

# Globalisation for Whom? A World for All

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I accepted the kind invitation to deliver this lecture with many mixed feelings. It is a year since I lost one of my greatest friends, the late Ishak Shari, whom this lecture series now commemorates. I still remember leaving him in late May 2001, at Hospital UKM, before going abroad, not wanting to think that it would be the last time I would ever see him. In a week too, it will be five years since the beginning of the Southeast Asian debacle, the end of the miracle. It is also almost exactly two decades since I left this university for the one I now work in, leaving behind Ishak, Anuwar Ali, now the Vice Chancellor, Rugayah Md Zin, now IKMAS Director, and many other close friends, and taking with me fond memories of the five and a half years (spent) at this then young university.

In his inaugural lecture some years ago, entitled *Bumi Semua Manusia* (This Earth For All Humanity), Ishak reminded us that we are all equal in the eyes of God, that this Earth is our common right and responsibility, and that we are all equal. In many ways, his lecture was a powerful reminder of the ethics that should guide human conduct and social relations in this day and age, which we often call globalisation.

In this spirit, I'd like to raise some issues about globalisation and how it affects developing countries in general, and Southeast Asian economies in particular, namely Malaysia, Indonesia, and Thailand. In many ways, the other Southeast Asian economies – like Singapore, Brunei and so on – are not very representative and not very comparable to most other developing economies. The Philippines is considered a Latin Asian country, with Latin American-type problems rather than Southeast Asian-type problems.

Let me first emphasise the historicity of the current phase of globalisation. This is not the first time we've been globalised in the world. The last time was probably for about half a century until the outbreak of the First World War in Europe. In many senses, the outbreak of the First World War was due to the changing nature of international relations and the nature of colonial empires during that period.

If we agree that there was a period of globalisation then, how do we describe it? It's useful to refer to the work of the English liberal economist John Hobson, who described it as a period of imperialism. Many people wrongly think that the term was coined by Lenin. It was first used in a serious and rigorous way by a liberal economist. For Hobson,

of course, imperialism was due to the rise of what we now call oligopolies – the tendency of concentration of enterprises during what seemed, at that time, to be a relatively advanced stage of capitalist development; and the tendency for these influential, large enterprises to influence their governments to secure particular advantages, which were best secured through colonial-type relations.

Although the term “imperialism” was greatly used particularly in the 1960s and 1970s, we find that in the last couple of decades, there is increasing use of the term “globalisation”. In some ways, it is useful to use the term “globalisation” although it does obscure the historicity of the current use of the term, and its hegemonic, oppressive, exploitative and unequal dimensions.

Let’s focus on five economic aspects of globalisation that are, to varying degrees, distinctly different from the earlier period of imperialism of the late 19<sup>th</sup> century and the early 20<sup>th</sup> century. These five are not arbitrarily chosen, but are of the greatest importance in understanding contemporary international economic relations. These are, first, international trade; second, foreign direct investment; third, international finance; fourth, intellectual property rights and related technology issues; and fifth and last, the changing structure of international governance.

Let us begin with international trade. Contrary to what many people think and assume, many of the issues first raised by early critics of the pattern of international trade, such as Raúl Prebisch, the distinguished Argentinean Keynesian, Hans Singer and others, are still very much with us. Of course, there continues to be a debate on what the trends in international terms of trade are due to, but there’s unambiguous evidence that the trends identified earlier continue to plague us at the beginning of the 21<sup>st</sup> century.

Let me reiterate the three major trends that I think are still relevant. First, Prebisch and Singer identified the secular decline in relative prices of primary commodities compared to manufactured goods. Second, Arthur Lewis, the West Indian Nobel laureate, emphasised the relative decline of tropical product prices compared to temperate product prices. Third, and this is a more recent phenomenon, there seems to have been a decline in the prices of generic manufactured products compared to manufactured products for which transnational corporate control of intellectual property rights has been important.

