The Truth about Globalisation

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Ladies and Gentlemen, Distinguished Guests, it is a great pleasure to be here today. I would like to thank the Lithuanian Free Market Institute and the British Embassy in Vilnius for organising this conference, and for inviting me to address you here today. It is my first visit to this delightful country, and I am sure that it will not be my last.

I have always had a soft spot for Lithuania. I grew up in London very near what was then the Lithuanian House and I would walk past it every day on the way to school. My mother is of Estonian origin, so I was aware from an early age of the tragic fate of Estonia, Latvia and Lithuania after the Second World War. As a teenager, I was active in the Baltic Association of Great Britain, and demonstrated regularly for freedom in the Baltic States outside what was then the Soviet embassy in London. I strongly hoped that your country would one day be free again, but never quite believed it would actually happen. And then Lithuania declared independence, I remember the day clearly, March 11, 1990. It seemed unreal, and at the time it was, as the Soviet army reminded us by brutally attacked the Vilnius TV Tower on January 13 the next year, while the world was distracted by the preparations to evict Saddam Hussein from Kuwait. And then came the failed August coup, and suddenly Lithuania was truly independent again. And now, finally, Lithuania is in the European Union too.

It is fantastic, then, that we are even able to ask the question “How can Lithuania survive on a global market?”: Lithuania is independent and free to choose whether and how it wants to interact with the global market, which was not always the case.

Perhaps the most pernicious myth about globalisation, which is widely believed by both its critics and many of its supporters, is that we no longer have a choice. It is argued that we must accept globalisation as it is, whether we like it or not. Some people say that globalisation is a technological inevitability; others say that markets are sweeping all before them, making governments and individuals impotent; still others claim that big global companies call the shots and we must all bow to their demands. Yet none of these assertions are in fact true.

You only have to travel a few miles from here, to Belarus, to see that there is nothing inevitable about globalisation. While distance-shrinking technologies such as the internet, mobile phones, television, and air transport have the potential to bring the world closer together, governments have plenty of scope to impede, or encourage, that process. At one extreme, there is North Korea, which exists in almost total autarky, at the other was Estonia, which for a time had no barriers to trade whatsoever. Most countries lie somewhere in between.

Consider that most global of industries: the airline business. While jet aircraft make it possible to fly anywhere around the world, in practice governments severely restrict which airlines can fly where. In many cases, there is a duopoly, where only the national airlines of the countries linked are allowed to fly. Within the European Union, however, airlines from any European country can now fly to any other, so that I had a choice of flying from London to Lithuania via Air Baltic or Ryanair, as well as British Airways and Lithuanian Airlines. It is a liberalising government policy that has made this possible; and what governments have done, they can undo: if Lithuania wished to, it could withdraw from the European Union and ban other airlines from flying here, while the EU could decide to re-regulate airline travel in the Union if it wished too. Hopefully, though, it will go in the other direction, by removing, for instance, the restrictions that remain on non-European airlines flying within the EU.

Not only do countries have a choice about whether they wish to embrace globalisation, they can also choose how, and to what extent, to embrace it. Globalisation is not an all-or-nothing choice. Countries can opt to open up their markets to trade in industrial goods, while protecting their agriculture markets, as European Union countries do. The Chinese government is busy dismantling its remaining trade barriers as part of its agreement to join the World Trade Organisation and mobilising the efforts of ever more of its citizens into exporting manufactures, while at the same time strictly controlling its citizens' access to the internet. Within the framework of the North American Free-Trade Area, or NAFTA, agreement, the US and Canada trade most things freely, but Canada reserves the right to protect its cultural industries, much as France insists on its *exception culturelle*. Several East Asian countries have liberalised their trade since the financial crisis in 1997, while maintaining, or even raising, their restrictions on the free flow of capital. And perhaps most notably, whereas the first era of globalisation in the nineteenth century was characterised by the free movement of people – with 60 million or so Europeans crossing the seas to move to the Americas, Australasia and European colonies in Asia and Africa – governments nowadays generally maintain strict immigration controls, although there are notable exceptions: Lithuanians can now come work freely in Britain, and many have done so.

