CHAPTER 13

THE AGE OF GLOBALIZATION

The Battle for the World Economy

IN NOVEMBER 2001, the dusty city of Doha, capital of the emirate of Qatar, next door to Saudi Arabia and set at the very tip of a peninsula that juts out into the Persian Gulf, played host to a gathering of dignitaries from 142 countries. They were there to hammer out the rules of engagement in the global economy for the next decade or more. Together, the four thousand attendees of the World Trade Organization summit—trade ministers and their delegations, representatives of international organizations, and a legion of journalists—overflowed the capacity of the country's hotels. Those with the least pull found themselves in apartment complexes several miles into the desert. Those at the top were ensconced in the conference hotel, a handsome, pyramid-shaped structure with stunning ocean views and an extensive concourse of boutiques that could be in any such hotel almost anywhere in the world. A nearby mall boasted, incongruously, an ice-skating rink. But the delegates had little time for ice skating. For the four days of the meeting, they were locked in intense debate that could have a far-reaching impact on the destinies of all the countries represented in Doha. For that reason, the negotiations were difficult and lasted deep into each night. The stakes were so high that, no matter how late the delegates caucused, there were no eleventh-hour compromises. Rather, the conference had to be prolonged by a day. But finally there was an agreement. This time failure was not an option.

From the beginning, Doha's isolated location had much to recommend it, considering that the last meeting of the WTO in Seattle, two years earlier, had been disrupted by violent street protests. It was hard to get to Doha in the first place, let alone near the conference hotel. But while the security planning for Doha had been targeted at preventing violent demonstrations of the Seattle flavor, a wholly different kind of security threat hung over the meeting. Two

months earlier, on September 11, 2001, Al Qaeda terrorists had struck both the World Trade Center in New York City and the Pentagon outside Washington, D.C. In response, an American-led coalition had carried the war back to Afghanistan, which had been Al Qaeda's safe haven and from which it ran its global terror network. Although the battle was now being fought in Afghanistan, the main targets of the Al Qaeda leadership—in addition to the United States—were the regimes on the Arabian peninsula, on whose fringe Doha sat. Moreover, if Al Qaeda wanted to strike out again at the world economy, what better target than a WTO meeting in Doha?

Although there was talk about postponing the meeting, in the end it went ahead. Security was incredibly tight. Some delegations brought their own medical personnel and carried their own antibiotics, for fear of anthrax. Yet despite the jitteriness, Doha turned out to be a landmark in the post–World War II saga of trade negotiations—and in the new debate about globalization. Notwithstanding the media images, Seattle had failed two years earlier not on the streets but in the negotiating rooms—in the clash between the industrial countries and the developing countries over the latter's drive to become more fully integrated into the new world trading system by gaining freer entry to the markets of the rich countries. The costs of another "Seattle" could be enormous. But at Doha, such leading developing nations as India and Brazil—now becoming known as the "new globalizers"—had forged a common front to pursue the objectives of the developing world. Most notably, they sought improved access to the markets of industrial countries for the agricultural and manufacturing exports of developing nations. As a result of Doha, their priorities would now be enshrined in the mandate of the next round of trade negotiations and the "Doha Development Agenda." And the WTO itself had been further strengthened by the accession of two economic powerhouses, a day apart, to the organization—member numbers 141 and 142 respectively—China and Taiwan.

September 11 had made a difference in the outcome: It had changed the tenor of the negotiations and, indeed, of the overall globalization debate. Though a few opponents bobbed in boats offshore, almost all of the would-be demonstrators had decided, in light of circumstances and the new war, that it was better to stay home. And for the delegates who were in Doha, it had become all the more important to have a success. To have walked away from Doha without an agreement would have been another shock to confidence both for the world economy and for the international community, at a time when the rebuilding of confidence was essential to heading off a deep and protracted global recession.

Doha also seemed to mark, at least for the time being, a shift for the "antiglobalization" movement that had unexpectedly burst upon the world political stage two years earlier in Seattle. After first opening in Seattle, in protest of the WTO, this new form of international political theater had gone on the road to such diverse venues as Quebec City, Prague, Gothenburg, and Genoa. The cast varied, but it seemed at any given time to be several tens of thousands

of people. Some of them were studiously serious; some of them were deeply concerned about specific issues; some of them styled themselves as the vanguard of an undefined new mass movement; and some of them dressed for carnival. The causes that animated them were many and varied: debt relief, poverty, rain forests, hormones in beef, animal rights, intellectual property rights, anarchism, anti-Americanism, dams, multinational companies, labor rights, sweatshops and working conditions, trade protection, and—to be sure—a rejection of capitalism itself.

Their targets were the institutions of the global economy: the newly minted World Trade Organization; the World Bank and the International Monetary Fund, hatched nearly sixty years ago by Keynes at Bretton Woods; the assembly of leaders from the major industrial economies known as the G-7; the European Union; the Summit of the Americas. There was, at least implicitly, a great debate about political theory and democracy between the demonstrators on the streets and the delegates inside, one that went back, unbeknownst to most of the debaters, to Montesquieu and Rousseau. The protesters claimed to be the shock troops of greater democratization and insisted that they represented the "people" against the oligarchs. This antagonized their targets, who asked who had elected the protesters and contended that they themselves were for the most part the representatives of democratically elected governments. "We were elected by millions of poor people to raise their standard of living," said the finance minister of South Africa. "Who are these people who say we can't have trade and investment?" *The Economist* had an answer: "The main things holding the anti-globalist coalition together," it said, "are a suspicion of markets, a strongly collectivist instinct and a belief in protest as a form of moral uplift." Notwithstanding, the antiglobalizers said that their collective voice as the sound of the pendulum swinging. Others were not at all so sure.

