NEW THREATS TO GLOBALIZATION

Address to a dinner for the

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by

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To Mr Peter O'Byrne, CEO of Austrade, Mr Yasushi Hayashi, Chairman and CEO of Jetro, the Honourable Bruce Baird MP, officials and other distinguished guests from overseas, ladies and gentlemen, thank you very much for the extraordinary privilege of being able to speak with you at such an august gathering.

You are meeting here, for the twentieth time, after two decades which have seen an astonishing increase in the extent and range of engagement and interaction among the countries represented here, and between them and other parts of the world.

Twenty years ago, exports of goods and services accounted for about 17% of world GDP – a figure not much higher than it was on the eve of the First World War. Over the past twenty years, exports of goods and services have risen at an average annual rate of 9.0%, half as fast again as the growth rate of world GDP. As a result, last year exports of goods and services exceeded 30% of global GDP for the first time[1].

Twenty years ago, the stock of outward foreign direct investment was equivalent to about 6.5% of annual world GDP. Today it is around 23%. Foreign affiliate enterprises now produce almost ten cents in every dollar of world GDP, and are estimated to employ directly over 62 million people world-wide, or about 2% of the global labour force, compared with fewer than 24 million people twenty years ago[2].

Nowhere in the world have these trends been more dramatic than in Asia. Twenty years ago, merchandise exports accounted for just 7½% of Asian GDP[3], barely more than half the figure for the world as a whole.

Since then, Asian merchandise exports have increased by just over 13% per annum, on average, compared with 8½% per annum for the rest of the world. Last year, merchandise exports accounted for 25.2% of Asia's GDP, slightly above the corresponding figure for the world as a whole of 24.8%. Add in commercial services, and exports represented 28.5% of Asia's GDP in 2005 (2006 data are not yet available).

Asia now accounts for 22½% of the world's merchandise exports, almost exactly double its share years ago, and for 22% of the world's exports of commercial services.

Asia has absorbed around 19% of total global foreign direct investment inflows over the past three years, nearly double its share of these flows two decades ago. These flows funded more than 10% of all fixed investment in Asia in 2005. Some 14% of the global stock of FDI is now located in Asia, up from about 9% two decades ago[4]. The stock of inward foreign direct investment into Asia is equivalent to almost 26% of GDP.

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[1] Statistics from World Trade Organization, *International Trade Statistics 2006* and International Monetary Fund, *World Economic Outlook* September 2006 database.
[2] Statistics from United Nations Conference on Trade and Development, *World Investment Report 2006* and International Labour Organization, *Global Employment Trends.*
[3] 'Asia' in this paragraph includes Japan and the countries of East and South Asia. Statistics quoted are sourced from International Monetary Fund *Direction of Trade Statistics* in addition to the sources referred to in footnote 1.
[4] Note that some 44% of the stock of FDI is in the European Union, much of it intra-EU investment.

Asia has also been the origin of about 13% of global foreign direct investment outflows over the past three years. While this is down from a share of nearly 25% in the late 1980s, this decline is entirely attributable to a sharp fall in FDI emanating from Japan; other Asian economies have provided almost 8% of global FDI outflows over the past three years.

Twelve of the world's top 100 non-financial transnational corporations are Asian (eight are Japanese, and one from each of Korea, China, Malaysia and Singapore), as are three of the world's top 50 financial TNCs.

This increasing integration and engagement with the global economy has considerably assisted the growth of Asian economies and improvements in the standard of living of the people of Asia. Asia's real per capita GDP[5] has risen at an average annual rate of 4¼% per annum over the past two decades – or by 5½% per annum excluding Japan – compared with just 0.1% per annum in the rest of the world. Per capita Asian GDP has risen from 42% of the global average twenty years ago to 70% last year; or, excluding Japan, from 29% to 60% of the global average.

Moreover, the gap between the per capita income of Asia's richest economy, Japan, and its poorest, Laos[6] has narrowed from nineteen times to just under fourteen times over this period. Vietnam, which was almost as poor as Laos twenty years ago, has since seen its per capita income rise from one-twentieth to one-tenth of Japan's figure.

