It is difficult to read an academic or popular analysis of the U.S. economy without encountering the “fact” that it has been globalized, with the clear implication that this country no longer has an independent national economy but instead is merely part of a single world entity. Debates occur as to whether this melding of the U.S. economy into a global economy is desirable or undesirable, but whether it has actually happened is seldom raised. In reality, the evidence of a globalized economy is quite weak, indicating instead that the U.S. economy retains a large part of its historic national independence.

This issue has become increasingly important because fear of the effects of globalization on the United States have become widespread. The World Trade Organization (WTO) meetings in Seattle were disrupted by groups opposing a globalized U.S. economy, Pat Buchanan and Ralph Nader ran for president largely on the basis of such fears, and congressional debates frequently revolve around this issue. Perhaps most important, opposition to the increasingly globalized U.S. economy was a major factor in the defeat of President William Clinton’s request for fast-track authority to negotiate the expansion of the North American Free Trade Agreement (NAFTA) and to pursue other trade agreements. This is the first time that a president has been refused such authority, and this defeat represents Congress’s movement away from its past willingness to liberalize international trade. As long as fears of the effects of globalization on our economy play a major role in debates over trade and other international economic issues, there is little prospect for the expansion of NAFTA or for U.S. participation in another multilateral WTO negotiating round. These fears presume, however, that

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the U.S. economy actually has been globalized. Four economic indicators are used here to show that these fears are largely groundless. As this becomes more widely understood, the international economic policy of the United States may return to its previous, and more productive, pattern.

The Criteria for Globalization

What statistics might measure the extent to which the U.S. economy is more integrated into the rest of the world than in the past? A number of indicators could be suggested, but this study relies on the following concepts:

1. **The role of international trade in the economy**

   If the U.S. economy has actually been globalized, the share of trade in its gross domestic product (GDP) should be much higher than in the past. This share merely returning to, or moving slightly above, previous levels would not be evidence of global integration; the role of trade in the U.S. economy should be an order of magnitude greater than in the past.

2. **Real interest rates**

   If capital markets are globalized, real interest rates in the major industrialized countries would have been arbitraged together and should now be quite similar. U.S. real yields should now be determined primarily in Europe, Canada, and Japan rather than exclusively in U.S. capital markets.

3. **U.S. macroeconomic policies**

   If the U.S. economy is globalized, both U.S. fiscal and monetary policies should be constrained by policies in the other major industrialized countries. It should no longer be possible for the United States to pursue macroeconomic policies that differ significantly from those in other large countries of the Organization for Economic Cooperation and Development (OECD).

4. **Business cycles**

   A globalized economy should mean a global business cycle, of which the United States is merely a part. The timing of U.S. business cycles should have become similar to the timing of cycles of other industrialized countries in recent decades. The close ties among markets here and abroad, both for goods and for financial assets, should make it impossible for the United States to avoid either the recessions or the macroeconomic expansions that occur in other major OECD countries.
History as a Yardstick

Despite discussion of the enormous growth in the role of trade in the U.S. economy, this share has only recently returned to the levels of the late nineteenth century.

As column 4 of table 1 shows, merchandise trade constituted 16.4 percent of U.S. gross national product (GNP) in 1880 and matched that level only at the end of the 1970s. The striking event of this 120-year period is its collapse in the 1920s and its very slow recovery after World War II, not the recent growth of trade. As recently as 1970, merchandise trade was only 9.1 percent of U.S. GNP, slightly more than half of the share prevailing in 1880.

The United States maintained a relatively open economy in the late nineteenth and early twentieth centuries, moved sharply toward autarky in the 1920–1940 period, and then maintained a small and largely unchanged role for trade in the 1940–1970 period. In the 1970s, trade recovered sharply and then grew slowly as a share of the economy in the next 19 years.

<table>
<thead>
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<td>1,155,200</td>
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<td>1999</td>
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<td>1,748,100</td>
<td>2,250,500</td>
<td>18.9</td>
<td>24.3</td>
</tr>
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</table>

^ GDP for 1999  ^ X+M=exports plus imports

In 1999, the role of merchandise trade in U.S. GDP was only 2.5 percentage points higher than it was in 1880.

