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**Responding to Globalization: Facilitating the  
Integration of Developing Countries into the World  
Economy in the 21<sup>st</sup> Century**

**Regional Perspectives on Globalization**

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## **The Regional Perspective of the Economic Commission for Europe on Globalization**

### **I. Trade and investment in the ECE region: globalization or regionalization?**

1. While the global economic interchanges of the countries of the ECE region have grown, on average it is their regional ties that have intensified the most. Far from becoming more global west European trade has become more and more concentrated in the European region itself. Well over two thirds of Europe's exports and imports now consist of intra-west European exchanges compared with some 55 and 46 per cent in the inter-war period. Trade with the rest of the world, and especially with the developing countries, has tended to decline in relative importance. There was a brief recovery in the share of developing countries in western Europe's trade as a result of the oil shocks of the 1970s but this was quickly reversed with the subsequent shift in the terms of trade against the Middle East and other oil producers.

2. With free capital movement it is of course possible that trade flows may be replaced by direct investment abroad, but the empirical evidence suggests that west European FDI, in the main, is positively, not negatively, correlated with the structure of trade by partner country. FDI data by provenance and destination are not among the most reliable of economic statistics, but the basic conclusion from the available statistics is that outward flows of FDI from west European countries have been increasingly directed to other parts of the region. In the 1990s some 60 per cent of all west European FDI has remained within western Europe, a much higher proportion than in the 1980s, with another 3.5 per cent on average going to the ECE transition economies (see below). Thus the regional concentration of trade is repeated, if a little less sharply, in the pattern of foreign investment. In a longer historical perspective the change in concentration is especially marked. In 1914, at the end of a previous phase of globalization, just under 19 per cent of the gross value of west European capital invested abroad went to other parts of western Europe; 40 per cent or so was invested in Latin America, Asia and Africa, 27 per cent in "western offshoots" in other parts of the world (the British Dominions, for example), and 14 per cent in eastern Europe.<sup>1</sup> In other words, west European foreign investment was more globally oriented before the First World War than in the 1990s.

3. In the former centrally planned economies (CPEs), planners rather than economic forces shaped external economic relations with the result that the bulk of trade flows were with CMEA trade partners (reflecting the priorities of the leadership). But the extensive trade liberalization which occurred in eastern Europe and the Baltic states after the revolutions of 1989 has led to a rapid re-orientation of trade away from the former CMEA towards western Europe. Longer-run comparisons are difficult because of boundary changes, the re-integration or disintegration of states, and inconsistent valuation of different trade flows, but the basic picture is that the trade of the transition

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<sup>1</sup> Angus Maddison, *Monitoring the World Economy 1820-1992*, OECD: Paris 1995, table 3-3, p.63. Western Europe here comprises the United Kingdom, France, Germany, Belgium, the Netherlands and Switzerland.

economies has more or less reverted to its pre-war structure: western Europe in the late 1920s was the destination for around three-quarters of east European exports and the source of a similar proportion of imports. These shares fell to about a fifth to a third under the regime of central planning and the CMEA trading area, but by 1998 they were again in the region of 70 per cent or so. Trade with developing countries which, as in western Europe, increased momentarily in the wake of the oil shocks of the 1970s, is proportionately much smaller than is the case for western Europe and has tended either to stagnate or to fall in the 1990s.<sup>2</sup>

4. Thus the general evolution of European trade has not been towards a more global distribution of relationships but instead towards a more intense integration with close neighbours. Interdependence among the economies of the region has increased but with the rest of the world it has tended to weaken.

5. With some minor exceptions the CPEs were closed to foreign direct investment. Since 1989 economic reform including, privatization and the liberalisation of capital movements (which the transition countries undertook to very different degrees), have boosted FDI inflows from less than \$1 billion annually to over \$28 billion in 2000.<sup>3</sup> Policy objectives have included improvements in economic efficiency, restructuring, increases in export capacity, boosting foreign currency reserves, among others. A considerable share of this FDI has been associated with the privatisation of state assets, but greenfield investment has become increasingly important. FDI has become an important factor in the export growth of the transition economies.<sup>4</sup> In particular FDI in the automobile sector has increasingly integrated these countries in the production chains of multinational companies. The bulk of the FDI flows into the transition economies originate in the developed market economies (chiefly in western Europe) and most of that has been invested in those countries bordering on western Europe and the Baltic Sea (these are the transition economies that have made the most progress toward EU membership).<sup>5</sup> The growing attraction of the transition economies for FDI is reflected in their increasing share of FDI outside the developed market economies, which has risen from 7.6 per cent in 1993 to 12.4 per cent in 1998. Their corresponding shares of global FDI flows are 3 and 3.5 per cent respectively.<sup>6</sup>

## II. Why regionalization?

6. Why should the flows of European trade and direct investment become more concentrated in the region when the most powerful forces for integration are supposed to be leading towards a global economy?

7. Although a number factors may have played some role in supporting the regionalization of Europe's trade and investment flows, the fact that such concentration

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<sup>2</sup> Russia has a higher proportion of trade with developing countries (around 20 per cent or so), largely a reflection of its trade with China and other Asian countries, but it has fluctuated with no tendency to rise in the 1990s.

<sup>3</sup> Chapter 5, "Economic Growth and Foreign Direct Investment in the Transition Economies", UNECE, *Economic Survey of Europe 2001* No. 1.

<sup>4</sup> Ibid

<sup>5</sup> Ibid

<sup>6</sup> Ibid

has been high and increasing over a very long period, and especially for trade in manufactures, suggests that more fundamental influences are at work.

8. One of the characteristics often claimed for "globalization" is that international trade in manufactures is increasingly "intra-industry" as opposed to inter-industry. However, this is not only a long-established feature of trade in manufactures but it has also been long dominated by trade among the industrialized countries themselves and especially among the countries of western Europe. A plausible explanation for this pattern of trade is that, as the extent of the market increases, economies of scale and of coordination allow the intermediate parts and processes required in the production of manufactured goods to be separated and entrusted to specialist producers who can be spread over a larger area and, eventually, over national boundaries.

9. This dynamic division of labour could in principle be extended on a global basis, given the steep decline in co-ordination costs<sup>7</sup> as a result of improvements in communications technology and transport, but in practice it is likely to proceed more rapidly among countries with similar levels of income per head and hence similar industrial structures - increased specialization in capital or skill intensive machine tools, for example, can only proceed between relatively capital abundant countries with machine tool industries.<sup>8</sup> Since western Europe has for a long time consisted of a cluster of economies at roughly similar levels of development it provides a favourable environment for intra-industry specialization. Moreover, since increased interdependence is a cost, not a benefit, of increased specialization, enterprises will be anxious to minimize the risks of disruption to their supplies of intermediate inputs and to remain close to the sources of specialized services; they will therefore tend to keep their supply lines as short as possible since both geographical and economic distance are likely to increase these risks.<sup>9</sup> These factors working towards increased concentration are also likely to trigger cumulative processes which may reinforce the degree of concentration over time: enterprises tend to migrate to areas with available supplies of skilled labour and good transport systems, and if the enterprises succeed they will in turn attract further supplies of similarly skilled labour to the region and increased investment in communications. In other words, the strong evidence of regionalization in trade and FDI flows is not so much a sign that protectionism or other policies are obstructing the development of a global economy but that the underlying theory of an inevitable globalization is basically flawed.

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<sup>7</sup> The costs of co-ordinating a given production process spread over wider geographical areas has been reduced not only by lower transport costs and trade barriers but also by cheaper business travel and telecommunications.

<sup>8</sup> Such processes underline the importance of historical factors in the explanation of current trade flows. Eichengreen and Irwin have suggested the importance of history by including lagged trade variables in a traditional gravity model of trade flows. See Jeffrey A. Frankel (ed.), *The Regionalization of the World Economy*, Chicago: University of Chicago Press, 1998.

<sup>9</sup> They are not of course *eliminated* in Europe. The risks of increased interdependence are illustrated by the fact that a strike of metal workers in Germany, for example, can sometimes lead to warnings of job layoffs in Paris and Birmingham within a week or so.

