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COMMENTS WELCOME!

ECONOMIC GLOBALIZATION AND THE "ANTI"-COALITION

Contents

I. Introduction

The process of "globalization" has given rise to much controversy throughout the world. Some view it as an irreversible process that is indispensable to further economic development and to promote wealth in developed and developing countries alike[1]. Many others regard it with diffuse angst. They believe that globalization creates inequalities within and between countries, reduces job security and increases environmental devastation as well as cultural and ethnic dilution[2]. Therefore, they blame globalization for fading the dream of development as a universal norm[3].

Based on this notion an anti-globalization movement has developed that vigorously supports measures to stop or at least to delay the process of globalization. Various groups of activists even draw on the right to civil disobedience and violence to express their concerns[4]. Two features of the movement, however, are particularly intriguing. First, it comprises a sprawling diversity of ambition including organized labor, environmentalism, nationalism, and human rights activism. These groups share hardly any other common goal apart from the detraction of globalization or, more specifically, of global libertarian capitalism. Second, due to its focus on the negative aspects of globalization, the anti-globalization movement is able to attract support from members of almost all political parties. Admittedly, many of the activists can be vaguely deemed part of a leftist tradition

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[1] Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003); INT'L MONETARY FUND, GLOBALIZATION: THREAT OR OPPORTUNITY (2000), available at http://www.imf.org/external/np/exr/ib/2000/ 041200to.htm (last visited Oct. 15th, 2007) and more recently, WORLD ECONOMIC OUTLOOK, SPILLOVERS AND CYCLES IN THE GLOBAL ECONOMY (April 2007), available at http://www.imf.org/external/pubs/ft/weo/2007/01/index.htm (last visited Oct. 15th, 2007).

[2] International Forum on Globalization, ALTERNATIVES TO ECONOMIC GLOBALIZATION: A BETTER WORLD IS POSSIBLE, (San Francisco, 2002) available at http://www.ifg.org/programs/alternatives.htm (last visited Oct. 15th, 2007). See also B.S. Chimni, A JUST WORLD UNDER LAW: A VIEW FROM THE SOUTH, 22 Am. U. Int'l L. Rev. 199 (2007); Jim Chen, GLOBALIZATION AND ITS LOSERS, 9 Minn. J. Global Trade 157 at 162 (2000); Alan Tonelson, THE RACE TO THE BOTTOM, WHY A WORLDWIDE WORKER SURPLUS AND UNCONTROLLED FREE TRADE ARE SINKING AMERICAN LIVING STANDARDS, 2002.

[3] Jim Chen, GLOBALIZATION AND ITS LOSERS, 9 Minn. J. Global Trade 157 at 162 (2000).

[4] This is especially salient during the annual G 8 summits, see infra, at III.

in politics. But it is also not unheard of for politicians of so called conservative parties to actively support the movement[5].

The extraordinary success of the anti-globalization movement has already attracted attention, and frequently precipitated fascination, among social scientists, intellectuals and journalists[6]. This fascination is not challenged by the fact that many economists and trade specialists simply dismiss the considerable opposition to globalization as pure populism. To the contrary, the economists' reasoning, mathematically and logically persuasive as it might be, is bluntly countered with the argument that history has not always been kind to the oversimplified models and static analyses of economists.

The political consequences of this fashionable attitude, however, are likely to be fatal. As this paper will show, the results of global trade and economic integration are clearly beneficial. Indeed, globalization may be the only chance for many poor countries to catch up with developed countries. On the other hand globalization is likely to be less self-evident and irreversible as many believe. History is replete with examples on how the fears of vested interests and politically influential groups can lead to a political backlash[7]. Signs for such a backlash already abound - even in the U.S. According to Stephen Roach, chief economist at Morgan Stanley, Congress has enacted 27 pieces of anti-China

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[5] For instance, Heiner Geissler, a former Family and Health Minister under chancellor Helmut Kohl and former secretary-general of the of the Conservative Party (CDU) in Germany, recently joined the Association pour la taxation des transactions pour l'aide aux citoyens (Association for the Taxation of Financial Transactions for the Aid of Citizens, ATTAC). ATTAC criticizes global capitalism and economic globalization by means of free trade and capital flows, though it purports not to be anti-globalization per se.

[6] Leslie Green, GLOBALIZATION, DISOBEDIENCE, AND THE RULE OF LAW, discussion paper 2006, available at http://www.law.nyu.edu/kingsburyb/fall06/globalization/papers/Leslie%20Green.pdf (last visited Oct 15th, 2007). See also Robert Howse & Makau Mutua, PROTECTING HUMAN RIGHTS IN A GLOBAL ECONOMY: CHALLENGES FOR THE WORLD TRADE ORGANIZATION (2000) available at http://www.ichrdd.ca/english/commdoc/publications/globalization/wtoRightsGlob.html.

[7] Jeffrey Williamson, GLOBAL MIGRATION AND THE WORLD ECONOMY (2006), at 155 (describing a policy shift in the 20th century to anti-immigration policies) and Peter Lindert and Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE (2002).

legislation in 2005 and 2006 alone[8]. A representative survey of the German Marshall Fund revealed that, although most US citizens still purport to favor free trade, more than half of them also support protectionist policies to protect domestic companies - even at the expense of slower economic growth[9]. In Europe, the EU member-states agreed to dump the long-standing commitment to "free and undistorted competition" in the new EU-treaty. The new skepticism against free competition primarily asserted by French President Sarkozy can be traced back to French voters rejecting the bloc's draft constitution in a referendum two years ago.

A sound political concept is thus urgently needed to prevent the anti-globalization sentiment from preventing or delaying the beneficial effects of global economic integration. Such a policy concept should rely on economic analyses based on facts not emotions but it must also take serious the various concerns expressed by the anti globalization movement. Accordingly, this paper contemplates the basic economic models and theories about free trade and international economic interaction in light of the harsh critique of anti-globalists.

Following the Introduction, Section II seeks to define the controversial and elusive term “Globalization”. Section III then turns to the anti-coalition and its political claims. It describes how different the various supporters of the movement are and discusses the manifold objectives of their central claims which are sometimes mutually exclusive. Section IV illustrates the economic theory that supports an open economic. It argues that, despite many claims to the contrary, the spread of global capitalism and free trade is no form of modern exploitation of poor countries but instead benefits developed and developing countries alike. Section V focuses on another frequently alleged shortcoming of globalization: The inequality within countries. This section establishes that globalization may contribute modestly to increasing inequalities but does not deprive countries of the oppor-

[8] Stephen S. Roach, CHINA’S REBALANCING IMPERATIVES: A GIANT STEP FOR GLOBALIZATION (2006).

[9] German Marshal Fund, PERSPECTIVES ON TRADE AND POVERTY REDUCTION, 2006. The annual survey of transatlantic public opinion on international trade, economic development, and poverty reduction, is conducted in France, Germany, Italy, Poland, Slovakia, the United Kingdom, and the United States. The survey 2006 is available at http://www.gmfus.org/press/article.cfm?id=100&parent_type=R (last visited Oct. 15th, 2007).

tunity to pursue offsetting social welfare policies. Section VI examines the policy implications of these findings. It recommends maintaining and increasing economic openness but suggests a policy that helps people adjust to a quickly changing working environment. Section VI summarizes the main ideas.

II. Globalization – A New Round

It is essential to first define what is meant by the term "globalization" before assessing its economic effects and the criticism against it. When people gather to discuss, dispute and protest against globalization they usually address an economic process based on human innovation and technological progress[10]. Globalization refers to the increasing integration of large segments of the economies around the world into few economies and – as many people seem to claim – into one world economy. The main driving forces of this integration process are international trade and financial flows, but also migration and knowledge transfer[11].

The development of the automobile industry illustrates this quite technical definition: Less than 50 years ago, most nations had at least one independent motor vehicle manufacturer within their borders. And virtually all of them were selling their products predominantly within their own domestic markets. Today, the industry has consolidated and many manufacturers have expanded globally. While there are still some 50 vehicle manufacturers worldwide, only 10 manufacturers produce more than 75 % of all cars. And

[10] Jagdish Bhagwati, IN DEFENSE OF GLOBALIZATION, HOW THE NEW WORLD ECONOMY IS HELPING RICH AND POOR ALIKE (2004).

[11] Sometimes globalization is also used as a generic term that broadly signifies the cultural, political, social and environmental implications of international economic integration rather than the process itself. This paper employs the term with a clear focus on the international processes and transactions leading to a "globalized economy". For a comprehensive and systematical description of the various definitions of globalization see Jan Aart Scholte, GLOBALIZATION: A CRITICAL INTRODUCTION (2nd ed. 2005).

each of these 10 manufacturers assembles and sells its cars in far more than just one country.[12]

From a historic perspective, the process of economic integration through trade, migration and technology transfer is not just a recent phenomenon. A similar trend towards international commodity price convergence prevailed throughout the 19th century until World War I[13]. This first globalized era was ushered in by stable peace after the Napoleonic wars and a shift away from mercantilism towards more liberal policies. A rapid decline in transportation costs due to the development of electricity, iron steam vessels and railroads as well as the soaring global migration then brought about so far unknown economic interactions between nations[14].

World War I and II, and anti-global trade and migration policies in the interwar period put an abrupt end to these processes and transactions[15]. But Globalization quickly resumed after World War II. Globalization's new wave was driven primarily by lower trade barriers whereas regulatory restrictions to migration remained high[16].

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[12] Organization Internationale des Constructeurs d'Automobiles, Statistics Committee, "WORLD WIDE MOTOR VEHICLE PRODUCTION BY MANUFACTURER," 2005. Available at http://oica.net/category/production-statistics/ (last visited Oct 15, 2007).

[13] Jeffrey Williamson, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION (Wider Annual Lecture 2002), at 5 – 7.

[14] Jeffrey Williamson, GLOBAL MIGRATION AND THE WORLD ECONOMY (2006), at 110 - 115 argues that migration alone could be made accountable for all the convergence in GDP per capita observed in the Atlantic economy between 1870 and 1920 if all other conditions remained constant.

[15] Peter Lindert and Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE (2002), demonstrate that price gaps between Atlantic economy trading partners doubled, returning those gaps to 1870 levels. See also Jeffrey Williamson, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION, (Wider Annual Lecture 2002), who points to the fact that policy barriers restricted the ability of poor populations to migrate and higher tariffs choked off the gains from trade whereas the big pre-World War I productivity gains in transportation and communications did not evaporate. He concludes that the interwar retreat from globalization was carried entirely by anti-global economic policies.

[16] This may be particularly tied to the policy of the United States which switched from a protectionist welcoming immigrants to a free trader restricting their entrance, see Jeffrey Williamson,

History thus suggests that there is nothing mystic or even new about globalization. From a historical point of view we may be simply experiencing a "second truly global era"[17]. Yet, the term "globalization" has come into common usage only since the 1980s. This mirrors the unprecedented acceleration of international economic integration owing in part to the transition of the industrialized to the information society and in part to political developments favorable to free trade and global capitalism:

Within the last 25 years technological advances have made it much easier and cheaper to communicate worldwide and to complete international transactions - expediting both trade and financial flows. The same market forces that have operated for centuries at all levels of human economic activity—village markets, urban industries, or financial centers – now easily extend beyond national borders. Most strikingly, so far segregated financial markets have started integrating. Capital flows around the globe that used to take many days are now processed within seconds.

