Prospering in the Global Economy

John D. Sullivan

Globalization has replaced the Cold War as the main arena of debate over the values upon which societies, nations and international organizations should be built. The process of globalization has recently been accelerating for several reasons, including the latest wave of democratic transition. Following the collapse of communism in Eastern and Central Europe, many formerly authoritarian countries have embraced democracy and rejoined the international economy. In fact, countries that try to hinder globalization find they can do so only by limiting political and economic freedoms, thereby restricting democracy and markets. In stark terms, globalization can be halted only by denying the universal aspiration for freedom.

Globalization is both the construction of a set of international relationships and a process of change. The wave of globalization that began after the Second World War has been shaped by a set of international rules or institutions ranging from the well known, such as the World Bank, to the relatively obscure, such as the International Organization for Standardization.

John D. Sullivan is the Executive Director of the Center for International Private Enterprise (CIPE). This article was written while he was working in Bucharest, Jakarta, Lima, Vienna, and Washington DC, reflecting the advent of the global economy and the world-wide reach of CIPE's activities.

Although this process has seen periods of pause and acceleration over the last fifty years, it is now fundamentally different than earlier periods in world history. The development of a rules-based, international trading system, the increasing integration of financial markets and other new institutional developments have created a different international economic system from that which existed previously. Indeed, the future pace and direction of globalization will depend in large measure on the collective choices national governments make in deciding whether or not to continue developing these institutional rules of the game.

As a process of change, globalization relates to the increasing speed of business transactions and the rapid pace of technological change. This dimension of globalization parallels earlier periods when advances in technology such as the telegraph and telephone drastically reduced the cost and time of conducting transactions. On the other hand, the process of change is not fully understood at the level of the firm. As Charles Oman points out in his interview with *Economic Reform Today (ERT)*, on page 46, the advent of new technologies has changed the basic business model that helps to organize society. Interestingly, a recent report by World Steel Dynamics predicts that by the end of this decade the steel industry—an economic hallmark of the pre-Internet era—will trade electronically about a quarter of the world's supply of steel each year. These changes in the business model, coupled with the new institutional settings, means that a fundamental shift has occurred from the industrial era to a new era whose shape is still being developed.

Each nation also has to decide how to engage in the globalization process. Developed and developing countries alike must come to terms with the rapid integration of markets, the increasing flow of finance and the widespread use of technology. Even countries with a small, open economy need not be hapless victims swept up by international forces beyond their control. Experience shows that the public and private sectors working together can forge institutions and programs to allow citizens to take advantage of globalization and the potential it offers for economic growth. A series of challenges and resources are presented at the end of this issue to help guide the public and private sectors as to the types of institutions and programs they will need.

Failing to integrate into the emerging rules-based global system also has consequences. The experience of the former command economies in Central and Eastern Europe, including the former Soviet Union, is not simply the result of a failed ideology. It demonstrates that attempts to supplant a competitive market economy with government- driven investment plans can no longer be sustained. Furthermore, the communists' attempt to create their own trading system through COMECON was a dismal failure. Ultimately, command economies lost out as a result of cutting themselves off from the challenges and benefits of open international trade, technology transfers and access to capital.

How much globalization?

In general, globalization represents the increasing integration of the world economy, based on five interrelated drivers of change:

- International trade (lower trade barriers and more competition)
- Financial flows (foreign direct investment, technology transfers/licensing, portfolio investment, and debt)
- Communications (traditional media and the Internet)
- Technological advances in transportation, electronics, bioengineering, and related fields
- Population mobility, especially of labor

Each of these drivers of change has accelerated in recent years and each reinforces the other.

UN Secretary General Kofi Annan recently released a comprehensive millennium report entitled "We the People: The Role of the United Nations in the Twenty-First Century." The Secretary General provided a comprehensive picture of the changes that have occurred in the world over the last fifty years as globalization has begun to take hold. In the report's introduction, Secretary General Annan describes the dimensions of globalization:

> Indeed, when the United Nations was founded two-thirds of the current Members did not exist as sovereign states, their peoples still living under colonial rule. The planet hosted a total population of fewer than 2.5 billion, compared to 6 billion today...We know how profoundly things have changed. World exports have increased ten-fold since 1950, even after adjusting for inflation, consistently growing faster than world GDP. Foreign investment has risen more rapidly; sales of multinational firms exceed world exports by a growing margin, and transactions among corporate affiliates are a rapidly expanding segment of world trade. Foreign exchange flows have soared to more than $1.5 trillion daily, up from $15 billion in 1973...This is the world of globalization—a new context for and a new connectivity among economic actors and activities throughout the world.

To put the issue even more starkly, Willard Workman, the US Chamber's Vice President for International, notes that "As globalization marches forward, it is fundamentally changing the relationship of the public and private sectors, especially in the industrialized world. Chase Manhattan Bank (a medium-sized money center bank) processes international financial transactions in eleven minutes that exceed in dollar value the annual foreign aid budgets of Japan, the European Union and the United States combined."

Trade as a driver of change

The growth in world trade over the last century is the most visible face of globalization. While there was a long period of decline in trade between the Great Depression and World War II, there has been a growing liberalization of trade through lowering of tariff and nontariff barriers since the end of that war. The creation of the General Agreement on Tariffs and Trade (GATT) and the subsequent institutionalization of GATT into the World Trade Organization (WTO) has been a major force in the growth of world trade. Currently, the WTO has 138 members, and about 30 nations are lining up to join. Two of the most noteworthy are China, which seems poised to enter soon, and Russia, which is actively pursuing accession. While it is clear that the future negotiations within the WTO will be difficult, it is equally clear that it has become the foundation of a new global trading system.