### III. Trends in the integration of the transition economies into the world economy

10. One of the consequences of the shift in transition economy trade toward western Europe is an increased dependence on the west European economic cycle.<sup>10</sup> This can be positive as in 2000 when the primary impetus for the east European and Baltic economies came from the acceleration in the demand of western Europe for manufactured and semi-manufactured goods, which accompanied the economic upturn in that part of the continent. (In contrast, the primary impetus for the commodity exporting countries (in the first place, the oil and natural gas exporters in the CIS) originated in the upsurge in world market prices coupled with a stronger dollar.)

11. External factors helped to make the year 2000 the most successful year for the ECE transition economies since the start of economic transformation in 1989. For the first time in a decade all the transition economies in the region were growing and their average rate of GDP growth was quite impressive: at 6 per cent it was 1.5 percentage points higher than the rate of growth of world output. Also for the first time since the start of their market reforms, the Commonwealth of Independent States (CIS) was the fastest growing regional group among the transition economies: nine out of the 12 CIS economies had rates of GDP growth of 5 per cent or more, resulting in an average of 7.4 per cent for the Commonwealth as a whole. The main engine of the robust recovery in the CIS was the Russian economy where GDP grew by an unprecedented 7.7 per cent in 2000. After a weak performance in 1999, output also recovered strongly in eastern Europe and in the Baltic states, their aggregate GDP increasing by 3.9 per cent and 5 per cent, respectively. In general these outcomes exceeded (in some cases considerably) the expectations of policy makers in the transition economies.

12. However, in 2001 the international environment has been less supportive, the pace of growth of the global and west European economies having steadily weakened. The economic performance of most transition economies has become highly dependent on export-led growth, and they often have little scope for offsetting negative external shocks with expansive domestic policy measures.

13. During the past decade, most transition economies have posted current account deficits, which in many cases have tended to rise (Russia is the major exception with recent large surpluses). Increasing access to foreign resources has helped them to grow during a period of generally low domestic savings and weak financial intermediation. Foreign resources will continue to be counted on to help them catch up with western levels to income, though even in the most favourable circumstances this goal is very far off.<sup>11</sup>

14. Subsequent to the economic and financial turbulence of the early 1990s, the implementation of economic reforms in the transition economies has led to more or less steadily rising capital flows (although that has not been the case in Russia and several other CIS).<sup>12</sup> FDI has become the most important source of foreign capital in

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<sup>10</sup> *Economic Survey of Europe 2001*, p.10

<sup>11</sup> "Catching up and falling behind: economic convergence in Europe", Chapter 5, *Economic Survey of Europe 2000*, No. 1.

<sup>12</sup> "Capital flows into the transition economies since 1989", *Economic Survey of Europe 2000*, pp.145-154 and *Economic Survey of Europe 2001*, p.155-156.

eastern Europe and the Baltic states (recently accounting for some 70-80 per cent of the total net inflows). It has financed the bulk of these countries' current account deficits and reduced the need for other types of capital imports.

15. Given the intense global competition for FDI, most transition economies have pursued policies to increase their attractiveness to investors. To this end, they have given priority to macroeconomic stabilization, lowering tax rates, improving infrastructure, among other policies. Investor-friendly policies are essential to attract greenfield investment, which will be increasingly relied on as privatization draws to a close. This point has already been reached in the fast reforming countries, particularly in Hungary.

16. However, the marketization and opening up of the transition economies has also increased their vulnerability to external shocks and occasionally imposed new costs. Large capital inflows have often put upward pressure on exchange rates and complicated the conduct of monetary policy. On the other hand, the rouble crises in 1998 triggered large outflows of short-term funds and increased exchange rate volatility, which in several transition economies led to sharply currency depreciation.

17. Over the long-term, however, credible economic policies have improved investors' perception of many transition economies, giving them more access to the international capital markets. As of mid-2001, eight central European and Baltic countries have received investment grade credit ratings. The improving terms obtained by the creditworthy ones (smaller margins and longer maturities) reflect a more general recovery from the conditions prevailing during the global financial crisis, in addition to improved economic fundamentals and progress toward EU accession. These terms increasingly differentiate them from other countries in the region. Most of the candidates for EU membership – the Czech Republic, Hungary, Poland, Slovenia and the Baltic states are rated as investment grade risks by at least one international rating agency (which is also the case for Croatia). Given their prospects for EU accession, international fund managers no longer consider them to be emerging market economies. The stability of the yields on their external bonds during the recent financial turbulence in Argentina and Turkey suggests that this assessment is widely shared. However, there are indications that local securities markets continue to be highly vulnerable to changes in foreign asset prices.

18. Despite the general progress, the process of integrating into the world economy continues to be uneven among the ECE transition economies. In some, trade in goods and services has failed expand despite favourable external conditions in 2000, and there has been little success in attracting private capital. Ten transition economies lack international credit ratings, and the several with sub-investment grade ratings have faced very difficult borrowing conditions or have not been able to borrow at all. The latter group of countries thus remains dependent on bilateral and multilateral financing. Explanations for this vary from country to country, but political uncertainty (or outright instability), a slow pace of economic reform (including privatisation), and a failure to build the necessary market supporting institutions, are among the factors most frequently cited.

## **The Regional Perspective of the Economic and Social Commission for Asia and the Pacific on Globalization**

### **I. Globalization: the experience so far**

1. Much has been written on the benefits and costs of globalization i.e. the rapid integration of countries through trade, financial flows and ICT. There is general agreement that the process – which visibly gathered pace in the early 1990s - has offered significant new opportunities to developing countries to integrate into the world trading system, to have access to a bigger pool of international private capital and thus benefit from the technology, modern management practices and marketing know-how that this access facilitates. There has been an underlying presumption that globalization would eventually lead not only to higher GDP growth rates as such but to greater convergence in these rates between countries at different stages of development.

2. At the same time, however, it has been known that globalization was likely to pose substantial new challenges for many countries. It was always accepted, for instance, that participation in globalization was not likely to prove a costless option, in that it would almost certainly confront countries and their governments with both transitional and on-going costs. Transitional costs were likely to arise in the way investors and entrepreneurs responded to the challenge of greater international competition; on-going costs would arise as governments grappled with a loss of freedom and leeway in policy-making, especially in fiscal and investment matters, in order to facilitate participation in the global trading and financial system. In addition, there were likely to be social impacts through greater vulnerability in employment.

3. Taking the ESCAP region as a whole, experience of the last decade, and of the last four years since mid-1997 in particular, shows that globalization has indeed brought both significant benefits and serious challenges for the region. Some of the principal benefits can be seen in the rising trade-to-GDP ratios in virtually all ESCAP sub-regions as well as in the progressively bigger share of foreign private capital in domestic investment in several countries. The challenges, on the other hand, have emanated from the fact that economic downturns or episodes of financial instability in one region, or even one country, have had immediate repercussions in other countries, magnifying the initial fall in demand or financial instability significantly. As a result GDP growth has been reversed for several countries with a major impact on the incidence of poverty in the region.

4. As mentioned above, an important on-going challenge of globalization is that it has necessitated, *ipso facto*, through the liberalization of the trading and investment regimes of individual countries, continuous adaptation and, often extremely rapid, adjustment to changes in the patterns of consumption and production and, hence, in the structure of employment. Such changes have generated considerable transitional costs, particularly loss of employment and increase in social deprivation for people at the lower end of the skills spectrum. As new production activities and skills have been created, other long-standing traditional activities and skills have become unviable and have been swept away in the face of changing consumption patterns and international competition. Indeed, the evidence suggests that the process has been intensified to some

extent through globalization with foreign capital in the form of FDI accelerating such change on account of its footloose nature.

5. It needs to be stressed here that while society as a whole in individual countries can benefit from the more efficient allocation of productive resources that participation in globalization brings about it is also equally the case that the ensuing benefits can and, indeed, have been unevenly distributed both within and between countries. The following two examples make uncomfortable reading. One by 1997, i.e. just before the crisis, a mere 12 countries in the ESCAP region accounted for 90 per cent of the foreign trade and of foreign capital inflows into the region as a whole. The position is unchanged today. As a result, instead of rising trade-to-GDP ratios and convergence in growth rates and economic performance, differences between the faster and the slower-growing economies in the region have widened in nearly all respects. The fear is that the latter risk being marginalized on a semi-permanent basis.

