GLOBALIZATION—THEN AND NOW

Review of Globalization and History
by K. O'Rourke and J. Williamson (2000)

The appeal of economic history, at least to me, lies in its lessons for today. O'Rourke and Williamson's publication of this carefully researched and persuasive history of the evolution of a 19th century Atlantic Economy is timely. However, although the debate over globalization is raging across the world, the concerns vary depending on the venue. In developed countries, the major concern is that in order to fulfill our international treaty obligations, we may have to sacrifice painstakingly created national institutions (e.g. environmental protection, social security, health care). There is also a concern that trading with countries with cheap labor will bring down the living standards of workers in the developed countries. In the developing countries, the suspicion is that globalization is a game played by the rich for the rich; it may benefit the rich but not the poor in poor countries. Some of these concerns, such as worries about the preservation of national institutions, are new and have no parallels during the earlier phase of globalization in the 19th century. Other concerns, such as the lack of impact on poverty in the poor countries are age old, and here we have much to learn from history.

Globalization and History reminds us that the ups and downs of the phenomenon called "globalization" are not entirely a new experience and focuses on the last such episode (1850-1913). A hundred years ago, Europe had a more developed Core (Belgium, Britain, France, Germany, Netherlands) and a less developed Periphery (Denmark, Ireland, Italy, Norway, Portugal, Spain, Sweden). Real wages in the Core had been much higher (2 to 5 times in most cases) than in the Periphery prior to 1870 and yet several countries in the Periphery, especially the Scandinavian countries, had caught up with the Core by 1913. Real wages were also higher in the resource rich countries of the New World (the Americas and Australia) at the beginning of this period but the gap was narrowed during this period. How did they do it? What role did freer movement of factors and commodities within Europe and between Europe and the New World play in this catch-up process?

For this reviewer, the crucial issue is whether the present process of globalization is likely to benefit the poor in developing countries. O'Rourke and Williamson use a much wider canvas. They discuss the effect of globalization on the convergence across the Atlantic Economy (Europe and the New World), on the distribution of income among workers, capitalists and landlords, and the resultant unraveling of the political arrangements that enabled globalization in the first

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place. My focus here, on the other hand, will be more narrowly on the connection between globalization and the wages of workers in poor countries.¹

The word “globalization” has come to mean different things to different people and some unproductive aspects of the debate could be attributed simply to the vagueness of the term. O’Rourke and Williamson use the term to mean a reduction in the obstacles to the movement of goods and factors of production across nations and this review follows that usage of the term. It is important to note at the outset that even the most ardent supporters of globalization today shy away from including in their notion of globalization a large scale international movement of labor. In O’Rourke and Williamson’s account of globalization, on the other hand, such a labor movement takes center stage. In the present day context, we can talk only about “capital” as a mobile factor of production.

O’Rourke and Williamson’s script begins in the second half of the 19th century and continues up to the outbreak of the First World War. As transport costs fell dramatically, the Corn Law in Britain was repealed in 1846, and a wave of trade concession treaties swept Europe, the belle époque of globalization was ushered in. Commodities and factors began to move more freely across national borders affecting wages, rents and profits. O’Rourke and Williamson argue that globalization played a significant role in raising the real wages of the workers in the poorer countries but the role played by commodity trade was relatively minor. They point to factor (capital and labor) movements as being primarily responsible for raising the living standards of the working class of the relatively poor countries of the Atlantic Economy.

In particular, O’Rourke and Williamson note that wages, already high, were growing at a higher rate in the land abundant New World than in Europe and this resulted in mass migrations. As a significant part of the population in some European countries moved to the New World the wage gap between the two areas fell. The cumulative emigration figures between 1870 and 1910 are staggering. No less than 36 percent of the Irish, 31 percent of the Italian, 19 percent of the Norwegian and 15 percent of the Swedish populations emigrated during this period. Europe, a crowded place, discovered a far less crowded continent in which to place millions of its workers, many of whom were unskilled. The result was to boost the wages, of both those who emigrated and those left behind. In the view of O’Rourke and Williamson, the most significant factor responsible for the reduction of poverty in Europe was this mass migration. The New World gave Europe a new lease on life.

