Globalization and Economic Growth in the World Economy

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Abstract

An analysis of the process of globalization in tastes, production, and labor markets during the past two decades has done. Although there is no perfect correspondence between non-globalizers and the poorest countries in the world, most non-globalizers do include most of the poorest countries in the world. Thus, inequalities in per capita incomes and standards of living did increase between non-globalizers, on the one hand, and globalizers and rich countries, on the other. But the fault for this increased inequality cannot be attributed to globalization, as such. Indeed, it was the globalizers that grew fast while the non-globalizers stagnated or regressed. This is a far cry from globalization being itself the cause of the increased inequalities between the rich and the globalizing developing countries and the poorest developing nations during the past two decades.

Résumé

Ce travail analyse le processus de mondialisation au niveau des goûts, de la production et du marché du travail au cours de ces deux dernières décennies. Même s'il n'y a pas une correspondance parfaite entre les non-globalisateurs et les pays les plus pauvres du monde, la plupart des non-globalisateurs comprennent la majorité des pays les plus pauvres du monde. Ce qui a entraîné de plus fortes inégalités des revenus par tête et des niveaux de vie entre les non-globalisateurs d'une part et les globalisateurs et les pays riches de l'autre. Mais la responsabilité de cette inégalité croissante ne peut pas être attribuée à la mondialisation en tant que telle. En réalité, on a assisté à une croissance rapide des globalisateurs alors que les non-globalisateurs ont été stagnants ou ils ont même régressé. On est loin de la mondialisation en tant que cause en soi des inégalités croissantes entre les pays riches et globalisateurs et les nations en développement les plus pauvres au cours de ces deux dernières décennies.

1. Introduction

The past two decades have witnessed an increasingly rapid tendency toward globalization in the world economy and this has significantly affected the rate of economic growth around the world. A great deal of controversy exists, however, on whether globalization has increased or reduced the rate of economic growth in advanced and developing countries. This paper begins with an analysis of the process of globalization in tastes, production, and labor markets during the past two decades. Then it shows how globalization significantly affected economic growth around the world.

2. Globalization in the World Economy

Every decade seems to have a favorite concept or theory, which captures the public imagination and is frequently discussed in news programs, magazines, newspapers, and in general conversations. In the 1970s, the buzzword was "dynamics". Firms had to behave dynamically rather than statically. Dynamics referred to the necessity of firms to be alert and innovative rather than dormant and complacent, and, of course, no one could argue against that. In the 1980s, the favorite concept was "strategy". That is, firms and governments had to pursue strategic policies to be successful. Thus, strategy was the name of the game during the decade of the 1980s. Since the beginning of the 1990s, the prevailing topic of discussion has been globalization and the New Economy. But if we ask even an expert to explain the meaning and importance of globalization we get rather confusing and unclear answers. The best way to examine globalization is to identify its three fundamental aspects, which are globalization in tastes, globalization in production, and globalization in labor markets – in order of increasing complexity and importance. Let's examine each of these three aspects of globalization, beginning with globalization in tastes.

2.a Globalization in Tastes

The revolution in telecommunications and transportation during the past decade led to a strong convergence of tastes and cross-fertilization of cultures around the world. Tastes in the United States affect tastes around the world and tastes abroad strongly influence tastes in the United States. Coca-Cola has over 40 percent of the U.S. market and an incredible one-third of the world's soft drink market, and today you can buy a McDonald's hamburger in most major cities of the world. As tastes became global, firms responded more and more by introducing truly global products. For example, in 1990, Gillette introduced its new Sensor Razor at the same time in most nations of the world and used the same advertisement (except for language) in 19 countries in Europe and North-America. By 2002, Gillette had sold over 500 million of its razors and more than 10 billion cartridges. In 1994, Ford spent more than $6 billion to create its "global car" conceived and produced in the United States and Europe and sold under the name of Ford Contour and Mercury Mystique in the United States and Mondeo in the rest of the world. The list of global prod-

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ucts is likely to grow rapidly in the future and we are likely to move closer and closer to a truly "global supermarket".