6. Two, while Hong Kong China, the Republic of Korea, Singapore and Taiwan Province of China have either attained developed status or are very close to it, and China, Malaysia, Indonesia and Thailand experienced rapid growth up to 1997, and thereafter as well in the case of China, most ESCAP economies remain as far away from that status today as in the mid-1980s. Very few have achieved a significant and sustained acceleration in GDP growth over the last 10-15 years through the stimulus of faster trade growth and enhanced access to foreign private capital. There is little evidence thus far of any convergence in growth rates taking the ESCAP region as a whole. The least developed countries and the small Pacific island and landlocked economies with their limited resources and narrow production possibilities have neither benefited from increased flows of trade nor from an enhanced access to foreign private capital. Their long term growth and development prospects have shown little improvement. Moreover, income disparities have widened in a large number of economies in the region with many of the gains in income and wealth generated in the 1990s going disproportionately to the relatively well-off segments of society. Wages for the low-skilled have either remained static or have fallen in real terms in most economies, a phenomenon exacerbated by growing unemployment and increase in poverty in the region in 1998 and again in 2001 following the recent downturn<sup>13</sup>. Such trends are clearly unsustainable over the long term.

7. A further and essentially unpredicted development has come in the shape of the 1997 financial and economic crisis in the region. This development has manifested itself in an extraordinarily severe bout of macroeconomic and financial instability and its associated losses of output and rise in unemployment and poverty in a number of countries in the region. It would not be an exaggeration to say that the 1997 crisis has been a uniquely cataclysmic event with its adverse repercussions lingering on today, more than four years after its onset. Globalization has clearly played a major role in it. As national financial markets integrated in the 1990s many governments failed to prepare for the

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<sup>13</sup> A recent report on the BBC (<http://news.bbc.co.uk> of 23 August 2001) stated that 2 million more jobs are likely to go in Asia this year based on government data from 10 ESCAP economies: Japan, Singapore, Malaysia, Thailand, the Philippines, Indonesia, Hong Kong China, Taiwan Province of China, the Republic of Korea and Bangladesh. This will inevitably worsen the incidence of poverty in the region.

downside risks this entailed. Regulatory and oversight capacity in the financial sectors of most countries was not adequately developed. Intermediation of foreign capital was a largely unchecked affair involving large maturity and currency mismatches. Most national financial sectors were shallow and under-capitalized. Risk management through currency hedging and/or interest rate derivatives was largely unknown. When financial market contagion emerged in 1997 in the region many, if not most, countries were left floundering, presiding over large scale financial and corporate sector insolvencies with huge knock-on effects on the real economy.

8. A post mortem of the 1997 crisis suggests that apart from increasing enormously the complexity of economic policy-making that globalization brings with it, there is unmistakable evidence of its huge costs via externally induced macroeconomic and financial instability for nearly all economies. Moreover, there is compelling evidence that globalization has increased the frequency and intensity of episodes of financial market instability and of financial market contagion. This applies both to increased volatility in exchange rates and to fluctuations in stock market indices that have mostly tended to occur independently of domestic developments. Indeed, the fear of financial contagion is now all-pervasive in the minds of investors and policy-makers as recent events in Turkey and Argentina have starkly demonstrated with their adverse impact on the cost and availability of foreign capital for all developing countries.

9. The fear is not unfounded. Research shows that over the last 10-15 years different types of financial crises have generated large, negative output effects: these range from a 3 per cent GDP loss for a banking crisis to a 7 per cent loss for an exchange rate crisis and to a massive 15 per cent loss for a twin crisis, i.e. of the kind that was experienced in the ESCAP region in 1997 involving both the financial system and the exchange rate.<sup>14</sup> While domestic policy shortcomings have undoubtedly played a contributory role in the 1997 crisis globalization has been the major culprit in setting it in motion in the first place and generating such profound after-effects.

10. Events of the financial crisis have also reflected the stark reality that existing social security and assistance schemes are grossly inadequate in meeting the social protection needs of populations affected by such external shocks. Social protection, including the provision of social safety net programmes to mitigate the adverse impact of such crises has become a major emerging social policy issue given the limited benefits provided by traditional and informal social safety nets.

## **II. A policy agenda for the future**

11. What are the policy options available to ESCAP countries now? At a general level it should be emphasized at the very outset that globalization is an exogenous reality over which individual countries have little or no control. For the time being it has acquired the status of conventional wisdom. Given that reality, any attempt at insulation by an individual country, say, by re-introducing high tariff walls or other restrictions on trade and capital flows, is likely to be counter-productive. In fact, it is likely to increase the risk of retaliatory trade restrictions and possible exclusion from the international financial markets. But at the same time, in dealing with globalization, governments need

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<sup>14</sup> Bordo, Michael and Barry Eichengreen, 2000. "Is the crisis problem growing more severe". Unpublished manuscript. University of California, Berkeley

to devise better policy responses that take a more realistic account of their own unique circumstances.

12. In the realm of trade, as the slowdown through 2000/2001 amply demonstrates, over-dependence on particular markets and on a narrow range of items has been shown to carry tremendous downside risks. Likewise, in financial sector opening, the sequencing and speed of liberalization measures require special attention. This caveat applies particularly in the area of capital account opening. If done hastily it can severely undermine financial sector stability. The caveat also applies to rules governing foreign investment and the opening up of the banking sector and stock markets. Liberalization measures should not merely follow an external blueprint but keep in view the institutional and human resource capacities available in individual countries.

13. But, however diligently individual countries carry out their responsibilities in these areas, a supportive international and regional environment is a critical pre-requisite for the avoidance of financial market instability. The avenues for collective action in the latter have been discussed under the rubric of reform of the international financial architecture.<sup>15</sup> It is self-evident that the agenda for the reform of the international financial architecture is essentially long term in nature. Short of another major financial crisis, its implementation will at best occur through a step-by-step approach with progress coming gradually in increments rather than in a large single initiative. Over the next 3-5 years, given the above background, cooperative initiatives via a regional approach offer better prospects of more rapid progress to tackle some of the costs and downside risks of globalization.

### **III. A regional approach**

14. There appears to be little doubt that in the area of financial contagion and external shocks the coordination of policies and institutions between countries can be more effectively addressed at the regional level. In general, it seems inappropriate from a practical point of view to burden global institutions such as the IMF or World Bank with yet more mandates and responsibilities. Interest in the regional approach attracted attention following the 1997 crisis based upon a strong perception that the advice and conditionality of the IMF and World Bank were not sensitive to the regional nuances of the crisis and may even have aggravated it to some extent. This perception gave rise to the proposal of an Asian Monetary Fund. Even though the Asian Fund has not materialized, the Chiang Mai initiative of 2001<sup>16</sup> can also be seen as a response to regional thinking on how to deal with a new bout of financial market volatility in the region through the regional provision of liquidity.

15. In the same vein, tentative discussions on greater stability in exchange rates, specifically on the merits and demerits of a common currency peg system in the region on the lines of the European ERM are also a tentative regional response to the dilemma of having to choose between fixed and floating exchange rates and the policy

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<sup>15</sup> See the *Economic and Social Survey of Asia and the Pacific 2001*, chapter VIII

<sup>16</sup> Under the Chiang Mai initiative ASEAN members plus China, Japan and the Republic of Korea have agreed to set up a swap facility to provide liquidity for mutual support in times of need.

complications created by the floating rate regimes that have come into vogue after 1997<sup>17</sup>. There is a belief that some ESCAP economies could avoid their current difficulties more successfully by establishing a common exchange rate peg and supporting it collectively with their considerable foreign exchange reserves. In Europe, this approach to institution-building, as reflected in the ERM, EMU and euro, has encouraged policy harmonization in other areas. Above all, it has created a zone of financial stability within the EU 11 and perhaps even facilitated greater political cooperation. Some sub-regions within ESCAP certainly have the resources and institutional sophistication to make progress in the area of exchange rate cooperation.

