

**Be Careful What You Wish For**

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## BE CAREFUL WHAT YOU WISH FOR

It is a pleasure to be here, to see old friends and to make new ones. My congratulations to the organizers on the splendid arrangements, and thanks to them for inviting me and for their hospitality. My topic for today is one that essentially addresses what to me is a huge puzzle: as I shall attempt to demonstrate (as others have also done), there has been enormous progress in improving the opportunities and material conditions for much of mankind. That progress has been in significant part been a result of globalization. Given that, the puzzle is why there are so many critics of globalization when in fact most of the critics' goals would have been even more remote and unachievable had it not taken place. The critics should be on the defensive: yet somehow, the supporters of globalization have found the critics on the offensive and they have let themselves be on the defense.

In this lecture, I shall start by considering what is meant by globalization. I shall then address the factual issue: there have been huge gains in economic well-being, first for industrial countries starting around 1800, and then for almost all countries after the Second World War. The next step will be to show that globalization has been a necessary background for these enormous gains. Over the past two centuries, mankind's well-being has advanced enormously, by any measure. Life expectancies have risen dramatically, the incidence of debilitating illness has greatly diminished, literacy and educational attainments have increased remarkably, and, of course, real incomes have

risen greatly. It is no exaggeration to say that the nature of life itself has changed qualitatively as well as quantitatively,

Moreover, the rate of improvement in these and other measures of well-being has accelerated in the sixty years since the Second World War. This is true not only of countries that did not significantly participate in the improvements prior to 1945, but even of the industrial countries.

No observer of the economic scene can contend that all is perfection, and clearly there remain economic problems – including the abject poverty that still exists in parts of the world – but equally, it would be difficult to contend seriously that things have not improved. Indeed, as I shall argue later, it is possible if not probable that the changes have been so great that many in the current bodies politic simply take current well being and living standards for granted without recognition of the facts that life has not always been this way or of the factors that enabled the transformation of life for so many.

One of the key contributors to economic progress has been globalization. The increasing integration of the global economy been a necessary underpinning for much of the progress, but, sadly, many observers have blamed globalization for some of the world's remaining ills, rather than recognizing its role in enabling the advances that have been made to date. So, after sketching some of the key indicators of progress in economic well-being, I will address the role of globalization in enabling it.

After addressing these factual issues, I will turn (defensively, regrettably) to some of the criticisms of globalization, arguing that some of the complaints are simply false – in the sense that the facts do not support the assertions – and that others are correctly pointing to issues that require addressing, but that those issues would not be resolved, nor

would conditions be made better, by attempting to stem the tide of globalization; the appropriate policy responses are otherwise. I will conclude by sketching some of the policy responses that can meet the legitimate objectives of some of globalization's critics and simultaneously be consistent with further progress.

A first step is to define what is meant by globalization for present purposes. In a meaningful sense, globalization has been occurring throughout recorded history, if by globalization is meant the increasing interaction and integration of economic activity over ever-longer distances. On that definition, which I shall use, the Romans were great globalizers, as they built roads and shipped goods by sea (especially from North Africa to Italy) to a much greater degree than had earlier been done. One might even nominate Alexander as an important globalizer!

But, in fact, after the Romans there appears to have been little progress in improving transport routes or in further integration. While there appear to have been some productivity increases starting around 1200 in manufacturing in northern Europe, population changes (both positive and negative) seem to have absorbed them, and it is quite possible that there was less integration in 1600 than there had been in Roman times.<sup>1</sup> Roman roads were often not maintained. Blanning reports that roads built by the Romans had in fact deteriorated over the centuries, and that in consequence times and costs of transport were probably higher in 1600 than they had been fifteen or more centuries earlier. Thus, there was little further globalization for the next fifteen or so centuries.

Integration, in the sense of increasing economic interaction and integration over distances, started once again as transport and communications costs (both time and

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<sup>1</sup> Blanning, pp. 3ff

resources) began falling. Most travel was by road: in England, where road travel was apparently at least somewhat better than on the continent, Blanning estimates that travel time from London to Manchester in 1700 was 90 hours; by 1750 it had fallen to 65 hours, and by 1800 it was 33 hours. While 33 hours looks incredibly long by today's standards (and the journey was arduous as it was mostly by foot or, at best, by coaches without springs), the improvements in earlier years must have seemed huge to contemporary travelers. It is estimated that most people never were more than 5-6 miles from their places of birth during their lifetimes.

Evidently, travel on the continent was even more arduous than in England. While water routes (the Rhine, in particular) were an alternative for much of what did move between places barge animals dictated the pace of travel inland, and prevailing winds set the pace for seagoing vessels. Even then, tolls were a heavy burden on river traffic, as Eli Hecksher so well documented.

Because the costs and difficulties of moving between places were so high, and because most productivity of persons engaged in agriculture (probably more than 90 percent of the population) was so low, there was very little interdependence. Most goods consumed had been produced within a short distance of the consumption point. We all know about the spice trade: but spices were among the few goods with a sufficiently high value-to-weight ratio to be economic for trade at longer distances. For the average person, what went on even a hundred miles away was probably of little relevance to their everyday life. In that sense, we can conclude that integration, and hence globalization, was minimal between Roman times and 1700 or thereabouts.

