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The Effects of Globalization: A View From the Developing World

Andrés Mejia-Vergnaud

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Globalization has been hailed as a deliverer and condemned as a destroyer of developing countries. How can globalization elicit such divergent responses? And what do people mean when they praise or condemn globalization?

As you will see in the course of this paper, I will often point to the beneficial effects of free trade and free-markets. The gains from free trade and free markets are indeed relevant from the point of view of public policy: they offer a guide to which sort of policies we should pursue. This doesn't mean, however, that I believe these positive effects are the main justification for globalization and economic freedom.

At the philosophical and human level, freedom to trade and freedom to interact with other human beings in the marketplace do not need to be defended in terms of their effects. Freedom to trade is a part of human dignity. Only when political institutions and public policy respect human self-determination and sovereignty, can we speak of human dignity from a political perspective. When a group of people place themselves in an arbitrary position of higher moral authority, no matter how benevolent their intentions, imposing their values over others is a form of tyranny.

Perhaps the best expression of this idea can be found in the words of Amartya Sen, winner of the 1998 Nobel Prize in economics. In his book Development as Freedom, Sen writes:

> To be generically against markets would be as odd as being generically against conversations between people (even though some conversations are clearly foul and cause problems for others - or even for the conversationalists themselves.) The freedom to exchange words, goods or gifts doesn't need defensive justification in terms of their favorable but distant effects; they are a part of the way human beings in society live and interact with each other (unless stopped by regulation or fiat). The contribution of the market mechanism to economic growth is, of course, important, but this only comes after the direct significance of the freedom to interchange - words, goods, gifts - has been acknowledged.[1]

The following essay examines the merits of the widespread notion that globalization and free trade have been harmful for the economies of low-development countries. It shows how the critics, in their rush to attack global integration and free markets, fail to understand and recognize the true causes of poverty. Moreover, it points out that most of the countries that the critics cite as examples have not really fully participated in global economic and social exchange.

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GLOBALIZATION ON TRIAL

In November 1999, during the World Trade Organization (WTO) ministerial conference in Seattle, the world woke up to a reality previously ignored: the existence of hundreds of groups opposed to "globalization". These groups took to the streets to demonstrate against free trade and free markets, sometimes in a not very peaceful way. The fact that the Seattle ministerial meeting resulted in failure has encouraged anti-globalization protesters to show up in every multilateral meeting since.

These groups constitute a colorful variety of causes and ideologies: environmental activists, communist and socialist parties, ethnic groups, etc. And their activities now have been provided with an intellectual foundation in a handful of books opposed to globalization.

Recently, during one of my frequent visits to Bogotá's biggest bookstore, I noticed that, apart from the usual sections on politics and economics, there was a new section completely devoted to books against globalization. In all my years as a bookstore visitor, this was the first time I encountered such a big section devoted to a specific issue. The shelves were full of Joseph Stiglitz, John Gray, Naomi Klein and other anti-globalization authors. A conversation with the owner confirmed my conjecture: in his words, "These books are selling like hot cakes."

An interesting feature of the anti-globalization groups is the diversity of concepts and meanings of "globalization" that can be found in their writings and speeches. To some, globalization means free trade. Others, recently encouraged by Mr. Stiglitz and his book, identify globalization with the policies recommended by the International Monetary Fund (IMF).[2] But globalization is much more than free trade; and the policy recommendations of the IMF do not necessarily favor globalization and trade liberalization.[3]

In essence, globalization is a process of tearing down barriers between nations. This, of course, includes free trade, but it also implies cultural, political and human exchange. A freer flow of goods and services is a part of globalization -- so is Internet dating.

GLOBALIZATION AND THE DEVELOPING WORLD

One of the most important claims made by critics of globalization is that this process is especially harmful to the poor – poor countries and poor people.[4] In my own corner of the globe, Latin America, economies have indeed gone through very difficult times recently. Recession, financial turmoil and political instability have been seen as consequences of unfettered globalization.[5] This comes in contrast with the high hopes that global exchange raised ten years ago.

At the beginning of the 1990s, Latin America was emerging from the "lost decade". A huge debt crisis, combined with the effects of populism and military governments had caused a severe economic contraction during that period. The fall of the Berlin Wall and the collapse of the Soviet Union, along with the evident failures of state-based economic policies, created hopes that liberalization, privatization and free markets would finally help Latin America to achieve prosperity.