There was also a significant movement of capital, mostly from the countries in the European Core (Britain, France and Germany) to some select countries of Europe and the New World. European capital built infrastructure (e.g. railroads) in countries as varied as Argentina and Sweden. Interestingly, capital did not go to countries with cheap labor, but to the resource rich countries. The average level of human capital as well as macro-stability may also have played a role in determining the target destinations for foreign capital. Where foreign capital

¹Both Crafts (2000) and Rodrik (1997) have excellent discussion on “Globalization—Now and Then”, though not in the context of the book being reviewed. In this essay I draw on their works. My emphasis, however, is different. I am trying to look at the globalization process from the point of view of the workers in less developed countries trying to catch up.
went, it increased the productivity of workers in the host country and built the foundation of future prosperity by developing essential infrastructure.

In Europe, it was, however, only Scandinavia and not other poor countries such as Italy, Spain and Portugal that attracted foreign capital. In fact, Ireland, a low wage country, experienced capital outflows. On the whole, capital movements are likely to have contributed to the divergence rather than the convergence of real wages in the 19th century Atlantic Economy—the exception was Scandinavia.

Trade too played some role in improving real wages in the European Periphery. As the commodity prices converged, the relative price of each country’s exports rose in that country. Since a country typically exports those goods that use its abundant factor more intensively, an increase in the relative price of a country’s exports tends to increase the price of its abundant factor. The abundant factor—land in the New World and labor in Europe—gained and the scarce factor lost. The inequality in rich countries of North America grew as landowners got richer while the inequality in poor countries declined as workers became less poor. The 19th century globalization episode followed the route predicted by a textbook trade theory—the Stolper–Samuelson Theorem. However, it is noteworthy that only a very small part (under 10 percent) of the real wage convergence between the European Periphery and either Britain or the United States can be attributed to the increases in commodity trade.²

Last but not least, O’Rourke and Williamson argue that a process of technological catch-up played a major role in helping workers in the European periphery to catch up with those in the European Core. Its contribution to the real wage convergence on Britain is comparable to that of capital inflows and seems to be somewhat correlated to it.³ Does this mean that technology diffusion took place through embodied capital? We don’t know; there is no discussion about the sources of technological progress in the European Periphery (which had a faster growth of total factor productivity than Britain). This is unfortunate because for present day globalization, technological diffusion, perhaps through multinational corporations (MNCs), is considered to be one of the promising channels of real wage improvements in the developing countries. The “Periphery” was, however, far from homogeneous. Scandinavia, a set of countries with high human capital gained through both capital inflows and technological progress while the countries with relatively lower human capital (Italy, Portugal, and Ireland) gained much less through these avenues.

Together, these various channels of globalization created a redistribution of income that, in turn, resulted in a backlash against globalization. Those who lost in the process—workers in North America and farmers in Europe—organized politically to reverse the process of globalization. The political will to push trade liberalization and global factor movements weakened and the deteriorating environment culminated in anxiety, distrust and then protectionism. By 1913, tariffs had gone up everywhere in the Atlantic Economy and immigration policy had become more restrictive in North America. The prevailing wisdom on the

²Numerical results of this kind are based on a CGE model.
³A casual glance at Table 14.4 indicates this. I am not aware of a comment in the book pointing out this correlation, however.
desirability of flexible trade and factor movements had now come full circle. O’Rourke and Williamson’s tale thus has an unhappy ending.

There is much wisdom in this tragic tale: efficiency enhancing arrangements can ignore the accompanying changes in income distribution at their own peril. One of the main motivations in writing this book may have been to drive home this message. Hence the authors emphasize the folly of talking about the convergence of GDP per capita rather than the convergence of specific factor incomes (rents, wages and profits). It is changes in the relative incomes of groups with common interests (factor incomes) that drive the political economy of any economic regime. The liberal economic regime of 1850 through 1913 made it possible for the much poorer workers of the European Periphery (e.g. Sweden and Norway) to play catch-up with their much richer counterparts in the New World and England but not without subsequently unraveling the same regime that made it possible. It is clear that the globalization process underway today faces the same dangers. But while this phase of globalization lasts, will it help to lift the poor in poorer countries out of poverty, as it did then?

An aspect of O’Rourke and Williamson’s account that is under-emphasized in the text is the fact that the main success story in the 19th century European Periphery was Scandinavia. What Sweden could do, Spain simply could not do. Sweden had mass emigration; Spain did not—at least until quite late. Sweden’s natural resources attracted foreign capital; Spain did not have comparable natural resources.