It is also worth noting that economic historians estimate that living standards in 1700 are thought to have been little, if at all, better than they were two thousand or more years before. Indeed, Clark reports that for England (for which the best data are available), “Real wages in England showed remarkably little gain in the six hundred years from 1200 to 1800. The fluctuations over that period are much more dramatic than any long-run upward trend. Thus in thirty-nine of the sixty decades between 12—and 1800 real wages for farm workers are estimated to be above their level in 1800. The highest real wages are found in the interval 1400-1549...”<sup>2</sup>(p. 42) I should mention in passing that he also concludes that “there is no sign of any improvement in material conditions for settled agrarian societies as we approach 1800. There was no gain between 1800BC and AD1800 – a period of 3600 years.”(p. 49)

By 1800, however, transport costs were falling, and trade between Europe and the western hemisphere had started. But, starting about 1870 – the date now chosen by most economic historians – the decline in transport costs became precipitous. Data given by Mohammed and Williamson<sup>3</sup> indicate that the decline varied between routes and cargoes. But overall, their real ocean freight rate index shows a decline of 78 percent between 1870-74, a date by which there had already been substantial declines for more than a century, and 1975-79 (after which they rose somewhat). While declining costs surely reflected in part the smaller wage bill associated with faster trips, the benefits of more rapid transit no doubt also enabled shipment of goods that earlier could not be transported over given distances.

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<sup>2</sup> Clark, p. 42

<sup>3</sup> Mohammed and Williamson

Meanwhile, many observers credit containerization, and later the ability to ship at least some high value and/or perishable goods by air as providing an equally important reduction in transport costs.

As well as transport, the cost, timeliness, and ease of communications is also crucial for many economic transactions, and, if anything, the drop in costs and pickup in speed has been even more dramatic than in transport. It was 84 days after the Treaty of Nanjing before the report reached London in 1842, and 46 days before the Indian Mutiny of 1857 was reported. By contrast, news of Lincoln's assassination reached London in 12 days in 1865. And only 17 years later, the assassination of Alexander II in St. Petersburg was news in London in 1881 a half a day later; the Japanese earthquake of 1891 was reported within a day. This sharp change was of course attributable to the introduction of the telegraph and the telephone. It constituted a major revolution in communications. But costs were still high, especially overseas.<sup>4</sup> One frequently cited and dramatic number is that a New York-to-London 3 minute telephone call cost \$290 (in 2000 prices) in 1930 and cost only a few cents by 2000. Currently, of course, the price is even lower and the internet makes instantaneous communications virtually cost-free.

It should be noted that falling costs of transport and communications enabled increased integration of domestic economies as well as of the global economy. Transactions between distant parts of individual countries obviously became more economic as the costs and difficulties of doing business at a distance fell.

Until the Second World War, though, transport and communications costs were so high that increasing economic integration – globalization – was primarily the result of the technological and other changes that enabled transport and communications costs to fall

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<sup>4</sup> Clark p. 306

so dramatically. With very high transport costs, tariff barriers did not constitute the biggest obstacle to trade: with a 20 percent tariff and transport costs of 50 percent, a reduction of the tariff to 10 percent – halving it, that is - would have resulted in a reduction in the imported price of a good of only about 6 percent. At the end of the Second World War, however, high barriers to trade imposed by governments constituted the more important deterrent for people in most countries. Removal of quantitative restrictions under the GATT, the WTO, and self-interest of countries, combined with multilateral and unilateral tariff reduction, brought about large reductions in costs of doing business across borders.

In the mid 1940s, it is estimated that the average tariff on manufactured goods among the industrial countries was between 45 and 50 percent, while transport costs for manufactured goods averaged around 20 percent. The calculus had changed, but with it, international political economy. Successive rounds of trade liberalization under the GATT brought the average tariff among industrial countries on manufactures down to around 2 percent. Simultaneously, many developing countries, which had had (and still have) much higher trade barriers than the industrial countries, recognized the harm those measures inflicted on their economies and were dismantling their restrictions (both tariffs and quantitative restrictions on imports).

As a result of all these factors, the costs of trading at any given distance have fallen dramatically over the past two centuries. Whether that fall was greater in the twentieth century with the development of transport and communications via the internet, airplanes and containerization, or in the 19<sup>th</sup> century with the telegraph, telephone, steam

engine, is an open question. But the economics of doing business at a distance certainly changed.

As a result, there has been increased economic integration worldwide. Whereas farmers and people in villages doing farm-related activities were constituted over 90 percent of populations almost everywhere and were relatively self-sufficient in 1700, in advanced countries today fewer than 3 percent of the population is engaged in agricultural activities and, even then, they rely on goods produced at considerable distances both for consumption and for inputs (such as fertilizers and farm machinery) into production. Clark presents estimates that, prior to 1800, laborers (in England, a country for which the most reliable data seem to be available) are estimated to have spent 75 percent of their incomes on food and drink, 10 percent on clothing and bedding, and 25 percent on housing. Today, less than 20 percent of income is spent on food in industrial countries, and much of that 20 percent consists of services such as processing and restaurant-provided meals. Obviously, much of the 80 percent of nonfood expenditures (as well as the nonfood) originates from much greater distances, and has much greater variety than 200 years ago.

