1

Globalisation and the Current Global Economy

'Globalisation should not be just about interconnecting the bell jars of the privileged few.'

De Soto (2000, p. 219)

'The benefits of globalization of trade in goods and services are not controversial among economists. Polls of economists indicate that one of [the] few things on which they agree is that the globalization of international trade, in which markets are opened to flows of foreign goods and services, is desirable. But *financial* globalization, the opening up to flows of foreign capital, is highly controversial, even among economists …'

Mishkin (2006)

In this chapter we discuss some of the background to attitudes towards money and debt. We explore the historical erosion of despotic power. We aim to understand globalisation, both ancient and modern, identifying the trends most important for current events and policy actions.

1.1 WHAT IS GLOBALISATION?

Globalisation has been through a number of cycles including in the nineteenth century period of free trade.[1] The term requires careful use: its range and ambiguity in common parlance can cause misunderstanding.

Globalisation is both a state and a process. It has an economic facet, perhaps best described as the greater interconnectedness of trade and investment as transactions costs and barriers reduce, but also the idea of lack of constraint on markets by government. It is this element that investors are ultimately most interested in. But globalisation also has a technological aspect (not distinct from the economic aspect), notably as represented recently by innovations and speed in modern communications. And it has a cultural facet, as exposed in the spread of common means of entertainment and ideas. It homogenises, and through standardisation commodifies, but also creates diversity of choice; complicates and simplifies; brings benefits and conflicts; produces winners and losers.

For emerging markets today, globalisation accelerates convergence to the living standards of developed markets. For some, in a world in which the voices of those with something to lose are louder than those who gain, the term is laced with emotive content, often negative, and while it creates jobs and wealth, globalisation is, for many, associated with job losses and erosion of local values.

[1] The term has many definitions and while Findlay and O'Rourke (2007, p. 108) argue that globalisation may have begun with the Mongol unification of the Eurasian land mass, that process is a distant shadow of what is called globalisation today.

Ridley (2010) argues that, among other things, it was trade which propagated innovation, technology and civilisation, as do Findlay and O'Rourke (2007). Jane Jacobs in her book *Systems of Survival* (1992) uses a Platonic dialogue to describe the different logics of politics, which is a zero-sum game, and commerce, a positive-sum game. Nations have historically competed for scarce territory, which, if one gained, another must lose; whereas both parties gain from a trade freely entered into.

If we want to avoid conflicts, commerce has a positive role to play. It is no mere historical coincidence that periods of protectionism and limited international trade often precede wars. The failed logic of isolationism and of fighting over land and other limited resources leads from mercantilism to gunboats, to strategic invasions of third countries, and to empire. Empires fall, however, or at best are managed into relative decline. The human tendency to barter and trade is certainly older than recorded history, and has long been geographically broad in extent. Though this is a generalisation, in the progress of greater economic interconnectedness there are waves, affected by human policy and history, as well as trends, driven by technology. Wars of the 'hard' and trade variety, restrictions on economic activity and trade, mass migration and natural disasters have all been disruptive but also sometimes stimulate innovation and new forms of economic activity. In contrast, political stability and incentive structures compatible with innovation have generally nurtured both existing patterns in trade and globalisation.

Braudel (1998) in his history of the ancient Mediterranean world argues that early transhumance (seasonal migration between summer and winter pastures) established a pattern of seasonal trade in the region. The world has clearly seen ebbs and flows in the extent of trade links and civilisations. Toynbee (1946) and others have categorised the rise and fall of civilisations, and with them trade and international links. The story of lack of stability wreaking havoc on economies and trade has repeated itself many times. Globalisation can and does ebb as well as flow. Technology has reversed on occasion as inventions have been forgotten once civilisations collapse. Our European Renaissance is in name a rediscovery. Arguably, however, it takes the destruction of civilisation to reverse technology, and in the modern era, as during periods of stability within earlier civilisations, it has been tenacious and non-reversible.

Technology profoundly impacts globalisation. It can aid economic growth, productivity and, by reducing transport costs, trade. Technology, by changing relative prices, also changes our institutions, as Douglass North (1990) has taught us. For example, technology effects disruptive upheavals in communication from time to time. Neil Postman (1985) has described how the written word, printing and then newspapers changed the pace and nature of interconnectedness. For example, in the 19th century, the telegram helped create the commercial success of newspapers and their news – the interest and novelty of new information from a long distance being of interest primarily, if not solely, because it was new. This 'news' content eroded and then eclipsed more considered thought, telescoping cultural knowledge and political debate to focus more heavily on the near present. Thus with the telegram came the modern newspapers, and with them came trivia, including the invention of the crossword puzzle – to test the reader's knowledge of news trivia.

Subsequently broadcasting has impacted our communication patterns: for example, in the 1850s US presidential candidates would deliver speeches several hours long in public debates, long enough to justify meal breaks. That voters would spend the time to listen to such debates, and that they could comprehend the complex structured paragraphs which were so characteristic, stands in stark contrast to the norm of exchange so typical today.

Have we since 'dumbed down', and does the process of globalisation contain a series of dumbing-down episodes? Not entirely: the telegram, newspapers and then radio and television created a breadth of participation in culture not previously experienced. Political debates became less elitist and more inclusive, with more elite communication and interaction continuing, but less dominantly – less unchallenged.

