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An Introduction to Globalisation and its Impacts

BHAGIRATH LAL DAS

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Chapter 1

INTRODUCTION

Globalisation is a very common theme of discussion and analysis these days. It has become a major concern of thinkers on development and those connected with development policies in governments. It should indeed be the concern of the people in general, particularly in the developing countries, as it has the potential of having a deep impact on their lives.

One hears the loud voices of the proponents of globalisation who proclaim that it has infinite potential for the development and welfare of mankind. They say that it is an inevitable and irreversible process in any case, and thus one should endeavour to make the best of it.

On the other hand, the opponents, who are equally loud and persistent if not more, assert that globalisation is a veritable evil, out to drive the poor countries back to their colonial days and the poor of these countries to abject poverty. Powerful arguments are placed by both sides in support of their respective claims.

As it will be explained later, globalisation has particularly adverse impacts on the poorer and weaker sections of society and on small business enterprises. Hence, a proper awareness of its nature, implications and impacts is necessary in the developing countries, where poverty is rampant and business activity is almost entirely limited to small and household units. It should be relevant for people to know how globalisation influences the development process and what impact it has on poverty.

Main features

Globalisation broadly means fully-free economic operations across the borders of countries, without any impediments by governments of countries. There are broadly two types of such economic operations, viz., one, the flow of goods and services from one country to another, and two, the flow of capital from one country to another. A possible combination of these two types of activities could exemplify another type of economic operation i.e., the production of goods and services.

The flow of goods across the borders means export and import of goods. Examples of the flow of services across borders are banking, insurance, telecommunication and similar services provided from one country to another. The flow of capital takes place, for example, by the establishment or acquisition of factories or by the investment of capital in deposits and share markets in other countries.

An example of the globalised production of goods is a factory established in a country through the capital invested from another country and the use of inputs from other countries in the production process or targeting the production to the consumers of other countries. As is obvious, the various types of cross-border economic activity mentioned earlier should not be considered watertight, as in most cases the activities are a mixture of these elements.

Import and export of goods

Let us now see what is meant by free operations across borders in these cases. In the case of the flow of goods, i.e., export and import, it means that a country should not apply restraint or regulation at its border for the goods coming in or going out; and thus any product can be imported or exported in any quantity. It implies that the government should not limit the quantity of the import of any product, and preferably it should also not impose customs duty on imports.

The product, price and quantity of exports and imports should depend entirely on the judgement of the exporters and importers doing these transactions. The implicit presumption is that the traders will enter into such transactions only when they consider them economically viable; for example, when their assessment is that the consumers will be prepared to buy them and the producers will be prepared to sell them.

Trade in services

The free and unrestrained flow of services across borders will mean, for example, that the banks of a country should be able to operate fully in other countries. They should be able to open branches anywhere and perform various banking operations without any control of the government. Thus they should be able to mobilise deposits and give loans without any monitoring or guidance from the government. Similar is the situation for other services, like insurance, communication, construction, consultancy, etc.

Flow of capital

Totally unhindered movement of capital across borders means that foreign firms should be able to bring capital for any activity at any time and take it out at any time. It implies that a foreign firm can invest in establishing a factory or a shop at any place in the country, it can buy shares in the market or deposit money in banks, it can take away profits or returns in foreign exchange at any time, it can sell shares, withdraw deposits and take away money at any time in foreign exchange.

The choice of the product for which the factory will be established and the geographical location will be left entirely to the foreign investor to determine. Moreover, the foreign investor, establishing a factory, will be totally free to determine from where to get the inputs and where to sell the products, i.e., whether the inputs, including the raw materials, should be imported or procured domestically and whether the product of the factory should be exported or sold in domestic market.

Underlying assumptions

The underlying assumption is that the economic operators, like manufacturers, traders, service providers, banks, etc., work with great efficiency and their unhindered operations will bring benefit to the society along with them getting profits from their operations.

It is further assumed that any interference by government reduces their efficiency, thereby reducing the benefit to society. The firms, in the course of open competition among themselves, are supposed to improve their performance continuously. Any slackness on the part of a firm is punished by open competition, in the sense that the weak ones get weeded out by the strong ones. This line of argument and thinking presumes that free operation of the market is beneficial to society and its people.

A further assumption is that an intervention by the government reduces free competition and thereby reduces the efficiency of the economic operation. It is argued that governments act with political motives, and their intervention will harm the economic process.

These arguments attach a lot of significance to the wisdom of private business. It is presumed that the market determines the preferred economic operations in the most efficient and best manner. This type of thinking may be the best for the interest of private business, but it is doubtful if it is also the best for the people, in particular for the poor and weak sections of society.

In the best of its form, private business works for profit, which, of course, is quite understandable and in some ways also desirable.

The investment made by the private business must earn enough income to pay for the investment and also to grow steadily; otherwise it cannot be a sustainable business and would die early.

It is important to have healthy business in society, because it boosts employment and economy as a whole. But one cannot expect business to take care of the poor and weak sections of society and to have broad social goals. One cannot also expect it to take into account the economy of the country as a whole, least of all the long term aspects of it, while it is conducting its own limited business activity, with efficiency as the prime objective.

Private business works basically in an environment of competition, where it is the strong that wins and the weak that loses. Also, one must have some assets to start a business. An asset could be in the form of money or physical form such as land or a building. Or, it could be in the form of some mental or physical attribute, like a professional skill or simply the strength to do unskilled physical work. Those who have higher assets and skills win in this situation; while others without assets are left behind and have no place at all. Besides, the market has its deficiencies, and the failure of the market system is quite possible in several circumstances. In that case the best efficiency will not be achieved and thus the expected benefits to the society will not be accrued.