In short, Lithuania can pick and choose how it wishes to engage with the rest of the world. It has already made one decisive choice: to turn its back on the Russian-led Commonwealth of Independent States and join the European Union instead. For the most part, this is a liberalising choice. It implies accepting the free movement of goods, some services, capital and people from the other 24, soon to be 26, EU member states. At the same time, though, it means accepting the EU's common agricultural and trade policies, which may be more or less liberal than Lithuanians might prefer. It offers the option, once the entry conditions are met, of joining the euro, which Lithuania looks likely to exercise sooner rather than later, albeit not as soon as it may have wished. For sure, now that Lithuania has joined the EU, its policy options are to some extent constrained by the need to conform with common EU policies where they exist. But Lithuania chose to join the EU voluntarily, presumably because it thought the benefits of doing so – such as access to the EU single market, political integration into Europe and so on – outweighed these potential costs.

Benefits of globalisation

What, then, are the benefits of globalisation? Lowering trade barriers produces one-off gains as countries specialise in what they do best while importing the rest at least cost from around the world, and free trade also allows countries to reap economies of scale. Specialisation is equivalent to a productivity increase: instead of making a particular good, an economy can obtain more of it, indirectly, by exporting something else.

The gains from shifting from a virtually closed economy to an open one can be huge - since trying to produce everything domestically is extremely inefficient - and lead to very fast growth as the economy adjusts.

Reasonably free trade also leads to sustained long-term gains: increased foreign competition forces companies to continually innovate and become more productive, stimulating investment and boosting economic growth year after year.

Last but not least, trade boosts productivity through imports of capital and intermediate goods that embody superior foreign technology, for instance, high-tech car-making machinery.

Free trade is usually the best policy even if domestic markets do not always work perfectly. It is better to tackle these market failures directly rather than through the second-best option of trade restrictions. Likewise, policy aims such as helping the poor are best pursued through domestic redistribution and other measures rather than by trade restrictions that may benefit some poor people, but at a greater cost to the economy as a whole.

Countries therefore benefit from opening their markets unilaterally, although in a world where other governments behave in a mercantilist – exports good, imports bad – way, it makes sense for them to open their markets through negotiations based on reciprocity at the WTO, thereby also securing greater access to other countries' markets.

Of course, free trade is not a panacea. Some countries that have liberalised their trade have failed to see a boost to growth, because weaknesses in the domestic economy may have prevented them reaping the new opportunities or other factors may have offset the pro-growth impact of liberalisation. For instance, a country may lack adequate road and port facilities to enable farmers to export their produce, corrupt customs officials may prevent importers from seeing the benefit of lower tariffs, the government may have applied contractionary monetary and fiscal policies to curb inflation and public debt, or a financial crisis may have wreaked havoc with the economy.

It is also true that a burst of economic growth is possible in the absence of trade liberalisation. Stalin, for instance, used brutal state power to mobilise the Soviet economy's resources and industrialise extremely rapidly. His efforts were not a path to long-term development, however.

More happily, domestic market-based reforms and sound government policies, such as increased spending on infrastructure and education or an anti-corruption drive, can all be good for growth.

Trade liberalisation is not the only source of growth for transition countries - but it is certainly a necessary condition for the sustained economic growth that leads to advanced development. There are no examples of countries that have risen in the ranks of global living standards while being less open to trade in the 1990s than in the 1960s.

So perhaps we ought instead to ask the question: "How could Lithuania survive outside a global market?" – and the answer, of course, is that it could, but that it would be much poorer if it tried to isolate itself.

