# GLOBALIZATION: AN ALTERNATIVE VIEW

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This paper explores the trends in globalization especially financial sectors liberalization as promoted by international donor agencies and its impact on developing world with special emphasis on Pakistan. The paper highlights the shortcomings in policy implications of promoting financial liberalization. It discusses the self propagating ideas of international financial institutions having narrowly defined globalization. The view is based on few established economic theories whose assumptions are somewhat unrealistic from the perspective of the developing world lacking flexibility and adaptability. It also emphasizes the consequences of these policy flaws on East Asian economies and Pakistan.

Keywords: Globalization, Pakistan, Asian Financial Crisis

## INTRODUCTION

The process of globalization is a combination of economic, technological, socio cultural and political forces unifying societies. In modern world, globalization is synonymously used for trade liberalization and financial integration.

Trade liberalization advocates free trade model in which trade in goods and services between or within countries flow unhindered by government-imposed restrictions. Restrictions to trade include taxes and tariffs, and other non-tariff barriers, such as legislation and quotas. Trade liberalization therefore entails reductions to these trade barriers. Whereas financial integration can be defined as the extent to which countries are linked through cross-border financial holdings. In discharging its mandate, a key issue for the IMF is to advise member countries about how they can reap the benefits of globalization while limiting its potentially harmful effects on macroeconomic volatility and crisis propensity.

The inherent characteristic of globalization is that money should flow from rich to poor countries, but in recent years it has been going in the opposite direction. While the rich are better able to bear the risks of currency and interest-rate fluctuations, it is the poor who bear the brunt of this volatility. But while the case for trade liberalization is quite compelling, the way it has been pushed by the IMF has been somewhat problematic. The basic logic is simple: Trade liberalization is supposed to result in resources moving from inefficient protected sectors to more efficient export sectors. The problem is not only that job destruction comes before job creation resulting unemployment and poverty but that IMF's structural adjustment programs make job creation almost impossible. These programs are often accompanied by high interest rates that are often justified by a single-minded focus on inflation. What happens is that trade liberalization, rather than moving workers from low-productivity jobs to high-productivity ones, moves them from low-

productivity jobs to unemployment. Rather than enhanced growth, the effect is increased poverty. To make matters even worse, the unfair trade-liberalization agenda forces poor countries to compete with highly subsidized American and European agriculture.

Globalization's advocates are right when they say that it has the potential to raise everyone's living standards. But it has not done that. The questions posed by workers, who wonder how globalization will make them better off if it means accepting lower wages due to cheaper product being flooded into the markets, and weaker job protection, can no longer be ignored. Nor can such questions be answered with the wistful hope that everyone will someday benefit. As Keynes pointed out, in the long run, we are all dead. Growing inequality in the advanced industrial countries was a long-predicted but seldom advertised consequence of globalization. Full economic integration implies the equalization of unskilled wages everywhere in the world, and, though we are nowhere near attaining this "goal", the downward pressure on those at the bottom is evident.

## GLOBALIZATION AND ASIAN FINANCIAL CRISES

Globalization indeed has left some adverse impact on the world. The most recent one is the Asian financial crises. The global economic crisis began in Thailand, on July 2, 1997. The countries of East Asia were coming off a miraculous three decades: incomes had soared, health had improved, poverty had fallen dramatically. Some had not suffered a single year of recession in 30 years but the seeds of calamity had already been planted. In the early '90s, East Asian countries had liberalized their financial and capital markets--not because they needed to attract more funds (savings rates were already 30 percent or more) but because of international pressure, including some from the U.S. Treasury Department. These changes provoked a flood of short-term capital--that is, the kind of capital that looks for the highest return in the next day, week, or month, as opposed to long-term investment in things like factories. In Thailand, this short-term capital helped fuel an unsustainable real estate boom. And, as people around the world have painfully learned, every real estate bubble eventually bursts, often with disastrous consequences. Just as suddenly as capital flowed in, it flowed out. And, when everybody tried to pull their money out at the same time, it caused an economic problem.