The antiglobalizers had many different aims. They generally wanted to win the media spotlight for their concerns. The medley made, as one commentator put it, for a strange combination of "civil" and "uncivil" society. Some were thoughtful analysts concerned about the high debt levels of poor African countries or rural drinking water. But others wanted to clog the streets and disrupt the interchange and negotiations taking place inside the meetings. And some were seeking violence, deliberately provoking police to ensure confrontations that would make good television, especially when repetitively shown worldwide. Whatever their specific grievances and many differences, on one thing almost all the protesters could agree: They opposed the thing called "globalization." With this, the protesters seemed to tap into an uncertainty, disquiet, and even angst about a global economy that was changing fast.

The New Line-up

As so often happens, thinking and understanding had had trouble keeping up with the pace and significance of the changes. The line-up of the world

economy had changed. The old division among developed, developing, and "centrally-planned" economies no longer describes what is happening. The "new globalizers"—countries like Mexico, Brazil, India, and China—now play large roles. Their emergence—and the impact on poverty—is one of the least-understood changes. "One of the distinctive features" of the current globalization age, observed a new report from the World Bank, "is that the importance of developing countries in the world economy is growing." Globalization, it continues, "has been the engine of remarkable poverty reductions among the three billion people of the new globalizing countries" where "poverty is falling rapidly." During the 1990s, this group grew at much faster rates than the industrial countries—5 percent per capita, compared to 2 percent for the rich countries. In 1980, manufactures constituted only 25 percent of the exports of the developing country exports; by 1998, they were more than 80 percent!

At the same time, there are new problems, unknown, or at least unanticipated until now. A new kind of virulent financial crisis erupted. Terrorism went from being primarily nation-based into a transnational network that proved adept at taking advantage both of the tools of globalization and of the lowering of national borders. There are new efforts to solve the various emerging problems and to create international institutions to handle them. Nongovernmental organizations (NGOs) of many different types have become active participants and, in some cases, major players.

In the process, this rather abstract five-syllable word—"globalization"—has itself become reified and elevated to become the central pole of the debate. Suddenly, it seemed, one had to be "for" or "against" globalization. And globalization has somehow been credited (or blamed) for a series of results—many of which had other causes, such as technological innovation. Those who approve of globalization cite its contributions to economic growth and higher standards of living, health, education, and environmental performance; to lower costs and improved efficiency; to a sharing of technologies; cultural integration; and to stronger international relations. Critics argue that it undermines wages in rich countries, exploits workers in poor countries, hurts the environment, compromises human rights, diminishes sovereignty, concentrates wealth, and gives large corporations too much power.

When one stands back, one sees that globalization is in many ways the result of the hundred-year arc of the commanding heights. It reflects the opening up of the world economy, the increasing integration of national economies, and the emergence of the global marketplace. It can do much to reduce poverty worldwide and promote higher standards of living. At the same time, it creates broad anxieties and carries new risks that were not initially so evident.

September 11, 2001, did change much. Yet, in the new and less confident era that followed September 11, the big questions persist about the market-oriented, increasingly interconnected world economy: What, after all, is globalization, and what are its benefits, risks, and costs? What is driving it, and

what are its consequences? Who wins, and who loses? Is globalization inevitable and irreversible? What are the new issues it projects, and what kind of new rules of the game are needed to keep up with the fast-paced, immense engine? And how can governments—entrusted with a mixed agenda of promoting economic growth and competitive markets and social, consumer, and environmental welfare—properly design and implement regulations in an increasingly interconnected world?

The questions are certainly perplexing; the arguments often seem to run right past one another. There is a starting point, however. And that is to sort out the confusion as to what globalization actually is.[1]

What, After All, Is Globalization?

The term *globalization* itself seems to have so many meanings. Foreign direct investment and trade are obviously major aspects—but it is also more than that. Globalization is a move to a more connected world in which barriers and borders of many kinds—from the Iron Curtain to corporate identity to government control of airwaves—are coming down, felled both by technological change, especially technologies that bring down the costs of transportation and communication, and by ideas and policies that bring down the barriers to the movement of people, goods, and information. This is an era in which a world that is organized around nation-states is increasingly conjoined in a global marketplace—and in which ideas about the relationship between states and markets continue to change.

Globalization is often attacked or lauded as a thing. It is, more accurately, a process. In a more narrow sense, it represents an accelerating integration and interweaving of national economies through the growing flows of trade, investment, and capital across historical borders. More broadly, those flows include technology, skills and culture, ideas, news, information, and entertainment—and, of course, people. Globalization has also come to involve the increasing coordination of trade, fiscal, and monetary policies among countries.

Not only have international flows increased, technologies and communications have in important ways eroded borders, corporations have become multinational, work is carried out jointly across continents, and governments have increasingly integrated their economies—to the point, in the case of Europe, of currency union. All this is leading to globality—a highly integrated world economy: Work will be increasingly networked across national boundaries; comparison shopping will take place on a worldwide basis; a growing share of economic output will take place in a single, flexible global market; and time and space will be further compressed.

