The South in an Era of Globalization

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Globalization has many faces — in trade, finance, investment and production systems. It affects development thinking and action, relegating ethical, equity and social concerns behind market considerations and reducing the autonomy of the state. Countries of the South need to come to terms with these phenomena by adjusting their development strategies. The writer is John F.E. Ohiorhenuan, Director of the Special Unit for Technical Cooperation among Developing Countries, United Nations Development Programme, New York.

NEXT TO EL NIÑO, globalization is, perhaps, the most widely discussed phenomenon today. Like El Niño, globalization occasionally manifests itself dramatically in its effects on the lives of ordinary people. But globalization is not just a destructive leviathan; it is also a powerful force for the improved material well-being of humankind. Dealing with the imperatives of globalization, capitalizing on its positives and mitigating its negatives is perhaps the most important challenge for the new millennium.

Although its effects are felt worldwide in various degrees, the notion of globalization is still not universally understood, and positions for or against are often taken on the basis of ideological leanings or gut feelings. As a first step, therefore, this article describes the main dimensions of globalization, providing a factual basis for analyzing its scope and effects. Countries of the South, in particular, need to come to terms fully with globalization in order to make the appropriate changes in their development agendas and strategies. This article also examines some of its implications for developing countries

*** The views expressed here are the author's and not necessarily those of the United Nations. The assistance of Cosmas Gitta and Nand Bardouille in preparing this article is gratefully acknowledged.**

and raises some questions about its ramifications for the policy-making autonomy of the state.

THE ELEMENTS OF GLOBALIZATION

Globalization is first and foremost apprehended in economic and financial terms. In this sense, it may be defined as the broadening and deepening linkages of national economies into a worldwide market for goods, services and, especially, capital. As a result of changes in economic policy across a wide range of countries and a revolution in telecommunications and information technologies, the last fifteen years have witnessed dramatic increases in trade linkages and cross-border capital flows, as well as radical changes in form, structure and location of production.

Furthermore, due to developments in media technology and communication, globalization brings with it a growing tendency towards the universal homogenization of ideas, cultures, values and even lifestyles. In addition, running parallel with and even overarching the economic dynamics, there has been a growth of new supranational policy regimes such as the World Trade Organization (WTO), the Global Environmental Facility (GEF), and various global environmental conventions. There has also been a subtle realignment of older ones such as the Bretton Woods Institutions, the Organization for Economic Cooperation and Development (OECD), and even the United Nations.

TRADE

Over the last 40 years, world trade in goods and services has consistently grown more rapidly than world output. As a result, close to 20 per cent of the total volume of world output is exported. These exports are worth $7 trillion, or about 23 per cent of the value of world output. Developing countries account for just over 30 per cent of global exports. Manufactures now account for over 60 per cent of developing country exports, compared to 40 per cent only ten years ago.

However, the secular buoyancy of trade is not enjoyed equally by all regions. Asia and Latin America have had annual export growth rates of around 7 per cent and 5 per cent, respectively, over the last 25 years. But Africa has suffered an average annual decline of 1 per cent, and its share of world merchandise trade has fallen to about 2 per cent from around 6 per cent in the early 1980s. Latin America has maintained a share of about 5 per cent over this period, while Asia's share has increased significantly from about 16 per cent to 27 per cent.

FINANCE

Perhaps the most prominent face of globalization is the rapid integration of financial markets over the last decade. Innovations in communications and computer-mediated technologies have made possible a vast array of new financial instruments and risk-management technologies. In addition, fixed exchange rates were abandoned in the early 1970s, and finan-

cial markets were subsequently deregulated. The result has been a spectacular increase in cross-border capital flows. Cross-border transactions in bonds and equities were generally less than 10 per cent of GDP in 1980 for the major advanced economies; by 1996, they were generally over 100 per cent. The average daily turnover in foreign exchange markets, adjusted for local and cross-border double-counting, has risen sharply from about $15 billion in 1973 to about $200 billion in 1986, to over $1,300 billion in 1995.

The last 25 years have seen a sharp rise in the growth of portfolio equity flows, particularly to the so-called emerging markets. From nothing in 1970, portfolio equity flows to developing countries were estimated at $46 billion in 1996 and $33 billion in 1997, the downturn being mainly the result of the East Asian financial crisis. Regional variations are also quite sharp here, with Latin America and East Asia receiving 62 per cent of total portfolio equity flows to developing countries.

Even more significant for developing countries is the changing character of net long-term resource flows. First, private capital is now dominant, contributing 85 per cent in 1996 versus 45 pert cent in 1990. Second, portfolio flows constitute almost 30 per cent of total non-debt private capital flows, a manifestation of the growing importance of non-bank financial institutions (insurance companies, mutual and pension funds, etc.) as sources of development finance.

