MODULE #4
The nature and impacts of globalization
Distinctive features of the current process of globalization

• It is widely accepted that the key features of globalization are liberalization of international trade, the

• It is also widely accepted that this came about through the combined effect of two underlying factors:

• These developments created the enabling conditions for the onset of globalization. The effects of new technology have given a distinctive character to the current process of globalization. The natural barriers of time and space have been vastly reduced.

• The cost of moving information, people, goods and capital across the globe has fallen dramatically, while global communication

• Another distinctive feature of the current process of globalization relates to what is conspicuously absent. Unlike earlier episodes of globalization that were characterized by massive cross-border movements of people, the current process largely excludes this. While goods, firms and money are largely free to criss-cross borders, people are not.
World trade has expanded rapidly over the past two decades. Since 1986, it has consistently grown significantly faster than world gross domestic product (GDP) (figure 1).

Throughout the 1970s, trade liberalization within the framework of the General Agreement on Tariffs and Trade (GATT) was modest and gradual. It involved industrialized countries much more than it did the developing ones. From the early 1980s onwards, the extent of trade liberalization, especially in the developing countries, began to accelerate (figure 2).

This trade expansion did not occur uniformly across all countries. The industrialized countries and a group of 12 developing countries accounted for the lion’s share. In contrast, the majority of developing countries did not experience significant trade expansion (figure 3).

Many the Least-Developed Countries (LDCs), a group that includes most of the countries in sub-Saharan Africa, experienced a proportional decline in their share of world markets – despite the fact that many of these countries had implemented trade liberalization measures.
During the early 1980s, FDI accelerated, both absolutely and as a percentage of GDP (figures 1 and 4). Since 1980, the policy environment worldwide has been far more conducive to the growth of FDI. Over the 1990s, the number of countries adopting significant liberalization measures towards FDI increased steadily (figure 5). Despite the rapid growth of FDI flows to developing countries, investment remains highly concentrated in about ten of these countries (figure 6).

The nature of investments has changed. The information and communications technology (ICT) revolution and declining transport costs made the growth of far-flung, multi-country based production of goods and services both technically and economically feasible. Coordination and control of these dispersed production systems is easier. Production processes could be unbundled and located across the globe to exploit economic advantages arising from differences in costs, factor availabilities and the congeniality of the investment climate. Components and parts can easily be trans-shipped across the world and assembled at will.
Rapid integration of financial markets is the most dramatic element of globalization over the past two decades. The Bretton Woods system, created after the Second World War, rested on closed capital accounts and fixed exchange rates. In contrast to trade and FDI where gradual liberalization had begun, financial globalization was not on the policy agenda at the time. The world lived with a system of separate national financial markets.

This began to change in 1973 but there was no rush to capital account liberalization. Since the late 1980s there has been a global trend towards financial liberalization. This ranged from relatively simple steps such as unification of exchange rates and removal of controls over the allocation of credit to full-blown liberalization of the financial sector, including the opening of capital accounts. The world monetary system underwent three revolutions all at once: deregulation, internationalization, and innovation.

The increase in capital flows was greatly boosted by the revolution in ICT. This made possible the improved and speedier knowledge of foreign markets, the development of “round the world and round the clock” financial transactions, and the emergence of new financial instruments, especially derivatives.

Explosive growth in private financial flows from North to South was concentrated in emerging markets with a greater range of institutions of financial intermediation. These flows consisted of elements such as investments in the equity markets by investment funds, bank lending to the corporate sector, short-term speculative flows and lending through the international bond markets (figure 7).
• The technological revolution underlying globalization turned knowledge into an important factor of production. The knowledge-intensive and high-tech industries are the fastest growing sectors in the global economy.

• Successful economic development will eventually require that countries become able to enter and compete in these sectors. This implies that they will have to emphasize investments in education, training and the diffusion of knowledge.

• There are serious North-South imbalances in access to knowledge and technology. Almost all the new technology originates in the North, where most research and development occurs. This is an important source of the dominance of MNEs in the global markets, and of their bargaining strength vis-à-vis developing country governments.

• The world has become more interconnected (figures 8 and 9) with the spread of the Internet, e-mail, low cost international phone services, mobile phones and electronic conferencing.

