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Globalization

With the discrediting and collapse of fascism, communism, and central planning in general, international markets are again becoming more integrated—a process now named "globalization." Those who oppose it usually are the beneficiaries of special privileges maintained by their governments.

More than 200 years ago, Adam Smith observed that the division of labor is limited by the extent of the market, and the division of labor lies at the foundation of modern economic life. In a process that was well under way in Smith's time, cheaper, faster, and more reliable communications and transport have made it possible for people to enter into economic transactions across oceans, mountain ranges, and deserts that once posed insurmountable barriers to trade.

Only recently has this become known as "globalization," a name that probably excites as much fear and disapproval as it does approbation. Despite much discussion in the media, most people have only a slight understanding of what it involves or its implications: globalization can mean different things to different people.

To a U.S. manufacturing worker it can mean no job; to a U.S. consumer it can mean lower prices. To a subsistence farmer in an underdeveloped country it can offer either the prospect of a better life, or ruinous competition from subsidized farms in the developed countries. To an investor, globalization means considering investment opportunities anywhere in the world. And so on and so forth.

Globalization can be all of these and none of these. In its basic economic terms it involves changes that facilitate freer flows of labor, capital, goods, and even services between national economies. In a fully globalized world, prices would be uniform: any differentials would reflect only differences in transport and distribution costs.

Needless to say, the world has a very, very long way to go before becoming fully globalized, and the process is neither inevitable nor irreversible. In many respects, the world economy was more "globalized" 100 years ago than it is today.

A Long Detour

As a percent of total production, international trade only recently surpassed what it was during the years immediately prior to World War I. At that time there were far fewer restrictions on emigration and immigration than there are today. The currencies used in most of the world were linked via convertibility into gold, and capital movements were not constrained by either exchange controls or the exchange-rate risks encountered today.

The process of globalization was interrupted by the advent of World War I. "Trading with the enemy" was proscribed during wartime, and enforcement brought exchange controls and naval blockades. International travel and shipping became hazardous or impossible. Most of these barriers came to an end when the war was over, and the most lasting legacy of the First World War was an increased acceptance of central planning, which had found its first widespread application in the mobilization of resources for wartime production. (In the United States, for example, railroads and other industries were placed under Federal control.) Similar interventions and controls were to be found among the other belligerents. In Germany, General Ludendorf called the process "war socialism"—all resources and assets were to be mobilized for military purposes. (After brutally grabbing power in Russia, Lenin used this as his model for the economy of the Soviet Union.)

The turning inward of economic policies that began with World War I was greatly accelerated by the great depression of the 1930s, which witnessed widespread tariff increases and the rise of fascism with increased state control over economic life, to the detriment of international trade. In this country, the National Recovery Administration heavily regulated the economy before it was declared unconstitutional.

The Second World War did little to reverse these trends. The world economy emerged from that conflict with even more controls promulgated by socialist governments, which, like the fascist governments

Comparative Advantage

Would it make sense for the editor of this newsletter, the fastest and most accurate typist in the office by far, to type all routine correspondence, manuscripts, and subscription orders? Of course not: editing is a more highly valued skill than typing and less competent typists are hired, not because they are relatively poor typists, but because the deficit in their typing skills compared to the editor is relatively less than that of their editing skills. What makes sense is for the editor and the typists to find work where they have a comparative advantage. That the editor is paid more than the typists does not mean the work of either is uneconomic.

In international transactions, the same approach to the division of labor is appropriate. This is obvious when existing trade patterns are examined (France exports wine to, and buys whisky from, Great Britain, for example). When new patterns are established, *i.e.,* when production shifts from one country to another, workers displaced by cheaper production from abroad will find employment in industries that are expanding to meet the increased export orders resulting from the increased earnings of foreign workers from their sales to us. Such is the theory and, over the long term, the practice of international trade. That the problems of adjustment can be exacerbated when vested interests are involved does not disprove the principle of comparative advantage.

of the 1930s, were focused on national economies, rather than on the international economy. Of course, the advance of communism into Eastern Europe and China and the advent of the cold war had the effect of removing large areas and populations from the international economy.

