SOME ECONOMIC ASPECTS OF GLOBALIZATION: BLESSING OR CURSE!

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1. *Introduction*

There was hardly any topic in economics that was so widely discussed in the last two decades of the XX. century as globalization. By now, there is vast literature on the topic. Yet the discussion is far from being over. Each day we can read in the newspapers about the process of globalization.

Although globalization has long history[1] we shall concentrate only on the most recent developments of that process.

The difficulties with globalization start with its very definition. There are many definitions of the globalization. Economic Report of President 2000 defines economic globalization as the worldwide integration of national economies through trade, capital flow, and operational linkages among firms. For others globalization encompasses declining barriers to trade, migration, capital flows, technological transfers and foreign direct investment.[2] Majority of definitions of globalization concentrate on the freedom of movements of capital. P. D. Sutherland, former Director General of WTO, defines globalization as: »dramatic growth in cross–country investment and international trade combined with explosive growth in global communications and technology.«[3] Free and unrestricted flows of capital (in different forms) through the world and removing all restrictions to the capital inflow in each and every country has been accepted as the essential part of the definition of globalization.

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1 See: Masson, P. »Globalization: Facts and Figures« IMF Policy Discussion Paper 01/4, 2001

2 See: O'Rourke, K. H.. »Globalization and Inequality« in *Annual World Bank Conference on Development Economics* 2001/2002 p. 40.

3 Finance & Development, IMF, September 2002, p. 20

The freedom of movements of capital is very important for the process of globalization. But not only the freedom of capital flows. What about the freedom of movements of the other factor of production: labor? Should not the freedom of movements of labor be also the essential part of the process of globalization? What about the freedom of movements of goods, services, ideas and information?

These are the reasons why I shall define the process of globalization in this way:[4] *Globalization is the process of economic integration of the world with free movements of: a) ideas; b) information; c) goods and services; d) factors of production: labor and capital.*

2. *Globalization and the theory of international trade*

The theory of international trade is one of the oldest subfields of economics. It is an extension of the theory of exchange. The exchange is the consequence of the division of labor and specialization. The division of labor and specialization increase the productivity. The increase of productivity decreases the costs of production and prices of products. This enables the increase of consumption and the material welfare. Thus greater degree of division of labor and exchange could mean greater degree of welfare.

However there are some constraints to the increase of specialization and exchange. The most important constraint is the size of the market. The larger the market the higer the degree of specialization and exchange. This is why the exchange is proportionate to the size of the market. The largest possible market is the world market.

This idea was clearly exposited in the period of history of economic thought called *mercantilism* extending approximately from 1500 to 1800. Merchants of each country, especially the colonial powers, England, Spain, and France, sought the measures for the expansion of their activity because this would increase the wealth of the country. The increase of wealth will increase the power of a nation. This was succintly expressed by the mercantilist writer J. Child: »Foreign trade produces riches, riches power, power preserves our trade and religion«.[5]

The wealth was intimately associated with specie. So the accumulation of gold (because of the gold standard) was taken as reflection of increasing wealth. If a country had no gold mines it had to acquire the gold by the »fa-

4 Similar definition was given by E. Aninat in »Surmouting the Challenges of Globalization« *Finance & Development,* IMF March 2002, p. 4

5 This quotation is from: J. A. Schumpeter: *History of Economic Analysis*, Oxford University Press, 1954, p. 347.

vorable« trade balance which ment greater exports than imports. So each country tried to stimulate her exports by subsidies and other privileges and to restrict imports by taxes, and other protective measures. In order to expand the market, each country tried to conquer as much colonies as possible. The development of colonies was controlled and directed from the metropolitan country in order to prevent that the colony becomes the competitor to the metropolis. The higher–valued production was located in the metropolitan country and the lower–valued was (re) located in the colony. The monetary and the exchange system of the colonial power, was introduced in the colony. Even in the case when the colony was allowed to have its own currency it was done in the form of *Currency Board* which allowed the colony to issue its own currency but coverd completely by the currency of the metropolis.[6]

Since the quantity of gold in the world was given, one country could increase her share only at the expense of another.

Further developments of the international trade theory came with the liberal ideas of A. Smith and his *theory of absolute advantage* published in his famous »Wealth of Nations« in 1776. According to this theory, free trade between sovereign countries could be mutually profitable. Two countries will participate in the international trade if their productivities of a good differ. A country will export those goods in which it has absolute advantage i. e. which it can produce more efficiently (less expensive).