All this calls for the role of government in critical circumstances and in certain areas. The welfare of the people is rightfully the responsibility of the government. Private business, and specially the foreign business firms, cannot be saddled with it, though they can also have some social content in their activity. Taking care of the weak and those with no assets or meagre assets is an important aspect of the work of the government.

In pursuit of that objective, the government has to play an active role, which may hinder the free pursuit of profit by the private business. Besides, there are certain items of work and activities which give no direct and visible return on investment, or very small and delayed returns, like public health measures, primary schools, village roads, etc. Private business will not find them attractive enough; and the government has to undertake those responsibilities. Also, the government has to ensure that the firms do not indulge in activities which are exploitative in nature or otherwise harmful to society and the people. After all, upholding public interest is ultimately the responsibility of the government.

The proponents of globalisation would like governments to limit their role to the traditional core areas, like maintenance of law and order, etc. In any case, they frown upon governments undertaking any work which interferes with the operation of the private business firms and their pursuit of profit.

Chapter 2

SOURCES OF PRESSURE FOR GLOBALISATION

Before analysing the deeper implications of full freedom in private economic operations and its impact on development and poverty, let us examine the origin of the pressures for such freedom. Naturally the prime movers for policies on total freedom of economic operations are those that are the main beneficiaries of this process. The direct beneficiaries are the transnational corporations (TNCs), i.e., the firms which have their headquarters in one country and operations spread over several countries.

There are several thousands of TNCs in the world, comparatively big and small, though almost all of them are much bigger than the normal size of the firms of developing countries. Some common examples are: IBM in the electronic field, Mc Donald's and Coca-Cola in the food and beverage area, Citibank and American Express in the banking and financial service sectors, etc.

Most of the TNCs have the developed countries as their home countries, i.e., their headquarters and main central controlling establishments are in the developed countries. The TNCs want to expand their operations throughout the world, particularly in the developing countries.

The prospect of fast growth of their operations in their home countries is limited. The population growth in the developed countries is almost nil. Besides, the growth of GNP is quite low, being 2 to 3 per cent per annum. Hence there is only limited prospect for the growth of real demand of goods and services in these countries. They have been generating demand in the recent past generally by fast diversification of products and bringing about marginal improvements in the products, thereby encouraging replacement of goods at short intervals. There is a limit to this type of demand generation. Moreover, a slight fall in income of the people is likely to dampen such demand growth. Even in the financial sector the return is limited in the developed countries, as the interest rates are quite low. Hence the TNCs are naturally keen on the markets and opportunities in the developing countries, particularly those having a large population and growth prospect.

The TNCs have immense resources at their command. They have a huge financial base and assets, possess a high order of human resources and command high technological knowledge. The combination of all these strengths make them formidable in their influence and over-reach. They have strong influence on their governments. They press their governments continuously to exert pressure on other governments, so that they can have smooth and unhindered operations in other countries. And the developing countries are the natural targets. In fact, international economic relations in the last two decades have been characterised by the thrust of the major developed countries to expand the economic space of their firms in the developing countries. This objective is sought to be achieved by the combined use of the immense political strength of the governments and the tough economic muscle of the TNCs.

The growth of their TNCs and expansion of their operations around the world helps the major developed countries in consolidating and deepening their influence in other countries. Thus it is of great advantage to the governments too. Hence it is no surprise that the governments of these countries back their TNCs to the full in their operationS in other countries.

The major developed countries try to push their way through in this regard in the international, regional and bilateral negotiations and agreements. They also use the strength of some international organisations to achieve their aims, as will be explained in the next chapter.

Chapter 3

ROLE OF INTERNATIONAL INSTITUTIONS

The process of globalisation is facilitated mainly by three international institutions. The import and export of goods and services as well as the control over the rights on new technologies is guided by the agreements in the World Trade Organisation (WTO). The flow of capital is broadly guided by international financial institutions, like the World Bank and the International Monetary Fund (IMF). Of course, they do not directly control the flow but they exert tremendous influence in the formulation of the policies of the developing countries in respect of the flow of capital.

WTO

The WTO administers a set of agreements on goods, services and intellectual property rights. Nearly 136 countries are the members of the WTO, out of which nearly 100 are developing countries.

Formally the decision-making process of one country one vote, should work in the interest of the developing countries that are nearly four times as many in number as the developed countries. And yet the working processes in the WTO are such that the developing countries are always on the defensive and not able to safeguard their interests, while the major developed countries are able to steer their economic interests quite effectively in this organisation The major developed countries utilise their political and economic power in a big way in blunting the strength in number of the developing countries.

The influential role of the major developed countries in shaping the rules and operations of the WTO has naturally resulted in deficiencies, imbalances and inequities in the WTO agreements. The mode of operation of the agreements by the major developed countries has further aggravated the inequities.

And now the major developed countries are keen on introducing new areas in the WTO, like investment, competition policy, government purchases, labour standards, etc, which are aimed at further constraining the flexibility and power of the developing country governments in formulating and conducting their national development policies. If the major developed countries succeed in their efforts, the power of the TNCs will get further enhanced.

The question naturally asked is why should the developing countries not come out of the WTO if it is being used against their interest. The reason why the WTO is necessary for them is that it provides a framework for the conduct of international trade. If they are not in it, they will have to contract bilateral agreements with various countries for their export and import from year to year. It will be a cumbersome process. Besides, they will come under severe pressure from year to year at the time of the renewal of these bilateral agreements. Moreover, a multilateral discipline of this type provides at least some protection to the weak countries against possible whimsical unilateral actions of the powerful countries.

