and tackle social problems. There is a limit to what the industrialized economies can do to help those developing countries that do not take the necessary measures. They can, however, reduce their debt burden, trade with them, invest in them, and support education and training policies. Blair and Clinton's Davos speeches, I believe, sum up quite clearly the opportunities and challenges posed by globalization.

I am grateful to my friend, the great economist Paul Krugman, for providing the introduction to this book, which has been written during weekends and holidays where I found the time and, I hope the inspiration, for this task of trying to bring such an important economic debate to as wide an audience as possible.

CHAPTER 1

What Is Globalization?

Globalization is a dynamic process of liberalization, openness, and international integration across a wide range of markets, from labor to goods and from services to capital and technology. It is not a new process but, rather, has unfolded gradually since the middle 1950s and it will take many years yet to finally reach completion, if politics permits. Nor is this the first wave of globalization. Between 1870 and 1914 a similar process occurred which was nearly as intense as this one. The twentieth century began with global market integration and this was resumed several decades later, but only after a sinister relapse in the globalization process that coincided with two bloody world wars, the spread of communism and fascism and the Great Depression. The latest phase of globalization looks likely to be more durable. The first wave lasted only 44 years and ended violently with the First World War while the present period is already surpassing 50 years and has more solid foundations than the first.

It can only be hoped that this globalized era does not end as badly as the previous one since that would again mean a retreat from peaceful economic competition under market rules, to political and military competition and armed conflict. This would be a tragic denouement. There are winners and losers in both cases but the losers in the former do not also lose their lives, although some could be severely disadvantaged by the process. In the final analysis, globalization is based upon freedom: the freedom to trade with the rest of the world and capitalize on each country's comparative advantage; the freedom to invest where returns on capital are greatest, within a tolerable level of risk, and the freedom to set up shop in the country of one's choosing, whether as a business to reap higher profits or larger market share, or as an individual seeking better wages and/or working conditions.

Not paradoxically, business economists have been the first to use the term globalization. One of the first to use it was Theodore Levitt (1983) in his work on the globalization of markets. Levitt described a process in which the concept of production, based upon product cycles, was being replaced by a new concept of global marketplace. In the first stage, new products were sold in the most developed countries until they became obsolete. From then on they were restricted to the less developed economies until they disappeared from the market. In the second global stage, the same product is sold throughout the world using the same methods and techniques. This reduces costs and harmonizes consumer tastes on a global basis.

Michael Porter (1990) also used the term globalization to differentiate a so-called multinational company from what he termed a global one. A multinational corporation is one that operates in several countries but makes no attempt to unify its operations from a strategic standpoint. The global company, on the other hand, pursues a world strategy with perfect coordination and integration between different national operations, generating synergies and allowing the whole to become far greater than its parts.

Kenichi Ohmae (1990) went a step further and defined the global company as one which has entirely abandoned its national identity, operating as a denationalized entity on a world scale. Consequently, the supervision of the nation state is basically irrelevant for this type of company, whose R&D activities, financing strategies, and human resource policies are also played out on a global stage. A typical example would be Nestlé, a Swiss company with just two Swiss nationals amongst its top ten executives. The rest are from five different foreign countries. Nestlé is present in 150 countries yet its activity in Switzerland is relatively insignificant.

The primary agents of globalization, then, are the big multinational corporations, both financial and non-financial, established in many or most countries. They raise trade and capital flows between regions and integrate markets on a global basis. However, these companies are only able to drive globalization thanks to a series of technological advances and political decisions that allow them the freedom to do so.

What are these determining factors in the globalization process? The first, undoubtedly, is technology. The development of new technologies in transport and telecommunications has led to a spectacular fall in costs.

