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The world crisis: the implications of globalised finance

Report

The term "globalisation" has survived its first significant sell-by date in modern times. Rightly, it continues to attract policy attention and debate at the very highest levels. Together with just a handful of others—economic growth and inequality, financial crisis, climate change—with all of which it remains inextricably intertwined, only globalisation among economic phenomena has both effects and causes observable from outer space. Its impact on the welfare of humanity is therefore singular. This is even before one considers the sweeping changes in culture and politics that ever greater global integration both requires and engenders.

This article cannot hope to cover the massive body of modern thinking that surrounds globalisation. Instead, what it seeks to do is two-fold: first, flag, with the benefit of hindsight, some of the key background points that any continuing discussion of globalisation needs to keep in mind; and second, offer conjecture where the most likely contentious issues in the near future might be.
To keep within space constraints, careful and exhaustive discussion of empirical evidence is omitted. Instead, just the largest salient facts are provided where needed.

THE MECHANICS

Globalisation is the ever greater integration of economic activity across geographical, national, and man-made barriers. Its logic is that of the move from individualistic, self-contained Robinson Crusoe-like economic existence on the one hand, to the exchange of good, services, people and capital, and ideas seamlessly across countries and geography, on the other.
In that shift globalisation has, among much else, brought to consumers worldwide at low cost a previously inconceivable variety of goods, and made available to producers everywhere thriving marketplaces otherwise well beyond their reach.

Globalisation, therefore, most obviously comprises the shipping across countries of massive quantities of steel, aluminium, DVD players, bananas, textiles, coal, and grain. But globalisation is also the offshoring via Internet of insurance claims processing, Powerpoint deck preparation, secondary school mathematics tutoring, and back office computer functions. It comprises foreign direct investment, foreign worker employment (for which total global repatriations already match in value foreign direct investment), and portfolio investment. And, not least, globalisation comprises the value encoded in bitstrings of zeroes and ones coursing across Internet and other media pathways disseminating advertising, knowledge, ideas, and invention across the world.

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Globalisation is therefore driven by two principal proximate factors. First is the secular decline in costs of transportation and communication across the globe. Sea and air shipping, telecommunications, and passenger transportation all have seen dramatic price reduction and productivity gains in the last five decades. The fundamental drivers here are again two-fold: drastic innovation and incremental improvement in technology have now allowed transportation and communication where none were previously possible, or have dramatically improved the efficiency by which goods and services could be transported vast distances. Just as important, the reorganization of firms and businesses and of methods of production has leveraged these technological improvements to disperse operations geographically in the most efficient manner.

The second principal proximate factor underlying globalisation is policy. No technologically-determined inevitability forces nation states to allow their citizens access to ever greater trade, foreign investment, capital flows, immigration, and flows of information and ideas—but to varying degrees this has nonetheless occurred.

Institutions have emerged that attempt in some cases to improve or in others hinder the progress in the ever greater global integration of economic activity. This is to be expected not just from the sheer scale of globalisation—it stands ready to influence the lives of over 6.6 billion humans across hundreds of nation states on the planet—but from the nature of the disruptive changes that it necessarily accompanies.

THE IMPLICATIONS: COSTS AND BENEFITS

A global economic system, even if initially dispersed into just individual self-contained autarkic units, ends up achieving some kind of efficiency in operation. At some point any large enough change disrupts that order and fractures the operations of that global economy into interest groups that stand to gain and others that stand to lose from that disruption.

Globalisation then obviously comes with costs and benefits. The global economic system should continue to embrace globalisation if the benefits outweigh the costs, and not otherwise. The largest potential economic benefits can be reduced to very simple terms: raised economic growth and improved standards of living. But these are no trivial gains. From them, under normal circumstances, flow increased life expectancy and the reduction of disease, hunger, and poverty.

The last statement provides a sobering reminder of what's at stake in this discussion. In developed economies, increased economic growth might be associated with a few percentage point improvements in income. In developing economies, however, containing five-sixths of humanity, economic growth is a matter, literally, of life and death. There, the welfare gains from economic growth are considerable. Any discussion of globalisation that fails to take this into account is just incomplete. The greatest potential economic costs are three: increased income inequality; increased economic and financial instability; increased climate and environmental degradation.

As far as I know, no attempt has yet been made to quantify these largest of costs and benefits in the modern debate on globalisation. Some illustrative numbers, however, are useful.

