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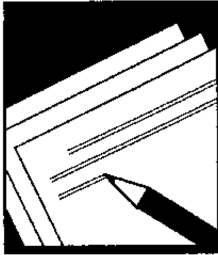

IMF Policy Discussion Paper

Globalization: Facts and Figures

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Research Department

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Abstract

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Globalization has become the focus for a wide range of protests against various features of the world economy. This paper aims to give a concise summary of the economic dimensions of globalization, while leaving to one side other aspects—such as cultural, environmental, or political ones—that are beyond the scope of the IMF. Periods of increased globalization have tended to be associated with technological innovations that reduce transportation and communications costs and with generally rising standards of living. Moreover, countries that have embraced openness to the rest of the world have done better than those that have not. Nevertheless, globalization may also be associated with increased inequality and volatility, which may justify strengthening domestic safety nets and financial supervision and regulation, and enhancing international economic policy coordination. The IMF helps to ensure economic gains from globalization by encouraging trade liberalization, reducing countries' vulnerability to crises, lending to them when they are in difficulty, and assisting them in putting in place structural reforms that help reduce poverty.

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I. Introduction

Globalization is a phenomenon whose economic dimensions involve increases in the flows of trade, capital, and information, as well as mobility of individuals across borders. Even though it has received much attention in the last few years—indeed, an inordinate amount—it is by no means new. It has been argued that globalization has proceeded throughout the course of recorded history, though not in a steady or linear fashion.[2] It has been driven in many cases by significant technological advances, and has, as such, been associated with the vast improvements in prosperity that the world has experienced in recent centuries.

While increased international trade and capital flows (relative to domestic activity) associated with globalization have been the source of an unprecedented rise in living standards around the world, neither the process of globalization nor the gains are guaranteed or automatic. On the contrary, there are numerous examples from the 20th century of countries limiting their exposure to foreign trade and capital. However, attempts to restrict the advance of globalization hamper individual countries' abilities to share in the gains, and can have disastrous consequences when imposed on a global scale. An example is the generalized attempt to turn inward and cut off influences from the outside world that occurred during the period between the two world wars of the twentieth century.

Despite a general trend to increasing globalization in the post-1950 period, not all countries have benefited, nor have all citizens of a given globalizing country prospered. Those countries that have seen the greatest increases in per capita income have pursued outward oriented policies, rather than a policy of import substitution, and have put in place structural reforms to develop the institutions necessary for good governance and economic growth and to increase their economies' flexibility. Strong growth gives governments the resources to improve the prospects of the poor. Since globalization, like technological change, produces both winners and losers within each country, it is important to put in place social safety nets to cushion the

[2] O'Rourke and Williamson (2000) however argue that globalization only began in the 19th century, following dramatic declines in transportation costs.

losers from the worst effects and more generally to put in place policies that equalize opportunities, including improved public education, health and security.

Finally, the international financial institutions have a crucial role in ensuring that globalization occurs in an orderly fashion. This role has become prominent with the financial crises that struck emerging markets in recent years; while the hardships resulting from these crises have far from erased the gains from openness in the countries affected, preventing such crises and alleviating their consequences would clearly be beneficial. In particular, the IMF must help to create a financial architecture that decreases the risk of crisis and eases the burden of adjustment on countries negatively affected by crises.

II. The Recent Experience of Globalization in Historical Perspective

It is instructive to compare the post-1950 period of globalization with the previous phase of strong globalization that occurred in the late 19th-early 20th centuries, because they are probably the two periods of strongest sustained output growth in world history (see Annex, *World Economic Outlook*, May 1997). The turn of the century also exhibited rapid growth in world trade, as the expansion of exports (3.5 percent per year) significantly outpaced that of real output (2.7 percent). The share of exports in world output reached a peak in 1913 that was not surpassed until 1970. Growth in trade occurred partly as a result of reduced tariffs, but more importantly was due to sharply falling transportation costs (Table 1). In the 50 years before World War I, there was a massive flow of capital from Western Europe to the rapidly developing countries of the Americas, Australia, and elsewhere. At its peak, the capital outflow from Britain reached 9 percent of GNP, and was almost as high in France, Germany, and the Netherlands. Capital importing countries, such as Canada, had current account deficits that reached 10 percent of GDP. These levels of net capital flows were favored by the fact that the world was on the gold standard which ensured convertibility and stable exchange rates. Migration was also very large during this period, with decadal migration in the 1880s, 1890s and 1900s equaling 5–7 percent of the population in several of the European countries sending emigrants, 4–9 percent in the United States, and much higher figures for other "new world" countries receiving immigrants (Baldwin and Martin, 1999).