The perception of dumbing down, and indeed the collapse of our sense of history to a more myopic immediate past, is clearly a strong one but not just a 19th-century one. The impact of television is an issue studied by Postman and especially in the post-Second-World-War US context by Robert Putnam (2000). His book *Bowling Alone* created a vigorous debate about whether television has been the main factor behind the postwar decline of US civic culture (an example of which has been the decline of community bowling alleys). Cries of 'Dumbing down!' go all the way back in history. The move from the oral tradition to the written word was lamented in ancient Greece and seen as destructive of the memory skills developed in the time when Homer's 'Iliad' and 'Odyssey' – arguably still the greatest epics of literature – were related by word of mouth.[2] Broad access to books, particularly the Bible in 16th-century Europe, facilitated religious revolution and war. Dumbing down may look sacrilegious to an elite,[3] but while it may represent a destruction of the means of valuable interchange of ideas, at the same time it can be revelatory and intellectually enriching for many more people not previously communicating with each other.

Technological change in the media has been not only traumatic but also irresistible as old technologies have been replaced. It affects the way newer generations think and interact. There is a feeling of erosive unstoppable destruction of the old as globalisation, via new media, invades. New technologies and the young bring myopia and collective amnesia. Older generations and traditional societies alike feel the tension as their children and communities adopt new modes of speech and ways of thinking and abandon the past. And this is not new. We may fear (or embrace) such change but we can't credibly blame (or give all the credit to) our children. Globalisation may be a more convenient and acceptable receptacle for our emotional discomfort.

Modern communications have massively increased information flow, and the technologies of the Internet and mobile phone have leapfrogged older technologies in many developing countries.[4] As with technological change before, much of this is inexorable and non-reversible. Knowledge of the wider world and aspirations for a better life combine in emerging countries to increase awareness. As populations become more vocal, this leads to pressure on elites for political and economic reform at home.

Economic growth and international competitiveness is in part the result of greater entrepreneurial opportunities. Others leave and migrate to the developed world, competing in labour markets there. Either way, the result is greater economic competition with the developed world, which either has to adapt or face job losses from increased competition. Thus many in the developed world feel threatened by globalisation, while at the same time it opens vast new opportunities to many in developing economies.

Part of globalisation is significant international trade, and also substantial cross-border flows of factors of production (capital, labour, technology). These flows take advantage of

---

[2] See also Gleick (2011) p. 48 for more recent examples of complaints about the loss of oral culture.

[3] See for example Judt (2010, p. 172): "In the US today, town hall meetings and 'tea parties' parody and mimic the 18th century originals. Far from opening debate, they close it down. Demagogues tell the crowd what to think; when their phrases are echoed back to them, they boldly announce that they are merely relaying popular sentiment."

[4] See for example Jeffrey, R., and A. Doron's *The Great Indian Phone Book* (2013).

pricing differences, but in the process, also help reduce them – globalisation helps move the global economy towards an equalisation of returns to factors of production. It also involves multilateral production, and with it the spread of ideas and technology. There is greater openness to foreign inward investment. There is competition between governments for that investment, and for the jobs and knowledge which come attached. Different parts of the same production process may take place in several countries, exploiting comparative advantages. This is made possible by sufficiently low levels of protectionism and reliable low cost transport.

1.2 ECONOMIC HISTORY AND GLOBALISATION

To concentrate on the economic facets of globalisation, it may be useful to consider its historical precedents. Large-scale globalisation is not new. Maddison[5] argues that '[i]n proportionate terms, globalisation was much more important from 1500 to 1870 than it has been since. A great part … due to gains from increased specialisation and increases in the scale of production'. International trade and capital flows are much larger today, but so is the global economy. There was an interruption as the world went to war in the 20th century, and then protectionism was only reduced gradually, but globalisation is clearly not a novelty.

There are also long economic waves of concern with inflation and deflation. Allen (2005) for example argues that the inflation of the 1970s was partly born from the concern over employment that had previously dominated since the Depression, and similar long waves have been picked by many others since Kondratiev (1925).

Kaplinsky (2005) makes a comparison between the late 19th and early 20th century period of internationalisation on the one hand, and on the other hand the period of globalisation starting in the late 20th century. He comments on the different mix of goods traded, and on the different migration patterns – of the poor in the earlier phase and the skilled and a greater proportion of the monied in the latter.[6]

He also points out[7] that there is a high correlation between effective financial intermediation and economic growth, but that excessive volatility can reduce growth. Hence policymakers often want the competition, ideas and capital which come with openness but are concerned about volatility. Although portfolio investors are not necessarily short term in their outlook, some policymakers – not liking potential volatility in their exchange rate driven by short-term changes in cross-border portfolio flows – are attracted to the idea of discouraging portfolio flows through taxing capital inflows rather than trying to attract more long-term stable investors. Yet trying to prevent inflows rarely has more than a temporary impact on the exchange rate; given inevitable efforts to bypass the restrictions, it can encourage speculative pools of capital and discourage longer-term flows. Hence the simple mantra that characterises

[5] Maddison (2007) pp. 78/9.

[6] He also asserts that the recent period saw short-term as opposed to long-term capital flows. Yet, although the speed at which financial transactions can occur has quickened, there were in both periods crises involving short-term bank loans as well as longer-term bonds. Moreover, after the Brady plans and certainly since the Russian crisis of 1998, as we shall relate in more detail in Chapter 2, the dominant investors in emerging debt moved from those with more speculative motives to those with long-term liabilities making strategic allocations. Markets have remained liquid and on occasion volatile, but both the bonds and the timeframes of the investors are now longer term.

