

Globalization and Liberalization: A View from the Developing Countries

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The term globalization is extremely controversial. Debates currently raging about globalization include whether it even exists (Unger, 1997), whether it is more important now than at some earlier date (Bordo, Eichengreen, and Irwin, 1999), whether it is displacing the nation state (Strange, 1996; Wade, 1996), and whether it is more important than regionalism (Fishlow and Haggard, 1992) or localism (Rosenau, 1997a). Also, of course, there are endless analyses as well as polemics about whether the results are good or bad and for whom. Recently, such controversies have spilled over from academic journals to the streets in locations as diverse as Seattle, Davos, and Bangkok.

With respect to this list of issues, I take it for granted in this paper that globalization exists and that it is a very important phenomenon without entering into the various comparisons with the past or other parallel processes. The main objective will be to make some comments on the impact of globalization, particularly in terms of the effects on developing countries.

Globalization is a multifaceted, multidisciplinary topic in its broadest reaches. It includes not only economic topics, but also political, social, cultural, and ideological ones. For example, political scientist, James Rosenau, defines it as "a label that is presently in vogue to account for peoples, activities, norms, ideas, goods, services, and currencies that are decreasingly confined to a particular geographic space and its local and established practices" (1997b, p.360). Deciding to focus on the economic aspects of globalization still leaves many doors open since economic globalization has both microeconomic and macroeconomic aspects. The former refer to the technological revolution and the impact at the firm level, while the latter are related to the integration of markets for goods and services (Oman, 1994).

I will deal mainly with the macroeconomics of globalization (trade and finance), but before proceeding, a final distinction needs to be drawn between globalization and liberalization. Developing countries themselves had to take some important steps before the full impact of globalization could be felt. Specifically, they had to open their own economies, to lower the barriers to trade and capital flows that had been an important component of the import-substitution industrialization model that almost all followed for some period. Without these policy shifts, globalization would be much less relevant than it is today, especially in the developing world. Liberalization, then, is the other side of globalization.

The rest of the paper is organized as follows. I first examine the quantitative importance and the qualitative characteristics of developing countries in the expanding trade and financial flows of the 1980s and 1990s. Next I turn to regional differences within the developing world. Then I look at dynamics in one particular region, Latin America, in terms of differential impacts across countries, sectors, and types of firms. Finally, I conclude by summarizing both the advantages and disadvantages of being part of a globalized world and suggesting some ideas about how to emphasize the former while minimizing the latter.

Developing Countries in a Globalized World

Developing countries as a group (including the former communist countries of Central and Eastern

Europe) have become more integrated into the world economy in the past twenty years as a result of the parallel processes of globalization and liberalization. Table 1 provides a quick idea of the changes. In terms of world imports, developing countries' share fell slightly during the 1980s (from 33 to 27 percent) and then recovered to 34 percent by the late 1990s. A similar situation was found with exports from developing countries to the world although the trend is more pronounced. In both cases, however, the country and product composition masks the degree of increasing integration as will be explained below. It is also important to note that trade flows in general rose rapidly in this period, nearly tripling in nominal terms. Another way of thinking about the rising importance of trade is to look at trade as a share of countries' own output, i.e., the change in export and import coefficients. By this measure, too, international integration has increased as coefficients for developing countries followed a pattern similar to that just seen: a decline from 24 percent in 1980 to 22 percent in 1990, then an increase to 28 percent in 1997.

Table 1. *The Role of Developing countries in Trade and Capital Flows*

	1980-82	1987-90	1996-97
Exports (%)	32.7	27.2	34.0
Imports (%)	30.4	25.4	34.3
Total ^a (billions of \$)	1,856	2,864	5,459
Direct Investment (%)	32.7	14.3	43.2
Portfolio Investment (%)	7.7	3.1	13.3
Total ^a (billions of \$)	107	355	1,319

Source: IMF, *Direction of Trade Statistics Yearbook* and *Balance of Payments Statistics Yearbook*.

^a Total for developing and industrial countries

Financial trends were more dramatic than those for trade, declining more abruptly in the 1980s and rising faster in the 1990s. For example, the developing country share of foreign direct investment (FDI) plummeted from 33 percent in 1980-82, before the debt crisis hit, to only 14 percent by the end of the decade. It then more than recovered to 43 percent by 1996-97. Portfolio trends were similar but much smaller: 8 percent to 3 percent to 13 percent, respectively. Financial flows rose much faster than trade, a nominal increase of more than 11 times in this period.