• One result is that a vast and rapidly growing stock of information, ranging from science to trivia, can be accessed from any location in the world connected to the Internet. It can be transmitted and discussed just as easily. At the same time, satellite television and the electronic press have created a global fourth estate.
• Changes in trade, FDI, financial flows and technological diffusion are becoming part of a new systemic whole, evolving from increasing economic openness and the growing influence of global market forces. This is a profound change, affecting the role of the State and behaviour of economic agents.

• Trade and FDI are closely intertwined as the global production system shapes patterns of trade, especially through the rapid growth of intra-firm trade in components. The MNEs are now estimated to account for two-thirds of world trade while intra-firm trade between MNEs and affiliates accounts for about one-third of world exports.

• Trade in components and intermediate goods has increased. The qualitative changes in the structure of world trade – specifically trade in components and intermediate inputs – may be as significant as the quantitative increase in trade.

• Portfolio investments and other financial flows are increasingly important determinants of the macroeconomic environment that shapes patterns of trade and investment in the real economy.

• The diffusion of new technology has had a profound effect on comparative advantage, the competitiveness of enterprises, the demand for labour, work organization and the nature of the employment contract.
A shift has occurred in economic thinking since the 1980s, when industrialized countries were in stagflation while several developing countries were in a debt crisis. This prompted a rethink on prevailing economic models in both industrialized and developing countries.

One element of the revised thinking in developing countries related to import-substitution policies which were running out of steam, whereas the export-oriented industrialization policies of the newly industrializing economies (NIEs) of East Asia were successful.

Bretton Woods institutions played a pivotal role after the debt crisis of the early 1980s in redefining industrialization strategies by encouraging liberalization of trade and FDI. Some trade unions, CSOs, policy analysts and third world governments argued that the IFIs imposed excessive conditionality on developing countries, which put them in an inappropriate policy straitjacket and inflicted heavy social costs.

The rise of pro-market economic doctrines over the last 20 years played a key role in laying the foundations for globalization. The collapse of communism in Europe in 1989-90 was a turning point. At a stroke, it added to the global free market economy an additional 30 former communist countries with a combined population of 400 million people.

To some analysts, the end of the bipolar world also meant the disappearance of any systemic alternative to the market economy. As a result, free-market globalization took off in 1990. Coincidentally, this was also the period when the explosive growth of the Internet occurred, giving a fortuitous technological boost to this process.
• A new round of multilateral trade negotiations launched in 1986 transformed GATT into the WTO in 1995. The agenda of trade negotiations expanded well beyond reducing tariffs and other direct barriers to trade. Subjects such as services, intellectual property rights (IPRs), investment measures and competition policy (the “behind-the-border” issues) were added.

• These issues were seen as impediments to the free flow of goods and services across borders. So it was essential to harmonize national policies to deepen liberalization of world trade. This logic may also apply to other aspects of national policy and regulation, especially when the objective of free trade is extended to encompass fair and sustainable trade.

• Tensions linger over the desirability of extending “behind-the-border” issues since many developing countries see Uruguay Round outcomes as being unbalanced. They feel the deal was unfavourable because of limited market access concessions given by developed countries in exchange for the high costs of binding themselves to new multilateral trade rules.
The emergence of global production systems that drove FDI created new opportunities for developing countries. Some 65,000 MNEs, with around 850,000 foreign affiliates, are the key actors behind these production systems. They coordinate global supply chains which link firms across countries, including local sub-contractors who work outside the formal factory system and outsource to home workers.

The growth of global production systems is most pronounced in the high-tech industries (electronics, semi-conductors, etc.) and in labour intensive consumer goods (textiles, garments and footwear). They are also significant in the service sector where technological advances allow software development, financial services and call centres to be operated from countries around the globe.

High-tech industries have scored the fastest growth and now constitute the largest single share of manufactured exports of developing countries. Production of parts and components is done by subsidiaries of MNEs located in developing countries. Most of the research and development (R&D) and other technologically sophisticated functions are carried out in the industrialized countries.

In labour-intensive consumer industries, MNEs design the product, specify product quality and outsource production to firms in developing countries. They control the quality and timing of production, including frequent changes in design and volume. The driving force is the flexible and timely adjustment to changes in consumer demand with minimal inventory costs.

The result is a global “just-in-time” production system. The MNEs control marketing, branding and logos. Interestingly, these production systems have grown without parallel development of multilateral rules to govern its key element, FDI. This has given rise to a number of concerns.
The global financial system has changed. Private financial flows dwarf official flows and the influence of banks, hedge funds, equity funds and rating agencies has increased substantially. Rating agencies determine the costs and access to sovereign borrowing. Stock analysts influence the flow of funds into stock markets while the decisions of hedge fund managers impact on national currencies.