The economic growth and industrialization of Asia, led initially by Japan, followed by Korea and the other what were called 'Newly Industrializing Economies' in the 1980s and now gaining massive impetus from China, India and Vietnam, has of course been enormously beneficial to Australia. No longer do we derive 90% of our export income from selling wool and other primary products to Britain, as we did until the 1950s. Twenty years ago, just over 50% of Australia's exports went to Asia and around 38% of our imports came from Asia. Today, Asia takes nearly 63% of Australia's exports and supplies over 52% of our imports.

Moreover, Asia's willingness to pay higher prices for Australia's mineral and energy exports, and its growing ability to supply an increasing range of manufactured goods (and in some cases services) at lower prices than Australia can itself, has halted and dramatically reversed the deterioration in Australia's terms of trade which contributed (along with our own economic mismanagement) to this country's slide down the 'league ladder' of relative per capita national income over the first nine decades of the 20th century.

It is worth making the point that the increasing engagement with the global economy through (among other things) trade and investment that has played such a crucial role in promoting economic growth and lifting living standards across Asia over the past twenty years has come about as a result of conscious decisions by Asian governments to facilitate and foster it.

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[5] Measured, as it should be for these purposes, at purchasing power parities. Statistics quoted in this paragraph from the IMF's *World Economic Outlook* September 2006 database and author's calculations.
[6] Excluding Burma (Myanmar) and North Korea, which have continued to 'opt out' of greater engagement with the global economy and – largely as a result – have remained the poorest economies in the region.

Unlike the 'globalization' of the 19th century, which in many instances was forced upon Asia by a combination of European colonialism, 'gunboat diplomacy' and 'unequal treaties', during the last quarter of the 20th century and the first decade of the 21st century Asia has 'globalized' by choice. No 'black ships' forced China, India or Vietnam to join the World Trade Organization. No threat of European or American military power paved the way for European, American, Australian or for that matter other Asian companies to sell goods and services or open factories and offices in Shenzhen, Shanghai, Guangdong, Bangalore, Ho Chi Minh City, Penang or Balikpapan.

And yet I believe it is not being unduly alarmist to say that 'globalization' as we understand it today is under greater threat now than at any other time during the last thirty years – and certainly more so than a few years ago when meetings and occasions such as these were routinely besieged by rowdy and usually violent demonstrations.

There is a widespread view, fostered by authors such as Thomas Friedman[7], that the processes encapsulated in the term 'globalization' are inevitable and unstoppable. Yet even the most casual reading of history tells us that this is simply not true. The onward march of technological progress, which is undoubtedly one of the factors enabling greater economic and social engagement and integration among nations, may well be unstoppable. But this engagement and integration also requires the consent of governments. And what governments give they (or subsequent governments) may also take away.

The last three decades of the nineteenth century witnessed technological innovation no less dramatic in its impact than that of the past thirty years. According to Professor Kevin O'Rourke of Trinity College, Dublin, 'no other innovation, including … the telephone or … the internet, has had comparable impact on the speed of information flows and capital market integration' as the laying of the first transatlantic cable in 1866[8].

Yet during this period, beginning with Bismarck's tariffs of 1879, 'there was a powerful and comprehensive globalization backlash on the European Continent prior to World War I, and it was even more dramatic in the New World'[9]. American tariffs escalated sharply after having been initially increased as a revenue-raising measure during the Civil War: whatever their other virtues, the victorious North (and in particular the Republicans) were unabashed protectionists, the vanquished South, whatever their other vices, were free-traders.

Here in Australia, the [then] pre-eminent colony of Victoria introduced tariffs in 1865 at a maximum rate of 10%; but by 1893 the maximum rate had risen to 45%. Immigration policy in the United States, Canada, South American and Australia also began to become more restrictive during this period[10]. These developments did *not* begin after, and were *not* solely a consequence of, the First World War.