What would happen if one country is more efficient in all goods than the other? Will the exchange between them be profitable? The answer to these questions came with the *theory of comparative advantage* of D. Ricardo. According to this theory the country that is more efficient in the production of all goods will export those goods in which it has comparative advantage, i. e. in which it is comparatively more efficient. The comparative advantage is defined as the ratio of productivity of labor in the production of different goods.

Now comes the question: why a country has comparative advantage? The Heckscher–Ohlin (or the Heckscher–Ohlin–Samuelson) theory gives the answer to this question. The country has the comparative advantage in the production of a good if it is more endowed, or richer in the factor of production which is used more intensively in the production of that good. So the reason for the specialization and trade between countries lies in their different endowments of factors of productian. Exporting goods in which a country has comparative advantage the demand for abundant (and cheap) factor of production increases thus raising its price while imports of goods leads to decline for the scarce (and expensive) factor of production, thus lowering its price.

6 First Currency Board was established in Mauritius by England in 1849.

The end result in a world with free movements of goods services and factors of production, could be equalization of prices (incomes) of production factors all over the world.

All these models of international trade were based on the assumption of perfect competition and constant or decreasing returns to scale.

2.1 *The new theories of iternational trade*

But what if the market structure is not perfect competition but of oligopolistic, or even monopolistic structure and if there are increasing returns to scale? The answer to these question was tried to be given in the »new theories of international trade« developed in the last two decades of XX century. The basis of these new theories are economies of scale in the production of industries on the market of imperfect competition. The assumption is that certain industries enjoy increasing returns to scale. The more those industries produce, the lower per unit costs and the prices of products. But these industries need largest possible market. This is global market i. e. the market of the whole unified world. The result was the introduction of the globalization in the new trade theories in order to secure the largest possible market for the industries that enjoy increasing returns to scale. The production in those industries has been concentrated in the small number of enterprises which are active in more national markets and are known as *MNCs* (Multinational Companies). Increased size of the market due to globalization allowed MNCs to benefit from scale economies and network effects. Worldwide some 60,000 parent operations of MNCs and their 500,000 foreign affiliates account for roughy 25% of global output.[7] International trade between firms and their foreign affiliates, so called **intra firm** trade has been developing very quickly. Over a third of U. S. marchandise exports and two fifths of U. S. imports are estimated to be intrafirms.[8]

Globalization is not only the result, but also the cause of the new theoris of international trade. The problem of globalization was introduced in economics literature in 1980 s with the new approach in the international trade theory. Before 1980s it was common in expositions of international trade theory to start by the division of labor and trade with two isolated countries. Then the intregated economy approach reversed the direction of analysis. It started with the unified economy, then breaking it up.

Professor Krugman expressed the opinion that this approach came from P. Samuelson's parable he used to explain the concept of factor price equali-

7 Economic Report of the President 2000, p. 207

8 Ibidem, p. 215

zation[9]: »Once upon a time, all the factors of production in the world were part of a single economy, able to work freely with each other. This intergrated world economy had reached an equilibrium, with all the things that go with such an equilibrium: goods prices, factor prices, resource allocations, and so on.

And then down came an angel. (Although Samuelson does not say so, this is obviously the Angel from the Tower of Babel story; presumably the factors of production had dared to challenge heaven, and were being punished for their presumption.) The angel smote each unit of each factor of production on the forehead, labelling it as belonging to a particular nation; and thenceforth factors could only work with other factors from the same country.

But how much damage had the angel done? Well, perhaps none. Provided that the angel had not divided the factors of production too unevenly between the nations, it might still be possible through specialization and trade to achieve exactly the same global output and consumption as before. In that case, trade would have the effect of »reproducing the international economy«; and one could indeed describe such a restoration of the inegrated economy (which would involve, among other things, equalization of factor prices) as the purpose of international trade.«

By using the integrated economy approach, economists were able to accomplish several things. First, they could show that the details of particular monopolistic competition models of trade do not matter when it comes to the description of the motives for and pattern of trade. Second, they could very easily offer a picture of trade in which both economies of scale and comparative advantage are motives for trade. Third, this approach makes role of increasing returns seem less a departure from, than a natural extension of the grand tradition in trade theory: both trade in embodied factors and specialization to achieve scale economies are ways in which the trading world »tries« to reproduce the integrated economy. In the models based on increasing returns to scale, international trade will occur even if there is no comparative advantage. Due to economies of scale, each good is produced in only one location and sold everywhere. The location of production is determined by the minimum of production costs. If the costs of production are the same, in dif-

9 See: Krugman, P.: Increasing Returns Imperfect Competition and the Positive Theory of International Trade« in Grossman, G. and Rogoff, K. *Handbook of International Economics,* Vol. 3, North–Holland 1995, p. 1245.
In our textbook we follow literally the Bible in presenting the Tower of Babel story and explaning the origins of multinational division of labor which resulted in the international trade. See: Babi_, M &
Babić, A.: *Međunarodna ekonomija V. edition, MATE, Zagreb, 2001.*

ferent countries then the deciding factor of location is transport costs. Total transportation costs are lower if production takes place in the country with larger market. The largest possible market is the unifed world. This is why the globalization of the world market would be the best solution.