[7] p. 78.

portfolio flows as speculative and thus undesirable may be misplaced. Indeed, efforts to restrict such flows can result in more not less volatility.[8]

1.2.1 The desire to control and its impact on trade

Why do simple policy measures to reduce volatility so often backfire? Today's environment is one of economic complexity, economic liberty and freedom of thought and action. There is a lot of uncontrolled international movement of goods and capital, whereas in the pre-industrial past the movement that did exist was smaller and simpler. The state may have become less able to impose direct control on the mass of individuals and firms, but many have also become more sophisticated at indirect control and at exploiting the behaviour of firms. As Lucas (1976) pointed out in the so-called 'Lucas critique', the use of aggregate macroeconomic data to predict the effect of policy changes can be frustrated. This is due to the behaviour captured by such aggregate data not being independent from policy, but affected in complex ways.

Political control in many spheres has changed. It has been decentralised in some cases as smaller groups have asserted themselves and the centre become less powerful, such as during the fall of Rome in the 4th century, but also due to deliberate delegation of responsibility downwards. In other spheres power has centralised, and many of the problems faced by policymakers today require action above the level of the nation-state to be effective, including some aspects of anti-terrorism and environmental policy. As people's identities and loyalties have multiplied and become more complex and global, identification with the state has also changed, and the degree to which countries can co-opt their citizens in certain ways.

But democracy and well-being are both probably strengthened by this greater complexity. The multiplication of special interests, competing with each other, reaches a point beyond which any central source of political power can command a majority of support whatever mix of policies is chosen. Democratic institutional forms constitute instead legitimising filter mechanisms, the function of which is not merely to create compromises between political groupings but also to allow all politically active groups and individuals to accept and abide by these compromises. Such decentralisation of power is incompatible with authoritarianism. Authoritarian governments fail when their populations no longer acquiesce to their policies.

Today, the freedom of action which comes from the failure of totalitarianism and central power through filter mechanisms such as democracy, erodes national boundaries and creates more scope for globalisation. Competition of ideas and in markets aids creativeness and wealth production.

Let us cast our minds back to medieval Europe, and in particular England. A useful working hypothesis for any government is that it strives to maximise revenue in order, in turn, to maximise power.[9] Medieval monarchs needed revenues for wars, and could often justify taxes to finance them. How they managed this is instructive for how economies, international trade and capital markets developed. A characteristic of England's history is that the king's power, being weaker with regard to the aristocracy compared with that of the king of France, had greater need to legitimise taxation. The Magna Carta of 1215 limited King John's and

[8] Li and Rajan (2011) conclude from an empirical study that controls on equity inflows tend to raise the volatility of those inflows, and controls on FDI (foreign direct investment) and also on debt outflows may both increase the volatility of equity outflows – substitution effects. Controls on FDI inflows may also raise the volatility of FDI outflows. Controls on debt inflows tend to raise the volatility of those inflows. See also Frenkel *et al.* (2001).

[9] See Levi (1988).

subsequent monarchs' powers (weakening under the Tudors and Stuarts in particular), establishing personal and property freedoms and elevating the rule of law above the will of the monarch. Subsequent efforts to raise taxes were notoriously difficult, but this led to an ironic reversal.

> 'The relatively weaker bargaining position of English monarchs vis-à-vis their constituents led to concessions that French monarchs did not have to make. However, the Parliament that evolved ultimately enhanced the ability of English monarchs to tax. Parliament provided a forum for conditional cooperation. It engendered quasi-voluntary compliance and reduced transactions costs.'
>
> Levi (1988)

Compared to 18th-century France or Rome under the later Caesars, tax farming in England was not widely employed, but rather the taxes collected by Parliament and later the bonds issued involved lower transaction costs, were more legitimate and more reliable.

The range of taxes to finance the monarchs (and their wars) was varied, but was also driven by and impacted the pattern of trade. Taxes needed to be collectible with minimum transaction costs and maximum legitimacy, and hence moved from general levies (amounts collected across the population) to consumer goods to trade to income. But strategic and mercantilist concerns over trade led to developments in policy too. In the mid-16th century the focus of English trade policy was to generate employment and food after the devastating costs of war on the continent (the English were at war for much of the previous 50 years, with a break in the 1530s). The discouragement of domestic production of luxuries including luxury clothing, seen as unnecessary and sapping of the national economy, led to surges of some of these items as imports, and so eventually the reversal of the original trade policy.[10] Then mercantilist and strategic concerns regarding foreign trade started to give way in the later 17th century to the appreciation that 'projects' (schemes of domestic investment for home consumption) were important for the country's overall income and economic health.[11] Patents, starting from the Tudors (the first in 1552 for a technique for making glass, then in 1554 to search for and work metals in England), were established to promote production but often led to the aristocratic holders of such exclusive licences closing down domestic (and less aristocratic) competition. International trade was a small share of the total economy, but it was also clearly impacted by the dominant position of government policy in the national economy. We can say there were periods of great increase in foreign trade, but it was still very much monitored and to a large extent controlled or controllable by governments. Governments in turn acted for a combination of political, strategic and revenue-maximising ways, both directly and through taxes, distorting the incentives to trade.

