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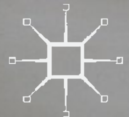
Revisiting Globalization and the Rise of Global Production Networks

S. Javed Maswood



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Revisiting Globalization and the Rise of Global Production Networks

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List of Acronyms

ACLL	Anti Corn Law League
ADIZ	Air Defense Identification Zone
AMC	American Motors Corporation
CCP	Chinese Communist Party
CETA	Comprehensive Economic and Trade Agreement (Canada-EU)
CPEC	China-Pakistan Economic Corridor
EOI	Export Oriented Industrialization
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GM	General Motors
GPN	Global Production Network
GSP	Generalized System of Preferences (UNCTAD)
GVC	Global Value Chain
G77	Group of Seventy Seven (UNCTAD)
G20	Group of Twenty
HST	Hegemonic Stability Thesis
ICT	Information and Communications Technology
IMF	International Monetary Fund
ISI	Import Substitution Industrialization

ITO	International Trade Organization
JIT	Just in Time
LDC	Least Developed Country
MAI	Multilateral Agreement on Investments (OECD)
METI	Ministry of Economy Trade and Industry (Japan)
MFN	Most Favored Nation (GATT/WTO)
MITI	Ministry of International Trade and Industry (Japan)
MNC	Multinational Corporation
NAFTA	North American Free Trade Agreement
NIEO	New International Economic Order
OECD	Organization for Economic Cooperation and Development
OMA	Orderly Marketing Agreement
PPP	Purchasing Power Parity
RTAA	Reciprocal Trade Agreement Act
SAP	Structural Adjustment Program
SEZ	Special Economic Zone
SOE	State Owned Enterprise
TNC	Trans National Corporation
TPM	Trigger Price Mechanism
TPP	Trans Pacific Partnership
TQC	Total Quality Control
TTIP	Trans-Atlantic Trade and Investment Partnership
TVE	Township and Village Enterprise (China)
UKIP	UK Independence Party
UNCTAD	United Nations Conference on Trade and Development
UR	Uruguay Round (GATT)
VER	Voluntary Export Restraint
WB	World Bank
WTO	World Trade Organization

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CHAPTER 1

Introduction

Since the early 1990s, the literature on economic globalization has grown in plentiful abundance. This book adds to that but also stands somewhat apart from it. Here I take issue with our common assumptions about economic globalization, about its origins and historical precedents. Following that, and based on a revised understanding of contemporary political economy, I look at some of its key consequences. Economic globalization in the twenty-first century includes globalization of financial transactions and of production, and the liberalization of trade. The major exclusion is labor mobility, which continues to be limited by border controls. Unlike globalization of finance and of production, globalization of labor is a project for the future. This is in contrast to conditions during the nineteenth century and until the outbreak of the First World War when international labor mobility was relatively easy and, indeed, welcomed particularly in the New World, the USA, Australia, Canada, Brazil, and so on. Security considerations at the time of the First World War, however, restricted international labor mobility. More recently, terrorist attacks in the USA on September 11, 2001, heightened concerns for border protection and added to even stricter controls on cross-border flow of people. Terror groups that have spread fear through indiscriminate acts of murder and mayhem have lessened the likelihood of any progress, in the immediate future, toward liberalizing international movement of people. There are some exceptions, such as Japan, where demographics and a declining

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population have forced the government to relax immigration policies and facilitate the entry of migrant labor. Germany too stands out as a relatively open country. In 2016, it accepted about one million immigrants and refugees from war-torn Middle East, considerably more than any other country, again in part because of domestic population pressures.

A commonly held view is that contemporary economic globalization represents a continuation of liberal economic and trade policies after the Second World War. Adam Smith established an intellectually convincing case for free trade in the late eighteenth century and demonstrated that it maximized wealth and welfare of consumers. He based his free trade theories on the principles of specialization and division of labor and argued that if a 'foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage' (Smith 1964:401). For reasons of efficiency and maximization of consumer welfare, Smith advocated free trade and the removal of barriers between domestic and international markets so that consumers could source products from the most efficient producers, whether domestic or foreign. A capitalist system based on free trade policies was, therefore, best in maximizing both production and consumption, and wealth and welfare. For Smith, there was no sense in simply accumulating gold and precious metals as advocated by the dominant mercantilist ideas of the time. For him, the true measure of wealth was consumption, the power to purchase and consume, not accumulate. He understood also that expanding the consumption frontier required free trade (See Heilbroner, 1993:44). Unlike in mercantilism, a capitalist economy protected the interests of consumers by maximizing their market choices and purchasing power.

Nonetheless, even as capitalism became more deeply established in Europe after the industrial revolution, mercantilist policies continued to hold sway. In the 250 years since Smith's advocacy of it, free trade policy has never found universal acceptance and we have only ever had periods of relatively liberal trade policies in the late nineteenth and the late twentieth centuries. Liberal trade in the twentieth century initially produced a period of increased interdependence between states, which arguably later morphed into contemporary globalization. Many analysts, as we shall see in the next chapter, have also retrospectively labeled nineteenth-century liberal trade as the first period of globalization. An implication of this is that there is basic continuity between the two periods, and a denial of anything particularly unique about contemporary globalization.

Globalization of finance followed liberalization of capital accounts and removal of exchange restrictions. The Bretton-Woods agreement after the Second World War included these measures as a necessary complement to proposed trade liberalization. It was the function of the International Monetary Fund (IMF) to oversee and encourage financial liberalization but, in reality, not many countries lived up to their commitments in the first decades after the War. Eventually, however, IMF members phased out exchange controls and this liberalization led to an unprecedented and unanticipated globalization of finance. The increase in international financial flow vastly outpaced the level of trade and this was completely unanticipated because, at the time of the Bretton-Woods agreement, a common assumption was that settlement of trade accounts would determine cross-border financial flows. In the contemporary period, however, speculative, not trade related, capital flows dominate all aspects of international financial transactions. Moreover, contrary to expectations, financial institutions have themselves become major players in national economic structures. In years preceding the global financial crisis in 2008, banks and financial institutions in the USA accounted for 40 percent of all profits generated.

Liberalization and removal of capital restrictions allowed safe and quick foreign exchange transactions, and enabled capitalists and investors to profit from opportunities elsewhere. This was the main driver of financial globalization. In 1990, total cross-border financial assets were close to 60 percent of global GDP but had more than doubled to slightly above 130 percent by 2004 (IMF 2007: Chap. 4). Financial globalization has its share of supporters who see access to global capital markets as beneficial, and detractors who are apt to see global capital flows as destabilizing and conducive to crises. Imprudent and irresponsible lending practices of international banks precipitated both the Latin American debt crisis of 1982 and the global financial crisis of 2008, and yet, these financial institutions received considerable taxpayer-funded bailout packages that secured their corporate viability and survival. These actions increased moral hazard and financial concentration, and strengthened banks at the expense of other groups in society. Kose et al. (2007) acknowledge that while it was unclear whether the supporters or detractors had a stronger case, the benefits of financial globalization were significant, including 'development of the domestic financial sector … discipline on macroeconomic policies … efficiency gains among domestic firms by exposing them to competition from foreign entrants, and … better government and corporate governance. These collateral benefits could enhance efficiency and,

by extension, total factor productivity growth.' However, the frequency of crises alludes to inherent difficulties in assuming good governance in financial institutions.

In this book I deal with globally fragmented production networks that have become a defining feature of contemporary globalization. An orthodox explanation for the emergence of such networks and globalized production is trade liberalization after the Second World War, and facilitated by breakthroughs in communications technology and lower transportation costs. Technological facilitation is indisputable, but I will argue that globalized production originated from a different set of circumstances. Its roots are, indeed, in state-level policy shifts, but from liberal to neo-protectionist policies in the 1980s. The USA turned to protectionism in order to provide relief to struggling domestic industries and firms from Japanese competition, and to encourage manufacturers in Japan to rely less on exports and invest, instead, in manufacturing in export markets. In this way, policymakers hoped that an inflow of Japanese investments would create jobs and other benefits for the US economy. Japanese manufacturers not only met these expectations, but they went a step further and transplanted their own 'networked' manufacturing strategy on to foreign soils, aspects of which were soon also adopted by their western competitors. This export of their production strategy ultimately became the source of globalized production that is so ubiquitous in contemporary economic globalization.

This book deals with the origins and consequences of globalized production, defined as the disaggregation and dispersion of various stages of production across different countries. Manufacturing has evolved in the shape of global production networks (GPNs), a collective of inter-linked, but geographically dispersed, production units. Whether loosely integrated or otherwise, these GPNs constitute the nucleus of an emerging global economy. Economic globalization and globalization of production are, as the terms imply, a process of becoming, a journey leading to a fully evolved *global economy*, when national economic identities fade into insignificance. There is no timeline or expectation that this project will come to full fruition anytime soon, nor even a clear vision or mapping of the end-state. Globalization and global economy are as democratization and democracy except that while there are multiple definitions of liberal democracy, a global economy is, as yet, undefined essentially because there are no historical parallels or precedents to draw upon. Nonetheless, even if we cannot fully comprehend the end-state, it is still a mistake to speak of a journey without a destination.

I will present an analysis of globalization that highlights differences from nineteenth-century interdependence, and identifies some of its important consequences. In the nineteenth century, trade as a percentage of GDP grew rapidly but trade was essentially in finished consumer goods. In the contemporary period, particularly since the 1980s, trade in parts and components have increased at a rapid pace and today constitutes a large chunk of total international trade. This is because of the spread of global manufacturing strategies. Instead of a single production location for any given consumer product, manufacturers have taken advantage of disaggregating and dispersing production in different geographic locations, leading to the emergence of globally networked production. This feature of the contemporary period was missing in earlier times of economic interdependence. Moreover, it has arisen not only because it is now technologically feasible to maintain and operate globally dispersed production networks but largely because of protectionist policies in the 1980s that threatened to limit access to export markets. Not progressive trade liberalization after the Second World War, but a short burst of protectionism in the early 1980s triggered the initial drive to dispersed and networked production. Protectionism spawned the birth of GPNs, but from a broader perspective, trade liberalization was also useful in facilitating trade across borders and in globalizing consumption patterns.

A main argument in this book is that global integration of finance and production will continue. Admittedly, however, as the level of globalization has deepened, so has the voice of those who are opposed to it. The decision of British voters, in 2016, to leave the European Union was a prominent reflection of this opposition. Advocates of British exit, or Brexit, argued forcefully, and in the end successfully, for an end to British globalism and a return to the defense of national sovereignty and territorial integrity, eroded by membership in the EU. In January 2017, British Prime Minister Theresa May reinterpreted Brexit not as a rejection of globalism but of Britain's European identity and an opportunity, therefore, for a more global engagement but with full control over labor mobility. Across the Atlantic, the Republican nominee in American presidential elections in 2016 also made similar arguments, and promised to scale back globalization, keeping 'America First.' Defying all expectations, Donald Trump won the election in November.

A number of factors have contributed to this backlash against globalization. These include the large chasm between real and promised gains, and concentration of benefits in the hands of a small minority. While recent

events may not reverse the course of globalization, there is a palpable sense of anger and frustration that deserves serious consideration. The reality is that even if economic benefits are significant, globalization can only achieve broad-based support and legitimacy if the process of trade integration is fair and does not lead to the marginalization of a large section of society. Rising global inequality is indicative of political failure but for political leaders it is easier to channel anger toward 'the system' rather than acknowledge their own sins of the past. I will discuss these issues in some depth in the final chapter.

The main body of the book is in two parts. The first chapter in Part 1 develops an alternative explanation to globalization than is commonly presented in existing literature. In this chapter, I will explain why it is an error to compare contemporary globalization to interdependence in the nineteenth century or as an extension of interdependence in the 1970s. In Chap. 2, I trace the origins of globalization to American neo-protectionist trade policies of targeted trade restrictions in the early 1980s, and secondarily to currency realignment in mid-1980s following the Plaza Accord. I will show how Japanese foreign investments after neo-protectionist trade restrictive measures led to the emergence of networked manufacturing and eventually to globally networked manufacturing. Just as trade can be a mechanism for technology transfer, Japanese foreign investments led to a transfer of Japanese production technologies that formed the basis of the central component of globalization, the spread of disaggregated production.

Part 2 of the book has three chapters. Each chapter will examine some of the main consequences of globalization, in particular for development, income inequality, and trade stability beyond that resulting from political leadership, as proposed by the hegemonic-stability thesis. These are not an exhaustive list of consequences and there are many other important consequences of globalization in the contemporary period and indeed much has been written about the impact on welfare states and on labor standards and trade unions because states are forced to balance social goals with pressures to enhance international trade competitiveness. Globalization also has conflict mitigation effects but we should not presume a world of immediate, or immanent, peace and harmony. I will touch on some of these and others cursorily in the course of my analysis, but will leave their more exhaustive analyses to others.

Chapter 3 deals with the issue of trade stability. There are a number of economic and political economy explanations for the cyclical drift between

liberal trade and protectionist policies and I will discuss each of these before explaining the impact globalization has had on trade stability and trade liberalization. The essential argument is that globalization has added a degree of permanence to liberal trade and it is not surprising that there was no surge in protectionist policies even after the global financial crisis. This was unlike earlier periods of economic crises when states instinctively moved to protect domestic manufacturers from foreign competition. Absolute trade levels fell sharply after the financial crisis but this drop was more a function of difficulties in obtaining trade finance rather than higher levels of import protection.

Chapter 4 looks at the developmental impact of globalization. Following the collapse of earlier unorthodox models of economic development, such as import substitution industrialization and the developmental state model following the Latin American and East Asian economic crises respectively, developing countries have only the liberal economic pathway open to them as they pursue development. Within that context, globalization of production has opened up a promising alternative although a number of scholars have expressed reservations and argued that globalization is essentially detrimental to developing countries. I will review the different arguments and explain why globalization is an important development for the future success of trade-led economic development. In the postwar period, the trade-led route to development had been successful for only a select group of countries in East Asia and most developing countries failed to benefit from GATT-based liberalization of manufactured goods trade. Nearly two decades ago, the World Trade Organization promised developing countries a more advantageous trade regime but even though its efforts have yet to bear any positive result, developing countries have still managed to move ahead on their developmental agenda because of newer options offered in the expanding system of globalized production.

Chapter 5 shifts focus to look at inequality in developed and developing countries and the often-made suggestion that the wealth gap is a result of economic globalization that has delivered for a few at the expense of the many. In developed countries, globalization is frequently associated with burgeoning incomes and wealth inequality but association is not causation, at least not in the way that we presume that the fault lies in globalization rather than in the capitalist mode of production per se. Chapter 6 looks at the problem of income inequality that has increased in prominence alongside economic globalization. It is not difficult to jump to causation from association, but the reality is that even if capitalism and globalization have

tendencies to exacerbate inequalities, the present dilemma is largely a result of political failure.

The concluding chapter pulls together the main themes presented in the book as well as identifies some other interesting aspects of globalization, and challenges that remain. The many challenges and the contemporary backlash against globalization, in both developed and developing countries, is largely a result of its 'legitimacy deficit.' Legitimacy normally flows up from below and the deficit for globalization, rightly or otherwise, is because many consider globalization as beneficial mainly to a small class of already wealthy individuals.

There are two caveats to the consequences of globalization. First, globalization, as the term implies, is a process leading to some, yet, imprecise destination. Since globalization itself is an evolutionary concept, the consequences are, likewise, also in the process of becoming. I have stated the consequences in definitive terms but given the evolutionary nature of globalization, there is room for some slippage. It will be a mistake to see the consequences in absolutist terms but, at the same time, not so flexible as to make the assertions meaningless.

Second, I should mention that in this book I have tried to make, as much as possible, a logical case, especially for the presumed consequences of economic globalization. For example, logically, economic globalization has strengthened the case for liberal trade and stabilized it in ways that was not previously possible. The logic withstood the test of the Great Recession but I should add the caveat that we are, in the end, dealing with human subjects and there are often times we behave in a manner that defies economic logic, either because we are not aware of rational self-interest or because of emotional, fanatical, or impulsive reasons. History is replete with examples where individuals and state actors have defied a seemingly logical course of action. At the end of the First World War, the USA had replaced Britain as the sole hegemonic power and logic, and economic interests dictated that it remain engaged in global affairs, both politically and economically, but, for various unforeseen and unpredictable reasons, the US government chose a policy of isolationism. Arguably, this created a vacuum on the international stage and laid the foundations for a very grim inter-war period. However, the USA did not choose to be knowingly irresponsible and apportioning blame retrospectively is perhaps a little unfair. Hegel, for instance, reminds us that the owl of Minerva takes flight at dusk after the (mis)

adventures of the day. In that context, there is no cause to scorn wisdom gained after the event. Norman Angell who predicted, shortly before the First World War, that commerce and economic prosperity had made wars redundant was wiser after the fact, and in a later book (Angell 1939: 24) wrote that 'If it is easy to be wise after the event, it is also wise.'

Later, after the Second World War, and with the benefit of hindsight, the USA, acting on its rational self-interest, led western countries to commit to peaceful alternatives and to create a virtuous cycle of economic prosperity and political peace through trade expansion. American leadership, based on its international hegemonic status, was instrumental for the establishment of a liberal economic order, and for its subsequent maintenance. The policies that state adopted and the multilateral institutions that were established helped realize that goal, but there were no guarantees that liberal trade and trade expansion was secure from political and external forces. Globalization, however, has added another important support for liberal trade that is much more significant than hegemonic leadership.

Another more recent example of how human decisions can play havoc with rational expectations was the British referendum on membership in the EU. When former Prime Minister David Cameron called for a referendum, he was confident that voters would choose to protect their, as well as British, economic interests. Instead, emotive issues, like immigration and sovereignty, carried the day. That forced the government to start a withdrawal process that it had not anticipated. The fact that unanticipated outcomes are not impossible, however, does not make the analysis wrong, only that we have to be mindful that individuals and groups will, at times, defy economic logic and behave unpredictably. As individuals, we do not always follow the course of perfect rationality, and, indeed, if we all followed a perfectly logical pattern, the world might be perfect but at the same time, be less interesting.

Finally, I must confess that this book is not what I had in mind when I started writing. In preparing the manuscript, there were a number of false starts and the final version of the manuscript turned out to be very different from the first draft. It took its current shape gradually as I learned more about the subject matter. Moreover, although my regional area of specialization is East Asian political economy, I did not set out to force Japan into a more prominent role in the globalization process. However, the connections gradually became obvious. I should add, however, that

Japan is not the intended hero in the narrative. Globalization was not a planned or deliberate policy initiative, rather a result of complex market forces.

I am grateful to several colleagues, at the American University in Cairo and elsewhere, including Kanishka Jayasuriya and Linda Weiss, who read and reviewed, or contributed their own ideas and pointed out the many flaws. I presented parts of the book at conferences and seminars and I acknowledge the feedback of participants and attendees. They helped make it a better book than I could have managed myself. I am grateful also to Zane Larwood, my research assistant, for his help with data collection, preparing some of the tables and figures, and general editorial assistance. For the flaws that remain, I am solely responsible.

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PART I

Origins of Globalization

CHAPTER 2

Globalization Revisited

As noted in the previous chapter, analysts attribute contemporary economic globalization to trade and economic liberalization after the Second World War. A related, commonly held position is that this is the second coming of globalization, after the late nineteenth century when Britain led a European transition to liberal trade. It is also assumed that trade liberalization was a primary determinant of the ubiquitous fragmentation of production that defines contemporary globalization. The role of technology is of course central to this fragmentation because without the revolutionary advances in communications and transport technologies, it would have been impossible to coordinate and manage the dispersed production units in real time and in a cost-effective manner. In each of the two periods of globalization, a dominant hegemonic power was instrumental to adoption of liberal trade practices. Nineteenth-century free trade began as unilateral British action that spread to other European countries to create a high level of trade integration, as measured by the percentage of trade to gross domestic product (GDP). When Britain transitioned to liberal trade, it was the leading manufacturing center and the policy shift was a self-interested act to benefit its manufacturers. The British economy prospered, and as other European countries followed suit, prosperity and welfare spread across the continent. This first episode of liberal trade in the modern period, however, did not last and collapsed early in the twentieth century. Several decades of turbulent global economic conditions, political

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conflicts, and two world wars followed. Thereafter, the USA led the restoration of liberal international economic relations in the late 1940s. In liberal economic theory, free trade is a rational policy choice for all states but has only ever materialized when a single hegemonic power assumed responsibility for leading other states to accept liberal trade. Application of the hegemonic principle in the late nineteenth and again in the late twentieth centuries implies a similarity between the two periods. There are similarities also in the role of technology to narrow the tyranny of distance. Breakthrough in transport and communications technologies, such as railroad and steamships, and telephone and telegraph, was a prominent feature of the late nineteenth century. These revolutionized communications systems but not nearly enough to make globally dispersed production a viable option, as happened in the contemporary period with the introduction of computer- and web-based communications in real time regardless of distance. Technology has nullified the 'coordination problem' as a factor for firms in deciding the most rational organization of production processes.

Modern technological advances are critical to globalized production. Without technology to overcome coordination issues, and substantial reductions in freight and shipping charges, it would have been impossible to link dispersed production sub-units in a seamless and cost-effective manner, or to assemble finished products with parts and components sourced in multiple and geographically dispersed locations. Nineteenth-century advances in communications technology could not have sustained globalized production. Yet, technology is no more than a facilitative variable. The real driver of globalized production was also not trade and economic liberalization, but precisely its antithesis, the neo-protectionist resurgence in the 1980s and the Japanese response to potential loss of access to foreign markets. Contrary also to the dominant explanation that contemporary globalization is, at least, its 'second coming,' I will show that it is historically unprecedented and unique. The uniqueness of contemporary globalization is essentially because of globalized production that was never possible at any earlier period in history.

Recent (and Not So Recent) Roots of Globalization

Even if short of a full consensus, a majority view is that contemporary globalization has deep historical roots. The assumption is that nineteenth-century interdependence/globalization and contemporary globalization

both originated in liberal trade policies, initiated and negotiated by the respective hegemonic power in the two periods. That is to say, state-driven policies instigated the growth of international trade and integration of economic markets and that there is a natural linear progression from liberal trade, passing through interdependence to its contemporary state. When seen as a progression from interdependence, globalization implies either deep or multiple interdependencies or both. Again, the implication is to deny a qualitative shift in favor of continuity, such that globalization today is neither unique nor unprecedented.

Nineteenth-century liberal trade began when Britain *unilaterally* repealed the so-called Corn Laws, a series of protectionist legislations to protect British farmers from cheap continental imports. The coverage of the laws extended beyond corn and restricted their import unless in the event of drought or crop failure. With repeal of Corn Laws in 1846, Britain became the first country to embrace relative free trade. The repeal was as much a practical necessity as it was a reflection of a belated conversion to the logic and dictates of free trade inspired by Adam Smith. As the principal producer and exporter of manufactured goods, Britain could not expect to continue exporting manufactures unless it was prepared to import farms products, because European countries obviously had to be able to export their agricultural products to Britain and acquire British Pounds in order to finance their import of British manufactured goods. British industrialists understood the links between exports and imports and that import liberalization was essential to continuing export success of British industry. There were as well other reasons for the repeal. One was that the Corn Laws were morally indefensible given that higher domestic prices for farm produce caused considerable distress to struggling working-class populations. It also hurt manufacturers because a higher cost of living meant that they had to pay relatively more in wages than in continental European countries. According to Holland (1980: 175), the proportion of arable land to population in Germany, for example, was much larger, and food prices 'markedly lower than in England, and the wages of artisan labour were lower.'

The Anti-Corn Law League (ACLL) that brought down agricultural protectionism was an unlikely alliance of different social and economic classes. The poor working class and industrialists formed the ACLL in 1836 to demand liberal trade. Robert Peel, the Conservative prime minister who had previously been a champion of trade protectionism, switched his views quickly, a move that Schonhardt-Bailey (2006) explained was necessary to prevent revolutionary upheaval led by the ACLL, or a major

reform of an aristocratic Parliament that was the focus of the even more radical group of Chartists. The strategy worked—repeal of the Corn Laws almost instantaneously blunted whatever force and momentum ACLL and the Chartist movement had acquired. There was, as such, a combination of economic and political factors that explains the repeal and it was fortuitous as well that tariffs were no longer an important revenue source for state finances. Tariff revenue had been important to public finance in early years but introduction of income tax in Britain provided the government with a new source of revenue and reduced its dependence on tariffs, although in the initial years after its introduction in 1799, revenue collection fell considerably short of government targets. Over time, however, the revenue base increased and it became possible to consider a trade-off with import tariffs. The transition to liberal trade was the result of a long campaign by its proponents, such as Adam Smith himself, and Richard Cobden.

Repeal of the Corn Laws was the first practical implementation of the principle of liberal trade. A measure of trade liberalization, in Britain, was the drop in tariff revenue from about 35 percent of the value of imports in 1841 to a mere 6 percent by 1881 (Harley 1994: 314). Since this was not because imports had fallen drastically under trade restrictive tariffs, we can safely conclude that import tariffs were no longer a serious impediment to import trade. Led by Britain, European countries also transitioned to liberal trade in the coming decades, and this ushered in a long period of trade growth and prosperity. Initially of course, there were voices of caution on the continent because not all were trusting of British motives. The German economist Friedrich List interpreted it as a clever conspiracy to structure world trade to Britain's perpetual advantage. In his conspiratorial view, liberal trade would consolidate Britain's position as the world's premier and only industrial power, and consign continental European countries to dependence on agriculture, becoming the breadbasket for an industrial Britain. Indeed, the British government tried to protect its industrial monopoly by prohibiting export of machineries but, ultimately, could not stem the spread of industrialization. Trade liberalization also spread. In 1860, a little over a decade after the repeal of Corn Laws, the Cobden-Chevalier Treaty between England and France reduced tariffs on bilateral trade. Britain reduced duties on French wines by 80 percent and reduced export tax on coal. The Treaty led to a doubling of British exports to France in that same decade as well as to a significantly expanded export of wine from France to Britain. Others, such as Italy,

Spain, and Switzerland, followed the British example and lowered their imports tariffs.

Interestingly, trade continued to expand even after protectionist policies began to reappear after 1879, first in Germany and then in France as well in 1892. Between 1870 and 1913, European exports as a share of total output increased, in real terms, from 10 percent to 16 percent, and globally the share went up from 4.6 percent to 8 percent (Trésor-Economics 2011: 2–3). Trade expansion contributed to better growth performance in Europe. Trade flourished not only between contiguous territories, but also between distant countries. Tea from India, silk from China, and spices from the East Indies were readily available to consumers in major European cities and consumption patterns became increasingly globalized. Globalization of consumption was, as it is always, intrinsic to trade liberalization and, from a Smithean perspective, an ideal state of affairs. Not surprisingly, globalization of consumption reappeared after trade was again liberalized, following the end of the Second World War.

Free trade and interdependence, in the late nineteenth century, also lowered inter-state tensions and this was one of the longest periods of peace on the continent. The peace dividend was not entirely a result of trade liberalization because there were other institutional forces also at work, such as the Concert of Europe, introduced after the Napoleonic Wars, to stabilize European politics through concerted and cooperative action among the five European powers (Britain, France, Russia, Austria, and Prussia). Trade nonetheless deepened multilateral interdependencies and strengthened the bases of peace. Apart from the peace dividend, trade liberalization also had a positive impact on economic growth and industrialization. However, even as overall national wealth expanded, there was unfortunately no immediate benefit to the working classes. As observed by Pamuk and van Zanden (2010: 219) 'a few profited quickly, many had to wait a lifetime before returns came in.' Both capitalism and liberal trade enriched a few but left the vast majority in continued impoverishment. That is not, however, an argument against the merits of either because economics is concerned, largely, with expanding the economic pie (total national wealth and overall prosperity) but distributional issues (of wealth and prosperity) are political decisions. Clearly, in the first century of capitalism and liberal trade policies, governmental inaction had failed a sizeable portion of European populations. Late in the nineteenth century, Thomas Greene introduced modifications to the classical liberal position of *laissez faire*.

The revised 'reform liberal' doctrine was inspired primarily by the perceived threat from Marxism but it was only several decades later that the ideas were put into practice. Reform liberalism did not sanction extensive state intervention in the realm of production but limited it to some presumed fair and equitable distribution of the national wealth and income, without which capitalist reproduction might be in potential jeopardy over the long term. From that initial departure from classical liberalism, Keynes, early in the twentieth century (but not early enough to help lessen the global impact of the Great Depression) added a new role for states in managing economic crises.

Following the long period of peace and prosperity in the nineteenth century, the first half of the twentieth century witnessed the tumult of two world wars, a Great Depression, and 'beggar thy neighbor' economic policies in Europe and America that undid all the gains of the previous 50 years. The trade-peace nexus looked less promising than before, and making matters worse, less than a century after the repeal of Corn Laws in UK, the American Congress deliberated the Smoot-Hawley tariffs that, when approved, triggered a global slide down the protectionist path. More than 1000 economists signed and submitted a petition reminding members of the Congress, and if that failed then the US President, that others,

> cannot permanently buy from us unless they are permitted to sell to us, and the more we restrict the transportation of goods from them by means of ever higher tariffs, the more we reduce the possibility of our exporting to them. (Eckes 1995: 133)

The petitioners essentially borrowed the successful message of the Anti-Corn Law League but were unsuccessful in stopping passage of the Smoot-Hawley tariffs, which added to the depth of an ongoing economic crisis. Crop failure and drought further exacerbated economic conditions and during the Great Depression, trade levels dropped across the world but for the USA, the single largest economy in the world, the decline in total trade (imports and exports) was precipitous, from approximately $9.5 billion in 1929 to $3.0 billion in 1933.

It is a puzzle as to why nineteenth-century liberal trade and economic prosperity broke down so quickly and completely. There are many possible explanations, although as I will show in Chap. 4, its fragility was largely because it incorporated only globalization of consumption, or interdependence. This was just one side of the market equation, and consumers have

historically been notoriously fickle and ineffective in articulating and protecting their interests. Another explanation, based on hegemonic-stability thesis, is that establishment and maintenance of liberal trade requires an asymmetric distribution of power in the international system. From this perspective, collapse of nineteenth-century liberal trade was a result of British economic decline and end of *Pax Britannica*. When the Great War ended, Britain was no longer the global economic and political superpower and in its place, the USA had emerged as the new global superpower. The USA was instrumental in negotiating the peace treaty that ended the War but beyond that, there was a complete failure to step into a global leadership position, even though it was now the new hegemonic power. The hegemonic-stability thesis provided an explanation for global economic instability in terms of American unpreparedness to shoulder the burden of global leadership.

After the Second World War, as noted above, the USA took the lead in re-establishing liberal trade on the principle of *reciprocity*, not British unilateralism. The USA also chose an institutional approach, in which the international community committed to rule-governed behavior, embedded in and enforced through a multilateral institution. There are clear advantages to a hegemon from free trade given its size and productivity, but on the other side of the ledger, the hegemonic-stability thesis required the hegemon to act as balancer of periodic supply–demand imbalances, particularly in times of economic downturn. In the absence of such a balancing mechanism, any liberal economic system is potentially at risk of spiraling into a protectionism. The USA took upon itself to be the balancer of periodic global supply and imbalances without which protectionism is an ever-present threat. In pursuit of an institutional framework, the American government negotiated the Havana Charter in 1948 to establish an International Trade Organization (ITO) that would facilitate trade expansion. The institutional approach, though ideal, was unsuccessful when mood in the US Congress turned against the formation of a global trade organization. One member of the US Congress described the ITO as an unconstitutional intrusion by foreigners on domestic policy (Zeiler 1999: 148). Even senior administration officials, including the Secretary of State, were not too committed to the free trade agenda, given that the USA was not a major trading country. Trade as a percentage of US GDP was only around 10 percent and remained at that level until the 1970s. Sensing the mood of the Congress, the administration decided against submitting the Havana Charter for ratification. Failure of the ITO was

partly because of its many protectionist critics but also because free trade purists in the business community felt that the Charter did not go far enough in bringing about free trade.

Instead of the ITO, the General Agreement on Tariffs and Trade (GATT) filled the institutional void and acquired a small secretariat in Geneva. As an institution, it was much smaller than the World Bank (WB) or the International Monetary Fund (IMF), but effective nonetheless in liberalizing global trade. It concentrated on trade in manufactured goods, which it liberalized through eight separate rounds of trade negotiations. A measure of its success is that trade growth outpaced growth in global output. The progressive expansion of trade in goods and services benefited consumers everywhere who now had a vastly expanded consumption frontier. Producers that were internationally competitive also gained from lower trade barriers. Alongside the expansion of trade in goods and services, capital flows also expanded in both periods. Table 2.1 provides world trade statistics to show increased economic interdependence in the two periods.

Stability of the second period of economic interdependence was buttressed by the GATT but America's relative economic decline and presumed loss of hegemony in the 1970s and 1980s adversely affected confidence in the future viability of the liberal order. Symptomatic of US decline was its resort to bilateral trade protectionist measures. These were inconsistent with GATT mandated rules of international trade. Even if there was no wholesale abandonment of liberal trade, it was enough to warrant concern. To counter the drift toward illiberal trade, GATT launched a new round of trade negotiations in the mid-1980s. The Uruguay Round (UR) began with a consensus to 'standstill and roll-back' protectionism. Negotiations continued beyond the scheduled completion date and produced important agreements, including a phase-out of quantitative restrictions on textile trade and establishment of the World

Table 2.1 Share of world exports in world GDP (%)

1870	4.6
1913	7.9
1950	5.5
1973	10.5
1998	17.2

Source: *World Trade Report 2013*, World Trade Organization, Geneva, p. 47

Trade Organization. Successful completion of UR removed the threat of trade instability, but equally important to this was US economic recovery and a sense of hegemonic renewal. Both liberal trade and hegemony have proved resilient and enduring. Nonetheless, this episode of protectionism turned out to have important consequences, becoming a catalyst for contemporary economic globalization. It instigated a globalization of production that has strengthened the foundations of liberal trade beyond the hegemonic principle, as detailed below. Unlike in the nineteenth century, contemporary globalization includes a network of geographically dispersed but integrated manufacturing units, which does not logically flow from opportunities provided by trade liberalization. Its catalysts lie elsewhere, as explained further below.

The trajectory from liberal trade to globalization passed through a period of interdependence (and globalization of consumption) between countries. Koehane and Nye, in *Power and Interdependence* (1977), introduced complex interdependence as a concept to highlight high levels of mutual dependence between countries at multiple levels. Interdependent relations meant that while there were considerable flow-on benefits, disruptions in dyadic dependencies could impose substantial sensitivity (short-term and relatively easily overcome) and vulnerability (longer-term and harder to overcome) costs to both. Following the logic of this analysis, just as complex interdependence was an extension of interdependence we can interpret contemporary globalization as an extension of complex interdependence, with the additional dimension of dispersed manufacturing networks. Barry Jones (1995: 93), for example, argued that globalization overlapped significantly with interdependence with the main difference being that globalization allowed a greater role for transnational corporations (TNCs) in the standardization of production technologies. Today, TNCs are, at times, in contention with states and their growing dominance may threaten the functioning of nation-states and of governmental authority to regulate their activities. Although TNCs span across the two periods, the logic responsible for dispersion of production is particular to the second and not the same as that which led to interdependence and complex interdependence.

Nonetheless, the consensus position is that contemporary globalization is essentially a continuation of nineteenth-century economic and trade integration resulting from liberal trade policies. Claiming that the precise triggers of economic globalization were unclear, Krugman (2009: 26) confidently suggested that some 'combination of factors that we still don't

fully understand—lower tariff barriers, improved telecommunications, the advent of cheap air transport—reduced the disadvantages of producing in (other) countries.' Krugman (1994) pioneered spatial economics, which suggested that firms base their production and locational decisions partly on transportation costs, such that when exports expands and transport costs become substantial, firms decide to locate production closer to destination markets. This may indeed explain some of the foreign direct investment (FDI) patterns but does not explain either the fragmentation of the production chain, or the apparent reluctance of Japanese car manufacturers to invest in the USA until after the imposition of a voluntary export restraint (VER) agreement in the early 1980s. The USA was the largest foreign market for Japanese car manufacturers and their preference had been to supply it solely through exports. Krugman and others also emphasize the importance of market liberalization in the emergence of globalization and from that perspective, the ubiquity of GPNs should come as no surprise. Similarly, Thomas Friedman (2000: 106) suggested that globalization began with the liberalizing agenda of Margaret Thatcher in Britain, Ronald Reagan in the USA, and the subsequent global liberal push as part of the so-called Washington Consensus whereby multilateral agencies like the World Bank and the IMF brought the liberal agenda to developing countries. Alongside liberalization, most analysts also stress the importance of technological advances that have allowed an unprecedented level of integration through, for instance, computers and Internet and cheap air travel. Hufbauer and Suominen (2010: 7) attributed the origins of globalization to three principal drivers: technology; economic growth and prosperity; and open domestic policies and trade liberalization. Yarbrough and Yarbrough (1997: 91–94), and Szirmai et al. (2013: 24) too, identified trade liberalization and technology as the main sources of economic globalization.

The reality is that trade liberalization facilitates exports, but does not logically require the relocation or disaggregation of manufacturing facilities to other countries. Trade liberalization was still important for globalization, but for only globalization of consumption. Standard explanations gloss over, or ignore a key intervening factor that contributed to the emergence of global production networks, a central characteristic of contemporary economic globalization. Economic globalization as globalization of production and networked manufacturing has multiple determinants, the most important of which was protectionism rather than trade liberalization.

Like Huntington and waves of democratization, Geoffrey Jones (2005: 20) identified similar waves of globalization in which the first wave was between 1880 and 1929 and the second 'new' wave from 1979 onward. According to him, similarities extended also to the technological shift experienced by contemporaries in each of the two periods. For individuals living in the nineteenth century, advances in information and communications technologies (ICT), such as telephone and telegraph, and steamships and railroads, were just as revolutionary as modern day computer-based communications technology. It was a quantum leap from earlier, non-mechanical means of communication, even if still very slow and expensive by today's standards. However, contemporary globalization, too, is a quantum leap from interdependence. It did not stem from a gradual, incremental, and linear progression from liberal trade and interdependence between countries, but from a Kuhnian (Kuhn 1970) step-function transformation within capitalism, involving firstly, the rise of neo-protectionism and secondly, the revaluation of currencies. Globalization has not transformed capitalism *per se* but it constitutes a shift in a manner similar to the transition from competitive to monopoly capitalism. Globalized production has taken Smith's call for division of labor on the factory floor to the global stage, where the global factory is made of an interconnected network of dispersed production units. These production units and tasks are, in a globalizing economy, located in areas of specific locational advantages. In the process, as we shall see later on, there have been momentous changes to the roles of producers and consumers in the global economy.

According to Gibbon and Ponte (2005: 2), early enthusiasts of globalization, like Ohmae, argued that this was, indeed, a radical new departure, 'unmatched during any previous stage in history.' Ohmae's book on a 'borderless world,' first published in 1990, however, was not taken very seriously by scholars, presumably because he had minimal academic credibility and was regarded, instead, as a popular writer. Gibbon and Ponte continue that since then revolutionary globalization had died a slow 'death by a thousand qualifications,' inflicted first by Hirst and Thompson (1996). They set the bar high and argued that true globalization required, first, a complete re-articulation of national economies into a new system of global transactions and processes; second, global governance; and third, a replacement of multinational corporations with truly footloose transnational corporations. Hirst and Thompson (1996: 78) acknowledged the increase in international capital flows by multinational corporations

(MNCs) but maintained that analysis based on capital flows presented a distorted picture that played down the relative importance of home markets to foreign economic activity. According to them, there was no evidence that the global was in the process of replacing the national, and that only a fortuitous Allied victory in the Second World War and exercise of American hegemony had made it possible to recommence a journey of trade liberalization and internationalization begin in the nineteenth century. Globalization, implying a march toward a global economy, therefore was really a misnomer, but since it had caught everyone's imagination, Hirst and Thompson simply redefined it as internationalization, and retroactively applied the term also to the late nineteenth century. For them, globalization was not a structural and enduring shift but like before, subject to cyclical change. Thus, they argued that 'there is no reason to assume that (globalization) will continue indefinitely or that they have an inherent dynamic that prevails over all countervailing forces.' (Hirst and Thompson 2002: 248). That they raised the bar very high was not a problem, but their error was in the failure to grasp the true essence of ongoing changes or to imagine the transformational forces in play. They concluded that globalization leading to a global economy was not only not credible but equally, as well, unlikely because citizens of democratic polities were not likely to countenance such an outcome, where control and authority structures were fundamentally reorganized to the detriment of familiar national structures of regulation.

Globalization, like democracy, is a process, and one that has very recent origins. We may also never arrive at the perfect ideal of a global economy as the end state of globalization, but it is unlike anything that we have experienced in the past. Hirst and Thomson are probably correct to reject the likelihood of a global economy taking shape in the immediate future, but even so, the forward momentum of globalization is also irreversible, even if there are periodic stops and starts, not reversals, resulting from the particular interests of different domestic constituencies or unpredictable circumstances. Dani Rodrik (1997: 71), like Hirst and Thompson, agreed that contemporary globalization was a re-creation of nineteenth-century interdependence but acknowledged, as well, that contemporary globalization, given a high level of technology and global connectivity, was irreversible barring improbable and extreme protectionism that resulted in more harm than good.

Once Hirst and Thompson had created an opening, others soon followed their example. We can include in this group Gilpin (2000: 18–19),

Morrison (2012), Keohane and Nye (2000), Beaud (2001: 279), Sachs (2005), Frankel (2000: 46), and many others. Morrison, and Hirst and Thompson, for example, argue that nineteenth century was the 'First Era of Globalization.' Similarly, Keohane and Nye (2000: 7) attribute 'ancient roots' to contemporary globalization, even suggesting that there has never been anything but globalization, at times 'thick,' other times 'thin.' Thus, in their conceptualization, nineteenth century and contemporary periods are periods of 'thick' globalization, with periods of varying 'thinness' in between. In one fell swoop, it reduced globalization to the mundane and we have not been able to recover from our self-inflicted wounds. In its extremely loose usage, globalization has simply come to signify any period of lower trade restrictions, and conversely, de-globalization any period of higher tariffs. Thus, in their study of Latin American economic development, Luis Bertola and Jeffrey O. Williamson (2006: 31) write that higher tariffs after independence in the nineteenth century 'induced deglobalization in the young Latin American republics.' It is important to rescue and reclaim globalization from misuse and give it specificity so that it actually represents something particular. Indeed, in the same volume of the *Cambridge Economic History of Latin America*, Alan Taylor (2006: 58, emphasis added) writes of four waves of globalization since European conquest, according to a 'persuasive chronology of that *slippery concept*.' Globalization has become a very loose and pliable concept to mean primarily some form of integration through trade but used in that context, there is no distinction made between trade in finished products for final consumption, and that of trade in parts and components, or intermediate goods, that are of interest mainly to other producers and manufacturers. However, based on precisely such a distinction, it is possible to identify two forms of globalization: that of globalization of consumption benefiting individual consumers, and that of globalization of production, a fragmented production strategy, benefiting mainly producers. Earlier periods of globalization were limited to globalization of consumption that was possible because of trade liberalization. Only the contemporary period encompasses both globalization of consumption and globalization of production. To the extent that this differentiation is meaningful, it is important not to conflate globalization and interdependence as interchangeable concepts. Interdependence best describes integration of economies at the level of consumption goods and services and there were many such periods before the term came to be widely used in the 1970s. Globalization, in contrast, best describes contemporary developments

and the combined development of globalization of consumption and of production, which encompasses the entirety of capitalist market transactions. It is, however, not the choice of terminology that is important but rather the distinction between the two forms of economic integration.