Of the countries of the world, those in East Asia have grown the fastest and done most to reduce poverty. And they have done so, emphatically, via "globalization." Their growth has been based on exports by taking advantage of the global market for exports and by closing the technology gap. It was not just gaps in capital and other resources that separated the developed from the less-developed countries, but differences in knowledge. East Asian countries took advantage of the "globalization of knowledge" to reduce these disparities. While some of the countries in the region grew by opening themselves up to multinational companies, others, such as Korea and Taiwan, grew by creating their own enterprises. Here is the key distinction: Each of the most successful globalizing countries determined its own pace of change; each made sure, as it grew, the benefits were shared equitably; each rejected the basic tenets advocating minimalist role for government and rapid privatization and liberalization.

During the 1960s, 1970s, and 1980s, the East Asian economies not only grew rapidly but were remarkably stable. The single most important factor leading to the troubles that several of the East Asian countries encountered in the late 1990s was the rapid liberalization of financial and capital markets. In short, the countries of East Asia benefited from globalization because they made globalization work for them; it was when they succumbed to the pressures from the outside that they ran into problems that were beyond their own capacity to manage well. How then could a trend with the power to have so many benefits have produced such opposition? Simply because it has not only failed to live up to its potential but frequently has had very adverse effects. The most adverse effects have arisen from the liberalization of financial and capital markets which has posed risks to developing countries without commensurate rewards. The liberalization has left them prey to hot money pouring into the country, an influx that *fueled speculative real-estate booms; just as suddenly, as investor sentiment changed, the* money was pulled out, leaving in its wake an economic devastation. Early on, the IMF said that these countries were being rightly punished for pursuing bad economic policies. As the crisis spread from country to country, even those that the IMF had given high marks found themselves ravaged.

Historically, most of the disturbances in capital flowing into and out of a country are not the result of factors inside the country. Major disturbances arise, rather, from influences outside the country[1]. When the world suddenly faced high interest rates, it was because of what happened in USA. The world cannot be blamed for crisis in America.

The liberalization of capital markets has not brought growth: How can one build factories or create jobs with money that can come in and out of a country overnight? And it gets worse, prudential behavior requires countries to set aside reserves equal to the amount of short-term lending; so if a firm in a poor country borrows $ 100 million at, say, 20% interest rates short-term from a bank in the United States or is recipient to equivalent amount of portfolio investment, the government must set aside a corresponding amount in form of reserves. The reserves are typically held in U.S. Treasury bills, a safe liquid asset. In effect, the country is borrowing $100 million from the United States and lending $100 million to the United States. But when it borrows, it pays a high interest rate, 20%; when it lends, it receives a low interest rate, around 4%. This might get even worse for portfolio investment as short term gain sometime is in tune to more then 50% in booming capital markets, would result in similar yet more devastating outcomes. Its like US investing in China and getting 50% returns financed by money borrowed from China at T-Bills rate. This may be great for the United States, but it can hardly help the growth of the poor country. There is also a high opportunity cost of the reserves; the money could have been much better spent on building rural roads or constructing schools or health clinics. But instead, the country is, in effect, forced to lend money to the United States.

[1] Stiglitz, Joseph E., (2004), "Capital market liberalization, Globalization and IMF", Oxford Review of economic policy Vol 20, no.1.

