

3

Will Terrorism Defeat Globalization?

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Globalization is the process of creating a common economic space. It leads to a growing integration of hitherto relatively closed economies through increasingly free movements of goods, capital, and labor. It is not a new process. It has usually been associated with the creation and maintenance of empires. The latter have been created in part to provide “order” in the larger economic space, by suppressing various threats to the productive and sedentary ways of life of civilizations from various roving bandits, who today are called terrorists. An elaboration of these points will allow us to answer the question posed in the title of this paper.

One of the features of a closed economy is that goods and services do not enter international trade—they are non-traded. Their prices are set by domestic demand and supply. The efficiency gains which accrue from differences in the domestic and international prices of traded goods in an open economy cannot be obtained. These gains can be decomposed into the consumption gain, which allows consumers to obtain their consumption bundles at lower cost, and the production gain, which arises from the specialization in domestic production on the basis of comparative advantage, allowing countries to use the more productive “technology” provided by international trade to raise their output from given resource endowments.

Goods can be non-traded because natural barriers raise transport costs or because tariffs prohibit trade. In the millennial past when costs of communication and transport were very high, only high-valued non-bulky goods entered into long-distance trade. This trade was always threatened by pirates and bandits of every kind. They imposed a further cost in addition to natural barriers to trade. If the costs of piracy were high enough, trade would cease as happened when the Great Powers’ attempts to control the bandits failed.

Further, given the costs of doing international business, most traded goods were not locally produced. Domestically produced goods rarely faced foreign competition because they were not traded. The major gain from foreign trade was thus the consumption gain. But the spice trade—which involved transfers between East Europe and the tropics—did lead to production gains because meat from East Europe was stored for later shipment during long northern winters. This demanded new storage technology which was produced locally. Luxuries and the instruments of war were the major items involved in this long-distance trade. But the realization of these gains required a modicum of order enforced by military power.

With the Industrial Revolution, and the creation of a British-led international economic order policed by the Royal Navy, there was an expansion in the goods traded around the world. This period of globalization saw the growing integration of nearly the whole world into an international economy. The predators were kept at bay by the exercise of direct and indirect control over a vast economic space by British naval and military power. Nevertheless, there were still terrorists, mainly fueled by nationalism as well as the romantic revolt against capitalism, who did disturb domestic order in the metropole and its dependencies.¹ This terrorism did not, however, raise the costs sufficiently to undermine the processes of globalization. As long as the imperial peace was maintained, it was at worst a local irritant.

During this 19th century liberal international economic order there were substantial consumption and production gains from the free mobility of goods, capital, and labor. It was only during the first half of the 20th century, with the decline of the British Empire and the ravages of the interwar years, particularly the Great Depression, that domestic economic policy led to growing barriers to foreign trade in many countries, converting many previously traded into non-traded goods. These inward-looking policies had predecessors, most notably China in the Middle Ages and Japan under the Tokugawa Shogunate. Such regimes had completely banned foreign trade as they looked upon the accompanying foreign influences as sources of domestic disorder.

Order is required to maintain three elementary and universal goals that any society must pursue if any social life is to exist. These are, first, to secure life against violence which leads to death or bodily harm; second, that promises once made are kept; third, the stabilization of possessions through rules of property. These are the minimal functions that any state in its domestic domain needs to perform. But, for international trade and commerce, there is also the need to protect the trading networks: to maintain international order. In an anarchical society of equally matched states, there is always the danger that interneccine warfare will disrupt these trading channels. Given the high value of the objects traded in the past, taxing long-distance trade has always provided an important source of revenue for states. It has been in their interests to protect these channels.