PRODUCTION

The global stock of foreign direct investment (FDI) was $3,233 billion in 1996, having grown at an annual average rate of 24 per cent in 1986-1990, and 17 per cent in 1991-1996. FDI inflows averaged about $28 billion in the l970s, $50 billion in the first half of the 1980s, $142 billion in the second half, and $243 billion between 1991 and 1996. Here again, there are marked disparities by region. Africa's share of FDI inflows was only 1.4 per cent of global inflows in 1996, compared to 11 per cent for Latin America and the Caribbean, and 13 per cent for South-East Asia. Indeed, the bulk of FDI flows occurs among the high-income countries — about 63 per cent; and ten countries account for 78 per cent of the total developing country share.

The growth of FDI underscores the enormous role of Transnational Corporations (TNCs) in economic activity worldwide. The value of goods and services produced by foreign affiliates was estimated at $7,000 billion in 1995. Not surprisingly, production by TNCs is becoming the dominant mode of servicing foreign markets. With the dramatic fall in transport and communication costs over the last 40 years, firms are finding it efficient to locate different stages of production in different parts of the world. Foreign trade is becoming more and more intraindustry and intrafirm, especially for the advanced economies. The TNC has also become the quintessential vehicle for knowledge and technology transfer. Sig-

nificantly, the global assets of TNCs were estimated at over $8,000 billion in 1994, compared to global gross domestic investment of $5,681 billion. The main features of TNC activity are presented in the box below.

Intrafirm trade is increasingly becoming the leading edge of foreign trade. For the US, for instance, intrafirm trade accounted for over 35 per cent of exports and 40 per cent of imports in 1995. The US Federal Trade Commission estimates that, between 1983 and 1992, intrafirm trade accounted for 43 per cent of US-Europe trade, and 71 per cent of US-Japan trade. With the evolution of the TNCs into a global network of interlocking activities, the nature of comparative advantage is changing from its old locational basis (country) to a new organizational basis (the firm). This development carries significant implications for the relationship between policy and market outcome.

Against the background of disenchantment with the results of 30 years of social engineering in developing countries, a "neoclassical counterrevolution" was launched in the late 1970s to reassert the virtues of the market.

GLOBALIZATION: SOME CRITICAL CONSIDERATIONS FOR THE SOUTH

The implications of globalization are not yet fully understood, even for the high-income economies. For countries of the South, the issues are considerably more complex because globalization is changing radically the parameters of the development agenda. Two questions seem to be fundamental for the South. First, is globalization rendering the notion of development redundant? Second, how does globalization affect the relative autonomy of the developing country state in national policy-making?

Globalization and the Idea of Development

From the earlier idea of development as growth, the prevailing paradigm insists on several qualifiers to drive home the notion that development is about people in social interaction and in interaction with other occupants of the planet. Hence: sustainable development; sustainable human development; environmentally sustainable development; equitable development, etc. With or without qualifiers, however, the idea of development is undergirded by the teleological philosophy that means are prefigured by ends; that development implies purposive action to get from an existing state to a desired state.

While globalization is not completely new, the current era is located firmly in the context of a new market fetishism. Against the background of disenchantment with the results of 30 years of social engineering in developing countries, a "neoclassical counterrevolution" was launched in the late 1970s to reassert

SOME FACTS ABOUT TRANSNATIONAL CORPORATIONS AND THE GLOBAL ECONOMY (1995)

- There are 39,000 TNCs, including 4,148 from developing countries. They have 270,000 affiliates, of which 119,765 are in developing countries.
- FDI stock at the end of 1995 was $2.7 trillion. Of this amount, 65 per cent was accounted for by France, Germany, Japan, the United Kingdom and the United States. Developing countries accounted for about 7.8 per cent of the worldwide FDI stock.
- The sales of foreign affiliates of TNCs in 1993 were estimated to be $6 trillion, compared with $4.7 trillion of world exports.
- China was the leading developing country recipient of FDI flows in 1995. South and South-East Asia received 65 per cent of the total flows to developing countries, and Latin America and the Caribbean 27 per cent of the total flows.
- The largest 100 TNCs (excluding those in banking and finance) are estimated to account for about one-third of global FDI.
- Worldwide cross-border mergers and acquisitions of all kinds doubled in value between 1988 and 1995, and accounted for 72 per cent of FDI outflows (42 per cent in the case of majority-held M&A transactions).
- 75 to 80 per cent of all FDI stock in 1992 was in sectors requiring above average levels of human skill, capital or technology intensity.
- 50 to 55 per cent of all FDI in 1992 was in the tertiary (service) sector.
- FDI and strategic alliances are growing faster than other forms of international transactions.
- Some 73 per cent of the stock of inward investment at the end of 1995 was in developed countries, though developing countries accounted for 32 per cent of all new FDI. Central and Eastern Europe accounted for almost 4 per cent of worldwide inflows of FDI in 1995.
- Over the period 1991-1994, FDI from privatization schemes in Central and Eastern Europe amounted to over $8.5 billion, or 49 per cent of the region's total FDI inflows. In the case of developing countries, privatizations amounted to $17.6 billion, or 6 per cent of their total FDI inflows in 1989-1994.