Capital-market liberalization is inevitably accompanied by huge volatility[2] .Recent trends of international capital flows to the developing countries, indicate that large capital flows, that were directed to emerging markets were easily reversible, suggesting that these flows are highly volatile, which is often associated with severe consequences for the economy[3]. Small developing countries find it virtually impossible to withstand this volatility and this also impedes growth and increases poverty. It increases the risks of investing in the country, and thus investors demand a risk premium in the form of higher than normal profits. Not only is growth not enhanced but poverty is increased through several channels. The high volatility increases the likelihood of recessions and the poor always bear the brunt of such downturns. Even in developed countries, safety nets are weak or nonexistent. Without adequate safety nets, the recessions that follow from capital-market liberalization lead to impoverishment. In the name of imposing budget discipline and reassuring investors, the IMF invariably demands expenditure reductions, which almost inevitably result in cuts in outlays for safety nets that are already threadbare. Further more there is another adverse impact in terms of profit outflows made from hot money which causes pressure on current account and further deteriorate the situation. Few studies are made in this regard[4]; These argued that the impact of FDI and other capital flows on the current account is further complicated by the investment income payments that arise from FDI. According to UNCTAD[5], unregulated FDI flows can bring about serious difficulties to balance of payments owing to high import content and profit outflows related to multinational capital.

But matters are even worse under the doctrines of the "discipline of the capital markets". If countries try to tax capital, capital flees. Thus, the IMF doctrines inevitably lead to an increase in tax burdens on the poor and the middle classes. While IMF bailouts enable the rich to take their money out of the country at more favorable terms (at the overvalued exchange rates), the burden of repaying the loans lies with the workers who remain behind. This in fact results in subsidizing capital and taxing poor labor. Making employers substitute labor to capital causing more hardships and unemployment in the poor classes.

Mobilization and allocation of saving through the financial systems are intermediate process. Their role ideally is to keep the cost of borrowing financial resources low while encouraging savings. As a result a liberalized system may lend to a socially unacceptable distribution of credit. And also instability generated through capital markets largely unrelated to market fundamentals.[6]

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[2] Ghosh, A., Ostry, J. D., (1993). "Do Capital Flows Reflect Economic Fundamentals in Developing countries?". IMF Working Paper, 93/94.

[3] Hutchison, M., Noy, I.,2006. "Sudden stops and the mexical wave: Currency Crices, Capital flow reversal and output loss in Emerging markets". Journal of Development Economics Volume 79, Issue 1, February 2006, Pages 225-248.

[4] Jansen, K. (1995) "The Macroeconomic Effects of Direct Foreign Investment: The Case of Thailand" World Development 23, 193-210.

[5] UNCTAD (2002) Trade and Development Report 2002, (United Nations Publication, Geneva). Chapter 1 page 21-27.

[6] Paolo Mauro and Jonathan D. Ostry., "Reaping the Benefits of Financial Globalization", IMF Discussion Paper, IMF Research Department, 2007 pg 24-28.

# IMF SPONSORED GLOBALIZATION AND IT'S IMPACT ON PAKISTAN

The decisive role of IMF (International Monetary Fund) on the policies of Pakistan in later part of its history is evident. In the first decade of its conception, Pakistan pursued a policy of import substituting industrialization[7], whereby it kept its exchange rate overvalued and put some direct quantitative controls on imports in the form of quotas and licensing. This was mainly to regulate the level and composition of imported goods by imposing a highly differentiated tariff structure with lower tariff on intermediary and capital goods and tight control over import of luxury and consumer goods. Export taxes on raw materials were also placed. This by giving more incentives to export capital goods, instead of just exporting raw material, kick started the process of industrialization. 1960s saw an era of immense growth. Industrialization process produced results and in 1965 Pakistan's manufactured exports were greater than those of South Korea, Turkey, Thailand and Indonesia combined. As the process of industrialization started inequality of income emerged and created different social classes. It was only afterwards that this method of directing industrialization through trade policy softened as the country moved from more direct controls to indirect controls.

The 70s witnessed extreme political disturbance causing the country to split. As the new government took charge, a totally new policy based on pro-socialist agenda was introduced. Exchange rate was devalued and most of the economy was nationalized. This was followed by the oil crisis. But despite severe odds, the economy maintained its momentum. The sixth five-year plan (1983-88) marks the beginning of the process of deregulation and liberalization. This was carried out with much greater force after 1988 when Pakistan's economy became subservient to IMF and World banks directives. There was a very strong emphasis in most structural adjustment programs on increasing FDI and portfolio investment. Capital controls were eased with aim to make FDI and other capital flows a driving force for economic growth rather then reliance on domestic savings. IMF programs were supposed to be based on stabilization of country's macroeconomic situation by focusing on balance of payment, insistence to cut aggregate demand through drastic cutback in public spending and higher interest rates, re-aligning the domestic currency with international markets, and above all financial liberalization[8]. But it was only afterwards when IMF backed financial liberalization and trade policies came into hold that the country seemed to be in trouble.