At the same time political conditions have been extremely favorable to globalization. In the late 80s and 90s the American model of capitalism celebrated an almost complete triumph: The Soviet Union collapsed, enduring deflation and recession eased the fear of the Japanese "threat" in the 1980's, a financial crisis initiated by currency devaluation brought the so-called East Asian miracle to an (at least temporary) end and the Scandinavian and western Europe types of welfare states languished in high rates of unemployment and fairly low growth rates[18]. In search for a sustainable economic growth path there seemed to be only one prescription: copying the liberal Anglo-American type of capitalism. Liberalization and privatization dominated the policies around the globe and globalization reached a new quality.

WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION (Wider Annual Lecture 2002), at 10.

[17] Peter Lindert and Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.). GLOBALIZATION IN HISTORICAL PERSPECTIVE (University of Chicago Press 2002).

[18] See Eric Lundberg, THE RISE AND FALL OF THE SWEDISH MODEL, 23 Journal of Economic Literature 1 (1985).

III. The Anti-coalition

The triumph associated with the Anglo-American style of capitalism has faded to some extend. Globalization has increased anxiety everywhere about job security[19]. Capitalist countries have been afflicted by problems of rising inequality and environmental degradation[20]. Even in the US – a nation which is second to none in supporting capitalism – concerns have increased. This is in large parts due to the bursting of the technology bubble and the decrease in the housing market[21]. Other concerns evolve from the latest “outsourcing mania”, particularly since upscale jobs are increasingly transferred offshore, too[22]. Income concentration at the very top with stagnation at the bottom have called into question weather productivity growth actually translates into higher incomes for all[23]. Unemployment rates in the US and the UK remain significantly lower than, for example, in much of Europe. However, there is an unedifying flip side of the coin: Many jobs in the US and the UK are poorly paid. Therefore, many workers are forced to take up more than one job in order to sustain a living. Moreover, the crisis in health insurance with skyrocketing costs, significant co-payments and increasing numbers of uninsured looms large.[24]

Against this backdrop it is not surprising that the opposition against globalization has gained support in the US as well as in most other countries. Activists have taken to the streets to protest against the policy of the International Monetary Fund (IMF), the World Trade Organization (WTD), the World Bank and the leading industrial nations in general.

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[19] Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, THE NEW GLOBAL JOB SHIFT, 2/3/03 BUSW 50 (2003); Branko Milanovic, WHY GLOBALIZATION IS IN TROUBLE, YaleGlobal, 29 August 2006. See also The World Commission on the Social Dimension of Globalization, A FAIR GLOBALIZATION: CREATING OPPORTUNITIES FOR ALL (2004), at 40.
[20] The World Commission on the Social Dimension of Globalization, id.
[21] Branko Milanovic, WHY GLOBALIZATION IS IN TROUBLE, YaleGlobal, 29 August 2006.
[22] Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, THE NEW GLOBAL JOB SHIFT, 2/3/03 BUSW 50 (2003).
[23] Thomas Piketty & Emmanuel Saez, INCOME INEQUALITY IN THE UNITED STATES, 1913-2002 (2004); Thomas Piketty & Emmanuel Saez, THE EVOLUTION OF TOP INCOMES: A HISTORICAL AND INTERNATIONAL PERSPECTIVE, NBER Working Paper No. 11955 (2006).
[24] Theodore Marmor, Fads, FALLACIES AND FOOLISHNESS IN MEDICAL CARE MANAGEMENT AND POLICY, 2007.

Most notably, the so called G8[25] summits, an annual meeting of the heads of government of the world's major industrialized democracies, have become a favored occasion of at times violent protests[26].

Three circumstances and concerns appear to provide the background of most protests. First, the unease with globalization emerges in response to the perceived intensification of international economic and symbolic interaction that is thought to increase inequality within and between countries: In rich countries, there is the widespread perception of increased job insecurity due to competition from low-wage countries. In poor countries the notion of exploitation by rich countries and globalized firms prevails[27]. To anti-globalization protesters, “transnational corporations …expand, invest and grow, concentrating ever more wealth in a limited number of hands.”[28]

Second, anti-globalists worry that the forces of globalization are weakening the capacity to regulate economic processes. By the same token, they fear that existing national legal orders are “losing control” over central tools in the fields of social, health and environmental policy[29]. In developed countries these concerns are typically expressed as disenchantment with the “impotent” national government; in developing countries, by contrast,

[25] The Group of Eight (G8) is an informal international forum for the governments of Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States. Unlike international organizations, like the UN or WTO, it lacks an administrative structure.

[26] See, for example, the ABC News report about the latest summit in Heiligendamm, Germany, available at http://www.abc.net.au/news/newsitems/200706/s1940800.htm (last visited Oct. 15, 2007).

[27] See e.g. Isabella D. Bunn, THE RIGHT TO DEVELOPMENT: IMPLICATIONS FOR INTERNATIONAL ECONOMIC LAW, 15 AM. U. INT'L L. REV. 1425, 1465 (2000) (stating that globalization contributes to global economic inequality).

[28] A Report of the International Forum on Globalization, ALTERNATIVES TO ECONOMIC GLOBALIZATION: A BETTER WORLD IS POSSIBLE, (San Francisco, 2002) p. 140. See also B.S. Chimni, A JUST WORLD UNDER LAW: A VIEW FROM THE SOUTH, 22 Am. U. Int'l L. Rev. 199 (2007), at 212 (claiming that the “world is today coming to be divided into two worlds that of the Global Rich and that of the Global Poor” with the divide having a “strong North-South dimension”).

[29] Saskia Sassen, LOSING CONTROL? SOVEREIGNTY IN AN AGE OF GLOBALIZATION (1996). See also Noreena Hertz, THE SILENT TAKEOVER: GLOBAL CAPITALISM AND THE DEATH OF DEMOCRACY 2 (2001), at 10.

they spark fury about the domination of the national governments by foreign multinationals.

Third, most protesters argue that many economically influential international institutions, including the IMF, the WTO and the World Bank, are undemocratic and dominated by western countries. The protests thus reflect the widespread belief that these institutions are illegitimate and that their policies are misguided and fundamentally unjust[30]. Indeed, the IMF and the World Bank as well as their operative norms are seen as sinister agents striving for an outcome "in which all productive assets in developing countries are owned by foreign corporations producing for export."[31]

These protests against globalization significantly differ from previous political movements. In a broad, overarching interpretation they may be understood as a rebellion against the burgeoning global capitalism[32] and the failure of a countervailing political authority[33]. What is missing, though, is any coherent positive claim. Instead the anti-globalization movement gathers a number of different groups - including trade unionists, environmentalists, human rights activists, nationalists, indigenous people, and anarchists - with a broad variety of objectives under one anti-label.

This, in its own right, does not question the legitimacy of the protest. One cannot label the movement as wrong or misguided simply because it encompasses various unrelated purposes. If each of its agendas was to be legitimate, then the lack of an overall message would be immaterial. However, not all of the movement's objectives can be legitimate since many of its claims are mutually exclusive. For example, the critique of trade-unionists in developed countries aimed at implementing protectionist policies is scarcely reconcilable with the critique from developing countries seeking access for their products

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[30] For specific criticisms of the IMF, see Joseph Stiglitz, GLOBALIZATION AND ITS DISCONTENTS (2002).

[31] A Report of the International Forum on Globalization, ALTERNATIVES TO ECONOMIC GLOBALIZATION: A BETTER WORLD IS POSSIBLE (2002), at 52.

[32] Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 92.

[33] Leslie Green, GLOBALIZATION, DISOBEDIENCE, AND THE RULE OF LAW, 2006, p. 17 – 18, available at http://www.law.nyu.edu/kingsburyb/fall06/globalization/papers/Leslie%20 Green.pdf.

to the markets of industrialized countries. Similarly, there can hardly be a greater gulf between the views of nationalists and anarchists.

The inconsistency of the various positive aims weakens the credibility of the joint protests and the unified opposition against globalization and global capitalism. On the other hand, it does not prove all objections wrong. In order to justify a shift away from global capitalism, however, one would have to present viable alternatives, which are incentive-compatible and thus sustainable. The protesters have so far failed to come up with such ideas. There are, if at all, very few new approaches and their old concepts have not turned out to be ducating.

What is more, the very critique against globalization is unpersuasive. As the following analysis of international economic integration establishes, the demonstrators should be protesting for, not against globalization, were they to take their central moral impetus seriously: Global capitalism has brought countries that opened their markets unprecedented welfare in the last 25 years and it has been the basis of reduced poverty in many parts of the world.

IV. Beneficial effects of economic globalization

Economic globalization is driven by international trade, investment, migration, and technology transfer. Each of these processes engenders similar economic and social effects[34] and the opposition of most anti-globalists extends to all of them[35]. Historically, migration played the dominant role in the first global era during the 19th century. In contrast, the current globalization process predominantly rests on the extension of trade[36]. Therefore,

[34] The similarities have been stressed and explained frequently. See for example Paul R. Krugman, POP INTERNATIONALISM 65 (1996) (stating that imports of labor-intensive products are like an indirect form of low-skill immigration).

[35] For example, the opposition from labor unions to greater immigration in the United States is often propagated under the banner of protecting the economic welfare of natives and promoting "distributive justice" among them. Howard F. Chang, THE ECONOMIC ANALYSIS OF IMMIGRATION LAW, in B. Brettell & James F. Hollifield eds., MIGRATION THEORY: TALKING ACROSS DISCIPLINES 206 (2000).

[36] See supra at II.

the following sections focus on the economic analysis of free trade. The central findings, however, also hold for migration, capital flows and technology transfer.

1. Free trade and the models of absolute and comparative advantage

The dispute about the economic and social consequences of free trade is everything but new. Based on the logic of absolute and comparative advantage, economists developed a coherent theory about the benefits of free trade and economic integration as early as in the late 18th and early 19th century. Indeed, much of the fame of the classical economists Adam Smith and David Ricardo is based on their support of free trade and their rejection of protectionism.

In his famous work Wealth of Nations, first published in 1776[37], Smith stressed the benefits of free trade against a deeply entrenched bias towards mercantilism in the British public and Parliament: "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage."[38] This statement is based on the concept of absolute advantages in production. Its logic is intuitive: If the home country can produce some set of goods at lower cost than a foreign country, and if the foreign country has a cost advantage in producing another set of goods, then both countries may gain from trade if they trade the relatively cheaper goods.

Less intuitive is the concept of comparative advantage that covers a broader set of circumstances. Ricardo introduced a formalized version in 1817[39] which, reformulated as the Heckscher-Ohlin theorem, still forms the basis of modern trade theory. In his book “On the Principles of Political Economy” Ricardo imagined two countries, England and Portugal, producing two goods, clothes and wine. He then assumed that labor was the

[37] Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, first published in 1776 (R. H. Campbell & A.S.Skinner, eds., Oxford University Press 1976 (reprint 1981)).
[38] Adam Smith, id., at Book IV, Section ii, 12.
[39] David Ricardo, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (1817). A less developed statement of the principle of comparative advantage and trade appears already two years earlier in an article by Robert Torrens, titled Essay on the External Corn Trade.

only input in production and that the productivity of labor, i.e., the quantity of output produced per worker, varied between industries and across the countries. Moreover, Ricardo assumed that Portugal was more productive in producing both goods. Based on the notion of absolute advantage, then, it would appear that trade could not be advantageous, at least for England: Portugal would end up producing both goods, wine and clothes while England would be left with nothing to trade with in order to buy those goods from Portugal.