The growth in trade has been truly impressive. In 1913, exports of goods and services as a percentage of world output totaled 8.7%, rose to 12.1% in 1973, and had nearly tripled to 23.6% by 1996. An even more telling statistic is the total trade of exports plus imports. Together they represented only 28% of world output in 1970, but by 1998 they had soared to 45%. With total trade now nearly equal to half of the world's output, it is very clear how much integration among nations has already occurred.

Of course, these figures hide great differences among countries evidenced in the list of national trade patterns presented in the *Economic Globalization Indicators* at the back of this issue of *ERT* and in abbreviated form in Table 1 on this page. The tables begin with two sets of figures on trade. The first is trade in goods (exports plus imports) as a percentage of gross domestic product. This indicator gives a general idea of how important trade is to an individual country, and how engaged various countries are in the world economy. The vast difference between the low-income economies—principally but not totally in Africa—and the middle and high-income countries is particularly striking. Poor nations tend to be unable to participate in the system of international trade and, in turn, tend to attract much less private investment capital as a result. Thus, it would seem to be a lack, not an excess, of globalization that is the challenge facing these countries.

The second trade indicator—"trade in goods: percentage of goods as a percentage of GDP"—shows how much a nation's manufacturing sector is incorporated into the world economy. By excluding services and other components of GDP from the picture, one can begin to see that manufacturing really is becoming more globally integrated. For example, one could conclude from the figures on trade as a percentage of GDP that the United States is much less affected by globalization, especially when compared to the European economies. However, when the GDP figures are restricted to just the manufacturing sector economy, it is clear that globalization does affect the US to a great degree. Specifically, trade in goods as a percentage of the US economy is only 19.9%, but trade in goods is 78.9% of the manufacturing economy, indicating that the US manufacturing economy is indeed very much a part of the global economy.

Obvious regional differences exist in the overall trade patterns, as can be seen in Table 1. There are some surprises as well. Africa's exclusion from the world trading regime is especially evident, as is East Asia's integration into world trade. With the exception of some countries, Latin America is now moving much more quickly into the international trading system. A

TABLE 1. ECONOMIC GLOBALIZATION INDICATORS 1998 *

	Trade in Goods % of GDP	Trade in Goods % of Goods GDP	Gross Private Capital Flows % of GDP	Gross Foreign Direct Investment % of GDP
Income				
Low Income	8.3	62.5	2.0	0.9
Middle Income	22.1	98.9	6.4	1.6
High Income	38.3	*95.1*	22.3	5.7
Regions				
East Asia/Pacific	15.5	98.1	4.0	1.3
CEE Europe/Central Asia	21.1	106.4	3.8	1.0
Latin America/Caribbean	19.1	*74.5*	7.1	2.5
Middle East/North Africa	17.4	*80.5*	7.3	0.9
South Asia	4.8	*40.5*	0.9	0.1
Sub-Saharan Africa	16.8	*99.5*	4.9	0.7
European Monetary Union	54.4	*106.4*	32.2	6.1

Source: World Bank, *World Development Indicators 2000.*

* Calculated using US$ adjusted for purchasing power parity. Italics indicate data are for an alternativceyear

glance at the numbers for Latin America also indicates that there is probably a lot of room for growth within the region, since it does lag behind East Asia. On the other hand, South Asia's participation in international trade is at a much lower level than Latin America's, and many East Asian countries are moving into international trade at a much slower pace.

Capital flows as a change agent

Like international trade, gross capital flows between nations have increased dramatically over the last several decades. Among the high-income economies, gross private capital flows have more than doubled in the last ten years from 9.9% in 1988 to 22.3% in 1998, according to World Bank statistics. Within the European Monetary Union countries, the average flow has jumped by a factor of three, to over 30% of GDP. Once again, though, the reality facing the developing countries is very different. As the globalization indicators show, the low-income countries have succeeded in attracting funds equivalent to only 2% of GDP, of which only 0.9% is in foreign direct investment (FDI). This is, however, a partial success, since it represents more than a doubling of the total flow from less than 0.7% ten years ago.

Foreign direct investment, a subset of the overall flow of private finance, has become a particularly important factor in the globalization process. The flow of money into stock markets and other short-term equity investments is significant, but recent experience shows that such flows can easily be reversed. FDI tends to be much more stable, representing a long-term investment strategy, and it benefits recipient countries by transferring state-of-the-art technology, stimulating trade and promoting growth. In some ways, how much FDI a country attracts is an excellent indicator of the hope for a better, more prosperous future. As can be seen from Table 2 on this page, the picture has changed greatly over the last decade.

Developing countries are becoming a more attractive destination point for foreign direct investment, as indicated both in the percentage share and in the overall amount of inflows. There is some controversy over FDI flows, however. The top emerging markets have consistently attracted a lion's share of FDI. This has led some critics of current trends in the world economy to conclude that the rest of the developing world will be excluded from the benefits that flow from investment flows, and that they will be left as some type of permanent underclass.

One caveat needs to be kept in mind when looking at the principal destinations for FDI. Evidence is beginning to mount that China's figures may be overestimated by as much as one third. This is due to the fact that Chinese firms send capital out of the country and then bring it back as FDI, a practice known as "round tripping." In addition, as much as one-third more in funds may be coming from the overseas Chinese community that has historical, family and language links to individual provinces in China. This means that about one-third of inflows truly constitute what is traditionally known as FDI. Despite this caveat, China is a major destination for FDI because of the size of its market and the economic reform path it has embraced, at least in its dynamic coastal provinces.

