

## The Miracles of Globalization

Arvind Panagariya

From *Foreign Affairs*, September/October 2004

*Why Globalization Works*. Martin Wolf. New Haven: Yale University Press, 2004, 398 pp.

\$30.00

Summary: Economic journalist Martin Wolf adds sharp insights to the trade-liberalization debate and scores a major victory against critics of globalization.

*Arvind Panagariya is Professor of Economics and Bhagwati Professor of Indian Political Economy at Columbia University.*

By the early 1980s, a number of distinguished economists had amassed compelling evidence that outward-oriented trade policies were far more likely than protectionism to lead to economic growth. The evidence was contained in two multi-country research projects—one at the Organization for Economic Cooperation and Development (OECD), led by Ian Little and others, and the other at the National Bureau of Economic Research, directed by Jagdish Bhagwati and Anne Krueger—and in a series of studies at the World Bank.

When developing countries, convinced by these findings, began to embrace outward-oriented policies, pro-free trade economists believed they had scored a decisive victory over protectionists and turned their attention to other problems related to development. But the protectionists were not so easily defeated. Over the next few decades, they regrouped, building a new case for protectionism based on examples of countries that had apparently opened up but had failed to grow rapidly or had suffered financial crises. They also forged new alliances with certain nongovernmental organizations (NGOS) dedicated to preserving the environment and improving labor standards. By the late 1990s, the protectionists—now rechristened "anti-globalizers"—to reflect the expanded scope of their agenda—seemed to have recovered some of their lost ground. Their newfound vocalism made headlines during the World Trade Organization (WTO) ministerial meeting in Seattle in 1999.

Today, however, advocates of globalization are gaining the upper hand again. Bhagwati's strikingly successful defense of open markets in his recent book *In Defense of Globalization* has been bolstered by another influential pro-globalization voice, that of Martin Wolf of the *Financial Times*. Wolf's weekly columns have already established him as one of the world's most respected economic journalists. Now his ambitious new book, *Why Globalization Works*, offers a patient and persuasive refutation of many of the arguments most frequently marshaled by critics of trade liberalization.

### STRAW MEN

Wolf's book ranges over many topics, including, in Part III, the rise and fall of what may be called the period of "first globalization" that flourished from 1870 to 1914. But the book's most important contents are in Part IV, in which Wolf examines and dismisses current

critiques of free trade, of the role of multinational corporations in the global economy, and of capital mobility. Since this is the part of the book that will invite the most attention from pro- and anti-globalization advocates alike, it deserves particularly close scrutiny.

To those who complain that increased openness to trade during the 1980s and 1990s has failed to deliver faster growth, Wolf points to the contrary experiences of China and India. Both countries witnessed significant jumps in their growth rates as they opened up their economies to international trade and foreign investment. As Wolf points out, "Never before have so many people-or so large a proportion of the world's population-enjoyed such large rises in their standards of living."

Wolf argues that although trade openness alone may not always lead to sustained growth, the former is necessary for the latter. In my own research, I have found that growth "miracles"-countries that grew at rates of three percent per capita or more on a sustained basis between 1961 and 1999-almost always experienced rapid growth in trade. Moreover, there are few examples of highly protected countries that managed to grow rapidly on a sustained basis without lowering their level of protection. Symmetrically, countries that had stagnant or declining per capita incomes-what I call growth "debacles"-were characterized by dismal trade performance. Wolf is correct, therefore, in asserting that the empirical evidence refutes the claim made by critics of globalization that trade openness wreaks havoc on economies.

Although the data show that openness to trade is not sufficient for growth, this is readily explicable by proponents of free trade such as Wolf. Trade is enabling, but if other obstacles remain in place, it may not lead to results. Thus, for instance, Indian economists working on the OECD project in the 1960s correctly identified that India's stifling industrial licensing system would nullify any benefits from opening up trade. More generally, if trade is embraced but there are no transport facilities, or if potential trading partners have closed their markets, de facto autarky will continue.

Wolf also argues that the ability of trade to improve growth may be undermined by poor governance: "Poor performers have corrupt, predatory or brutal governments or, sometimes even worse, no government at all, but rather civil war among competing warlords." But this is not an argument against opening to trade. Indeed, Wolf could have made his defense of trade even stronger by posing the question, Is a poorly run country better off pursuing outward-rather than inward-looking policies? More often than not, the answer would be yes.

