Why Globalization Works
Martin Wolf
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Martin Wolf, chief economics commentator at the *Financial Times,* is a brilliant journalist and an able economist. *Why Globalization Works* is an excellent example of the author's capacity for examination and analysis. The book is based on a series of articles on globalization that originally appeared in the FT, and on his Hayek Memorial Lecture to the Institute of Economic Affairs in London.

Wolf presents a detailed reply to the main arguments proffered by the forces opposed to globalization, and demonstrates conclusively its advantages—historically, and both in theory and in practice—over all alternative systems. He presents a splendid survey of the literature about this topic. He holds not only that globalization works, but also that it is needed if we are to aspire to extend prosperity and freedom to the whole planet. His presentation is sophisticated, complete, and comes out roundly in favor of globalization. It is the best analysis of the subject yet: a passionate voyage across one of the most vital aspects of cultural, social, political, and economic life at the start of the 21st century.

Wolf is convinced that the market is undeniably the most powerful vehicle ever to exist for raising living standards. From this premise, he analyzes the debacle of the collectivist experiments of the 20th century—nationalism, communism, fascism—and their profound negative effect on the wealth and freedom of nations. In the same way, he testifies to the demise of light collectivism, which was based on the preachings of

Keynes and was practiced in many states from the end of the Second World War until the crises of the mid-1970s. The collapse of central planning was not brought about by the work of a group of fanatical liberal thinkers; it was a logical result of the inherent contradictions of the collectivist model, particularly its inability to build viable economic systems and raise per capita incomes, and its failure to promote democracy. Wolf's critique is rooted in the thinking of Hayek and Mises, with an emphasis on the insurmountable restrictions on the flow of information that are inherent to all statist models for running complex societies.

Within this framework, *Why Globalization Works* is also a cold, rational, and convincing defense of classical liberal values. The relationship between the market economy and individual rights constitutes the base of all liberal democratic systems; its underpinnings are both ethical and practical. The survival of such a complex and fragile system of social organization demands a strong state (an idea drawing on scholars from Adam Smith to Douglass North), but one which limits its functions to three areas: first, the provision of public goods (those that markets cannot provide); second, the internalization of externalities, which can also be thought of as providing remedies for market failure; and third, to help people who, for a number of reasons, do worse from the market or are more vulnerable to what happens within it than society finds tolerable. Apart from the classic function of the state—the protection of property rights—Wolf argues that the second and the third have a "facilitating" role in the Mill sense of the word; in other words, they must be the subject of constant review, and must be updated, eliminated, or reduced if the market develops its own solutions. (There is, of course, the question of whether the provision of certain services by the state determines whether or not alternative sources of private provision arise, but that is a separate matter.)

Wolf gives ample evidence to back up his arguments, and his analysis of the last century and a half is illuminating. He provides an overwhelming theoretical and practical case to show that movement toward a freer, more open, and integrated world economy from the middle of the 19th century to the First World War fostered an unprecedented period of peace and economic growth. This was the "Golden Age of security and freedom" so lauded by Stefan Zweig. It is true that this first wave of globalization was restricted essentially to those states that now make up the OECD, and therefore had less impact than the current wave. But in several aspects it was more intense. Specifically, it resulted in massive migratory flows. Between 1850 and 1914, 60 million people left Europe for America, Oceania, and the south and east of Africa. Twelve million Chinese and six million Japanese emigrated from Asia. Until the First World War, governments operated relatively few restrictions on immigration. This was the determining factor behind the convergence in real incomes that took place over this period.

After a long upswing of liberalism in the 19th century, there was a pronounced reaction that began in the 1870s and reached its zenith in the first half of the 20th century. The combination of collectivist ideas, protectionist interests, war, monetary disorder, and economic crises had converged to discredit the assumptions, beliefs, policies, and practices that had underpinned the liberal economic regime. Laissez-faire capitalism seemed to have ended. The great powers created economic systems that reinforced their own dominance and shielded them from their rivals. Multilateralism was replaced by bilateralism, free trade by protectionism, capital freedom by exchange controls, the gold standard by fiat money, and free movement of labor by powerful restrictions. This was the new world, the collectivist paradise so lauded by the new millennium's antiglobalization forces.