Within the logic of perfect markets, the increased influence of private actors should lead to greater efficiency in worldwide allocation of financial resources while imposing more market discipline on developing country governments. But financial markets are far from perfect because of severe problems of information failure and information asymmetries.

Problems are magnified on global financial markets because international lenders may have limited and poor information about local borrowers. For example, concerns have been raised over the operations of hedge funds and rating agencies, and the probity of some large international investors.

There are no effective institutions for supervising global financial markets like those at the national level. The global financial system is plagued by frequent and severe financial crises, which can be devastating and wipe out years of economic progress. They can also inflict heavy social costs through increased unemployment and poverty.

Only a small minority of developing countries are part of global financial system, since private financial flows are usually concentrated in emerging markets. The vast majority of developing countries, including almost all the LDCs, receive very little.

Low-income countries, mostly in sub-Saharan Africa, depend on aid. Their marginalization from financial markets means they can not mitigate the effects of reduced ODA. As a result, many such countries are still in the debt trap they fell into in the early 1980s.
REVIEW #4.1

1. What are the key features of globalization?

2. Did trade expansion occur uniformly across countries?

3. Is FDI broadly-based or focused on a few countries?

4. What is the most dramatic element of globalization since the 1980s?

5. Why has knowledge turned into an important factor of production?

6. Is a new systemic whole emerging of trade, FDI, financial flows and technological diffusion?

7. How did global production systems create new opportunities?

8. Is there need for institutions to supervise global financial markets?
Globalization should benefit all countries and should raise the welfare of all people. This implies that it should raise the rate of economic growth in poor countries and reduce world poverty. It should not increase inequalities or undermine socio-economic security within countries.

It is widely accepted that the litmus test for globalization is whether it significantly speeds up development and the reduction of absolute poverty in the world, and whether it ensures economic, social and environmental sustainability.

The social impact of globalization is not confined to poor countries that have been marginalized from the process. In relatively successful countries, significant social costs are involved.

For example, China faces problems of transitional unemployment that are likely to intensify with the reform of State-owned enterprises. The Asian financial crisis showed that even countries with exemplary past records of economic performance can suffer heavy social costs.
- It is striking that global GDP growth has been slower than in previous decades (figure 10) since 1990, the period in which globalization has been most pronounced. This contrasts with predictions of the growth-enhancing impact of globalization.

- Growth is unevenly distributed among both industrialized and developing countries. In terms of per capita income growth, only 16 developing countries grew at more than 3 per cent per annum between 1985 and 2000 (table 1). Some 55 developing countries grew at less than 2 per cent per annum, including 23 that suffered negative growth.

- The income gap between the richest and poorest countries increased significantly (figure 11). This uneven pattern of growth is shaping a new global economic geography.

- The most striking change is the rapid economic growth in China over the last two decades, together with a more gradual but significant improvement in the economic growth performance of India. These two countries together account for more than one-third of the world’s population.
A larger picture of globalization reveals highly uneven distribution of the benefits among countries. Industrial countries are well placed to gain substantial benefits from global production systems and liberalized investment rules. There are new opportunities for MNEs to increase market power and for investments with higher returns in emerging markets. Some benefits are partly offset by internal problems of adjustment that could generate losses for some workers.

A minority of developing countries have been highly successful in increasing their exports and in attracting large inflows of FDI. Foremost are the original NIEs of East Asia that are attaining industrialized country income levels. Some other middle-income countries in Asia, the EU and Latin America such as Mexico and Chile may also be on track.

For the most part, these countries had relatively favourable initial conditions such as prior industrialization, human resource development, transport and communications infrastructure, and the quality of economic and social institutions. But all have not pursued the same development strategies. China, India and Vietnam have not followed orthodox liberalization strategies, while the Republic of Korea relied on strong government intervention.

At the other extreme, the exclusion of LDCs, including most of sub-Saharan Africa, from the benefits of globalization remains a reality. LDCs are trapped in a vicious circle of interlocking handicaps including poverty and illiteracy, civil strife, geographical disadvantages, poor governance and inflexible economies largely dependent on a single commodity. Many are also burdened by high external debt and hard hit by the continuing decline in the price of primary commodities.

