An exploratory examination of the benefits and risks of deeper globalisation for less developed countries

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Abstract

The World Bank has expressed strong support for globalization as a tool for promoting economic growth and reducing poverty. It has been argued that openness in terms of trade liberalization and reduced economic distortions raise economic growth rate among low income countries and leads to a convergence of per capital income with the higher income per capital of developed countries. However, for a less developed country normally characterized by low per capital income, economies that are basically at the primary sector with exports made up of primary raw materials, poor institutions, and a host of other structural imperfections, whether or not globalization delivers the acclaimed benefits is arguable. The article examines the benefits and risks of embracing deeper globalization by less developed countries. The methodology employed is a Qualitative research approach which uses secondary data accessed from publications and reports by relevant bodies. It is concluded that deeper globalization carries more risks to less developed countries than benefits. Although when these countries have achieved a certain threshold level of income and sound institutional base, greater integration could bring more benefits to them.

1. Introduction

The 1990s saw the emergence of the most far-reaching changes in the global economic environment. This is reflected in the following, as identified by Dunning (2009): The fall of Birling wall, and the transition to market based economies by most central and eastern European countries, further liberalization of cross -border markets as most notably shown in several regional integration scheme and huge increase in cross-border trade and foreign direct investment (FDI) in services, the emergence of the information /digital revolution leading to a dramatic fall in many kinds of international transaction costs, a series of technological breakthroughs, growth in FDI, and the emergence of third world MNEs- especially from Asia. The term "globalization" is used to describe the continued interdependence of countries of the world whereby there is free flow of goods and services, capital, technology, and knowledge across the world (Cheng, and Mittelhammer, 2008). It is a process that has transformed the world into a global village.

The arguments of IMF/World bank in favour of globalization has always been that deeper globalisation results in more trade, more foreign investments and more knowledge transfer and faster economic growth. However, for a poor country normally characterized by low per capital income, economies basically at the primary sector with export of primary raw material, poor institutions, and a host of other structural imperfections, whether or not globalization delivers the acclaimed benefits is arguable.

This paper examines the gains and risks of embracing deeper globalization by less developed countries. The methodology employed is a Qualitative research approach which uses secondary data accessed from publications and reports by relevant bodies. The secondary data will be evaluated qualitatively.

Accordingly, the paper is split into five sections. Following the introduction is section two which is a brief review of the theoretical underpinnings of globalization, while section three briefly explains the methodology. Section four provides discussion and findings on the gains and risks of deeper globalization for poor countries, and the fifth and final section draws a conclusion

2. Theoretical Underpinnings of Globalisation

The question of whether globalization is a positive phenomenon, especially as it relates to developing countries has continued to generate debate. The World Bank has expressed strong support for globalization as a tool for promoting economic growth and reducing poverty (World Bank, 2001).It has been argued that openness in terms of trade liberalization and reduced economic distortions raise economic growth rate among low income countries and leads to a convergence of per capital income with the higher income per capital of developed countries (Sachs and Warner, 1995). On the other hand, there is conflicting evidence indicating that globalization may actually harm developing countries in various ways. For instance a study by UNCTAD (1995) revealed that, with the exception of few developing countries in Asia, there was divergence rather than convergence between rich and poor countries during the last twenty years due to trade liberalization.

The Washington consensus, a term coined by John Williamson in 1989 to describe an original set of ten interrelated and clear policy prescriptions considered to be standard reform package for developing countries, underpins the idea of globalization. Williamson (1989) used the term to summarize commonly shared themes among policy advice by Washington-based institutions at the time, such as the International Monetary Fund, World Bank, and U.S. Treasury Department, which were believed to be necessary for the recovery of developing countries from financial crisis and to pick up economically. Amongst the recommendations is financial liberalization, trade liberalization, openness to FDI, deregulation, etc.