However, even with the ubiquity of globalized production and global supply chains, the literature on globalization still tends to define it largely in terms of trade liberalization and the nineteenth-century variant of globalization. In their article exploring, and questioning, the trade-peace linkage, Martin et al. (2008: 865) identify, for example, two periods of globalization, one in the late nineteenth century and the second after the Second World War, and define both periods essentially in terms of 'increasing trade flows and the spread of free markets.'

In the 1970s, Keohane and Nye made important and path-breaking contributions to the literature on interdependence between countries and, quite understandably, reluctant to discard that concept and chose to define globalization as 'multiple interdependencies.' If interdependence implied a state of affairs between a pair of countries, each dependent on the other, globalization simply became an extension of interdependence into a complex web of interlinking networks between a large number of countries, and across multi-continental distances. In this understanding, there is nothing intrinsically distinctive about globalization: it is simply multi-dyadic interdependence extending over large continental distances, implying that networks are global instead of simply regional or local. Indeed, Akira Iriye (2014) writes it as 'global interdependence.' He added, however, that twentieth-century globalization was distinct from its nineteenth-century variant in that while the latter was Western and European in character, modern globalization was largely non-Western in origin in its emerging economies and included also non-state actors. Still, he failed to give credit either to Western neo-protectionism as the great catalyst for global production networks, or to its target country, Japan, for bringing its production technologies to the West, which eventually transformed manufacturing globally.

Similarly, Barry Jones (1995) conflated globalization to interdependence, suggesting a basic similarity between these two concepts and Friedman (2000) stretched out its historical connections even further back in time. He identified three continuous periods of economic globalization since the sixteenth century with a different agent of change in each: states and governments in the sixteenth to the eighteenth centuries; multinational corporations in the nineteenth and twentieth centuries; and individuals in

the contemporary period of globalization from the twenty-first century onward. The inclination to trace historical roots is so pervasive that scholars use terms with only modern referents to historical times, as when Friedman identified the contemporary period as Globalization v.3.0 and earlier times as v.1 and v.2. To this, Moore and Lewis (2009) added an even earlier period of globalization, duly classified as v. 0.5. The suggestion is that each new version was a logical and natural progression of an earlier format. From a Marxist perspective, there is the same historical continuity and Mark Rupert and Scott Solomon (2006) write that the 'time-space compression' that defines globalization, time compression because of the information and communications technology (ICT) revolution and space compression because of liberalization, is an essential continuity since the start of Smith's call to 'truck, barter, and trade.' Interestingly, Keynes too had observed in his time what we see as a defining feature of globalization, the globalization of consumption. According to Keynes (as cited in Rupert and Solomon 2006: 8):

> The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth … and reasonably expect their early delivery upon his doorstep.

Collectively, these scholars adopt a position that, in the modern period, trade liberalization that began in the 1950s, after the Second World War, expanded global trade and led initially to economic interdependence and ultimately to economic globalization, a state of profound, deep, or thick interdependence. According to this formulation, liberal trade, economic interdependence, and globalization are all located on the same continuum. However, discussing the continuities and discontinuities, Bordo et al. (2000) point out, correctly, that all 'back to the future' analyses miss the point that contemporary globalization represented a far greater level of integration than existed in the late nineteenth century and before the First World War. This too, however, underplays the differences between contemporary globalization and earlier periods of interdependence.

An important difference is the way firms have adopted a globally networked production strategy that was simply not possible in earlier times. It began not with trade liberalization but as the unintended consequence of protectionist trade policies in the early 1980s. While this is a counter-intuitive assertion, I will show, in the following chapter how neo-protectionism became a catalyst for networked manufacturing, the

first step in the eventual transition to global production networks and globalization of production.

Unlike interdependence in the nineteenth century and the 1970s, globalization is a better descriptor of contemporary developments because it incorporates and integrates, at the global level, both forms of market activity. In the nineteenth century and after the Second World War, globalization of consumption integrated the world into a single market for consumers, and today globalization of production is in the process of doing the same for producers. The two processes do not derive from the same initial conditions and, as such, contemporary globalization, incorporating its two sub-components, is not a linear extension of postwar interdependence, nor a resumption of the nineteenth-century journey. Overall, however, there is insufficient attention given to a comparative analysis of the two concepts and in explaining why globalization is, indeed, a proper descriptor of contemporary realities but not for the nineteenth century. It is important to add specificity that makes it distinct and different from interdependence. However, as a concept, globalization remains under-conceptualized almost as if buzzwords require no careful explication because their meaning is somehow implicitly clear and well understood.

Lack of conceptual clarity has contributed to misconceptions about globalization, at least to the extent that we attribute the emergence of global production networks that define contemporary globalization to trade liberalization. All definitions of globalization include spatial dispersion and disaggregation of production across different countries but it is important to highlight that this is not a natural progression of market liberalization. Although economic interdependence is a logical consequence of trade liberalization, globalization is not an extension of interdependence facilitated by advances in communications technology. Such an understanding is simplistic and belittles the true significance of globalization, both in terms of causal influences and consequences. The reality is that globalization is much more than 'deep' or 'thick' interdependence between countries. However, assumptions of an essential similarity have mistakenly led us to assume that it is possible to check its advance, even reverse it, in ways similar to the rise and decline of economic interdependence in the nineteenth and early twentieth century. Critics of globalization, for example, who decry distributional inequities, both within and across countries, attribute it to globalization and, consequently, urge its reversal. Reversal, or de-globalization, is a possibility if we consider globalization as a continuation of nineteenth-century interdependence. From

that standpoint, if nineteenth-century interdependence proved impermanent, then contemporary globalization, too, can potentially be scaled back and the genie returned to the bottle. Among its critics, Walden Bello (2002) argues in favor of de-globalization. In the aftermath of the global financial crisis of 2008 and the sharp drop in global trade, de-globalization was, for a short time at least considered a distinct possibility, on the assumption that globalization and interdependence were essentially similar. That, however, is an invalid assumption.

It is neither the state nor its direct political decisions that have driven the machinery of economic globalization, but rather private sector initiatives to organize production more efficiently. Strictly speaking, globalization was instigated by state-level neo-protectionism but its primary actors and drivers were private sector entities, corporations threatened by loss of access to markets and encouraged into networked production for reasons of international trade competitiveness. Globalized production and emerging economic globalization have been overwhelmingly beneficial to both developed and developing economies, but are not without challenges. For instance, the period of globalization has coincided with increasing economic inequality within countries and this is a challenge to states because if left unchecked, this inequality can tear into the social fabric of individual societies. This glaring political failure has undone some of the cohesive features of post–New Deal Western societies. Many have alluded to this basic flaw, including Thomas Piketty (2014), but states have generally avoided the hard political decisions to achieve a fairer distribution of benefits. Consequently, the sense and reality of a widening divide between the so-called 1 percent who have largely monopolized the gains, and the 99 percent whose welfare has either stagnated or suffered in relative terms has been a source of popular frustration and angst. Some may welcome the prospect of de-globalization but this is not a likely future scenario, even from a perspective of events that marked the year 2016, such as Brexit, the anti-globalization mood of many US voters that propelled Trump to the presidency, and the rise of right-wing nationalist political parties in several other Western countries. I will return to this discussion in the concluding chapter but intervening chapters will set out my reasons for not giving too much credibility to the de-globalization sentiment. There are clear anti-globalization forces at work but these are not in a position to instigate a comprehensive roll-back.

Redefining Globalization

Contemporary economic globalization is a composite of globalization of consumption and globalization of production. Like all markets, the global market comprises two forces of supply and demand, and of production and consumption, respectively. Before contemporary economic globalization, the world had only ever witnessed period of globalization of demand and consumption. Globalization of production in the late twentieth century, however, completed the picture by adding the missing element of supply. The two market forces, at the global level, derive from different stimuli. Globalization of consumption can be traced to trade liberalization after the Second World War, but the latter is largely a product of neo-protectionism in the 1970s and 1980s, facilitated by advances in ICT that made it possible to connect the different units in a segmented manufacturing process in real time, despite large geographic distances. It is both unique in its fundamentals and transformative in its implications. It is unique because globalization of production is unprecedented, and does not logically follow from any classical and neo-classical theoretical formulations. On the other hand, globalization of consumption in the late nineteenth century was simply a triumph of liberal market principles, as advanced and advocated by Adam Smith. Economic globalization today includes the same liberal trade policies and its realization is a reflection both of 'enlightened' policies, and of forced conversion through structural adjustment programs of the IMF. The guiding principles of structural adjustment included trade liberalization, deregulation, privatization, and fiscal discipline, and became known as the Washington Consensus. In the Consensus, the role of the 'intellectual and ideological leader' was assigned to the US government and the Treasury Department, whereas its 'dedicated global enforcers' were multilateral agencies like the IMF and World Bank. These multilateral agencies were successful enforcers because they were stepping into a situation where a country in crisis could not ignore the neo-classical policy prescriptions as a condition for financial bailout packages. Often, technocrats in positions of power in the so-called client countries were important to the enforcement process. In these countries, a genuine and shared sense of interest allowed the IMF and World Bank to facilitate transition to a more liberal market-based economy (Woods 2006: 66).

However, contemporary globalization extends beyond liberal trade in goods and services for the benefit of consumers, as envisioned by Adam Smith and later neo-classical theorists. Liberal theories have the central

goal of bringing about a globalization of consumption in which consumers gain access to the global market place. Trade liberalization also leads to improved growth and welfare outcomes and shifts the individual, and aggregated, consumption-possibility frontier further to the right, but contemporary globalization incorporates an additional dimension of globalization of production, which stems from an ever-widening web of global production networks and disaggregation of a single production function across different and distant locations. According to Henry Yeung and Neil Coe (2015: 32), a global production network is 'an organizational arrangement comprising interconnected economic and noneconomic actors coordinated by a global lead firm and producing goods or services across multiple geographic locations for worldwide markets.' Horizontal integration of geographically dispersed units had been a long-standing feature of multinational production and of foreign direct investment but the remarkable new feature is vertical disaggregation of a single production function across countries. In the process, the nature of consumption has changed. Unlike in feudalism, capitalism separated out the roles of consumers and producers but globalization is, again, in the process of collapsing the two. This has important flow-on consequences.

Globalization of production has developed rapidly over the previous three decades. Consequently, international trade today is increasingly in components and parts for use as inputs in a disaggregated production process, rather than in finished products for the market place. As mentioned, liberal theories have always advocated trade as beneficial to consumers but trade is also important, as Adam Smith recognized, for producers who can through increased division of labor achieve higher productivity and efficiency gains. In the contemporary period, globalization of production has increased the trade relevance to manufacturers, but this time as *consumers* of intermediate goods. As such, the line separating production and consumption is indistinct, and producers have become, as well, consumers in the new global reality. There are two categories of consumers, those of manufactured parts and intermediate goods, and those of finished consumer products or individual consumers. The former category of consumers have heightened prominence in global economic activities. To some extent, producers always were consumers, but of industrial raw materials. Now, they have become important consumers of machined products, as reflected in the growing dominance of trade in parts and components in total world trade, much of it carried out within networked value chains and GPNs.

These production networks have become powerful forces of global integration with both positive and negative consequences. On the plus side, industrialization has spread to developing countries but production everywhere is also more vulnerable than ever before to disruptions in any single location, whether from natural causes like tsunami and earthquakes, or deliberate actions like political conflict. For example, flooding in Bangkok and surrounding regions in 2011 disrupted manufacture in Japan as did also popular unrest and agitation against Japanese interests in China during the Sino-Japanese conflict of 2012. The lingering fragility of globally networked production creates powerful incentives for industries to insulate their networks from human-induced disruptions. This admittedly is not an easy task when powerful nationalist and political forces are at work.

Geographically dispersed production systems are practical and viable only because of technological breakthroughs that have shrunk both time and space, and made it possible to communicate across vast distances in real time and at minimal costs. Technology, however, is an enabling condition but does not explain change, such as the emergence of globally disaggregated production processes. By attributing globalization to technology and trade liberalization, the dominant narrative has obfuscated the immediate trigger for the spread of global production. Moreover, by linking it to a further consolidation of liberal trade, it has confused cause and effect. My argument avoids this circularity and I will show that there is demonstrable evidence to link globally disaggregated production to neo-protectionist trade practices in the 1970s and 1980s, which has indeed strengthened liberal trade. The truly unique and distinctive feature of twentieth-century globalization is *globalization of production*. The neo-protectionist episode of the 1980s laid the groundwork for disaggregated, but networked, manufacturing that is the defining feature of globalization of production. The two component parts of globalization are also mutually independent and one does not presuppose the other. They are parallel formations as shown in Fig. 2.1.

Nineteenth- and mid-twentieth-century 'globalizations' (before the late 1980s) are properly described as interdependence and were a partial subset of the contemporary economic globalization that incorporates a globalization of both supply (production) and demand (consumption) functions. In the rest of the book, I will use the term 'interdependence' to refer to earlier periods of economic integration and reserve globalization to signify developments since the 1980s. The difference is qualitative and

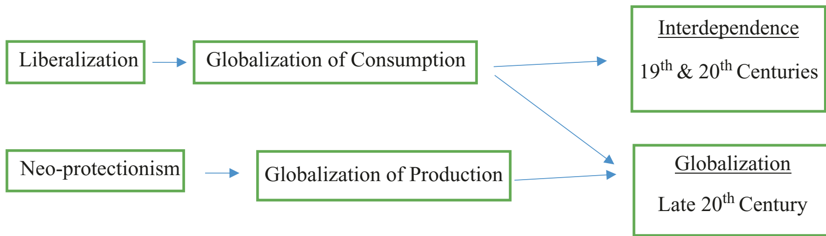

Fig. 2.1 A schematic representation of interdependence and globalization

not one simply of degree. Contemporary globalization is not a deeper and more comprehensive form of nineteenth-century interdependence, but qualitatively different.

Samuel S. Kim's analysis of globalization emphasized its two demand and supply side components and its truly global spread following the end of the Cold War. He identified the following as the main elements and attributes of globalization (Kim 2000: 7):

1. The end of the Cold War and collapse of socialism led to a reprioritization of the dominant issues in global politics and to a fully integrated global economy.
2. The extraordinary advances in communications technology, which led to a rapid decline in transportation, telecommunications, and computing costs, led to erosion of the barriers of space and time.
3. The presence of globalization of production in the contemporary period and its absence in earlier globalization.
4. The linking of developing countries into the global system, and as 'partners' not 'colonial dependencies.'

Clearly, there is a degree of overlap between contemporary globalization and nineteenth-century interdependence not only in the globalization of consumption but also in the coincidence of a technological revolution in each of the two periods. Nineteenth-century interdependence also accompanied a revolution in communications technology with the invention of telephone, telegraph, and steam locomotion. However, the differences are significant. Not only is globalization of production historically unique, but it also has important consequences for the emerging global economy.

Conclusion

Globalization is a commonly used term to describe contemporary economic realities and in this chapter, I presented as faithfully as possible the dominant narrative, and then a revised understanding of globalization. The existing literature on globalization conflates it with earlier periods of trade interdependence in the nineteenth century or in the 1970s but globalization is historically unprecedented. It is a composite of two different economic forces, of consumption and of production but in the dominant understanding of it, the focus has mainly been on the consumption aspect of globalization that originated primarily because of economic liberalization and trade integration. The literature also considers trade liberalization as the main reason for the emergence of globalized production processes, facilitated by technological advances, but such an analysis 'normalizes' contemporary globalization. Instead, I argue that it is unique and unprecedented and a result of neo-protectionism in the 1980s. Neo-protectionism, not liberal trade, explains more of the variance in the way a globalizing economy has reorganized production. Targeted American restrictions on Japanese car imports provided a breathing space to American producers from Japanese competition. In turn, it also prompted manufacturers in Japan to invest in production facilities in the USA so that they could bypass the protectionist hurdle. The US government welcomed the inflow of Japanese investments as necessary to rejuvenate a declining industry and for the employment that it generated. Japanese investments did not disappoint but in the process of reviving a failing auto industry, the transplant of Japanese manufacturing technologies helped to advance networked manufacturing on a global scale. The transfer of Japanese manufacturing processes and the *keiretsu* relationships between the main firm and subcontractors ultimately became the basis for global production networks and global production. In the next chapter, I will present a detailed analysis of how protectionism became a force for the establishment of globalized production that constitutes the core of contemporary globalization. In introducing neo-protectionist restrictions on Japanese imports, the US government did expect it to encourage Japanese investment and production in the USA, to compensate for lower exports, but what was not expected was the way Japanese investments would revolutionize the nature of production. As Japanese firms expanded overseas, they essentially replicated their own domestic networked production processes on a global scale.

Economic globalization is unlike anything that has existed in the past but the thread of an assumed continuity from the nineteenth century onward still runs through many scholarly analyses of it. In 2016, in light of the Brexit decision and Donald Trump's election to the US presidency after a campaign that included many bombastic anti-globalization pronouncement, one conclusion is that the second wave of globalization is about to break. In his speculative assessment about the second wave of globalization, Laurence Chandy (2016) benchmarked the two period of globalization in terms of merchandise trade, foreign capital stock, and migration. Table 2.2 shows that contemporary globalization had surpassed nineteenth-century globalization in two of the three indicators.

It is noteworthy that his benchmarking indicators did not include the extent of globalized production in the second wave, because there is really no parallel to it in the first. Chandy produced his assessment about the future of globalization following the Brexit decision but before Trump's election to the presidency. The latter would seem to reinforce his basic conclusion that, while 'globalization is not yet in retreat, it seems likely that globalization is at an inflection point … the coming years will be characterized either by stabilization in the level of globalization, or further growth in the degree of integration but at a more modest pace than in the past.' Neither stabilization nor modest expansion is a 'breaking' of the wave and, indeed, if my interpretation of globalization is correct, then a retreat is highly unlikely, if not impossible. The complex production networks that firms have established in many of the leading industries cannot be reverted to traditional manufacturing practices and so, even if the pace

Table 2.2 Globalization across two waves

	Wave 1 peak (%)	*Year of wave 1 peak*	*Year wave 1 Peak passed*	*Wave 2 peak (%)*	*Year of wave 2 peak*
Merchandise exports	7.9	1913	1971	19.8	2008
Foreign capital stock	32.4	1914	–	29.8	2014 (today)
Migrant stock	2.5	1914	1988	3.3	2015 (today)

Source: Chandy (2016: 13)

of globalized production tapers off, reversal is hardly a credible option. In later chapters, I will discuss the challenges posed by Brexit and a seemingly protectionist new administration in the USA. Before that and in Chap. 4, however, I will provide a logical explanation for the irreversibility of globalization, barring a revolutionary collapse of capitalism. That is improbable and we can safely assume that political leaders will not let matters slide to that extent and act to safeguard against it, just as previous generations of political leaders had intervened to ameliorate the negative externalities of capitalism in the nineteenth and early twentieth centuries.

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CHAPTER 3

Protectionism and Global Production Networks

In the previous chapter, I argued that globalization is historically unique and unprecedented, and defined it as a combination of globalization of production and of globalization of consumption. The former signifies production that is spatially disaggregated, but networked. Adam Smith, more than 200 years earlier, had advocated division of labor on the factory floor, but contemporary globalization has redefined the factory on a planetary scale. The physical separation between the different requisite tasks is immaterial because advanced communications and transportations technologies have compressed space and time, and made possible the emergence of global factories. If technology made it feasible, protectionism was the ultimate catalyst behind this development.

Of course, there are elements of the past in almost everything that is new. Globalization of consumption, for example, existed in the late nineteenth century and was then, as it is now, a result of liberal economic policies. However, the totality of contemporary globalization, and the inclusion of globalization of production is unprecedented. In this chapter, my focus is to link the causal roots of globalization of production, or globally networked production, to American neo-protectionist policies of the 1970s and 1980s. I will sketch out the connection between protectionism and globalization, and explain how networked manufacturing processes that were common in Japan spread to western firms, leading to global 'Japanization' (Oliver and Wilkinson 1992). In the literature, the role of

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protectionism in catalyzing and fomenting economic globalization has gone largely unrecognized, but it cannot be underplayed. While interdependence in the nineteenth century (an incomplete form of globalization consisting only of globalization of consumption) was a result of trade liberalization, economic globalization today is the unintended consequence of two separate causative processes—the progression of postwar trade and economic liberalization *and* the spread of neo-protectionist measures several decades later. Rather than conflate the two forms of globalization, it is best to treat 'similar' periods in the past as that of interdependence between countries and reserve globalization for contemporary developments. Earlier periods share only one of the two features that defines contemporary economic globalization. Globalization has revolutionized manufacturing in many industries but it is a revolution without a heroic cast. After all, its origins go back to theoretically indefensible economic practices, at least according to the prevailing orthodoxy. Attributing globalization, a liberal integration of national economies, to its antithesis may be odd and misconstrued as giving a heroic status to protectionism. There is nothing heroic about trade protection, but globalization, as networked global production, began as a defensive response to protectionism in the 1980s. It was facilitated by technological advances and transportation cost reductions but these were not, unlike common characterizations (Ma 2006), the main reasons for fragmentation of production. Fragmented production includes both vertically integrated manufacturing within a firm, but across different countries, and arms-length subcontracting activities. Not surprisingly, fragmented manufacturing has had a significant impact on international trade and according to estimates based on data for the late 1990s, roughly 30 percent of international trade in manufactures was in parts and components related to globalized production (see Ma 2006). This form of economic globalization is equivalent to a tectonic shift and contains a logic that is substantially different from that of interdependence. It may have made sense to rename the Great War as the first of two world wars, after a second outbreak within a short span of time, but it is useful to avoid renaming periods of past interdependence retroactively as globalization because that dilutes the singularity of the contemporary period.

Globalized production was a result of neo-protectionism that targeted Japanese exports to the USA and were outside General Agreement on Tariffs and Trade (GATT)-approved schemes that required all liberalizing, and likewise all trade-restrictive measures, to adhere to the fundamental principle of multilateralism. Neo-protectionism deviated also from

rules-based mechanisms, such as tariffs, to impose quantitative restrictions on imports. These results-based and quantitative instruments bypassed GATT. One explanation for this unilateral and arbitrary imposition of sanctions was the cumbersome nature of GATT-approved processes, which required lengthy and complicated deliberations. The US government, instead, was anxious for quick remedies to perceived unfair import competition. The three main neo-protectionist instruments were the Trigger Price Mechanism (TPM) on steel, Orderly Marketing Agreement (OMA) on color television sets, and Voluntary Export Restraint (VER) on automobiles. It was the last of these policy instruments that had the greatest trade-disruptive effect. It established annual ceilings on Japanese exports of cars to the USA. The imposition of export restrictions reflected, in part, a power imbalance at a bilateral level that allowed the USA to dictate trade terms. Japanese vulnerability stemmed largely from its dependence on US defense and security guarantees.

The terms of the VER on cars required Japanese manufacturers to reduce their volume of exports and, in effect, their percentage share of the US market, so that American manufacturers could increase production and return to profitability. For Japanese manufacturers, intent on protecting market shares in the USA, it became necessary to supplement exports with local manufacturing in the USA. This shift in Japanese marketing strategy was an almost immediate outcome of the VER, and welcomed by the USA as helping to rejuvenate its flagging industrial competitiveness. Prior to the imposition of quantitative limits, Japanese manufacturers had relied almost exclusively on exports to service foreign demand. The VER ended the viability of that business model. Moreover, American imposition of VER prompted other advanced countries to follow suit with similar restrictions, for fear of a surge in Japanese exports and harm to their industries. In years following the imposition of export restraint, Japanese FDI to the USA and other countries increased significantly so that they could continue to supply foreign markets with a combination of exports, capped at a level lower than before, and increased local production. Indeed, the American government had held out the hope that export restrictions would induce Japanese firms to set up production facilities in the USA, contribute to industrial renaissance, and generate new employment opportunities. In this, not only did neo-protectionism not disappoint, but actually accomplished much more than might have been anticipated. Alongside Japanese FDI came Japanese manufacturing technologies, chiefly that of networked manufacturing and these have since revolutionized manufacturing on a global scale.

At the same time, despite Jones' (1995, See also James 1999) cautionary advice against reading too much into contemporary globalization, I will show that it has a degree of permanence unlike any previous form of economic integration. Economic globalization is unlikely to break down in the way that nineteenth-century-trade liberalization did; nor is it likely to suffer a reversal in any significant way. Claims, such as this, are, as Barry Jones points out, always risky given the changeability of things, but globalization, as I will show, is a relatively enduring reality. Not all countries participate equally in the global economy but those that have developed integrated or otherwise networked production across borders are less, or not at all, susceptible to de-globalization. In the past, interdependence based on trade in consumer goods was always at the mercy of protectionist pressures, and protectionism, in turn, waxed and waned with fluctuations in the economic cycle. However, in a globalized economy, the correlation between economic cycles and protectionism is weak to non-existent, and the threat of de-globalization is less of a practical concern. I discuss these issues in the next chapter, but here I will trace its origins to the period of neo-protectionism in the 1970s and 1980s.

Revisionists and Results-Oriented Trade

The immediate trigger for emergence of global production networks was American neo-protectionism in the early 1980s. That was the first step in the process of globalizing the common practice of networked, rather than in-house, manufacturing of Japanese firms. Network manufacturing existed in Japan before it became global, and neo-protectionism was instrumental in its global diffusion. Neo-protectionist instruments targeted Japanese manufacturers and imposed quantitative limits on their exports with the purpose of forcing them to increase local production in the USA rather than rely on exports from Japan, and to give a breathing space to American manufacturers to restructure and recover their competitiveness. Other western countries followed suit, concerned that limited access to the US market would force Japanese producers to expand exports elsewhere. These restrictive trade practices became a catalyst for the transfer of networked manufacturing strategy from Japan to the rest of the world. As Japanese manufacturers ventured abroad, they and their subsidiaries replicated their networked manufacturing processes on foreign soil. These networks were initially international to the extent that finished products in foreign subsidiaries also included parts and

components imported from Japan. That was the first of a two-step process, and the second was the extension of these bilaterally linked networks to global networks following currency realignment in the mid-1980s. The Plaza Accord in 1985 revalued the Japanese Yen and resulting cost pressures encouraged Japanese manufacturers to broaden production networks to include also low-cost developing countries in the manufacture of parts and components in order to regain their trade competitiveness. Developing countries played an important function, but production networks are not simply about exploiting cheap labor; indeed the inclusion of developing countries became a pathway for industrialization, growth, and development. Individual networks span a range of both developed and developing countries.

Neo-protectionism was a response to perceptions of unfair Japanese trade practices. There is no clear definition of unfair trade but in the context of US–Japan relations, measures of unfairness included imbalance in market penetration and composition of intra-industry trade, high for the USA and most advanced industrial countries but low for Japan. Proponents of neo-protectionism viewed US trade deficit as symptomatic of Japanese free ride on American trade openness and security guarantees. Japan was not only not paying for its own defense, with a defense budget less than 1 percent of GDP, but also relying on the USA as a market for its surplus production. This may have been easy enough to ignore when Japan was still trying to recover from its wartime devastation but now, as the second largest economy, Japan was perceived as a destabilizing force in the liberal international economic order. Some even likened the Japanese trade onslaught as the economic equivalent of Pearl Harbor.

The USA had facilitated Japan's manufacturing and export-led recovery after the Second World War with a favorable exchange rate, generous financial assistance, and access to its market. US special procurement plan during the Korean War also was significant in kick-starting industrial recovery in Japan. Relying on these ideal conditions, Japanese manufacturers developed a strong export dependence on the USA. In the initial stages of Japan's export-led economic growth, in the 1960s for instance, the USA was unconcerned because Japanese exports consisted mainly of cheap labor-intensive manufactures, such as the so-called one-dollar blouses. Over time, Japanese exports edged closer to core sectors of the US economy, such as steel and automobiles, and foreign market share of Japanese products steadily increased, helped by the two main considerations of quality and price. However, even as manufactured exports from Japan sat-

urated western markets, imports into Japan from western countries remained relatively insignificant and this gross imbalance suggested to observers that Japan was not following the GATT rule of reciprocal liberalization. Western exporters blamed non-tariff barriers in Japan, such as opaque and unpublished standards for various consumer products, for difficulties in accessing the Japanese market, resulting in ever-increasing trade surpluses for Japan. Japanese imports comprised mainly raw materials and natural resources. According to Edward Lincoln (1990: 20), the relatively small and declining share of manufacturing imports to manufacturing output in Japan in the 1980s, despite lower oil prices and higher value of the Japanese Yen, were indications that informal Japanese protectionism had distorted its trade pattern. Against this view of deliberate and artificial exclusionary policies, Bergsten and Cline (1985) argued that it was normal for a resource-poor country, like Japan, to have a vertically structured trade pattern, in which trade deficits against exporters of raw materials in the Middle Eastern countries and Australia, balanced surpluses against developed western countries as markets for Japanese manufactured goods.

The dominant narrative was that Japan was an unfair trader. Regimes with a large number of members can accommodate a few free riders that are relatively small, but free ride by large member states can easily become a destabilizing force, and Japan, for all purposes, seemed to be a destabilizing presence. The looming threat to US capital and technology-intensive industries coincided with an on-going debate about American economic decline. Revisionists joined the debate and insisted that American trade imbalance was a Japanese conspiracy to de-industrialize the USA.

Part of the alleged conspiracy involved Japanese manufacturers dumping their products in the USA and foreign markets simply to win market share and eliminate competition, a modern-day replication of mercantilist, zero-sum trade strategies. The revisionists Clyde Prestowitz, Karel van Wolferen, Chalmers Johnson, and James Fallows argued that if left unchecked, Japan's export surge would lead to American de-industrialization, as successive sectors of the American economy succumbed to unfair Japanese competition. For the revisionists even if Japan was not being deliberately unfair in its trade policies, the Japanese model of capitalism was sufficiently different to the West and a cause of systemic disturbance. For instance, the Japanese economic system sacrificed domestic consumption in favor of production for foreign consumption and Japanese industries, shepherded by the Ministry of International Trade and Industry (MITI, now renamed Ministry of Economy, Trade and Industry

or METI), had an unspoken agenda of global dominance. Having identified 'the Japan problem,' Karel van Wolferen (1986) proposed that the USA use its influence, as guarantor of Japanese security and a market for Japanese exports, to force Japan to end its unfair trading practices and commit to liberal and transparent trade. Cautioning against inaction, others argued that if Japan continued with its unfair trade practices, the two countries would soon end up *Trading Places*, as the title of Prestowitz's book (1988) suggested. The revisionists argued that the USA suspend its commitment to rules-based trade, the core of postwar GATT-based system of international trade, in favor of results-oriented trade and force Japan to trade more fairly, rather than in a predatory and adversarial manner.

In the revisionist perspective, Japan's MITI was the leading, very visible hand responsible for achieving the national goal of economic predominance. It was up to countries, like the USA, to declare economic war on Japan and to use their influence to force Japan to become more market-oriented (See Lindsey and Lukas 1998; Bergsten et al. 2001: 6). The revisionists presented an image of Japan as having uncovered the secret of perennial success. According to Clyde Prestowitz (Cited in Lindsey and Lukas 1998):

> The power behind the Japanese juggernaut is much greater than most Americans suspect … for Japan has created a kind of automatic wealth machine, perhaps the first since King Midas.

If revisionists railed against Japan, anger among Congressional leaders was palpable and their mood soured further following revelations that Toshiba Corporation had sold sensitive submarine technology to the Soviet Union. This was incomprehensible from a country that was an ally and dependent on US security guarantees for protection from the Cold War rival. Some legislators, in a public display of anger smashed electronics manufactured by Toshiba Corporation on the steps of the US Capitol. This public smashing of a Toshiba radio-set reflected both a frustration with Japanese trade practices and, as some described it, 'Japan bashing.'

Revisionists had clearly tapped into a growing mood of public anger and frustration, and Kent Calder (1988), while not a revisionist himself, strengthened their world-view when he added the missing theoretical component to the utility of foreign pressure, thus completing the circle. Calder conceptualized Japan as a 'reactive state' in its foreign economic policy-making, a state that was so completely controlled by bureaucratic

incrementalism that it was incapable of policy shift and change without external pressure, or *gaiatsu*. Revisionists emphasized the utility of foreign pressure, partly because bureaucratic policy-making in Japan relied upon standard procedures and norms established over a long period. In that context, change was likely to be difficult without external stimulus and pressure on bureaucrats to change and modify their policy preferences. Calder not only recast foreign pressure as necessary but also as beneficial, even welcomed by Japanese politicians in their campaign against bureaucrats who had usurped policy-making in Japan. Moreover, as indicated above, the USA was in an ideal position to apply pressure because Japan depended on the USA not only as a market for exports but also for its security and defense. Foreign pressure was necessary not only to bring a recalcitrant state in line with best foreign economic policy practices, but also to assist the Japanese government overcome bureaucratic adherence to standard operating procedures. Even where individual Japanese politicians understood the importance of trade concessions in order to preserve the broader relationship intact, they were presumably thwarted from implementing change, given powerful forces of bureaucratic inertia and industry opposition.

In the revisionist mind-set, in the absence of foreign pressure, the Japanese state was only ever likely to continue in its default state because bureaucratic policy-making everywhere is incremental and uninspired. If domestic interest groups easily captured American trade policy, dominated by elected politicians, Japan's bureaucratic policy-making system was equally impervious to domestic pressures, even from elected politicians, who had ceded policy-making authority to unelected officials. To rectify trade imbalance and Japanese 'free ride' on open markets overseas, critics and revisionists maintained sustained pressure on the US government, in particular, to apply pressure on the Japanese government to allow market access to foreign companies and cease unfair exports and dumping (see Calder 1988). For revisionists, foreign pressure became the twentieth-century equivalent of Commodore Perry's famous 'black ships' in Tokyo Bay in the nineteenth century, and thus the second historic mission of the USA to open Japan to foreign commerce.

The backdrop to neo-protectionism in the USA was a general deterioration in the balance of trade between the two countries but it is worth noting that Congress had also become more assertive in trade policy matters. Members of Congress were more receptive to lobbying activities of their constituent groups, but neo-protectionist measures, negotiated

and administered by bureaucrats, may have staved off even harsher legislative interventions. Another explanation is that government bureaucrats, increasingly more influential in trade policy, had a 'vested interest in the expanding system of discriminatory restrictions they administer[ed]' (Pearson and Riedel 1990: 115). Regardless, neo-protectionism was not a complete abandonment of free trade but selective in targeting Japan. Its emphasis on quantitative controls reflected a results-oriented approach and a rejection of earlier, and unfulfilled, vague promises by the Japanese government to restore trade balance. Japan's in-principle commitments and promises in the past to expand imports had all failed to produce any meaningful change in an ever-worsening situation, and the US government no longer trusted Japan to adhere to assurances. Moreover, it did not have the luxury of time. American car manufacturers, for instance, were teetering on the brink of collapse in the early 1980s. Japanese competition and the second oil shock had left them very vulnerable, with declining market share, and rising unemployment. Demand for fuel-efficient Japanese cars was strong and the future for Detroit looked bleak.

Consequently, there was mounting pressure inside Congress to provide relief to a significant and important domestic industry through tariff protection, and the concern was that a legislative approach might restrict trade more than the proposed VER. Even leading members of the economics profession, like Paul Krugman, defended the use of protectionist measures. Neo-protectionism may even have been a clever ploy to derail demands for more virulent protection of the domestic market and a softer option, even if inconsistent with GATT principles that emphasized rules-oriented multilateralism and non-discrimination. The open disregard for regime rules indicated that the USA had essentially given up on the idea that the 'Japanese economy will ever be genuinely open' (Lawrence 1992: 11) and that only export restrictions on Japan could balance trade between the two countries. Although it was not a wholesale abandonment of liberal trade, neo-protectionism was still the single greatest challenge to liberal trade in the postwar period. According to some estimates, by 1983 the overall coverage of neo-protectionist measures extended to nearly a third of the US market at an 'estimated cost of about $70 billion to American consumers' (Nivola 1986: 577).

Neo-protectionist quantitative restrictions promised quick relief to specific industries at home, and only targeted countries deemed to be trading unfairly, such as Japan. Even allowing for Japan's vertical trade structure it seemed unreasonable that Japan, an export giant, should have low market penetration

of foreign consumer products compared to other industrial economies. For example, in 1980, Japan exported 1.82 million cars to the USA but imported from the USA less than 10 per cent of its exports to the USA, an imbalance that was inconsistent with the explosive growth in global intra-industry trade in the postwar period. The VER agreement in 1981 limited Japan's exports of cars to the USA to 1.68 million units in the first year.

The Japanese government of course protested that it was not to blame, pointing out that Japan had low average tariffs on manufactured products and that there were no systemic biases against imports. Japanese trade officials insisted that low import penetration in particular industries was because foreign firms had failed to develop the right product mix for the Japanese market. From their perspective, American car manufacturers had not been successful in Japan because many narrow streets in Japan, for instance, could not accommodate larger American cars. American cars were also gas-guzzlers that had limited appeal in a country where energy prices were relatively high. Clearly, Detroit had not shown any serious interest in penetrating the Japanese market with competitive products. One Japanese industry official derisively remarked that the USA only had 'mops and buckets' to offer Japan.

The VER was a negotiated trade restrictive measure and reflected the application of considerable US pressure on Japan. The MITI Vice-Minister and lead Japanese negotiator, Amaya Naohiro, agreed with US officials that Japan had to limit exports to preempt more restrictive trade measures, but industry officials were unsympathetic to the idea. They could not see beyond the immediate loss of market shares that they had so assiduously secured in the USA. Eventually however, manufacturers conceded when Amaya reminded industry representatives of the greater interests involved in the negotiations and the potential for harm to US–Japan security relationship (Maswood 1989). The VER agreement restricted Japanese car exports to the USA to 1.68 million units a year. Both countries agreed to keep restrictions in place for three years but extended the program on a number of occasions until 1994, with slightly higher annual permissible exports. Voluntary export restraint reduced Japan's market shares in the USA but it also turned the terms of trade in favor of Japan and resulted in substantially improved profitability for Japanese exporters. Unmet consumer demand in the USA raised prices and, in addition, Japanese manufacturers replaced exports of lower-priced models with small profit margins, with more expensive cars with high-profit margins. A tariff increase, instead of VER, would have allowed some of the protectionist

rent to accrue to the US government but, in this instance, Japanese auto manufacturers monopolized the rent in its entirety. Once the USA had concluded this agreement with Japan in 1982, other western countries, fearing an onslaught of re-directed Japanese exports as access to the US market was restricted, negotiated similar export limiting agreements with Japan.

For US manufacturers, the VER provided a breathing space in which to restructure and recover market competitiveness. With fewer imports from Japan, the US auto industry recovered and returned to profitability relatively quickly, but at considerable cost to consumers, because of higher prices. According to Rhodes (1993: 169), in the period 1980 to 1983, there was a 35 percent increase in the unit price of Japanese cars to American consumers due to supply restrictions and increased luxury car exports from Japan.

Japanese FDI and Origins of Economic Globalization

Globalized production is the disaggregation and fragmentation of the production process and the location of various production units in different countries. Typical economic explanations rely on cost-benefit analysis, and Jones and Kierzkowski had proposed that fragmentation and dispersion is likely when the following two conditions are met (Kimura et al. 2007: 25):

1. Production costs are significantly lower because of locational advantages, such as low wages, quality infrastructure, or other regulatory benefits.
2. Costs of service links, transportation and telecommunications costs, connecting the different production units are not prohibitively high.

In this cost-benefit analysis, it is not just lower wages that have underpinned disaggregation of production, and networks do not simply integrate a developed center to various units in low-cost developing countries. Networks span across both developed and developing countries and critical to their success is the sharp drop in transportation costs, including airfreight. Transportation by air has the additional benefit that customs clearance at airports is faster and therefore less costly, than at seaports. In Malaysia, according to Kimura et al. (2007: 31), the border clearance time in airports is 7 hours, while that in seaports is 3 days. Hummels and Schaur suggested (see WTO 2014: 114) that burdensome border procedures and

longer time to export are particularly relevant to time-sensitive delivery of intermediate goods.

Technology, however, is only a facilitative factor, and the real reason for the spread of globalized production was the transfer of Japanese production technologies after the neo-protectionist phase of the early 1980s. The VER provided a welcome respite to American car manufacturers struggling under the onslaught of Japanese exports. Equally important was that it induced Japanese companies to re-think their reliance on exports and embrace the necessity of local manufacturing in foreign markets. Until then, Japanese manufacturers had not taken to foreign direct investments with any zeal, convinced that only exports from Japan allowed the requisite quality controls and cost competitiveness. Consequently, the Japanese economy was essentially export driven. Against this, a mix of local manufacturing was at the core of American neo-protectionist strategy, to encourage Japanese exporters to manufacture in the USA, revive a flagging industry and create employment, rather than rely on exports that destroyed jobs and contributed little to revenue generation for the state. No one anticipated that in the process of a VER-led foreign investment, Japanese firms would lay the groundwork for globalized production and contemporary economic globalization.

Since the 1950s, the Japanese government had laid the foundations of its 'miracle' economy on exports. The strategy worked well in the period when access to foreign markets was relatively unrestricted. There was little outflow of investment capital from Japan. The VER on cars changed that calculus and FDI picked considerably in the 1980s. Edward Graham and Paul Krugman contextualized this as part of a global surge in foreign direct investment in the 1980s; however, as their data showed, see Table 3.1, the global surge was really a surge in Japanese FDI. The growth

Table 3.1 Outward flow of FDI by country/region ($ billion)

	Outward stock		*Rate of growth (percent)*
	1980	*1982*	
United States	$220	$345	5.6
European Comm.	$203	$492	11.1
Japan	$20	$111	21.4

Source: Adapted from Graham, Edward M. and Paul R. Krugman (1993), 'The Surge in Foreign Direct Investment in the 1980s,' in Kenneth A. Froot (ed.), *Foreign Direct Investment*, University of Chicago Press, Chicago, p. 15. (http://core.ac.uk/download/pdf/6852225.pdf)

rate of European and American foreign investments was not particularly exceptional. Japanese FDI, which in 1980 was one-tenth of total US FDI, increased sharply to about one-third of US FDI in 1982.

Similarly, Karan and Bladen (2001: 18) observed that in 1980, Japan ranked seventh in total foreign direct investments in the USA with a share of only 5.7 percent of the total. In 1989, however, Japan ranked second and its share had increased to 17.4 percent of total. The US government welcomed this as an important step in the rejuvenation of American manufacturing, but it actually did much more than that. Along with this flow of FDI, came a gradual and steady 'Japanization' of manufacturing across countries. Japanese firms not only set up manufacturing facilities in the USA but they transferred their networked manufacturing processes. Thus, as Nissan, Toyota and others set up facilities in the USA, their subcontractors in Japan also established factories in the USA as suppliers of parts. In the 1980s, investments were driven by the automotive industry and in Kentucky, this came in two waves, led initially by the auto manufacturers followed by component manufacturers. According to Karan and Bladen (2001: 22):

> The Japanese investment in Kentucky came in two waves. The first wave arrived with the biggest Japanese automaker, Toyota, when it decided to build its plant in Georgetown in 1985. The first giant wave engendered a much more broadly based second wave: small Japanese companies arriving to supply parts and components to the big auto companies. This second surge of investment started to roll across Kentucky beginning in 1987 as smaller Japanese companies searched for towns and cities … with easy access not only to the Toyota plant in Georgetown but also to the other Japanese automakers …

The second wave of investments by subcontractors was standard practice in Japanese manufacturing because, as Lubben (1988:160) explained, when 'a Japanese company opens a new manufacturing facility, the company expects some of its suppliers to move into the same area, and this is a contingency of doing business'. Therefore, FDI by Toyota in the USA brought in additional foreign investments so that its suppliers could maintain the long-term trust and commitment they had developed, and which was essential to JIT (Just in Time) manufacturing. In the JIT system, manufacturers receive parts from subcontractors just when these are needed, obviating the need for large and expensive inventories. With long-established relationships between manufacturers and subcontractors

it was easy to replicate the same practices that had worked so well in Japan, such as the just-in-time inventory control system.