In consequence, the degree to which workers and employers in a city such as Manchester are integrated into the world economy is much, much greater. Not only is the share of goods and services entering international trade much greater now than it was earlier, but in addition, the speed with which events in far-flung parts of the world affects each economy has greatly accelerated. Interdependence has increased not only through the exchange of goods and services, but also because economic shifts anywhere in the world affect others much more directly and more quickly.

The trend has been almost unrelentingly for increased global integration. The exception was the period from 1914 to 1945, when there was a degree of global disintegration. It started with World War 1, which raised the costs of shipping dramatically. While there was some recovery to prewar levels in the 1920s, the Great Depression of the 1930s and the policy measures associated with it (especially competitive devaluations and rising tariff barriers) again reversed the trend. But since the end of the Second World War, economic integration has increased continuously.

There is little doubt that globalization will continue, barring a major geopolitical event or severe policy reversals. But one can question whether the pace of change, and the degree to which perceptions of interdependence have increased over the past several decades, will be sustained. Either way, it is clear, as I shall now argue, that there have been huge benefits to mankind from the economic changes over the past two decades.

Let me then turn to the changes in well-being over the past two centuries. The place to start is with the improvements in well-being that have taken place over the past two centuries. That these improvements have been huge is unquestionable, but they are now so often taken for granted that it is worth pausing and reflecting on them. Then, the crucial role of economic integration in enabling the attainment of these benefits can readily be shown.

It is difficult to know where to start. One dramatic and telling statistic is that economic historians<sup>5</sup> estimate that, as late as in 1900, only about 6-7 percent of the American population had incomes sufficient so that they would have been classified as

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<sup>5</sup> Fogel report...

above the poverty line by today's American standards. And real incomes in the richest industrial countries are estimated to be 10-20 times higher than they were in 1800.<sup>6</sup> And, over that long time period, those whose incomes rose most rapidly were the unskilled workers.<sup>7</sup>

But if there are claims that that is "just material", there are other indicators. Life expectancies have increased enormously, and those increases have come about as real incomes have risen. A first point to be made is that people with similar income levels have, by and large, similar life expectancies and similar lifestyles in other important dimensions of well-being.<sup>8</sup> Life expectancies at birth in the United Kingdom are estimated to have been 38 years in the last half of the 16<sup>th</sup> century, 35 years in the last half of the 17<sup>th</sup> century, and 38 years in the last half of the eighteenth century.<sup>9</sup> This was not significantly different from estimates for other countries in those and other eras: French life expectancy at birth is estimated to have been 28 years in the second half of the 18th century, the same as China's over the 5 centuries after 1300 and rural Egypt's over the period 11-257 (urban life expectancy is estimated to have been lower). Much of this low life expectancy resulted from high infant mortality rates, as well as deaths of those surviving birth but dying before the age of 15. By contrast, life expectancies in the rich countries today are approximately double those of earlier years, and continued to rise throughout the twentieth century.

But few would argue with the proposition that those in the industrial countries are better off today than were their parents, who in turn were better off than their parents, and

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<sup>6</sup> Clark, pp. 2-3

<sup>7</sup> Clark, p. 3

<sup>8</sup> Clark P. 3

<sup>9</sup> Clark, p. 94

so on. More observers question, or fail to recognize, the improvements in quality of life that have occurred in most other countries. And it is worth spending a few moments pointing to the enormous achievements in those countries that were identified as “developing” in the 1950s.

It should first be noted that the achievements of developing countries, even in the first twenty-five years of development, were significantly greater than had been thought attainable. In surveying the first twenty-five years of development for the World Bank, Morawetz concluded that “In average per capita income the developing countries grew more rapidly between 1950 and 1975 – 3.4 percent a year – than either they or the developed countries had done in any comparable period in the past. They thereby exceeded both official goals and private expectations...Increases in life expectancy that required a century of economic development in the industrialized countries have been achieved in the developing world in two or three decades. Progress has been made in the eradication of communicable diseases. And the proportion of adults in developing countries who are literate has increased substantially.”<sup>10</sup> And that was up to 1975. Economic growth has proceeded at even higher rates among the developing countries since 1975, while the rate of population growth has fallen. Indeed, over the past several years, developing countries as a group have achieved an average rate of economic growth well over 5 percent, contrasted with 2 percent in high income countries.<sup>11</sup>

Per capita incomes have risen rapidly in most, but not all, developing countries over the past several decades. The story of the East Asian “tigers” – Hong Kong, South Korea, Singapore, and Taiwan, all experienced sustained rates of growth of real GDP and

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<sup>10</sup> Morawetz, P. 67

<sup>11</sup> World Bank, WDR 2007 P. 289 – Appendix Table I.

per capita incomes well above any the world had earlier witnessed, doubling per capita income every decade from 1960 into the 1990s.. In so doing, their economies and the quality of their peoples' lives were transformed. South Korea went from being one of the poorest countries in Asia (and the world) as late as 1960, to its current classification as a rich country by the World Bank currently. And other countries in southeast Asia began growing rapidly in the 1970s. China followed suit in the 1980s and India began growing at accelerated rates in the 1990s. In these and other emerging economies, even those failing to experience such rapid rates of growth, real incomes have risen at far higher rates than had been experienced in earlier years.