Today's economic freedoms contrast with more restricted governance structures dominated by guilds and serfdom, tariffs and trade restrictions, economic dependency and personal immobility, and general government heavy-handedness. Whereas the norm in medieval Europe was that companies would seek a licence to engage in certain activities, now companies are prevented from not doing certain things – i.e. they can do anything else. Over time,

[10] Sir Thomas Smith listed various imports in his *Discourse of the Commonwealth*, and then sat on a committee in 1559 which framed plans for legislation to promote import substitution for a similar list of goods.

[11] As described by Joan Thirsk (1978).

governments have become less able to ignore the wishes of their citizens. And this is true globally not just nationally.

1.2.2 The influence of money

While our focus is economics, other social forces have also constrained and shaped economic activity. If importation of luxuries was long seen in medieval England as a distraction from more legitimate economic activities, attitudes to money as the medium of exchange take centre stage in the battle between God and Mammon. The history of money is fascinating, as is its sociology and philosophy.[12] The association of money with moral impurity is a common thread from Judas Iscariot to the laws against usury and right up to the present day. In Christian Europe at least, financial market development was restricted by religious mores. However, monarchs still needed to fight, and that cost money. The first banks began in the 15th century, and international loans commonly funded wars between monarchs. Potosí silver fuelled the wealth and power of 16th-century Spain, but the lack of development of a domestic capital market led to Spain under Philip II defaulting again and again to foreign bankers. Florence, Genoa and Amsterdam built their economies on international loans as well as international trade.

Banks were originally a place to secure one's money. Once they started lending out more than they had through issuing notes, there was a risk of bank runs… and the bigger the bank, the bigger the run. Though the Bank of England (1664) and Sveriges Bank (1668) were already established, the mass creation of credit proposed by John Law to the French government, in effect creating a central bank, was initially rejected in 1715, even though the French government was near default following the War of the Spanish Succession (1701–1714) and the Sun King's defeats at the hands of the Duke of Malborough and Prince Eugene. However, Law was allowed to establish the Banque Général, a private bank allowed to issue bank notes in place of scarce gold and so stimulate the economy. The bank in effect became the central bank, and from there Law's scope for credit creation grew and grew in an 18th-century version of our modern-day quantitative easing (QE). Initially providing assistance in financing government, by 1717, Law's notes were legal tender for paying taxes.

The attraction of printing money and credit extension became apparent as a giant means of financing government. Depositors and equity holders came to trust in paper returns. The bank also became an investor in the Mississippi, and shares in the bank were bid up in a financial bubble fuelled by promises of profits which were not forthcoming. It all ended in tears with one of the largest bubble-bursts in history in 1720; but for about 15 months this Scotsman, made Duke of Arkansas but wanted for murder in England,[13] was the most powerful man in France. Love of ingenious financial alchemy (the successful stimulus to the French economy by the initial period of credit creation) was followed by hate (the bursting of the Mississippi speculative bubble); just as today international bank alchemy (a key element of modern globalisation) can create huge benefits but then excessive leverage and crises, followed by public opprobrium.

[12] See for example Dodd (1994), Buchan (1998), Galbraith (1975), Shell (1982) and Simmel (1990).

[13] John Law initially fled to Scotland to escape justice, and lobbied against the Union with England, but then had to flee Scotland when the Act of Union (Scotland with England) was passed in 1707.

The closeness of bankers to political power continues to the present day.[14] The Rothschilds' agent in 19th-century Berlin, Gerson Bleichröder, became Bismarck's personal banker but also was central to the finances of the German state and even to foreign policy. Bleichröder provided Bismarck with backchannels via the Rothschilds to the government in Paris and to Disraeli in London. He also was heavily involved in foreign investment, particularly in railways (see Stern, 1977). Likewise in the 20th century, John Pierpont Morgan was famous for playing the role of domestic central bank, stopping the US financial panic of 1907. The associations between finance, international relations and globalisation have long been strong.

1.2.3 Trade and commodification

International trade enables international specialisation. In Britain's case it was the colonies and the ability to import food and raw materials which enabled the industrial revolution. One needs political stability and trust for international trade and globalisation, and trust is personal and built on reputation – hence the growth of family partnership merchant banks, with their own money on the line. These banks had detailed knowledge about others; but, as they lived or died on their reputation, which could be shattered by a single scandal, they kept secrets well.

Globalisation also entails creating the demand for international trade. Trade has existed for centuries, but large-scale trade had to wait for the consumer society. Prior to this, trade was either in luxuries for the few, or in one or two goods for the many. Roman imports of grain from North Africa were clearly considerable in scale, and a staple for the urban population, but the more normal pattern has been of relative self-sufficiency in most staples until the past few centuries, when large-scale trade in grain and textiles resumed. Trade built over several centuries in Europe, but important steps on the way were recognition from the late 17th century of the importance of domestic demand; increasing rural industry and incomes; agricultural enclosure and labour specialisation; and urbanisation.

Commodification – assigning economic value to things not previously so considered – was also a crucial step. London's Great Exhibition of 1851 was a triumph for the establishment of the commodity at centre stage. The exhibits were not explicitly for sale, but rather there for the glorification of industry and the production of items – commodities from soap to tea to heavy machinery – of use to the consumer and society. This was a revolutionary change and to a large extent the attraction of the exhibition: the focus of the commodity from derivative to dominator of human relations (and not just economic relations). Modern advertising and branding were born, and in some of the pictorial advertisements of the time people were in clearly subservient (smaller and not as important) positions to the commodity.[15] Complementary to this radical change was the British Empire, acquired as if by accident for an unknown purpose, but now perceived as having an important role in supplying the growing needs of the consumer (even if the Americas in practice were more important in this role).