This might be a bit obscure to some people; let me give you an illustration. If you look at the pages of the *Financial Times* or *The Economist* since the mid-1990s, there is talk of price deflation. This price deflation is not an even phenomenon affecting all prices, but is a very uneven phenomenon affecting some prices more than others. And the prices most affected are not just those of primary commodities, which have had a long historical experience, but also manufactured goods. Not surprisingly then, both Japan, China and other East Asian economies have been experiencing price deflation in recent years.

Let me give you a second rather dramatic example: the example of D-RAMs. In the late 1980s, a D-RAM unit cost somewhere in the region of over US\$80. This encouraged many Korean and Taiwanese firms to get involved in D-RAM production. By the mid-

1990s, a D-RAM unit cost less than two dollars. Of course, this decline was very dramatic, but characteristic of an industry where there were few entry barriers. There were no strong patents or other types of entry barriers, and so it was relatively easy for new firms to get into the industry. I would argue that there are actually quite a number of industries susceptible to such easy entry. And as a result of intense competition, there is a tendency for these generic manufactured goods to experience price declines comparable to, if not more dramatic than, primary commodities in the past.

So the decline in the international terms of trade is a very serious problem, which is going to get even more serious as trade liberalisation proceeds. There has been tremendous expansion in trade liberalisation, not only for manufactured goods, but also extended to agricultural products and services with the conclusion of the Uruguay Round. And all these will have tremendous effects.

The second area deserving our attention is the question of foreign direct investment (FDI). In much of Latin America and elsewhere in the developing world, there used to be, up to the 1970s, a strong critical stance, influenced by structuralist and *dependentista* positions, vis-a-vis FDI. Since then, there has developed a much more nuanced position about desirable as compared to undesirable FDI. I think much of this analysis has been obscured by data that does not distinguish between mergers and acquisitions, on the one hand, and what is called “green field” FDI, where new economic capacity is actually developed.

Mergers and acquisitions, I would argue, do not provide much in terms of real economic gains. It involves a change in ownership and control of assets, and usually, some related managerial changes. But as Paul Krugman has recently reminded us, there is no guarantee of significantly improved management because of such changes due to the extraordinary role of distress sales, i.e. “fire sale FDI”, leading to acquisitions and, sometimes, mergers.

This, however, has become the most important type of FDI in recent times. Mergers and acquisitions accounted for well over 80 per cent of FDI in the world in the 1990s. And especially in the wake of the recent crises in Mexico, East Asia, Brazil, Russia, Turkey and Argentina, such acquisitions have been far more important than “green field FDI”.

Of course, one can go into all kinds of critical observations about “green field FDI”. After all, FDI – and for that matter, most private investments -- are profit-seeking and, I would argue, rent seeking. Hence, it ultimately seeks to maximise repatriated profits, rent or surplus, and FDI conduct or behaviour should be expected to follow accordingly – unless host countries succeed in regulating them to their own advantage, which is increasingly difficult in a world where investor rights are being privileged over host country interests, as reflected, e.g. in the demise of the UN Centre for Transnational Corporations (UNCTC) a decade ago. [You’re all quite familiar with this, and I won’t detain you by elaborating.]

The third area that deserves our critical attention is international financial liberalisation. Since the early 1970s, there has been a great deal of pressure for policies of financial liberalisation following the critiques of MacKinnon and Shaw, against the earlier view of people like Gurley and Shaw, who clearly favoured developing banking systems as the principal means of financial development to mobilise funds for developmental purposes. The MacKinnon-Shaw critique of what has been termed “financial repression” developed a view that favoured “financial liberalisation”. This view of financial liberalisation was justified in terms of moving towards modern Anglo-American norms and standards, and became much more important for public policy from the 1980s, especially after the so-called Third World (sovereign) debt crisis. [The debt crisis is often said to have begun in Mexico in 1982, though the crisis actually began in Poland in 1981.]

This push for financial liberalisation often led, domestically, to poorly sequenced deregulation without adequate prudential regulation and supervision, leading to greater financial fragility, volatility, and ultimately, crises. International financial liberalisation, however, has had two main consequences. First, the same ill-sequenced deregulation and inadequate prudential regulation and supervision of capital account opening. Much of this deregulation was intended to facilitate private borrowing from abroad. And second, the promotion of securities markets, particularly stock markets, especially by the World Bank subsidiary, the International Finance Corporation (IFC).