Before World War I the pace of the widening of markets had been largely determined by the technology of communications and transport. There were political battles involved, as in the repeal of the Corn Laws in Great Britain,[1] but these were usually resolved as the overwhelming economic advantages of liberalization became evident. During much of the 20th Century, however, the political tide ran in the opposite direction, and it has been, to repeat, only during recent years that the extent of globalization has approached its level of a century ago.

The process received an enormous boost when the Chinese communists decided to take the "capitalist road," and when communist regimes collapsed in the Soviet Union and its satellites. Today there is no credible alternative to democratic governments with market-oriented economies that, by their nature, will become integrated into the world economy. Whether or not this marks the "end of history," as Francis Fukuyama stated in his book of that title (the author did not mean that there were to be no more noteworthy events, but rather that there would be no further struggles between contending political and economic systems), remains to be seen. Who predicted the spread of communism a century ago?

In any event, we believe there are two major aspects of the current situation to be considered. First, the country most identified with globalization is the United States. Why? Consider how we defined it above: free flows of labor, capital, goods, and services, with essentially uniform prices that differ only to reflect transportation and distribution costs. Sound familiar? These are the fundamental characteristics of the U.S. economy, and it is not surprising that some may view their extension to other countries as an expansion of U.S. power and domination.

All too often this question becomes tangled with cultural issues: the so-called "coca-colonization" of the rest of the world. Indeed, the world does appear to be headed toward a "universal" culture. This alarms and frightens many people around the world, including not just intellectual elites who view themselves as the guardians of a particular culture, but also such persons as the French farmer who demolished a McDonald's.

It should be noted, however, that no one is forced to watch MTV, eat Kentucky Fried Chicken, or wear sweatshirts with the logos of U. S. sports teams. They do so voluntarily. This is in marked contrast both to violently enforced norms,

[1] The Corn Laws restricted imports of grain, and were designed to protect the landed, agricultural interests. Their repeal benefited urban workers and their employers and facilitated industrialization.

"Islamicism"

The governments of Cuba and North Korea cling to Marxist ideology for legitimacy, and some despots, such as Saddam Hussein, appear content to rely on naked power alone, but nowadays autocratic regimes typically assert that they must rule dictatorially because, for one reason or another, their countries "aren't ready for democracy," as if they are only holding power in trust before one day turning it over to freely elected successors. In theory then, if not always in practice, democracy based on individual rights appears to have survived any number of alternative "isms" as the basic model of human political organization.

Since last September 11, it has become increasingly evident that some in the Moslem world have other ideas. We will call this view "Islamicism," for want of a better word, to distinguish it from Islam itself; for, in comparison to some other religions, Islam is remarkably decentralized—there is no religious hierarchy. It should be understood that the Islamicist agenda is not that of all Moslems, or perhaps any more than a small minority of Moslems.

The origin of Islamicism seems to be dismay at the weakness and backwardness of predominately Moslem countries, which has been widely evident in the Moslem world since Napoleon's Egyptian campaign, at least. Most scholars have attributed this backwardness to the lack of a Moslem equivalent to the Reformation and Enlightenment in predominantly Christian countries. An alternative explanation has long been that Moslem nations have fallen behind because their people have not been good Moslems. Such "fundamentalist" beliefs are by no means unique—there were pastors who blamed September 11 on Americans' behavior that they deemed unacceptable.

The Prophet Mohammed was a secular as well as a spiritual leader; the Koran is the basis and guide to civil law as well as religious practices, and the Prophet's immediate successors also held both civil and religious authority. In a remarkably short time Islam expanded across a vast stretch of territory from the Indus river to the Atlantic. Charles Adams, the tax historian, has noted that the tax collectors who followed and supported Moslem armies initially taxed only Christians, Jews, and pagans. Moslems, including converts, were exempt. This situation, and the dynamic period of Moslem expansion, ended when the tax collectors ran out of non-Moslems to tax and began taxing the faithful.

In any event, during these "glory days" of Islam, Moslem men held special privileges and were clearly superior to infidels, as well as women and slaves. This is what the Islamicists seem to long for—their "rightful" place in the world. Instead of democracy, they see an "Islamic Republic," in which clerics hold ultimate authority using the Koran as their only guide, as a model that is suitable for themselves and perhaps even for everyone else.