If the Great Exhibition drove the desire for domestic consumption, truly dominant mass consumption had to wait for Henry Ford in the US during the early 20th century.

---

[14] In Atlantic Monthly May 2009, Simon Johnson, Former IMF Chief Economist, referred to this banking-politics nexus as a "financial oligarchy that is blocking essential reform" http://www.theatlantic.com/magazine/archive/2009/05/the-quiet-coup/307364/

[15] See Richards (1990).

Commodification continues to this day and is a distinctive part of globalisation, combined with its offspring, advertising and branding.

1.2.4 Nationalism

Interaction between nations has also changed. Nationalism is a fairly new concept in its modern sense, with nation-states developing in the 1700s, as Hobsbawm (1990) has pointed out. It may yet, as a result of globalisation and the political consequences of societal complexity already mentioned, give way to more multinational political structures. It has already changed greatly. No longer (with a few exceptions) is it an extension of a monarch's ego: 'L'état, c'est moi' as Louis XIV, the Sun King, is supposed to have described it. The peace of Westphalia in 1648 after the devastating Thirty Years' War between Catholic and Protestant forces defined the sovereign state and established the principle of non-interference in the affairs of other sovereign states. But as Philip Bobbitt (2002) has described, the state has been through several stages of development since. Most recently, as the 1990s Balkan wars demonstrated, the concept of non-interference established in 1648 is now in conflict with that of self-determination. Having said that, global interference has always been with us: stronger states interfering in the affairs of smaller ones for a combination of reasons: their own (individual or collective) security, economic self-interest and humanitarian aid. In all but the short term, however, self-interest of some description invariably dominates.[16]

What global media and culture have aided is the move to a new reality in which the winning of hearts and minds is central to the modern strategic battleground, and in which traditional armed forces are largely redundant. As a population becomes more educated it will organise and will demand political rights: its voice[17] will be heard and authority perceived to be unjust becomes more difficult to preserve. The days when the 1000-strong Indian Civil Service of British expatriate administrators could run a subcontinent of 300 million is long gone, as was predicted since the British enhanced education for Indians from the 1830s. The values the British chose to spread in India were incompatible with their longer-term presence. Today the spread of these and similar values makes similar long-term passive subjugation of nations quite impossible. In today's world of the Internet and global media, guerrilla not industrial warfare, mass political participation not autocracy, control by physical force alone has become absurdly difficult – even if this is not yet sufficiently understood to have prevented some recent attempts.

Winning minds is the clear preferred route to stable prosperity in today's world, with a more limited support role reserved for physical force. This is in contrast to much of the structure of defence spending, as discussed by two modern generals with recent experience in the Balkans: Clark (2001) and Smith (2005). What has changed is not merely our education and communications technology, but the number of independent countries[18] and also the principle of non-intervention in what were previously considered the internal affairs of nation-states. The principle of such non-interference is now in conflict with the desires, often supported by international opinion, of certain sub-national groups for self-determination. The nation-state

[16] So-called humanitarian imperialism is not particularly credible as a justification for armed intervention in a foreign country for the simple reason that it tends not to work.

[17] See Hirschman (1970).

[18] The increase in the number of countries has made international policy co-ordination more difficult. This fragmentation has been the result of the end of empire, decolonisation and more self-determination. These processes in turn have been assisted by globalisation and with it the spread of economic liberty, education and liberal values.

has changed its form several times before. As nationalism is a relatively modern phenomenon in many ways, one should expect it to change further.[19]

Jane Jacobs describes politics as a zero-sum game, but maybe it is even worse: due to fragmentation and more issues requiring international co-operation, states are experiencing shrinking power. Some international problems which would have been resolved by a few countries in the past are now not being resolved. In the wake of globalisation, national politics are becoming less and less autonomous. A number of immigration, environmental and economic issues require supranational governance. In the face of these issues, and in the absence of powerful international institutions, national governments are becoming more impotent; and electorates, realising this, are becoming more frustrated that issues are not being resolved – more apathetic (as shown by voter participation trends), more difficult to please.

Winning minds is about having people agree with you, after letting them freely choose to do so. For the West this freedom or empowerment means allowing people to run their own lives, but also giving up some power – including sharing responsibility with emerging markets. Much more serious reform of the voting shares of the IMF, still heavily dominated by the US and Western Europe, would be a start. The problem is that some Western politicians have great difficulty with implementing this, or giving up their influence, especially when they have little central collective leadership, or are leaders with outdated world views. They often seem oblivious to the observable reality that their policies are getting in the way. Investors, the ultimate pragmatists, have the potential to offset the zero-sum (or all too often negative-sum) logic of politics. Commerce is an important component in bridging conflicts and avoiding them, of getting over ideological prejudices, of creating mutually aligned incentives: in short, of keeping down the testosterone levels in politics.