These problems have been compounded by continuing agricultural protectionism in the industrialized countries. This restricts market access while subsidized imports undermine local agricultural production.
There is no simple universally valid prescription on the best approach to trade liberalization. ILO studies show sharply contrasting impacts among countries. In three Asian emerging economies, trade growth had a generally favourable effect on employment and wages in manufacturing. In Latin American countries such as Brazil and Mexico, employment in manufacturing has either not risen appreciably or has fallen.

Regarding FDI, a critical precondition for success is the presence of local firms able to absorb the new technologies and respond to new demands. Also vital are policies to develop local education, training and technology systems and to build supplier networks and support institutions.

The evidence suggests that FDI does increase growth. That should have a positive effect on employment, but may be negated by strong crowding-out effects on local firms unable to compete and by the introduction of capital-intensive technology by foreign firms. Empirical evidence on the employment impact of FDI is sparse and does not permit simple generalization.

Cross-border investments can also raise the rate of growth if there are spillover benefits from the transfer of technology and skills to the local economy. The empirical evidence reveals mixed outcomes. While countries such as Singapore and Ireland have experienced strong spillover effects, this has not been true of all countries.

A full evaluation of the net benefits from FDI will have to include factors such as the impact of FDI on small and medium sized enterprises and on poor producers; the potential conflicts of interest between foreign firms and host countries; and the impact of FDI on the pattern of trade and the balance of payments.
On capital account liberalization, agreement is emerging that growth benefits are small. The potential benefits of access to financial markets are often reduced or negated by instability in countries with poorly regulated financial systems.

The prominence of short-term speculative capital flows is a basic structural flaw in the system. Such flows do not contribute to productive investment and place constraints to development policy.

In some cases, financial openness has led to misallocation of resources and increased the real cost of capital. The misallocation arises when information failures lead foreign lenders to finance unsound investments. The real cost of capital increases when governments raise interest rates to maintain exchange rate stability.

Financial openness limits countercyclical macroeconomic policy because countries have to surrender autonomy over either exchange rate or monetary policy. Maintaining a fixed exchange rate implies forgoing the freedom to fix domestic interest rates, while control over the latter can only be regained by allowing the exchange rate to float.

Globalization also affects public finances. In the world’s 30 richest countries the average level of corporate tax fell from 37.6 per cent in 1996 to 30.8 per cent in 2003 (figure12). Between 1986 and 1998, the top marginal tax rate on personal income declined in the vast majority of countries, both high- and low-income, often substantially.

Changes in tax rates do not necessarily reduce tax revenues since lower tax rates can also help to reduce tax evasion and increase production incentives. But tax systems may become less progressive and place more burden on labour, which is not mobile like companies and rich individuals.
ILO estimates that world unemployment increased over the last decade to about 188 million in 2003. Performance varied across regions (figure 13). Unemployment rates increased since 1990 in Latin America, the Caribbean and South-East Asia, and in East Asia since 1995.

Causes include the financial crisis at the end of the 1990s. In some major countries, unemployment rates declined after the crisis but not to pre-crisis levels (figure 14). Self-employment, which indicates the informal economy, increased in all developing regions, except for East and South-East Asia (figure 15).

Employment performance was mixed in industrialized countries. Over the last decade unemployment increased in Japan but sharply declined in some European economies and UK. Unemployment fell in the US despite job losses in some manufacturing industries.

Income inequality increased in some industrialized countries (figure 16). Earnings increased sharply of the top 1 per cent of income earners in the US, UK and Canada (figure 17). In the United States, the share of this group reached 17 per cent of gross income in 2000, a level last seen in the 1920s.

Causes include high compensation paid by MNEs, the development of new businesses with a global reach and global "superstardom".
It is an error to attribute all positive or negative outcomes to globalization. Domestic structural factors are also critical, including inequality in the income distribution and the quality of governance. The impact of globalization on poverty is difficult to assess. Most developing countries have seen greater income inequality but how far globalization can be blamed remains an open question (figure 18).

The number of people living in absolute poverty worldwide has declined significantly from 1,237 million in 1990 to 1,100 million in 2000 but most of the improvement was in China and India, which house 38 per cent of the world’s population. In China alone the number of people living in poverty declined from 361 million to 204 million.

In sub-Saharan Africa, Europe and Central Asia, and Latin America and the Caribbean, poverty has increased by 82, 14, and 8 million, respectively (figure 19). Regional and country-specific factors unrelated to globalization were key factors.