Nineteenth-century globalization thus had different results in different countries. Today’s policy debate is about bringing under the World Trade Organization (WTO) not just a narrow set of countries such as the European Periphery but the whole world—a far more diverse set of countries than those considered by O’Rourke and Williamson. As a consequence, we should expect a far greater variance of outcomes.

Does the O’Rourke and Williamson account of the 19th century episode of globalization produce optimism for the current prospects of the poor in the developing countries? After all, the poorer countries in the Atlantic Economy mostly experienced an increase in their real wages, and the poorest in poorer countries gained, in some cases dramatically. Is history likely to repeat itself? Similarities between now and then include the main cause for poverty in the poor countries: labor abundance and resource scarcity (e.g. natural resources—land or minerals or capital—human or physical), which together result in low marginal productivity of labor. Any measure that reduces labor abundance or resource scarcity can be expected to increase wages and reduce poverty.

Unfortunately, there is today no uncrowded continent willing to take the unskilled millions from the Third World. Thus, the channel of poverty removal that was most effective in the 19th century is simply not available. Instead, what we have today is a highly selective process of immigration into developed countries. Most immigrants to North America and Australia are selected from a pool of highly educated applicants (or entrepreneurs with sizable capital) from developing countries. Instead of creating an escape valve for the unskilled masses, present day migration is creating a problem of brain drain. Because the brain drain amounts to creating resource scarcity, albeit of a different kind, migration from
the periphery to the core may be reducing the wages of unskilled workers in the Periphery.

There is still the possibility of capital moving to developing countries. But here again, there is little in the 19th century episode for resource poor countries to take heart from; it was resource abundance rather than low wages that attracted foreign capital at that time. Capital markets and the nature of foreign investment have also changed substantially. Long-term investment of the kind that built railroads in Sweden and Argentina often took place through bond purchases. The investors, even the long term ones, were financiers. In the 19th century, MNCs of the kind that straddle the world today had yet to become a commanding presence.

What is the essence of the present day MNCs? Why do they exist and why have they become so controversial? Keynes (1933) opined:

Ideas, knowledge, art, hospitality, travel—these are things which should of their nature be international. But let goods be homespun whenever it is reasonable and conveniently possible; and, above all, let finance be primarily national.

The problem is that it is very difficult to protect rents on ideas, especially in the international arena. Most countries do not have proper legal structures to enforce patents. The present day MNC exists to protect the rents on its intellectual property and combines its access to capital with its specialist know-how. In the process, it attains an enormous amount of market power. The good part is that MNCs can serve as a conduit for developing countries to acquire new technology and grow. The bad part is that the financial and bargaining power of an MNC rivals and sometimes exceeds that of individual states. MNCs can buy politicians and influence social policy to the detriment of populations. The logic of protecting the intellectual property rights makes this somewhat inevitable—as in the conflict between African countries and drug companies over the pricing of drugs for AIDS. In these issues we get no guidelines from the history of the Atlantic Economy.

The most beneficial aspect of foreign investment in the 19th century, from the point of view of workers in the poorer countries, was that foreign investment helped create their basic infrastructure. Is that likely to happen today? Certainly, a number of multinational giants have the specialized knowledge necessary to construct and operate various kinds of infrastructure facilities. Enron and Bechtel can build power stations; General Electric and Westinghouse can supply generators; Nortel and Telus can build communication networks. If somehow this intellectual and financial capital can be tapped, it could be a great boon to the developing economies. The problem is that technology has marched ahead of legal and political structures that would make such international arrangements possible and viable. The scale of the projects is often so large and the financial risks (compounded by the fragile exchange rate regime) so great that mutually acceptable terms are difficult to devise and to honour.

4As quoted by Rodrik (1997).
5For example, Enron succeeded in negotiating such a lucrative deal with the state government of Maharashtra in India that the government cannot afford to fulfill the terms of the contract. After completing the construction of a sophisticated gas-fired power plant with enviable environmental safeguards, the project stands the risk of being abandoned.
It is also possible that an MNC may choose to locate parts of its production facilities in a developing country in order to reduce its production costs. But one thing that the experience of the belle époque teaches us is that capital seldom moves for the sake of cheap labor alone. Capital may move to East and South-East Asia—regions with good infrastructure and human capital and stable macro-policy—as it did to Scandinavia (for the same reasons) in the 19th century. But it is likely to shun other poor countries, since cheap labor is often unproductive labor. Countries that can attract foreign investment with price effective labor will have much to gain because such investment will generate manufactured exports. Unfortunately, there are very few countries that will serve as magnets for multinational investment on the strength of their price effective labor.