Ricardo, however, demonstrated numerically that if England specialized in producing the good in which its productivity disadvantage is smallest, i.e. the good in which it is "least worse" at producing**,** and if Portugal produced the other one in which its productivity advantage is greatest, then total world output of both goods would rise. Assuming England was least inefficient in producing clothes, England would simply focus on the production of clothes while Portugal would focus on the production of wine. Both countries would then trade with Portugal shipping wine to England and England returning clothes to Portugal. Portugal's employees who had formerly engaged in the production of cloth would be shifted to the production of wine. Therefore, after choosing appropriate terms of trade and trading clothes for wine, both countries could end up with more of both goods.

The model of comparative advantage exemplifies that absolute advantage is not a necessary, if a sufficient, condition for free trade to be beneficial. England benefits from free trade even though its productivity is assumed to be lower than in Portugal with regard to the production of all goods contemplated. International trade thus offers countries the chance to specialize, increase productive efficiency and maximize social welfare: If all resources worldwide are allocated in accordance with each country's comparative advantage industries, the total output of the world will increase by the difference in countries' opportunity costs. Allowing the countries to trade their comparatively advantaged goods freely, then, will necessarily raise the living standard in each of them.

2. Criticism of comparative advantage: „ Big Trucks versus Rickshaws"

What is compelling to many economists, however, seems to be far from generally accepted. Not only does the anti-globalization movement strictly reject the theory of comparative advantage. Many politicians, journalists, business-leaders and even some economists are also skeptical about the beneficial consequences of free trade. Paradigmatic is a guest commentary in a famous German news magazine by economist, banker and Nobel peace laureate Muhammad Yunus[40]: “I support globalization and believe it can bring more benefits to the poor than any alternative. But it must be the right kind of globalization. To me, globalization is like a 100-lane highway criss-crossing the world. If it is a free-for-all highway, its lanes will be taken over by the giant trucks from powerful economies -- Bangladeshi rickshaws will be thrown off the highway.”

Like Yunus, most critics of liberal trade policies in one way or another stress the aspect of absolute advantage without even mentioning comparative advantage. It is the prevailing credo that free trade offers no chance for the poor or, conversely, from the standpoint of industrialized countries, that the developing countries pay incredibly low wages which can’t be matched in the West[41]. Whether these statements are simply based on a confusion of the concepts of comparative and absolute advantage or whether they entail a fundamental critique of comparative advantage under real world conditions is more often than not unclear.

Since the basic model of comparative advantage is not overwhelmingly complicated and the criticism against it is shared by many distinguished intellectuals one is inclined to presume the latter. In fact, paying greater attention to the ways in which comparative advantage may fail to work out in practice reveals some necessary qualifications to the concept. Economists are already familiar with a number of circumstances of imperfect competition in which free trade does not achieve sustained success as easily as the simplest Ricardian model suggests[42]: For example, imperfectly competitive markets, e.g. markets

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[40] Guest commentary by Nobel peace laureate Muhammad Yunus, 06/07/2007, 'We Can Create a Poverty-Free World', available at http://www.spiegel.de/international/world/0,1518,487073,00.html (last visited Oct. 15th, 2007).
[41] Branko Milanovic, WHY GLOBALIZATION IS IN TROUBLE, YaleGlobal, 29 August 2006. (arguing that the “rise of the two Asian giants, reflected in their dynamic trade, large Chinese export surpluses and India’s role as an outsourcing center and a potential leader in information technology, has made the West wonder whether it can compete with such hardworking, cheap, plentiful and yet relatively skilled labor”).
[42] A quite comprehensive discussion of these issues is provided by Paul R. Krugman & Maurice Obstfeld, INTERNATIONAL ECONOMICS: THEORY AND POLICY 14 (7th ed. 2005). See

characterized by oligopoly that allow excess economic profits or rents, may render a shift away from liberal to strategic trade policy profitable for the intervening country[43]; distortions in domestic labor markets may cause unemployment and reduce wages if imports are flowing in without trade barriers[44]. As a consequence, a number of sophisticated extensions to and qualifications of the model have been introduced.

Neither of these specific situations, though, is explicitly mentioned in the typical political critique of liberal trade policies. And neither of them questions the validity of comparative advantage and the resulting benefits of free trade as a rule of thumb. Almost all studies bear out the presumption of trade experts that the potentially beneficial effects of interventionist trade policies, if any, depend closely on the specifics of a market[45]. In addition, one has to take into account the factor of international rivalry: If a policy benefits one country acting unilaterally it may nevertheless be harmful when pursued by everyone. In any event, quantitative analyses suggests that the gains from even optimal interventions are small while the negative impact of misguided strategic policies is likely to be enormous[46].

Altogether, the theory of comparative advantage does not only apply under ideal circumstances of perfect competition and perfectly rational competitors. By and large, it also holds under real world conditions. Imperfect competition in some markets may justify qualifications to the model but it does not establish a sound basis for the broad distraction expressed by many politicians, journalists, social scientists and practically all anti globalization activists.

This has left economist speculate about the reasons for the widespread brickbat. In lack of other explanations (apart from mere misconception or lack of comprehension) some

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also Elhanan Helpman & Paul Krugman, MARKET STRUCTURE AND FOREIGN TRADE (1987).

[43] The key concept of strategic trade policy has been introduced by J. A. Brander and B. J. Spencer, EXPORT SUBSIDIES AND INTERNATIONAL MARKET SHARE RIVALRY, J. of International Economics 18, 83-100 (1985) (envisioning two exporting countries selling to a third country that does not produce the product).

[44] See infra, at V.

[45] Elhanan Helpman & Paul Krugman, MARKET STRUCTURE AND FOREIGN TRADE (1987), at chapter 8, particularly at 177.

[46] Elhanan Helpman & Paul Krugman, id.

resort to Adam Smith[47] and blame the "interested sophistry of merchants and manufacturers" for mystifying the concept and confusing "the common-sense of mankind"[48]. Others point to the impetus of journalists and social scientists to act as enfant terribles attacking fundamental wisdoms of economists which are hundreds of years old[49]. On a very broad level, explanations are sought in the general division between the humanist and the mathematical-scientific visions of the world[50]. Whatever the reasons might be, it does not justify dismissing comparative advantage as a basic economic model.

Liberalizing trade allows countries to specialize, and thus to exploit their comparative advantages in production, increase productivity and avail themselves of the opportunity of economies of scale[51]. Trade barriers, on the other hand, result in prices distinct from world prices, causing a less efficient resource allocation[52]. Furthermore, open economies provide incentives for domestic producers to innovate and improve efficiency. They also offer opportunities and incentives for learning and innovating which is particularly crucial if migration is limited[53].

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[47] Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, first published in 1776, (R. H. Campbell & A.S.Skinner, eds., Oxford University Press 1976 (reprint 1981)), at Book IV, Section iii, 2: (stating that "In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind").

[48] Enry Haylitt, ECONOMICS IN ONE LESSON 74-75 (1979).

[49] Paul Krugman, RICARDO'S DIFFICULT IDEA (1996), available at http://web.mit.edu/krugman/www/ricardo.htm (stating that "Free trade … has some sort of iconic status among economists; so, in a culture that always prizes the avant-garde, attacking that icon is seen as a way to seem daring and unconventional.")

[50] Paul Krugman, THE IMPLAUSIBLE PUNDITS (1996), available at http://www.pkarchive.org/cranks/ImplausiblePundits.html.

[51] Paul Krugman & Maurice Obstfeld, INTERNATIONAL ECONOMICS: THEORY AND POLICY 14 (7th ed. 2005).

[52] Paul Krugman & Maurice Obstfeld, id.

[53] This was already observed by Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, first published in 1776, (R. H. Campbell & A.S.Skinner, eds., Oxford University Press 1976 (reprint 1981)), at Book IV, Section iv 1 and 2.

3. Comparative advantage through a historical lens

The hitherto stated economic reasoning usually does not impress critics very much given their general distrust in any (static) economic model. Such distrust is even understandable to some extend. All too often have economist models failed to correctly predict future dynamic developments under real world conditions.

Fortunately, the models of comparative and absolute advantage are quite old and globalization is not only a recent phenomenon either. This provides the opportunity to fall back on historical experience to demonstrate the fallacy of the critique against competitive advantage.

a) Marxist and leftist theories

Marxist and leftist theorists have considered the classical economic reasoning in favor of comparative advantage to be a subtle means of retaining disadvantaged nations in poverty. Lenin himself deemed comparative advantage a phenomenon of "imperialism". He considered Empires "extractive enterprises" which were launched to increase the affluence of the mother country. In reality, it is more likely to assume a net transfer of funds from mother countries to the colonies. The degree to which empires were burdensome as opposed to exploitative, of course, is speculative and dependent on the different policies pursued[54]. The decisions of the British, French, and Dutch to dissolve their empires in wake of World War II, however, clearly suggest that they had to bear significant costs for the status of an empire. And at least under the conditions of free trade, they could not pay the bill.

[54] Lance E. Davis & Robert A Huttenback, PUBLIC EXPENDITURE AND PRIVATE PROFIT: BUDGETARY DECISION IN THE BRITISH EMPIRE, 1860-1912, 67 American Economic Review 282 (1977).

b) Dependencia theories

The multitude of approaches combined under the heading 'Dependencia'[55] amount to a rescue approach to "imperialism". While imperialism theories consider the dependence relation to be directly responsible for the exploitation of developing countries, dependencia theories usually refer to the international division of labor and the resulting consequences on economic structures[56].

According to these theories the integration of undeveloped countries in a global economy necessarily causes these countries to focus on agriculture and a small export-oriented sector dominated by externally oriented elites[57]. This deforms the domestic industry and further intensifies and perpetuates the external dependency: While modern industrialism is seen as pushing societies to continued innovation and additional development, thereby promoting modern infrastructure (roads, methods of transportation, computerization, electronic tracking of goods, methods of retrieval), the predominant agricultural production in “dependent” countries is thought to follow traditional routes, providing only insufficient incentives to create new supportive economic structures. Thus, agricultural countries fall further and further behind industrial societies. Underdevelopment, from this point of view, is not a phase on the way to industrialization but rather an inescapable consequence of capitalism and free trade.

The dependencia theories are interesting and more logical than their predecessor models. Yet, they share the same fate: Like the imperialism theories, dependencia theorists have been proved wrong by history. Not only is the poor economic development of countries with limited external contacts, like Nepal and Ethiopia[58], hardly compatible with the attempted explanation of externally caused dependency. It also comes to no surprise that economies shaped by agriculture and extractive industries have not been stuck with out-

[55] See Wohlke, M., Wogau, P.V., Martens, W., DIE NEUERE ENTWICKLUNGSTHEORETISCHE BIBLIOGRAPHIC (Edition der Iberomaerikana Reihe II, Bibliographische Reihe 2) (Frankfurt 1977).
[56] See Jagdish N. Bhagwati, IN DEFENSE OF GLOBALIZATION (2004).
[57] The Elites are thought to accept the norms and values of the industrialized countries and cooperate in solely fulfilling their demands, thereby maintaining the status quo at home.
[58] The UN Human Development Report 2006 ranks Ethiopia 170th and Nepal 138th out of 177 countries. The Report is available at http://hdr.undp.org/hdr2006/ (last visited Oct 15, 2007).

moded structures when joining the international economy, but have instead developed modern institutions and infrastructure. Data from Latin America, where "dependencia" theories used to be rampant[59], reveal that roads, banks, futures markets, insurance, and innovations have evolved in quite the same fashion as in industrialized countries[60]. The preconditions for “independencia” are present, not only in parts of Latin America but in many formerly “dependent”, underdeveloped countries.

