

**Harnessing globalization for
development: Opportunities
and obstacles**

Eddy Lee

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International Institute for Labour Studies
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Preface

This paper examines the conditions under which globalisation improves the socio-economic prospects in developing countries. It is often claimed that the impact of globalisation depends crucially on domestic policies. Accordingly, the expectation is that, in the presence of well-designed domestic policies and institutions, globalisation will spur economic growth and promote job creation. The purpose of this paper is to examine the validity of this premise, based on a review of available studies.

The paper notes that there is no simple-minded link between globalisation and development. Some developing countries have engaged in freer trade and investment policies, and yet results have been disappointing so far. By contrast, some successful performers have not adopted orthodox liberalisation policies.

The paper looks into possible explanations behind country heterogeneity in the response to globalisation. These include different national policies, the role of international rules and standards and the pace and nature of the globalisation process itself. Paradoxically, the latter is often an omitted factor, and yet, according to the paper, it plays a crucial role.

Importantly, the author --one of the most prominent international experts in this area-- puts forward a research agenda which would usefully shed light on how developing countries can successfully engage in the international economy.

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Raymond Torres
Director
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I. Introduction

This paper will review the recent economic literature on globalization, examining its implications for the overall prospects of growth and employment creation in developing countries. A particular concern is whether the majority of these countries, rather than only a small minority as at present, will be able to harness the opportunities created by globalization to accelerate their economic development. This takes a different approach from the mainstream literature on the relationship between globalization and development.

That literature has focused largely on cross-section and country studies of the impact of globalization on growth, poverty, income distribution, and employment in developing countries. The overarching question is whether globalization has been good or bad for developing countries in terms of these impacts. A common method is to compare outcomes across countries with different degrees of engagement in the global economy. Subsumed within this is, of course, the issue of whether more open policies towards globalization have led to superior outcomes.

Not surprisingly, proponents of globalization have often used the results of some of these studies to preach the benefits of greater economic liberalization. A fair reading of this literature will, however, reveal that such a stance is not fully justified. There are divergent results from empirical studies on the impact of particular aspects of globalization and there is an ongoing debate over the policy conclusions that can validly be drawn from this literature.

Moreover, much of the mainstream literature also implicitly suggests that all developing countries can benefit from globalization if only they adopt the right policies and create effective institutions for economic and political governance. Thus the fact that only a small minority of developing countries have so far succeeded in enjoying the benefits of globalization is put down to deficiencies in national development efforts. In other words the main claim is that the successful countries have adopted orthodox liberalization policies while the laggards have not. Important as this issue is, it is not likely to constitute the whole answer. It has, of course, been disputed by those who point out that a number of the success stories have not in fact adopted orthodox liberalization policies, while many of the unsuccessful countries have done so, but to no avail.

In any case it is implausible that differences in domestic policies and institutions can be the whole answer to the puzzle of why only a minority of developing countries have succeeded in the global economy. It is therefore important to discover additional explanations, particularly since a crucial requirement for creating a better world is for very many more poor countries to embark on the path of rapid development. An interesting candidate among the possible alternative explanations is the very nature of the globalization process itself. Are there structural features and deficiencies in the current process that make it inherently difficult for more countries to succeed in joining the global economy on beneficial terms? If so, then we need to identify these failings and find ways to redress them.

The issue of the effects of globalization on the prospects for development is highly topical. An important strand in the general literature implicitly suggests that new developments in the global economy have indeed created vast new opportunities for all developing countries. This literature focuses on the impact on the advanced countries of new developments such as the rise of off-shoring in service sector jobs and rapid growth in China and India. The doomsday tenor of the more popular discussion of these issues clearly implies that many more developing countries are now better placed than ever to experience a take-off in development.

It is clearly important to assess the validity of such a prognosis as part of a broad attempt to understand the real opportunities and constraints to generalized development that are brought

about by the current process of globalization. To this end it has been necessary to review not only the literature that has fuelled this media interest - on the economic threat to advanced countries unleashed by globalization - but also a wide-ranging literature on other aspects of globalization such as the growth of global production systems in agriculture, manufacturing and services; financial globalization; global income inequality; the rise of a global labour market; international migration; and the implications of the increasing interconnectedness of nations for global ethics. These literatures remain largely separate and attempting to draw out common implications from them for the development prospects of poor countries has been a particularly interesting, and we hope useful exercise.

The rest of the paper is structured as follows:-

Section II begins with a review of the literature on the new elements in the globalization process and their potential implications for developing countries. It sets out a scenario where the expanding scope of globalization and the relocation of production that accompanies it may indeed have the potential of increasing convergence between rich and poor nations. It then goes on to examine other structural forces within the global economy which ensure that the economic fates of all nations are becoming more closely intertwined. It also highlights emerging tensions over the income gains being generated through globalization that are commanding the growing attention of all countries, rich and poor.

Section III makes a critical assessment of the basic proposition that globalization will indeed spawn broad-based development for all developing countries. It first examines whether the claims about the empowering effects of globalization are justified. It then considers whether the underlying dynamics (in terms of trade, capital and labour flows) in the current process of globalization are working in the right direction to bring about convergence between rich and poor countries. The section then considers whether there are any serious structural obstacles which prevent the rising tide of globalization from lifting all boats. Not least among the structural factors examined are the huge demographic imbalance between rich and poor countries, the blockage of some important equilibrating mechanisms and the widely different capacities among developing countries to compete for a foothold in the global economy.

Section IV makes a detailed examination of the opportunities and obstacles in the current process of globalization by considering in turn each of the main economic options that are open to developing countries. These pathways into the global economy are agriculture, manufacturing, services, financial integration, and international migration. In reviewing the largely separate literatures on each of these sectors, a basic concern is to identify common elements impinging on the prospects of entry by latecomers into these expanding global markets.

Section V concludes by first highlighting key issues of international policy. This is because the analysis indicates that there are limits to what national policies, however good, can achieve on their own. It then considers the implications of the preceding analysis for national policies, with a special emphasis on the important issue of employment creation. Again the focus is on the policies required to gain entry into the global economy, leaving aside the more general and well-trodden issues of overall development strategies.

II. New dimensions of globalization

i) The expanding scope

The globalization of the world economy has continued at a steady pace over the past decade. The shares of international trade, investment and financial flows in world output have all continued to rise. This reflects in large part an expansion in conventional flows of these items. An important new development, however, is that this is by no means the whole story. The scope of globalization has also been expanding significantly with the emergence of new items as well

as new forms of international economic transactions. This change has potentially wider ramifications than a simple quantitative expansion in the standard indicators of globalization.

A central element of this widening scope of globalization has been a change in the nature of international trade. The Ricardian theory of international trade was based on the then prevailing reality that trade consisted of the exchange of final goods such as primary commodities and simple manufactured items between nations. The extent of trade was limited by the fact that it was generally necessary to make goods close to the point of consumption. This constraint has since been broken by declining transport costs and by successive technological breakthroughs. As a result both the volume and scope of international trade have expanded vastly.

A first stage in the process was the emergence of trade in intermediate goods when the production of manufactures began to be fragmented vertically. With falling transport costs particular parts of a manufacturing process could be separated out and located in different countries to take advantage of differences in labour and other costs. Although there are few figures at the aggregate level, 'the intra-industry share of manufacturing trade has increased significantly since the late 1980s across many OECD countries.'¹ Between 1996 and 2000 intra-industry trade accounted for more than half of total trade in manufactures in 22 out of the 27 OECD countries for which data were available. In addition, *intra-firm* trade accounted for one-third of goods exported from Japan and the United States in 1999. 'Moreover, given the increasing importance of foreign direct investment relative to both world trade and output, it is likely that the importance of intra-firm trade has increased at the global level... there are some middle-income countries where intra-firm trade accounts for a high share of their bilateral trade'². The latest phase has been described as the 'great unbundling' since it has now become increasingly possible to fragment activities within a factory or an office to a finer level.³ Even specific tasks within an enterprise can now be outsourced when this is warranted by cost differentials whereas previously it was only possible to do this in the case of more aggregated clusters of the production process.

This was followed by the rapid growth of trade in services. Trade in all commercial services (which includes traditional services such as transportation and travel) grew at the rate of 11 per cent per annum between 2000 and 2006 compared to 5 per cent per annum between 1995 and 2000. Within this overall growth, trade in 'other commercial services' (which includes communication services, computer and information services, financial and other business services) doubled in value between 2000 and 2006 and now accounts for half of total commercial services exported in the world. Furthermore, within this category of 'other commercial services' the 'fastest growing sectors were computer and information services (17 per cent growth), insurance (14 per cent growth) and other business services (13 per cent)'.⁴ Overall, trade in commercial services now accounts for one-fifth of total world trade in goods and services. By comparison trade in agricultural products accounts for only 9 per cent of global trade.

The enabling effect of successive waves of technological change has been the underlying factor behind these developments. While it is true that trade, investment and financial liberalization also played an important role in advancing globalization, its scope could not have expanded without the new possibilities opened up by technological breakthroughs. The declining cost of transportation was sufficient to fuel the expansion of trade in physical goods. However, trade in intermediates, intra-industry trade and global production systems only became possible

¹ OECD: Economic Outlook 71, Paris, 2002 p. 159.

² *ibid.*, p. 163.

³ R. Baldwin: *Globalization: The great unbundling(s)* (Prime Minister's Office, Finland, Aug. 2006). See also G. M. Grossman: *The rise of offshoring: It's not wine for cloth anymore* (Paper for Federal Bank of Kansas Symposium, Jackson Hole, Aug. 2006).

⁴ WTO: *World Trade Report*, Geneva, 2006 p. 39.

with the emergence of new low-cost information and communications technologies. These made the coordination of multinational production systems feasible.

The effects of these new possibilities for coordinating multinational production were first felt in the manufacturing sector. These new technologies expanded the scope for the vertical fragmentation of production and the relocation of parts of the production process across borders in order to exploit differences in labour costs. This was done through increased FDI flows from the advanced countries to produce labour-intensive intermediate goods in low-wage economies. This led to the emergence of both consumer-driven and producer-driven global production systems for manufactured goods.

Consumer-driven systems consisted of the production of branded retail consumer goods such as garments and footwear through a system of global subcontracting to firms in developing countries. Multinationals controlled the production and distribution system, with the higher valued-added parts of the process such as design, advertising and retailing being retained in the advanced countries.

Producer-driven systems, on the other hand, consisted of the intra-firm production of specific components of a manufactured good through subsidiaries transplanted to low-cost locations. The products were then trans-shipped for final assembly and distribution; this process was reflected in the growth of both intra-firm trade and trade in intermediate goods.

For developing countries, both parts of this emerging global production system represented new opportunities for industrialization, the export of manufactured products, and employment creation. This was largely viewed as a boon in spite of concerns raised by critics over the labour exploitation and unequal exchange which they blamed on the economic power wielded by MNCs. In contrast, for the advanced countries, the same process was widely viewed with growing anxiety. A primary reason was the perception that manufacturing, and jobs, were being lost to developing countries. While the process was obviously profitable to the MNCs involved and also represented, from an economy-wide perspective, a desirable shift out of labour-intensive activities in which the advanced countries no longer enjoyed comparative advantage, there were clear losses to the workers involved.

The first wave of relocating production and jobs in the manufacturing sector has now reached a mature phase and, to that extent, the anxieties it provoked have subsided. The share of manufacturing in GDP and total employment has declined sharply in the advanced countries.⁵ Much of what was obviously ripe for relocation has already gone. While the underlying dynamics of shifting comparative advantage dictates that the process will continue, it will do so at a much slower pace than previously. However, a new threat of relocation has surfaced in the form of what has been termed the off-shoring of service sector jobs.

