*George Macesich**

# GLOBALIZATION: PROBLEMS AND PROSPECTS

## Globalization on Course

Thanks to increasing international trade in goods and services, capital flows, and operational linkages among business firms, worldwide integration and interdependence is now a fact of life. This is globalization.[1]

For all of its many problems, giobalization is worth pursuing as a way to raise the world's living standards. Its call for open markets is direct. It is often not simple to put in practice as public policy. Its decline during the turbulent years between World War I and II underscores how difficult it is to put such policy in place. Nevertheless, by the I 950s the world economy again resumed its upward trend toward globalization. Still, the road is not smooth.

## Turbulence In Capital and Money Markets

Critics of the International Monetary Fund (IMF) argue that the JiMF's mistakes may well have created a backlash against globalization in the post-Cold War years.[2] The Asian and Russian crises in the closing years of the 1990s and IMF attempts at fixing problems complicated the advance of Western-type market economies. A case in point is Malaysia, which in September 1998 effectively cut

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[1] Brookings Trade Forum 1999 (Washington, DC: The Brookings Institute, 1999).

[2] See, for instance, Milton and Rose Friedman, Two Lucky People: Memoirs (Chicago: University of Chicago Press, 1998), pp 219-221.

itself off from global financial markets by imposing controls on international capital flows. The country had benefited considerably for more than a decade by encouraging such flows. Decline of its currency and stock market was blamed on international capital movements prompting the country to reimpose controls.

Attempts to jumpstart or protect economies very often make matters worse. Controls may work in the short run as nations can hoard funds that investors cannot change into dollars and other hard currency. Eventually, such controls break down thanks in part to the ingenuity of people. To keep them effective, even greater controls and greater government intrusion into economic activity will be the end result. In general, controls are unmanageable and very susceptible to graft and corruption.

Nevertheless, controls on short-term currency flows continue to be popular particularly since the currency turmoil of 1997-1998. Some observers point to the apparent success of the Chinese model, which welcomes foreign investment in factories and businesses but imposes strict controls on currency trading. Indeed, they note that countries whose currencies have not been freely convertible have done best. Chile's successful attempts to discourage the inflow of volatile short-term money is tempered by the caution of its economists that controls should be used only as a preventive measure by countries that already have in place solid fiscal, monetary, and exchange-rate policies.

Other observers argue that controls should be considered provided they can be designed to discourage short-term investment such as bank loans or short-term currency trades without disrupting foreign investment in factories and infrastructure. In fact, the World Bank has conducted studies examining the experiences of such countries as Chile, Colombia, Thailand, and the Czech Republic that have experimented with such controls. Still others argue that such controls should disrupt ordinary business such as travel as little as possible, clearly be temporary, be accompanied by a highly competitive exchange rate, and be used as an aid to reform and not as an alternative.

The backlash against globalization draws strength from perceived negative effects in local labor markets. Trade encourages countries to move more resources including labor to those industries in which they have a comparative advantage. Needless to say, there are winners and losers of such trade adjustments. The necessary adjustments can be very painful indeed. In order to ease such adjustment costs, various policy measures are put forward. These include some form of compensation for losers such as job retraining, relocation assistance associated with employment, health care insurance, and other measures to assist firms and their displaced workers.

In this spirit and to shield poor countries from the whims of international money and financial markets, in 1971 the late James Tobin, a Yale professor of economics, conceived his now famous Tobin tax, a small levy on foreign currency transactions. Though flawed in practice, the tax's goal was to bring the benefits of free trade to the world's poor and assist adjustments made necessary by free trade. Unfortunately for Professor Tobin's proposal, anti-globalization groups later attempted to use Tobin's tax against his own free trade position.

Some idea of the difficulties with Tobin's tax, for instance, is that it would not have prevented the various financial crises in poor countries. Far more helpful would have been measures to limit the accumulation of short-term foreign currency liabilities in the context of pegged currency regimes. To be sure reducing the frequency of big financial crises and increasing prospects for the poor are worthy goals. But these problems should be handled by separate and targeted policies.