This trend towards international financial liberalisation, it was promised, would have at least three advantages for developing economies. First, it would result in a net flow of funds from the capital-rich to the capital-poor; this has simply not materialised. If we look at the figures over the last two decades, there has been no net flow of funds from the capital-rich to the capital-poor. In fact, except for East Asia in the early and mid-1990s, net flows have actually been in the opposite direction. There was massive capital flight from countries such as Russia when they opened their doors. As the late James Puthuchery argued many decades ago, this expectation is like expecting more birds to fly into, rather than out of an open birdcage. So, capital flight has actually been in the opposite direction, from the capital-poor to the capital-rich!

Even in the case of East Asia, where there were significant capital inflows from the capital-rich, mainly from European and Japanese banks, the flows eventually reversed – with devastating consequences – leading to the crises of 1997-98. This is important to remember, because there was a subsequent resurgence of inflows into parts of Latin America before the Argentine crisis, and neo-liberals were unrealistically optimistic about the sustainability of such flows.

The second claim by advocates is that international financial liberalisation would reduce the cost of funds. Again, the evidence suggests the contrary, and now its proponents are trying to explain this away by saying that the low real interest rates in the second half of the 1970s were exceptional for three reasons. One, increased liquidity – due to the post-oil shock availability of petrodollars being recycled by Anglo-American banks – lowered real interest rates. Two, the high inflation of the period – often associated with “stagflation” in the West – lowered real interest interests despite high nominal interest

rates; hence, for many months, real interest rates were even negative, because of this unusual conjuncture of events.

Three, banking systems in many developing economies then were characterised by “financial repression”. Financial repression is acknowledged to have kept interest rates low, supposedly at the cost of lowering the savings rate; while negative interest rates would most certainly have depressed savings rates, the East Asian experience suggests that a modest positive interest rate has been enough to encourage savings.

Hence, you had unusually cheap funds available in that period. Thus, the low cost of funds before financial liberalisation is said to have been exceptional and unsustainable. It is then argued that, with international financial liberalisation, the real cost of funds is reflected by the financial sector, and this is sustainable, unlike in the earlier period.

The third argument often made in favour of international financial liberalisation is the claim that financial deepening would reduce volatility in the financial system. It is true to say that financial deepening – the development of new financial instruments and derivatives – has resulted in the reduction of some of the old sources of volatility. For instance, where economies are often vulnerable to exchange rate or interest rate volatility, this has often been reduced by the availability of hedging options. Nowadays, corporations can hedge, at some cost, rather than expose themselves to such volatility.

However, the very creation of new financial instruments and derivatives like these has created new vulnerabilities. For instance, the very existence of hedge funds, and the desire by hedge funds to make money for their investors, has meant that hedge funds indulge in various types of activities which are highly leveraged (and hence, highly vulnerable) and very speculative, which actually creates and enhances new sources of volatility in the financial system. So the consequence of this has been much greater volatility in the system, and this has resulted in much greater frequency of currency crises in the last two decades, especially in the years since the 1995 Mexican “tequila crisis”.

However, the East Asian crisis – rather than the “tequila crisis” – seems to have sparked crises of new types. The last half-decade has been a period of new crises, characterised by more speculation and what many have called “casino capitalism”. In East Asia and Latin America at least, contagion – “being in the ‘wrong neighbourhood’” – has become more pronounced, with (the) crises otherwise unexplainable. This has increased the unpredictability of crises. Who could have predicted the Malaysian crisis of 1998 before mid-1997? So you have a situation where the global financial system, and as a consequence, the international economy, is becoming increasingly vulnerable to new sources of volatility, with rather devastating consequences.