This was the case in my home country, Colombia. After decades of relying on state-based policies of import substitution (closing borders to trade as an attempt to help local industries), controlled exchange rates, state-based industries and governmental promotion of development, public opinion appeared to be demanding a change. Consequently, President Virgilio Barco (1986-1990) launched a program of economic liberalization in 1990. This program was continued and somewhat altered by Barco's successor César Gaviria (1990-1994). The promises and achievements of this liberalization program were seriously questioned at the end of the decade and the beginning of the 21st century. Recession and political instability unleashed a wave of criticism against free-market-oriented policies.[6]

Similar cases have occurred in other Latin American countries. The Argentinean crisis created the perception that the entire region was about to fall apart. Investors wondered who would be the next to fall.[7]

INSTITUTIONS AND POVERTY

From the first decade of the post-war years, the problem of poverty and under-development in the third world has been of international concern. During nearly forty years, there was an implicit agreement on what poor countries in places like Africa and Latin America should do to grow and reduce poverty. First of all, poor countries were advised to protect local production against foreign competition. This was supposed to help develop local industry, keeping it from being destroyed by larger (more efficient) foreign competitors. Secondly, developing countries were counseled to carry out extensive programs of public investment (public works, state-owned enterprises, etc), mostly financed with Aid-to-Development money.[8] Poor countries were believed to be trapped in a "vicious cycle of poverty" caused by lack of capital. Aid-to -Development and an active public sector were seen as the tools to break that cycle.

Dr. Kenneth Chilton, ISEE Director and Professor Andrzej Wlodarczyk interview Andrés Mejía-Vergnaud for LUHE-TV program "Focus on Business

During those years, economist Peter Bauer was one of the few who warned that this model would fail to launch the third world towards growth and prosperity.[9] According to Bauer and others, poor countries need to create a framework of institutional conditions favorable to investment, trade and economic activity. They should also guarantee that the benefits of growth will not end up

in the hands of privileged elites. This institutional framework is built on the basic rules of liberal democracy, including: limited government with division of powers, individual rights, private property rights, clear taxation rules, an independent and reliable judiciary, and freedom to trade.[10]

Experience shows that countries that are organized under these rules achieve remarkable growth. Moreover, equality of opportunities afforded by a liberal-democratic system promotes, to a large extent, a more equal distribution of the benefits from economic growth.

The age of central planning and Aid-to-Development produced a bitter fruit: most countries that had been beneficiaries of aid and that had applied central planning could never overcome poverty; some of them were even poorer than before. Moreover, as if poverty were not enough, the large size and huge powers of governments in these countries produced extreme cases of corruption. In addition, these policies had the effect of postponing reform in the right direction.

In order to yield all of their beneficial effects, globalization and free-market-oriented policies must be coupled with liberal-democratic political institutions. Unfortunately, many developing countries have failed to carry out reform in that direction, whereas others have done so only partially. Without clear and stable legal rules, investment is unlikely to flow from rich to poor countries. Without constitutional guarantees for equality of opportunities, privatization is likely to become a very corrupt game of benefiting political friends.

Today, more than ten years after liberalization began in Latin America, there is still much to be done to reform institutions. This is seen by many as a necessary "second wave of reforms."[11] The positive effects of free trade and globalization will not reach countries affected by corruption, legal uncertainty, and low incentives for private investment and entrepreneurship.

Colombia is one of the best (or worst) examples of institutional confusion and the resultant impact on growth and investment. Colombia's institutional framework is derived from its 1991 Political Constitution. This document is based on principles from the liberal-democratic tradition combined with socialist-oriented concepts. From the liberal-democratic tradition, it incorporates separation of powers, basic individual liberties and an independent central bank, for example. From the socialist tradition, it establishes the national government as the main director and promoter of economic activity. According to Colombia's constitution, the mere guarantee of equality before the law is not enough: the state should pursue active policies to guarantee "effective equality."[12] The latter principles inspire a number of rules, institutions and practices that result in what economist Salomón Kalmanovitz calls "the anti-liberal Colombian model."[13]

The notion that individual rights must yield to the "public good", along with the principle that the pursuit of the "public good" is a constitutional mandate, has led to widespread judicial activism. This judicial activism, in turn, has led to a grave state of legal uncertainty. According to COINVERTIR (a Colombian non-profit devoted to promoting foreign investment), legal uncertainty is the biggest concern of potential investors in Colombia, even a greater worry than terrorism and violence.[14]

The gains from free trade and free flow of capital are high, but poor countries will never experience them unless they undergo profound processes of institutional reform.