Moreover, many countries have managed to further develop these structures and establish highly competitive industrial and information technology clusters, most notably China and India. These developments have not been hampered by free trade policies. To the contrary, they have been inextricable intertwined with a shift towards economic openness.

India is indicative of this. In the aftermath of independency, the state owned most major industries, discouraged foreign trade, and made the production of any new good subject to authorization[61]. In response, India's economy faltered, annually growing only at what came to be known as the "Hindu rate of growth" of 3.5%. This remarkably slow growth rate for a developing country with a burgeoning population skyrocketed only after the government in New Delhi opened its markets and began to embrace capitalist reforms in

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[59] See Jagdish Bhagwati, IN DEFENSE OF GLOBALIZATION (2004), at 9 (reporting that even the Brazilian economist Cardoso invented a “dependencia” theory, but after becoming president of Brazil started to support globalization.).

[60] Marianne Fay and Mary Morrison, INFRASTRUCTURE IN LATIN AMERICA AND THE CARIBBEAN – RECENT DEVELOPMENTS (2005) (Arguing that infrastructure has improved in most of Latin America and the Caribbean (LAC) over the last decade, but that a sharp fall in investment in the sector is now hindering economic growth).

[61] The general requirement of permission was implemented to steer the country's scarce resources away from frivolities, following the path of Mahatma Gandhi, who had envisioned the nation he helped create as a land of self-sustaining and self-sufficient villagers. As Jawaharlal Nehru, India’s first Prime Minister, put it, "Why do we need 19 brands of toothpaste?”

1991[62]. The economy hasn't lost speed so far and is projected to continue to grow at eight to ten percent per year.[63]

The creative energies, unleashed by globalization, did not only fuel economic growth. They also quickly started to transform significant parts of the economy. Based on a huge reservoir of skilled workers and English-speaking university graduates[64] a highly competitive IT Industry has evolved[65]. The leading Indian IT services Companies Tata Consultancy Services, Infosys, and Wipro today each generate revenues of more than $ 3 billion a year. That still looks tiny in comparison with the market leader IBM. Its global services division generated revenues of $47.5 billion in 2005. Yet, the Indian enterprises have caught the attention even of the market leader. Today, Tata Consultancy Services, Infosys and Wipro all happen to be listed as three of the five main competitors of IBM Global Business Services[66].

The rise of big India-based tech companies convinced many politicians who used to associate foreign investment with imperialism of the benefits of liberal economic policies.

[62] Despite the shift towards economic openness India has not entirely embraced a libertarian form of capitalism, particularly in matters of privatization, deregulation or fiscal deficit management. In the 2007 Economic Freedom ranking of the Heritage Foundation, India ranks 104th, far below most Latin American and many African countries!
[63] See IMF World Economic Outlook (April 2007), at 60.
[64] In his best-selling book, THE WORLD IS FLAT: A BRIEF HISTORY OF THE TWENTY-FIRST CENTURY (1st ed. 2005), Thomas Friedman ties the reforms in India to the fall of the Berlin wall in 1989 and the collapse of communism in Eastern Europe. In particular, he points to a discussion he had with the Nobel Laureate Amartya Sen in which the prize-winning economist argued that the Wall's absence allowed policymakers to think of economic, financial, and social policies in truly global terms. See id. at 51-53. While these aspects certainly have prepared the ground for the policy shift it seems clear that the reforms were ultimately initiated by a much narrower event: the catastrophic currency crisis in 1991 which forced India to ship most of its gold reserves to London as collateral for an IMF loan.
[65] It is noteworthy, that the high qualification of many Indians and the focus on IT-services is also closely related to the process of globalization. While India as a nation hardly joined the global market economy until the 1990s, millions of Indians developed the necessary skills to change this by emigrating to the U.S., Britain, and elsewhere. Furthermore, starting in the 1970s, Indian software companies began sending teams of engineers to the U.S. to work on software projects for American clients and bring home dollars. See the account of Justin
[66] http://en.wikipedia.org/wiki/IBM_Global_Services.

This, in turn, stabilized the policy of economic openness[67] and invited many more foreign multinationals to avail themselves of Indian talent at Indian salary levels: Texas Instruments has led the way when it opened an R&D center in Bangalore in 1985. Dozens of Western IT companies followed suit, setting up subsidiaries or entering into joint ventures in recent years[68]. Furthermore, this phenomenon is not limited to Bangalore, New Delhi or other Indian cities. Similar developments occurred in many Asian, Eastern European and Caribbean Countries[69].

With millions of miles of high-speed data networks girdling the globe and a modern IT industry prospering in the formerly "underdeveloped world" the global outsourcing process assumed a new quality[70]. Corporations in many developing countries are no longer restricted to making clothes, shoes, cheap electronics, and toys for the export trade. They have also quickly outstripped the next wave of outsourcing in which simple service work, like processing credit-card receipts and writing software code, began fleeing high-cost countries. Today, all kinds of knowledge work are performed throughout the world: Indian Companies handle the book-keeping for Western companies, Philippine experts help prepare tax returns for customers in the US and Europe, Rumanian workers turn layouts of industrial facilities into detailed architectural blueprints. Cutting edge research for new microprocessors, cell phone chips, generic drugs etc. is carried out not only in Silicon Valley but is increasingly performed in India, China, or Eastern Europe, too[71].

Maybe the early waves of outsourcing were reconcilable with dependencia theories. These latest developments are clearly not. Globalization has reshaped the economy of many developing countries profoundly. The success and competitiveness of the new industries in developing countries is so spectacular, that many in the West fear that a great

[67] Fox, WHERE YOUR JOB IS GOING, 11/24/03 FORTUNE 84 (2003) (stating that "the Indian leaders of the software industry have become hugely influential in the nation's political and economic life. Their message: Economic openness is good for India, because India is perfectly capable of competing internationally.").
[68] Justin Fox, WHERE YOUR JOB IS GOING, 11/24/03 FORTUNE 84 (2003).
[69] See Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, THE NEW GLOBAL JOB SHIFT, 2/3/03 BUSWK 50 (2003) pointing to "dazzling new technology parks" in major Indian cities but also in Manila, Shanghai, Budapest and San Jose, Costa Rica.
[70] Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, id.
[71] Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, id.

deal of white-collar work will migrate to these countries[72]. What may be troublesome to some upscale employees in developed countries, however, elucidates the fallacy of dependencia theories. It is palpably wrong, even absurd to further believe that comparative advantage keeps developing countries in underdevelopment and prevents structural development, when (i) knowledge and research intensive work is increasingly done all over the world and (ii) Indian IT companies begin challenging the leading position of the US in some IT sectors only 25 years after Indian's government dismissed protectionist, anti-global policies[73].

4. Income inequality between poor and rich countries

This leaves the central argument of many anti-globalization activists against subscribing to the theory of comparative advantage: The rising inequality between developed and developing nations. Various studies have confirmed the popular notion of a widening difference in GDP per capita[74] between poor and rich countries[75]. The increasing disparity in income is not only criticized as unjust. It may also question the very concept of comparative advantage.

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[72] Thomas Palley, THE ECONOMICS OF OUTSOURCING: HOW SHOULD POLICY RESPOND?, FPIF Policy Report (March 2006); Branko Milanovic, WHY GLOBALIZATION IS IN TROUBLE, YaleGlobal, 29 August 2006.

[73] See, for example, the comment of Peter Engardino, id. (stating that "the rise of a globally integrated knowledge economy is a blessing for developing nations").

[74] Cross-country inequality and trends towards convergence or divergence over long time periods are usually measured in terms of GDP per capita or per worker hour. What really matters, though, is the gap between workers' living standards in rich and poor countries. GDP per capital is only a very vague proxy for this. Therefore, some economists writing about historic developments resort to other benchmarks. Timothy Hatton and Jeffrey Williamson, for example, favor purchasing-power-parity-adjusted real wage rates to better assess the impact of globalization on economic well-being. See, Timothy Hatton & Jeffrey Williamson, GLOBAL MIGRATION AND THE WORLD ECONOMY (2006), particularly at 101 -127.

[75] See, for instance, Albert Berry, Francois Bourguignon, and Christian Morrisson, GLOBAL ECONOMIC INEQUALITY AND ITS TRENDS SINCE 1950, in L. Osberg (ed.) Economic Inequality and Poverty: International Perspectives (1991); Angus Maddison, MONITORING THE WORLD ECONOMY, 1820-1992(1995); François Bourguignon & Christian Morrisson 'THE SIZE DISTRIBUTION OF INCOME AMONG WORLD CITIZENS: 1820-1990' (World Bank, 2000).

Pursuant to economic theory, poor and developing nations should benefit most from liberalizing trade policies because liberalization has a bigger effect on the terms of trade of those countries joining the integrated world economy than on countries that are already members. Other aspects of trade like the diffusion of ideas across borders should also benefit developing countries more than developed countries. And the bigger the change in the terms of trade and the greater the gain of dispersed knowledge, the bigger the gain in GDP per capita should be[76]. In reality, however, rich OECD members have on average seen the biggest growth in terms of GDP per capita since 1960 while poor countries have fallen even further behind the US and Western Europe[77]. This result is striking. Nevertheless, it does not call into question the logic of comparative advantage. A closer look at the data reveals the coherence of reality and theory:

Postwar trade consisted primarily of trade among OECD members. Trade between the OECD and the rest of the world played only a minor role. International treaties on trade policies like The General Agreement on Tariffs and Trade (GATT) did nothing to change this. To the contrary, from the outset the GATT explicitly allowed low-income countries to maintain their import barriers and exchange controls. This permission was a concession to the anti-global ideology prevailing in previously-colonial Asia and Africa, in the communist dominated states of Eastern Europe and in most parts of Latin America. But it permanently cut off these countries from the benefits of free trade: All succeeding rounds of GATT-agreements brought the gains from freer trade mainly to OECD members.

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[76] Raymond Robertson, RELATIVE PRICES AND WAGE INEQUALITY: EVIDENCE FROM MEXICO (2001) (stating that Mexico's economy was only about 6 percent the size of the United States when Mexico joined NAFTA in 1994. Furthermore, only about 9 percent of US trade was with Mexico. On the other hand some 75 percent of Mexican imports and 84 percent of Mexican exports involved the US. These shares suggest that Mexico took North American market prices as given. Therefore, it should have benefited form the full measure of terms of trade gains by joining the NAFTA.).

[77] Jeffrey Williamson, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION (Wider Annual Lecture 2002), at 9. See also Paul Masson, GLOBALIZATION: FACTS AND FIGURES, IMF Policy Discussion Paper PDP/01/4, 9 (Oct. 2001). In 1980, Mexico's real per-capital income, adjusted for the differential purchasing power in Mexico and the US, was a third of that in the US. Today, the ratio is almost 4.5 to 1. Many African countries have seen no economic growth in 50 years. Even Ghana, a country often touted as an African success case, has not done well: Around its independence, in 1957, its income was one half of Spain's; today, it is one tenth.