Moreover, why should the developing countries come out of the WTO system, when they are there in such a large number? They should rather try their utmost to shape things there in their own interest and not allow the WTO to be used by the major developed countries as their economic and political tool for gaining supremacy in the world.

Lately there has been a shift in the position and role of the developing countries in the WTO. As the impact of the trade liberalisation brought about by the WTO agreements is fast unfolding itself, there is more awareness of the inherent dangers among the trade and industries of the developing countries and also among the people in general. This has put pressure on the developing countries governments to try to change the rules and the mode of operation of the WTO. These governments have now become more active and they are also having better coordination among themselves. The aim should be to ensure that the WTO rules work in the interest of the development of the people and not only in the interest of a few mega firms of the world.

IMF and World Bank

The working of the capital flow is more complex. Countries are free to control the flow of capital across their borders right now. But international financial institutions, like the World Bank and the IMF, encourage them to loosen their control. Of course, the World Bank has somewhat softened its line after the financial crisis in South East Asia in 1997.

These institutions also put pressure on the developing countries to liberalise their imports. Since the developing countries often go to these institutions for loans, they are under the great influence of their policy prescriptions and demands. And these are not always in the best interest of the developing countries.

Particularly the IMF has been very widely criticised for its uniform policy prescriptions for all countries in all situations, even though the conditions of the countries, the nature of the problem and the situations are widely divergent. The manner in which it influences governments unduly has often been the subject of adverse comment and criticism. One particular case in point is the manner in which it conducted itself in East Asia and South East Asia during the financial problems of 1997. On a wider scale, these institutions have been criticised for their policy prescriptions in Africa, which have not improved the lot of these countries, rather, they have been more impoverished.

These institutions often ask the developing countries to open their markets for the goods, services and capital of other countries on the ground that such openness will help their development. But as will be explained later, total openness may lead to the slowing down of development and increasing poverty. Thus the criticism is often made that these institutions are helping the operation of the TNCs across borders, more than they are assisting the development of the developing countries.

The decision-making process in these institutions is on the basis of weighted votes depending on the shareholding of members. The rich developed countries have very high shares, compared to the developing countries; consequently these institutions are guided primarily by the major developed countries. The developing countries do not have an effective role in the formulation of policies and the manner of working of these institutions.

The developing countries are becoming more aware of the risks of following the prescriptions of these institutions. Most of them have learnt by their own experience that those prescriptions do not work. Hence there is a wave of discontent and criticism of these institutions all around, some times even from within.

The Chief Economist of the World Bank criticised the policies of the IMF in East Asia and South East Asia in the aftermath of the financial crisis in these countries in 1997. Then, the economist, who had been entrusted with preparing the annual report of the World Bank in 2000, resigned midway. It was alleged that there had been high-level interference in and obstruction to his independent analysis and conclusions.

NGOs as allies

A new emerging feature is the effective activism of the non-governmental organisations (NGOs) around the world in highlighting the adverse consequences of the activities of these international organisations in their championing of globalisation.

Moved by the sad plight of the people in the developing countries and the adverse effects of unrestrained globalisation on these peoples, the NGOs, both of the developing countries and the developed countries, have come out openly in opposing the moves of the major developed countries' governments and also of the operations of the international institutions.

They have even held street demonstrations in places like Geneva, Seattle, and Prague during the important conferences of the WTO, the World Bank and the IMF. They are very active in highlighting the adverse effects of globalisation. And now they are being heard both inside their own countries and outside. They can be helpful allies of the developing countries in safeguarding their development interests.

Chapter 4

MAIN IMPLICATIONS OF GLOBALISATION

Now let us revert to the impact and implications of free and unrestrained economic operations across the borders. We shall consider two types of operations, viz., the flow of goods and services and the flow of capital, separately.

Trade in goods

In respect of the trade in goods, there are three aspects which need to be separately discussed. These are: import of goods, and export of goods and subsidy.

Import of goods

Totally unrestrained imports will mean that the traders can import anything, ranging from machines to motor cars to agricultural products. Several benefits of this aspect of globalisation are pointed out by the proponents. One, the consumers will have a wide choice for themselves. Abundance of supply from various sources will make it possible for them to have better quality goods at lower prices.

Imports will thus give greater satisfaction to the consumers at less expense. Two, imports can result in improvement of domestic production. It can happen in two ways. First, the use of good imported machinery may improve the production of goods. Second, the domestic producers may have the inclination as well as the possibility of improving the quality of their products and the production process, by observing the performance of a better quality imported product.

More generally, it is suggested that, in the long run, the domestic producers will be forced to improve their production, once they are exposed to international competition in the domestic market. The proponents of liberalisation suggest that unrestrained import improves the export capacity of a country by reducing the price and improving the quality of products, which can thus have better acceptability in foreign markets. In fact some experts have suggested that the countries that have taken to trade liberalisation have had higher growth of economy.

Several eminent experts have, however, contradicted this assertion. They assert that the empirical evidence from the developing countries does not indicate any linkage between trade liberalisation and growth. In any case, there are serious problems with trade liberalisation, which may not make the supposed benefits actually realisable, particularly in the developing countries. Some of the important problems are discussed below.

Free and unrestrained imports can result in a severe drain on foreign exchange reserves. The benefit to consumers can come only so long as the foreign exchange is available for imports. Most of the developing countries have a very unstable foreign exchange position, and it can be put under severe strain by unrestrained imports. There is also a possibility of foreign exchange being spent on luxury goods and non-essential goods, leaving little for important items like capital goods, industrial intermediates, import of technology, etc., which are essential for growth and development. Besides that, the drain on foreign exchange resulting from indiscriminate imports may also suppress the capacity to import essential goods for mass consumption, which may bring misery to a poor population.