As Japanese companies ventured overseas, they replicated on foreign soil their own manufacturing techniques of 'networked' production and alliances between the firm, the *honsha*, and its subsidiaries, the *shitauke*. Alongside the final assembly plant, some subsidiaries established factories for the manufacture of parts and components in the same as the location assembly plant while other parts, for example, engine blocks, were to be imported from Japanese factories. Manufacturers can organize production as an in-house activity from start to finish, or as based on parts and components sourced from either independent external producers or subsidiaries, or as some combination of the two. Typically, Japanese manufacturers rely on networked manufacturing among firms that are part of a large conglomerate or *keiretsu*. Production networks involve a parent company (*honsha*), such as Toyota, and its many independent but affiliated subcontractors (*shitauke*). Another Japanese *keiretsu* structure links a group of firms that are formally independent and yet informally connected and structured around a lead company or bank, such as the Mitsui Group and its main bank, the Sakura Bank. In Japanese manufacturing networks, subsidiaries are fully integrated and involved in the manufacturing process, providing creative input and design ideas, whereas western in-house manufacturing may also rely extensively on subcontractors for manufacture and supply of components but all engineering decisions are largely controlled in-house and subcontractors manufacture parts according to a final design. Chrysler in the USA, for instance had many more suppliers of parts than Toyota in Japan, but these only supplied parts according to Chrysler's design, with little input in the engineering of components (Dyer 2000). Moreover, Chrysler did not foster long-term relational arrangements but rather procured parts only on cost considerations and from the cheapest supplier. The American car manufacturer General Motors (GM) also had subcontractors for the supply of parts but the main procurement criterion was cost that was determined by a bidding system and without the establishment of long-standing networks. Even if Japanese suppliers were lower in the organizational hierarchy, the relationship was long-term, based on loyalty and partnership, whereas western parts manufacturers were always under constant pressure to lower production costs. American car manufacturers also relied on subcontractors but without any long-term relationship. Thus, whereas Japanese producers procured parts from 100 to 300 tightly linked subcontractors, Chrysler had subcontracting arrangement with 3000 to 4000 companies. GM relied on supplies

from more than 10,000 companies, but it still had a much higher in-house manufacturing rate than in the case of Japanese companies (Monden 1993: 337–339). Later, however, as they embraced Japanese-style supply management, they rationalized and reduced the number of subcontractors and formed long-term contractual arrangements.

Japan's manufacturing networks resembled their hierarchical family or household (*ie*) structure involving an *oyabun-kobun* (parent-child/elder-junior) relationship. Early in the twentieth century, Weber had hypothesized that industrialization and modernization tended to create impersonal corporate relations and weaken familial patterns in pre-industrial societies but the Japanese experience was somewhat different. In Japan, traditional relationship patterns at the household level persisted into modernity and some of these patterns could also be found in the industrial sector, both in terms of how firms related to each other as well as in employer-employee relations, such as lifetime employment (at least in large corporations) and bonds of trust and loyalty. At the inter-firm level, networked companies fostered and maintained a bond of familial loyalty.

The Japanese industrial structure consists of a small number of large corporations and a substantially large sector of small- and medium-sized companies. The latter are often networked with larger firms based on specialization and division of labor. Production networks are enduring long-term relationships. A survey in the mid-1980s found that two-thirds of small subcontracting firms had never changed their relationship with the parent honsha and 97 percent of relationships exceeded five years (Whittaker 1997: 88). Often these long-term networked relationships are consolidated with cross-holding of shares, sometimes exceeding 70 percent of outstanding shares in a company which, according to Dore (1997: 24; see also Sheard 1994), explains why corporate executives in Japan do not turn first to the stock market reports in newspapers. Company directors do not have to be excessively sensitive to shareholder concerns since retail shareholders are a relatively small minority. Iwao Nakatani (cited in Bergsten and Noland 1993: 7), for example, made a distinction between Japanese 'network capitalism' and American 'market capitalism.' This system of networked manufacturing was very different from western in-house manufacturing practices, where GM, for example, did much more of its automotive car manufacturing in-house, rather than subcontract to suppliers. As an illustration of networked manufacturing, within the Toyota Group there are a small number of lead companies and more than 200 parts suppliers that participate in Toyota's networked production process.

Initially, in the USA, there were concerns about the seemingly closed nature of Japanese manufacturing, that Toyota was not prepared to procure components from local American suppliers. However, in the early years, this was inevitable and since then, as the production network strategy spread, Japanese manufacturers established long-term network relationships with non-Japanese firms in host locations. Because of greater reliance on local production, in 2014, of all the Japanese-branded vehicles sold in the USA, more than 70 percent was of North American manufacture, a remarkable shift from the early 1980s (JAMA 2014). Moreover, Japanese factories in the USA also emerged as exporters in their own rights. Essentially, the set of forces unleashed by Japanese investments in western countries had important global consequences. The existing literature has largely overlooked the process of Japanization, its emulation, and culmination ultimately in globalized production. The initial stimulus for this came not from trade liberalization but from precisely the opposite forces.

Global production networks began as a defense against the rising tide of protectionism and Japanese firms were at the forefront of this manufacturing strategy. Export restrictions allowed Japanese firms to demand a premium, raise prices, and gain additional protectionist rent, but in the immediate aftermath, for a country like Japan, neo-protectionism and reduced access to foreign markets was a serious challenge to the export-led growth model and foreign market shares. It prompted a major shift from export dependence to local manufacturing in export markets. From a broad, global perspective, it is important not to downplay the significance of neo-protectionism. Indeed, it may not have contributed to a significant reduction in global trade levels but it certainly was an important factor in the transition to global and disaggregated manufacturing processes. As mentioned, one objective behind introduction of VER was to force Japanese manufacturers to rely less on exports and more on local production that would add value to the US economy and generate employment. This is precisely what happened. Honda was the first of the Japanese manufacturers to set up production in the USA in 1982 partly because with a smaller share of the Japanese domestic market, it required access to foreign markets and could not afford to lose market share in the USA. Other Japanese car manufacturers followed and as these ventured overseas, they took their own manufacturing networks with them to respective host locations. Over time, the balance between export and local production has shifted markedly. In the early 2000s, foreign production of Japanese car

manufacturers was close to 50 percent of the total and, in 2012, J.P. Morgan forecast that by 2014 foreign manufacturing would like reach 76 percent, or three-fourths of all production by Japanese car companies (*The Economist*, January 14, 2012). The goal was to protect foreign market shares but Japanese FDI became also the first step toward contemporary globalization. Global production networks modeled on Japanese networked production, *keiretsu*, have spread globally, but with its origins in Asia, nowhere 'in the world is production fragmentation quite as much … or as fast growing, as in Asia' (Ferrarini and Hummels 2014: 1). It was easy to see also that networked manufacturing was, in many ways, superior, to in-house manufacturing. Some of the advantages include the following.

First, networked production kept manufacturing costs down and added to a firm's international competitive advantage. In networked production, large firms, like Toyota, relied on subcontractors to produce many of the parts and components for final assembly. Subcontractors were either wholly or partly owned by Toyota, or completely independent and yet, linked to the main firm through a long-term loyalty relationship. Subcontractors became part of the Toyota Group and a member of the Toyota production network. In this instance, Toyota as the main firm kept only core activities, and the final assembly, in-house. Subcontractors had exclusive supply agreements and by devolving some manufacturing to firms within the network, the main firm was able to operate with lower capital requirements and capital costs. In production networks, subcontractors manufactured and delivered parts on a just-in-time basis that obviated the need for stockpiles of costly inventories, whether with the subcontractor or the main firm. Carl Pegels (1984: 97) cites the example of engine blocks manufactured in a factory in the morning and fitted to a functioning automobile engine at night, without having to be stored for any extended period, as was common practice in the West. An obvious advantage was lower production cost. The just-in-time delivery system forced subcontractors to ensure quality standards and to deliver parts with zero defects, in order to avoid disruptions to final product assembly or manufacture. By contrast, in American manufacturing practices, firms were obliged to carry large inventories at substantial costs, to account for wastage and defects. Since price was the main consideration, American, western subcontractors had little incentive to invest in new technology, and this resulted in 'high proportion of defective parts and additional costs to the automakers' (Koichi 1992: 153).

In the Japanese *keiretsu*, the just-in-time (JIT) system further enhanced quality control because production runs were typically smaller, and defects and flaws rectified quickly without creating a large volume of waste and discarded products compared to when production volume was larger and where wastage may be as high as 10 percent of total production. Flexible manufacturing required frequent changeover of machineries, and Japanese factories were able to reduce setup times by simplifying procedures, to ensure that the cost of changeover did not override the savings in lower inventory management (Pegels 1984: 117). Flexible and smaller production runs meant that firms, instead of aiming for economies of scale, opted to maximize economies of scope, allowing them to produce a diversified product on the same production line with a quick and simplified setup systems. Early during the postwar reconstruction phase, Japanese manufacturers understood that, 'domestic and proximate East Asian markets for volume goods were not large, and it was extremely risky to compete on the basis of economies of scale in most instances' (Fruin 1992: 113). For example, in car manufacturing, even if American and Japanese car manufacturers had approximately the same number of product models, a Japanese factory with switchable components and parts, could produce products more specialized to suit individual preferences and needs. Inability to achieve economies of scale was not a handicap. Rather, Japanese manufacturers used flexible manufacturing to achieve other goals of consumer satisfaction and quality control. Networked production was perfectly suited to small lot manufacturing and did not require extensive vertical integration as was common in American (Asanuma 1994: 118). The downside as noted by Asanuma (1994: 124) was that it was 'risky for [a] company to build … cars without receiving orders from those who actually want to buy that particular version of the vehicle.' Japanese manufacturers overcame the dilemma which involved an otherwise long lead time for delivery, if production was started only after receiving a specific order, by staggering production in two or more stages with a generic build in volume followed by a final build to full specifications, according to the order book, during each of their ten-day building cycles.

The benefits of a just-in-time inventory control system was not only the cost savings that it generated but also that flexible and smaller production runs allowed for a greater range and variety, or differentiated production. Production changed from 'mass production' to 'lean production' and to 'mass customization'. Kaplinsky and Farooki (2010: 127) attribute this to shifting consumer demand patterns who, once their basic consumption

demand had been satiated, demanded 'higher levels of quality, much greater product differentiation, and faster rates of product innovation.' Management experts in the USA considered the just-in-time inventory control system so useful to company bottom lines that they were recommending it for wider adoption, even before the surge in Japanese FDI in the USA. For example, according to Richard Schonberger (1982a: 12; 1982b), 'There are … reasons why Western manufacturers … should learn all they can about Japanese JIT/TQC (Just in Time/Total Quality Control).' One important benefit of JIT for Japanese manufacturers was lower manufacturing costs. Schonberger (1982a, 1982b: 200) cites a study of the US Department of Transportation prepared by James E. Harbour that estimated a cost advantage of about $1600 for Japanese manufacturers of compact cars over US manufacturers, and due largely to the benefits of JIT systems.

The function of the just-in-time production system, discussed above, was essentially to make each individual and each unit in the production network both a consumer and producer and a customer and supplier. Richard Lubben (1988: 8) writes that the five main principles of JIT and networked production were:

1. To include each worker or work unit as both a customer and a supplier
2. To treat customers and suppliers as an extension of the manufacturing process
3. To continually seek the path of simplicity
4. To ensure that problems are avoided rather than having to fix them
5. To obtain or produce something only when it is needed (JIT)

Second, network manufacturing is much more flexible and because firms did not have to maintain large inventory levels, they were better able to adapt to shifting market trends or to operate with smaller production runs. Thus, whereas the American production model emphasized standardization (e.g., Henry Ford is reported to have said that customers had the choice of any color of the Ford Model T as long as it was black), the Japanese were able to appeal to a more diversified market with a more differentiated product line to suit individual tastes. According to Peter Marsh (2012: 17), in this new industrial revolution, manufacturing was increasingly moving away from 'mass production' to 'bespoke' manufacturing and the idea of tailoring production to different needs of consumers.

This type of craft manufacturing preceded the first industrial revolution and, as we shall see, there are other similarities in the way globalization has evolved to earlier forms of economic organization. I do not however intend to suggest that these appearances of similarity imply a meaningful connection. Globalization, as I have argued, is unique and unprecedented.

Third, according to Mark Fruin, the advantages of a corporate structure based on interdependent alliance relationships was that 'networks lowered investment levels for individual firms, reduced risk, minimized adverse selection, and lessened capital expenditures' (Fruin 1992: 7; see also Aoki 1994: 18). For example, Toyota in Japan decentralized its production because of capital constraints, and its success became a model for others in Japan and, eventually also, the West (Fruin 1992: 259). Even though it was a leading global car manufacturer and despite emulation of the Japanese manufacturing process by others, Toyota remained far more decentralized than other car manufacturers, with far fewer employees in the main firm. In the early 2000s, Toyota had approximately 50,000 employees in Japan compared to nearly 100,000 employees for General Motors in the USA. With the transfer of Japanese manufacturing strategy to western countries, local industries could not but take notice and it is in that context that neo-protectionism, Japan, and the USA take center-stage in the eventual spread of production networks.

Fourth, while there were coordination and transactions costs associated with network manufacturing (Coase 1990), firms in Japan managed to keep such coordination cost low with long-term loyalty arrangements and secured the other advantages of subcontracting a bulk of their manufacturing activities. As well as long-term supply arrangements, subcontractors were exclusive suppliers. This made it possible to have open lines of communication between main firm and subcontractor on proprietorial technological developments without the concern of technology transfer to competitors.

Ultimately, it was superior quality and cost control that underpinned Japan's economic success, not dumping and unfair trade practices, as was the popular myth in the early 1980s. In any event, the resulting neo-protectionist response brought Japanese manufacturing technologies to the USA and acquired by American companies, especially after they were included in Japanese production networks as suppliers of parts and components, or as joint venture partners. Thus, as Japanese manufacturers moved overseas, many western companies adopted the networked, and just-in-time, production strategy themselves. Japan, the so-called land of copycats,

became a model for others to copy and emulate. In the USA, Xerox introduced the JIT delivery system for its photocopier manufacturing facility in Webster New York in 1984 with a network of suppliers in a 40-mile radius, and based on information from about 1400 deliveries in the first year of operation the system had demonstrated 'impressive performance with zero late deliveries, zero early deliveries, and zero defects' (Lubben 1988: 158).

As noted above, globalization today has resulted in a Japanization of manufacturing technologies across the world. In the West, the process of learning from Japan was led by the USA and UK. Dyer (2000) documented this learning process and pointed out that Chrysler was among the first to transform itself into a Japanese-style *keiretsu*, with loyalty-based subsidiaries involved in production and design at all stages of manufacture, as opposed to the adversarial relationship with suppliers that existed before. When Honda commenced operation in the USA, Chrysler conducted an extensive study of Honda and its supplier relations to understand what Chrysler might incorporate in order to enhance its product development, manufacture, and profitability (Dyer 2000: 66). Chrysler management did not act to incorporate Japanese processes, convinced that these were too foreign and unworkable in an American workplace. Still, the extensive study showed that American car companies were curious about the sources of Japanese success, instead of blaming them for dumping their products in foreign markets. The study of Honda was the start of a learning process but the real opportunity for radical transformation came when Chrysler, in 1987, acquired AMC that manufactured the highly successful Jeep range. The acquisition provided executives at Chrysler a better and practical insight into viability of Japanese practices in an American company. AMC showed that Japanese practices were, after all, not so alien as to be impractical in US factories. As a relatively small manufacturer in an industry dominated by the Big-3, AMC had to be innovative in its manufacturing processes and it had adopted Japanese-style processes to ensure success in the USA. This included a Honda-style supplier-management and product development practices. In 1990, Chrysler unveiled its SCORE (Supplier Cost Reduction Effort) program to build trust with suppliers and establish a mutually beneficial partnership, rather than simply chip away at supplier's profit margins as it had in the past, a focus that had created an adversarial relationship between Chrysler and its suppliers. Suppliers welcomed their implied elevation in the corporate structure, and, for Chrysler, the incentive to undertake this major corporate restructure was economic pressure.

Export restrictions had *pushed* Japanese car manufacturers to invest overseas, and desperation and survival became the *pull* factor that forced American car companies to learn from and emulate Japan. The successful adoption of Japanese manufacturing strategies demonstrated that there was nothing cultural about Japanese business practices. Not all aspects of the Japanese supplier chain was incorporated, and Chrysler, unlike Toyota and other Japanese *honsha-shitauke* relations, did not acquire any equity stake in its major subcontractors but moved to a system of long-term relationship agreements. Equity participation is more problematic in the US context because of antitrust legislation and the precedent that, in 1957, the Supreme Court found Du Pont to be in breach of antitrust legislation because it had a 23 percent stake in GM, a client of its paint products. The restructured supply chain relationship at Chrysler produced quick payoffs, and profits per vehicle jumped from $250 in the 1980s to $2110 in 1994. This was due largely to savings that stemmed from inventory and quality control processes.

Of course, Japan's networked manufacturing process had never been a secret and as with many other things, Japanese firms had actually borrowed their manufacturing structures from the West and adapted them suit local own conditions (Sheng 2012: 170). Some western firms had introduced a form of networked manufacturing even before the flow of Japanese FDI to the West. Howells and Wood (1993: 144) cite the example of IBM in Europe, which in the 1960s and 1970s adopted a strategy of horizontal networks as a safeguard against possible nationalization by European governments. This strategy of what they term 'horizontal switching' was meant to establish 'plants which would be highly integrated and dependent on overseas components/materials, ensuring that they would not be able to survive on their own in a purely national framework.' That was then, but now as Japanese firms set up their networks overseas, western firms could observe them in close proximity in their own countries and their demonstrated superiority and cost advantages encouraged an increasing number of foreign and western companies to emulate Japanese strategies in order to remain or to enhance their competitiveness. Organizational structures are not static and change as conditions change. For instance, governmental organizations that provide public goods sometimes do so within established governmental structures and at other times, through public-private partnerships (PPP). The organizational structure of western industries may have changed without the influence of Japanese organizational patterns but that is purely speculative. In this instance, the change was largely due to recent arrival of Japanese industries in the USA. Other firms that already had in place a system of procuring parts

from multiple sources switched to loyalty-based network of suppliers. British Leyland, for example, procured batteries for its cars from multiple sources with no long-term loyalty connection, but in 1982, it moved to an exclusive arrangement with Lucas Batteries to supply car batteries (Turnbull 1986: 194–5). This was influenced by the presumed advantages of the Japanese manufacturing process that created a sense of group loyalty and long-term network linkages based on price and quality guarantees. The catalyst for British Leyland was a marked deterioration of market conditions and falling production and sales. Rover, a successor of British Leyland rapidly geared up to shift to Japanese manufacturing and industrial relations strategies. In partnership with Japanese car manufacturer Honda, it adopted a just-in-time inventory control system, a hallmark of Japanese manufacturing, and began moving away from multiple sources for its parts and components to a select network of more competent suppliers. In 1987 Rover announced that it would give 'preferred supplier status' to a small number of its components suppliers, just as was common practice in Japan (Oliver and Wilkinson 1992: 104).

As indicated above, as Japanese car manufacturers ventured overseas, so too did their parts and components suppliers, and this network of manufacturing was brought closer to western firms and industries, which gradually moved to adopt many aspects of Japanese manufacturing. When Nissan, for example, established a manufacturing facility in the Sunderland Borough Council in the UK, it encouraged subcontractors to locate nearby as well and indicated its intentions of developing 'supplier relations in a similar manner to those that it employs in Japan' (Oliver and Wilkinson 1992: 223). Similarly, Ernst and Ravenhill (2000: 232) observe that 'Japanese companies had a greater propensity than their American counterparts to internalize their ownership-specific advantages through the replication of their domestic production networks when investing overseas.' In the USA, Bergsten and Noland (1993: 108) write that Japanese investments accelerated 'the diffusion of Japanese management and production techniques in the United States,' including flexible networked manufacturing. The transition has been extensive, and Jenny Chan and Selden (2013: 104) cite Sturgeon, Humphrey, and Gereffi to the effect that in the 1990s, such major companies like Apple, Lucent, Nortel, Alcatel, and Ericsson had divested most of their in-house manufacturing capacity in favor of contract manufacturers. For Apple this was immensely profitable, earning it a profit margin of 58.5 percent on the iPhone, with labor costs in China accounting for only 1.8 percent (about $10) of the retail price of an iPhone (Chan and Selden 2013: 106–7).

Flexible manufacturing was different not only from American manufacturing systems but also, apparently, not well understood even within Japan by the ministry charged with industrial development. The Ministry of International Trade and Industry persevered, in the 1950s and 1960s, to enhance economies of scale in the car manufacturing industry in Japan. It encouraged mergers in the belief that rationalization of production would strengthen international competitiveness of Japanese car manufacturers. Small production runs would conceivably leave Japanese firms unable to withstand pressure from more cost-competitive international firms. To MITI bureaucrats, it was not viable for Japan to maintain an industry with 11 manufacturers when the USA, with twice the population base, had only three car companies. MITI did not have any great success with its mergers plan and managed only to secure the solitary merger of Prince Motor Company and Nissan in 1966. The merger was successful and the two Prince models, Gloria and Skyline, have continued to perform well for Nissan after the merger. However, apart from this, MITI's overall plan for rationalization of the automobile industry failed but not to any great detriment, either to industry or to Japanese export success. In a curious way, MITI's successes in planning, implementation, and strategic guidance were a source of postwar Japan's economic miracle (Johnson 1982), but, interestingly as well, some of its failures were also important contributors of Japan's ultimate economic success. While MITI can take some credit for helping to create successful industries such as shipbuilding and electronics, it was short-sighted in its attempts to obstruct two new start-ups, Sony and Honda. Thankfully, for global consumers, MITI failed, and these two firms became eventual symbols of Japan's competitive strength.

Orthodox economic explanations reject industrial policy as a source of success and instead point to sound macroeconomic policies as the underlying foundation of success. At the extreme, Mikitani and Mikitani (2014: 6) not only rejected industrial policy as contributing anything to Japanese success but argued that MITI had 'ruined' every single industry it had become involved in and that the 'Japanese disease' was misguided industrial policies and regulation. Writing about Japan's on-going and multi-decadal economic malaise, they championed a future driven by government withdrawal from economic regulation in favor of classical Schumpeterian liberalism. In fairness, while MITI did have some spectacular failures, it is simplistic to write it off as either inconsequential, or, worse, a handicap to Japan's ultimate growth and economic success.

Globalizing the Production Networks: The Plaza Accord

Quantitative restrictions on some Japanese exports instigated momentous changes but did not lead to any reduction in US-Japan trade imbalance. In 1985, Japan's trade surplus against the USA, at about US$50 billion, was a new record. It was substantially more than the $37 billion surplus Japan had recorded the year earlier. Frustration with an ever-widening trade gap prompted the US government to find a quick fix through currency realignment to reduce the competitive advantage of Japanese exports and, by equal measure, increase competitiveness of American products. In 1985, the G-5 countries, the USA, Japan, Germany, Britain, and France, at a meeting in the Plaza Hotel in New York, agreed to revalue the Japanese Yen and the German Mark against the Dollar. In the case of the Japanese Yen, it appreciated about 30 percent in real terms by the end of 1986 and practically stymied export and GDP growth in the first half of 2006 (IMF 2011: 53). To restore economic growth, the Japanese government responded with a massive stimulus package. The result was asset price inflation, a bubble economy that persisted until early 1990, when the bubble burst and economic growth came to a grinding halt.

Just as neo-protectionist measures had triggered a flow of Japanese FDI to developed economies, the Plaza Accord was a catalyst for investments in East Asia, especially in China which had recently opened up for foreign trade and investments. In 1985, total Japanese investments in Asia, on a notification basis, was about $1.5 billion but increased rapidly to approximately $5 billion in 1987. Not only did Japanese manufacturers relocate mature industries to China and elsewhere for reverse import of finished products back to Japan, but they also established regional facilities for the production of intermediate goods for supply to downstream manufacturers in Japan and elsewhere (Xing 2006: 116–117). Within Japan, the rapid relocation of some manufacturing activities to regional concerns raised concerns about the potential 'hollowing out' of industries in Japan. This was a valid concern, and indeed in the electronics industries, which accounted for much of the outflow of manufacturing investment, domestic employment fell by 10 percent from 1990 to 1995 (Farrell et al. 2004: 168). On the other hand, new production units in Asia became part of existing production networks, marking an important step toward their eventual spatial expansion and globalization.

The transition from domestic, to regional, and ultimately to global production networks was a natural progression. It was natural also for competitors in other countries to emulate and replicate Japan's manufacturing success. The result was a proliferation of networked manufacturing and supply chain activities that was inconceivable at any time in the past. Adam Smith advocated disaggregation of the production process on the factory floor (division of labor and specialization) in order to enhance productivity, but the possibility of locating production of components of a single consumer good across national borders would have been unthinkable, even a few decades earlier. Production networks can be either vertically integrated but geographically dispersed with substantial intra-firm trade, as in the case of Nokia, or can include substantial outsourcing across geographical distances and arms-length trading as in the case of Apple and Motorola. At the same time, these supply chains can be either producer-driven, as in the case of automobile manufacturing, or buyer-driven where large retailers, such as Wal-Mart, set up production networks in low-cost developing countries. Large developing countries, such as China and Thailand, are major participants in producer-driven network production but other developing country firms are 'already major participants in [buyer-driven] form of global chain through the supply of labour-intensive finished goods to transnational buyers' (Weiss 2002: 148). In the process, a unique new feature of global capitalism is the growth in trade of components among the chain of firms that constitute a production network.

Globalized production is distinct from global production. The latter is a long-standing multinational strategy that stems from a number of different considerations, including the product life-cycle approach, where home production initially leads to development of foreign export markets, followed by local production in foreign markets when demand makes it feasible and when home country demand is relatively saturated. This is what Susan Strange (1985) identified as 'relay affiliate' type of globalization of production, but which is more appropriately designated as global production. The other, according to Susan Strange, is the 'workshop affiliate' type, in which, she says, 'one stage of a production process is farmed out … to [affiliates in] another country where labor is cheaper or more docile or taxes are lower' (Strange 1985: 245). This captures the reality of contemporary globalization of production although it is inaccurate to think that existing networks only link developed countries with cheap production platforms elsewhere, because existing networks do not focus only on the exploitation of cheap labor in developing countries. Nokia, in 2009,

had offshore production bases in ten countries, both in OECD member states, like Finland, Germany, Mexico, and the UK, and in emerging market economies with cheap labor costs, such as Brazil, China, and India (Lanz and Miroudot 2011: 11). Cheap labor is important and the inclusion of developing countries in value chains suggests that cost considerations play an important part in networking decisions (Yeung and Coe: 2015). Ultimately, however, production networks are efficiency-driven. Globalization of production does not simply mean the inclusion of low-cost production platforms, although it may have started as such when Japanese firms relocated some of their manufacturing to East Asian countries after the currency revaluation that followed the Plaza Accord. Most existing production networks include both developed and developing countries and lower labor costs are not the only considerations for globalized producers, such as Nokia. When developing countries participate in production networks, they usually specialize in less capital-intensive manufacturing, but this can be in some of the most high technology industries. For example, India is part of the global manufacturing network spread out across many countries for the production of the 787 Dreamliner. Aircraft manufacture is not something that is typically associated with developing countries (there are some exceptions such as Indonesia and Brazil) but it is not impossible to be included in the manufacture of some parts and components. Deepak Nayyar (2008: 91) says that China may continue to dominate low-end manufacturing but the reality is that the manufacturing technologies have changed considerably with GPNs, and developing countries do not all have to begin with textile and garments manufacturing, the usual bottom rung of the manufacturing ladder. In global value chains that exist today the notion of relocating entire low technology industries to developing countries has lost meaning, and developing countries no longer have to start at the traditional bottom and gradually move up to more sophisticated manufacturing. It is not impossible for a developing country with a low technology base, but cheap labor costs or some other advantage, to participate in the value chain of sophisticated finished products. Disaggregation of manufacturing process means it is possible to devolve to developing countries even some aspect of high technology industries, and not only for the more labor-intensive processes. Bangladesh, for instance, is a major producer and exporter of garments and textile but also exports ships and sea-going vessels, and bicycles, even though it does not possess all the requisite technology for building ships or for manufacturing bicycle. In 2014, Bangladesh exported about 500,000 bicycles to Europe with

only about 45 percent of parts and components sourced locally and the rest imported from other countries. At the same time, these manufacturers also sold bicycles for the domestic market with 80 percent local content, because the domestic market had less stringent quality standards and the final production cost had to be low enough to be affordable to cash-strapped local consumers (Rajon 2015). In this industry, Bangladesh typifies developing country participation in global value chains where its manufactured exports have strong 'backward linkages,' that is, the share of foreign value-added in exports (Lopez Gonzales et al. 2015: 17). The challenge for developing countries is to enhance 'backward linkages' so that exports embody more local content and fewer imported parts and components. More specifically, the challenge for Bangladesh is to enhance quality of local parts to a standard that meets international requirements, for use in both domestic and export sales and as a stand-alone export of intermediate goods. The objective is not 100 percent local content but improving local manufacturing to international standards.

Globalized production requires extensive coordination among different units but it is still a good manufacturing strategy to rely on a network of specialized precision manufacturers for individual components. This type of manufacturing has increased in significance, and increasingly fewer products have a clear national, as opposed to global, identity. Statistics on how much of world trade is composed of network trade is not available but is greater than intra-firm trade because networks include also firms that are outside vertical relationships. Trade in parts and components is a better estimate of global production networks and for some countries this can range to as much as 60 or 70 percent. At present, networks include subsidiaries based in multiple locations. Toyota, for instance, has manufacturing plants in more than 20 countries, some producing only engines and aluminum wheels for sale and export to other Toyota factories globally in order to generate economies of scale and contribute to cost-competitiveness. Globalization has affected all industries, including aircraft manufacturing. For example, the European Airbus not only has diversified production among its European partner countries but recently also has established production facilities in Mobile, Alabama, to assemble aircraft from parts and components manufactured in Europe. Airbus established manufacturing facilities in the USA to give it better prospects of defense and civilian aircraft sales in the biggest market for aircrafts. Similarly, Mitsubishi in Japan, the latest entrant in the passenger jet industry, manufactures its MRJ regional jet with 70 percent of parts and components sourced from

outside Japan. The Boeing 787 Dreamliner also is a product of global manufacturing, not because Boeing could not make the entire aircraft itself but because exploitation of synergies across the globe was more practical and cost-effective. Boeing is among the most recognizable of American brands, but in the manufacture of its Dreamliner, outsourcing to Japanese companies accounted for 35 percent of parts and components. Firms in Japan produce parts of the fuselage and wings, and manufacturers in Australia, Korea, and a number of European countries, contribute other parts of the final aircraft. The network of suppliers included India, a developing country. The inclusion of developing countries in production networks has increased rapidly since 2000. In that year, developing country participation in manufactured intermediate goods trade was slightly below US$1.5 billion but doubled to nearly US$3 billion in 2006. The corresponding share for the Commonwealth of Independent States had barely moved above zero in that period. Of course, as to be expected, developed economies dominate the trade in intermediate goods (Sturgeon and Memedovic 2011: 13).

Globally networked manufacturing has become standard for many high technology consumer goods. In its World Trade Report for 2014, the WTO reported the results of its Google search on global production networks (global value chains) and found that scholarly writing about fragmentation of production had picked up pace since the mid-1980s. The results are given below, in Table 3.2.

With globally networked production, there is an understandable increase in trade in intermediate goods, relative to finished consumer goods. Trade in intermediate goods is essential to networked manufacturing and has increased for both developed and developing countries. According to Frensch et al. (2016: 237) the greater the relative difference

Table 3.2 Google search results for global value chains

	Number of results
1980–89	6
1990–93	3
1994–97	17
1998–2001	156
2002–05	1310
2006–09	4200
2010–13	7210

Source: WTO (2014), *World Trade Report 2014*, Geneva, p. 80

of goods and factor prices between countries before integration into production networks, the larger the potential gain from trade. Thus, they (2016: 237) observed that intermediate goods trade growth averaged 6.2 percent a year for the OECD countries during 1992–2008, but was slightly higher in Europe and higher still for the new Central and East European members of the EU, often above 10 percent a year. This showed the potential gains for developing countries in linking into global supply chain networks.

Globalization of production is more than simply a greater prominence of multinational corporations on the global stage. Multinational activity goes back several centuries to include the dominance, at various times, of such firms as the Dutch VOC (*Vereenigde Oost-Indische Compagnie*) and the British East India Company. Global production of finished products, too, has a long history that predates globalization of production. In the latter, multinational companies have dispersed fragments of a single manufacturing process across many countries, to utilize specific locational advantages. Balancing this supply side transformation in contemporary globalization, as manufacturing has moved from national jurisdiction to regional and to the global stage, consumers too have become more cosmopolitan in their purchasing decisions. Sophisticated consumers form their purchasing decisions increasingly on 'value for money' than for reasons of national pride and identity. Because of networked production, it is not easy to establish the national identity of finished goods, even when such products carry a 'Made in X' label. Many manufactured products, such as the Apple iPhone, have dispensed with a clearly visible manufacturing label. Denationalized production was evident even earlier than networked production, and a good example of this was the Nike shoe, an American brand manufactured always outside the USA. Globalization of production and networked manufacturing has further enhanced the denationalization of production. An interesting twist in this saga of denationalization happened in the 1980s when, in the middle of a trade row with the USA over widening trade imbalance, Japanese Prime Minister Nakasone urged citizens to each purchase at least a $100 worth of American products. However, as Kenichi Ohmae (1999: 147–8), pointed out, it was no longer easy to identify an American product because 'if you needed a new tennis racket, you bought one made by Wilson. If you were out of ketchup, you bought some made by Del Monte. You picked up some [tissue boxes]… of Kleenex and Scotties. The problem however, was that all these items had been made in Taiwan, Portugal, Hong Kong and Japan.'

Robert Reich, former US Secretary of Labor in the Clinton administration, highlighted this trend by asking a poignant question *Who is Us?* (1990) that raised questions about the national identity of products and companies. Globalization of production may have started with the separation and off-shoring of labor-intensive aspects of manufacturing to developing countries where labor costs were low but increasingly companies have discovered that it is good business strategy to specialize in particular aspects of manufacturing and source other parts and components from specialist manufacturers elsewhere, even other countries.

On the other hand, it might also be argued that any suggestion of a loss of national identity is a myth since many of the largest transnational companies actually have a low score on the so-called trans-nationality index, defined as the percentage of asset and employment located outside the home country (Dicken 2003). General Electric, for example, had a trans-nationality index in 2001 of only 36 and Toyota a score of 31 (Dicken 2003: 224). That may be so, but globalization is an evolving reality and trans-nationality index today is higher than what it was ten years earlier and so on. Further, such quantitative indicators miss the underlying shift. No one, for example, will deny that Apple is an American company, but many will also readily acknowledge that it no longer makes sense to resort to nationalist propaganda and appeal to American consumers to buy Apple instead of a Samsung smart phone. Apple has substantial non-American components and similarly, Samsung includes American technology and components. As mentioned, the WTO prohibits nationalistic campaigns by governments aimed at influencing consumer behavior although these were common practices at the unofficial level only a few decades ago. Such practices might even be continuing today in parts of the world but are increasingly anachronistic and ineffective. On the other hand, some manufacturers of finished products who have not ventured into globalization of production can make a virtue of this and attach appeal to consumers' sense of nationalism by attaching labels that proclaim '*Proudly* Made in X.' Increasingly however, nationalism is difficult to channel in ways that influence consumption choices. In produce, the trend to localization is often less an appeal to nationalism and more likely based on grounds that locally harvested produce is likely to be fresher and, therefore, more nutritious than produce sourced from distant locations.

The blurring of national identities applies to both global production and globalization of production, and in the above example, these products were probably better examples of global production than of globalization

of production, and production based on a network of value chains. Globalization of production is distinct from manufacturing in foreign countries that we associate with multinational corporations (MNCs). MNCs have engaged in foreign production for more than a 100 years but this manufacturing was usually always a finished product for local consumption. Today, global manufacturing has introduced a detailed division of labor and specialization across countries and integrated the disparate manufacturing units into a network for final assembly.

Conclusion

Building on the proposition that contemporary economic globalization consists of two key components: globalization of consumption and globalization of production, this chapter provided a logical explanation for the emergence of globalized production in terms of neo-protectionist trade policies in the 1980s. I described globalized production as part of a 'learning from Japan' triggered by neo-protectionism and Japanese manufacturing investments in the USA. The alternative, prevalent thesis is that globalized manufacturing was a result of liberal trade outcomes and technological advances that made it possible to fragment production. This is certainly possible, but the balance of evidence suggests that American and western adoption of networked manufacturing was a result of close proximity of Japanese manufacturing strategies in the USA. As mentioned, Chrysler had studied Japanese *keiretsu* and decided that it had no practical applicability. Chrysler only began to move in that direction after it had acquired AMC, which had already adopted many of the Japanese practices. Once one of the Big-3 car manufacturers had moved ahead with networked processes, it was only a matter of time before the others began to take serious interest. As Dyer (2000: 86) observed, 'Chrysler … proved that highly productive partnerships with suppliers not only can flourish in the United States but are the wave of the future.'

The reality is that introduction of a completely new process does not happen simply because it is possible but has to be triggered by an imperative for change. Japanese firms, as noted above, and Japan itself is exemplary of a country with a long history of foreign borrowing and learning. It borrowed and adapted Chinese characters for its writing script, and western science and technology following the Meiji Restoration of 1868. In the latter instance, arrival of menacing and modern American warships in Tokyo Bay led to capitulation of the Tokugawa rulers to American

demands for trade rights and openness. Isolationism, however, had been a core commitment of the Tokugawa rulers and its withdrawal undermined their political legitimacy. Following a short military campaign by opposition forces the regime collapsed and the young Emperor Meiji restored to full imperial powers. The new government quickly embarked on a program of rapid development and modernization that required learning from the West in order to build a 'rich country; strong army' (*fukoku kyohei*), the driving ideology of the new regime. A century later, American firms faced a steep learning curve. For Chrysler and the American car industry, the choice was between oblivion and industrial restructuring and they chose the latter and learned from Japan in order to enhance their competitive position.

Globalized production is an increasingly ubiquitous feature of western manufacturing and has led to a ballooning of international trade in parts and components. Of course, no social and economic phenomenon is the result of a single causal variable but it is clear that globalization of production was predominantly a result of protectionism. Liberal economic policies encouraged trade expansion between countries but it is difficult to see how such policies could have dramatically altered the nature of production processes without some additional trigger mechanism. Globalization of production makes the contemporary period historically unique and unprecedented and this has had a number of important consequences. For instance, product nationality is less clearly identifiable and less important in the consumption decision of global consumers. Moreover, globalization of production has also diminished the separation between producers and consumers because firms integrated into a global value chain are both consumers of products from upstream manufacturers, and producers either of finished products for the market or of components for downstream producers.

Export restrictions prompted Japanese car manufacturers, like Nissan, Toyota, and others, to set up production facilities in the USA and elsewhere, and as they ventured out so, too, did their parts and components suppliers (Maswood 1989). In effect, this introduced the Japanese production system to other countries. At the same time, firms in the USA and elsewhere, were receptive to new forms of industrial organization given on-going debates about American economic decline and loss of international competitiveness. It was appropriate to emulate and learn from a country that was poised to become 'No. 1.' Just as Japan had borrowed and learned ideas and technologies from the USA in its quest for

modernization, first in the late nineteenth century and again after the Second World War, the USA in the late twentieth century was fertile ground for a similar learning of Japanese manufacturing strategies. Some of these Japanese manufacturing concepts, like the just-in-time inventory system, had actually been borrowed from the West but the Japanese application of it proved its utility and made it attractive to American and western businesses. Culture had not impeded Japanese learning and borrowing from the West, and in the 1980s, Japan became an inspirational model for reverse learning by the West. Having learned and perfected western management, there was now a reverse flow of learning across the Pacific. There were no culturally insurmountable barriers. Regionalization and globalization of production networks was a defensive response to neo-protectionism and to cost imperatives, and the emergence of economic globalization has strengthened the foundations of liberal trade.

In using trade-restrictive measures, a key US goal was to encourage Japanese manufacturers to rely less on exports and to engage in local production in the USA. In this way, they hoped to rectify their persisting trade deficits with Japan. Other western countries followed with their own trade-restrictive measures. The results exceeded expectations because as Japanese manufacturers ventured overseas, they replicated their networked manufacturing strategies on a global scale and provided a model for others to follow and emulate. Networked production has emerged as a growing global trend, not confined only to Japanese producers. In these GPNs, the core entity and the lead firm is not only the final producer but also a consumer of parts and components from its many different subsidiaries spread across many different countries.

Once we understand the origins and logic of economic globalization, it is easy to grasp its true consequences in strengthening the foundations of liberal trade. Its roots go back to a defensive response against protectionism, and logically, to the extent that it is successful, it should keep protectionism at bay. More precisely, globalization has achieved this by progressively conflating the roles of consumers and producers in the global economy. Typically, in a capitalist economy, producers and consumers have a separate identity and come together in the market place to effect the process of exchange. However, in globalization there is an on-going conflation of the two roles such that producers have also become consumers of parts and components sourced from diverse locations. Geographically dispersed production has blurred lines separating producers and consumers. Producers in one part of the world are also consumers of parts and

components produced in far-off places, and the formation of production networks means that international trade is becoming more in-house than arms-length. This has resulted in other flow-on effects in transfer pricing and tax evasion and a mark of the weakness of existing regulatory infrastructure. That may change over time but the fusion of production and consumption is an important enduring shift in capitalism. At a superficial level, it marks a return to pre-capitalist modes of production. For example, feudal restrictions on trade and market exchange led to self-sufficiency as a basic norm in which producers were consumers and vice versa. As in feudalism, globalization has narrowed the gap between the two functions of production and consumption and producers have emerged as consumers as well, of intermediate manufactured goods. Despite similarities, liberal and open trade, rather than mercantilist protectionism, is the bedrock of contemporary globalization. As such, this duality is not a retrograde evolution of capitalism, or a new form of feudalism because it still features the essential attributes of capitalism, such as specialization of production, market exchange, private ownership of property, competition, and rational self-interest. It is fundamentally different also from earlier forms of capitalism, during which trade was vertically organized. In globalization, intermediate goods trade, within horizontal networks, are dominant. Primary products, whether raw or processed, are fundamentally different from manufactured intermediate goods and components. The evolutionary path of globalization has enormous consequences for trade stability and a number of related issues.

In globalization, producers have the additional perspective of consumers of upstream manufacturing, often of production outside the national boundaries, and this has made an important difference to stability of liberal trade. For example, some Japanese manufacturers relied on parts and components imported from Thailand, but floods in October 2011 disrupted local production, and Japanese producers, who were 'consumers' of parts from Thailand, also had to suspend their manufacturing activities. When producers enter markets as producers, they are in competition with other producers and consequently have an incentive to engage in protectionist behavior, especially in periods of economic downturns. That is much less a driving force for producers in a globalized economy. Unlike nineteenth-century liberal trade that was always susceptible to the ebb and flow of economic cycles, of booms and bust, twentieth-century globalization has made liberal trade a durable reality. Adam Smith and his contemporaries easily anticipated globalization of consumption and the welfare

and peace dividend, but could not have anticipated production processes that went beyond nationally based division of labor and specialization. Contemporary globalization is, as such, a revolutionary new development that has significantly altered capitalism. The next three chapters will explore some of the key consequences of contemporary globalization.