However, looking at the flow of FDI as a percentage of GDP may be a more realistic way of judging these trends. Poor countries, and poor small countries in particular, have a limited amount of absorptive capacity for investment. Although it may be desirable to increase investment flows to these countries, it does not necessarily follow that it is practical to do so. A glance at the global indicators at the end of this issue reveals that many countries' flow of FDI is much more impressive as a percentage of their GDP. For example, Brazil's FDI in 1998 reached 3.2% of GDP, while China's FDI amounted to only 1.3% of GDP. Looking at the overall trends, especially for Africa and other very poor regions, it is obvious that many of these

Table 2. Destination for Foreign Direct Investment (in US$ millions)

	1987-1992 (Annual Av.)	%	1995	%	1998	%
Developed Countries	136,628	78.74	208,372	63.36	460,431	71.51
Developing Countries	35,326	20.36	106,224	32.30	165,936	25.77
Central/East Europe	1,576	0.91	14,266	4.33	17,513	2.72
World	**173,530**		**328,862**		**643,879**	

Source: UNCTAD, *World Investment Report 1999.*

countries could absorb more investment than they are receiving now.

Attracting FDI is becoming a crucial strategy for developing countries, as the United Nations Conference on Trade and Development (UNCTAD) points out in its 1999 *World Investment Report: Foreign Direct Investment and the Challenge of Development* (featured on the UN web site). FDI enables countries to gain access to advanced technologies and capital. More importantly, it brings in modern management practices and linkages to the advanced developed markets. These market linkages are especially important. Recent studies by UNCTAD have shown that trade among the affiliates of multinational companies (MNC) may account for as much as one-third of world trade. This so-called interfirm trade (i.e., trade within an MNC) can only be accessed through investment by the MNCs into a developing country. The challenge, of course, is how to manage this investment so that it increases the competitiveness of the host country by linking the FDI to domestic firms. In this respect UNCTAD's report is well worth reading for those countries seeking to gain access to increased FDI and the trade it can generate.

Table 3.
Top Destinations for FDI in Developing and Transition Economies (in US$ millions)

	1995	1998
China	35,849	45,460
Mexico	9,526	10,238
Argentina	5,279	5,697
Brazil	5,475	28,718
Hungary	4,453	1,935
Indonesia	4,346	356
Malaysia	4,178	3,727
Poland	3,659	5,129
Chile	2,977	4,792
Thailand	2,068	6,969
India	2,144	2,258
Czech Rep.	2,561	2,540
Peru	2,056	1,930
Russia	2,016	2,183

Source: UNCTAD, *World Investment Report 1999.*

In addition to the benefits of FDI, countries need to concentrate on what attracts FDI to their country. A useful checklist, developed by the US Chamber of Commerce, is called the "12 commandments" of foreign direct investment, which appears on page 17. In fact, when the Chamber's list is compared to the globalization challenges and resources list featured at the end of this issue, it is easy to see that they mirror each other. The Chamber's list looks at the world from the perspective of a global firm evaluating opportunities, while the challenges list looks at that same world from the perspective of a country seeking to engage international firms while advancing its national interests.

Communications & technology

The wealth of economic, especially trade, statistics summarized above allows for a fairly comprehensive picture of these aspects of globalization. The communications and technology dimensions are much more elusive. However, they are capturing increased attention from scholars and international organizations. According to Jeffrey Sachs, countries across the globe fall into three categories: technological innovators, technological adopters and the technologically excluded (*The Economist*, 6/24/2000). Sach's innovators comprise about 15% of the globe's population, yet they provide virtually all of the world's technology innovations. The adopters—accounting for roughly half the world's population—are able to adopt these technologies successfully in production and consumption. The rest of the world's population is not connected to technology, nor is it innovating at home or adopting foreign technologies, as evident in Table 4 on the next page.

The Economist Intelligence Unit recently looked at much of these data in a study on the degree to which countries are ready for e-commerce (see Table 5). The study combines ratings on connectivity with the overall business environment to produce a ranking on e-business readiness. Not surprisingly, the study found that the US and the Nordic countries ranked in the top tier. Interestingly, the study found that Japan falls behind such countries as Ireland and Israel, demonstrating some potential future economic vulnerability.

Most of the developing countries fall into the bottom tier in terms of connectivity as well as overall infrastructure, demonstrating once again that the problem may be not too much globalization, but rather too little. For example, India—for all of its tremendous brainpower and expertise at work both in the US's Silicon Valley and its own Bangalore region—falls into the bottom tier. The reason is that while many developing countries such as India may have pockets of excellence, their overall business environment suffers from inadequate, costly telecommunications as well as general technology. This poses serious challenges for developed and developing nations.

International rules and systems

George Orwell's famous novel *1984* warned of a future society in which independent nations would merge into three supra-regional governments able to control their citizens through the application of ever-present technology. Other authors and futurists have praised or warned of the evolution of some form of world government that would produce either total control or utopia—and sometimes both. None of these predictions seems to be anywhere close to coming true. Far from seeing the growth of totalitarian superpowers, the world has witnessed a renewed commitment to political and economic systems based on individual freedom, democracy and market-oriented economies. There is very good reason to believe that in a globalized world, where national competitiveness depends on knowledge, inventiveness and openness, the liberal values of a democratic society are essential to the proper functioning of the market.

As noted earlier, all nations must come to terms with the rapid integration of markets, the increasing flow of finance and the widespread use of technology. Remarkably, sovereign nations have responded to globalization by beginning to institutionalize the bulk of economic exchanges so that all participants play by the same rules. In particular, an overwhelming number of nations belong to several multilateral bodies that stipulate universal standards for various aspects of economic exchanges and, more importantly, have agreed to adhere to their bylaws. These institutions haven't become some form of world government; rather they are separate entities or sets of rules for dealing with a host of issues. These include international organizations as disparate as the World Trade Organization, the International Labor Organization, the International Organization for Standardization, and the Bank for International Settlements. For a summary description of these and other organizations, see the list at the end of this issue.