History can teach us a lot about globalisation but we have to be cautious in interpretation. A reader may misinterpret the values and motives of past decision makers. How do we square Britain's great historical achievements with urban squalor, Irish famine in the 1840s, and Orwell's description of waning empire in Burmese Days? Much of the past has been horrific, and governments have gone to great efforts to rewrite and in some cases to deny history[20], but we also need to recognise that moral values change over time and geography.[21] And values remain different in different geographies today, even if people in distant lands consume some of the same brands and superficially may appear very similar in their values. Also, in the midst of global economic dynamism, there can still be a tendency to be surprised, anti-sympathetic and hostile to change. The combination of remaining partially myopic yet more interconnected leads to greater risk of sudden uncomfortable change, and indeed conflict.

1.3 RECENT GLOBALISATION

International trade often collapses during war, and economies have struggled with inflation and debts in peacetime. Hence the importance of local and global rules to facilitate trade and capital flows – to facilitate globalisation. Stability matters, as Maddison (2007, p. 111) writing about the period 1500–1800, points out:

[19] See Bobbitt (2002) and Hobsbawm (1990).
[20] See for example Paris (2000).
[21] See Harris (2010) for an interesting exposition of how science can determine morality.

> 'In the UK and the Netherlands, the legal system protected commercial property rights and ensured the enforceability of contracts. State levies were predictable and not arbitrary, and credit for long term ventures was available. As a result groups of capitalists in these countries were able to establish corporations like the Dutch Far East Company (VOC), and the British East India Company (EIC) which could organise risky ventures over huge distances.'

The Bank of England had established the model for central banks up to the 19th century, balancing liquidity needs in the economy with the avoidance of inflation;[22] and the gold standard had emerged to create stability in foreign exchange transactions, with major currencies convertible to gold. This facilitated global trade. The gold standard, however, was vulnerable to supply shocks as new gold deposits were discovered and, in times of war and crisis, countries abandoned it. The Treaty of Versailles in 1919 imposed unrealistically high costs on Germany, which (as John Maynard Keynes warned in The Economic Consequences of the Peace, written in 1919) later forced an exit from the gold standard as their debts became unpayable (and unpaid for their creditors), and set the scene for hyperinflation.

1.3.1 Bretton Woods

The roaring twenties and the stock market boom of 1929 were followed by deflation and depression and then World War II, during which trade patterns were radically curtailed and war economies operated in more planned fashion. Given the strong desire to avoid the inter-war protectionism, and the periods of both deflation and then inflation, in 1944 at Bretton Woods a new global monetary architecture was designed. The International Monetary Fund (IMF) was created to police exchange rates. The main arm of the World Bank, the International Bank for Reconstruction and Development, was tasked to help rebuild Europe. An international trade organisation failed to be agreed to, but belatedly in 1947 the General Agreement on Tariffs and Trade (GATT) was established instead to promote multilateral trade, replaced by the World Trade Organization (WTO) in 1995. An objective was to start to reverse protectionism and promote current account convertibility.

The agenda at Bretton Woods after the inter-war deflation was thus to re-establish some form of managed gold standard. However, there was not enough gold in the world (without a major and geopolitically unacceptable price increase which would have benefitted Russia and South Africa) for full convertibility. Keynes conceived that all foreign exchange transactions would continue to go through central banks, as during the war, and suggested a new international currency called 'Bancor' which would be the unit of account for international transactions, expressed in units of gold. A new international clearing union would facilitate transactions and prevent the build-up of major imbalances. Keynes' design was rejected by the US. This was because, as a major creditor, the US decided not to have penalties imposed on her Bancor surpluses: countries running excessive trade deficits are eventually penalised by being cut off from capital as their credit-worthiness deteriorates, but for every deficit there is necessarily an equivalent surplus somewhere,[23] and so to avoid the build-up of deficits Keynes also proposed that interest be charged on excessive Bancor surpluses.

[22] See for example Galbraith (1975) for a history of the development of the banking system and central banking.

[23] Though it is to be noted that for a well-functioning gold standard the converse is not necessarily the case: while there is a surplus for every deficit, there is not always a deficit for every surplus.

Instead of Keynes's plan, a system with an inbuilt tendency towards imbalance was implemented, and still (in 2014) codified in the 'Articles of Agreement Establishing the IMF'. Currencies had fixed exchange rates to the US dollar, which in turn was convertible to gold at $35 an ounce (the official US Treasury price since 1934). Though other countries could have also chosen to have their currencies convertible to gold, none did. Other major currencies were pegged to the dollar.

This led to the so-called Triffin dilemma: a national currency, which is also the international currency, has conflicting pressures of attaining short-term monetary balance nationally and longer-term international balance. Currency and yielding government securities are issued to meet international demand. Otherwise international trade and growth would fall. This, however, creates a tendency towards trade deficits for the issuing country, as the money is printed there and then makes its way into the international economy through being used to purchase goods and assets (as opposed to a more international currency which might be distributed, on printing, more evenly across countries). This in turn builds US debts to the rest of the world. In order to prevent requests that these claims be converted to gold (this leading to an eventual breakdown of the system), the US would either have to raise interest rates on the government securities issued and which are held by foreigners; or to tighten fiscally in order to shrink the economy and its indebtedness, or otherwise reduce the trade deficit. There is an understandable reluctance to do either. They could (as Triffin observed) also allow the price of gold to rise, but this was outside the Bretton Woods agreement and could create destabilising speculative moves into gold by both central banks and private investors – in turn draining US gold stocks and undermining the ability to intervene, and so faith in the reserve system.

