

United Nations Commissions for Europe

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REGIONAL PERSPECTIVES ON GLOBALIZATION:

AN OPPORTUNITY FOR CATCHING UP OR A RISK OF FALLING BEHIND IN THE DEVELOPMENT PROCESS

1. The term "globalization" is used indiscriminately to cover a large mixture of statements or beliefs, on the one hand about how the world economy, and especially the relations between its component parts, is actually developing and, on the other hand, assertions about whether or not progress towards a global economy is in fact desirable. In fact, the term is used to cover such a wide range of issues, ideas and assertions, that it is virtually meaningless for analytical as opposed to rhetorical use.
2. Nevertheless, it is clear that globalization is used in both a descriptive and a normative sense. On the one hand it claims to describe various processes of international integration which have led - or are leading - to the point where national boundaries, and national authorities, become increasingly irrelevant to the decisions taken by economic agents. On the other hand, the process of globalization is also seen in normative terms: many governments and policy makers, especially in North America and Western Europe, as well as large multinational companies, tend to see it as one which is essentially benign in which open trade and foreign investment régimes will lead not only to faster growth for the world economy but also to increasing convergence of national incomes per head across the world, since developing and transition economies can expect to benefit more than average from increased openness. The normative programme is therefore to achieve these objectives by giving as full a reign as possible to market forces and reducing the role of the state, and of any form of interference with market forces, to a minimum.
3. In a short note, it is not possible to "deconstruct" the idea of globalism and examine all the positive and normative statements with which it is associated, but most of them would appear to be open to question or at least in need of significant qualification. Consider the claim that the late 20th Century has witnessed an unprecedented rate of technical change and, especially, a revolution in communications and information technology. Without denying that there has been significant technical progress in recent years, can it really be claimed that the pace of change is greater than in the late 19th Century when the speed of communication between North America and Europe, for example, was reduced in the

1860s from several days sailing time to the minute or so that it took to send a telegraph message? This development, in conjunction with the technologies of the steamship and railway led to a boom in foreign investment and to a degree of openness (measured by the ratio of merchandise trade to GDP) that for many countries before the First World War was as high or higher than in the early 1990s. The earlier period was still characterized by generally high rates of protection of merchandise trade; what was more striking was the considerable mobility of capital and labour.

4. International trade and foreign direct investment, which are two main vehicles of global economic integration, are greatly influenced by the activities of multinational corporations. They generate considerable effects in local economies, but to assess their full impact requires further progress in overcoming difficulties related to both conceptual and measuring issues. The common view that multinational corporations are bringing about a close convergence of national economies through their integration of innovation, trade and investment has been shown to be wide of the mark, in large part because "the MNCs themselves are not converging toward global behavioural norms ... the most strategically significant operations of MNCs continue to vary systematically along national lines. The global corporation, adrift from its national political moorings and roaming an increasingly borderless world market, is a myth". This is not to argue that there are not important issues concerning the role of MNCs in national economies and their relations with governments and society at large - but in the main these concern perennial questions of corporate power and are not new.
5. It is claimed that the process of globalization has made national boundaries and authorities less relevant to economic agents' decisions. National boundaries, however, continue to have a depressive effect on trade notwithstanding gradual disappearance of tariffs, due to high transactions costs introduced by discontinued political and legal systems. Contrary to conventional wisdom we are quite far from international economic integration. It remains remarkably limited.
6. The anticipated benefits of globalization are basically that, via more efficient resource allocation, world income will not only increase but will also be more equally distributed – the relatively poor countries will catch up with the relatively rich. Greater prosperity will encourage the growth of democratic institutions and strengthen the basis for peace.
7. However, actual developments do not appear to fit these benign predictions and we are witnessing growing resistance to the process of globalization, not only from protestors in Seattle and Prague, but also from governments in the developing world. International differences in per capita income have increased over the last 100 years. Convergence of incomes per head has been confined for the most part to the members of OECD and a small number of countries in South East Asia. In addition, there are increasing fears that the increased power of market forces has weakened the authority and power of the state, and the increased mobility of capital has important consequences for government spending and the ability to support social safety nets and welfare.

8. In a truly global economy, complete integration would be signalled by the presence of the law of one price, and the institutional underpinnings of the global economy - the protection of property rights, the enforcement of rules, the conduct of regulation, the maintenance of monetary stability, etc. - would become the responsibility of supra-national bodies. This is a text-book model of a global economy, but a much looser description of globalization is that the increasing volume and variety of cross-border transactions in goods, services and capital flows is moving in the *direction* of a global market by increasing the interdependence of national economies on a world-wide basis.
9. The data on the evolution of the *structure* of west European trade from 1928 to 1998, however, shows that far from becoming more global west European trade has become more and more concentrated on 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.
10. 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 data problems, but the basic picture is that the trade of the transition economies had 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 between 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. 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.
11. 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. It is of course possible that trade flows have been replaced by direct investment abroad, but the data suggest 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 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. 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. In other words, west European foreign investment was more globally oriented before the First World War than in the 1990s.