To this list, one must add two other consequences of international financial liberalisation that have had adverse consequences for development. First, international financial liberalisation neglected the ascendance of financial interests – I would argue financial *rentier* interests – viz a viz more productive, entrepreneurial interests. This was particularly true in Southeast Asia, where FDI dominated industrial capacity, leaving

other economic activities, especially finance and real estate, to domestic investors. And so, we in Southeast Asia hardly have any real captains of industry, i.e. we lack significant domestic industrial entrepreneurial communities. So the rich in our societies gravitated to finance and other services – i.e. non-tradeable activities. The consequence of this, of course, was that these financial interests, in turn, influenced government policies in ways that have been detrimental to development – creating, if you will, a vicious cycle.

Let me give you a simple example. In 1995, the US and Japanese governments decided to reverse the relationship between the dollar and the yen. The dollar had declined against the yen for a decade, from the time of the second Plaza Hotel meeting in New York in September 1985. So when Larry Summers and Sakakibara Eisuke got together in the second quarter of 1995, they decided to reverse this trend, after several years of Japanese stagnation. This meant that the Southeast Asian currencies – pegged to the US dollar – began to appreciate with the US dollar. This meant that one source of Southeast Asian competitiveness began to erode with the appreciation of their currencies.

But the financial interests who dominated public policy insisted on retaining the pegs, even though it was adversely affecting competitiveness in the real economy, because they were heavily leveraged in dollars (often without hedging their debt), and did not want the pegs to change. Because of their growing influence, public policy generally, and financial policies in particular, have been increasingly influenced by such financial interests, who sought to protect the value of their financial assets. As a consequence, they tend to propose, favour and insist upon policies with deflationary macroeconomic consequences.

Last, but not least, it is now widely acknowledged that much of the rapid growth achieved in the last few decades in East Asia as well as in other parts of the world, has been due to appropriate, selective government interventions. Economic liberalisation reduces the scope for such industrial policy interventions, including those in the sphere of finance. Joseph Stiglitz has argued that “financial restraint” is distinct from liberalisation, on the one hand, and “financial repression”, on the other. Financial restraint basically involves the creation and allocation of rents to financial interests to direct financial resources to priority areas in favour of growth and development. This becomes less possible with financial liberalisation.

The fourth issue, which I shall only mention very briefly, is the strengthening of intellectual property rights in the last decade-and-a-half. This was particularly emphasised by the second Reagan administration from the mid-1980s. Secretary of State George Schultz, for example, put a lot of effort during his tenure into strengthening and policing intellectual property rights internationally. This has meant that the options for transfers of technology have been reduced, on the one hand, while the costs of technology transfers have gone up.

This severely restricts the possibilities for latecomer industrialising economies. Their options have become much more severely limited in important ways. Such monopolistic powers, in the name of intellectual property rights, actually have important market consequences that raise the cost of living in very important ways. This has been most

dramatically illustrated by the South African challenge to ensure the availability of affordable pharmaceutical drugs for the treatment of HIV and AIDS. The Doha meeting of the WTO actually involved little more than a modest concession by pharmaceutical companies who stood to lose more if they did not compromise.

Clearly, the strengthening of intellectual property rights is hardly a form of liberalisation. It actually involves strengthening monopolistic powers, but is nonetheless correctly associated with globalisation. It will have very severe consequences for the potential of latecomer industrialising powers to try to “catch up”. And it basically means that the possibilities earlier available to latecomers – whether the United States, Germany or Japan in the mid-19th century, or South Korea and Taiwan Province of China in the last third of the 20<sup>th</sup> century – are not open to the same degree to others seeking to emulate them today.

The fifth and last area is international economic governance. As is well known, the basic framework for contemporary international economic governance was set up just before and just after the end of the Second World War. First, two major institutions were established at the 1944 Bretton Woods conference – the International Monetary Fund (IMF) and the World Bank. The IMF, in particular, was the crucial basis for the so-called Bretton Woods system, which prevailed until it was unilaterally dissolved by (US President) Nixon in 1971. After the end of the war, the attempt to establish the International Trade Organization (ITO) was scuttled by the US Congress. Instead, a compromise General Agreement on Tariffs and Trade (GATT) was established. In 1995, GATT was replaced by the World Trade Organisation (WTO). But it’s not simply putting old wine in new bottles. The character of the WTO is significantly different from GATT. Three examples with significant implications for development will illustrate this assertion.

