Globalization: Myths and Realities

Debates over controversial economic issues—and few issues have been more controversial in recent years than globalization—can always be improved by the introduction of facts. This is particularly true when claims based on casual observation, rather than research, crystallize into "conventional wisdom." Here, then, are a few common myths about globalization, along with their more complex realities.

Myth: Globalization Is Generally Bad for the Environment.

Several forces are at work in the relationship between globalization and environmental quality, as noted in a recent paper by Harvard economist Jeffrey Frankel.[1] One force—the one drawing concern from environmentalists—is the "race to the bottom effect." To attract increasingly mobile international capital, nations may attempt to outbid one another in offering investment climates that are "business-friendly"—that is, low-tax and low-regulation. Environmental rules may be pared back. There is, in fact, strong evidence that changes in countries' environmental regulations do influence the location of investment.[2]

Complicating this simple story, though, is the effect of income growth on environmental quality, itself subject to a complex relationship. Many measures of environmental degradation follow a hump-shaped pattern with respect to per capita income, a relationship that economists refer to as the environmental Kuznets curve.[3] Loosely, this hypothesis says that as countries' per capita incomes rise from very low levels, pollution initially rises but then begins to fall when income passes a critical threshold. The source of the initial increase in pollution is the onset of industrialization; the source of the decline is the positive effect of rising incomes on the demand for environmental quality. Like the demand for better cars or bigger homes, the demand for a cleaner environment ultimately rises with income.

Globalization can also impact environmental quality in less obvious ways. Openness to trade, which encourages countries to specialize in producing the goods for which they have a comparative advantage, can alter the composition of a country's output. The effects on pollution are ambiguous. Foreign direct investment can introduce more up-to-date—and often cleaner—production techniques in place of older, less environmentally friendly ones.

> *Wisdom don't consist in knowing more that is new, but in knowing less that is false."*
>
> —Josh Billings, American humorist

Which of these many forces dominates? That is an empirical question. As Frankel notes, for certain measures of pollution, such as sulfur dioxide concentrations, there is little evidence that the unfavorable forces dominate and some evidence that the reverse is in fact the case—that globalization has led to *less* pollution. For other pollutants, like greenhouse gases, the opposite seems to be true. Even in these cases, though, the culprit is not globalization but rather a "free-rider problem." Because the environmental harm from greenhouse gases is global, no individual country has an incentive to undertake the costly measures necessary to reduce its own emissions.

Myth: Globalization Encourages Child Labor.

As is the case with globalization and the environment, conflicting forces make the relationship between globalization and child labor complex. A developing economy that opens itself to investment and trade may be expanding its opportunities for, and the productivity of, child labor. Other things equal, this effect would increase the incidence of child labor, however regrettable that practice may be. Acting in the opposite direction, though—analogous to the case of environmental quality—is an "income effect." Poor households that see their real incomes rise through trade may have less need to rely on the labor of their children.

In principle, either effect might dominate. Globalization could lead to more or less child labor. In practice, for the one economy where a thorough and detailed empirical study has been done—Vietnam, which gradually liberalized its trade policy during the 1990s—the results overwhelmingly indicate that the income effect dominates. The study, by Dartmouth economists Eric Edmonds and Nina Pavcnik, shows that the real income growth among Vietnamese farming families between 1993 and 1998 can account for nearly one-half of the large decline in child labor in rural Vietnam that occurred over this period.[4] The authors conjecture that much of the real income growth was likely due to increased openness to trade, in the form of relaxed restrictions on rice exports.

Myth: Globalization Is a Recent Phenomenon.

In reality, we are in the midst of the world's *second* era of globalization. The first great globalization occurred from the middle of the 19th century to the eve of World War I, fueled partly by liberalized trade and immigration policies and partly by steep declines in transportation costs. This earlier era has been studied extensively by economic historians. What these investigations have shown is that by 1913, globalization—whether measured in flows of goods and people or in the convergence of national economies' prices and wages—had been realized to an extent never before seen. And globalization to such an extent would not be seen again for several decades. Between the first and second world wars, a combination of restrictive trade and immigration policies, together with the collapse of the international gold standard, deglobalized the world economy. Much of the post-World War II movement toward globalization has simply recovered gains lost during the interwar years.

Despite what is said by globalization's proponents or, in moments of resignation, by its opponents, the process is not inevitable, as the aborted first great globalization makes clear.

With regard to some measures—notably, the free movement of people—globalization's extent today is still short of where it stood at the start of the 20th century. In the United States, for example, foreign-born residents constituted 14.5 percent of the total population in 1910. By 1970, this fraction had fallen to 4.7 percent. It has risen since then, particularly in the 1990s, to a bit over 11 percent, still short of the 1910 level.

Taking a more global perspective, economists Kevin O'Rourke and Jeffrey Williamson estimate that, in the 40 years from 1870 to 1910, immigration reduced the labor force in the Old World sending countries by 13 percent, while increasing the labor force in the New World receiving countries by 40 percent.[5] Were similar flows to occur over the next 40 years, they would involve anywhere from 20 million to 80 million people.

All myths are impediments to good policy, but the perception that globalization is a relatively new phenomenon holds a particular harm: It helps to nurture a belief in the inexorability of the current globalization process. Despite what is said by globalization's proponents or, in moments of resignation, by its opponents, the process is not inevitable, as the aborted first great globalization makes clear. One becomes less confident that globalization is a train that can't be stopped—or a genie let out of a bottle—when one realizes that 90 years ago the train was derailed, the genie recaptured.

—Jim Dolmas

Dolmas is a senior economist and policy advisor in the Research Department of the Federal Reserve Bank of Dallas.

Notes

1. "The Environment and Globalization," by Jeffrey Frankel, National Bureau of Economic Research Working Paper no. 10090, November 2003.
2. See, for example, "Trade, Growth and the Environment," by Brian R. Copeland and M. Scott Taylor, *Journal of Economic Literature*, vol. 42, March 2004, p. 7.
3. The environmental Kuznets curve derives its name from a similarly hump-shaped relationship between income inequality and per capita income, documented in the 1950s by the economist Simon Kuznets. Frankel's paper, cited above, contains references to many of the statistical studies of the environmental Kuznets curve. Interestingly, more recent and comprehensive data on inequality show the original Kuznets curve to be on a much less secure empirical footing than its environmental namesake.
4. "The Effect of Trade Liberalization on Child Labor," by Eric V. Edmonds and Nina Pavcnik, forthcoming in the *Journal of International Economics*. (A working paper version is available at www.dartmouth.edu/~eedmonds/.)
5. *Globalization and History*, by Kevin O'Rourke and Jeffrey Williamson, Cambridge, Mass.: MIT Press, 1999. The New World consists of the United States, Canada, Australia, Argentina and Brazil, while the Old World is essentially Western Europe.

Globalization Conference

What: "Myths and Realities of Globalization," a conference hosted by the Dallas Fed to discuss a variety of free trade issues

Topics: The environment, labor and outsourcing, national sovereignty, intellectual property, technology and capital flows, history of globalization

When: November 3–5, 2004

Where: Federal Reserve Bank of Dallas

More information:
www.dallasfed.org/news/research/2004/04global.html