Wade's call to focus on inequality rather than poverty as impractical and misguided. Previous attempts to 'tilt the playing fields in favour of lagging regions' through protectionism and aid have been largely unsuccessful. Other ways of achieving this aim have very little chance of getting off the ground. 'I look forward to your attempts to sell strategies such as huge transfers to the world's poor, free migration into rich countries, or a permanent depression in the developed world,' Wolf says to Wade. He concludes his response by pointing out that 'the very notion that the impoverishment of the north might be a good thing shows the absurdity of your obsession with equality itself. World income distribution was far less unequal two centuries ago, when perhaps 80 percent of its population lived in extreme poverty. Did this make 1800 better than today?'

For Wolf, poverty is the key issue in the debate about the impact of globalisation. Poverty reduction is something that can be achieved, and has been achieved by countries such as China and India after embracing globalisation. Those countries, especially those located in Africa, that desperately need to make similar progress should focus on creating environments conducive to growth. In constructing such an environment, globalisation can only be a help, not a hindrance.

the world is, again, simplistic and wildly exaggerated. Contrary to the essentially Marxist idea that the power of money controls the world, it is far more the case that big businesses have influence but not control, and that ideas are frequently more important than interest groups. For example, the notion that liberal economic policies of the past two decades or more, or the structure and rules of the contemporary WTO are the result of a 'single minded plot by corporate interests is plain wrong'.

World income distribution was far less unequal two centuries ago, when perhaps 80 percent of its population lived in extreme poverty. Did this make 1800 better than today?

Established businesses dislike competition and are more likely to look for ways to reduce it than expand it. Nor are all sections of business necessarily in favour of privatisation as this threatens to disrupt lucrative government contracts acquired by some companies and priced way above market rates. As Wolf puts it:

> Liberal economies are competitive, dynamic and unforgiving, precisely what most incumbents loathe. Corporations would be happier with monopolies and cartels. It was not corporations that pushed liberalisation and privatisation, but governments (and, behind them, intellectuals) convinced this was in the interests of their countries. Companies adapt, however. They have to do so.

Is the state withering away?

According to both the critics and some of the more enthusiastic supporters of globalisation, the dominance of international markets is causing the state to become impotent or irrelevant. Left-leaning critics deplore this development, as they see it as the end of social democracy. States can no longer protect the weaker members of society from the ravages of the market. Right-wing free marketeers, on the other hand, celebrate this development, as it means that markets can now finally overwhelm the states which want to interfere with and regulate markets. Wolf disagrees with both these propositions. He demonstrates that there has been no recognisable movement towards either smaller governments or shrinkages in regulation; in fact, the state is now more omnipresent than ever before. Only Ireland had a lower ratio of public spending in 1996 than in 1980. Wolf admits that the rate at which government spending expanded slowed down after 1980, but this had very little to do with globalisation. Wolf explains:

> It is possible to argue that the growth of the state has slowed. So, indeed, it has. But it could hardly have done otherwise. By 1980, average public spending was 41.9 percent of GDP. In Sweden, it was 60 percent. If the same proportionate rise in the share of spending in GDP had occurred between 1980 and 1996 as between 1960 and 1980, the whole OECD region would now look like Sweden and Sweden's public spending would exceed GDP. By 1980, further growth at the rate seen in previous decades was impossible. That may have been a shock to many politicians, but it was an inescapable one.

The second important finding which Wolf presents is that highly regulated social democracies have not shown any symptoms of either uncompetitiveness or of losing people and capital to less regulated countries. In fact, these countries have mostly had trade surpluses, and have attracted both human and physical capital. The reasons for the success of these countries are that they are rich, stable, and provide superb social services. Of course, those countries that are less developed and less attractive have been less successful at keeping their skilled and wealthy people. But the point is that globalisation does not force governments to disappear; it forces them to take the interests of their most valuable assets, their skilled and entrepreneurial people, into account.