A key lesson of Wolf's book is that the damage caused by the collapse of liberalism in the early 20th century—war, hyperinflation, worldwide depression, mass unemployment, and tyranny—was brought about under an assault of assorted collectivist forces. Between 1870 and 1913, global GDP per capita grew 1.3 percent, while in the years 1913–1950 it grew at just 0.9 percent. The liberal market economy had produced the fastest increase in living standards ever known. The collectivist era, by contrast, was the worst period for growth in living standards of the past 130 years. The previous collapse of the liberal global economy seems incompatible with Wolf's claim that "in the very long run, where the long run consists of many centuries, the trend toward globalization is almost certainly irreversible."

After the Second World War, the United States initiated the long march to restore the liberal global order. Globalization, the movement in the direction of greater integration, proceeded as both natural and manmade barriers to international economic exchange began to fall. This process had three key goals: first, the promotion of economic growth and the raising of living standards; second, an extension of prosperity in the world in order to check communist expansionism and third, the adoption of a liberal democratic institutional framework. It is noteworthy that the postwar system was both an economic and a political program. The proliferation of liberal democracy was seen as possessing international utility. Experience shows that it is the only system of governance where harmonious and cooperative interstate relations are a natural outcome. The prosperity of a liberal nation derives not from the size of territory, its military power, or population under its direct control, but rather from the combination of internal economic development with international exchange.

From the 1950s, the roots of globalization were to be found in a steady attack on the barriers to the movement of goods, services, and capital, but far less opening took place in the free flow of individuals. The liberalization began with trade between high-income countries and spread gradually to capital flows. (Many European countries liberalized their capital accounts only around 1990.) This opening spread to much of the rest of the world in the 1980s and 1990s in the form of trade and capital flows. However, the degree of international integration remains limited today. It is true that high-income countries are more open to trade and capital flows than ever before, but they continue to protect labor-intensive, inefficient agricultural activities and operate tight controls on inflows of immigrants. In so doing, they inflict substantial harm on developing countries.

Many of these developing countries remain more closed to trade, capital, and movement of people than they were a century ago. Poverty is the price paid for these deficiencies. Wolf observes that "globalization is not rampant. It remains remarkably limited." There is wide consensus that the prevalence of obstacles to the free movement of goods, services, capital, and people is damaging the poorest nations. Globalization represents an enormous opportunity for these countries. Our failure is not that there is too much globalization, but rather that there is too little.

However, for Wolf, economic international liberalization is not enough. He rightly devotes considerable attention to the vital role that a healthy state can play in promoting prosperity. This is important, given that the poorest nations are often failed states. Economic integration will bring benefits to no one unless states guarantee the security of property rights and the rule of law. If not, the potential benefits of globalization disappear in the short-term or accrue only to a small and corrupt ruling class, rather than to the general population. The market economy needs not only good economic policies and open markets but also good governance and a credible, predictable, transparent, and consistent institutional framework, both over time and across activities. The state exists to serve its citizens and is duty-bound to protect them from harm, including from itself. We will only have more and better globalization if we have better states, Wolf notes.

The intellectual clash between liberal capitalism and its opponents is the chief theme of the book. It focuses largely on the arguments advanced by those who want to halt or reverse market-driven globalization and destroy the international institutions that promote and oversee it. These members of "antiglobalization.com," in Wolf's words, fall into two groups: on the one hand, old-fashioned interests—farm lobbies, trade unions, protectionist interests—and, on the other hand, and more important today, single-issue NGOs, often with mass memberships. They are the "new millennium collectivists." Included with the latter is a more traditional assortment of old-fashioned socialists and neo-Marxists and, probably far more dangerous in the long run, mercantilists, nationalists, and anti-liberal groups of the right that played a substantial role in bringing down the liberal order of the late 19th century. The antiglobalization forces are united only in what they oppose. They offer no alternative way of running an economy but rather sentiments, emotions, and protests. They are split in their objectives. The reality is that all these groups seek a post-enlightenment form of tribalism. As ideas matter, this ideological Molotov cocktail is dangerous for the survival of an open society.