The desire by foreigners to offer their goods in exchange for one's currency (in the case of the dollar) can be an attractive alternative to greater domestic fiscal discipline. If, however, there is a tendency to fiscal indiscipline or substantial overseas expenditure, there will be more debt growth relative to the gold supply (eventually reducing the credibility of the promise of convertibility to gold). The problem is exacerbated if the international economy outside the US expands faster than that of the US: then international demand for dollars also expands faster than domestic demand for dollars.

At the end of the war, this system, initially assisted by the Marshall Plan, helped create global stability and the rapid re-industrialisation of Europe and Japan – the (re-)emerging countries of the day.[24] With the US dominating global tradable goods production, European countries bought US goods with the US dollars from the Marshall Plan. The recovery of these economies was successful. The pattern of strong growth in Europe and Japan then continued after the Marshall Plan and the initial period of US surpluses ended. By the early 1960s Europe and Japan had become highly competitive. The fixed exchange rate facing the US had become inappropriately high. The move to current account convertibility in 1958 had put additional pressure on the dollar, as had European concerns about the fiscal policies of the newly elected US president Kennedy. The dollar traded as low as $40 an ounce in 1960. The response was the London gold pool: an agreement whereby the US and seven European central banks co-ordinated sales of gold in the London gold market, buying dollars, which they then invested in US Treasuries. This was no more than a temporary fix, though. In this monetary system the US in the immediate postwar period was doing the rest of the world a

[24] The term 're-emerging markets' is from Wolf (2009).

huge favour by creating demand for their goods, but at the cost of building up more and more debt.[25]

As Herb Stein, US President Nixon's adviser at the time, said: 'If something cannot go on forever, it will stop.' Add the cost of the Vietnam War and the unpalatable choice of fiscal adjustment through higher taxes, and the pressure grew. The more aggressive stance by the incoming Nixon administration towards Europe over gold purchases, and specifically the rhetoric of his Treasury Secretary John Connally, backfired and led to market pressure on the gold price. The German mark was floated in May 1971 and then on August 13th the Bank of England asked the US to convert some of its dollars to gold before it was too late. Nixon decided instead to de-link from gold on August 15th, devaluing the dollar, which then rapidly fell from $35 an ounce to $44 an ounce. As the dis-equilibrium had grown to such a level, there was indeed little else he could have done.[26] Sterling floated in June 1972 and some other currencies still pegged to the dollar until early 1973, but the credibility of their anchor had been damaged. Setting a precedent for the more recent build-up in global imbalances in the early 21st century, it was the action of surplus central banks which forced the 1970s crisis. US debts were far in excess of gold reserves. Foreign surplus central banks, wanting to preserve the purchasing power of their reserves, started buying back gold on the secondary market, and eventually asked for gold from the US Treasury in exchange for dollars. Nixon then had a choice: start giving out the gold, run out and then renege on the commitment to convertibility; or renege early and keep the gold. He quite sensibly chose the latter option, although technically another option would have been to raise just the gold price, but that had not been agreed with Europe.

Without the monetary anchors of the Bretton Woods system, inflation became a larger problem from 1973. Oil prices rose as OPEC exerted newfound bargaining power, and food prices spiked due to supply disruption. But the main cause of the 1973 uptick in inflation was arguably the macroeconomic policies in the OECD at the time of loose money which accommodated fiscal deficits. By the end of 1974 gold had reached $195 an ounce, but was volatile, not least due to official gold sales. With inflation, more instability in global (now floating) exchange rates had returned. Countries with large domestic investor bases managed to borrow in their own currencies, which they could then debauch. Without the discipline of the gold standard or fixed parity with the dollar, deficit spending became the norm and inflation became a preferred form of taxation. Gold had been a part of the global monetary system from prehistory to 1971, but has not been since and may never be again. Indeed, in a world of floating exchange rates, inflation may again be used as the principal method of reneging on Western government debt obligations.

1.3.2 Ideological shifts

After World War II, involving as it did enormous state economic planning and mobilisation by all of the major combatants, the consensus was for the state to continue taking a prominent

[25] The creation of IMF Special Drawing Rights (SDRs) in 1968 was designed to create a new reserve currency and complement the limited stock of gold to meet growing reserve asset demand, but this need was averted by the growth of the Eurodollar market – private sector borrowing in dollars offshore (in Europe) – which reserve managers could purchase instead of US official debt assets. See Isard (2005), p. 33.

[26] For a more detailed account see Eichengreen (2011).

role in the economy. Added to that were the anthropological[27] and political priorities of building societies with less inequality, leading to the start of the creation of the modern European welfare state. There were very few economists who thought let alone argued differently.[28] With state dominance came government control in a wide range of areas, including (and consistent with the Bretton Woods agreement) European blanket controls on the free flow of cross-border capital.[29] The modern period of globalisation is thus associated with the period when these controls came off, which they started to do in 1979 with the lifting of UK exchange controls.

The experience of World War II and the need to rebuild afterwards were clearly behind the desire for a large economic role for the state, but ideology was also at play. When this fell to more pro-market ideology in the 1980s, policies shifted dramatically, in some cases with a slapdash disregard for consequences, in the opposite direction.