As was the case in the relocation of labour-intensive manufacturing, technological developments paved the way for this new phenomenon. The spread of the infrastructure of fibre optic cables to many parts of the world increased global connectivity, and was additionally facilitated by the increasing use of standard software and operating systems across the world. Furthermore, the increased supply of scientists and engineers in several key developing countries such as India and China created a global supply base of the skilled labour that was required. The pre-conditions were thus in place for the off-shoring of service sector jobs.⁶

Beginning with simple repetitive tasks such as data entry and processing, and call centres, the process of off-shoring has since worked its way up the skill chain to include a range of business services and complex professional tasks. Although the extent to which this has occurred is still limited, these new forms of off-shoring have triggered alarm in the advanced countries about an impending massive loss of skilled service-sector jobs. Global trade flows and the

⁵ A. Blinder: *Offshoring: The next industrial revolution?* in *Foreign Affairs*. (2006) Vol. 85, (Mar./Apr.).

⁶ R. Dossani and M. Kenny: "The next wave of globalization: Relocating service provision to India" in *World Development* (2007), Vol. 35, No.5 May.

competition for jobs unleashed by them can now operate through both physical and virtual channels.

ii) Forces driving increasing linkages

This expanding scope of globalization means that the array of economic interrelationships among countries has grown. Over and above this, other factors are also creating a general tendency for the economic fates of nations to become more closely interconnected. We consider two of the most important of these factors — structural inequalities within the global economy and global tensions over the distribution of income.

Structural inequalities

Two structural inequalities are fuelling this greater interconnection. One is the persistence of large income gaps between advanced and developing countries. The other is the related and equally large gap in the capital-labour ratios between these two groups.⁷

Beginning with the latter gap, the Penn World Tables provide data on capital stock per worker for about 60 countries for the years 1985 and 1992. The data show that the capital-labour ratio for the G-7 countries was US\$ 31,000 in 1985. In contrast it was US\$ 1,900 for the seven sub-Saharan economies for which data were available, giving a 16:1 ratio between the rich and poor countries in the sample. By 1992 this ratio had increased to 28: 1 as a result of an increase in capital per worker in the rich countries and a decline in the sub-Saharan countries. A similar picture is true of India, albeit to a much smaller extent. The ratio of capital per worker between the G-7 countries and India increased from 18.2:1 in 1985 to 18.4 :1 in 1992. The corresponding situation for the only two middle-income industrializing Asian economies for which data were available was that the ratio remained unchanged between 1985 and 1992.

This gap in the capital-labour ratio is a reflection of both the much larger population size and the lower average income of developing countries. Some 5.5 billion people live in the developing countries compared to 1.2 billion in the advanced countries. Similarly, workers from developing countries constitute the bulk of the labour force in the world. Until recently most of the labour force in developing countries was engaged in subsistence agriculture and the informal sectors of the respective economies. These activities were at best only loosely linked to the global economy.

There has, however, been a significant increase in the number of workers from the developing world whose jobs and incomes are now connected to the global economy through trade and investment flows. This has been depicted as a dramatic increase in the size of the 'global labour market'. In this new context, the large gap in the capital-labour ratio between rich and poor countries assumes much greater significance than hitherto.

Globally, the increased involvement of China, India, and other developing countries in the world economy has resulted in a huge increase in the potential supply of unskilled labour. These workers bring with them little physical capital and thus increase the relative abundance of labour as well as the relative scarcity of capital. Although we should not exaggerate the extent to which this new entry of unskilled labour has actually occurred, the trajectory is nonetheless clear.⁸

The gap between rich and poor countries in terms of per capita GDP is even greater than the gap in terms of capital stock per worker. The ratio between the average per capita incomes of the 20 richest countries and the 20 poorest was 37:1 in 2000.⁹ This gap has also been increasing

⁷ Penn World Tables: Capital stock per worker (accessed through <http://datacentre2.chass.utoronto.ca/cgi-bin/pwt/jump?t=1>).

⁸ R. N. Cooper: *How integrated are Chinese and Indian labour into the global economy?* (Washington D.C., World Bank, mimeo, Feb.2006).

⁹ World Bank: *World Development Report 2000/01* (Washington, D.C., 2001).

steadily for several decades. The per capita income of all developing countries expressed as a percentage of that in the advanced countries fell from 18 to 15 per cent between 1950 and 2001 in spite of the fact that Asian developing countries have been closing the gap since 1990.¹⁰ The latter implies that for Latin America and Africa the gap widened considerably more than the average for all developing countries.

It will of course be objected that the use of such simple ratios of average incomes (un-weighted by the population of countries) gives a misleading picture of the extent of global inequality.¹¹ If we do weight average incomes by population then we see some closing of the gap in average incomes between rich and poor countries from around 1990.¹² But it is important to note the reason for this change. It is almost entirely due to the rapid growth of China and India, two very populous countries that raised the population-weighted average income figures for the developing world. 'It is this growth in these two countries, the transformation of China from desperately poor to poor, and the transformation of India from desperately poor to extremely poor...that has for the first time in at least two centuries narrowed the proportional gap between rich and poor'.¹³ Indeed, 'in the absence of the influences of China and India the pattern of improvement in inequality and poverty reduction would instead have been one of worsening'.¹⁴

The reason for this worsening is that most other developing countries have done much less well than China and India. There are 49 other countries that are classified by the World Bank as low-income and they have a combined population of almost half that of the two giants. Most of these countries have fared very poorly in terms of economic growth and have diverged further and further from the income levels of the advanced countries.¹⁵ In addition, a significant number of middle income countries have also fallen behind, albeit to a lesser extent.¹⁶ If we think in terms of the number of countries that were in the group where average incomes were converging then a striking fact of the period between 1950 and 2000, in contrast to earlier phases of globalization, was that 'the convergence club both expanded and contracted massively, as many economies joined, but also for the first time many economies dropped out...over the past two decades many countries have fallen behind not just relatively but absolutely in terms of both income levels and structural development'.¹⁷

Given that our main concern is the implication of the current phase of globalization for the economic prospects of developing countries as a whole, it is valid to focus on the nation state as the basic unit of analysis rather than on proportions of the total population of the developing world. Development policies are framed at the national level regardless of population size. Taking a systemic view of globalization, a key issue is how its current nature affects the development prospects of different groups of countries. While the high growth in China and India is a cause for celebration from a cosmopolitan standpoint and does make for a better world in a number of important ways, it should not in itself reduce concern over the fact that so many developing countries are still falling behind the advanced countries in terms of income levels.

¹⁰ B. Sutcliffe: "World inequality and globalization" in *Oxford Review of Economic Policy* Vol 20, No.1, 2004.

¹¹ There is a lively literature on the pros and cons of alternative measures of global inequality, the trends they reveal and the extent to which globalization explains the observed outcomes. Three useful reviews of this literature are B. Milanovic: *Global income inequality: What it is and why it matters* (World Bank Policy Research Working Paper 3865, Mar. 2006), P. Svedberg: *World income distribution: Which way?* (Institute of International Economic Studies, Stockholm, Seminar Paper No.724, Sep. 2003), and K. H. O'Rourke: *Globalization and inequality: Historical trends*, paper for Annual World Bank Conference on Development Economics, May 2001.

¹² J. Bradford Delong: *The world's income distribution: Turning the corner?* (University of Berkeley, Feb. 2001).

¹³ *ibid.*, p.2.

¹⁴ A. Berry and J. Serieux: "All about the giants: Probing the influences on world growth and income distribution at the end of the 20th Century" *CESifo Economic Studies*, Vol. 50, No.1, p.155.2004 p.155.

¹⁵ P. Collier: *The bottom billion. Why the poorest countries are failing and what can be done about it* (Oxford University Press, 2007).

¹⁶ E. Leamer: "A flat world, a level playing field, a small world after all, or none of the above?" in *Journal of Economic Literature*, 2006.

¹⁷ S. Dowrick and J. Bradford Delong: *Globalization and convergence*, Paper for NBER Conference on Globalization in Historical Perspective, Santa Barbara, California, May 2001.

Moreover, from a systemic perspective the essential fact is that income gaps are widening between the advanced countries and a large majority of developing countries. These gaps are what will drive the dynamics of globalization in terms of the flows of trade, FDI, other financial flows and international migration. In this context it is also important to note that even if we include China and India among developing countries, *absolute income gaps* between advanced and developing countries will continue to increase for a long time to come. 'While the relative world income distribution may not have changed much over recent decades and stands a chance of remaining relatively stable in the near future, we can be absolutely certain that absolute income gaps will continue to grow for at least one or two generations.'¹⁸ This is likely to tempt 'the elite in poor countries to push for more unequal economic policies' and also 'create increased incentives for migration of both educated and unskilled labour from poor to rich countries'.¹⁹

These structural features of the global economy heighten what has been described as a clear tendency towards 'global labour arbitrage'.²⁰ In other words, there are vast new opportunities for businesses to profit from exploiting the current large price differences across national labour markets. The wide gap in capital-labour ratios and wages is likely to prevail or even widen given the significantly higher rates of population and labour force growth in the developing countries compared with the advanced countries. This not only creates huge incentives for workers from developing countries to emigrate; it also poses equally strong incentives for enterprises in the advanced countries to intensify the search for possibilities to reduce costs and maximize profits through the relocation and outsourcing of production. Thus even though actual international migration remains limited, the inherent 'law of one wage' can still exert its influence through the increasing mobility of jobs because of the expanding scope of globalization.²¹ In a sense these channels can be seen as alternative ways round the fact that the labour market remains the least integrated of global markets; wage gaps in labour markets remain much larger than price gaps in product and financial markets.²²

This global labour arbitrage illustrates our opening observation about the wider ramifications of the expanding scope of globalization. Much of the anxiety in the advanced countries emanates from the basic fact that the increased possibilities for global labour arbitrage now pose an increasing challenge to jobs and wage levels for a larger segment of the labour force. The biggest change is that the service sector, until recently insulated because it was largely non-tradable, is now also vulnerable to the forces of global labour arbitrage. In short, the expanding scope of globalization and the deep structural inequalities in the global economy are working together to intensify the underlying dynamics of global labour arbitrage.

Global tensions over the distribution of income

Another important source of increasing inter-connectedness is through the distribution of global income. A basic rationale for globalization is that it raises global GDP. While not all agree that this is the case, it is still reasonable to say that some countries and social groups within countries have enjoyed a significant increase in income as a result of globalization. The problems associated with globalization in fact reside not so much in the issue of whether there has been a net overall increase in global income but more in how the income gains associated with globalization have been distributed. These distributional tensions are important at both the global and national level.

¹⁸ P. Svedberg, op. cit., p.26.

¹⁹ *ibid*, p. 29.

²⁰ S. Roach: *Perils of a different globalization* (Morgan Stanley Equity Research, Mar. 2006)

²¹ D. Colander: "The Long-run consequences of trade and outsourcing", in *Challenge* (2005). Vol. 48 No. 1: pp. 94-103.

²² R. Freeman: "People flows in globalization", in *Journal of Economic Perspectives* (2006). Vol. 20 No. 2.

From a global perspective it would be a useful heuristic device to think of world GDP in terms of a basic division between income that is clearly linked to globalization and that which is not (or is only marginally so). Since with increasing globalization the first component of global income is the predominant and much more dynamic source of growth, most of the distributional tensions centre on this. A basic part of these tensions is over inclusion and exclusion from this dynamic source of global income growth.

From a cosmopolitan perspective, the fact that many less developed countries are still largely excluded from this income-generating circuit is a cause for great concern. Globalization may well yield income gains that clearly pass a global welfare compensation test, that is, the income gains of winners could potentially more than compensate for the losers. This is a meaningful test in the context of nation states with well-developed institutions for the redistribution of income, since actual compensation is feasible. Thus workers in such countries who have lost out from globalization can be, and often are, compensated. However, at the global level a compensation test is meaningless. Short of more effective global governance, the fact that income gains are large enough to fund compensation is of little comfort to countries that have lost out (either from participation in the global economy on unsatisfactory terms or through being excluded from it) since there are no actual compensation mechanisms.