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[7] Thomas Friedman, *The Lexus and The Olive Tree* (Harper Collins, 1999) and, more recently, *The World is Flat* (Penguin, 2006).
[8] Kevin O'Rourke, 'Europe and the Causes of Globalization', Chapter 3 in Henryk Kierzkowski (ed.), *Europe and Globalization* (Palgrave Macmillan, 2002), pp. 74-76.
[9] Kevin O'Rourke and Jeffrey Williamson, *Globalization and History* (MIT Press, 1999), p. 117.
[10] Ibid. pp. 185-195.

Although there were perhaps fewer epoch-defining technological innovations during the 1920s and 1930s than in the last decades of the 19th century, this was nonetheless a period when technologies invented some decades earlier – such as electricity, radio and the automobile – became much more widely diffused than they had been hitherto, at least in the more advanced economies.

Yet this was, as is widely understood, a period in which governments around the world consciously sought to 'roll back' the globalization of the pre-1914 era (so wistfully described by Keynes in 1919[11]) – and in which they emphatically succeeded in doing so.

There are two things about the anti-globalization backlash of this period that are important to understand if we are to learn the lessons from it that are relevant to today.

The first is that it did *not* begin with the Smoot-Hawley Tariff of 1930. The groundwork for Smoot-Hawley was laid by the Fordney-McCumber Tariff Act of 1922. Most other industrial countries also raised tariffs, and further restricted migration, during the 1920s[12].

The second thing is that – notwithstanding their devastating economic and social consequences (including not just the Great Depression but the rise of Hitler in Germany and the militarists in Japan) – policies aimed at restricting trade, capital flows and migration enjoyed widespread popular support.

Globalization is under threat today, not from violent demonstrators motivated more than anything else by a hostility to capitalism and to liberal ideas for which 'anti-globalization' provides a more acceptable cloak than Marxism, but from a growing belief on the part of some governments that there are no votes in it, and indeed that there might be votes to be had in 'rolling back' at least some aspects of globalization – as it was in the latter part of the 19th century, and again in the 1920s and 1930s.

As Jeffrey Immelt, CEO of General Electric, has observed, 'if you [were to] put globalization to a popular vote in the US, it would lose'[13].

The threat to globalization is evident in the inability or unwillingness of a growing number of governments to complete the Doha Round of trade negotiations, notwithstanding the overwhelming evidence of the benefits to be gained by doing so[14].

And it is evident in the mounting protectionist sentiment in the United States, most recently exemplified by the Commerce Department's 30 March preliminary ruling foreshadowing the imposition of 'countervailing duties' on imports of coated paper from China.

Given the overwhelming evidence of the damage done by protectionism (evidence which I assume it is not necessary to recount this evening), why is it so popular?

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[11] In *The Economic Consequences of the Peace* (London, Macmillan, 1919), pp. 6-7.
[12] Harold James, *The End of Globalization* (Harvard University Press, 2001), pp. 108-133 and 172-186.
[13] Quoted by Pankaj Ghemawat, 'The Myth of Globalization', published in the *Australian Financial Review* 'Review' section, 16 March 2007, p. 4.
[14] See, for example, The World Bank, *Global Economic Prospects 2007: Managing the Next Wave of Globalization* (Washington DC, December 2006), pp. 89-90.

Part of the reason, I believe, is because of the way in which politicians and trade officials typically seek to 'sell' trade liberalization to their electorates. Almost without exception, trade negotiations are presented as a matter of reluctantly making 'concessions' to other countries – by lowering barriers to imports from them, or by allowing inflows of investment from them – in order to gain 'concessions' from other countries in the form of enhanced access to their markets. Yet, in truth, the greatest benefits of trade liberalization come from the enhanced access it gives a nation's consumers to a broader range of cheaper and often higher-quality imports.

The essentially mercantilist presentation of the benefits of trade liberalization – 'exports good, imports bad' – panders to the widespread belief that tariffs are something a country make foreigners pay in order to get their goods into its market; as opposed to the truth which is that tariffs are something a country forces its own consumers to pay in order to keep foreign-produced goods *out* of the country. Little wonder, then, that reducing tariffs is so rarely popular; or that imposing or increasing tariffs, especially when described in such superficially heart-warming terms as 'protecting jobs', enjoys such widespread support.