Globalization is evident in many different ways. Today, the Christmas ornaments sold in America are manufactured in China. Silicon Valley companies engineer their software in India, and one in seven U.S. manufacturing

workers is employed by a foreign-owned firm. Americans would be surprised to find the proportion of non-U.S. shares held in their pension plans (approximately 20 percent of the holdings of Calpers, the huge California public employees' pension fund, are outside the United States). And credit card holders in the United States or Britain would be no less surprised to learn that the call center handling their inquiry is actually in Bangalore, in India. The Mexican border hosts 3,500 *maquiladora* assembly plants from dozens of countries around the world. Among other things, these plants assemble an estimated 80 percent of the television sets sold in the United States. Chicken tikka, a food of South Asia, now rivals fish and chips as Britain's favorite fast food. McDonald's sells Big Macs at 28,000 restaurants in more than 120 countries *outside* the United States. (McDonald's is a favorite target of some antiglobalizers—more likely because of the symbolism than the calories and fat content. But the 28,000 sites say that an awful lot of people vote with their feet every day.) Yet sushi is now challenging McDonald's hamburgers and all other competitors as a global fast food. Two decades ago, multinationals were attacked as engines of American imperialism. Today the majority of multinationals are non-American.

This same kind of reach extends to ideas and culture. The British magazine *The Economist* has its largest market in the United States. Students at Beijing University fanatically follow their favorite basketball team, the Utah Jazz, while the Manchester United soccer team has a huge following in Southeast Asia. Viewers in London and Bangkok tune into Larry King (though not quite live) on CNN. Teenagers around the world download the same music from the Internet. Hollywood film studios can no longer stagger non-U.S. release of their movies over a year. Information flows too fast and too freely. Now they must manage almost-simultaneous release around the world, with all the additional issues of coordination, resource allocation, and show biz razzmatazz that this entails.

The extent to which a common global culture is emerging from all of this is a matter for debate—as is the question of whether such a culture is desirable or detrimental. But what is certain is that no national culture has gone unaffected by globalization. It seems undeniable as well that globalization has advanced faster, and produced results (whether these are seen as positive or negative) more quickly, than was generally predicted. This means that observers are continually struggling to catch up with the reality of the changes, which perhaps helps to explain why globalization holds so much promise and yet induces so much anxiety at the same time.[2]

How New? The First Age of Globalization

Of course, it would be ludicrous to assert that these elements that make up globalization are brand new. Trade has been a natural human condition for ten thousand years. Mycenaean Greece was trading with populations on the

Baltic coasts as early as 1200 B.C. Phoenicians from the coast of what is now Lebanon plied the Mediterranean Sea around 800 B.C. and controlled copper mines in Spain. The Roman Empire, which stretched from the border of Scotland to the eastern reaches of what is now Turkey, was integrated economically as well as politically. Its trade links reached still farther—demonstrating even then the anxieties and frictions that trade can bring. For in the first century A.D., so concerned did the emperor Tiberius become about the prevalence of Chinese "silken clothing" among Romans that he issued an edict limiting the amounts of silk from China that they could buy. During the centuries that followed, a string of empires provided not only political integration but also relatively free movement of goods, people, and cultural mores within and among them.

The current age of globalization has a precursor closer to our times: the first age of globalization, which extended from the early 1870s to 1914. Two great nineteenth-century innovations overtook the pace of the horse, broke the bounds of winds and tides, and made possible a far more integrated international economy. The steam engine created railroading and also dramatically reduced sailing times, allowing larger ships to move larger cargoes. Steam-powered shipping also dramatically cut costs—over the century, by as much as 80 percent per ton for cargoes between Britain and the United States. And the telegraph made communications nearly instantaneous. News of the American Revolution took weeks to reach London; less than a century later, news from post–Civil War America arrived in London in hours and then, as technology improved, in just minutes. So revolutionary was this advance in communications that *Scientific American* at the time described the Atlantic telegraph as "that instantaneous highway of thought between the Old and New Worlds." During this era, great new industries provided the infrastructure and tools for tying the world together—whether oil, the internal combustion engine, the telephone or mass media. It was a period characterized not only by rising flows of trade and investment but also by mass migration. Between 1878 and 1914, some 60 million people boarded steamships, the vast majority lodged in steerage, and sailed from Europe to new lives in North America and Australia.

Great Britain provided the anchors for this first age of globalization. It promoted a policy of free trade that drove international commerce. It exported capital to the "emerging markets" of the day, the most prominent of which was the United States, along with the rest of the New World. And the British provided a currency—the pound—that served as the stable foundation for the flows of trade and capital. One final element underpinned this first age of globalization: It was, for the most part, a time of peace, for which Britain's Royal Navy deserved much credit.

To be sure, the interconnections could be felt in other ways as well. More trade and close investment links could spread economic disruption, not just goods and wealth. When the stock market in Vienna collapsed in 1873, it set off reverberations that led to an economic depression in the United States. But

for those who participated in this era of expanding trade and interconnection, the spirit of progress and promise far outweighed any sense of danger or risk. John Maynard Keynes looked back to paint a picture of this world in his prophetic *Economic Consequences of the Peace:* "The inhabitant of London could order by telephone, sipping his morning tea . . . the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep. . . . The projects and politics of militarism and imperialism, of racial and cultural rivalries . . . which were to play the serpent to this paradise, were little more than the amusements of his daily newspaper. What an extraordinary episode in the economic progress of man was that age which came to an end in August 1914."

This first great era of global commerce was abruptly ended when Gavrilo Princip pulled the trigger on a street in Sarajevo on June 28, 1914. He not only slew Archduke Franz Ferdinand of the Austro-Hungarian Empire but also triggered the series of events that ignited, six weeks later, "the guns of August"—and a worldwide cataclysm. The First World War fractured the global economy. Empires fell, cross-border commerce dissipated, and tariff barriers rose sharply. The volume of trade in goods and services spiraled downward until 1930, when it was finally crushed by America's Smoot-Hawley Tariff. World trade, which had been growing 33 percent per decade since 1800, abruptly slowed to a growth of 0.9 percent annually in the years after World War I. Trade and currencies became tools of political ambition, managed for national power. The world economy was defined not by increasing integration, as before World War I, but by continuing dislocation, depression, a drive for autarchy—and, ultimately, another war.