There are also serious distributional tensions along other important axes. First, there is the long-standing North-South distributional issue that is intensified in the current context of globalization. A topical aspect here is anxiety in the advanced countries that the current phase of globalization has opened the Pandora's box of 'catch up' by the South, with the consequential erosion of their current economic predominance. This has been provoked largely by the rapid growth of countries from the South which have successfully integrated into the global economy, especially when these include giants such as India and China. Apart from the obvious geopolitical fact that sustained growth at current rates would lead to growing economic and political power for India and China, there are two other major anxieties. One is the fear that rapid growth in these countries has also been accompanied by a rapid growth of the absolute numbers of scientists and engineers.²³ This fact, combined with the continuing transfer of technology through FDI and off-shoring, has raised the spectre of a coming challenge to the dominance of the advanced countries in their last economic bastion of high technology and high skilled industries.

We discuss below the likelihood that such a scenario will unfold in the near future. Be this as it may, we still have to recognize other current distributional tensions between North and South. One is the issue of income distribution within the expanding global production system. The divide here is between Northern 'winners' and Southern 'losers'. In the first category are Northern MNCs who are often accused of earning super-normal profits through their considerable market power, as well as Northern consumers who benefit from low prices.²⁴ In the other category are Southern sub-contractors of the MNCs who face severe competition and insecurity and Third World workers who make up the exploited bottom of the global production system. While the issue of how to shift income distribution within global production systems is the rallying cry of anti-globalization movements and underlies arguments for product labelling, ethical trade and corporate social responsibility, there is also a basic issue of development strategy involved.

This relates to the question of whether it makes any sense to seek participation in the global economy on these unequal terms. A purely economic calculus would indicate that the answer depends on a comparison between the economic outcomes of participating and the counterfactual of not doing so. The case has been made that such a comparison would favour participation, given the lack of meaningful alternatives for a poor country. This aside, the key

²³ R. B. Freeman: *Does globalization of the scientific-engineering workforce threaten US economic leadership?* (NBER, Working Paper 11457, June 2005).

²⁴ J. Heintz: "Low-wage manufacturing and global commodity chains: A model in the unequal exchange tradition" in *Cambridge Journal of Economics* (Vol. 30, 2006).

issue from the perspective of a developing country is whether participation in this global production system can serve as a stepping-stone to wider development options. This involves questions of industrialization strategy such as whether there are effective policy instruments to promote greater learning by local firms, entry or upgrading into higher value-added lines of production and, above all to raise productivity and hence wages.

Apart from this great North-South distributional divide, there are also other axes of contention within both the advanced and developing countries as well as among developing countries as a group.

Within the industrialized countries, a major new source of tension is the emerging divergence of interests between capital and labour that has been provoked by the new globalization. In the context of new opportunities for global outsourcing and off-shoring, profit-maximization on a world scale is now the main driver of corporate strategy. This has different distributional implications from profit-maximization on a largely national scale. In the latter case the interests of capital and labour were largely congruent as captured in the saying that 'what is good for General Motors is also good for the US' (and its workers). Competitive success in both domestic and foreign markets meant greater profits but also more domestic jobs and rising productivity and wages. In contrast, profit-maximization on a global scale may no longer carry any guarantee of these benefits for workers.²⁵

This is because a new type of divergence between private and social benefits has now arisen. A key element is the transfer of jobs to lower cost locations but this is not all. Owners of general and technological knowledge now also stand to gain from the exploitation of these assets on a global scale, strengthening the incentive for greater transfer of technology to developing countries. This works through the direct establishment of production facilities in the South as well as through subcontracting, franchising, and licensing arrangements. All this increases the scope for spill-over and learning effects to strengthen the technical capabilities of potential economic rivals. This is the real basis of the concerns in the advanced countries about a possible loss of the comparative advantage that they currently enjoy in the skill and technology intensive industries to emerging rivals such as India and China.²⁶

From a developing country perspective, however, a cause for concern should be the fact that these developments have not increased the relative demand for their most abundant factor of production, unskilled labour. Contrary to the predictions of the Heckscher-Olin theorem that growing trade with the industrialized countries will raise the relative demand for unskilled labour, skill premiums have in fact increased in many developing countries. Several explanations have been advanced for this phenomenon.

One is that increasing trade and investment flows are spreading skill-biased technological change to the developing countries.²⁷ Although the direct evidence so far is only partial there are grounds for believing that this may in fact be occurring. A closely related explanation is that trade and investment flows increase the incentives for producers in export and import-competing industries to adopt more skill-intensive technologies.²⁸ The competition for export markets pushes exporters to adopt newer and invariably more skill-intensive techniques of production. The same applies to import-competing firms who have to preserve or strengthen their position in domestic markets in the face of increasing competition from imports.

²⁵ R. E. Gomory and W. J. Baumol: *Global trade and national interests* (MIT Press, Cambridge Mass., 2000).

²⁶ P. A. Samuelson: "Where Ricardo and Mill rebut and confirm arguments of mainstream economists supporting globalization", in *Journal of Economic Perspectives* (2004), Vol. 18, No. 3, pp. 135-146.

²⁷ E. Berhman and S. Machin: "Globalization, skill-biased technological change and labour demand; in E. Lee and M. Vivarelli (eds): *Understanding globalization employment and poverty reduction* (Palgrave McMillan, 2004).

²⁸ D.J. Robbins: *The impact of trade liberalization upon inequality in developing countries, A review of theory and evidence* (International Policy Group, ILO, Geneva, 2002, mimeo).

At the same time, foreign investment is usually the vehicle for introducing more skill-intensive technologies as it sets up or subcontracts production in developing countries. Finally, the transfer of production from the advanced countries to developing countries tends to increase the skill-intensity of production in the latter countries. Production that is outsourced occurs at the margin of what constitutes the least skill-intensive jobs in the advanced countries. Yet these very same jobs are likely to be relatively skill-intensive from the vantage point of the developing countries that now come to host them. This is true of both manufacturing and service sector jobs, but with the added twist that the latter which are now being outsourced also include some that are skilled even from the advanced country perspective.

This new tendency towards increasing wage differentials between skilled and unskilled workers in developing countries has also to be viewed in the context of the great gap between North and South in terms of capital-labour ratios. Over and above the disturbing fact that current levels of FDI and other capital flows do not appear to be sufficient to close this gap, there is now the fact that neither increased openness to trade nor the transfer of capital and jobs that occurs is necessarily helping to boost the relative demand for unskilled labour in developing countries. Instead, 'there appears to be a widespread tendency for wage and income inequality to increase in the wake of trade liberalization and contemporaneous developments such as the increase in trade in services and intermediate goods, increased flows of FDI and outsourcing, and the diffusion of skill-biased technical change. The increase in the relative demand for skilled labour is a global phenomenon that often leads to an increase in wage inequality.'²⁹

This phenomenon has important implications for employment policies in developing countries since the corner-stone of these policies has been the attempt to increase the demand for unskilled labour in order to maximize the rate of growth of productive employment. At the same time labour markets in these countries are also being confronted by other challenges. A key one is that several factors are tending to generate greater turbulence in labour markets. For instance, the recent literature indicates that labour market adjustments following trade reform occur not only between sectors but also within sectors, thereby increasing the extent of job reallocation. This implies that jobs are at risk in all sectors and not, as conventionally thought, only in the import competing ones.³⁰ Similarly, as more industries become footloose small shifts in costs can cause comparative advantage to shift abruptly from one country to another, implying an increase in labour turnover. In addition, in globally integrated production systems fixed cost activities are concentrated in the industrialized countries while variable cost activities are concentrated in developing countries. Since output shifts are driven mostly by changes in variable costs the volatility of output and employment will be higher in developing countries.

III. Globalization and the prospects for development

These new developments in the process of globalization define a changed opportunity set for developing countries. There are more paths for access to the global economy. Instead of just primary commodity production and home-grown labour intensive manufacturing, a variety of new points of entry have been created by the expanding scope of globalization. At a more fundamental level, it has been argued that the Internet has made access to knowledge much easier in principle. Taken together, this easier access to knowledge and the increased incentive to transfer knowledge that has been created by the expanding scope of globalization could be seen as potentially enhancing the development prospects of low-income countries. With a narrowing of the digital divide and progress in education in the developing world, there should be increasing access to a new 'global brain'. It has been argued that this opens vast potential opportunities for learning and perhaps innovation in developing countries and will thereby boost their economic prospects.

²⁹ M. Jansen and E. Lee: *Trade and employment: Challenges for policy research* (ILO/WTO, Geneva, 2007), p.86.

³⁰ *ibid.*

i) Rapid convergence globally?

In spite of this optimistic scenario, rapid convergence in income levels is not likely to occur in the near future. There are a number of reasons for this.

A basic one is that in spite of its expanding scope the current process of globalization is still relatively shallow.³¹ Unlike a national economy, the global economy is still characterized by the persistence of jurisdictional and legal discontinuities across nation states. This implies high transaction costs that will continue to limit the extent of convergence. For example, trade is hampered by differences in national regulatory regimes and currency risks while capital flows are hindered by the absence of effective international financial regulation and bankruptcy procedures. Similarly international labour mobility is severely restricted by national controls over immigration. This makes the current global economy quite unlike nation states which did experience significant convergence between states or regions because they were truly single markets. The global economy is thus, at its present level of integration, unlikely to deliver rapid convergence.

The limits to convergence so far can be seen in the areas of trade and investment flows. In spite of the fall in transport and communication costs, geography is still a principal determinant of trade as attested by the continuing robustness of the gravity model of international trade. This is due to the many economic benefits of geographical proximity and the agglomeration of activities.

In the case of investment flows, if the global economy were comprised of perfect markets the large gap in capital per worker between the advanced and developing countries should be diminishing because of equilibrating capital flows. However, this is not happening in the real world. The bulk of FDI and other capital flows remain among industrialized countries. In contrast to the previous phase of globalization, 'globalized capital markets are back but with a difference: capital transactions seem to be mostly a rich-rich affair, a process of "diversification finance". The creditor-debtor country pairs involved are more rich-rich than rich-poor, and today's foreign investment in the poorest developing countries lags far behind the levels attained at the start of the last century. In other words, we see again the paradox noted by Lucas (1990), of capital failing to flow to capital poor countries, places where we would presume the marginal product of capital to be very high.'³²

Moreover, this is likely to continue because the returns to *both* capital and labour are higher in the advanced countries, because there are far higher levels of complementary factor inputs, other than capital and labour, in those countries. These complementary factor inputs such as technical knowledge and research and development, the quality of infrastructure and institutions, and the efficiency of markets raise the overall level of productivity in an economy.³³

Thus the basic equilibrating forces that could drive convergence are operating at a very limited level. At the same time the current process of globalization continues to pose many obstacles to developing countries hoping to accelerate their growth through their own efforts. These derive from the many unfair aspects of the current process of globalization. It has often been argued that unfair global rules relating to trade, investment, intellectual property rights, the

³¹ D. Rodrik: *How to save globalization from its cheerleaders* (Harvard University, July 2007, mimeo).

³² M. Obstfeld and A. M. Taylor: *Globalization and capital markets* (NBER Working paper 8846, Cambridge, MA, Mar 2002). See also M. Schularick: "A tale of two globalizations: Capital flows from rich to poor in two eras of global finance", in *International Journal of Finance and Economics* (Vol. 11, 2006) pp. 339-354.

³³ R. B. Freeman: "People flows in globalization", in *Journal of Economic Perspectives* (Vol. 20, No. 2; Spring 2006).

global financial system and national policy autonomy are all serious impediments to the growth prospects of developing countries.³⁴

In addition, entry into global economic activity is becoming more difficult for other reasons. Competition between countries (and firms) is now becoming more intense and spans a wider range of economic relationships. In this new context, comparative advantage is no longer derived simply from differences in natural endowments and factor-proportions. It is increasingly also driven by differences in technological capacity and by policy-driven competition. Among the advanced countries and their emerging competitors strategic industrial policy backed by competitive investments in technological research and development plays an important role. This operates in a world where imperfect competition characterizes many markets and where product differentiation is a key strategic variable. In such a world, gaining a competitive edge often depends on the ability to achieve economies of scale and to develop dealer and other support networks. Initial market power derived from intellectual property rights and reputation and trust advantages is another important ingredient, one that also makes entry by potential rivals exceedingly difficult.