Ocean freight costs per short ton, in 1990 US dollars, have come down to less than $30 in 2000, having been $100 in 1930. Average air transportation revenue per passenger mile has been reduced from $100 in 1930 to $10 in 2000. Moreover, jet air shipping and refrigeration have changed the status of goods that had previously been classified altogether as not tradable internationally, such as perishable fish, live lobsters, fruits, vegetables, and flowers. The cost of a three-minute telephone call from New York to London, for example, was $300 in 1930, $50 in 1960 and is now a few cents of a dollar. Satellite charges have come down from $100 of 1990 in 1975 to less than $1 in 2000. The cost of processing information by computer plunged from $100 per second in 1975 to a cent in 1995. Today, the cost is just $0.001 per second. The number of Internet users as a percentage of the total population has gone up from 1 percent in 1990 to 14 percent in 2000 as an average in the world, but up to 55 percent in the US, to 45 percent in the European Union, to 37 percent in Japan and to 18 percent in Emerging Asia (IMF, 2005).

The same can be said for road, air, or maritime transport. The cost of ocean transport as a percentage of the price of wheat has come down from 80 percent in 1830 to less than 10 percent today. Not only has the price of transport fallen; so has the importance of commodity trade in the world economy. The transport of raw materials and unprocessed food products has been replaced to a large extent by finished manufactured goods that are made with lighter materials and so occupy less space. In other words, the products traded today have a greater unit value and the cost of transport has fallen, reducing the ratio of the former to the latter. All of which has radically diminished the natural barriers of time and space between countries, and decimated the cost of sending goods, services, people, capital, technology, or information from one to another. The world size is shrinking as economies internationalize and become increasingly interdependent.

The second factor is the liberalization of the exchange of goods, services, and capital. This has taken place at a multilateral level via the General Agreement on Trade and Tariffs (GATT), the World Trade Organization (WTO), the Organization for Economic Cooperation and Development (OECD), and the International Monetary Fund (IMF), and has been strengthened by a plethora of unilateral, bilateral, and regional agreements between different national and regional authorities. As a consequence, average tariff rates have come down, between 1980 and 2000, from 30 percent to 12 percent in developing countries and from 10 percent to 4 percent in industrial countries. Global trade of goods and services has gone up from 20 percent of GDP in the early 1970s to about 55 percent of GDP in 2003 (IMF, 2005).

The depth of globalization

All this does not mean that the globalization process has yet assumed massive dimensions. On the contrary, there is still a long way to go. One of the simplest ways of measuring the extent of globalization in goods and services is by comparing the relation between external trade and output in each country. Although this proportion has grown constantly since the mid-1950s (i.e., the volume of international trade has risen much more rapidly than national output), it is still barely above its level a year before the outbreak of the First World War. The share of exports in world output reached a peak in 1913 that was not surpassed until 1970. In 1913 Japan, for example, was a more open economy than it is now. Then, the sum of Japanese exports and imports represented 30 percent of GDP. Today, it represents 22 percent. The UK has become more open. Britain's trade–GDP ratio has risen from 47 percent to 57 percent. France, Germany, and the USA have also increased the international exposure of their economies. Their trade–GDP ratios are now 51 percent, 69 percent, and 26 percent, respectively.

Obviously, the greater the size of a country or region, the smaller it is its trade to GDP ratio. While in countries such as the US, the European Union, and Japan, the ratio is between 22 percent and 26 percent, countries such as Holland, Belgium, or Ireland have ratios well over 100 percent. Spain, my own country, has undergone a radical transformation. In 1918 the sum of Spanish exports and imports represented 24 cent of GDP. In 1959, during the period of autarchy under the Franco dictatorship, it had fallen dramatically to 9 percent. Since then the ratio has soared to close on 60 percent, above countries such as France and Italy. As a whole, the volume of world trade has increased sixteen fold since 1950 while world GDP has only increased five fold. This trend toward larger openness has been helped by the lowering of tariffs and other barriers to trade. At the peak of the previous globalization episode, in 1913, average effective tariffs in Europe which were around 12 percent, are now less than 5 percent for the OECD countries, thanks to the GATT rounds, after having reached 22 percent in the 1930s. Nevertheless, their tariff dispersion is very large, being much higher in agricultural produce and in labor-intensive manufactures, which are making it very difficult for developing countries to access OECD markets.