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PART II

Consequences of Globalization

CHAPTER 4

Globalization and Trade Stability

The intellectual case for free trade, that it enhances national and individual economic welfare, is convincing. In addition to the economic logic, free trade is also associated with stable and peaceful international relations because it raises the opportunity costs of conflict and war. However, trade disruptions do happen, often for ill-conceived nationalist reasons, and can lead to economic and political conflicts. The 1930s was a good example of economic competition and trade disruption that progressed to political conflicts, an arms race, and eventually to the Second World War. One explanation for this particular cycle of trade disruption and war is American return to isolationism after the First World War. Proponents of this view blame the USA for not just the passive act of withdrawal from international involvement but for an active policy of exacerbating international instability and turmoil, when it passed the Smoot-Hawley Tariff Act in 1930. The Smoot-Hawley tariff was a blatantly protectionist legislation that triggered a descent into a trade war as other countries retaliated with their own tariff measures. This protectionist legislation coincided with the Great Depression and resulted in a massive drop in world trade from US$3 billion a month in 1929 to US$1 billion a month in 1933 (WTO 2013b: 52). According to Harold James (2001: 108), the 'turn to protectionism on a massive scale was the most obvious feature of the interwar collapse of globalism.' Holding the USA responsible, Kindleberger (1986: 233) described American foreign economic policy in this period as

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amounting to 'world economic irresponsibility.' Similarly, Appleby (2010: 276) remarked that as the world's leading economic and industrial power the USA could have stepped in as the 'new guardian of stability but didn't, preferring to act as the Lone Ranger.'

The suffering and hardship during the Second World War eclipsed even the brutality of the First World War. Following the Second World War, the USA did not repeat its earlier mistake of isolationism and, instead, used its hegemonic power and influence to establish the foundations of a liberal international economic system. The system survives to this day but a hegemon-dependent international system is inherently subject to potential instability either because of hegemonic decline or leadership fatigue. In this chapter, I will show that globalization, and especially disaggregated production, has stabilized trade and insulated it from protectionist pressures. When liberal trade is dependent on government policy or a particular distribution of power in the international system, such as hegemony, it is vulnerable to shifting national interests and to changes in the distribution of power. Bhagwati (2004: 11) noted that 'governments that can accelerate globalization can also reverse it. Herein lies a vulnerability that cannot be dismissed complacently.' Liberal trade can also unravel during periods of economic downturn and a good example of that was trade policy during the Great Depression.

In the contemporary period, however, fragmentation of manufacturing has diminished the threat potential of those earlier challenges and it is reasonable to assume that the corporate sector will resist retrograde steps that might destabilize liberal trade practices and jeopardize viability of networked manufacturing. Although liberal trade is on firmer footings, recent events give pause for concern. In the USA, President Trump's protectionist rhetoric and, in the UK, a decision to leave the European Union may suggest that trade stability, and the stability of production networks, is not a foregone certainty. I will discuss these recent developments later, after first establishing the trade-stabilizing consequence of globally networked production.

Globalized production was a result of corporate decisions to offset the impact of state-led trade restrictions in the 1980s, and should therefore be natural safeguards against protectionism in the future. Globalization did not originate in enlightened state leadership but from a series of market-based decisions to bypass protectionist obstacles to trade. Globally networked production has become part of a corporate strategy to protect

liberal trade and it is consequently unlikely that states will deliberately roll back liberal trade for fear of jeopardizing production activity within their own country. The reasoning is simple; in a capitalist system, governments cannot defy corporate and business interests without also undermining their own political survival. This has also de-linked trade stability from economic cycles. The newness of globalization means that we mainly have the 2008 global financial crisis against which to assess the trade-stabilizing consequences of globalization. However, this was the worst economic crisis since the Great Depression and it is important that there were no major breaches of liberal trade compared even to lesser crises in the past. Trade levels did fall after the latest financial crisis but not necessarily because of protectionist barriers to trade. Evidence from the earlier Asian Financial Crisis, in 1997, also supports the general conclusion. Looking only at intra-firm trade, a subset of GVCs, one finding was that US trade with Asia was less affected for intra-firm than for arms-length trade. Between 1996 and 1998, US arm's-length exports to Asia declined by 26 percent, while intra-firm exports fell by only 4 percent (Lanz and Miroudot 2011: 29). In this chapter, I will present logical reasons why outcomes following the 2008 crisis constitute the 'new' norm and why globalization has delinked trade stability from earlier explanations based either on hegemonic distribution of power or interest group politics. An underlying assumption is that some rational calculation of costs and benefits will guide policy-makers.

Postwar Liberal Trade

Liberal economic theorists, from Adam Smith onward, have advocated free trade for its benefits to consumers everywhere. Yet, there has never been policy consensus around the principle of free trade. Governments everywhere have ignored Adam Smith's call for good governance and rejection of any special privileges (protection) that diminished the level of competition and consumer welfare. According to Smith (1964: 415), 'The legislature, were it possible that its deliberations could be always directed, not by the clamorous importunity of partial interests, but by an extensive view of the general good, ought upon this very account, perhaps, to be particularly careful neither to establish any new monopolies … nor extend further those which are already established.' Here, he was referring not only to industrial concentration but also to the grant of protection to firms from competitive pressures. Notwithstanding Smith's

advice, the reality is that policy-makers tend to buckle when confronted with protests and complaints from producers that are internationally uncompetitive. Their sectional interests historically have trumped the general interest, and protectionism has always been a part of states' economic policies.

Moreover, consumers, despite their numerical strengths as a group, have tended to be relatively passive rather than act on their self-interest. Collective action theory suggests that consumer inactivity in securing free trade is consistent with rational self-interest. Traders and mercantile capitalists were better organized to defend, advocate, and protect free trade but hamstrung because the trading sector, in most economies, was a small portion of the national economy. By contrast, manufacturers and producers often succeeded in securing protection, when necessary, from import competition. In place of free trade, there have only ever been periods of liberal, or freer, trade.

The postwar liberal order had an institutional underlay that became a basis for stability through periods of economic disorder, and the system largely endured the alleged American economic decline of the 1980s. The liberal economic regime, defined as rules and norms of behavior around which expectations converge, was a school of good behavior for its members, and in time, regime members internalized the rules of engagement to ensure that system stability was not dependent only on overt hegemonic leadership. The rules included a grant of most favored nation status to all GATT contracting parties and a commitment to not discriminate against foreign products and accord them full national treatment. GATT contracting parties generally respected these rules, even through periods of American decline and loss of hegemony. The *institution* of liberal trade functioned almost like a school of good behavior. One exception was American neo-protectionism that was, however, selective in its application and limited in scope.

Before the World Trade Organization replaced it, GATT successfully concluded eight rounds of multilateral trade negotiations that liberalized trade in manufactured goods and expanded world trade. With liberalization, trade expanded at a rate faster than GDP growth. Lack of firm data has created some confusion about actual tariff levels at the end of the Second World War, but Brown and Irwin (2015) estimated average tariffs on manufactured goods to be around 22 percent, considerably less than earlier suppositions that tariffs were as high as 40 percent. Tariff peaks before the Second World War were, presumably, much higher given that countries

were ratcheting up their protectionist measures in the 1930s. In 1947, average trade-weighted tariffs for GATT members (based on tariff revenue and total imports) ranged from 6.2 percent for Chile, to 16.6 percent for Canada, to 24.4 percent for the USA, and to 47.7 percent for the UK (Brown and Irwin 2015: 21). By the turn of the twenty-first century, these tariffs were reduced to single-digit levels. As protectionism declined, it triggered a boost in global trade that became the building block of international interdependence by the 1970s. By the late twentieth century, world trade relative to GDP had surpassed levels reached in the nineteenth century, the first period of liberal trade.

However, GATT's success was limited to industries of interest to developed countries. GATT was of little benefit to developing countries. It acted like a club for the rich countries and, until the Uruguay Round (UR) in the 1980s, ignored issues of interest to developing countries. The agenda for the Uruguay Round included negotiations on products of interest to developing countries, such as textiles and agriculture. The UR liberalized trade in textiles, though at a rate slower than originally promised by developed countries, but trade in agricultural products remained largely unchanged. In primary products, protectionist levels remained high. Disillusionment with the GATT structure led developing countries to pursue their interests through the United Nations Conference on Trade and Development (UNCTAD). This became their preferred negotiating forum. It was in UNCTAD negotiations that developing countries secured the Generalized System of Preferences (GSP). It allowed some of their exports duty-free access to developed country markets. Most developed countries introduced their GSP schemes in the late 1960s and early 1970s. The USA extended GSP privilege to nearly 130 developing countries with duty-free access on many products. However, because the GSP was not part of GATT, there was no long-term certainty that the scheme would continue. Bangladesh, for instance, lost its GSP privileges in the USA after the Rana Plaza accident. Structural defects and poor safety standards resulted in the death of more than 1100 garment workers when the Rana Plaza, a building that housed garment factories, collapsed in April 2013. The accident led to intense international pressure on the government to improve work practices and worker safety. As part of the international campaign, the USA withdrew GSP privileges for Bangladesh that had allowed many of its exports duty-free access to the US market. This was justified, on grounds that the Bangladesh government had failed to protect worker rights and safety and that the USA could not grant concessional import

status to goods that did not comply with fair manufacturing practices. Loss of GSP status in the USA was a setback for garments exporters but tougher standards and regulations may ultimately be beneficial because it forced manufacturers to improve their technological base to achieve compliance with international norms. At the same time, a quirk of the GSP system was that its withdrawal did not change the pricing structure significantly because importers in the USA had already priced-in the advantage of GSP and, consequently, captured most of the benefits of the scheme. Where it hurt Bangladesh, however, was that it resulted in trade diversification as some American importers shifted to procure imports from countries that had the GSP privilege.

The additional tariff burden slowed the growth of textile and garments exports, a mainstay of the Bangladesh economy, but it also stunted the growth of other newly established industries. Before USA rescinded duty-free imports, Bangladesh had developed significant exports of ceramic tableware to the USA but exports fell sharply with the withdrawal of GSP and imposition of a 30 percent MFN tariff on tableware imported from Bangladesh. Foreign pressure forced the government in Bangladesh to improve worker rights and safety but progress remained patchy and, until 2016, insufficient to convince the US government to restore GSP for Bangladesh exporters. A problem for most developing countries, like Bangladesh, is that bureaucratic inefficiency and corruption mean that they lack administrative capacity to police and enforce legislations, even when the legislative apparatus is already in place. Workplace safety legislations may exist on paper and yet, with little difference to conditions on the ground. Moreover, sanctions do not necessrily help build state capacity to implement existing safeguards.

For most developing countries, introduction of GSP was a significant benefit but the GSP, unlike GATT's MFN tariffs, lacked permanence. Moreover, the margin of benefit provided by this scheme, in other words the difference between MFN and GSP tariffs, was progressively reduced as MFN tariffs were negotiated down following the Tokyo and the Uruguay Round negotiations of the GATT. A large portion of MFN tariff lines are duty-free and in these sectors the margin of GSP preference is meaningless, and in other sectors where MFN tariffs are low, the margin of preference is insignificant. There are exceptions, such as MFN tariffs on ceramics imports in the USA which are relatively high and where the loss of GSP privilege has severely impaired the profitability of this growing industry in

Bangladesh and limited its growth relative to exporters from developing countries with GSP privilege.

Even with limitations of the GATT system, overall, trade expansion was impressive. Multinational companies and competitive industries, with increasing international presence, were strong proponents of liberal trade, especially during periods of economic boom, when market demand was adequate to support both domestic production and imports. According to Helen Milner (1988: 19–20), firms that had greater export dependence tended to be generally supportive of freer trade because protectionism at home could invite retaliation in foreign countries. She claimed as well that American industry was much less protectionist during the 1970s recession than during the Great Depression, due to deeper multinational connections (Milner 1988; Chorev 2007: 142). The protectionist dragon, however, was not slain and remained a constant presence. Thus, even without a general ramping up of tariff levels, there was still considerable selective protectionism through various non-tariff measures. In the decade of 1970s through till the early 1980s there were a series of such neo-protectionist measures, including the Multi Fibers Agreement (MFA) that introduced quota restrictions on textiles trade, trigger price mechanism (TPMs) limiting steel exports to the USA, and Orderly Marketing Agreements (OMAs) on television exports. It is possible, as suggested by Bhagwati, that selective and targeted protectionism prevented the resort to much harsher protectionist measures or more comprehensive trade restrictions (Bhagwati 1988: 57 cited in Chorev 2007: 144).

Explaining Protectionism and Liberal Trade

Economists have a difficult time explaining protectionism because the argument for free trade is so overwhelming. Some however, have made a case for an optimum tariff or a 'terms of trade tariff' that trades off declines in consumer welfare from tariff increase against gains to producers (producer surplus) and additional tariff revenue. To the extent that the final figure is positive, it is theoretically possible to argue that a country can improve its total welfare position by imposing an optimal tariff greater than zero. It is possible to make a case for an optimal tariff if gainers (small number of producers) were to compensate losers (majority of consumers), but this is an unrealistic assumption. The theory, however, also assumes that there is no retaliation against the first mover (Bhagwati 1991: 31), an unrealistic assumption given experiences in the 1930s. A

relatively small trading country may indeed get away with it, but cannot be beneficial or recommended for all states. Protectionism has also coincided with downturns in the economic cycle (Nivola 1986: 580). An exception to this was what southerners in the USA called the Tariff of Abominations, passed in 1828 to protect industries in the North, but at the expense of the South, during an expansionary phase of the economy.

Apart from this, states have at various times, relied on tariffs as a source of revenue especially because tariffs at the border and the ports are easier to administer than broad-based income taxes. In the USA, for example, tariffs provided about 88 percent of the federal government's revenue between 1789 and 1800 (Chorev 2007: 42).

A simple non-economic explanation, according to Jagdish Bhagwati (2002), is that consumers are often either ignorant or under-informed of the benefits of free trade, because economists had failed in their professional responsibility to educate societies and to disseminate the logic of free trade and its benefits. This failure and oversight allowed advocates of protectionism and economic nationalists to sway public opinion to support misguided anti-trade policies. Bhagwati chides professional economists who, with some exceptions, had vacated the public stage and allowed critics to propagate their illiberal biases as objective truths. He is perhaps a little too harsh on his profession because protectionism, after all, has not completely drowned out arguments for liberal trade. The absence of a 'bonfire of protectionism' after the global financial crisis was a remarkable outcome, which Hufbauer and Suominen (2010: 20) attributed to the 'influence of academics, policy makers and observers who relentlessly tout the benefits of open trade regimes.' It is comforting to think that academics matter, but the classicals had already won the academic debate. Sectional interests, in particular, frequently sway policy-makers in all societies, even when such a course is contrary to national interest.

Even if critical of his profession, Bhagwati singled out his student Paul Krugman as one of only a few economists who had actively defended free trade in public forums. Nonetheless, even this heroic defender of the orthodoxy was apparently imperfect. This is because Krugman 'in his youthful surrender to irrational exuberance, went so far as to propagate the view that … it was not possible now to oppose protectionism on theoretical grounds' because countries like Japan, for instance, had shown how international trade could be manipulated to advance national goals of industrial development (Bhagwati 2002: 22). In the 1980s, highly popular notions of 'unfair' Japanese trade practices and the flow-on attendant

threats to US supremacy had inspired the development of new and strategic trade theories. Krugman himself was an advocate of strategic trade policies, of successful government intervention to nurture internationally competitive industries, as the Europeans had done with the Airbus Industries. Bhagwati of course, ever the defender of orthodoxy, dismissed these so-called welfare-maximizing arguments for protection as unfortunate heresies from the principle of free trade.

It is possible also to explain overall postwar trade stability to institutional support provided initially by the GATT and later by the World Trade Organization (WTO) in 1995. The WTO filled in some of the weaknesses of GATT and while it had been effective in managing and resolving trade disputes between member countries, it has failed, as of now, to complete its inaugural trade liberalization round that was launched 15 years earlier. Judith Goldstein (2000) also cautioned that a stronger WTO might have actually impaired trade stability by re-igniting fears about a supra-national trade body. She added that this 'may make it increasingly difficult for American leaders to find support for free trade' and that, as a consequence, American 'allegiance to the trade regime is far more tenuous than at any earlier time' (Goldstein 2000: 268, 269).

Two political economy explanations for liberal trade and protectionism include interest-group politics at the level of the state, and hegemonic-stability at the level of the international system. The former suggests that trade protection results frequently from manufacturers lobbying for exclusion of foreign competition from domestic markets. The benefit to producers is always at the expense of consumer interests. Despite losses to consumer welfare, they rarely campaign for liberal trade, and introduction of liberal trade, according to one strand of the political economy literature, is instead associated with the presence of a hegemonic power. The hegemonic-stability thesis (HST) assumes that a hegemon, given its superior economic productivity and competitiveness, has an *interest* in stabilizing liberal trade and, given its political power, has the *capacity* to negotiate its establishment and secure compliance at a systemic level. The HST is associated with the writings of Charles Kindleberger (1986) and Robert Gilpin (1987). For the other political economy explanation, Grossman and Helpman (1994) modeled the influence of special interest groups in securing protection, and according to them, large industries, which make political contributions to campaign finances through industry lobby groups, are more successful in rent-seeking activities.

According to hegemonic-stability thesis, a hegemon with vastly superior economic and competitive advantages finds it advantageous to pursue policies of liberal trade. Britain took that step when its manufacturing industries had reached global dominance and when these industries demanded liberal trade policies. In nineteenth-century Britain, Richard Cobden and John Bright were committed advocates of free trade but the message became a winning force only after industries in Manchester threw their weight behind liberal trade. Similarly, in the USA, the Reciprocal Trade Agreement Act (RTAA) of 1934 reversed some of the ignominious blunders of the Smoot-Hawley Tariffs and this was possible only when mass production industries in Detroit rose to political dominance (Kindleberger 1986: 234). The RTAA linked US economic recovery to trade liberalization and expansion and allowed the government to reduce tariffs in return for similar tariff concessions by other countries.

Although hegemony correlates with liberal trade, hegemony does not always produce liberal trading outcomes. Although a hegemon, almost by definition, possesses internationally competitive industries that are potential beneficiaries of open markets overseas, it is possible for a hegemon to prioritize other non-economic goals. Thus, in the interwar period the USA decided, wisely or otherwise, that it was better to avoid entangling alliances that might again drag it into old European conflicts. Instead of pursuing a liberal international order, it returned to policies of isolationism. After the Second World War, however, the USA chose engagement, and liberal trade rules worked to the advantage of American industries, at least until the recovery of European and Japanese economies. The USA also provided enough inducements for others to commit to liberal policies, including access to its markets. Hegemonic-stability thesis claims that hegemonic leadership is necessary not only as an originating condition but also to ensure continued stability of liberal trade. First, it is necessary as an originating condition because the hegemon, with the largest and most efficient industries, has a presumed interest in establishing liberal trade practices. Second, a hegemon is also essential as a stabilizer because stable liberal trade requires a large market that only a hegemon can provide and in which periodic global supply and demand imbalances can be reconciled, without which countries are likely to resort to protectionism to shelter industries at the first indication of a production surplus or insufficient demand. Without a large open market to 'absorb' periodic deficiency of demand, protectionist pressures are likely to spread and spiral out of control. This explains concerns in the 1980s when the USA appeared to be in

economic decline and Japan ascendant as the next 'Number One.' Hegemonic transitions can be unpredictable and there was no certainty that Japan, even as a loyal western ally, would retain the main principles and structures that formed the basis of the liberal economic order established by the USA. At all other times of hegemonic absence, protectionism is the historical norm. Contemporary economic globalization, however, has finally ended the cyclical nature of liberal trade and protectionism that was the case over the past 200 years. This is not because globalization has ended the cyclical nature of capitalism but because of other factors, discussed below.

Hegemonic-stability thesis explained trade policy as a function of power distribution at the systemic level. At the state level, Mancur Olson provided an interest-group-based explanation of free trade and protectionism. The theory of free trade identifies consumers as its prime beneficiaries, and this group should be the most ardent defender of liberal trade. In reality, consumers have rarely been forceful champions of liberal trade. Olson's (1965) explanation hinged on apathy, passivity, and organizational capacity of large groups, such as consumers. Smaller groups of producers, by contrast, are more effective and possess organization strength to secure government assistance and protection. He points out that protectionism is attractive to producers because it allows rent to accrue to a small minority of producers, while diffusing the costs of protectionism to society at large, creating in the process an incentive for relatively uncompetitive industries to lobby for protection (see Goldstein 2000: 250). The likelihood that such industries will organize and lobby for protection is higher if the costs of lobbying to each individual firm in the industry are lower than potential benefit. Olson began his analysis with group theory and human tendency to voluntarily band together in associational groups, whether large or small, to advance their common interests. Group theory makes no distinction between the size of groups and all are equally likely because of human herding instincts. To this, Olson added the other basic human instinct of free ride, the desire to pass on organizational and other associational costs to others while still benefiting from group action. This qualification allowed Olson to make a distinction between large and small groups and explain why large groups, say consumers, will either not form or be inefficient in pursuing collective interests compared to smaller groups of producers in an inefficient industry.

Large groups of consumers, he suggested, tended to be relatively ineffective in realizing their common interests because of free rider problems.

Olson explained that even if all members in a groups had a 'common interest in obtaining the collective benefit, they have no common interest in paying the cost of providing this collective good' (Olson 1965: 21). Consequently, collective goods were under-produced in large groups (consumers) because there were greater opportunities to free ride on the efforts of others, and avoid paying for the costs of securing the desired benefit. The free rider problem robbed large groups of organization strength and cohesion as no single member or leadership group was likely to volunteer to assume costs associated with organization efforts when benefits flowed equally to free riders, and when the cost-benefit matrix for leaders sapped the potential for leadership. Olson found that large social groups were at a lobbying disadvantage because no one was prepared to lead in order to secure collective benefits. Contrary to widespread belief in the strength of a majority, his conclusion was that the majorities were at a distinct disadvantage and often come out second best to small but better organized minority groups within society. In a democracy therefore, if the majority is intuitively expected to achieve its preferred outcomes, Olson demonstrated that it is the minority that often prevailed, that it may be the majority that deserved protection from the minority rather than vice versa. The same point was also made by Anthony Downs (1957: 64) who noted that governments will always follow the majority principle unless 'the majority hold their opinion lukewarmly; [and allows] a passionate minority [to determine] policy.' In the case of free trade, the costs to any one individual or group to organize and lobby for liberal trade would be greater than the direct benefit to them.

By contrast, small groups (such as producers) were often more effective in securing their collective interests because it was easier to maintain group coherence and discipline especially in ensuring that all members shared equitably in the burden of lobbying activities, minimizing the free rider problem. The free rider problem arose because, as Olson (1965: 34) explained, all groups, large and small, had a common interest in securing their collective benefit but had no common interest in paying for its provision. Thus, larger groups with a lax discipline and potential free ride had greater difficulty in organizing for their collective interests. At a general societal level in democratic systems, industries, being fewer in number than consumers, were easier to organize and more successful in securing their preferred policy options. Consumers may be interested in free trade and constitute a majority, but it was more likely for a small number of

producers to lobby policy-making to deliver outcomes in their interests rather than for the majority of consumers.

In the USA, the Congress is responsible for trade policy-making and, as an institution, is much more susceptible to lobbying by vested groups in society. Schattschneider captured the dilemma confronting the Congress and in his book, he observed that 'the pressures upon Congress are extremely unbalanced. That is to say, the pressures supporting the tariff are made overwhelming by the fact that the opposition is negligible' (cited in Destler 1992: 3). There was no effective opposition to pressure for protection because consumers, as beneficiaries of free trade, were not sufficiently organized, engaged, and active to make their voices heard in Congress. In the end, minority interests derailed liberal trade policies. Globalization, however, has allowed consumer interests in liberal trade to become more decisive, not because of greater activism of individual consumers but because producers in global value chains have acquired a second identity as consumers of upstream manufacturing. Producers *as* consumers are more effective in securing and defending liberal trade at the level of state policy-making.

In his study of US tariff and trade policy, David Lake (1988) dismissed the interest-group explanation because of unexplained anomalies. An assumption of the interest-group explanation is that a trade-dependent country was less likely to invoke protectionism than a state less reliant on trade. However, Lake noted that, in the 1890s, American trade policy remained highly protectionist even as US trade shares went up dramatically (Lake 1988: 8). Because of this anomalous finding, Lake provided an explanation based on a modified hegemonic-stability thesis. He identified seven different state categories whose trade policies determined the structure of the economic system, including also a possibility of cooperative liberal order in which leadership was not hegemonic but shared. If interest-based explanations are imperfect, that is also the case with hegemonic-stability. The USA, despite its hegemonic position at the end of the First World War, failed to provide systemic leadership and stabilize liberal trade. While Kindleberger, as noted above, had accused the USA of world economic irresponsibility, Lake sidestepped this anomaly by re-classifying the USA as 'an opportunist from at least the early nineteenth century until World War II. After a brief two decades as a hegemonic leader, the United States returned to this category in the mid-1960s' (Lake 1988: 47). However, if hegemony had slipped, there was no wholesale abandonment of liberal trade.

Neither explanation may have been perfect, but those were the two key theoretical explanations for liberal trade and protectionism. Globalization however, has injected much greater certainty to liberal trade and my argument is that it has rendered hegemonic leadership redundant. In the next section, I will explain how GPNs and disaggregated production have placed trade stability on a firmer footing than ever before, even rendering hegemony as superfluous. Hegemony was, at best, conducive of liberal trade but the global spread of networked manufacturing has given a causative boost to trade stability. This new reality has made continued US hegemonic presence less critical. This is not necessarily a bad thing given the subtle shifts in global political economy. For the near future, the USA will remain the single most important economy in the global system. One indicator is that American firms continue to dominate the list of 20 largest manufacturing firms, with not a single Chinese entity making it to the list. Yet, China has surpassed the USA as the largest economy. China is the single biggest exporter of manufactured goods, and in 2013, its total manufacturing output was more than the combined manufactured output, in US Dollar, of the next four manufacturing economies, the USA, Japan, Germany, and South Korea. In the two instances of hegemonic-stability, both Britain and America were the preeminent 'workshops to the world' given their superior manufacturing prowess, but today in the new era of globalization China has emerged as the world's latest industrial workshop even though it is not yet in a hegemonic position. Although the USA has lost its standing as a manufacturing powerhouse, it is still the leading source of innovations and technological breakthroughs. Moreover, it is no longer simply manufacturing but technological change that has become a driving force for growth and development. According to the World Intellectual Property Organization (WIPO), of the 2,18,000 patent applications that were filed in 2015, the USA accounted for 57,385 applications, followed by Japan and China, with 44,235 and 29,846 applications respectively. The USA clearly is the global leader in technological innovation.

Globalized Production and Trade Stability

Globalization of production has important consequences for the future of liberal trade and protectionism. In a system of globally dispersed production, there is a confluence of interests between individual consumers and producers, now also transformed as consumers of parts and components in the global value chain. This has changed the nature of interest-group

politics and weakened the influence of protectionist forces, because producers engaged in lobbying activities, have now developed global supply chain activities and, consequently, acquired multiple identities as producers, traders, and as consumers. The last of the three manifestations of producers is particularly important for liberal trade because consumers are the prime beneficiaries and the mainstay of liberal trade. In globalized production, individual units in the supply chain consume production from upstream producers, add value, and supply to units further downstream or to final consumers of finished and assembled production. As these chains have dispersed globally, it has changed the dynamics of protectionism and liberal trade. If competitive producers in the past advocated free trade to reach consumers globally, under globalization it is producers as consumers who depend upon and require free trade for the integrity of production processes. There have always been producers of intermediate goods but not necessarily as members of a network. When production networks are entirely domestic, there are few implications for protectionism and free trade, but when such networks span across national boundaries, there is an in-built and powerful mechanism to inhibit protectionist pressures. The spread of global production networks have strengthened the foundations of liberal trade and reduced protectionist threats, because if weak and unorganized individual consumers of finished consumer goods were ineffective defenders of liberal trade, producers as consumers have a distinct policy advantage in ensuring that protectionism does not interfere with management of supply chains. In recent decades, the composition of trade has shifted away from finished goods to parts and components, increasingly. Trade statistics show the magnitude of changes.

- Exports of non-fuel intermediate goods increased from US$2711 billion in 2001, to US$7723 billion in 2011.
- Share of non-fuel intermediate goods in total world exports increased from 50 percent in 2001, to 55 percent in 2011.
- Share of foreign value-added in world exports was 26 percent in 2008 (WTO 2013a, 2013b).

Network trade, the emergence of producers as consumers, and production for consumption within the value chain are all significant developments for the future of the trading system. Producers *as* consumers have more at stake and are, consequently, much more vigorous defenders of free trade. For example, when it became public knowledge in the late 1980s

that a Toshiba subsidiary, Toshiba Machine, had sold sensitive defense-related technology and equipment to the Soviet Union in the late 1980s, there was a clamor in the USA to impose sanctions on Toshiba and its products. The technology in question allowed the Soviet Union to build quieter-running submarines to evade detection by US naval forces. In effect, Toshiba Machines had undermined western security in the interest of corporate profits, and incensed American legislators introduced bills in Congress to punish Toshiba with significant financial costs. Toshiba spent millions in a desperate lobbying campaign to stave off legislative action and eventually managed to do so, but only with the help of pressure 'from US firms that feared the disruptive costs of being cut off from Toshiba inputs.' (Destler 1992: 194). Retaliation against Toshiba would have adversely affected American business reliant on import of parts and intermediate goods from Toshiba. Similarly, in 2016, suggestions by President-elect Trump that the USA should introduce import tax to protect domestic manufacturing jobs invited opposition from various sections of the US economy that sensed jeopardy to their supply chains (See *Financial Times*, December 16, 2016: 2). A key campaign promise was the introduction of a 35 percent import tariff on cars imported from Mexico. Forty years earlier, such a pledge would have brought cheers of joy from carmakers in Detroit, but in 2016 the threat invited a sense of foreboding.

Global manufacturing has changed the dynamics of trade and protectionism. This dependence of manufacturers on imported manufactured inputs has increased in recent decades, whereas previously, trade, whether driven by inter-industry specialization or by intra-industry competition, was essentially in finished products. Now, however, the nature of production had changed to include suppliers of parts and components not located in close geographic proximity and within national borders. Consequently, the demand and utility of protection has diminished and liberal trade has become much more stable than at any times in the past. It is of course in that context that we now find it harder to conceive of protectionism to exclude foreign products when 'foreign' and 'domestic' have become contested ideas.

The stability of liberal international trade is less dependent on hegemonic presence and more on global manufacturing. Moreover, the logic of disaggregated production is beyond easy reversal. Any attempt to return to earlier forms of international trade will incur high, if not prohibitive, costs. According to Michel Beaud (2001: 279), 'Rather than the neighborly charm of a "global village," the vast majority of the six billion inhab-

itants of the Earth must instead simply put up with developments and changes they are unable themselves to influence.' The triumph of globalization is the triumph of large multinational industries. In 2015, gross sales of 200 of the world's largest firms were greater than the combined GDP of all but the nine biggest countries in the world. Their dominance has grown progressively, considering that, in 1960, these firms accounted for only about 17 percent of global production (Beaud 2001: 286). We can assess the desirability of this development from a number of different perspectives and levels of analyses, but at the firm level, concentration has allowed for greater economies of scale. For consumers however, there is a lessening of competition in the market place with the usual adverse outcomes. These largest companies also employ only a very small fraction of the global workforce. A key future challenge is the nature of regulatory structures to balance the varied interests and to ensure that flow-on benefits are equitably distributed and shared.

In the previous chapter, I described globalization in its comprehensive form as a product both of progressive liberalization after the Second World War and of trade restrictions in the 1980s. The central message in this chapter is that present-day globalization has established a solid foundation for stable liberal trade. That stability, more enduring than before, emanates from the market mechanism, and stable liberal trade is a consequence, not a cause of globalization. This is in sharp contrast to orthodox analyses of globalization in which most analysts see liberalization as both a cause and consequence of globalization. Globalization can be one or the other, but not both, and as discussed in Chap. 3, the origins of contemporary globalization, including globalization of production, cannot be traced to postwar liberalization but rather to a defensive reaction to trade protectionism in order to protect liberal trade. Trade stability is on stronger footings because integrity of supply chains hinges on preservation of liberal trade. The asserted permanence of trade liberalization and stability is not because of the web of free trade agreements but the web of global production agreements. The former, however, is not superfluous and states have pursued these with considerable vigor in recent decades. In Asia, for example, at the start of the millennium, there were only three free trade agreements (FTAs) but by the end of 2014, there were 77 FTAs, with negotiations under way for another 50 (Wilson 2015). Future prospects appear mixed, however, because while the Trump administration in the USA may pull back from trade agreements, Britain after Brexit will

have to negotiate many more trade agreements to compensate for potential loss of market access in the EU.

Globalization is also a function of technological advances that have enabled dispersed production units to function as an integrated entity. By situating different aspects of the production process in different countries, companies are able to take advantage of specific locational benefits, including cost-savings of transferring labor-intensive processes to developing countries. In explaining globalization, trade protectionism and technological advances were the push-and-pull factors, respectively. The consequence is a strengthening of liberal trade, independently of hegemonic and institutional supports. This means also that trade stability is now independent of the economic cycle. Economic downturn need no longer raise the specter of increased trade protectionism. The separation of politics and trade does not however mean that businesses will no longer seek political influence, only that they are less likely to focus on issues of protectionism.

As such, there is less likelihood that collective action problems that, in the past, impeded and imperiled liberal trade policies will have the same adverse effects, even during recessionary economic conditions. If consumers were feeble defenders of liberal trade and producer sentiments contingent on the state of economic cycles, contemporary globalization has altered the calculus of free trade. Producers have a commitment to liberal trade irrespective of economic cycles, and to the extent that public policies reflect producer sentiments, a significant new outcome is the transition from trade stability based on hegemonic principles to 'stability without hegemony.' With global production, liberal trade is the only game in town. A Report released by the WTO in April 2012 confirmed this, noting that while there had been an increase in protectionism after the global financial crisis, it had affected only 1 percent of world imports. Similarly, Bussière et al. (2011: 839) found that in the aftermath of the crisis and contrary to public pronouncements, the G-20 countries did announce or implement nearly 400 trade-damaging measures but that only a few of these actually raised tariff levels. Consequently, there was no 'large scale retaliatory tariff increases, comparable with those observed in the 1930s.' They (2011: 840) attributed this atypical response to the following three factors:

1. Macroeconomic expansionary policies that were not possible in the 1930s because of the gold standard.
2. Web of bilateral, regional, and multilateral agreements.
3. Globalization and pressure to maintain open markets.

Fiscal and monetary policies were important, although as Krugman (2013) pointed out, the scale of expansionary measures were incommensurate with the magnitude of the crisis. For Bussière et al. (2011: 840), globalization was critical and they observed that 'countries that [had] taken explicit protectionist actions tend[ed] to be less integrated into the global supply chains.' It is not that consumers as beneficiaries of free trade have become more organized and vocal in their demands but simply that the business community has acquired a more global outlook in which the voices of protectionism have faded in the distance, and continue to do so with the progression of time. Indeed, in the aftermath of the global financial crisis, as unemployment mounted, popular support for free trade declined in advanced countries. In the USA, as Hufbauer and Suominen (2010: 21) report, an opinion poll by *New York Times*-CBS News in early 2008, showed that 38 percent of respondents, nearly twice as many as in a similar poll in 1990, viewed trade as a negative for the domestic economy. The recession, triggered by the collapse of a US housing bubble led also to the sharpest fall in world trade in nearly 100 years. In 2009, the first year after the crisis, the fall was 12 percent according to the WTO. This sharp contraction, an 'overreaction' according to Cattaneo et al. (2010: 9), might be attributed to production networks which tend to amplify the trade effects of production outcomes, because disruption, or reversals, tend to have a ripple effect all through the value chain. Moreover, since manufactured goods and commodities dominate trade, the fall was sharper relative to GDP, because GDP, at least in advanced countries, is composed mainly of output of services. They also suggest that the fall in world trade was because of difficulties in obtaining trade finance after the crisis. Remarkably, despite the sharp drop-off in world trade volume, there was no concomitant rise in protectionism, even compared to earlier crises of lesser magnitude.

Dispersal of production across different countries has created a broad coalition that is committed to preservation of liberal trade. Indeed, if capital was fickle before, it is a firm defender of trade openness because that is an essential element in the spread of globalized production. It is now no longer possible to protect markets at home, even in times of weak consumption demand, without harming their own interests and the integrity of supply chains. Alongside that, another important development is that producers have also become consumers, of intermediate goods and components, in the globalizing economy. Both of these features have strengthened the foundations of stable trade.

Globalization of production is an effective firewall against any future resurgence of protectionism. The trigger for American protectionism in the 1980s was trade deficits against Japan, but deficits are now, as Ohmae points out, largely illusory. What registers as imports into the USA, in official statistics, are often the products of American corporations produced elsewhere in a networked process and shipped back to the USA from some foreign country. However, these are both exports from that particular country and sales also, of American corporations. Ohmae (1999: 149) writes that Texas Instruments (TI) is the most 'competitive producer of memory chips in Japan. Not Hitachi or NEC. More than half of TI's annual production goes back to the United States via assembly operations in Singapore.' The USA could not possibly act to limit such imports without inflicting harm to its own industries. Not surprisingly, even a deep Great Recession failed to instigate any major protectionist backslide in any of the major globalized economies.

The Bizarre World of Sino-Japanese Relations

Logic, as laid out above, dictates that expanding webs of globalized production must strengthen the foundations of liberal trade and weaken nationalist pressures for protectionism. Thus, according to Sturgeon and Memedovic (2011: 4), global production networks had rendered conflicts less likely, at least among countries that were highly integrated. Yet, recent developments in Sino-Japanese relations defy logic and expectation. Economically, this is one of the most integrated and networked dyad, but political relations have frequently descended into acute conflict that has disrupted both manufacturing and bilateral trade. The paradox of conflict inside a networked dyad is inconsistent with the globalization-stability thesis, unless we can identify other countervailing explanations for such conflict.

The integration of Chinese firms into existing production networks in Japan began in the 1980s and was a result of cost pressures that had undermined Japan's international competitiveness. Following a sharp revaluation of the Japanese Yen in 1985, firms looked to China as an attractive low-cost production platform and the two countries rapidly consolidated very close economic relations. China had earlier abandoned its insular and isolationist trade and investments policies and the new post-Mao leadership in Beijing welcomed foreign investments to help it achieve the goal of Four Modernizations, that of science and technology,

agriculture, industry, and defense. Proximity and cultural similarity also encouraged Japanese firms to expand their investments in China. During the 1990s, China received roughly 40 percent of all Japanese foreign direct investments. The stock of Japanese FDI in China increased from slightly more than US$8 billion at the end of 1996 to more than 108 billion at the end of 2015 (about 30 percent of Japan's stock of FDI in Asia). Japanese manufacturers were particularly bullish in relocating some of their assembly and production activities so that they could combine their own firm-specific advantages with 'relatively low production cost of host countries, consequently strengthening their global competitiveness' (Xing 2006: 114). As a result, according to official Chinese estimates, by the end of 2010 there were 22,300 Japanese companies and joint ventures in China with approximately 3 million employees. As bilateral economic links deepened, Japan's domestic production networks morphed into regional production networks.

Increasingly as well, production in China by Japanese subsidiaries and companies became part of 'triangular trade' to meet demand both in Japan and in foreign markets. Trade of components and parts expanded as well, and, naturally enough, production networks in Japan gradually incorporated subsidiaries in China and elsewhere as part of their global manufacturing networks. This, and FDI from other sources, thrust China into its present position as a leading export-based economy. The total trade sector in China expanded, from a low base in the 1970s, to approximately 40 percent of annual nominal GDP in the late 1990s (Moore 2000: 107). Chinese export statistics confirm also that the share of foreign subsidiaries in total exports is very high, more than 50 percent in 2001 (Xing 2006: 110).

Their networked economies benefited both countries. It hastened Chinese economic and industrial development and, in Japan, helped firms lower production costs at a time of shrinking Japanese population and workforce. A measure of Sino-Japanese integration is that China has replaced the USA as Japan's biggest trade partner, accounting for 20 percent of Japan's total exports and imports. Total bilateral trade is around US$340 billion and it is a networked relationship in which each is dependent on the other in particular issue areas. Especially in the early years, China depended heavily on Japan as a source of foreign investment and manufacturing technology. For Japan, China was, and remains, an important low-cost production platform with a plentiful supply of cheap labor, and a leading supplier of many essential raw materials. Japan also imports 82 percent of its rare earth metals, a critical component of high-technology

industries from China, and the Chinese government, sensing Japan's weakness, has periodically threatened to embargo such exports (Smith 2012: 375–76). Trade interdependence means that there are real costs to both countries from any disruption to their bilateral relations. In any networked system of production, disruptions in any single production unit can have flow-on consequences for upstream and downstream manufacturers in the network. Central to the globalization-stability hypothesis is not simply the absence of violence but the absence of actions that might disrupt economic and supply chain linkages. The assumption is that capitalist states protect essential interests of domestic capital. Part of the problem in the Sino-Japanese dyad is that only one of the two states is unashamedly capitalist.

In recent decades, even as bilateral economic linkages became stronger, Sino-Japanese political relations have deteriorated, especially after China's rapid economic transformation that emboldened Chinese leaders to adopt more assertive and aggressive international policies. In China, early positive sentiments toward Japan gave way to greater feelings of antipathy (Calder 2006: 133), and in Japan, too, negative perceptions of China supplanted the feelings of warmth expressed by many Japanese in the years after relations were normalized. The sources of conflict include territorial disputes, compensation for the forced recruitment of so-called comfort women into prostitution to serve Japanese soldiers during the Second World War, and distorted accounts of Japan's prewar and wartime involvement in East Asia in history textbooks. The Chinese government claims that Japanese school history texts do not accurately portray the horrors visited on China and regional countries by the Japanese imperial army.

Tensions between the two countries have periodically escalated to popular protests and violence against Japanese firms and property, resulting in damage to Japanese property and commercial interests in China. Such episodes of heightened tensions had occurred earlier in 1978, 1990, 1996, and in 2004–05 (see, Koo 2011). In 2005, for example, tensions flared up when Japanese Prime Minister Koizumi visited the Yasukuni Shrine in Tokyo to pay respect to the war-dead. The spirit of several Class A war criminals are also interred in the Shrine and visits by political leaders have always been interpreted as evidence of official Japanese insensitivity and lack of remorse for wartime misdeeds. Koizumi's visit to Yasukuni Shrine led to anti-Japan rioting in China that targeted Japanese businesses and disrupted production in their local supply chain networks. It forced a rethink in Japanese investment strategies in China, and in the years

following the riots, Japanese FDI in China fell dramatically. In 2005, total annual Japanese FDI in China was approximately US$6.5 billion and it declined each successive year thereafter, to reach a low of US$3.5 billion in 2008. By contrast, total Japanese FDI in other Asian countries, in those four years, increased from US$16.2 billion in 2005 to US$23.3 billion in 2008. As such, the drop in Japanese capital flows to China was clearly due to specific bilateral issues and not to any secular drop in Japan's global FDI flows. Japanese investment flows to China increased after 2008 and by 2011 had almost recovered to the level of 2005.

