Globalization in Historical Perspective

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Abstract

After World War 2 (WW2) and till mid '70s most less developed countries (LDCs) and newly industrializing countries (NICs) implemented a closed economy, import-substitute industrialization model with excessive interventionism and protectionism. The results were slow growth due to balance of payments crises and worsening income distribution due to inflation. Therefore since mid '70s most moved to market economy, outward orientation and export encouragement. This necessitated encouraging private investments and direct private investments (DPIs), flexible exchange regime, freer foreign trade, and implementation of privatization. Since '90s, this time large flow of financial funds from developed countries (DCs) to LDCs and NICs, in addition to free foreign trade and flow of DPIs ushered in the process of globalization. 1997-8 global financial crisis slowed the flow of funds and DPIs, but globalization continued in essence while China and India entered free market economy with remarkable success. What is important, market economy and globalization reduces excesses of interventions and protectionism. But there is still room and need for "good governance" on the part of the governments of LDCs and NICs to avoid pitfalls and reap greater benefits.

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A- '50s to '70s: Closed Economy, Interventionism and Protectionism

The move towards the market economy among less developed countries (LDCs) and newly industrializing countries (NICs) started since mid '70s and and '80s while the move towards globalization started since '90s. Attention was focused on economic development of LDCs and development economics, on the other hand, after World War 2 (WW2). The actual direction of developments in most of LDCs at the time was interventionism, protectionism and statism, assigning a large role for the state in terms of both public investments as well as macro and micro interventions.

In fact, after WW2 the western world had envisioned free trade between both developed countries (DCs) and also LDCs. This was based on the experience of WW1 after which DCs had resorted to protectionism which had hindered the growth of all countries involved. Accordingly, GATT (General Agreement on Tariffs and Trade) was signed in 1947 for free trade while IBRD (International Bank for Reconstruction and Development) later called the WB (World Bank) and the IMF (International Monetary Fund) was established by Bretton Woods Agreement in 1944. IBRD first aided European countries in their reconstruction and then turned its attention to LCDs and NICs exclusively. IMF was to take care of short-term balance of payments problems of member countries.

LDCs which joined the Western World were required to follow "liberal" economic policies, implying encouragement of private enterprise and of foreign private capital flow, that is, direct private investments (DPIs). It was foreseen that developmental credit from WB to LDCs would not be sufficient and had to be supplemented by DPI flow. Since WB credit was indeed insufficient, DPIs flowing to LDCs was also meager, USA tried to fill the shortage for foreign savings by means of additional aid programmes, such as Marshall Aid and Truman Point 4.

Although free trade and liberal economic policies were advocated by IMF, most of the post WW2 literature on economic development, as was surveyed by Hiç (2001), stressed at the time that the markets in LDCs were not competitive while external economies also existed, and hence prices were not good indicators for channelling investments to most productive fields. The new discipline, "development economics" that came into being after WW 2, therefore, advocated some extent of interventions at the sectoral level, including channelling of investments as well as interventions to be undertaken at the macro level to attain a steady growth rate within relative price stability. The latter necessitated taking measures to balance the budget as well as encouragement of savings. In addition to micro and macro interventions, governments of LDCs were also eager to introduce measures and interventions to improve the distribution of income among social groups.

The pioneers of the new discipline, “development economics” were Rosenstein-Rodan (1943) and Arthur Lewis (1954); and even Kingleberger (1958) noted that price mechanism in LDCs did not work satisfactorily. The later contributions of importance to the discipline were made by a group of economists, such as Arthur Lewis 1954) and Ranis and Fei (1961) who stressed the dual economy character of the LDCs; while Nurkse (1953) stressed the importance of developing the agricultural sector to induce development of industry; Myrdall (1957) stressed the importance of ameliorating the differences of development between regions within a country; and Singer (1952) and Coale and Hoover (1958) cautioned the adverse effects on development of high population growth rates. To do justice to this early school of development economists, none encouraged or called for extensive and intensive interventionism and absolute protectionism. But, in actual practice, most of the LDCs fell into excessive interventionism, protectionism and statism.