Why Globalization Works takes apart point-by-point the arguments against globalization. Wolf concludes that only a few of the claims can be taken seriously, and he shows remarkable patience in responding to those. The core of the book is a series of chapters that look in turn at the charges that antiglobalization.com levels against the international market economy: first, that worldwide economic integration has worsened inequality and poverty everywhere; second, that free trade undermines prosperity and thwarts development; third, that globalization only serves the interests of predatory multinational corporations; fourth, that financial liberalization is a threat to economic development; and finally, that integration undermines democracy, sovereignty, the welfare state, and environmental regulation, creating, instead, a headlong race to the bottom.

As Wolf demonstrates, global poverty and inequality actually rose until about the early 1980s. Since then, inequality among individuals has declined as a result of the rapid growth of Asia: above all, China and India. In the supposed period of globalization since the 1980s, the number of people in extreme poverty fell. There are discrepancies, but only about the dimension of the decline. All research shows substantial declines between 1990 and the end of the decade. The World Bank calculates a 9.5 percent decline over 9 years; this compares with Sala and Martin's estimate of 13.1 percent over 8 years, and Bhalla's of 25.6 percent over 10 years. And inequality? A very impressive indicator is the rise of the middle class. Bhalla has a particularly telling way of illustrating this. He defines the global middle class as those earning between $3,650 and $14,600 a year at PPP in 1993 prices. By his analysis, in 1960 some 60 percent of all middle-class people in the world lived in the high-income countries. Today, this is down to 17 percent, with 51 percent living in Asia, the Middle East, and North Africa, up from just 6 percent in 1969 and 16 percent in 1980.

What about human welfare? It is obvious that it has improved in recent decades. In the developing world as a whole, life expectancy rose from 55 years in 1970 to 64 years in 2000. In 1950, average life expectancy in developing countries was two-thirds of the levels in high-income countries. By 2000, it was 82 percent. Adult literacy, growth in food production, and other indicators have improved dramatically. Wolf turns to what has become one the most controversial indicators of the alleged exploitation induced by globalization: child labor. On this issue, the facts speak for themselves. The proportion of children ages 10 to 14 in the labor force has, according to the World Bank, fallen from 23 percent in all developing countries in 1980 to 12 percent in 2000. The fall in Asia, which has been astonishing, is from 26 percent to 8 percent. In sub-Saharan Africa, the decline has been less impressive, from 35 to 29 percent. This disparity reflects the fact that the countries' economies that have done well in the era of globalization have been the ones in which parents have subsequently chosen to withdraw their children from the labor force. In Wolf's words, "[d]eveloping countries are reaching higher levels of social progress at lower levels of income than the high-income countries of today. But, as one would expect, social progress has been greatest where incomes have risen fastest. It remains the growth, stupid."

The power and malevolence of large corporations is another touchstone of those who oppose globalization. In Wolf's words, "this is their Satan." Again, the facts speak for themselves. Multinational corporations are no more powerful than the states they operate in, and they do not dominate the world by dint of their brands. The author reminds us of two very interesting points: First, in 2000, the top hundred international companies generated only 4.3 percent of global GDP; second, the gap between the power of states versus that of companies is enormous, with the latter dependent on the former for the protection of their property. In the 1970s, the world's biggest oil companies watched weak developing-country governments seize their assets. Since their own governments chose to do nothing, they were unable to help themselves. It also is not true that corporations have used their alleged power to exploit workers in developing countries. The evidence that international companies pay more and treat their workers better than local companies do is overwhelming. The reason is clear: they can do so because their superior know-how makes them more efficient and productive, thereby more profitable.

The antiglobalization.com adherents argue that predatory market forces are making it impossible for kindly governments to shield their people from the beasts of prey that lurk beyond their borders. As Wolf proves, this claim is nonsense. If integration is chosen, it is impossible to argue that it renders states impotent. However, it is true that globalization constrains them in important ways and so makes them better able to serve the (properly defined) long-term interest of their citizens. But the severity of constraints should also not be exaggerated. In some high-income countries and in many developing nations the constraints have not worked, and governments have persisted in illiberal economic policies.