16. In the area of trade, despite recent progress, countries of the region remain less keen to cooperate in a region-wide RTA since much of their trade is with the US. But, the position is changing quickly. China has signified its interest to join ASEAN in a free trade arrangement with tariff reductions to be achieved in the comparatively short period of 2003 to 2009.<sup>18</sup> Other sub-regions could take similar initiatives. The Bangkok Agreement<sup>19</sup> is available as an instrument to make an advance in this area. Both financial market and trade cooperation initiatives reflect a desire to regain the economic stability and vitality that characterized the region prior to 1997 and which globalization has undermined. There is also an underlying fear that small economies on their own do not have the resources to cope with major global downturns and instability. This applies particularly to the Pacific island economies and the least developed countries. In the realm of social policy, there is a growing recognition of the need to develop and strengthen the interface between economic and social policies including the challenges imposed by greater vulnerability that globalization has brought for societies and countries.

17. Regional approaches thus offer a viable option by combining financial cooperation with preferential trade within the region to regain and sustain the momentum of growth lost in the 1997 crisis. There is, of course, no guarantee of long-term success. Nevertheless, the regional approach offers an important means for addressing the challenges of globalization.

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<sup>17</sup> See the Economic and Social Survey of Asia and the Pacific 2001, chapter I, Box on Inflation Targeting.

<sup>18</sup> Bangkok Post, Business, 23 August 2001, pp 1 and 3

<sup>19</sup> The Bangkok Agreement aims at promoting intraregional trade within ESCAP through preferential tariff arrangements among member countries. Six countries, including China and India, have joined the Agreement thus far.

## **The Regional Perspective of the Economic Commission for Latin America and the Caribbean on Globalization**

### **I. Foreign trade and investment flows**

1. During the 1990s, significant progress was made towards integrating the Latin American and Caribbean countries into the world economy. During the decade, the region posted the fastest growth of real export volumes in its history: 9% per year between 1990 and 2000. In fact, this figure is higher than the rate achieved by world trade as a whole. The strong growth of Mexican exports explains much of this strength. Indeed, in 2000, Mexico accounted for nearly half of Latin America's exports of goods. Brazil, on the other hand, stands out for the relatively slow growth of its exports (3.2% per year), which was not only lower than the regional average for the 1990s, but lower than its own performance since the 1960s, as well. The remaining countries, however, show strong growth, of close to 9% a year. Even so, the Latin American and Caribbean share of world exports remains very low, at only slightly above 5%.

2. Export diversification has progressed at very different speeds in different countries and subregions. The most salient development is the rapid change in the composition of Mexican exports. Great diversification also took place in Central America and the Dominican Republic. In the case of Mexico, there has been a boom in industrial exports to the United States covering a wide range of products, including assembly (*maquila*) products. In the smaller countries, the diversification is more closely related to the development of an assembly industry geared towards the United States market; it includes traditional manufactures (particularly clothing) and, to an increasing extent, electronic products. Given the increased weight of assembly products, both the rate of growth and the degree of diversification of exports have been less pronounced, in terms of value added. The change in the composition of exports has been slower in Brazil –which also has a highly diversified export structure– and especially in the rest of South America, where commodities, traditional manufactures and natural-resource-intensive manufactures still account for a large share of exports. Thus, in most countries of the region, the growth of exports has gone hand in hand with a still inadequate diversification of the export base, both in terms of products and of target markets. These patterns of specialization have meant that while Mexico and some Central American and Caribbean countries have been increasing their exports in dynamic items among the Organisation for Economic Co-operation for Development (OECD) countries imports (although, once again, assembly operations account for a significant part of this process), the South American countries have done so in goods that have been losing ground in terms of purchases by the developed countries.

3. One important element of the expansion and diversification of exports is the significant progress of intraregional trade associated with the strengthening of long-standing economic integration and free trade agreements or the creation of new ones. Growth in trade was especially strong within the two main subregional agreements, the Southern Common Market (Mercosur) and the Andean Community, between 1990 and 1998 (22% and 19% per year, respectively). Growth has been much slower in the Central American Common Market and the Caribbean Community (Caricom). One salient feature of intraregional trade has been its emphasis on non-traditional manufactures, which have also been increasingly diversified. In fact, if such trade is

excluded, the heavy concentration of South American exports on commodities becomes even more apparent. Thus, one of the most unfortunate costs of the 1998-1999 crisis has been the marked reduction of trade flows within the South American integration groups, a trend that was particularly acute in 1999.

4. In terms of productive restructuring in the context of international markets, the region has been generating three basic patterns of specialization. The first is distinguished by the strong growth of manufacturing exports with high contents of imported inputs, which are geared mainly towards the United States market. This pattern, which is prevalent in Mexico and some Central American and Caribbean countries, goes hand in hand with strong national linkages in the non-*maquila* sectors in Mexico, traditional agricultural exports or a process of agricultural export diversification in Central America, and the growth of service exports (especially tourism) in the Caribbean. Under the second pattern, the predominance of extraregional exports of commodities or natural-resource-intensive manufacturing goods is combined with much more diversified intraregional trade. This is the prevailing model in the South American countries. In the case of Brazil, it is combined with some technology-intensive manufactures, and in a number of other countries, it is combined with labour-intensive manufacturing exports. There is also a third pattern of specialization, which is found especially in Panama and some small economies in the Caribbean Basin, in which service exports (financial, tourism and transport services) predominate.

5. The opening up of economies and renewed access to financing from abroad has led to an even more rapid growth of imports. For this reason, the trade deficit has tended to widen, reaching levels comparable to those of the 1970s (or higher, if estimated as simple averages). This is serious cause for concern, since these deficits coincide with economic growth rates that are two or more percentage points below those registered in the 1970s. There has thus been a deterioration of the relationship between economic growth and external accounts, which results both from the structural changes brought about by economic liberalization and the trend towards real exchange rate appreciation that prevailed during the 1990s.

6. The boom in foreign direct investment is a second sign of the region's progress toward integration into the world economy. The boom has been created by a number of forces, namely, the deregulation of natural-resource-intensive sectors, the privatization of sectors traditionally controlled by the State, the application of free trade agreements or preferential arrangements granted by more industrialized countries or regions (particularly the North American Free Trade Agreement and the Caribbean Basin Initiative) and the restructuring of productive sectors in the framework of the regional integration process.

7. Given the instability of financial flows, foreign direct investment also became the basic engine for the return to a situation of net positive resource transfers from abroad, thus reversing the negative transfer characteristic of the "lost decade". The foreign direct investment boom has not always led to an increase in production capacity, since it has included a large share of mergers and acquisitions of existing assets, first public (privatizations) and more recently private. In recent years (1997-1999) in particular, flows associated with mergers and acquisitions have represented around 40% of foreign direct investment. The rapid growth of this type of investment has led to a rapid increase in the participation of foreign firms in production and sales, especially since the middle of the decade.

8. A new development, although involving smaller quantities, has been the appearance of considerable intraregional direct investment activity, including mergers and acquisitions and a wave of strategic alliances between large domestic firms, perhaps as part of a transition towards subregional or regional multinational corporations.

## **II. Macroeconomic performance**

9. The most salient economic development of the 1990s has been the renewal of growth in a context of greater concern about domestic macroeconomic imbalances. Renewed growth has been especially evident in Latin America, where gross domestic product (GDP) has grown at a higher average rate than during the previous decade (2% per year between 2000 and 2001 as against 1.0% in the 1980s, or, in per capita terms, 0.5% versus -0.9%), a pattern that characterizes most countries in the region. The increased concern with domestic macroeconomic imbalances among national authorities is reflected not only in the fact that fiscal deficits have been reduced to an average range between 1% and 2% of GDP (albeit with some exceptions, and an increase during the recent crisis), but also in the fact that inflation in Latin America has been stabilized at its lowest levels in half a century; it has stood at an annual rate of 10% or less since 1997 and has been brought down to single digits in most countries. In light of the major fiscal imbalances that had characterized the Latin American economies since the late 1970s, and given the long inflationary history of a number of them, especially in South America, these achievements are quite significant. They have translated into greater confidence in the region's macroeconomic authorities, though they have not brought stability of capital flows.