Indeed, I experienced the force of an ideological argument myself. Late in George H.W. Bush's presidency I was working in the Strategic Planning Office of the US Treasury-controlled Plans and Programs Department of the Inter-American Development Bank. Following a plebiscite in Uruguay against privatisations, a topic which had become highly politicised, there was concern that privatisations might be stopped in several countries. Hence I wrote a technical paper on when and how to privatise (and thus by extension also when not and how not to).[30] It was explained to me officially in a bizarre meeting that, while there was nothing wrong with the content of the paper, it was inappropriate that it should be seen to be written from inside the Department. As in Umberto Eco's *Name of the Rose*: knowledge is sin. In Eco's book the medieval library in which the plot is set is eventually burned down to avoid the revelations of knowledge in an ancient Greek text. My paper was banned from distribution, which, perhaps predictably, had the opposite effect to that intended.[31]

The 'Washington Consensus' is shorthand for some of the new thinking. The term was originally coined by John Williamson at a conference in 1989 to describe 10 areas of policy reform being enacted by Latin American governments: prudent fiscal deficit management, public expenditure priorities, tax reform, interest rates, the exchange rate, trade policy, foreign direct investment, privatisation, deregulation and property rights.[32] The term was controversial partly because of its name. Frances Stewart has argued, and Williamson did not deny, that by calling it the Washington Consensus as opposed to the more obvious Latin American Consensus, the intention was to create US support for what were highly pragmatic and largely orthodox policies Latin American governments wanted to continue to follow.[33] What started as a rough pragmatic list of what was happening soon hardened into (right-wing) dogma. And part of the dogma became free trade and free capital movement across borders: another part of the story of globalisation's progress.

Globalisation was also pushed in the post-World War II era in the successive trade rounds of GATT and then (after 1995) the WTO, though, in consequence of (certainly perceived)

[27] For example, the Beveridge report on social insurance and allied services can be seen as anthropological in nature.

[28] See Skidelsky (1995).

[29] US capital controls only began in the 1960s and had limited effect – though one was to stimulate the creation of the Eurodollar market in 1963.

[30] The full paper can be found on Jerome Booth's blog on newsparta.net.

[31] Distribution of an earlier draft escalated. I have been told subsequently the paper was used several years later as a guide for privatising CVRD, now known as Vale, one of the largest companies in Brazil.

[32] Williamson, Ed. (1990).

[33] Stewart (1997).

relative bargaining power at the time, with a clear favouritism to the developed world. The emphasis was on free movement of goods, but also capital and (much later) protection of intellectual property rights. Fligstein (2001) categorises three types of globalisation which followed: an increase in world trade, the rise of the Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan) at the expense of the first world, and the growth in financial markets in debt, equity and foreign exchange. We do not live in a world of free trade though, but in a world of more-or-less free trade, except in agriculture and textiles, where protectionism is alive and well – and highly distorting and disadvantageous to emerging countries.[34]

Nevertheless, developing countries have benefited enormously from globalisation. They have taken advantage of greater trade opportunities, grown fast and learnt from their own mistakes and those of others. The sharing of policy experiences across countries should not be underestimated as a great stimulus to better policies. While the bottom billion[35] in failed states in sub-Saharan Africa and Central Asia remain misgoverned,[36] aid-dependent[37] and poor, other economies have grown at the highest rates ever recorded in history. Low-skill jobs have moved to developing countries, but higher skilled ones are moving there too. India and China alone (accounting as they do for 36% of world population) have pulled hundreds of millions out of poverty.

1.3.3 Participating in globalisation: living with volatility

Protectionist sentiment and the import substitution industrialisation (ISI) ideas of Raúl Prebisch and others to support infant industries, popular in the 1960s and 1970s, went out of fashion with the rise of the Washington Consensus in the 1980s and 1990s. Capital accounts started to be liberalised in the Thatcher/Reagan period in a number of countries, both developed and developing.[38]

Countries risk incurring severe costs should they cut themselves off from the outside world. Policymakers are right to be concerned about capital flow volatility, but lack of international competition can reduce both productive and allocative efficiency. Nearly all choose to participate in global markets, but some want to retain an element of control.

No country, once partially liberalised, is currently planning blanket capital controls, but a number of measures have been tried to reduce capital flow volatility. However, while so-called macroprudential policies (not a clearly defined set of policies, but ones focused on reducing financial sector systemic risks) may be advisable to reduce risks of financial contagion and other spill-over effects from other countries' financial systems, capital control measures (as opposed to central bank intervention) designed to affect the exchange rate have no clear history of success except in the very short term. Investors seem always, in time, able to devise structures to get around them. Capital controls in the form of taxes on portfolio inflows can moreover be highly distortionary, and once imposed can create uncertainty over future policy and deter inward investment and damage investor sentiment – so raising borrowing costs for the government. In particular, they can discourage long-term institutional investors and encourage the more flighty speculative investors, and this in turn, ironically, can lead to great volatility. Volatility is often a function of fundamental factors inside or outside the country,

[34] See for example Booth (1992).
[35] Paul Collier (2008).
[36] Paul Collier (2010).
[37] See Easterly (2006) and also Moyo (2009).
[38] See for example Allen (2005), from p. 151.

including rapidly changing perceptions of risk, and heightened by significant offshore pools of capital.

We can see globalisation not as the primary cause of contagion or volatility, but rather as the medium. Central bank intervention can reduce volatility, but one needs reserves for that, and the willingness to use them. Beyond that, the way to reduce volatility is to address the fundamental problems, such as fiscal and other domestic imbalances, or factors such as global imbalances or bank deleveraging (a regulatory matter). However, the structure of the international monetary system is in dire need of overhaul and is cause for concern – an issue we shall return to.