But, as Jack Hirshleifer pointed out, in economics there is also the “dark side of the force.”² For one can make a living by either making or taking. Disrupting or stealing a rival’s long-distance trade can therefore form part of a country’s strategy, of which war is the most extreme alternative. So state-sponsored terrorism, as we now call it, to both directly “take” as well as damage the “making” of a rival’s income has also been a constant feature of human history.³

If an asymmetric advantage in military technology permits one state in an anarchical society of states to achieve hegemony, the resulting imperial state has usually been best able to provide the order over a larger geographical space, which is a necessary condition for the benign economic processes of “globalization” to operate. For these empires reduce the threats to these processes from roving bandits—either private or state-sponsored. In fact most of the ancient empires arose because of the threat posed by roving bandits to their sedentary ways of life. In long-term historical perspective, terrorists are best looked upon as roving bandits. They have threatened the sedentary civilizations of Eurasia for millennia. This is because these civilizations which arose in the ancient river valleys of the Tigris and Euphrates in Mesopotamia, the Nile in Egypt, the Indus in India, and the Yellow River in China, were sandwiched between two areas of nomadic pastoralism: the steppes to the north, and the Arabian desert to the south. The nomadic pastoralists in these areas had not given up the hunter-gatherer instincts of their forefathers. They periodically mounted raids on the sedentary civilizations and sought to turn their inhabitants into chattel like their cattle.⁴ All the sedentary civilizations had a common response to this terrorism. They sought to extend their frontiers to some natural barriers which would keep the barbarians at bay—thus creating their empires—and maintained specialists in warfare to protect them from the periodic barbarian invasions. They created manmade barriers and fortifications to protect their heartlands, of which China’s Great Wall is the most notable example. They also invested in the latest military hardware to keep up with the nomadic Joneses.

Quite often the barbarian roving bandits turned themselves into stationary bandits by taking over the sedentary civilizations they had attacked and creating their own empire. The earliest example is the conquest by Sargon of Akkad in Mesopotamia in c 2340 BC, who then created the first Sumerian empire. The one which reverberates to our day is the early Arab empire. These nomads from the southern fringes of antiquity fired by the messianic zeal of their prophet Mohammed, as well as their age-old desire for booty, smashed the world of antiquity. Unlike their nomadic cousins from the north—who were absorbed by the ancient civilizations—they created a civilization of their own. Osama bin Laden’s daring raid on the heartland of the current metropole on September 11, 2001 is resonant of these earlier nomadic raiders who created a new empire.

The motives for creating these imperial states, apart from this defensive one, have also included the desire for glory (Alexander the Great, Genghis Khan), booty (the Mesopotanian empires, the early Arab empire, the Iberian empires), and the messianic desire to convert heathens (the early Arab empire, the Iberian empires). But, once established, all these empires have by providing an Imperial Pax reduced if not altogether eliminated roving bandits, thereby facilitating the processes of globalization. Thus, the long period of the Pax Romana allowed commerce to develop under the most favorable conditions. It eliminated the piracy and brigandage which had continued to threaten commerce in the Hellenistic era, and the Mediterranean became the major artery for trade and commerce. Though the Romans did not place a high value on commerce in their cosmological beliefs,⁵ nevertheless their Pax, and the associated development of Roman law which spread with the expansion of the empire, created a large economic space with a coherent legal framework for economic activity.

Similarly, the Abbasid Empire of the Arabs linked the world of the Mediterranean and the Indian Ocean, the Mongol empire linked China with the Near East, the various Indian empires created a common economic space in the subcontinent, while the expanding Chinese empire linked the economic spaces of the Yellow River with those of the Yangtze. Finally, after their victory at Waterloo, the British created the first truly global empire, linking the whole world. In all these cases they provided protection against brigands and other predators. Together with the institution of an empire-wide legal system, the British promoted trade and commerce over a wide economic space, leading to those gains from trade and specialization emphasized by Adam Smith and generating what I call Smithian intensive growth.⁶ Thus, from the historical record, it would seem that suppressing international piracy and brigandage (terrorism) has been important for globalization to occur throughout the ages. Second, the international order required for globalization has usually been provided or at least assisted by a strong hegemonic power.