Another way of measuring the globalization process is by observing price convergence between different national economies for goods and services that are identical or homogeneous. In an entirely globalized world economy, prices for the same goods should be exactly the same everywhere, once local taxes and transport and insurance costs are excluded. However, the present reality is a long way from this perfect state. Arbitrage, defined as the activity of buying an item in a place where it is cheap and simultaneously selling the same item where it is expensive, should drive prices to equality. Its failure to do so perfectly is a source of repeated surprise to economists. Often the explanation is that the commodities in question are not in fact identical. Brand names matter as well as marketing, retailing, warranties, and customer service. Exchange rates are also part of the culprit for the price difference. Nevertheless, these price differentials are a larger surprise in the case of non-differentiated non-branded commodities.

The fact is that there are still notable divergences between countries, even within the European Union. The pre-tax price of exactly the same model of car, for example, can be found to be up to 30 percent higher in some EU countries than in others. This occurs either because distribution in one country is more efficient than in others, because national tastes are different and there is a clear bias in favor of nationally produced vehicles, or because consumers have been unable to compare prices. Whatever the reason, multinationals discriminate in their pricing strategies between different countries and are able to obtain higher average profit margins for the same model. The euro introduction is slowly tending to close this gap as the existence of a single currency makes comparison of prices for goods and services far easier.

Markets between countries are less integrated than national markets, even when the countries in question share a border. The volume of cross-border trade between Canada and the US, for example, is twenty times smaller than inter-provincial trade in Canada, despite the existence of a 4,000 km long border and the near absence of trade barriers. The fact that they both have a different currency may help to explain their preference for national goods and services.

The integration and globalization of financial markets has increased faster than the trade in goods and non-financial services, thanks mainly to technological advances. Yet the process is still far from complete. One way of measuring the extent of financial globalization is by observing net outflows from countries that export capital because they have a surplus of savings, i.e., those with current account surpluses on their balance of payments, and net inflows of those that import capital because thay have a savings shortage and so have a current account deficit. During the first phase of globalization from 1870 to 1914, capital exports from the UK were 5 percent of GDP as a yearly average, and reached 10 percent in some years. In the last few years, Japan, with the largest current account surplus in the world, has only exported capital worth 3.5 percent of its GDP. The average net outflow from OECD economies is just 2.5 percent of GDP.

Another way of measuring financial globalization is by comparing foreign direct investment with national direct investment. In OECD countries today, FDI is equivalent to 6 percent of national investment while in the UK during the first 13 years of the twentieth century FDI was equal to all national investment. Only in the last few years, in large developing countries such as Mexico, Brazil, and China, has FDI been able to reach up to 20 percent of net national investment.

Nevertheless, if measured by the amount of the total foreign assets and liabilities of the different countries, financial globalization has increased at a fast pace. In 1970, industrial countries' foreign assets were 25 percent of GDP and foreign liabilities were 28 percent of GDP; today they have increased to 210 percent and 225 percent of GDP respectively. In emerging market countries, during the same period, foreign assets have increased from 9 percent of GDP to 72 percent and foreign liabilities from 27 percent to 95 percent of GDP (IMF, 2005).

Nor has there been a total convergence of interest rates (controlling for exchange rate risk) on a global basis as should occur in an entirely globalized financial system. In other words, exchange rates have not responded to or fully compensated the spreads between short-term interest rates (as we would expect from the interest rate parity theory), nor long-term spreads between inflation rates (an assumption of the purchasing power parity theory). As a consequence, interest rate convergence has been slow and volatile, but in the right direction. For the major OECD countries real interest rate dispersion has been coming down from a standard deviation of 12 percent in the 1940s and 1950s to that of 1 percent in the 1990s (IMF, 1997).

Nevertheless, financial globalization is advancing at a satisfactory pace. Between 1980 and 2003, while world real GDP has grown at an annual average rate of 3.5 percent, the exchange of bonds and shares has grown, in real terms, at an annual rate of 25 percent. Foreign exchange transactions

have grown at an annual rate of 24 percent and international loans have increased at a rate of 8 percent. Meanwhile, foreign direct investment has risen at an annual rate of 9 percent and trade in goods and services at an annual average rate of 7 percent. If financial globalization continues to proceed at this pace, the process could be completed within 25 years, while trade globalization may take more than 40 years, provided nobody places obstacles in the way of liberalization and the Millennium Round of the WTO goes ahead as planned, which is not yet the case today.

