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Third World approach to globalization: comparing Latin America and China

While scholars around the world have not agreed on the specific definition of the buzzword "globalization", it is certain to say that it simply means the tendency of rapid movement of capital, goods, technology, information, etc., around the world. It also means that resource allocation is increasingly carried out across national borders, thus leading to more interdependence among nations, poor and rich alike.

In this paper I shall first review what globalization means for the developing countries, followed by a summary of the policy options for the developing countries to avoid financial crisis. Then an attempt will be made to briefly outline how Latin America and China react to globalization.

What globalization means for the developing countries?

It is believed that Theodore Levitt first put the term "globalization" forward in the early 1980s.[1] He used the term to describe the significant changes in the world economy in the past two decades, namely the rapid movement of commodities, services, capital and technology.

The notion of globalization is still being debated. Indeed, economists, political scientists, sociologists and historians, among others, all look at the dramatic changes in the world by using the term "globalization", though in many instances, globalization means economic phenomenon.

According to some Chinese scholars, however, the notion of "globalization" is not accurate. For instance, some would say that globalization is a tendency of economic integration represented by the birth of European Union, NAFTA and APEC. Others tend to claim that it means deepening interdependence between the North and South countries and among the developed countries. Still others would consider it as the fact of an increased role played by the transnational corporations (TNCs) in the world economy[2].

I would argue that globalization signifies a tendency in which vertical division in the whole framework of the international division of labor is being replaced by horizontal division; the movement of commodities, capital, technology and information is increasingly rapid; allocation of recourses has gone beyond the national boundaries; interdependence among nations is being strengthened; and the pace of regional integration has become all more speedy.

One of the debates around globalization is what its impact upon the developing countries could be. Regarding the fact that in the age of globalization all the countries of the world are interdependent, some Chinese scholars say that, if globalization is seen as an ocean, then the majority of countries, if not all, are undoubtedly

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[1] Theodore Levitt, "The Globalization of Markets", in A. M. Kantrow (ed.), *Sunrise ...Sunset: Challenging the Myth of Industrial Obsolescence,* John Wiley & Sons. 1985, pp. 53-68.

[2] Wang Yizhou, *Contemporary World Politics, Shanghai People's* Publishing House, 1995, p.9.

supposed to be on a certain type of vessels, although the rich countries are on the large steel ships, whereas the poor are on the small wooden boats or, for some, even on the tiny canoes. Others argue that globalization itself should be considered as a boat, and, while most countries of the world are on it, some Third World countries, particularly those in Africa, are still on the beach trying to get on the ship to avoid what is called "marginalization". Needless to say, even in the same boat, some countries are put into the very comfortable first class cabins; others can only find their place in the fourth or fifth class.

Indeed, in the last twenty or thirty years the process of globalization has been moving forward swiftly. Varied scholars with different understandings and meanings interpret the term globalization. Basically, however, there is a consensus that the term simply means the transnational movement of capital, goods, information and technology around the globe.

Globalization has affected every nation in the world. The impact of globalization upon the developing countries are reflected in the following aspects:

First, it deepens interdependence and economic integration between the developed and developing nations, an outcome that also tends to raise the position of the latter in the world economic arena. In the post-World War II period, for instance, the developing countries have been taking an increased share in global production, world trade and international capital flows, and this share would be expanded by globalization. This evident outcome is sure to benefit the developed countries as well, simply because they can export more goods to the Third World. As a matter of fact, it was the strong growth in the 30s or so developing countries during the early 1990s that succeeded in cushioning the side effects of the declining growth in the developed countries upon the global economy.

Second, globalization facilitates the inflow of capital and technology into the developing countries and also provides them with an opportunity to enlarge market shares. Needless to say, this benefit also entails more external competition for them.

One of the features of rapid process of globalization is the fast movement of international capital and new technology around the world and also the increased expansion of the world market. Much empirical research work has shown that those nations with an open trade system and other liberal policies would enjoy many benefits from the above features of globalization. East Asia and Africa might serve two extreme examples.

However, it is important to point out that following points: 1) The developing countries must be cautious against the negative effects of globalization. That is to say, as globalization is a two-edge knife, they should minimize the costs of integrating themselves with the world economy. 2) Compared with the developed countries, developing countries gain much less benefits from globalization. 3) In addition to pursue an active strategy of opening up to the outside world, decision-makers of the developing countries should deal properly with the notion of protecting their domestic markets.

Third, globalization tends to widen the gap within the developing world itself. In the past half a century divergence and disparity among the developing countries is becoming all the more visible. Many reasons can account for this fact, and one of them is globalization. The developing countries at a higher level of development and with an open economic system can attract more foreign capital. It is well known that such developing countries as Argentina, Brazil, Chile and Mexico in Latin America and China, Korea and Thailand in Asia are among the most "lucky" recipients of foreign investment and loans. At the same time, however, many other developing countries, such as those in Africa, just cannot gain access to enough external financing. In terms of foreign trade, some countries are aggressive exporters whereas others are hard to increase world market access.