TRADE LIBERALIZATION IN THE DEVELOPING WORLD

Critics of globalization speak about the effects of this process on poor countries assuming that these countries have in fact embraced globalization. They assume that low-development countries have reduced or eliminated their barriers to trade and investment, and conclude that they are worse off as a result. However, trade liberalization in poor countries has been very modest, when it has occurred.

According to Razeen Sally of the London School of Economics and Political Science, "Developing countries have noticeably higher average tariffs, tariff peaks, tariff escalation (higher tariffs on processed goods), as well as higher non-tariff barriers than developed countries, not to mention proliferating anti-dumping actions."[15] As if this were not enough, "Much of this developing-country protection is aimed at imports from other developing countries," says Sally.[16] Jagdish Bhagwati, one of the leading academics in the field of trade, concludes, "As of today, rich-country tariffs average 3%; poor countries tariffs average 13%.… Moreover, the trade barriers of the poor countries against one another are more significant restraints on their own development than those imposed by the rich countries."[17]

In Colombia, critics of globalization have been quick to blame trade liberalization for recession and especially for the crisis in the agricultural sector. Supposedly, unfettered liberalization left farmers vulnerable to low-cost imports. A recent study by Fedesarrollo (a well-known and respected local center for economic research) shows that tariffs in Colombia are still high, and are often combined with other sorts of barriers such as safeguards.[18] From a strictly logical point of view, trade liberalization cannot be blamed for economic crisis when liberalization has not taken place.

The relationship between actual liberalization and economic progress can be seen in the "Economic Freedom of the World"[19] index, published each year by the Fraser Institute. Consistently, countries that rank high in economic freedom and trade openness also rank high on social (e.g. infant mortality, longevity, etc.) and economic indicators (GDP growth, GDP per capita, income share of the poorest, etc.). Those countries with greater barriers to trade and economic activity exhibit high poverty and low levels of human development. This index provides additional evidence that low-development countries have not really liberalized their economies. Again, this shows a grave flaw in the anti-globalization argument regarding low-development countries.

A CASE STUDY IN LIBERALIZATION

The case of the paper market in Colombia provides evidence of the benefits of liberalization in the developing world. This example also shows how government-based initiatives are usually a poor substitute for market liberalization.

For most of the post-war period, Colombia was a highly protected economy. Paper and cardboard were among the most protected products. Basically, anyone seeking to import paper or cardboard had to pay a 20 percent tariff, but only after obtaining a license from the government. The procedures for obtaining the license were long and difficult. One of the steps consisted in obtaining a certification from the local producers stating that they

were not capable of producing the amount or the sort of paper that the importer sought to purchase. As a result, Colombia had a paper "market" totally dominated by two producers (one of paper, one of cardboard). Since consumers had no other choice but to purchase their products, these two companies were able to impose hard conditions.

According to an expert on the Colombian paper market, before liberalization, consumers faced a difficult situation: "Very often, the single producer would impose over purchasers the sale of specific amounts, more than the purchaser would need, threatening not to sell to him again unless he bought the imposed amount each year."[20] Producers set prices, amounts and technical specifications at will. According to the same expert, paper produced in Colombia was inferior in quality to that produced in the United States, Canada or Europe. The victims of this arrangement were not just potential competitors. Because paper is used to produce numerous consumer goods, such as notebooks, virtually every citizen of Colombia was a victim of this tyranny.

In the early 1980s, it became clear that the market for paper in Colombia was inefficient. Government officials and private investors proposed to break this monopoly and to show, at the same time, that liberalization was not necessary to correct these imperfections. The project was called "Papelcol". Ironically, its only effect was to show that liberalization is *the only way* to produce an efficient market.

The Papelcol project consisted of building a very large paper mill in a southern region of Colombia. The main investor was the Colombian government, though some private investors participated as well. It started with great hopes: Papelcol would not only break the paper monopoly, it would also improve technology and create thousands of jobs.

But in this case, as in many others before, the typical failures of public projects soon surfaced -- bureaucracy, inefficiency, and bad management. Papelcol was a shameful failure. The plant, full of state-of-the-art machinery, never opened. Corruption and mismanagement helped to bury the project forever. Ironically, the then-single producer of paper in Colombia later acquired the plant.

After barriers to trade in paper were lifted in 1991, consumers had the chance to compare what the monopoly producer offered with the products and contractual arrangements offered by foreign producers. As a consequence, the market became very dynamic and beneficial both for producers and their business customers, who now cooperated in matters such as product innovation, inventory management, and so forth.[21] Moreover, consumers were provided with more variety, lower prices and higher quality.

