

Globalization

Entry for Palgrave Dictionary of Economics, by William Easterly (NYU)

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“Globalization” is a word that gets both its proponents and opponents very agitated, but what exactly is it? What is the globalization debate really about?

The answer is that the globalization debate is about a surprisingly large number of issues, including some that lie outside of economics. A non-exhaustive list from a reading of the writings of both economists and non-economists (see a very partial list of references in the footnotes) is that it is a debate about:

- (1) Liberalization vs. regulation of international trade, capital movements, and migration.
- (2) How to deal with market imperfections that arise with (either domestic or international) goods markets, capital markets, privatization, macroeconomic crises, intellectual property rights, etc.
- (3) Evaluation of the performance of the International Monetary Fund and the World Bank including in particular their policy prescriptions (AKA the “Washington Consensus,” “shock therapy,” or “structural adjustment”)
- (4) Effects of freer trade and capital movements on rich country workers (“out-sourcing”) and on poor country workers (“sweatshops”)
- (5) What to do about extreme world inequality and poverty
- (6) Capitalism (AKA “neoliberalism”) vs. alternative systems
- (7) Westernization/Americanization vs. local culture

(8) Unequal distribution of political power between the West (both Western governments and corporations) and the Rest.

(9) Effect of global economic growth on the environment.

(10) Western imperialism and military intervention in the rest of the world

Arguably, the vagueness of a term that includes at least 10 separate debates has done a disservice to economic and political debate, causing many “globalization” debate participants to think they disagree with people with whom they really agree, or to think they agree with people with whom they really disagree. It also explains some of the difficulties in communication between economists and non-economists about globalization, because the two groups really have different debates in mind. Economists (including those identified as “globalization critics”) have focused largely on (1)-(5), while the non-economists --while not ignoring (1)-(5)-- seem to have something else in mind like (6) - (10).

So for example, Dani Rodrik (1997) and Joseph Stiglitz (2002), who have both gotten a reputation as globalization critics by focusing mainly on issues (1) – (3), are embraced eagerly by some “globalization protesters” whose main issue is really (6): the critique of capitalism (sometimes called “neoliberalism”). This is not meant as a criticism of Rodrik and Stiglitz -- it is meant just to point out the confusion that exists when two prominent mainstream economists who are talking about tinkering with and fine-tuning capitalist markets are seen as allies by those who are opposed to free market capitalism.

This essay can hardly do justice to the complexity of all of these debates, nor is there much hope of getting everyone to discontinue the almost criminally vague use of

the term “globalization” in debate. This essay will argue that most of the energy in the debate indeed comes from enthusiasm vs. antipathy to capitalism and free markets.

This essay will thus focus on two key themes about the globalization debate. I take as given that the intended audience for this essay (mainstream economists, given the likely readers of this publication) accepts the general argument in favor of free market capitalism, with some debate about tinkering around the edges. First, I will give some intellectual history of the debate about capitalism (6), which will place in perspective some of today’s globalization debate including that by the non-economists. This has the objective of dispelling some of the puzzlement that many economists feel about the sound and fury surrounding globalization, through realization that it is partly just another manifestation of a long intellectual debate about capitalist free markets, which economists have been engaged in for decades if not centuries. Second, the essay will try to place the antipathy to free markets in contemporary perspective by discussing whether overly simplistic models and unrealistic promises of quick and sizeable results from “globalization” for poor countries have further fueled this antipathy. I consider at the same time whether the zeal of the globalizers may have led them to endorse counter-productive and unrealistic attempts at wholesale social transformation, which generates an even more severe backlash.

Let’s start with the longstanding debate about capitalism. Intellectual history makes clear how the gains from trade (in goods, finance, and labor services) in capitalism are such a revolutionary idea that economists are often left as its lone proponents in the wilderness. There are three major habits of thinking that create difficulty in communication between economists and non-economists on gains from trade. One is the

mindset that economic interactions are zero-sum games (a partially understandable mindset when capitalists have such skeletons in the closet as military conquest, colonization, slavery, predatory behavior by firms, etc.). The second is the difference between economists' notion of Pareto superior outcomes and common social norms of fairness. The third barrier to communication is the difficulty of accepting the economists' notion of the invisible hand that creates spontaneous outcomes NOT designed by anyone, where the common habit of thinking is that a good or bad outcome must be the result of intentional action by a good or bad agent.