Fourth, it increases financial risks for the developing nations that are seeking integration with the world economy by opening up their capital account. Along with the rapid movement of global finance, many developing countries have been attempting to open their capital account. Indeed, globalization creates more opportunities for the developing countries to attract more foreign capital. At the same time, however, it also increases risks for them. The 1994 peso crisis in Mexico and the 1997 Asian crises were evident examples.

Policy options to deal with financial globalization

In recent years, thanks to the repeated occurrences of financial crises in the developing world, people have been paying more attention to the side effects of globalization in the financial areas, i.e., financial globalization. In order to keep a financial crisis out of its door, it might be helpful for the policy-makers in Latin America and other developing countries to keep the following implications in mind.

First, government regulations and supervision over the financial sector is highly necessary. The financial sector is very important in the economy, and a well-functioning financial system can allocate resources efficiently. More and more researches have found that liberalizing this sector does not necessarily mean that all financial regulations should be abandoned. The financial crises in Latin America and East Asia indicate clearly that lax regulations and supervisions over the financial sector can cause serious consequences.

Second, the first line of guarding against financial risks is in the hands of the market players themselves. For instance, the banks, which are usually the most important in the financial sectors of the developing countries, should maintain their prudential standings on a solid base. The recent financial crises in the emerging markets seem to indicate that, before capital account liberalization is undertaken, the domestic financial system should be made stronger.

Third, regarding timing, speed and sequencing in dealing with capital account liberalization, we can often hear three arguments. Some believe that capital account opening can take place at a later stage of reform. That is to say, macroeconomic stability should come first and sound financial institutions are in place. Others contend that capital account should liberalized at an early stage, because, without external pressure to be generated by the liberalization move, reform would not be possible to proceed. Still others maintain that, since capital account liberalization is an integrated part of the overall strategy of structural reforms, it is imperative to coordinate the domestic sectors with the external sectors to such an extent that opening the capital account becomes a natural necessity.

It seems that each of the above three positions has its own merits. Decision-makers need to understand that 1) there is no general rule that fits in with all situations and national conditions; 2) capital account liberalization is different from trade liberalization, and more cautious attitudes should be taken regarding the issues of speed and sequence. 3) When pre-conditions are not fully ready, a "tortoise" approach seems to be better than a "hare" approach.

Fourth, as mentioned earlier, globalization generates more opportunities for the developing countries to utilize foreign capital. In some cases, however, inflow of huge amount of foreign capital can cause headaches for the governments. For instance, it tends to generate macroeconomic instability by expanding consumption, raising inflation rates, appreciating the currency, etc. In particular, governments of the developing countries are expected to take a cautious position towards the inflow of short-term speculative capital.

Fifth, a proper system of foreign exchange rate is needed to protect the domestic financial sector. As is well known, both the peso crisis in Mexico and the financial crises in East Asia were triggered by their currency devaluation. Therefore, "putting the exchange rate right" is all the more important.

While fixed exchange rate can reduce some uncertainty of the economy and cut the cost of market transaction activities, it also has its inherited shortcomings. For instance, in order to maintain stability, the government sometimes needs huge reserves to intervene in the market. In addition, it is likely that the system of fixed exchange rate would "import" inflation from foreign countries. Under the system of floating exchange rate, however, the exchange rate can react properly to the market conditions. As a result, the government does not need large amount of reserves to intervene frequently in the market. However, the floating system encourages speculative activities, which tend to increase financial risks.

Given the fact that different system of foreign exchange has difference characteristics, the major task for the decision-makers of the developing countries is to choose a proper system that better suits varied national reality and contributes to the strengthening of international competitiveness. Moreover, from the experience of Mexico and East Asia, it seems that the system of pegged exchange rate would be dangerous.

How Latin America reacts to globalization

Developing countries react to globalization in several ways ranging from autarky to active participation. Latin America did not choose the option of autarky. But compared with East Asia, Latin America participated in the wave of globalization in a limited way at least before the 1980s. Especially in the 1960s and 1970s, when East Asia had started to enter the world market aggressively, Latin America, greatly influenced by the so-called "export pessimism", was still clinging to the inward-looking model of import substitution industrialization. As a result, in the 1970s, while the annual growth rate of export was 9% for East Asia, it was less than 1% for Latin America.

Since the late 1980s, however, Latin American decision-makers have realized that the region's fate would be determined by the degree of international competitiveness, which in turn would be closely linked to participation in globalization. Towards this end, Latin American countries have taken up the following steps.