The late 19th century–early 20th century period of globalization came to an end with the outbreak of world war, the unsuccessful attempt to revive the gold standard, and the great depression. Governments mistakenly thought that they could protect their citizens from an economic downturn abroad by raising tariffs and restricting imports. In fact, this just worsened the global depression and led to sharply reduced trade, plunging output, and pervasive unemployment. The post-1950 period of globalization and prosperity has been driven by the lowering of the barriers to trade and capital flows erected in the 1930s, as well as continued decline in transportation costs and, especially recently, communication costs.

The current period of globalization is in several respects less pronounced than the pre-World-War-I period. Net capital flows have been more modest. Capital exporting countries have rarely had current account surpluses that exceeded 5 percent of GDP, and similarly the sustainable deficits of net capital importing countries (now drawn from the ranks of so-called emerging market countries) have generally been below that figure. While transportation costs have seen a further fall (Table 1), it has been less dramatic than in the earlier period. And officially-sanctioned migration has been considerably more restricted than earlier, as the richer countries that are the preferred destination of migrants have limited their number. This in turn has led both to pent-up migration pressures and to illegal immigration (Hatton and Williamson, 2001).

While the nature of the technological innovations that characterize the recent period (such as those related to telecommunications, computers, and the Internet) is no doubt unique, the earlier period was also characterized by major inventions (such as the internal combustion engine, steamship, telephone, and telegraph) that decreased communication and transportation costs. As now, technological change was a major force for increasing the interdependence among countries, thus fuelling globalization. Conversely, globalization, in the form of the spread of information across borders, has allowed a far greater number of people to share in the benefits of those innovations.

Table 1. Transport Costs, 1830–1990

	Ocean Transport		Average Air Transportation Revenue per Passenger Mile (in 1990 US$)
	Wheat, Percent of Production Costs	Ocean Freight 1920 = 100	
1830	79		
1850	76		
1880	41		
1910	27.5		
1920		100	
1930		65	0.68
1940		67	0.46
1950		38	0.30
1960		28	0.24
1970		29	0.16
1980		25	0.10
1990		30	0.11

Sources: Baldwin and Martin (1999); *World Economic Outlook*, May 1997, Table 11.

III. Globalization in the Post-War Period

Since the Second World War, globalization has resumed, as the barriers to trade in goods and services, capital, and ideas that were imposed during the great depression and world conflict were rolled back, and technology has advanced, especially in the area of communications and computers (Table 2). The past fifty years have also seen a remarkable rise in living standards, as well as dramatic improvements in health and education (Table 3). While these advances have had other causes, including reconstruction after the wars, globalization has facilitated their spread throughout the world. For instance, medical advances have been pioneered in the richer countries, but improvements in health have also occurred in developing countries—indeed, to an even greater extent. Infant mortality rates declined by 40–50 per thousand from 1970–1999 in developing country regions, versus 13 per thousand on average in the developed countries. Life expectancy rose dramatically, as well. In China it essentially doubled (to 70 years) over 1960–99, while in India, it rose by 20 years, to 64 years (life expectancy rose in the United States from 70 to 77 years over the same period). Education has also shown a strong improvement in developing countries. For instance, adult illiteracy rates (Table 3) have declined by about 30 percentage points in China, Ghana, India, Korea and Mexico, over the

past three to four decades. The advances in living standards, health, and education have occurred because flows of goods, capital and information have allowed poorer countries to use modern technology in local production and public services.