Against this backdrop the superior performance of OECD member states comes to no surprise. The performance does not demonstrate that globalization favors rich countries. Rather, consistent with the logic of comparative advantage, the data show that economic integration promotes countries who liberalize and penalizes those who do not. Accordingly, Lindert & Williamson found clear signs of income convergence between countries joining the world economy, but divergence between these open countries and those who chose to stay insulated from global markets[78]. In particular since the 1990s GDP per capita grew much faster in developing countries that integrated in the world economy than in developed countries[79]. At the same time, GDP per capita did not grow in countries that did not globalize[80]. As a consequence, the gap between globalizing and non-globalizing countries increased. And since many developed countries pursue liberal trade policies and many poor countries do not there is no convergence between rich and poor countries taken together but a further dispersion[81].

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[78] Peter Lindert and Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.) GLOBALIZATION IN HISTORICAL PERSPECTIVE (2002).

[79] Paul Masson, GLOBALIZATION: FACTS AND FIGURES, IMF Policy Discussion Paper PDP/01/4, 9 (Oct. 2001), Gouranga Gopal Das, DOES TRADE AND TECHNOLOGY TRANSMISSION FACILITATE INEQUALITY CONVERGENCE? AN INQUIRY INTO THE ROLE OF TECHNOLOGY IN REDUCING THE POVERTY OF NATIONS, IMF Working Paper 07/16 (2007).

[80] Other non-income components of well-being, like education and longevity, very well did. See Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 108 -111 (stating that international HDI comparisons, which include these factors, "exhibit long run convergence for all geographic areas").

[81] Paul Masson, id. at 13. See also François Bourguignon & Christian Morrisson, THE SIZE DISTRIBUTION OF INCOME AMONG WORLD CITIZENS: 1820-1990 (World Bank mimeo 2000) (finding a constant increase in their between-country inequality index for 15 countries that slows down after 1950). Other studies, frequently using postwar purchasing-power-parity data for a much bigger group of countries, actually documented that between-country inequality stopped increasing after the late 1960tis or even declined. See, for example, Arne Melchior, Kjetil Telle and Henrik Wiig, GLOBALIZATION AND INEQUALITY: WORLD INCOME DISTRIBUTION AND LIVING STANDARDS, 1960-1998', Studies on Foreign Policy Issues Report 6B, Royal Norwegian Ministry of Foreign Affairs (2000); Xavier Sala-i-Matin, THE DISTURBING 'RISE' OF GLOBAL INCOME INEQUALITY', NBER Working Paper 8904 (2002). Critical to these benign studies Branko Milanovic, THE RICARDIAN VICE: WHY SALA-I-MATIN'S

Nevertheless, the World Bank has taken a fairly optimistic view of the latest developments stating that "less than 10 percent of the developing world's population live in countries where average income declined [since 1970], while 70 percent live in countries where per capita income growth exceeded that of industrial countries."[82] Such statistics, of course are not satisfactory for countries that fall further and further behind the West. But they entail a clear message: there is a perspective for poor countries to converge macro-economically with rich countries if they embrace the idea of comparative advantage and elect to integrate in the global economy[83].

As the previous discussion argues this claim is persuasive. Countries with open economies enjoy greater efficiencies and benefit of more innovation. This is true for both developed and developing countries. Despite the skewed global distribution of income there is a chance even for the poor to extricate themselves from the daunting prospect of zero growth and the state of underdevelopment: Developing countries that opened their markets managed to catch up with the leading industrialized nations. Many countries in Asia, Eastern Europe and Latin America did not remain underdeveloped, and, as dependencia theory has it, dependent on rich countries and multinational companies. Rather, competitive industrial clusters evolved, most notably in the IT sector. On the other hand, in all places where countries reject globalization, citizens are cheated out of their development opportunities. The discussion of comparative advantage thus allows a remarkable inference: Globalization activists should be protesting for free trade, not against globalization, if they were to take their moral impetus towards reducing income gaps seriously[84].

CALCULATIONS OF WORLD INCOME INEQUALITY CANNOT BE RIGHT (World Bank mimeo 2002).

[82] Int'l Monetary Fund, WORLD ECONOMIC OUTLOOK, ASSET PRICES AND THE BUSINESS CYCLE 132 (May 2000), at 116.

[83] Kevin H. O'Rourke, GLOBALIZATION AND INEQUALITY: HISTORICAL TRENDS 29 (Nat'l Bureau of Econ. Research, Working Paper No. 8339, June 2001), at 34.

[84] Indeed, much of the asymmetry in the world economy may be traced to attempts of Western nation-states to affect prices through import taxes and subsidies to production and export. Both the European Union and the United States, albeit to different degrees depending on the issue, have established investment climates favorable to their own corporate actors and have artificially imposed costs on others. See Philip Alston, Remarks on Professor B.S. Chimni's A JUST WORLD UNDER LAW: A VIEW FROM THE SOUTH, 22 Am. U. Int'l L. Rev. 221 (2007), at 226.

V. Economic globalization and inequality within countries

Globalization has brought unprecedented prosperity to countries joining the world economy in terms of aggregate welfare. Economic integration, whether by trade, migration or capital flows, however, does not guarantee an equal distribution of the wealth created. Indeed, one of the primary concerns of many anti-globalists is the effect of globalization on equality within countries. They allege that international trade and migration divides societies in a rich, prosperous part and a poor part which is essentially deprived of all chances. This point of view is widely shared in developed and developing countries and probably accounts for the tacit support of the anti-globalization movement by large groups of society. As Prof. B.S. Chimni, a human rights and international law scholar, puts it[85]: “What it means in the final analysis is that the world is today coming to be divided into two worlds that of the Global Rich and that of the Global Poor. Though it needs to be added that the population that lives on less than a dollar a day is nearly entirely present in the third world, injecting a strong North-South dimension to the divide between the Global Rich and the Global Poor.”

The common notion of a close correlation between economic openness and inequality within a given country, however, is questioned by many economists. Many economic studies that document divergence in incomes around the globe show that the increase of global inequality is driven almost solely by the rise of between-nation inequality, not by the rise of inequality within nations, as illustrated by the following figure[86]. Some studies even find that - under certain circumstances - openness reduces inequality[87].

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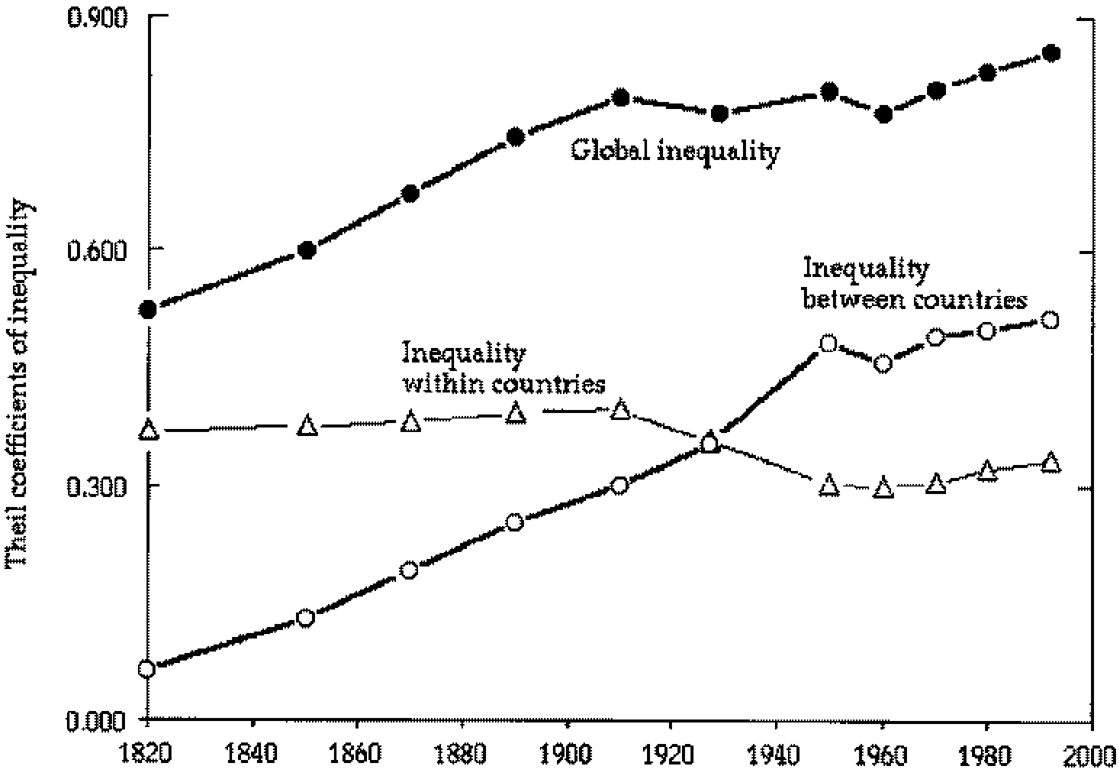
[85] B.S. Chimni, A JUST WORLD UNDER LAW: A VIEW FROM THE SOUTH, 22 Am. U. Int'l L. Rev. 199 (2007), at 212.

[86] Albert Berry, Francois Bourguignon, and Christian Morrisson, GLOBAL ECONOMIC INEQUALITY AND ITS TRENDS SINCE 1950, in L. Osberg (ed.) Economic Inequality and Poverty: International Perspectives (1991); Angus Maddison, MONITORING THE WORLD ECONOMY, 1820-1992(1995); François Bourguignon & Christian Morrisson ‘THE SIZE DISTRIBUTION OF INCOME AMONG WORLD CITIZENS: 1820-1990’ (World Bank, 2000); Raymond Robertson, TRADE LIBERALISM AND WAGE INEQUALITY: LESSONS FROM THE MEXICAN EXPERIENCE, 23 WORLD ECON. 827 (2000).

[87] Kevin H. O’Rourke, GLOBALIZATION AND INEQUALITY: HISTORICAL TRENDS 29 (Nat'l Bureau of Econ. Research, Working Paper No. 8339, 2001) (referring to Matthew Higgins & Jeffrey G. Williamson, EXPLAINING INEQUALITY THE WORLD ROUND: COHORT



Source: François Bourguignon & Christian Morrisson, The Size Distribution of Income among World Citizens: 1820-1990. (World Bank mimeo 2000)

Some commentators thus argue that globalization-related inequality within countries is negligible and claims to the contrary are not substantiated[88]. Such an inference, however, appears to be flawed. For at least three reasons within-country inequality should not be regarded immaterial in the context of globalization simply because it has not contributed significantly to the rise in global inequality so far:

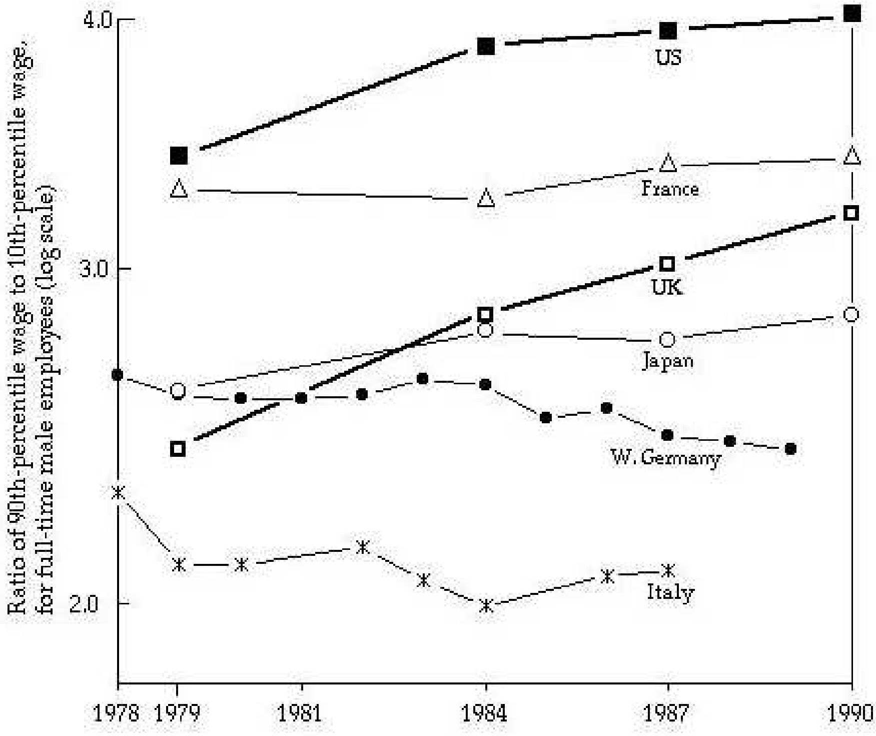
SIZE, Kuznets Curves, and Openness (Nat'l Bureau of Econ. Research, Working Paper No. 7224, 1999); Gouranga Gopal Das, DOES TRADE AND TECHNOLOGY TRANSMISSION FACILITATE INEQUALITY CONVERGENCE? AN INQUIRY INTO THE ROLE OF TECHNOLOGY IN REDUCING THE POVERTY OF NATIONS, IMF Working Paper 07/16 (2007).