First, through industrial restructuring and other policy measures, Latin America has been increasing its export capabilities. Though import grows faster than export in many countries of the continent, we have to admit that its export value has increased remarkably, from around $120 billion in 1990 to roughly $400 billion at present.

Second, since participation in globalization is not limited to promoting export, Latin America has also made great efforts to open its domestic market to foreign competition. As a result, the region's tariff rates fell drastically.

Third, Latin America has amended laws, or even constitution in some cases, to open more sectors to foreign investment. In many countries, the so-called "strategic areas", where no foreign capital would be allowed to enter in the past, have been eliminated.

Finally, regional economic cooperation has been reactivated. Since the late 1990s integration organizations like MERCOSUR, the Andean Community and the Central American Common Market have played an important role in the region's economic affairs. There are several reasons accounting for the rebirth of these organizations, one of which is Latin America's stronger desire to take part in the globalization process, as regional integration is an important part of this process.

It is necessary to note that Latin America is faced with several constraints in reacting to globalization. For instance, the region's exports are composed of more labor-intensive products and less technology intensive products. This situation is certainly closely linked to such factors as relatively low level of R&D and weak international competitiveness. Furthermore, with more opening of the market, Latin America's domestic firms are having a hard time. The region's decision-makers are faced with a tough question of how to protect national industries in the process of going along with the globalization wave. Another side effect of globalization upon Latin America is the volatile flow of foreign capital. The 1994 Peso crisis in Mexico, the 1999 currency crisis in Brazil and the 2001 - 2 crisis in Argentina were related, more or less, to this condition. As ECLAC points out, the volatile capital flows characteristic of the third phase of globalization have brought major instability to economic growth in Latin America and the Caribbean, and the authorities have found it hard to keep the real economy on course in the face of sharp variations in the international liquidity[3].

How China reacts to globalization

When China decided to carry out the policy of reform and opening to the outside world in late 1978, globalization tendency had already started to move in a swifter manner. It appeared, however, that the Chinese government put emphasis first on such domestic areas as agricultural reforms and de-regulation. In other words, it was not until the late 1980s when China made its application to join GATT that integration with the globalized world economy was given more attention.

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3 ECLAC, *Globalization and Development,* April 2002, p. 129.

When it decided to enter GATT, the Chinese government believed that, as a country transforming from central planning to market economy, China would reap the following benefits: First, GATT/WTO's non-discriminatory principle would enable China's exports to meet less protections in the overseas market. Second, GATT/WTO membership would provide China with a right to say in making the rules governing the international economic system. Third, it would signify a closer integration of the Chinese economy with the world, which will in turn facilitate China's use of external resources. Finally, adoption of GATT/WTO rules could promote China's reforms and opening to the outside. Indeed, as China was increasingly dependent on the world market, it could not move forward without integrating itself with the world and vise versa.

The government also understood that GATT/WTO membership meant challenges for China, especially in the near term.

First, China would have to amend its rules and regulations that are not in line with the GATT/WTO codes. It would not be an easy task for China to do so, although in the past two decades its economic system has been transformed greatly.

Second, high-level protection for some sectors of the economy would be gradually eliminated. Particularly, the state-owned enterprises would have a hard time to reform themselves, since the domestic market is increasingly open to imports. Also, as China's tariffs are quite high and many types of non-tariff barriers are still in place[4], economic restructuring would not be smooth and effortless. This is also the case in Latin America. Last but not the least, when in GATT/WTO, China's economy will depend more heavily upon the world market and thus will face more risks of external shocks. Latin America has had the same fate.

In the process of applying for GATT/WTO membership, China made greater efforts) speed up the process. In the area of foreign trade, for instance, tariffs were cut gradually and the domestic market was slowly opening. The market was beginning to have so many imported goods.

Before reforms started in 1978 China boasted that it had neither internal debt nor external debt. This complacence has proved to be negative and undesired. In the past two and a half decades China has borrowed much foreign debt. By the end of 2002, China's total foreign debt had reached almost $170 billion.

In the discussion of China's reaction to globalization, one important issue that has aroused great debate is the liberalization of its capital account. On January 1, 1994, China started to unify multiple exchange rates and adopted a single and managed floating exchange rate system. On December 1, 1996, China accepted Article 8 of the MF Agreement and began to allow free convertibility of RMB under the current account.

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[4] China's nominal tariff fell from 47.2% in early 1992 to 17% starting from October 1, 1997, compared with 15% for many other developing economy and 5% for the developed countries. According to many researchers, however, China's *real* tariff is very low, around 3% in 1997. (For more information about this low real tariff, see Fan Aijun: *Woguo mingyi guanshuilui gao er shiji shuilui di wenti zhi tantao* (A tentative study of the high nominal tariff and low real tariff), *Jingji Yanjiu* (Economic Research Journal), March 1999, pp. 48-51.