10. Nevertheless, the region's average growth rate is still too low to close the gap that separates it from the more developed countries; it is also below the rate considered by ECLAC to be desirable and necessary in order to overcome the serious problems of poverty afflicting the region. This growth has also been significantly slower than that experienced by Latin America between 1945 and 1980, namely, 5.5% per year or 2.7% per capita. This is the case even when the comparison is based on simple averages (4.9% and 2.1% respectively) so as to isolate the effect of the region's largest countries, Brazil and Mexico, whose economic growth in the 1990s was far below historical rates. The pattern of a slowdown in comparison with the three and a half decades preceding the debt crisis has been evident in most Latin American countries; indeed, the only exceptions are those countries whose performance was relatively poor during that period.

11. In itself, the fact that growth slowed down in comparison to pre-debt-crisis patterns raises questions as to whether reforms have had the strong positive effect on economic growth that some analysts believe they have. According to a recent ECLAC study, the effects have been positive, but only moderately so. In any case, given the variety of experiences in different countries in terms of the intensity of reforms, the different macroeconomic policies accompanying them and the overall outcome of such policies, it is difficult to make simple inferences about the impact of reform.

12. The trend in investment rates corroborates these observations. Although the investment ratio has generally recovered, it was not until 1997 and 1998 that the simple average ratio (which better reflects improvements in the relative strength of capital accumulation in smaller countries) reached levels comparable to those of the 1970s. The

weighted investment ratio, however, remained below the levels of the 1970s. Furthermore, the incremental capital-output ratio has been much higher in the 1990s than in the 1970s (6.6 versus 4.8), which shows that the pace of investment has been less effective in promoting economic growth .

13. Macroeconomic cycles also reflect a marked dependency on the ups and downs of external financing. In the light of the changes in capital flows, two entirely different stages may be discerned in the last decade. The first was characterized by a notable increase of capital inflows to the region, which facilitated the application of successful anti-inflationary programmes in several countries and the implementation of structural reforms. The upturn in flows and the success of anti-inflationary programmes, alongside initially underutilized production capacity, were fundamental factors contributing to the rapid recovery of growth in the region in the first part of the decade (4.1% in 1990-1994). The great instability of capital flows that began with the so-called tequila effect led to a period of lower GDP growth (3.1% per year for 1994-2000) and marked instability in growth rates. Other signs of this dependence on foreign financing are the high sensitivity of the trade balance to levels of economic activity and the tendency to replace domestic saving by foreign saving that is common during times of renewed growth associated with capital inflows. It should be noted that national financial crises have been frequent during the 1990s; this was a worldwide phenomenon. These crises have absorbed considerable fiscal and quasi-fiscal resources in many countries and have affected the very functioning of financial systems, sometimes for extended periods of time.

14. The rapid growth experienced by some countries during the early 1990s has subsequently slowed down. Only Chile, which achieved especially high levels of capital formation in the 1990s, maintained a slightly higher pace after the tequila crisis. Since that crisis, only one country, Dominican Republic, has increased its growth rate to over 5% per year.

15. It should be noted, moreover, that macroeconomic management has not been immune to the sensitivity shown by economic growth to capital flows, the propensity to domestic financial crises or the problems relating to productive restructuring mentioned below. This brings to light certain contradictions between different objectives and economic policy tools. In particular, the strong bias in favour of currency revaluation that has characterized the boom periods of the 1990s has been responsible for the serious adjustment problems faced in several countries by sectors that produce tradable goods and services, as well as for the speculative attacks that have accentuated instability and increased the risk of financial crises. Also, in many countries, the tendency to adopt pro-cyclical monetary and credit policies, which foster lending booms and sharp drops in interest rates during periods of expansion and marked monetary contraction and high interest rates during crises, has been the underlying cause of national financial crises and unstable economic growth.

### **III. Social trends**

16. The economic development has been characterized by the weakness of social linkages, reflected, in particular, in the performance of labour markets. Despite the economic recovery, open unemployment rose by almost three percentage points during the 1990s and shot up quite suddenly in some countries, particularly during the tequila

and Asian crises. Indicators of a deterioration in job quality are even more widespread, as shown by the relative increase in employment in low-productivity sectors, primarily in the informal sector, which accounted for seven out of 10 jobs in urban areas in the 1990s. This deterioration is also evident in the relative increase in temporary employment and in the number of individuals working without a contract in various countries. There are, of course, important exceptions to these negative trends, both in countries where several labour indicators have improved (Chile, Dominican Republic, Panama and Uruguay) and in sectors that have actively promoted job creation throughout the decade in several countries.

17. It is clear that the type of international specialization that has been emerging in Mexico and some Central American and Caribbean countries is more labour-intensive (although often involving unskilled labour), while in South America, activities tend to be more capital- and natural-resource-intensive.

18. The considerable increase in the income gap between skilled and unskilled workers – which has grown by 18%-24% on average in the region– has been an even more widespread phenomenon than the slow growth of employment, basically as a result of the widening of the income gap between college-educated workers and others. Hence, the greater participation of women in the labour market is the most common favourable pattern to be found in the current trends in labour markets. In a number of countries, women's participation has been accompanied by a reduction in the income gap between men and women, which still remains high.

19. Another important advance on the social front has been the gradual reduction of the high levels of poverty that were inherited from the “lost decade”; these figures fell from 48% of population in 1990 to 43% in 1999. Nevertheless, the size of the poor population remained slightly above 200 million until 1997 and rose to 211 million during the recent crisis. This increase was concentrated in the South American countries, which were hard hit by the Asian crisis. In addition, the phenomena connected with hard-core poverty have been reflected in the serious problems being faced by the countries (even those that have been most successful in reducing poverty) in their efforts to combat extreme poverty, especially in rural areas. Trends in regard to poverty have varied around the region. In any case, there are some countries where poverty is still greater than it was in 1990 and others where it is greater than it was before the debt crisis. The factor that has most significantly affected the aggregate result is economic growth. There has not, however, been an automatic relationship between high growth and reduced poverty. The relationship has been strong only when growth has been accompanied by strong creation of good jobs —a pattern which, as we have seen, has been absent in most countries of the region. This is why economic growth in a number of countries has not translated into a proportional reduction of poverty.

20. Some countries have succeeded in reducing poverty by efficiently channeling monetary transfers from the public sector towards poor households and checking hyperinflation, which was hitting the low-income population of some countries hard at the beginning of the decade.

21. Unlike poverty, changes in income distribution have been very uneven throughout the region and show no sustained tendency to improve. In fact, although comparing data on income distribution over long periods of time is a complex matter, there may be no country in the region where inequalities are lower than they were three decades ago

(when measuring instruments were already in place in a number of countries), and in many countries, the inequality is greater today. This unfavourable trend has aggravated the pattern of poor income distribution that had already existed in the Latin American and Caribbean countries during earlier stages in the development process. Hence, the lack of equity is not just a characteristic of the current development model, but a pre-existing condition that reflects serious problems of social stratification that have been handed down from generation to generation.

22. ECLAC studies show that the inequalities are due to a combination of factors relating to education, demographics, employment and the distribution of wealth. As regards the first two, some progress was made during the 1990s, although not enough, to be sure, given the increasing demand for skills on the new regional and international scenes. One sign of this situation, as noted above, is the growing income gap between college-educated workers and others; from the standpoint of distribution, this gap has offset the favourable effect of improvements in the average educational levels of the population. In some countries, there has also been some narrowing of disparities between the incomes of workers who have received only primary education and those who have some secondary education. This has had a positive effect in terms of traditional measurements of income distribution; at the same time, however, there has been a greater dispersion of incomes among college-educated workers, the negative effect of which may be more significant. In view of the increasing educational requirements for all occupations, even the significant progress that has been made in educational levels has been inadequate in terms of improving employment opportunities and earning power.

23. Indeed, the tension between income concentration and openness in trade and investment in Latin America and the Caribbean has become the most acute in the world. This brings forth the need to rethink our development agenda.