The composition of financial flows shifted in important ways. The private bank creditors, which in 1980 had been responsible for about two thirds of total long-term debt flows (which, in turn, accounted for about 80 percent of net resource flows), had almost disappeared from the scene by 1990. Moreover, debt flows themselves had become less significant by 1990, as direct investment had already come to represent about one quarter of net resource flows, and official flows (including grants) had again risen as a share of the total.

During the course of the 1990s, the composition shift continued. The most dramatic element was foreign direct investment, which represented 48 percent of total flows in 1997 and 56 percent in 1998. Direct investment, which had been considered the worst kind of foreign capital in the 1970s (one reason for the shift toward bank loans) is now considered the most valuable kind, since it is not only more stable than other flows but also brings access to markets and technology. Much more unstable are portfolio equity investment, bonds, and bank loans.

What is extremely difficult, if not impossible, to measure precisely is the most notorious type of capital flows in the 1990s: the so-called hot money. These are the flows that go in and out of countries on a very short-term basis, seeking a quick return on capital. The volatility that makes them hard to trace also can create havoc with economies, especially the small and often fragile economies of developing countries.

Closely related to the shift in the composition of capital flows was the change in borrowers within the developing countries. In the 1970s and the 1980s, borrowers had mainly been central governments and state-owned enterprises. In the 1990s, by contrast, reflecting the liberalization process, borrowers were increasingly large private-sector firms. FDI was, (almost) by definition, an element of the private sector. In addition, the share of private non-guaranteed debt flows increased from 15 percent in 1980 to 22 percent in 1990 to 60 percent in 1997. (With the 1998-99 economic downturn, private sector debt declined in importance although it is likely to pick up again in the future.)

In summary, developing countries saw important increases in trade and especially financial integration in the 1990s, but a substantial amount of this was recovering ground lost during the 1980s. Taking a longer-run view, however, the importance of the 1990s turnaround is significant in the trade area since it marked an inflection point with respect to the earlier postwar era when developing countries as a group had experienced a continual decline in their share in world trade. No similar data are available for capital flows in the earlier postwar period.

Regional Patterns of Global Integration

Talking about developing countries as a group only gets us so far; more interesting stories emerge by comparing across regions (see table 2). By far the fastest growing region with respect to trade was Asia, whose share nearly doubled in the 1980s and continued at the same high level in the 1990s. In the meantime, Middle Eastern trade fell dramatically with the drop in oil prices. It was the artificially high volume of trade in the Middle East in the early 1980s, and the later decline, that dampened the increase of developing countries in trade flows shown table 1; excluding the Middle East, the increase would have been larger. Africa's participation in international trade also fell sharply throughout, while Latin America recovered somewhat in the 1990s but not to the same level as in the early 1980s, again influenced by the role of oil. Differential trade coefficients mirror these trends: 36 percent in Asia at the end of the 1990s (up from 22 percent in 1980), compared to 19 percent for Latin America (17 percent in 1980) and 34 percent for Africa (down from 39 percent). Proponents of greater globalization would clearly point to the Asian countries as examples of increasing trade leading to strong growth performance, in contrast with other regions that both grew more slowly and traded less.

There were also important changes in the allocation of capital flows among developing country regions that reinforced trends in trade. During the 1980s, Latin America in particular was starved for funds from the private sector, leading to an increased role for the multilateral agencies. East and Southeast Asia, in contrast, continued to have access to private funds. In the 1990s, Latin America regained access to

private finance and Eastern Europe also became an active borrower, sharing the expanding pie with East/Southeast Asia. Sub-Saharan Africa and South Asia continued to draw primarily on official sources, but this resulted in to low and declining shares of total resource flows.

