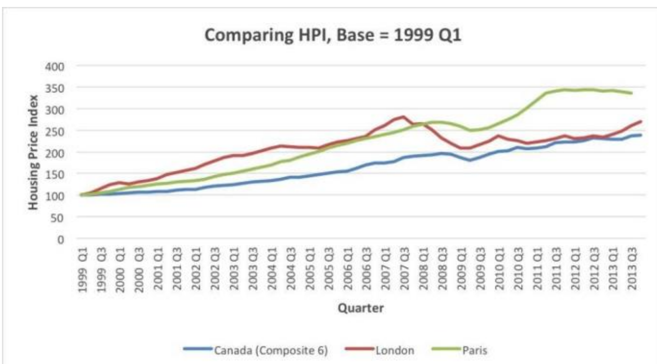
Has globalization turned against us?

Published Tuesday, Feb. 18 2014, 6:18 PM EST

Last updated Tuesday, Feb. 18 2014, 6:18 PM EST

Globalization has shrunk the world over the last quarter century. Free trade in products and services, the unencumbered movement of people, ideas and capital, open capital markets, production and technological inventions, public support for global trade and adherence to international law all reached record levels and the world economy thrived. Globalization benefited developed and developing countries alike, and helped lift millions of Chinese, Indians and others out of poverty.

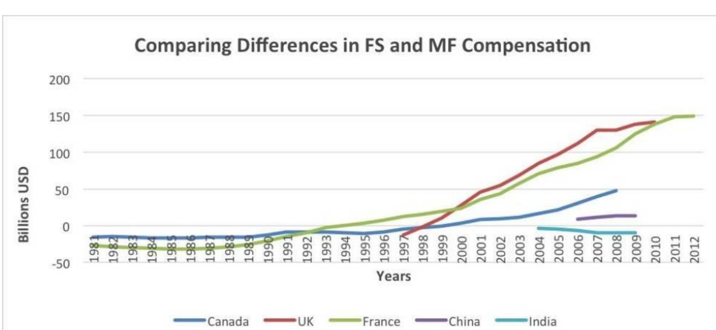
But has globalization now become a threat?



Wealthy people from around the world, who can now move capital freely, buy homes in Canada, the U.K. and France, driving prices to record levels. The luxury housing market in Toronto is booming and so is Vancouver's. The same is the case for London and Paris. House prices in Toronto, Vancouver, London and Paris have more than doubled over the last 10 years, as the accompanying graph shows.

But there is collateral damage. Freely moving capital and wealthy people make housing unaffordable for the majority of the citizens in developed countries, at the same time that many of them are displaced by the labour forces of China and India. Manufacturing jobs in developed countries are disappearing at an alarming rate and moving to developing countries, while service jobs are on the increase. Canada, for example, has lost more than 51,000 auto and auto parts jobs since 2000 to developing countries. An increased pool of labour drives wages down, or prevents them from rising, thus exacerbating economic problems in developed countries. Middle class wage growth, as a result, has stalled.

Globalization has benefitted the rich more than the poor in developed countries, engendering income inequality and all the problems associated with it. The graph below shows that the difference between financial services (FS) compensation and manufacturing (MF) compensation has skyrocketed in Canada, U.K. and France and has flattened out or declined in China and India.



In relation to this graph, what is most disconcerting is that the last time such a 16 year run up in the difference between FS and MF compensation was experienced was in the 1914-1930 period. That epoch began with the year widely believed to have ushered in the end of an earlier era of globalization, and finished with the stock market crash, followed by the Great Depression.

Economic theory suggests that, in the long term, things should reach some sort of equilibrium. But in the short run, there is going to be a lot of pain, and many countries may be unable to bear the political and economic cost. The continuing riots around the globe are the ugly face of globalization. No one seems to trust politicians and institutions any longer. The turmoil is widespread. Currency is being devalued in Argentina and Turkey. In Brazil and China growth is slowing down, endangering the growth of commodity exports/imports and their respective economies. Popular uprisings against governments around the world abound – Ukraine, Turkey, Greece, Brazil, U.S. and so on – all raising a cautionary flag.

To reach the long run, we need to overcome these short run problems, which, if not resolved, may cause de-globalization as it happened in 1914, exactly 100 years ago.

George Athanassakos is a professor of finance and holds the Ben Graham Chair in Value Investing at the Richard Ivey School of Business, University of Western Ontario.