It is also a world of increasing institutional complexity where the requirements in terms of the range and quality of institutions to support economic development strategies have become more demanding. Developmental capacity can no longer be seen largely in terms of the availability of basic physical infrastructure and a minimal level of human resource development. For example, the quality of services is an important determinant of the ability to achieve success in trade in goods as well as in services.³⁵ The quality of services such as the efficiency of transport terminals and other trade facilitation services at both ends of a trading relationship determines the intensity of trade that can develop.

The growing gap between the advanced and developed countries is thus not just a question of income but of economic and developmental capacity in a far larger sense. Catch up requires not only the successful initiation of sustained economic growth, fundamental as this is, but also simultaneous progress in a wide front of capacity development. This is over and above the fact that such differences in capacity have also increased within the developing world, that is, between the countries that have successfully integrated into the global economy and the rest.

Against this background it is ironic to note the exaggerated fears in the advanced countries over their imminent economic eclipse. Consider two topical fears. One is the fear of a potential loss of comparative advantage. On this, the arguments overlook several important considerations. These include the considerable market power and control over intellectual property rights enjoyed by the industrialized countries in capital- and skill-intensive industries; the fact that it is not the absolute but the relative endowment of skilled labour that determines comparative advantage; and that, more importantly, successful innovation and technical progress require a supporting structure of institutions that are still relatively underdeveloped in developing countries and which cannot be created overnight. It is also relevant to note in this context that there are still significant differences in nominally the same categories of skilled labour between the industrialized and developing countries, and that the actual integration of unskilled labour from the developing world into the global labour market is still quite limited.

The other is the specific fear that there will be massive job losses through the off shoring of service sector jobs.³⁶ This is based on the simplistic view that all transactions are like the trading of standardized commodities in impersonal markets. In such a world there would be no limit to the markets that could be contested by lower cost producers. The reality is quite different. The extent of outsourcing has been fairly limited so far and there is in fact a limit to how far the

³⁴ World Commission on the Social Dimension of Globalization: *A fair globalization: Creating opportunities for all* (Geneva, ILO, 2004).

³⁵ S. S. Golub, R. W. Jones, and H. Kierzkowski: *Globalization and country-specific service links* (Geneva, Graduate Institute of International Studies, Working Paper No. 05/2007, 2007).

³⁶ A. S. Blinder; *Fear of offshoring* (CEPS, Princeton University, Working Paper 119, Dec 2005).

process can go.³⁷ The majority of the skilled jobs that have been outsourced have consisted of those involving mundane tasks that can be codified. However, most skilled jobs involve the exchange of complex messages that are context-dependent and hence cannot easily be codified and outsourced. Rather, they require face-to-face interaction, long-term relationships and trust. Physical closeness and agglomeration of activities will thus continue to be an inescapable determinant of the location of economic activity.³⁸

ii) Convergence among developing countries?

Even if rapid convergence between advanced and developing countries is unlikely it nevertheless remains true that production is now far more footloose. This implies that, in the aggregate, the opportunities for developing countries to enter the global economy should increase. However, how far this will be translated into a broad-based boost to development across most developing countries depends on another great distributional tension, that of the distribution of the benefits of globalization among these countries themselves.

A basic issue here is whether this new global environment for development will lead to greater or less inequality. The evidence thus far does not favour the view that it will be equalizing. The literature in the new economic geography suggests that growth has been increasing inequality both within and between countries.³⁹ This literature notes that there are very large global spatial inequalities at present, even within well-functioning national economies and that in the previous wave of globalization there had also been, contrary to the predictions of trade theory, little convergence in income levels across countries. The main message is that the process of globalization and development is inherently uneven. Quite apart from the problems faced by many poor countries handicapped by unfavourable geography, there will remain strong tendencies towards increased inequality even among countries which have the prerequisites for growth in terms of good geography, institutions and policies. The key problem is that small differences in initial conditions tend to be cumulative and make entry for latecomers more difficult.

These tendencies towards increased inequality can be seen in the fact that only a small number of developing countries have so far managed to break into the growing circuit of 'globalization income'. Much of the access to advanced country markets for manufactured exports and the receipt of FDI inflows have been concentrated in a dozen or so developing countries.⁴⁰ Although this select group has recently come to include China and India, thereby greatly increasing the proportion of the southern population that now stands to benefit from globalization, this is of little comfort to 150 other developing countries and the 3 billion people who are still left out. Moreover, uneven development still operates strongly within countries especially within the large emerging economies that have succeeded in an overall sense in entering the global economy. Much of the overall economic dynamism has been concentrated in what are essentially enclaves, be it Bangalore for the high-tech industries in India or the coastal belt of rapid industrialization in China.

This aside, in terms of the basic intra-South distributional tension over development prospects, the very fact that the select group of developing countries that have successfully integrated into the global economy now includes India and China raises the spectre of the possible pre-emption of the development prospects of the rest of the developing world. Given the

³⁷ E. Leamer, 2006, *op. cit.* and E. Leamer and M. Storper: *The economic geography of the internet age* (NBER Working paper No. 8450, Aug. 2001) but see also A. S. Blinder: *How many US jobs might be outsourced?* (CEPS, Princeton University, Working Paper 142, Mar. 2007).

³⁸ *ibid.*

³⁹ A. J. Venebles: *Shifts in economic geography and their causes*, Paper for Jackson Hole symposium, Federal Reserve Bank of Kansas, Aug. 2006.

⁴⁰ A.K. Ghose: *Jobs and incomes in a globalizing world* (Geneva, ILO, 2003).

size of these two countries and the basic structural fact that the population of the advanced countries is, in comparison, much smaller, it is understandable that worries have surfaced that these two countries can capture the bulk of the growing market opportunities in manufacturing and services as well as most of the FDI flows to developing countries on their own.⁴¹ This would leave little space for other developing countries still waiting hopefully on the margins of the global economy.

To illustrate the problem, imagine that China's rapid growth takes it into the ranks of high income countries. This would boost demand for the exports of labour-intensive goods by a huge margin while also liberating substantial production space. How likely is such a helpful outcome? The rate at which India and China will converge to advanced country income levels is one crucial variable. The other is the rate of population growth in the rest of the developing world in relation to that in the currently advanced countries. 'If the disparity in population growth rates is sufficiently large, then the long-term evolution of the world economy will depend on whether or not the share of population living in advanced countries (and resulting demand for developing country labour and migration) is above a critical level necessary for the development and migration process to dominate the opposing demographic trend.' The model used in this study suggests 'that disparities in population growth rate are large enough that the proportion of the world population living in poor countries will not decline rapidly'.⁴² Hence the possibility that the economic space for the developing world will be pre-empted by India and China is likely to remain a problem for quite some time to come.

There is also the problem of competition among developing countries for whatever economic space is available. If one conceives of this as a queue then only a limited number of countries can gain a share of advanced country markets at any particular time. Not all countries can move ahead at the same time through adopting policy and institutional reforms to increase their competitiveness. It is only the countries that have done best in relative terms that can achieve integration into the global economy. This may 'explain why growth rates have not increased substantially despite dramatic improvements in economic policies of several developing countries'.⁴³

A different perspective on the same problem is to think in terms of the overall limits to the growth of aggregate exports from developing countries. The intuitive argument is that if all developing countries were to pursue an export-led development strategy simultaneously, there would be a fallacy of composition problem. While one or a few countries could successfully pursue an export-led strategy, this same success cannot be generalized if many or all developing countries were to do the same. A recent empirical study of this issue focused on the manufacturing sector and concluded that 'individual developing countries typically face demand-side constraints on their growth both in the sense that growth of industrial country demand for their products places constraints on export growth, and in the sense they produce relatively highly substitutable manufacture products and are, therefore, in active competition with each other...considering the significant presence of competition among developing country exporters of manufactures, there may be diminishing returns to export-led growth'.⁴⁴

In terms of its impact so far, the rise of China in particular as a manufacturing powerhouse has clearly had negative repercussions on other middle-income industrializing countries within the same cone of competition. In the case of Asia it is the low-income exporters of unskilled-labour intensive consumer goods that have experienced very strong Chinese competition in third markets. They have also lost out in the competition for FDI with China. In contrast the high-

⁴¹ M. M. Moreira: "Fear of China: Is there a future for manufacturing in Latin America?", in *World Development*, Vol. 35, No.3, Mar. 2007.

⁴² M. Chaman and M. Kremer: *Economic transformation, population growth and the long-run world income distribution* (NBER); Working Paper 12038, Feb. 2006).

⁴³ *ibid* p.18.

⁴⁴ A. M. Raymi and R. A. Blecker: *The limits to export-led growth: An empirical study* (American University, Washington D.C., May 2004). pp. 49-50.

income Asian Newly Industrializing Countries have experienced a net gain because the effects of Chinese competition have been more than compensated for by increased imports of capital goods from China. These countries are linked to China through global supply chains and have also gained from increased flows of FDI to China in the context of the expansion of these chains.⁴⁵ More generally, the growth rates of countries producing similar goods to China have declined in face of the powerful new competition from China for export markets and foreign direct investment and, in some cases from increased penetration of Chinese exports into their domestic markets.

There are other channels through which the increased role of China will be felt. One is through the terms of trade for labour-intensive manufactures. It has been argued that 'the greater China's participation in global product markets, the more likely prices will fall. And, second, this seems to have a disproportionate impact on the low-income country group which faces intense competition from Chinese producers.'⁴⁶ There will also be increasing pressure on other middle-income countries to increase the quality of their exports as China and India do so.⁴⁷

Looking further ahead, however, the picture appears less bleak since we can expect adjustment mechanisms, which had accommodated the rise of Japan and the Asian NICs, to begin to operate in this case as well.⁴⁸ These consist of rising real wages because of sustained growth and increases in labour productivity and the upward adjustment of exchange rates. This would shift their comparative advantage to higher value-added activities and hence vacate the economic space they currently occupy. A key issue, however, is how long this process would take. Given the very large pool of unskilled labour that still exists in China, it is highly likely that its comparative advantage will reside in unskilled-labour intensive goods for quite a number of years.⁴⁹

IV. Pathways into the global economy

The obstacles that many developing countries face in harnessing the potential benefits of globalization remain evident when we break down the issue of overall development prospects into its key components. These are global manufacturing, services, agriculture, finance and migration. We examine each in turn.

i) Global manufacturing

The growth of global production in manufacturing ensures continued opportunities for developing countries seeking to break into this system. Manufacturing remains the most potent source of growth for developing countries since, in contrast to primary products, there is a high income-elasticity of demand for manufactured goods. Moreover, because of lower wages and other costs developing countries have been steadily gaining comparative advantage in manufacturing. This began in simple labour-intensive products but the more successful industrializing countries then moved up the chain of capital - and skill-intensity in production.

⁴⁵ B. Eichengreen and Hui Tong: "How China is reorganizing the global economy" in *Asian Economic Policy Review* (2006) Vol. 1, pp.73-97.

⁴⁶ R. Kaplinsky: "Revisiting the revisited terms of trade: Will China make a difference?" in *World Development*, Vol. 34, No. 6, 2006.

⁴⁷ B. Dimaranan, E. Ianchovichina and W. Martin: *China, India, and the future of the world economy: Fierce competition or shared growth?*, World Bank Policy Research Paper 4304, Aug. 2007.

⁴⁸ World Bank: *Global economic prospects 2006* (Washington D.C., 2006).

⁴⁹ Eichengreen and Tong, 2006, op. cit.