Table 2. *Regional Differences among Developing Countries in Trade and Capital Flows*

	1980	1990	1997
<i>Trade flows</i>			
Asia ^a	28.3	51.4	52.3
Europe ^a	16.0	11.1	16.8
Latin America	21.8	15.4	16.2
Middle East	20.5	13.0	8.7
Africa	13.3	8.7	6.1
Total	100.0	100.0	100.0
<i>Capital flows</i>			
East Asia Pacific	15.8	27.6	36.3
Eastern Europe	16.1	13.3	17.5
Latin America	36.1	21.6	34.3
Middle East	10.3	10.2	2.0
South Asia	7.8	9.1	4.3
Sub-Saharan Africa	13.9	18.2	5.6
Total	100.0	100.0	100.0

Source: IMF, *Direction of Trade Statistics Yearbook* and World Bank, *Global Development Finance*, 1999.

a Developing countries only.

Other insights about the nature of globalization can be obtained by noting with whom developing countries trade and from where investment comes. Based on data for the first half of the 1990s, a clear distinction can be made (Stallings and Streeck, 1995). Asian developing countries mainly traded among themselves, and with Japan, and a growing share of their investment also came from within the region. In Latin America, in contrast, trade and investment were heavily weighted toward the United States, especially in the northern tier of countries. In Africa and Eastern Europe, there was a focus on Western

Europe.

What we referred to as the "tetrahedron" meant that different developing regions were tied into the global economy in different ways through their with main trading and investment partners. Since the respective industrial countries featured different "models" of capitalism, this led to somewhat different policies in the developing countries themselves. Growth rates of the industrial countries also differed. In the 1980s and early 1990s, these differences contributed to the great economic dynamism in the Asian region, but the collapse of the Japanese economy exacerbated the later problems of its Asian neighbors, and the high level of interaction within the region propelled the contagion effect once the crisis there began in 1997. The lagging U.S. economy, which had appeared to be a drag on Latin America in the 1980s and early 1990s, proved a boon to its neighbors, particularly Mexico, Central America, later in the decade.

Heterogeneous Effects of Globalization and Liberalization in Latin America

It is hard to get a good feel for the impact of globalization and liberalization when talking of very large aggregates of countries. A somewhat better notion comes by looking at particular countries within a single region. Drawing on a book on Latin America that we have just finished at ECLAC, we can add to the analysis thus far (Stallings and Peres, 2000; see also Stallings, 1995). The main message that comes across is that globalization and liberalization have increased heterogeneity across countries, sectors, and types of firms. Some have been able to take advantage of new opportunities, while others have only encountered more obstacles.

Of the nine countries we studied, four did substantially better in the 1990s than in the base period (1950-80), while the other five did much worse. (The fact that Brazil and Mexico, the two largest countries in Latin America, are among the latter group gives a downward bias to performance for the region as a whole when using weighted averages.) This difference held for output, investment, and productivity. Especially large differences were found with respect to productivity, which may imply continued differentiation in the future. For countries that improved their performance, foreign capital played a major role. FDI in particular contributed to increased investment, both in tradeables and in the services sector.

Investment in the post-liberalization period was concentrated in a relatively small number of sectors. Only one sector (telecommunications) saw dynamic investment in all countries, and only one country (Chile) increased investment in all major sectors. Manufacturing investment was particularly dynamic in certain capital-intensive subsectors (for example, cement, steel, petrochemicals, and chemicals). Nonetheless, investment coefficients overall were, at best, slightly higher than in the pre-liberalization period.

Privatization was instrumental to investment recovery and to modernization when other necessary conditions were also present. It fostered investment in certain tradeables (for example, mining and natural gas), although linkages with the rest of the economy continued to be weak. In nontradeables, the biggest increases in investment were in telecommunications; results were mixed in electricity and transportation. Privatization alone did not guarantee efficient performance. Strengthening property rights proved to be an important factor for attracting foreign investment in mining, while increased competitive pressures were necessary to ensure efficient market outcomes in the services sectors, like telecommunications.

Large firms were the most dynamic investors, although smaller companies had a minor presence in some

activities where investment grew rapidly. Among big firms, transnational corporation subsidiaries gained ground vis-à-vis large domestic conglomerates. These subsidiaries were responsible for much of the investment growth, not only in the most dynamic areas of manufacturing, but also in mining and telecommunications. Privatizations, liberalization of regulations that prevented foreign firms from investing in many sectors, and the globalization of important industries combined to strengthen the position of foreign corporations. Nonetheless, the large firms contributed relatively little to the generation of employment since they tended to be more capital-intensive.