The liberalization drives paid off as there was a sharp surge in capital flows witnessed after 1988 when capital and investment restrictions were removed. Over the year major negative impact that was witnessed was rising income outflows in the form of profits, which were sometimes more than the actual investment, causing pressure on current account. A brief over view of capital flows is given below.

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[7] Zaidi, S. Akbar, "Issues in Pakistan Economy", 2nd Edition. Oxford University press, 2005, Chapter 6 Pg 91-95

[8] World Bank , "Global Economic Prospects and the Developing Countries". (2001), World Bank, Appendix 1, page 140-143.

**Table 1**

| PERIOD | FDI | FDI % GDP | GWT IN FDI | PORTFOLIO | PORT % GDP | GWT IN PORT |
|---|---|---|---|---|---|---|
| 76-80 | 177.61 | 0.199% | | | | |
| 80-85 | 388.27 | 0.333% | 118.615% | 24.777 | 0.0442% | |
| 86-90 | 877.46 | 0.563% | 125.991% | 44.732 | 0.0287% | 80.538% |
| 90-95 | 2,087.11 | 0.946% | 137.857% | 1773.008 | 0.8036% | 3863.623% |
| 96-00 | 2,984.23 | 1.147% | 42.984% | 693.949 | 0.2667% | -60.860% |
| 00-05 | 11714.57 | 1.858% | 292.549% | 423 | 0.0983% | -39.045% |

Source: IMF Stats[9] and SBP[10]

## Foreign Direct Investment

In 1976, FDI inflow was just $ 8 Million which had risen to about $ 2.2 billion in 2005. However Major increase was witnessed in 1985, and FDI increased by about 140% from 0.19% to 0.44% of GDP. As compared to the preceding years, Pakistan have received considerably higher amount of FDI over the last two decades. Especially during the decade of 1990s, where market openness, and focus on private sector for economics growth, created an environment of investment conduciveness, investment largely concentrated in agriculture and energy sector. In 1995, FDI increased about 50% from 0.8% of GDP to 1.25% amounting to $ 722.65 Million. FDI flow increased from $ 308 million in 2001 to $ 2.18 Billion in 2005 with cumulative increase of about 600%. In the same period Pakistan GDP also increased about 50% this trend is continuing till the present

During FY06, FDI flows into Pakistan more than doubled from the preceding year, sustaining a 5-year trend. In fact, even adjusting for the privatization transactions, FDI flows in FY06 amounted to US$ 2.0 billion, registering a sharp rise of 70.6 percent over the preceding year. During FY06 privatization proceeds registered an unprecedented rise to US$ 1.5 billion

[9] IMF (2007), "IMF International Financial Statistics"
[10] State Bank of Pakistan, Annual Report (various issues)

## Foreign Portfolio Investment

Portfolio investment is considered to be extremely instable, but some links can be traced from capital market reforms and financial liberalization. Sizable amount of portfolio investment is only a recent trend. Before nineties, foreign investments in portfolio assets were neglect able. Portfolio investment increased from average investment around $ 10 Million in 70s and 80s to $241 Million in 1992 and $ 1.25 Billion in 1994. But it sharply decrease afterwards and from 1997 to 2003 showed ever negative numbers in 1998, 2001 and 2003.However, we have witnessed yet another revival and FDI pushed backed to over $ 400 Million mark in 2005.