In the interest of creating a fair, rules-based trading system in which every country—developed and developing—is truly on equal footing, countries must work together to eliminate inequitable practices. In a recent speech to an international conference entitled "The Sovereign Debt Crisis in the New Global Financial System," Axel Van Trotsenberg, the World Bank's expert on the heavily indebted poor countries, summarized the issue in simple yet compelling terms:

> Today, continuing barriers to poor country exports, particularly in agriculture, stand as a severe impediment to their potential export development. In this context, it is worthwhile to keep in mind that OECD countries each year spend approximately $300 billion in agricultural subsidies—this equal to Africa's annual GDP. It makes no sense for industrialized countries to give debt relief and aid to poor countries with one hand while denying their products full and unlimited access to markets with the other. There has been enough talk about generating "self-sufficiency and ending aid dependency" but far too little real action to help bring this about. Opening markets to the world's poorest countries would be a genuine signal of commitment to the most isolated and vulnerable among us, and to really help them on the road from aid dependence to real development. It is also central to a country's debt sustainability.

Interestingly, the WTO is built around a set of accepted principles that are very much in keeping with

TABLE 4. INFORMATION AND COMMUNICATION
(per 1,000 people)

	Mobile phones	Fax machines	Personal computers	Internet hosts
Low Income	8	0.9	6.2	0.3
Middle Income	39	1.9	37.4	13.4
High Income	265	72.3	311.2	607.6
United States	256	78.4	458.6	1,508.8

Sources: World Bank, *World Development Indicators 2000*; International Telecommunications Union, *World Telecommunications Development Report 1999*; Internet Software Consortium, www.isc.org. Data are from 1998 or 1999.

TABLE 5. TECHNOLOGY AND e-GLOBALIZATION
(selected countries)

United States	8.8	Thailand	6.1
Sweden	8.6	Poland	6.1
Finland	8.6	Mexico	5.9
United Kingdom	8.4	Indonesia	5.6
Singapore	8.3	Philippines	4.9
Hong Kong	8.3	Peru	4.7
Ireland	8.2	Egypt	4.6
Germany	8.2	India	4.5
France	8.1	China	4.4
Israel	7.8	Pakistan	4.0
Japan	7.7	Iran	3.3
Chile	7.4	Nigeria	3.3
South Korea	7.2	Iraq	2.0
Argentina	6.6		

Source: Economist Intelligence Unit, www.ebusinessforum.com

Van Trotsenberg's remarks. Refer to page 18 for the key WTO principles that are at the heart of the system, as John Howard pointed out in his article in *Economic Reform Today*, "Why Open Trade is Critical to Economic Development." (See *ERT*, number 3, 1997, available at *www.cipe.org*.)

Although there may be much room for improvement on the part of many developing countries, on balance Van Trotsenberg's observations are right on the mark. Unless the industrial world is prepared to live up to the WTO principles, developing and transition countries cannot be faulted for refusing to continue to negotiate tariff reductions and market openings that ignore their major export markets.

Challenges of globalization

The future pace and direction of globalization will hinge on the decisions national governments make in formulating the future rules of international institutions. Much of the controversy about globalization stems from the feeling or perception that the rules of the game are being dictated by others, either by the international financial institutions, multinational corporations, the major industrialized countries, or some combination of all of these. While these groups obviously have a major say in the emerging international system, the failure of the last meeting of the WTO in Seattle demonstrates that developing countries can and do have a major influence on the future. Recently there have been several meetings of the major industrial nations with developing country leaders to attempt to resolve these impasses. Furthermore, the recent trend toward crafting bilateral or regional trade groups such as Mercosur (Argentina, Brazil, Chile, Paraguay, and Uruguay) will likely accelerate.

Every country faces a strategic choice in attempting to turn the forces of globalization to the benefit of its people. Nations can attempt to employ a variety of protectionist tools that will ease the impact of globalization on existing domestic groups, including the private sector, state-owned firms, unions, and other parts of society. Alternatively, they can opt to open their economies to greater participation in the international system. The latter choice will lead to greater competition from international companies. But it will also lead to increased foreign investment, technology transfer and, if phased in properly, accelerated economic growth. Indeed, the choice between these two strategies is now a central element of the political debate in country after country.

India is now in the grip of this debate, as those who would accelerate development argue for adopting new technologies, privatizing state-owned firms, dropping protection for many of India's largely uncompetitive firms, and opening to increased foreign investment. After a prolonged debate, the government has opted to open dramatically the telecommunications sector, largely due to the fear that keeping the restrictions in place would halt India's e-commerce and information technology revolutions. Thanks to this strategic decision, India is attracting new foreign investment as well as reversing the brain drain that has seen the best and brightest of its citizens leave the country due to the lack of opportunity. Today, India is committed to increasing educational opportunities and creating the kind of environment that will allow its people to build the country into the global economic force it should be.

The success of countries as diverse as India, Ireland, Mexico, Poland, and Taiwan, to name but a few demonstrates how countries can shape national strategies to capture the forces of globalization and turn them to their advantage. While each nation will have to craft its own unique strategy depending on its circumstances, there are four key elements that must be addressed by the public and private sectors working together:

1) Reforms to develop and maintain sound, democratic, market-supporting institutions so that their country can stand up to the forces of globalization

2) Policies to develop or adopt technological innovations so that their country gains the cutting-edge technologies essential to national competitiveness

3) Transparent rules for trade and capital flows to ensure that their country can fully participate in the international and regional trading structure.