Overall manufactures have been the fastest growing item of developing country exports. Between 1980 and 2000 the share of manufactures in total developing country exports increased from 20 to 80 per cent.⁵⁰ However, it is important to note that the main source of this dynamism has not been the low technology and labour-intensive exports that would be the principal point of entry for low-income developing countries. ‘High-technology exports are now the largest single component of developing country manufactured exports. In 2000, at 445 billion US dollars, they were 60 billion dollars larger than developing country primary exports, 210 billion larger than resource-based manufacturing exports, 39 billion larger than low-technology exports and 140 billion larger than medium technology exports.’⁵¹ However, ‘export dynamism and success in technology-intensive exports are highly concentrated, both by region and country...East Asia now accounts for about 75 per cent of total manufactured exports, and about 90 per cent of high-technology exports...the 10 largest developing world exporters of manufactures now account for over 80 per cent of developing country exports and their dominance has been rising over time.’⁵²

The reason for this concentration is that these high-tech activities are characterized by ‘strong economies of scale and agglomeration and so tend to concentrate in the few locations that can provide the minimum critical mass of skills, suppliers, services and institutions they need...Once established in particular developing countries TNCs are likely to stick for long periods...’ Thus, ‘the main drivers of recent export growth in medium to high-technology industries... are unlikely to reproduce their benefits to new developing regions’.⁵³

Although less pronounced, a similar tendency towards concentration is also observed in low-technology manufacturing activities. A recent study of clothing, footwear and furniture indicated that ‘these three industries — and many others like them — are characterized by a basic spatial dynamic that leads persistently to the formation of agglomerations of capital and labour, representing key locales within the broader landscape of production. In spite of steady improvements in technologies of communication and transportation over the last few decades, the general propensity of these industries to cluster together in geographic space has not been undermined.’⁵⁴ Similarly, while global supply chains have been growing rapidly in manufacturing ‘only a few countries have become part of global supply chains to a significant extent, even in low-technology activities’.⁵⁵

Apart from the difficulties of finding a niche in global production systems, there is also the issue of breaking out of a dead-end of low value-added production once entry is achieved. Although there have been a variety of different experiences in this respect, the basic story of exceptional success by just a few East Asian countries repeats itself here. It is only the Republic of Korea, Taiwan and Hong Kong (China) that have moved from the simple assembly of imported inputs to the highest stage of being original brand name manufacturers and players in the global industry in their own right. These countries have in turn built up a regional supply chain that provides an entry point to other lower income Asian countries.⁵⁶ Nothing similar has occurred in other developing regions.

Entry into the global manufacturing system is also made difficult by the fact that ‘there is rapid technical change in all activities, forcing enterprises in all countries, regardless of the level of development, to adopt new technologies to be viable...in this setting the ability to generate and

⁵⁰ J. Heintz: “Beyond sweatshops: Employment, labour market security and global inequality”, in *Anipode*, 2004.

⁵¹ S. Lall: *Industrial success and failure in a globalizing world* (UNIDO, 2002, www.unido.org/idr) p.7.

⁵² *ibid.* p. 8.

⁵³ *ibid.* p. 5.

⁵⁴ A. J. Scott: “The changing global geography of low-technology labour-intensive industry. Clothing, footwear and furniture”, in *World Development*, Vol. 34, Issue 9 Sep. 2006. p. 18.

⁵⁵ S. Lall, *op.cit.* p. 4.

⁵⁶ G. Gereffi and O. Memedovic: *The global apparel value chain. What prospects for upgrading by developing countries?* (Vienna, UNIDO, 2003).

sustain employment depends on the ability of countries and firms to promptly gain access to, efficiently use, and then keep up with new technologies'.⁵⁷

On the whole, therefore, it is unlikely that many more low-income countries will soon join the global manufacturing system. This judgement is reinforced when we take into account other factors that are particularly important in the manufacturing sector. The expanded scope of globalization has resulted in a more complex world of international economic relationships, one that is more exigent in terms of the scope and quality of physical infrastructure and institutions, and of the quality of human resources. Economic links are also now more elaborate and involve a much wider array of actors and potential partners, again raising the bar in terms of the policy sophistication and negotiating skills that are required for successful entry into the global economic circuit.

The task of creating sound institutions in developing countries also becomes more daunting as the market expands in scope and transactions become more complex.⁵⁸ Barriers to entry remain strong, not only in terms of the control over technology and intellectual property rights enjoyed by the advanced countries, but also because of less tangible factors such as accumulated advantages in terms of reputation and network effects. This makes the task of spreading the benefits of globalization through growth more complicated than just getting conventional policies and institutions right, essential though this remains.

The only way out of this impasse is for successful first-movers to shift up the ladder of industrial sophistication and thereby liberate economic space for the currently excluded. This can only happen in the context of high overall growth in the global economy coupled by accommodations from the North. Advanced countries will have to keep their markets open and manage orderly adjustments to a new global economy where their relative dominance is reduced.

ii) Global services

Most of the observations on manufacturing also apply to the new opportunities that are emerging through the off-shoring of service sector jobs. At one level the increased outsourcing of routine and relatively less skilled service sector jobs such as call centres, data entry and preparation, and information processing can be seen as analogous to the growth of global production in labour-intensive manufacturing products. Just as the latter created many millions of jobs in industries such as garments and footwear so too could the new service off-shoring generate jobs in analogous 'factories' producing 'commoditized' service products in low-income countries. More generally, the emergence of service sector off-shoring creates new entrepreneurial and employment opportunities for developing countries.

However, in the first wave of off-shoring less skilled and routine jobs, the dominance of India was even greater than that of China and a few other countries in global manufacturing. It is still unclear from the current literature how much demand for these jobs will grow in the future and what scope there will be for latecomers to claim a share of this.⁵⁹

What is clear, however, is that although India is enjoying an even greater dominance in the recent off-shoring of more highly skilled service sector jobs, it is unlikely to cede comparative advantage in the earlier less skilled jobs in the near future. This is because of its vast labour supply and highly dualistic labour market. So far, in spite of very rapid growth in employment in

⁵⁷ S. Lall, *op.cit.* p. 2.

⁵⁸ P. A. Yotopoulos: *Asymmetric globalization: Impact on the third world* (Stanford Center for International Development, Working Paper 270, Mar. 2006).

⁵⁹ See C. P. Chandrasekhar and J. Ghosh: *It-driven offshoring: The exaggerated development opportunity*. Human Systems Management Vol. 25 Number 2/2006. For a more optimistic view see T.N. Srinivasan: *Information technology enabled services and India's growth prospects* (mimeo, Yale University, 2005). Carmel (*op.cit.*) however, notes that in spite of very rapid growth India accounted for only 2 per cent of the global software industry in 2002.

the IT-related service sector, the share of these jobs even in modern sector employment remains very small.⁶⁰ The number of workers continuing to seek lower-end service sector jobs will thus remain large since these are relatively desirable jobs for the vast numbers of educated workers. For this reason, a rise in wages that could reduce India's comparative advantage in these jobs is unlikely to occur for several years. At the same time, given the labour market dualism and the large absolute supply of highly skilled IT workers and other professionals, it is also unlikely that the growth of this higher skilled segment will lead to any competitive bidding for the labour currently engaged in the lower skilled sector. This scenario is supported by the fact that there has been very little upward transition of firms from the low skilled segment to the higher skilled segment of the industry.⁶¹

Turning to the higher skilled segment of the industry, India is the only developing country which has become a major new entrant into this market.⁶² Outside the core advanced countries, only three economies, (India, Ireland, and Israel) have become major exporters of software and other IT-related products, with exports worth more than a billion US dollars in 2002. Behind these three countries are China and Russia with exports of over 200 million US dollars, of which only China is a developing country. In the next tier down there are only another six developing countries (Brazil, Costa Rica, Malaysia, Mexico, Pakistan and Sri Lanka) that have exports of more than 25 million dollars.⁶³ Apart from the two south Asian countries these are all middle-income countries that have been relatively successful in terms of integration into the global economy. Most of the developing world has thus not gained a tiny foothold in this market.

It would thus appear that the same obstacles to generalized developing country access that exist in manufacturing also operate in the case of these new activities. It has been pointed out that the 'first movers [Ireland, Israel, and India] have been able to build up contacts, policies, knowledge, infrastructure, working methods, track records, etc. They therefore threaten to consolidate their position whilst squeezing late-comers.'⁶⁴ The problem for late-comers would also appear to be more acute in the case of the latest wave of off-shoring.

The 'economic space' problem is additional to that of the conventional barriers to entry on the supply side. These include prerequisites in terms of a well-maintained telecommunications and broadband infrastructure and a pool of potential workers with general literacy and numeracy, basic computer skills, proficiency in English and perhaps other major Western languages. These prerequisites have yet to be built up in many low-income countries. In addition, it has been argued that in the case of the successful first movers a key ingredient of success was a tradition of emphasis on advanced technical education that went back at least one or two generations. Having a critical minimum of highly skilled workers, a strong 'cluster' of firms, an effective national consortium of the industry on the model of NASSCOM in India, internationally credible quality standards and a reputation of trust on matters such as the protection of intellectual property rights are all other essential ingredients for success.

iii) Global agriculture

Agriculture still provides jobs and livelihoods for much of the population in the developing world, and for many low-income countries raising productivity and incomes in the agricultural sector remains a key prerequisite of development strategy. A significant part of agriculture in

⁶⁰ Chandrasekhar and Ghosh, *op.cit.* The figure for 2003-4 was that employment in the sector was 245,00 i.e. less than 1 per cent of modern sector employment.

⁶¹ R. Hicks and B. Nickolson: *Software export success factors and strategies in developing and transitional economies* (2002, Paper No. 13, Institute for Development Policy and Management University of Manchester). The low-skill end consists of data services and software labour, moving up to software services and products.

⁶² E. Carmel: "The new software exporting nations: Success factors" and "Taxonomy of new software exporting nations" in *The Electronic Journal on Information Systems in Developing Countries* (2003, <http://www.ejisdc.org>, Vol. 13, No. 4).

⁶³ *ibid.*

⁶⁴ R. Heeks and B. Nicholson: *Software export success factors and strategies in developing and transitional economies* (2002, Paper No. 13, Institute for Development Policy and Management, University of Manchester). P. 19.

low-income countries still largely consists of smallholder subsistence farming although the production of export crops has also been important in some countries.

How has globalization affected the prospects of increasing output and incomes in the agricultural sector? A significant aspect of globalization has been the growth of buyer driven global food chains not only for traditional export crops such as coffee and cocoa but also a growing range of floricultural and horticultural products. These global food chains are dominated by large MNCs, and smallholders in developing countries are at the bottom of these chains.⁶⁵

At one level, the growth of these chains has increased the export opportunities available to smallholders because of the expanded range of products that are now traded internationally. The process of exporting is also made easier because of the increased possibilities for entering into contracts with the MNCs running the chains. This type of contract farming can also reduce risk and uncertainty for small farmers. Against this is the fact that such contracts are drawn up with multinationals which enjoy considerable market power. This opens the possibility of unfair contracts with low returns and wages for the small farmers and workers involved.

In order to have access to export markets developing country smallholder agriculture is increasingly constrained to operate within the framework of these global supply chains. The nature of these chains is such that the end markets are dominated by large retail firms which compete against one another in terms of price, packaging and product quality. This results in rapid adjustment in product volumes and the enforcement of exacting quality criteria, both of which complicate life for the smallholders at the bottom end of the global supply chain.⁶⁶ There is also the problem of growing concentration at the global level among buyers of agricultural products. This increases their market power vis-à-vis small producers.⁶⁷

Within this overall context, there are particularly strong benefits to be gained by entry into the growing niche markets for high-quality specialist products (e.g. coffee and vegetable varieties) since these command higher prices. This has been termed as a 'de-commodification' of certain agricultural products, allowing these goods to go against the general trend of falling terms of trade for primary commodities. However, 'a key characteristic of these niche markets is that they are very demanding at the level of process, particularly with respect to certification...It is in this extensive and demanding process that barriers to entry are created.'⁶⁸ This severely limits the number of developing countries that can meet these requirements and find a foothold in these specialized markets.