Can the factor price changes brought about by commodity trade raise wages in poor countries? Certainly, opening a closed economy could enable poor countries to export labor-intensive goods to rich countries, which would cause an increase in the factor price (wages) of the abundant factor. But as pointed out earlier, this process was hardly significant in raising real wages in the 19th century Atlantic Economy. Do we have reason to believe that it will be more effective now?

One way to analyze this is to examine a basic two sector model in which food is produced with a constant return to scale technology using land and labor, while manufacturing requires labor and capital. Saving results in capital accumulation but land remains a fixed factor. Given diminishing returns in the food sector, the wage in this economy will be determined by: (a) the (marginal) productivity of labor in agriculture, and (b) the allocation of labor across the two sectors. If new practices or new seeds or opportunities for diversification make labor more productive in agriculture, it will improve wages. If globalization enables importation of new technology (e.g. seeds with low water requirement) that improves yields or provides opportunities for diversification by opening up foreign markets, it will have a direct positive effect on wages. Similarly, as labor moves from agriculture to manufacturers, the wage will rise and the poverty will recede.

In this model economy, if demand is not a constraint, all labor can be moved to the manufacturing sector. However, in a closed economy, domestic demand may be a hindrance to having a significant part of the labor force in manufacturing. If preferences are need based so that they conform to the Engel’s Law and exhibit higher income elasticity for food at lower incomes (Eswaran and Kotwal, 1993), a very poor country may not have much of a market for manufacturers. Even if it could assimilate industrial technology quickly from developed countries and improve its own industrial productivity, the country would be unable to increase its wages through a continuous change in labor allocation. If, on the other hand, the country could find a market abroad for manufacturers, it would be able to raise its wages.

If this model is appropriate, globalization (in the sense of removal of trade restrictions) thus creates opportunities to eradicate poverty in developing countries. They could either import suitable agricultural technology and have a direct

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5O'Rourke and Williamson point out these reasons along with the resource richness of Scandinavia.
impact on wages, or import industrial technology, increase productivity of labor in manufacturing, reallocate labor from agriculture to manufacturing and export the manufacturing output. This can be a continuous process if the imported technology continues to improve. The amount of wage improvement will depend partly on how much labor can move off the land and that in turn will depend on how much labor is there in agriculture to be moved.

Poor countries today still have a substantial part (over 60 percent) of their labor force in agriculture. There is, therefore, great scope for the improvement of wages through the above process. However, all this assumes that the less developed country succeeds in acquiring comparative advantage in manufacturers, which in turn depends on the quality of their labor and infrastructure. As mentioned above, it is the countries that attract multinational investment on the strength of their price effective labor and become exporters of manufacturers that will belong to this privileged set.

How did resource allocation actually change in response to freer trade in the Atlantic Economy? Which non-agricultural activities did labor get reallocated to? In general, the New World had a comparative advantage in grain and Europe was ahead in industrial goods. But although Britain was clearly an exporter of industrial goods it is not clear from the account given by O’Rourke and Williamson whether other European countries were. The book is sparse on detail on the nature of trade flows between Britain and Continental Europe. We really do not get a feel for whether the economy wide labor allocation changed significantly in any of these countries. It is possible that most of the émigrés came out of continental agriculture and not a great deal of new labor was absorbed in continental industry.

The most lucrative exports from continental Europe during the belle époque were not all manufactured products that match our image of industrial goods. Wines, olive oil and citrus fruit from Italy, Parisian luxury goods and silks from France are some examples of continental exports. Nonetheless, these goods provided employment outside agriculture. In Denmark, the grain invasion brought diversification of Danish farmers, who found their special niche in dairy farming, which created industrial links by inducing dairy machinery production. It is these examples that are most relevant for present day developing countries because the prospect for suddenly emerging as major industrial exporters is remote for most of them. A much more viable prospect is to be found in niche agriculture—fruits, flowers and other cash crops, and agro-processing. However, the viability of this will depend on how accommodating the developed countries will be in receiving agricultural imports.