"12 Commandments" of Foreign Direct Investment

1. *Stable, predictable macroeconomic policy.* Companies must have the confidence that the economy in which they make an investment will be managed in a competent and predictable way. Simply stated, investors must believe that the rules of the game will not change in the middle of a contest.
2. *An effective and honest government.* An investor must be able to rely upon the integrity of the host government and its ability to maintain law and order.
3. *A large and growing market.* The size and potential for growth of a country's domestic market, especially the purchasing power of its customers, are key. Companies do not seek to invest in a market where there is little potential to make a profit.
4. *Freedom of activity in the market.* The strength of the competition, as well as the degree of government (theirs and ours) interference to entering a country's market, are important factors. The freer the market, the more attractive it becomes as an investment site for international investors.
5. *Minimal government regulation.* The cost of government regulation and intervention in the affairs—and profits—of private companies must be kept to a minimum.
6. *Property rights and protection.* Private property must be protected. The likelihood that a company's real or intangible (patents, copyrights, etc.) property will be stolen must be avoided.
7. *Reliable "infrastructure."* The ability to consummate transactions and get products and services to market is also critical. Whether it be reliable transportation, power generation, insurance and accounting services, a competent financial system or other basic factors, investments cannot yield a sufficient or reliable financial return without them.
8. *Availability of high-quality factors of production.* While the investor brings capital, technology and management to the table, the quality of the indigenous work force and the availability of local raw materials are also key ingredients in the recipe for success.
9. *A strong local currency.* The local currency must retain its value. If you make an investment in dollars and then the local assets (valued in the local currency) are devalued, you have lost part—or possibly all—of your original dollar-based investment.
10. *The ability to remit profits, dividends and interest.* If you cannot get your money out of the country, why invest?
11. *A favorable tax climate.* Although tax incentives geared to attract initial investments are important, a company's final investment decision is usually based on how a country's taxation will affect the normal operating environment once the venture is off the ground.
12. *Freedom to operate between markets.* A company must be able to source goods and services from its operating unit in one market in order to serve other markets or to maximize its global efficiency by trading among its operating entities in different countries to "round out" its product lines.

Accepted WTO Principles

- *Trade without discrimination.* This means WTO members agree to give equal treatment to commerce from other member countries ("most-favored-nation") as to domestic commerce ("national treatment").
- *Predictable and growing access to markets.* This includes a continuing commitment by WTO members to reduction of tariff and non-tariff barriers to trade, as well as transparency in domestic laws, regulations and practices.
- *Fair competition.* Where conditions and restrictions on free trade remain, applicable rules and procedures enforced by WTO members must be fair and, again, nondiscriminatory.
- *Economic development and reform.* Over three-quarters of the 150-plus members of the WTO are developing countries and countries in the process of reform from nonmarket systems. Accelerated trade concessions and extra flexibility in required adherence to WTO rules are provided in a number of areas.

Source: www.wto.org

4) Forming coalitions with other countries to press for equitable international and regional trade agreements and ensure that emerging markets are treated fairly in the WTO and the other international organizations described at the end of this issue so that all countries enjoy a level playing field

These four key issues are spelled out in more detail in the section entitled "Globalization: Challenges and Resources" that appears at the end of this issue.

Surviving in the global economy

To those who see the future in the increasing integration of the world economy, the rapid exchange of information, and advances in technology, globalization seems to be offering new hope for human advancement. Others fear these very same changes as the French scholar, Dominique Moisi, recently wrote in the *Financial Times* (9/27/99), "Discontent stems from both the fear of being absorbed into an artificially homogeneous culture, and the fear of being left out in an increasingly unequal world." The challenge facing both developed and developing countries is how to answer these fears by crafting more open and participatory governance at both the national and international levels.

In order to benefit from globalization, countries face significant but not insurmountable international and domestic challenges. Developing countries, even those with advanced emerging markets, must adjust the roles of state and market, as both Mexican President Ernesto Zedillo and Minister of Finance José Angel Gurría, point out in their contributions to this issue of *Economic Reform Today*. Through privatization and deregulation, the state needs to scale down its role as a producer while enhancing its role as provider of well-functioning, democratic, market-supporting institutions.

According to Nobel Laureate Amartya Sen, the democratization debate has been refocused from whether or not countries are fit for democracy to how countries can become fit through democracy. Even in countries that remain under authoritarian rule and in nations where democracy is under pressure, citizens espouse the long-term goal of building and strengthening democracy. Widespread adoption and implementation of democratic values such as transparency and accountability have fostered more open, rules-based and sound political and economic systems. This trend, coupled with revolutionary technological innovations, has facilitated democratization, market-oriented reform and increased economic integration.

In addition, there is much the developed countries can do to foster an equitable, inclusive, rules-based global economy. In particular, as US Ambassador Charlene Barshefsky notes in her speech on page 26, the agreements of international and regional trading organizations need to be made more democratic, transparent, fair, and consistently enforced. The developed countries must also be as open to exports from developing countries as the latter are to the exports from the OECD nations.

Globalization is not a solution to the world's problems, nor is it to be feared as the source of all ills that inflict so many poor nations. Rather, it is both a process of change and a set of international relationships that are under construction. The next few years will be a time of significant challenge as these new relationships are worked out.

(Continued on page 59.)