These higher incomes have been accompanied by dramatic changes in life expectancy. Life expectancy in India, for example, is estimated to have been around 30 years in the late 1940s and was 64 years in 2005. And in Korea, which as already mentioned was the 3<sup>rd</sup> poorest country in Asia in the late 1950s with a life expectancy similar to India's, life expectancy (with per capita income at around \$20,000) in 2005 was estimated at 78 years, the same as the United States and one year less than the United Kingdom.<sup>12</sup>

Two things should be noted: life expectancies have risen not only proportionately but absolutely more in developing countries than in developed countries; and those countries that have grown more rapidly have achieved even greater increases in life expectancies. Even in developing countries where growth rates were discouragingly low, life expectancies and other health indicators were increasing until the AIDS epidemic began taking its toll in the 1990s. For many, where the toll from the AIDS epidemic is not

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<sup>12</sup> World Development Indicators 2007, Table 2.20

so high, life expectancies have risen even when per capita income growth has been anemic or virtually nonexistent.

Poverty reduction within individual developing countries has by and large been greatest with more rapid per capita income growth. That poverty in China has been reduced by 300 million people is a widely-repeated statistic; poverty in India has begun dropping more rapidly as economic growth has accelerated. It is widely expected that the global millennium development goals with respect to poverty reduction will have been met by 2015 because of the successes of China and India.

Literacy rates have also increased substantially, and more so in countries with higher growth rates of per capita income over sustained periods. Whereas many poor countries had literacy rates of 20-30 percent in the late 1940s, those same countries now report rates between 60 and 80 percent. While there are still many educational deficiencies including both the failure to provide universal primary education and the low quality of education in many cases, there can be little question that rising real incomes have contributed significantly to this result.

Most developing countries (weighted by population) have experienced rising living standards and improving conditions, with a falling fraction of people in poverty, longer life expectancies, better nutritional status, improved health, and so on. In a moment, I will turn to the proposition that much of that progress would not have been possible without globalization, the increasing integration of those economies into the global economy. But before doing that, I must note that there are a number of countries where the evidence is strong that living standards now are no higher, and in some instances are lower, than they were several decades ago.

The countries that have failed to experience rising per capita incomes are largely, but not exclusively, in Africa. I shall return later to some of the reasons for their failure, but at this juncture I want simply to point out the changing relative global landscape. One dramatic statistic that highlights change is the relative positions of South Korea, a dramatic success story, and Ghana, a country which has experience much greater economic difficulties. In the 1950s, estimates of per capita incomes put that of Ghana more than two and a half times that of South Korea. By 2005, South Korean per capita income was estimated to be almost seven times that of Ghana! When discussions of poverty were held in the 1950s, most observers regarded Asia as the poorest continent: South Asia's 1950 average per capita income was estimate to have been \$85, and East Asia's \$130 (not including Japan), while Africa's was \$170. Now, most East and many South Asian countries have living standards and life expectancies well above those of most SubSaharan African countries.

Let me summarize the argument to this point. First, global economic integration, or globalization, has proceeded at a rapid pace since about 1800, and the degree of interdependence has greatly increased. The only interruption in this trend was from the outbreak of the first world war to the end of the second. Second, whereas the vast majority of the world's population lived at very low living standards until about 1800, thereafter there was rapid growth in the quality of life in many dimensions in the industrial countries – referred to by some as “the Great Divergence”. By the middle of the twentieth century, the industrial countries had real incomes a large multiple of that of the poorer countries.

But, starting after the Second World War, many of the poor countries began experiencing more rapid per capita income growth, in some cases very rapid. Most of the population of the world's poor countries now has a much improved quality of life contrasted with a half century ago. In the most rapidly growing countries, lifestyles more closely resemble those of other industrialized countries than those of people in those countries two hundred years ago. Gains in life expectancies, health and nutritional status, literacy, and other measures are larger in countries where real output and incomes grew more rapidly, but they took place in virtually all countries.

Those propositions take us immediately to the question of the role of globalization in achieving the enormous material progress, and accompanying improvements in economic well being, of the past two centuries. There is no question but that economic integration took place; and there is equally little question but that material well-being improved and, with it, the quality of life for the vast majority. The only possible question is the link between these two phenomena. Association, after all, does not prove causation.