The well being of the poor in poor countries thus depends to a large extent on the final draft of the WTO Agreement on Agriculture. One of the main stumbling blocks for removing restrictions on trade in agricultural goods is the farmers’ lobby in Europe, whose genesis can be traced to the grain invasion (imports of grain from the New World and Russia) of the 19th century. O’Rourke and Williamson’s discussion of the political economy of agricultural protectionism in the aftermath of the grain invasion helps us understand why it is so difficult to overcome Europe’s agricultural protectionist sentiment. This historical background will influence the outcome of the current WTO negotiations, but although
the battle lines are drawn between North America and Europe, the developing countries are a significant ally of North America in the deliberations on the Agreement on Agriculture. The final draft of this agreement will be a crucial determinant of how the present globalization process will affect poverty in developing countries.

In addition, a major difference between “now” and “then” is that:

. . . there was little head-on international competition in identical or similar products during the previous century, and most trade consisted of the exchange of noncompeting products, such as primary products for manufactured goods. (Rodrik, 1997, p. 8).

The probability that another producer producing exactly the same good in an environment of totally different cost structures would find a way to undercut a domestic entrepreneur is much higher now. This makes industrial investment a lot riskier today than it did then, even if the rewards for success may also be higher. For risk-averse entrepreneurs, this is a disincentive to investment, making the task of increasing labor productivity that much harder today.

An interesting part of the book is its discussion of the political economy responsible for the birth and death of the globalization regime. In contrast to today, when the United States plays a leadership role in forging international institutions such as WTO and the International Monetary Fund, Britain then played a similar role as the economic superpower of the day. However, instead of formal organizations such as WTO, there were a series of bilateral treaties, with leadership coming from Britain, starting with the repeal of the Corn Laws in 1846. It is remarkable how much simpler and centralized the decision making process was then. Although Robert Peel, the British Prime Minister who signed the repeal, was a Tory and his party was firmly on the side of the landlords and hence against the repeal, he could simply decide to sign the repeal document and push it through—a process that seems almost incredible today.

The political process is now much more complex, partly because it has evolved into a system that is much more accountable to ordinary citizens. With post-war prosperity in Europe and North America, democracies have become, in varying degrees, much more of welfare states. Governments are expected to be more caring creatures. Social insurance programs and government supported health schemes play an important role in maintaining social cohesion and stability.

The market system is ideal for the generation of continuous innovation and growth but it is also prone to the ups and downs of business cycles. Without government financed social insurance schemes, it would have been difficult to reap the fruits of the market system. Each nation has come up with its own model of social insurance programs according to its own history and national character. The antipathy toward WTO, and not just in developed countries, is largely due to the perception that it threatens these social programs and those peculiarly national institutions.

The role of the WTO is to establish a common set of rules for all its members so that international trade can occur with minimum encumbrance. However, “a common set of rules” clashes directly with the desire to maintain diverse preferences and institutions across countries. But when countries use their “special”
institutions and programs to camouflage trade barriers, the WTO reacts to what they perceive to be a camouflaged violation of their rules, thereby creating conflict and thus resentment.

Making the WTO rules optimally flexible to minimize such conflict without sacrificing the gains from globalization is therefore the key to the success of the present process of globalization. Both Crafts (2000) and Rodrik (1997) have persuasive discussions of the importance of social programs in the debate on globalization today. Rodrik (1997) points out that the greater need for social insurance programs is difficult to meet when the fiscal system in many OECD countries is already under so much strain under conflicting claims—a problem which is often far worse for developing countries that (unlike the OECD countries) have huge government deficits.

In addition to trade unions and business and farmers’ lobbies, there is also the new phenomenon of public interest groups (non-governmental organizations, NGOs), some of which are international (itself, ironically, a product of globalization). These lobbies (Greenpeace, for instance) now have a strong organizational and financial base and know how to use the media and mobilize public support. The causes they espouse (e.g. the environment) cannot be dismissed easily, and trade agreements today consequently have to consider a wider set of issues.