Table 2. Communication and Computer Costs, 1960–2000

	Cost of a 3-minute Telephone Call, New York to London (in 2000 US$)	Price of Computers and Peripheral Equipment Relative to GDP deflator (2000 = 1000)
1960	60.42	1,869,004
1970	41.61	199,983
1980	6.32	27,938
1990	4.37	7,275
2000	0.40	1,000

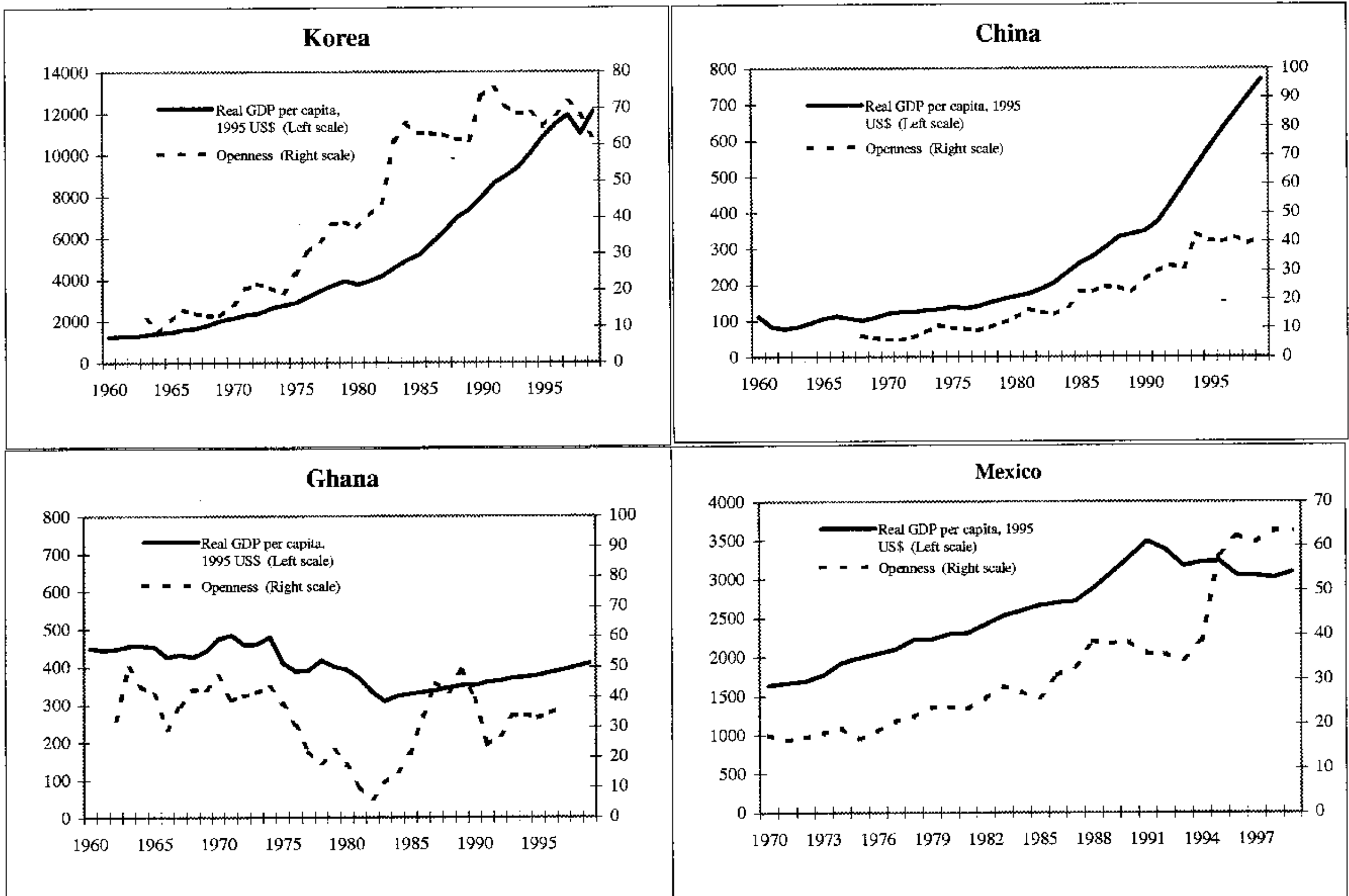
Sources: *World Economic Outlook*, May 1997, Table 11, updated to 2000; U.S. Commerce Department, Bureau of Economic Analysis.