# **The Regional Perspective of the Economic Commission for Africa on Globalization**

## **I. The Challenge for African Countries**

1. The key challenge for African countries is to design strategies and policies to maximize the benefits from globalization while at the same time avoiding or minimizing the disruptive consequences to their societies and economies. Africa is the weakest partner in international interdependence; this testifies to the enormity of the tasks at hand to re-position the continent into the mainstream of international economic interaction and development. Exports are vital for Africa's economic development. Most African countries offer very small home markets: populations are small and income per head is low. It is, therefore, harder to follow the route of middle and large countries, which has been to produce first for the national market and then for regional and/or world markets once producers have become experienced and competitive.

2. The weak capacity prevailing in many African countries is also reflected in lack of: capacity to understand the linkage between trade and development and thereby mainstream trade in development; technical capacity to analyse trade issues and their implications on African economies; capacity to understand and appreciate the legal complexities of multilateral and bilateral trade agreements and arrangements; capacities to implement the Uruguay Round and WTO Agreements; and capacity to effectively deal with supply constraints that inhibit African countries from being effective partners in the global economy

## **II. Adapting to Globalization**

3. From the point of view of a strategy and its accompanying actions, the key factors underlying the marginalization of Africa can be grouped into two broad categories. First, structural constraints and policy inadequacies of many African economies that result in supply bottlenecks, non-diversified output, low domestic savings, and inadequate inflows of foreign savings for investment. Second, an international economic system that still poses unnecessary obstacles in the efforts of African countries to benefit from the process of globalization. Thus, actions are required at the country, regional, and global levels.

### **A. Country-Level Policies**

4. Africa needs to pay sufficient attention to the domestic part of the policy equation defining international outcomes in trade, investment and financial flows. Research on Africa's export performance shows that Africa has progressively lost her global market share in traditional exports to a broad range of competitors due to domestic supply factors that reduced the competitiveness of exports. Some of these factors are amenable to macroeconomic and structural reforms.

5. The nature and timing of domestic policy responses to external shocks has a strong bearing on the course of growth and development in the globalized environment.

While most countries have undertaken substantial economic and political reforms, aimed at laying the foundation for sustained growth and development, there are significant policy measures that remain. The cost to Africa of loss of competitiveness has been phenomenal.

6. Taking country-level actions focusing on a number of key priority areas is essential. Two such areas are of special interest to African countries: (i) macroeconomic; and (ii) industrialization and trade policy. The benefits of macroeconomic, industrialization and trade policy coherence are well understood. In these areas, country policies need to be consistent, coherent and aligned with those of other countries to strengthen regional efforts to enhance the same national objectives.

#### Macroeconomic policy co-ordination and consolidation

7. Africa needs to consolidate macroeconomic stability by continuing to undertake sound fiscal and monetary policies including realistic exchange and interest rates, as well as maintaining an outward oriented trade and investment strategy. In this regard, there is a need for fiscal consolidation, which, among other things involves strengthening tax and customs administration, as well as re-allocation of expenditures from non-priority areas. Resources released should go to social and development sectors, such as basic, secondary and technical education, health, and infrastructure. More importantly, there is need to establish safety nets for addressing poverty and the adverse consequences of economic reforms on segments of society. At the same time, and given the limited revenue resources, there is need to develop incentives to attract the participation of the private sector in the provision of some of the basic social and economic services, such as infrastructure, education and health.

8. In the financial sector, it is essential for African governments to deepen and enhance the reforms that have already begun in order to mobilize savings, attract foreign capital and increase the efficiency of financial intermediation. This should be done paying particular attention to the need to develop sub-regional frameworks for delivering these services, as a key step to supporting regional trade. While significant progress has been made in this area, important issues remain:

- Most central banks still lack the necessary autonomy, and banking supervision and regulation are inefficient and subject to political pressure.
- The range of financial products is very limited and many financial institutions are fragile.
- The payments systems in most of the countries are inefficient and cannot ensure rapid settlement of transactions, and interbank markets are very thin.

9. These constraints reduce the efficiency of financial intermediation, raise borrowing costs, reduce savings incentives, and increase the risk of bank failures. In the period ahead, these impediments should be removed to lay a foundation for the development of a dynamic and efficient financial sector – which is critical for the social and economic transformation of the continent. Moreover, specialized financial institutions and instruments for mobilizing long-term savings as well as mechanisms for extending credit to the rural sector should be established.

## Industrialization and trade policy

10. Development cannot occur without industrialization. At the core of the development strategy for Africa should be the need to promote co-ordinated trade and industrial development, in a regional integration framework with a stable and predictable policy environment. Maintaining a credible and stable policy framework is essential to minimising risks investors associate with possible policy reversal. Public policies charting the course of trade and industrialization are necessary because many African countries exhibit complex market imperfections and market failures, which are associated with externalities and economies of scale, imperfect and asymmetric information, co-ordination problems, deficient capital markets and the absence of supporting institutions and skills. Under such conditions, entrepreneurs are usually not prepared to undertake the investments necessary for industrial take-off. Government intervention is, therefore, required to provide protective support while at the same time promoting competitiveness. East Asian countries' experiences support this approach.

11. For Africa, as regional integration advances and industries become more competitive, countries need to accelerate the pace of removing trade restrictions, which tend to create inward looking tendencies by local entrepreneurs who do not seek export opportunities, thus preventing the economy from achieving attainable higher growth. Moreover, high tariffs and non-tariff barriers can significantly raise prices for production inputs in manufacturing activity and greatly diminish potential exporters' ability to compete in foreign markets.

### **B. Regional Level Actions**

12. To ensure the success of the strategy to accelerate the pace of Africa's integration into the global economy, Africa needs to intensify its efforts at mainstreaming regionalism in the development process. The open regionalism concept should be applied not only to enlarge the economic space, but also to lock in trade reforms – and by negotiating regional convergence criteria on macroeconomic, regulatory, and infrastructure reforms –important as they are. However, the process of regional integration should be premised on three dimensions. Firstly, by extending and connecting Africa's physical space, with efficient regional infrastructures. Secondly, by integrating the production structure of key goods and services. Thirdly, by integrating markets, through trade liberalization, monetary harmonization, and facilitating private sector business interests and involving the private sector in the planning and implementation of this aspect of integration.

13. This means that the process will require broadening the areas of integration beyond macroeconomic policy co-ordination, trade liberalization and a common external tariff. Regional integration must include non-traditional areas for cooperation, particularly in the following:

- Regional transport and communication and other infrastructure projects, such as power projects;
- Higher education and training institutions and programmes, particularly science and technology education;
- Information and communications technologies and content;
- Conflict, post- conflict reconstruction and peace building;
- Institutional capacity building;

- Promoting regional capital markets development;
- Natural resources development planning, particularly for large projects – especially those where the resources straddle national borders;
- Agriculture and food security; regional grain marketing and drought early warning systems;
- Systematic learning from the experience of others who have successfully integrated their regional economies.

14. Africa, by moving ahead with the creation of an "African Union", has undertaken a historic opportunity to accelerate regional integration. The African Union is an expression of the political commitment of African leaders to regional integration and to a united Africa. A strong regional economy can facilitate the pooling of risks between otherwise vulnerable economies and enable Africa to exploit complementarities and attract FDI. For Africa to become an active player in the global economy, the process of regional integration must focus on improving Africa's competitiveness, integrating markets through trade liberalization, harmonizing monetary policies and promoting private sector investment.

### **C. Global Level Actions**

15. A composite of international actions will be needed in support of Africa's development and better integration into the world economy. Such measures should encompass the areas of trade, market access, debt and resource flows.

#### Trade

16. Future rounds of negotiations need to go beyond trade liberalization to address the broad development needs of Africa, particularly the need for full liberalization of export commodities in which Africa has a comparative advantage. The international community should facilitate “a development round” during the next trade negotiations. Specifically, such a round should be one that takes up explicitly the question of adapting obligations and the timing of their implementation, to the needs and capacities of the poorer members of the WTO.

17. In this spirit, the main components of a development-oriented agenda of trade negotiations would need to ensure the developmental dimensions of trade liberalization – notably agriculture, whilst taking into account the special role of agriculture in developing countries and the need for food security and of services of particular interest to developing countries. It would also need to address a number of issues of interest to developing countries including: a fairly large across-the board reduction of tariffs, particularly peak agricultural and industrial tariffs for products of major export interest to developing countries; substantial expansion of the tariff rate quotas for developing countries and binding- in quota tariffs at the same rates as the average tariffs applicable to manufactured products.