Three lines of argument, or proof, all point to the central role of increasing integration as a component of, and indeed, even as a necessary – if not sufficient - condition for the tremendous increase in the efficiency, or productivity, of the global economy. The first is that no country, or group of countries, has for any considerable period of time sustained reasonable (or faster) rates of growth of real per capita incomes without integrating into the international economy as they did so. The second has to do with the economics of productivity gains, as first noted by Adam Smith: the size of the market is an important determinant of productivity. The third is the record of within-country growth performance wherein the same countries experienced slow growth, if not

stagnation, while maintaining barriers to integration, while achieving much more satisfactory economic performances once they had liberalized and opened up their economies.

Let me elaborate briefly on each of these, only pausing first to note that, quite clearly, other factors such as innovation also contributed to growth and enabled the integration that took place. Without the introduction of the steam engine and many other productivity-enhancing innovations, there would have been no opportunity for integration. But, had authorities fought the technical changes that were occurring, as for example, by prohibiting imports of now-cheaper goods, increases in economic well being would have fallen far short of the major accomplishments of the past two centuries.

With that in mind, we turn to the first line of argument as to the role of economic integration. Every country that has grown rapidly has been increasingly integrated with the world economy as it did so. That trade has been an “engine of growth” has been recognized by all for the past half century. To be sure, integration with the rest of the world has generally been more crucial the smaller the domestic economy. But even among economies with large populations, trade in goods and services has generally increased as a percentage of GDP as the economy has grown. Indeed, as already mentioned, for the world as a whole, trade as a percentage of world GDP has increased over the entire postwar period, and had been growing during the 19<sup>th</sup> century until 1913. It is estimated that trade volumes (the sum of imports plus exports) in 1800 were about 2 percent of output<sup>13</sup>, and about 22 percent in 1913. By 1938, that figure had fallen to 9 percent (below even the level of 1870). But since 1945, the importance of trade has increased dramatically. It is estimated that trade (again, exports plus imports of goods and

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<sup>13</sup> Estevadeordal, Frantz, and Taylor, p. 4

services) as a percentage of world GDP was 40.1 percent in 1990 and 58.3 percent in 2005.<sup>14</sup>

This upward trend was shared by all groups of countries. Low income countries' trade was equal to 29.8 percent of GDP in 1990 and 50.9 percent in 2005; middle income countries' trade was 41.6 percent in 1990 and 72.6 percent in 2005; and industrial countries' shares were 40.2 and 55.0 percent in those same years.

Moreover, the growth of trade relative to real GDP has generally been most rapid for those growing most rapidly. This has been true of both industrial and of developing countries. During the European Union's period of rapid growth, trade increased sharply as a proportion of GDP. The same has happened in the United States since growth rates accelerated in the mid-1990s. And, of course it has happened for the world as a whole.

But in developing countries where trade barriers were even higher, the association has been even stronger. When South Korea embarked upon the export-oriented growth strategy, for example, exports were 3 percent of GDP. Less than thirty years later, during which time incomes had doubled every 7 years, exports constituted almost 40 percent of GDP. Taiwan, Singapore, and Hong Kong recorded the same sorts of sharp increases in the role of trade. And countries that later accelerated growth, most notably India and China, have experienced share increases in the importance of trade for their economies. In the case of China, trade rose from almost zero in 1980 to 63.5 per cent of GDP in 1995 and 70.7 percent in 2005; in India, over the 1990-to-2005 period, trade rose from 16.5 percent of GDP to 36.7 percent.

The association between more openness and trade holds over the developing world as a whole. The World Bank reports that during the decade starting in 1995, the first

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<sup>14</sup> World Bank, World Development Indicators 07, Table 6.1, Merchandise trade plus trade in services.

decade in which growth rates were significantly higher in developing than in industrial countries, countries that opened up trade less rapidly “recorded much lower per capita GDP growth”.<sup>15</sup> For the worst performers in terms of trade opening, per capita GDP growth was minus one percent; for the best, it was plus 0.4 percent. The Bank notes, of course, that some domestic policy changes result in increased competitiveness in ways that affect both per capita income growth and also trade share, and as such, the statistic does not prove causation.

That shares of trade in GDP were growing rapidly is part of the phenomenon of globalization, or global integration. That the relative growth of shares in the more rapidly growing countries was increasing more rapidly is a telling statistic for suggesting, at a minimum, a strong association between trade integration and more rapid improvements in well-being. It should, of course, be pointed out that a high share of trade in GDP may not reflect openness in a poor economy where only one or two primary commodities constitute the vast bulk of exports. In those cases, policies have rendered the export of all but a few primary commodities with high rents from being profitable for export. That is why focus is on the changing share of exports in GDP, rather than the share itself: differences in per capita income levels, location, factor endowments, and size all affect the “optimal” share of exports in GDP.