Productivity gains were more evenly spread across broad sectors (agriculture, manufacturing, and services), but heterogeneity increased within subsectors, for example, between commercial and family agriculture. Likewise, within manufacturing, some subsectors performed very well but others lagged behind. Despite productivity growth, the productivity gap of manufacturing as a whole vis-à-vis the United States did not narrow in the 1990s. Specific subsectors in which investment was dynamic showed a sharp increase in productivity and did narrow the gap. This was partly a continuation of adjustment processes begun during or even before the crisis of the 1980s. Although the gap between the productivity of large firms and that of small and medium-size enterprises narrowed in some countries, performance continued to be extremely dissimilar. Modernization processes, like investment, occurred mainly among larger firms.

The importance of external factors in the incorporation of new technologies increased in tandem with the investment process. The growing significance of imported capital goods, the substitution of foreign for domestic inputs, and the construction of technologically advanced plants by foreign firms all resulted in a greater presence of foreign components in the region's national innovation systems. At the same time, the state reduced its involvement in technological efforts, but private actors have not always stepped in to fill the void.

Trade liberalization and privatization were the reforms that had the greatest impact at the sectoral and microeconomic levels. Trade liberalization put pressure on firms to increase competitiveness by substituting imported for national inputs. It also facilitated subregional integration processes that opened markets for manufacturing exports. Privatization, meanwhile, was instrumental in stimulating investment and modernization, especially when it coincided with growth in international demand or took place in activities experiencing accelerated technological change. Despite these positive developments, important problems remain, including growing manufacturing trade deficits; the enclave nature of large mining firms; and poor regulation plus high barriers to entry for new competition in both electricity and telecommunications.

Liberalization did not solve, and quite probably increased, two problems: investment continued to be concentrated among large enterprises that have not shown the capacity to develop backward and forward linkages with smaller firms, and supplier chains were destroyed by the quest for competitiveness through increasing imported inputs. Both processes led to specialization and higher efficiency, but they also led to polarization among actors and the persistence of trade deficits and thus reliance on foreign savings.

Moreover, liberalization did not deliver the expected employment growth in the tradeables sectors. Commercial agriculture and formal sector manufacturing firms underwent an important process of modernization, which implied a more intensive use of capital. This negatively affected job creation in those sectors where output grew most strongly, such as natural resource—based commodities and the automobile industry. Changes also occurred across sectors, as well as within sectors. Specifically,

activities that have traditionally produced the largest volume of employment, such as textiles and garments, declined across the board. Only the *maquila* assembly plants, operating under special international regulations, provided the strong growth in highly labor-intensive activities that liberalization was expected to produce.

Slow growth in labor-intensive tradeables had a number of causes. First, the contradiction between liberalization, which sought to move toward an export-led growth model, and macroeconomic policies, which in the presence of large foreign capital flows, led to overvalued exchange rates, sent producers ambiguous signals that hindered investment in tradeables. Second, assumptions made about the region's comparative advantage were wrong, at least for the level of generalization to which they applied. The regional experience and international comparisons have shown that the main advantage of Latin America in general, and of the South American countries in particular, lies in natural resources rather than in unskilled labor. This factor was compounded by changes in the relative prices of factors of production, which occurred when trade liberalization sharply reduced the relative cost of capital goods.

When the concentration of growth in capital-intensive activities created few jobs, services became the residual source of employment. Services had a heterogeneous performance: high-quality jobs were created in telecommunications, banking, and finance, but the bulk was in low-skill services. In the services, polarization increased between activities that had been rapidly modernized and traditional ones that employed a low-skill workforce. The residual labor tended to be employed by the latter, leading to slow growth in the overall productivity of the sector. Microenterprises offered the greatest number of jobs, with most of them operating on an informal basis. The low rate of job creation by large, modern firms that offered higher wages led to a widening wage gap. Poor employment performance in the tradeables sectors has thus been accompanied by increasing heterogeneity and polarization in the labor market.

It is important to stress that not all of these changes can be attributed to globalization. Liberalization, as reflected in domestic policy changes, was at least as important. The key point to emphasize is the close interrelationship between globalization and liberalization in determining performance outcomes, both faster growth and increased heterogeneity.