The truth is, as a former Secretary to the Australian Treasury put it more than 27 years ago, in a context (of rising commodity prices and capital inflows) which for this country was not too dissimilar from today's, in a speech which (unlike one recently given by the current Secretary to the Australian Treasury) was intended to be heard and read by a large audience, 'the more successful we prove to be at exporting, the more successful we are going to have to be at importing'[15].

As an historical aside, after John Stone gave this speech, the Australian Chamber of Manufactures (one of the organizations representing Australia's then highly-protected manufacturing sector) complained about it to the then Prime Minister and Deputy Prime Minister (who in turn complained to the Treasurer, only to discover that Mr Stone had 'cleared' it with his then Ministerial boss) and sought to ascertain from the then Chairman of the Public Service Board whether it was open to the Government to dismiss Mr Stone from the Public Service for his presumed impertinence[16].

Regrettably, I can vouch from personal experience that tactics such as these still occasionally find favour with some in industry who believe that their interests would be served by the Government forcing consumers of their products to pay higher prices for them.

Returning to more current issues, although I accept that the preliminary ruling by the US Commerce Department on imports of coated paper from China may be a 'negotiating tactic', that (depending on the response of the Chinese authorities) it may not, in the end, result in the imposition of higher tariffs on these products, and that the annual value of imports potentially affected by this ruling is less than US$230mn annually, the episode does nonetheless exemplify two of the major flaws in the current set of rules governing international trade.

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[15] John Stone, *Australia in a Competitive World – Some Options*, Paper Presented to the 21st General Management Conference of the Australian Institute of Management (Sydney, 19 November 1979), p. 4. *Disclosure:* As a very junior Treasury officer, I proof-read several versions of this speech.

[16] The answer, according to the then Chairman of the Public Service Board, Sir William Cole, was that it was not. I am grateful to Mr Stone for his personal recollections of these events.

First, users of these products have no ‘standing’ in the legal procedures by which producers are able to procure court rulings which ultimately lead to higher prices for them. The system is ‘stacked’ in favour of producer interests. It is a vivid of illustration of what Adam Smith had in mind when he wrote over 230 years ago that ‘people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or some contrivance to raise prices’[17].

The second is the sheer hypocrisy inherent in the laws under which such rulings are procured.

The basis for last month’s rulings by the US Court of International Trade and the Commerce Department is that the Chinese government allegedly subsidizes the export of coated paper products (something which China of course denies). The US Trade Representative’s Office has also listed steel, petrochemicals, high technology, forestry and paper products, textiles, plywood, machinery, copper and other non-ferrous metals as sectors which (in its opinion) receive subsidies from the Chinese Government through administrative measures such as tax reductions or exemptions, credit allocations, low-interest loans, debt forgiveness and the reduction of freight charges[18]. Last month’s rulings will no doubt have encouraged US producers in these sectors to seek similar rulings.

Why is it illegitimate for countries to subsidize the export of manufactured goods – so that WTO rules allow other countries, under certain circumstances, to impose ‘countervailing duties’ on imports of those goods from those countries – but it is quite legitimate for countries to subsidize the export of agricultural commodities, as the United States (in particular) and the European Union do?

The answer is, of course, because WTO rules do not preclude agricultural subsidies[19].

But given that, and given the persistent refusal of the United States and the European Union to agree to bring trade in agricultural products under the same set of rules as those pertaining to manufactured goods, is it any wonder that nations (particularly those in the developing world) whose comparative advantage lies primarily in agricultural commodities see those rules as being stacked against them?

The second reason why protectionism may be gaining in popularity may be the growing dissatisfaction, particularly in the United States, with the way in which the rewards of globalization are being distributed. There are two aspects of this on which I want to focus this evening.