[88] See, for example, Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 104: “The data indicates that openness decreases inequality, and not the other way around. At worst, the effects of globalization on within-country income inequality are ambiguous and, in any event, are likely to be small”.

First, the within country-inequality trends diverge sharply between developing and developed countries and within these groups[89]. In two of the most open countries, the US and UK, a clear trend towards wider wage gaps is discernable since the 1980tis, as illustrated in “Figure 6”[90]. Notwithstanding a growth of real earnings for the US labor force taken together, lower-skilled groups incurred a loss, at least no significant gain, in real income over the last three decades[91]. At the same time real wages of the top 1 percent have more than doubled[92]. According to a new study by Thomas Piketty and Emmanuel Saez [93], the richest percentile now controls almost 20 percent of total US income, a proportion higher than at any time since the Twenties.

[89] Peter Lindert & Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE, (2002), at chap. 5.
[90] Peter Lindert & Jeffrey Williamson, id. AN INFORMATIVE ACCOUNT OF THE HETEROGENEOUS COMPOSITION OF THE TOP INCOME DECILE IN THE US PROVIDE Thomas Piketty & Emmanuel Saez, INCOME INEQUALITY IN THE UNITED STATES, 1913-2002 (2004).
[91] Peter Lindert & Jeffrey Williamson, id.
[92] Thomas Piketty & Emmanuel Saez, INCOME INEQUALITY IN THE UNITED STATES, 1913-2002 (2004).
[93] Thomas Piketty & Emmanuel Saez, INCOME INEQUALITY IN THE UNITED STATES, 1913-2002 (2004); Thomas Piketty & Emmanuel Saez, THE EVOLUTION OF TOP INCOMES: A HISTORICAL AND INTERNATIONAL PERSPECTIVE, NBER Working Paper No. 11955 (2006).

Figure 6. Inequality of Full-time Earnings of Male Employees in Six Countries, 1978 - 1990



Source: Peter Lindert and Jeffrey Williamson, Does Globalization make the world more unequal, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), *Globalization in Historical Perspective*, (2002).

In other OECD member states, most notably France, Japan, Italy and Germany, there was, if at all, only a minor widening in *full-time* labor earnings. Taking into account work hours and unemployment, however, one can identify a trend towards more unequal labor earnings even in these countries[94]. The fact that labor earnings became more unequal, while *full-time* labor earnings remained at the same inequality level, allows the inference that these countries "took their inequality in the form of more unemployment and hours

[94] Peter Lindert & Jeffrey Williamson, id.

reduction, rather than in wage rates"[95]. Finally, the literature on wage inequality and trade liberalization in developing countries demonstrates income convergences when Korea, Singapore, and Taiwan liberalized in the 1960tis[96]. The bulk of developing countries, though, experienced the opposite development: when Argentina, Chile, Colombia, Costa Rica, Mexico, and Uruguay liberalized after the late 1970s[97], China after 1984[98], and India and Russia in the 1990tis[99], income gaps rose sharply. Unlike the Asian Tigers in the 1960tis, all of these states faced significant competition from other low-wage countries[100]. After all, a closer look at the individual country-data suggests that within-country inequality is much more a topic in the context of globalization than some aggregate inequality statistics purport[101].

Second, the lack of a significant change in within-country inequality at the global level may stem from countervailing policies in many countries. This would also explain the different inequality trends in countries that are all integrated in the world economy: In-

[95] Peter Lindert & Jeffrey Williamson, id. According to a recent study 20 out of 21 OECD countries had a noticeable rise in inequality due to widening labor earnings after the 1980tis. See Burniaux, J. et al. (1998), "INCOME DISTRIBUTION AND POVERTY, IN SELECTED OECD COUNTRIES", OECD Economics Department Working Papers, No. 189, OECD Publishing.doi:10.1787/730801800603.

[96] Adrian Wood, Openness and Wage Inequality in Developing Countries: THE LATIN AMERICAN CHALLENGE TO EAST ASIAN CONVENTIONAL WISDOM. WORLD BANK ECONOMIC REVIEW 11 (January 1997), at 33.

[97] Adrian Wood, id. See also Gordon Hanson & Ann Harrison, TRADE LIBERALIZATION AND WAGE INEQUALITY IN MEXICO, Industrial and Labor Relations Review 52:271-88 (1999).

[98] In 1984 the reforms in China reached the industrial sector. Earlier reforms were rural and agricultural and had an egalitarian effect. See Keith Griffin & Zhao Renwei (eds.). THE DISTRIBUTION OF INCOME IN CHINA (1993), particularly at 60-61.

[99] For the Indian Case see supra, at IV 3 b. THE RISE OF INEQUALITY WITHIN RUSSIA IS COINCIDES WITH THE COLLAPSE OF THE SOVIET REGIME IN 1991.

[100] Peter Lindert & Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE, (2002), at chap. 5; Adrian Wood, OPENNESS AND WAGE INEQUALITY IN DEVELOPING COUNTRIES: THE LATIN AMERICAN CHALLENGE TO EAST ASIAN CONVENTIONAL WISDOM. World Bank Economic Review 11 (January 2002), at 33.

[101] The IMF World Economic Outlook, Globalization and Inequality (2007) specifically focuses on the question of within-country inequality. The report finds that, over the past two decades, income inequality has risen in most regions and countries.

creasing inequality within countries is likely to precipitate policy responses that constrain the inequality to some socially acceptable level. Since the tolerable inequality level is far higher in the Anglo-American World than, for instance, in Germany the distributional policies vary between the countries. The fairly slow rise in global within-country inequality and the differing inequality trends in economically open countries thus may indicate divergent mitigating policies which blur the real impact of economic globalization on within-country inequality.

Third, it is perceived injustice because of unequal income opportunities and income distribution within borders that usually leads to political complaint[102]. Moreover, it is the political complaint of the economic losers that predominantly triggers policy responses[103]. Accordingly, one has to take even relatively minor shifts in within-country inequality seriously in order to prevent policymakers from interfering with economically beneficial processes and adopting protectionist policies.

1. Sources of within-country inequality

In the last 25 years, the biggest increase in within-country inequality among developed nations occurred in the US and the UK[104]. Both countries are among the seven countries classified as "free"in the Economic Freedom index of the Heritage Foundation[105]. Within-country inequality also soared in major developing countries such as India and China after liberalizing in the 1980tis and 1990tis[106]. The trend in the latter countries, though, may be explained by intrinsic policy decisions resulting in unequal openness[107].

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[102] Jeffrey Williamson, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION, (Wider Annual Lecture 2002), at 2.

[103] Jeffrey Williamson, id.

[104] See supra at V.

[105] The US ranks fourth, the UK sixths in the 2007 index. See http://www.heritage.org/index/countries.cfm.

[106] In the study of Paul Masson, GLOBALIZATION: FACTS AND FIGURES (IMF Policy Discussion Paper PDP/01/4, 9, 2001) China's increase in inequality is the largest in both relative and absolute terms of all the countries examined.

[107] Peter Lindert & Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE, (2002), at chap. 5.

That is, the rising inequality appears to stem from the exclusion of broad swathe of the population from the benefits of globalization, rather than – conversely - from the process of globalization[108]. For example, in China income gains have been concentrated in Shanghai and other coastal cities which enjoyed the integration in the global economy from the very outset of the industrial reforms in 1984[109]. The masses in the hinterland were left behind mostly because migration to the cities was practically prohibited before the mid-1990s and remained heavily restricted ever since[110]. Similar political distortions, which are hard to quantify but significant, do not disturb the inequality development in the US and the UK. Hence, it makes sense to focus on the UK and especially on the US, where the bulk of the pertaining research has been carried out, to assess the impact of globalization on within-country inequality.

The recent rise in UK and US wage inequality has generated an energetic dispute about its sources[111]. In essence, the dispute has boiled down to an ‘economic openness versus technology’ bi-polarity. Some have argued that increased competition from imports using cheap labor is to be blamed for much of the divergence[112]. Others have rejected the idea

[108] Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 104 (stating that most of this increase in China’s inequality “was attributable to a growing gap between urban and rural incomes. Regions that were more open to international trade, however, experienced a decline in urban-rural inequality over this period.”). See also IMF World Economic Outlook, GLOBALIZATION AND INEQUALITY (2007), at 42-44 (stating that trade liberalization has actually reduced overall inequality in China).

[109] See Keith Griffin & Zhao Renwei (eds.). THE DISTRIBUTION OF INCOME IN CHINA (1993), particularly at 61.

[110] Peter Lindert & Jeffrey Williamson, DOES GLOBALIZATION MAKE THE WORLD MORE UNEQUAL?, in M.D. Bordo, A.M. Taylor and J.G. Williamson (eds.), GLOBALIZATION IN HISTORICAL PERSPECTIVE, (2002), at chap. 5.

[111] Ben Bernanke, chairman of the Federal Reserve, provides an excellent overview of the discussion in a speech given before the Greater Omaha Chamber of Commerce on Feb 6, 2007, transcript available at http://www.washingtonpost.com/wp-dyn/content/article/2007/02/06/AR2007020600882.html. An overview of the exuberant literature is provided in the IMF World Economic Outlook, Globalization and Inequality (2007), at 62 – 65.

[112] See, for example, Adrian Wood, GLOBALISATION AND THE RISE IN LABOUR MARKET INEQUALITIES, 108 Economic Journal 1463 (1998).

of globalization-related, or at least trade-related, wage widening[113]. They argue that markets in the post-industrial, information society increasingly reward education and high productivity. According to this view, the new technologies are strongly biased in favor of high-skill labor[114].