The forces driving globalization include technology, and policy to reduce obstacles to international trade in the form of transport costs and economic policy measures. Technological improvements in transportation, communications, and information technology have reduced costs of doing business internationally thus lowering significantly barriers to trade. Policy measures have sought to reduce tariff and nontariff barriers through several »rounds« of negotiations within GATT and more recently WTO. Policy measures have been even more efficient in the liberalization of international capital flows.

The decrease of transportation and communications costs made the technological barriers to fall, and the multilateral trade negotiations have reduced drastically the tariffs and nontariff barriers.

The reduction of transportation costs could be illustrated by the following numbers.[10] Advances in shipping technology have reduced average ocean freight charges per ton from $ 95 in 1920 to $ 29 in 1990.

Air transport costs per passenger — mile fell from 68 cents in 1930 to 11 cents in 1990. A 3–minute telephone call from New York to London dropped from $ 244. 65 in 1930 to $ 3. 32 in 1990 and to $ 0. 40 in 2000.[11] Improvements in information and communications technology have also underpinned rapid technological change in the financial sector. This can be illustrated by decrease of the cost of a transaction made:[12]

by teller	1.4 USD
by telephone	0.52 USD
by ATM	0.22 USD
by Internet	0.01 USD

Besides, recent years have seen an explosion in the range of financial instruments which has contributed to massive gross flows of financial capital. So the financing of international trade was easier and less costly.

This enabled tremendeous increase of international trade in goods and services that led to wider competition allowing countries to benefit from their comparative advantages and raising living standards in all countries.

However, globalization brings with it both risks and opportunities.

10 Economic Report of the President 1997, p. 243

11 Finance & Development, IMF March 2002, p. 9

12 The Economist 23. IX. 2000.

3. *Economic advantages of the globalization:*

Globalization spurs inovation, and improvements in communications and technology. This lowers the costs of cross–border transactions in goods, services, and factors of production, leading to increased trade and investment and to higher incomes. In this way all countries could benefit from the process of globalization. The possible gains from the process of globalization depend primarily on policies at home.

We can identify four ways in which open, competitive trade promotes the economic welfare of all countries. 1) It secures the benefits of national comparative advantage, allowing each country to devote more of its resources to producing those goods and services most efficiently. 2) By increasing the number of competitors on domestic market it strenghtens the competitive pressures on domestic producers and it forces domestic producers to innovate and to increase their productivity. 3) It quickens the flow of ideas and informations first of all about the technology of production and market, allowing countries to learn from each other. 4) It broadens the variety of inputs available to producers and variety of goods and services to consumers, boosting efficiency of production and standard of living.

If we understanded globalization according to our definition given in the Introduction of his paper, then globalization coud have significant economic advantages.

There are several important advantages that can arise from the process of globalization;

a) *Free movements of ideas:* the ideas concerning production, demand, consumption, marketing etc. are available to everyone. Everybody can pick–up the ones that he or she considers best. The cultural and spiritual needs of people could be also satisfied more efficiently.

b) *Free movements of information* could benefit everyone because the information is necessary in the decision making process. With the increased degree of availability of information, the quality of the decision making process could be increased.

Advances in information and computer technologies have made it easier for all countries to collect and process the information they need to adapt their production capacities to the changes in the world demand; to increase productivity with the newly available technological information; to measure, monitor, and manage financial risk; to price and trade new financial instruments that have been developed in recent years.

The spread of technological information have contributed not only to the health, increase of efficiency in production, but also to dramatic improvements in life expectancy and literacy in poor countries.

c) *Free movements in goods and services* would enable higher degree of specialization and productivity, with smallest per unit costs of goods and services. The result will be the increase of the welfare of all ecomic subjects in all countries.

Free trade policy (defined as absence of tariffs, quotas, exchange restrictions, taxes and subsidies on production, factor use, and consumption) permits the marginal rate of transformation in domestic production and foreign trade to be equalized with each other and with the marginal rate of substitution in consumption. This further follows from the fact that, under free trade, domestic prices are equalized (allowing for transport costs) with foreign prices–and domestic prices are equated with the marginal rate of transformation in production and the marginal rate of substitution in consumption.

d) *Free movements in factors of production* could stimulate their movements from places (countries) where their prices (incomes) are low to the places where their prices are high. This will tend to equalize the incomes of factors of production and reduce the degree of economic inequalities in the world. The welfare of the people would increase.