International trade in goods and services as a share of GNP followed a similar pattern, but the growth in recent years has been slightly more rapid than for trade in merchandise alone. As column 5 of table 1 shows, this broader measure of trade was more than 19 percent of GNP in both 1880 and 1920, but then fell to only 10.8 percent in 1930 and 8.9 percent in 1940. Recovery was very slow in the 1940–1970 period, but considerably more rapid in the 1970s. By the 1980s, it had recovered to slightly more than the late nineteenth and early twentieth-century levels, and by 1999 it was 4.6 percentage points above the 1880 level. The share of U.S. GNP (GDP in 1999) that is now exported or imported is higher than that in the late nineteenth century, but the increase is far too small to suggest a globalized economy.

The collapse of the Bretton Woods system represented a shift away from globalization.

The lack of major trade growth as a share of U.S. GNP is surprising in light of the sharp decline in tariff rates in the past 130 years. In 1870, the average tariff rate on U.S. imports was 44.9 percent; in recent years it has been less than 2 percent.\(^1\) Despite this reduction in tariffs, the U.S. economy has not become globalized.

Not only has trade failed to globalize the U.S. economy thus far, but it is unlikely to do so in the future if remaining trade barriers are reduced. A recent statistical study by the U.S. International Trade Commission concludes that, if this country were to remove all of its remaining statutory import restraints, total employment losses in import-competing sectors would be only 135,000 jobs. This is less than the number of new jobs created in this country in a typical month in the recent boom. Predicted efficiency gains from the removal of remaining trade barriers are less than one-half of 1 percent of GDP. The likely effects of removing the remaining barriers are modest because there are not many left. The United States is already close to free trade, retaining high tariffs or other major barriers only in textiles, garments, sugar, dairy products, and coastal shipping (the Jones Act).\(^2\) Trade has not globalized the U.S. economy and would not do so even if the few remaining barriers to imports were removed.

Although trade has not globalized the U.S. economy, it may have done so in many other countries. The 24 percent role of trade in U.S. GDP contrasts rather strikingly with the data for nations whose economies are smaller and therefore more open. The trade-to-GDP ratio in the United Kingdom is 54 percent, in Canada it is 81 percent, and in the Netherlands it is 104 per-
cent. Ireland, at 157 percent, is an even more open economy, but Singapore’s 254 percent is probably the record. Among industrialized countries, only Japan, with a trade-to-GDP ratio of 20 percent, is less integrated with the world economy than the United States, due to high Japanese import barriers.

This country really is different. The United States has an enormous economy and a wide range of natural resources, making trade less vital than elsewhere. Distance from European and Asian industrialized countries is sufficient for transportation costs to be a modest but significant barrier to trade. The concept of economic globalization through trade is relevant for small industrialized countries, but not for the United States.

The Myth of the Single Capital Market

Articles in the U.S. financial press would lead one to conclude that there is now a world capital market, or at least a single capital market for the major industrialized countries. According to these reports, flows of funds are large enough to have destroyed national distinctions. There is no longer a U.S. capital market, but instead merely a U.S. segment of a much larger market consisting of all the major industrialized countries.

If there were such a single capital market for the industrialized countries, rates of return across those countries should have converged. Because many of these countries maintain flexible exchange rates and therefore may experience quite different rates of inflation, nominal interest rates may not be driven together through an arbitraging process, but real interest rates should have converged.

Because the real interest rate is the nominal rate minus the expected rate of inflation over the lifetime of an asset, such real yields are difficult to observe for long-term debt instruments. Because there is no way of knowing the rate of inflation that investors expect over the next decade or more, one cannot be certain what real yields are foreseen. For short-term assets, this is less of a problem. One cannot be certain what inflationary expectations are, but, for a period as brief as 90 days, it is not unreasonable to assume that people typically expect approximately the same rate of inflation that has prevailed during the previous three months. This means that the short-term real interest rate can be approximated as the nominal short-term interest rate minus the annual rate of inflation prevailing during the previous 90
days. Early 2000 observations for this estimate of real short-term yields in the G-10 industrialized countries are found in Table 2.

The globalized capital market is not apparent in these numbers. Even among the G-10 countries that are members of the European Monetary Union (EMU), there is a range of real yields of 300 basis points. For all 11 countries, the range of real yields is a high of 4.46 percent in the United Kingdom to a low of -1.15 percent in Japan, or 561 basis points. These data strongly suggest the continued existence of national capital markets with considerable degrees of autonomy.

Although real yields differed significantly in January 2000, evidence of some convergence of U.S. real interest rates toward those of other major industrialized countries during recent decades may exist. This would indicate some globalization of U.S. capital markets. In Figure 1 are data on the absolute value of the difference between the U.S. real interest rate and the average of real yields in four other countries during the 1960–1998 period.1 To
eliminate the impact of the EMU, only one entering country (Germany) is included with Great Britain, Japan, and Canada. If U.S. capital markets have actually been globalizing, the data should show a clear declining trend in recent years as U.S. real yields became very similar to those in the other four countries.

