BY MICHAEL D. INTRILIGATOR

The term "globalization" was coined in the 1980s, but the concept is an old one that has meant different things to different people. Some see it as a force for advancing the world economy, while others see it as a serious threat to global economic health and stability.

I believe there are both positive and negative aspects to globalization. Some of its positive features stem from the competition it stimulates, while some of the negatives could be offset through the development of new international institutions. Thus, while globalization can cause conflict, it can also contain conflict by realizing the potential for global cooperation.

GLOBALIZATION: AN INTERPRETATION

Globalization, from my perspective, means major increases in trade and exchange in an increasingly integrated international economy. There has been remarkable growth in international transactions – not only in traditional trade, but in the transfer of capital, labor, technology and ideas. One measure of the extent of globalization is the volume of international financial exchange: some $1.2 trillion flows through New York currency markets each day.

A variety of factors have primed this pump in recent decades. One has been technological innovation, which has significantly lowered the costs of transportation and communication, while driving down the costs of data processing and storage.

A second source of globalization has been trade liberalization and other forms of economic liberalization. These processes started in the 19th century, but the two world wars and the Great Depression interrupted them. The processes resumed after World War II, embodied in the 1946 General Agreement on Tariffs and Trade, which has since evolved into the World Trade Organization. Barriers to trade in goods and services are down sharply, while movements of capital, labor and technology face fewer obstacles.

Some have suggested that globalization is little more than a return to the economic framework of the late 19th century. At that time, borders were relatively open and there were substantial international flows of capital and people. Moreover, Europe depended critically on international trade as part of its colonial system.

Yet, that earlier era lacked much of the technology that has made globalization such a potent force for change today.

A third source of globalization has been changes in institutions. Organizations – public and private – have a wider reach, due in large part to advances in transportation and

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communications. Thus, corporations that once focused on regional markets now produce in many countries and sell to the whole world. Indeed, almost a third of international trade now occurs *within* multinational enterprises. Accordingly, international conflict has, in part, become conflict between multinational businesses. These global firms are seen by some as a threat to the scope and autonomy of the state. But the nation-state still runs the show.

A fourth factor driving globalization is ideological convergence – specifically, a consensus on the value of free markets. This process began with the post-Mao reforms in China followed by the collapse of the Soviet system and empire. The division between market economies in the West and command economies in the East has been replaced by a near-universal reliance on markets.

It is worth emphasizing that this transition, built on a foundation of stabilization of the macro-economy, liberalization of prices and privatization of state-owned enterprise, has not been easy. Indeed, this "SLP" agenda neglects the role of reform in building the institutions to defend free markets and to provide a safety net for the losers.

A fifth force pushing globalization has been culture – and, in particular, the rise of a homogenized English-based popular culture propagated by television, movies and the Internet.

The French and some other continental Europeans see globalization as an attempt to assert America's cultural hegemony. In effect, they see globalization as a new form of imperialism. Some have even interpreted globalization as a new form of colonialism, with the U.S. as the new metropole power and the rest of the world as its colonies.

Wherever one stands on the merits of globalization, it should be understood that the process creates both opportunities and challenges. It is also clear that the process is moving rapidly. Thus, barring radical changes, the trend toward greater global integration will continue, perhaps at an accelerating pace. For example, integration of commerce in services, notably telecommunications and financial services, has only just begun.

IMPACT OF GLOBALIZATION ON NATIONAL ECONOMIES

Globalization has had a significant impact on all economies. It affects production, as well as the employment of labor and other inputs in production. It affects investment, both in physical and human capital. It affects the direction and pace of technology. And in the process, it has major effects on efficiency, productivity and competitiveness.

