

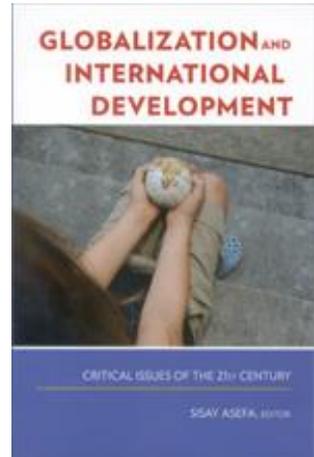
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Upjohn Institute Press

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# The Challenges and Opportunities of Twenty-First-Century Global Markets

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Chapter 7 (pp. 105-116) in:

**Globalization and International Development: Critical Issues of the 21<sup>st</sup> Century**

Sisay Asefa, ed.

Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2010

DOI: 10.17848/9781441678829.ch7

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Sisay Asefa  
*Editor*

2010

W.E. Upjohn Institute for Employment Research  
Kalamazoo, Michigan

**Library of Congress Cataloging-in-Publication Data**

Globalization and international development : critical issues of the 21st century /  
Sisay Asefa, editor.

p. cm.

Includes index.

ISBN-13: 978-0-88099-366-1 (pbk. : alk. paper)

ISBN-10: 0-88099-366-9 (pbk. : alk. paper)

ISBN-13: 978-0-88099-367-8 (hbk. : alk. paper)

ISBN-10: 0-88099-367-7 (hbk. : alk. paper)

1. Globalization—Economic aspects. 2. Economic development. 3. International  
trade. 4. International finance. 5. Economic assistance. 6. Poverty. I. Sisay Asefa,  
1950-

HF1359.G58277 2010

338.91—dc22

2010010285

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Kalamazoo, Michigan 49007-4686

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the W.E. Upjohn Institute for Employment Research.

Cover design by Alcorn Publication Design.

Index prepared by Diane Worden.

Printed in the United States of America.

Printed on recycled paper.

# 7

## **The Challenges and Opportunities of Twenty-First-Century Global Markets**

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Are we preparing our younger generations for the challenges and opportunities of the twenty-first-century global markets? As markets become increasingly global, tough competition for every skill is emerging from around the world. But fascinating opportunities are also being formed to serve people in different corners of the globe in new ways. Are we, as a society and as individuals, developing the right skills and procedures to deal with the upcoming challenges and to take advantage of the new global opportunities? Or are we about to see our jobs outsourced and our lives face greater uncertainty?

These are critical questions that all of us living in the early twenty-first century have to grapple with, one way or another. Global trends have come to matter in significant ways in our career choices and business decisions, as well as government policies that we advocate. To think through these issues and to make informed choices as professionals and citizens, we need to have a basic understanding of the main forces behind global market dynamics. The literature on globalization offers many perspectives that highlight such forces from different angles. This chapter brings together a host of those perspectives and makes new observations regarding the current and future globalization trends. To start the discussion, it is useful to briefly review the key trends and lessons from the past.

## PAST GLOBALIZATION TRENDS

The most notable forces behind globalization are improvements in transportation and information technologies that have brought different parts of the world into closer contact with each other. This has enabled companies in each country to see the world market within their reach and to think globally when choosing what processes to keep inside the firm, where to locate, and which processes to outsource domestically or internationally. Such considerations are not just for large corporations such as Caterpillar or Archer Daniels Midland. Small firms and individuals also need to be aware of their positions in global markets. Many industries, such as auto parts, have long been involved in that process. More recently, many products and services that previously enjoyed natural protection in each locality, such as retail sales, have come to face a much wider competition.

Technology, however, is not the entire story behind globalization. Government policies and institutional developments have also played major roles. Even decades ago, when transportation and communications costs were high, they were often minor compared to the myriad of barriers erected by governments to protect domestic industry or to generate rents and collect revenue. Those barriers have markedly declined since World War II. Government action has also mattered in terms of streamlining domestic regulation, law and order, and control of corruption and extortion (or security of property rights in general). Globalization would not have been possible without expanding public support for liberal trade and without increasing government ability to invest in public goods and to bring order, efficiency, and security to domestic markets.