Source: Dunning, 1997.

How to engineer a new balance between the market and society? How to continue unleashing the creative energies of private entrepreneurship without eroding the social basis of cooperation?

the virtues of the market and the importance of "getting the prices right". With the collapse of communism, the triumph of market over state was complete. The resultant tendency towards ideological homogeneity considerably reduces the intellectual space for the consideration of ethical and equity issues in social interaction and international relations.

Implicitly, the new market fetishism is elevating the notion of self-interest as the basis of market rationality to a "take-no-prisoners" attitude in interpersonal and intercountry relations. The contemporary manifestation of market liberalism, in its pursuit of pure commercialism, appears to leave little room for charity or the generosity of spirit that used to be taken for granted as the essence of civilized behaviour. With no constraints beyond the ethics of respect for property rights, the post-cold-war market ideology justifies predatory behaviour as the natural tendency of humankind.

Despite the genuine concern of the international development community with the existential conditions of people in developing countries, the Darwinian logic of the market is also increasingly reflected in the discourse on development cooperation. In debates at the United Nations, powerful countries argue that the end of the cold war has made any North-South distinction basically irrelevant, as such distinctions were merely a reflection of the cold war ideological divide. The New World, they argue, is one of "partnership", and each country is wholly responsible for its own destiny. But this new partnership is essentially a quid pro quo relationship except, perhaps, in purely humanitarian causes.

The declining level of Official Development Assistance (ODA) over the last decade is, at least partly, a result of the growing perception that development assistance is anachronistic. It may also be argued that the increasing powers of those multilateral institutions with a one-dollar, one-vote decision-making mechanism, and the corresponding weakening of those with a one-country, one-vote mechanism is symptomatic of an unabashed acceptance of plutocracy as a morally acceptable basis of global governance.

In the context of the high-income countries, Dani Rodrik makes an eloquent case for the reaffirmation of the "social insurance" role of governments. In his words: "Globalization .... is part of a broader trend that we may call marketization. The broader challenge for the 21st century is to engineer a new balance between market and society, one that will continue to unleash the creative energies of private entrepreneurship without erod-

ing the social basis of cooperation."

Development cooperation is in many ways the international relations analogue of social insurance. Just as social insurance has historically facilitated trade integration and multilateral liberalization, so too has development cooperation helped to foster world peace (precarious as it may be). The phenomenon of declining ODA and the growing impatience with the endemic problems of developing countries is, perhaps, a logical outcome of globalization. But it would be myopic to forget that globalization by its nature tends to generate international market failures because it is uneven in intensity and scope and because it impacts differently on different classes of people.

Globalization and the Relative Autonomy of the Developing State

In Adam Smith's famous formulation, the pursuit of individual self-interest produces the best good for society. Advocates of the new market liberalism often go back to Smith as the oracle. It is often forgotten, however, that Smith was emphatic in portraying "large combinations of capital" as contradicting the realization of market efficiency. More significantly, perhaps, it is often neglected that Smith's distrust of the state was mainly because he saw it as an institutional manifestation of the conspiracy of the rich and/or propertied against the poor and/or propertyless. He did expect the state to provide an enabling institutional and infrastructural framework, and it is this dimension of his work that is said to justify the notion of a minimalist state.

However, the evolution of the state in the high-income countries has seen the full acceptance of its role in providing the social overhead capital that is necessary for the market to function reasonably effectively. Accordingly, while there may have been debate as to the neutrality or autonomy of the state (i.e. the extent to which it is a register of the balance of social forces), there was no serious questioning of its role in mediating internal social conflict, whether negatively (as in repression) or positively (as in the provision of social services and safety nets). It was also broadly accepted that the state has preeminence in mediating between the domestic and external domains.