Wolf's rejection of the idea that globalisation means the end of national, democratically elected governments is based on three crucial ideas that are strongly supported by the evidence. First, as we have already discussed, governments do not merely interfere with markets; they are also an essential aspect of market-based systems, and have a vital role to play if countries want to take advantage of global market opportunities. Second, people and the networks of skills, trust, regulations, and ways of doing business that are the essential source of value creation in most countries do not easily move across borders. Third, people are not necessarily opposed to *all* regulations. They frequently value and support them if govern-

Governments are an essential aspect of market-based systems, and have a vital role to play if countries want to take advantage of global market opportunities

ments provide them effectively and consistently. Therefore, people don't necessarily flee from regulations – instead, they flee from bad governments, and it is these governments, which, don't reflect the will of their citizens, that are hurt by globalisation.

Lastly, Wolf shows that globalisation does not spell the end of government, but he is not arguing that governments are unaffected by globalisation; he acknowledges that there are certain constraints on governments wishing to participate in the international economy. But these are positive constraints that tend to make policy more transparent, and governments more predictable. It may now be harder to run inflationary policies and to impose predatory forms of taxation, but the only people who should get upset about this are those who want to run predatory states. What globalisation actually means is that states have to become more democratic. And, as long as they do not abuse their powers, they will have a great deal of freedom of manoeuvre.

Is a liberalised capital account a good thing?

In recent years, liberalised capital accounts have caused a great deal of pain, especially to developing countries. The most prominent example of this is the so-called Asian crisis of 1997. As Wolf points out, as a result of this crisis and its aftermath, the GDP of Indonesia, Malaysia, the Philippines, South Korea and Thailand shrank by 8,1 per cent in aggregate during the year after the crisis. The broad reasons for this collapse, and the problems created by the free movement of capital across borders in general, have

GLOBALISATION IS MORE LIMITED THAN ITS CRITICS SUPPOSE

'The degree of international economic integration remains limited. The high-income countries are more open on trade and capital flows than ever before. But they continue to protect labour-intensive, resource-processing, and agricultural activities. In so doing they inflict substantial harm on developing countries. The high-income countries also operate tight controls on inflows of immigrants. Many developing countries still remain more closed to trade, capital and movement of people than they were a century ago. Net inflows of capital and direct investment to developing countries are, in all, also very modest.

'Globalisation is not rampant. It remains remarkably limited.'

already been outlined in our discussion of financial markets. The problems of inadequate information, uncertainty, herd behaviour, moral hazard, and self-fulfilling expectations become severe when capital flows across borders, particularly when it flows from ignorant and nervous investors and their brokers to poorly run banking systems.

What globalisation actually means is that states have to become more democratic

The solution is not, however, to avoid liberalisation altogether. This would be an unnecessarily extreme way of avoiding a potential crisis by not allowing oneself any of the benefits that access to foreign capital brings. Instead, Wolf argues that less developed countries and the institutions involved in global capital markets should learn the lessons of the Asian crisis, and not repeat the mistakes that led to it. He advocates that the process of liberalisation should be gradual, based on a plan which ensures that the necessary institutions are well developed and adequately monitored, and that information is freely available and adequately distributed.

He is also critical of the IMF's performance before and during the crisis. He recognises that, once the crisis hit, the IMF's choices were severely constrained, and that, with hindsight, some of its mistakes are easy to identify. His main criticism is that the IMF did not warn countries adequately of the dangers that confronted them. The IMF, in Wolf's view, must take a more realistic view of the benefits and costs of capital market liberalisation, and must improve its monitoring capabilities.

He further advises that countries should be careful about exposing themselves to large-scale foreign currency borrowing. In his opinion, 'equity is safer, with foreign direct investment best. Factories do not walk.'

If this advice is heeded, then, Wolf believes, capital market liberalisation, a process that can currently be viewed as the double-edged sword of the globalisation process, can make a more unambiguous contribution to uplifting developing countries. Wolf therefore agrees to some extent with the strident criticisms of Joseph Stiglitz, but only up to a point. Wolf is more prone to recognise the difficult job the IMF has to perform and to emphasise the inescapable reality that 'countries must live within their means'.