Costs of free trade

But what about the costs of free trade? Governments lose the revenue from import duties. The profits of domestic firms fall. Capital and workers must shift to more efficient uses. In the short term, there are losers. Their pain - like that of anyone who loses their job - can and should be eased with welfare benefits and job retraining. But it is odd for protectionists to argue that the temporary losses of a few should prevent the country as a whole reaping the much bigger – and permanent – gains from free trade. After all, the interests of candle makers were not allowed to stop the introduction of electricity. Nor are governments scrambling to stop the internet cutting out middlemen. Freeing trade, like new technology, causes change; that is how it boosts economic growth. Some of us lose at first, but eventually we all gain. It makes no sense to try to protect yesterday's jobs at the expense of tomorrow's. And faster growth also provides the means to spend more on pro-poor policies such as education and health.

Evidence
There is a mountain of evidence to support the belief that freeing trade promotes economic growth. Studies of nine countries – Chile, Colombia, Egypt, Ghana, India, Israel, Korea, the Philippines, and Turkey – directed by Anne Krueger and Jagdish Bhagwati for the National Bureau of Economic Research in the late 1970s showed that liberalising trade led to faster economic growth. These findings were confirmed by studies of nineteen countries – Argentina, Brazil, Chile, Columbia, Greece, Indonesia, Israel, Korea, New Zealand, Pakistan, Peru, the Philippines, Portugal, Singapore, Spain, Sri Lanka, Turkey, Uruguay, and Yugoslavia – over four decades conducted in the early 1990s by Demetris Papageorgiou, Michael Michaely, and Armeane Choksi of the World Bank.

More recently, and conclusively, Romain Wacziarg and Karen Horn Welch of Stanford University have found that between 1950 and 1998 "countries that have liberalised their trade regimes have experienced, on average, increases in their annual rates of growth on the order of 1.5 percentage points compared to pre-liberalisation times."

Developing and transition countries that have embraced globalisation are growing faster than before; so fast that they are closing the gap with rich countries, slashing poverty and reducing global inequality for the first time since the industrial revolution catapulted Western Europe forward. Globalisation is working.

According to the latest IMF figures, the world economy grew by 3.9 per cent a year from 1996-2005, up from 3.3 per cent a year in the previous decade. Better still, while in 1986-95 emerging economies grew only fractionally faster than advanced economies (3.7 per cent a year compared with 3 per cent), in 1996-2005 they grew over twice as fast (5.5 per cent a year compared with 2.7 per cent). It is fantastic that Lithuania is growing at over 7% a year, and thus closing the gap with North America and Western Europe. The world economy is booming—and emerging countries are outpacing developed ones.

Consider China. Since 1978, it has gone from a system where trade was determined by the central government's five-year plan to one where a huge number of private companies engage in foreign trade, import licences have largely been abolished, industrial tariffs have fallen to single figures and service sectors are being opened up too. The volume of China's trade has risen seventy-fold, trade's share in the economy fivefold and the country's share in world trade has jumped from 0.8 per cent to 7.7 per cent. Over the same period, Chinese living standards, as measured by GDP per person at purchasing power parity, have risen fivefold—and the country has witnessed the fastest fall in poverty ever recorded.

China's great leap forward has helped reduce global inequality since 1980. India, home to more than a fifth of the developing world's population, is also catching up with the west. Indeed, the income share of the poorest 70 per cent of the world's population has increased significantly since 1980. The countries that are continuing to fall behind are mostly in sub-Saharan Africa. It is a tragedy that some very poor countries are doing very badly. But it is not an indictment of globalisation—by and large, the poorest countries are victims not of globalisation, but of a lack of it—nor does it alter the fact that global inequality is falling overall.

Better still, the proportion of people in developing countries living in extreme poverty almost halved between 1981 and 2001, from 39.5 per cent to 21.3 per cent—a huge achievement. There's no doubt about it: globalisation is working. We need to do more to help everyone reap its benefits, not misguidedly try to protect the poor from trade-led development.

Markets vs. governments

Yet many critics of globalisation object that once governments have agreed to open up their markets to international competition, they lose their power over really important policy areas, such as taxes, social spending, labour and environmental regulation, and so on. In particular, critics argue that global competition is causing a race to the bottom, whereby taxes, spending and regulation are driven inexorably downwards – in effect, sounding the death-knell for Europe's social-market economy.