To start with the zero-sum mindset, one early father of Christianity, St. Jerome thought any wealth was automatically 'unjust riches', since "no one can possess them except by the loss and ruin of others." St. Augustine put it more tersely: "If one does not lose, the other does not gain."¹

Centuries later, even after Adam Smith and the industrial revolution, all sides of the political spectrum still often thought in zero-sum terms. Friedrich Engels wrote that "the consequences of the factory system" were "oppression and toil for the many, riches and wealth for the few."² Henry Adams saw capitalism as a system that divided humanity "into two classes, one which steals, the other which is stolen from."³

We are so used to thinking of conservatives as pro-market, it surprises us that some on the Right in the 19th century also attacked free market economics (see Levy 2001 for a great narrative). The Right's attack on the laissez-faire Left (how things have changed!) was that the latter were hypocritical advocating both capitalism and the end of slavery, because capitalism made "free" workers no better than slaves. For example,

¹ Muller 2002 p. 6

² Muller 2002 p. 180

³ Herman 1997 p. 160

Thomas Carlyle (the man who disliked economists so much that he coined the phrase “dismal science”) told workers: “you are fallen captive to greedy sons of profit-and-loss; to bad and ever to worse... Algiers, Brazil or Dahomey hold nothing in them so authentically “slave” as you are.”⁴ This is zero-sum thinking in the extreme!

Similarly, on the American 19th century right, John C. Calhoun defended American slavery in 1828 by claiming that industrial capitalism in the North was no better; it caused wages to “sink more rapidly than the prices of the necessaries of life, till the operatives ... portion of the products of their labor ... will be barely sufficient to preserve existence.”⁵ Ironically the great African-American intellectual WEB Dubois reached similar conclusions to Calhoun’s about industrial capitalism, as he observed it in the South after the Civil War:

{The} men who have come to take charge of the industrial exploitation of the New South...thrifty and avaricious Yankees... . For the laborers as such, there is in these new captains of industry neither love nor hate, neither sympathy nor romance; it is a cold question of dollars and dividends. Under such a system all labor is bound to suffer. ... The results among them, even, are long hours of toil, low wages, child labor, and lack of protection against usury and cheating.⁶

Lenin famously linked zero-sum Western imperialism and nonzero-sum trade and capital flows. Profits for the companies that follow in the wake of the imperialists are high in the “backward countries,” where the capitalists relocate their capital because “the price of land is relatively low, wages are low, raw materials are cheap.”⁷ Lenin may have been the first 20th century critic of out-sourcing.

⁴ Thomas Carlyle, Latter-day pamphlets (1850)

⁵ Muller 2002 p. 177

⁶ WEB Dubois, On the Souls of Black Folk,IX, Of the Sons of Master and Man

⁷ Vladimir Lenin, Imperialism: the Highest Stage of Capitalism, 1916
<http://www.marxists.org/archive/lenin/works/1916/imp-hsc/ch04.htm>

Today, we see similar zero-sum thinking in globalization critics on the left and the right. Oxfam identifies such products as Olympic sportswear as forcing laborers into “working ever-faster for ever-longer periods of time under arduous conditions for poverty-level wages, to produce more goods and more profit.”⁸ A popular globalization web site elaborates: “trade is inherently unequal and poor countries seldom experience rising well-being but increasing unemployment, poverty, and income inequality.”⁹ Former Tanzanian president Julius Nyerere summarized the zero-sum mindset back in a 1975 state visit to Britain: “I am poor because you are rich.”¹⁰

On the right, there is still today concern about free markets creating winners at the expense of losers. Patrick Buchanan wrote in a 1998 book about how free trade causes “broken homes, uprooted families, vanished dreams, delinquency, vandalism, crime.”¹¹ Edward Luttwak wrote in 1999 how global capitalism requires “harsh laws, savage sentencing, and mass imprisonment” to deal with “disaffected losers.”¹² Although of course the right in general today is more sympathetic today to free market capitalism than the left, the persistence of this thinking shows how the zero-sum mindset is an independent force from political ideology.