The model implemented by the LDCs was aptly described later as inward-looking or closed economy model aimed at import-substitute industrialization. Major policy instruments below will shed more light on the properties of the model used:

- Absolute protectionism by means of quantitative restrictions and prohibitions on imports; high and differentiated customs taxes with lower taxes on investment goods, differentiated export tax rebates and premiums.
- Fixed exchange rates, leading over time to over-valued currency (under-valued foreign exchange) because of much higher inflation rates compared to DCs from which imports are obtained.
- Low (nominal) interest rates in order to encourage investments despite high rates of inflation, sometimes leading to negative real interest for investments.
- Relatively high wages despite abundance of labor or relative scarcity of capital, with the purpose of improving the lot of workers which, however, affected employment negatively.
- Chronic budget deficits due to the desire of the governments to increase (public) investments as well as social expeditures on the one hand, inability or unwillingness to increase taxes on the other. The budget deficits were, in major part financed by Central Bank credits leading to increase in money supply and inflation.
- Since private savings and investments were not forthcoming at the desired high levels, public investments were generally increased, leading to a high ratio of public sector in total fixed investments.

In some countries public investments were considered as complementary to private investments and were directed to those areas not taken up by the private. Thus, though they went to some super-structure in addition to both productive and social infra-structure, they were not *de facto* competing with but were actually aimed at encouraging private investments and production by providing the required basic industrial and agricultural inputs. In some countries, however, the tendency was to prefer development and industrialization based in large part on the public sector as opposed to the private.

It should be granted here that some degree of protectionism, some degree of interventionism, some relatively high ratio of state investments and basically an import-substitute industrialization strategy were unavoidable particularly during the initial years of development as in the ‘50s and ‘60s. But the important point is that LDCs went to excesses in these strategies. And the main reason for the excesses lied with the prevalent opinion at the time that USSR was recording a fast economic growth with the strategy of state investments, soviet central planning, closed economy model and import-substitute industrialization, concentrating on establishing heavy industries first. Many LDCs were obviously impressed. India, for example tried a development model (Mahalonobis model 1955-61) similar to Russian central planning, which, however did not work. In Turkey many preferred a “mixed economy” in which state investments would exist side by side with the private for the foreseable future.

Whenever LDCs met with balance of payments difficulties, inability to pay their external debt or else to pay for their import requirements, they had to apply to the IMF and the WB. IMF, in turn, advised a large-sacle devaluation, plus a stabilization programme to eliminate or reduce inflation. But, having passed through the difficult periods of economic crisis, the governments of LDCs soon fell into the same mistakes of over-valued currency practices, enlargening budget and balance of payments deficits, and again had to have recourse to IMF and WB aid and credit. The exceptions were S.Korea, Taiwan as well as Singapore and Hong Kong. The latter two city-countries were, because of their position, international finance centers of the region.

The former two countries, on the other hand, implemented a strategy based on export-encouragement instead of import-substitute industrialization. But they could do this because DPIs from USA flowed extensively to these countries, taking advantage of low wages, and brought the cheaply manufactured goods to the USA. Such an opportunity did not exist for most other LDCs. Otherwise, both S.Korea and Taiwan, like Japan, were interventionist and protectionist, with interventions and protections geared to export instead of import-substitute industries. In addition, they deliberately implemented under-valued currency (over-valued foreign exchange) to boost exports and prohibit imports. Hence, they were not implementing "market economy" as it is conceived today. But they had good governance and attained significantly high rates of growth, distancing themselves in time from other LDCs in terms of *per capita* GNP levels.

The net results of the policies of other LDCs, however, were low growth rates due to frequent balance of payments crises and worsening income distribution due to inflation.

B- Mid '70s till '90s: Toward Market Economy and Outward Orientation

Starting since '70s, many observers and economists, having become aware of the excesses of closed-economy import-substitution industrialization, excess interventionism, and protectionism in LDCs and NICs blamed the "Classical" development economics for the faults incurred in practice. "Classical" here means not *laissez-faire* but allowance of some degree of interventionism and protectionism due to market and price imperfections in these countries. Many of these economists argued that for LDCs and NICs as well as for the DCs the optimal model should be "Neo-Classical", implying non-intervention and non-protection in the *laissez-faire* sense. Some in this group argued that in LDCs and NICs even though market imperfections may be met in some sectors, the governments trying to correct it would cause greater disruptions due to the intervention. Hence, a hands-off by the government is the better policy. Some economists went further and argued that there was no need for development economics as a separate discipline on its own. As Toye (1993) succintly surveys, the pioneer critic was Bauer (1972), most vociferous critics were D.Lal (1983) and S.Lall (1981)*;* pathbreaking studies include Little, Scitovsky and Scott (1970), Little and Mirrless (1974), Bhagwati and Srinivasan (1975) amongst many others.