Free movements of labor will be beneficial especialy for labor rich countries (mostly underdeveloped ones). Moving from the countries where it is abundant to countries where it is relatively scarce, labor will have higher incomes. This is not the only (even perhaps not the most important) advantage of labor movement. Coming in the more developed country, labor enjoys higher K/L ratio, more capital equipment and on the job training, increasing its skills. The labor exporting countries improve their balance of payments by remittances of the exported labor, which enables them to increase capital import, investment and the growth rates, thus closing the gap between them and developed countries.

International capital mobility allows portfolio diversification and improved risk sharing. It allows investments to take place where they offer the highest returns, thereby improving global resource allocation. Free capital mobility has many economic advantages especially when domestic financial system is well developed, properly regulated and supervised. In that situation the market is free to allocate savings to the best investment opportunities. Firms and other borrowers can obtain funds more cheaply to finance investments.

Capital inflows contribute to growth of the receiving country by stimulating investment and technical progress and promoting efficient financial development. In the capital exporting countries free capital mobility allows investors to diversify risk and to enhance the benefits of portfolio diversification.

Official capital flows to undeveloped countries are mostly from international financial organizations and usually have speeding up growth and development as the objectives.

Private capital flows have profit motive as the primary objective. By channeling funds to their most productive uses, private capital owners could achieve their objective, maximum profit but also could help developing countries to accelerate their growth.

International private capital flows take three forms: FDI (Foreign Direct Investment), portfolio investment in securities, and bank lending. FDI occurs when an investor sets up an enterprise in a foreign country or obtains a large enough share (10% or more) in an existing foreign enterprise to influence managerial decisions. FDI grew from an annual average of $ 181 billion between 1986 and 1991 to $ 649 billion in 1998 and accounted for a quarter of total international capital outflows between 1990 and 1996.[13]

4. *Possible economic disadvantages of globalization*

However, we can identify also some possible economic disadvantages of globalization.

a) One–way movements of ideas could impose ideas that are not in the best interest of some people(s). This could result in the decrease of diversity of ideas, their availability or even in the danger of disappearance of some good ideas. One–way movements of ideas could even jeopardize cultural inheritage and moral values of some (smaller) peoples.

b) One–way flow of information could result in the selective movements of informations that could be in the interest of some but detrimental to someone else. Patent laws are an exemple of the restriction to the free flow of ideas. This has sometimes been called »patent injustice«. Richer countries could afford bigger R&D costs and reap big profits through royalties. Large R&D expenditures and an increasingly open global economy resulted in the New Economy, located in rich countries that contributed to the increase of well–being in these countries in the last ten years. In this way, most benefits from the globalization went to the rich countries. The result could be the increase of inequalities among rich and poor nations.

13 Economc Report of the President 2000, p. 207

c) Restrictions on the free movements of goods and services could result in the suboptimal specialization, less than optimal division of labor, lower productivity and the decrease of the welfare of the people(s).

When poor countries enter global markets, they face tariffs some four times higher, on average, in industrial countries than those faced by other industrial countries. The most punitive tariffs are to be found in precisely those ares where developing countries enjoy the strongest potential advantage such as labor–intensive manufacturing and agriculture. Nowhere are the double standards more staggering than in agriculture. While developing countries liberalize, industrial countries spend $1 billion a day subsidizing overproduction[14] and export dumping, destroying the livelihoods of vulnerable smallholder farmers in the poor countries. Nicholas Stern, chief economist of the World Bank described the problem in this way: »The average European cow receives around $ 2.50 a day in subsidy. The average Japanese cow receives around $ 7.00 a day in subsidy. In sub–Saharan Africa 75% of the people live on less than $ 2.00 a day.«[15] Although the removal of industrial countries agricultural restrictions will be not only in the interest of poor countries, but also in their own interest[16], it is certainly hard to imagine the goverments of France or the United States accepting liberalization conditions in agriculture routinely applied in poor countries.