What accounts for the change in public attitudes and the improvement in government capabilities? Concerning attitudes toward trade policy, the important factors have been improvements in the operation of labor and capital markets and the expansion of social insurance mechanisms such as unemployment insurance and social security. These factors have mattered because they have reduced the costs of external shocks on domestic producers. Under liberal trade, innovations and entries and exits in global markets often force local producers to respond and compete or go out of business. In either case, access to effi-

cient sources of credit and insurance can reduce the costs imposed on local firms and workers and enable them to withstand external shocks, adjusting to them or moving to new localities and lines of business where they can compete more effectively. The enhanced efficiency of capital and labor markets and the expansion of social insurance over the past several decades have eased such adjustments and account for the increased palatability of liberal trade policies, especially in more advanced countries. Lack of similar developments in many poor regions of the world has either prevented governments from opening up trade or has rendered local industries vulnerable to external shocks, impeding investment and causing hardship for large parts of the population. For similar reasons, the pre-WWII free trade under colonial rule did not bring much prosperity to the Third World.

This discussion raises the question of why many countries have managed to improve their governance and make globalization possible. Note that this is a central question because the developments in market institutions and technology ultimately depend on the capabilities of the government to establish an enabling environment for innovation and exchange. Also, it so happens that the full answer to this question has remained elusive. In fact, if we had a complete answer to this question, we could devise solutions to governance problems of all countries, and underdevelopment would be a problem of the past. Of course, we do have some insights regarding the sources of good governance in parts of the world. But our knowledge remains limited, and that is a major reason why spreading good governance has met with limited success.

We know that good governance ultimately requires constraints on arbitrary rule, that is, separation of powers and checks and balances. We also know that there must be mechanisms to aggregate the demands and information of individuals and interest groups regarding what needs to be achieved through government policy. In addition, there must be procedures for assessing the performance of policymakers and rewarding them based on their success in delivering socially desirable policies. However, we don't know which sets of rules and institutions can ensure these goals in each society and what the necessary steps are to implement them if the country has not already found a solution. In fact, progress in most societies has been made mostly through experiments and accidental discovery rather than fully analyzed designs. Typically, the process has started with periods of massive uprising against arbitrary

or foreign rulers. The new institutions that have come about in those ways have often proved to be inadequate, either resulting in deterioration in governance or prompting further change. In some cases, such as with the United States, the vision of the leaders and the constellation of forces at the time have produced valuable and lasting results. In other situations, such as in Cambodia in the 1970s, the uprising has replaced one inadequate regime with another, far more arbitrary and destructive one.

The difficulty societies have in attaining good governance lies in the complexity of the problems that they face. The governance rules and policies that work in each society must match a myriad of elements that comprise the society's economic resources, culture, religion, group affiliations, and identities. For example, decentralization seems to have been a very positive force in China's impressive economic growth. But in an economically underdeveloped, fragmented, and partially tribal society such as Pakistan, decentralization may strengthen clannish social relations that impede education and infrastructure and thereby deny most of the population the benefits of integration into national and global markets.

Another major problem in reforming governance is the massive coordination effort that it requires: An overwhelming majority of the population must be convinced that the new rules being adopted are likely to work and that everyone else shares the view that such a consensus exists. This requirement also poses a dilemma: broad coordination often needs to be reached with the help of a charismatic leader or a well-organized group. Once in the coordinator position, the leader or the group may come to control the system and have the option to impose certain rules. This could defeat the purpose of the initial movement to bring about change. However, in some contexts, the dictatorship of the coordinator can be crucial in achieving reform, as in Korea, Taiwan, and Singapore, where the heavy hand of the ruling politicians in the initial stages has been associated with spectacular takeoffs. Absence of effective coordination, on the other hand, could undermine economic growth, as shown with the sharp drop in Indonesia's economic growth after democratization in 1998 has shown. Note that these examples also suggest that in an underdeveloped country, governance improvement may come about under dictatorship, even though eventually economic development requires democratization. These observations, together

with the fact that the conditions of each society are complex and constantly subject to change, highlight the reasons why governance reform has been so difficult in many countries and has remained an art rather than a science.