Given the impossibility of mass migrations from developing to developed countries today, today’s catch-up process must depend on the diffusion of technological know-how and access to capital. MNCs can only be a means to this end. But technology is a two edged sword. It has galloped right past developments in social and public institutions, creating much uncertainty and confusion. Biogenetic technology, for example, can breed pest resistant seeds that require little water, which can eradicate droughts from arid regions where poverty is at its worst. But it also has the potential for creating ecological risks that we know little about. Since many of these technical breakthroughs have occurred in the labs of multinational corporations, they hold the keys of the kingdom—but we hardly trust them to tell us everything they know about the risks lurking behind the impressive specifications. There is acute antipathy among some people toward these new genetic technologies, which sometimes turns into vilification of multinational corporations and by association into protests against globalization.

O’Rourke and Williamson think that the belle époque came to its end because the losers in the globalization process joined ranks: farmers and capitalists in Europe and workers and capitalists in North America. Although the well being of these individual groups was threatened by international competition, a vast number of unskilled workers from a less developed set of countries also heaved themselves onto a higher income plateau—something that would not have been possible without the whirlwind process of globalization.

But although the globalization of the 19th century laid the foundation for the prosperity of future generations, only part of it can be replicated. Mass migrations are inconceivable today but technological diffusion still looks promising. Then, it was unskilled labor from poor countries that went in search of resources, and through the process managed to improve its productivity and income. Mass migrations offered the poor in poor countries an escape valve and helped to match unskilled labor with capital and land. Can we now argue that
capital from rich countries will go in search of labor, and accomplish the same?

Perhaps, but there is a big difference: technology today requires a much higher level of skills from labor. In the 19th century, even unskilled workers from Italy and Ireland found ready employment in the sweatshops of New York and Chicago. Today, when IBM and General Electric set up shop in India, they are looking to employ the cream of the crop. Technology has thus changed qualitatively.

The implication is that even if mass migrations were possible now, there is a small chance that it would radically transform the living standards of those who are unskilled—wherever they come from. And there are no short cuts available anymore to a fast acquisition of skills. However, a country with a skilled labor force will not have to lament the end of the era of mass migrations. In fact, they have reason to be grateful as they no longer have to worry over the emigration of their skilled workforce. As it did in the 19th century, globalization will be a boon to countries with a relatively high level of human capital—but unlike then it will be of little benefit to those without it.

Can globalization benefit the unskilled (and hence the poorest) segment of the workforce in countries with high average levels of human capital? There are only two processes that can produce this outcome: (a) agricultural productivity improvement through importation of suitable technology or through opportunities for agricultural diversification, and (b) a declining share of labor force in agriculture. As more and more land becomes available to the relatively unskilled labor force left in agriculture, their wages can be expected to rise. Thus, if globalization results in increased opportunities for expansion of other activities, as in China, even the poorest will benefit from it.

But even in the optimistic scenario sketched above, the process is bound to be tumultuous. In the short run, there will be many losers. What is the cost–benefit analysis of such a development process? In the process of creative destruction, those who lose are already on the scene. They have lobbies and representation. Future generations are not yet here to make their voices heard and have no representation.

The only practical solution is to build social structures at the national as well as international levels to minimize the pain of the potential losers. The evolution of democracy to the present level of complexity makes it harder to push through structural changes inducing productivity improvements. But it is also true that once enacted these changes are longer lasting, because the vigilance of lobby groups creates institutions that arrange side-payments to cushion the shock for the losers.

The WTO will have a rough ride before it becomes an institution that functions well. Losses will come before gains begin to manifest. As in the 19th century, it is likely that some countries with a relatively more literate labor force will find globalization a great opportunity to climb out of poverty while others may languish. There will be huge upheavals. Traditional ways of livelihood will come to an end. New sectors and new activities will take time to take root and grow. There will be protest marches where those with private interest will join ranks with those with public interest. Some will be there to protect their livelihood—some to vent their most heartfelt resentment. There will also be concerned citizens on the street.
terrified by the specter of uncertainty and gloom. Nobody will be marching on behalf of the faceless poor whose swelling ranks are doomed without substantial productivity improvement. MNCs will be inspired by their self-interest to shore up the fortress under siege but they may be the last ones to push for the repairs that can ensure its long-term survival.

As O’Rourke and Williamson note, it is the political backlash to globalization that can threaten its continuation. If ideas and technology spread around the world and help the poor to climb out of poverty, it will be because national governments will have evolved, under pressure from concerned groups, to build institutions to spread the losses of the globalization process over the global society at large.

ASHOK KOTWAL
Department of Economics
The University of British Columbia

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