Trade restrictions are sometimes more intensive in rich than in poor countries. IMF's Trade Restrictiveness Index (TRI)–a scale of openness that ranks countries from 1 (completely open) to 10 (completely closed). The countries of the European Union and the United States and Japan measure 4 on the TRI. Meanwhile, countries as poor as Uganda, Peru, and Bolivia measure between 1 and 2.

d) Restrictions in the freedom of movements in labor and capital could increase inequalities among nations. This could result in widening the gap between rich and poor countries and increase of the number of people living below the poverty line (1 USD per day). Restrictions of freedom of movements of labor from countries that are rich in labor (L) and poor in capital (K) where the K/L ratio is low, and therefore the productivity of labor and the wages are low, to countries that are rich in capital and where K/L ratio is high and consequently productivity of labor and wages are high, does not result in diminishing the degree of inequality in the welfare among nations. Restrictions in the freedom of movements of capital decrease potential earnings of capital in

14 The amount of subsidies to agriculture in OECD countries was six times overseas development aid. *World Economic Outlook*, IMF, Sept. 2002, p. 81

15 *IMF Survey*, October 21, 2002, p. 322

16 World Economic Outlook, Sept. 2002 Table 2. 4, p. 85

the poor countries, where the marginal productivity, and consequently income, of capital is higher than in rich countries. It is in the interest of rich countries to insist on capital inflow liberalization in poor countries.

Capital–rich countries press poor countries to rapidly remove controls of capital inflows (They often do this through international financial organizations). One recent IMF review of seven Poverty Reduction and Growth Facility programs found that each loan came with seven trade policy conditions attached. Following the 1997 financial collapse in East Asia, the IMF's rescue loan again came heavily laden with import–liberalization requirements.

Capital account liberalization needs to be carried out carefully, in conjuntion with the development and strenghtening of domestic financial system, and adequate institutional building to enable the country to increase her absorption capacity of increased capital inflows. If domestic financial systems are weak, poorly regulated and supervised, and subject to institutional distortions, rapid capital account liberalization can lead to excessive short–term borrowing and lending, a mismatch of maturities, and currency denomination which could result in difficulties or even in financial crisis.

If there are restrictions in the freedom of movements of labor, but freedom of movements of capital, then the capital rich countries would benefit more than capital poor and labor rich countries and the gap between them would widen. Namely, the flow of capital from capital rich countries where its price (income) is low, because of its abundancy (and its marginal productivity low), to countries that are poor in capital and where income of capital is high, would benefit more to capital rich countries. This could result in the increase of inequalities between rich and poor countries.

5. *Some concerns about globalization*

Economic disadvantages of the globalization process brought about quite a few concerns. The main concern about globalization is the increase of inequality in the distribution of income both between countries and within countries. If the human talents in an econommy and between economies are assumed to be normally distributed and the distribution of income is skewed, then there are losses resulting from suboptimal allocations between talents and outcomes. The existance of great disparities in distribution of income is also morally repugnant.

Concerns about the process of globalization have been widely expressed by the antiglobalists[17] who blame neoliberal economic policy that goes with

17 See: Cohen, D. »Fear of Globalization: The Human Capital Nexus« *Annual World Bank Conference on Development Economies 2001/2002, p. p. 69–93.*

globalization for the widening gap between rich and poor countries and for the increase of the number of people living below the poverty line.

Neoliberal paradigm prescriptions known as the Washigton Consensus that have dominated international public policy about development over the past twenty years–generates a strong expectation that as national economies become more densely interconnected through trade and investment, world income distribution tends to become more equal.

According to the »Law of even development«, which says that all national economies gain from more integration into international markets (relative to less integration), and lower–costs, capital–scarce economies (developing countries) are likely to gain more from fuller integration than higher–costs, capital–abundant economies (developed countries). Developing countries wishing to catch up with standards of living in the West should therefore integrate fully into international markets (by lowering tariffs, removing trade restrictions, granting privileges to foreign direct investment, welcoming foreign banks, enforcing intellectual property rights, and so on) and let the decisions of private economic agents operating in free markets determine the composition and volume of economic activities carried out within the national territory. This »integrationist« strategy will maximize their rate of development; put the other way around, their development strategy should amount to an integrationist strategy–the two things are really one and the same.

The critical point is that openness in and of itself is not a poverty–reduction strategy. The self–interest of the rich countries coincides with this integrationist strategy for developing countries, because as developing countries grow richer, their demand for products of rich countries expands and their capacity to absorb their population growth at home also expands, reducing the pressure on the rich countries created by surging immigration. For every $ 1 generated through export activity, $0.75 goes to the world's richest countries.

Liberalization of imports as a part of the globalization process, presents some challenges for enterprises and workers especially in undeveloped countries. As markets in these countries become more open because of the globalization, some domestic industries and/or enterprises will experience difficulties. The adjustments that business and workers in shrinking industries must undergo, can be costly and painful, and could disproportionately hit the poor. Some workers may face wage reductions or even loose their jobs. It is therefore necessary to develop programs that directly address problems of restructuring domestic industries, their dislocation and the increase of unemployment. The programs to assist in job search and training should be clearly defined especially regarding of the sources of their financing and the accountability of those responsable for their implementation.