As the new globalization took hold in the final decade of the twentieth century, historians and economists drew attention to the parallels it revealed with that first era of global commerce that preceded the two world wars. Some argued, that in some ways, the world was more "globalized" a century ago than it is today, and by some measures—such as world trade as a share of output—that is indeed the case. In other basic ways, however, the economic integration of a century ago hardly begins to match the breadth and density of the globalization process today. The contrast is obvious, for instance, in the enormous output of multinational firms in countries that are not their "home" markets. Perhaps the most striking difference of all is in the human dimension: the shift from the very limited international connections for most people a century ago to today's circumstances, in which a much broader population is internationally connected, whether in terms of their jobs, their purchases, their travel, their communications, or their entertainment. The broad, even pervasive, human base of globalization today raises the stakes of interconnection: By engaging ever more people in ever more aspects of their daily lives, it increases both the sense of promise and opportunity that has accompanied contact and trade for thousands of years, and the anxiety that the promise might fail to come true.[3]

Signals of Integration

Globalization as we know it today could never have come about without a few signal moments in the great arc of the commanding heights—moments of choice when nations altered the ways that governments organized and directed economic life. The first came in the aftermath of World War II, when the major nations of the West committed to a vision of interdependence in which trade was an engine of both growth and peace—a generator of economic and political benefits at one and the same time. The second shaping event was the choice, in these same industrial economies, to fight back stagflation and the economic doldrums of the 1970s by rolling back against Keynesianism, thus setting the stage for harmonizing fiscal and monetary policies and for a deeper economic integration than through trade alone. The third, culminating in the landmark events of 1989–91 but actually rolling through more than a decade of changes, from the Mexico debt crisis of 1982 forward, was the failure of the closed economies and their reintegration into the global market economy. An acute sense of the need to catch up spurred these countries not only to embrace global trade but also to welcome foreign corporations and—most of all—to establish capital markets, in order to capture a stream of the rapidly growing planetary flow of investment money seeking opportunities and returns.

These three major transitions established the landscape and the possibility of globalization. They played out in specific countries and contexts, but their impact overflowed the boundaries of nations and regions, defining the terms of a global transformation that would feed off the astonishing progress of communications and information technology until it would come to be seen as comprehensive, relentless, and, in its intensity, increasingly new.

Reconnecting: Postwar Foundations of Globalization

The decades after World War II were an era of reconnecting. To remember a time when economic expansion and international peace had advanced in tandem required harkening back forty years and more—to the years before World War I. As the Allied victory came into view, the political leaders charged with building the peace were determined to absorb the lessons of the interwar years. The result was a remarkable set of institutions and policies that created the foundations for the new era. The decision makers of this period read with striking accuracy—and knew from bitter experience—the history of the interwar years; and they set about creating institutions that would promote international financial stability and coordination. At Bretton Woods, New Hampshire, in 1944, they established the International Monetary Fund (IMF) and the World Bank. The IMF, a sort of international credit union, would lend to member countries in financial difficulty—giving them time to get out of

trouble. The World Bank would lend to countries first to promote reconstruction, then to support development projects in poor nations.

These leaders were also convinced that trade barriers had been a source of impoverishment and a breeding ground of animosity and the Second World War. They saw trade as a way to promote higher standards of living, tie nations together, create interdependence, and avoid future wars. They recalled the theory of comparative advantage—the fundamental insight of liberal economics, propounded by Adam Smith and his successors, that demonstrated that two nations stand to make mutual gains by engaging in trade. The prosperity of the first age of globalization appeared to offer ample confirmation of this theory. And the period of peace that had accompanied it, compared with the disintegration of the interwar years, now lent the pursuit of expanded trade a political, even a moral, dimension. The global institutions that would cement the post-1945 peace needed also, therefore, to create mechanisms that would allow countries, safely and in confidence, to reduce their trade barriers and engage in commerce in pursuit of peace and a shared prosperity.

Alongside the Bretton Woods institutions, a planned International Trade Organization (ITO) was intended to provide the postwar framework for free trade. But not everyone was prepared to fully move away from trade barriers and to give up the pockets of benefits they had created, over time, for various vested interests. As discussed in chapter five, it was protectionist opposition in the U.S. Congress in 1950 that killed the concept of the ITO. Its place was taken by the more circumscribed General Agreement on Tariffs and Trade (GATT). The purpose of GATT was twofold: to provide "rules" of international trade and to promote liberalization and expansion of trade. Though hardly well known, and decidedly low profile as international institutions went, GATT was profoundly important in providing the framework for an expansion of trade. Although intended as a "temporary" improvisation, it ended up lasting almost half a century. GATT, as one scholar has put it, was "both a set of rules for governing trade policy and a forum for resolving disputes and reaching accords." Under GATT's auspices, eight rounds of negotiations led to substantial reductions in trade barriers over the fifty years.

These political initiatives provided the framework for the expansion of trade. Technological innovation and economic growth made it happen. In shipping, for example, faster and larger vessels and then containerization led to declining freight charges. Similarly, the cost of airfreight dropped substantially. The first commercial service across the Atlantic began in 1939, less than a decade after Charles Lindbergh's solo flight. In 1950, only the elite could afford to cross the Atlantic Ocean by air. However, the advent of jet aircraft in the late 1950s, and then wide-body aircraft in the early 1970s, would bring international travel to the broad population. The cost of communications, meanwhile, was shrinking at a dramatic rate. In 1930, a three-minute telephone call from New York to London cost what in today's terms would amount to close to \$300. In 1946, just after World War II, it was the equivalent of \$97. By 1986, it was down to the equivalent of \$6.40—which seems very expensive by today's

standards but testified in fact to a drastic fall in costs, which stimulated trade and affected international business of all sorts.