The most recent episode of conflict began in 2012, and it resulted in disruptions to supply chain relationships, trade and investment flows. The trigger for the 2012 conflict was a decision of the Japanese government to nationalize the disputed Senkaku/Diaoyu Islands in September of that year. Previously, these islands had been under private, but Japanese, ownership. However, in 2012, when the nationalist Governor of Tokyo, Ishihara Shintaro, threatened to acquire the islands for the Tokyo Metropolitan government to preempt any possible future handover to China, the central government decided to nationalize the disputed islands to ensure that it was unencumbered in any future negotiations to resolve the final status of the islands. The suggestion that the central government had simply prevented a nationalist metropolitan government from acquiring the islands however did not assuage Chinese sentiments. Further, the Japanese Prime Minister Shinzō Abe had exacerbated Chinese sensitivities with his annual visits to the controversial Yasukuni Shrine, and with his push to revise the so-called Peace Constitution. That Constitution, for the past 70 years, had assured regional countries that Japan was determined not to repeat its militarism of the past and these governments were, understandably enough, worried about Japan's future directions. For Abe, however, revision was simply to be the culmination of a long process of normalization that began in the 1980s under Prime Minister Nakasone.

The Chinese government reacted angrily to unilateral nationalization and people took to the streets with waves of anti-Japanese demonstrations that caused extensive physical damage to Japanese property and businesses in China. In a country with a history of ruthless suppression of opposition to its authoritarian rule, the Chinese government was surprisingly tolerant of social violence and anger directed at an external target, Japan. Some even see quiet encouragement and political manipulation by the state and the CCP, perhaps as a vent for social frustration. According to one political analyst, it is convenient that the 'protests come when the leaders need

one to come, and the protests will stop when they want them to stop' (*Washington Post*, September 17, 2012). This is not to suggest that people were not genuinely angry over Japan's nationalization of the islands but for two countries with so many economic interests at stake, it would have been reasonable for both governments to resolve their dispute in a less conflictual manner.

In late 2013, bilateral relations were again in free-fall when China declared large tracts over the Sea of Japan as part of its Air Defense Identification Zone (ADIZ). Normally, foreign aircrafts entering or traveling through another country's ADIZ are required to notify air traffic controllers, and is an acknowledgement of that country's area of responsibility. The Chinese ADIZ, however, included airspace over the disputed islands and overlapped with those of Japan. The Japanese government declared this a provocative act even though Japan itself had encroached earlier into Taiwan's ADIZ and paid no heed to Taiwanese protests. The high level of tensions between China and Japan continued into 2015. The Chinese government allowed nationalist sentiments and public antipathy toward Japan to spill over to widespread vandalism against Japanese business interests in China and disruptions to their manufacturing and trading activities. This, in turn, affected manufacturing in Japan. The violent protests that ensued not only damaged Japanese property but disrupted also supply chain linkages and manufacturing in Japan. Disruption to normal commercial relations was extensive and trade between the two countries fell by 3.9 and 5.1 percent in 2012 and 2013, respectively. Bilateral investment, essentially Japanese investments in China, also declined compared to earlier years (Chang 2014). There was, as well, significant reputational damage to China as a reliable production platform. Production stoppage in China disrupted the flow of components and parts and affected networked manufacturers in Japan. Japanese investors declared they would curtail future investments in China but in the climate of public hostility and anger, Japanese exports to China also fell significantly in the two years that followed. In 2013, Japan's exports to China fell 8.7 percent year on year when, in the same period, US exports to China increased 14.8 percent (Hosomi and Nishimura 2014). Any loss of capital inflow of course dampens Chinese economic growth, but for Japan, loss of a major export market complicates its recovery from a long spell of low growth and deflation. Yet, relations continued to deteriorate and Japanese Prime Minister Shinzō Abe likened Sino-Japanese relations in 2014 to British-German relations shortly before the First

World War. He quickly added a correction that hostilities were unlikely, but the episode still called into question the postulated hypothesis on trade stability because Japan and China also are among the most integrated economies in terms of production networks.

The deterioration of Sino-Japanese relations and disruptions to production networks called into question the proposition that globalized economies (and dyads) will maintain stable trade relations, and that political conflicts managed in a way that did not undermine supply chain linkages. That clearly was not the case in Sino-Japanese relations but as the following discussion shows, this was largely the result of the peculiar nature of Chinese politics and state-civil society relations in China. We do not expect similar situations to arise in relations between open democratic systems. For the specific Sino-Japanese case, the main reason is the lack of space for civil society groups to influence politics. In addition, it is possible that Chinese leaders have used external conflicts to deflect attention from mounting domestic problems, such as environmental degradation, income inequality, and labor disputes. In 2016, CNN reported that according to China Labor Bulletin, labor disputes in China had increased from 185 in 2011 to 2726 in 2015 (CNN.com, March 28, 2016, http://edition.cnn.com/2016/03/28/asia/china-strike-worker-protest-trade-union/index.html). The negative externalities of rapid growth have become major challenges for Chinese leaders. Interestingly also, the potential for upheaval increases the further we leave 1989 behind and as memories of Tiananmen fade. In their contribution to a collection of papers under the theme of China at a Tipping Point, Su et al. (2013: 30) made the case that the 'regime's own efforts to stifle discussion of what happened during and shortly after (Tiananmen 1989)…ha[d] helped to dispel fear by dispelling memory. Less memory means less fear, and less fear means more contention.'

It is possible also to trace the periodic heightening of tensions between the two countries to the nature of state-society relations in Chinese and its refusal to allow greater democratic participation in keeping with economic openness. The Chinese state is very unforgiving of dissent or deviation from the Party line. The Chinese system of command capitalism has curtailed opportunities for civil society organizations to influence foreign policy decisions, when state-state interests diverge. In China, although civil society groups have multiplied, these are ineffective in shaping policies. The flow of influence is almost entirely top-down, and businesses and civil society groups encounter a glass ceiling that prevents

their voice from being heard, especially in dissent. Whyte (2014: 44), for example, is dismissive of corporate influence and ability to press their interests and demands, and suggest that even though successful capitalists can aspire to CCP membership this does not necessarily yield influence, only an opportunity to learn about policies. Industry associations take directions from the center and when industry groups, or other civil society agencies, do voice independent opinions, it is usually within the bounds of what is permissible and as long as it does not veer 'into outright dissent' (Stern and O'Brien 2012: 176). The parameters, however, are indeterminate and under these conditions, caution becomes the normal practice because, as Stern and O'Brien (2012: 177) described it 'even the well-connected find it difficult to discern state intentions.' The culture of uncertainty may be deliberate because it induces people to exercise self-control, an outcome that is cheaper and easier than 'stepping up surveillance or throwing boundary-pushers in jail' (Stern and O'Brien 2012: 18) Despite proliferation of industry associations in China, their influence remains weak and constrained, unless industry interests align with those of the national government. According to Margaret Pearson (1997: 115):

> Contrary to predictions that economic reform would lead to strong pressures from below for change, then, China's new business elite has not evolved into a strong, independent, politically active, democratizing stratum. Indeed, there is evidence that the state has initiated its own strategy for organizing the business elite, with the aim of pre-empting any independent societal pressures.

Based on extensive survey research, Bruce Dickson (2003: 19) reached the conclusion that civil society groups in China 'do not seek autonomy but rather closer embeddedness with the state. They recognize that to be autonomous is to be "outside the system", and therefore powerless. Instead they seek to be part of the system in order to better pursue their interests and maximize their leverage.' However, even within it, business groups have limited capacity to either question or criticize the system.

By contrast, during the latest dispute, Japanese firms with exposure to China lobbied in Tokyo to de-escalate and contain the fallout. The Chairman of Keidanren, Hiromasa Yonekura, in September 2012 urged restraint and added that the government's refusal to even acknowledge a

territorial dispute 'defied common sense' (*Asahi Shimbun,* September 29, 2012). By contrast, when Chinese industrialists spoke out for a peaceful resolution, they did so in statements aimed at the Japanese government and during visits to Japan. In the middle of the territorial dispute, a delegation of Chinese business executives arrived in Tokyo in late 2013, led by Chang Zhenming, Chairman of CITIC Group, China's largest state-owned conglomerate. Like his Japanese counterparts, he also expressed the view that territorial and political disputes should not upset their close economic relations. It is interesting that he offered these statements in Tokyo and not in Beijing.

Ultimately, in the dispute neither side gained a strategic advantage. However, economic costs, in terms of foregone investments and disruptions to production, may encourage both sides to be more circumspect in managing their political relations. Corporate and economic interests suffered as foreign investors reassessed their China risk factor and redirected new investments to other parts of East Asia. The confrontation lasted three years. In early 2014, Japan offered a concession to include references to territorial disputes with China and Korea in school textbooks, a clear departure away from earlier denials about even the existence of such disputes. This open acknowledgement was a necessary first step to a future resolution and enough also for leaders of the two countries to meet separately at the APEC (Asia Pacific Economic Cooperation) summit in Beijing later in the year. The dispute dragged on for a few more months and it was only in in late March 2015 that the Chinese government agreed to renew discussions to stabilize bilateral relations.

It will take a massive effort from both governments for a final resolution of their territorial dispute and unless that happens there is no certainty that future bilateral relations will remain stable. In the interim, the best that we can expect is that China and Japan will be careful to insulate their manufacturing networks from the vicissitudes of their political relationship. One positive sign was that Chinese leadership, in January 2017, openly expressed support for the structure of economic globalization. China's President Xi Jinping attended the annual Davos World Economic Forum for the first time and in his speech called on all states to advance the globalization project and to eschew nationalistic motivations for protectionism and trade disruptions. Analysts welcomed his speech as a statesman-like affirmation of Chinese commitment to principles of liberal trade and if that is indeed the case, we can expect that future Sino-Japanese disputes will be resolved without harm to regional production

networks. Xi's commitment to globalization was noteworthy also in that it came at a time of enormous challenges on multiple fronts, such as Brexit in the UK, Trump in the USA, and a spike in xenophobic nationalism in several other western countries.

Conclusion

Continued political tensions between China and Japan are largely a result of political realities specific to China and do not constitute a test case for the postulated hypothesis that globalized dyads will avoid conflict in order to protect trade stability. In general, in a perfectly globalized world where all production is within global networks, human-induced trade disruption or protectionist policies are unlikely because of the damage such an action would cause the country involved. We are not yet at that level of globalization but even so, it is remarkable that the Great Recession, the worst since the 1930s and which would in all other circumstances, led to no great reversal of liberal trade policies. Trade used always to be subject to political manipulation, especially in times of economic crises and recessions but with the progressive transitioning to economic globalization, there is a gradual separation of trade stability from the tyranny of economic cycles. Globalization has not ended the cyclical nature of capitalism but economic downturns are unlikely to unravel liberal trade, as was often the case in the past. Some, such as Hufbauer and Suominen (2010: 5), expressed concerns that the 2008 global financial crisis could derail the globalization project by weakening state commitment to openness, the analysis presented here is that globalization is on a much more stable footing and likely to endure downturns in the economic cycles as well as economic shocks and crises. The 2008 Global Financial Crisis (GFC) was the worst economic crisis since the Great Depression but resulted in no significant increase in trade protectionism. This was the first true test of globalization and trade stability but several years later, in 2015–16, there was another global economic contraction triggered largely by economic slowdown in China. In 2015, world trade fell by 13.8 percent in Dollar terms (*Financial Times*, February 26, 2016: 1) but, again, despite the growing trade and growth crisis, there was no evidence of any upsurge in levels of protection. Indeed, as argued in the previous chapter, globalization was an inadvertent response to protectionism of an earlier period and its success has put protectionism on the back foot.

This level of trade stability through the GFC was not a result of national enlightened leadership or of international institutional safeguards. On the contrary, multilateral institutions like the WTO have become less critical to trade stability. More than two decades after its establishment, the WTO has yet to finalize its inaugural trade liberalization Round. Nonetheless, that inability has not prejudiced global trade stability. In defense of the continued relevance of WTO, we might put a Churchillian spin that as long as WTO member states continue to periodically 'jaw-jaw,' to break the Doha Round stalemate, they are likely to avoid contrary actions that instigates a descent down the slippery road of protectionist 'war-war.' The WTO also has important dispute resolution functions, and yet it has not lived up to expectations.

Instead of the WTO or enlightened leadership as a firewall against protectionism, economic globalization has eroded boundaries between home and foreign markets and negated the possibility of insulating and protecting home markets from foreign competition. The result is greater trade stability. Similarly, states as inter-connected dyads in a global economy have an interest in resolving differences peacefully rather than through brinksmanship to avoid costly disruptions to supply chain linkages. Partial globalization in the nineteenth century had also produced a period of stability and peace, but being incomplete, this was necessarily infirm. In the contemporary situation, trade stability has the backing not only of consumers even if they have rarely acted to protect their interests, but also of producers who find that they are now not only producers but also consumers of intermediate goods and parts produced in different countries. The first test of this newfound stability came in 2008. Clement Henry and Robert Springborg (2010: 21) suggested that if the global financial crisis were to deepen into a Great Depression, globalization might break down. Similarly, Paul Krugman advocated aggressive Keynesian policies to avert a return to the 1930s but strong opposition to deficit financing in the Congress prevented the government from the more modest programs that it implemented. Even so, there was neither a descent into economic depression nor a retreat into protectionist policies.

We stand at the dawn of a new moment, relatively unburdened by the oppressive weight of history. The nature of capitalism itself has moved to a different plane, from competitive capitalism of the nineteenth century, to monopoly capitalism in the twentieth, and now to global capitalism defined by globalized production. There are, of course, lessons from history that we can learn, but there is an equal danger of becoming prisoners

of history. In the period after the Second World War, every economic crisis (e.g., stagflation in the 1970s, the Latin American debt crisis in 1982, the stock market crash in 1987, and the global financial crisis in 2008) raised the specter-heightened protectionism and global economic turmoil. As Harold James (2001: 26) put it, 'We are constantly concerned with the possibility of a repetition of the breakdown of globalization (in a replay of the 1930s).' Contemporary globalization includes features common to the late nineteenth century as well as enough new elements and dynamism to make this new period unlike anything that we may have witnessed in the past. James (2001) pondered the possibility of a reversal and did not rule it out, but it is a mistake to presume that we are dealing with essentially very similar circumstances. Globalization pre-1930s and pre-World War I was not the globalization that we experience today.

Centering globalization on private rather than state actors, globalization has acquired a degree of independence from state-based decisions and outcomes, unlike simple trade interdependence that preceded globalization. The USA led the establishment of a liberal international economic after the Second World War, and remained its principal backer throughout the postwar period as the global hegemon. If the analysis presented here is correct, hegemonic leadership is no longer a necessary condition for either international trade stability or globalization, and that constitutes a radical new feature of contemporary political economy. As a defensive response to neo-protectionism in the 1980s, globalization of production is a powerful and reliable safeguard against future protectionism. Later, in the concluding chapter, I will look more closely at the prospects of de-globalization, given political developments in the UK and USA in 2016.

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CHAPTER 5

Globalization and Development

There are sharply divergent views about the developmental consequences of economic globalization. Proponents see it as providing new opportunities and a pathway for industrial growth and development. An example of development through global integration is China, which has transformed itself into a leading producer and exporter, both of manufactured intermediate goods for Japanese and western GPNs, and of finished goods that incorporate substantial foreign value-added. China's economic success is remarkable and multilateral agencies hold it up as a model for emulation by other developing countries. Critics of globalization, on the other hand, point out that premature and forced liberalization, under pressure from the IMF or World Bank, had the undesirable consequence of de-industrialization and economic reversals. Jomo and Arnim (2008: 13, Table 8) estimated that for some petroleum-dependent African countries, the share of manufacturing to GDP fell from 21 percent in the period 1970–79 to around 5 percent in 2000–06 as a result of liberalization. Similarly, Joseph Stiglitz, a former Chief Economist at the World Bank, cautioned that fallout from hasty and early liberalization had contributed to a climate of discontent with globalization.

For many of the former colonies, development has been a long struggle, plagued by internal flaws and weaknesses, such as corruption, and external constraints, such as trade restrictions. With some notable exceptions, mainly in East Asia, these countries have not been able to narrow

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the divide separating them from advanced industrial countries. Moreover, development itself is a contested concept. Disagreements range from whether industrialization is central to development and whether trade is a help or hindrance. There are disagreements even about how to measure and assess development. In the early 1960s, Raul Prebisch, Secretary General of the United Nations Conference on Trade and Development, was a leading advocate of industrialization as a way forward for developing countries, in order to overcome their deteriorating terms of trade as producers and exporters of primary products. Prebisch presented empirical evidence to show that historically terms of trade had moved against exporters of primary products. This meant that each year developing countries were able to import less for any given level of exports. This was an obstacle to growth and development because any increased export revenue, instead of enabling investments, only paid for equivalent imports of the previous year. Without expanded investments, growth faltered and resulted in a widening of income gaps between developed and developing countries. Prebisch's emphasis on industrialization reflected the experience of developed countries that were mainly industrialized economies. Intuitively, this indicated a need for infant-industry protection to encourage industrial expansion and, yet, as Secretary General of UNCTAD, an initiative to boost development through trade, Prebisch concentrated his efforts on negotiating a new trade deal for developing countries. To offset the power asymmetry between the rich and poor countries, he helped unite developing countries to form the Group of 77 (G-77), to speak with one voice in negotiations with the West. UNCTAD negotiations resulted in a western commitment to introduce a Generalized System of Preferences (GSP) for developing countries. The GSP was an important achievement because it gave selected developing country exports duty-free access to western markets at a time when GATT's most favored nation (MFN) tariffs were still relatively high. However, being outside the GATT framework, GSP privilege had to be negotiated on a bilateral basis between pairs of developed and developing countries, and could be rescinded at any time.

For its part, GATT added a new provision in its Articles of Agreement that permitted special and differential treatment for developing countries that introduced exemptions from full reciprocity. This was partly a promise of positive discrimination, and an acknowledgement that GATT could not demand reciprocity when its trade liberalization achievements had not benefited developing countries in any meaningful way. These early gains and concessions heightened expectations for a new international economic

order (NIEO) that would reflect the needs and interests of developing countries. However, in the decade of the 1970s, UNCTAD failed to follow through with any additional new benefits, and the West, too, preoccupied with the crisis of stagflation was unprepared to revise trade rules. The expected NIEO remained on the drawing board and, in time, forgotten.

As noted above, Prebisch's research pointed to industrialization as the desirable development strategy and this required protection from imports. However, unlike dependency theorists, who advocated a clear break in trade relations with the West in order to escape continued exploitation, Prebisch, and the new sub-discipline of Development Economics, went no further than advocate industrialization through policies of self-reliance and import substitution. Development Economics modeled itself as a variant of the neo-classical orthodoxy, but it was a tenuous relationship, as neo-classical economics did not subscribe to either import substitution industrialization (ISI) or infant-industry protection. The policy recommendations, however, attracted a number of developing countries, including India, which embarked on industrialization through basic ISI policies and progressed on to more advanced ISI. Industrialization behind protective tariff barriers did lead to industrial deepening, and even if the resulting industries were not internationally competitive, Ajit Singh described this period as the 'third world industrial revolution' (See Chang 2008: 9). This industrial revolution however was different from earlier industrial revolutions, such as that in Britain or the USA. With some exception, industrialization in developing countries did not extend much beyond easy import substitution. There were exceptions, such as India and Brazil, where ISI spawned a broad range of manufacturing activities that survived because these countries had a large population base, and therefore a sizeable domestic market, and could continue forward from basic to advanced import substitution strategies that required economies of scale.

China too, achieved significant broad-based industrialization following the socialist revolution in 1949 that disrupted international trade. Even so, there was little manufacturing export from these countries because industries, sheltered behind tariff protection, were not internationally competitive. Industrialization, however, provided a useful launching pad for exports following their later transition to liberal market principles in the 1980s and 1990s. China's dominance in low-cost and labor-intensive manufacturing led to a huge global market presence and it became, for a time after the global financial crisis, an engine for growth for the world economy.

Both India and China began their industrial journey in the postwar period, but elsewhere, in many Latin American countries, industrialization began early in the twentieth century when trade disruptions during the First World War and the Great Depression allowed local manufacturing to develop without foreign competition. According to Baer (1989), manufacturing in Brazil started in the early years of the Great Depression, when a sudden drop in value of coffee exports, from US$446 million in 1929 to US$181 million in 1932, forced the government to introduce import curbs and currency restrictions. According to Baer (1989: 37)

> The curtailment of imports and the continued domestic demand resulting from the income generated by the coffee support program caused shortages of manufactured goods and a consequent rise in their relative prices. This acted as a catalyst for a spurt of industrial production.

With inroads into the industrial process, it became necessary to protect infant industries once normal trade was again possible. That became the basis for protectionist policies in Latin America. During the Great Depression, Latin American countries also abandoned the gold standard and under a floating exchange rate, currencies depreciated sharply adding further to the implicit protection of markets from foreign imports. Later after the Second World War, as an additional protectionist safeguard, the Brazilian government introduced the Law of Similars to prevent the import of goods that had a domestic equivalent. This law carried the sanction that such importers would lose various governmental privileges, including access to credit, taxation privileges, or the right to bid for government contracts (Krueger 1997: 5). High levels of tariff protection continued until the Latin American crisis in the early 1980s. In 1960, for example, the nominal tariff on consumer non-durables in Chile was 328 percent, compared to 17 percent for the European Economic Community (EEC); and the nominal tariff on consumer durables in Brazil was an equal 328 percent compared to 19 percent for the EEC (Haber 2006: 574, Table 13.8). Helped by protectionist trade policies, some Latin American countries eventually acquired a diversified industrial structure but sheltered from foreign competition, homegrown industries were not competitive on the international stage.

In countries without a sizeable domestic market, exhaustion of early and easy import substitution meant there was no easy path forward for more sophisticated manufacturing. In East Asia, this led to a shift

to export-oriented industrialization (EOI), which forced industries to become internationally competitive. East Asian economies, known also as developmental states, however, were an exception and most other small developing countries only managed rudimentary industrialization behind tariff walls, unable to transition from simple ISI to EOI to broaden their industrial base.

Practically therefore, developing countries pursued one of three different development pathways: Dependency-inspired socialism and autarky, ISI, or EOI strategies. The distinctions were not always easy to discern as, India, for example, was mildly socialist with an ISI strategy. If we isolate and focus on ISI and EOI, the two industrialization strategies produced very different results. India developed a diversified industrial base that was internationally uncompetitive, whereas several East Asian countries exploited export opportunities to emerge as global manufacturing power centers. Common to both strategies was extensive state involvement, either in protecting domestic industries or in industrial planning and export subsidies. Neither was consistent with neo-classical economic orthodoxy and eventually dismantled at the first available opportunity.

The Demise of Heterodox Development Theories

Decolonization at the end of the Second World War brought self-rule to a third of the world's population that lived under colonial administration. Governments in the newly independent states faced many key challenges, including national unity and integration, and economic development and catch-up. Financial constraints and lack of administrative capacity compounded their difficulties, and the promise of a better life after independence remained unfulfilled, for decades, for a vast majority of inhabitants of newly independent states. Reflecting on the history of shattered dreams and promises, Joseph Stiglitz (2006: 26) observed that economic development had proved almost as elusive as the pot of gold at the end of a rainbow, a 'quixotic quest.'

In pursuit of their aspirations, developing countries had a number of alterative policy choices, each with its own claim to be pro-development. That multiplicity of options remained part of the policy environment until the 1980s when the policy space began to shrink dramatically. At the start of that decade, Stiglitz (2006: 26–30) observed that developing countries had three alternative developmental pathways to choose from, such as liberal market capitalism, communism, and state capitalism. Liberal market

capitalism was the dominant economic orthodoxy and communism a stark alternative to it. Communism rejected the capitalist model and competed with it to win favor among developing countries. As a result, many countries aligned themselves on one or the other side of the Communist East and Capitalist West spectrum. A large number of developing countries refused to be formally compartmentalized and chose the path of non-alignment and neutrality in the East-West confrontation. Communist countries and others that chose to distance themselves from the West and to extensive international trade adopted policies of import substitution in the belief that development was most likely without external influences. The third policy option was state capitalism, which unlike communism was a deviation from, but not an alternative to market capitalism. It included the developmental state model of East Asia (export-oriented industrialization, or EOI), and the more familiar strategy of import substitution industrialization (ISI) with theoretical roots both in dependency analysis and development economics. Developing countries chose policy outcomes that borrowed from these alternatives either exclusively or in some combination. For example, India was formally non-aligned but combined elements of socialist policies with capitalist principles of market exchange and private property rights.

Over the next two decades, however, the various heterodoxies collapsed to leave liberal market capitalism as the sole remaining policy choice. Against a complexity of policy choices in the past, the policy environment for developing countries is now relatively simplified. To a great degree, the communist alternative lost relevance with the collapse of the Soviet Union and its satellite East European countries. This collapse reflected failure of a system that was unable to meet the needs of citizens in their respective countries, and failure at 'home' meant that it was less likely to be seen as a model by others. Similarly, economic crises in Latin America and East Asia discredited the two deviant forms of market capitalism, ISI and EOI. The cumulative result of these crises was a convergence on the liberal orthodoxy, whether because of internal policy decisions in the case of the former communist countries, or because of external compulsion and pressure from the IMF in the case of ISI and EOI countries.

The discussion that follows will focus mainly on ISI strategies and the developmental state model, which were identifiable as deviations from the economic orthodoxy. The socialist pathway to development, in contrast, was a complete repudiation of market principles, and required, of course, a socialist revolution as a precondition. In the absence of such a revolution,

the few that had a socialist identity were only loosely identifiable as socialist. India and Egypt, for example, incorporated elements of socialism in their policy choices but did not completely abandon core features of market capitalism.

As deviations from liberal market principles, ISI and EOI usually attracted criticisms from liberal scholars. The negative assessments of statist models for economic development were based not on the criterion of performance, whether neutral, negative, or positive, but rather because these models were inconsistent with neo-classical assumptions. As far back as the late 1970s and early 1980s, there began a sustained attack on these alternatives to neo-classical developmental strategies (Chang 1999: 183). However, when state capitalism lost ground to orthodoxy, this was not because of theoretical critiques that exposed logical flaws but because of crises and performance failures. The Latin American debt crisis of 1982 discredited the ISI model of inward-looking development policies, and, likewise, the Asian Financial Crisis of 1997 undermined the viability of the developmental state model. Consequently, developing countries today have a limited menu of choice although it is still possible for some to continue to follow inward-looking industrialization policies or the developmental state model but neither model is now on equal footing with the liberal orthodoxy. Most developing countries that had established structures and institutions based on the alternative policy paradigms have returned to the fold of mainstream liberal market economics and participation in the globalizing economy.

Crises played an important role in discrediting these alternative models of economics because crises tend to strip away legitimacy based on performance. In East Asia, for example, as long as the developmental state model produced creditable economic results, criticisms were rebuffed as irrelevant but at the first sign of an inability to deliver positive results, in other words a crisis, the model was stripped of performance-based legitimacy. In contrast to the EOI model, ISI had no shining examples and the 1982 debt crisis was a perfect opportunity to remove it as an option for developing countries. Below, I will briefly discuss the role of crises in returning the deviant countries to liberal market principles.

1. Both development economics and dependency theory advocated self-reliant development and industrialization, and that essentially meant a commitment to ISI policies. A large number of developing countries in the 1960s and 1970s pursued autarkic development

strategies and this group included two of the most populous developing countries, India and China. In the case of China, autarky was a natural progression from the socialist revolution of 1949. Both countries were able to achieve a reasonable level of industrialization and economic development although, in the case of India, benefits of economic development did not trickle down to the bottom rungs of society where the need was the greatest. Socialist policies in China, by contrast, restructured society to reflect a highly equitable level of income distribution. In ISI countries, high tariffs protected the domestic market for local entrepreneurs and industrialists, but had the additional utility of generating revenue for states that had little capacity to collect income taxes. In Pakistan and Bangladesh, for example, less than 1 percent of population paid income taxes in 2014, compared to nearly 60 percent in France. In general, less than 5 percent of the population in developing countries pay personal income taxes compared to nearly 50 percent in developed countries (IMF 2011: 31). The low tax base in developing countries is partly a result of administrative inefficiencies, but also because of tax avoidance and because the ruling elite, as policy-makers, have a conflict of interest in improving income tax collection capacity that would increase their own tax liability. Tariff revenue, by contrast, is easier to implement and collect but, as a policy preference, weighs heavily on manufacturing efficiency and export growth, even after industrial deepening. Increasingly however, as tariff levels have come down, so has the weight of tariff revenue to total tax revenue in developing countries. In Kenya and Thailand, for example, customs and import duties as a percentage of tax revenue dropped from 20.5 percent in 2001 to 7.8 percent in 2013, and from 12.9 percent to 4.9 percent, respectively. There is of course, a greater push to increase income tax collection and expand the tax base. For example, in Bangladesh the government has convened annual tax fairs in different locations to make it easier for individuals to pay their taxes. In tax fairs in 2011, the government raised a total of US$5.2 million, about 1.5 percent of total income tax revenue for the year, a substantial increase over the revenue raised in 2010 of US$1.4 million, less than 0.5 percent of total (*The Daily Star,* August 13, 2012). The government also introduced incentives, such as publishing an honours list of leading taxpayers, and award of special identity cards for extra privileges in hospitals and airports.

ISI policies assumed that industrialization was key to growth and development. For example, development economics characterized developing countries as marked by dual economies, in which the rural sector had surplus labor and low productivity. Only a progressive expansion of the modern industrial sector was capable of absorbing the surplus labor and improving economic conditions. It rejected liberal trade as unhelpful. Myrdal (1968: 583; see also Riedel 1988: 27–28), for example, pointed out that foreign trade was not an engine for growth for most developing countries, given high levels of protectionism in the West on products in which developing countries had a relative advantage. Development economics maintained that developing countries required not reliance on unfettered markets but a 'big push' engineered by the state to achieve development, assisted with import substitution policies. Moreover, with limited export opportunities, they advocated industrialization based on infant-industry protection. One unintended consequence of this was a severely limited capacity to generate foreign exchange revenue with which to finance imports from the West. Developed countries could have lowered tariffs on goods of interest to developing countries in order to enable them to earn foreign exchange but this was politically infeasible. Unwilling to repeal the modern-day equivalent of Corn Laws, the postwar period saw the innovation of foreign aid as a tool to finance the flow of goods from the developed to developing countries. Of course, development aid was a poor substitute for trade and the amount of aid disbursed by most developed countries was a fraction of what they had committed themselves to provide.

Critics of insular development argued that backwardness was a function primarily of endogenous factors and that the terms of trade argument, proposed by Raul Prebisch, was an unhelpful distraction. ISI and protectionism, they pointed out, was a result of 'bad' theory and research. From his orthodox economic perspective, Deepak Lal (2000: 21) rejected the terms of trade argument as both factually and empirically wrong, and argued against any depiction of international trade as a zero-sum game. Anne Krueger (1997) was equally critical and held mainstream economists culpable for wandering off-message from comparative advantage to offer improper policy advice based on ISI and protectionism. She attributed this to timid and sparse defenders of the orthodoxy who

had not bothered to add the corrective that free trade neither impeded industrialization nor condemned developing countries to a future of dull agricultural pursuits. Just as agriculture could be labor intensive, there were also labor-intensive manufacturing opportunities for developing countries. Moreover, she added that there was no real basis for determining the right mix of effective protection, an argument used to reject any state intervention. Moreover, they pointed out that past centuries had already demonstrated the folly of inward orientation. China, for example, was an indisputable global technology and economic superpower several centuries earlier, but had squandered its superiority by turning inward, a fateful step that robbed it of dynamism (Sachs 2005: 151). Soon, it was so weak that the West was able to establish its dominion. It was only after the 1949 communist revolution that China was able to begin its long process of recovery. The new communist government closed China off from much of international trade and during this period of socialist isolation, the country established a domestic industrial base. Over the next 30 years, China achieved substantial levels of industrialization, often at tremendous human cost, but the next leap toward a modern and advanced economy began with its transition toward a more open economy.

China's transition to a more open economic system preceded similar shifts in Latin America and elsewhere following the debt crisis of 1982. The IMF, as the new global crisis manager, wasted no time in forcibly shepherding developing countries back on the *correct* path of liberal trade and open markets. This also heralded the end of development economics as a guide to developing countries.

The debt crisis implicated a large number of countries in Latin America and elsewhere that relied on high tariff protection for their infant and emerging industries. These countries accumulated huge debts as major international financial institutions, flush with petrodollars, looked for new outlets for their reserves. Debt in itself is not problematic as long as borrowers are careful about their debt-servicing capacity. With loans denominated in foreign currencies, it was imperative for Latin American countries to increase their export revenue in line with the debt repayment obligations, simply to ensure that the debt-service ratio (repayment obligations as a percentage of foreign exchange revenue) remained manageable. Typically, a debt-service ratio of 25 percent or less is safe but by the

early 1980s, several Latin American countries had substantially exceeded that safe threshold. These countries had large foreign currency debt that they had failed to invest judiciously to ensure a capacity to meet future repayment obligations. Apart from using loans for luxury imports, their principal failure was in not ensuring adequate export growth. Even if these countries had a diversified industrial base, industries had enjoyed generous protection from imports for decades and, consequently, fallen behind in international competitiveness. In the end, debt became unserviceable and in 1982, Mexico became the first Latin American country to declare an inability to repay its creditors. Concerned that large-scale debt-default would undermine the stability of financial institutions, the IMF stepped in with bailout programs. Structural adjustment loans became the lever to force Latin American countries to abandon import substitution policies and to liberalize and become more export-oriented.

2. The other postwar ‘heresy’ was the developmental state model that had guided a number of the East Asian countries to stellar economic performance. For instance, in 1950, South Korea had a per capita GDP of US$100, but in 2014, per capita income was nearly US$28,000. This was a remarkable achievement, replicated in several other East Asian economies. The developmental state model deviated from fundamental principles of *laissez faire* economics, except during a depression, to incorporate targeted and planned state intervention to promote specific industries. Planning in developmental states was rational and market-based unlike in the socialist countries but it was nonetheless, planning and clearly inconsistent with liberal economics. The developmental state theory extended the work of Alexander Gerschenkron (1962: 19) that late industrialization can be facilitated through greater state involvement in the industrialization process through ‘preferential orders to domestic producers….high prices, subsidies, credits, and profit guarantees to new industrial enterprises.’ He attributed Russian and German economic success to state intervention in hastening industrialization with lessons derived from experiences of other industrial economies. Similarly, according to Alice Amsden, the first industrial revolution (in Britain) relied on policies of *laissez faire*, but the second industrial revolution (in Germany and in the USA) benefited from state resort to protectionism. Late industrialization required subsidies,

involving both protection and financial incentives (Amsden 1989: 143–4). East Asian countries, according to Amsden, could identify and read market signals in order to identify industries that were likely to be successful simply by surveying the international scene. Moreover, designated planning agencies had the necessary technical skills to develop and execute plans effectively. The key planning agencies, the Ministry of International Trade and Industry in Japan and the Economic Planning Board in South Korea recruited the best and brightest technocrats from the elite educational institutions. Not only did they plan well, rationally and without societal political pressures, but they also executed and implemented plans faithfully because they were not beholden to sectional interests. Both aspects of planning, and implementation, required a strong bureaucratic state that could resist rent-seeking activities. The socialist countries also made extensive use of state planning but an important difference was that developmental states planned rationally using market signals, whereas planning in socialist countries was driven by ideological concerns.

The model acquired intellectual credibility when the World Bank in its report titled *East Asian Miracle* (1993) acknowledged that state intervention had contributed to enviable East Asian growth and performance. At the IMF, Joseph Stiglitz, too, extolled the virtues of developmental states and state intervention. Writing one year before the Asian financial crisis, he acknowledged the useful role of state intervention in injecting an entrepreneurial spirit, essential to capitalist growth and development. In East Asia, governments were involved in the economy as entrepreneurial risk-takers but in a way 'that promoted rather than thwarted the development of private entrepreneurship.' (Stiglitz 1996: 162) Similarly, in a paper written in the early 1990s, Robert Wade (2011: 131) extolled the virtues of developmental states and described it as a model that was 'now "available" for other catch-up countries to copy.'

East Asian developmental states began their industrialization drive with import substitution policies but instead of moving from basic to advanced import substitution, opted to shift to export-oriented industrialization (EOI). South Korea and Taiwan, for example, simply did not have a large enough domestic market to sustain advanced manufacturing that catered only to domestic needs, and ISI-based advanced industrialization was not likely to penetrate

foreign markets. Export-oriented developmental states in East Asia continued with extensive interventionist policies that included economic planning and industrial policy, that included identifying future growth (sunrise) and declining (sunset) industries. Japan was the lead model where, according to Chalmers Johnson (1982), the state was actively involved in the market and responsible for identifying future growth industries and developing incentives to channel investment in targeted sectors. The government agency responsible for planning was MITI, which produced multi-year industrial policies. Implementation was also a responsibility of MITI, which achieved that through administrative guidance and incentives rather than legislative instruments. For example, administrative instruments included price distortions and subsidized interest on investment loans, in order to divert resources to particular sectors. Economic growth in the 1960s is legendary, Japan eventually emerging as a world leader in steel manufacturing, ship building, and so on. Economic growth in that decade averaged 10 percent per annum, considerably above the 7 percent that the government had targeted as part of its 10-year income-doubling plan. With sustained double digit, the size of the Japanese economy doubled in only seven years. Equally impressive was that Japan achieved high growth without exacerbating domestic income inequalities. The Japanese achievement of equitable growth in the 1960s was termed an 'economic miracle' because it defied the typical pattern of growth in capitalist economies. Following the spectacular success of Japan, other East Asian countries emulated the developmental state model, which led to similar and very rapid development where previously, economists like Gunnar Myrdal (1968), had dismissed these countries as unlikely to succeed. This pessimism was partly because their cultural tradition of Confucianism, with its emphasis on group orientation, was seemingly inconsistent with demands of modernity, which required, instead, the liberal and Smithian qualities of self-interested rationality as the essential ingredient to lift a society out of its backwardness.

Yet, in the space of a single generation, President Park Chung-hee transformed the country from an economic basket case to an exemplar of modernization. In South Korea, the government became bankers to industry after President Park Chung-hee nationalized the banking sector in the early 1960s. Lee Kuan Yew and Chiang Kai-shek

managed the same economic transformation in Singapore and Taiwan, respectively. In South Korea, even as the state nurtured particular industries, it did not lose focus on ensuring that firms remained internationally competitive without becoming dependent on protection or bailouts. When Shinjin, a car manufacturer with a domestic market share larger than Hyundai Motors, struggled to cope with oil price increase in the 1970s, the government, as its banker, transferred Shinjin's assets to Daewoo Motors, rather than simply bail it out (Amsden 1989: 15). Industrial policy meant not only that governments took the lead in identifying 'sunrise' and 'sunset' industries but also in determining the fate of individual corporations in those industries to ensure the success of ultimate policy goals. That the government stayed its pre-determined course was broadly beneficial but that is not to say that the state planners always found the right balance in their policy design or implementation. Even the much-vaunted Japanese developmental state was guilty of a number of policy errors. As mentioned earlier, the government tried its best to prevent two of the world's most successful companies, Sony and Honda, from entering their respective industries on the assumption that market size in Japan could not support any more new entrants. Indeed, the official policy was industrial rationalization through mergers and acquisitions. Policy-makers in Japan also erred in assuming that the future of computing was in supercomputers, and consequently failed to capitalize on the boom in personal computers.

It is a mystery that the developmental state model did not find favor with developing countries elsewhere even though the model was, as Wade stated, 'available' for emulation and despite the World Bank appearing to sanction it in its annual report in 1993. Even though there was no learning in other developing countries, Fukuyama (1992: 41) writes that:

> The East Asian miracle was carefully observed … in the communist bloc … the Chinese leadership recognized that they were being left behind by the rest of capitalist Asia … [and led to] Chinese liberalizing reforms… The Asian lesson was later absorbed by economists in the Soviet Union, who knew the terrible waste and inefficiency that central planning had brought about in their own country.

By contrast, Chinese growth since the 1980s followed the 'normal' pattern of capitalist growth, at the expense of socialist 'equality

of condition.' China, however, is not a capitalist state because even with substantial marketization of the economy, the state retained control over much of the economy. The Chinese model is one of 'strategic capitalism' with the state assuming responsibility for strategic vision and outcomes. It is not the same as developmental state because the Chinese government had no qualms about inviting large-scale capital inflows, except that the state retained control over strategic industries. The capacity to be strategic appears to require not only a strong state as in the developmental state model but also a state with considerable discretionary autonomy and authority. In industries that the state designates as strategic, it retains final say concerning market entry and FDI (Hsueh 2011: 257). If developmentalism in China did not remake China as a capitalist country, it also did not advance the cause of communism and an egalitarian society. In the widening income inequality, factory workers in China missed out, in relative terms, on the benefits of economic growth and did not 'partake of the fruits of China's wealth' (Yew 2013: 385). As a result, industrial unrest and strikes have increased, as has political suppression by the state. The Japanese and Chinese growth experience were widely divergent in terms of equity but on the single common feature of exceptional growth, both cases, including the many other successful growth stories in East Asia, several analysts have defined the entire region, with some exceptions, as a 'miracle' (Krugman 1994; Stiglitz 1996).

As with any crisis that raises questions about prevailing practices, a crisis in the miracle economies became grounds for questioning and ultimately rejecting their growth model as flawed regardless of its earlier transformative success in the same countries. A common neo-classical response to claims of the developmental state model was that East Asian growth was a result of high levels of savings and investments rather than state intervention (Krugman 1994). Moreover, sound macroeconomic management may have offset statist distortions in part or whole (Wade 2011: 117). Indeed, investment rates were exceptionally high but in East Asia and Krugman asserts that the miracle was a myth, not in the sense that growth was illusory but that the achieved growth was not a result of some new difficult to model developmental practice, or because of unique cultural reasons. Defending the orthodoxy, Krugman argued that East Asian growth was because of capital investments and

despite statist policies. Moreover, unlike in the West, where productivity growth had allowed economic growth and development, East Asian countries, in a repeat of the Soviet experience, had achieved growth simply through greater application of factor inputs, helped also by their low base of human and capital development. Whether growth in East Asia would have been better in the absence of interventionist states is uncertain but there is no denying that these countries, with intervention, achieved growth rates higher than any other country in any region or at any time.

The opportunity for a practical dismantling of the developmental state edifice presented itself only after the 1997 Asian financial crisis. Shortly after the crisis, Larry Summers, US Undersecretary of the Treasury, condemned East Asian countries for ‘crony capitalism’ that he suggested was at the root of the crisis. Only a few years earlier, as Chief Economist at the World Bank, he had heaped praise on these countries and their developmental state model for excellent economic performance. Like all previous crises, there was no advance warning that economic meltdown was imminent. The crisis began in Thailand and the contagion spread rapidly across the region. The trigger for the crisis was a sudden flight of capital that reversed capital flows. It communicated a lack of confidence in these economies and quickly became a self-fulfilling prophesy. These countries had maintained an exchange rate pegged to the US Dollar in order to safeguard foreign investors from potential exchange losses. In the first few months of the crisis, central banks intervened heavily in open market operations to protect the peg but could only do so as long as there was adequate foreign exchange reserve. However, the Central Bank in Thailand rapidly depleted its reserves and had no option but to let the Baht float freely. This led to a sharp fall in exchange rates. In a matter of months during 1997–98, the Thai Baht fell from 25 to 56 Baht to the US Dollar. Other currencies followed and the Indonesian Rupiah declined from 2600 to 11,000 Rupiah to the Dollar. At these new exchange rates, foreign debt repayment became a problem and companies that relied on imported parts and components could no longer afford imports or continue production. Factory closure and job losses triggered massive social and political instability. The crisis had started as a financial and currency crisis, a paper crisis, but quickly escalated to an economic and political crisis, a real crisis. In the ensuing economic and political turmoil, the IMF

stepped into the breach with structural adjustment plans to return East Asia to the 'correct' path of liberal market economies, without state intervention. Even though affected Asian countries recovered quickly from the crisis, unlike the long period of suffering that Latin American countries endured after their debt crisis of 1982, the crisis had discredited the developmental state model. Triumph of the neoclassical orthodoxy was now complete and unquestioned.