It is a terrible irony that the left has lost faith in government. Governments are not impotent. If globalisation is forcing governments to slim down, how come the average tax take in rich OECD countries has risen from 35% to 38% of GDP since 1985? Corporate taxes are a bigger share of government revenues than 20 years ago. Surveys show that skilled workers, good infrastructure and nearby customers determine where companies invest far more than low taxes and regulation. Why else is high-tax and expensive New York so successful? Or Finland for that matter.

Labour and environmental standards are generally rising, not falling. An OECD study found that workers' union rights had not got significantly worse in any of 75 countries since the early 1980s. In 17 (including Brazil, South Korea and Turkey) they had markedly improved. The same study found that pollution havens are a myth. If anything, competition is bidding up environmental standards. In rich countries, the air is cleaner than it has been for 200 years, and so are our rivers/

Corporate power

Another common fear is that big companies now run the world for their own private benefit rather than the public good. Profits come before people's needs, it is said. Companies' brands are colonising our minds. Their sheer size gives them clout. Their financial muscle bends elected representatives to their will. Their freedom to shift factories from country to country disempowers workers. The governments we elect connive in this, either because they are in the pockets of big business or because their power has leached away. So our votes are useless. In place of democracy, we face a grim choice between apathetic acquiescence and doubtless futile resistance.

This is dangerous nonsense. Start with brands. If they are so powerful, why couldn't Coca-Cola convince us to drink New Coke? Why does own-label cereal outsell Kellogg's? The grip of Nike shoes hardly compares with that of patriotism or love. Although some susceptible people, mainly poor kids, may unfortunately be conned into spending money they can ill afford, this hardly means brands are conquering the world.

Brands are actually signs of corporate weakness, not strength. It is only because fickle consumers have so much choice that companies try to woo them with their branding. Monopolists needn't bother. Moreover, companies that are trying to sell an image or a reputation are incredibly vulnerable to anything that is perceived to damage them. After all, Shell caved in to a handful of Greenpeace activists over the disposal of the Brent Spar oil platform. As companies increasingly make a virtue of being "socially responsible" - of being good to their employees, the environment and the community, rather than mere money-making machines - their vulnerability can only increase. Thus, brands, far from being vehicles for corporate global domination, give people unprecedented sway over companies' behaviour.

Corporate power is much exaggerated. Take the oft-repeated "fact" that 51 of the 100 biggest economies are corporations. It is arrived at by comparing companies' sales and countries' gross domestic product (GDP). But this double-counting inflates companies' importance, since one company's inputs are another's sales. A less misleading comparison - between companies' value-added, the difference between their sales and the cost of their inputs, and countries' value-added, their GDP - reveals that only two companies make it into the top 50 value-added creators. The biggest, Wal-Mart, an American supermarket chain created value-added of $68bn (£43bn) in 2000, around the same as Chile's GDP. Together, the 50 largest countries are 22 times bigger than the top 50 corporations.

In any case, inferring from companies' size that they are as powerful as countries is fatuous. Whereas companies have to attract workers and capital that are free to go elsewhere, countries can impose taxes and regulations: mighty Exxon Mobil pays taxes even in tiny Luxembourg. Supposedly footloose companies cannot, in fact, easily escape governments' writ: they are tied to places in many ways - by their customers, a skilled workforce or the good roads, schools and hospitals that our taxes pay for. Even if companies became more mobile, governments could collude to nab them, by cooperating over tax raising, for instance.

Companies that fail to persuade customers to buy enough for them to earn sufficient profits to pay shareholders and workers an acceptable return go bust or get taken over, whereas even failed states rarely disappear. All of Wall Street's combined financial clout could do nothing to avenge the destruction of the World Trade Centre; but the American government could. A handful of states can blow up the earth. The only "companies" with powers remotely comparable to those of states are the drug cartels: Colombia's earn billions of dollars a year, control parts of the country, have private armies and operate outside the law.