Despite the difficulties in improving governance, there has been a gradual process of reform in a large part of the world, which has in turn facilitated international exchanges and has ushered in the current globalization episode. This process and its concomitant technological and attitude changes have furthermore mounted pressure on other countries to change and adapt. When a country such as Myanmar does not respond, it becomes isolated and loses out on the tremendous benefits that interaction with the rest of the world can offer. But simple responses, such as opening domestic markets to international trade, do not solve the problem either. Yemen's economy, for example, has virtually stagnated since its trade liberalization in the mid-1990s. The government has been waiting for a surge in private investment to create jobs and motivate the young to acquire education and skills, but the private sector has focused on imports rather than domestic production, doubting that the government's policies would produce a skilled labor force and a buoyant demand for domestic goods. In any event, the challenges of globalization have increased the urgency of finding solutions to local economic and governance failures in all countries, and there is increasing realization that solutions need to be tailored to the specific conditions at the national and subnational levels.

Although tailoring solutions may seem a reasonable and straightforward point, applying it in practice has not been easy for international organizations. A vivid example of this was the response of the International Monetary Fund (IMF) to a financial crisis in East Asia. In the 1990s, many East Asian countries had followed the advice of the IMF and opened up their economies to international finance. But due to regulatory weaknesses, many of those countries had attracted too much short-term foreign capital. When signs of economic weakness appeared in some of those economies in 1997–1998, foreign lenders withdrew their money and asset markets in East Asia collapsed. The solution to the problem should have been foreign support for regulatory reform in banking and finance, with governments maintaining their expenditures and allowing their deficits to rise as a means of cushioning the shock for the local population. The IMF offered assistance but conditioned it

on governments cutting their expenditures and bringing unnecessary hardship to those economies. The reason for the IMF's condition was its past experience in many other developing countries where government deficits themselves had been a major culprit in causing or deepening financial crises. However, those conditions did not apply to East Asian countries in 1997–1998. The IMF failed to adjust its policies to specific conditions for three main reasons: 1) the situation was complex, and the right solution was not entirely obvious at the time; 2) allowing for variation in IMF policies would have opened the door to demands for exceptions in other cases where fiscal adjustment is indeed crucial; and 3) since IMF managers did not believe that their organization could easily sort out different cases, they must have felt that allowing for variation could undermine the IMF's internal discipline.

The need for diversity of solutions across places has posed a problem for global markets. It has meant that in the economic game, the world is not completely flat, as Thomas Friedman (2005) would suggest. Labor regulations, for example, have to take account of local circumstances in terms of social and family structure, formal insurance options, work habits, legal systems, etc. Similarly, environmental regulations have reflected the priorities of the populations across places and their abilities to turn their concerns into policies. Multilateral organizations such as the IMF and the World Bank tried to devise uniform recommendations to facilitate their own decision-making processes, and multinationals have shown preference for uniform and permissive regulations that reduce their costs of operation. But the people in many localities have been reluctant or unable to adapt, resulting in an uneven distribution of global economic activity.

To sum up, the past trends in globalization have consisted of greater integration of world markets with the help of technological progress and policy changes across countries. However, the result has been uneven, with or without efforts to impose uniform solutions. The question is, what should we expect for the trends in the coming decades given what we know about the past?