It may be that government interventions in the money and capital markets are all efforts to correct the excesses of a decade-long experiment in which money was free to flow worldwide. Throughout much of the post-World War II era many countries maintained controls on capital and money markets. Thus far the growth of controls has not spread to that of imports and exports of goods and services- important ingredients in the process of globalization. In any case, the IMF had hoped to make their case for a new global financial system that involves ever greater openness in capital and money markets, and a more prominent role for itself may well have been overtaken by events.

One result of the reimposition of controls is that it has prompted a global redefinition of risk and a reassessment of how that risk should be valued. Until the reassessment is completed, world money and capital markets will almost surely remain highly volatile. Most analysts now agree that the world is a riskier place where the IMF could not and the G-7 industrial countries would not play the role of lender of last resort on a global scale.

It is important to put the recent attractiveness of controls on money and capital in perspective. Economists have long argued the benefits of free trade in goods and services. The idea that governments permit free international flow of money and capital is of relatively recent vintage. Indeed the principal intellectual founders of the IMF, J.M. Keynes and Harry Dexter White, feared capital and money flows would become an independent and disruptive force that would interfere with trade. In fact, Keynes argued that control of capital movements-both inward and outward- should be a permanent feature of the system. For years controls were as Keynes had hoped, more or less permanent.

The globalization of money and capital markets has indeed made their management very difficult both domestically as well as internationally. In fact, the various and on-going changes in global markets complicate the tasks of monetary authorities, central banks, and international institutions in judging and lending with systemic risk and financial crisis as events of the 1990s underscore.

One of the more vexing problems raised in attempts to regulate money and capital markets is their computerization and whether this will fragmentize or centralize them. Undoubtedly, large and important traders will play for even larger stakes, making it very difficult for the small trader to participate. The big players will not stop at attempts to predict markets. They will want to control them. If you are a big enough player in a market for your own move to influence the market, then you can predict your own next move. Given past experience, the success rate in cornering markets is not notable. More likely, computer programming will lead to diversities in trading strategies in good part because no single program will remain dominant.

## Role of Technology

Globalization serves technology as does technology globalization. By reducing costs of doing business internationally (as well as domestically) technological advances have served globalization very well indeed.[3] Not only does technology work to open new markets around the world it increases the efficiency of existing markets for products and services.

For instance, the arrival of "containerization" in sea-based (and land-based) shipping has reduced both handling requirements and transit time for deliveries. As for air transportation, readily available data indicate that worldwide the cost of air freight, insured as average revenue per ton-kilometer, dropped by 78% between 1955 and 1996. Indeed, the falling cost of air freight drives significant increases in air shipments which in 1998 accounted for about 28% of the value of U.S. international trade. In 1965 air freight accounted for only 7% of such trade.

Other readily available examples are improved communication and information systems that have served globalization. A case in point is that in 1930 a three-minute telephone call between New York and London would have cost several hundred dollars. By the late 1990s such a call could be made for less than a dollar. These advances increase the ability of business firms to provide customer support by telephone or email at relatively low cost. By enabling firms to transmit digital products electronically via the Internet, the importance of market proximity is reduced for some industries.

The role of technology in money and capital markets is noted above. Its importance is facilitating the creation of a wide range of new financial instruments.[4]

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[3] See George Macesich, Political Economy of Money: Emerging Fiat Monetary Regime (Westport, CT, London: Praeger, 1999) pp. 77-88.

[4] *Ibid*.

This contributes to significant flows of financial capital discussed earlier. Computing technology in particular enables traders to implement complex analytical models. This in turn allows traders and other market participants to better manage risk (e.g., through the use of such financial instruments as swaps, options, and futures).

Advances in technology increase the ability of business firms to divide up their production processes either domestically and/or globally. Thus research and development, design, assembly, and packaging among others, are now performed by firms in the U.S. and elsewhere according to the ability of their outsources to complete their assigned tasks. Again, the computer industry is but a case in point. Where in the late 1 990s, more than 40% of domestic U.S. producer' total shipments were exported and more than 50% of first and intermediate domestic consumption was imported. In fact, more than 60% by value of the hardware in a typical U.S. personal computer system comes from Asia.