Wal-Mart seems puny in comparison. Indeed, because it faces fierce competition from other retailers, it has less scope to mark up its prices than the only shop in an isolated village. Competition can constrain even the biggest companies - one reason why globalisation is such a good thing. Closed domestic markets, where national champions can cosy up to government, are much more likely to be monopolised than open global ones. So even though global companies are bigger than before, they are not necessarily more powerful. It is the absence of competition, not size, that gives companies clout.

Of course, competition is not a cure-all. Some companies gain an unhealthy monopoly. Others are able to fix prices. Companies may exploit their workers or pollute too much, and so on. So governments often need to regulate companies - and they do.

Yes, companies sometimes have an undue influence on governments. Money and politics should be kept as separate as possible and government conducted more openly. Yet business has a right to lobby governments, just as trade unions, environmental groups and individuals do. This does not imply that governments are companies' lackeys.

The WTO is a good example of governments seeking to overcome corporate power. Even though the benefits of free trade far outweigh the costs, governments often find it hard to lower trade barriers. Companies that fear foreign competitors tend to lobby governments harder than the disparate millions of consumers who benefit from cheaper imports.

The WTO helps to break this deadlock. Governments offer to open domestic markets in exchange for greater access to foreign ones. This galvanises exporters' support for liberalisation, which helps to overcome the opposition of import-competing industries. The economy as a whole benefits as a result.

Governments can - and do - tame the corporate leviathans. The European Commission stopped giant General Electric from buying Honeywell. The US government nearly broke up Microsoft, which is still being prosecuted by US states and investigated by the European Commission. Business has to abide by a battery of legislation on workers' rights, product liability, health and safety, environmental protection and much else.

Companies have to pay their employees a minimum wage, provide a healthy and safe work environment, and not discriminate against women or minorities. They generally have to recognise unions and give some notice and compensation to workers they want to fire. They have to comply with environmental standards on everything from how much they can pollute to how much they must recycle. Food and drugs have to be shown to be safe. Consumer-protection law sets out standards for advertising as well as customers' right to refunds. Product-liability laws make companies accountable for any harm their products may cause. A whole of host of industries, such as water, electricity, telecoms, banking and broadcasting, are even more tightly regulated.

Where governments fear to tread, lawyers do not: each year people start almost 2 million lawsuits against American companies, which pay out damages of around $150bn a year. Last but not least, taxes on company profits have steadily risen as a share of rich OECD countries' GDP: from 2.2% in 1965 to 3.3% in 1999. If businessmen are running the show, they must be masochists.

In fact, many would argue that governments regulate too much, not too little. Smokers complain about the punitively high price of cigarettes and the restrictions on where they can indulge their habit. Patients awaiting new life-saving drugs grumble at the long and costly delays that onerous government safety tests impose.

More broadly, many blame high unemployment in Europe on the red tape that ties up companies in knots. And the high price that Americans pay for medicines is in large part due to government-granted patents that give companies the exclusive right to sell the drugs they develop for 20 years.

Whether you think that governments regulate too much or too little, there is no doubt that they are capable of regulating companies - and thus that companies do not enjoy unfettered power.

The truth is companies are not running the show. We are still free to determine our future - as individuals, as groups of like-minded people and through the power of our elected governments. If people really wanted to, they could reverse globalisation - as they did in the 1930s, with catastrophic consequences.

Globalisation is a choice, not an imposition. We should embrace it because it makes us richer - in the broadest sense - and because it allows governments to spend more on schools, hospitals and helping the underprivileged. It does not imply that all countries have to become like America: there is space in the global economy for Finland to thrive, as well as China and Lithuania too. Globalisation comes with several options: we can to a large extent pick and choose what kind of globalisation we want. I strongly hope that Lithuania will continue to embrace globalisation in order to build a better future for itself.