Since the Second World War, the United States has forged a degree of stability in world politics which has led to the current period of globalization. This has come about both with the demise of the “evil empire” of the Second World which challenged the global capitalism that is the hallmark of the new international economic order, and with the gradual acceptance by the Third World that its postwar “inward looking” policies were dysfunctional and needed to be reversed. Since the 1980s it too has joined the global bandwagon, with two major exceptions: Africa and much of the Middle East have remained aloof.

In this current period of globalization, with the revolution in communications, there have been further falls in “transport costs.” So that hitherto non-traded goods like various back-office services are now being traded. The call centers in India are part of the trend in outsourcing these services. At the

same time the growing trade in components has led to the fragmentation of the production of goods: with parts being produced in the lowest-cost “country” and being shipped for assembly for final consumption all around the world. This is leading to a finer and finer global division of labor.

But this global division of labor depends even more than in the past upon an intricate web of global communication networks, which are susceptible to damage by pirates and brigands as of yore. But do these terrorists pose more of a threat than did those when Pax Britannica held sway in the 19th century? One way of answering this is to see what the gains were from suppressing piracy and brigandage (terrorism) in the past, and then to see how current terrorist threats might affect the international order required for globalization to proceed.

We do not have any quantitative estimates of what the gains from the Imperial Pax in suppressing piracy and brigandage (terrorism) were for pre-modern times. But we do have some estimates made by Douglass North of the gains from suppressing piracy once the British navy came to rule the waves in the late 18th and 19th centuries. North estimates that from the mid-17th to the end of the 18th century there was a large increase in the productivity of shipping due to the suppression of piracy. Without any change in technology, freight rates on the technological revolution associated with steamships, productivity in shipping increased by 3.5 percent per year. The decline in piracy with the extension of the British international order also reduced insurance costs by about two-thirds between 1635 and 1770.⁷ Who are the current international pirates and brigands, and do they have the means to erode the current hegemonic system and thereby the processes of globalization? Four major sources for these undesirables can be distinguished. The most important is provided by militant Islam. Its objectives are messianic and cannot be met with any compromise. If someone wishes to use the sword to establish their divine Kingdom on Earth, those reluctant to convert have only one option—to contain or kill the relevant purveyors of terror.

The second are sundry nationalists who in the name of a separate ethnicity or of religion wish to use terror to gain political ends—normally secession from an existing state and the creation of one of their own. They pose a difficult problem for the current imperial power. For since one of its high priests—Woodrow Wilson—pronounced the end of the Age of Empires and the dawn of that of Nations, its rhetoric has emphasized the principle of self-determination as the highest moral principle.⁸ When does a freedom fighter become a brigand and a terrorist? This is a question which the proconsuls of the current hegemonic arrangement have great difficulty in answering. But the damage these terrorists do is more to their own people and those from whom they want to separate. The domestic disorder they breed rarely spills into international disorder which would damage the processes of globalization.

But, as the failing state of Afghanistan shows, they can provide succor and shelter to terrorists of various other hues.

The third are closer to past pirates and brigands. These are the international Mafias linked to trade in illegal substances and humans. They are the result of particular policies adopted by states. The War on Drugs, for example, increases the price of banned substances and heightens the criminal return. Current policies also curtail the 19th century's liberal international economic order's free movement of people through immigration controls. The latter are in turn due to the creation of welfare states in developed countries which, through restrictions, makes citizenship itself an issue of great material and political importance. Changes in these drug and immigration policies would suck the lifeblood out of the brigands who feed on them. They do not however pose a direct threat to globalization. For as they live by trade and commerce—albeit illegal—their interests do not lie in fouling the networks through which they operate.⁹ Their threat is indirect. They can, however, promote domestic disorder leading to failed states, and by providing illegal and thereby secret sources of funds for the "nationalist" and "messianic" terrorists, help them in furthering their brigandage. The profits from drug smuggling by the Taliban in Afghanistan helped to support the state as well as to finance terrorism, for example.

Finally, there are the IT terrorists: the computer nerds whose motive is generally one of creating mischief for fun, but also increasingly theft—of money and identities—for personal gain. There is nothing new about theft, except in the mounting costs of the arms race between the law and thieves. IT technology provides a new avenue for cheating, which in turn requires further resources to counteract the thieving. This has further raised the dead-weight costs associated with policing.