Osama Bin Laden and his gang apparently believed that it was the expulsion of the Russians from Afghanistan that brought about the collapse of the Soviet Union, and that their attacks on the World Trade Center and Pentagon would bring about a similar collapse in the United States. Enthusiastic mullahs reportedly have spoken of establishing a Caliphate in America and others of repeating the Mogul conquest of India. These views would seem to be based on the assumption of some sort of divine intervention rather than an assessment of geopolitical reality.

In the same way, the notion of an Islamic Republic has not lived up to expectations. In Iran, the populace is becoming ever more resentful of the restrictions of the Mullahs and their corruption. In Afghanistan, where the clerics' rule was even more rigid, the economy was driven into the ground and the overthrow of the Taliban was welcomed by most people. Thus, it seems most unlikely that Islamicists will ever be able to bring into being dynamic societies with staying power or that amount to anything more than major nuisances to the rest of the world. Simply denying education and participation in economic life to women (half of the population) would seem to be enough to guarantee stagnation.

such as the Taliban's regulation of the length of men's beards, or rear-guard (and probably futile) attempts to keep people from using American slang in their speech.

The appeal of U.S. clothing, food, music, movies, etc. around the globe does not reflect an invidious plot of the American government or businesses, but rather the choices of ordinary people. This may be what is most galling to the critics. People in foreign countries are far more influenced by and focused on the United States than the U.S. public is on other countries. P.J. O'Rourke has likened this relationship to that of a schoolboy with a crush on his teacher—he is constantly thinking about her while she barely acknowledges his existence.

A second important aspect of the situation is that the current constraints to further globalization are human in origin rather than physical barriers. Nowadays, fresh produce and flowers that are out of season in the northern hemisphere are routinely shipped (often by air) from Africa and South America. Designs and production orders can be transmitted and confirmed instantly, almost anywhere on the globe, as can insurance contracts and other financial services. That many potentially advantageous international transactions do not take place reflects human customs and institutions rather than the constraints of time and space.

Special Privilege

Needless to say, a custom or institutions that are impeding globalization may remain in place if it benefits someone. The costs of a special privilege are almost always widely dispersed, while the benefits are almost always concentrated on a small group.

Special privilege takes many forms. In some third-world "kleptocracies" it can reflect raw power, when, for example, the strongman or his relatives run local monopolies or are granted favors such as import licenses that others are denied. But more commonly there will be some rationale for special privilege. Such measures include restrictions on land tenure, preferential tax statuses, occupational licensures, and price and rent controls that mainly affect the internal workings of an economy. In the international economy, tariffs, import and export quotas and controls, and even product health and safety regulations can all be used to favor domestic products over imports.

In this regard, the United States is hardly beyond criticism. For example, U.S. steelworkers began to receive above-average wages only after their unions became favored by government policies. The government has subsequently attempted to preserve such jobs by imposing import quotas and tariffs on lower-priced steel produced abroad. This adds far more to the costs of steel-using producers and the prices paid by consumers than it provides the steel workers. There are similar situations in other industries, even industries that pay below average wages, such as textiles and apparel.

Many have been led to believe that these policies are sensible because they "preserve American jobs" and they could serve a purpose if used only temporarily to ease the decline of affected industries. However, with rare exceptions (U.S. shoe manufacturing comes to mind), protected "sunset" industries never seem to set. Similarly, "infant" industries, claiming they need to be protected from international competition while they develop, never seem to "grow up."

Whenever trade liberalization threatens to displace workers with "cheap foreign goods," it is commonly argued that the government needs to come to the aid of such workers. However, the fact is that one could be just as logically argue that those workers should be punished for their years of mulcting their fellow citizens!

The important points to remember are that special privilege is the creation of government policy, that the total of the widely dispersed costs can be much larger that the total of the narrowly distributed benefits, and that the beneficiaries tend to be highly vociferous and inventive in advancing arguments why their privileges should be maintained.

Sometimes it is alleged that globalization exacerbates income inequality. No doubt this has occurred in some instances. The disparity of living standards among countries has widened. According to the International Monetary Fund, the richest quarter of the world's population has seen per capita GDP increase nearly six-fold during the past century, while the poorest quarter experienced less than a three-fold increase. But, while globalization is clearly an important reason for the overall increases in per capita GDP, it is perverse to blame it for the disparities. The extent of economic integration with the rest of the world is closely correlated with growth rates, and the poorest countries are the least integrated. No country has ever prospered via autarchy. ❑

LABOR MARKET UPDATE

There are signs that the job market is starting to improve, but it may be months before there is clear evidence of a turnaround. The national unemployment rate is relatively low compared with earlier recessions, but state unemployment rates vary widely.

