World 3.0: Global prosperity and how to achieve it

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Guest speaker **Pankaj Ghemawat**, Anselmo Rubiralta Professor of Global Strategy at IESE Business School, discussed his new book: **World 3.0: Global Prosperity and How to Achieve It**.

André Sapir, Senior Research Fellow at Bruegel, introduced the presentation with a few words on Prof. Ghemawat's background and how the subject of his book might apply to the Euro crisis. This is a very important time in Brussels and the EU. The World 3.0 concept may help the EU to adapt by putting the euro crisis in the perspective of global changes – for example, the issue of governance relating to the Euro viewed against the backdrop of global currents. Similarly, global trends were accelerated by the Euro crisis. There is fear that the crisis could mean an end to globalization, though that has not been the case thus far. What does the issue of globalization mean for the EU and what should we be reflecting?

The concept of World 2.0 is the idea of the "flat" world famously advocated by Thomas L. Friedman. In World 2.0, technology has enabled business and ideas to be exchanged without regard to geography, distance, or, soon, even language. In contrast, World 3.0 is a world in which, in the words of a quotation used by Prof. Ghemawat, "There is a balance on the spectrum between 'local' and 'global' that represents the sweet spot [and makes for] the race to the middle."

Prof. Ghemawat demonstrated, through figures, that there appears to be a widespread belief that we are living in World 2.0; that technology has created a "flat" world. This flat world concept was found to be the most widely supported view in a survey of Harvard Business Review readers. However, Ghemawat's new book proposes that we are still in World 3.0. Prof. Ghemawat began the presentation with an interactive overview of the World 3.0 concept and its implications. Prof. Ghemawat surveyed the audience for guesses on various metrics of global integration such as the percentage of cross-border phone calls, immigrants, direct investment, etc. A survey of Harvard Business Review readers found asymmetric errors in guesses with a large (10-20%) bias toward overestimating globalization. What does this mean for business?

Firstly, this means that there is a large space for additional gains – significantly larger than estimates (Doha round estimates in particular). Secondly, this means that fears surrounding globalization may be reduced or reversed. In fact, there is evidence that globalization reduces cross-country inequality. In terms of within-country inequality, the United States has only a third of the trade intensity of Germany but social inequality is much higher in the US than in Germany. The determining factor has more to do with the changes in social policy since Reagan than level of globalization. Given how little globalization actually is, we can imagine that changes to tax regimes may be more important in affecting social inequality.

So, focusing on the EU, is the EU in EU 2.0 (very integrated) or EU 3.0 (where local still matters)? The concept of EU as a World 2.0 (very integrated) landscape is grossly inaccurate. There is a notion that the EU is nearly as integrated as the United States. However, per data, this appears to be far from the reality. Data were gathered for the World 3.0 book, and trade maps are available on Prof. Ghemawat's website, which show that even the more integrated countries (such as Belgium) trade mostly with countries relatively close in terms of linguistic similarities, common land borders, and per capita income. The implication is that commonalities boost trade. This pattern applies to both goods and services. In integrated economy merchandise, there is a home bias. Other goods would have even more home bias.

The CAGE Distance Framework can be applied to measure the differences between countries. CAGE stands for Cultural, Administrative, Geographical, and Economic. These four dimensions of distance provide a way of analyzing differences between countries. In the EU versus US question, Trust, is one indicator of integration. Trust levels are high between US states but between EU countries, trust levels drop significantly between the home country and other countries in the EU. In terms of trade, the US has an Interstate Commerce Commission but within the EU it is still very administratively difficult to do business in other member countries. The economic disparity between US states is nothing when compared to the per capita income differences in the EU. Migration rates across the USA are several times as high as in the EU. In terms of culture, cross-state coverage in terms of news is much higher than cross-EU country in EU countries.

Prof. Ghemawat used the CAGE Framework to propose solutions to lessening the barriers. Although much attention has been paid to Administrative barriers, it is the Cultural dimension which is most often ignored. Cultural barriers have been neglected/ignored with the idea that the population will follow given the legislation. However, a deep-seated resistance is manifesting itself and this can be a strong barrier to integration. In order to alleviate cultural barriers, Europe should consider encouraging the exchange of information - dispelling the idea that integration means extermination of local things through information. Cultural exchange should be encouraged through programs such as the Erasmus Exchange. National governments should pay attention to press releases and local news – for example, the scare over Spanish Cucumbers did not serve to increase trust in the EU.

It should is also very worthy of noting that economic problems contribute to fracturing. When unemployment rises, it often does so with a hardening of xenophobia. In order to move to World 3.0, Europe must examine all aspects of the distances separating its member countries.

Discussion

One participant proposed the idea that the EU's success should be measured through its ability to incorporate new economies, and to create an internal market. There is a lot of mobility compared to the rest of the world, which is a factor in convergence. The EU should be viewed as a machine of integration and integration is not so small, though it is not as big s the US. Yes there is big heterogeneity but the capacity through the internal market to foster convergence is not negligible.

So, is Europe at a level of heterogeneity which creates too much resistance against convergence? If so, then will Europe remain with dispersion and a great number of problems? Or, alternatively, can heterogeneity be an opportunity for Europe to achieve its aspirations – openness, speed, and competitiveness?

Prof. Ghemewat agreed that Europe has done well in the transition stage through the injection of structural funds, but past the transition stage it was assumed that countries would naturally overcome the heterogeneity. The objective would be to have more openness but less confidence that initial help is all that is needed. The cultural barriers must be addressed. Non-administrative things can be done; the EU has been working with an artificially constrained set of tools. He also thinks that there is a huge gap between the urgency of the unemployment problem and what is being proposed. Too much emphasis has been put on productivity instead of unemployment; the unemployment problem can be addressed by economists. The role of small and medium business in job creation has been overlooked by many countries. In Spain, the top 37 companies account for 5% of Spain's employment. Spain has the best record in productivity growth and this is mostly due to the loss of jobs. Unemployment has social consequences and other effects which impact the possibility of an integrated Europe. In addition, per the Lisbon Agenda, there has been a glorification of innovation. Countries might, instead of trying to create another Google, look at how to bring the lower quartiles up.

Another question which arose was the question of whether globalized finance presents a lot of risk. Prof. Ghemawat responded that the book addresses four flows of globalization (goods, services, labor, and capital), and that the Capital flow is the most vulnerable to imbalances. There are a few things which the global community might consider implementing:

1. Alarms for when the capital accounts imbalance exceeds 3% of global GDP. This is an indicator that things are heating up. At 4%, historically, this has resulted in a crisis.
2. Circuit-breakers should be practiced in the domestic context (e.g. Black Monday) but there are times when things in the short run drive to an undesirable long run and this is difficult to foresee.
3. Buffers should be instituted – Mr. Market miscalculates. It is not reasonable to run a country on the assumption/basis that markets will be reasonable all the time.

André Sapir closed the presentation by thanking Prof. Ghemawat, and summarizing that the current problem with economics is that it has not paid attention to history. Prof. Ghemawat helped to put things in international perspective (one country versus others) and has also put things in a temporal perspective.