In his 1983 article "The Globalization of Markets" in the Harvard Business Review, Theodore Levitt asserted that consumers from New York to Frankfurt and Tokyo want similar products and that success for producers in the future would require more and more standardized products and pricing around the world. In fact, in country after country, we are seeing the emergence of a middle-class consumer life-style based on a taste for comfort, convenience, and speed. In the food business, this means packaged, fast-to-prepare, and ready-to-eat products. Market researchers have discovered that similarities in living styles among middle-class people all over the world are much greater than we once thought and are growing with rising incomes and educational levels. Many small national differences in taste do, of course, remain; for example, Nestle' markets more than 200 blends of Nescafe' to cater to differences in tastes in different markets. But the converging trend in tastes around the world is unmistakable and is likely to lead to more and more global products. This is true not only for foods and inexpensive consumer products but also for automobiles, portable computers, phones, and many other durable products. The importance of all of this is that the market for many products is truly becoming global and firms do compete on a truly global level in these products.

2.b Globalization in Production

Globalization has also occurred in the production of goods and services with the rapid rise of global corporations. These are companies that are run by an international team of managers, have research and production facilities in many countries, use parts and components from the cheapest source around the world, and sell their products, finance their operation, and are owned by stockholders throughout the world. In fact, more and more corporations operate today on the belief that their very survival requires that they become one of a handful of global corporations in their sector. This is true in automobiles, steel, aircrafts, computers, telecommunications, consumer electronics, chemicals, drugs, and many other products. Nestle', the largest Swiss Company and the world's second largest food company has production facilities in 59 countries, and America's Gillette in 22. Ford has component factories in 30 different industrial sites around the world, assembly plants in six countries, and employs more people abroad than in the United States.

One important form that globalization in production often takes in today's corporation is in foreign "sourcing" of inputs. There is practically no major product today that does not have some foreign inputs and foreign trade in parts and components has been growing much more rapidly that trade in finished products. Foreign sourcing is often not a matter of choice for corporations to earn higher profits, but simply a requirement for them to remain competitive. Firms that do not look abroad for cheaper inputs face loss of competitiveness in world markets and even in the domestic market. Two thirds of the total cost of producing an IBM PC is incurred for parts and components manufactured by foreign by IBM outside the United States or purchased from foreign producers. Such low-cost offshore purchase of inputs is likely to continue to expand rapidly in the future and is being fostered by joint ventures, licensing arrangements, and other non-equity collaborative arrangements. Indeed, this represents one of the most dynamic aspects of the global business environment of today.

Foreign sourcing can be regarded as manufacturing's new international economies of scale in today's global economy. Just as companies were forced to rationalize operations within each country in the 1980s, they now face the challenge of integrating their operations for their entire system of manufacturing around the world in order to take advantage of the new international economies of scale. What is important is for the firm to focus on those components that are indispensable to the company's competitive position over subsequent product generations and "outsource" other components for which outside suppliers have a distinctive production advantage. In short, the new managerial theories of the firm advocate that firms should specialize in their core competencies and outsource everything else.

Indeed, globalization in production has proceeded so far that it is now difficult to determine the nationality of many products. For example, should a Honda Accord produced in Ohio be considered American? What about a Chrysler minivan produced in Canada now that Chrysler has been acquired by Daimler-Benz (Mercedes)? Is a Kentucky Toyota or Mazda that uses nearly 50 percent of imported Japanese parts American? It is clearly becoming more and more difficult to define what is American and opinions differ widely. One could legitimately even ask if this question is relevant in a world growing more and more interdependent and globalized. Today, the ideal corporation is strongly decentralized to allow local units to develop products that fit into local cultures, and is very centralized at its very core to coordinate activities around the globe. It is clear that globalization in production strongly affects the comparative advantage and international competitiveness of nations.

2.c Globalization in Labor Markets

Even more dramatic has been the globalization of labor markets around the world. Work which was previously done in the United States and other industrial countries is now often done much more cheaply in some developing countries. And this is the case not only for low-skilled assembly-line jobs but also for jobs requiring high computer and engineering skills. Most people in advanced nations have only now come to fully realize that there is a truly competitive labor force in the world today willing and able to do their job at a much lower cost. If anything, this trend is likely to accelerate in the future.

Not even service industries are immune to global job competition. For example, more than 3,500 workers on the island of Jamaica are connected to the United States by satellite dishes to make airline reservations, process tickets, answer calls to toll-free numbers, and do data entry for U.S. airlines at a much lower cost than could be done in the United States. Nor are highly skilled and professional people spared from global competition. Some years ago, Texas Instruments set up an impressive software programming operation in Bangalore, a city of four million people in southern India. Other American multinationals soon followed. Motorola, IBM, AT&T and many other high-tech firms are now doing even a great deal of basic research abroad. American workers are beginning to raise strong objections to the transfer of skilled jobs abroad. Of course, many European and Japanese firms are setting up production and research facilities in the United States and employing many American professionals. In the future, more and more work will simply be done in places best equipped to do the job most economically. Try to restrict the flow of work abroad to protect jobs in the United States, and the company risks loosing international competitiveness or ends up moving all of its operations abroad.