Under the old GATT system, there was some recognition of difference, through the Generalised System of Preferences (GSP). The GSP compensated for different national capabilities by developing an international trading system that recognised and sought to compensate for such differences. These and other related arrangements have now been diluted or abolished. For example, it is no longer possible for governments to impose local content requirements.

The process of industrialisation in much of the world from the late 18<sup>th</sup> century has, of course, been led by textiles and garments. With the imminent expiry of the Multi-Fibre Arrangement (MFA), the possibility of more developing countries industrialising around textiles and garments will no longer be there. And this, of course, will further limit the options for many countries to begin their industrialisation process.

Also, the WTO now provides for retaliation, the possibility of a state taking action against another in an area other than that for which the first state feels aggrieved. For example under the new rules, if country A has a dispute with country B over issue X, A can retaliate in a completely unrelated area, say Y. And, for all intents and purposes, if A is a relatively rich and powerful country and B is a relatively poor country, it is most

unlikely that B will be able to afford the legal and other costs involved in taking up the matter for some form of legal adjudication. And so the new system is basically stacked against smaller, poorer and weaker countries.

Finally, the WTO's scope has expanded tremendously. Whereas GATT was primarily interested in tariffs involving industrial products, after the Uruguay Round, the scope for GATT – and now the WTO – has been expanded to include agricultural products, services, and also the so-called trade-related investment measures (TRIMs) and trade-related intellectual property rights (TRIPs). There is pretty much nothing in economics that the WTO is not involved in – financial services, intellectual property rights, and so on and so forth. So the WTO has grown from being an organisation primarily concerned with reducing tariff as well as non-tariff barriers in trade involving industrial products, to covering pretty much everything that the IMF does not cover. This, of course, will have serious consequences.

Let me just add a few words on the IMF. The IMF has been under a lot of criticism from all over the world, especially for its treatment of the East Asian crisis, particularly the conditionalities it imposed there, and more recently, its handling of the Argentine crisis.

There has also been a very important right-wing critique by the US Congressional Commission led by Allan Meltzer, who is personally very much influenced by the Austrian School, and who has disputed the effectiveness of both Bretton Woods institutions. Hence, many people were waiting to see what the new Bush-O'Neill administration might do with its influence over the IMF. Developments so far suggest that rather than weakening the IMF, the IMF will become more onerous. O'Neill has announced that governments seeking IMF emergency credit facilities would not only be subject to conditionalities, but also to *pre*-conditionalities, meaning that they will need to fulfil whatever terms the IMF demands as preconditions before having access to emergency credit facilities. This will, of course, have very serious consequences, especially for the international financial system, which has become increasingly volatile.

So far, I've not said much about Southeast Asia. The rapid growth experienced in Southeast Asia over the last few decades, until 1997, was relatively impressive compared to much of the developing world, but was actually more modest than what was achieved by South Korea, Taiwan Province of China, Japan, and even Singapore. On the average, the first-generation of newly industrialising economies achieved 8 percent growth per annum over at least two decades, sometimes three decades, before the nineties. In contrast, the Southeast Asians achieved 6 percent on average despite an impressive decade before the 1997-98 collapse. But the Northeast Asians had much slower population growth rates, except for Hong Kong, where there was significant emigration from mainland China.

There were also much higher population growth rates in Southeast Asia. So on a per capita basis, the difference is not just the 2 per cent mentioned earlier, it's closer to 3 per cent. And over a period of a quarter of a century, a 3 per cent difference in the growth rate actually becomes very big. So, the Southeast Asian performance is not really the

superior example that the World Bank has touted it to be. Nevertheless, for many countries in Africa, and to some extent in Asia and Latin America, the Southeast Asian economies were held up as examples to emulate, although the region's performance has not been more impressive than Northeast Asia's.