Economic Globalization Indicators 1998*

	Trade in Goods % of GDP	Trade in Goods % of Goods GDP	Gross Private Capital Flows % of GDP	Gross Foreign Direct Investment % of GDP	Indicator of Rate of Trade Integration**
Income					
Low Income	8.3	62.5	2.0	0.9	
Middle Income	22.1	98.9	6.4	1.6	
High Income	38.3	*95.1*	22.3	5.7	
Regions					
East Asia/Pacific	15.5	98.1	4.0	1.3	
CEE Europe/Central Asia	21.1	106.4	3.8	1.0	
Latin America/Caribbean	19.1	74.5	7.1	2.5	
Middle East/North Africa	17.4	*80.5*	7.3	0.9	
South Asia	4.8	*40.5*	0.9	0.1	
Sub-Saharan Africa	16.8	*99.5*	4.9	0.7	
European Monetary Union	54.4	*106.4*	32.2	6.1	
Developed Countries					
Finland	69.2	*127.1*	62.6	35.5	3.7
France	46.3	*116.6*	22.8	5.5	2.8
Germany	55.0	*67.3*	36.7	5.8	2.4
Japan	21.3	*49.5*	20.7	1.0	3.5
Singapore	269.1	690.8	57.6	13.5	
United Kingdom	48.1	*81.4*	47.2	18.5	2.8
United States	19.9	*78.9*	10.3	4.6	5.3
Developing Asia					
China	8.3	49.8	2.3	1.3	3.5
Bangladesh	7.0	56.1	0.8	0.2	7.2
India	3.9	33.6	0.9	0.1	4.5
Indonesia	15.2	134.9	4.4	0.9	3.2
Korea (South)	35.6	146.7	13.2	1.6	5.3
Malaysia	70.1	307.6	7.6	2.6	6.3
Philippines	22.1	186.9	3.6	0.7	6.8
Thailand	26.7	153.2	5.9	2.1	4.2
Middle East/North Africa					
Egypt	10.2	43.4	3.8	0.6	-0.7
Iran	8.4	*73.9*	1.1	0.0	-4.2
Jordan	34.1	175.9	2.1	2.0	4.9
Morocco	18.1	96.1	1.1	0.4	2.6
Sub-Saharan Africa					
Botswana	42.4	*178.6*	4.6	1.1	-3.6
Côte d'Ivoire	31.4	135.9	2.4	1.9	1.1
Ghana	13.0	320.8	0.6	0.2	3.6
Kenya	17.6	86.5	3.3	0.0	3.9
Nigeria	18.9	60.2	4.1	1.1	1.5
Uganda	7.1	35.8	*1.0*	*0.8*	1.7
Zambia	37.3	141.6	—	—	-0.7
Latin America/Caribbean					
Argentina	12.9	48.4	6.2	1.9	9.0
Brazil	9.9	30.4	9.3	3.2	6.5
Chile	24.7	83.5	13.9	5.7	4.2
Colombia	10.4	53.8	3.3	1.5	6.5
Ecuador	25.7	125.9	4.5	2.3	1.9
Haiti	8.9	—	1.5	0.1	8.4
Mexico	32.9	153.9	3.4	1.4	9.4
Venezuela	24.0	81.2	13.3	3.7	3.0
Central/Eastern Europe					
Albania	10.9	42.4	1.9	0.5	15.8
Bulgaria	22.8	133.6	2.9	1.0	-13.4
Czech Republic	43.5	—	7.2	2.0	11.0
Hungary	42.4	*185.5*	7.7	2.3	5.1
Poland	26.4	*99.0*	5.9	2.5	13.9
Romania	15.1	83.8	3.0	1.6	6.6
Slovak Republic	45.5	324.5	6.8	1.7	9.1
New Independent States					
Armenia	13.2	—	5.5	2.7	-12.6
Belarus	24.1	109.6	1.3	0.2	-6.7
Kazakhstan	18.2	126.4	3.6	1.7	6.8
Russia	14.0	101.4	1.9	0.4	6.6
Ukraine	18.7	126.3	2.8	0.5	7.8

*1998 Calculated using US$ adjusted for purchasing power parity. Italics indicate that data is for an alternative year.

**Note: This indicator is the growth in real trade minus growth in real GDP, 1988-98. It shows how fast an economy is moving into the global trade regime.

Source: World Bank, *World Development Indicators 2000.*

KEY INTERNATIONAL INSTITUTIONS: BUILDING A GLOBAL SYSTEM

The new global system that is under construction is a deliberate product of the actions of national governments, business communities, labor unions, and others who are working to shape a rules-based system of international life. The international institutions shaping the structure of globalization are:

❒ *The World Trade Organization (WTO)* is the successor to the General Agreement on Tariffs and Trade. The WTO is an intergovernmental organization whose rules are set by binding treaties among governments. Although the WTO does have a staff and a series of working groups—including groups that adjudicate disputes between members—the WTO has no authority to enforce decisions of its panels or to create new rules. These decisions must be made by consensus of the member governments. Web site: www.wto.org

❒ *The International Monetary Fund (IMF)* is another intergovernmental organization that is often seen as setting policy or enforcing decisions on countries. All IMF actions must be taken as a result of negotiations between the Fund and a borrowing country, and all lending decisions (including loan conditions) must be approved by the Fund's governing body composed of representatives of national governments. The IMF often is seen as having the power to force countries to accept harsh economic reforms as a condition for securing badly needed loans. While this is true, it should not be forgotten that the IMF's governing body (especially the representatives of the United States, Japan and key European countries) is the one making the IMF decisions. Web site: www.imf.org

❒ *The World Bank* and its affiliates work in much the same way as the IMF with policy direction and overall lending patterns subject to the approval of member governments. Recently, the World Bank has undertaken a set of new policy priorities centered on poverty reduction and on a comprehensive development framework (see www.worldbank.org). Through the leadership of its current president, James Wolfensohn, the Bank has been able to develop a consensus around these initiatives, as well as on the need to combat corruption and foster democracy, both of which are welcome changes in the Bank's policy.