Domestic production can derive benefits from imports only if the domestic industry is able to withstand competition from imports in the first place. The industries in the developing countries are generally weak. They will find it difficult to compete with the firms of the developed countries, that are backed by huge resources and other facilities. Most of the firms of the developed countries have easy access to cheap capital and modern technology. They enjoy the facility of highly-developed infrastructure, particularly in the area of transport and communication. They have the advantage of extensive networks of production, services and trade in their countries and in other developed countries.

Against these advantages of the firms of the developed countries, those of the developing countries have, in some cases, advantage only in terms of low labour wages. It hardly compensates them for the enormous handicap which they face in respect of finance, technology, infrastructure and services. Indeed, they have to face competition from the firms of the developed countries on totally unfair terms. In such a situation, totally unrestrained import may lead to the closure of domestic firms. Particularly the small and medium industrial units are likely to meet with this fate. Apart from causing large scale unemployment in industrial sector, it is likely to result in the breakdown of the domestic industrial production structure.

In the agricultural area, the adverse effects are likely to occur with greater intensity. Most of the developing countries have small farms, and the farmers are poor. They will find it very difficult to face international competition, and thus it is likely that a large number of them may have to give up farming all together. This will lead to large-scale unemployment in the rural areas, and, in fact, it may break the backbone of the rural economy in most of the developing countries. The farmers, unlike big business men, cannot sustain losses for a long time. Hence a setback brought about by international competition even during a year or two may make them disheartened. And once they give up their cultivation, it is unlikely that they will resume it soon.

In this way, free and unrestrained imports in the agriculture sector may result in making even the land-rich developing countries dependent on imported food. This will be very dangerous. They are not sure of sustained availability of foreign exchange; and in that situation, their capacity to import food will remain uncertain. This will expose their domestic population to the dangers of acute scarcity of food.

Export of goods

At present there are some stipulations in the WTO on the discretion of governments to restrict exports in certain situations; but real globalisation would require that there should be no restraint on the export of goods. Thus the export of industrial raw materials cannot be stopped or controlled. This will undermine the efforts of the developing countries to develop processing industries, based on their raw materials. Besides, full freedom of export of food items may have adverse effects on the availability of food for domestic consumption.

Subsidy

Another significant requirement of globalisation is that the government should not provide subsidy for production and export. The idea is that the firms should be dependent on their own financial resources and on those that they can themselves raise. This restriction puts the firms of the developing countries at a tremendous disadvantage. They have severe structural handicaps as mentioned above and, at the same time, if they do not get any financial support from their government, they will be tied in tight knots which may totally strangle them.

Import of services

The picture is similar in the case of the flow of services across the border. There may be some benefits to the domestic economic activities by the import of services; but totally unrestrained imports may cause severe damage to the domestic economy.

Let us take for example the banking services. Free operation of foreign banks in a developing country may initially appear to be beneficial for trade and industry, at least in the short term. This will widen the choice of the sources of finance for the trading and manufacturing activities. Further, it is likely that with the operation of efficient foreign banks in a country, the domestic banks may learn to improve their own performance. Similar may be the case in some other sectors, e.g., insurance services, telecommunication services, transport services, etc. These days services form an important part of the production process. They can help a lot in improving productivity as well as in quickly adapting the product mix to the emerging demands. Import of high technology services may thus be helpful in the production of goods and other services in the country.

But totally free and unrestrained import of services has the potential of grave damage. For example, if the foreign transnational banks come to operate in a totally unguided way, the domestic banks in the developing countries will face stiff competition. The foreign banks with their immense resources may drive out the domestic banks from the profitable sector of business. They are likely to capture the business in major urban, industrial and trading centres, that give profits with only small geographical spread of the activities. And the domestic banks may be totally displaced in these centres.

The domestic banks generally have a network of branches spread over both the urban centres and the remote rural areas. Generally their operation in the remote areas, e.g., villages and small towns, are not profitable but they sustain it out of the profits they get from their business in big urban areas. If they lose out on their profitable part of the business to the foreign banks, they will find it difficult to sustain their operations in the remote areas. In such a situation, they may have to close down their business. It will have two immediate adverse results. One, the profits in the profitable areas will be taken by the foreign banks and it will be sent out of the country in foreign exchange. Two, the remote areas will remain without adequate banking services which will slow down their development. Moreover, there may be wider adverse impacts in as much as the foreign banks will not feel any social responsibility for the people of the country as the domestic banks may feel. A similar situation applies to some other services sectors, like insurance, telecommunication, etc.

Flow of capital

Inflow

Let us now move on to the flow of capital across the border. Foreign money may come into or go out a country in many forms. One simple form is inflow or outflow on account of trade in goods and services. Another form of the flow is the payment of interest and dividend on investments. These types of the flow of capital are said to be on "current account". There is yet another type of capital, which comes on its own, unrelated to the payment for export of goods and services or to the income on loans and investments. This inflow of capital is said to be on "capital account". Its main components are the investment and repayment of the instalments of loan.

The inflow of capital into a country on current account is thus through the export of goods and services and through interests and dividends paid on the investments made by the country abroad.

The inflow on capital account is through the investment from foreign countries and instalments of loan repayment by foreign countries. Most of the developing countries do not have much investment abroad; hence the inflow because of interest, dividend or repayment is not much. The inflow through the export of goods and services is generally steady with a slow rise, depending on the supply capacity of the country and the international trading environment. As mentioned above, the developed countries apply direct trade restrictive measures quite frequently and regularly as the exports from the developing countries in any sector start rising fast. To that extent, there is not much prospect for fast growth of capital inflow on this account in the current atmosphere.