This “consensus” has, no doubt, become a “contentious” issue over the years. Some of the critics are concerned about some issues addressed, for example, with the Consensus's emphasis on the opening of developing countries to global markets. Rodrik (2006) argued that the standard policy reforms do not produce lasting effects if the background institutional condition were poor, and that there were additional complementarities across different areas of reform. Guttal (2007) explained that experience of the past revealed that countries that maintained controls and regulated the market to build infrastructure and agricultural capacity and protect employment such as china, India, Malaysia, Taiwan, Thailand, and South Korea fared better economically than those that followed the world bank/IMF development model. The ideology underpinning globalization is the same with that of the Structural Adjustment Programme (SAP) - that markets unfettered by national regulations are the most efficient allocators of resources, and that by tying themselves to the limitless word market, poor countries can achieve rapid economic growth and development (Guttal,2007). This view is however unacceptable to bahaviourial economists - The Keynesian disciples who believe there has to be an element of control over the economy as the allocative mechanism is not as efficient as presented.

3. Methodology

The methodology employed is a Qualitative research approach which uses secondary data accessed from publications and reports by relevant bodies.The secondary data was evaluated qualitatively.

4. Discussion and Findings

Some of the possible benefits of globalization are said to be higher economic growth, less poverty, higher social mobility and less inequality (Wade, 2009).This view had earlier been shared by Wolf (2004:4) who maintained that the need to raise the living standard of the poor of the world calls for more global markets. A comparism of average income measured in purchasing power parity (PPP) dollars between the advanced world and the third world from 1950 – 2001 revealed that the average income tend towards divergence rather than convergence, with the exception of Asia (Wade, 2009). This is inconsistent with the argument that a general process of globalization has driven a general process of catch-up growth. Wade (2009) argued that the ratio of third word to advanced world incomes at market exchange rate in 2007 was well below the level reached in 1980.

Another argument adduced by globalization proponent is the trend in poverty headcount – the number of people in the world who live on an income of less than $1 dollar a day measured in PPP dollars. The World Bank extreme poverty headcount shows that in 1981, 1.5billion people lived in extreme poverty and in 2001, it was 1.1billion people. This represents a fall of poverty level by 400 million people. This fall in poverty level was attributed to the global shift to trade and financial liberalization. However, it is important to add that the reduction in extreme poverty headcount depends entirely on China. If china is removed from the statistics, the extreme poverty headcount increases (Wade, 2009; Haynes, 2011). All these show that the assertion that globalization reduce poverty and inequality may not be completely true. It is agreed that export has a significant positive effect on growth, although empirical results seem to support the argument that extractive FDI might not be growth enhancing as much as manufacturing FDI (Akinlo, 2004).

Globalisation is characterized by the emergence of multinational companies and these companies play important role not only in their domestic economies but also in the economies of many overseas territories where they have presence. The theory of comparative advantage propounded by Adam Smith and developed by David Ricardo implies that the greatest economic benefit is not necessarily served by local firms serving their local population, and that an overall welfare gain was made if countries produced goods in which they had an absolute cost advantage and traded them with other countries for goods in which those countries had absolute cost advantage (Faulkner and Segal-Horn, 2004).One possible gain of trade globalization therefore is that countries can benefit from comparative economic advantage. However, Bond (2008) argued that trade liberalization has exacted heavy toll on the developing countries especially the sub Saharan Africa over the years, saying that a whopping $272 billion has gone into unfavourable trading arrangement over the past twenty years. The reasons for this, explained Bond (2008), are dependence on primary commodities, unfair terms of trade, and falling prices for most exports, which have all combined to grip African producers in a price trap as they increase production level but generate decreasing revenue. Haynes (2011) shares in this argument adding that commodity prices could be quite volatile and that export dependency could occasion unfair terms of trade.

Schumkler (2004) argued that the potential gain of financial globalization leads to a more financially interconnected world and a deeper degree of financial integration of developing countries with international financial markets and that inward FDI becomes a major benefit. FDI has been considered as one of the most stable components of capital flows to developing countries and can also be a vehicle for technological progress through the use of, and dissemination of improved production techniques (Benassey-quere, Coupet, and Mayer, 2005). However, an observation of the global pattern of FDI reveals that the bulk of FDI in the world

flows from high income to high income country. It is a known fact that a country with high GDP per capital normally attracts more FDI because high GDP per capital generally implies some fertile ground for product differentiation and higher profits. Moreover, empirical findings have confirmed that even though FDI is acknowledged as an important vehicle for transfer of technology, contributing relatively more to growth than the domestic investment, the higher productivity of FDI holds only when the host country has a minimum threshold of human capital and sufficient absorptive capacity (Borensztein, De Gregorio and Lee, 1996**).** Also, (Schmukler, 2004*)* maintained that financial globalisation improves the health of domestic financial system whereby borrowers and lenders operate in a more transparent, competitive, and efficient financial system. He added that greater competition generates efficiency gains, and the adoption of international accounting standards improves transparency. Schmukler also argued that the introduction of financial intermediaries would push the financial sector to the international frontier. In addition, Stulz (1999) maintained that financial globalization improves corporate governance as new shareholders and potential investors can bring about closer monitoring of management.