There is no evidence in figure 1 to support the globalization of U.S. short-term capital markets. Real short-term yields converged in the late 1960s but sharply diverged when the Bretton Woods system collapsed in the early 1970s. Convergence in the early 1980s was reversed later in the decade, a pattern that was repeated at the end of the 1980s and in the early 1990s. U.S. capital markets, as represented by real short-term interest rates, have not become more closely linked to those of other major industrialized countries in recent decades.

**Converging Macroeconomic Policies?**

If the United States and the other major industrialized countries now constitute a single economy, their macroeconomic policies should have converged. That would suggest that the rates of growth of the money supplies of these countries had become more similar. Short-term interest rates might be viewed as an alternative monetary policy tool, but it has already been argued that there is no evidence of convergence in real interest rates. Using narrow money (M1) supply growth as another indicator of monetary policy, the same statistical exercise was performed as for short-term real interest rates. A 1970–1998 time series was prepared for the absolute value of the difference between the rate of growth of the U.S. money supply and the av-

![Figure 2: Difference in Money Supply Growth](image)

- **Y-axis**: Difference in percentage growth of U.S. and average of four other industrialized countries

- **Legend**: Difference in percentage growth of U.S. and average of four other industrialized countries

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verage of that of the other four countries. This time series is found in figure 2. Again, if U.S. monetary policy had been globalizing, this time series should show a clear trend toward zero.

Evidence for the convergence of U.S. monetary policy toward that in the other four countries is difficult to discover in these data. Once again, convergence at the beginning of the 1970s was reversed when the Bretton Woods system ceased to operate. Convergence at the beginning of the 1980s was followed by sharp divergences in the late 1980s and the mid-1990s.

Further evidence for the continuing independence of U.S. monetary policy is provided by the manner in which the Taylor rule was estimated. This rule, developed by John Taylor of Stanford University, is the most widely used monetary policy rule explaining the policies of the Federal Reserve System, as represented by the federal funds rate. The rule, which was estimated from U.S. data, includes only two explanatory variables: the U.S. rate of inflation and the domestic unemployment rate relative to a full employment norm. The Taylor rule does an impressive job of explaining data for the U.S. federal funds rate in recent decades, without any foreign or international variables. Federal Reserve System targets for the federal funds rate can be explained solely by U.S. rates of inflation and unemployment. The Open Market Committee of the Federal Reserve System does not appear to be constrained in any significant way by pressures of globalization.

The role of trade has only recently returned to the levels of the late nineteenth century.

Figure 3: Difference in Budget Deficits as a Share of GDP
If U.S. fiscal policy had been globalized, budget deficits as a share of GDP should also have become increasingly similar to those in other industrialized countries. The same time series was prepared for the absolute value of the difference between the U.S. budget deficit as a share of GNP and the average of the same number for the four industrialized countries that appeared in previous exercises. These data are in figure 3.

This graph leads to the conclusion that U.S. fiscal policy has actually become more dissimilar to that prevailing abroad in recent decades, with similarities existing in the 1960s, but not after the early 1970s. The breakdown of the Bretton Woods system appears to have triggered greater national independence in budgetary policies. U.S. macroeconomic policies have not been globalized.

**Business Cycles: Timing Is Everything**

If a globalized economy, of which the United States is part, really exists, the major industrialized countries should share the timing of business cycles. National patterns of expansion and recession should have been replaced by a single pattern, largely shared across these economies. The data in table 3 indicate that this was not the case in 1999.

The range of growth rates was 5.0 percentage points, from a high of 5.0 percent in the United States to a low of zero in Japan. The fact that the 10 non-U.S. countries had an average growth rate of only 3 percent did not preclude the United States from enjoying 5 percent growth in its eighth consecutive year of expansion. Serious constraints do not seem to be placed on U.S. economic growth by a global business cycle.

It might be argued that, although 1999 saw large differences in growth rates among the industrialized countries, there has still been a trend toward convergence in the business cycles of the major industrialized countries.