## Profit Outflows from foreign investment

Table 2

Income Outflows (IO)

| Period | IO | Avg. Yearly IO | IO as % of GDP | GIO |
|---|---|---|---|---|
| 76-80 | -1304.02 | -260.80 | -1.46% | |
| 80-85 | -2853.79 | -570.76 | -2.45% | 118.85% |
| 86-90 | -4867.81 | -973.56 | -3.12% | 70.57% |
| 90-95 | -8310.40 | -1662.08 | -3.77% | 70.72% |
| 96-00 | -11122.14 | -2224.43 | -4.27% | 33.83% |
| 00-05 | -12764.05 | -2552.81 | -2.97% | 14.76% |

Source: IMF Stats

Note: IO- Income Outflows
GIO- Growth in income outflows

Not only Capital flows witness huge volatility in Pakistan but the problem has widened as it is causing pressure on current account too. Net income deficit constitute a major part of current account deficit over the years, and is expected to increase further as income and dividend repatriation by foreign entities to their home country seems to be in a rising trend. With average yearly outflows of $ 260 Million in 1976-80, it gradually increased to$ 570 Mio, then 973 Mio in periods of 1980-85 and 1985-1990 respectively. This increase was due to market oriented reforms, softening of foreign exchange regime and increase foreign investment in the country. This trend further increased in the decade of 90s, with average outflow of about $ 1.6 Billion in 1990-95 and $2.3 Billion in 1995-00.During FY06, the net income deficit further expanded by12.0 percent Year to Year to US$ 2.7 billion. This was mainly due to higher direct investment outflows. Within the investment income all three heads, i.e., direct investment, portfolio investment and other

investment recorded net outflows backing the fact that globalization policies as pursued by International donor agencies are clearly not the solution to growth and development but a problem.

The main reason advocated for International Financial Institutions getting hold of Pakistani policies is said to be economic mismanagement. Similar financial crises had occurred in Latin America in the 1980s, when bloated public deficits and loose monetary policies led to inflation. There, the IMF had imposed fiscal austerity (balanced budgets) and tighter monetary policies, demanding that the government pursue those policies as a precondition for receiving aid. In 1997 the IMF imposed the same conditions on Thailand and other Asian economies delivering the same medicine to each ailing nation that showed up on its doorstep.

There are countries which have restricted the role of international financial institutions while still being major players and beneficiaries of globalization either because of active civil society like India or strong nationalist leadership like Malaysia[11]. Pakistan sadly has neither. Impact on globalization on Pakistan has been severely negative as policies of financial liberalization came on hold, especially in exports where it could not respond as it should.

## CONCLUSIONS

Economic theory does not say that everyone will win from globalization, but only that the net gains will be positive, and that the winners can therefore compensate the losers and still come out ahead. But conservatives have argued that in order to remain competitive in a global world, taxes must be cut and the welfare state reduced. But the Scandinavian countries have shown that there is yet another way. Of course, government, like the private sector, must strive for efficiency. Investments in education and research, together with a strong social safety net, can lead to a more productive and competitive economy, with more security and higher living standards for all.

As globalization takes hold, many new developments have now diminished the role of institutions which was very pivotal in the early stage of globalization. International financial institutions like IMF and World Bank who dictated the policies of developing world during 80s and 90s lost its ground. Global funds and international capital markets have gained such a volume that nations now have no problem getting much needed financing from these new avenues. As a result volume of sovereign bonds issued by different governments has outmatched financial support given through international financial institutions. IMF and World Bank now have billions of dollars yet to be invested in some profitable ventures. This new dynamics of globalization have increased the risk of hot money out flowing at the time of need, and nations relying on international capital markets are now more susceptible to decline.

[11] Athukorala, P. and J. Menon (1995) "Developing Countries With Foreign Investment: Malaysia" Australian Economic Review 1, 9-22.

Enhancing our understanding of globalization's problems will help us to formulate remedies - some small, some large - aimed at both providing symptomatic relief and addressing the underlying causes. There is a broad array of policies that can benefit people in both developing and developed countries, thereby providing globalization with the popular legitimacy that it currently lacks.