Second concern is about environmental aspects of the process globalization and the dislocation of »dirty industries« to the less developed nations.

Next challenge of globalization is that volatility of flows of goods, services and capital can be the source of macroeconomic shocks. This is especially true for the volatile capital flows as the experience of Thailand (and some other Asian countries) showed in 1997, Russia and Brazil in 1998, Argentina 2001/2002. These examples show that sudden swings in capital flows could cause a financial crisis which is manifested in financial market volatility and macroeconomic instability. Short–term capital, such as overnight bank loans, can flow out of a country very quickly. Rapid outflows can force a sudden and costly adjustment in financial markets and the real sector of the economy. There are plenty of examples like Mexico 1994 and 1995, Thailand 1997, Russia and Brazil 1998, Argentina 2001 and 2002.

For countries known as emerging markets which peg officially or unofficially their currencies to the euro or to the dollar the scenario of the crisis was similar. On the eve of a crisis, a country had budget deficits, low inflation, and a liberalized trade and capital account, but also weak, badly managed banks that were piling–up short–term debt in foreign currencies. Then the boom was punctured. The initial manifestation of the crisis was a sharp fall in reserves, which forced abandonment of the pegged rate; the currency's value then fell precipitously. Stock markets also dropped sharply. Severe declines in output soon followed. The increase of unemployment was logical consequence.

The increase in international indebtedness was another common characteristic of these countries. Debt piling was the consequence of the combination of lax financial supervision and regulation, a tradition of lending to politically favored borrowers, and poor corporate governance, which led to considerable lending to low–productivity projects. These weaknesses interacted with an inadequate focus on risk on the part of banks and investitors in industrial countries, which had contributed to the rapid inflows of capital in the first place. This combination of stuctural weaknesses, policy biases that favored risky forms of finance, and an insufficient regard for risk led ultimately to an abrupt collapse in confidence that spread outward from Asia in 1997, as investors realized the extent of their exposure. Once confidence was lost, the problems in the affected countries were compounded by rapid and self–fulfilling outflows of capital.

When reversals of capital flows do occur, an important task is to keep the damage to a minimum. Several actions can help in this regard. First, it appears clear that countries should avoid policy biases that encourage excessive reliance on short–term, foreign currency–denominated debt, since it is those flows that can flee most quickly. Second, ensuring that the financial system is sound can enable a country to cope with capital and exchange rate movements without excessive damage to finacial intermediation.

Some economists are convinced that globalization is reinforcing income inequalities.[18] Income inequalities consist of within–country inequalities and between countries inequalities. Both could be affected by globalization. Economists differ on the intensity of influence of globalization on inequality. »Between–country inequality rose continually from 1820 to 1950; it fell during 1950s and 1970s but rose during 1960s and 1980s, and rose over the post–1960 period as a whole. Over the period 1820–1992 as a whole, within–country inequality declined sharply. Since World War II between–country inequality has been the most important factor in total inequality«.[19]

Empirical research results are sometimes counterdicting. There are several reasons for that. Cross country comparisons could be unreliable because data on income and inequality in different countries are not always comparable because of differences in the definition of variables and data collection methods. Besides differences in culture and institutions, may influence inequality.

At the end of the 1990s, some 15 million more people were living below the $1 a day poverty line than in 1987, despite economic recovery. The World Bank's World Development Report 2000/2001: Attacking Poverty shows that the number of people living on less than $1 a day grew from 1.18 billion in 1987 to 1.20 billion in 1998–an increase of 20 million. Less than two years later, a headline chart in another major World Bank publication, Globalization, Growth, and Poverty: Building an Inclusive World Economy, showed that the number of people living in poverty fell by 200 million from 1980 to 1998 and showed no trace of an increase between 1987 and 1998. The poverty decrease was reaffirmed in the press release accompanying »The Role and Effectiveness of Development Assistance« a World Bank research paper issued before the March 2002 UN Financing for Development Conference in Monterey, Mexico:« Over the 20 years, the number of people living on less than $1 a day has fallen by million, even as the world's population grew by 1.6 billion.«

The concentration of world income in the wealthiest quintile of the world's population is indeed shocking and cannot meet any plausible test of legitimacy. At the end of the 1990s, high–income countries representing 14 per cent of the world's population accounted for three–fourths of world income (roughly the same as at the start of the decade). The world economy ended the 1980s more unequal than any national economy, and since then it