⁸ http://www.oxfam.org.uk/what_we_do/issues/trade/playfair_olympics_eng.htm. Statements like this come from an organization that is actually much friendlier to free trade than most non-governmental organizations (NGOs).

⁹ <http://www.globalpolicy.org/soecon/trade/index.htm>

¹⁰ Quoted in Lindsey 2001, p. 105

¹¹ Micklethwait and Wooldridge, 2000 p. 282

¹² Luttwak, 1999, p. 236

Of course, capitalism/globalization does create losers as well as winners, unleashing gales of creative destruction. Since losers tend to be more vocal than winners, it is easy to understand the perception that the losers outnumber the winners, which then reinforces the already ingrained habit of thinking in zero-sum terms. To complicate matters further, some poorly conceived attempts at rapid transition from non-capitalism to capitalism (e.g. “shock therapy,” to be discussed below) can in fact have more losers than winners.

The second source of communication breakdown about globalization is the difference between economists’ general enthusiasm for Pareto improvements and common norms of fairness (see Aisbett (2006) for a provocative discussion). Following Aisbett, let’s say for example that a multinational firm opens a factory in a low income country. Suppose that the new investment enables the firm to double its profits and for the newly employed workers in the factory to double their previous incomes. Suppose the workers were formerly part of the extreme poor (conventionally measured at \$1/day), so that now they have escaped extreme poverty. Who can argue with such a Pareto improvement?

From another perspective, however, what is happened is that a very poor person has gained \$1 a day (in a “sweatshop”) while a captain of industry previously making, say, \$1000 a day, has gained another \$1000. It violates many norms of fairness (abundantly confirmed in the laboratory by experimental economics), where someone already far better off gains 1000 times more than the less fortunate person from this transaction. To point this out doesn’t lead to any obvious conclusions – most economists

will say the transaction is still worth doing to relieve absolute poverty, while critics will protest that a more fair division of the gains should be possible (but even if the worker gets a five-fold increase in income, an amazing escape velocity from poverty while the capitalist stays at double, the capitalist gains are still 250 times larger).

The third barrier to constructive communication about globalization is the common assumption that an outcome must result from an intentional action by an identifiable agent. This couldn't contrast more with the economists' notion of the invisible hand. The intentionality mindset is that "Globalization" represents someone's agenda, and it is to blame for the tragedies of world poverty. To give an illustrative example of this kind of anti-globalization rhetoric (not necessarily representative):

The "transnational corporations ... expand, invest and grow, concentrating ever more wealth in a limited number of hands. They work in coalition to influence local, national and international institutions". "corporate elites...forge common agendas outside the formal institutions of democracy." They use forums such as the Trilateral Commission, the International Chamber of Commerce, the World Economic Forum, trade associations, and the many national and international business and industrial roundtables."¹³ The participants at such "posh gatherings...chart the course of corporate globalization in the name of private profits..."¹⁴ Searching for whom to blame for the miseries of the poor, the rich multinational corporations make for natural villains (alternative villains are the IMF and World Bank). These are not only villains, but foreign villains! This mindset is further strengthened when corporations (who of course really ARE self-interested profit-

¹³ A Report of the International Forum on Globalization, p. 140

¹⁴ A Report of the International Forum on Globalization, p. 4

seekers) get caught doing something like despoiling the environment in a poor country or doing shady deals with the local kleptocrats. The economists' idea of a spontaneous system of myriads of uncoordinated agents, with nobody in charge, generating outcomes that are not intended (or even foreseeable) by anyone is a lot harder sell.

With such fundamental differences in thinking, perhaps we can understand why there is little prospect of a constructive conversation between advocates and opponents of globalization/free market capitalism/neoliberalism. The World Social Forum, the counterpoint annual meeting to that of the capitalist globalizers at the World Economic Forum in Davos, says on its web site for the January 2007 meeting that it is “an open meeting place for reflective thinking, democratic debate of ideas, free exchange of experiences,” except that the debate is limited to “groups and movements of civil society that are opposed to neoliberalism.” A similar spirit seems to inform the complaint that the case for capitalism arises from “rationalist constructions of knowledge” featured in such reunions of the “global managerial class” as “AEA meetings.”¹⁵ Of course, mainstream economists probably do not seem much more open to debate on “neoliberalism” to their critics!