However, as long as a state provides services that the residents wish to enjoy, it can continue to tax, regulate, and intervene. As the experience of the northern European welfare states shows, it is possible to sustain a high measure of distributive taxation and social insurance in an open economy. The ability to raise taxes to sustain high ratios of public expenditure is contingent on electoral opinion than on globalization. International integration merely tends to make policy more transparent and government more predictable—both are desirable. Also it is true that a regime that "wants" its people to be fully engaged in the global economy cannot prevent them from gaining access to an extraordinary range of information, including about their own country. This makes despotic and inefficient regimes unsustainable or unstable in the long term.

Another familiar cry of the antiglobalization community is that globalization is inimical to protection of the environment. This proposition, says Wolf, is wrong. The relations between globalization, growth, and environmental quality are positive. As people become richer, for example, they insist on a cleanup of local environmental damage. Alan Krueger and Gene Grossman of Princeton University argued that this generally happens when a country's GDP per capita reaches $5,000, and that after about \$8,000, local pollution starts to improve substantially. In addition, capitalism has been far less environmentally damaging than socialism. The former Soviet Union was responsible for some of the greatest environmental catastrophes in history. Many of the harms to which the "red-greens" point are not related in any significant way to globalization but rather to poverty and bad government. Deforestation is driven not by trade liberalization but by land-hunger and poverty, or by the indifference of dictatorships to political and social pressures. Of course, there are real environmental problems, but the rational policy to deal with those, says Wolf, is through cost-internalization and here it is possible to use market solutions.

One of Wolf's most controversial positions is his defense of capital account liberalization. His case is prudent. Emerging-market economies have tried to integrate into world capital markets. "The gains," says Wolf, "have been questionable and the cost of crises enormous." But it would be wrong to conclude that the simple lesson is not to liberalize. It is in the interest of all countries to integrate into global financial markets—the advantages are evident—but they should do so carefully. Developing countries will have to rethink domestic regulations, laws, and behavior in such areas as the role of banks, the role of foreign financial institutions, deposit insurance and other guarantees, bankruptcy regimes or exchange rate policies. They will also have to be careful about exposing their economies to large-scale foreign currency borrowing. Wolf believes that the IMF did not do a wonderful job in the 1990s, but he also does not think that the world would be better off without the IMF. "If this institution did not exist, countries would not be left alone to sink or swim. They would be subject to even more confused outside pressures. If crises hit, they would have to deal directly with the U.S. Treasury. That would be no improvement." For Wolf, the IMF is a necessary, second-best solution.

Wolf says that "global economic integration will not collapse, as it did in the early twentieth century." The question is why? The combination of fears of terrorism, economic instability, protectionist reactions to economic change, and the rise of new competitors and protesters against economic integration could yet do great damage. Wolf's answer for ensuring that the forces of economic convergence overwhelm those of divergence is a magic bullet: jurisdictional integration, a worldwide federal state.

But this ignores the fact that the liberal order did not collapse in the 19th century because of political fragmentation, but rather because of the triumph of ideas and interests opposed to liberal democratic values. Ideas matter, and bad ideas are always the main risk for freedom and prosperity surviving. The old collectivists were perhaps more demonstrably dangerous than the new, because they knew what they wanted to do. On the other hand, it is easier to combat a regular army than a guerrilla force. The new collectivists are characterized by a hodgepodge of contradictions that make confronting their ideas that much more taxing. Their contradictions grant them a comparative advantage because they can attack from all directions.

Why Globalization Works is an excellent defense of globalization and an intelligent rebuttal to its critics. Wolf's message is unequivocal: "The sight of the affluent young of the West wishing to protect the poor of the world from the processes that delivered their remarkable prosperity is depressing. So too is the return of the old anti-capitalist clichés, as if the collapse of Soviet communism had never happened. We must, and can, make the world a better place to live in. But we will do so only by ignoring these siren voices. The open society has, as always, its enemies both within and without. Our time is no exception. We owe it to posterity to ensure that they do not triumph."

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