The developmental state model has lost its appeal and the emphasis now is on getting prices right, managing inflation, sound macroeconomic management, and so on. To this Doner (2009) added that in order to get prices right and to get policies right, states have get the institutions right, to give themselves the capacity to implement policies and deal with new issues. He argues that of the group of countries that achieved growth and development, including Brazil, Thailand, Argentina, and South Africa, only Taiwan, Singapore, and Hong Kong managed to go to a higher plane of development, high value-added, and high productivity growth, because these three countries also emphasized institutional development and capacity building.

Each of the two economic models made a case for developing countries to reject liberal market principles, and each could claim some success. For example, according to Rodrik (2009: 168), ISI 'actually did quite well for a substantial length of time in scores of developing countries.' He concluded similarly for developmental states, writing that export orientation also had its share of success. This led him to a conclusion that there 'is no single model of a successful transition to a high-growth path. Each country has to figure out its own investment strategy' (Rodrik 2009: 172). He added that that just as no country had achieved high growth by turning its back on international trade, no country had developed by simply opening itself to foreign trade (Rodrik 2009: 176). Crises, however, in Latin America and East Asia became an opportunity for the West to force developing countries to restructure their economies in line with orthodox liberal economic policies.

Multilateral agencies were the main agents of liberal market-oriented reforms in developing countries. The IMF and other multilateral agencies encouraged and coerced countries to abandon state intervention and trade protectionism and to participate more actively in the international economy. The immediate results were not particularly inspiring. Proponents

of liberalization assumed that an unshackled economy would quickly achieve good growth rates, but in Latin America, the result was prolonged economic stagnation and a decade that was 'lost to development.' Latin American GDP growth rates in the 1980s and 1990s lagged considerably behind growth rates in the previous four decades. The situation was equally dismal for developing countries elsewhere. In sub-Saharan African countries average annual growth dropped from 5 percent per annum in the 1960s (higher than in China) to around 2.5 percent in the 1990s. The 1983 *World Development Report* published by the World Bank had projected a 'central case' of 3.3 percent annual per capita GDP growth in developing countries from 1980 to 1995. Instead, in 1980–98 the median per capita growth in developing countries was zero percent, compared to 2.5 percent between 1960 and 1979 (Easterly 2001).

Eventually economic growth did pick up but following structural adjustment, developing countries have essentially a single development path that emphasizes liberal economic and trade policies. Both the developmental state and the ISI models have been relegated to history, even though as Rodrik suggested, we cannot deny that these pathways had produced positive results, for some countries and for extended periods. Just as collapse of the Soviet Union does not necessary discredit Marxism as a mode of analysis, crises in 1982 and 1997 do not, necessarily, wipe clean the successes of each model in earlier years. On the particular success of developmental states, Ron Bevacqua (1998: 411) writes, 'it is hard to deny the economic achievements of Japan and the nations which followed in its footsteps; or make the claim that they would be even wealthier had they followed some other path.' Szirmai et al. point to the irony that developed countries had withdrawn their support from state-led industrialization even though this was precisely how they themselves had achieved industrialization. They take the example of the first industrial country and cite Robinson that the industrial revolution in Britain 'was the result of "the mother of all industrial policies….a vector of policies which probably constitute one of the world's most successful, and most consequential industrial policies"' (Szirmai et al. 2013: 18). Examples of British industrial policies included the prohibition on export of capital goods and skilled labor to the Continent in order to consolidate Britain's position as the industrial workshop of the world. Countries that followed Britain on the industrial ladder made similar use of industrial policies and protectionism, including the USA and Germany, and have continued to do so. Germany followed Britain, and Bismarck had this to say about Britain's industrial success:

> I believe the whole theory of free trade to be wrong … Free trade is the weapon of the strongest nation, and England has become the strongest nation … [by also] protecting herself against foreign competition with exorbitant protective tariffs until her industries became so powerful (Holland 1980: 177).

The US government protected its infant industries in the past, and continues, even now, to step in with protectionist measures, whenever necessary. Based on recent history, Szirmai et al. (2013: 4) concluded that industrial policy remained a viable option and, indeed, that opposition to it was weakening, even in the USA. In reality, even if the USA had engaged in interventionist policies, such as in support of the farming industry, these were primarily involuntary reactions to events rather than a result of strategic planning or premised on clearly developed industrial policies. American state intervention in the economy more frequently reflected state-capture by certain industrial sectors. By contrast, developmental states engaged in well-planned and executed policies for industrial development. Industrial planning, a responsibility of lead agencies, was based on market signals in a way that that the plans were 'market rational,' and not grounded in ideological belief systems. Developmental states did not dispense with markets but rather than simply allow pure market principles to get 'prices right,' there was intervention and tweaking of the market to get 'prices wrong,' in order to direct investments into sectors considered desirable by the state and away from other sectors of the economy.

At the margins, import substitution and industrial planning may continue to be used by some developing countries but unlikely to become widespread and a mainstream pathway to development. An exception is of course China, which while not a typical developmental state, has also not embraced liberal market capitalism. That it is only partially a liberal market economy is clear given the level of state intervention and presence of state-owned corporations, but it departs also from a developmental state model in a number of important aspects. As Roselyn Hsueh (2011: 16ff) points out, an important difference is that where developmental states were focused on nurturing indigenous industrial champions, Chinese reform programs launched by Deng Xiaoping welcomed foreign direct investments. It is remarkable that China achieved its modernization goals largely with the help of foreign capital, mainly from other Asian countries and the Chinese diaspora, whereas developmental states limited foreign entry and

FDI to promote domestic industries. Hsueh also says that another point of difference between China and other East Asian states was that China launched straight into export-oriented industrialization instead of progressing to that after a period of import substitution industrialization, as had been the case for other East Asian economies. This however overlooks the fact that China had already gone through several decades of import substitution industrialization under Mao Zedong. Mao was guilty of many policy errors, such as the Great Leap Forward, but he did establish the foundations for rapid industrialization in the 1980s. One real difference to other East Asian countries is that China, after nearly four decades of liberal market reforms, is still unprepared to commit to complete liberalism. Instead, the CCP is determined to persist with 'socialism with Chinese characteristics,' a formula developed to ensure its political longevity.

For now, however, the 'other' path of neo-classical policies is the only remaining option. Developing countries confront additional frustrations of broken western promises to liberalize trade in the farm sector. The Doha Round negotiations of the WTO had started with just these promises to produce outcomes that would deliver positive results for developing countries but negotiations have been deadlocked since 2003. Yet, even in these turbulent times, some developing countries continued to perform well and held out much hope for others that economic globalization could be a useful tool for development for many others. For now, the tide appears to have swung against the developmental state model of state-led industrialization, mainly because of the Asian financial crisis and the liberal advocacy of multilateral institutions.

But then again, neither are they essential to industrial expansion in the contemporary period. Consequently, the unavailability of models pursued by Latin America or by East Asia is no reason to be pessimistic about future prospects of developing countries. Globalization has opened new pathways to development, and China's success, for example, is deeply rooted in the ability of its manufacturers to secure participation in global production networks, not simply state-led industrial policies. Developing countries have to shift with the times and tap into the new set of opportunities.

Globalization and Development

For much of the postwar period, developing countries relied on either ISI or EOI as their guide for industrialization, but by the turn of the century, the two models had been largely discredited. Moreover, the early

promise that the WTO's Doha Round (DR) would deliver significantly improved access to markets in developed countries for primary developing country exports was shattered just two years after the Round began in 2001 and the DR has now been essentially forgotten. These setbacks notwithstanding, it was already becoming clear by the early 1990s that developing countries had new opportunities in a globalizing economy to achieve industrialization and development. Before looking at the developmental consequences of globalization, it is perhaps useful to first touch upon some of its presumed detrimental impacts.

The first note of caution from skeptics is that developing states have to manage the pace and type of global integration to avert potential transitional risks associated with globalization. Rubens Ricupero, Secretary General of the United Nations Conference on Trade and Development (UNCTAD) in his speech to UNCTAD X in 2000 stated that, 'it is not the amount and pace of international integration that counts but its quality. There is indeed such a thing as too much and too rapid integration of the wrong kind' (cited in Vilakazi 2007). A United Nations study concluded that trade liberalization 'prematurely exposed African "infant" industries to global competition … [and precipitated] deindustrialization' (Sundaram et al. 2015: 4). At the same time, early global integration in the context of unchanged domestic economic policy errors can also produce negative outcomes. Paul Collier (2008) estimated that such policy failures, including an overvalued exchange rate, led to large capital outflows when African countries proceeded to capital market integration. He estimated that Nigeria had US$107 billion of its private wealth held overseas, a figure that was three times the size of domestic capital stock (Collier 2008: 45).

Problems for African countries may have been because decolonization and import substitution industrialization strategies came much later than in other former colonies in Asia, and forced liberalization policies after only about a decade of ISI strategies had not given their infant industries sufficient time to gain strength and survive import competition. Thus, according to the report the timing of trade liberalization had worked to the detriment of sub-Saharan African economies but that, overall, the benefits of globalization exceeded potential harm. One overwhelmingly positive indicator of the advantages of liberal economic policies and global engagement was the sustained drop in global poverty levels. However, the finding was perhaps skewed because of the inclusion of China and India, two large countries that have done exceptionally well in reducing aggregate poverty levels.

Ha-Joon Chang (2007: 90–91) is much more critical of western advocacy of global engagement which he termed as hypocritical and unwise, given that their own development and industrialization had relied on, and benefited from protectionist policies. For instance, in the USA, Alexander Hamilton, the architect of modern America, had urged Congress to impose higher tariffs on imports to encourage local manufacturing, and consequently, tariffs increased from 5 percent in the late eighteenth century to 12.5 percent and to 25 percent in the early nineteenth century. Chang is particularly critical of multilateral agencies and their advocacy of trade liberalization, as a handicap for the next generation of industrial economies. Instead, Chang argues that developing countries deserved an opportunity to engage with the global economy with strategic foresight and on their own terms. Arguing against premature trade liberalization, Ha-Joon Chang (2008) provided statistical evidence to show that economic growth during the third world industrial revolution was significantly higher than in the 1980s, a period of forced global engagement and structural adjustment following the debt crisis. Against the orthodoxy of free markets, Chang (1999: 192) showed that statist intervention to promote development was not only necessary but also desirable, insisting that a general critique of de-politicization was flawed and that it was better to reform states to manage the economy without too much costs (Chang 1999: 192). Yet, even if Chang was justified in criticizing the West for forced liberalization and structural adjustment programs that had literally brought growth to standstill in a large number of developing countries in Latin America and elsewhere, at least in the short term, we cannot ignore the failed ISI policies that had led to the debt crisis is the first place.

Sachs (2005: 79) too, criticizes the IMF for peddling the same policies everywhere regardless of context when in fact the IMF should when 'in Afghanistan or Bolivia … think automatically about transport costs; when in Senegal, attention should turn to malaria.' The problem was that the IMF and World Bank, staffed by technocrats trained in neo-classical economics, lacked area expertise and applied, by default, formulaic liberalization programs to developing countries. Neither institution was capable, or even convinced, of the need to provide policy advice based on specific circumstances in each individual client state. Sachs' advice to IMF was that it scraps its failed structural adjustment policies in favor of clinical differential economics to reflect local conditions rather than textbook principles.

While criticisms of structural adjustment programs (SAPs) are common, critics are not necessarily anti-globalizers. For Stiglitz (2005), international financial institutions, like the IMF, had simply 'oversold' globalization and failed to factor in local conditions, making conditions on the ground worse than before. For instance, IMF involvement in the Asian Financial Crisis may have exacerbated conditions in Indonesia. According to Stiglitz, even though global engagement had assisted East Asian economies in advancing growth and development, formulaic and blanket liberal market reforms imposed on developing countries by multilateral institutions had been less than beneficial because these policies were often inconsistent with local conditions. The World Bank acknowledged as much in its 1993 acknowledgement of the success of the developmental state model. The President of the World Bank, Lewis Preston wrote, 'This diversity of experience [in East Asia] reinforces the view that economic policies and policy-advice must be country-specific, if they are to be effective' (cited in Johnson 1999: 35–36). Arguing against premature globalization, Stiglitz argued that in the case of East Asian countries, it was their 'ability to take advantage of globalization, without being taken advantage of by globalization, that account[ed] for much of their success' (Stiglitz 2006: 31; see also Stiglitz 2005: 228–229).

Early liberalization can have devastating effects on nascent and internationally uncompetitive industries and it is necessary, therefore, to manage the transition, not with a view to protecting such industries but to ensure transition to international competitiveness within a reasonable timeframe. Western countries, for instance, gave themselves a ten-year transition period before liberalization of the textile sector and it was unreasonable, in that context, to require more speedy transition in developing countries. For that reason, it is important that countries take ownership of their liberalization process. Although this is not precisely how Richard Falk (1999) used these terms, but 'globalization from below' is superior to 'globalization from above.' For Falk, globalization from below included measures of social justice to balance the neoliberal policy agenda, which underpins globalization from above and is a result of external pressure. That may be ideal, but, at a minimum, developing countries should calibrate their global engagement to avoid painful dislocations but be aware also that industrial deepening behind tariff walls is incapable of producing true development or an industrial base that is globally competitive.

Elsewhere, Nooruddin and Rudra (2014) found that liberalization often prompted developing countries to secure and enhance domestic

support for these policies by expanding job creation through the public sector, to take the sting out of liberalization. Again, these policies benefited the 'privileged poor' in the urban centers rather than the vast majority of their poor citizens. They point out that developing countries were 'often unresponsive to the needs and demand of the poor … [and adopt] compensation strategies that disproportionately benefit business interests and historically powerful group of workers that are experiencing increased economic insecurity due to neoliberal economic reforms' (Nooruddin and Rudra 2014: 608).

At an empirical level, Thompson and Reuveny (2010) found that globalization had no positive impact on development. Based on their quantitative and longitudinal study, from the late nineteenth century through to the start of the millennium, they concluded that aggregate per capita income of the group of Northern (developed) and Southern (developing) countries showed no convergence between the two groups, except for certain short periods in the 1930s and after the Second World War (Thompson and Reuveny 2010: 50). In each of these two instances, convergence was short-lived and a result of a sharp drop in Northern per capita incomes rather than any sudden increase in the level of economic development in the South. Overall, the income gap has had a divergent trend. In 1870, the countries of the North had a real per capita GDP that was 3.52 times larger than that of the South, but in 2003 that gap had widened to 5.94 times (Thompson and Reuveny 2010: 48).

As a collective, the South today remains disadvantaged and poor and there is no magic bullet to lift them all up simultaneously. However, globalization does offer new pathways that individual countries can exploit to improve their developmental prospects. Of course, even in earlier periods, there were countries of the South that had successfully achieved the impossible. East Asian economies, such as South Korea, Taiwan (Republic of China), Hong Kong, and Singapore, not only achieved convergence after the Second World War but also exceeded the per capita incomes of many developed countries. Their outstanding achievement in industrialization and per capita income growth may not stand out as significant 'Southern' achievement because these four Tigers economies account for only a small fraction of the total population base of the South and their economic performance dwarfed by the poor growth record of the rest of the South. At the same time, even if the East Asian developmental state was not culture-specific, its wider applicability was limited because of very stringent requirements, such as their emphasis on education, and

technocratic policy-making and so on. A prevalence of personalist and corrupt regimes in the South meant that the developmental state model had limited appeal.

However, despite criticisms, globalization has introduced a new pathway to industrial development. Industrialization is still the Holy Grail for developing countries, and countries such as India, China, have done extremely well in promoting growth, industrialization, and poverty alleviation in the post-globalization period. Successful globalizers also include smaller countries, like Bangladesh, that had a very rudimentary and sparse industrial base. In 1990/91, the share of manufacturing GDP was only 12 percent in Bangladesh, but by 2015, had increased to 30.4 percent, with a concomitant drop in the share of agriculture from 32 percent to 16 percent. The single most important advantage of globalization is that developing countries do not have to develop an entire industry and achieve international competitive advantage, not an easy task, but can with relatively greater ease, identify and integrate into appropriate points in the globally fragmented production process. This may not be easy, but relatively easier than developing an entire industry. According to the World Trade Report (2014: 94):

> Before the mid-1980s, achieving industrialization was largely synonymous with building the whole supply chain within one economy. Early entrants, such as Japan, the Republic of Korea and Chinese Taipei, did this successfully. Requiring decade-long learning by doing, this road led to durable industrialization. Nowadays, unbundled production implies that economies can specialize in specific tasks instead of products or industries.

Critical to success is the ability to link with global value chains. Successful globalizers encouraged local participation in GVCs through the establishment of special economic zones (SEZs) where foreign investors have special privileges and incentives to develop backward linkages with local industries as suppliers. Participation in GVCs can increase both foreign investments and exports, especially of non-traditional products. For developing countries that are dependent on a few export commodity, diversification is important to the creation of a more resilient economy. GVC participation has dynamic gains as well, such as productivity gains through exposure to cutting-edge leading technologies, and technical skills development. For example, in 2011, Samsung established Electronics Engineering Academies in several African countries to ensure adequately

trained personnel for its expanding GVCs in Africa (Taglioni and Winkler 2014). FDI flows to developing countries, in general, increased substantially in the 1990s, and China was the largest single beneficiary of western FDI. It not only had a large domestic market but western investment gravitated to China also because of generous conditions offered in the large number of export processing zones (EPZs) and special economic zones (SEZs).

Special zones have been important to industrial diversification and in establishing backward linkages to the domestic economy. China was among the first countries to experiment with Special Economic Zones in the 1980s and the Shenzhen SEZ was a good example of an export-oriented zone linked to the domestic economy. Since then SEZs have proliferated across many other developing countries but not all SEZs have been as successful as the original Chinese SEZs.

India was relatively late in liberalizing its economy. Economic stagnation and declining foreign exchange reserves were the catalysts that forced the government, in 1991, to chart a course of economic liberalism. The architect of this shift was Finance Minister Manmohan Singh who defied local opposition to end decades of ISI policies. Earlier, the Latin American debt crisis of 1982 had forced many developing countries to initiate trade liberalization as part of structural adjustment programs imposed by multilateral agencies in return for bailout and financial assistance. Liberalization produced success and failure in different countries but the two that did well, China and India, did exceptionally well. Joyce Appleby (2010: 367) writes of their spectacular success saying that whereas in 1820 these two countries together contributed about half of the world's income, their share had slipped to about one-tenth by 1950. The two countries have now not only reversed the trend but stand poised to account for a third of a far richer world by 2025. Chinese growth rates have slipped considerably since 2015 but still remains above the global average. Even if average per capita income is low, Chinese success in poverty alleviation has been considerable and greatly reduced the percentage of individuals living below the poverty line globally.

Similarly, Bangladesh did well in its fight against poverty. It is among only a small group of countries to achieve the UN's Millennium Development Goals (MDGs) on poverty reduction, and projections are that, if current growth rates continue, Bangladesh will achieve the much-vaunted middle-income country status within a decade. The strategy pursued by Bangladesh, like China, Mexico, Turkey, and India (in services trade), was

industrial deepening through participation in global value chains and by encouraging the location of some of the disaggregated production activities within its borders. Although industrialization is not the same as development, manufactured exports allow countries to break out of a dependence on primary products and the terms of trade difficulties. Diversified exports stabilized revenue stream for these countries and participation in production networks provided developing countries with 'access to information … new markets, and … opportunities for fast technological learning and skill acquisition' (Sturgeon and Memedovic 2011: 2). Openness is not only essential to a competitive economy but participation in global supply chain activities can be a source of important technology transfer. There is always an element of technology transfer associated with foreign direct investment and there are many different perspectives on this. MNCs may bring in advanced technology in a labor-rich country that perhaps might do better with less advanced and more labor-intensive technologies (Evans 1979: 29). At the same time, dated technology can be a disadvantage in developing an export profile. For example, China developed its automotive industry with the help of joint venture operations with American auto manufacturers but US partners did not transfer the most advanced technology because they were 'afraid of spawning competitors' (Gallagher 2006: 122). Limited access to advanced technology made it difficult to develop exports to advanced western economies. In 2008, China produced nearly 7 million passenger vehicles, but exported only 2000 cars to Europe, either because of poor quality, safety, or fuel efficiency standards. Chinese manufacturers will eventually also overcome their technology handicap, and already in the late 1990s, new government policies and increased competition had resulted in advanced technology transfers (Gallagher 2006: 125). In the meantime, however, Chinese car manufacturers were able to develop exports to less sophisticated developing country markets such as Egypt, where consumers tend to be more sensitive to price than to quality. Not surprisingly, there has been a progressive expansion of South-South trade in manufactures in recent years, as shown in Table 5.1 below. Before this opportunity to participate in global production networks, South-South trade was limited because of complementarity of their export profile.

Given the growth in disaggregated manufacturing, industrial deepening is no longer dependent on targeting specific industries. Instead, developing countries need only to create the right conditions and incentives to provide a platform for participation in globally dispersed production networks. This does not require targeting a specific industry but

Table 5.1 Growth in world merchandize exports

	1995–2012
Total world	258%
Developing countries	470%
South–South	520%

Source: *UNCTAD Handbook of Statistics* 2014. UNCTAD. (http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=673)

the provision of requisite infrastructure and incentives for a range of manufacturing activities to take root. Many developing countries have succeeded in this through well-planned special economic zones (SEZs). Manufacturing activities in these zones might only be a fraction of a particular industry but spread across a diverse range of industries. The attraction of economic zones is that it is easier to manage development in a small geographic area rather than across the board. It is easier, for instance, to ensure stable power supply to industries within a zone, rather than to nationally dispersed firms and industries.

There are no hidden secrets to success but it is worth observing that for some of the successful countries a critical ingredient was the establishment of Special Economic Zones to attract foreign investments and establish global linkages. There are many different types of economic zones including Free Trade Zones, but the most successful are the SEZs, which are both multi-purpose and integrated into the national economy, as for instance the Shenzhen SEZ in China. EPZs, by contrast, are like enclave economies with limited linkage to the host economy, and Farole and Akinci (2006: 14) suggest that it is worth 'shifting from a traditional fenced-in EPZ model to an SEZ model that eliminates legal restrictions on forward and backward links and domestic participation.' In 1986, there were 176 SEZs in 47 countries but by 2006, the number had increased to 3500 zones in 130 countries (Farole and Akinci 2006: 5). These have been very effective in effecting a growth of manufacturing activities in Central America (Dominican Republic, Honduras, El Salvador), Asia (Republic of Korea, Taiwan, China, Bangladesh, Vietnam), and Africa (Mauritius, Madagascar). China has the largest number of SEZs and its success has encouraged other countries, such as India, Honduras, and Bangladesh, to follow suit. In 2015, Bangladesh had eight export-processing zones with ambitious, and unrealistic, plans to establish 100 EPZs, over the next 15 years, with generous tax concessions and subsidies.

SEZs and EPZs have had considerable success, as a catalyst for manufacturing expansion and export orientation, including 'transformed exports,' where imported inputs undergo value-added manufacturing for re-export. Transformed exports are a particularly good example and measure of a country's integration into global manufacturing chains. The International Trade Center (ITC) calculated that a majority of even the Least Developed Countries (LDCs, a group of about 50, mostly African, countries) had considerable success in integrating into global value chains and had increased their share of transformed exports to 60 percent of total exports (ITC 2013: 9). Overall, it found that LDCs had increased their share in total world exports from an average of 0.6 percent in the years 2000–2005, to 1 percent in 2011, an increase of about 40 percent over a six-year period.

There are, as well, examples of zones that have failed to significantly advance development in the local economy. In the early 1970s, the Philippines, for example, established the Bataan Export Processing Zone but assessment of it in the late 1980s showed that it had limited success, partly because of locational issues and distance, disconnect with local economy, and political instability. According to Balasubramanyam (1988: 164) the employment and welfare benefits of Bataan EPZ were largely overwhelmed by 'heavy subsidies on capital to foreign firms locating in the zone.' In recent years, the Chinese government has established a number of export zones in African countries, either as wholly owned ventures or in partnership with national governments or local corporations. Most, but not all, investors in these zones have been Chinese companies. The most advanced of the Chinese led EPZ is the Chambishi Zone in Zambia, which in 2009 had attracted 11 Chinese companies for a total investment of US$760 million (Brautigam and Xiaoyang 2011a: 91). Africa is of interest to Chinese companies because of opportunities in the natural resource sector, and Brautigam and Xiaoyang caution that these could end up serving mainly Chinese interests, especially as African governments have opted not to be deeply involved in these activities, relying instead on Chinese commercial partners. The Chambishi Zone did not deliver on initial expectations. It became a site for extractive industries and for processing of copper without spillover and linkages to other sectors of the Zambian economy, or boosting local manufacturing.

Egypt did better and was able to boost exports of manufactured goods quite considerably, following the establishment of SEZs with Chinese collaboration. In the Suez economic zone, one of the first companies to set

up was the Chinese state-owned China Textile Manufacturing Company (CTMC). For CTMC, Suez had locational advantages, being near a port and in close proximity to European markets. An additional advantage was that goods exported from Egypt had an Egyptian certificate of origin that made entry to Europe easier and more preferential than from China. In a number of other countries, EPZs helped boost exports and in Bangladesh, Kenya, Mali, Ghana, Mozambique, and Nigeria, the various EPZs accounted for more than 70 percent of total national exports. India also established an extensive number of EPZs but these accounted for less than 10 percent of national exports (Palit and Bhattacharjee 2008: 12–19). It is less clear from statistical data whether EPZs simply divert exports away from the national economy, or whether they add to total exports. The latter is, of course, the true measure of success and more likely to be the case given that industries inside SEZs have better infrastructure and reliable power supply, not always available to industries located elsewhere. Apart from exports, EPZs can also be a conduit for technology transfer, and again, the significance of this depends on the extent of backward linkages to the host economy. A study by OECD/WTO (2013) emphasized the importance of fostering backward linkages but not through local content requirement, rather with rewards for local sourcing. According to Brautigam and Xiaoyang (2011b: 51):

> Yet the timing is right for some African countries to catch the new wave of investors coming out of China. If even some of these experiments lead to a genuine transfer of knowledge and opportunity from China to Africa, much as happened with Japan and south-east Asia in the 1970s and with Hong Kong and Mauritius in the 1980s, employment could see significant gains and, in some spots, long-delayed industrial transitions may yet be realized.

In determining success, it is important for host states to be involved and provide leadership and direction. In many EPZs in Sub-Saharan Africa, governments failed to provide basic facilities required by companies, such as reliable electricity and water, or control other deficiencies, such as excessive regulation and corruption (Auty 2011: 208). For example, in a comparison of non-African and African SEZs, Zeng (2015) found that the average number of hours lost due to power disruptions was 9.5 hours per month in Africa (Kenya, Nigeria, Lesotho, Ghana, Senegal, and Tanzania) compared to slightly above 3.5 hours per month in SEZs in Bangladesh, Vietnam, and Honduras. Despite acute power shortage and

disruptions in the rest of the country, 113 hours of disruption per month, Bangladesh provided relatively stable power supply to producers in SEZs, with monthly disruptions of only 6 hours. Similarly, the time needed to clear imports through customs in the same African SEZs was 50 days, compared to only 3 days for the non-African SEZs.

While Honduras and Bangladesh have had greater success in developing exports, they have not been able to achieve a diversified industrial base and remain focused on the manufacture and exports of garments and clothing for large western retail companies, such as Walmart. This reflects a failure of governmental leadership in pushing firms to move up the value chain. Instead, in Bangladesh the focus has been on keeping costs and wages low to benefit existing manufacturing, rather than using wages growth as a tool to encourage more value-added manufacturing. The clothing and apparel industry in Bangladesh accounts for approximately 80 percent of exports and the government has allowed itself to become too close to this industry rather than explore and exploit new opportunities. This is a shortsighted strategy focused on meeting immediate export targets rather than ensuring a broad-based manufacturing base. There are lessons that we can learn from the experiences of Japan and Singapore, about how to move up the technology ladder. It is not enough to excel as a low-cost producer; governments need also to plan to move up the level of manufacturing sophistication. This requires education and technical skills development to bring in jobs that provide better wages and conditions.

In Africa, given the relative lack of success of EPZs and the endemic social, economic, and political dislocations, Richard Auty (2011: 210) suggested that a more appropriate path in these 'distorted economies' was establishment of Early Reform Zones (ERZs), a small enclave where a government might quickly establish the conditions of a reformed economy for investors. Indeed, it is interesting that when China established its first SEZ in Shenzhen, it was in the context of a highly distorted national economy dominated by state-owned enterprise and price controls and so on. The Chinese government also emphasized dynamic and spillover gains from forward and backward links to the broader national economy. A well thought-out and managed SEZs or EPZs strategy is a promising option in the tool-kit of policy measures available to developing countries. A successful EPZ required the provision of physical infrastructure and incentives, but also, as a report prepared by the OECD and the World Bank identified, governments in developing countries need also to commit to necessary investments in people's education, skills development,

and effective labor market policies in order to connect to global value chains as a strategy for industrial development (OECD and World Bank 2015: 17). Infrastructural bottlenecks can also impede the contribution of SEZ to growth and highlights the importance of adequate preparation by states in respective countries to extract the most benefit from an SEZ policy. Finally, long-term political stability is important as well, to reassure foreign buyers of uninterrupted security of supplies. A network is only as strong as the weakest link and countries with a history of political and social unrest will find it harder to integrate into production networks. This is not a rationalization for authoritarian governments because all authoritarian governments inevitably fail in the long term and only democracies have a capacity to ensure against acute political failure.

Obviously, however, not all countries have had the same success in forging links with global supply chains and important reasons for the variance include government policies, incentive structures, and macroeconomic policy management. The growth potential of global supply chains is not exhausted and many more developing countries will have opportunities to participate and enhance their developmental prospects. It is important to note that simply removing trade restrictions to encourage competitive markets may not be the ideal developmental strategy and can be detrimental to industrial development and, in the worst-case scenario, lead to de-industrialization. Critical to success is not only internal reforms and some measure of economic diversification, but also an ability to develop linkages to international production networks. Critics point out that the liberalizing agenda advocated by multilateral agencies disregards the history of development in western countries, which all protected their infant industries. As such, they argue that forcing developing countries to liberalize is detrimental to their developmental prospects. Yet, at the same time, it is true for most developing countries that decades of protectionism had failed to advance their developmental objectives. Some, like India, China, and Brazil, built up a solid industrial foundation behind protectionist walls but these were the exceptions rather than the rule. The contemporary focus on liberalization has forced developing countries to find new pathways to development that is different from that of the early trailblazers in at least two respects. First, they have less access to infant-industry protection, and second, they are being encouraged to find more environmentally sustainable pathways to development that protects resources and minimizes the use of fossil fuels. Globalization is one such pathway. Some of the successful globalizers, like India and China, had already achieved

a high level of industrial development before they introduced liberalization. China for example, as McNally (2012: 754) observed, 'entered the global capitalist system after large-scale industrial and financial competitors were already well established.' Liberalization forced protected industries to become more internationally competitive. Apart from the more conspicuous success stories, a number of smaller developing countries also achieved better growth results by linking into the global economy through global production networks. As such, while developing countries have a narrow range of policy options in their industrialization drive, their prospects are not necessarily bleak either. The key is to understand that climbing the ladder of industrialization no longer presupposes establishing entire industries with a full complement of tasks or functions. Instead, industrialization may involve only a particular component in a disaggregated manufacturing process. Industrial deepening is possible with partial industries and manufacturing may require not protection from foreign competition but infrastructure and basic facilities. Liberalization is essential but successful liberalization requires other accompanying conditions, including for example integration through production networks, as happened in China and other successful developing country examples. Samir Amin, on the other hand, argues that Chinese success and that of other East Asian countries was due more to protectionism than liberalization. He (Amin 1997: 99–100) writes:

> I simply draw attention to the fact that [the East Asian countries]….have, to one degree or another, adopted policies marked by strong economic nationalism, in the protectionist and statist sense… They have not … followed the policy prescriptions of liberalism. They have, in fact, done the opposite, whether we look at Japan … Korea … China … or … Southeast Asia and India.

While it is true that none of the East Asian countries committed to complete economic liberalization, the same is also true for all other countries. No country has ever faithfully implemented liberal policies in trade. Protectionist was an important element in East Asian industrialization.

Industrialization is never easy and that is as true for the current generation of developing countries as it was for developed countries in the past. Britain did not make it easy for continental European countries and ninth-century British trade liberalization accompanied policies designed to extend its monopolistic hold on industrial development. It prohibited the

emigration of skilled industrial workers and the export of patented industrial machineries but despite these restrictions, France was able to persuade 'close to a thousand factory operatives to emigrate…and Germany smuggled in machines…[and] Americans with good memories inspected British plants and later copied them' (Appleby 2010: 165). According to Appleby (2010: 167), the late industrializers were so successful that, by 1870, the USA had far exceeded Britain in the volume of steam power and, by 1886, had also surpassed Britain in the production of steel. Seven years later, Germany too, had had overtaken Britain in steel production. In the course of implementing a catch-up, countries also relied on protectionist support and assistance to domestic industries. In the twenty-first century, countries on the same path of industrial development have the task of finding innovative pathways to achieve their national objectives and goals, rather than focus only on the strategies adopted by their earlier, nineteenth-century, counterparts. There is however, a large literature that tries to do just that or to accuse western powers of hypocrisy in forcing developing countries into forced liberalization when their own industrialization strategies depended on protection from imports.

Success within a regime of liberal trade and economic policies ultimately depends on an interplay of several other factors. In the contemporary period, successful liberalization and industrialization for developing countries require an emphasis on integration into global supply chains. Countries that have been able to develop and expand exports through participation in international supply chains, such as India, China, and Bangladesh, have done much better in growth and development than others that have experienced only globalization of consumption, such as in parts of Africa. Thus, Szirmai et al. (2013: 26) argue that success is still possible without old-style industrial policy:

> Integration into GVCs [global value chains] and upgrading within the value chain will require greater emphasis than before on innovation, transport, and agglomeration effects, and less emphasis on the old industrial policy instruments such as tariffs, exchange rate policy and quotas.

Industrial policy included sectoral targeting, and measures to channel investments into targeted sectors. However, with fragmentation of manufacturing processes and its spatial distribution across national jurisdiction, there are no great benefits from *industrial* policies, only with good economic fundamentals and an appropriate incentives structure.

Conclusion

The globalization period witnessed momentous global changes. The collapse of socialism in the 1980s and 1990s left capitalism supremely positioned at the top of the perch. At the same time, demise of developmental state and import substitution models of development left the sole pathway of liberal market globalization for developing countries. Earlier committed socialists, like Perry Anderson, 'embraced' capitalism, not enthusiastically but reluctantly, as a central reality for 'any foreseeable future' (see Saul 2006: 4). The changes over the last three-and-a-half decades, however, do not necessarily convey a message of doom and gloom for developing countries.

The duality of global convergence on neo-classical liberal market principles and the spread of networked production have created opportunities for developing countries to advance their industrialization and development. At the same time, there is no substitute for good governance, measured not simply by corruption indicators. Just as Singapore had success with an emphasis on transparent and clean government, free of open corruption, there are several examples as well of successful globalizers with extremely corrupt governments, such as Indonesia or Bangladesh. Instead, the essential ingredient is a commitment to development. Globalization provides opportunities but requires good government to realize the potential for industrialization in networked manufacturing.

A downside to globalization is vulnerability to global economic crises. Following the 2008 global financial crisis, for example, economic slowdown had an adverse effect on trade, disproportionate to production cutbacks. This is because when production is fragmented and distributed across countries on the basis of particular 'tasks,' there is a consequent growth of trade in tasks that inflates total levels of world trade beyond that which might happen if trade was primarily in finished commodities. If there is more trade than normal in periods of economic upswings, crises have a similarly exaggerated negative trade effect. In the 2008 financial crisis, however, the fall in trade level was particularly precipitous for developed countries and less so for developing countries, which were able to offset loss of exports to developed countries with higher levels of exports to other developing countries. As explained earlier, however, the fall in world trade was not a result of any sharp increase in protectionism.

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CHAPTER 6

Globalization Under Siege: Inequality, Democracy, and Sovereignty

Globalization and economic integration produced good growth results for many developed and developing countries. Many observers and analysts, as well as representatives of multilateral agencies, welcomed globalization as an important and positive development. There is, however, a darker side. Globalization has created a sense of alienation and marginalization among many either because of an inequitable distribution of the gains from globalization or because globalization had a net negative impact on the lives of some groups. Many in both developed and developing countries share the negative perceptions. For instance, we might attribute recent political developments in the USA, at least in part, to iniquitous growth. Similarly, while Ivory Coast, after many years of civil conflict in 2002–2004 and again in 2010, achieved creditable growth rates of around 9 percent a year over the three years between 2014–2016 benefits, inequity and poverty remained a serious problem for the country. In a December 2015 report on economic conditions in Ivory Coast, titled *The Might of the Elephant: Benefiting from Strong Growth to Create Better Jobs*, the World Bank stressed the importance of shared growth. According to Jacques Morisset, co-author of the report, 'The main economic challenge facing Cote d'Ivoire [Ivory Coast] is the promotion of a shared economic growth that guarantees higher incomes for the population living below the poverty line, and narrows the income gap between the poor and non-poor. However, the rapid growth posted in recent years has not

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yet translated into a significant decline in poverty.' This iniquitous growth was a factor behind a mutiny by disaffected soldiers, in early January 2017 who demanded better pay and economic conditions.

Another source of disquiet about globalization is that it had undermined long-established institutions, like sovereignty and democracy. In this chapter, I will assess criticisms that globalization is responsible for rising income inequalities, and perceived erosion of democratic governance and state sovereignty. According to Dani Rodrik (2011), there is a tension between prosperity that globalization has delivered, and other cherished principles of national political democracy and the nation-state that have been eroded by the same forces of economic globalization. According to him, globalization had confronted us with a so-called political trilemma, in which we eventually are forced to choose any two of the three desirable goals: prosperity (globalization), nationalism (nation-state and sovereignty), and political democracy. Assuming moreover that globalization is irreversible, our choice is ultimately between the nation-state and democratic governance. At the same time, even with higher levels of prosperity, it is undeniable that, since the 1980s, income inequality has risen in both developed and developing countries. The prosperity that we attribute to globalization has not been a shared prosperity. As such, not only is there a growing sense of despair about losses in democratic rights and shared sense of nationalism, the lack of shared prosperity has also undermined globalization as a legitimate and desirable process.

These however do not exhaust the full extent of criticisms and challenges. Anti-globalizers accuse it also for eroding cultural identities in the march toward a homogenous and global oneness. However, cultures in close proximity and contact have, throughout history, changed and adapted, and many cultures have a long and deliberate history of foreign borrowing that has not weakened but instead strengthened cultural identity. The Japanese, for instance, have a long history of foreign borrowing from the West and from China without losing their distinctive Japaneseness. Perhaps, contemporary concerns stem more from the rapid pace of changes brought about by globalization. However, it is worth noting that for the new generation of millennials, change and adjustment is just as normal, as stability and tradition was for older generations. Others have questioned its impact on gender, and raised concerns about the rapid pace of globalization.

Globalization Versus Sovereignty and Democracy

If globalization is irreversible, as argued here, then the choice is between the remaining two alternatives. Despite the many regional ambitions, the nation-state remains an attractive force, and indeed, many have observed an increase in nationalistic sentiments. Globalization has eroded the freedom of maneuver for states but this predates globalization. States have willingly accepted limitations to freedom of choice in exchange for stable international outcomes and for security, achieved through treaty relations with other states. All treaties restrict the menu of choice for states. This is not a bad thing and all states today have treaty obligations restricting their absolute sovereignty and committing them to behave in an orderly and, more importantly, predictable manner. Over time, state expectations have changed. In the 1940s, the USA protected its national sovereignty and freedom of action by refusing to join the International Trade Organization but by the 1990s, it was confident that benefits of joining the World Trade Organization outweighed any loss of sovereignty. There were misgiving in the US Congress about the sovereignty implications of WTO but the vote was overwhelmingly positive after some safeguards that related to the WTO's dispute resolution mechanism. Apart from membership in international organization, states have increasingly committed to various preferential trade agreements (PTAs) that have limited their foreign economic policy options. In 1990, for instance, the number of PTAs notified to the WTO was about 70, but by 2010, only 20 years later, that number had increased to 300 (WTO 2011: 6). By 2016, there was not a single country without either a bilateral or a multilateral PTA commitment. In that year, however, further trade liberalization appeared to have run into difficulties when a small group of dissenters from the French-speaking part of Belgium held up a trade agreement between Canada and the EU, the Comprehensive Economic and Trade Agreement. The treaty negotiated over a seven-year period and extending to nearly 1600 pages would have eliminated most tariffs on trade between the two trans-Atlantic partners. The regional parliament in Wallonia withheld its assent on grounds that Canada's efficient farmers and small industries would harm local farms and businesses. This was an unexpected show of strength from a small province and indicative of deeply held views against further trade liberalization among different groups across many countries. Eventually,

assurances to Wallonia placated its opposition and the Agreement signed into effect, but it was a sobering reminder of the shifting mood against aspects of globalization. It was not surprising that President Trump, soon after assuming Office, pulled the USA out of the proposed Trans Pacific Partnership (TPP).

Sovereignty has again become a highly debated issue because of a sense that states have already bargained away 'too much' of their sovereignty in the process of globalization. Obviously, this entails a cost-benefit analysis, but in the 2016 US presidential elections, the Republican candidate made it a part of his campaign promise that, if elected, he would renegotiate all major treaties, including the North American Free Trade Agreement (NAFTA), to ensure that the cost-benefit matrix was more in favor of the USA. He however promised more, not fewer, trade agreements to secure and advance US interests.

From the Westphalian concept of absolute sovereignty, we have progressed to a more flexible notion of shared sovereignty between states, treaty organization, and multilateral institutions that Hardt and Negri (2000) defined as Empire. Others have also supported the basic notion of a transfer of sovereignty to international organizations from states as well. In the European Union, Ku and Yoo (2013: 220) write that several institutions, such as the European Court of Justice, had 'acquired sovereign powers from member states to override significant parts of domestic law.' This however, is an overstatement. International organizations (IOs) generally are not supranational and derive their mandate from member states. Member contributions also fund their operating budgets. There are no international organizations with an independent revenue source or which are sovereign entities, in a position to rival state sovereignty. It is true, however, that multilateral agencies have become prominent actors in international relations but their rise is a result of negotiated outcomes in which states retain ultimate sovereignty. In 2016, the Belgian province of Wallonia demonstrated that even a small province was able to protect its sovereign interests when it held up the ratification process for the CETA, the Canada-EU Comprehensive Economic and Trade Agreement.