Things are made even worse by the second major theme of this essay, the overselling of globalization. Simplistic models and promises of quick and sizeable results create expectations, and when these expectations are disappointed (even when the results are gradually and increasingly positive), there is a backlash against globalization.

¹⁵ <http://www.globalpolicy.org/globaliz/define/2006/03scholte.htm>

A classic example of the overselling of globalization is the World Bank 2002 report *Globalization, Growth, and Poverty*. An instance of the overselling is the following graph, the first one shown in the report, prominently displayed in the overview.

Figure 1 Divergent paths of developing countries in the 1990s

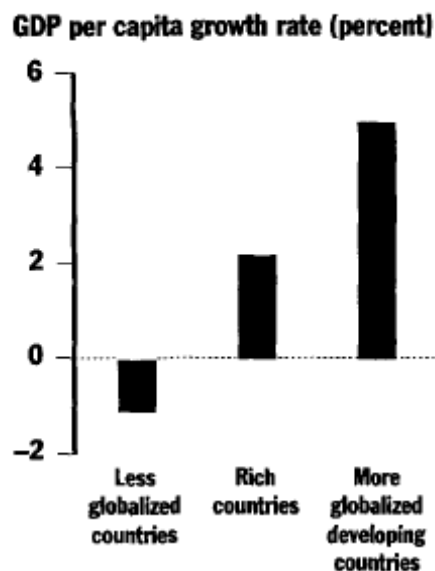


Figure reproduced from World Bank (2002), p. 5

Although never explicitly stated and some caveats are expressed, the impression left with many readers is that being more globalized makes the difference between 5 percent per capita growth and -1 percent per capita growth, which is an amazingly strong claim for the effects of globalization. World Bank researchers reinforce this kind of claim with statements promising that world poverty can be cut in half with policy reforms: “Poverty reduction – in the world or in a particular region or country – depends primarily on the quality of economic policy. Where we find in the developing world good

environments for households and firms to save and invest, we generally observe poverty reduction” (Collier and Dollar 2001).¹⁶

The International Monetary Fund likewise have a standard set of policies that it advocates (together the IMF and World Bank notion of “good policies” form what is often called the “Washington Consensus”), many of which are oriented towards creating freer markets (more “globalization”). The IMF also claimed in 2000 that “Where {good} policies have been sustained, they have raised growth and reduced poverty.”

This is speculation, but some of the World Bank/IMF belief in policy reformers to explain good outcomes may ironically stem from the same intentionality impulse that makes critics blame the World Bank and IMF for bad outcomes. People find it more comfortable to attribute success to action of a few heroic policy reformers or technocrats (or strong leaders implementing good policies like Lee Kuan Yew), rather than to some more mysterious bottom-up process of many spontaneous individual entrepreneurs.

Unfortunately, there is little evidence for strong growth effects of policy changes that involve anything less than getting rid of self-destructive extremes (like moving from autarchy to allow some trade, or from hyperinflation to moderate inflation), and even then hardly six percentage points permanent change in growth, as documented in Easterly (2005). Contrary to the impression conveyed in the foregoing statements, the economics profession actually knows very little about how to raise economic growth over the short to medium run with policy changes in the range in which most countries are operating

¹⁶ I have to admit with some embarrassment that this statement was based on one of my own unpublished growth regressions, which eventually showed up in published form in Easterly 2001 making the opposite point – that the growth response to policy reform was disappointing. Regressions can be dangerous!