Lack of adequate understanding of the process of globalization has led even some topnotch economists astray in recent years. For example, most macroeconomists incorrectly predicted in the second half of the 1990s that with the rate of unemployment falling below 6 percent, the US economy was going to face a resurgence of rapid inflation. As it turned out, the rate of unemployment fell to a low of 3.9 percent in the middle of 2000 without any sign of inflation. It is clear that these macroeconomists had not taken globalization sufficiently into consideration in his analysis. In the open and globalized U.S. economy of the late 1990s (and to some extent in other advanced economies), firms find it dangerous or impossible to raise price for fear of losing their market to foreign competitors. Since the restructuring of the U.S. economy that started in the 1980s, U.S. firms have been striving to contain costs in order to avoid raising prices and losing their market, and if they could not contain costs sufficiently then they simply shifted production to Mexico or Southeast Asia. Similarly, because of inadequate understanding of the globalization process, Alan Greenspan, the brilliant Chairman of the Board of Governors of the Federal Reserve Bank, believed that the most serious problem facing the U.S. economy in the fall of 2000 was a resurgence of inflation, without realizing that instead growth had collapsed.

2.d Globalization: Inevitable and Important

Globalization in tastes, production and labor markets is important and inevitable – important because it increases efficiency; inevitable because international competition requires it. Besides the well-known static gains from specialization in production and trade, globalization leads to even more important dynamic gains from extending the scale of operation to the entire world and from leading to the more efficient utilization of capital and technology of domestic resources at home and abroad. Globalization is inevitable because with tastes converging, consumers around the world increasingly demand similar products. Firms must outsource parts and components from wherever in the world they are made better or cheaper, and they must invest their capital and technology wherever they are more productive. Otherwise, competitors would do so and the firm would lose its markets and might even be forced to shut down. For the same reason firms must outsource labor services or employ labor off-shore where it is cheaper or more convenient.

The terrorist attack of September 11, 2001 and subsequent attacks sharply reduced travel, trade and investment in the weeks following these tragedies. Although conditions have now returned to near normality, the cost of travel, transportation and communications has risen in order to pay for increased controls and protection. This is like the imposition of a tariff or tax on international transactions and tends to slow down the process of globalization without, however, bringing it to a halt. Despite all the criticism against globalization, no alternative model of world growth and development has been or is being advanced by the demonstrators who oppose globalization or those (such as Joseph Stiglitz, 2002) who blame it for increasing world poverty and inequalities; indeed, no alternative model exists. When rapid growth in the United States and in the world economy resumes next year, the process of globalization will also resume its rapid growth, even if at a somewhat slower pace than during the past decade.

3. Globalization, Economic Growth, and Development

Growth is the most important economic goal of countries today. But great care must be used in how we define it. Measuring it by the growth of real GDP, would not be appropriate because this type of growth could be entirely absorbed by increases in population, leaving real per capita GDP unchanged. Thus, it is the growth of real per capita income that is appropriate. Using national accounts, domestically within each nation, however, would not allow us to compare the average level of per capita incomes or standard of living across countries.

To compare real per capita incomes across nations, we need to convert the domestic-currency per capita income of each nation into a common currency (traditionally, the U.S. dollar). Using the official exchange rate to make such a conversion, however, could be very misleading because exchange rates are often grossly misaligned and do not take into consideration differences in the purchasing power of money in different countries. Even more problematic is the fact that the less developed a country, the greater the proportion of its subsistence production that does not enter the market, and thus the greater is the degree of underestimation of its true level of real per capita income or standard of living. Thus, the best available way to measure the growth in standards of living and the method that also allows us to compare levels of per capita incomes across countries is to use purchasing power parity (PPP) exchange rates. Yet most international institutions, such as the World Bank and the United Nations, still publish traditional data, and only recently they have started to focus on PPP data.