Although there are signs that the economy has turned the corner, the labor market has yet to show any sustained improvement. For the past few months the employment data as initially reported have been favorable, only to be revised downward. Payroll employment increased by 66,000 in February, according to the preliminary data, but it actually decreased by 165,0000 according to revised data. March's 58,000 increase was revised to a 5,000 loss, and April's 43,000 gain was revised to an increase of just 6,000. The latest data, which show that employment increased by 41,000 in May, are subject to similar revisions, and may be further distorted by unpredictable seasonal fluctuations as students enter the summer job market in May and June. Thus the underlying trend in the job market may not become clear for several more months.

One of the first signs of an improving labor market is an increase in hours worked. Employers typically will change the workweek more quickly than they will change the number of employees. While overtime costs more, it requires no long-term commitment and the extra hours can easily be cut back if conditions warrant. For this reason, the average workweek in the manufacturing sector ,which is more cyclical than other sectors, has long been followed by AIER and other forecasters as a leading indicator of business cycles. Since reaching a low of 40.3 hours in November, the average workweek has increased to 41 hours. This pickup suggests that the number of persons employed may soon begin to trend upward too.

The unemployment rate is typically the last statistic to improve after a recession ends. Even after businesses start hiring, the demand for workers is apt to grow more slowly at first than the labor force. Thus the unemployment rate, which is the percentage of the labor force that is actively looking for work, is a lagging indicator. After reaching a 30-year low of 3.9 percent in October 2000, the unemployment rate increased to 6.0 percent in April and declined to 5.8 percent in May, and the number of unemployed persons has increased to 8.4 million.

This national unemployment rate masks a wide variation in local rates. It

has long been apparent that recessions do not affect all regions of the American economy to the same extent, and the current cycle is no exception. As shown in the accompanying table, which shows a state-by-state breakdown of unemployment rates in May, unemployment ranges from a high of 7.3 percent in Oregon to a low of 3.0 percent in South Dakota.

Unemployment is also high in Washington (7.1 percent) and California (6.3), reflecting the impact on the West Coast of the sharp downturn in the technology industry. Interestingly, the unemployment rate in New York, 6.1 percent, is only slightly above the national average. Although the jobless rate in New York City spiked after the attacks on the World Trade Center, it rose only slightly in surrounding metropolitan areas, perhaps due to the relocation of businesses from the city to those areas. The unemployment rates in nearby New Jersey (5.4) and especially Connecticut (3.7) are below the national average. The region least affected by the recession, however, appears to be the midwest. The states with the lowest unemployment rates are Nebraska, Iowa, North Dakota, and, lowest of all, South Dakota.

The table also shows the highest unemployment rate reported by each state since 1978. These figures underscore how mild this recession has been compared with earlier ones. Unemployment in most states peaked at double-digit rates during the 1981-82 recession, which was one of the deepest and longest of the postwar era. (These are not the lowest rates ever recorded. During the Depression, the national unemployment rate reached an astonishing 25 percent.)

A few states, such as Massachusetts, posted their highest unemployment rates in the 1990-91 recession. Alaska, Texas, and Louisiana hit their highs in 1986, when plummeting oil prices pushed these oil states into a deep slump even though the national economy was not in recession. It is not uncommon for there to be "rolling recessions" in different areas of the country, *i.e.*, regions that stagnate or contract even as the rest of the economy expands. Just as the latest recession has hit some regions harder than others, the emerging recovery is likely to be uneven as well.

The table also shows that the unemployment rates reached in the late 1990s and 2000 were, for many states, the lowest in at least 25 years. The economic, financial, and political conditions that contributed to those historic lows have changed sharply in the past couple of years. So far, the labor market has weathered these changes remarkably well, but it remains to be seen how soon unemployment rates will return to those exceptional levels. ❑