The inflow through foreign investment is principally in three forms. One, it may come as: (i) foreign direct investment (FDI), which is the direct investment in some projects, e.g., those for production of goods or services, or (ii) portfolio investment, i.e., investment in the share market or bond market, or (iii) deposits in banks and financial institutions.

FDI, in turn, may be in two forms, viz., as (i) green field investment, which is the fund invested in the establishment of new firms, or (ii) merger and acquisition (M & A), where the fund is invested by a foreign firm in acquiring an existing domestic firm, either through direct acquisition or through merger.

We discuss below the implications of FDI and other forms of capital flow separately.

Portfolio investments and deposits

Portfolio investments and deposits are generally unstable, as foreign money may be taken back by the investor at any time. The investor will like to keep the money in the share market, based on its perception of the possibility of a rise in the value of shares. Even a slight erosion of confidence makes them rush out of the share market of a country. Similarly, the investors transfer the deposits quickly to other countries, where they expect to get better returns. (This practice is popularly known as arbitrage.) Thus both the portfolio investment and deposit are highly volatile and unpredictable. A country cannot depend on these foreign exchange reserves for any long term or medium term programme of foreign exchange commitment.

No doubt, the volume of the in-flow of foreign funds of these types may be indicative of the confidence of the foreign investors in the economy of a country, and to that extent it may be considered to have some positive effect; but its uncertain and unstable nature reduces its utility significantly.

Foreign Direct Investment

FDI is somewhat more stable. Particularly the green field FDI may, under certain conditions, be useful as it adds to the production capacity and creates new prospects for employment in the country. The M & A type of FDI does not add to the production capacity but it may improve the efficiency and productivity of an existing firm. Further, FDI of both types has the potential of bringing in higher technology into the country and cause upgradation of the technical skill of workers.

But like the flow of goods and services as well as the portfolio investment and deposits, FDI also has some grave and adverse implications for the economy.

One, it may not be automatically aligned to the development objectives and programmes of the country. The main objective of the investor of FDI is to have quick and assured profits. It will select the sectors of production and geographical location based on this objective. The main objective of the host country, on the other hand, is to have foreign investment for exportable production, technological upgradation and for infrastructure development. Also the host country would like to have linkages of foreign investment with local economic activities, so that the investment has a direct positive effect in the area. If the objective of the investor and that of the host country coincide, it will be the appropriate form of investment. But in most of the cases, it may not so happen.

The sectors and regions preferred by the host country may not have the potential of yielding the highest profit and thus not fulfilling the objectives of the foreign investor. In such a situation, if the foreign investor is allowed full freedom to decide on the sector of industry and the geographical region for investment, FDI will not be in the best interest of the host country.

Two, FDI may directly result in net outflow of foreign exchange over the span of a few years. The investor takes out the profit annually in foreign currency. These annual outflows may exceed the one time inflow of investment within a few years. Hence, though FDI may appear to increase the foreign exchange reserve in the year of investment, it will result in draining out much larger reserves within a few years, thus contributing to balance of payment problems for the country. Of course, it is possible that FDI may cause the inflow of foreign exchange indirectly, if it fulfils the objectives of the host country as mentioned above. But this process is not automatic. Several countries, particularly of Latin America and South East Asia, have had the experience of the drain of foreign exchange as a result of the repatriation of profits from the FDI.

Three, FDI is generally highly import intensive, as the foreign investor is more inclined to depend on imported inputs and foreign technical and administrative personnel. This feature adds to further outflow of foreign exchange. Besides, given such inclination of the investor, the objective of the linkage of FDI with local economic activities is also not realised.

Four, TNCs have the tendency to conduct higher technological operations in the developed countries and only low-technology and high labour intensive operations in the host developing countries. To that extent, FDI does not automatically upgrade the technology of the host country. Nor does it result in the training of the local workmen in higher technical skills.

All this indicates that though FDI has the potential of some benefits for the host country, the benefits may not flow automatically. It needs the active role of the host government to ensure that the investor follows certain appropriate practices, norms and conditions. This will be discussed towards the end.

Outflow

The outflow of capital on current account may occur through the import of goods and services and through the dividend and interest payment on the investments made from foreign countries. The outflow on capital account may be through the repayment of loan instalments, repatriation of the proceeds of the sale of shares and bonds and investments made by the country abroad.

Most of the developing countries firms do not make much investment abroad on their own. The capital outflow on account of import of goods and services may be sizeable, and, in fact, with the spread of globalisation, it may rise very high. With the limited supply capacity of the developing countries and their constraints in competing with big firms in the developed countries, their capacity to finance their imports may get reduced over time. It can create problems. The danger, however, is much more severe from the other types of outflow.

The outflow due to the repatriation of profit, dividend and interest on foreign investment may result in a heavy drain on foreign currency over a course of time and increasing steadily over time. This part of the outflow may cause severe problems; but it will be fully anticipated. What is still more risky is the outflow which takes place suddenly in the absence of any control. For example, domestic firms or residents in a country can take out savings or other funds in foreign currency at any time. This tendency will be enhanced, if there is a low level of confidence in the domestic economy and in the local currency. Thus there will be a snowball effect of the mutually reinforcing factors of financial problems in the country and the tendency of the firms and persons in the country to take out their funds from the country in foreign currency.

Several countries in Latin America have had problems of severe outflow of foreign currency. The memories of the Mexican crisis of 1982, and again of 1987, are still fresh in our minds. Suddenly, Mexico found that it had no foreign currency to make payment against the interest and instalments on foreign loans. Several other countries in that region have been in severe difficulty regarding loan repayment from time to time. The foreign banks and international financial institutions have been helping them by reworking the repayment schedules, thereby adding more to their loan burden. This has gone on repeatedly for many decades.