Globalization fundamentally challenges the mediative role of the state vis-à-vis external pressures. The combined effect of the global fluidity of finance capital, the growth of FDI, and the emergence of global corporations is to undermine the economic sovereignty of states. Vincent Cable describes how highly mobile capital leads national regulators to cede control to global markets that are wholly unregulated (currency markets), lightly self-regulated (bond markets), or imperfectly regulated (...multinational banking ...). (Cable, 1995)

For instance, the management of exchange rates depends less directly now on government action than on the action of foreign exchange and securities traders. The recent experience of some

East Asian economies and of Mexico in 1994 shows what can happen when international finance decides to pull out for whatever reason.

While international trade as an element of globalization is, perhaps, less spectacular than finance, it is in this area that the new constraints on the state are most visibly demonstrated. Globalization is market-driven, but, in the area of trade, it is clear that the process is significantly facilitated by the actions of states. The establishment of the rules-based multilateral trade regime embodied in the WTO is the result of a process where the leading actors are government officials. The whole process engenders a tension, identified by Cable and Rodrick among others, between countries over domestic norms and social institutions. The main point for the developing country, however, is that the ability to take advantage of (or create) opportunities and mitigate threats is a function of the capacity and discretionary power of the state.

By broadening the notion of trade into trade-related issues, the Uruguay Round moved critical issues of economic policy such as foreign investment, intellectual property, technology, technical, health and safety standards, and a broad range of services onto the platform of international trade relations. It is of particular concern to developing countries that negotiations tend to be heavily influenced by the powerful countries.

The rules-based trade regime imposes an additional burden on the countries of the South to build national capacity to project and protect national interests and to be more effective negotiators; developing the capacity to comply with agreed obligations and exercise their rights; and putting in place a whole panoply of new institutional arrangements in order to be more competitive.

The declining autonomy of the state is not unique to developing countries. For instance, in the high-income countries, governments are under pressure to help their citizens adjust to the changes brought about by globalization, even as the tax base to support public consumption is eroded by the imperatives of competitiveness. The difficulty of taxing increasingly footloose capital combined with the need to maintain comparative (low) taxation levels tends to shrink the fiscal base. It is possible, as Cable observes, to resort to higher levels of deficit financing. But this strategy "is eventually circumscribed by international financial markets: which foreign investors are willing to lend and on what terms".

For the developing country, the problem is compounded by the fact that the notion of an activist state (which is required to establish safety nets and lead the development process) is passé intellectually and infeasible practically. Intellectually, the activist state is incompatible with the ideology of liberalization. Historically, the activist state has relied heavily on domestic and external resources for which it did not always pay full market value. It also requires

an international policy context which allows considerable variation in development strategies and domestic policy regimes among countries.

The Managing Director of the IMF, in describing his organization's prescription for the "second generation" of reform, highlights implicitly the enormity of the challenge for developing countries. The four core elements of this policy regime — better fiscal adjustment, "bolder" structural reforms, better government and strengthened finances — all require a highly competent state machinery. Better fiscal adjustment includes reducing budget deficits and changing the composition of government expenditure: improving education and training, reforming pension schemes and health care delivery, and providing social safety nets. "Bolder" structural reforms means securing a smaller, better paid and more efficient civil service, undertaking extensive labour market as well as trade and regulatory reforms, and creating/reinforcing property rights regimes. Better government means improving transparency and accountability as well as ensuring reliable public services. Strengthening domestic financial institutions implies establishing appropriate prudential and oversight mechanisms.

Even this minimalist agenda shows quite clearly that, in Dunning's words, markets are not a free good; they cost resources to set up, to operate and to maintain. The major challenge for the developing country is to find the resources to ensure a reasonably competent state, and the resources to set up and maintain reasonably effective markets at the same time that the traditional providers of these resources are threatened by the forces of globalization.

CONCLUSION

The last four decades have witnessed increasing differentiation among the large group of countries designated as developing. Indeed, a few of them are almost fully integrated into the globalized economy. Most of them, however, are still marginal players. To be effective participants, these countries need to understand fully the new opportunities globalization brings and the new constraints it imposes on the development process.

The first issue addressed here is that globalization seems to make the idea of development redundant. It would appear that, on the logic of marketization, development and, by extension, development cooperation are anachronistic. But it would be self-defeating in the long run if the values of equity, fairness and civilized behaviour were sacrificed on the altar of globalization.

The second issue relates to the relative autonomy of the developing country state. Globalization threatens the discretion of the state everywhere. But the more developed the country, the more robust is the response mechanism of the state. For the developing country, the challenge is to be able to retain the idea of an activist state, even while recogniz-

ing that the new activism must be different from the *dirigisme* of the 1960s and 1970s. The challenge for the international community is to recognize that development requires an exceptional combination of circumstances and to provide the space for each developing country to find its own exceptionality. ■

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