Another gain of financial globalization as identified by Mishkin (2003) is that, foreign bank entry into the domestic economy can significantly improve the financial infrastructure of developing countries. Foreign banks enhance financial development in various ways: first, they have more diversified portfolios as they have access to sources of funds from all over the world and therefore they are less susceptible to risks and are less vulnerable to negative shocks, second, best practice in the banking industry especially in risk management and management techniques could be achieved, finally, the fact that possibilities of bailout with its attendant moral hazard is ruled out for foreign banks encourages more prudent behaviour by them (World Bank, 2001).

Although financial globalization has a lot of gains as evaluated above, it have considerable risks. Financial globalization has been associated with economic crisis. Rodrik (2006**)** and Guttal (2007) argued that the risks of globalization was clearly manifest in the South-Asian financial crisis that rocked countries like South Korea, Thailand, and Indonesia in 1997. These countries embraced the recommendation of IMF to liberalise, and because their economies lacked the substance to back up the massive capita flight that was left unrestricted, a full blown crisis emerged. . Similar crisis erupted in Turkey, Russia, and Argentina that also accepted the IMF model. In the midst of the Asian crisis, the economies of countries like Malaysia, and China that practiced strict capital controls were unaffected (Guttal, 2007).There is several ways in which globalisation precipitate financial crisis. It is argued that globalization brings a situation whereby the financial system become subject to the market discipline of both local and foreign investors and the cumulative reactions of both of them to unsound fundamentals could trigger financial crisis (Schmukler, 2004).

Again, globalization can lead to crisis as a result of imperfections in the international financial markets. The imperfections generate bubble burst scenarios, herd behaviour, moral hazard which leads to over borrowing as a result of implicit government guarantees. All these could culminate into financial crisis. A very good example is the present crisis in the Euro zone. Moreover, if a country become over dependent on foreign capital, sudden shift in foreign capital flows can create economic downturn.

Financial globalization could also lead to financial crisis due to risk of contagion - shocks that are transmitted across countries. Three broad channels of contagion have been identified; these are real links, financial links, and herd behaviour (Schmukler, 2004).Herd behaviour is a situation where people's actions are tailored towards what others are doing (animal spirit),

people basing there actions on “what they think others are thinking”. A typical example of the risk of contagion is the 2007-2009 financial crises that began with the United States subprime mortgage crisis in the summer of 2007 which exploded in September 2008 following Lehman Brother’s collapse. This later spread to Europe and many other developed and emerging market economies and became a global financial crisis. Also, .the present financial crisis in the Euro zone where the five fiscally vulnerable members of the monetary union known as the PIIGS – Portuguese, Ireland Italy, Greece and Spain are plunged into crisis spontaneously is typical of how the risk of contagion could make crisis spread like wild fire (Filger, 2011).

5. Conclusion

The effects of globalization for poor countries of the world could be summarized in widening gap between the rich and the poor countries, increased vulnerability of domestic economies to crisis, and a host of others. This supports the claim by Cheng and Mittelhammer (2008**)** that at low income levels, globalization seems to bring more adverse effects to the poor. This implies that globalization carries more risks to developing countries than gains. Although when these countries have achieved a certain threshold level of income and sound institutional base (Benassey-Quere, Coupet and Mayer, 2005**)**, greater integration could bring “good things” to them. Despite the risks of globalization, however, most developing countries have embraced it as a preferred model of development, and the true explanation of this has a political undertone. In view of all that has been said, it is concluded, on a more general note, that, rather than any single "one size fits all" formula for development through globalization, strategies need to be tailored to the specific circumstances of individual countries

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