18. Such negotiations would further need to agree on tighter disciplines on subsidies, including the removal of agricultural export subsidies and production incentives, and more stringent disciplines on export credit and associated measures in developed countries; and stricter disciplines on anti-dumping and countervailing duties.

19. In order to increase trade opportunities for Africa, it is therefore necessary to both tackle market access problems of these countries in developed economies, and also address the weaknesses that make it difficult for African countries to take advantage of the market access that they already have been given under various initiatives. An integral part of this aspect will need to be promoting mainstreaming trade into African countries' overall development strategy, and ensuring that trade-related technical assistance is coherent with, and complementary to, trade policy aims of the country concerned; and through the partnership, encouraging greater political priority in Africa for regional trade integration.

20. The issue of whether a new round of multilateral trade negotiations should be launched at the Doha WTO Ministerial Conference has as yet to gather a critical mass of WTO members. As African countries prepare for that meeting, a number of concerns have emerged. These include: the need for the negotiations to adequately deal with the major issues that have emerged in the negotiations on trade in agriculture and trade in services; the importance of moving forward in the discussions on "implementation issues"; the need to adequately deal with some of the asymmetries in the WTO Agreements between rights and obligations, especially in the TRIPS and TRIMS Agreements, anti-dumping and sanitary and phytosanitary measures. Other concerns include the need to avoid overburdening the negotiations for developing countries, through inclusion into the agenda of the WTO of the "new issues" as well as the importance of providing fast track mechanism for accession of LDCs to the WTO. Progress on negotiations on agriculture and market access is crucial for many developing countries (including those in Africa), prior to Doha, at Doha and after Doha.

#### Financing Africa's development

21. Trade is one facet of external sources of financing for Africa's development. At present levels of savings (about 15 percent of GDP) and projected ODA, and if the poverty reduction targets of the World Social Summit are to be met, there remains a financing gap equivalent to 9 percent of GDP. While private rather than public transfers will eventually be the decisive factor in sustaining growth, public investment in infrastructure and the social sectors needs to increase rapidly in Africa over the next few years in order to reduce operating costs of private enterprises and increase competitiveness. Two sources for financing those investments could be official development assistance (ODA) and debt relief.

22. **Official Development Assistance:** ODA in the past helped to bridge the resource gap and hastened the developmental process in a number of countries. International partnership has long been an important component of African development. But this has had a mixed record in terms of delivering development objectives for Africa. Lessons have been learned that enable us to derive key guiding principles that can stand as a minimum for making future development partnerships work. Towards this goal, a new partnership for improving ODA should be based on four fundamental guiding principles, namely:

- **African ownership** of visions and goals for national development, as well as policies and programmes for poverty reduction and the increased participation of African countries in the global economy.

- **Stable long-term resource flows** to Africa and the predictability of long-term donor support.
- **A transformed partnership** based on mutual accountability to agreed development outcomes, including peer review and performance monitoring among both African countries and international partners.
- **Recognition of Africa's diversity.** Some countries can immediately benefit from the full range of measures outlined, while others need to make progress in governance and economic management before they will qualify.

23. **Debt Relief:** Debt relief is a potential non-conventional source of financing public investment and poverty programmes, which also improve business confidence for private sector financial flows. Key actions needed are:

- Looking at debt initiatives not in terms of a sustainability issue, but in the context of the continent's overall development financing needs;
- Linking the impact of debt relief and the objective of poverty reduction;
- Strengthening the political will and moral courage on the part of creditor nations and institutions to resolve the debt overhang issues;
- Developing an effective partnership with African nations for a durable solution to the debt crisis, with the possible involvement of third-party mediation, if necessary at the technical and negotiating levels, to arrive at a fair arrangement, including debt moratorium options on terms designed to enable African economies to grow.
- Helping Africa to strengthen information management, administrative capacity and political structures to effectively manage and control public expenditure programmes for proper debt management in Africa.

24. The development problems of Africa are also problems for the entire international community and in particular the developed world. The contribution of the international community will, therefore, be important in addressing the constraints African countries face in their efforts to integrate into the global economy. That contribution is likely to further energize African countries to deepen their domestic policy reforms in a sustainable manner.

## **The Regional Perspective of the Economic and Social Commission for Western Asia on Globalization**

### **I. Globalization and the ESCWA region**

1. The countries of the region have shown their commitment to globalization through their support of initiatives aimed at enhancing global trade. Seven of the thirteen ESCWA members are now members of the World Trade Organization (WTO), three have observer status, and one has expressed its wish to join. Only two members have not yet initiated steps towards accession. Some countries of the region have concluded association agreements within the Euro-Mediterranean Partnership framework, while others are in the negotiation process.

2. Moreover, with the advent of globalization, regionalization was reinforced by the creation of regional economic groupings and free trade areas worldwide. Despite the transformation, the regional perspective remains the weakest link in development.

3. Notwithstanding such achievements, globalization in the ESCWA region is slow compared to other developing regions in terms of both trade flows and its ability to attract capital flows. The ratio of manufactured exports to total exports—a good indicator of competitiveness in foreign markets—is below the average for developing countries. The bulk of foreign export earnings still comes from oil sales. The share of the region's non-oil exports in total world exports and imports dropped sharply in 1990 compared with the 1980s. There is a lag in both the extent and the speed of integration; the gap is evident in the performance of the ESCWA members in the 1990s, a period during which most other developing countries witnessed a surge in trade integration. The lack of political stability in region is one of the main obstacles facing regional integration and, consequently, the integration of ESCWA countries into the world economy.

4. Trade restrictions have been reduced in some countries of the region but remain high in many others. The most significant steps towards easing these restrictions have been taken by the members of the Gulf Cooperation Council (GCC).

5. Another area in which the countries of the region lag behind is foreign direct investment (FDI). The ESCWA members have attracted only a modest amount of FDI, on average, and their net portfolio capital inflows tend to be lower than those of other developing countries. This has been a mixed blessing; the region has forgone potential benefits but has also been less exposed to the financial vulnerabilities experienced in East Asia, Mexico and Russia.

6. Privatization efforts have generally continued unabated, with particular progress made in the services and telecommunications sectors, and there is now greater emphasis on competition and reliance on market forces. There has been a discernable move away from centralized State control towards State management of a combination of public and private sector activities; however, the process has been quite slow.

## **II. Opportunities of globalization**

7. Globalization brings vast opportunities for the region. The potential exists for higher economic growth, flexibility and dynamism; surges in exports; higher productivity and better allocation of resources; better governance through partnership and a more equitable and efficient sharing of tasks between the public sector, the private sector and non-governmental organizations (NGOs); increased use of modern technologies; the development of a more specialized and skilled labour force. However, the rough path to globalization needs to be better paved before the region can reap such benefits. A strong political will, coupled with tremendous advocacy efforts, will be needed to institute the reform measures required in the different spheres of activity. Skill-intensive industries should be targeted and lean production systems applied to capture the benefits deriving from WTO membership.

## **III. Risks associated with globalization**

8. Before the region can hope to take advantage of the enormous opportunities brought by globalization, it must overcome numerous obstacles and minimize the risks involved. A wide range of problems must be addressed; particular effort should be made to combat unemployment and marginalization, establish an enabling environment, overhaul the legislative system, institute policies and laws to upgrade the infrastructure, especially in the information and communications technology (ICT) sector, and facilitate the shift from an economy dominated by the public sector to one based on cooperation between the public and private sectors and NGOs.

9. Rising unemployment, at least in the short- to medium term, is one of the most prominent risks associated with globalization in the ESCWA region. This is particularly true for six members already facing very high rates of unemployment. The problem is compounded by the decades-old policy of “stuffing” the public sector with new entrants to the labour force, which has resulted in underemployment from a labour perspective, and in overemployment and inefficiency from a bureaucratic perspective.