## THE COMING TRENDS

In the past, while technological developments have generally contributed to increased integration of world markets, institutional factors—basic norms and rules such as culture and constitution—have not always been as supportive. Also, technologies embodied in physical capital have been relatively easy to transfer across countries, whereas the replication of institutions and intangible technologies such as management has faced greater obstacles. However, there is increasing realization among policy analysts as well as policymakers the world over that some essential lessons from each country's experience must be transferable to others if careful attention is paid to the conditions and nuances. The consequences of this realization will likely set the trends in globalization during the coming decades. Cross-country lessons will be increasingly distilled to arrive at general messages, along with a host of ifs and buts and examples for potential application in specific circumstances. This is likely to yield more practical ideas for governance reform with minimal risk, hence further lowering the institutional barriers to globalization.

The policy reforms of the coming decades are *unlikely* to make countries uniform in terms of governance and regulation, but they will bring about greater harmony. They will enable countries to participate in global processes and cooperate in establishing effective international treaties and organizations that enhance fair and broad competition. At the same time, diversity in institutions and regulatory systems is likely to remain. Although this may entail some costs for business, it will also serve as a source of strength for the global economy. Country differences can increase the range of options available in terms of products and processes, allowing better potential fit between production requirements and consumers. Indeed, markets will reaffirm their great ability to bring harmony to the diverse set of actors working differentiated conditions. And this will increase the resilience of the world economy in the face of unforeseen shocks, for exactly the same reasons that diversity in biology ensures longevity of species.

As the means to establish and harmonize situation-specific solutions proliferate, decentralization will become a more tangible reality for larger parts of the world. There will also be greater demands for and

materialization of deeper democratic rule. These and all other reforms and adaptations at the local level are likely to strengthen and broaden the participation of national and subnational governments in forming the institutions of global governance (such as the United Nations, the World Trade Organization, the IMF, the World Bank, the Bank of International Settlements, and the World Court). Rather than preaching uniformity, as the World Bank and IMF have often done in the past, international institutions will increasingly move toward a role parallel to that of markets: bringing harmony to a diverse set of players.

How will governments and markets deal with our current concerns about globalization? To explore the possible answers to this question, let's start with the outsourcing issue, which has caused some anxiety in recent years for workers and professionals in many countries. This also happens to be among the easiest issues to address. To understand the reason, first note that outsourcing will be going in all directions. So, if some jobs are lost in the United States and outsourced to countries where they can be done relatively more cheaply, there must also be other tasks that are relatively more expensive in those countries and can be outsourced to the United States. Would this type of global competition press down the U.S. wages and salaries toward those currently prevailing in India or China? Not if American workers win the competition in their fields of specialization because of their productivity and high quality of their services. Of course, this cannot happen in all lines of economic activity. So, over time, part of the American labor force may have to shift to new jobs as its comparative advantage is redefined by global markets. Continued improvements in the labor market will reduce the costs associated with the shift, and the remaining burden is likely to be cushioned with the help of well-functioning private capital and insurance markets, as well as social insurance mechanisms. Similar trends will also be taking place in the rest of the world. In many developing countries, where the costs of adjustment have been falling mostly on labor, there will be further institution building to diminish the hardships and share the risks. All of these effects will soften the opposition to liberal trade around the world and thereby deepen globalization.

Another current concern about globalization is the rising inequality. Globalization has increased the returns to skills and, as a result, has widened the gap between the rich and the poor. This is parallel to the effects of technological and institutional changes, which have in fact

been much stronger forces behind the increased inequality. These forces will continue raising the rewards to skills, largely because ultimately that is how they help incomes rise. However, the level and composition of skills are likely to change, enabling a much larger share of the labor force to take advantage of opportunities presented by globalization and new technologies. The enhanced abilities of the governments will also bring about more efficient, situation-specific labor regulations that expand rewarding job opportunities for broader segments of the population around the world. These factors should jointly help to stop or even to reverse the recent trends in inequality.

Of course, for the enhancement and expansion in skills to take place, there must be major reforms in education (especially curricula and teaching methods) to facilitate the acquisition of the relevant skills. There will be better ways to condense information in various fields and pass them on to students, along with more general skills of communications and critical thinking. Like many other reforms, at the moment we may not know the exact solutions that will come about in different contexts, but our efforts to improve knowledge in this area and to experiment with possible solutions are likely to bear fruit over the coming decades.