Advantages and Disadvantages of Globalization

There are both positive and negative aspects of increased integration into the global economy as was clear in the case of Latin America. One of the positive aspects is that there has been an additional amount of external finance available to developing countries in comparison with the 1980s and (perhaps) in comparison with earlier years. This relaxed the foreign exchange constraint that had held back growth during the 1980s. In addition, an increasing share of the new funds has consisted of foreign direct investment that is currently highly valued by the governments of most developing countries. At least in part, it adds to the capital accumulation process and thus makes possible higher growth both in the present and in the future. Moreover, such investment tends to embody new technologies that increase the productivity and, thus, the competitiveness of developing countries. (It is noteworthy that it also frequently brings more environmentally friendly technology than would be used by local firms.)

In an interesting recent paper, and in contrast to usual perceptions, it has also been argued that the increasing role of the capital markets (especially institutional investors trading in bonds and stocks) may be more compatible with democracy and transparent government than is often believed (Maxfield, 1999).

Indeed, the argument is that capital markets may actually contribute to democracy by dismantling oligopolistic corporate structures in developing countries, and that the demand for additional information on the part of foreign investors (and the IMF) may increase private and public-sector transparency.

On the other hand, it seems clear that there are also serious problems that are being caused — at least in part — by the new trade and capital flows and the way they impact on the economies and societies of developing countries. One such problem is the increase in heterogeneity or polarization across regions and countries and also within countries (firms, regions, and groups of workers). Some are much more able than others to take advantage of the new opportunities that globalization offers, which can lead to increased social and political conflicts and rejection of liberalization and globalization per se, as we have seen in a number of cases recently.

The new capital flows have also brought problems to governments in trying to manage their economies. Macroeconomic problems have been documented in many cases during the 1990s. The clearest combination is the role of capital inflows in contributing to the overvaluation of exchange rates, which leads to declining competitiveness and, in extreme cases, to foreign exchange crises. In addition, the volatility of capital flows also magnifies the typically pro-cyclical nature of macroeconomic policy, which also can lead to crises. If there is weak financial supervision (as was clearly the case in East/Southeast Asia), then banking crises can further complicate foreign exchange crises.

Both domestic and international policy changes are needed to deal with the new situation. As Dani Rodrik, one of the most prolific and most interesting analysts of globalization, has put it: "Openness to the world economy can be the source of many economic benefits.... But these are only *potential* benefits, to be realized in full only when the complementary policies and institutions are in place domestically" (1999, p. 1; see also Rodrik, 1997).

On the trade front internationally, it is vital to recover momentum after the debacle of the World Trade Organization (WTO) negotiations in Seattle. It is very important to note the change in attitude on many developing countries with respect to the Seattle meeting. Thanks to liberalization, the developing countries have become major advocates of international trade opening since they need markets if they are to continue to pursue export-led growth and extend the benefits to other parts of their economies. They see the industrial countries as being in favor of trade liberalization only if it directly benefits them — and trying to hold back the advance of developing countries through labor and environmental restrictions on trade. See, for example, the speech of the Brazilian foreign minister in Seattle (Lampreia, 2000).

In the international financial realm, a number of proposals are on the table for a "new international financial architecture." The basic idea is that new regulations of international capital flows, especially short-term flows, are needed to prevent the great volatility that the world has seen in the last few years. While such volatility can harm all economies, the developing countries are least well situated to deal with the consequences. In addition, new mechanisms are needed to deal with crises, once they develop. Despite much interest at the height of the so-called Asian crisis, nothing has really emerged thus far since the crisis atmosphere has abated. (For a discussion of such proposals from a developing country perspective, see United Nations, 1999.)

If international solutions are not found, developing countries have no choice but to try to substitute at the country or regional levels. In trade, regional integration has become a much higher priority in Latin America and in Asia. Central and Eastern European countries are also trying to join the European Union.

At the same time, individual countries or regional groupings need to devise policies to protect themselves from the vagaries of international capital flows and volatility more generally. Controls on the entry of short-term capital flows during periods of strong international liquidity have proved useful in some cases. Also there is need for higher domestic savings in most developing countries to lower the need for external savings (but note the paradox that high savings in East/Southeast Asia went together with large capital inflows). Finally, policies are necessary to offset the polarization that is being exacerbated by global financial flows. These involve both social policies (especially education) and policies to assist firms that are being left behind in the increasingly competitive world.

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