Clearly, real GDP growth in a country creates the means necessary for sharing the benefits of globalization among the population: only with growth are the poor able to lift themselves from poverty. Cross country evidence suggests that incomes of the poorest 20 percent of the population increase roughly one-for-one with average per capita income: growth is good for the poor (Dollar and Kraay, 2001).

The evidence is strong that openness to international trade is a key ingredient of more rapid growth. The World Bank has classified countries on the basis of the extent that they increased trade relative to income in the post-1980 period. The top third of developing countries classified on this basis—termed the "new globalizers"—lowered average import tariffs by 34 percentage points and increased trade relative to income by 104 percent. In these countries, per capita income grew by 3.5 percent per annum in the 1980s and 5 percent in the 1990s. In contrast, the remaining developing countries—termed the "marginalized countries"—lowered tariffs by only 11 percentage points and saw little or no growth in GDP per capita in the post–1980 period (World Bank, 2001).

Figure 1 gives some illustrations of the dramatic increases in per capita income in constant prices that have accompanied the expansion of trade of those countries which have globalized. For instance, Korea has seen an average annual increase of 6.0 percent, doubling real incomes every 12 years, and increasing them more than 8-fold between 1960 and 1999. China has seen average growth of 5.1 percent over that period. In Africa, Ghana saw its per capita income increase steadily after 1983, once its policy of inward focus and declining openness was reversed. Mexico has seen a dramatic increase in openness since 1970 and substantial per capita income growth, albeit punctuated by economic crises. Other countries in Asia, Africa and Latin America that opened their economies also experienced faster growth than in the advanced countries.

Figure 1: Trade Openness[1] and Real Per Capita Income



1/ Sum of Exports and Imports, divided by GDP.

Table 3: Infant Mortality, Life Expectancy, and Adult Illiteracy, Selected Countries and Regions, 1960–99

	1960	1970	1980	1990	1999
China					
Infant mortality rate (per 1,000 live births)	132	69	42	33	30
Life expectancy at birth (years)	36	62	67	69	70
Adult illiteracy rate (%)		49	35	23	17
Ghana					
Infant mortality rate (per 1,000 live births)	131	112	94	66	57
Life expectancy at birth (years)	45	49	53	57	58
Adult illiteracy rate (%)		71	56	42	30
India					
Infant mortality rate (per 1,000 live births)	151	137	116	92	70
Life expectancy at birth (years)	43	51	55	59	64
Adult illiteracy rate (%)	76	64	57	52	48
Korea					
Infant mortality rate (per 1,000 live births)	82	46	26	12	8
Life expectancy at birth (years)	54	60	67	70	73
Adult illiteracy rate (%)	29	13	7	4	2
Mexico					
Infant mortality rate (per 1,000 live births)	93	73	51	36	29
Life expectancy at birth (years)	57	62	67	70	72
Adult illiteracy rate (%)	38	25	18	12	9
United States					
Infant mortality rate (per 1,000 live births)	26	20	13	8	7
Life expectancy at birth (years)	70	73	76	76	77
Adult illiteracy rate (%)	2	1	< 5	< 5	< 5
Sub-Saharan Africa					
Infant mortality rate (per 1,000 live births)		132	114	107	92
Life expectancy at birth (years)				51	52
Adult illiteracy rate (%)				50	43
East Asia and Pacific					
Infant mortality rate (per 1,000 live births)		77	56	35	35
Life expectancy at birth (years)				68	68
Adult illiteracy rate (%)				24	17
South Asia					
Infant mortality rate (per 1,000 live births)		138	120	93	75
Life expectancy at birth (years)				58	61
Adult illiteracy rate (%)				54	51
Latin America and Caribbean					
Infant mortality rate (per 1,000 live births)		82	60	48	31
Life expectancy at birth (years)				68	69
Adult illiteracy rate (%)				15	13
Developed / High Income Countries					
Infant mortality rate (per 1,000 live births)		19	13	8	6
Life expectancy at birth (years)				77	77
Adult illiteracy rate (%)					

Source: World Development Indicators and World Development Report (various issues), World Bank.