At a more realistic level, a group of economists including those from the WB argued in narrower sense in favor of discarding closed-economy, import-substitution industrialization, interventionism and protectionism. Instead, they advocated a move towards market economy, outward-orientation of the economy, encouragement of export-industries, and foreign-exchange-earning sectors, reliance on private enterprise, and encouragement of DPIs. The more prominent members in this group include Balassa (1971, 1983) and Anne O.Krueger (1974, 1913) both from the WB and both of whom have accentuated free trade for LDCs and NICs.

The IMF and the WB also endorsed this view; urging the LDCs and NICs to move towards the market economy and outward orientation. What was more important was that the public opinion in most of the LDCs and NICs by mid '70s and '80s had become aware of problems faced with the former development strategies and were willing to actually shift permanently in favor of the strategies advocated by IMF and WB.

Thus, we witness serious efforts in most Latin American countries, Turkey, India and Southeastern Asian countries to move towards the market economy and outward-orientation. This required the implementation of policies and measures below:

- Encouragement of private enterprise.
- Encouragement of DPIs; free (or freer) flow with respect to sectors and the participation rate.
- Less public investments, and preferably only in the fields of productive and social infra-structure, leaving super-structural fields to private investments; and also allowing private enterprise to the former two fields.
- Privatization programme, to sell the existing public enterprises to the private, including foreign capital.
- Getting rid of excessive interventions on prices, such as high agricultural support prices, low prices on basic industrial and agricultural inputs produced by public enterprises, with prices in general to follow world prices at the going exchange rate.
- Discarding fixed exchange rate regime and implementing, instead, flexible exchange rates.
- Liberalization of imports, removal of quantitative restrictions and prohibitions on imports, reductions in customs taxes and elimination of multiple exchange rates on imports.

- Elimination or reduction of export tax rebates and export premiums; reliance on the flexible exchange rates for the encouragement of exports – plus export credits – and elimination of multiple exchange rates in exports.
- Market economy and reliance on market forces and prices necessitated that LDCs and NICs should prevent inflation and attain price stability. Hence, the need for a balanced budget was most important. Privatization, restriction of public investments, control of wage rises, raising of interest rates, shedding high agricultural support prices and of price subsidies on products of public enterprises, all went to decrease the budget deficit. But these did not obviate the need to implement tax reform and attain tax increases along with tax equity.

Since the '50s LDCs had shown a conspicuous differentiation in their development and growth over time and some had begun to be categorized more aptly as NICs. The more developed NICs, on the whole, could adopt these policies with less tensions because their industrial base had developed sufficiently to take on the shift towards export-orientation and shedding of the excesses of import-substitution. Thus, many countries did adapt themselves to the new economic strategies. The case of most of the African (Sub-Saharan) countries, on the other hand, remained as an economic, political and social catastrophe all throughout.

It should be mentioned at this point that many Latin American economists, called the "structuralists" continued to remain opposed to the move towards market economy and freer trade. The pioneer was Prebisch (1988, a later work), other notable economists included Cardoso and Faletto (1979), amongst many others. They argued that LDCs and NICs had different economic structures from DCs and were in need of permanent and intensive interventionism and protectionism. In the "center and periphery model" they devised, they tried to stress that if not intervened and protected, free trade would work to the advantage of the "center economy" (*i.e.* USA) and to the disadvantage of the "periphery" (*i.e.* Latin American countries). They pleaded, however, for trade and opportunity and encouragement for Latin American countries to export industrial goods, instead of merely receiving aid from the USA; they were not, advocating a socialistic model.