The dominance of MNCs in global agriculture also raises questions about the nature of the research that will be undertaken. In principle, developing country agriculture stands to gain from advances in biotechnology that will facilitate the development of transgenic crops that can give higher yields, that are better adapted to local ecological conditions, and that can be produced at lower costs.⁶⁹ It is unlikely, however, that such research, which is in the nature of a global public good, will be undertaken by the MNCs.⁷⁰ There are market failures in private research and it is

⁶⁵ M. Boehlje: *Globalization and agriculture: New realities* (Center for Food and Agricultural Business, Purdue University).

⁶⁶ J. Kidd: *Agriculture and rural livelihoods: Is globalization opening or blocking paths out of rural poverty?* (Overseas Development Institute, Agricultural Research and Extension Network, Paper No. 121, Jan. 2002).

⁶⁷ Kaplinski, 2006, op.cit.

⁶⁸ *ibid.*

⁶⁹ E. Huan-Niemi: *The impact of globalization on agriculture and employment for the poor* (Paper presented at the EGD-WIDER conference on *Unlocking Human Potential*, WIDER; Sept. 2004 and UNDP/FAO: *Globalization, agriculture and the least developed countries*, Issue Paper for UN Ministerial Conference for the Least Developed Countries, Istanbul. July 2007.

⁷⁰ D. J. Spielman: "Pro-poor agricultural biotechnology: Can the international research system deliver the goods?" in *Food Policy*, Vol. 32, No. 2, Apr. 2007.

rare that the interests of developing country smallholders will coincide with those of profit-maximizing MNCs. Much of this private research is focused on crop-protection chemicals and biotech applications for internationally tradable crops with large-scale commercialized agriculture and do not address the needs of marginalized smallholders. A related issue is that of access to the new knowledge that is produced through private research. Intellectual property rights are already held and will increasingly be held by MNCs through their new research. This will further reinforce the market power they enjoy and increasingly block independent access to new varieties by smallholders.

This creates a strong case for international and national action to stimulate and promote research on new crop varieties that will be of direct benefit to farmers in developing countries. A related concern is that the process of globalization has coincided with a reduced role of the state in promoting agricultural development.⁷¹ In many countries public investment in irrigation, rural roads and other rural infrastructure has been declining, as have state expenditures on extension services, rural credit, agricultural research and marketing assistance. This trend needs to be reversed if poor farmers are to benefit from the opportunities generated by the increasing globalization of agriculture.

iv) Global finance

Another option that exists in principle is for more countries to seek greater access to the burgeoning global financial market as a means to raise investment in order to spur growth. This would be in line with the neo-classical prediction that capital should flow from capital-rich to capital-poor countries. Yet we have seen that this has not happened to any significant extent in the current phase of globalization. Worse, ‘not only is capital not flowing from rich to poor countries in quantities the neo-classical would predict—a paradox pointed out by Lucas(1990) but, in the last few years, it has been flowing from poor to rich countries’.⁷²

Before discussing the possible explanations for this paradox, it is important to note that the North to South flows that have been occurring have been highly concentrated in a very small number of recipient countries. Private flows (FDI, portfolio equity flows and debt) have gone overwhelmingly to emerging markets, a small minority of developing countries. Even within this minority the distribution of flows is highly uneven with the result that for FDI, which accounts for 50 per cent of all private flows to developing countries, almost half went to five top destinations in 2005-06, with China alone accounting for a quarter of all FDI flows to developing countries. In the case of bank lending to developing countries, ‘large middle-income countries continue to dominate cross-border loan commitments. Lending became more concentrated over the past two years, with just ten countries accounting for three-quarters of all borrowing in 2006.’⁷³

Net South to North flows are not the only anomaly in the relationship between foreign finance and development. For example foreign capital, apart from FDI, does not flow more ‘to poor countries that are growing more rapidly and where, by extension, the revealed marginal productivity of capital (and probably creditworthiness) is indeed high...fast growing economies do have better investment opportunities, which is why they attract more FDI. Yet they do not utilize more foreign capital overall, and in the case of China, export capital on net’.⁷⁴ A corollary is that ‘developing countries that have relied more on foreign finance have not grown faster in the long run, and have typically grown more slowly’⁷⁵ Thus it is not surprising that an exhaustive review of the literature from no less a source than the IMF on the relationship between financial openness and growth concludes that ‘our reading of this large literature based on aggregate data

⁷¹ *ibid.*

⁷² E. Prasad, R. Rajan, and A. Subramanian: *Foreign capital and economic growth* (Research Department, International Monetary Fund, 30th August 2006. p.2.

⁷³ World Bank: *Global Development Finance 2007* (Washington D.C World Bank: 2007) p.43.

⁷⁴ E. Prasad et al. 2006, *op. cit.* p.3.

⁷⁵ *ibid.*, p.1.

is that it remains difficult to find robust evidence that financial integration systematically increases growth, once other determinants of growth are controlled for.⁷⁶

Explanations of these paradoxes essentially rely on weaknesses within developing countries. For example the risk-adjusted returns to investment may in fact be low in spite of the scarcity of capital because they have weak governance and institutions. From the perspective of a foreign lender the risks of default, expropriation and exchange rate depreciation lower potential returns. In addition the rate of domestic investments and the returns to these may be lowered by poor domestic policies. 'The institutional environment of weak property rights, a lack of collateral, government intervention through directed credit programs and state ownership of banks, an inefficient legal system, and weak government regulation to promote transparency all help explain why many countries stay poor while others grow rich'.⁷⁷ It has also been argued that underdeveloped domestic financial systems limit the capacity of developing countries to absorb foreign capital. 'The fastest growing developing countries generate more savings than they can use, in part because their financial system may be underdeveloped'.⁷⁸

While these issues remain unresolved at this stage in the debate, there are two other points on which there is relatively little disagreement. The first is that there are serious downsides to financial openness in developing countries with underdeveloped financial systems. Perhaps the most important of these is that 'opening up an economy to international capital flows, particularly if not managed properly, can lead to financial crises that are disastrous to the economy. That is why financial globalization is so controversial'.⁷⁹

The capital account liberalization that is required for full access to international capital markets exposes the country to unpredictable surges in capital inflows and outflows that are not usually linked to economic fundamentals. At the same time open capital accounts imply a loss of policy autonomy in that there is no alternative to facing the policy tri-lemma of surrendering control over either the exchange rate or the domestic interest rate. Coupled with past examples of herd behaviour and contagion effects not linked to economic fundamentals, a developing country with open capital accounts is really vulnerable to financial crisis. Such crises not only have strong immediate economic and social costs but also strong hysteresis effects that can seriously harm developmental capacity.

In addition, there are other systemic problems in global finance that can be detrimental to development. A basic one is that 'excessive reliance on foreign capital (i.e. large current account deficit) can result in currency overvaluation'.⁸⁰ Such an outcome would thwart strategies to boost manufacturing and other exports as an engine of growth. If a country then seeks to avert this through avoiding excessive deficits it may well be required to hold high levels of external reserves to protect its exchange rate because it suffers from reputational disadvantage. This would carry a high opportunity cost in terms of foregone investments for development.

It is also important to note another point on which there appears to be broad agreement. This is the fact that in order to harness the benefits and avoid the costs of financial openness a country has to fulfill some threshold conditions. 'Full-fledged opening of the capital account in the absence of essential supporting conditions can vitiate the realization of any benefits, while making a country more vulnerable to sudden stops of capital flows. These supporting conditions

⁷⁶ M. Ayhan Kose et al. ; *Financial globalization/A reappraisal* (Research Department, International Monetary Fund, Dec. 2006), p. 10.

⁷⁷ F. S. Mishkin: *Is financial globalization beneficial?* Columbia University, Sep. 2005 p. 8, as well as, by the same author, *The next globalization. How disadvantaged nations can harness their financial systems to get rich* (Princeton University Press, 2006).

⁷⁸ E. Prasad et al, 2006, op.cit. p.6.

⁷⁹ *ibid.*

⁸⁰ *ibid.*

include stable macroeconomic policies as well as sufficiently strong financial and other institutions, regulation and governance.⁸¹ These are not easy conditions for a typical developing country to meet. For example, referring to only one part of these conditions it has been observed that 'it is not easy to build the legal and regulatory institutions that facilitate the flow of information which in turn allows financial markets to function well. The development of these institutions took hundreds of years in the advanced countries of the West'.⁸²

There is little doubt that only a few developing countries have managed to meet these conditions so far, a depressingly familiar pattern to that in other spheres of globalization.

Thus financial globalization is an alluring but difficult and risky option. This is because it is not just a simple matter of adopting financial liberalization since this will be far from sufficient. There are many other necessary conditions to be met and some of these may be counter-productive from a developmental perspective.

The basic problem is that in order to borrow a developing country has to establish its credit worthiness as well as offer competitive rates of return to the lenders. This is easier said than done. Establishing reputation from a position of poverty and backwardness is akin to a Catch 22 situation. There are two basic ways of trying to establish reputation. The first is through the initial 'bootstrap' route, that is, through demonstrating good governance and a sound economic environment and policies. But this is clearly self-contradictory. If a country can do this then it has less need to borrow since it is already able to bring about home-grown development. Moreover, this route to accessing international finance through a gradual build-up of reputation is no use to a country that requires an initial boost of investment to help it over a basic threshold of developmental capability.

The other route to establishing creditworthiness also turns out to be rather a dead end. This consists of accepting external rules and policy conditionality that involve a huge surrender of policy autonomy. A country gains access to additional funds but cannot use them in accordance with its best judgments of what is most likely to boost development.

v) International migration

The other great hope in the minds of people in developing countries, if not also of governments, is increased migration to richer countries. There is no doubt that from the perspective of individual migrants entry into a rich country is a bonanza, representing a potential quantum leap from relative poverty to relative affluence. It is also true that from the perspective of a sending country there are large potential benefits in the form of remittances. These not only add to GDP, and perhaps investment, but also loosen the foreign exchange constraint faced by many developing countries. There is also the diaspora effect that can bring benefits in the form of investment, an additional channel for the transfer of knowledge and technology, and access to business networks. Although there may also be costs if much of the emigration is in the nature of a brain drain, the net benefits are likely to be strong.

It is therefore understandable that many developing countries favour a move towards the freer cross-border movement of workers. Some economists have supported this position on the grounds that increased migration from South to North would be a logical extension of the current process of globalization.⁸³ They point out the anomaly that the increasing freedom of movement of capital and goods across national borders has not been extended to labour, which remains largely immobile.

The underlying economic rationale for increased migration is that it would increase global output since labour from developing countries can move to higher productivity jobs in the

⁸¹ Kose et al. 2006, op. cit., p.25.

⁸² Mishkin, 2005, op. cit., p. 9.

⁸³ L. Pritchett: *Let their people come: Breaking the gridlock on global labour mobility* (Washington D.C., Center for Global Development, Mar. 2006).

advanced countries. Apart from representing a desirable relocation of factors of production on a global scale there is also the normative argument that increased migration would represent a desirable change in the global distribution of income. Poor people and poor countries would gain proportionately more from the process than their richer counterparts would. A variant of this argument is that even a small increase in the opportunities for international migration would do more for development and global poverty reduction than would further trade and investment liberalization or increased aid.

These largely economic arguments have been joined by arguments in terms of cosmopolitan ethics. A fundamental issue is whether it would be desirable to move towards the free movement of labour in the same way as towards the flow of goods and capital. From a cosmopolitan standpoint the answer would be an emphatic yes. Several arguments have been marshalled to support this position. A rights-based argument is that freedom of movement within a country is universally recognized as a basic human right and there are no convincing ethical grounds for not extending this to the international level. An argument based on social justice is that immigration controls exercised by rich countries perpetuate and aggravate international income inequalities and should be removed. From this standpoint 'citizenship in the western liberal democracies' has been characterized as 'the modern equivalent of feudal privilege'.⁸⁴

The opposing view is that there are strong justifications for nations to preserve immigration controls. A basic view is that there is an ethical basis for preserving the integrity of communities, and by extension nations, where a community is defined as 'a group held together by common recognition, shared culture, and mutually acknowledged obligation.' Members of the nation can exercise at the collective level the equivalent of autonomy at the personal level.⁸⁵ This is akin to the right to self-determination. Apart from this type of communitarian argument⁸⁶ there are, of course, the consequentialist arguments that highlight the various negative effects of unrestricted immigration such as the threat to social peace and the economic harm it would bring to nationals.