Wolf also could have challenged the frequent assertion that Latin America-which has tried neoliberal reforms, including trade liberalization, with disappointing results-undermines his arguments for globalization. The fact remains that much of South America has borrowed too much and has therefore been particularly vulnerable to financial crises. This, in turn, has made it difficult for many countries in the region to reap gains from trade liberalization. Chile is a rare counterexample: it has managed to grow at more than 5 percent for nearly two decades largely because it has reduced its trade barriers to OECD levels while limiting its foreign borrowing to prudent levels and maintaining macroeconomic stability.

## BEYOND POPULISM

Admirers of Wolf's pro-globalization arguments in the Financial Times will be surprised by his endorsement of the notion that rich countries practice "hypocrisy" and "double standards" in setting trade barriers and framing rules at the WTO. He does not make a convincing case for these charges and, at times, too readily embraces populist arguments without necessary qualification.

Wolf chides rich countries for imposing higher barriers on imports from poor countries than on imports from other rich countries. He notes, for example, that the United States imposed an average 14 percent duty on imports from Bangladesh in 2001, compared with 1 percent on imports from France. But a simple comparison between the two countries' average duty levels is misleading, because the products they export are different. Under WTO rules, trade concessions have to be given to all members simultaneously. Because developing countries kept themselves aloof from the negotiating process until the Uruguay Round, which did not begin until 1986, developed countries unsurprisingly concentrated their initial liberalization efforts on the products they traded most intensively with one another. When developing countries did finally join the negotiations, they were successful in getting developed countries to agree to end their extensive import quotas on textiles and clothing by January 1, 2005.

Again, because developing countries did not participate in early negotiations and therefore were not subject to any liberalizing commitments, they are now saddled with higher tariff barriers on industrial products than are developed countries. This fact is tacitly acknowledged by Wolf in his discussion of the benefits of trade liberalization in the current Doha Round of trade talks: he notes that developing countries will gain more from their own liberalization than from any other kind.

On agricultural subsidies, Wolf makes a stronger case. Developed countries do indeed massively subsidize their agricultural exports, whereas developing countries do not. Unfortunately, however, Wolf undermines the point by buying in to rhetoric-popularized by the World Bank leadership and by Oxfam-such as the assertion that the European Union provided \$913 for each of its cows in 2000 but only \$8 for each person in sub-Saharan Africa. The economic argument lurking behind this comparison is nonsense. The truly meaningful comparison is between the damage EU subsidies do to sub-Saharan Africa by reducing the prices of its exports (damage that amounts to a tiny fraction of the total subsidies going to EU men, cows, land, and exports) and the grants disbursed by developed countries to the region. (It is important to remember, moreover, that not all aid takes the form of grants: the World Bank, for example, gives loans at concessional terms, rather than grants.)

Wolf also fails to point out the flaws behind the assumption that lifting rich countries' agricultural subsidies would help poor countries. NGOS are right to point out that reducing subsidies on cotton would indeed benefit poor countries, because the latter are unambiguous net exporters of cotton goods. But that does not mean that removing agricultural subsidies is always in poor countries' interest. As many as 45 of the world's 49 least developed countries (LDCs) are net importers of food and 33 are net importers of agricultural products, according to the economists Alberto Valdes and Alex McCalla. The removal of tariffs and subsidies would hurt, rather than help, these countries, because such a move would raise the prices they pay for their imports. The counterargument-that these countries would still benefit because as prices rise they would become net agricultural exporters-is not persuasive. Very few net importers are likely to make this switch. And those countries that do are unlikely to offset the losses they accrued as importers-unless they become large net agricultural exporters.

Even those LDCs that are net exporters of agricultural goods could find themselves worse off. With the temporary exceptions of rice, sugar, and bananas (which are slated to end during 2006-9), the EU's Everything But Arms (EBA) initiative gives these countries duty-and quota-free access to the EU market. This means the LDCs sell their exports to the EU at its internal prices. Given that the removal of the EU tariffs and subsidies would lower these internal prices, developing countries participating in the EBA initiative would also lower their export earnings.