This revolution in communications and transportation accelerated trade and helped spur human contacts and the dissemination of information and culture. There was, in fact, some skepticism about trade and the benefits of comparative advantage, but in the prosperous countries of the West these doubts were put squarely on the defensive from the end of World War II on. There was greater skepticism in the poorer countries, on the other hand—much of it stoked by the influential economists of the West. There were those who argued that the framework of trade appropriate for the developed economies was not suited for economies that were not yet fully industrialized. The development of domestic industry required protection from outside competition and a cautious, selective engagement in trade. This notion—fundamentally, that differences in levels of economic development made it impossible to create a unified global marketplace—permeated the advice given to developing countries in the 1950s and 1960s and contributed to closing them off from much of world trade, even as the United States and Europe and Japan moved to greater volumes and higher intensity of commerce. A result over time would be a damagingly sharp polarization between the "North" and the "South" in global trade negotiations. Within the "North," however, confidence in commerce would come in time to extend beyond the traditional confines of trade and into the capital markets.[4]

After the Seventies: From Trade to Capital Markets

As stock exchanges and sophisticated capital markets took root across the Western industrial countries, national barriers to the movement of money came to appear artificial, cumbersome, and unnecessary obstacles to the search for productive application of investment and the generation of wealth. What kept the markets from integrating was, in part, national regulations—restrictions on foreign participation in brokerage and trading and banking and other financial services—and differences in standards and practices in accounting, investments, and corporate transactions. But the underlying reason for much of these differences could be found in the premise of interventionism—in the ideas that governments had much to do to manage the economy and that government intervention was better suited to guarantee economic stability than was the abstract force of "the market." Thus government spending would be modulated to blunt the effects of the boom-and-bust cycle. But if capital markets were to be thrown open, the effectiveness of this method would be greatly reduced and undermined. Market confidence would preempt or second-guess the government, causing capital to enter or exit the country. Governments would lose control and the ability to fine-tune the economy to preserve consumer well-being and economic growth.

But in the 1970s, stagflation got the better of the Keynesian method; in-

flation and unemployment began to rise in tandem in the Western economies, and no amount of government spending could halt the trend any longer. The spiral of wage and price increases had taken on, through collective bargaining and the dynamic of public expectations, a life of its own, beyond the reach of economic policy makers, and inflation embedded itself into the economy. The oil shocks of the 1970s and the compounding effects of the failure of quick-fix policies all played a part in discrediting the traditional Keynesian management—or at the very least, demonstrating that it, too, fostered adverse unintended effects that, once set loose, it could not rein in.

The solution that would come to prevail was an aggressive attack on inflation by reining in the supply of money, followed by greater fiscal discipline, with the role of moderator of the economy increasingly turned over to the capital markets. This transformation took the prime focus of economic decision making away from the traditional finance ministries and placed it instead on the central banks: the Federal Reserve, the Bundesbank, the Bank of England, and their counterparts. Adjustments in central-bank interest rates became lead material for prime-time news broadcasts. And with currencies floating freely and in volatile ways after Nixon closed the gold window in 1971, the central banks were also called upon to protect the overall stability of international commerce by "intervening" in the currency markets—buying or selling one another's currencies to blunt sudden swings in their relative prices.

As monetary policy took over from fiscal policy as the touchstone of economic management, creating the conditions for private investment took on a sharp new importance. Capital was seeking uses, and marketplaces would have to meet certain criteria in order to attract that capital on favorable terms. One dimension of these criteria was regulatory: the terms of investment would have to be "enabling"—i.e., transparent, predictable, seen to be fair. A still more fundamental dimension was the size of the market. For a company to invest in a small country meant confining its procurement and hiring and sales to a constrained territory—unless it could be sure of access to the resources and customer base of neighboring countries. By this logic, free or liberalized trade between countries was no longer enough by way of coordination. Inexorably the economies of the West found themselves drawn to "harmonization" and eventually "convergence"—the removal of major impediments to the flow not just of goods but also of services and capital and, to varying extents, labor, in increasingly sophisticated and technology-oriented marketplaces.

The gradual strengthening and deepening of the European Union provided, of course, the most thorough example of this process. The grouping that had begun as a trading pact for coal and steel had by the mid-1980s forged its commitment to a "single market"—much more than a trading bloc, an integrated economic area where capital and services and labor could travel virtually unimpeded and enjoy quasi-identical rules and rights from country to country. By the beginning of the twenty-first century, the process had culminated with the European Union up to fifteen members (and a considerable waiting list of others) and the adoption of a single continental currency. Al-

though the European Union represents a "bloc," in competition with the United States, Japan, and others, it is also, by virtue of the size and strength of its internal market and the role and confidence that size allows it to play in international economic negotiations, a powerful force spurring globalization.

The convergence in the rich economies around the model of integrated and regulated markets, as opposed to direct intervention, also gave momentum to greater cooperation and coordination at the level of high politics. The G-7, or group of seven large industrial economies (the United States, United Kingdom, Japan, France, Germany, Italy, and Canada), met officially for the first time in the 1970s. Since then (and more recently sometimes as the G-8, expanded to include Russia), it has become an important defining and stabilizing forum for the global economy. As governments have delegated economic responsibilities to market actors, it is no surprise that some of these coordination functions now also take place in the financial markets.