10. Even without the added pressure of globalization, unemployment figures are expected to rise in the coming years as a result of increasing numbers of new labour force entrants (youth comprise a large proportion of the population); relatively low rates of economic growth, especially in real terms, which limit the creation of new job opportunities; and the inability of the private sector to provide sufficient employment opportunities to take up the slack. With the compounded effect of the temporary displacement of workers once protected sectors are open to competition even for a short time, the problem will be exacerbated and might pose a threat to social stability.

12. While the region is not characterized by the incidence of extreme poverty, it does contain pockets of poverty, especially in the non-oil-producing countries; rural areas are especially vulnerable. Rising unemployment and underemployment, low labour productivity and inflexible wage structures will lead to an increase in poverty rates, at least in the short term. Unemployment and underemployment are major factors contributing to marginalization and social exclusion.

13. Notwithstanding the initial increase in unemployment, globalization is expected to contribute to increases in trade, labour productivity, and skill development, and thus to better employment opportunities, in the long run. There is an urgent need to raise the quality and effectiveness of the region's education and training systems to enable the labour force to acquire the necessary tools and adapt to the requirements of a globalized market. Labour market distortions will also have to be reduced. Of particular importance is providing youth and others that may be adversely affected by the globalization process with technical and educational skills and training in order to enhance their capabilities and hence their competitiveness and employment prospects.

14. Policies and strategies need to be designed and implemented to increase labour productivity and render wage and labour structures more flexible in order to increase the competitiveness of local products and provide more employment opportunities in the region.

15. ICT is the driving force behind globalization. It has provided a means of accelerating growth and promoting sustainable development in South-East Asia and elsewhere. Many developing countries are on the wrong side of the digital divide, however, and urgent efforts are needed to bridge the rapidly widening gap.

16. The ESCWA region needs to accelerate its pace in the adopting of and adaptation to ICT. There are some regional differences in this respect; most of the oil-producing countries are faring better than the more diversified economies. The relatively low level of ICT integration may be largely attributable to the poor quality of education in the region. Participation in the information and telecommunication revolution necessitates the availability of a highly skilled labour force with a strong knowledge base. The dearth of Arabic-language content and relevant applications on the Internet and the relatively high cost of access constitute additional barriers. If the countries of the region are to avoid being marginalized, they must implement national development strategies that emphasize investment and work to improve their basic ICT infrastructures and facilitate human resources development.

17. Small and medium-sized enterprises (SMEs) in the region will need help in the early stages of joining the globalization process. These (mainly private) enterprises make a substantial contribution to output, employment and trade, but will inevitably bear the brunt of the challenges associated with globalization and will therefore require assistance. Thus far, very little has been done to meet their needs.

18. Globalization will have a significant impact on government earnings in the ESCWA region; tariff revenues currently account for a sizeable share of State revenues. Finding ways to compensate for those revenues represents a challenge for Governments, especially those that have budgetary deficits and/or large public debt and debt service burdens.

19. Financial volatility is a risk associated with the liberalization and opening of financial markets. Many problems in this area may be avoided if the countries of the region can apply the lessons learned by others. It is recommended that the ESCWA members establish safeguards, set up institutions for monitoring and regulation, and adopt relevant policies and measures before their financial markets are fully liberalized.

The countries of the region will gradually be required to shift their resources to more competitive sectors or areas. Well-designed programmes are needed to ensure the availability of a trained labour force, adequate infrastructure and necessary services. Information must be easily accessible (through the Internet), and transport facilities and procedures must be streamlined and made more efficient. In short, steps should be taken to enable the productive sectors to reach outside markets at minimal cost and with minimal delay.

20. Experience over the past several decades has shown that globalization tends to be associated with wider income disparities within countries and between developed and developing countries, and with the marginalization of some segments of society. This development pattern is not sustainable. Special measures are needed to address the social implications and manage the social impact of globalization, especially as it affects the most vulnerable groups in society.

#### **IV. Regionalism and the role of ESCWA**

21. Against this backdrop, regional economic integration becomes a critical issue for ESCWA members. Its urgency stems from two considerations: the first relates to the complementarity of physical and human resources at the regional level; and the second to the radical changes in the world economy, particularly with respect to world trade, which underline the need for regional integration as a transitional step towards integration at the international level. The ESCWA members have a variety of resources; some are oil-rich, while others have vast agricultural potential; some have an excess cheap labour, and there are those that have an abundance of skilled manpower. Regional integration would allow these countries to achieve complementarity through the appropriate combination of requirements and endowments; all could benefit from the free flow of capital and labour and economies of scale. Economic integration would give these countries the opportunity to better define and optimize the division of labour, based on comparative advantage, so that they may avoid the duplication of work and agree on areas of specialization, again in pursuit of complementarity.

22. WTO rules allow regional trading arrangements, providing certain criteria are met. Such arrangements should permit the free flow of trade between the members of a regional group without erecting barriers against non-members. This type of regional interaction allows developing countries to increase their trade competitiveness and strengthen their financial markets in a less risky environment, which makes them better prepared to deal with global trade competition and the volatility of capital markets. Within such a framework, regional and multilateral integration initiatives may be complementary rather than mutually exclusive. Regional integration is an important step in increasing the preparedness of developing countries for globalization.

23. Regions such as Eastern Europe and Asia are becoming increasingly competitive in the world market. Integration among ESCWA members would stimulate growth and employment and increase regional competitiveness, and would constitute a building block in terms of global integration. The potential for effective interaction remains largely untapped in the region, especially with regard to trade and investment flows. Widening markets by dismantling national economic barriers will serve a number of broader objectives: countries can raise their levels of productivity and competitiveness, create and benefit from increased opportunities for economies of scale, attract more

domestic and foreign investment, pool their resources to achieve technology-related goals, and rationalize their investment in other areas through a more efficient allocation of resources. In this way, the region's economies may be strengthened and new capabilities developed so that the ESCWA members may hold their own in the world markets.

24. The role of ESCWA in furthering regional integration is perhaps most evident in its efforts to build consensus, foster harmonization of norms, standards, procedures and legislative instruments in the areas of industry, technology, transport, agriculture, statistics and other areas and the adoption of concerted sectoral policies; providing advice on appropriate areas of specialization and the division of labour, and identifying appropriate mechanisms for the realization of these objectives. In addition to, and in support of, these efforts, ESCWA is also providing advice with regard to human and institutional capacity building, reform and liberalization policies, and achieving complementarity in the exploitation of resources. The larger goal, as mentioned above, is to raise competitiveness and efficiency and thereby ease the transition to global economic integration.

25. In specific terms, The ESCWA secretariat plays an active role in helping the countries of the region benefit from opportunities to catch up with globalization. By promoting and facilitating regional integration, it helps the member countries gradually adapt to the global set-up. The secretariat alerts the members of the Commission to the opportunities and the challenges associated with WTO membership, and provides them with assistance in various areas in that domain. Particular attention is currently being given to the General Agreement on Trade in Services (GATS), in the light of relevant negotiations for the upcoming Ministerial Meeting in Doha. Through its meetings and workshops, the secretariat provides a platform for the exchange of views and experiences and the sharing of lessons learned, for countries which have acceded to WTO and those who wish to accede, has proved especially beneficial for the latter. It is also playing an active—and crucial—role in the development of the Integrated Transport System for the Arab Mashreq (ITSAM), which is expected to facilitate the international transport of goods and open up new opportunities for economic growth and development. ESCWA is promoting the adoption of science and technology (S and T) policies and their integration in the socio-economic development process, as well as the creation of new institutional forms that foster closer linkages between parties concerned with S and T capacity-building, including SMEs.

26. While developing countries may benefit greatly from globalization and liberalization, the conventional view that liberalization should automatically be pursued is to be approached with some caution. If the conditions for success in a country are not ripe, proceeding with trade liberalization may have adverse effects; determining the appropriate timing, sequence and scope of liberalization are vitally important. This is another area in which ESCWA can play a role.

27. In sum, globalization can open many doors for ESCWA members, provided they are ready and able to advantage of the available opportunities. To that end, they must prepare themselves by adopting appropriate strategies and policies, implementing the necessary reform measures, and accelerating efforts to achieve increased regional integration in order to ready themselves for the fiercer and wider competition at the international level.

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