Globalization and asymmetry

One of the biggest problems for globalization is that while market integration for goods, services, and capital advances at a lively pace, labor markets are barely integrated at all. Robert Reich (1991) asks "Who are we?" and reaches the conclusion that in a world where most factors of production (capital, technology, production plants, capital goods) can be shifted from one country to another, except for non-tradable land, the only truly national factor is labor, which can globalize only very slowly or, in some cases, not at all. For this reason, the "we" in Reich's question are workers. Everything else is going global.

Labor mobility between OECD countries has stagnated in recent years and it advances slowly between developed and developing countries. This has led to an increasing divergence between per capita income in different countries and regions given that migration is the quickest, but not the optimal, way of equalizing income across countries. In the first wave of globalization between 1870 and 1914, more than 60 million people emigrated from Europe to America and a total of more than 100 million migrated globally out of an average world population of 1500 million; that is, migration accounted for 6.7 percent of the total. Today's migration flows are much smaller as a proportion of the total population. Immigrants represent close to 200 million out of a world population of 6,100 million; that is 3.3 percent, half that in the previous globalization. This slow integration between labor markets is a result of immigration control, on the one hand, and cultural, linguistic, and educational barriers, on the other. In 2000, the stock of migrants as a percentage of world population was almost 3 percent. The largest stocks of legal immigrants were in Oceania, with 19.1 percent of total population, in North America with 13 percent, and in Europe with 7.7 percent. The lowest stocks were in Latin America, with

1.1 percent, in Asia, with 1.4 percent, and in Africa, with 2.1 percent of total populations. In 2000, 7 percent of the population of the EU countries was foreign born, and out of 27 million non-nationals, 10 million came from other EU countries and 17 million from developing countries. In the United States 35 million – the 12.6 percent of the total population – were immigrants, most of them from Latin America.

Nevertheless, it is very likely that immigration into the OECD countries will rise significantly in the coming years in view of the problems posed by its increasing ageing population. In 2004, the median age of the OECD population was 39 years, and it is likely to reach almost 50 years by 2050, while, in the developing countries, median age will go up only from 24 years now to 35 years in 2050 (United Nations, 2005). This trend will make it more necessary than ever to have an international organization that tries to guide the increasing migration flows as well as their different contractual systems and the proper treatment of migrants in the countries of destination.

Despite all this, the present phase of globalization has more solid foundations than the former period at the beginning of the century. Then, far fewer countries were part of the process. Never before have so many economies been open to global trade and finance flows than now, after the liberalization of the former communist economies. Technological advances in telecommunications mean that global companies are more integrated than ever and that the market can integrate consumers and producers faster through the Internet. Technology has also powered the development of financial markets, speeding up transactions, settlements, and payments to an extraordinary extent. Daily transactions in foreign exchange markets, for example, have risen from $15 billion to $3 trillion, a 200-fold increase in just 30 years. While net capital flows, as we have seen, have not increased from their levels at the beginning of the twentieth century, gross flows of foreign exchange, bonds, deposits, and stocks have risen exponentially, all thanks to increases in velocity and integration facilitated by information technology.

Present-day globalization is also far more widely institutionalized than the first wave. The existence of international organizations like the WTO, the IMF, and the OECD as well the development of multinational corporations and global financial entities, all make it much more difficult to reverse the process.

Bordo, Eichengreen, and Irwin (1999) go further and argue that the world we live in today is radically different from that of the early twentieth century partly because political systems are more democratic and, therefore, allow greater representation of citizens' interests but also because the character of globalization itself has changed. Integration is broader and deeper than a hundred years ago. International trade represents a greater proportion of output and both trade and investment now reach sectors such as retailing, and public and private services that were localized and closed in the years before the First World War. Financial integration is far greater and far more profound than then, despite the fact that FDI has still not reached previous levels. Finally, these economists believe that the evident tensions in the process of trade liberalization and financial instability should not be too great a cause of concern now since they were similar or greater at the beginning of the century, despite lower levels of globalization than those which we enjoy today.