Adapting to the new globalization

By Laura Tyson and Susan Lund
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Around the world, countries are rethinking the terms of engagement in global trade. This is not all bad; in fact, acknowledgement of globalization's disruptive effects on millions of advanced-economy workers is long overdue. But new trade policies must be based on a clear-eyed understanding of how globalization is evolving, not on a backward-looking vision based on the last 30 years.

Globalization has done the world a lot of good. Research from the McKinsey Global Institute shows that, thanks to global flows of goods, services, finance, data, and people, world GDP is more than 10% higher – some $7.8 trillion in 2014 alone – than it would have been had economies remained closed.

More interconnected countries capture the largest share of this added value. For example, the United States, which ranks third among 195 countries on MGI's Connectedness Index, has done rather well. Emerging-market economies have also reaped major gains, using export-oriented industrialization as a springboard for rapid growth.

Yet, even as globalization has narrowed inequality among countries, it has aggravated income inequality within them. From 1998 to 2008, the middle class in advanced economies experienced no income growth, while incomes soared by nearly 70% for those at the top of the global income distribution. Top earners in the US, accounting for half of the global top 1%, reaped a significant share of globalization's benefits.

To be sure, this isn't all, or even mostly, a result of globalization. The main culprit is technological change that automates routine manual and cognitive tasks, while increasing demand (and wages) for highly skilled workers. But import competition and labor arbitrage from emerging economies have also played a role. Perhaps more important, they have proved more salient targets of voters' fear and resentment.

Indeed, in the industries and regions hit hardest by import competition, years of simmering discontent have now boiled over, fueling support for populists promising to roll back globalization. But, as the advanced economies reformulate trade policy, it is critical that they understand that globalization was already undergoing a major structural transformation.

Since the global financial crisis, cross-border capital flows have plummeted, with banks pulling back in response to new regulation. From 1990 to 2007, global trade grew twice as fast as global GDP; since 2010, GDP growth has outpaced that of trade.

Both cyclical and secular forces are behind the trade slowdown. Investment has been anemic for years. China's growth has slowed – a secular trend that is unlikely to be reversed. And the expansion of global supply chains seems to have reached the frontier of efficiency. In short, slower global trade is likely to be the new normal.

None of this is to say that globalization is in retreat. Rather, it is becoming a more digital phenomenon. Just 15 years ago, cross-border digital flows were almost non-existent; today, they have a larger impact on global economic growth than traditional flows of traded goods.

The volume of cross-border data flows has soared 45-fold since 2005, and is expected to grow another nine-fold over the next five years. Users worldwide can stream Beyoncé's latest single immediately upon its release. A manufacturer in South Carolina can use the e-commerce platform Alibaba to buy components from a Chinese supplier. A young girl in Kenya can learn math through Khan Academy. Eighty percent of students taking Coursera's online courses live outside the US.

This new form of digital globalization is more knowledge-intensive than capital- or labor-intensive. It requires broadband connections, rather than shipping lanes. It reduces barriers to entry, strengthens competition, and changes the rules governing how business is done.

Consider export activities, which once seemed out of reach for small businesses lacking the resources to scout out international prospects or navigate cross-border paperwork. Now, digital platforms like Alibaba and Amazon enable even small-scale entrepreneurs to connect directly with customers and suppliers around the world, transforming themselves into "micro multinationals." Facebook estimates that 50 million small businesses are on its platform, up from 25 million in 2013; 30% of these companies' Facebook fans, on average, are from other countries.

While digital technologies open the door for small companies and individuals to participate in the global economy, there is no guarantee that sufficient numbers will walk through it. That will require policies that help them take advantage of new global market opportunities.

The US has pulled out of the Trans-Pacific Partnership (TPP) deal, but many of the issues it addressed still require global rules. Data localization requirements and protectionism are on the rise, and data privacy and cyber-security are pressing concerns. In the absence of the TPP, it will be critical to find some other vehicle for establishing new principles for digital trade in the twenty-first century, with a greater emphasis on intellectual property protection, cross-border data flows, and trade in services.

At the same time, advanced economies must help workers acquire the skills needed to fill high-quality jobs in the digital economy. Lifelong learning cannot just be a slogan; it must become a reality. Mid-career retraining must be made available not only to those who have lost their jobs to foreign competition, but also to those facing disruption from the continuing march of automation. Training programs should be able to impart new skills in a matter of months, not years, and they should be complemented by programs that support workers' incomes during retraining, and that help them relocate for more productive work.

Most of the advanced economies, including the US, have not adequately responded to the needs of the communities and individuals left behind by globalization. Addressing these needs is now of paramount importance. Effective responses will require policies that help people adapt to the present and take advantage of future opportunities in the next phase of digital globalization.

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