Given these differing views and the interdependency of economic openness and technological innovation, the exact impact of globalization on the rise of within-country inequality is very difficult to ascertain. Furthermore, the very focus on economic openness and technology appears to be too narrow. Other country specific factors, like the number of immigrants and their skill-level or the weakening of labor unions, influence the inequality level, too[115]. Nevertheless, most scholars appear to accept the estimation by Robert Feenstra and Gordon Hanson[116] that 15-33 % of the rising inequality is due to the international economic integration. Whether this rise in inequality is an inevitable consequence of economic globalization and global capitalism, however, is much more controversial.

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[113] IMF World Economic Outlook, GLOBALIZATION AND INEQUALITY (2007), at 52-53 (stating that trade actually reduces inequality but conceding that financial globalization, and foreign direct investment in particular, has been associated with widening income disparities); see also Nancy Birdsall, DISCUSSION OF THE IMPACT OF GLOBALIZATION ON THE WORLD'S POOR, ed. by Machiko Nissanke & Erik Thorbecke (2007).

[114] Eli Berman, John Bound, and Zvi Griliches, CHANGES IN THE DEMAND FOR SKILLED LABOR WITHIN U.S. MANUFACTURING: EVIDENCE FROM THE ANNUAL SURVEY OF MANUFACTURES. 109 Quarterly Journal of Economics 367 (1994); Stephen Machin & John van Reenen, TECHNOLOGY AND CHANGES IN SKILL STRUCTURE: EVIDENCE FROM SEVEN OECD COUNTRIES, 113 Quarterly Journal of Economics 1215(1998).

[115] Jeffrey Williamson, WINNERS AND LOSERS OVER TWO CENTURIES OF GLOBALIZATION, (Wider Annual Lecture 2002), at 11. See also IMF World Economic Outlook, Globalization and Inequality (2007), p. 56 f. (stating that there is a strong "regional and sectoral dimensions of inequality").

[116] Robert C. Feenstra & Gordon H. Hanson, THE IMPACT OF OUTSOURCING AND HIGH-TECHNOLOGY CAPITAL ON WAGES: ESTIMATES FOR THE UNITED STATES, 1979-1990. 114 Quarterly Journal of Economics 907 (1999).

2. Social welfare policies in a globalizing world

Many anti-globalists assert that multinational corporations are using their increasing economic strength to usurp political power. As a consequence, local governments become more and more incapable of mitigating the inegalitarian effects of global capitalism by providing social safety nets[117]. Along the same lines, Noreena Hertz laments the existences of a world in which the physical safety of people are determined by the strategies of financiers and corporations and in which the primary function of government is to attract investors[118].

On the other hand, many liberal trade enthusiasts allege that, as far as globalization is associated with increased inequality, it still can be eliminated by strengthening domestic safety nets, economic regulation and – on the broadest level - adhering to the “rule of law”. They point to studies that have found a tight empirical association between economic openness and government spending on social security[119], and they presume that the exposition to greater external risks by integrating in the global economy has triggered the social legislation aimed at protecting individuals against such risks. The widespread concern that in the future free trade and capital mobility will render large parts of the nation’s tax base footloose and effectively nontaxable – and thus diminish the ability to fund social security policies[120] - is countered with a hint at the stable capital tax revenues in most countries[121]. The famous notion of tax and subsidy competition between countries, leading to an international "race to the bottom", is answered by pointing to the still large Government Expenditure as Percent of GDP in many highly globalized countries,

[117] See, for example, Noreena Hertz, THE SILENT TAKEOVER: GLOBAL CAPITALISM AND THE DEATH OF DEMOCRACY 2 (2001), at 10 - 11 ("unelected powers - big corporations - are taking over governments’ roles").
[118] Noreena Hertz, id. at 34.
[119] Dani Rodik, HAS GLOBALIZATION GONE TOO FAR? 14 (1997), at 53, 65.
[120] See Dani Rodik, id. at 73. He suggests taxing footloose factors at the global level and sharing the revenues among countries afterwards.
[121] Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 111 (citing Nicholas Crafts, GLOBALIZATION AND GROWTH IN THE TWENTIETH CENTURY 16, IMF Working Paper WP/00/44 (Mar. 2000)).

like Israel, Sweden and Finland[122]. From this point of view, globalization might modify the tax structure in a healthy way but it does not create significant pressure to forgo tax revenues and curb social spending[123].

Ultimately, both positions are one-sided and not persuasive. More often than not vested interests and political attitudes rather than analytical rigor appear to inform the opposing points of view. The argument that globalization does not impair social spending and even encourages countries to build up social safety nets has been frequently used to solicit political support for international free trade agreements[124]. It is thus not without irony that free market proponents also lead that vanguard in criticizing the welfare state in the 1990tis and in the new millennium[125]: The regulating welfare state was seen as inhibiting international efficiency and governments were advised to jettison regulation, add-on benefits and job protection to overcome high unemployment rates and economic stagnation[126].

On the other hand, the leftist argument that states are loosing the capability to provide adequate social safety nets might have been swayed by discontent with left wing governments: In many Europe countries, leftish coalitions have taken the corrective steps to curtail the underlying social security system; in others, they have refrained from reversing the cuts initiated by conservative governments after winning the subsequent vote. Blaming globalization, multinationals and international institutions like the IMF for the misery, then, appears to be the most convenient way to live with the obnoxious policy of own partisans in the government.

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[122] Larry J. Obhof, id, at 111.
[123] Larry J. Obhof, id.
[124] See for example David Vogel, TRADING UP (1995) in the context of the NAFTA and the Central American Free Trade Agreement (CAFTA).
[125] Samuel Krislov, CAN THE WELFARE STATE SURVIVE IN A GLOBALIZED LEGAL ORDER?, 603 Annals Am. Acad. Pol. & Soc. Sci. 54 (2006), at 55.
[126] These arguments reached an Apex when France and the Netherlands rejected the European Community Constitution in mid-2005. The reaction of the voters were considered nostalgia-based efforts to cling to a social insurance state whose day had come and gone, see for example Steven Pearlstein, “EUROPEAN UNION BITTEN BY FEAR OF FREE MARKETS,” Washington Post, June 22, 2005, at D1.

Keeping the relevant data and historic developments in perspective, one can fairly infer that the welfare state witnessed a confidence crisis in the late 1990tis. Demonstrated or putative costs and competitive disadvantages in international trade lead to significant retrenchments. Even the already riddled social benefits in the US encountered a relatively strong political headwind[127]. But many of these retrenchments in social welfare spending were also pushed by the fundamental challenge of demographic shifts, and they were accompanied by a sense that social benefits had been overgenerous[128].

The expansion of the welfare state after World War II coincided with the rise of the "Soviet empire" up to a point, where it “had overreached its ability to deliver on its promises”[129]. Unlike the USSR, however, the welfare state did not collapse. Its truncation has been characterized by incremental steps aimed at bringing incentives for hard work and social backing into a better balance. Thus, the failure of communism can hardly be deemed paradigmatic for the welfare state. Indeed, the amount of money transferred from the wealth-creating core to the non-productive fringes of European societies remains impressive. In Germany alone, the social budget amounts to almost a trillion $[130] and the obligation to provide “social justice” (Sozialstaatsprinzip) is explicitly stated in its constitution[131].

[127] Samuel Krislov, CAN THE WELFARE STATE SURVIVE IN A GLOBALIZED LEGAL ORDER?, 603 Annals Am. Acad. Pol. & Soc. Sci. 54 (2006), at 64 pointing to the widespread notion that the “elimination of regulatory hindrances will enrich society” and to the “unwillingness to regard sudden or catastrophic economic changes as beyond individuals' control and therefore partly a social responsibility”.

[128] See Samuel Krislov, id. at 59 (arguing that “there was also a revulsion as these benefits encouraged grosser and grosser claims of entitlement by nonproductive segments of society rather than more socially responsible attitudes expected by welfare statists”.)

[129] Samuel Krislov, DO FREE MARKETS CREATE FREE SOCIETIES? 33 Syracuse J. Int'l L. & Com. 155 (2005), at 163.

[130] According to an OECD report, Germany’s gross public social spending was 30.7 % of GDP in 2005, the net public social spending still reached 26.9 % of GDP, which is the second highest rate among OECD countries. See Willem Adema and Maxime Ladaique, Net Social Expenditure, 2005, DELSA/ELSA/WD/SEM(2005)8, at 33; available at http://www.oecd.org/dataoecd/56/2/35632106.pdf. (last visited Oct 15th, 2007). The German GDP is USD 2,897 billion (2006).

[131] See Art. 20 (1) Basic Law for the Federal Republic of Germany: “The Federal Republic of Germany is a democratic and social federal state.”

After all, there is no reason to believe that the demise of the welfare state is a foregone conclusion. Rather, the trimmed welfare state appears to have survived the crisis of confidence. Today, the reform efforts around the world and particularly in Western Europe and Scandinavia would appear to be necessary readjustments that have preserved the viability of social security systems. And this perception would appear to be substantiated. Many states in Europe, in particular Germany and to some extend the Scandinavian countries, have demonstrated the political will and liberty to cut social benefits where economically required and politically desired. The residual safety provisions are still considerable, but with a clearer focus on access to opportunities rather than on equal outcomes. Therefore, neither fears that globalization would render the welfare state unsustainable and dispensable nor that the welfare state would endanger freedom and economic efficiency seem verified by recent historic experience. To the contrary, institutions like the IMF begin to criticize inequality and embrace countervailing social policies as a means of furthering long-term development and efficiency[132].

3. Significance of within-country inequality

The European experience in the last 10 to 15 years suggests that social policies aimed at reducing within-country inequality are not precluded by economic integration in the world economy. The policy shift of the IMF, however, raises another interesting question: *Should* countries actually try to counter the rising inequality with offsetting policies. Or, to put it in another way: Does inequality matter economically?

Some commentators have answered this question in the negative?[133] They claim that absolute growth, not equality is crucial[134]. At first glance, this proposition sounds persuasive: Social benefits have a propensity to interfere with free market conditions. And the

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[132] See World Bank Development Report 2006, EQUITY AND DEVELOPMENT (2006) and the following sections.
[133] See for example for example Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 107 - 109.
[134] Larry J. Obhof, id. at 107 (“The simple reality is that relative wages, and even relative employment, are not as important as the changes in absolute terms”).

less regulatory interference with free trade, capital flows and migration, the more prosperous the international community collectively and its component nation-states individually will become in the short run. The larger economic pie, then, may theoretically translate into better living conditions even for those dramatically disadvantaged. There is also empirical support for this assumption: poverty has declined in many countries following market reforms and the living-standards, measured by the U.N. Human Development Indicators (HDI)[135], have improved considerably in all strata of society - even in the poorest countries[136]. Yet, three reasons, at least, suggest that inequality matters in terms of individual well-being.

First, income disparities raise concerns of fairness and justice. Most people feel that rampant inequality violates central moral imperatives. This accords with the bulk of political philosophy and the ethical teachings of the world's leading religions. In particular, inequality is seen as intolerable if the adversely affected individuals can do little about it[137]. This, however, is usually the case. According to the World Development Report 2006, the World Bank's major annual publication, inequalities have a tendency to propagate over time and across generations. For example, very poor children commonly do not have as good access to high quality education as children from wealthier families. Consequently, they are likely to earn less than adults. Furthermore, disadvantaged families leading a precarious existence usually have less voice in the political arena. Hence, they will not be able to influence decisions about spending money on public schools. This, in turn, further cements the prospect of poor education thereby creating a vicious circle, or, as the Word Development Report 2006 has it, "inequality traps"[138]. Such inequality traps

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[135] The human development index (HDI) looks beyond GDP to a broader definition of well-being. The HDI provides a composite measure of three dimensions of human development: living a long and healthy life (measured by life expectancy), being educated (measured by adult literacy and enrolment at the primary, secondary and tertiary level) and having a decent standard of living (measured by purchasing power parity, PPP, income).