A key argument which is specific to migration is that in an increasingly integrated world economy, liberal principles such as fundamental human rights, fundamental rights at work, and democracy are strongly championed by the advanced countries as values that should be universally upheld. But such arguments are never mentioned with respect to international migration. Fundamental labour market rights such as non-discrimination by national or ethnic origin or the freedom to change jobs are held to apply only within the confines of a nation state. Yet in an increasingly integrated global economy, a case could be made that these values should increasingly apply on a global scale. From this perspective, the immigration regimes of the advanced countries have even been depicted as a form of global labour market discrimination and incompatible with the basic liberal values that are being espoused.⁸⁷

Be this as it may, there is unlikely to be any significant increase in the rate of legal international migration (apart from skilled labour) in the near future. There are several reasons for this, a fundamental one being that, unlike trade and investment flows where there is arguably a strong element of reciprocity, there is very little of this in the case of international migration.⁸⁸ As mentioned earlier there are strong benefits for migrant workers and for sending countries but estimates for the advanced countries show only very small macroeconomic benefits. A basic reason for this is that the gains from immigration in terms of increased labour market efficiency and flexibility and of relieving strains on pension systems arising from population ageing are often substantially offset by the fiscal cost of providing migrants and their dependents with

⁸⁴ J. H. Carens: "Aliens and citizens: The case for open borders" in R. Cohen (ed.): *Theories of migration* (Edward Elgar, Cheltenham, 1996), p. 252.

⁸⁵ D. Millar: "The ethical significance of nationality", in R. Cohen, 1996, op.cit., p 654.

⁸⁶ See also M. Waltzer: *Spheres of justice: A defence of pluralism and equality* (Basic Books, New York, 1983).

⁸⁷ J. Benhabib and B. Jovanovich: 'Optimal migration: A world perspective' NBER Working Paper 12871, Jan. 2007.

⁸⁸ T. J. Hatton: "Should we have a WTO for international migration?" in *Economic Policy* Apr. 2007.

social services and other welfare benefits.⁸⁹ Distributional problems are also created within the host country since the employers of migrant workers gain most, while native workers stand to lose from immigration.

Against these modest economic gains, we have to take into account the possible social costs associated with the influx of a large foreign population. In the heyday of faith in the social and cultural benefits of multiculturalism such a notion was barely mentionable in the political mainstream. However, this faith has largely disintegrated in the wake of the 'war against terror' and the footholds gained by Islamic fundamentalism among Muslim communities in the West. The pendulum is now swinging towards the view that multiculturalism is a chimera given the clear failures of assimilation even in terms of universal acceptance of the most basic values that underpin liberal Western democracies. In this context, the costs of immigration in terms of its detrimental effects on social cohesion and other dimensions of social capital are now often emphasized.

For all these reasons there is little prospect of any lowering of immigration barriers to the North. Increased emigration as a route to development is thus largely barred. The remaining emigration opportunities will consist largely of those granted for family reunion reasons and of selective skilled migration.⁹⁰ Far from being a general boon to development, such migration will have a double-edged effect. The family reunion type of migration means that benefits will not be evenly shared across the developing world but will remain confined to the original first movers in international migration. The pattern of emigration from the South has always been highly uneven where the first movers reinforced their position through the 'friends and families effect'; this created a strong path-dependence in migration flows.⁹¹ In addition, as already mentioned skilled migration creates problems of a brain drain.

Even abstracting from these difficult current realities there is an underlying structural problem with the view that increased international migration would be an important pathway to development. This is because of the huge imbalance between the populations of the North and the South that has been pointed out earlier. There is a clear limit to how many migrants a North with such a small population in relation to the vast multitude of potential Southern migrants can absorb even with very liberal immigration policies.

Nevertheless, pressures for international migration are likely to continue to increase not only because of growing income gaps between rich and poor countries but also because of declining transport costs. This is reinforced by the fact that successful poverty reduction in some developing countries is also making emigration feasible for a growing proportion of the South. Faced with limited opportunities for legal entry, this rising demand for entry into the advanced countries is likely to be reflected in a rise in attempted and actual illegal migration, which raises the returns to the human trafficking industry and feeds its continued expansion. At the same time, there is real demand within the advanced countries for the services of unskilled workers performing menial tasks such as domestic work, cleaning, etc. The illegal workers who manage to circumvent immigration barriers will thus obtain such work fairly easily, thereby sustaining the lottery of illegal immigration.

In such a scenario, it is important to recognize that immigration policy in the advanced countries has to be seen in the broader context of other policies towards developing countries. Migration is a deeply embedded transnational process that cannot be dealt with through immigration policies alone. Trade policies that give greater market access to developing country products are likely to help reduce the pressure for migration. Similarly, successful foreign aid policies that promote development will work in the same direction. In contrast, increased FDI

⁸⁹ G. H. Hanson : *The economic logic of illegal immigration* (Council on Foreign Relations, CSR No. 26, Apr 2007).

⁹⁰ T. Hatton and J.G. Williamson: *What fundamentals drive world migration* (NBER, Working Paper No. W1959, Sept. 2002).

⁹¹ R. J. Flanagan: *Globalization and labour conditions. Working conditions and labour rights in a global economy* (Oxford University Press, Oxford, 2006).

can have mixed effects. If it generates growth and net employment creation, it will help to reduce migration pressures. However, if the displacement effects of FDI are strong it will have the opposite effect. It also needs to be noted that increased FDI tends to strengthen the links between source and host countries and that multinationals often create internal labour markets for skilled labour that cut across national boundaries. Both these factors tend to increase migratory pressures. There is thus a clear need for policy coherence in the approach to issues of international migration.⁹²

V. Policy issues

The preceding discussion should have made it clear that the current process of globalization is unlikely to deliver equitable and generalized development without additional instruments of international public policy. The hope that a 'laissez-faire' global economy will create sufficient opportunities for all countries to achieve development is misplaced. As was argued earlier respectable rates of global GDP growth are indicative only of the widening gap between countries within the dynamic income stream generated by globalization and those that are excluded. They do not indicate generalized progress.

The problem is made even more acute by the fact that the least developed countries are still failing to achieve even the metabolic conditions for initiating economic growth. They lack the most basic requirements such as a unified state authority, civil peace, and a functioning market.⁹³ Above this tier of Hobbsean nightmares of countries, there are countries with the basic prerequisites but which still face enormous problems in terms of the quality of governance and institutions for initiating successful economic development. What can be done to deal with this basic structural inequality in the global economy as globalization continues its onward march? The answer requires a rethinking of both international and national policies

i) International policies

From a cosmopolitan perspective, it is clear that at the very least some form of a global 'redistribution with growth' strategy is required, so as to ensure that a proportion of the increase in global GDP is redistributed to help the countries currently excluded from the global economy to become integrated and share in its benefits. This is a wider perspective than the way the problem is usually cast in terms of increased ODA plus increased funding to provide a growing list of global public goods as well as to eliminate a number of global public 'bads'. It involves a systemic view of how the structural faults of the current process of asymmetric globalization must and ought to be corrected.

This view can draw support from arguments based on cosmopolitan ethics. It could be argued that in a world where the economic fortunes of peoples are becoming increasingly intertwined there is a corresponding need to foster a cosmopolitan view of ethics. A key issue would be the distribution of the fruits of globalization. Is there a case for moving towards the development of say a Rawlsian theory of justice on a world scale?⁹⁴ This would imply, for instance, that the global economy should function in such a way that the interests of the weakest participants should not be jeopardized. It would be in the common interest to ensure that some form of global difference principle applied to the least advantaged within the global economy.

⁹² T. Xenogiani: *Policy coherence for development: A background paper on migration policy and its interaction with policies on aid, trade and FDI* (OECD Development Centre, July 2005).

⁹³ Collier, 2007, op. cit.

⁹⁴ Branko Milanovic: *Ethical case and economic feasibility of global transfers* (Munich Personal Re Pec archive, paper no. 2587, April 2007).

There would be clear ethical obligations on the part of the winners from globalization towards the least advantaged of losers.

There is an ongoing debate in the literature over the precise form this obligation should take. One position is that the obligation is a strong one⁹⁵ arising from the duty to rectify injustice because it is the fault of the advanced countries that the developing nations are poor and unable, for the most part, to develop. This is based on the argument that global institutions have been shaped by the rich countries by virtue of their superior military and economic power and imposed on developing countries; they work to the benefit of advanced countries and to the detriment of poor countries. This is a continuation of a long and violent history of colonialism that inflicted grievous wrongs.

The alternative view is that the obligation is weaker, but is nonetheless unavoidable.⁹⁶ Rejecting the case that world poverty is the fault of the advanced countries would still leave at least two other grounds for providing assistance to poor countries. One derives purely from enlightened self-interest. Poor (and worse, failed or collapsing states) generate negative externalities in the form of increased flows of refugees and illegal immigrants and the spread of disease, terrorism and various types of cross-border criminal activities. The other is moral consistency. Since human rights and justice are fundamental values in the rich countries that have been extended to become universal, there is an obligation to act when these are systematically flouted in poor and unstable countries.

The form which this obligation of the rich countries should take depends on the view of the cause of poverty and underdevelopment. If it is believed that the cause is past and continuing injustice perpetrated by the rich, then there should be redistributive transfers to poor countries. In the opposite case there should be at least an obligation to support institution building in poor countries in order to put them on the path of stability and development.⁹⁷

An alternative way of addressing the same point is to think of some form of affirmative action towards the developing countries which are both marginalized and falling behind. Such affirmative action would need several elements. First, there would have to be direct international assistance in terms of aid and other interventions that may be necessary to create the basic preconditions for development such as a functioning state and civil peace. Secondly, there will need to be special concessions in terms of market access for the exports of the least developed countries. This could extend to the distribution of opportunities for immigration to the advanced countries as well as to measures to encourage increased flows of foreign direct investment to the least developed countries. Thirdly, there should be exemptions from multilateral rules governing trade, intellectual property rights, and financial flows in view of the special needs of these countries for policy space and their limited capacity to adhere to these rules. Fourthly, aid needs to be directed more strongly than at present to strengthening the basic capacities of these countries to gain a share of the developmental opportunities generated by globalization. This would include strengthening the physical and institutional infrastructure and the human resource base that are now required for successful entry into the global economy. While the deployment of aid for alleviating the many symptoms of poverty is laudable from a humanitarian standpoint and will also enhance development capacity over the long run, there should be at least equal attention to the issue of how the capacities of these countries to become viable players in the global economy can be strengthened as quickly as possible.

In addition to capacity-building there is also a need to confront issues of intra-developing country distribution of the opportunities generated by globalization. If there is a real danger that most of these opportunities will continue to be concentrated in a limited group of successful

⁹⁵ T. Pogge: *World poverty and human rights* (Blackwell, Cambridge, 2002).

⁹⁶ J. Rawls: *The law of peoples* (Harvard University Press, Cambridge Mass., 1999).

⁹⁷ M. Risse: *What we owe to the global poor: Political philosophy meets development economics* (Working paper RWP03-032, John F. Kennedy School of Government, Harvard University, Aug. 2003).

countries, thereby pre-empting development opportunities for the rest of the developing world, what options are there for remedying this? Would it make sense to think of additional measures such as promoting South-South cooperation to reduce the pre-emption of economic space by successful first-movers; or of strengthening coordination of development policies amongst developing countries to avoid problems of excess supplies and cut-throat competition in particular industries and markets?

ii) National policies

Changes to the governance of the global economy have at best been slow and gradual. It might well be clear to many countries that globalization needs to be made more supportive of broad-based global development. However, there is no guarantee that the political obstacles to reaching meaningful agreement for change can be overcome in the near future. A realistic scenario is that a typical developing country will have to manoeuvre in a global economy where a level playing field is yet to be created. In such a context, it will have to rely largely on national policies to make the best of what is currently available from the existing process of globalization.