Could the rise in global incomes be thwarted by the exhaustion of natural resources on earth? While that is a possibility, it is by no means a likely outcome. The incentives to find renewable and expandable substitutes for exhaustible resources are getting stronger. There are already such substitutes available for many natural resources, though they are not always used widely due to cost or safety consideration (such as nuclear energy, which can be a substitute for petroleum). Another factor that makes the picture more hopeful is the shift in the pattern of production and consumption toward products that use fewer natural resources per dollar of their value. This trend is most vivid in the rising role of services in the economy, which require substantially less energy than manufacturing and agriculture. Similar trends, combined with institutional reforms in developing countries, are likely to address the environmental concerns of expanding production around the globe.

Similar responses and trends should be expected in the case of many other problems associated with globalization. The overall picture seems to be a hopeful one, largely based on the ability of the world community to overcome the most pressing obstacle to its economic prosperity

at present, which is lack of sufficient knowledge and ability to spread good practices in governance, regulation, and market development.

## **WHAT COMBINATIONS OF SKILLS DO WE NEED IN THE TWENTY-FIRST CENTURY?**

There will be no shortage of decent jobs in the coming decades. To enjoy a prosperous life, people need, among other things, good shelter, food, medical care, education, and entertainment. Those who deliver these products need to identify the demands and satisfy them with high standards and low costs. To achieve this, they need high-quality and cost-effective inputs, which must be produced by others, who in turn depend on each other's products and services.<sup>1</sup> An important part of the inputs needed at every stage is the innovative know-how to perform tasks more effectively and improve the output. Furthermore, those who provide such inputs will need the services of others who offer research and advice on how innovation processes can themselves be made more effective and innovative. At every stage, there is also a need for individuals who can facilitate the transactions and make them more reliable. Finally, there is a need for people who study the global system of transactions at broader levels and help make it more effective. It is evident that in its entirety, this chain is very complex and, with globalization, spans the entire world economy, involving billions of jobs. Each of those jobs can be made more productive and remunerative, which will benefit the jobholders as well as all others who interact with them as buyers or sellers.

In this context, the skills that one can acquire and use productively in each country depend on the production processes already in place and the institutional capabilities of that country. For example, in the past, the conditions in the United States enabled it to lead in the development of new knowledge, technologies, and products (ranging from scientific and industrial equipment to music and cinema). This position is likely to be maintained in the first half of the twenty-first century, and the skills most rewarded will be those that contribute to innovations. Of course, competition will increase around the world. But as the numbers of those involved in the process rise, there will be room

for greater specialization and focus on narrower areas where leadership can be maintained, with some of the activities being passed on to other countries that can perform them more effectively. This will make the jobs more productive in the United States and in other countries, raising incomes here and abroad.

Finally, to be effective in our jobs, we need to specialize in the tasks that we take up, communicate effectively with those who interact with us, and develop a practical and reasonably good understanding of the big picture of the global economy. At the same time, we must maintain some flexibility to be able to redefine our positions, learn new skills, and switch to new tasks as our sources of comparative advantage shift over time. This requires a combination of quantitative and technical knowledge as well as communication and business skills. Many of the specialized skills may be learned on the job or at the graduate level. In pregraduate stages of education, we need to learn a great deal of relatively general math and sciences as well as social sciences and humanities. And, of course, in all these areas, our knowledge must include broad perspectives on where things stand globally.

### Note

1. For example, to paint the rooms in your house, you need a painter to do a neat job while spending a minimal amount of time. This depends on the skills and incentives of the painter, as well as the equipment and the quality of paints she can use. In particular, she needs durable brushes and painting equipment that spread paint quickly and consistently. Producing such equipment and material in turn requires use of appropriate inputs and the application of scientific and industrial innovations, which are produced by others, and so on and so forth.

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