The Closed-Economies Relink

It was the failure of the closed economies, and their turbulent return to open trade, that cemented the foundations of the present era of globalization. The most obvious turning point was the rush of political events between 1989 and 1991—the fall of the Berlin Wall, the dissolution of the Soviet empire, and eventually the end of the Soviet Union. But the crisis was already long brewing by this time at the commanding heights of the countries that had made the bet to develop either by avoiding, or by tightly regimenting, exposure to world trade. These countries formed two groups—the communist, command economies on one side, and on the other those developing countries that had followed the 1950s dogma of "import substitution industrialization," or ISI: fostering domestic industry to replace imported goods, protecting these industries from competition, and importing only the goods and materials required to support this strategy—such as bulldozers, or heavy machinery to install in industrial plants.

For the import-substitution countries—which in the 1960s and 1970s included the powerhouses of the developing world, such as India, Brazil, Mexico, Egypt, Argentina, and many others—the gingerly approach to trade was based on the skepticism about comparative advantage that Western as well as local economists had encouraged in the 1950s. The *dependencia* economists, most of them Latin American, had taken the argument a step further and posited that only a complete "delinking" from world trade would enable the poor countries to advance. But no matter the flavor, import substitution bred sheltered and uncompetitive industries with little incentive to improve productivity or quality—and a vested interest in continued protectionism. The capital costs of ISI were heavy as well, and often financed through foreign debt. The combination of poor management, isolation from competition and innovation, and vulnerability to debt pushed the "import substituters" into

deep crisis in the 1980s. It discredited the strategy and delivered these countries with more or less pain, as our story has shown, back into the global marketplace.

For the communist economies, the crisis was starker yet. The deadening effect of the lack of competition—preventing innovation, entrenching mediocre production quality, creating vested interests in inefficiency and promoting waste—was pervasive. The debt crisis played a role too in hastening the unraveling of those countries, such as Poland, that had borrowed heavily. When oil prices came down in the mid-1980s and the true fragility of the Soviet economy could no longer be concealed, the exhaustion of the central-planning model was clear and contributed mightily to the tide of political change. The most successful communist economy by 1989, of course, was China—which had launched market reforms a decade earlier and was beginning its ascent as an enormous trading power.

Relinking, for the formerly closed economies, meant much more than simply taking part in trade; it meant, more importantly, catching up. "Most of the former communist countries had been closed and now felt that they had a huge need for investment," said Moisés Naim, editor and publisher of *Foreign Policy* magazine and former minister of trade and industry of Venezuela. "They needed telecommunications, they needed roads, they needed hospitals, they needed productive companies and computers and manufacturing—all sorts of things. . . . All of a sudden, the Cold War was no longer there, and they were involved in another kind of international rivalry—not about ideology, but about markets." The standard of living in most of these economies had stagnated or deteriorated for one or several decades. Indeed, as the 1990s began, the previous decade of the 1980s became known, in Latin America and in Africa, as the "lost decade"—a time when resistance to trade liberalization and market reform had combined with adverse global conditions to arrest growth, accentuate inequalities, and widen the gap with the prosperous countries.

The gap was widening also, more pointedly, with the tigers—the dynamic East and Southeast Asian economies that earlier had bet on trade. Now the tigers were becoming destinations for capital: They had active stock exchanges and were opening more doors to foreign direct investment as well as short-term capital flows. "Asian countries that have grown fastest—Korea, Hong Kong, Singapore, China—have been the ones that have recognized that they can do better by integrating into the world economy, by exporting, by relying on import markets and gradually opening up," observed Stanley Fischer, former deputy managing director of the IMF. For the countries coming out of central planning or import substitution, it was important to not only relaunch trade but also to attract investment capital to assist in the vast enterprise of making up for lost time.

The Second Age of Globalization

The relinking of the closed economies did something essential to make globalization possible: It made, for the first time since the First World War, the world economy truly global. By the early 1990s, there was only a handful of countries that explicitly rejected participation in world trade, or that had regimes so eccentric or chaotic as to be outside the global economic system. To be sure, just who within each country was able to "participate" in the global economy, and on what terms, varied enormously from place to place and was everywhere a matter of contention. But the economies themselves were linked and economic activity across borders was blossoming, as many indicators revealed. As trade barriers came down, international trade expanded. Total world trade grew in the 1980s at an annual rate of 4.5 percent. In the 1990s, the average annual rate was 6.8 percent—compared with annual world GDP growth of 3.2 percent. The value of world trade doubled in the 1990s to almost $8 trillion.

Alongside trade, foreign investment and capital markets were growing at a similar, sometimes even more dramatic, pace. In the mid-1980s, the scale and pace of foreign direct investment (FDI)—productive investment across borders, such as the setting up of factories or banks or hotels in other counties—began to accelerate. The volume of FDI was more than $800 billion in 1999. Of this total, more than three quarters went to developed countries. Among developing countries, China stands out. It is host to $400 billion in such investments—about 20 percent of all the FDI in the developing world. The rapidity with which FDI in China has grown is striking: in the middle of the 1980s, at the beginning of the globalization era, there was next to none. China is followed by Brazil, Singapore, Hong Kong, Indonesia, and Mexico. Cross-border investment greatly expands the web of global interconnection. It also has become a much more important engine for economic growth in the host countries.

The sources have become more diversified, as well. For several decades, FDI was associated with multinational corporations, which in turn were closely associated with the United States. Coca-Cola, IBM, and other large corporations based in America were seen as the typical foreign investors—and were often the lightning rods of discontent. But in the 1980s and later, flows from other countries increased substantially, and the United States became the biggest recipient as well the leading source of FDI. Multinational corporations are now as likely to be based in Paris or London or Tokyo as in the United States. More tellingly, countries once leery of trade and investment are now some of the more dynamic sources of FDI into their neighbors, other developing countries, or indeed in the West. Today there are significant multinational corporations with headquarters in Madrid or Bombay or Istanbul or São Paulo or Helsinki. The largest cement company in the world is headquartered in Mexico City.