When Malaysia faced the financial crisis in 1997, it adopted a different course. It did not take help of these banks and institutions; it prescribed certain controls on the outflow of funds and it directed all Malaysian money which had been kept abroad to be brought back within a short time. It overcame the crisis. It is worth recalling that the votaries of globalisation had bitterly criticised Malaysia at that time for introducing controls on the movement of capital. But its home grown remedy worked and it came out of the crisis successfully.

Possibility of financial chaos

Another type of sudden and unanticipated outflow may be due to the foreign investors suddenly deciding to sell their shares or bonds and take out the proceeds of the sale in foreign currency. What is more serious is that adventurous investors and speculators may indulge in speculation in currency and in shares on a big scale; and take out profits. Such currency speculation, particularly what is called the short selling of currency, happened in Thailand in 1997, which was the beginning of the financial crisis of South East Asia in 1997.

A typical example of share market speculation is the one tried in Hongkong in 1998 by short selling the shares. Here the government was able to detect it in time and also prevent it by buying the share on a large scale. This action of the government defeated the design of the share speculators. But such type of counteraction cannot be done in most of the developing countries, because there may not be enough reserve to buy the shares on a large scale. Like the protective measure adopted by Malaysia mentioned above, here too the votaries of free market operations had criticised the action of Hongkong government in protecting its share market stability and currency stability. But the government remained firm and its method succeeded.

These experiences of the past have shown that speculators with huge resources at their command can destabilise the financial market and the currency of a country in pursuit of quick profit. This can cause financial crisis in a country with both short term and long term impacts on development and employment. One cannot forget the sad plight and sudden impoverishment of the common people in South East Asia and East Asia after the financial crisis of 1997.

Chapter 5

DIRECT EFFECTS ON DEVELOPMENT AND POVERTY

Some idea of the positive and negative aspects of the main economic operations in the wake of globalisation has been given earlier. Let us now move on to the effect of these operations on development and poverty. Here we are limiting ourselves to economic development.

As has been mentioned earlier, unrestrained import of agricultural products is likely to hurt farmers, particularly small farmers. They do not generally take to agriculture as a commercial venture, but more because the land is with the family from before and there is no other alternative means of livelihood.

Such farmers and the farm labourers working with them will be unemployed. The rural economy will get disrupted. The economic theory will suggest that these people will take to other more profitable professions. But there will hardly be any such alternative possibilities. The rural population on such a large scale in most of the developing countries cannot be shifted to alternative employment in the foreseeable future. A vast section of the rural population will thus be submerged in poverty.

With the depression of income of such farmers and farm labourers, the demand for goods, both agricultural and industrial, will diminish, and this will naturally have an adverse impact on the various sectors of production.

Similarly, unrestrained import of industrial products is likely to hurt the domestic industry, as mentioned earlier. Even the big industries will find it difficult to cope with the competition, because the foreign firms are backed by much superior financial and technological resources. The small and medium enterprises will, of course, feel the impact much more. They will be exposed to grave danger of extinction, because they do not have the resources to stand in competition with the big firms in the world. A very large section of the population in the industrial sectors, both the industrialists and workers, are likely to lose income and employment . Development will slow down and poverty will be enhanced.

A similar scenario is likely to emerge in the services sectors as well, if there is unrestrained import of services. In a short term, the users of services may be happy that they have got cheaper and better quality services from foreign sources. But gradually, as the domestic service providers are eliminated by competition, the service users will be totally dependent on the imported services, which may be very costly and also uncertain in supply.

As mentioned earlier, free flow of capital is likely to make foreign exchange reserves and income uncertain and it is also likely to destabilise the financial sector and, in fact, even a country's economy as a whole. This will clearly have adverse effect on development and will add to the burden of the poor. There have been several instances in the past, the main example being some Latin American countries a few years ago, and the latest being the financial crisis of the South East Asian countries in 1997.

Globalisation constraining competition

It is highly ironical that globalisation, which is being championed mainly on the merit of it encouraging competition, is actually resulting in constraining competition in some ways. There is a spate of the merger and acquisition (M&A) of firms. Free movement of capital is making M&A also possible across borders. It is being defended on the ground that it improves the production process by increasing the scale of production, deepening research and development activities, cutting duplication of activities, etc. But it does curtail competition.

Operation of free competition in economic activities can be effective only if the number of operators is large; to that extent the reduction of the number of operators through M&A reduces competition. If it is only some isolated instances, it might not cause worry; but the rate is alarmingly high.

Almost every day there is some news of M&A in economic journals. Just in two months, i.e., during March and April 1999, the Financial Times reported as many as 139 such cases (including both intra-country and cross-border M&A). And these firms must have been really big to have caught the attention of this newspaper. In 1998, the ten biggest M&A were each valued above US$30 billion; the highest being the Exxon-Mobil case valued at US$86.35 billion. In fact, the number of cross-border M&A, each exceeding the value of US$3 billion, was 32 in 1998.

The M&A of firms results in increased concentration of supply; and to that extent it constrains competition. In some sectors, it has resulted in a very high concentration of production within just a few mega-producers. This process has a tendency to get intensified. A mega-merger leads some other big firms in the sector to come together, as they feel threatened. Thus one merger leads to another.

Even if the M&A is among the firms within a country, the effect is felt outside. The resulting merged firm has stronger muscles, which it can use in its operation in other countries. The developing countries are particularly vulnerable, as their domestic firms, which were weak compared even to the individual firms, will be much weaker compared to the merged firm.

