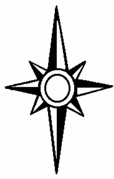

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Globalization - Economic Development's Best Friend

by Edmund B. Fitzgerald

While I can take no issue with the various faces of globalization in today's society, as described by Dr. Charles E. Morrison in PacNet #32, I am disappointed that he did not place more emphasis on globalization's most productive role -- accelerating economic development. As recently said by the World Trade Organization Director General Mike Moore: 'Trade alone may not be enough to eradicate poverty, but it is essential if poor people are to have any hope of a brighter future." The same can be said for trade's partner in globalization – foreign direct investment (FDI).

For too many years the world has addressed the issue of economic development largely through international agencies such as the U.N., the World Bank, and the International Monetary Fund (IMF) plus grants-in-aid or official development assistance (ODA) from developed nations. This aid was often tied to commercial interests from the donor country. There has also been assistance from non-governmental organizations (NGO's), many of which are faith-based. Without the necessary domestic infrastructure to plan and monitor the projects for which these funds were intended, the funds were often squandered and the concessionary loans were often uncollectible. Several recent major World Bank projects, in China and India, have also resulted in unintended environmental degradation.

In the years since World War II, the world should have learned that you cannot force economic development in poor nations simply through grant assistance and concessionary loans. The world must also recognize that developing nations should be allowed to earn their own way into the process of economic development through the acquisition of knowledge of how to perform useful tasks and of how to create useful products, often called technology transfer. For decades, international trade has grown twice as fast as global output and had been generally regarded as the mighty engine of global economic growth. In the last decade, foreign direct investment has grown twice as fast as international trade, which has caused many now to recognize FDI as the mighty engine of global economic growth.

According to IMF statistics, the source of capital for the developing world has undergone massive change in the last decade. Up until 1989, capital inflows were equally divided between public and private sources, with each equivalent to approximately 1% of the developing world's Gross Domestic Product (GDP). But during the decade of the 1990s, private sources rose to about 3.5% of developing world GDP and the public share shrank to about 0.5%.

As noted earlier, public capital inflows include development assistance from institutions such as the World Bank, the IMF, and the U.N., official assistance from individual developed nations and other assistance from many NGOs. Private capital flows include bank loans and other short-term credits, portfolio investment, and FDI. FDI is differentiated from portfolio investment by the intent of the investor to realize some form of control over the acquired asset, such as a business property. Such assets are normally a less liquid and longer-term commitment than a portfolio investment.

The Institute for International Economics notes that in the period 1992-1998, net private capital inflows into the 29 major emerging market economies accounted for over 86% of all capital inflows into these economies. FDI accounted for almost 40% of all private capital inflows and 33% of total capital inflows during this period. In the Asian Financial Crisis year of 1998, total capital inflows to these 29 nations dropped by $103 billion from 1997 levels. This included a $60 billion reversal in bank lending, a $40 billion reduction in funds from other creditors, a $20 billion reduction in portfolio investment, but a $4 billion increase in FDI. Public capital inflows also increased by $16 billion.

The long-term stability of foreign direct investment is an obvious advantage brought by this form of developing world finance, but is not the only advantage. Its principal advantage is that this capital inflow normally comes bundled with other resources, such as the transfer of technology, skill enhancement of domestic workers, management acumen, and knowledge to assist in the development of domestic and global markets.

Some of the poorest nations in the world are located in sub-Saharan Africa and have not yet enjoyed the benefits realized by other developing nations from this shift in capital inflows from public to private sources. If you eliminate South Africa and Nigeria, which enjoy the largest private capital inflows (Nigeria because of its oil reserves), the remaining sub-Saharan nations enjoy net capital inflows of only 0.8% of aggregated GDP and rely three times as heavily on ODA which accounts for 2.5% of their aggregated GDP. This area of the world is stuck in the pre-1990s model of economic development.

Fundamentally, private capital is attracted to nations in which risk is reduced by the practice of democracy, market economics, and transparency in governance by law. I believe it is a fair question to ask whether the global income gap is caused by globalization or is the fault of those governments that fail to provide the above opportunities to their citizens; that fail to foster education and the necessary economic, social and political infrastructures; and, thus fail to attract long-term private capital. Paraphrasing Mike Moore, globalization alone will not be enough to eradicate poverty, but it is essential if poor people are to have any hope of a brighter future. It needs

the support of best practice governance to obtain its inherent benefits.

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