The first is the growing share of national income accruing to businesses as distinct from households. In 2006, after-tax corporate profits represented 12.2% of US GDP. By a wide margin that is the highest proportion since at least 1929; over the past 77 years this ratio has averaged 5.9% and, prior to the present decade, had exceeded 7½% only five times (the last such occasion being in 1950).

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[17] Adam Smith, *The Wealth of Nations* (1776; Penguin 1985), Volume 1, Book 1, pp. 232-3.
[18] US Trade Representative’s Office, *National Trade Estimate Report on Foreign Trade Barriers*, (Washington DC, 2 April 2007), pp. 104-5.
[19] Which, in OECD countries, amounted to US$385bn in 2005, according to OECD estimates: OECD PCE/CSE database 2006.

Similar trends are apparent in many other countries. In Japan, for example, companies' current profits were last year higher as a share of nominal GDP than at any time since at least 1960. 'Entrepreneurial income' as a share of Germany's GDP in 2006 was at a post-reunification high, almost 4 pc points above its 1990s average.

Here in Australia, the gross operating surplus of corporate non-financial enterprises in 2006 was the highest since records commenced in 1959, and some 7 pc points above its five-decade average[20].

In the sense that globalization has resulted in a significant increase in the global supply of labour relative to that of capital – the IMF's latest *World Economic Outlook*, published this week, suggests that the effective global labour supply has quadrupled over the last 25 years, with most of the increase taking place since 1990[21] – this result is exactly in accordance with the long-established predictions of economic theory[22].

To the extent that enhanced trade and productivity have boosted the size of the 'total pie', workers may still be better off in absolute terms even if their share of that pie has diminished – and the IMF suggests that this is indeed the case in all advanced economies[23].

But this may be of little comfort to householders – that is to say, voters – to whom their diminishing share of national income appears to be of greater importance. Nor has it been of any assistance in alleviating those grievances in the United States in particular, that taxes on corporations have been cut at a time when their share of national income has been rising sharply.

The second aspect of the distributional question is that, in the United States at least, the distribution of income among households has become considerably more skewed (in favour of the highest income households). According to the US Census Bureau, the top quintile of the income distribution has received over 50% of total household income in three of the past five years, for the first time since at least World War II[24]. The share of household income going to the top 5% of the income distribution topped 22% in 2005 for the first time.

As Federal Reserve Chairman Ben Bernanke has noted, 'skill-biased technical change … does not provide a complete explanation for this trend … especially the large wage gains seen at the top of the distribution … the variety of economic forces grouped under the heading of "globalization" may also have been a factor in the rise in inequality'[25].

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[20] In Australia the 'corporate profits share' of national income (the short-hand term by which this measure is often described) has been boosted by the privatization of formerly government-owned enterprises.

[21] International Monetary Fund, *World Economic Outlook* (Washington DC, April 2007), p. 162.

[22] The Stolper-Samuelson theorem: see Wolfgang Stolper and Paul Samuelson, 'Protection and Real Wages', *Review of Economic Studies* Volume 9 (1941), pp. 58-73.

[23] IMF, op. cit., p. 168.

[24] Carmen DeNavas-Wait, Bernadette Proctor and Cheryl Hill Lee, *Income, Poverty and Health Insurance Coverage in the United States: 2005* (US Census Bureau, Washington DC,, August 2006).

[25] Ben S. Bernanke, *The Level and Distribution of Economic Well-Being*, Remarks before the Greater Omaha Chamber of Commerce (Omaha, 6 February 2007), pp. 4-5.

As was the case in the late 19th and early 20th centuries, increasing inequality in the distribution of income provides a fertile soil for those seeking to sow the seeds of protectionism and other 'anti-globalization' policies. In that earlier era, the 'anti-globalization' backlash was initially led by populists such as William Jennings Bryan, but was quickly taken up by the Republicans under Theodore Roosevelt and continued under the Harding, Coolidge and Hoover Administrations in the 1920s and early 1930s.

Today, the protectionist charge may be being led by Democrats such as Charles Rangel, Charles Schumer and the recently-elected James Webb; but according to Republican Senator Lindsey Graham, 'this is one issue where Republicans and Democrats are together'[26].