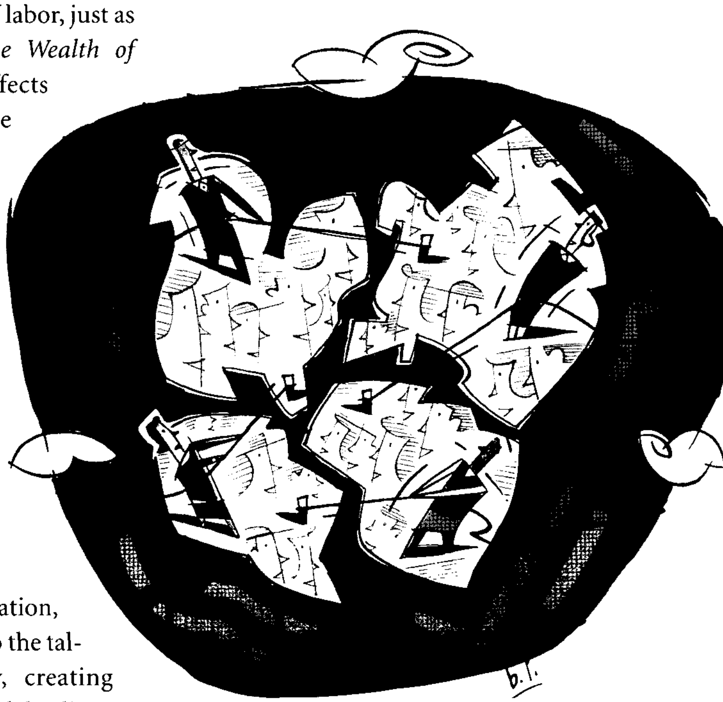
Several consequences deserve particular mention. One is the pace of foreign direct investment (FDI), which is growing more rapidly than trade. FDI plays a key role in technology transfer, in industrial restructuring and in the formation of global enterprises – all of which are transforming national economies.

A second impact is on innovation. New technologies, as already noted, have driven globalization. But there is a positive feedback effect: globalization and the consequent spur to competition have also stimulated further advances in technology.

A third consequence is the growth of trade in services, including financial, legal, managerial and information, "intangibles" of all types that have become mainstays of international commerce. In 1970, less than a third of FDI involved the export of services. Today that fraction has risen to half; indeed, intellectual capital is the single most important commodity on world markets.

THE BENEFITS OF GLOBALIZATION STEMMING FROM COMPETITION

Globalization allows – in fact, forces – firms to compete across borders. While some fear competition, it is critical to increasing productivity. The widening of markets allows specialization and the division of labor, just as Adam Smith suggested in *The Wealth of Nations*. Other beneficial effects include the economies of scale and scope in production, which can reduce costs. Perhaps most important, globalization forces innovation. Would Detroit, for example, be producing reliable, energy-efficient cars today without the spur of competition from Japan and Germany?



THE COSTS OF GLOBALIZATION AND POTENTIAL CONFLICTS

There is a dark side to globalization, too. Much of the gain has gone to the talented, industrious and lucky, creating greater economic inequality and leading to conflict, domestic and international. Some like to believe that all will end well, as rapid growth in poor economies narrows the gap with the rich countries. The reality, however, is that the least developed nations have been left in the dust. Globalization has not led to convergence, but to the polarization of incomes, with an unlucky rump losing ground in both absolute and relative terms. Indeed, income distribution is a major challenge in the process of globalization.

A second problem is the potential for regional or global instability stemming from economic interdependence. In a world of open markets, a crisis in one nation can easily spread. Thus in 1997, a currency collapse in Thailand toppled the (admittedly vulnerable) economies of Malaysia, Indonesia and Korea, and played a role in the fall of the Russian ruble. A worldwide recession or depression could lead to efforts to isolate national economies – a process that in the Great Depression led to the collapse of international trade and sowed the seeds for World War II.

A third source of anxiety is the loss of sovereign control associated with the globalization of markets. In a world where critical technology comes from somewhere else and trade protection is limited by treaty, national leaders quite rightly feel they are in the grip of economic forces they cannot control.

It is sometimes alleged that globalization causes unemployment in the high-wage industrialized economies that can't compete against third world workers who labor for "a bowl of rice a day." The low unemployment rates in many high-wage nations and the high rates in many low-wage nations, however,

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suggest this simply isn't true. National policy and technological trends are much more important determinants of employment.

Consider, however, that the economic costs are but one component on the liability side on the globalization balance sheet. There are potential noneconomic costs – notably, in security, where open borders and rapid diffusion of technology make us all vulnerable to terrorism. By the same token, globalization leaves us more vulnerable to pandemics and to environmental pollutants.

THE ROLE OF GLOBAL COOPERATION IN DEALING WITH THREATS

How will the costs of globalization stack up to the benefits? The answer depends on the competence of the institutions created to guide it. Thus, globalization represents both a challenge and an opportunity. The challenge is to create a new world system that mitigates the costs. And success turns on the ability to convince the critical players that their own interests lie in cooperation.

Consider how global cooperation might cope with the problems identified earlier. A supranational institution could address the problem of income distribution by taxing the nations gaining from globalization and using the proceeds to provide financial and technical assistance to the losers. This is already being done in a somewhat haphazard way through the World Bank – in particular via its soft lending arm, the International Development Association, which provides loans to poor nations at below-market terms. The loans should be made, however, on a more systematic basis – and that would require either a new international institution or a revamping of the World Bank's charter.