The second set of linkages between growth of the relative importance of trade and economic well being of people, especially the poor, has to do with the effects of trade. In all countries, growth is faster when there is more competition; when trade barriers are reduced, competition is increased. For many developing countries, high barriers to trade conferred monopoly positions on the elite few, and kept the majority of the labor force in

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<sup>15</sup> WDI 07, P. 3

agriculture or the informal sector. Opening up to trade meant that entrepreneurs had to compete for business, often with dramatic increases in productivity. Often, new exports were manufactures, employing considerable unskilled labor where there was comparative advantage. At the same time, having the world for a market enabled producers to take advantage of economies of scale; especially in poor countries, the size of markets for virtually any nonstaple food commodity was extremely small; producing behind a highly protective trade barrier enabled domestic producers to have monopoly positions in their home markets, but left them high-cost not only because of their monopoly positions, but because of their short production runs and uneconomically small scales of production.

Another consequence of falling trade barriers was that domestic producers who had previously been forced to rely on domestic (often high-cost, low-quality) sources of supply for their intermediate goods and raw materials were enabled to obtain needed quality and precise specifications from international markets; as such, they were enabled in many cases to become competitive internationally, no longer handicapped in their suppliers. Needless to say, many of those finding exporting attractive were those using factors of production which were relatively abundant in their countries, generally unskilled labor. That in itself enhanced growth prospects, as shortages of scarce factors arose only more slowly, while real wages for unskilled labor, in particular, could rise as productivity increased. Again using Korea as an example, it is estimated that, when the policy reforms were undertaken, about 25 percent of the small urban labor force was unemployed. Within four years, however, unemployment had fallen to less than 5 percent. Meanwhile, real wages for manufacturing workers rose at an average annual rate of 8 percent over a period of 30 years, while the migration of farm labor to the cities

permitted rapid expansion in urban employment: by the 1990s, more than 90 percent of Korea's labor force was in the urban sector, whereas in 1960, more than 60 percent had been rural.

While cross-country comparisons are useful, it is always wise to check the results against evidence provided by changes in the same country over time. Here, too, the evidence is overwhelming that the increased integration into the international economy was an important component of improved economic performance and well being. The Korean, Chinese, and Indian dramatic cases have already been mentioned. South Korea's rapid economic growth started after a policy change in which the authorities switched from an import-substitution regime to an outer-oriented regime. Likewise, China's rapid growth has been accompanied by a dramatic opening of the economy to trade with the rest of the world, and India, too, reduced trade barriers dramatically after reforms started in 1991. Chile, whose economic performance since reforms has transformed its economy, started with very high protection levels, and reduced trade barriers until now, when there is a uniform tariff of 5 percent on all imports, except for those originating from countries with which the country has free trade agreements.

One could, with more time, elaborate a great deal. But, despite my earlier criticism of those who are defensive about globalization, I should turn to some of the major allegations of the critics and consider them before concluding. There are four broad groups of criticisms that come to mind, and seem to be widely believed. Three relate to developing countries and one to the impact on developed countries. The three concern the use of child labor, volatility arising from terms of trade fluctuations or other disturbances in the international economy, and immiserization of the poor in low-income

countries including the absence of labor standards. The allegation regarding developed countries has been that globalization has harmed workers.

That there is child labor in many poor countries is beyond dispute. It is quite obviously a tragedy that these practices exist. And certainly some of the child workers are employed in activities that will result in exports. Not only is the fact of child labor to be deplored, but those children who are working are usually being deprived of any educational opportunities, as well, thus building in a future generation of poor people.

A first point to be made is that child labor has been a necessary and unhappy fact of life for the poor for many centuries. For that reason alone, it is hard to accept the argument that globalization has brought it about, although there are surely instances when the incentives to employ child labor have increased, although there is an offset as populations become more urban with growth, and urbanites have higher rates of school enrollment. Secondly, as real incomes have risen, use of child labor has diminished. Economic growth itself has been part of the solution to the problem, not the cause. One careful study of child labor in Vietnam, where about 33 percent of children work, examined what happened when the price of rice rose by about 30 percent as a result of trade liberalization. Researchers found that households earning higher incomes from rice were enabled to remove their children from the labor force.<sup>16</sup>

The question is what can make things better. Simply outlawing child labor and leaving all else unaltered is not necessarily a solution. Some alternatives to child labor – infanticide when struggling parents do not believe they can feed more children or otherwise cope, early forced marriages for girls (again depriving them of education), starvation, and begging – may be worse. The real problem is low incomes. Historically,

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<sup>16</sup> Quoted in Bhagwati, Pp. 71-2

child labor was a factor throughout the world; the practice diminished and finally ceased as living standards improved. Accelerating the growth of per capita incomes is certainly a partial palliative. And, since globalization enables more rapid growth and generally raises real wages of unskilled workers, it contributes to the reduction in the use of child labor. Other measures, targeted at enabling parents to send their children to school (such as school lunches), can also contribute. But the main message for present purposes is that globalization contributes to the solution to the problem and is not its cause. Rejection of globalization leaves countries with much slower, if any, rate of increase in real incomes and living standards, which in turn is likely to perpetuate more child labor for a longer period of time.

Critics of globalization have also argued that developing countries' increasing integration to the global economy exposes those countries to greater fluctuations than they would experience if trading and other ties were weaker. That there are fluctuations in the international economy is certainly true, although there is hope that as policy makers are learning more, the extent of volatility has been reduced.