While reduction in world poverty deserves celebration, it is of little consolation to those outside the few beneficiary countries. Real social costs may occur even if aggregate indicators of unemployment and poverty do not deteriorate. Those indicators may mask the increased “churning” in labour markets and movements in and out of poverty.

Perceptions of the social impacts of globalization are coloured by direct experience of job or income losses, regardless of the overall picture. The mixed pictures of economic performance, employment, inequality and poverty make it extremely difficult to generalize about the impacts of globalization. Observed outcomes reflect the combined results of a complex of factors of which globalization, however broadly defined, is but one.
The economic benefits and social costs of globalization are not evenly distributed. People who benefited most were shareholders, managers, workers or sub-contractors of successful MNEs and competitive national enterprises. Generally, those with capital and other assets, entrepreneurial ability, education and skills have benefited.

People in uncompetitive enterprises are adversely affected, including firms protected by trade barriers, subsidized State enterprises, and less flexible small and medium sized enterprises. Many could not seize new opportunities because they lacked access to capital, credit and information.

Increased capital mobility and high unemployment have weakened the bargaining position of workers. Pressures have increased for labour market flexibility, eroding labour protection and causing concern about the quality of the employment. That highlights the importance of international action to protect fundamental worker rights in all countries.

Unskilled and indigenous peoples are particularly vulnerable. Investments in extractive industries, mega-hydroelectric dams, and plantations have led to massive dislocations, disruption of livelihoods, ecological degradation and violation of basic human rights.

Increasing tax competition and a reduced role for the State have led to cuts in government expenditures vital for the poor, including health, education, social safety nets, agricultural extension services and poverty reduction (figure 20). For example, of the 680 million children of primary school age in developing countries, 115 million are not in school, 65 million of them girls. Of the children who start primary school, only one in two complete it.
• In many developing countries, the social cost of globalization has fallen disproportionately on women. Many have been adversely affected both absolutely and in relation to men. For instance, trade liberalization has allowed the import of subsidized agricultural products and consumer goods that have wiped out the livelihoods of women producers.

• The increased entry of foreign firms often displaces farming women from their land or out-competes them for raw materials essential to their productive activities. Women producers also face formidable barriers to entry into new economic activities generated by globalization. This is often because of biases, either against women directly or against the micro- and small enterprise sector in which they predominate.

• For instance, women own less than 2 per cent of land worldwide and receive less than 10 per cent of credit. Women have also been more adversely affected than men during the increasing number of financial crises generated by globalization and more disadvantaged by cuts in social protection.

• For many other women with some education and skills, globalization has resulted in an improvement in their economic and social status. They include the millions of women workers absorbed into the global production system.

• This wage employment gave them higher incomes than in their previous situations, which were either intra-family servitude or a penurious and precarious existence in the informal economy. Wage employment also gave these women greater potential economic independence and often raised their social status within oppressively patriarchal societies.
There are two key wider effects of globalization: increased global awareness and the growth of illicit cross-border activities.

For people living in deprived parts of the world, global awareness raises their expectations and lowers their tolerance of the situation they are in. This is probably a factor in the spread of democracy and growing demands for political freedoms where these are still denied. Electorates are better informed which is a boon for the quality of democracy.

For people in richer countries, the information revolution is helping to forge a sense of global community and transnational solidarity. That is visible in the growth of global coalitions of non-State actors around issues of universal concern such as globalization itself, the environment, human rights, humanitarian aid and labour exploitation.

The global information revolution has also clearly affected cultures and social values. The fear is that constant exposure to the images of Western lifestyles and role models could lead to tensions which would be both culturally and socially divisive.

The global interconnectivity which facilitates legitimate cross-border economic transactions also provides the means for illicit cross-border transactions. It has helped to increase tax evasion, money laundering, trafficking in people, and the sex and drug trades.

This inadvertent facilitation of cross-border crime is reinforced by the increase in the economic returns through more lucrative opportunities for arbitraging across markets, e.g. through off-shore financial centres and tax havens. It is also helped by the slow development of multilateral arrangements for the detection and suppression of illicit cross-border activities.
1. What are the chief concerns about the impacts of globalization?

2. Why are the benefits of globalization distributed unevenly among countries?

3. Are there any critical preconditions for success in benefiting from FDI?

4. What are the main findings about financial openness and globalization?

5. Why are there mixed impacts of globalization on employment?

6. Which people have benefited the most from globalization and why?

7. Do the adverse social impacts of globalization fall disproportionately on women in development countries?

8. How does globalization encourage global awareness and community?