18 Kevin Watkins: »Making Globalization Work for the Poor« *Finance & Development March 2002, p. 24*

19 Watkins, K. ibidem p. 25

has become even more unequal. The global Gini coefficient (which measures inequality of distribution of income and wealth, 0 meaning perfect equality, 100 perfect inequality) rose by 3 points between 1988 and 1993 alone.[20] China's Gini coefficient rose from 28. 8 in 1981 to 38. 8 in 1995, the period Chinese economy increased its opennes embracing globalization.[21]

Within many developing countries, globalization is exacerbating inequalities at various levels. In much of Latin America, rapid import liberalization has been associated with further concentration of already extreme inequalities. Income gaps based on access to markets, productive assets, and education are widening, acting as a brake on poverty–reduction efforts. This is why some insist on the flexibility in labor markets as a precondition for poverty reduction and growth. »Flexibility« in labor markets has sometimes become a euphemism for stark violations of basic rights. As one Colombian flower worker recently interviewed by Oxfam put it:[22] »Yes, I have more money, but I have lost my health. I have a job–but I have no rights and no security.« One of the problems with the current debate on globalization is that the non–income dimensions of poverty–such as self–respect, security, and health–have been ingnored.

Therefore, a lot is at stake in the question of whether world income distribution has become more, or less, equal over the past twenty years or so. It turns out that there is no single correct answer, because the answer depends on which combination of measures one adopts. In the literature we can find eight measures that can be used in answering the question whether world has become more equal or unequal.[23]

None of the eight alternative measures clearly shows that world income distribution has become more equal over the past twenty years. Seven of the eight show varying degrees of increasing inequality.

There are many causes of the rise in world income inequality: 1) Differential population growth. 2) The fall in non–oil commodity prices. 3) Debt trap. Fast–growing middle–income developing countries, seeking to invest and consume more than can be covered by domestic incomes, tend to borrow abroad. They borrow on terms that are more favorable when their capacity to repay is high and less favorable when their capacity to repay is low as in a financial crisis. The debt trap might be thought of a force in the world econ-

20 O'Rourke, op. cit. 52–53

21 Shang–Jin Wei: »Is Globalization Good for the Poor in China?« *Finance & Development,* IMF, September 2002, p. 26–27

22 These figure come from a 1999 World Bank report, »True World Income Distribution, 1988 and 1993«.

23 Wade, R. H. »The Rising Inequality of World Income Distribution« IMF, *Finance & Development* Dec. 2001, p. 38.

omy that is somewhat analogous to gravity. 4) Another basic cause is technological change. Technological change has the tendency to cluster in the Western economies rather than disperse to lower–cost developing countries. Silicon Valley is the paradigm.

Income divergence result in a large mass of unemployed and angry young people. More and more people see migration to the wealthy zone as their only salvation, and a few are driven to redemptive terrorism directed at the symbolic centres of the powerful (like 11 Sept. 2001 World Trade Center in New York).

Poverty reduction is not only the moral question, but is recognized as a necessity for international peace and stability. These reasons led international community to adopt Millennium Development Goals endorsed by 189 countries at the September 2000 UN Millennium Summit–to »halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.«

The poverty reduction programs include the call on rich countries to increase foreign aid and market access for export from poor countries. The target is that rich countries spend 0.7% of their GDP on development assistance. Next very important target is debt relief for highly indebted poor countries. The need to revisit the institutions of global governance, to establish mechanisms to implement global solutions to global problems, and to ensure that governments become more accountable, seems to be very important. This target includes the environment, labor rights, international and local migrations, and human rights which must be addressed if globalization is to be sustained.

We may conclude that the globalization can be a blessing or a curse. What it will be depends primarily on domestic policy, but also on international enviroment. In order to make globalization process a blessing it is very important to humanize it which means first and foremost, to succeed in the fight against extreme poverty. This fight should be done on both national and international level. M. Camdessus former managing director of IMF expressd it in this way: »To build an effective globalized system it is necessary to correct many flaws of the present system: These include inadequate financial information, weak financial and banking institutions... a lack of governance and a global system that allows extreme poverty and inequality to persist.«[24]

Conclusion

There was hardly any topic in economics that was so widely discussed in the last two decades of the XX. century as globalization.

24 *IMF Survey*, 13. XII. 1999, p. 2

Globalization is the process of economic integration of the world with free movements of: a) ideas; b) information; c) goods and services; d) factors of production: labor and capital.

The problem of globalization was introduced in economics literature in 1980 s with the new approach in the international trade theory. Before 1980s it was common in expositions of international trade theory to start by the division of labor and trade with two isolated countries. Then the intregated economy approach reversed the direction of analysis.