Another source of disquiet is that states, in a globalizing economy, appear to have relinquished more of their sovereign rights to the corporate sector. The corporate sector is the driving force behind the spread of GPNs, and the process of globalization has weakened state capacity to manage either the emerging global economy or even their own national economies. The globalizing economy has no parallel authority structure

to regulate it but if that absence and void is a growing problem, equally troubling is the erosion of state capacity to manage their own economies. The latter became painfully obvious to the Australian government when, in the late 1980s and early 1990s, it embarked on a regime of higher interest rates to lower domestic consumption and import demand in order to reduce its balance of trade deficits. In theory, this was an appropriate policy choice but high interest rates actually added to the trade imbalance and the deficit. This was because higher interest rates resulted in substantial capital inflows that strengthened the Australian Dollar and made imports more, not less, cost-competitive. Imports ballooned, exports suffered, and ultimately the trade deficit was larger than before. Managing national economies that are globally connected is problematic. In 1997, when the Malaysian government sought to contain harm to its economy from the Asian financial crisis, it felt compelled to suspend exchange convertibility, albeit temporarily, to prevent currency flight.

There are growing concerns that the private sector has enhanced its relative position vis-à-vis states but that proposed new international trade agreements appear to further exacerbate that power and relative imbalance between corporations and states. That was the case for the Multilateral Agreement on Investments (MAI) that OECD members agreed to formulate in the 1990s. The terms of agreement granted corporations a legal right to sue states for non-fulfillment of treaty obligations and for any resulting financial loss. Ultimately, public anger in Canada and some European countries forced OECD to abandon the MAI. The same fears were revived in 2016 when the proposed TTIP between the USA and EU included provisions for similar rights to the corporate sector.

On democracy, one view is that globalization is a tool for facilitating democratic transition of authoritarian regimes through the contagion effect and through growth and wealth creation, often considered a prerequisite for democratization (see Dinello and Squire 2005: 9). There is sufficient empirical evidence to support this position. A number of countries transitioned to democratic politics since the 1980s, for example in East Asia, and this transition followed a period of creditable economic performance that reduced poverty and expanded economic opportunities for many. It was not always a peaceful process and often-included external pressure as well, but democratic transition in East Asia was consistent with models proposed by Lipset and others that economic development enables democratization. Further, Bhagwati (2002: 43) explained that 'openness to the benefits of trade brings prosperity that, in turn, creates or expands the middle class that then seeks the end of

authoritarianism.' Another related mechanism that connects globalization to democratic outcomes is that liberal market principles and economic empowerment will inevitably raise demands for a similar empowerment and democracy at the political level. If this is accurate, then China, a leading participant in the global economy, should transition to liberal politics at some point in the not too distant future. There are however, no real indications of this at present and the communist party is intent on retaining political control even as it continues on the path of liberal economics.

On the other hand, a frequently expressed concern is that globalization has weakened democratic processes at the national level with unrepresentative governance of unelected global technocrats in the various multilateral agencies or by private actors operating in an informal and political vacuum. This is the argument that globalization is responsible for democratic deficit at the national level. Economic globalization may have outstripped governance structures and democratic accountability, an issue that deserves attention in the interest of safeguarding democratic politics. On the other hand, the threat to democratic politics emanates not so much from globalization but from other factors that predate globalization. William E. Scheuerman (1999) argued that there had been a shift in power away from elected parliaments and legislatures to the executive branch in all major democracies in the USA and European countries. In the USA, for example, Congress delegated substantial authority to the executive branch in trade policy and for dealing with emergencies, such as conflict and terrorism. These predate globalization and constitute a diminution of democratic oversight. Globalization may have weakened democratic safeguards but it was not a qualitative shift.

In his analysis of the political trilemma, Dani Rodrik suggested that globalization had placed in jeopardy either our commitment to national sovereignty or to democracy and he expected that at some point we will be forced to choose between state and democracy in order to enjoy the benefits of globalization. Interestingly however, the 2016 British decision to leave the EU reflected perhaps a willingness by British voters to sacrifice globalization at the altar of sovereignty and democracy. The popular decision took the government by surprise. Even Rodrik (2016), in his reflections on the Brexit decision felt compelled to write that Britain should have chosen to remain within the EU not only because of the economic costs but because the decision to leave EU had weakened democracy in Europe. The decision, however unexpected, was indicative of growing skepticism about the merits of global integration. However, in the next

section, I will show that the flaw lies not in globalization but in political failure to manage globalization.

Frustrations surrounding the perceived loss of sovereignty and democratic governance are symptomatic of a bigger underlying problem, that of rising inequity and marginalization of the majority of population (the so-called 99 percent) in many countries that have pursued economic globalization. The 99 percent, justifiably or otherwise, feel that they have paid a high price for globalization and not received any compensating benefit. That today is the biggest challenge facing many countries where popular sentiment against globalization runs deep. In his assessment of globalization, Robert Cox (1996: 30) identified three contradictions, two of which related to issues of inequality and democratic accountability. He suggested that social polarization had increased as well as a widening of the gulf between the base and political elites, leading to a loss of trust in the elites. Because of these unresolved contradiction, he expressed a hope that 'globalization has not brought us to the "end of history."'

Growth and Equity

Economic inequality has emerged as a major challenge for both developed and developing countries in recent years. In this section, my primary focus will be on this inequality within states but rather than attribute it to globalization suggest that it reflects political failure, including as noted also by Bourguignon, reductions in income taxes, cuts to welfare, and financial deregulation. There is widespread perception that globalization is to blame for the growing concentration of wealth which has in turn resulted in popular backlash against further trade liberalization and integration.

Adam Smith had defined capitalism as a rational, self-regulating economic system that produced optimal results for any given society, despite capitalists being motivated primarily by self-interest and greed. Moreover, with market forces to regulate production and economic activity, he saw no reasons for governments to intervene in market processes. Karl Marx, in the nineteenth century, also identified greed as a driving force of capitalism but he blamed it for poverty and suffering of the masses and the workers. Evidently, in those early years of capitalism, Adam Smith and Karl Marx had vastly divergent understanding of the societal impact of capitalist greed and self-interest. Life was, for many, solitary, poor, nasty, brutish, and short. According to Maurice Dobb, the motivating force for a capitalist was not simply an acquisitive desire, but to use capital to 'yoke labor to

the creation of surplus-value in production' (cited in Edwards et al. 1986: 16).

Having identified greed as the bedrock of the capitalist mode of production, Marx could not see any prospect for improvements in the living conditions of the poor except through a revolutionary overthrow of capitalism. Conditions for the poor improved in the late nineteenth century as the cost of living dropped with cheaper produce from the continent, but even in the late nineteenth century about a quarter of the British population lived in poverty, with a sizeable percentage of them barely able to pay even for their meals. For example, a study in York in 1899 showed that 30 percent of the population lived in poverty and could not afford to spend enough on necessities to maintain physical efficiency (see MacKinnon 1994: 278). Although the study was specific to a particular geographic location, the conclusion was equally true for the rest of Britain at the time. Even though capitalism had liberated workers from a lifetime of feudal servitude, their living conditions had not improved. Symptomatic of the inequality and poverty was the expected longevity of different social classes. In England in the early eighteenth century, the average life expectancy of all social classes was roughly similar but by the mid-nineteenth century, peerage families had a life expectancy that was roughly 15 years longer than workers, whose life expectancy had stayed much the same over the previous 100 years.

Convinced that capitalist exploitation and greed of the capitalist class were constants, Marx concluded that just as peasants and serfs had broken free of feudal chains, workers would rise to break free of chains of capitalist exploitation, within a few short decades, perhaps even in his own lifetime. He was convinced that one of the ever-recurring crises of capitalism, such as the one in 1858, would provide a perfect setting for the coming revolution that would replace existing social and economic inequalities with equality of condition for all. This was not a normative prescription but a scientific conclusion. Marx may have stood at one extreme with his advocacy for a revolutionary overthrow of capitalism, but he was not alone in his pessimistic views on capitalism. Many, including Ricardo, Thomas Malthus, and John Stuart Mills, shared similar pessimism about prospects for the working class (Lindert 1994: 358). To the dismay of Marx, and later Marxists, however, each crisis appeared to pass without triggering a worker-led revolution.

In the twentieth century, the prospect of revolution receded further into the distance. Following the shock of the Great Depression in the 1930s,

western governments resorted to interventionist strategies to re-engineer capitalism and reverse the progressive immiseration of working classes. States introduced welfare provisions to ameliorate some of the gross inequities in the living conditions of their citizens, and workers were granted the right to form trade unions and use collective bargaining strategies and industrial action to achieve significant gains for themselves. Table 6.1 below shows the improved wealth distribution in the USA and UK in the first half of the twentieth century, an improvement that was accompanied by significant rises in real per capita incomes (Kuznets 1955: 5).

In all, at the end of the Second World War, the life of the average worker was not as bleak as it was in the early years of capitalism. These improvements within the framework of capitalism insulated it from serious challenge and instability. Based on empirical findings that living conditions for workers and other groups in society had improved, Simon Kuznets deduced that capitalism ultimately benefited a large cross-section of society but with an initial lag. The so-called Kuznets curve postulated an inverted 'U' shaped pattern of income distribution where early and extreme inequality eventually gave way to a more equitable distribution of income. It was a good fit to developments in all western societies and readily accepted as an accurate representation of modern capitalism. The Kuznets curve became the promise of a better future for all. The only remaining controversy was whether trickle-down or government intervention explained equity in later stages of capitalism.

However, with economic globalization in the 1980s, the situation has reverted to reflect widening inequalities, although without the nineteenth-century extremes of poverty, and with vastly improved, but declining, public welfare provisions. Not only is our overall level of prosperity

Table 6.1 Share of income by quintile in the USA and UK

	1929	*1944–47 (average)*
United States		
Top Quintile (20%)	55%	44%
Bottom 2 Quintile (40%)	13.5%	18%
Top 5 per cent	31%	20%
United Kingdom		
Top 5 per cent	46% (1880)	24% (1947)

Source: Kuznets, S. (1955), 'Economic Growth and Income Inequality', *American Economic Review*, Vol. XLV, No. 1, March, p 4.

unprecedented, but so is the unprecedented concentration of wealth in the hands of a very small minority. The return of income inequality today may not the harbinger of a postponed nineteenth-century social upheaval but should still be a cause for concern, even if only on grounds of social justice. The extent of this inequality has sparked debate as to whether this is the result of globalization. Defenders of globalization highlight its overall economic benefits in both developed and developing countries, whereas critics condemn it for benefiting only a small minority and for widening the gulf between the rich and the poor, again both in developed and in developing countries. The gulf between the rich and the poor has spawned an anti-globalization protest movement, but according to Jeffrey Sachs (2007: 358), protesters are responsible for 'misguided attitudes' and a 'knee-jerk antipathy to capitalism.' This movement surfaced most visibly in Seattle in 1999 when protesters disrupted a ministerial meeting of the World Trade Organization that was to have launched a new trade liberalization round. According to Sachs, the protest in Seattle was symptomatic of this antipathy to capitalism. Noting that Africa had lagged behind other developing countries in many of the key development indicators, he argued that fault was not with global capitalism but rather with the failure of African countries to engage effectively with global forces. From his perspective, blaming globalization and global corporations, like for instance Microsoft, was ironic because the Gates Foundation, established by the founder of Microsoft Bill Gates, was perhaps the leading agency committed to promoting 'public health in poor countries' (Sachs 2007: 356). To add to the charitable work of Gates Foundation, Mark Zuckerberg, founder of Facebook and his wife Priscilla Chan announced in September 2016, a commitment of $3 billion over a ten-year period to develop cures for all diseases. At one level, the generosity of Bill Gates and Mark Zuckerberg is admirable. These are all extraordinary acts of generosity and philanthropy, but that does still not justify the incredible concentration of wealth in the hands of a few individuals. In 2016, the combined net worth of just four individuals (Bill Gates, Mark Zuckerberg, Warren Buffet, and Jeff Bezos), at US$271 billion, was more than the nominal GDP of bottom 122 countries. There is no logic for such concentration of wealth when poverty is so prevalent, even in many developed countries. According to S. Ibi Ajayi (2005: 71–72)

> The gap between the top and bottom quintiles of national income has grown from 30 to 1 in 1960 to 82 to 1 in 1995. By the late 1990s, the twenty

> percent of the world's population living in the highest-income countries had 86 percent of the world GDP… the bottom quintile registered barely 1 percent.

Evidence provided by Saez and Zucman (2014) also showed the magnitude of long-term shifts in wealth holdings in the USA. Their two main findings were:

1. The wealth share of the top 0.1 percent of population was twice as high in 2012 as in 1916 and three times higher than in 1970s. Saez and Zucman also suggest that the wealth holding of this group is probably conservative because of various offshore wealth management strategies, tax optimization behavior, and indirect wealth ownership through trusts and foundations.
2. The wealth share of the bottom 90 percent of population had initially increased from 20 percent in the 1920s to 35 percent in the mid-1980s but had fallen since then to 23 percent in 2012.

Similarly, according to Robert Went (2002: 4–5), globalization is responsible for growing income inequality in the world as a whole. He cited UNDP data showing that, in the late 1990s, the richest 20 percent of the world's population had increased their share of income from 30 times to 82 times that of the poorest 20 percent. In January 2016, Oxfam reported that in 2015 the top 1 percent of global population had accumulated wealth equal to the remaining 99 percent. For Bourguignon (2016), globalization is responsible for both the positive 'between country' reduction in inequality, and the negative 'within country' exacerbation of inequality.

According to Thomas Piketty (2014: 22), the internal logic of capitalist growth leads inevitably to iniquitous income distribution. That logic was moderated in the first half of the twentieth century only as a result of deliberate state intervention to improve the living condition of the poor during the two world wars and the Great Depression. State-led redistributive measures were necessary during the Depression and the world wars to compensate the average working-class individuals, distribute wealth more equitably if only to give all members of the society a stake in the system and deal effectively with expansive and aggressive foreign threats. Indeed, if the state had not agreed to greater economic democracy, inequality in the USA might have continued to widen, as it actually has since the end of

the twentieth century. Apart from potentially negative longer-term social consequences of such inequality, this trend is inconsistent with the conclusions reached by Simon Kuznets.

Income inequality is a result of both systemic tendencies within capitalism and individual greed but the extent to which it begins to corrode social order and harmony is a function of political failure. Even if the number of individuals below the poverty line has declined, the extreme nature of contemporary inequality is worrying and morally indefensible. The remedy lies in better regulatory control of corporate excesses and better provision and management of social welfare provisions. States are not helpless in countering inequality. They may chose not to, but that is not an iron law. Scandinavian countries and Japan, in the 1960s, were examples of state intervention to produce more socially desirable outcomes. Japan in the 1960s achieved double-digit economic growth and yet managed to avoid the extreme of income inequality. That earned admiration as a 'miracle economy' but the miracle was not transcendental. Re-distributive policies can ameliorate and lessen income gaps, as happened in early twentieth century. Inequality has risen to the surface not so much because of globalization but because states have abnegated their social responsibilities. Globalization and inequality may have an associational link but that link is not as cause and effect.

In his analysis of inequality, Simon Kuznets acknowledged that dynamic forces within capitalism were partly responsible for moderation after the extremes of inequality in the nineteenth and early twentieth century. He also identified 'legislative intervention' as essential to the process of equitable distribution of incomes. Kuznets (1955: 8–9) noted that 'legislative interference and "political" decisions' were responsible for at least some of the improved income distribution in the first half of the twentieth century. Globalization is an overwhelmingly positive development but one that has been mismanaged. Western governments, since the 1980s, are complicit in the dysfunctions that legitimized unbridled greed and, today, have created a backlash against globalization. The British vote to leave the European Union and the election of Donald Trump to the American presidency on a platform that promised disengagement and de-globalization were clear signs of a popular backlash. Countries like China have also failed to distribute the benefits of rapid and sustained economic growth and prosperity in an equitable manner. Political and legislative intervention to redistribute wealth in the first half of twentieth century had defused potential social instability and a similar assertive political leadership is required

to contain the triumph of misguided xenophobic ideas. Political failure led to the current situation and the popular backlash against globalization, and strong political leadership is necessary to correct the growing inequities. Although globalization did not emanate directly from any deliberate political decisions, and even if it has purged protectionist impulses at the state level, its future may depend on political intervention to distribute the benefits of globalization in an equitable manner, unlike experience in the last 30 years. Globalization is a tool for prosperity, but it must be a source of prosperity for all, not just a few.

In developed countries, structures that had previously encouraged equity and shared growth were progressively dismantled by conservative governments in the USA and UK in the early 1980s, around the same time as economic globalization. Along with lower taxes to benefit the wealthy, governments also scaled back welfare provisions in a determined attempt to return to classical roots of capitalism and shrink the role of the state in the economic system. The assault on governmental and state activism began with conservative governments in the UK and USA, in the late 1970s and early 1980s. Early in the twenty-first century, US President George Bush weakened progressive taxation by giving additional tax breaks to wealthy Americans. The Bush tax cuts were for a fixed period and meant to boost economic growth from which the benefits would presumably trickle-down to lower sections of the society. Later, during the very partisan debate to extend the tax breaks for another ten years, Vermont Senator Bernie Sanders pointed out the unfairness of tax breaks. He observed that the top 1 percent of the population already controlled 23 percent of total incomes, a figure that was more than the share controlled by the bottom 50 percent of the American population. He added that 'It's not only that the rich are getting richer. The very, very rich are getting richer. In the last 25 years, we have seen 80 percent of all the new income going to the top one percent' (Tabb 2012: 4). With rising income inequality in western countries there has been a return of the nineteenth-century anti-corporate, anti-capitalist attitudes, combined with anti-globalization, the latest iteration of capitalism. In the 2016 American presidential elections, the Republican candidate, Donald Trump, admitted that he managed to avoid having to 'share' some of his wealth because of systemic advantages embedded in the American taxation and regulatory system.

Although opportunities in a globalizing economy facilitated growth, development, and poverty alleviation in several developing countries,

globalization also coincided with a worsening of national income inequality. In Russia, China and the USA, the income gap, as measured by the Gini co-efficient, widened sharply. Russia, for instance, has one of the highest concentration of billionaires even though its per capita GDP is about a third of that of the USA. In the USA, the Gini co-efficient increased from 0.41 in 1990 to 0.48 in 2014, and those living below the official poverty line accounted for more than 13 percent of the population in 2015. Not surprisingly, frustration among the so-called 99 percent, those who experienced stagnating incomes in recent decades, led to protests against Wall Street greed and the wealthy. A survey in 2005 found that most Americans were concerned that income divide had widened and that they would prefer an income distribution like that of Sweden (where the top 20 percent held 38 percent of the wealth) rather than their own (where the top 20 percent held 84 percent of the wealth) (Harvey 2014: 167). Thus, although, globalization had produced generally good growth results, most of the new wealth accumulated in the hands of a small minority, creating an unprecedented gap between the so-called one percent of society that was wealthy and the remaining 'ninety-nine percent.' The income gap widened because even as senior corporate executives rewarded themselves with high salaries and bonuses, wages for most others and for the middle class failed to keep pace.

Inequity has a corrosive effect on the bonds that hold societies together and during a recent visit to Latin America, even the Pope felt obliged to condemn pervasive and rising inequality as the 'dung of capitalism.' The USA is more vulnerable than a number of other western economies, where government intervention and redistributive policies had staved off acute inequities. Existing inequality is a challenge and even if it is the economic system and capitalist growth that inevitably produces a skewed distribution of income, the fault is with the political system for not correcting for natural, and undesirable, tendencies. Government failure is a primary reason for the anti-globalization backlash and for the shrinking support base for globalization. States have, at their disposal, policy choices to ensure that benefits of growth are widely shared and a case in point was the Japanese economic miracle of the 1960s, a period of double-digit growth without income inequality.

In the years since globalization began, living conditions for the working and middle class either stagnated or became progressively worse. That reversed some of the gains of the early twentieth century when extension of voting rights to previously marginalized communities resulted in

improved living condition for workers and other groups that had suffered through much of the nineteenth century. Franchise meant that plight of the poor could no longer be ignored. In England, social welfare programs, such as free school meals and old-age pensions, expanded progressively from around 1905 (Macmillan 1998: 107–8). The two world wars and the Great Depression further extended welfare provisions that improved living conditions for workers and the poor. This was a deviation from Smithean *laissez faire* policies but quickly became part of a new social contract. Kuznets extrapolated from this to suggest that just as it was natural for income inequality to widen in the early phase of capitalist expansion, it was natural also that income gaps would shrink as capitalism matured, creating an inverted 'U' shaped curve of income distribution over time.

Recent developments cast doubts over the Kuznets curve and the assumptions that capitalism in the longer term produces improved incomes distribution, even if with the help of political intervention in the accumulation process. In the 1980s, there was a return to more conservative ideas and over the next few decades, states in most western countries wound back their expansionary social programs. As the state divested itself from social obligations, capitalism returned to its normal growth trajectory with rising income and wealth disparity. Piketty is dismissive of the explanation provided by Kuznets, based on a superficial reading of history, that capitalism initially produces inequality followed by later moderation. According to Piketty, the dip in inequality in the first half of twentieth century happened entirely because of external pressures and that late twentieth century capitalism returned to its 'normal' income distribution pattern. This has enormous social implications and although nothing short of a rejection of capitalism can eradicate this inequality, political intervention, according to Piketty, can alleviate it to a certain extent through measures such as progressive, even confiscatory, levels of taxation.

Without greater state commitment to a more equitable distribution of income, globalization will invite more opposition over time. Already in the 2016 US presidential election campaign, there was ample evidence of a backlash against the uneven spread of costs and benefits of globalization from each of the two polar ends of the political spectrum. The first focused on the international unevenness of growth to present a disingenuous case that success of developing country globalizers was essentially due to their unfair practices that had also inflicted harm on the USA. This was reminiscent of the revisionist case against Japan in the 1980s, when revisionist

scholars, like Karel van Wolferen and Clyde Prestowitz, warned of a Japanese conspiracy to enrich itself at the expense of the USA. In 2016, US President-elect Donald Trump, during the election campaign evoked those same sentiments but implied that the situation was much worse than in the 1980s. He accused China of currency manipulation to flood the American market with Chinese goods, and Mexico of stealing American jobs. Complicit in all this, according to Trump, was an incompetent US leadership that made the situation worse with international trade deals that did not protect American national interests. The narrative appealed to many people frustrated with three decades of globalization. Even if globalization had brought an escape from poverty, even prosperity, to many in other parts of the world, in the USA stagnant wages reversed gains made by earlier generations. Himself a billionaire who readily admitted to having exploited globalization and existing regulatory structures to his own financial advantage, Trump somehow managed to channel frustrations of the disaffected '99 percent' into xenophobic anger, creating an 'us-them' divide at the global level. As a presidential candidate, he offered simplistic solutions, such as building a wall along its southern borders to keep out illegal immigrants, and renegotiating trade agreements to allow the USA to capture more of the gains from economic globalization. His plan to help the 99 percent of the population and ameliorate the domestic income gap was not through any income redistribution, but through conservative trickle-down policies. Trickle-down economics had failed in the past but is a favorite mantra of conservatives. Trump pledged, implicitly, that his renegotiated trade deals would allow the USA to capture more of the gains from globalization, with more trickle-down benefits for those who had been marginalized in previous years. His campaign rhetoric reflected an anti-globalization message and a commitment to put 'America first.' In choosing anti-globalization, he followed the lead of a growing right-wing nationalist surge in Europe, such as the UK Independence Party (UKIP) that successfully secured a popular mandate for Britain to opt out of the European Union, and the National Front in France. As President-elect, his first meeting with a European leader was with Nigel Farage, leader of the UKIP. The Trump phenomenon represented America's European moment. He also campaigned actively against immigration by raising the specter of refugees from the Middle East entering the USA to engage in terrorist activists. As President, one of his first Executive Orders was to ban citizens of seven Middle Eastern countries from entering the USA. The courts, however, lifted the ban as unconstitutional and the President then

issued a revised order restricting arrivals from six countries. On appeal, a court in Hawaii, again, lifted the ban.

Second, there was also a backlash against globalization and its assumed negative consequences, but from the more progressive end of the political spectrum. Against the demagoguery of Trump, Democratic presidential candidate Bernie Sanders focused on income imbalance within the USA and offered solutions to rectify this through implementation of Scandinavian-style democratic socialist policies. Since the imbalance was of recent vintage, he attributed it, by association, to globalization. He pledged to stem the tide of globalization by rejecting any further trade liberalization agreements, such as the TPP, and pledged to help the struggling middle class with new welfare initiatives, free health and education programs, and income redistribution. Advocacy of these policies at any other time would have been immediately dismissed as contrary to American values and positively un-American, but surprisingly, in the 2016 election year, the Sanders campaign attracted a large following, rivaling that of Donald Trump. Sanders eventually lost the primary race to Hillary Clinton but the issues he raised had a deep impact on the Clinton campaign, which incorporated some of the progressive policies championed by Sanders, including a pledge to raise the minimum wage and provide cheaper, even free, tertiary education to students from less-affluent family backgrounds. In the final showdown between Trump and Clinton, angry and frustrated American voters propelled the Republican candidate into the White House. The 2016 election was an angry election in which voters vented against the established order, and against the negative fall-out of globalization and, ultimately, against the predictions of mainstream media and political pundits, Trump emerged victorious in the contest. As president-elect, Trump appealed for unity and healing, but the flames of bitterness and anger he had himself fanned during the campaign may not dissipate easily. For that, much of the blame falls on incumbent governments that, for decades, had failed to recognize growing social inequalities and corporate greed, or to implement effective structural adjustment and social safety-net programs to manage problems caused by loss of some manufacturing industries and jobs.

The rise of anti-globalization forces is a warning to future leaders that there remain important issues requiring solutions that are more equitable. It is a challenge for political leaders everywhere to ensure that globalization does not alienate significant portions of their electorate. The solution lies not in promises or attempts to wind back the wheels of

globalization but in ensuring that wealth gains are more equitably distributed. Programs to achieve that will require political commitment and intervention, not a retreat from liberal economic and trade policies. The genie of globalization has escaped the bottle and not likely to be returned. In addition, states have to remain engaged to ensure that benefits are not monopolized by a few but shared by all members of a society.

In a marked break from Conservative governments in Britain, Prime Minister Theresa May announced in January that the government had to stay involved to ensure shared benefits, rather than simply rely on markets to secure individual self-interest. Delivering the Charity Commission Annual Lecture, she argued that inequity and injustice bred resentment and anger, and called for an active government to lay the foundations of a 'shared society.' She departed from the classical liberal traditions of the Conservative Party and added that there was more to life than 'individualism and self-interest.' She said that the government had to be:

> rooted not in the laissez-faire liberalism that leaves people to get by on their own, but rather in a new philosophy that means government stepping up – not just in the traditional way of providing a welfare state to support the most vulnerable, as vital as that will always be. But actually in going further to help those who have been ignored by government for too long because they don't fall into the income bracket that makes them qualify for welfare support.

She committed herself to this new approach and new philosophy and if she actually manages to change the course of government that will be a major achievement. She did not offer any detailed plan; it remains to be seen whether her pronouncements are real or rhetorical, and whether the shared society programs deliver a fair society. For his part, the leader of the Labour Party in Britain, Jeremy Corbin, proposed a maximum wage, to bring down a large and growing income divide. He also did not provide any detail or explain how a maximum wage might benefit the poor, especially if it meant a loss of revenue for the state to fund its social programs.

In his analysis of income inequality, Kuznets had acknowledged the role of political intervention to undo some of the harsh inequities, but essential to this legislative agenda also was increased worker activism. The trend since the 1980s toward increased inequality was a consequence of state withdrawal from social welfare provisions during the Reagan and Thatcher periods. Prime Minister Thatcher had famously suggested that there was

no such thing as a society, only individuals and families. That of course meant that the state had no responsibility for social remedies. Following her example, Prime Minister David Cameron tried to shift the burden and responsibility for social welfare to private charities and not the state, a position that was reminiscent of classical liberals in the nineteenth century. Thatcher and Reagan also intervened to weaken the power and influence of organized labor that had been at the forefront of early struggles to improve the living conditions of the poor working classes. Always low compared to other developed countries, the US Bureau of Labor Statistics reported that while union membership in the USA was 20.1 percent in 1983, it had slipped to 11.1 percent in 2015. In the UK, according to the Department of Business Innovation and Skills, union membership had peaked at 13 million in 1979 but declined progressively to only around 6.4 million workers by 2014.

Developing countries have benefited from participation in global supply chains but there is also a strong temptation to protect international competitiveness by curbing labor rights and wages. Disregard for worker rights was one reason for the many casualties in the Rana Plaza industrial accident in Bangladesh in 2013. Lack of safeguards meant that workers found themselves forced to work in an unsafe factory building, even after large cracks had appeared the day before the accident. In the aftermath of the accident, safety standards improved but legislative requirements and obstacles to unionization left workers without protection. In January 2017, when garment workers in several factories went on strike demanding an increase in minimum wage from US$68 to about US$190 per month, factory owners filed criminal complaints against strike leaders. In the end, this industrial action resulted in the dismissal of about 1500 workers. Some even view globalization to be a clever ploy to impede the revolutionary struggle in developed countries. Petras and Veltmeyer (2001: 55) argue that globalization is meant to 'disorient the political struggle, for if not over the state, which is now supposedly non-existent, what could the struggle be about?' Similarly, Ross and Trachte (1990: 9) argue that globalization and disaggregated manufacturing have become a major resource and a strategic lever in the conflict between capitalism and organized labor to 'restrain workers' demands' with the threat of relocating to cheaper production platforms. As evidence, we can cite rising income inequality and stagnant wages for less skilled workers in recent decades. In developed countries, the threat of relocation to cheaper production sites, and in developing countries, an army of un- and underemployed

has encouraged workers to scale back wage demands for fear of losing global competitiveness and job losses. In countries where labor groups are included in corporatist networks, there is pressure to be 'responsible' and moderate. Elsewhere, in the USA, for instance, in the course of the presidential election campaign in 2015, Republican candidates generally cautioned against increases to the minimum wage because that would result in de-industrialization and loss of international competitive strength. There is an incredible asymmetry in the respective power and influence of corporations and workers, especially in view of declining rates of organization and unionization.

Inequality in developing countries has also increased despite a closing of the income gap with developed countries and poverty alleviation. Rapid economic growth, for instance, lifted tens of millions out of poverty in China and significantly reduced poverty numbers globally. However, just as many were lifted out of poverty in China, many more became significantly prosperous and wealthy, creating a widening social chasm. Before its globalization-fueled growth, Chinese per capita income ranked it among the poorest countries but income distribution was relatively equitable, as measured by the Gini co-efficient. Today, China is a relatively rich developing country but with a massively skewed distribution of income, and this comes in a country that still, at least formally, adheres to socialism and communism. Harvey (2014) argues that while globalization and globally networked production has allowed industrialization in developing countries, industrialization has failed to produce development or to improve economic conditions in countries of the South. He concluded that 'industrialization, which had always been a sure pathway to rising per capita incomes in the past, was now in some instances, such as that of Bangladesh, more associated with the perpetuation of poverty than with the turn to affluence' (Harvey 2014: 123). Dismissing this as a pathway to development, Harvey argued that this new international division of labor would ultimately lead to a revolution led by secular humanists to re-create the world in anti-capitalist ways, devoid of inequality and divisions. Inequality is indeed a problem but its persistence is more a political problem than an economic one. Countries that have failed to improve living conditions for the majority are examples of political failure.

Like Harvey, Nita Rudra is also critical of globalization. In the preface to her book, Rudra (2008: xv) described globalization as an inescapable vice that had constrained policy choices in developing countries and to their detriment. This is because successful globalization required states

to reduce social welfare spending in order to enhance international competitiveness. Interestingly, Rudra (2008) noted that the most adversely affected are not the poor in developing countries because welfare regimes serve and subsidize the lower middle class. Egypt, for instance had, until 2015, generous subsidies on fuel that benefited the middle class, rather than the poor with little prospect of car-ownership. Egypt however, also had subsidies on bread, a local staple, which provided an important degree of protection to the extremely poor groups. Rudra (2008: 6), a critic of globalization, admitted that observable dysfunctions of globalization were only partly due to the internal logic of free trade and globalization, and mainly because of government policies. As such, she argued that it was necessary for 'governments to do something about the negative consequences it [globalization] can yield.'

China has held on to a formal socialist identity, but reforms in the post-Deng Xiao Ping period have restored both private property and market competition, a de facto embrace of capitalism. Several decades of reforms and several decades of spectacular GDP growth has completely transformed China and lifted millions out of poverty. However, at the same time, distribution of income is highly skewed, perhaps worse than in the USA, although inequality in the USA and other western countries has also increased considerably in the last few decades. Despite that, capitalism is unchallenged and in the absence of a viable alternative, there may be less reason to mask this ugly and dark side of capitalism. Protest movements, too, have failed to gain lasting social and political traction.

Industrialization was a major focus for the government after the revolution and Mao sought to drive it forward with campaigns like the Great Leap Forward (1958–1961). The goal was to achieve rapid modernization and great power status, but the various associated policy measures were not well crafted or implemented. For instance, the government's emphasis on steel production saw a proliferation of small steel mills that did not produce steel that was of requisite quality or strength to be useful. The plan also was to develop both agriculture and industry simultaneously but in reality, industrial growth came at the expense of falling agricultural output. This, in combination with adverse weather conditions and draught, resulted in famine, and untold misery and deaths across the country. Following the fiasco of the Great Leap Forward, Mao returned a few years later with another disastrous policy initiative, the Great Proletariat Cultural Revolution (GPCR). In the years of the GPCR, everything was secondary to ideological purity and faith and this

had debilitating consequences for economic progress and development. Following his death in 1976, a new leadership team under Deng Xiaoping ended isolationist economic policies and introduced wide-ranging structural reforms to stimulate growth and modernization. Success of the 'Four Modernizations' initiative (of agriculture, industry, science and technology, and the military) transformed China into an economic powerhouse and it leap-frogged Japan to become the second biggest economy in the world. China lags considerably behind in per capita incomes, but, in absolute terms, it is poised to become the largest economy in the world, in purchasing power parity (PPP).

Reformers in China did not abandon socialism in its entirety or privatize all state-owned corporations, but created space for the private sector by introducing a separate category of Township and Village Enterprises (TVEs). The TVEs became the dynamic motor of the Chinese economy and eventually grew to overshadow the state sector. In 1978, state owned enterprises accounted for about 78 percent of total industrial output in China, but by 2014 that share had dropped to a little over 23 percent. Still, 19 of the 20 largest firms in China are SOEs. These firms dominate their respective industries, such as petroleum, chemicals, banking, and so on, and serve an important function of providing employment to millions of Chinese who might otherwise find themselves in the ranks of the unemployed. Chinese reform efforts and transition to a more market-oriented economy also benefited from substantial investment flows from Japan and other countries, which shifted some of their manufacturing to take advantage of lower production costs.

From the start of the reform process, Chinese economic performance was beyond all expectations. The average citizen enjoyed improved living conditions but a new class of capitalist entrepreneurs managed to acquire enormous wealth that created a highly unequal society from the original tableau of socialist uniformity and equity. This inequality is one of the many challenges that could potentially spiral out of control in the event of serious economic crises and jeopardize regime stability. Reformers in China focused on modernization, growth, and poverty alleviation without worrying too much about emerging economic inequality. Where Mao was committed to socialist purity and an egalitarian society, contemporary Chinese development created considerable

household income inequality, as measured by the Gini Co-efficient. Estimates prepared by China's National Bureau of Statistics [NBS] in 2013 suggested a Gini co-efficient of 0.49 in 2009. While considerably worse than in Maoist times, it may still understate the actual reality. A group of private researchers rejected official statistics as too low and estimated that in 2010 China's Gini co-efficient was 0.61, on par with the worst sub-Saharan African countries (Whyte 2014: 41). Another facet of the Chinese income inequality is the growing divide between the coastal and the western parts of the country, mainly because investment and growth has been concentrated in coastal areas. The income inequality can be attributed to inherent tendencies within capitalism for inequitable growth, as suggested by Thomas Piketty (2014). Chinese and US Gini coefficients are shown in Fig. 6.1, below.

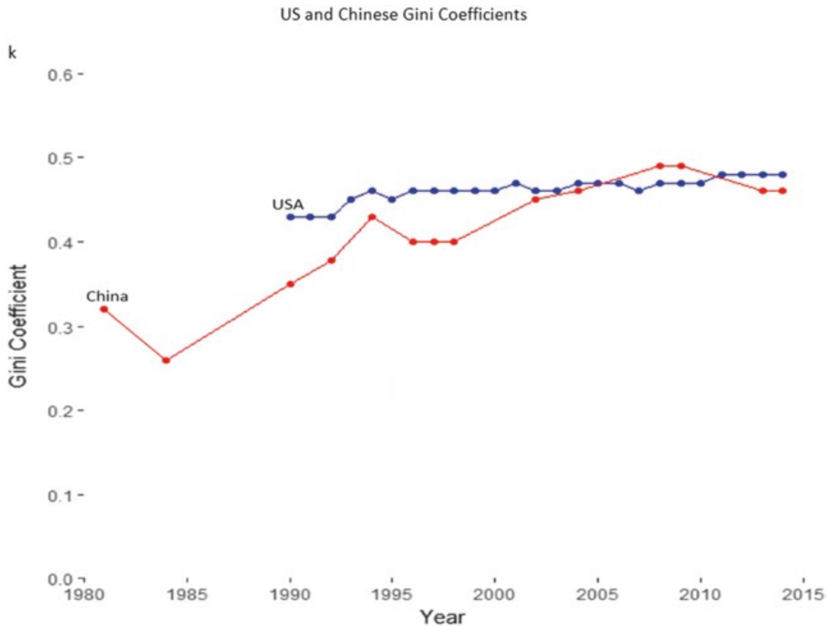

Fig. 6.1 US and Chinese Gini coefficients. Source: Calculated by author from various published sources

Inequality statistics are important because the legitimacy of any political regime is dependent either on actual *performance*, or in decision-making *processes* based on popular mandate and which respect basic human rights and freedoms. Typically, democratic regimes derive their political legitimacy from process-based practices and their stability, consequently, is more robust and unlikely to breakdown even in the event of a crisis, whether short or prolonged. Since the early 1990s, Japan, for instance, has been in a state of prolonged economic crisis and even though several successive governments were responsible for economic mismanagement, there was no questioning of its democratic political system. By contrast, authoritarian regimes depend primarily on their promised ability to deliver superior economic performance and are more susceptible to loss of internal legitimacy in the event of a crisis or when performance falters. In China, where the ruling CCP has refused to accept democratic governance, legitimacy of CCP is shallow and dependent on its ability to continually produce good economic growth, in line with expectations that have ossified over the last 30 years. For the CCP, any sharp drop in economic growth rates could create real problems and destabilize its rule, especially now that communism no longer holds any great popular appeal. Contrary to surface appearances, its grip on power is fragile and the leadership has tried to consolidate its position with appeals to nationalism and anti-corruption campaigns.

In the years after the revolution and until the end of the Cultural Revolution in the late 1970s, the legitimacy of the Chinese Communist Party derived from its ideological claims; however, since ascent to power Deng Xiaoping and his modernization program, the CCP has defined its legitimacy in terms of economic performance. Performance however, has slipped in recent years. In 2015, after three decades of sustained double-digit GDP growth rates, growth slipped to below 7 percent. This was still robust by international standards but for a regime that derived its domestic legitimacy on the single criterion of economic performance, the worry is that economic slowdown might fuel opposition to communist rule. It explains, at least in part, the greater emphasis on weeding out corruption to highlight the government's focus on transparency and good governance. There is also a renewed emphasis on developing the western parts of China and if communication and transport were good reasons for the earlier focus on coastal regions, the Chinese government has pushed ahead with development of a China-Pakistan Economic Corridor (CPEC) to entice investments in the western provinces for transportation and shipment through the corridor. The CPEC will cut shipment costs not

only on oil flows from the Middle East but also for exports to European destinations. The CPEC was welcomed in Pakistan as a great gesture of friendship, but it was really a calculated move to assist the development of neglected western regions of China.

The government remains determined to suppress any opposition to its continued rule. Ever since the Tiananmen protest movement of 1989, any form of dissent is discouraged. If the population was placated with a promise of strong economic growth and improved living standards, that implicit social contract was subject to stress by a sharp economic downturn in 2015. It forced the government to devalue its currency twice in a matter of days in August, in order to boost international competitiveness, export performance, and economic growth. Nonetheless, it is unlikely that China will return to double-digit growth and the reality is that the Chinese economy is entering a new phase of 'normal' growth and the pressure is on the Chinese political leaders to adjust to an era of slower growth and retain their domestic legitimacy. In keeping with slower economic growth, they now have to engineer a transition to lower public expectations, as well as growth based less on exports and more on domestic demand, less on borrowings from advanced western countries and more on domestic innovation and invention. Only then will China be able to avoid the middle-income trap and continue to bridge the income gap between itself and the West (Sharma 2013: 19). Political stability will depend to the extent that this transition is managed but the risks are substantial not only for the ruling Party but for stability in the region. If transition to slower growth raises legitimacy issues for the CCP because of long-established expectations, it could force the Party to fall back on brute force as it did in 1989, or preferably, accept the inevitability of competitive politics.

The Chinese 'variety of capitalism' contains within itself a contradiction between marketization and economic openness on the one hand, and representational and political closure on the other, such that there are no checks and balances to policy-making by the ruling Chinese Communist Party. The contradiction between a capitalist base and socialist superstructure may eventually be resolved but for the present, there remains potential jeopardy to its own economic interests and to existing production networks.

The problem of inequity is not intrinsic to globalization, which then, therefore, had to scaled back. Inequity is instead a capitalist constant and its presence, and exacerbation, a reflection of political failure. Largely, inequality has grown in countries that have tried to re-engineer public

policy along lines of classical economic prescriptions, of deregulation and reliance on market principles to generate growth. Unfortunately, this only produced a trickle-down effect where the vast majority benefited only marginally, from an insignificantly small trickle-down of the wealth accruing to individuals at the top of social hierarchy. Former British Prime Minister Gordon Brown cautioned that 'the argument that the economy operates according to iron laws and the only role of men and women is to live by what these laws dictate demeans our humanity, because there always options, always choices, always solutions that human ingenuity can summon' (Brown 2010: 235–6).

Conclusion

As countries have become more interconnected, one consequence is the contagion effect, especially of crises that begin in one country or region. The contagion effect, too, is much greater and economies are far more vulnerable to crises and disturbances emanating elsewhere. Borders are more porous than ever before and it is difficult for governments to regulate economic activity free from disturbing external influences. It is a serious issue that, according to Rodrik (1997: 2–5), could potentially lead to social unrest resulting from tensions between the beneficiaries of globalization, those with internationally mobile skills and resources, and other members of a society who are unskilled and less mobile internationally. In a globalized economy, demand for unskilled workers is more elastic, resulting in an erosion of their bargaining capacity and ultimately lower wages and benefits. To safeguard against social disintegration, Rodrik proposed a series of measures at the individual, national, and international level to protect the weaker members of a society. This, he argued had to be 'a critical complement to the expansion of global markets' (Rodrik 1997: 72). To offset the costs of any insurance mechanism, Rodrik borrowed on the so-called Tobin tax and proposed an imposition of a levy on capital flows, as well as on footloose workers whose departure for greener global pastures reduced the domestic tax base. James Tobin had proposed a levy on capital flows to curtail the movement of speculative capital and any such scheme for flow of employers (companies) and labor will have the unintentional, and negative, consequence of applying the brakes on globalization. Ultimately, therefore, Rodrik's solution will, if accepted, amount to delaying globalization in the guise of 'dealing' with globalization.