Fluctuations are of two types. On one hand, individual countries experience marked and often abrupt changes in their terms of trade. On the other hand, some countries with strong linkages to the international economy have experienced major financial crises. Both of these sorts of fluctuations obviously have sharp economic costs in individual countries experiencing them. While domestic policy measures, such as being prudent and adopting countercyclical fiscal stances, have the potential to offset much more of these fluctuations than has happened historically (when the afflicted economies' governments have run procyclical fiscal policies), there is no doubt that

fluctuations in the terms of trade make macroeconomic management more difficult than it would be were international prices constant. But international prices are not, and never will be, constant. So the relevant question is whether people in low and middle-income countries are better off integrating with the global economy and managing fluctuations as well as possible, or whether the fluctuations are severe enough so that some degree of delinkage is warranted.

The answer is clearly on the side of globalization. First of all, in countries in which subsistence agriculture is a large component of GDP, weather fluctuations domestically can be as large, if not larger, than the fluctuations brought about by changes in the terms of trade. It is not true that there are no sources of fluctuation domestically. In an open economy, increasing imports can compensate significantly from a poor harvest; in a closed economy, offsetting domestic supply fluctuations is much more costly or difficult.

Moreover, the gains from trade are so large (especially when the terms of trade are an issue as they are with primary commodities) that the costs of terms of trade fluctuations take away at most a small part of the gains. Even for countries with high tariff barriers that have rejected integration with the world economy, there has been no effort to reduce exports of the primary commodities (and it is primarily primary commodities) whose prices are subject to large fluctuations. Indeed, there could be a great deal more mitigation of the ill effects of fluctuations through domestic economic policies than in fact takes place.

As to financial crises, these appear to be largely the domain of middle-income countries, such as Korea and Brazil. Obviously these countries experienced sharp

changes in real incomes because of the crises and there was great hardship for many individuals. There has been learning, and it is to be hoped that there will be fewer such crises in the future. But even if that is not the case, if one contrasts the rate of economic growth and level of per capita income in the Asian crisis countries (all of which were closely integrated into the international economy) with that of countries that remained much more inner-oriented, there can be little doubt that the costs of fluctuation were smaller than the costs of remaining inner oriented. Korean real GDP fell for about 18 months and at its trough was less than 10 percent below its peak. The previous peak was reattained within two years, and Korean economic growth since that time has exceeded 5 percent on average. But even at its trough, Korean per capita incomes were about seven times what they had been in 1960. Had per capita incomes grown over those decades at an average annual rate of three per cent – a relatively high number for an inner-oriented economy – and there been no crises, average per capita incomes would have been less than half of what they actually were. One could, in addition, point to policies that could have averted or at least diminished the magnitude of the crises. But even given the magnitude of past crises, the point is that the globally integrated countries were far better off than those in relatively similar countries where integration was eschewed.

But those considerations still leave open the last item to be considered. It is argued by many antiglobalists that higher rates of growth of real income do not translate into rising living standards for the poor. That is just plain wrong. Throughout economic history, and across developing countries at the present, higher rates of per capita economic growth are associated with higher rates of growth of real incomes of the poor. Conversely, those countries where real incomes of the poor have grown most slowly (or

even fallen) have been, by and large, those countries where inner-oriented, anti-globalization policies have been followed.

It is certainly not true that every single poor individual benefits as real incomes rises, but the vast majority do. And it is certainly not necessarily true that the income distribution becomes more equal as real incomes rise, at least at early stages of development. But increasing income inequality is sometimes a necessary concomitant of rapid economic growth: witness China, where rapid economic growth has removed several hundred million from poverty but simultaneously increased inequality. Income distribution generally changes only slowly over time; as such, when real incomes rise, most benefit, although some more than others. To be sure, development policies – such as improving access to health services and educational opportunities – can affect income distribution and the extent to which the poor gain regardless of the rate of growth of real incomes. But it has been amply documented that higher rates of growth of per capita incomes are associated with more rapid improvement in living standards for the poor.<sup>17</sup>

The World Bank reports that in only one country (out of 60) was poverty reduced over the 1990-2004 period despite negative income growth. In 17 countries, income distribution became more unequal but the poor became better off because of rising real incomes; in another 11 countries, reduced inequality accentuated the effect of rising real incomes. Statistically, the relationship between poverty reduction and growth was positive and significant. The same has been found in other studies.

Globalization has clearly not made things worse. As already seen, globalizing countries have grown more rapidly on average than others. As such, real incomes have

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<sup>17</sup> WDI 07, P. 5 says much of this . P. 5

risen more rapidly. In a survey done with Andrew Berg<sup>18</sup> in 2002, we showed that the preponderance of evidence suggested that trade liberalization accelerated growth and reduced poverty; the impact on income distribution was less clear-cut but was certainly not more likely negative than positive.