C- Since '90s Till Present: Globalization and Major Events

The years '90s, on the other hand, witnessed several pathbreaking developments. The first to be mentioned is the move towards globalization. Globalization encompasses international relations far more extensive compared to market economy and outward orientation. The latter includes free trade, that is, free movement of commodities as well as free movement of DPIs, Globalization, however, also involves, in addition, free flow of financial capital, short term and longer term. And as P. Kennedy (1993) has underlined, the amounts involved dwarfs total credit lent by IMF and WB. Globalization was enabled, no doubt, by technological developments involving the computer and the internet, but obviously it is, in essence, a policy option taken by the mutual consent of both LDC and DC governments and business circles.

Interestingly, free flow of labor is conspicuously absent in globaliztion as well as the market economy. Legal immigration is generally limited in many countries, foremost the USA. To fill the economic void, however, illegal emigration takes place extensively from poor countries to the richer. This includes illegal emigration to the USA from Latin American and other countries, illegal emigration to UK, continental EU countries, particularly to France and Germany, and emigration even to Turkey, to the latter country from Moldova, Bulgaria, Azarbaijan and Armenia.

A second very important development in the '90s was the crumbling of USSR and the emergence of independent East European countries. Many of these countries chose to become and were accepted as candidate and later many as full members of EU. According to the Copenhagen economic criteria, EU members are required to implement an "operational" market economy. And they would have to enter a "customs union", implying eventually zero customs on imports from other EU countries and applying Common Customs Tariffs to third countries. Thus, East European countries chose, *per force*, to enter the market economy and globalization as well. By the addition of the new members reaching from 15 to 25, on the other hand, EU has become number 1 in terms of total GNP, pushing USA to 2nd place. But in terms of military potential and political influence, EU needs much to be achieved compared to the USA.

Still another important event was the global financial crisis that emanated from the Southeastern Asian countries and encompassed the world. In addition to Southeastern Asian countries, Russia, Argentina and Turkey also fell into severe economic crises, and many more were on the brink, including S.Korea, Brazil, and even Japan.

Many of the countries were saved by strict adherence to IMF and WB recipes and credits. Some, including Malasia and Russia, however, tried to get over the crisis single-handedly, but still by implementing strong austerity measures. Although the crisis reached worldwide proportions, thanks to the strong US economy and the efforts by IMF and WB, it was relatively short-lived for most of the countries. As a consequence, however, there was a drop in the volume of financial funds flowing to the LDCs and NICs from DCs. But globalization continued, in essence, with short-term financial flows at a lower level.

Many observers criticized the financial flows as "hot money" deserting the country just at a time of economic difficulties and thus compounding the crisis. In fact, however, the real fault lied not with the flight of financial funds but with the governments of LDCs and NICs, including Southeastern Asian, which had plunged into economic crisis not because of the presence of financial flows but on account of economic mismanagement which, in turn, had prompted the flight of foreign funds back. The governments of Southeast Asia, foremost Indonesia, for instance, had not put the short-term financial funds into good use. They had used them in long-term and mosty unproductive fields. Further mismanagement of the economy, corruption, partisanship, cronyism had led the countries in question into economic crisis, in the first place. The crisis was definitely compounded when short term funds wanted to flee the country in view of the economic difficulties.

Hence, "good governance" or "good economic management" has acquired importance. The IMF and the WB were also careful from this time on to stress transparency to avoid corruption, partisanship and cronyism. They were also more careful in strengthening the financial structure of the banking system in LDCs and NICs, to make banks stronger for times of economic difficulties. In particular, increases in banks' own capital as a ratio of credits they lent, was increased.

A fourth important development in the '90s and since is the entry of China to the free market system, outward orientation, extensive encouragement of DPI flows and encouragement of exports by foreign capital companies operating in China and taking advantage of low labor wages as well as political stability. This has enabled China to register unpredecented and very high rates of GNP growth for a very long time. It has thus made China into a big world economic power, the 3.rd following USA and Japan. Private capital has flown to China not only from the USA but also from Germany, other European countries and Japan.

Similarly, India has also entered the globalization process particularly in computer programming with extensive outsourcing received from the USA and also from Europe. India also seems good in health services and by now has some internationally known big private firms.

Prior to India and China, Ireland, one of the relatively poor European countries of the recent past had adapted its economy successfully to the new economy involving computer programming and has presently become much richer.