There are, of course, some checks on M&A in the major developed countries, but mostly they relate to the effect on the domestic consumers. The possible adverse impact on the industries and consumers of the developing countries is generally not taken into account in their inquiries on proposed M&A in their countries.

Double standards in major developed countries

One important point to note is that the governments and the firms of the major developed countries often display double standards in respect of the freedom in economic operations. When they want to capture the markets of other countries, they sing the praise of liberalisation and the virtues of the operation of markets without government interference. But when the open and free market operation hurts them, they immediately apply government intervention. In fact, this hypocrisy has been one of the most shameful chapters in international economic relations over the last three decades. And the developing countries have been the victims.

There are demands from the developed country industries for protection, immediately when the imports from the developing countries start showing dynamism in any sector. Earlier, direct restraints on imports were imposed. Later, somewhat more sophisticated forms of protection were applied through the anti-dumping process. And recently, still more subtle arguments are made for protection ostensibly on the grounds of protecting the environment and safeguarding workers' welfare.

The story started with the restraint on the imports of textiles from the developing countries in the 60's. The normal GATT rules were circumvented and special rules were framed. The developing countries agreed under the threat of unilateral actions of trade restraint. Most of the restrictions imposed by the major developed countries are still in place. And all the time, the restraint has been only on the imports from the developing countries, totally sparing the developed countries. Systematic restraints on import have also been applied in some other sectors, like jute, leather, etc.

Another example of the double talk is the agricultural sector.

The principle of free trade and hands-off for the government was entirely given up in this sector by the developed countries. Severe restraints on imports were imposed and huge subsidies were provided for production and exports. Even now, the major developed countries impose very high tariffs on some agricultural products and grant enormous subsidies to their farmers in various garbs.

Even in respect of the flow of capital, most of the developed countries continued with government control for a very long time. Only when their economies improved and they were confident of their financial position, they removed these controls. The developing countries should draw lessons from this behaviour of the major developed countries. The main lesson is that the vulnerable sectors must be given protection in spite of all the calls for globalisation.

Chapter 6

WHAT SHOULD BE DONE

The developing countries should not go by the slogans on globalisation given by the major developed countries, the international institutions and the TNCs. They should formulate policies in this regard with their own interest in view. The borders should neither be totally closed nor totally kept open; the degree of openness should be determined by a country in its own best interests. The interests of a country can be best judged by the country itself, and not by the other countries or the TNCs.

A developing country needs the financial and technological resources from outside. It needs foreign capital to augment its resources for development. It also needs modern technology to move on a fast growth path. However, while fulfilling these objectives, it should not be exposed to exploitation by other countries and by the TNCs. The government and the parliament of the country must have full control over the economic governance of the country and on the role of the TNCs in the country.

The TNCs may not be boycotted, but their activities should be effectively monitored and controlled. The development, interest, priorities and objectives of a country should be placed above the narrow profit interests of the TNCs. There is thus a need for countries having effective machinery and capacity to monitor, control and guide the TNCs.

There is also the need for the developing countries to resist strongly the attempts in international forums at further weakening the role of governments in shaping the development policies of their own countries.

A developing country has to ensure that the wave of globalisation does not engulf and distort its development process and submerge its people in abject poverty. At the same time, it should use the resources of the foreign firms, particularly their technology. It should also use the FDI for selected industries and infrastructure development. All this needs a balanced approach to globalisation.

Entry and operation of TNCs

A developing country should not allow fully free and unrestricted entry and operation of foreign firms in its economy; but, at the same time, it should not totally prohibit their entry. The government should continue to have the power to select them for entry and also to prescribe the conditions of their entry and operation. Some of the important criteria should be:

- they are bringing in good technology for the development of priority sectors;
- their operation will generate enough foreign exchange, directly or indirectly, to meet their continuing profit repatriation;
- there will be spin-off effects in technical upgradation of the local workers; and
- their operation will generate additional economic activities in the local area.

Appropriate conditions should be prescribed at the time of entry to ensure that these criteria are fulfilled.

Apart from the conditions for entry, there should be appropriate conditions for the operation of these foreign firms. They should work in close harmony with the domestic firms and should not act against their interest. Besides, there should be appropriate conditions for the use and repatriation of profits, which should be supportive of the development policies of the host government.

If these conditions are fulfilled, the foreign firms will have a congenial and hospitable environment to operate in, which will be advantageous to them too. In fact, filtering globalisation through such criteria will reduce risks and make it useful both for the foreign firm and the host country.

The developing countries should apply the conditions with prudence. The policies should be formulated and implemented under conditions of full transparency and also adequate stability and predictability.

The developing countries should ensure that they do not lose their right to apply these or similar conditions to the entry and operation of the foreign firms. There are pressures on them by international organisations for surrendering or diluting these rights. In particular, there are strong moves in the WTO in this regard through the proposed negotiations and agreements on investment and competition. The developing countries must resist these pressures.

Movement of capital

A developing country should not make the inflow and outflow of capital totally free, until it is confident of a stable and steady balance of payment position and foreign exchange reserve, as well as a stable and healthy domestic fiscal position and monetary position. The exact conditions will depend on the situation of a country. It should be kept in mind that the seemingly healthy economies of the South East Asia and East Asia were shaken in 1997, partly through the manipulations of capital, as the movement of capital was free.

Area of trade

In the matter of import of goods and services, the developing countries have lost a lot of ground in the WTO agreements. Still there is considerable scope for discretion and flexibility in many areas, and all this should be utilised. There should be a two-pronged strategy. One, the existing provisions of the agreements should be fully utilised in pursuance of the development objectives of a country. Two, efforts should be made to change the rules wherever they work against the development objectives and interests of the developing countries.