The integration of financial markets is particularly significant. Information and communications technology has, of course, provided the architecture for globally connected capital markets, but that is only part of the explanation. The big British privatizations in the mid-1980s were the first true global offerings of equity, and they changed the orientation and widened the ken of investment managers throughout the world. Not long after, European companies began to offer their shares globally. Now companies in Moscow and China do the same. Increasingly, investors around the globe are using the same approach and criteria to make their decisions, and they are looking at the same pool of companies. The distinctions among national markets are receding. In not so many years, a few national stock exchanges could well become global exchanges, opening for business before the sun rises and not closing until well after it sets—all in order to deal in the equity of world-scale companies, irrespective of their domicile. In turn, shares of leading firms will be traded on a twenty-four-hour basis.

When Harold Wilson was Britain's prime minister in the 1960s, he would blame the "gnomes of Zurich" for the pound's recurrent weakness, suggesting a cabal of a few hard-faced Swiss bankers cynically betting against the British currency. Conspiracy theories die hard: no less colorful allegations—against the "rogues" and "highwaymen" of the international economy—surfaced with the 1997–98 contagion crisis in Asia. But, in fact, today thousands and thousands of traders drive a foreign-exchange market that has grown from a daily turnover of $190 billion in 1986 to an estimated $1.2 trillion in 2001. "What we've had is a vast opening up of global markets—global capital markets where capital can move between countries instantaneously," said Gordon Brown, Britain's chancellor of the Exchequer. "Forty years ago, you could only take £250 out of the United Kingdom if you went abroad. Now money is flowing round the world at such speed and with such magnitude." Analysts, brokers, and strategists see the same information at the same moment and compete in their response time. Performance and events—whether a company's quarterly earnings, a country's inflation or trade balance data, or the outcome of a national election—set off an immediate chain reaction. While the publics vote only every few years, the markets vote every minute. And it is private capital—the pensions and accumulated retirement savings of the first world—a total of $11.5 trillion just in the United States—that is being courted and lured by what used to be called the third world. But this financial integration comes with a price. National governments, whether in developed or developing countries, must increasingly heed the market's vote—as harsh as it sometimes can be.

"Open capital markets create tremendous opportunity and benefits," observed former U.S. secretary of the Treasury Robert Rubin. "But they create risks as well." That was demonstrated when the financial crisis that began in Asia turned into a global contagion with Russia's default and devaluation in 1998. America's financial system froze up shortly thereafter when a virtually unknown hedge fund called Long Term Capital Management, which had over

$100 billion of assets (mostly based on borrowed money) collapsed. The crisis that began in Bangkok in July 1997—and so threatened the world economy—did not actually end until almost two years later, in March 1999, when the Brazilian economy finally stabilized.

It was the dawning awareness of all of these ongoing economic phenomena—the renewal of trade, the mushrooming of capital markets, the development and diversification of foreign investment—that, accompanied by the sense of collapsing borders due to communications and travel, brought forth the term "globalization" to describe the process on hand. And the connotations, at least at first, were optimistic ones. After all, the events of the day appeared to signal a great transformation, and one overall for the good. The end of the cold war and the collapse of communism not only seemed to remove the threat of general nuclear war that had hung over humanity for decades, but also meant that the boundaries that had divided the world economy would disappear. The Persian Gulf crisis pushed back a new military threat and portended a more peaceful world order. The thrust of the time was the shift from confrontation to cooperation and integration. With the Maastricht Treaty in 1991, the Europeans took a decisive step forward in an enterprise that had first gathered momentum as the solution to the conflicts that had devastated Europe in the first half of the century. Now, increasingly, they were to be joined at the hip, with a single economy. At almost exactly the same time, the North American Free Trade Agreement was moving in the same direction for the United States, Canada, and Mexico.

Other indicators seemed relevant as well: Democracy was on the rise, with Latin America coming out from the shadow of its various dictatorships. And a wave of democratic elections appeared to portend improvements in Africa—not least of these, the end of apartheid in South Africa in 1994. "Globalization is not just an economic and financial phenomenon," observed Moisés Naim. "Globalization is also a political phenomenon . . . There was great political contagion of the good kind when democracy started spreading. It was present in the countries that were transitioning out of communism, countries in Asia, in Africa."

The spread of communications and media also bolstered the sense of progress and change. The rise of the Internet, with its woven world of distant encounters and close connections, furthered the sense of discovery. All of this seemed to contribute, in one way or another, to globalization, and gave grounds, it appeared, for optimism about its prospects.[5]

New Concerns

In those years, globalization was still new. A few years later, it had become almost a given. But as such, it provided the context in which new sets of issues are emerging, and a new debate is taking place around the world.

And yet, to be "for" or "against" globalization is a simplification that po-

larizes the debate but does little to solve it. Beyond the generalizations, the protests, and the debates, has been a more elusive but fundamental challenge—a challenge to political communities, and particularly to the state. For after all, globalization overflowed national boundaries, yet did not erase them. And for all the attempts to forge a "global civil society" through nongovernmental organizations and the use of new media and communication tools, individual political expression—voting—still occurred at the level of the state, as did individual participation, in the form of paying taxes and enjoying social benefits. Yet globalization somehow challenged all of this—as some astute observers had predicted. "No national leaders are in sight prepared to emulate China's emperors who six hundred years ago ordered their huge vessels destroyed and commanded their people stay at home," Raymond Vernon, a pioneer in scholarship on multinational firms and international economy, wrote in 1998. "The great sweep of technological change continues to link nations and their economies in a process that seems inexorable and irreversible." But as Vernon argued, there were inevitable clashes of interests between "an international economy dominated by multinational enterprises and a global political system composed of nation states." And on occasion, he observed, those clashes would turn into outright conflicts.[6]

Not the End of Government

For a number of years, an apparent characteristic of the new globality was the precedence—even the triumph—of economics over politics. But as it has turned out, that meant precedence only over traditional ideological politics. A half-stated assumption as globalization unfolded was that eroding borders meant the end of national politics, national identity, and economic nationalism. On the contrary, these forces, in one way or the other, will continue to express an amalgam of aspirations and ambitions. Each country's politics will be shaped by its history, its culture, and its definition of national objectives—a reality that can be ignored only at peril. Countries and peoples that should have every rational economic reason to get along will nevertheless be drawn to bloodshed and war to settle scores.