Turkey too has entered the globalization process with enlargened exports from automotive industry, the whites, electrical appliances and electronics as well as textiles destined mostly to Europe, Russia, the Middle East, and Caucasian and Central Asian Turkic states. It has also a large portfolio of construction undertakings, again in Russia, the Middle East and the Turkic states.

Many communist countries, following the Chinese example, are also trying to attract Western private capital flow. The list includes, Vietnam; and post-Castro Cuba would likely follow the same direction. This leaves aside, outside of worldwide international relations only Iran, which is immersed in islamic (shiite) fundamentalism and harbors regional power aspirations, and communist N.Korea. But N.Korea receives a sizeable flow of private capital from South Korea.

Particularly during the years 2000s, however, this time an interesting reverse was witnessed in some Latin American countries. These countries had to carry a long fight against very wide differences in income distribution. Although they were disappointed with closed-economy model prior to '70s and had shifted towards the market economy and outward orientation, the social problems in many of these countries were not solved sufficiently and satisfactorily. Therefore, many discarded the market economy and outward orientation as "Washington consensus" and returned once more towards socialistic strategies, increased role of the state, protectionism and interventionism. The list of such countries includes Venezuela which has also benefitted extensively from the rises in the price of petroleum; and Bolivia; with Argentina also keeping a wide distance from the USA.

Brazil, has turned towards center-left, but it has retained a pragmatic approach in its economic policies. Mexico, on the other hand, keeps a free trade agreement with the USA and Canada, thereby retaining the outward-oriented strategy in essence. Time will show what the future developments will be in Latin American countries.

Many prominent economists, including. Stiglitz (2002, 2003) has criticized globalization and also the IMF for engaging more in stabilization measures with less emphasis on long-run growth and employment prospects of these measures. Many as prominent economists, such as Bhagwati (2004), however, has come to a balanced defense of globalization. One should agree along with Rodrik (1997, 1999) that although globalization brings mutual advantages to all parties concerned and is inevitable, it may also create some economic and social problems; hence these will have be to eliminated or ameliorated by the help of "good governance", that is, good economic management by the governments.

Major criticisms levelled against globalization must be taken into account here, albeit briefly, for a sounder evaluation and final word. One such major criticism was that globalization benefitted the DCs more; hence leading to a worsening income distribution among countries. This argument is more recently disproved by the fact that China and India have made much greater strides compared to the USA and other DCs, thus narrowing the gap in *per capita* income between these two groups of countries. The list should also include Ireland and Turkey, among many others. For those countries, for instance, like Sub-Saharan Africa, which have not entered the market economy and globalization, however, the gap has widened.

A second important criticism is it gives rise to worsening income distribution in those LDCs and NICs which entered the globalization process; employment also is not increased much. Indeed, depending on a host of factors, this may be witnessed in some LDCs and NICs. In the initial phases of globalization, there may be less flow of DPIs to LDCs and NICs directly creating employment opportunities. Instead, DPIs may prefer to buy or otherwise participate in the already existing private companies or public enterprises when these latter are privatized. At that stage there will be no increase in employment; but much depends on how the foreign exchange that entered will be used. If the owner of the private enterprise that has sold the company or its share to foreign private capital takes this money outside; then it will evidently result in no increase in employment. But, if the domestic company uses the proceeds undertake new investments, then in the medium run the benefits of higher growth and increased employment will definitely be registered. In the case of privatization of public enterprises and foreign capital participation in privatization, if the government uses the proceeds in wasteful expenditures then, of course, the transactions will in the end bring no palpable benefits to the economy. But if the government uses the funds say, in productive infra-structure, the end-result in the long-run will be different. Even if the government uses these proceeds to reduce foreign debt, it will be able to reap long-run benefits. Thus, much depends again on "good governance" to go hand in hand with the process of globalization.

Therefore, we may conclude, that market economy and globalization brings advantages and opportunities to all countries that enter the process. But it should be supported by proper economic and social policies by the governments of LDCs and NICs to avoid some possible pitfalls and drawbacks. This also accepts the fact that although the excesses of government interferences will be reduced compared to a closed economy model and statism, there is still an important role for the government to play with "good governance" of the economy.

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