So the major threat, if any, to globalization remains that of the messianic terrorists. These at present are mainly Islamists. How serious is the damage they can do? Considering their most spectacular terrorist act to date, the destruction of the World Trade Center, what were the effects on the U.S. and global economy? It is difficult to separate out the effects of the global recession which coincided with the collapse of the Twin Towers in New York. But one crude indicator is that after 9/11 the consensus forecast for U.S. real GDP growth was instantly downgraded by 0.5 percentage points for 2001 and 1.2 percentage points for 2002. The implied projected cumulative loss in national income through the end of 2003 amounted to 5 percentage points of annual GDP, or half a trillion dollars. The total loss for the three years was estimated at \$630 billion. But, as Alice Rivlin has pointed out, these estimates certainly overstate the effects, largely because with the puncturing of the dot-com bubble and the sharp decline on Wall Street, New York was already going into a recession. Nevertheless, even if we take the expected loss for U.S. GDP based on the changed forecasts after 9/11 as having been realized,

this would still be only about 5 percent of U.S. and a much smaller fraction of world GDP.

The specific damage from 9/11 has been estimated by Peter Navarro of the University of California, Irvine, as between \$10 and 13 billion for property damage (the costs of the lost buildings, aircraft, public works and infrastructure, and corporate property like office equipment and software); the economic value of the lost lives in the range of \$40 billion; the lost economic output in the immediate aftermath in the range of \$47 billion (from lost air-line and cargo shipping revenues, lost hotel industry revenues, lost advertising revenues in the first days during commercial-free TV and radio, two-day work stoppage, lost consumer spending and retail sales). This gives a total of \$100 billion which is less than 0.8 percent of U.S. GDP. Thus the economic damage from 9/11 to the U.S. and the world economy was fairly small.¹⁰

Nor did New York's economy—the worst-hit by the immediate aftermath of the collapse of the Twin Towers—suffer a long decline as many had feared. Research by a team at the Russell Sage Foundation found that, comparing New York's performance before and after September 11 with its performance in past recessions, with the performance of the rest of the country before and after September 11, and with the experience of other large cities, it was not knocked off track in any fundamental way by 9/11.¹¹ Moreover, and most importantly, the communications networks on which globalization depends did not collapse. Trading recommenced very speedily. The damage was to the U.S. psyche.

What of future threats from biological and chemical weapons or a dirty bomb? Of these, for various reasons, the danger of a dirty bomb is the most pertinent. Biological and chemical weapons are not easy for private agents to use. They are more likely to be used by states and state-supported terrorists. But a dirty bomb is relatively easy to produce. It is difficult to estimate the damage, but most likely it would be to the real estate in the large area which was made radioactive. (See Graham Allison in chapter 6.) I guess its effects would be similar to that of a massive earthquake in California. Being localized, its damage would again be more to the psyche than to the world economy.

A worse nightmare for globalization would be if there were a series of explosions in the main shipping ports around the world in containers holding dirty bombs. It is difficult to estimate the damage this would do to shipping and commerce, but some estimate can be made from the costs of the insured losses from other recent disasters. Navarro provides estimates of these insured losses (adjusted for inflation). They are \$5 billion for the 1989 Hurricane Hugo, \$844 million from the 1992 Los Angeles riots, \$16.9 billion from the 1992 Hurricane Andrew, \$542 million from the 1993 World Trade Center bombing, \$13 billion from the 1994 Northridge, California earthquake, and \$127 million from the 1995 Oklahoma City bombing. Again, though tragic, these were not catastrophic losses.

The most serious costs associated with continuing terrorism are the general increase in the uncertainty associated with doing business that it might cause. But equally serious costs arise from preventive measures taken in a society seeking to be risk free from overreacting to the terrorist threat. (See John Mueller in chapter 4.) Besides the direct costs of homeland security there are for instance the costs imposed on travelers in terms of the opportunity costs of the time lost in long security searches at airports. Navarro estimates these costs at between \$16 and 32 billion annually. But while all these costs will reduce the gains from the ongoing developments in and spread of communication technology in the globalization process, they are unlikely to hinder the globalization process.