<table>
<thead>
<tr>
<th>Table 3: G-10 Countries’ Real GDP Growth Rates in 1999^</th>
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</table>
| Belgium .................................. 4.6% | Italy ................................. 2.1%  
| Switzerland ......................... 2.5% | Canada ............................ 4.7%  
| Japan ................................. 0.0% | United Kingdom .................. 3.0%  
| France .................................. 3.1% | Netherlands ......................... 4.2%  
| United States .......................... 5.0% | Germany ............................ 2.3%  
| Sweden .................................. 3.8% |  

^ Note: 11 countries are referred to as the G-10.  
Source: OECD, Main Economic Indicators, May 2000, p. vi.
Evidence on that issue can be found in figure 4, which presents the absolute value of the difference between U.S. GDP growth and the average growth rate in the four countries used in the discussions above.

Once again, there is very little evidence for convergence. Similar rates of growth after the end of the Bretton Woods era were followed by sharp divergence in the early 1980s. Convergence in the mid-1980s was followed by very different growth rates in the early 1990s. Similarity followed in the mid-1990s, but divergence returned late in the decade. The United States retains its own macroeconomy, and business cycles in this country frequently differ sharply in timing and amplitude from those of other major industrialized countries.

Many other industrialized countries have far less independent macroeconomies than does the United States. The absence of independent macroeconomies is particularly true of members of the EMU, who have not only given up any national control of monetary policy but have also had their control of fiscal policy severely compromised by Maastricht rules. These countries should not run budget deficits in excess of 3 percent of GDP and may be fined for doing so. All members of the European Union (EU), including the four that are not members of the EMU, have to abide by rules that greatly constrain economic independence. Many European economies therefore have not been globalized, but have been EU/EMU-ized.

Even a country such as Canada, which is not a member of the EU or EMU, has considerably less macroeconomic freedom than does the United States. A depreciation in the Canadian dollar will cause the acceleration of inflation in our northern neighbor, meaning that the Bank of Canada may feel compelled to follow U.S. monetary policy to maintain stability in the
Canadian exchange rate and price level. By contrast, in the United States, trade is a sufficiently small share of GDP that the linkage from the exchange rate to the price level is quite weak, meaning that the Federal Reserve System is not constrained to follow policies being pursued abroad to stabilize the exchange rate.

The previous arguments are not meant to imply that the United States has become isolated from the rest of the world. Our culture, society, and economy are affected more by the rest of the world than they were previously. The sharp decline in the cost of international telephone calls and other communications means that Americans have more regular contact with citizens of foreign countries than they did a few years ago. International travel by Americans and foreign visits to this country have grown significantly, due to higher incomes and a decline in air fares relative to other prices. Flows of investment funds in and out of this country have grown enormously, and trade is a slightly larger part of the economy than it was a century ago. These factors indicate that the society, culture, and economy of the United States have become more connected to the rest of the world, but our national economic independence has remained largely intact.

**More than Enough Hysteria**

Evidence of a fully globalized U.S. economy is sparse. The role of foreign trade has only recently recovered to levels present in the latter part of the nineteenth century, and, even at the end of the 1990s, it was only modestly above those levels. U.S. interest rates, both nominal and real, are frequently different from those in other major industrialized economies, and both fiscal and monetary policies remain independent. The timing of our business cycles is often entirely different from those abroad, and there is no evidence that these cycles have converged in recent decades.

Some of the macroeconomic indicators discussed above were similar in the industrialized countries in the late 1960s, but diverged sharply in the early 1970s. The collapse of the Bretton Woods system at the beginning of the 1970s, and the subsequent maintenance of a system of floating exchange rates by the United States and many other industrialized countries, represented a shift away from globalization. A regime of flexible rates makes it possible for macroeconomic policies to differ more than was possible with the fixed parities of the Bretton Woods system and loosened the linkages.

If the Bretton Woods system were still in operation, or if the United States returned to a fixed parity, the potential for a globalized economy would probably have more meaning for this country. As long as the United States retains a flexible exchange rate, which it now appears virtually certain to do, this economy will largely retain its independence.

Because the U.S. economy is not globalized, economic policy should not be based on fears of its effects. The fiasco in Seattle, the defeat of fast-track authority, and the unfortunate tenor of recent public discussion of international economic policy all result from fear of something that does not exist. Gertrude Stein’s description of an unfortunate city in California applies equally to the globalization of the U.S. economy: “There’s no there, there.”

As Americans come to understand that the globalization fears of the past few years were irrational, it should again be possible for this country to pursue traditional international economic policies. It can at least be hoped that the new administration will be granted fast-track authority to expand NAFTA and move toward another WTO round. The “globalized U.S. economy” is largely a myth.

Notes

3. Figure 1 contains average annual data, so the entries are annual average short-term interest rates minus the average rate of inflation during that year. All the data in this and the later time series and graph come from the International Financial Statistics of the International Monetary Fund.