Robert Cox, as noted earlier, had identified several contradictions in globalization, which led him naturally to the task of 'taming' globalization to arrive at a desirable end of history without the presumed flaws. Globalization may not be a paragon of perfection, but we have unfairly attributed to it some of the poor growth performance in parts of Africa and elsewhere. While it is true that not all developing countries achieved superior growth results, globalization does not selectively seek out countries for development. Some of the negatives were due to policy failures and, indeed, many of the earlier laggards in Africa did achieve improved outcomes in subsequent years. Average African growth rates in the first decade of the twenty-first century, at 5.28 percent per year, was better than in the three previous decades (UNCTAD 2014: 3). However, despite higher growth, head count poverty had also increased and is a continuing challenge for African countries. Moreover, the good growth results of the first decade gave way to a significant deceleration because of political instability in North African countries, like Egypt and Libya, and because of the collapse of oil and commodity prices that affected Nigeria.

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CHAPTER 7

Conclusion

In this book, I presented a narrative of economic globalization, its origins, and consequences that are sharply different from commonly accepted explanations. I rejected the logic of an essential, if broken, continuity between nineteenth-century- and contemporary globalization and asserted the historical uniqueness of the latter. Globalization today is unlike any other period of trade liberalization and there are no historical parallels. It is a combination of globalization of consumption and of globalization of production. A period of trade interdependence preceded globalization, similar to the interdependence that had existed in the late nineteenth-century. Interdependence, both in the nineteenth century and before contemporary globalization, was a partial system that, if it was globalization, was only globalization of consumption. In periods of trade interdependence, consumers have a global consumption horizon that is possible because of progressive liberalization of trade between countries. In both the late nineteenth century and in the 1970s–80s trade as a percentage of global GDP was roughly similar, about 15 percent.

Contemporary globalization however has an additional dimension of globalized production that has never existed at any time in the past. This resulted from targeted US protectionism in the 1980s, not trade liberalization. Globalization combines and integrates the two market functions of supply and demand, where only the latter had ever existed before. Globalization of production was neither a planned nor a deliberate result

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of state policies. Instead, it was a result of uncoordinated decisions at the level of the firm and in response to threats of market closure and protectionism in the USA. The process started with Japanese investments in the USA and transfer of networked production technologies. There had been earlier bouts of protectionism but those could not have produced the same results because the technology to maintain a globally dispersed production process simply did not exist. In the 1980s, there was a confluence of the primary trigger, protectionism, with appropriate enabling technology. The information and communications technology revolution meant that it was now possible, for the first time in history, to coordinate the activities of geographically dispersed production units in real time and at minimal costs. Globalization is still an evolving process and countries are variously engaged in the many production networks that define the core of contemporary globalization.

Contemportary globalization is irreversible largely because of the revolution in global manufacturing. With usual caveats to the unpredictability of human behavior, it is difficult to foresee a situation in which states and the private sector might deliberately reverse the spread of global production networks. Disruptions to supply relationships, however, may occur because of natural disasters. For example, the *tsunami* and Fukushima nuclear disaster in Japan in March 2011, and flooding in Bangkok later that same year, disrupted production in Japan and elsewhere because supply chain producers in the affected regions were forced to suspend their activities. The floods, for example, affected production in components manufacturers in Thailand and the resulting shortage of parts forced Honda to scale back car production in all its global facilities.

In terms of the main line of reasoning, I presented an optimistic view of globalization and credited it with stabilizing international trade and for providing a promising new pathway for developing countries to achieve growth and industrialization. In addition, just as globalization has stabilized trade, it may also be a force for international peace. The democratic peace theory assumes that democracies tend to be peaceful in relations with other democracies but the correlation between trade and peace is, perhaps, stronger. The former has empirical validity but liberal and conservative scholars alike, Mill and Schumpeter, assumed that trade introduced a strong self-interest at the collective and individual levels to preserve and protect peace (Mill 1965: 594; Doyle 1997: 245). Trade heightens the opportunity costs of war and if the opportunity costs are sufficiently high, then peace is likely to prevail at bilateral and multilateral levels. Others

argue that trade is conducive to peace because it enhances cultural awareness and understanding of others although that is not the reason countries engage in trade. Thus, the late nineteenth century was not only a period of stable trade but also of relative peace.

However, evidence on strength of the trade–peace nexus from periods before globalization is mixed. According to Topik (2013: 65), trade is a double-edged sword and can be both a force for peace as well as a source of interstate conflict and tension. For example, Patrick McDonald (2009) observed that trade expansion in the early twentieth century failed to prevent outbreak of the First World War. There were two contradictory forces at play in the early twentieth century. On the one hand, economic and political conflict between states had led to rising levels of trade protectionism and yet, on the other hand, trade levels continued to expand, partly because of significantly lower transportation costs. In the end, higher trade connectedness did not avert outbreak of hostilities but despite the contrary evidence of the First World War, McDonald maintained that 'liberal economic institutions have historically played a larger role in promoting peace than liberal political institutions' (McDonald 2009: 130). In particular, he pointed out that the 'capacity of globalization to promote peace depends critically on whether it alters the domestic balance of political power in favor of groups that gain from international trade' (McDonald 2009: 65).

Writing before the latest round of territorial disputes that marred Sino-Japanese relations between 2012 and 2015, Weede (2010: 210), came to a reasonable conclusion that, 'Given the record of Sino-Japanese wars in the past and the power of these neighboring states, the extent of Sino-Japanese economic cooperation provides… [a] reason for optimism.' Certainly, bilateral relations did not degenerate to overt acts of hostility but confrontation and civil disturbance in China was disruptive of stable trade between the two counters. Given the extent of economic linkages and bilaterally networked production, it is reasonable to concur with Weede that an outbreak of hostility between the two countries is extremely unlikely in the future.

Globalization has created a stronger foundation for peace because it has integrated countries at a basic level of economic activity, production, rather than only at the pinnacle of international commerce in finished products. Manufacturing is still a core economic activity and a measure for the state of an economy even if does not dominate the national GDP. In the USA, for instance, manufacturing constitutes less than 20 percent of national GDP but it is still the foundation, and many contemporary

analysts worry that US manufacturing capacity is hollowing out, as firms relocate elsewhere to improve their cost-competitiveness. For example, there are many American companies, such as Apple and Nike, that do most of their manufacturing outside the USA, but regardless of its precise form and method, manufacturing is important to the US economy. Besides, it is not that Apple and Nike do not engage in manufacturing in the USA; their manufacturing, to borrow from Hardt and Negri (2000, 2008, 127ff), is 'immaterial,' that is, not tangible production and includes instead, engineering, design, and knowledge and so on. In the USA, there were job losses in the manufacturing sector but jobs growth, perhaps not as many, in more technology-intensive areas. Unemployed workers in the manufacturing sectors cannot easily transition to high-tech sectors of the economy, without extensive retraining, and this explains partly the anger and anti-globalization sentiments that have spread in most advanced countries. This sense of alienation is compounded by the reality that, even though globalization is beneficial at the aggregate level, the gains have not been distributed equitably.

Globalization has integrated countries at a core level of economic activity and the level of international integration is much deeper than when countries traded in finished consumer products. Earlier periods of trade interdependence and globalization of consumption only produced a shallow linking of states. It was relatively easy for states to recover from disruption to shallow linkages by transferring dependencies to other countries through trade diversification measures. The deeper level of integration under globalization has rendered individual economies more vulnerable than before to disruptions in networks, whether from natural causes or deliberate acts. There are no controls for disruptions from natural events and disasters but the threshold for justifiable supply blockages due to intentional acts is high and increasingly prohibitive. Networks are long-term production arrangements, bound together with bonds of loyalty and commitment, and individual suppliers not readily replaceable in the event of disruptions. For that reason, the globalization-peace connection in the contemporary period is much stronger and definitive than the correlation between trade interdependence and peace. The opportunity costs of conflict, high even when only consumption is globally integrated, are higher still when globalization includes as well production and manufacture. In the past, sections of manufacturing capital were often leading advocates of protectionism, especially in recessionary economic conditions, but globalization of production has converted them as defenders of liberal trade and

stability and against any action, such as conflict, that threatens normal commercial exchange. To date most disruptions in supply networks have been because of natural calamities. Disruption during the Sino-Japanese conflict however was the first major instance of direct, even if unintentional, human intervention.

Globalized production has rendered conflict less likely but it is necessary to add the caveat that we are still in a process of transition and the global economy is a project for the future. Networked producers are reliable supporters, both of liberal trade and peace in order to protect supply chain stability. This is important because trade disruption usually follows protectionism arising from the business cycle or economic downturns, or from state conflict. Compared to pre-globalization periods, when competitive industries and firms supported liberal trade in the growth phase of the economic cycle, producers now have a commitment to liberal trade that transcends the economic cycle. In the past producers swayed between liberal trade and protection depending on the state of economic activity and their own trade competitiveness, but have now coalesced as committed supporters of liberal trade, alongside consumers and mercantile capital, beneficiaries and consistent supporters of liberal trade policies. This is especially true for big businesses that have developed network linkages. These are also considerably more politically influential than either consumers or mercantile capitalists. Merchants had always benefitted from liberal trade but regularly had their interests trumped by producers, especially during difficult economic conditions. Consumers too, were less than exemplary defenders of their interests because of collective action problems or other reasons. In economic globalization, however, there is a new group of consumers, the networked producers, and these are often organized and influential actors in policy-making. Globalization has transformed producers as consumers of intermediate goods, and producers, now as consumers, have emerged as supporters of free trade and of peace, as a necessary precondition for the stability of supply chains. Since countries and companies are more vulnerable to supply chain disruptions, we can expect to see this reflected in a national aversion to conflict escalation and disruptions to networks of productive activity.

Globalization of production has sensitized states to international considerations and to the fact that domestic economy conditions are also dependent on foreign factors. In that way, corporations that engage in global production are a constraint on states, and a force for international stability. More so than consumers acting individually or as a group, such

corporations have the capacity and an interest in influencing policy-makers to lower tensions and resolve conflicts in ways that does not disrupt supply chain linkages. This dynamic is potentially much more effective than the simple trade-peace correlation, and there are some indicators to suggest that the world is more peaceful. In 2006, for example, the Stockholm International Peace Research Institute noted that violence and conflict have continued to decline for a number of decades. It found that since 1990, the number of on-going conflicts had dropped from 33 to 17, and that all of those were civil wars. Moreover, that 2005 was the second year in a row that no two countries were at war with one another (cited in Griswold 2007). Following on that, the Institute for Economics and Peace observed that in 2013, interstate violence had declined, and estimated the peace dividend on global GDP to be about US$9.5 trillion. Although, it noted that the world in 2013 was less peaceful than in 2012, this was mainly because of a jump in fatal crimes and the situation in the Middle East, in particular Syria. In recent years, the number of war deaths has increased but mainly because of conflict in Syria, Iraq, and Afghanistan. According to Daniel Griswold, Director at the Cato Institute in Washington, the trade/globalization-peace hypothesis held true for the following three reasons:

1. Trade facilitated the transition to democracy, and democracies were inherently peaceful.
2. Trade expansion and economic globalization promoted economic integration and increased the opportunity costs of war, which inevitably applied the brakes to open conflict between states.
3. Trade allowed acquisition of wealth and prosperity through exchange rather than through war and conquest of territory and resources.

If we assume that the globalization-peace thesis is mediated through a spread of democratic governance, then room for optimism comes from the spread of democracies as a result of deepening economic globalization (Grindle 2000). Indeed, it is perhaps not just globalization but also the spread of democratic governance that has made a difference to peaceful outcomes. There are many more democratic states than there were 20 years earlier, and both liberal politics and liberal economics contributed to a less conflictual environment.

There are of course many critics of globalization and in Chap. 6 I looked at one of the main criticisms, that it has exacerbated income

inequality across both developed and developing countries. Globally, the income divide within countries is a worrisome trend but even if it is a result of rapid capitalist growth, the fault lies not in the capitalist promise of expanding the economic pie, but in the political failure of ensuring equitable growth, through some form of redistributive policies and regulatory interventions. Other critics decry liberal trade as deleterious to national wealth and, because of immigration and multiculturalism, as detrimental to national identity. Still others see global entanglements as harmful and dangerous to the principle of national sovereignty. Critics may have different motivations but they all share a common goal in slowing globalization or perhaps even reversing the trend.

The prospect and potential for de-globalization requires serious consideration. Individual countries, of course, can opt out but at considerable economic costs. On the other hand, Russia had no option but to de-globalize involuntarily after its invasion of Crimea and after the imposition of western sanctions, but Russian integration into the global economy was, even before, minimal. By existing measures of globalization and networked production, such as trade in intermediate manufactured goods, Russia ranked well below developed and developing countries. Not only were the CIS (Confederation of Independent States, the successor states to the former Soviet Union) group of countries ranked low in their total trade of manufactured intermediate goods, but there had also been no marked increase since the early 1990s whereas developing country participation in such trade showed a marked increase in the twenty-first century. Compared to an overall deepening of OECD's share of trade in goods and services to GDP, Russia's export and import share as a proportion to GDP dropped from 44.1 percent to 28.6 percent and from 24.1 percent to 22.7 percent, respectively between the years 2000 to 2013 (OECD 2015: 23–24). According to Sharma (2013: 90), Russian companies are not major international players and the Moscow stock exchange listed 'not one large global manufacturing company.' The contrast with important globalized economies, even China and India, could not be starker. In the list of top 100 global companies by market capitalization in 2015, as compiled by PricewaterhouseCoopers, American companies made up more than half, China had 11, and even Korea and Taiwan had one firm each, but not a single Russian firm made it on the list.

Russia's forced global disengagement followed events in Ukraine and Crimea. In 2014, President Putin of Russia, in a defiant show of nationalism, and solidarity with Russian-speaking minorities in Ukraine,

annexed Crimea and incited Russian separatists in eastern Ukraine to try and break away and unite with the Russian Federation. These unilateral moves to alter recognized international borders played well with nationalists inside Russia but led to western economic sanctions on Russian businesses. These sanctions, in combination with a sharp fall in the price of oil, Russia's main export commodity, dealt a severe blow to the Russian ruble, which lost nearly 40 percent of its value in the space of a few months in late 2014. The fall would have been even larger if the Russian central bank had not used $30 billion in foreign exchange reserves to stabilize exchange rates. The drop in the value of ruble increased import costs of components and parts and affected manufacturing in Russia. It was a main reason why General Motors, in 2015, suspended its Opel manufacturing facility in Russia because it was no longer viable to manufacture with more than 50 percent imported components at increased prices (Sharman 2015: 38). Similarly, as the Russian ruble lost value after imposition of sanctions, automaker AvtoVaz, manufacturers of Lada, announced plans to increase localization (a de facto de-globalization) of components from an already high 84 percent to 90 percent. The lower value of ruble had priced foreign parts and components uncompetitive and AvtoVaz ended up making a virtue out of necessity. The downside was that the car manufacturer had to shelve its ambitious plans to reposition itself as a globally competitive producer. In March 2016, Bo Andersson, the Swedish CEO of AvtoVaz, decided to leave when he failed to win support for his restructuring plans. Despite these negative consequences, there was a renewed sense of pride that after many years of economic and military decline, the country had finally regained its old glory and position as a global superpower. The economic costs of this de-globalization are significant but the state recast it as a nationalistic virtue, not necessarily by choice but under pressure of western sanctions.

The sanctions were bad news for Russian capitalists who aspired to develop and deepen Russia's global linkages as part of a diversification program. It also, of course, added to economic hardship and suffering of ordinary Russians. Stoic Russians may endure their hardship, as they often had to in the past, but sanctions and forced de-globalization will have lasting and negative effect on the Russian economy. In 2015, the Russian economy contracted by nearly 4 percent and resulted in some protest and labor unrest in the country.

The drop in exchange rates was a painful blow to businesses that had contracted foreign loans denominated in US dollars and used the borrowed

funds for luxury consumption and not necessarily in productive activities to help pay off the loans. Ordinary Russian citizens who were enticed to take out dollar denominated mortgage loans to take advantage of lower interest rates also felt the pain. Their ruble-based monthly payments had doubled. Fortunately, much of the Russian debt was private rather than 'sovereign,' and debt-service ratio well below the levels experienced by Latin American countries before their debt crisis in 1982. In September 2014, Russia's debt-service ratio, according to Bank of Russia, was 29 percent whereas the same ratio for many of the Latin American countries, in 1982, was above 40 percent. Moreover, while the total dollar-denominated debt of the Russian government was $38 billion, the government had a reserve cushion of ten times that amount, making it unlikely that Russia will have any difficulty in meeting its repayment obligations. Even if government debt is not a problem, foreign debt exposure of Russian banks and other companies could create difficulties, especially with falling oil prices. In early October 2014, the CEO of Sberbank, Russia's largest banking institution, warned that government policies that had led to progressive tightening of western sanctions defied 'the laws of economic development' (White and Troianovski 2014: 10–11).

Elsewhere, the Brexit vote in Britain and the election of Donald Trump to the presidency in the USA were both clear and powerful signals, in 2016, of a growing nationalist backlash against further trade liberalization agreement to deepen economic links between countries. Critics of globalization heightened community anger with suggestions that trade integration came at excessive diminution of national sovereignty and increased income inequality. The UK referendum and US election results were completely unexpected by most analysts and observers. Ultimately, however, these two shocking developments may lessen global engagement of the two respective countries but are unlikely to lead to systemic de-globalization. Economic globalization is Adam Smith's division of labor writ large and unlikely to be undone, whether on the factory floor or globally.

The British decision to exit the EU confounded most experts. Indeed, 2016 was a year when experts were blindsided by the intensity of popular anger and their rejection of normal politics in several countries. Britain had joined the EU after two earlier failed attempts in 1972, without a referendum, but in 2014, Prime Minister David Cameron signaled his intention to renegotiate aspects of Britain's status within the EU and promised to hold a referendum following a new agreement in 2016. This was perhaps

part of British negotiating strategy with EU, in which he raised the specter of an exit to secure maximum concessions from the EU. The call for a referendum was a surprise since Cameron had rejected the idea previously, in 2013. Still, no one could have imagined that a majority of voters would opt to leave the EU, but that is precisely what 52 percent of voters did in the referendum held on June 23, 2016.

A number of factors contributed to the leave decision and to voter disaffection with continued EU membership. Most important perhaps was that successive British governments had done little to secure popular support for full EU membership. Instead, they had constantly peddled the misinformation that Britain retained a national veto on the integration project. As Stephen Wall (2008: 208) pointed out, successive British governments had failed to explain the true significance of the supranational EU project, or to explain that:

> Without that framework of supranational institutions, the settlement of disputes would be achieved by the law of the survival of the fittest … Had a consistent and persistent campaign of information been undertaken, it is possible that public opinion….might have been more ready to recognise their [EU institutions] role in defending important freedoms as well as to accept their inevitable imperfections.

Without a plan to mobilize public opinion in support of EU, the EU remained vastly unpopular in Britain, more so than in some of the other member states, such as Denmark and Sweden, which had a 'large dollop of skepticism.' (Wall 2008: 205). There was as well, reflected in the leave decision, a natural anxiety with the rapidity of change, an anxiety more likely to affect older generation. This segment of the population is also more concerned with other issues, such as immigration, loss of national identity, and sovereignty. By contrast, young millennials and the 'Facebook' generation that have grown up with rapid technological change is relatively unperturbed by constant pressure to adjust to new breakthroughs in computing and social media every few years. For instance, in the Brexit referendum, those under 25 voted overwhelmingly to remain inside the EU whereas each older demographic was inclined to vote in larger numbers for Brexit. For millennials, constant and rapid change is a given in the twenty-first century. Table 7.1 below provides a demographic breakdown of the Brexit vote.

Table 7.1 EU referendum vote by age group (%)

Age	*Remain*	*Leave*
18–24	75	25
25–49	56	44
50–64	44	56
65+	39	61

Source: *New Statesman*, June 24, 2016

Brexit dealt a setback to the postwar dream of a united Europe but not necessarily fatal to the broader European agenda or to established production networks across Europe. Not globalization, but Britain's position in the globalizing economy might suffer much more.

It may, in the extreme case, lead to a restructure of supply chain networks that harms British economic interests. In January 2017, Prime Minister May indicated that Britain would negotiate for a hard Brexit, but with access to European markets for British industries. The Brexit White Paper, released by the British government in early February 2017, elaborated that Britain would stay out of any customs union arrangement with the EU so that it could negotiate independent trade deals with other countries. At the same time, it confirmed that Britain wanted preferential and free access to EU markets. The government's wish list clearly was for the best of both worlds, free access to European markets but with complete sovereignty on immigration and all legal issues. History, however, does not suggest that prospects for such a settlement are particularly bright, given that her predecessor had failed in his attempts to secure a 'special deal' for Britain. When, in January 2013, David Cameron agreed to hold a referendum in 2016, he had hoped, in the interim, to negotiate special terms for Britain to placate those who had become uneasy with diminished British sovereignty. The referendum result, subsequently, sealed his fate and Brexit proved fatal to his political career.

Cognizant of her predecessor's failure to secure a favorable settlement, the speech by Prime Minister May, and the White Paper that followed, appeared to signal to British businesses to prepare to operate within the constraints of a hard Brexit that restored British sovereignty but with less than ideal economic access to the EU. To assuage any negative sentiments, she boldly expressed optimism that a hard Brexit would not cause too much harm to the national economy especially if Britain succeeded in securing good access to other important markets in North America

and elsewhere. With carefully crafted rhetorical flourish, she added that leaving the EU created new opportunities to pursue 'greater globalization' for the British economy. Despite the promise of greater globalization, the immediate reaction of the finance sector in the City of London was extremely negative. Several banks announced plans to relocate some of their businesses to other European cities because a hard Brexit implied loss of 'passporting rights,' the automatic right of any firm in any EU member state to operate freely in all EU jurisdictions. Hard Brexit and potential loss of passporting rights will also affect European companies that do business in the UK, but the effect on the City of London will be much more significant and affect its status as a leading center of global finance. The referendum outcome was a reminder that political decisions can produce unimaginable consequences and added a cautionary note to states that there was no easy and painless path to delink from the global economy. That option to delink is always there, but at a cost to individual states. Moreover, even if some states delink from a globalizing economy that is unlikely to wind back the process of globalization.

The final status of British association with the EU is uncertain, but there are few indications that the 27 remaining EU countries will be magnanimous and charitable to Britain. The *Financial Times* (November 21, 2016: 9) reported, that even Denmark, a presumed British ally in the EU, was pushing for harsh terms and conditions in defense of its own national interest. The Danish Foreign Minister was quoted as saying that, 'what we must go for is not what is good and bad for UK, but what is best for Denmark.' In the worst-case scenario, Britain will not only lose access to the European common market, but also preferential access to more than 50 countries with which EU has trade agreements and others with which it might negotiate preferential agreements in future.

Many analysts are convinced that there will be considerable short-term harm to the British economy, a necessary consequence of readjustment, given Britain high trade dependence on the EU. The EU depends much less on UK for its exports and Brexit will affect the remaining EU members much less. EU exports to the UK range between 8–17 percent, whereas approximately 45 percent of British exports go to EU member countries. If forced to trade under MFN rules, the costs to British industries will be substantial. As a member, British exports to EU attract zero tariffs but estimates are that under hard Brexit conditions, 16 percent of British exports to the EU will attract tariffs of 7 percent and that half of UK exports, including motor vehicles, will incur tariffs of 10 percent

Table 7.2 Economic impact of Brexit on the UK

	Impact on GDP (%)	*Costs per households*
Near term (by 2020)	−3.3	2200 (GBP)
Long-term optimistic (by 2030)	−2.7	−1500 (GBP)
Long-term mid point (by 2030)	−5.1	−3200 (GBP)
Long-term pessimistic (by 2030)	−7.7	−5000 (GBP)

Source: OECD (2016: 7)

(Holmes et al. 2016: 26). British firms will also have to develop substitute markets elsewhere for exports previously destined for EU countries. Brexit has costs for both EU and Britain and those costs are considerably more for the latter. Britain stands to lose a great deal, unless existing supply chain arrangements that include Britain and EU countries continue to remain viable in the context of WTO's MFN rules, as opposed to the EU single-market agreement. The OECD estimated the potential long and short costs of Brexit on the UK, including the loss to individual households, as shown in Table 7.2. There will also be some loss to members of the EU but less than the impact on Britain given the asymmetric nature of their relationship. Whatever the final settlement, Brexit is unlikely to be the critical event to reverse globalization.

Britain is expected to start the process of leaving the EU in March 2017 and as it negotiates the terms of its exit from EU, the possibility of a 'hard Brexit' without some privileged access to the European common market will hurt corporate interests in Britain and might induce companies to relocate to the continent. Signs of such harm to British interests became evident within months of the Brexit vote. In late 2016, Nissan threatened to suspend further investments in Britain without explicit guarantee from the government and, reportedly, received unspecified guarantees against potential future losses should access to the common market in Europe become curtailed after Brexit. Other companies will no doubt want similar assurances, resulting in welfare losses for consumers. Indeed, across the Atlantic, a similar story played out in November 2016, when the airconditioning company, Carrier, received assurances of government subsidies and incentives, by the incoming Trump administration, to remain in the USA and not shift its manufacturing to Mexico.

In the USA, the anti-globalization rhetoric of the Republican presidential nominee in the election campaign was as unexpected as it was strident. President-elect Donald Trump ran a campaign that promised to

lessen global engagement, or at least renegotiate the terms of its engagement to ensure the primacy of American interests. He did not offer any detailed plan of action, only bombastic pronouncement that was short on substance. Still, his support base was solid and convinced that as a successful businessperson, he had the necessary skills to extricate the country from unfair trade deals and secure better conditions. Trump campaigned aggressively on an anti-globalization platform, arguing that it had hollowed out American industries and transferred jobs overseas, and made countries, like China, prosperous and wealthy at America's expense. In the process, he recast trade and globalization as a zero-sum game, much like mercantilists of the past. The message that the USA had been adversely affected or, at least, not been a net relative beneficiary, resonated well with sections of the American society, specially the working-class blue-collar voters. Equally well received was his anti-immigration message, including a pledge to deport illegal immigrants, prohibit all Muslims from entering the country, and build a wall along the southern border.

There is no denying that many Americans had seen their economic situation stagnate or made worse off in the 30 years since globalization had taken root. The implied correlation was not lost on supporters of Donald Trump, who used his anti-globalization message to secure electoral support. In the summer of 2011, protesters in the Occupy Wall Street movement had branded themselves the '99 percent' who had been left out of the rising wealth accumulated by 1 percent from globalization. They railed against the greed of Wall Street but ultimately the protests died down and without having achieved much. The protests died down but the conditions that had given rise to the protests remained largely unchanged and the political elite failed to respond to this early warning sign of future turmoil. Donald Trump tapped into the latent seam of anger and frustration to launch his political career. There was self-serving hypocrisy in his political message because his businesses and he, personally, had benefited from the system that he now criticized. However, the message was so appealing and attractive that voters were prepared to forgive the past sins of the messenger, or even the intemperate behavior during the campaign. Trump promised the unemployed and underemployed to return jobs back to the USA, jobs that his own businesses had transferred overseas, to China and other developing countries. Interestingly, even as parlayed a nationalist message, Ford announced that it was shifting more of its manufacturing activities to Mexico. Trump also promised to revive failing industries, such as coal mining, and, for many, in the depressed coal mining areas this

message of hope was a last straw to cling to in their search for a better future. Most political commentators could not see past the palpable anger that marked his campaign rallies that attracted mainly blue-collar workers and low-income demographics, but that anger was central to the underlying promise of better times that only he was able to deliver to the forgotten 99 percent. It mattered little to them that Trump was himself a prominent member of the 1 percent. Stiglitz (2011) had previously forewarned that the 1 percent had failed to understand, despite their wealth, the riches, and an extravagant lifestyle that 'their fate [was] bound up with how the other 99% live. Throughout history, this is something that the top 1% eventually do learn. Too late.' Trump, however, demonstrated quite ably that a member of the 1 percent could aspire to become the leader and champion of those who had received little of the benefits of globalization.

During the US primaries, both Donald Trump, the main Republican contender, and Bernie Sanders, the Democratic candidate, railed against globalization as a leading cause of inequality. Both candidates insisted that globalization, combined with bilateral and regional free trade agreements, had destroyed jobs and manufacturing in the USA. Sanders, in particular, chipped into Hillary Clinton's support base with his criticisms of the Trans Pacific Partnership (TPP), a trade deal under negotiations in the Pacific region and supported by Obama and his former Secretary of State Hillary Clinton. As the public mood shifted, Clinton who had earlier described the TPP as the 'gold standard' of trade agreements abandoned her support for this and a similar trade agreement across the Atlantic. Trump won the presidential elections and one of his first actions as new President was to sign an executive order pulling the USA out of the TPP agreement. It is still unclear whether this means the end of TPP, or whether the USA will ultimately renegotiate aspects of the TPP agreement to make it more palatable to its interests, as the government has also proposed to do with the existing NAFTA trade agreement with Canada and Mexico. If Trump were to follow through on his earlier anti-globalization rhetoric that will have a major impact on the entire globalization agenda but it is not a pathway that American, and international, business community is likely to support given their considerable investments in promoting and protecting fragmented production arrangements.

De-globalization is not an easy proposition but events in 2016 triggered a debate on scaling back globalization to restore national sovereignty. The same sovereignty issues also surfaced within the EU following the Brexit vote and lingering fears that it may trigger other EU members to leave the

Union. After the Brexit vote, French Premier Manuel Valls voiced concerns of a potential break-up of the EU while German Chancellor Angela Merkel warned that EU was at a turning point [*FT Weekend*, 25–26 June 2016, p. 1 Middle East edition]. In an analysis of the way forward for EU after Brexit, Matthias Matthijs (2017) argued that EU leaders should acknowledge the set of events that produced a Brexit vote and recognize the need for less, not more Europe, a future that restores the principle of 'nation-state' over 'member states.' Similarly, less globalization may be the popular mood of the moment but states that seek to de-globalize will also forego the not-so-insignificant benefits of globalization. If there is anger with globalization it is with the monopolization of benefits by only a section of national societies. Instead of thinking in terms of either 'more' or 'less' globalization, it is time for political leaders to intervene to ensure 'fair globalization' that allocated benefits more equitably across a broader cross section of societies.

In aggregate terns, globalization is beneficial to participating states but it is also true that benefits have not been distributed equitably or fairly, a glaring political failure. The 'Brexit' vote was an indictment of state failure, not of economic globalization as such. The immigration and refugee issues influenced the outcome of the referendum as well but, in all likelihood, a more equitable distribution of the gains of globalization might have staved off the negative result. The vote outcome also revealed the difficulties of managing change. Understandably, some in Britain and in Europe blamed Prime Minister Cameron for the 'original sin' of allowing a referendum that was unnecessary as well as risky. George Soros, a leading hedge fund manager, better known as the man who 'broke' the Bank of England with his speculation against the Pound, declared that David Cameron could go down in history as the man who broke the European Union. However, in all likelihood, the process of economic globalization will continue and not suffer because of the British vote to exit the EU. Nonetheless, it also threw down a challenge to western governments to better manage and distribute the benefits of globalization.

The reality is that states cannot force industries to scale back globalized manufacturing. Networked manufacturing was not a direct and intended consequence of state policies and states are unlikely to be able to wind it back. States can offer incentives, such as subsidies, to secure for themselves, more of the disaggregated manufacturing units and jobs. However, subsidies are often like a doubled-edged sword. These can add new jobs or protect existing jobs but at some considerable cost to tax payers. In the USA, for example, subsidies protected roughly 20,000 jobs in the sugar

industry but at a cost of US$1.7 billion in 2013, or about $85,000 for every farmer in the industry. Subsidies and government procurement at high prices doubled the price of sugar in the USA and forced firms, in the confectionary industry for example, to rely on imported sugar products or relocate manufacturing operations overseas where sugar prices are lower. The US Department of Commerce estimated that every job saved in the sugar-growing industry resulted in the loss of three manufacturing jobs. Subsidies are not necessarily the most efficient instrument for mitigating against underlying shifts in the market place. The new US administration has indicated its interest in bringing manufacturing jobs back to the USA but losses cannot be solely attributed to globalization. Job losses have occurred also because of automation and domestic policy and regulatory mechanisms. Moreover, given near full employment position in the USA, the real concern should be not with repatriating jobs lost to China or Mexico, but to find ways to bridge the wealth gap that have left the middle- and working-class members feeling disillusioned with the globalization process. At the same time, however, it is worth noting that while US low unemployment rates, at 4.9 percent in mid-2016, are low, the USA also suffers from low labor participation rates and that means that many have simply given up looking for employment. Again, the focus should be not on bringing back low-wage jobs from developing countries, rather on structural adjustment and skills development programs both to create better-paid jobs and to better prepare the workforce.

Every change produces its own set of winners and losers and globalization today is no exception. It has benefited most consumers and producers but there is continuing debate as to whether overall benefits outweigh costs, and whether benefits are equitably distributed. In some countries, the balance of effects was overwhelmingly positive, whereas others fell further behind. In the worst case, some developing countries even lost nascent industries to foreign competition following liberalization and global engagement. Those are some of the initial shock results of economic liberalization but in the longer term, liberalization should produce improved growth results. The challenge for all states is to distribute benefits in a relatively equitable manner, to compensate the losers, so that it does not de-legitimize an emergent and inevitable economic system.

For states, however, there are indeed concerns but the solution lies not in de-globalization but in structural adjustment policies to reposition industries. In developed countries, there are manufacturing activities that either can be outsourced, such as in labor-intensive sectors, or retained, particularly in high technology areas. Globalization has set in

motion a new period of division of labor and specialization at the global level and states have to carve out their own niche in the globalizing economy. De-globalization is nothing more than a nostalgic yearning for a simpler past but the harsh reality is that it is no longer possible to return the genie of globalization to the bottle. What is required is not simple, and simplistic, solutions but considered strategies to adjust to the forces of economic globalization. The right approach to an America First policy is not weakening the ties to economic globalization but by adjusting to it while ensuring a more equitable distribution of the benefits of globalization. The alternative can only produce sub-optimal outcomes.

Large-scale de-globalization is not a credible future scenario and, according to Wynne and Kersting (2009: 8), 'concerns about deglobalization are in many ways overblown.' The prospect of de-globalization appeals to our sense of agency, but is not very likely, unless there are exceptional circumstances, not just an economic crisis or a cyclical economic downturn. At the same time, British voters did not choose to de-globalize, rather to renegotiate the terms of global engagement that secured desired economics benefits without a concomitant diminution of national sovereignty. In particular, British voters were concerned about open borders and liberal immigration policies as mandated under EU rules. This, notwithstanding the benefit to Britain from migrant workers coming from EU countries, which the OECD estimated at contributing on average 0.7 percentage points annually to British GDP since 2005 (OECD 2016: 26).

The economic consequences of Trump for the US and the global economy are harder to gauge but much will depend on actual policies and the extent to which he is actually able to distance America from global engagement. Trump channeled public anger to bring a message of hope and American rejuvenation to the many who felt marginalized by globalization. In this, however, he was not the best messenger given his own personal and business circumstances, which were completely at odds with the 99 percent he claimed to represent. Polls and the mainstream media initially regarded his candidacy as a less than serious bid for the presidency but later, even as the campaign gained traction, the media continued to be dismissive. Against all odds, however, he won the presidential election in November 2016. Having won the election, his supporters will expect him to deliver on his promises. There is no certainty that he will, but Trump is less beholden to globalization forces, since his wealth derived mainly from real estate, rather than international capital or global manufacturing. If he actually followed through on all his campaign promises, the potential loss to global welfare will be significant. During the campaign, he had suggested that he would

retaliate against China, by labeling it a currency manipulator and by restricting Chinese exports to the USA. That could trigger a damaging trade war but it is possible that his advisors will hold him back. Even so, he openly indicated that he would act to stop industries moving overseas, threatening 'consequences' for such actions. He may not succeed in unraveling established GPNs, but could significantly slow their advance.

In the mix of policies that led to these concrete instances of a backlash against globalization was the erosion of state sovereignty. Absolute sovereignty is a myth that has probably never existed, and compromised immediately when a state enters into an agreement with another state, or when a group of states come together to form a system. Any time a state enters into treaty agreements with other states sovereignty for the respective parties is diminished because all agreements put constraints on state choices and force them to adhere to certain predefined pathways. Erosion of state sovereignty under globalization has impaired state capacity to respond to popular demands and, therefore compromised effectiveness of democratic politics. Critics raise concerns that while globalization had benefited the corporate sector, sovereignty and democratic politics had suffered in consequence. The modality and terms of some on-going trade negotiations have fueled the perceptions of assault on sovereignty and democratic accountability. For instance, the Trans-Atlantic Trade and Investment Partnership (TTIP) raised the same concerns voiced roughly two decades earlier when OECD countries tried to negotiate a Multilateral Agreement on Investments (MAI). In order to secure a high-standards agreement, developed countries decided to negotiate the MAI inside the OECD rather than in the WTO, because a preponderance of developing countries in the latter would require concessions and lead, consequently, to a weak and watered-down compromise solution. Expectations were that once a high-standards agreement was completed, developing countries would also accept it as a condition for future investment flows. In the end, however, even the small group of developed countries could not agree on the proposed high-standards and MAI negotiations broke down in 1998. The secrecy that shrouded these negotiations became a basis for conspiracy theories that claimed corporate interests had trumped consumer protection and state rights. The same accusations re-surfaced in the TTIP negotiating process but a more telling criticism, true also of the earlier MAI, was that TTIP included provisions for corporations to sue sovereign states if state actions impinged on corporate profitability. The fear was that states might be vulnerable to litigation by firms through a mechanism known as 'investor-state dispute settlement' or ISDS. John Hilary,

Executive Director of War on Want, a British charity, explained that TTIP was 'an assault on European and US societies by transnational corporations' (Williams 2015). It is unlikely, however, that European states will allow any agreement that limits their capacity to regulate business for environmental safeguards and so on, or allow a mechanism through which US firms could sue EU member states.

In developed countries, globalization has eroded state capacity to respond to domestic demands for improved welfare services or higher minimum wage levels in the interest of protecting international trade competitiveness (see Reich 2007: 131ff). This is not a vindication of the 'race to the bottom' scenario because ultimately trade competitiveness is potentially welfare enhancing for all, depending of course on the nature of distributive policies. Further, it is not only in developed or democratic countries where the trade-competitive consequences of globalization has or is likely to have an impact. Conversely, developing countries, too, have discovered that participation in the global economy may result in international pressure to enhance domestic welfare provisions by, for instance, ensuring labor rights or work conditions.

Debate on the economic balance sheet continues but the effects of globalization extend beyond economics to politics as well. These include suggestions that democratically elected governments, for example, have a reduced capacity to deliver improved social welfare programs because of potentially adverse impact on national competitiveness in the globalizing economy. The demands of economic globalization have made it much more difficult for governments to manage national economies purely on domestic political and economic considerations. Thus, if states had greater capacity, and were more in control in earlier period, they are less so now.

The notion of state obsolescence predates the emergence of economic globalization. After the Second World War, with states no longer able to provide any credible defense to their citizens from nuclear weapons, there was speculation that the state system itself had become obsolescent, because a central premise of state formation had always been the presumed protection afforded to citizens from external threats. In the end, that did not materialize and Huntington (1966) concluded that states were actually more obstinate than obsolete. Similarly, there is no reason to believe otherwise in the contemporary period. It is too early to proclaim the demise of the state system, at least in the near future.

Even if globalization is irreversible, claims of permanence are inconsistent with social truths. According to Barry Jones (1995), such claims

are counter to 'human record,' as there are numerous contrary evidences. History, he says, is 'replete with reversals of apparently well-established trends and of overconfidence in ephemeral truths and "realities" The only real certainty about the future is the constancy of change' (Jones 1995: 13). However, it is uncertain how the complex web of production networks can be wound back just as it is difficult to envisage an end to monopolies and return to a period of competitive capitalism. In the nineteenth century, Marx predicted the end of history and a changeless socialist nirvana but history proved him wrong. Some of the assumptions behind the prediction did not play out as Marx had expected, especially about progressive immiserating effect of capitalism. He was convinced that workers would rise up and free themselves from the yoke of capitalist oppression. Instead, his predictions instigated reformist policies from within liberalism that effectively forestalled any possibility of a socialist uprising. Where revolutions happened, it was not in advanced capitalist societies, where presumably the contradictions were most acute, but in countries still in a transition from feudalism to capitalism, such as in Soviet Union and China. A perverted form of statist socialism took root in these countries, where after some early success in industrialization and growth, the economy settled into a long period of stagnation and decline. At varying times in the 1980s, the socialist bloc countries abandoned their socialist experiment and began a transition to liberal market capitalism, a transition that completely defied the linear model of historical progress presented by Marx. The socialist alternative to capitalism has imploded but true socialism is still attractive to a great many people.

Equally important was that in the twentieth century western countries managed to reverse the immiserating effect of capitalism and kept socialism at bay by reinventing classical liberalism as a more humane and caring philosophy. This was a result of individuals like Thomas Greene, in the late nineteenth century, who helped shape modern liberalism as necessary to address social ills and challenges in capitalist societies. Modern liberalism created space for the state to step in to combat poverty, for instance, or to ensure equal opportunities for those who had no individual means to improve their living conditions and social standing through the provision of subsidized or free education.

Socialism no longer casts a shadow over capitalism but there remain yet other challenges on the horizon. For instance, if liberal globalization is, indeed, the end of history, there remains the unresolved issue of its regulation. Every system of production requires some corresponding system of

regulation, and of protection. When production was nationally organized, the state performed the requisite regulatory and protective functions. In the contemporary period, production is increasingly organized on a global scale but without a corresponding regulatory authority. A new regulatory mechanism will eventually emerge but it is uncertain what shape and form that might take, whether some form of multilateral governance based around existing institutions, or an Empire with its own monarchy and supporting aristocracy. Speculating on the nature of the emerging imperial order, Antonio Negri (2008: 124–5) suggested that the role of a monarch could be assumed by the USA. However, no matter how powerful the USA is, it is not able to rule on its own and without the assistance of an international aristocracy, made up of large MNCs and the various multilateral agencies, such as the World Trade Organization.

The scope of contemporary globalization is largely limited to trade, investment, production and capital flows, with the glaring exception of labor mobility. It is possible that easier cross-border movement of people would have evolved gradually, but terrorist attacks in New York, Washington, and Pennsylvania on September 11, 2001, foreclosed that option. High-profile acts of terror in subsequent years in many western countries have resulted in greater emphasis on border protection, in order to limit the movement of terror groups. Only the European Union eased border controls to allow for movement of people but only inside the Union. In 2015 and 2016, border protection also became a major concern for European countries following a spate of terrorist acts in Paris, Brussels, and elsewhere. The influx of refugees from Middle East, North Africa, and Afghanistan added to these concerns and resulted in greater popularity for ring-wing political parties with a tough anti-immigration policy stance. The resurgence of nationalism in the wake of foreign-inspired terrorists has precluded the possibility of liberal labor mobility, at least in the short term.

Even so, the consequences of globalization without labor are truly revolutionary, although still in an evolutionary phase. In the transitional phase, there remain many contrary tendencies, foremost being the persistence of nationalist sentiments, exemplified by Brexit in Britain, Trump's election in the USA, and Putin's assertiveness in Russia. These are unlikely to derail the overall process of economic globalization but can still inflict considerable harm to each individual country. That is not to say that globalization is perfect but many of the observed shortcomings are symptomatic of political failure, rather than flaws intrinsic to globalization.

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