The most serious threat to globalization arises from the Islamist terrorists, not because of the direct physical damage they can cause—as this is likely to be fairly localized—but because of their desire to sap the will of the metropole in maintaining its imperial sway. This could in theory succeed. To prevent this, it is important to realize that, despite protestations to the contrary, America presides over an informal empire. Since it overtook the British Empire in economic and military strength towards the first quarter of the last century, it has been the natural successor to the British in maintaining a global order. It can be argued that many of the bloody events of the last century were due to its failure to take over these responsibilities which Britain was too weak to carry out. Realizing this error, the post–World War II foreign policy elite has surreptitiously built an informal agglomeration of power.¹² But many including President George W. Bush remain frightened of the “E” word. It goes against the American self-image.

It is claimed that the U.S. is a hegemon but not an imperial power. Hegemons seek control over only the foreign policies of their dependencies. Empires seek control over both their domestic and foreign policies.¹³ But in the current “war on terror” it is the domestic policies of states—providing money and succor to Wahhabi madrassas which breed terrorists, channelling money through Islamist charities to finance terrorist operations, building nuclear power plants which can be used to produce nuclear weapons as in Iran—that need to be controlled. Instead of the distinction between hegemony and empire, a much more meaningful distinction is between formal and informal empire. Of these an informal empire is always to be preferred as it is less costly in maintaining an imperial order. The British knew this. A predatory choice—despite nationalist historiography denigrating British imperialism for being exploitative—was never the option. Direct imperialism was only reluctantly taken to control what would today be called “failed states.” The informal route was always the preferred route. For instance, in areas of indirect British control, the Imperial Pax was maintained through gunboats and Gurkhas.

The same choice faces the U.S. in maintaining its imperial order. But in making it and still retaining domestic political legitimacy, it is essential to be clearheaded in recognizing that the American order involves imperial responsibilities. Perhaps the greatest inadvertent service Osama bin Laden’s 9/11 raid has done is to make it easier for the foreign policy establishment to come clean about America’s international role and responsibilities. The recent Bush doctrine with its acceptance of preemptive strikes is a departure along these lines, as is the war in Iraq. In maintaining the Pax which is essential for the processes of globalization, the U.S. will have to continue to bear the burden with probably changing “coalitions of the willing.” The Wilsonian dream of securing the peace through collective security enforced by the United Nations was always a dream, and the Iraq war should have made this obvious. The UN only wishes to tie Gulliver down with a million strings. Relying on this ineffectual and increasingly redundant institution will only promote international disorder.

It is nonetheless true that maintaining an informal U.S. hegemony is costly in terms of men and materiel. It also requires (as the British discovered and the U.S. is currently learning in Iraq) the equivalent of a colonial service with the requisite political and administrative skills to run an empire. But today, the United States’ role is the necessary though perhaps not the sufficient condition for globalization to operate. It is the hope of the messianic terrorists that the American people will not have the necessary will to bear the burden of empire. It is their attempt to sap American will through their acts of terror which constitutes the greatest threat to globalization from terrorism. But an overreaction to the terrorist threat will also indirectly play into their hands. As the British discovered as an imperial power, the American homeland will continue to be subject to terrorism. The IRA has not yet given up its quest for reunion with Ireland, and has in the past bombed Britain to demonstrate this. But the British populace has learned to live with this threat for nearly a century without overreacting by restricting civil liberties—including the freedom to travel without restraint—and without giving in to terrorism. The citizens of the new U.S. informal empire will have to learn to do the same.

NOTES

1. See George Dangerfield, *The Strange Death of Liberal England* (Stanford, CA: Stanford University Press, 1935).

2. Jack Hursleifer, *The Dark Side of the Force: Economic Foundations of Conflict Theory* (Cambridge: Cambridge University Press, 2001).