What about the environment?

Many of those opposed to what they see as the environmental damage that globalisation inflicts are in fact opposed to growth per se. They regard economic growth as inevitably leading to environmental degradation, and therefore oppose the positive effects that globalisation has on the growth prospects of poor countries. They then find themselves in the difficult position of either opposing growth in poor countries or of advocating massive redistribution from the rich countries to the poor.

Neither of these policies has any chance of being realised. Evidence shows that, while there is some truth to the idea that increased growth leads to increased pollution, this is true only up to a point. Once countries pass a certain level of per capita income, they invariably start to reduce the levels of pollution. From that point onwards, growth is associated with a reduction in local pollution. It is also undeniable that market-based systems have inflicted far less environmental damage than socialist ones.

There is also no 'race to the bottom' in environmental regulations. Environmental regulations have tended to tighten during the current era of globalisation and, as Wolf points out, 'a polluted atmosphere and poisonous water are a rather substantial disadvantage if one wishes to attract multinational companies, since these strongly discourage foreign professionals from living in the country'. He concludes that virtually all the environmental degradation that exists in developing countries has nothing to

ON THE MISGUIDED NOTION OF 'SATANIC CORPORATIONS'

'Perhaps the core faith of globalisation's critics is the power and malevolence of the corporation. This is their Satan.

'When one looks closely, one finds that corporations are not more powerful than countries, and do not dominate the world through their brands. It is clear also that inward investment benefits recipient countries (given the right policies) and above all the workers the corporations employ. Many of those who protest at the conditions of workers in developing countries do so in comparison to their own happy state, not in comparison to the often awful alternatives confronting the world's poor.

'Difficult though it may be for some to believe, there are worse places to work than those we call "sweatshops".'

do with trade, and that the spread of democracy that has accompanied globalisation has greatly strengthened the power of environmental lobbies. In general, he argues that globalisation has helped, rather than hindered, improvements in environmental regulation.

IMPLICATIONS FOR SOUTH AFRICA

Wolf argues convincingly that all countries should see globalisation as an opportunity rather than a threat. Secondly, he points out that the real threat to people's welfare is contained in the ideas advocated by the anti-globalisers. Thirdly, his analysis makes it clear that the solutions to problems such as poverty should be found from within. Globalisation is neither the cause of poverty nor a panacea for getting rid of it. Instead, what is vital is for countries to develop the institutions and the politics that will allow them to take full advantage of the opportunities offered by international markets.

Wolf argues convincingly that all countries should see globalisation as an opportunity rather than a threat

Therefore, Wolf does not believe that the benefits of globalisation will simply rain down on all people who adopt a faith in markets. Instead, he asserts that the ability of people to take advantage of global market opportunities will depend heavily on the quality of their state. The difficulty is that quality states are hard to find. Wolf is aware that there are no easy solutions to this problem, but he does provide some advice of how the quality of a state can be improved.

One essential principle is that problematic governments should not engage in activities that can easily lead to inefficiencies and corruption. In Wolf's words, 'the more the government focuses on its essential tasks and the less it is engaged in economic activity and regulation, the better it is likely to work and the better the economy itself is likely to run. Good markets protect governments just as good governments protect markets. They have a symbiotic regulation'. When markets work, government is assured of a broad-based, expanding source of income, as well as the legitimacy

GROWTH, POVERTY, AND INEQUALITY – WHAT DO WE KNOW?