Overall, the benefits from removing protective measures would accrue less to poor countries than to rich ones, which enjoy the greatest comparative advantage in agricultural products. Without proper appreciation of this fact, policymakers will fail to design appropriate compensation and adjustment mechanisms to ease the pain of agricultural liberalization in poor countries. By the same token, countries that are promised huge benefits but end up hurt could become badly disillusioned about free trade, which, in turn, could complicate further global liberalization.

#### WRONGLY CONVICTED

Multinational corporations are yet another favorite punching-bag for critics of globalization. Such companies, the argument goes, exploit poor workers abroad and impoverish workers at home by moving capital overseas. Wolf debunks both myths eloquently and decisively.

The first charge, commonly made by NGOS and student organizations in the United States, is easiest to dismiss. If multinational jobs are so exploitative, why do workers in Bangalore, and even in predominantly Marxist Kolkata (Calcutta), line up to take them? The answer, as Wolf painstakingly documents, is that multinationals pay their workers more and treat them better than do local companies. Among other data, he cites a study of 20,000 plants in Indonesia showing that the average wage paid to workers in foreign-owned plants in 1996 was 50 percent higher than in private domestic plants. Even after controlling for education levels, plant size, and other relevant variables, wages paid by multinational companies were 12 percent higher for blue-collar workers and 27 percent higher for white-collar workers. According to surveys by the International Labor Organization, moreover, allegations that foreign-owned plants in "sweatshop industries" (such as footwear and apparel) pay lower wages and provide inferior working conditions also turn out to be false.

Another prominent concern about free trade is that capital flows within multinational corporations have the effect of lowering wages in rich countries. Anti-globalization advocates also argue that the ability of such firms to move operations abroad reduces the bargaining power of workers in unionized industries. Yet in 2001, the amount of outward foreign investment from the United States was virtually equal to the inward flows, according to figures cited by Wolf. Net capital outflows, in other words, were negligible. (CNN's Lou Dobbs, who concentrates on firms that are outsourcing jobs but fails to discuss foreign firms that are in-sourcing jobs, should take note.) If anything, increased volumes of capital flows (both ways) may help labor productivity-and hence real wages-because they stimulate technological improvements.

As for the second criticism, it must also be remembered that corporations in the United States have always had the option of moving to another U.S. state. It is not clear how much extra leverage they gain by threatening to move abroad rather than within the country, especially when the bulk of the investment flowing from the United States goes to other rich countries, not poor ones.

Few economists and policymakers will disagree with Wolf's incisive criticism of the anti-globalizers' position on trade and multinationals. But his views on short-term capital mobility are much more controversial. Some of the most respected economists today, such as the Nobel laureate James Tobin, Bhagwati, and New York Times columnist Paul Krugman, have written against full capital mobility, particularly when it is pursued with the kind of haste witnessed prior to the Asian financial crisis in 1997-98 under International Monetary Fund and U.S. Treasury guidance.

In his columns in the Financial Times in the late 1990s, Wolf generally agreed with these economists. But in *Why Globalization Works*, he moves away from their position. Although he recognizes that full capital convertibility can easily lead to crises, he comes out in favor of convertibility, even though there is no evidence that such conditions contribute positively to growth. Citing another Nobel laureate, economist Friedrich Hayek, he argues that if free choice is valuable in its own right, people should be given the right to hold their savings wherever in the world they choose. He characterizes the 1960s exchange restrictions in the United Kingdom, for example, as a "predatory policy" that ended up destroying a sizable proportion of that country's middle-class savings. For Wolf, a well-run financial system, of which he considers currency convertibility to be a key part, is critical. Controls are costly and ineffective, and they force otherwise law-abiding citizens into corrupt arrangements. He also sees full convertibility as a vehicle for speeding the reform of the financial sector.

But Wolf's case is far from persuasive. A large number of countries—including several Latin American countries during the 1960s and early 1970s, eastern Asian countries during the 1960s through the 1980s, and China and India during the 1980s and 1990s—have grown rapidly on a sustained basis without convertibility. Many countries that have embraced convertibility, on the other hand, have experienced devastating financial crises, such as Brazil, Indonesia, Mexico, and Thailand.

Despite this quibble, however, Wolf's book offers a series of highly effective rejoinders to the main criticisms marshaled by opponents of globalization. For those of us concerned with one of the most far-reaching issues of our time, this elegant and passionate defense of trade liberalization is essential reading.