The forces driving globalization include technology, and policy to reduce obstacles to international trade in the form of transport costs and economic policy measures. Technological improvements in transportation, communications, and information technology have reduced costs of doing business internationally thus lowering significantly barriers to trade. Policy measures have sought to reduce tariff and nontariff barriers through several »rounds« of negotiations within GATT and more recently WTO. Policy measures have been even more efficient in the liberalization of international capital flows.

Globalization spurs inovation, and improvements in communications and technology. This lowers the costs of cross–border transactions in goods, services, and factors of production, leading to increased trade and investment and to higher incomes. In this way all countries could benefit from the process of globalization. The possible gains from the process of globalization depend primarily on policies at home.

There are several important advantages that can arise from the process of globalization;

a) Free movements of ideas; b) Free movements of information; c) Free movements in goods and services; d) Free movements in factors of production.

Free movements of labor will be beneficial especialy for labor rich countries (mostly underdeveloped ones). Moving from the countries where it is abundant to countries where it is relatively scarce, labor will have higher incomes.

International capital mobility allows portfolio diversification and improved risk sharing. It allows investments to take place where they offer the highest returns, thereby improving global resource allocation.

However, we can identify also some possible economic disadvantages of globalization.

a) One–way movements of ideas could impose ideas that are not in the best interest of some people(s).

b) One–way flow of information could result in the selective movements of informations that could be in the interest of some but detrimental to someone else.

c) Restrictions on the free movements of goods and services could result in the suboptimal specialization, less than optimal division of labor, lower productivity and the decrease of the welfare of the people(s).

d) Restrictions in the freedom of movements in labor and capital could increase inequalities among nations. This could result in widening the gap between rich and poor countries and increase of the number of people living below the poverty line.

Capital–rich countries press poor countries to rapidly remove controls of capital inflows. If there are restrictions in the freedom of movements of labor, but freedom of movements of capital, then the capital rich countries would benefit more than capital poor and labor rich countries and the gap between them would widen.

Concerns about the process of globalization have been widely expressed by the antiglobalists who blame neoliberal economic policy that goes with globalization for the widening gap between rich and poor countries and for the increase of the number of people living below the poverty line.

The main concern about globalization is the increase of inequality in the distribution of income both between countries and within countries.

Liberalization of imports as a part of the globalization process, presents some challenges for enterprises and workers especially in undeveloped countries. As markets in these countries become more open because of the globalization, some domestic industries and/or enterprises will experience difficulties. The adjustments that business and workers in shrinking industries must undergo, can be costly and painful, and could disproportionately hit the poor. Some workers may face wage reductions or even loose their jobs. Second concern is about environmental aspects of the process globalization and the dislocation of »dirty industries« to the less developed nations. Next challenge of globalization is that volatility of flows of goods, services and capital can be the source of macroeconomic shocks. This is especially true for the volatile capital flows. The increase in international indebtedness was another common characteristic of these countries.

Some economists are convinced that globalization is reinforcing income inequalities.

Between–country inequality rose continually from 1820 to 1950; it fell during 1950s and 1970s but rose during 1960s and 1980s, and rose over the post–1960 period as a whole. Over the period 1820–1992 as a whole, within–country inequality declined sharply. Since World War II between–country inequality has been the most important factor in total inequality.

The concentration of world income in the wealthiest quintile of the world's population is indeed shocking and cannot meet any plausible test of legitimacy. At the end of the 1990s, high–income countries representing 14 per cent of the world's population accounted for three–fourths of world income.

There are many causes of the rise in world income inequality: 1) Differential population growth. 2) The fall in non–oil commodity prices. 3) Debt trap. 4) Technological change.

Within many developing countries, globalization is exacerbating inequalities at various levels. Income divergence result is a large mass of unemployed and angry young people. More and more people see migration to the wealthy zone as their only salvation, and a few are driven to redemptive terrorism directed at the symbolic centres of the powerful (like 11 Sept. 2001 World Trade Center in New York). Poverty reduction is not only the moral question, but is recognized as a necessity for international peace and stability.

We may conclude that the globalization can be a blessing or a curse. What it will be depends primarily on domestic policy, and on international enviroment.

To build an effective globalized system it is necessary to correct many flaws of the present system: These include inadequate financial information, weak financial and banking institutions, restrictions on free movements (both ways) of ideas, information, factors of production and lack of governance and a global system that allows extreme poverty and inequality to persist. Urgent progress is essential in enlarging market access for developing countries and phasing out trade–distorting subsidies in developed countries. It is of utmost importance that a man is not being lost in process of globalization.

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