3. The Royal Navy which created and maintained the British Empire was itself the result of the state-sponsored pirates who had previously raided the Spanish Main. See A. Herman, *To Rule the Waves* (New York: Harper Collins, 2004).

4. See William H. McNeill, *The Human Condition* (Princeton, NJ: Princeton University Press, 1980).

5. The distinction between the material and cosmological beliefs of a culture is outlined and discussed in D. Lal, *Unintended Consequences* (Cambridge, MA: MIT Press, 1998). The former are concerned with ways of making a living, the latter with, in Plato's words, "how one should live."

6. This implied a rise in per capita income based on the Smithian gains from trade. But it was bounded because the ancient agrarian economies depended upon a fixed factor of production—land. The Industrial Revolution converted these agrarian economies into mineral energy economies which were no longer bounded by land but could use the near unlimited stock of fossil fuels for energy. This unleashed modern economic growth which allows a sustainable and continuous rise in per capita income. These two forms of *intensive* (with rising per capita incomes) are to be distinguished from *extensive* growth (where output grows pari passu with population, leaving per capita income unchanged), which has been ubiquitous through human history. See D. Lal, *Unintended Consequences*.

7. Douglass North, "Sources of Productivity Change in Ocean Shipping, 1600–1850," *Journal of Political Economy*, no. 5 (1968).

8. The fatuity of this principle was noted by Dean Acheson in a speech at Amherst College on Dec. 9, 1964. He said this high-sounding moral principle of self-determination "has a doubtful moral history. He [Woodrow Wilson] used it against our enemies in the First World War to dismember the Austro-Hungarian and Ottoman Empires, with results which hardly inspire enthusiasm today. After the Second World War the doctrine was invoked against our friends in the dissolution of their colonial connections. . . . On the one occasion when the right of self-determination—then called secession—was invoked against our own government by the Confederate States of America, it was rejected with a good deal of bloodshed and moral fervor. Perhaps you will agree it was rightly rejected" (Acheson, "Ethics in International Relations Today," in D. L. Larson, ed., *The Puritan Ethic in U.S. Foreign Policy* [Princeton, NJ: Van Nostrand, 1966], 134–35).

9. The illegal drug trade was estimated to be about \$400 billion in 1997, compared with a value of legal world exports of \$5 trillion that is about 8 percent of the value of legal world trade. The profits from the trade are enormous. Thus, a kilogram of cocaine base sells for between \$650 and \$1000 in Bolivia or Peru. It can be processed into cocaine hydrochloride for export for between \$900 and \$1200, which sells for between \$13,000 and \$40,000 wholesale in the U.S. before reaching consumers at a retail price of between \$17,000 and \$172,000. Heroin from Burma begins its progress at \$70 per kg to the Burmese producer, to \$3000 after processing in Thailand, whence it is exported from Bangkok at \$6000–\$10,000. It sells wholesale in the U.S. for between \$90,000 and \$200,000, and at retail for nearly \$1 million (A. Krueger and C. Aturupane, "International Trade in 'Bads,'" in H. Giersch, ed., *Merits and Limits of Markets* (Berlin: Springer, 1998)). The direct budgetary costs of enforcing the prohibition of drugs in the U.S. have been estimated to be over \$20 billion per annum. Yet the war shows no sign of succeeding. There is a strong case for legalization, while Krueger and Aturupane rightly contend that following the theory of trade and welfare, the correct policy is not to prevent production by the most efficient worldwide producer, but only to seek to tax or prohibit domestic consumption.

10. P. Navarro and A. Spencer, "September 11, 2001: Assessing the Costs of Terrorism," *The Milken Institute Review*.

11. See A. Krueger, "New York's Economic Resilience," *New York Times* (September 16, 2004).

12. See Deepak Lal, *In Praise of Empires* (New York: Palgrave, 2004).

13. See M. Doyle, *Empires* (Ithaca, NY: Cornell University Press, 1986).