12. 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? Although a number of factors may have played some role in supporting the regionalization of Europe's trade and investment flows, the fact that such concentration has been high and increasing over a very long period, and especially for trade in manufactures, suggests that fundamental economic influences are at work.
13. 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. This dynamic division of labour could in principle be extended on a global basis, given the steep decline in coordination costs as a result of improvements in communications technology, 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. 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.
14. 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. These factors working towards increased concentration are also likely to trigger cumulative processes which may reinforce the degree of concentration over time. 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. This is the regional level where the major standardization and harmonization processes take place, facilitating economic integration and development of common markets. This is also the regional level where economic policies tend to be coordinated and integration mechanisms developed. Geography still matters and risks are approached more efficiently at the regional level. As

an increasing number of transboundary concerns calls for transboundary solutions, subregional cooperation gradually contributes to strengthening regional linkages.

15. It has been suggested above that although the integration of national economies has increased, the extent of global markets has been greatly exaggerated in current policy debates, although this does not mean that important global developments have not taken place: the liberalization of the international capital markets is clearly one with important implications for national economic policy making and for the stability of the international monetary system. Similarly, the power of "exit" of international companies and capital is also exaggerated; if, as suggested, there are fundamental reasons for their regional concentration there are a limited number of places to which they can flee.
16. In many respects what is more important is not so much the exaggeration about actual developments as the emphasis on an ever widening agenda of liberalization to force the pace of development towards a global economy, an agenda which is accompanied by a rhetoric which insists that the process is inevitable and irreversible. The rhetoric which proclaims that "there is no alternative" is effectively an attempt to stifle debate and criticism, and therefore to undermine democratic processes in both national and international institutions. Those who complain about the costs of transition and adjustment, or about increasing inequality and poverty or falling behind other countries, are judged to have only themselves to blame for not introducing and maintaining the appropriate policies. Such policies may hurt at first, but if they are maintained "all will be right in the end".
17. In ECE we have always insisted on the importance of institutions (including private property rights) and other socio-political variables in determining economic performance, and that is why we have emphasized their crucial role in the transition process in Eastern Europe and the CIS. The evidence of research into the effect of political variables on growth and development strongly suggests that growth and productivity are to a large degree explained by politics, policy and institutions, rather than by endogenous processes of capital formation. The record of the former planned economies of the former Soviet Union and Eastern Europe illustrate the point. They had high rates of employment, high levels of education, and high (albeit forced) rates of savings and investment, and apparently large stocks of physical capital. Yet these resources were inefficiently employed and living standards stagnated. The institutional arrangements, which embody the incentive structures of an economy, were unable to produce efficient outcomes or respond to changes in the economic environment.
18. One of the key lessons to be drawn from this, and it is one that has already been drawn by the international financial institutions in the context of capital account liberalization, is that the benefits of liberalization will not be forthcoming if the crucial institutional framework for a market economy is weak or absent. In such circumstances, rapid liberalization can trap countries at low levels of relative income and block the process of catch-up. In other words, we can have globalization but not integration.
19. As in the case of any process of grand social change, there are both winners and losers of globalization. The idea that globalization is a destructive force is often strongly felt by

those who lose their jobs as a result of restructuring or downsizing – although the causes may be largely domestic, by those who see their elected governments being ready to adopt certain policies as the result of perceived pressures from multinationals or international authorities, or who suffer the consequences of short-term capital flows. It is also felt as a threat to cultural identity, leading often to a need of a new cultural self-identification. Language, ethnic, religious communities get new stimulus to seek of its reassured identity.

20. What we see is a growing conflict between the attachment to national jurisdictions, or national policies, and the growing pressures from increasingly international markets to remove not only traditional barriers to trade and the movement of capital but also to eliminate significant differences in national jurisdictions which impede international transactions. The nationals of each jurisdiction, in turn, see such pressures as an attack on their legitimate preferences and their way of life. This is not a minor issue because for most of the residents of most countries their loyalties are still national or local, and these are not seen as matters which are purely instrumental for economic ends.
21. This points to perhaps one of the greatest challenges for at least the first half of the 21st century: how to reconcile national politics with the demands and opportunities of increasing globalization. One way forward might be to enlarge the scope of national politics to match the expanding domain of economic integration – in other words, to expand the domain of international federalism. For some this implies a world government of some sort, but for the moment this is just a dream of a few idealists – and also a dangerous one if it implies postponing any serious attempt to face the challenge. But a more pragmatic approach is already discernible in the growing acceptance of the need to control disruptive short-term capital movements, in the increasing international co-operation to deal with money laundering, tax heavens and international economic crime. What was dismissed a few years ago as impossible and futile interference with the irresistible force of the financial markets turns out to be quite feasible when governments decide to co-operate in achieving shared objectives. The growth of international standards, rules and regulations, both for individual sectors as well as for the environment and labour, all point to an emerging rule-based system in which the interests of particular groups can be articulated and accommodated. But this process will have to be much more transparent than it is at present and more open to interests other than international companies or the companies will have to demonstrate clearly the openness to social problems. Much of this rule-setting activity takes place behind the closed doors and with limited participation by the non-enterprise sector.
22. More generally, if the problems of democratic governance and the social consequence of globalization are not to lead to a disruptive backlash against the entire process of international economic integration, perhaps in the form of a resort to national protectionism, then ways have to be found to ensure that the benefits are more fairly distributed. It was shown long ago that the crucial argument for free trade, that everyone could be better off, depended on the winners being prepared to compensate the losers.
23. In practice, domestic adjustment strategies incorporating this compensation principle have been notoriously weak. Not only do they need to be revived but they also need to be