On the one hand, with the rapid development of globalization, Latin America and other developing countries are increasingly forced to open their capital account. On the other, China is committed to the implementation of the policies of further opening to the outside world. Therefore, it can be said that, sooner or later, China will liberalize its capital account. The question now is when and how to do so.

While not many economists ask for a quick action in this regard, many more others argue that, given the recent developments of the international economic scenario, particularly after the repeated financial crises in other emerging economies, as well as he current conditions inside China, swift liberalization of the capital account would not be in ideal option. This is simply due to the following reasons:

First, China's financial system itself is not strong enough to meet the external challenges. It was estimated that the percentages of the non-performing debts for the four largest banks were between 20-25%. Despite government efforts, this unwelcome situation has changed very little. Moreover, the capacity and ability of the government regulation and supervision over the financial sector has yet to be strengthened.

Second, the developed countries and large money traders dominate the international financial system. Under these circumstances, because RMB is not an international currency, opening the capital account would mean that RMB is likely to be the object of speculative attacks.

Finally, in some of the productive sectors of the Chinese economy, foreign companies have occupied a very solid position. In recent years, with the expansion of their business, the transnational banks in China have cooperated actively with the transnational corporations. Further expansion of the foreign financial institutions would pose tougher challenges to China's industrial policies.

Given the nature of gradualism in China's economic reforms, opening its capital account should also be implemented in a gradual way so as to "cushion" the powerful shocks from the liberalization. In any case, to strengthen its own financial system and competitiveness seems to be the best prerequisite for China to move forward towards the objective of capital account liberalization.

Concluding Remarks

From the comparative overview of how Latin America and China react to globalization, we can find both similarities and differences (See table 1). We can also reach the following tentative conclusions:

● Globalization is a two-edge knife. Both Latin America and China have reaped benefits by embracing globalization. At the same time, however, both have felt the negative repercussion of globalization. But it is unwise and impossible to keep this irresistible historical trend out of the door. As Dr. Sun Yat-sen, the great Chinese figure in history, said one century ago, going along the historical tide would mean survival whereas going against it tends to bring death.

● Most of the Latin American countries seem to have opening its doors in a more radical way, and China adopted a strategy of gradualism. This difference might explain why China was successful in keeping the Asian financial crisis of 1997 out of its door on the one hand, and Latin America has suffered from several crises on the other. It can also answer the question why more domestic industries in Latin America have been washed away by foreign capital, though we cannot overlook the fact some of the public-owned-enterprises in China have been under increasingly immense pressure of competition from foreign products.

● In the process of participating in globalization, those domestic enterprises with less international competitiveness would sink into hardships. The question is whether it is necessary to keep out foreign competition simply for the sake of protecting them. While some Chinese economists claim that, only by "dancing with the wolf", i.e., allowing foreign competition in, can the competitiveness of the domestic industries be strengthened, others argue that before the "lamb" gets stronger, "dancing with the wolf" simply means that the lamb would end up in the its stomach. However, more people seem to agree that the domestic industries with strategic importance should be protected. In this regard, protection of these industries does not necessarily mean the protection of backwardness.

● Capital account liberalization is a very important issue for the policy-makers. Liberalization can bring many benefits such as attracting more foreign capital. At the same time, however, it will make the economy more vulnerable to external financial shocks. Some Latin American countries seemed to open their capital account in a rapid and unprepared way and this has been one of the causes for the financial crises. China succeeded in avoiding the contagion effect from the Asian crisis in 1997 by keeping the capital account closed. China understands well that only when the domestic financial system is strong enough can the government make the brave step.

In conclusion, globalization can be both blessing and cursing for the developing countries. This historical tendency cannot be stopped by anyone. Faced with opportunities and challenges, developing countries should strengthen their own international competitiveness by all means. Particularly, they need to pay great attention to maintaining economic security in a new world dominated by increasingly free movement of capital, goods, information and technology.

Table 1. Latin America and China in the Age of Globalization

	Latin America	**China**
General attitudes towards globalization	Active and positive	Active and positive
Anti-globalization sentiment	Conspicuous	Little
Position of globalization in the overall strategy of reforms	Important	Important
Internal reforms and external opening	Simultaneously	Domestic front first
Policy instruments	Almost the same	Almost the same
Domestic market opening	rapid	slow
Capital account liberalization	rapid	slow
Foreign capital inflow	In great amount	In great amount
Exchange rate movement	Volatile	Relatively stable
Negative repercussion from globalization (1)	Repeated occurrence of financial crisis	No financial crisis so far
Negative repercussion from globalization (2)	Some domestic industries in hardships	Some domestic industries in hardships
Overall speed of participating in globalization	Bold and hasty	Cautious and gradual
Overall achievement	Good	Much better