The fourth major concern of antiglobalists concerns the impact of increasing integration internationally on workers, and especially unskilled workers, in industrial countries. That jobs are “lost” seems to be a difficult argument to make, given the relatively low rates of unemployment in industrial countries. Indeed, at least in the United States, it is arguable that the noninflationary rate of unemployment is lower than it used to be because of the availability of more goods intensive in the use of unskilled labor from developing countries. Certainly, many observers associate the lower rates of inflation (which themselves bring gains to the poor even more than the rich) with the increased availability of imports from lower income countries. And there is a wider variety of goods consumed by the majority of workers, at a lower price, as a consequence of increased production in low-income countries. Both of these, considerable, benefits seem to be ignored in discussions of the impact of globalization.

But the more telling argument concerns not the impact on employment, but on real wages. Labor economists attribute much of the increased differential between compensation of skilled and unskilled workers (whose real wages have risen, but less rapidly) to biased technical change: information technology and other innovations have shifted the demand for labor from relatively less skilled workers to those with more skilled. While trade may have played a role, it is likely secondary to that of innovation.

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<sup>18</sup> Anne Krueger and Andrew Berg.....2002.....?

But there is another, more serious, argument. The costs of trying to (probably unsuccessfully) protect workers from competition with imports would be exceptionally high in terms of their own real living standards over the long run. Appropriate policy responses to any difficulties experienced by the less skilled in the labor force need to find ways in which those individuals can be more productive through more education and training, fostering greater mobility, and other measures. The need for these responses within any modern society originates in the plight of those with few skills and low incomes, not only from trade. Attempting to use trade protection measures as a means of fighting any impact of economic growth on the less-skilled would be a cure worse than the disease. It is hard to estimate how high the trade barriers would have to be to have a significant impact on the wages of the unskilled in industrial countries, if trade protection would have a positive impact at all. And the costs within industrial countries would be enormous relative to alternative ways of achieving the same objectives.

Moreover, efforts to thwart trade on the part of industrial countries would doom countries – especially those that have not yet opened up their economy – to much poorer economic prospects than could exist were they to alter their policy frameworks in the context of a healthy, growing, world economy. While increased protection in the industrial world would reduce growth rates and possibly result in recession and even stagnation in real incomes, the negative impact on developing countries would be even larger.

Hence, some of the criticisms of the antiglobalizers are simply wrong: developing countries and workers in those countries benefit from globalization if other policies are appropriate. Globalization and integration of emerging markets has not caused child labor

– it was already there, and rising real incomes tend to reduce its incidence. Even when there is an element of truth – as with financial crises and other fluctuations – the appropriate policy responses would keep globalization and adopt policies to mitigate side effects. The same surely holds true of industrial countries in efforts to improve the lot of lower-wage workers: domestic policy measures to improve productivity and efficiency through education, training, and other means, can enable surer gains for low-skilled workers and simultaneously avoid the great harm that would otherwise be inflicted upon the prospects for improvement in living standards in developing countries.

Let me conclude. The world is a very imperfect place. Millions of people live in miserable conditions, with poor health, poor nutrition, and little hope. But in that dimension, the world is a much better place than it was two centuries ago. Much has been learned about the process of economic growth and rising living standards, and policies needed to achieve them, over the past half century, and many have escaped poverty. The world is thus a much less imperfect place than it was. The now-industrial countries have living standards that would have been beyond recognition two hundred years ago. Globalization has been a major contributor and there is every prospect that integration, and with it, rising living standards and attainable economic welfare will continue to improve.

Most of the very poor countries have still to embrace globalization, although they are less insulated than they were fifty years ago. Policies in individual countries aiming at rising living standards can do much to improve prospects for the poor, but growth rates will be far below those potentially achievable unless globalization is further embraced.

Globalization by itself cannot do the job; but in the absence of globalization, the job cannot be done.

Today's antiglobalizers recognize the many challenges that remain, but appear not to recognize the progress of the past two centuries for the world and the past half century for some poor countries. In decrying the continued existence of poverty, they blame globalization, failing to recognize that poverty and its associated evils existed long before globalization. Efforts to reverse globalization, or to discourage those still-inner-oriented countries from embracing it, will diminish the prospects for those countries to accelerate their growth. For the world as a whole, a setback to globalization of the sort advocated by the antiglobalizers might succeed in reversing rising living standards in developing countries and reducing trade flows. While that would disadvantage the relatively poor in the now-rich countries, and could result in worldwide recession, even more seriously it would dash the prospects of those countries whose governments are now recognizing the need for faster growth and trade liberalization. Quite likely, many of those who recently escaped from poverty might once again slip into that catastrophic state.

Without a healthy and growing international economy, the outlook for continued economic progress in the industrial countries would greatly diminish, and world economic growth would surely slow, if not grind to a halt. Once that happened, the growth rates of poor countries would certainly fall. With those events, the prospects for future progress in poverty reduction would be greatly diminished.

Globalization is not a cure-all. But it is a necessary condition. Attention needs to turn to finding policies to mitigate those undesirable accompaniments while

simultaneously maintaining and strengthening the healthy and sustainable growth of the international economy.