[136] Larry J. Obhof, WHY GLOBALIZATION? A LOOK AT GLOBAL CAPITALISM AND ITS EFFECTS, 15 U. Fla. J.L. & Pub. Pol'y 91 (2003), at 108-110.

[137] Federal Reserve Chairman Ben Bernanke stressed this point in a speech before the Greater Omaha Chamber of Commerce on Feb 6, 2007: "in our society … economic opportunity should be as widely distributed and as equal as possible", transcript available at http://www.washingtonpost.com/wp-dyn/content/article/ 2007/02/06/AR2007020600882.html.

[138] World Bank, World DEVELOPMENT REPORT 2006, Equity and Development, at 20.

are not only considered unfair by most people. They also create dissatisfaction and unhappiness, both among the disadvantaged persons and the rich[139].

Second, there is also an instrumental relationship between equity and long-term economic development and efficiency. Unequal opportunities created by inequality traps lead to an underutilization of productive potential and an inefficient allocation of resources. The aforementioned example of poor children receiving poor quality education illustrates the problem. In many third world countries the situation is even worse. Parents are forced to send their children to work at the expense of schooling. These coerced parental decisions on behalf of their children deprive large numbers of the population of the opportunity to fully develop and utilize their talent in the long run[140]. Human potential may also be wasted due to poverty related discrimination and stereotyping-mechanisms. These mechanisms have been found to significantly impair the self-esteem and performance of individuals in the groups and strata discriminated against[141]. Hence, inequality traps – especially when accompanied by stereotyping - are likely to weaken the long-term prospects for overall prosperity and economic growth.

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[139] Rafael Di Tella, Alberto Alesina and Robert McCulloch, INEQUALITY AND HAPPINESS: ARE EUROPEANS AND AMERICANS DIFFERENT?, 88 Journal of Public Economics, 2009 (2004). The study reveals remarkable differences between the US and Europe: In Europe, the poor and those on the left of the political spectrum are unhappy about inequality, whereas no significant correlation between inequality and happiness of the pauper and leftist exists in the US. Interestingly, in the US, the rich are dissatisfied with inequality. The authors of the study suggest that sees finding are tied to a different perception of promotion prospects and inequality traps. That is, Americans believe to live in a mobile society, where individual effort can move people up and down the income ladder, while Europeans think that they live in less mobile societies.

[140] The skewed access to credit is another issue leading to wasted long-term development. World Bank, World Development Report, Equity and Development, at 89.

[141] In the Development Report 2006, Equity and Development, at 94-97, the World Bank refers to a striking experiment in India. Children from different castes were asked to solve a maze and they were offered real performance-related monetary incentives. In the experiment low-caste children performed much worse then high-cast children when their caste was publicly announced. However, no performance difference occurred when the affiliation to the caste remained hidden. The report concludes that a similar inhibition of talent due to discrimination in the real word appears likely.

Finally, rising inequality may adversely affect the support to economic globalization in the population and lead to significant opposition by vested interests. The likelihood of an inequality induced political backlash to economic openness, of course, depends on the varying social acceptability of inequality as well as on the political clout and the bargaining power of organized labor. In many European countries, where advocating equality is deeply rooted in society and both, labor and business interests are highly vested in protectionist policies, the acceptable inequality level may be fairly low. On the other hand, the greater tolerance of inequality in the American and British society reduces the propensity of politicians to erect trade barriers or to adopt other policies that are known to impede economic efficiency. The same is true for the waning influence of labor unions which have long lobbied for flatter pay scales in these countries. Yet, with the recent outsourcing wave of upscale jobs the attitude towards economic globalization may change even in the US and the UK if the white collar workers left behind are not able to find alternative positions quickly and incur measurable income losses[142].

VI. Policy implications

The previous discussion suggests that a prudent globalization policy must involve a holistic concept. It must not interfere with the beneficial effects of economic globalization; but it should also carefully contemplate policies against inequality traps regardless of the fact that the causal impact of globalization on within-country inequality is modest at best.

Economic theory and historic experience unequivocally indicate that the benefits of economic globalization are large. Free trade, capital flows, technological transfer, and migration all provide incentives for innovation, disseminate valuable knowledge, and, above all, offer the chance to specialize and fully exploit efficiencies. Based on the logic of comparative advantage, they lead to greater welfare in industrialized and developing countries. The contention of many anti-globalists that open economic policies are likely to impede development in poor countries is unsubstantiated. It boils down to a reanima-

[142] Peter Engardino, Aaron Bernstein, and Manjeet Kripalani, THE NEW GLOBAL JOB SHIFT, 2/3/03 BUSW 50 (2003); Thomas Palley, THE ECONOMICS OF OUTSOURCING: HOW SHOULD POLICY RESPOND?, FPIF Policy Report (March 2006).

tion of leftist imperialism theories. Like these old ideas, the new "dependencia" theories have also been proved wrong historically, most notably by the development of highly competitive industries in many developing countries that chose to integrate in the global economy. Moreover, these open countries have managed to considerably catch up with the industrialized West. On the other hand, the economic development of those countries electing to remain isolated has been faltering, leaving them further and further behind. Thus, embracing open policies that support free economic interaction and remove trade barriers would appear to be central for developed and developing nations alike.

The distribution of the benefits of trade and economic integration among the members of society, however, is not necessarily equal. Indeed, careful analyses of individual country data suggest that globalization increases within-country inequality, thereby producing winners and losers. This is not only problematic with regard to intrinsic concerns of justice and fairness. The skewed income distribution may also engender long term inefficiencies and impede economic development, particularly if it translates into permanently unequal opportunities (inequality traps). Furthermore, perceived inequality traps increase the odds in favor of a political backlash to economic globalization. Thus, regardless of the differing moral and ethical attitudes of societies towards inequality, policy should generally address the last two problems brought about by inequality traps to preserve the full potential of economic growth and development. Solutions tailored to the specific circumstances in individual countries are indispensable in this context[143].

As a general matter, however, policies should not target inequality in outcomes. Rather, the primary concern should be the foreclosure of opportunities due to inequality traps. Owing in part to different efforts, talents, and luck and in part to different preferences one must expect different outcomes and varying incomes even if opportunities were genuinely equal. Therefore, stressing equality of incomes will distort incentives to work hard, take risks, and invest in education and physical capital[144]. These short run effects are

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[143] The following discussion focuses on developed nations. In many developing nations basic concepts, like the rule of law, appear paramount. Other important aspects involve nation building and containing nepotism.

[144] This dilemma has been stress by Federal Reserve Chairman Ben Bernanke repeatedly. See, for example, his speech before the Greater Omaha Chamber of Commerce on Feb 6, 2007, transcript

likely to be more deleterious than the long-term, hard-to-measure benefits of greater equity. As stated above, the history of the twentieth century is replete with examples of overgenerous welfare policies that seriously harmed—rather than fueled —growth[145]. Taking into account this historical experience any policy tradeoff between equity and short-term efficiency should attempt at unblocking opportunities for all members of society and spurring dynamic efficiencies without creating unnecessary market deficiencies in the short run.

Policy measures that have almost no immediate costs to individual incentives but contribute significantly to overcome market failures leading to unexploited opportunities in the long run are paramount. Such measures include providing help to adjust as comparative advantage shifts rapidly from one activity to the next[146]. If those who lose their jobs—from whatever cause— are assisted to find new work by means of generous training and other active policies potential frictions in labor markets due to redeployments of investments and labor will diminish. Other important measures include an education system that equips people with general skills[147] and social security systems that are not (solely) financed by contributions of employers and employees. Above all, health care and pensions should not be closely tied to specific employer-employee

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available at http://www.washingtonpost.com/wp-dyn/content/article/ 2007/02/06/AR2007020600882.html.

[145] Supra, at V 2.

[146] Such policies also account for the critics of Stiglitz arguing that globalization leads to asymmetrical betterment in terms of timing and allocation of income opportunities. Such asymmetries may impair human contentment and social stability, particularly because uprooting oneself and one's family is harder then moving machinery. Abrupt personal upheavals may also produce negative side effects such as crime, mental illness, and neglected education. See Joseph Stiglitz, Globalization and Its Discontents (2002).

[147] See Ben Bernanke in his speech before the Greater Omaha Chamber of Commerce on Feb 6, 2007 (arguing that "policies that boost our national investment in education and training can help reduce inequality while expanding economic opportunity. A substantial body of research demonstrates that investments in education and training pay high rates of return both to individuals and to the society at large. That research also suggests that workers with more education are better positioned to adapt to changing demands in the workplace.") A transcript of the speech is available at http://www.washingtonpost.com/wp-dyn/content/article/ 2007/02/06/AR2007020600882.html.

relationships, so that moving one's job poses the risk of loosing much of the social backing[148].

None of that comes cheap. But an economy that benefits from economic globalization and free trade is in the best position to find the money to pay for it. Using the money for the described policies, then, may help to prevent a political backlash driven be dissatisfaction about personal hardships and raising inequality.

VII. Conclusion

The amazing success of the anti-globalization movement is primarily based on the subliminal fear of broad parts of the world population that free trade and liberal economic policies increase inequality between developing and developed countries as well as within the boarders of countries. By and large, though, these fears are unsubstantiated.

Economic globalization has generated prosperity in countries that embrace liberal trade policies because of increased efficiency and innovation. This is not only true for industrialized countries. The promises of comparative advantage also hold for developing countries. The impressive success of countries like India and China, which have developed highly competitive industrial clusters, proves leftist theories of imperialism and dependencia wrong. Of course, inequality between countries still exists - it has even been increasing during the last decades. The skewed global distribution of income, however, has not been caused by globalization but is, by and large, attributable to the divergence between globalizing countries and those nations which have elected to stay isolated. Among the countries integrated in the world economy a clear trend toward converging incomes is discernable. Thus, as far as anti-globalization activists are concerned about income gaps between countries they should protest for, not against economic globalization.

The correlation between the increase in within-country inequality and economic openness turns out to be a more complicated matter. A country-related analysis of the available

[148] Ben Bernanke, id ("Policies that reduce the costs to workers of changing jobs -- for example, by improving the portability of health and pension benefits between employers -- would also help to maintain economic flexibility and reduce the costs that individuals and families bear as a result of economic change.").

data suggests that inequality within countries has in fact increased parallel to the accelerating process of global economic integration. The direct impact of liberal trade policies on this increase, however, is limited. The bulk of the inegalitarian trend may be related to other factors like migration and a technology-specific bias towards skilled labor. Yet, an active social policy should be pursued to mitigate the sometimes harsh personal consequence of rapidly altering working conditions in a quickly developing and specializing world-economy so as to ensure and fully exploit all productive opportunities and long term efficiencies. Furthermore, such a policy helps prevent a political backlash to economic-globalization.

The actual features of such a policy have to be calibrated to country specific needs and circumstances. As a general matter, social welfare policies should not aim at simply buying support for economic openness which is likely to benefit all in the long run. Rather, it should concentrate on assistance in the necessary adjustments of employees, especially by providing further education and professional training, but also by reducing the costs of mobility.