❒ *The International Labor Organization (ILO)* in Geneva is another key intergovernmental body, but it is one that also includes a formal role for business and labor in its structure. The ILO was formed during an earlier wave of globalization in the wake of World War I and within the context of the League of Nations. Today, the ILO is advancing the concept of core labor standards as one of the pillars of a rules-based international economic system. Although there are and will continue to be fundamental debates on labor standards, there is growing international consensus around the core standards developed within the ILO's tripartite decision-making body. Web site: www.ilo.org

❒ *The Organization for Economic Cooperation and Development (OECD)* is an intergovernmental group that is playing a larger role on the world stage as a vehicle for the developed nations to craft key standards. For example, the OECD's recent convention on anti-bribery sets new standards for member countries to adopt in order to prevent their national companies from bribing foreign government officials. The convention is a form of treaty that national governments can agree to join, and then pass their own implementing legislation. Although the OECD's membership is limited to developed, democratic nations, non-members can agree to join the convention. Several have done so, including Bulgaria and Romania. In addition to its anti-bribery convention, the OECD has also developed corporate governance principles that are quite useful to developing countries as they struggle to integrate into the international business system. Web site: www.oecd.org

❒ *The Bank for International Settlements (BIS)* located in Basle, Switzerland, represents the world's major central banks. It is a forum for international monetary and financial cooperation and a bank for central banks, providing them a broad range of financial services for managing their external reserves. The BIS has worked with its members to develop banking standards, including standards on capital adequacy. The BIS is also a center for monetary and economic research, contributing to a better understanding of international financial markets and the interaction of national monetary and financial policies. Web site: www.bis.org

❒ *The International Organization for Standardization (known as ISO)* is an international nongovernmental organization whose members represent the most important standards-setting bodies in their countries. Although the mix varies from country to country, the standards organizations are usually nonprofit entities that work with both public and private sector representatives. The ISO is a key part of globalization since it is the body that makes it possible to produce many international goods. For example, the ISO standard on film speeds is known throughout the world to professional photographers and photo buffs alike. Two newer ISO standards on quality processes (ISO 9000) and environment (14,000) are very instrumental. Web site: www.iso.ch

There are many other international organizations heavily involved in creating the infrastructure of globalization. They set the rules, norms and laws or treaties that form the basis for a globalized world. They range from the International Accounting Standards Committee, which is working to craft a common set of accounting principles, to numerous specialized groups within the United Nations system attempting to deal with food security and biodiversity. Overall, the process of globalization is being built deliberately although it may be that very few governments or experts have a full grasp of the dimensions of the undertaking.

Globalization: Challenges and Resources

The following list of specific challenges provides additional details for these four major areas. The list is meant to be thought-provoking, not inclusive. It can serve as a starting point for assessing the kinds of challenges that need to be addressed as countries come to grips with the forces of globalization and attempt to integrate into the international system.

Challenge: Strengthening Democratic Governance

Key government institutions must function effectively in order for a country to attain sustainable growth and benefit from globalization. Democratic governance must be more than just elections, although elections remain the vital force of democratic government.

- ➤ Legislative bodies. (Establish democratic structures to increase participation in rule-making.)
- ➤ Executive agencies must create clear, transparent and enforcable implementing regulations and encourage democratic participation in policy processes.
- ➤ Judicial systems must function in open and transparent ways that result in credible decisions within an acceptable amount of time. (Lengthy delays are the most costly feature of the judicial systems in many developing countries.)

Resources:

- The National Democratic Institute-sponsored Sana'a conference gathered 350 decision-makers from sixteen developed and developing countries to elaborate action agendas. See page 8 of this issue for their final declaration. Also, visit www.ndi.org

Challenge: Building a Modern Market-Oriented Economy

Experience gained in the financial crises of the 1990s, including those in Mexico and Asia and the collapse of the Russian economy, has demonstrated conclusively that fundamental institutions (rules, laws and norms) of a modern market economy have to be carefully built. In addition, the government and/or the private sector have to provide the infrastructure essential for a market system.

- ➤ A clear and enforceable set of property rights
- ➤ Sound contracting mechanisms to enforce commercial transactions and investments
- ➤ Strong prudential supervision of the banking and financial systems
- ➤ Physical infrastructure including roads, telecommunications and transport
- ➤ Commerce and trade services, especially the customs service
- ➤ Compliance with the Code of Good Practices on Transparency in Monetary and Financial Policies

Resources:

- The International Society for New Institutional Economics is developing a wealth of studies and materials on how institutions underlie markets. See www.isnie.org
- The World Bank's Annual Development Reports give a comprehensive overview of many of the supportive governmental services essential for a modern economy; in particular, see "The State in a Changing World," *World Development Report 1997*, www.worldbank.org
- The IMF and the Bank for International Settlements worked with a representative group of central banks, financial agencies and other experts to create a Code of Good Practices on Transparency in Monetary and Financial Policies. The code is available on the IMF's Web site: www.imf.org. This site also provides a series of experimental reports on the Observance of Standards and Codes on a country-by-country basis.

Challenge: Building Strong Corporate Governance and Anticorruption Systems

Two aspects of building a modern market economy that are separated out here for additional emphasis are at the heart of efforts to open economies and create fair and transparent systems. Corporate governance is the set of rules (public and private) by which modern corporations govern themselves in a competitive market system. The lack of corporate governance was one of the key reasons for the recent Asian and Russian economic crises. Similarly, effective anticorruption measures are increasingly regarded as essential to attract foreign investment, build a competitive economy and ensure fair treatment for all.