Since we are interested in examining the effect of globalization on growth and development, we will compare the growth of real PPP per capita incomes in various countries and regions in the period 1980-2000, which is usually taken as the most recent period of rapid globalization, with the 1960-1980 pre-globalization period. Of course, the rate of growth and development of a nation depends not only on globalization but also on many other domestic factors, such as political stability, improvements in education and labor skills, the rate of investment and absorption of new technology, the rate of population growth, and so on. But globalization is certainly a crucial ingredient to growth. For example, no one forced China to open up to the world economy, but without such an opening China would not have received the huge inflows of capital and technology and it would not have been able to increase its exports so dramatically, and thus be able to achieve its spectacular rates of growth during the past decade. A possibly strong positive correlation between globalization and growth does not, of course, establish causality, but it would refute the assertion on the part of anti-global groups that globalization has caused increased inequalities between advanced and developing countries during the past two decades.

Table 1 gives the weighted yearly average real PPP (with base 1993) per capita income in various regions and countries of the world in the 1960-1980 period and in the 1980-2000 period. From the table we see that Asia, except East Asia, did well during the 1960-1980 period and spectacularly well (especially China) during the 1980-2000 period. The Middle East and North Africa did well during the first period but very badly during the second period because of political turmoil and wars. Sub-Saharan Africa did not do well during the first period and actually became poorer during the second because of political instability, wars, droughts, and the aids virus. Latin America did well during the first period, but per capita incomes were practically stagnant during the second period, so that the 1980-2000 period can be considered lost decades as far as economic development is concerned because of political and economic crises.

Table 1. *Weighted Yearly Average Real PPP Per Capita Income in Various Regions, 1960-1980 and 1980-2000*

Region	1960-1980	1980-2000
East Asia	2.85	6.12
South Asia	0.55	3.00
Asia	1.98	4.86
China and India	1.74	5.75
Middle East & North Africa	3.21	0.15
Sub-Saharan Africa	1.29	-0.58
Latin America	3.13	0.08
Developing World	2.12	3.11
Developing World, excl. China & India	2.51	0.69
Eastern Europe	4.03	-1.88
Non-Industrialized World	2.32	2.84
Industrialized World	3.27	1.55
World	2.50	2.65

Source: Bhalla (2002) from World Bank (2002) data.

The developing world as a whole did reasonably well during the first period and even better during the second. Eastern Europe did very well during the first period but suffered a significant decline in average per capita incomes during the second period as a result of the economic collapse associated with the fall of communism and the required economic restructuring that followed it. Overall, only Asia grew faster than industrialized countries and sharply reduced inequalities vis-à-vis industrialized countries as a group during the 1980-2000 period. Latin America and the Middle East & North Africa did poorly and so inequalities with respect to industrialized countries increased. Sub-Saharan Africa and Eastern Europe actually became poorer in an absolute sense during the second period with respect to the first and so they fell further behind industrialized countries and developing Asia.

Table 2 shows more directly the correlation between globalization and growth. It shows that the growth of real per capita PPP GDP increased sharply in each decade from 1960 to 2000 for the developing countries that globalized (i.e., those in which the ratio of trade to GDP increased) and far exceeded the average growth of rich countries and that of non-globarisers during the past tow decades. The growth of rich countries was very high and much higher than for globalisers and non-globalizers during the decade of the 1960s, but it declined in each subsequent decade. The growth of non-globalizers increased from the decade of the 1960s to the decade of the 1970s, but then it declined sharply during the 1980s and was very low during the 1990s. It seems that growth can be rapid without liberalization and globalization at the beginning of the growth process, but as the nation develops economic efficiency associated with liberalization and globalization become increasingly important.

Table 2. *Weighted Yearly Average Real PPP Per Capita Income Growth in Rich Countries, Globalizers and Non-Globalizers, in the 1960s, 1970s, 1980s, and 1990s*

Group of Countries	1960s	1970s	1980s	1990s
Rich Countries	4.7	3.1	2.3	2.2
Globalizers	1.4	2.9	3.5	5.0
Non-Globalizers	2.4	3.3	0.8	1.4

Source: Dollar and Kraay (2001).

Although there is no perfect correspondence between non-globalizers and the poorest countries in the world, most non-globalizers do include most of the poorest countries in the world. Thus, inequalities in per capita incomes and standards of living did increase between non-globalizers, on the one hand, and globalizers and rich countries, on the other. But the fault for this increased inequality cannot be attributed to globalization, as such. Indeed, it was the globalizers that grew fast while the non-globalizers stagnated or regressed. Thus, the only criticism that can be levied against globalization, as a process, is that it did not permit the poorest countries in the world to also participate in the tremendous benefits in terms of economic efficiency and growth in living standards that globalization made possible. This is a far cry from globalization being itself the cause of the increased inequalities between the rich and the globalizing developing countries and the poorest developing nations during the past two decades, as claimed by the opponents of globalization.

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