By the same token, institutions must be devised to cope with the international economic system's vulnerability to financial shocks. The IMF has played a key role in supporting economically unstable nations in times of trouble – think Mexico during the peso crisis or South Korea during the East Asian financial crisis. More credible insurance against such risks would require a substantial augmentation of the resources of the IMF – its assets have not grown apace with the volume of international transactions. This might be financed with a "Tobin tax," a very small tax on all foreign exchange transactions that would serve to reduce the chance of destabilizing currency speculation.

The third problem stemming from globalization is the loss of sovereignty. Once again, however, international cooperation can play a role in minimizing conflict – here, by drawing a firm line between the province of sovereign governments, and the province of international organizations and global enterprise. For example, the regulatory regimes of nations and even international organizations have become more porous and more easily overcome through technology advances. Examples include the lack of capital market regulation, of trade in information services, and of labor and environmental safeguards.

Overall, there are several possible vehicles for responding to the challenges of globalization. One is strengthening existing international institutions. Another is the establishment of new institutions that have binding dispute-settlement mechanisms. A third is the establishment of larger entities, such as the European Union, or loose combinations of nations to cope with specific economic issues, such as the G-8 or the Asian Pacific Economic Cooperation. Through such cooperation it should be possible to ensure equity and stability in a globalized world – while speeding the transition of the former socialist states and jumpstarting growth in poor nations.

BIG IDEAS

The sixth annual Milken Institute Global Conference, held in Los Angeles, March 31-April 10, attracted an audience of 1,600 to sample the ideas of 180 panelists ranging from major corporate CEOs, to Nobel laureates in medicine and economics, to a senior official from the CIA.

Among the highlights:

- A heated debate on "America's Role in the World" with Bob Bartley, William Bennett, Gary Hart and Stephan Richter.
- A discussion of "The Long View" of history with Paul Ehrlich, Robert Fogel, Steven Pinker and Alvin Toffler.
- A Nobel economist roundtable with Kenneth Arrow, Gary Becker and Myron Scholes, moderated by Michael Milken.

To view summaries of the conference sessions or listen to recordings of the sessions, visit www.milkeninstitute.org/gc2003.

AWARD WINNERS

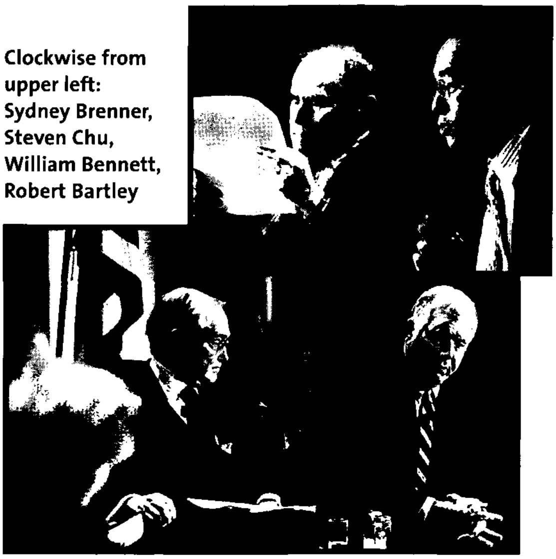
Six scholars have been named winners of the 2003 Milken Institute Award for Distinguished Economic Research. The group includes Darius Lakdawalla (RAND), Tomas Philipson (Chicago), Frank Lichtenberg (Columbia), Hillel Rapoport (Stanford), Michel Beine (University Libre de Bruxelles), and Frederic Docquier (Belgian government).

2003 CAPITAL ACCESS INDEX

Hong Kong, the United Kingdom and the United States remain at the top of the Milken Institute's Capital Access Index, an annual ranking of the openness and efficiency of capital markets worldwide. The runners-up: Singapore, Netherlands, Switzerland, Canada, Luxemburg and New Zealand.

The complete listings, along with an explanation of the methodology and an analysis of trends in capital access, are available at www.milkeninstitute.org.

Clockwise from upper left: Sydney Brenner, Steven Chu, William Bennett, Robert Bartley



ECONOMICS, HEALTH CARE AND NEW ENGLAND

According to Institute researchers Ross DeVol, Rob Koepp, Perry Wong and Armen Bedroussian, health care directly comprises 7.5 percent of New England's gross regional product. More important, they suggest, the spillovers from health care make it a key driver of growth in the New England economy. Their report, *The Economic Contributions of Health Care to New England*, is available at www.milkeninstitute.org.