The preponderance of empirical evidence suggests that promoting openness, and supporting it with sound domestic policies, leads to faster growth (Srinivasan and Bhagwati, 1999). The earlier strategy of attempting to grow through import substitution—that is, by limiting ties with other economies—has been conclusively shown to have failed, as there are *no* successful cases of fast-growing countries that followed this strategy in the recent period (Krueger, 1978; Lindert and Williamson, 2001).

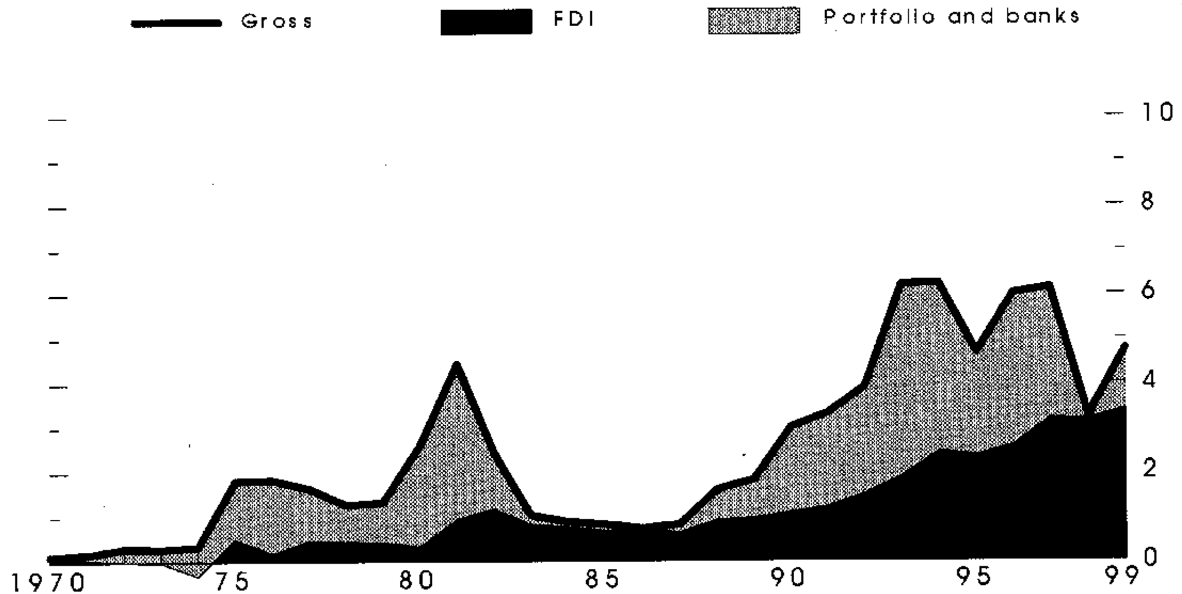
Studies of the effects of the most recent round of global trade liberalization, the Uruguay Round, bear this out. Reducing tariff and non-tariff barriers is estimated to have produced annual increases in global GDP (in 1992 dollars) of between $100–300 billion (with a few estimates below or above this range), which is 1½ to 5 times total aid flows to developing countries. Moreover—and contrary to the rhetoric of the protectionists—most of the gains accrue to the countries (including especially advanced countries) that offered the most concessions in the negotiations (Harrison et al., 1997; Whalley, 2000). As with technological change, however, not everyone gains from trade liberalization: as countries better exploit their comparative advantage, formerly protected sectors may shrink and their workers suffer. However, detailed studies of trade liberalizations suggest that the benefits are more than ten times the costs (Matusz and Tarr, 1999).

Capital market integration is another feature of globalization that has expanded substantially in recent years. Capital inflows contribute to growth by stimulating investment and promoting financial development. While capital flows to developing countries have been subject to volatility, foreign direct investment has exhibited the steadiest sustained growth (Figure 2).

Figure 2

Developing Countries: Gross Capital Flows
(Percent of GDP)

Gross capital flows have risen over time, but are also volatile.



Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

FDI has clear benefits for host countries because it is often associated with transfers of technology as well as financing, and it tends to be more stable than other capital flows. Recent crises have pointed to the need to provide appropriate incentives for capital to stay in a country and not flee at the first sign of trouble. More generally, countries with more open capital accounts tended to grow faster in the 1980s and 1990s, although experience across countries has varied (Chapter IV, *World Economic Outlook*, October 2001). Another aspect of integration with international capital markets is openness to trade in financial services. Cross-country evidence indicates that opening domestic financial markets to foreign financial institutions brings significant increases in stability and efficiency (Litan et al., 2001). Entry by foreign banks tends to aid diversification of domestic risks, enhance competition and efficiency, and lower moral hazard (Mishkin, 2001).

IV. Problems and Policy Challenges Accompanying Globalization

While globalization generally brings benefits, it is also associated with problems which have raised legitimate concerns. Apart from cultural, environmental, and political issues, which are not discussed here, the two principal areas of concern are **inequality** (both within and across countries) and **volatility** (in financial markets and of economic activity). In particular, there has not been a narrowing of global income inequalities, either across countries or within a number of individual countries, and recent emerging market financial crises have brought home the risks of exposure to international capital markets. In these areas, there is scope for improving government policies and the operation of the international economy in order to widen access to the benefits of globalization.

Inequality

Global inequality has two dimensions: inequality across and within countries. While per capita income has grown for the world as a whole, not all countries have experienced satisfactory growth, so that the average per capita income **across** all countries (advanced and developing) has become more dispersed—despite convergence among the advanced countries (Pritchett, 1997). Moreover, **within** some countries, inequality has increased over the past two decades (Table 4). As a result, global income inequality (combining the effect of developments within and across countries) rose throughout much of the post-World-War-II period (and the previous century), though by some measures it seems to have at least stabilized since 1990 (Dollar, 2001).

The causes of increased inequality have given rise to vigorous debate. Within industrial countries, it is linked to the widening skill premium that is reflected in the increasing gap between wages of skilled and unskilled workers. This contributes to the increases in inequality in the United Kingdom and the United States, for instance (Table 4). Evidence suggests that it is technological change, not trade with lower-wage developing countries, that has driven that widening premium (Slaughter and Swagel, 1997; Krueger, 2000; Krugman, 2000). Therefore, there seems to be little support for the contention that increased openness and reduced barriers to trade have been a significant cause of widening inequality **within** advanced countries.

Moreover, as a group, per capita incomes **across** these countries have strongly converged over the past 50 years.

Table 4: Income Inequality (Gini Index): Selected Countries

Year	1950	1960	1970	1980	1990	1995	1997/98
Brazil			57.6	57.8	59.6	60.1	
China				28.8	34.6	41.5	40.3
Ghana					36.7	32.7	32.7
India	35.5	32.6	30.4	31.5	29.6	29.7	37.8
Korea	34.0	32.0	33.3	38.6	33.6	31.6	
Mexico	52.6	55.5	57.9	50.5	54.9	53.7	
Poland			25.8	24.8	26.2	33.0	
Sweden		33.4	27.3	32.4	32.5	25.0	
United Kingdom		25.3	25.1	24.9	32.3		
United States	36.0	34.8	34.1	35.2	37.8	45.0	40.8

Source: Dollar and Kraay Database on Income Inequality, World Bank; indices may not be comparable across countries, in particular because some are net of taxes while others are not.

Within some developing countries, inequality has also increased even as income has grown for both rich and poor. Many factors can be expected to affect inequality, some of them specific to the countries concerned (such as wars and natural disasters) while others are more general (such as technological change, mentioned above), so it is wrong to try to link it solely to globalization. In China, opportunities in the rapidly developing cities have exacerbated the gaps between rural and urban incomes. However, those regions that were more open to international trade experienced a decline in urban–rural inequality, so globalization per se does not seem to have been the cause of greater inequality (Wei and Wu, 2001). In the transition economies in Central and Eastern Europe, widening inequality was an inevitable outcome of the return to a system of economic incentives and rewards. In some countries, however, high inequality may reflect lack of opportunity and the persistence of poverty, which can be the source of social conflicts that inhibit the achievement of adequate growth and development.

