Globalization: End of the Beginning — or Beginning of the End?

By Éloi Laurent | Tuesday, September 11, 2007

While global GDP growth continues unabated and inflation remains low, signs are emerging that the world economy may be headed toward a rough patch. As Éloi Laurent argues, this is because turbulences encountered by the United States and China — particularly income inequality and protectionist sentiment — are increasingly having global repercussions.

Summer has not been kind to globalization. While there are no signs of a crash, doubts are increasing that the forward motion is perpetual.

Trade talks could resume and by miracle finally lead to a deal. Even more unlikely, financial markets and central banks could manage to reassess risks and set prices accordingly in a sustainable manner. And yet globalization would still be in jeopardy.

Contradictory times

Few ideas seem as counterintuitive in the present. The world economy, now truly

deserving its name, in 2006 concluded its most prosperous five-year term since 1945, with annual GDP growth of around 4%. International trade is buoyant, with exports growing twice as fast as global GDP for the last ten years. Global inflation is moderate, at around 3%.

As is well-known, the combination of those three dynamics — accelerated by ever more creative and free financial markets — is made possible by emerging market countries — or, more precisely, renascent nations. After all, Angus Maddison’s data show that they accounted for three-quarters of the world’s riches before 1820.

Changing times

The Churchillian wisdom after the battle of El-Alamein in 1942 once again makes full sense: “Now, this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning.”

According to Malcolm D. Knight, the General Manager of the Bank for
International Settlements, we should hail the “golden age” of globalization. “Golden age”? Now we know for sure that we are in trouble.

**Dangerous signs**

The nature of armed conflicts around the globe should wake us up from our sweet illusion. Contemporary wars are in their vast majority intra-national, not international. And economics is no different from politics in this respect.

The globally pressing issue is not the promise of Ricardo’s theory of comparative advantage, which foresees and delivers mutual gains to nations opened to trade reciprocity.

The problem lies with what one could call the Stolper-Samuelson theorem curse — that is, the uneven distribution of those gains within each country according to skills. In a time of technological acceleration, technical progress and globalization conspire to fracture national compacts into separate and unequal societies.

**A long-standing dilemma**

The chicken or egg torment about the relationship between both factors and the rise of inequalities politically is of secondary order. The priority is to understand the difference between globalization and technical progress. People don’t revolt against technical progress, at least not anymore.

The core of today’s globalization is transpacific, while the “first” globalization (1871-1914) was transatlantic. That is why the ever-growing turbulences encountered by the United States and China are bound to affect the world.

**Increasing inequality**

True, China is just the “C” in BRICs — and the BRICs are not the entire range of emerging countries. True as well, the EU’s internal and external trade
growth of about 4%.

Still, there is little doubt that the United States and China are the two pillars of our globalization. Just think about growth of GDP, growth of trade and financial flows. And these very pillars may be vacillating.

By a stunning historical coincidence, these two nations have also reached almost the exact same income inequality levels, in both cases, after a spectacular increase since the 1980s: Measured by the Gini index (0 = perfect equality, 1 = perfect inequality), China attained 0.472 in 2004 (according to the Asian Development Bank), while the United States reached 0.469 in 2005 (according to the U.S. Census Bureau).

Similar situation

For all their ostensible — and real — differences, the two colossuses have simultaneously entered a critical zone.

China is in the well-known situation of skyrocketing inequality brought about by the pressure of an economic catch-up resembling a forced march. But China’s head-spinning pace of development unsettles even the warmest partisans of an occidental path to stability, where political liberalization more or less smoothly follows economic take-off.

Rising economic tension

What if China stumbles and falls into a new Boxer revolt, fueled by insurrectional social unrest that tends, according to some observers, to intensify and aggravate in the current period?

In any event, the anti-foreign sentiment is palpable. Restrictions against investment from abroad are increasing. All of the country’s economic sectors suddenly becoming “strategic.”

Changing views

Now regarding the United States, the country finds itself in the new, but empirically well-documented, context of increasing inequality — moving towards the “Victorian” levels of the early 20th century. In addition, the protectionist temptation has rarely been so powerful, even compared to the “Japan-bashing” era.

According to the latest World Public Opinion poll, Americans — by a 60% majority — now consider international trade to be harmful to employment. They rank just behind the French (at 73%).

As the U.S. Congress returns from its summer recess, legislation against currency manipulation targeting Beijing — which has already been publicly backed by Barack Obama and Hillary Clinton — awaits action.

More debate
Last but not least, a public debate — launched by MIT’s Paul Samuelson in 2004 and boosted by Princeton’s Alan Blinder a few months ago — now rages in academia between skeptics and unconditional free-traders.

The anxiety of the latter ranks so high that more than a thousand of them, swallowing their methodological individualism, felt the need to solemnly reprimand the U.S. Congress from implementing Smoot-Hawley Tariff Act-like laws in a petition published on August 1, 2007.

Relying on organizations

This transpacific malaise — exacerbated this summer by the discovery of hazardous Chinese consumer products, the widening trade deficit and a slowing U.S. economy — is the most serious threat to the future of globalization.

That applies even with regard to the current bout of very real instability in global financial markets — for which an end is not in sight.

Oft-criticized though they are, both the OECD and the IMF have sensed the danger. One rang the alarm against the risk of rising wage inequalities in developed countries. The other lectured emerging countries on unfair exchange-rate policies.

Solutions to the problem

But what can the United States and China do in practice? Economic historians of the first globalization have shown that the political economy of openness leads to two types of national reaction to market integration: trade and financial protectionism on the one hand, and the development of the welfare state on the other.

Those two policies are already implemented in our globalized world. The EU absorbs globalization with the welfare state — and India relies on protectionism to manage its development.

The result is that — in contrast to the United States and China — the EU and India have close to the same low level of income inequality (with India reaching 0.36 in 2004 and the EU 0.31 in 2005). It does not discourage protest, but it might avoid unrest.

What if China stumbles and falls into a new Boxer revolt, fueled by insurrectional social unrest that tends to intensify and aggravate in the current period?

Together in a cause

To their dismay, China and the United States may soon discover that globalization is very much like climate change: The accumulation of inequalities makes the level of “globophobia” climb so high that countries are
left with the need to combine adaptation tactics to a less fluid global economy and mitigation strategy.

That requires them to understand how to reduce the level of inequality generated by the economic growth of recent decades. Since China and the United States now produce the same amount of greenhouse gases and have similar levels of income inequality, maybe they can learn how to reduce them simultaneously.