Table 1
Current Unemployment Rates for States and Historical Highs/Lows

	April 2002	*Historical High*		*Historical Low*	
	Rate	*Date*	*Rate*	*Date*	*Rate*
National	**5.8**	**Dec. 1982**	**10.8**	**Oct. 2000**	**3.9**
Alabama	5.7	Dec. 1982	15.6	Aug. 1998	4.1
Alaska	6.0	Aug. 1986	11.6	Nov. 1998	5.5
Arizona	5.7	Feb. 1983	11.7	Jan. 2001	3.8
Arkansas	5.3	Feb. 1983	10.5	Nov. 1999	4.2
California	6.3	Feb. 1983	11.0	Feb. 2001	4.7
Colorado	5.2	Oct. 1982	8.8	Jan. 2001	2.7
Connecticut	3.7	Feb. 1992	8.2	Aug. 2000	2.1
Delaware	4.1	Jan. 1982	9.1	May 1998	2.9
District of Columbia	6.5	July 1983	11.9	Nov. 1988	4.4
Florida	5.1	Mar. 1983	9.7	July 2000	3.5
Georgia	4.7	Dec. 1982	8.5	Dec. 2000	3.6
Hawaii	4.2	Sep. 1978	7.8	July 1989	2.3
Idaho	5.0	Jan. 1983	11.4	Jan. 2001	4.5
Illinois	6.3	Dec. 1982	12.9	Apr. 1999	4.1
Indiana	5.0	Nov. 1982	12.7	July 1999	2.7
Iowa	3.5	Jan. 1983	8.9	Mar. 2000	2.4
Kansas	4.3	Aug. 1982	7.5	June 1978	2.7
Kentucky	5.3	Dec. 1982	12.6	May 2000	3.9
Louisiana	6.5	Sep. 1986	13.6	Dec. 1999	4.7
Maine	3.7	Feb. 1983	9.9	Jan. 2001	3.3
Maryland	4.7	Jan. 1982	8.7	Sep. 1999	3.4
Massachusetts	4.4	July 1991	9.6	Oct. 2000	2.5
Michigan	6.2	Nov. 1982	16.3	Mar. 2000	3.2
Minnesota	4.2	Feb. 1983	9.2	Aug. 1998	2.4
Mississippi	6.6	Feb. 1983	13.8	Feb. 1999	4.6
Missouri	4.8	Apr. 1983	10.6	Jan. 2000	2.9
Montana	4.1	Mar. 1983	9.2	Jan. 2002	4.2
Nebraska	3.7	Jan. 1983	7.1	June 1990	2.1
Nevada	5.5	Feb. 1983	11.6	June 1978	3.7
New Hampshire	4.2	July 1982	7.9	Mar. 1988	2.2
New Jersey	5.4	May 1992	9.4	Feb. 2001	3.5
New Mexico	6.0	Feb. 1983	11.7	Jan. 2001	4.5
New York	6.1	Apr. 1983	9.2	Apr. 1988	3.9
North Carolina	6.8	Feb. 1983	10.0	June 1999	3.0
North Dakota	3.5	May 1986	6.7	Oct. 1997	2.3
Ohio	5.8	Jan. 1983	13.8	Mar. 2001	3.9
Oklahoma	4.5	May 1983	9.7	Jan. 2001	2.9
Oregon	7.3	Jan. 1983	12.4	Mar. 1995	4.4
Pennsylvania	5.7	Feb. 1983	13.1	Mar. 2000	4.0
Rhode Island	4.7	Oct. 1982	10.9	May 1988	2.7
South Carolina	5.5	Feb. 1983	11.7	Mar. 1998	3.3
South Dakota	3.0	Feb. 1983	6.3	Mar. 2000	2.0
Tennessee	4.9	Dec. 1982	12.8	July 2000	3.8
Texas	6.2	Oct. 1986	9.4	Dec. 2000	3.9
Utah	5.3	Apr. 1983	10.5	Mar. 1997	2.9
Vermont	4.0	May 1983	7.5	July 1988	2.4
Virginia	4.1	Mar. 1982	8.0	Apr. 2000	2.1
Washington	7.1	Nov. 1982	12.5	Nov. 1997	4.4
West Virginia	6.2	Feb. 1983	19.5	Dec. 2001	4.6
Wisconsin	4.8	Jan. 1983	12.7	June 1999	2.8
Wyoming	4.3	Feb. 1987	10.7	Apr. 1979	2.2

Seasonally adjusted. Rates shown are a percentage of the labor force. Date series begin in January 1978, except for California, where it begins in January 1980.

PRICE OF GOLD

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