(see for example the survey in Kenny and Williams (2001)).¹⁷ Growth in developing countries is extremely volatile (on average 75 percent of a country's deviation from the global mean per capita growth in a 5 or 10 year period disappears in the following period, as pointed out in Easterly, Kremer, Pritchett, and Summers 1993 and since then replicated with more recent data.) Over-eager growth-watchers are too quick to proclaim "growth miracles" and the lessons that allegedly follow from them. As Dixit (2006) says,

At any time, some country is doing well, and academic as well as practical observers are tempted to generalize from its choices and recommend the same to all countries. After a decade or two, this country ceases to do so well, some other country using some other policies starts to do well, and becomes the new star that all countries are supposed to follow.

The success of China and the earlier successes of the East Asian miracles (all associated with great success in global markets) are often used by promoters of globalization to bolster their case. Unfortunately, the implicit promise that such unusually rapid growth (on the order of 5 percent per capita) is available to all "globalizers" is on very shaky ground. First, such rapid growth is very rare -- 1.7 percent of countries registered 5 percent per capita growth or more over 1950-2001 and only 0.7 percent of all half-century country per capita growth episodes since 1820 surpassed 5 percent.¹⁸ Most rich countries today (usually agreed to have been globalized and capitalist for quite some

¹⁷ Besides this, the methodological problem is that countries that are more or less globalized are not defined in terms of policies that promote free trade, free capital movements, free migration, or some other policy measure that features in the debates on globalization. The "more globalized" countries are defined in terms of outcomes: it is those that are in the top third of countries in terms of the increase in their trade to GDP ratios. Defining globalization in terms of one endogenous measure of success that is likely related to other endogenous measures of success (like the GDP growth rates being explained) is rather unfortunate.

¹⁸ Source for the data is the Angus Maddison (2003) historical database.

time) got to be rich by registering something on the order of 2 percent per capita growth for one or two centuries.

Things are made worse when casual empiricism is married to simplistic theory. In the simplest textbook model, freedom of trade and capital movements each promotes poverty alleviation, i.e. rapid catching up of wages or incomes in capital-scarce, labor-abundant poor countries to those in rich countries. According to the model, free trade allows unskilled wages in poor countries to rise rapidly through labor-intensive exports, while free capital movements allow high investment in poor countries to remedy the gap in capital per worker between rich and poor countries. A side effect would be that inequality within the poor country (driven mainly by the differences between labor and capital earnings) should decrease. Even aside from the fact that a vast trade literature does not support most predictions of the first story, the growth and development literature has pointed out that total factor productivity differences between countries are a much more plausible explanation of income differences between countries than differences in capital per worker (Hall and Jones 1999, Klenow and Rodriguez-Clare 1997, Easterly and Levine 2001, Hsieh 2002). Stylized facts on trade, inequality, and poverty do not support the predictions of the simple textbook model where income differences are due to differences in capital per worker.¹⁹

These false expectations of very rapid growth through globalization (AKA free markets in general) have arguably done a lot of damage, creating fertile ground for an anti-capitalist backlash in places as diverse as Thailand, South Africa, Russia, Bolivia, Venezuela, Peru, Argentina, Ecuador, and Mexico. The critics of globalization can all the more easily seize upon any growth setbacks (such as the Mexico crisis of 1994/95, the

¹⁹ See Easterly 2006 for a more extensive discussion of these points

East Asian crisis of 1997/98, or the Argentina crisis of 2001, or disappointing growth in Latin America in general since market liberalization in the 1980s), whatever their cause (usually hard to explain anyway in the volatile pattern described earlier), to say “see, globalization/neoliberalism doesn’t work.”

The backlash has been made all the worse because of the overconfidence of IMF and World Bank policymakers (and free-lance “reform consultants”) “globalizing” whole societies that start out with many different barriers to efficient free markets. The economics profession can demonstrate fairly convincingly some long run market-friendly policies and institutions that are most conducive to prosperity, but it knows very little about the sequencing and the transitional paths of reforms to get from initial conditions to that ideal state. (Lipsey and Lancaster’s (1956) theory of the second best recognized this problem 50 years ago, but it seems each new generation must discover it afresh.) It is obvious that different kinds of reforms are complementary to each other – for example, financial market liberalization only works well if there is sufficient transparency of banks to depositors and a good regulatory and supervisory framework to ensure that banks don’t cheat (Barth, Caprio, and Levine 2006). Otherwise, financial liberalization often leads to bad loans, enrichment of insiders, and subsequent banking system crises, as abundant experience has already demonstrated.