Once again, it has hardly assisted the cause of those who wish to argue against the proposition that globalization primarily or even only benefits the rich that taxes on upper-income earners in the United States have been explicitly reduced by the current Administration.

The more redistributive nature of Australia's tax-transfer system, by contrast, appears to have prevented a similar trend emerging in this country[27], at least as regards the distribution of income (although I am not as confident that this also applies to the distribution of wealth).

Ironically, the distribution of income is also becoming more unequal in China. By one account, the richest 10% of Chinese households now account for more than 40% of China's wealth, and the poorest 10% for only 2%[28]. However there is as yet no sign that these trends have contributed to rising anti-globalization sentiment in China, as they evidently have in the United States. That may be because the poor (at least in urban areas) and the middle classes are getting richer, and believe that they will continue to do so, even if they aren't getting as rich as quickly as the highest-income groups.

Nonetheless, the Chinese leadership has indicated it is acutely conscious of the need to ensure a wider distribution of the benefits of China's increasing engagement with the global economy.

A new emerging threat to globalization is the possibility that quite legitimate concerns about the environment may be used by protectionists as a cover to advance their cause.

With the growing acceptance by governments and businesses of the threat posed by anthropogenic climate change comes a danger that some will seek to use the contribution to greenhouse gas emissions made by the transportation of goods, services and people to advance their urging of greater restrictions on the movement of goods, services and people across international borders.

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[26] Reported by Stephen S. Roach, Morgan Stanley *Weekly International Briefing* (New York, 5 April 2007), p. 2.

[27] See, for example, Ann Harding and Quoc Ngu Vu, 'Income Inequality and Tax-Transfer Policy: Trends and Questions', Presentation to the 'Making the Boom Pay' Conference (Melbourne, 2 November 2006) available at www.natsem.canberra.edu.au/publications/papers/cps/cp06/cp2006_014/cp2006_014.pdf, pp. 9-12.

[28] Rawi Abdelal and Adam Segal, 'Has Globalization Passed its Peak', *Foreign Affairs* Vol 86 No. 108 (January-February 2007), reprinted in *The Australian Financial Review*'s Review section under the title 'Globalisation becomes a victim of itself', 2 March 2007 pp. 9-10.

It would not be surprising if industries which have traditionally enjoyed (and continue to seek) high levels of 'protection', and those who now purport to see something inherently noble in 'self-sufficiency' in food (a trend highlighted by the emerging practice of including 'food distances' on restaurant menus) sought to make common cause with those urging practical ways of ameliorating global warming. The European Union, in particular, has been seeking to have WTO rules altered to allow it to restrict trade on what it regards as 'environmental grounds'[29].

As Austrade's prolific Chief Economist Tim Harcourt points out, exports benefit economies and nations in many ways: they under-write economic growth; they encourage innovation and the transfer of knowledge; they generally achieve higher levels of productivity; they provide safer working environments and invest more in the training of their work forces; and they create personal as well as business relationships between nations[30].

But as Tim Harcourt also says, 'we can't have exports without imports'. Export promotion agencies need to be at the forefront of efforts to persuade people of the broader benefits of trade and investment liberalization, to ensure that those benefits are widely and fairly distributed (and seen to be so), and thereby help to counter the siren song of protectionism which once again threatens to grow in intensity to the detriment of us all.

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[29] See Alan Oxley and Steven Macmillan, *The Kyoto Protocol and the APEC Economies* (Australian APEC Study Centre, Monash University, November 2004), pp. 24-25; and Lawrence A. Kogan, *'Enlightened' Environmentalism or Disguised Protectionism* (National Foreign Trade Council, Washington DC, April 2004), esp. p. 86.

[30] Tim Harcourt, *Why South Australia Needs Exports: The Economic Case for Exporting* (Austrade, 9 August 2006), available at http://www.austrade.gov.au/Why-South-Australia-Needs-Exports/default.aspx; and 'Exporters key to better productivity', *Australian Financial Review* (10 April 2007) p. 55.