## Prospects

The policies of various governments are critical to continued globalization. In the interwar years (between World War I and World War II) much damage was done to the processes of globalization by various trade protectionist policies. In the case of the United States, which was a major creditor nation, it should logically have increased its imports in order to enable other countries to earn dollars so as to service their debt to the United States. One important way, of course, is to lower American import tariffs. The United States did just the opposite: it increased tariffs in 1922 (Fordney-McCumber Tariff) and again in 1930 (SmootHawley Tariff), thereby boosting protectionism to its highest level in American history.

The entire inter-war foreign trade and debt issue was further complicated by American insistence upon repayment of World War I debts. High tariffs however, meant that the United States did not welcome payment of war debts in goods. Moreover, there was not gold outside the United States for payment of debts. And, as noted, Allied insistence that Germany pay reparation rested in part in their desire to use the proceeds to pay war debts to the United States.

Improved arrangements known as the Dawes Plan (1924) facilitated debt financing. The United States made concessions to its allies by lowering the rate of interest at which the war debts accumulated. Between 1924 and 1929 all seemed to go quite well. Germany was able to make reparation payments and the allies to make war debt payments according to schedule.

However, the entire debt arrangement was wobbly and indeed illusory. The fact is that American private investors were making large dollar loans to Germany.

The Germans, in turn, used the dollars to pay reparations, and the allies used the dollars to pay war debts. In short, it appeared as though the United States was paying itself Given the magnitudes involved, this was not correct, but it was used by those in favor of cancellation of debts to support their case.

This international financial circus was brought to an end by the Great Depression of 1929 when American loans to Germany ceased. German industry however had been reconstructed and strengthened, but democratic government in Germany had been undermined partly over the reparations issue. International relations among wartime allies as well as between Germany and its allies had become embittered. In effect, attempts to collect war debts and to make reparation payments proved to be one colossal failure. It was an experiment that was not to be repeated in the post-World War II period.

John Maynard Keynes's ideas in the 1930s expressed in his General Theory provided the basis of postwar economic policy for the United States and other Western industrial nations.[5] Basic to Keynesian doctrine is the use of government fiscal power to stimulate the economy when unemployment is high and restrain the economy when high employment and excessive demand begin to cause wage and price rises to reach an inflationary rate.

In general, much of postwar economic policy has been post-Keynesian in the sense that some, but not all, theorists and policymakers in major Western industrial countries have agreed in principle in Keynesian ideas of how to deal with unemployment and inflation. Since their triumph in the post-war period, Keynesian ideas have not always come up to expectation. The theories and policies have been rigorously and increasingly challenged by many economists, most notably by Milton Friedman.[6]

Since World War II government policies have been put in place that remove barriers and distortions to world trade. For instance, the General Agreement on Tariffs and Trade and World Trade Organization are but cases in point. Many countries have also removed or reduced money controls on international capital movements as noted previously.

It is now also clear to most observers that moving away from globalization and disengaging from the global economy is not the road to economic prosperity and rising living standards. Even critics of globalization acknowledge that countries

[5] John M. Keynes, The General Theory of Employment, Interest and Money. (New York: Harcourt, Brace and World, 1964).

[6] Milton Friedman "The Keynes Centenary: A Monetarist Reflects." The Economist (June 4, 1983): pp 17-18; Milton Friedman, "The Quantity Theory of Money—A Restatement." in Studies in the Quantity Theory of Money edited by Milton Friedman (Chicago: University of Chicago Press, 1956).

resorting to self-sufficiency and an independent road to prosperity have little to show for their efforts. Most have now abandoned such efforts in favor of great global integration.

To be sure, the institutional structures associated with globalization continue to be developed.[7] For this reason, among others, positive efforts from various quarters to influence the development of such structures merit attention. On the other hand, a strategy of anti-globalization threatens economic well-being and is unlikely to gain much support.

It is the larger countries—particularly the United States—that have decisive voice in determining the shape and form that globalization takes. In these matters the United States in the post-World War II years has consistently promoted the role of markets, private property rights, trade liberalization and investment, fiscal discipline, reduction of subsidies, and the privatization of public enterprises. Thus far these policies have worked in liberalizing world trade as indicated by the dramatic increase in the international flow of goods and services.

[7] See George Macesich, Money and Monetary Regimes: Struggle for Monetary Supremacy (Westport, CT and London: Praeger, 2002).