Yet the usual answer to policy complementarity – “do everything at once,” “structural adjustment,” or “shock therapy” – doesn’t really escape the curse of the second best. Policy-makers neither know what “everything” is nor have the ability to change “everything” at once (or any time soon). The choice is really between large-scale partial reforms (which shock therapy mislabels comprehensive reform) and small-scale

partial reforms. Any economy is a complex system of informal networks, social norms, relationships, trades, and formal institutions, many of which lie outside the control of the policy-maker. As Dixit (2004) points out, an existing network under the current system of rules can at least enforce contracts in that it can threaten to expel any member who cheats another member. Drawing up a brand new set of rules overnight (like moving abruptly from an interventionist economy to a free market economy) can have perverse impacts in the short run. It can mean that people can choose to exit the old network (cheating their old partners) because they now have the option of operating under the new system of rules and the new networks generated by the new rules. The net effect can be to disrupt the functioning of the old economy much more than it facilitates the creation of the new economy. This is theoretical speculation at this point, but it does illustrate the potential pitfalls of promising rapid results from rapid reforms. To think that economists could re-engineer the whole society and economy looks in retrospect like the worst kind of intellectual hubris (see McMillan 2006 for a great discussion). Attempts at rapid “comprehensive” reform of poor countries look a lot like what Karl Popper long ago decried as “utopian social engineering,” versus what has worked for most rich countries to attain prosperity: “piecemeal democratic reform.”

The most notorious case of this hubris was the attempt to reform the former Soviet Union with “shock therapy.” Murrell (1992,1993) -- a long-time scholar of centrally planned economies -- argued against shock therapy as utopian social engineering. His objections are all the more compelling because they were ex-ante rather than ex-post. History vindicated his scathing description of shock therapy at the time:

There is complete disdain for all that exists... History, society, and the economics of present institutions are all minor issues in choosing a reform program...Establishment of a market

economy is seen as mostly involving destruction... shock therapists assume that technocratic solutions are fairly easy to implement... One must reject all existing arrangements...²⁰

Murrell was quick to realize the relevance of Popper for what was later half-jokingly called a Leninist push for free markets in Russia. His quote of Popper in 1992 is a perfect prediction of how Russian reform would fail: "It is not reasonable to assume that a complete reconstruction of our social system would lead at once to a workable system."²¹ After the former Soviet republics had some of the greatest depressions in economic history, the prescience of such viewpoints became apparent.

For its part, IMF/World Bank-supported "structural adjustment" was also uncomfortably like "utopian social engineering," and had a similar debacle in Africa and Latin America. The resulting anti-market/anti-globalization backlash (in the former Soviet Union as well as Africa and Latin America) was all the more severe because the reforms involved some IMF/World Bank coercion through conditional loans. One can hardly think of a better formula for an anti-capitalist backlash in poor countries than to introduce over-ambitious, over-promising programs of large-scale "globalization" reforms imposed by foreigners!

In conclusion, economists are unlikely to find the term "globalization" a precise enough concept to advance most research agendas. Instead, it mainly seems to point to the long-standing debate about economists' traditional embrace of free market capitalism. Perhaps some progress in these debates can be made by understanding some of the traditional mind-sets that make a system of spontaneous gains from trade such a revolutionary concept. It also would help a great deal if policymakers and the economists advising them did not pursue over-ambitious attempts at rapid wholesale transformation

²⁰ Murrell 1993.

²¹ Quoted in Murrell 1992

of the economy and society and did not over-promise how quick or large the gains will be for the economy from such programs.

Articulate arguments of the case for capitalism/globalization continue to be made in books such as Lindsey (2001) and Wolf (2004). Mishkin (2006) has recently made a fascinating case for the kind of globalization that opponents find most frightening (and even many economists shy from), financial globalization. Despite such eloquent statements, the discomforts caused by the spectre of globalization are unlikely to abate any time soon. Economists can arguably contribute more to the debate by seeking to understand the discomfort rather than dismissing it out of hand.

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