As in the case of the entry of foreign firms, here again a developing country should not altogether stop imports and shut itself up against the outside world. But it should also not keep its door totally open for foreign goods. The policy should aim at modulated import liberalisation. The types of imports needed for the development process or for the necessary consumption of the domestic population should be allowed and encouraged. For example, a country may at some stage of development like to have the import of capital goods for the production of downstream products.

Import of capital goods should be encouraged at that stage. But later, the country may itself like to manufacture some of the capital goods; thus necessitating a curb on the import of those capital goods. Thus the encouragement or discouragement of particular types of goods should be a dynamic process, responding to the development needs of the country at a particular time.

Within this broad frame of the policy choice, let us consider what can be the instruments to achieve the objectives of modulating the imports. Direct stopping of imports in a big way is now nearly impossible under the current rules and procedures of the WTO. Even the enabling provisions relating to the balance of payment problems have been so circumscribed that the developing countries will find it difficult to impose quantitative restraints on imports. Moreover, the major developed countries are extremely rigid with allowing the developing countries to undertake this course.

Under the current conditions of the WTO rules, the following steps may be taken.

- A comparatively easier way is to have high tariffs. The developing countries have relatively higher bound rates of tariffs in the WTO, i.e., they can impose high tariffs on certain products. Tariffs on the products of which the import is to be discouraged should be kept as high as the bound rates. If a country has not bound its tariffs on such products, it should impose such levels of tariffs which are high enough to discourage imports. There is a related problem of the pressure on the developing countries to reduce their tariffs. These pressures should be resisted, as they would otherwise lose the flexibility to discourage imports altogether.
- Then there are options for taking import control measures contingent on certain specified situations, e.g., safeguard measures and anti-dumping duties. A developing country should develop appropriate institutions and mechanisms for this purpose. There are elaborate procedures for taking these actions. It is necessary to have an effective mechanism for monitoring the volume and the prices of imports as also the impact of imports on domestic production or the prospect of establishing domestic production. Besides, it is also necessary to collect information regularly on the production and prices of the sensitive items in the countries, which are the main sources of the import of these items.
- The developing countries have also to pay attention to the standards of imported products. It is quite likely that the

liberalisation of imports in the developing countries may induce the exporters to try to push products of inferior quality into these countries. The developing countries should adopt appropriate standards for products and develop suitable machinery for testing products. The objective should be to stop the import of products which do not conform to their standards.

Following the second strand of the strategy, i.e., improving the rules, the developing countries have to identify the provisions which need improvement or which need to be freshly introduced. Some priority areas can be identified immediately. These are:

- Relaxing the provisions for imposing direct import restrictions in case of balance of payment problems;
- Improving the conditions and procedure for taking safeguard measures to protect domestic production, particularly agricultural production;
- Enabling the developing countries to use subsidies in industrial and agricultural production;
- Improving the dispute settlement mechanism, so that it genuinely improves the enforcement of rights and obligations and does not operate against the interest of developing countries;
- Improving the agreement on Intellectual Property Rights in order to stop the exploitation of the bio-wealth of the developing countries by foreign firms and also to encourage the genuine technological development of the developing countries;
- Improving the negotiating process and the decision-making process in the WTO, so that the developing countries have an effective role in the making and enforcement of rules.

Acting together

But the task of the developing countries is very difficult, as the massive forces of the TNCs and the governments of the major developed countries are united to gain advantage, as mentioned above. The developing countries, or at least a large number of them, would need to work closely together to avoid or limit the damage and also to get the best out of the process of globalisation.

Alone, a country will find itself quite helpless in its dealings with a major developed country; but if it is in a group of ten to twenty, it will be more strengthened. If some of them are together, it is quite possible that they can achieve their objectives in an organisation like the WTO. Even in respect of the IMF and the World Bank, they can push their interest to a significant extent by influencing some developed countries and also by mobilising the support of influential socially conscious groups in major developed countries.

The developing countries have also to develop their expertise in dealing with the TNCs. It is no use at all exhorting the TNCs to be good operators; what will however be effective is to bargain with them with ability and strength. And the ability as well as the use of the strength of the developing countries has to be developed. This exercise can be helped if the developing countries, or at least a large number of them, work in close cooperation and harmony.

What is important is that they must realise that their economy and even sovereignty are at stake in the current wave of the globalisation process, and they can protect themselves only if a large number of them work together.

AN INTRODUCTION TO GLOBALISATION AND ITS IMPACTS

Globalisation has an impact on the lives of people in all sectors of society, and most adversely on poorer and more vulnerable social groups, particularly in developing countries. Thus, it is urgent for these groups and countries to develop a critical awareness and assessment of the nature and process of globalisation and its effects on society.

This paper begins by examining the main features of the current trend of globalisation. It analyses financial and trade liberalisation, the operations of transnational corporations, and the globalisation of policy-making by multilateral institutions such as the World Trade Organisation and the International Monetary Fund, and considers the implications of these global processes on development and poverty.

Finally, the author recommends concrete policy options that governments can take to ensure that globalisation works to the benefit of the world's developing nations, which must ultimately act together in forging a globalisation that works for all – one that is pro-people, pro-poor and pro-development.

BHAGIRATH LAL DAS *was formerly India's Ambassador and Permanent Representative to the General Agreement on Tariffs and Trade (GATT) forum. He has also served as Director of International Trade Programmes at the United Nations Conference on Trade and Development (UNCTAD). He is currently a consultant and advisor to several inter-governmental and non-governmental organisations.*

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