It seems likely that globalization in fact promoted convergence of per capita incomes between poor and rich countries. As discussed above, per capita income has grown faster in globalizing developing countries than in rich countries—5 percent versus 2.2 percent a year in the 1990s. By contrast, per capita incomes have barely grown in countries that did not globalize, increasing the gap with rich countries. The difference in performance thus accounts for the

apparent lack of general convergence between rich and poor countries taken together. But the persistence of inequality across countries is a powerful force for **migration** to richer countries. Baldwin and Martin (1999) note that the earlier (pre-World-War-I) period of globalization saw lower formal barriers to migration and much larger flows. Nevertheless, formal barriers often prove ineffective, so this aspect of globalization will no doubt continue to be prominent as long as economic incentives for migration remain.

Volatility

The second major problem concerns the volatility in financial markets that openness to global capital markets seems to bring, and, more generally, the volatility of economic activity. The 1990s saw a series of financial crises affecting individual countries, regions, and even global financial markets. Recent international financial crises seem to be the result of home-grown vulnerabilities related to financial sector weaknesses, overvalued exchange rates, and unsustainable fiscal positions, often accompanied by volatile market sentiment and contagion effects from other countries. But the experience of these crises has been that they brought dramatic movements in exchange rates and current account balances that far exceeded any initial disequilibria, and were associated with severe economic contractions.

Another aspect of globalization, the spread of the information technology (IT) revolution, has strengthened real and financial linkages across countries (Chapter III, *World Economic Outlook*, October, 2001). The prices of IT goods have gone through large swings in recent years, and as a result a number of Asian countries and others have been exposed to high volatility in their export earnings. In addition, business cycles, flows of foreign direct investment, and stock price indices have become more synchronized as a result of the increasing importance of IT goods for many countries. Volatility derived from exposure to the global market for IT goods, combined with the uncertainty concerning underlying productivity growth (given the rapid pace of innovation in the IT sector), call for greater prudence in setting macroeconomic policies.

Policy Responses

Governments, with the help of the international financial institutions, need to address both of these problems. The persistence of poverty requires adequate social safety nets to mitigate negative effects on the most disadvantaged and government spending on public education, health, and security, that help to equalize opportunities. Tax competition (especially the tendency for the most mobile factor, capital, to flee high taxation) may, however, limit the scope for governments to raise revenue. The International Monetary Fund can contribute through financing associated with the PRGF and the HIPC Initiative in support of a coherent program of economic policies, and through technical assistance for capacity building to strengthen the institutional framework. Policies aimed at maintaining macroeconomic stability can help moderate the unemployment and wage losses associated with economic downturns, as well as the unfavorable effects of inflation, which has a disproportionately heavy impact on the poor.

Another important step is the further opening by rich countries of their markets to exports from developing countries by reducing tariff and non-tariff barriers and domestic subsidies (especially on agricultural goods, textiles, and clothing) so that the less developed countries can get the full benefits of the global trading system. Calls in rich countries for environmental and labor standards in developing countries are often presented as being motivated by a concern for limiting the adverse impact of globalization on poor countries. In fact, their effect would be to create barriers to the growth-creating trade that permits poor countries to narrow the gap with rich countries.

Improvements in the international financial architecture are aimed at decreasing the likelihood of crises and mitigating their costs. IMF initiatives in this area include mechanisms for private sector involvement, enhanced early warning systems, and the Contingent Credit Line facility. Though financial openness (once it has been achieved) brings important advantages, opening up an economy needs to be done in an orderly way and after strengthening domestic financial institutions through enhanced supervision, regulation, and transparency, and strengthening macroeconomic stability. The IMF can help governments make their financial systems more

robust through implementation of standards and codes (including those related to monetary and fiscal policies and to data dissemination) and the Financial Sector Assessment Program.

In sum, globalization, though it needs to be managed properly, has widespread benefits, including for the least fortunate. With properly designed policies, it can be harnessed to reduce poverty while at the same time keeping financial market volatility in check. The alternative, to attempt to reverse the course of globalization, is likely to reduce global prosperity sharply, with unfavorable effects on rich and poor alike.

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