extended internationally in a world where the process of liberalization, contrary to the claims of its most aggressive supporters, has not led to a convergence of national incomes per head but to increasing divergence. The major achievement of western democracies after the world war two was to combine allocative efficiency, driven by market forces, with a concern for equity and justice. This is the basic lesson of our history which cannot be ignored. We have to find ways to make global capitalism socially acceptable in order to avoid a lurch to totalitarian alternatives. For the social acceptance this is the domestic – national, regional and local - level that matters.

24. Perhaps the real triumph of capitalism in the 20th century was its ability to regain popular legitimacy via the intervention of governments to ensure low levels of unemployment and more acceptable distributional outcomes. Another feature of the late 20th century capitalism is that has developed in many varieties and is supported by different institutional arrangements. The question now is whether this tolerance of national varieties is under threat from those who see globalization in normative terms. Does the approach which seeks to harmonize policies and to set rules in the areas which have traditionally been regarded as matters for national policy and national preferences represent a radical change from the original philosophy behind the creation of the Bretton Woods institutions. This philosophy was to create an environment of international financial stability that would underpin the development of the world trade that would allow countries to develop.
25. Today we face the same challenge – how to ensure room for national preferences while pursuing the globalization agenda. When countries established new market institutions there is the necessity to enable them to become embedded in the broader framework of national political and social values. If those social and political values and preferences are attacked in the name of the new global economy, the chances are that there will be a backlash against that system of the economy rather than a change in values. Values are universal if you can adopt them your own way. The point of globalization therefore is not that it is global, the point is that it be local.
26. It remains to be seen which values will eventually be shared on a global scale. The question is who will participate in decisions shaping the global agenda. What will be the role of cultural sensitivity. The real issue of globalization is how to manage diversity, how to take advantage of it, how to use it in the world of increasing interdependence. Globalization, especially in the short and mid term, widens gaps between those who are better equipped to benefit from it and those who are not. This is true for any process of a social change.
27. Most of the countries of the world are unable to exploit the opportunities of liberal markets but are very vulnerable to the costs of adjustment. To strengthen the capacity to benefit from open trade and capital movements, good governance, appropriate legislations and institutions, effective implementation of the laws and rules are required, but also a wide range of micro-economic reforms are necessary. This has been underlined by the experience of many transitions economies. But also important is capacity building through education and especially in creating an infrastructure for the better absorption and adaptation of more advanced technologies. Technological change and its diffusion in the South and in many of countries with economies in transition is very slow. For attracting DI,

which can sometimes provide a vehicle for the transfer of technology and modern management techniques, the low cost of labour does not compensate for the low level of productivity and, just as important, the inadequacies of the legal and institutional structure. In this perspective the brain drain, not only a consequence of poor opportunities in many developing and transition economies but also of deliberate policy on the part of a few dominant countries, makes it even more difficult to close the gap between the embodiment of social and institutional capital in the transition and developing economies, on the one hand, and the developed market-economies, on the other.

28. The real challenge for all of us is to get all those affected, involved and caring into one credible, legitimate, transparent and efficient framework for consensus building and decision making. This framework should be sufficiently multilateral to avoid its use for national interests, making all countries feel they have a say, feel they are an integral part of the structure and mechanism. The world has changed so much that nobody should be surprised that there is a need for a new approach to the way we cope with the matters that go beyond national borders. Only if such a machinery is efficient and legitimate, the threat of nationalism can wane. This century is likely to produce more experimentation with international institution building and integration of political systems than ever before. The political revolution of the 90s has given us a chance to create a global market economy and to share the benefits with all of the world's people. This chance has not yet been fully exploited.
29. We all need an in-depth reflection on the key challenge today which is the coherence between globalization and domestic policies. This relationship goes both ways – global developments affect the directions, ways and means of domestic policies, the latter should be a building block of a massive cooperation effort. In this world of today we are increasingly depending on each other. This creates mutual interest – at home, on the country level, where the partnership between governments, business community, civic society is the only way to address major concerns of our societies; at the international level – both regional, interregional and global.
30. The last 50 years have seen considerable policy changes, often going towards extremes that many of us thought unthinkable. Although this is a matter for a debate, it is hardly an effective policy to move from one extreme to another. It follows that a proper balance is of the essence. In everything we undertake, a judicious mixture must be found, combining the best of old and new, hard and soft, global and national.