But the powers of liberalization go beyond the gains for consumers. Local companies must meet foreign competition by employing new technology, introducing new products, and focusing on quality management. Today, Colombian producers of paper have obtained quality certifications for almost all of their products and processes. Recently, the former single producer opened a new $65 million plant. Colombia has gained investment, technology and jobs as a result of trade liberalization.

OTHER CONSIDERATIONS

The following is a brief statement of some other important points to consider when evaluating globalization's impacts on developing countries:

- **Inequality**. Critics claim that globalization and free trade widen the gap between the rich and the poor. Several studies show that this is not true. Indeed, the positive relationship between free trade and economic growth is hardly a matter of debate. Further, recent studies show that robust economic growth leads to significant progress in reducing poverty.[22]

- **Corruption.** Critics of globalization have conveniently chosen to ignore the obvious link between closed markets and corruption. In a corrupt and closed economic environment, the gains from economic activity are more likely to be captured by elites, exacerbating economic inequality.

- **The "infant industry" argument.** Many in the third world believe that borders should not be open to trade, because this would expose local industries to competition with stronger foreign rivals. Local industries are not "competitive" because they are in their "infancy", they assert. Experience has shown that the only way to become competitive is to compete. Competition forces a company to listen to the markets and to respond to the signals received.

- **Sweatshops.** One of the main complaints of anti-globalization protesters is labor conditions in third world countries, and the fact that many transnational companies are establishing factories ("sweatshops") in nations where wages are low. Indeed, there are some workplace practices in third world countries that deserve condemnation. However, it must be clear that the reason why workers accept these conditions is poverty, not globalization.[23] Apart from abusive workplaces, it is a mistake to judge third-world working conditions, especially wages, by European or American standards. What seems unacceptable to well-to-do critics may be the best jobs available in the eyes of third-world workers.

- **Culture and globalization.** Some critics claim that globalization destroys local and native cultures in places like Africa and Latin America. Certainly, individuals in native cultures might change their preferences when exposed to global cultural influences. But who has the right to dictate that these individuals and their preferences remain unchanged? If the right of free individuals to make free choices is sacred for the developed world, how

can those in developing nations be denied this same right? Efforts by wealthy elites to forestall cultural changes are equivalent to forcing native peoples to be museum pieces, maintained for the contemplation and delight of wealthy westerners.

- **What is the alternative?** Critics of globalization are quick to attack free markets and economic freedom, but they rarely offer serious alternatives. The obvious alternative to economic freedom is a centrally controlled economy, a system that has already shown its failure. Mildly controlled economies, another alternative, produce stagnation and corruption

CONCLUSION

The claim that globalization and free trade harm poor countries is flawed for two basic reasons. In the first place, it ignores the real causes of poverty in the third world. Second, it assumes that poor countries have indeed embraced globalization and free trade. Moreover, it ignores the fact that poor countries that have opened their borders to trade have seen impressive results in terms of economic growth and social well-being.

For poor countries, the path towards development begins with institutional reform. Developing countries must create a framework of political, legal and economic conditions that guarantee equality of opportunities and create incentives for trade and investment. Unfortunately, most developing countries still have very imperfect political systems. In the rankings of economic freedom, most developing countries obtain poor scores in critical areas such as legal stability, size of government, regulation and sound monetary policy. These institutional impediments keep developing countries in poverty.

The same rankings of economic freedom show that most developing countries, despite the claims of the critics, have not embraced globalization and economic liberalization. Most of these lagging economies maintain high tariffs (much higher than developed countries) and other barriers to trade. They still impose heavy regulations on entrepreneurs. Their big government sectors spend too much, borrow too much and, thus, crowd out private investment.

Unless, and until, developing nations alter their underlying political institutions to embrace individual rights, especially private property rights, they will see little genuine globalization. Attempts to demonize open trade, foreign investment and expanded cultural interaction will only guarantee that these economies will continue to languish.

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[3] In fact, the approach of the IMF to many financial crises has been adverse to market liberalization, either by retarding needed reforms, or by exclusively focusing on fiscal indicators, neglecting the need to reduce or eliminate tariffs (which are a source of fiscal revenue.) See Hanke, Steve, "Abolish the IMF" (http://www.cato.org/dailys/04-14-00.html), and Schwartz, Anna, "Time to Terminate the IMF" (http://www.cato.org/dailys/10-06-98.html).

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[10] This doesn't imply absolute political harmonization, or the elimination of differences resulting from culture or geography. Liberalization, politically implemented as a commitment to not intervene, does not need to clash with cultural peculiarities.

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ISEE Economic Policy Series

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Andrés Mejia-Vergnaud
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