Craft Sound Corporate Governance Measures

- ➤ Develop legislation that protects investors, shareholders and stakeholders.
- ➤ Support transparent shareholder registries.
- ➤ Adopt and implement the Convention on Corporate Governance of the Organization for Economic Cooperation and Development (OECD).

➤ Adopt and comply with International Accounting Standards.

Devise and Implement Anticorruption Measures

➤ Streamline legal codes by eliminating duplicative and superfluous laws.

➤ Clarify laws to reduce the possibility of different interpretations and applications of laws.

➤ Clarify laws on conflict of interest.

➤ Strengthen the state's enforcement capacity by hiring and/or training sufficient numbers of qualified personnel.

➤ Adopt and implement Transparency International's Government Procurement Code.

➤ Adopt and adhere to the OECD's Antibribery Convention.

Resources:

- CIPE's Web site, *www.cipe.org*, offers a range of materials and links to other sites relevant to corporate governance and anticorruption.
- Transparency International, *www.transparency.de*, provides additional information about transparent business practices worldwide, a model government procurement code; and the perceptions index on corruption.
- The OECD has developed a comprehensive antibribery convention that is an excellent starting point and a set of corporate governance guidelines. See *www.oecd.org*

Challenge: Developing and/or Adopting New Technologies

In today's high-tech information age, cutting-edge technology is an important means of lowering the cost, increasing the speed and improving the quality of business transactions and of basic services essential to daily life. The following measures would help a country to get up to technological speed:

➤ Conduct a national information technology assessment and develop a technology strategy.

➤ Ensure passage and implementation of laws protecting intellectual property rights.

➤ Enact appropriate tax and investment policies and increase funding for science and technology research and education to stimulate new inventions, technology transfer and technology licensing agreements.

➤ Provide telecommunications services at low cost through competitive markets.

➤ Create national Internet portals.

➤ Aggressively seek out technology transfers and foreign direct investment.

Resources:

- The Center for Strategic and International Studies (CSIS) has created the Global Information Infrastructure Commission (GIIC) as a portal to resources on developing information competitiveness. See *www.giic.org*
- The Computer Systems Policy Project (comprising CEOs of top information technology companies) has developed the Global Electronic Commerce Readiness guide (*www.cspp.org/projects/cspp_gec/index2.html*), which has been applied in Ireland with very good results.
- The Center for the Study of Democracy has developed the Internet Alliance for Economic Development action plan that can serve as a model for other countries (It is available from Ognian Shentov at *www.csd.bg*)
- See also *World Bank Discussion Paper No. 412*, "Intellectual Property Rights and Economic Development," by Carlos A. Primo Braga, Carsten Fink and Claudia Paz Sepúlveda at *www.worldbank.org*

Challenge: Crafting Fair, Transparent Operating Procedures for International and Regional Trade Regimes

Building the world, bilateral and regional trading systems requires constant attention and effort. Developed and emerging markets must all work to create a fair system that balances national interest with the long-run development of the global economy.

➤ Ensure trade rules reflect equitable treatment for both developed and emerging markets.

➤ Craft fair and transparent operational procedures for all trading structures.

➤ Ensure that procedural breaches are punished adequately and consistently.

➤ Increase technical assistance to developing countries.

➤ Improve dispute resolution mechanisms.

Resources:

- The rules and procedures of international and regional trade systems can be found on their respective Web sites. The WTO Web site (*www.wto.org*) has links to the sites of international and regional trading groups. The WTO also is developing a program to assist emerging markets and developing countries to enhance their national trade policy capacity.
- The International Monetary Fund's Web site has links to the sites of almost all international and regional organizations relevant to globalization at the following site: *www.imf.org/np/sec/decdo/cotents.htm*

The Global Sullivan Principles of Corporate Social Responsibility

The "Global Sullivan Principles," which several multinational companies have endorsed within the last year, were announced at the United Nations in November 1999 by Baptist Minister Leon H. Sullivan from the US. In 1997, Rev. Sullivan drafted a similar corporate code of conduct for US companies operating in South Africa in an effort to abolish that country's apartheid policies. In his words, the overarching objective of these principles is "to support economic, social and political justice by companies where they do business," including respect for human rights and equal work opportunities for all peoples.

THE PRINCIPLES

As a company which endorses the Global Sullivan Principles we will respect the law, and as a responsible member of society we will apply these principles with integrity consistent with the legitimate role of business. We will develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to these principles throughout our organization. We believe the application of these principles will achieve greater tolerance and better understanding among peoples, and advance the culture of peace.

Accordingly, we will:

- Express our support for universal human rights and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business.
- Promote equal opportunity for our employees at all levels of the company with respect to issues such as color, race, gender, age, ethnicity or religious beliefs, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude, or other forms of abuse.
- Respect our employees' voluntary freedom of association.
- Compensate our employees to enable them to meet at least their basic needs and provide opportunity to improve their skill and capability to raise their social and economic opportunities.
- Provide a safe and healthy workplace; protect human health and the environment; and promote sustainable development.
- Promote fair competition including respect for intellectual and other property rights, and not offer, pay or accept bribes.
- Work with governments and communities in which we do business to improve the quality of life in those communities—their educational, cultural, economic and social well-being—and seek to provide training and opportunities for workers from disadvantaged backgrounds.
- Promote the application of these principles by those with whom we do business.

We will be transparent in our implementation of these principles and provide information which demonstrates publicly our commitment to them.