Wolf's analysis leads him to the following conclusions in response to globalisation's critics:

ASSERTION	RESPONSE
The ratio of average incomes in the richest countries to those in the very poorest has continued to rise in the age of globalisation.	Correct.
The absolute gap in living standards between today's high-income countries and the vast proportion of developing countries has continued to rise.	Correct. Inevitably so, given the starting point two decades ago.
Global inequality among individuals has risen.	False. Global inequality among individuals has in all probability fallen since the 1970s.
The number of people in extreme income poverty has also risen.	Probably false. The number of people in extreme poverty may well have fallen since 1980, for the first time in almost two centuries, because of the rapid growth of the Asian giants.
The proportion of people in extreme poverty in the world's population has also risen.	False. The proportion of the world's population in extreme poverty has certainly fallen.
The poor of the world are worse off not just in terms of incomes but in terms of a wide range of indicators of human welfare and capability.	Unambiguously false. The welfare of humanity judged by life expectancies, infant mortality, literacy, hunger, fertility and the incidence of child labour has improved enormously. It has improved least in sub-Saharan Africa partly because of disease and partly because of the continent's failure to grow.
Income inequality has risen in every country and particularly in countries most exposed to international economic integration.	False. Income inequality has not risen in most of the developing countries that have integrated with the world economy though it has risen in China. Inequality has apparently risen in the high-income countries, but the role of globalisation in this change is unclear and probably not decisive.

Human welfare, broadly defined, has improved. The proportion of humanity living in desperate misery is declining. The problem of the poorest is not that they are exploited, but that they are almost entirely unexploited: they live outside the world economy. The soaring growth of the rapidly integrating developing economies has transformed the world for the better. The challenge is to bring those who have failed so far into the new web of productive and profitable global economic relations.

that managing a healthy economy brings. Good governments, at the same time, provide the regulation and predictable environment that markets require to work properly. By contrast, regulations or restrictions that create a gap between the market value of goods or services and an official price automatically create opportunities for corruption, and should therefore be kept to a minimum. If governments are restricted in this way, and strengthened through this process, they will become better at making the opportunities of globalisation available to their people.

> *The problem of the poorest is not that they are exploited, but that they are almost entirely unexploited: they live outside the world economy*

Unfortunately, it is difficult to make governments see the wisdom of this course because, as Wolf puts it, 'predation is lucrative and attractive'. This is where globalisation itself can help to make governments better. By increasing the competition among states, globalisation more readily imposes the costs of bad behaviour and predation on states, while also providing the victims of what is effectively government sponsored theft with a way out. Once such states run out of people on which to prey, they quickly see the error of their ways. In this respect, Wolf directs a final devastating broadside at the critics of globalisation:

> If one believes governments are always benevolent, wise and caring, one may well object to the pressure [of globalization]. But the great irony of the anti-globalization critics is that most of them believe in none of those things. They are then in the paradoxical situation of wanting governments to intervene more, which will create corruption, and to close off markets, which will relieve bad governments of competitive pressure, while expecting governments to become more devoted to the weal of the mass of the public.

Good governance is therefore at the core of benefiting from globalisation, and reducing poverty through growth.

The South African government cannot be accused of being predatory, but it has increasingly extended itself into areas where it has little capacity to do good, and, by so doing, has increased the scope for corruption. Our government should focus on those areas where it has capacity, it should seek to build up the country's ability to take advantage of market opportunities, and it should allow markets to flourish and do the work of generating dynamic economic initiatives in a competitive and efficient environment. Contrary to what the critics think, globalisation is not preventing our policy-makers from doing what they can to help the poor; in fact, it is pushing them in the right direction.

Endnotes

1 Ignacio Ramonet, *Le Monde Diplomatique*, May 1998.

2 World Bank, *Global economic prospects and the development countries: making trade work for the world's poor*, Washington DC, 2002.

3 Edward Graham, *Fighting the wrong enemy: anti-global activists and multinational enterprises*, Washington, 2000, pp 84–5.

4 Theodore Moran, *Beyond sweatshops: foreign direct investment and globalisation in developing countries,* Washington, 2002.

Globalisation is neither the cause of poverty nor a panacea for getting rid of it. Instead, what is vital is for countries to develop the institutions and the politics that will allow them to take full advantage of the opportunities offered by international markets

The South African government should focus on those areas where it has capacity, it should seek to build up the country's ability to take advantage of market opportunities, and it should allow markets to flourish and do the work of generating dynamic economic initiatives in a competitive and efficient environment

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