In short, this era is not the end of the nation-state, even less the end of government. If money and goods travel more freely now at any time in living memory, individual life continues to be shaped by rules, customs, incentives, and constraints that are fundamentally national and political—the province of government and politics. Personal access to the twenty-four-hour interconnected world still remains restricted to a minority of the world's population. The vast majority of people still get their signals not from global financial markets, let alone cyberspace, but from the national capital.

This leaves governments with a daunting challenge: to figure out ways to reduce their intervention in some areas, and to retool and refocus in others, while preserving the public trust. It is a challenge of imagination. It requires

buying into the idea of fundamental global change and taking on the task of translating that change into politics that accord with national culture, history, and temperament.

What will be the new role of government? After all, there is no market without government to define the rules and the context. The state creates and maintains the parameters within which the market operates. And that is the new direction. The state accepts the discipline of the market; government moves away from being producer, controller, and intervener, whether through state ownership or heavy-handed regulation. The state as manager is an increasing laggard in the competitive, mobile, globalized economy. Instead, government shifts toward becoming a referee, setting the rules of the game to ensure, among other things, competition—and working in collaboration with other states to establish the systems required to make the coming globality work well.

Economic imperatives and political interests will also force a reconsideration of the government's role in dealing with the range of social programs that make up the welfare state. For governments do spend a great deal of money. Among OECD countries, public expenditure rose from nearly 27 percent of GDP in 1965 to a high point of 39 percent in 1995 before falling to 36 percent in 2000—a surge driven, most of all, by rapid growth in subsidies, transfer payments, and social spending. But government's performance in those roles will move more clearly into the spotlight as it withdraws from the commanding heights of industry and planning. For the shift of role also entails a shift of resources and the way they are applied. The public money and human skills freed up through privatization and deregulation will be partly invested, in many countries, in "human infrastructure"—health, education, the environment—with, it is hoped, the creativity and success that can come from a clearer and better-focused role. "It's not about the government disappearing," observed Manmohan Singh, currently leader of India's Congress Party opposition. "It is about restructuring the role of the government. Getting government out of activities where governments are not very efficient at doing things. Getting government more actively involved where we feel markets alone cannot provide the necessary amount of goods to the extent that our people need them: basic education, basic health care, environmental protection measures, basic social safety net. These are the things which we feel our country needs, and in a civilized society governments have a major responsibility to provide these basic public goods." What this means is that for all the erosion of boundaries and fundamental technological change, governments still matter enormously—as does political leadership. It also means that even if change in the direction of "more market" and "less state" is a continuing pervasive global phenomenon, it does not lead to a single, common result.

Globalization itself creates new agendas for governments. It adds to the imperative to invest in human capital to ensure that citizens can participate in the economy. Social safety nets need to be either created or updated to help people adjust to the changes brought by the global economy, protect them

from the pressures, and make transitions. The financial crisis that whipped through Asia brought this need into sharp focus. But the need is also underscored every day by the alterations in commerce and work brought about by growing global trade. "In a globalized economy the responsibility of national governments to manage their economy is much greater than it was in a closed economy," said Yashwant Sinha, India's finance minister. "Because in a closed economy you just built up the barriers and lived happily within them. In a globalized economy you have to continuously face challenges, and I strongly believe that national governments have the primary responsibility to manage their affairs in a way that globalization doesn't become a threat." Governments also face institutional adjustment. Globalization, in some cases, requires more government, not less, especially in developing countries. It is striking to observe that government in developed countries represents a larger share of GDP—30 to 50 percent—than in developing countries—20 percent. To begin with, the developing countries need the capacity to do a better job of collecting taxes. In many developing countries, national governments need to expand their capacity for regulation and surveillance of financial systems, something that was not needed or not necessarily even wanted when a country's capital market was a cozy, insulated national affair. They also need to develop their capacity for environmental management, firm up the institutions and legal framework for market economies, and make the investments in education and health that are the foundations for successful economies.

The World Trade Center attack of September 11, 2001, and its effects around the world offered a chilling reminder of another aspect of governance. This is the primary role that only governments—in developed and developing countries—can play in ensuring the security of their citizens. Indeed, September 11 expanded the definition of security in a world of "asymmetrical" terrorist threats to include renewed attention to nefarious use of the financial and communications systems so essential to the global economy. The sketches and notes found in safe houses in Kabul and Kandahar during the Afghanistan war dramatize the reality of the threats against which governments will have to prepare in the twenty-first century. These are the proliferation and availability of weapons of mass destruction—nuclear weapons, radiation bombs, chemicals, and biological toxins—in the hands of either nations or nonstate terrorists or criminal gangs. The major cities of the world are at risk, but the conventional response of mobilizing armies and scrambling jets does not provide protection. Nor do after-the-fact evacuation plans.

This new emphasis on security will likely, at least to some degree, slow the free flow of people and goods of the globalization era. It will not stop the flow. But what seemed destined to increasingly be a "just-in-time" world will now be somewhat less "just in time."[7]