Secondly, industrial capabilities in Southeast Asia are much more modest, partly because development of industrial capacity has been dominated by FDI, much more so than in Northeast Asia. In Northeast Asia, FDI has contributed to less than 2 per cent of gross domestic capital formation in South Korea, Taiwan Province of China, and Japan. In Southeast Asia, the average is much higher: 25 percent in the case of Singapore, 15 percent in the case of Malaysia, and 10 percent in the case of Thailand. Only Indonesia approaches the developing-country average of about 5 to 6 per cent. The implications of this gap in industrial capabilities between Northeast and Southeast Asia have become much more apparent as Southeast Asia strives for sustainable development after the 1997-98 crisis in the face of more intense competition from the new Asian "kids on the block" of industrialisation – China, India and others.

Hence, the promotion of Southeast Asia as a model for other developing countries to emulate was actually ideologically-driven by the Washington Consensus' claim that Southeast Asia could be characterised as being much more open and liberal as well as less *dirigiste* compared to Northeast Asia. And so Southeast Asia was promoted as the model for emulation, but as suggested earlier, the Southeast Asian experience was actually far less impressive and more vulnerable. And because of the nature of the interests that came to dominate public policymaking by the mid-1990s, the Southeast Asian economies adopted policies that led to the catastrophic crisis of mid-1997, which resulted in severe economic contractions in 1998.

I would like to add one more point regarding capital flows. It is often said, "Well, you can do without capital flows in East Asia, because you have such high saving rates averaging 40 percent. We in Latin America, or Africa, or wherever, cannot afford it as we need those funds." First, as we learnt in 1997-98, such funds are actually very easily reversible; they are short-term flows. Second, if we look at what happened to those funds in East Asia, it's not clear that they contributed to the growth process in any significant fashion.

The funds that came into the region seem to have resulted in three main developments. First, you had asset-price bubbles, mainly in the stock markets – the stock markets boomed – but also in property markets. Second, you had consumption booms. Before the crisis in Bangkok, for example, one in 11 cars sold was a luxury car, either a Mercedes or a BMW. And there were many other indicators of consumption booms, for example the largest market for cognac in the world is actually in Southeast Asia, not in France!

And the third outcome, mainly only true in the case of Korea, is called "over-investment," or poor investments. As I illustrated with the example of the D-RAMs earlier, with the benefit of hindsight it seems true that those investments were poor investments. They lost a lot of money. But if you were making a decision in the late-

1980s, I don't think it was so self-evident that the price of D-RAMs would collapse as they did, we all would probably have made the same investment decisions. And so it is very well and easy for us to say now that those were very poor investment decisions.

So in the exceptional case of Korea, one could argue that the funds that came in enabled the *chaebols* to borrow from the banking system to create new industrial capacity, rather than cause asset price bubbles. But in Southeast Asia, which I would suggest is closer to the norm in Latin America and much of the rest of the world, it is more likely that funds coming in only contributed to asset-price bubbles or consumption booms, and not to significant development of the real economy.

Many of these problems are relatively new, and quite different from the old problems that we tended to associate with imperialism. Some, of course, are similar: the problem of the terms of trade, foreign direct investment, and so on. But I've tried to concentrate on some new developments, particularly financial liberalisation, as well as the strengthening of intellectual property rights, to suggest that the challenges we face in developing countries in this era of globalisation are somewhat different.

And, very sadly of course, developing countries are not only weak, but have not been able to get their act together in terms of negotiating many of the new treaties which are being brokered. There are very few developing countries that are in a position to maintain a reasonable representation at such meetings. It is only countries like India and Brazil – the larger countries – that have some kind of effective representation. And, even in countries like Brazil, since the Collor administration, and India, since the BJP administration, the likelihood of providing acceptable and effective leadership to the developing countries has been further weakened. Thus, we find the leadership of the developing countries – and its effectiveness -- even further eroded as a consequence.

The prospects for development that adequately responds to the challenges posed by globalisation seem increasingly remote. If Ishak were with us today, I am sure he would fully endorse, if not actively lead a new pluralist network of heterodox development economists called IDEAs, for International Development Economics Associates, based in and led from the South. IDEAs is committed to Ishak's vision of an Earth for all humanity. Against the proponents of corporate globalisation from above, IDEAs will support a progressive internationalism from below.

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