1. INCOME INEQUALITY

Debate on income inequality in many developed economies has revolved on among other things, whether it is technology or trade that has been responsible for the increased disparities between rich and poor within those economies.
Just how much disparity are we talking about? Between 1973 and 2005 across US male workers aged 35–44 average annual wage income rose from US$49,705 to US$54,525 (in constant, inflation-adjusted, 2005 US$). The median such worker, however, saw his annual wage income decline from US$45,785 to US$40,964. Thus, in this reading, over 30 years of economic growth and globalisation brought no benefits to those relatively poor but instead saw only increased disparity between rich and poor.

If similar figures and trends manifest across developed countries other than the US, then the inequality side of the globalisation debate has a well-defined set of parameters to it where reasonable observers might well have to agree to disagree. But extend this comparison to a global scale, and the picture changes. Between 1981 and 2005 China brought 627 million people out of extreme $1/day poverty, even as inequality there rose from a Gini index of 0.28 to 0.50. That experience shows that a period of intensifying globalisation can, for initially poor countries, improve the lot of the very poorest in society even as measured inequality rises from just macroeconomic growth, i.e., the increase in average incomes.

More important, however, this throws into sharp contrast the gains of the poor in the world against the losses of those already rich. If globalisation increases disparities between rich and poor within any one country, that increase is nonetheless likely completely overwhelmed by globalisation's reduction of the income gap between rich and poor nations. And, in the case of a country like China or India or myriad others, the increase in overall national income from the trade impact of globalisation probably swamps all else.

2. FINANCIAL AND ECONOMIC INSTABILITY

In the midst of perhaps the world's most serious financial and economic crisis since the Great Depression, it can be difficult to maintain distance and remember the good things that financial liberalization and globalisation can engender. Financial markets continue to be the single most widely-used way historically available to channel resources from savers to investors, to facilitate innovation and economic growth that in turn has raised the income of humanity 50-fold in the last 200 years.

Up until the current global financial crisis the previous two—Mexico 1993; East Asia 1997—began in emerging economies, with their running up massive current account deficits, taking on debt denominated in foreign currency, and with large inflows of short-run portfolio investments by foreign commercial banks. In the current crisis, by contrast, it is the United States that had its current account deficit ramp up from essentially zero in 1990 to over 8% of GDP by 2006—a sum greater than the entire GDP of India. In the two previous recent instances, large sudden reversals of short-run capital flows sparked the crises. In the current situation, what brought about the collapse was the default of subprime mortgage accounts in the US, which although initially only a small portion of overall bank portfolios, had nonetheless grown pervasive, multiplied up into the global financial system through massive leverage.

In all cases, however, it is the excesses of the banking sector that first created the conditions for crisis and then later unwound to bring about collapse. National financial crises can occur even without the intrusion of globalisation. Unquestionably, however, cross-country financial contagion and trade spillover aggregate demand impacts can potentially spread such crises across borders, and it is a subtle calculation to determine the costs and benefits here.

3. CLIMATE AND ENVIRONMENTAL CHANGE

Global climate change from economic activity—the burning of fossil fuels—is now as near to scientific fact as almost anything can be in the study of economics. Its connection to globalisation is not perhaps as direct as, say, the cross-country spread of financial crises. On the other hand, its impact on human welfare is likely several orders of magnitude more pronounced and enduring. At the same time the international tensions that arise, and any useful policy proposals for ameliorating its effects are necessarily global and bring to bear all the same issues in every debate on globalisation. There is room here to put the matter only in the starkest simplest terms. The accumulation of greenhouse gas emission in the world's atmosphere has, historically, been due primarily to those countries now already developed. The greatest increments to that accumulation, however, are presently due to those countries such as China that are rapidly developing and raising their income levels. Schemes to stabilize greenhouse gas concentration in the atmosphere to prevent further dangerous disruption of the world's climate will succeed only with an agreement that allows both developed and emerging economies to arrive at a cooperate solution.

With globalisation both a driver of rapid growth in emerging economies and a mechanism for ever greater interaction and dialogue across different parts of the world, globalisation and global climate change will have their future progress intricately connected.

CONCLUSION

This article has outlined in the briefest terms one view on the current state of globalisation in the world economy. It points to three large issues, surrounding which most policy concerns can be seen to derive. The three are global inequality; global financial and economic stability; and global climate change. The quantification of costs and benefits on these three dimensions, and subsequent informed policy debate will usefully and significantly drive forwards our understanding of globalisation.