As mentioned earlier, however, it is difficult to believe that national policies alone can do much to address the major global problem of failed states. In the absence of effective international action, it is difficult to see how countries that are below a metabolic level of functioning can solve their own development problems. We will have to leave these countries aside since the problems they pose fall largely outside the main discourse on national development strategies. That discourse assumes a credible state that can use its authority to achieve development objectives. The issues are about how well that authority is used, what constitutes the optimal effort in terms of the mobilization and deployment of public investment and what institutions and policies are required for promoting development.

Within this framework there remains a daunting list of questions that need to be addressed but we shall narrow our focus to issues that relate to how a functioning developing country can claim a share of the benefits of globalization to promote development and employment.

A convenient starting point would be to consider whether the broad objective should be to aim for deeper liberalization of trade, FDI and capital flows as a prerequisite for reaping greater benefits from globalization. Although this is the default prescription of the international financial institutions, there are several grounds for caution. One is the lack of evidence that this has indeed been the optimal strategy for maximizing the benefits from globalization: several of the countries that have succeeded best have not followed these orthodox policies. Recent success stories in Asia such as China, India and Vietnam have in fact followed heterodox policies that involved controlled rather than all-out liberalization of trade, investment and capital markets. These countries maintained a measure of import protection, followed selective industrial promotion policies and retained controls over FDI and the capital account. The same use of controlled liberalization strategies was also broadly true of the earlier groups of newly industrializing countries in Asia. Conversely, there are few examples of countries that have prospered through full-blooded liberalization. A case in point is Latin America where several countries adopted extensive trade and financial liberalization without managing to accelerate the growth of exports and output. The same can be said of some African and transition economies.

There may be diminishing returns from a strategy of full-blooded liberalization, given the asymmetric nature of the process of globalization that was discussed earlier. In particular, convergence remains limited because of incomplete globalization; this will restrict the potential gains that can accrue from further liberalization. Put differently, if the current process of globalization is still far removed from a totally integrated global market that can ensure rapid convergence, then it is one where the economics of the second-best applies. In such a world

laissez-faire policies that would work in a well-functioning and integrated global market economy are unlikely to be the best means for promoting development. Instead what is required are second-best policies suited to the second-best world we are in.⁹⁸

This would call for policies designed to redress the many market failures that exist as the most effective means for promoting development. A prime example of such policies is the entry into new lines of activity. Taking advantage of new opportunities for entry into the global economy requires pioneering entrepreneurs within a country, who will lead the way. The risks are high and so are the potential rewards. However, there is typically a market failure that will retard such risk-taking. This lies in the fact that the innovative pioneers, when successful, will see the returns to their investment eroded by subsequent entrants who do not bear the same risk since the new activity has already been demonstrated to be profitable by the pioneers. The 'followers' do not need to compensate the pioneers for the initial risk that they took.⁹⁹ The upshot is that pioneering entry into new activities will be retarded. The way around this would be for government to subsidize pioneering entry into new activities as a key means of promoting development.

This can be seen most clearly in the case of manufacturing where entry into higher productivity export activities is difficult and highly risky. Some promotional role by the state is typically required.¹⁰⁰ The same could be said of other potential points of entry in either the agricultural or service sectors.

This approach implies that governments should assume a strategic role in promoting development through instruments such as the mobilization and allocation of public investment and some form of active promotion of targeted activities. However, such a role of the state is increasingly at odds with the prevailing conventional wisdom on the management of national economies. Such an approach is also becoming less feasible in the face of growing encroachments on national policy space under the current process of globalization.

In the absence of an active role of the state the policy instruments for development and employment are reduced to those that operate via the general macroeconomic and institutional environment. The underlying view is that the best means of promoting both output and employment growth is to ensure a stable macroeconomic environment, a conducive investment climate and a flexible labour market. The only other role of the state would be action on the supply side to provide public goods and social protection and to promote education and skill development.

In such a framework the process of exploiting the growth and employment creation opportunities presented by the global economy would depend on the actions of private entrepreneurs. Positive outcomes cannot, however, be assured if there are serious market failures and distorted incentives. Thus even in such a framework there is likely to be a strong rationale for state intervention to correct market failures that may reduce growth and employment creation below its potential rate. As pointed out earlier, a particularly important area for action is the need to correct the market failures that deter innovative entry into new lines of production and export. Another important area is the management of the extent, pace, and sequencing of the liberalization process as a means of ensuring the best attainable growth and employment outcomes. As argued earlier, there are no grounds for blind faith in a strategy of full-blooded liberalization across the board. Careful management of the liberalization process can help to avert negative impacts such as excessive job losses in previously protected industries, slow growth of output and employment in export industries and exposure to devastating financial crises.

⁹⁸ D. Rodrik: *How to save globalization from its cheerleaders* (mimeo, Harvard University, July 2007).

⁹⁹ R. Hausmann and D. Rodrik: "Economic development as self-discovery", in *Journal of Development Economics*, 2003, Vol. 72, pp. 603-633.

¹⁰⁰ D. Rodrik: *Doomed to choose: Industrial policy as predicament* (mimeo, John F. Kennedy School of Government, Harvard University, Sep. 2006).

Where a government has decided on activities to be targeted for promotion then there are a series of follow-through policies to be considered for adoption. These include giving preferential incentives to foreign and local investors for entry into these lines of activity, providing the required infrastructure, developing the institutional structure to support these activities, and ensuring adequate supplies of the required inputs such as skilled workers. Where warranted, additional measures targeted at maximizing employment creation could be deployed. These include incentives to influence investors to choose the most labour-intensive technologies that are economically viable.

Turning to the issue of employment creation it is important to recognize that increased integration into the global economy is of potential strategic importance in this area of policy. Success in seizing new opportunities is likely to enhance both growth and employment creation. Since the jobs created would be modern sector jobs in a developing country context they would be more productive than jobs in the traditional sectors, that is, peasant agriculture and the urban informal sector. A rapid rate of increase of modern sector jobs through increased integration into the global economy would therefore be a significant boost to efforts to provide decent jobs for all.

However, the preceding analysis has suggested that developing countries face serious constraints and competitive pressures among themselves in achieving successful integration into the global economy. In a fundamental sense, for an individual developing country the serious challenge of creating employment through exploiting opportunities in the global economy mirrors that in the realm of development strategy. Finding ways to expand existing activities already linked to the global economy and/or new entry into global production systems and global markets is the prerequisite first step for generating employment growth. It is only when this step has been taken, that is, when a potential set of feasible options for expansion and/or entry into the global economy has been identified, that the thinking on employment strategy can begin.

Since a fundamental objective of employment strategy in labour-surplus developing countries is to maximize the overall rate at which productive jobs are created, a basic criterion should be the *net employment creation effect* of a given line of activity. The emphasis on the net effects arises from the commonly observed fact that integration into the global economy often involves a dual process of job creation and job destruction. Other things being equal, a country should choose the most employment-enhancing activity. An added consideration is that in the interest of poverty reduction the search for opportunities for increased integration into the global economy should not focus only on the modern manufacturing and services sectors. Special attention should be paid to helping smallholder agriculture and small enterprises in the informal sector to find niches in the global economy.

Such an approach to maximizing employment growth will not, however, be easy to implement. The problem can be seen when we spell out the basic assumption that underlies it, i.e. the assumption that countries have the freedom to choose from a sufficiently large number of options to expand existing activities or to enter into new ones. This may not be the case given the many asymmetries in the current process of globalization and the many handicaps that developing countries face.

Where a country's endowments and capacities are such that it has very few options then the basic decision — to favour greater employment-intensity — cannot be applied. The decision is then to take what is available or to settle for nothing. This choice ultimately depends on whether taking what is available will enhance future development capacity (including the possibilities for future employment-creation) more than the alternative of not doing so.

It is important to take such an inter-temporal view of the issue even where countries are in a position to choose between several activities with different current employment impacts. A given activity that may have a superior immediate impact may not have the best impact over a longer

term time-horizon. As was discussed in the early literature in development economics on the choice of technique, it may sometimes be rational to choose a less labour-intensive (or more capital-intensive) technique of production if it boosts growth and future employment creation by a greater margin than currently more labour-intensive techniques.

This discussion so far has indicated the difficulties in finding a successful response to the challenge of employment creation. Yet it has only considered maximizing the overall rate of employment growth through increased integration into the global economy. This is a fundamental aspect of the problem but, as set out in the ILO's decent work agenda, it is not the only one. A clear implication of the new global political consensus on decent work as a global goal is that employment policies must not only meet quantitative targets in terms of employment creation but must also ensure progress towards other components of decent work, namely, fundamental rights at work, social protection and social dialogue.

A basic constraint facing policy makers charged with achieving these multiple sub-objectives is the lack of direct instruments within the sphere of economic policy per se. With respect to jobs generated through entry into the global economy a possible instrument is to impose requirements on investors in terms of the desirable decent work attributes of the jobs that are created. Indeed some trade unions advocate such an approach in calling on governments to ensure that economic liberalization does not result in the creation of 'non-decent' jobs that lock countries into exploitative labour conditions. However, there is a basic problem to be overcome before such an approach can be effective. This derives from the fact that in order for such an approach to work it is necessary that all countries adhere to the same standards. Otherwise in a world where production is increasingly footloose, capital increasingly mobile, and where the global labour surplus is growing, it is very difficult for a single country to make such an approach work. This obstacle is an objective reality regardless of whether adhering to decent work standards would impair economic performance or enhance it. While the available empirical evidence does indicate that decent work standards improve economic performance this is of limited import so long as governments and investors do not act as if this is the case.

However, where a country is in the happy position of being able to choose from a significant number of alternative investors seeking entry into new activities then it will have an additional instrument for promoting decent work. This would involve applying a decent work criterion as part of the investment screening process. Where this is not the case, most other possible instruments for promoting decent work would involve comprehensive multilateral action through strengthening the enforcement of international labour standards or through voluntary codes of conduct for international business.

This is not to say, however, that countries cannot do anything else to advance the decent work agenda through other spheres of national policy. Parts of the decent work agenda such as guaranteeing freedom of association, creating the institutions for social dialogue, and providing adequate social protection can very well be achieved through unilateral national action if the political will is there. This can in turn have a positive impact on economic performance and hence the attractiveness of the country as an investment platform within global production systems.

Although the creation of employment through increased integration into the global economy is of strategic importance, there are other aspects of employment policy that also require attention. These include programmes to raise productivity and incomes in smallholder agriculture, the non-farm rural economy, and the urban informal sector. Such programmes are important because these are the sectors where the majority of the labour force in developing countries still eke out a livelihood. Even with rapid growth of modern sector employment the transfer of labour out of these sectors will be a slow process, given that the initial size of the modern sector is typically very small in low-income countries. Thus there is still a strong need for a two-track employment strategy that includes programmes directed at the traditional sector.

Obviously this need is all the stronger in situations where employment growth in the modern sector does not increase rapidly.

It is also important to recognize the potential synergies between these two tracks of the employment strategy. Where viable opportunities exist for smallholders or small enterprises to find a niche in global markets there would be a case for active policies to facilitate their exploitation. Such policies would achieve both equity and efficiency objectives.

iii) Concluding remarks

Our review of the literature has shown that the expanding level and scope of globalization does indeed contain the potential to deliver higher growth in the global economy and greater opportunities for all poor countries to develop. At the same time it has also shown that many serious obstacles stand in the way of realizing this potential. Thus much of the hype on the wonders of globalization is pernicious. It ignores the difficulties and sustains the delusion that all that is required to arrive at a better world is for all countries to embrace globalization more ardently. This blocks the serious rethinking of international and national policies that is required to ensure that it delivers its full potential.

The obstacles that have been identified are serious but they are not insurmountable. The broad outlines of what needs to be done are known. Much of this consists of cooperative global action based on the enlightened self-interest of all countries and a minimal cosmopolitan ethical obligation to create a fairer and more inclusive process of globalization. These are powerful reasons why the required actions should be taken in the near future.

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